BANK OF MONTREAL /CAN/
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Subject to Completion, dated September 5, 2018

Preliminary Pricing Supplement

(To the Prospectus dated April 27, 2017 and
the Prospectus Supplement dated April 27, 2017)

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Senior Medium-Term Notes

Linked to a Quality Yield Basket of Common Stocks,

due September 30, 2020

· The notes will be linked to an equally-weighted basket of shares of 25 common stocks (each, a "Reference Share" and together, the "Basket") of entities that are not affiliated with us (each, a "Reference Share Issuer"). The Reference Shares were selected in August 2018 by Raymond James & Associates, Inc. ("Raymond James"). See the section below, "Reference Share Selection."

· You may lose all or a portion of the principal amount of your notes at maturity.

· The Reference Shares are: Analog Devices, Inc. ("ADI"); Aflac Incorporated ("AFL"); Best Buy Co., Inc. ("BBY"); BGC Partners, Inc. ("BGCP"); Chemical Financial Corporation ("CHFC"); Comcast Corporation ("CMCSA"); CyrusOne Inc. ("CONE"); Cisco Systems, Inc. ("CSCO"); CVS Health Corporation ("CVS"); Delta Air Lines, Inc. ("DAL"); Delek US Holdings, Inc. ("DK"); Fastenal Company ("FAST"); F.N.B. Corporation ("FNB").The Home Depot, Inc. ("HD"); Hewlett Packard Enterprise Company ("HPE"); Ladder Capital Corp ("LADR"); Leggett & Platt, Incorporated ("LEG"); Marathon Petroleum Corporation ("MPC"); MSC Industrial Direct Co., Inc. ("MSM"); Old Republic International Corporation ("ORI"); PacWest Bancorp ("PACW"); Plains GP Holdings, L.P. ("PAGP"); Union Pacific Corporation ("UNP"); Walmart Inc. ("WMT"); and Weyerhaeuser Company ("WY"). Each Reference Share has an equal weighting of 1/25th.

· The notes may pay interest on December 31, 2018, March 29, 2019, June 28, 2019, September 30, 2019, December 31, 2019, March 31, 2020, June 30, 2020 and the maturity date. The amount of any interest to be paid on the notes will not be fixed, and will depend upon the total dividends paid on the Reference Shares during the preceding quarter, as described in more detail below.

· On the maturity date, the amount that we will pay to you for each $1,000 in principal amount of the notes (the "Redemption Amount") will depend upon the performance of the Basket over the term of the notes. As described in more detail below, the Redemption Amount will be less than the price to the public set forth below if the "Basket Level Percentage" (as defined below) is not at least approximately 103.52%. We describe in more detail below how the payment at maturity will be determined.

- All payments on the notes are subject to our credit risk.
- The notes will not be listed on any securities exchange or quotation system.
- The CUSIP number of the notes is 06367WCD3.
- Our subsidiary, BMO Capital Markets Corp. (“BMOCM”), is the agent for this offering. See “Supplemental Plan of Distribution—Conflicts of Interest” below.
- The notes will not be subject to conversion into our common shares or the common shares of any of our affiliates under subsection 39.2(2.3) of the Canada Deposit Insurance Corporation Act (the “CDIC Act”).

Investing in the notes involves risks, including those described in the “Additional Risk Factors” section beginning on page PS-6 of this pricing supplement and the “Risk Factors” sections beginning on page S-1 of the prospectus supplement, and on page 8 of the prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these notes or passed upon the accuracy of this pricing supplement, the prospectus supplement or the prospectus. Any representation to the contrary is a criminal offense.

The notes will be our unsecured obligations and will not be savings accounts or deposits that are insured by the United States Federal Deposit Insurance Corporation, the Bank Insurance Fund, the Canada Deposit Insurance Corporation or any other governmental agency or instrumentality or other entity.

On the date of this preliminary pricing supplement, the estimated initial value of the notes is $959.60 per $1,000 in principal amount based on the terms set forth above. The estimated initial value of the notes on the pricing date may differ from this value but will not be less than $950 per $1,000 in principal amount. However, as discussed in more detail in this pricing supplement, the actual value of the notes at any time will reflect many factors and cannot be predicted with accuracy.

	Price to Public	Agent’s Commission	Proceeds to Us
Per $1,000 of the Notes	US$1,000.00	US$20.00	US$980.00
Total	US$	US$	US$

(1) $20.00 per $1,000 in principal amount per note will be received by Raymond James for its services acting as an agent in connection with the distribution of the notes. Please see “Supplemental Plan of Distribution (Conflicts of Interest)” in this pricing supplement.

BMO Capital Markets

Key Terms of the Notes

This section summarizes the terms of the notes, and should be read together with the additional information in this pricing supplement, including the information set forth below under the captions "Additional Risk Factors" and "Description of the Notes."

Issue Date of the Notes:	September 28, 2018
Issue Price of the Notes:	$1,000 per $1,000 in principal amount of the notes.
Reference Shares:	The 25 Reference Shares set forth on the cover page of this pricing supplement.
Reference Share Selection:	The Reference Shares were selected by Raymond James as described in the section "Reference Share Selection." Raymond James' objective was primarily to select securities that have (i) current dividend yields greater than 2% and (ii) a history of positive returns on capital, as discussed further below.
Redemption Amount:	The amount that you will receive at maturity for each $1,000 in principal amount of the notes will depend upon the performance of the Basket. The Redemption Amount will equal the product of (a) $1,000, (b) the Basket Level Percentage, and (c) the Participation Rate. *As discussed in more detail below, the Basket Level Percentage must exceed approximately 103.52% in order for you to receive a Redemption Amount per $1,000 in principal amount of the notes that exceeds the principal amount. In addition, the Redemption Amount could be substantially less than the principal amount of the notes.*
Reference Share Weighting:	For each Reference Share, $1/25^{th}$.
Reference Share Performance:	The Reference Share Performance will measure the change in value of each Reference Share over the term of the notes. For each Reference Share, the Reference Share Performance will equal (a) the applicable Final Share Price divided by (b) the applicable Initial Share Price, expressed as a percentage. See "Description of the Notes—Payment at Maturity."
Weighted Reference Share	For each Reference Share, the product of (a) its Reference Share Performance and (b) the Reference Share Weighting.

Performance:

Participation Rate:	96.60%. Because the Participation Rate is less than 100%, the Basket Level Percentage must exceed approximately 103.52% in order for you to receive a Redemption Amount per $1,000 in principal amount of the notes that exceeds the principal amount of the notes. In addition, because the Participation Rate is less than 100%, the interest payments you receive on the notes will be less than the applicable Dividend Amounts.
Basket Level Percentage:	The sum of the Weighted Reference Share Performances.
Initial Share Price:	The closing price of the applicable Reference Share on the pricing date, as set forth in the table below.

Reference Share	**Ticker**	**Initial Share Price ($)**
Analog Devices, Inc.	ADI	$
Aflac Incorporated	AFL	$
Best Buy Co., Inc.	BBY	$
BGC Partners, Inc.	BGCP	$
Chemical Financial Corporation	CHFC	$
Comcast Corporation	CMCSA	$
CyrusOne Inc.	CONE	$
Cisco Systems, Inc.	CSCO	$
CVS Health Corporation	CVS	$
Delta Air Lines, Inc.	DAL	$
Delek US Holdings, Inc.	DK	$
Fastenal Company	FAST	$
F.N.B. Corporation	FNB	$
The Home Depot, Inc.	HD	$
Hewlett Packard Enterprise Company	HPE	$
Ladder Capital Corp	LADR	$

Leggett & Platt, Incorporated	LEG	$
Marathon Petroleum Corporation	MPC	$
MSC Industrial Direct Co., Inc.	MSM	$
Old Republic International Corporation	ORI	$
PacWest Bancorp	PACW	$
Plains GP Holdings, L.P.	PAGP	$
Union Pacific Corporation	UNP	$
Walmart Inc.	WMT	$
Weyerhaeuser Company	WY	$

Final Share Price:	For one Reference Share, the closing price on the valuation date.
Pricing Date:	September 21, 2018
Valuation Date:	September 23, 2020
Maturity Date:	September 30, 2020
Interest Payment Dates:	December 31, 2018, March 29, 2019, June 28, 2019, September 30, 2019, December 31, 2019, March 31, 2020, June 30, 2020 and September 30, 2020 (the maturity date).
Interest Calculation Dates:	December 26, 2018, March 26, 2019, June 25, 2019, September 25, 2019, December 26, 2019, March 26, 2020, June 25, 2020 and September 23, 2020 (the valuation date).
Calculation of Interest Payments:	The amount of each interest payment, if any, will depend upon the amount of dividends paid on each Reference Share during the Interest Calculation Period preceding each interest payment date, and will equal, for each $1,000 in principal amount, (a) the sum of the Dividend Amounts for each of the Reference Shares multiplied by (b) the Participation Rate.
Interest Calculation Period:	The first Interest Calculation Period will commence on the pricing date and end on the first Interest Calculation Date. Each subsequent Interest Calculation Period will begin on the trading day following an Interest Calculation Date and end on the next Interest Calculation Date. The final Interest Calculation Date will occur on the valuation date.

Dividend Amount:	For each Reference Share, an amount in U.S. dollars equal to (a) $1,000 divided by the applicable Initial Share Price multiplied by (b) the applicable Reference Share Weighting multiplied by (c) 100% of the gross cash distributions (including ordinary and extraordinary dividends) per Reference Share declared by the applicable Reference Share Issuer where the date that the applicable Reference Share has commenced trading ex-dividend on its primary U.S. securities exchange as to each relevant distribution occurs during the relevant Interest Calculation Period, determined as described in more detail in the section below, “Description of the Notes—Interest Payments.”
Calculation Agent:	BMO Capital Markets Corp. (“BMOCM”)
CUSIP:	06367WCD3
Distribution:	The notes are not intended for purchase by any investor that is not a United States person, as that term is defined for U.S. federal income tax purposes, and no dealer may make offers of the notes to any such investor.

The pricing date and the valuation date for any Reference Share, as well as the maturity date, are subject to postponement if a Market Disruption Event occurs with respect to an applicable Reference Share, as described in the section “Description of the Notes – Market Disruption Events” in this pricing supplement.

The pricing date and the issue date of the notes are subject to change. The actual pricing date, issue date, interest payment and interest calculation dates, valuation date and maturity date for the notes will be set forth in the final pricing supplement relating to the notes.

Hypothetical Payments on the Notes at Maturity

The following hypothetical examples are provided for illustration purposes only and are hypothetical; they do not purport to be representative of every possible scenario concerning increases or decreases in the value of the Basket and the related effect on the Redemption Amount. The following hypothetical examples illustrate the payment you would receive on the maturity date if you purchased $1,000 in principal amount of the notes. Numbers appearing in the examples below have been rounded for ease of analysis. The examples below assume a Participation Rate of 96.60%. This table does not reflect any interest that may be paid on the notes.

Basket Level Percentage	Redemption Amount per $1,000 in Principal Amount	Percentage Gain (or Loss) per $1,000 in Principal Amount
140.00%	$1,352.40	35.24%
130.00%	$1,255.80	25.58%
120.00%	$1,159.20	15.92%
110.00%	$1,062.60	6.26%
103.52%(1)	$1,000.00	0.00%
100.00%(2)	$966.00	-3.40%
90.00%	$ 869.40	-13.06%
80.00%	$ 772.80	-22.72%
70.00%	$ 676.20	-32.38%
60.00%	$ 579.60	-42.04%

(1) For you to receive a Redemption Amount greater than the principal amount of the notes, the Basket Level Percentage must be greater than approximately 103.52% due to the effect of the Participation Rate being only 96.60%.

(2) If the Basket Level Percentage is not at least approximately 103.52%, you will lose some or all of the principal amount of the notes.

Please see the sections below, “Additional Risk Factors—General Risks Relating to the Notes—Your investment may result in a loss” and “—The notes will not reflect the full performance of the Reference Shares, which may negatively impact your return on the notes.”

Additional Terms of the Notes

You should read this pricing supplement together with the prospectus supplement dated April 27, 2017 and the prospectus dated April 27, 2017. **This pricing supplement, together with the documents listed below, contains the terms of the notes and supersedes all other prior or contemporaneous oral statements as well as any other written materials including preliminary or indicative pricing terms, correspondence, trade ideas, structures for implementation, sample structures, fact sheets, brochures or other educational materials of ours or the agent.** You should carefully consider, among other things, the matters set forth in "Additional Risk Factors" in this pricing supplement, as the notes involve risks not associated with conventional debt securities. We urge you to consult your investment, legal, tax, accounting and other advisers before you invest in the notes.

You may access these documents on the SEC website at www.sec.gov as follows (or if such address has changed, by reviewing our filings for the relevant date on the SEC website):

- Prospectus supplement dated April 27, 2017: https://www.sec.gov/Archives/edgar/data/927971/000119312517142764/d381374d424b5.htm

- Prospectus dated April 27, 2017: https://www.sec.gov/Archives/edgar/data/927971/000119312517142728/d254784d424b2.htm

Our Central Index Key, or CIK, on the SEC website is 927971. As used in this pricing supplement, "we," "us" or "our" refers to Bank of Montreal.

Bank of Montreal has filed a registration statement (including a prospectus supplement and a prospectus) with the SEC for this offering. Before you invest, you should read those documents and the other documents relating to this offering that the issuer has filed with the SEC for more complete information about the issuer and this offering. You may obtain these documents without cost by visiting EDGAR on the SEC website at www.sec.gov. Alternatively, Bank of Montreal, any agent or any dealer participating in this offering will arrange to send you the prospectus supplement and the prospectus if you so request by calling toll-free at 1-877-369-5412.

Additional Risk Factors

An investment in the notes involves risks. This section describes significant risks relating to the terms of the notes. The notes are a riskier investment than ordinary debt securities. In addition, the notes are not equivalent to investing directly in the Reference Shares. Before investing in the notes, you should read the following information about these risks, together with the other information contained in or incorporated by reference in the prospectus supplement and prospectus.

General Risks Relating to the Notes

Your investment in the notes may result in a loss. The notes do not guarantee any return of principal. The amount payable on the notes at maturity will depend on the performance of the Reference Shares and the applicable Dividend Amounts and may be less, and possibly significantly less, than your initial investment. If the prices of the Reference Shares decrease, the payment at maturity may be less than the principal amount. In addition, because the Participation Rate is only 96.60%, the Basket Level Percentage must exceed approximately 103.52% in order for you to receive a Redemption Amount that exceeds the principal amount. You may lose all or a substantial portion of the amount that you invested to purchase the notes. You may incur a loss, even if the Basket Level Percentage is positive (but less than approximately 103.52%). Please also see "—The notes will not reflect the full performance of the Reference Shares, which may negatively impact your return on the notes."

The notes may not pay interest and your return may be lower than the return on a conventional debt security of comparable maturity. There may be no periodic interest payments on the notes, and any such payments may be less than there would be on a conventional fixed-rate or floating-rate debt security having the same maturity. The amount of each interest payment, if any, will depend upon the Dividend Amount of each Reference Share during the Interest Calculation Period preceding each interest payment date, as adjusted by the Participation Rate. The yield that you will receive on your notes, which could be negative, may be less than the yield you could earn if you purchased a standard senior debt security of Bank of Montreal with the same maturity date. Your investment may not reflect the full opportunity cost to you when you take into account factors that affect the time value of money.

Owning the notes is not the same as owning the Reference Shares or a security directly linked to the performance of the Reference Shares. The return on your notes will not reflect the return you would realize if you actually owned the Reference Shares or a security directly linked to the performance of the Reference Shares and held that investment for a similar period. Your notes may trade quite differently from the Reference Shares. Changes in the prices and dividend yields of the Reference Shares may not result in comparable changes in the market value of your notes. Even if the prices and dividend yields of the Reference Shares increase during the term of the notes, the market value of the notes prior to maturity may not increase to the same extent. It is also possible for the market value of the notes to decrease while the prices and dividend yields of the Reference Shares increase.

Our initial estimated value of the notes will be lower than the price to public. Our initial estimated value of the notes is only an estimate, and is based on a number of factors. The price to public of the notes will exceed our initial estimated value, because, among other things, costs associated with offering, structuring and hedging the notes are included in the price to public, but are not included in the estimated value. These costs include the agent's commission and the profits that we and our affiliates expect to realize for assuming the risks in hedging our obligations under the notes and the estimated cost of hedging these obligations. The initial estimated value of the notes may be as low as the amount indicated on the cover page of this pricing supplement.

Our initial estimated value does not represent any future value of the notes, and may also differ from the estimated value of any other party. Our initial estimated value of the notes as of the date of this preliminary pricing supplement is, and our estimated value as determined on the pricing date will be, derived using our internal pricing models. This value is based on market conditions, interest rates, and other relevant factors. Different pricing models and assumptions could provide values for the notes that are greater than or less than our initial estimated value. In addition, market conditions and other relevant factors after the pricing date are expected to change, possibly rapidly, and our assumptions may prove to be incorrect. After the pricing date, the value of the notes could change dramatically due to changes in market conditions, our creditworthiness, and the other factors set forth in this pricing supplement. These changes are likely to impact the price, if any, at which we or BMOCM would be willing to purchase the notes from you in any secondary market transactions. Our initial estimated value does not represent a minimum price at which we or our affiliates would be willing to buy your notes in any secondary market at any time.

The terms of the notes are not determined by reference to the credit spreads for our conventional fixed-rate debt. To determine the terms of the notes, we will use an internal funding rate that represents a discount from the credit spreads for our conventional fixed-rate debt. As a result, the terms of the notes are less favorable to you than if we had used a higher funding rate.

Certain costs are likely to adversely affect the value of the notes. Absent any changes in market conditions, any secondary market prices of the notes will likely be lower than the price to public. This is because any secondary market prices will likely take into account our then-current market credit spreads, and because any secondary market prices are likely to exclude all or a portion the agent's commission of the hedging profits and estimated hedging costs that are included in the price to public of the notes and that may be reflected on your account statements. In addition, any such price is also likely to reflect a discount to account for costs associated with establishing or unwinding any related hedge transaction, such as dealer discounts, mark-ups and other transaction costs. As a result, the price, if any, at which BMOCM or any other party may be willing to purchase the notes from you in secondary market transactions, if at all, will likely be lower than the price to public. Any sale that you make prior to the maturity date could result in a substantial loss to you.

Any increase in the price of one or more Reference Shares may be offset by decreases in the price of one or more other Reference Shares. The price of one or more of the Reference Shares may increase while the price of one or more of the other Reference Shares decreases. Therefore, in determining the value of the Basket at any time, increases in the price of one Reference Share may be moderated, or wholly offset, by decreases in the price of one or more other Reference Shares. You may incur a loss, even if the Basket Level Percentage is positive (but less than 103.52%).

The notes may not have an active trading market. Your notes will not be listed on any securities exchange, and there may be little or no secondary market for your notes. Even if a secondary market for your notes develops, it may not provide significant liquidity. We expect that transaction costs in any secondary market would be high. As a result, the difference between bid and ask prices for your notes in any secondary market could be substantial. If you sell your notes before maturity, you may suffer substantial losses.

The notes will not reflect the full performance of the Reference Shares, which may negatively impact your return on the notes. Because the calculation of the Redemption Amount includes a Participation Rate of less than 100%, the return, if any, on the notes will not reflect the full performance of the Reference Shares. Therefore, the yield to maturity based on the methodology for calculating the Redemption Amount will be less than the yield that would be produced if the Reference Shares were purchased and held for a similar period. The Basket Level Percentage must be at least approximately 103.52% for the Redemption Amount to exceed the principal amount. In addition, because the Participation Rate is less than 100%, the interest payments you receive on the notes will be less than the applicable Dividend Amounts.

The market value of your notes may be influenced by many unpredictable factors. The following factors, many of which are beyond our control, may influence the market value of your notes:

- the market prices of the Reference Shares;

- the dividend yields of the Reference Shares;
- economic, financial, political, military, regulatory, legal and other events that affect the securities markets generally and the U.S. markets in particular, and which may affect the values of the Reference Shares; and
- interest rates in the market.

These factors may influence the market value of your notes if you sell your notes before maturity. Our creditworthiness, as represented by our credit ratings or as otherwise perceived in the market will also affect the market value of your notes. If you sell your notes prior to maturity, you may receive less than your initial investment.

Payments on the notes are subject to our credit risk, and changes in our credit ratings may adversely affect the market value of the notes. The notes are our senior unsecured debt securities. The payment due on the maturity date and any interest payments are dependent upon our ability to repay our obligations at that time. This will be the case even if the values and dividend yields of the Reference Shares increase as of the interest calculation dates and the valuation date. No assurance can be given as to what our financial condition will be at any time during the term of the notes.

The Final Share Price of each Reference Share may be less than the closing prices of such Reference Share prior to that date. The Final Share Price of each Reference Share will be calculated based on the closing price of that Reference Share on the valuation date. The prices prior to that date will not be used to determine the Redemption Amount. Therefore, no matter how high the prices of the relevant Reference Shares may be during the term of the notes, only the closing price of the Reference Shares on the valuation date will be used to determine the applicable Final Share Price and the Redemption Amount payable to you at maturity.

Correlation among the Reference Shares may affect the value of your notes. The Reference Shares may not represent a diversified portfolio of securities. To the extent that the Reference Shares move in the same direction (i.e., are highly correlated), you will lose some or all of the benefits that would ordinarily attend a diversified portfolio of securities. The Reference Shares may be concentrated in a limited number of industries. An investment in the notes might increase your exposure to fluctuations in any of the sectors represented by the Basket.

We will not hold shares of any Reference Share for your benefit. The indenture and the terms governing your notes do not contain any restriction on our ability or the ability of any of our affiliates to sell, pledge or otherwise convey all or any portion of Reference Shares that we or they may acquire. Neither we nor our affiliates will pledge or otherwise hold any assets for your benefit, including any Reference Shares. Consequently, in the event of our bankruptcy, insolvency or liquidation, any of those assets that we own will be subject to the claims of our creditors generally and will not be available for your benefit specifically.

You must rely on your own evaluation of the merits of an investment linked to the Reference Shares. In the ordinary course of their business, BMOCM, Raymond James and our respective affiliates may have expressed views on expected movements in any Reference Share, and may do so in the future. These views or reports may be communicated to our clients, Raymond James' clients, and clients of our respective affiliates. However, these views are subject to change from time to time. Moreover, other professionals who transact business in markets relating to any Reference Share may at any time have significantly different views from those of our respective affiliates. For these reasons, you are encouraged to derive information concerning the Reference Shares from multiple sources, and you should not rely solely on views expressed by us or our respective affiliates.

Our trading and other transactions relating to the Reference Shares, futures, options or other derivative products may adversely affect the market value of the notes. As described below under "Use of Proceeds and Hedging," we or our affiliates may hedge our obligations under the notes by purchasing or selling the Reference Shares, futures or options relating to the Reference Shares, or other derivative instruments with returns linked or related to changes in the performance of the Reference Shares. We may adjust these hedges by, among other things, purchasing or selling those assets at any time. Although they are not expected to do so, any of these hedging activities may adversely affect the prices of the Reference Shares, and therefore, the market value of the notes, and the amount payable at maturity. It is possible that we or one or more of our affiliates could receive substantial returns from these hedging activities, even though the market value of the notes decreases.

We, Raymond James, or one or more of our respective affiliates may also engage in trading relating to the Reference Shares on a regular basis as part of our general broker-dealer and other businesses, for proprietary accounts, for other accounts under management or to facilitate transactions for our customers, including block trades. Any of these activities could adversely affect the prices of the Reference Shares and, therefore, the market value of the notes. We, Raymond James, or one or more of our respective affiliates may also issue or underwrite other securities or financial or derivative instruments with returns linked or related to changes in the performance of the Reference Shares. By introducing competing products into the marketplace in this manner, we or one or more of our affiliates could adversely affect the market value of the notes.

Our business activities and the business activities of our affiliates may create conflicts of interest. As noted above, we, Raymond James, or one or more of our respective affiliates expect to engage in trading activities related to the Reference Shares that are not for the account of holders of the notes or on their behalf. These trading activities may present a conflict between the holders' interests in the notes and the interests we and our affiliates will have in their proprietary accounts, in facilitating transactions, including options and other derivatives transactions, for their customers and in accounts under their management. These trading activities, if they influence the prices of the Reference Shares, could be adverse to the interests of the holders of the notes. We, Raymond James, or one or more of our respective affiliates may, at present or in the future, engage in business with the issuers of the Reference Shares, including making loans to or providing advisory services to those companies. These services could include investment banking and merger and acquisition advisory services. These activities may present a conflict between our or one or more of our affiliates' obligations and your interests as a holder of the notes. Moreover, we, Raymond James and our respective affiliates have published, and in the future expect to publish, research reports and other materials with respect to most or even all of the Reference Shares. Our views are modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the notes. Even if our affiliates or Raymond James express a negative opinion about one or more of the Reference Shares, or if market conditions change, the composition of the Basket will not change during the term of the notes (except under the limited circumstances described below). Any of these activities by us or one or more of our affiliates may affect the prices of the Reference Shares and, therefore, the market value of the notes.

As calculation agent, BMOCM will have the authority to make determinations that could affect the value of your notes and your payment at maturity. As calculation agent for your notes, BMOCM will have discretion in making various determinations that affect your notes, including determining the Initial Share Prices, the Final Share Prices, the Basket Level Percentage, the Redemption Amount, the amounts of any interest payments on the notes, and whether any market disruption event has occurred. The calculation agent also has discretion in making certain adjustments relating to mergers and certain other corporate transactions that a Reference Share Issuer may undertake. The exercise of this discretion by BMOCM could adversely affect the value of your notes and may present BMOCM, which is our wholly owned subsidiary, with a conflict of interest.

The historical performance of the Reference Shares should not be taken as an indication of their future performance. The Final Share Prices of the Reference Shares will determine the Redemption Amount. The historical performance of the Reference Shares does not necessarily give an indication of their future performance. As a result, it is impossible to predict whether the prices of the Reference Shares will rise or fall during the term of the notes. The prices of the Reference Shares will be influenced by complex and interrelated political, economic, financial and other factors.

Holders of the Reference Shares are only entitled to receive those dividends as each issuer’s board of directors may declare out of funds legally available. Although dividends and distributions on one or more of the Reference Shares may have historically been declared by the applicable board of directors, they are not required to do so and may reduce or eliminate those dividends in the future. The Dividend Amount of one or more of the Reference Shares during the term of the notes may be zero. If the dividends paid on the Reference Shares are not significant, any interest payments that you receive on the notes may not be sufficient to provide you with your desired return on the notes.

Significant aspects of the tax treatment of the notes are uncertain. The tax treatment of the notes is uncertain. We do not plan to request a ruling from the Internal Revenue Service or from any Canadian authorities regarding the tax treatment of the notes, and the Internal Revenue Service or a court may not agree with the tax treatment described in this pricing supplement. Although the U.S. federal income tax treatment of the interest payments is uncertain, we intend to take the position that such interest payments constitute taxable ordinary income to a United States holder at the time received or accrued in accordance with the holder’s regular method of accounting.

The Internal Revenue Service has issued a notice indicating that it and the Treasury Department are actively considering whether, among other issues, a holder of an instrument such as the notes should be required to accrue ordinary income (in addition to the interest payments) on a current basis. The outcome of this process is uncertain and could apply on a retroactive basis.

Please read carefully the section entitled “Supplemental Tax Considerations” in this pricing supplement, the section entitled “United States Federal Income Taxation” in the accompanying prospectus and the section entitled “Certain Income Tax Consequences” in the accompanying prospectus supplement. You should consult your tax advisor about your own tax situation.

Insurance companies and employee benefit plans should carefully review the legal issues of an investment in the notes. Any insurance company or fiduciary of a pension plan or other employee benefit plan that is subject to the prohibited transaction rules of the Employee Retirement Income Security Act of 1974, as amended, which we call “ERISA,” or the Internal Revenue Code of 1986, as amended (the “Code”), including an IRA or Keogh plan (or a governmental plan to which similar prohibitions apply), and that is considering purchasing the notes with the assets of the insurance company or the assets of such plan, should consult with its counsel regarding whether the purchase or holding of the notes could become a “prohibited transaction” under ERISA, the Code or any substantially similar prohibition in light of the representations a purchaser or holder in any of the above categories is deemed to make by purchasing and holding the notes. These issues are discussed in more detail in the section “Employee Retirement Income Security Act” below.

Risks Relating to the Reference Shares

The inclusion of the Reference Shares in the Basket does not guarantee a positive return on the notes. The Reference Shares were selected by Raymond James in August 2018 as described in this pricing supplement. However, there can be no assurance that any Reference Share, or the Basket in its entirety, will increase in value. The Reference Shares included in the Basket are not a dynamic list; if Raymond James’ opinion of the selection process, or of one or more Reference Shares changes after the list is constituted, that change will not cause the deletion or addition of Reference Shares to the list. The performance of the Reference Shares may be less than the performance of the equities markets generally, and less than the performance of specific sectors of the equity markets, or other securities in which you may choose to invest. As of the date of this document, the Equity Research Department at Raymond James believes that the prices of the Reference Shares have the potential to increase during the term of the notes. However, there can be no assurance that they will in fact do so. Although Raymond James has expressed a positive view as to the Reference Shares prior to the date of this pricing supplement, its views may change significantly during the term of the notes. In addition, any positive views of Raymond James’ research division are separate and apart from the offering of these notes, and does not constitute investment advice. Our offering of the notes does not constitute our recommendation or the recommendation of ours, Raymond James, or our respective affiliates to invest in the notes or in the Reference Shares.

Rising interest rates may adversely impact the value of the Reference Shares. The Reference Shares were selected in part due to their historic dividend yields, and potential future dividend yields. A strategy of this type may not be successful. For example, in a rising interest rate environment, dividend paying stocks may perform less well than other types of securities.

You will not have any shareholder rights and will have no right to receive any Reference Shares at maturity. Investing in the notes will not make you a holder of any of the Reference Shares. Neither you nor any other holder or owner of the notes will have any voting rights, any right to receive dividends or other distributions (except to the extent that the Dividend Amounts, as adjusted by the Participation Rate, are reflected in the interest payments on the notes) or any other rights with respect to any of these securities.

Changes that affect a Reference Share may affect the market value of the notes and the amount you will receive at maturity. Changes affecting a Reference Share or a Reference Share Issuer, such as reorganizations or mergers, will be reflected in the price of that Reference Share and therefore could affect the amount payable on your notes at maturity and the market value of the notes prior to maturity. If these events occur, the calculation agent may, for example, adjust the applicable Initial Share Price. See "Description of the Notes—Anti-dilution Adjustments."

No Reference Share Issuer will have any role or responsibilities with respect to the notes. None of the issuers of the Reference Shares will have authorized or approved the notes, or will be involved in this offering. No such company will have any financial or legal obligation with respect to the notes or the amounts to be paid to you, including any obligation to take our needs or your needs into consideration for any reason, including taking any corporate actions that might affect the value of the Reference Shares or the notes. No such company will receive any of the proceeds from any offering of the notes. No Reference Share Issuer or any other company will be responsible for, or participate in, the determination or calculation of the Redemption Amount.

The notes are subject to risks associated with Basket Components that have a limited trading history. The securities of Plains GP Holdings, L.P., Ladder Capital Corp, and Hewlett Package Enterprise Company included in the Basket have been publicly traded only since 2013, 2014, and 2015 respectively. Accordingly, there is only a limited trading history available for these Basket Components upon which you can evaluate their prior performance.

We do not control any Reference Share Issuer and we are not responsible for any disclosure made by any other company. Neither we nor any of our affiliates have the ability to control the actions of any Reference Share Issuer, nor do we assume any responsibility for the adequacy or accuracy of any publicly available information about any of these companies, unless (and only to the extent that) our securities or the securities of our affiliates are represented by that Reference Share. We are not responsible for any other issuer's public disclosure of information on itself or any Reference Share, whether contained in U.S. Securities and Exchange Commission (the "SEC") filings or otherwise. We will not perform any due diligence procedures with respect to the applicable Reference Share Issuers. You should make your own investigation into the Reference Share Issuers.

Industry consolidation and other corporate events may alter the composition of the Basket. If a Reference Share Issuer is acquired in a stock-for-stock transaction, the stock of the acquiring company will assume that Reference Share's place in the Basket, including if the stock of the acquiring company is already in the Basket. Consequently, any consolidation among issuers of the Reference Shares will result in an increased weighting in the Basket for the surviving company. The effects on the Basket and the Initial Share Prices of the Reference Shares of consolidation transactions and other reorganization events with respect to the Reference Shares are described in "Description of the Notes—Anti-dilution Adjustments."

You will have limited anti-dilution protection with respect to the Reference Shares. The calculation agent will adjust the Initial Share Price of a Reference Share for stock splits, reverse stock splits, stock dividends and other events that affect the applicable issuer's capital structure, but only in the situations we describe in "Description of the Notes—Anti-dilution Adjustments" below. The calculation agent will not be required to make an adjustment for every corporate event that may affect a Reference Share. For example, the calculation agent will not make any adjustments for events such as an offering by a Reference Share Issuer of equity securities or a tender or exchange offer for less than all outstanding shares of that issuer by a third party. Those events or other actions by the applicable issuer or a third party may nevertheless adversely affect the price of the Reference Share, and adversely affect the value of your notes.

Risks Relating to the Terms of the Indenture and the Notes

The notes will be subject to risks, including non-payment in full, under Canadian Bank Resolution Powers. Under Canadian bank resolution powers, the Canada Deposit Insurance Corporation ("CDIC") may, in circumstances where we have ceased, or are about to cease, to be viable, or in certain other circumstances, assume temporary control or ownership of us and may be granted broad powers by one or more orders of the Governor in Council (Canada), each of which we refer to as an "Order," including the power to sell or dispose of all or a part of our assets, and the power to carry out or cause us to carry out a transaction or a series of transactions the purpose of which is to restructure our business. As part of the Canadian bank resolution powers, certain provisions of, and regulations under, the Bank Act (Canada) (the "Bank Act"), the CDIC Act and certain other Canadian federal statutes pertaining to banks, which we refer to collectively as the "bail-in regime," provide for a bank recapitalization regime for banks designated by the Superintendent of Financial Institutions (Canada) (the "Superintendent") as domestic systemically important banks, which include us.

If the CDIC were to take action under the Canadian bank resolution powers with respect to us, this could result in losses to the holders of the notes. As a result, you should consider the risk that you may lose all of your investment, including the principal amount plus any accrued interest, if the CDIC were to take action under the Canadian bank resolution powers, and that any remaining outstanding notes may be of little value at the time of the exercise of these powers and thereafter.

There is no limitation on the type of Order that may be made where it has been determined that we have ceased, or are about to cease, to be viable. As a result, you may be exposed to losses through the use of Canadian bank resolution powers.

The indenture under which the notes will be issued will provide only limited acceleration and enforcement rights for the notes. Our indenture under which the notes will be issued will be amended to provide that acceleration of the notes will only be permitted (a) if we default in the payment of the principal of, or interest on, any of the notes and, in such case, the default continues for a period of 30 business days, or (b) certain bankruptcy, insolvency or reorganization events occur.

Description of the Notes

This pricing supplement, the accompanying prospectus supplement, dated April 27, 2017 and the accompanying prospectus dated April 27, 2017 relating to the notes, should be read together. Terms used but not defined in this pricing supplement have the meanings given to them in the accompanying prospectus or accompanying prospectus supplement, unless the context requires otherwise.

The notes will be issued in book-entry form through The Depository Trust Company. Owners of beneficial interests in the notes should read the section entitled "Description of the Notes We May Offer—Legal Ownership" in the accompanying prospectus supplement and "Description of Debt Securities We May Offer—Legal Ownership and Book-Entry Issuance" in the accompanying prospectus.

The notes are part of a series of senior debt securities that we may issue from time to time under the senior indenture, dated January 25, 2010, between Bank of Montreal and Wells Fargo Bank, National Association, as trustee, as amended and supplemented. Terms that apply generally to our medium term notes are described in "Description of the Notes We May Offer" in the accompanying prospectus supplement. The terms described in this pricing supplement, supplement those described in the accompanying prospectus and the accompanying prospectus supplement, and, if the terms described here are inconsistent with those described in those documents, the terms described in this pricing supplement are controlling.

Composition of the Basket

The Basket will be composed of the Reference Shares, which will be the securities selected by Raymond James. The Reference Shares will not change over the term of the notes, except in limited circumstances relating to corporate events that may affect the Reference Shares, as described below.

Each Reference Share will be assigned a weighting (each, a "Reference Share Weighting") so that each Reference Share represents a specified portion of the value of the Basket on the pricing date. The Reference Share Weighting of each Reference Share is 1/25th.

Payment at Maturity

The amount that you will receive at maturity for each $1,000 in principal amount of the notes (the "Redemption Amount") will depend upon the performance of the Basket. The Redemption Amount will equal:

($1,000 × the Basket Level Percentage × the Participation Rate)

Basket Level Percentage. The Basket Level Percentage will equal the sum of the Weighted Reference Share Performances.

Weighted Reference Share Performance. For each Reference Share, the product of (a) its Reference Share Performance and (b) its Reference Share Weighting.

Reference Share Performance. The Reference Share Performance will measure the change in value of each Reference Share over the term of the notes. For each Reference Share, the Reference Share Performance will equal (a) the applicable Final Share Price divided by (b) the applicable Initial Share Price, expressed as a percentage.

Initial Share Price. For each Reference Share, the Initial Share Price is equal to its closing price on the pricing date.

Final Share Price. For each Reference Share, the closing price on the valuation date.

Interest Payments

We may make periodic interest payments on the notes. The amount of each interest payment, if any, will depend upon the amount of dividends paid on each Reference Share during the Interest Calculation Period preceding each interest payment date, and will equal, for each $1,000 in principal amount, (a) the sum of the Dividend Amounts for each of the Reference Shares multiplied by (b) the Participation Rate.

The first Interest Calculation Period will commence on the pricing date and end on the first Interest Calculation Date. Each subsequent Interest Calculation Period will begin on the trading day following an Interest Calculation Date and end on the next Interest Calculation Date. The final Interest Calculation Date will occur on the valuation date.

Interest will be paid on the Interest Payment Dates set forth in "Key Terms of the Notes." Interest will be payable to holders of record on the third business day before each Interest Payment Date. However, the final interest payment will be paid to the holders entitled to the payment at maturity. If an Interest Payment Date falls on a day other than a business day, interest will be paid on the next succeeding business day, and no additional interest will accrue as a result of that postponement.

Dividend Amount. For each Reference Share, an amount in U.S. dollars equal to (a) $1,000 divided by the applicable Initial Share Price multiplied by (b) the applicable Reference Share Weighting multiplied by (c) 100% of the gross cash distributions (including ordinary and extraordinary dividends and extraordinary dividends where a holder of the Reference Share has the option to receive additional shares or cash in lieu thereof) per Reference Share declared by the applicable Reference Share Issuer where the date that the applicable Reference Share has commenced trading ex-dividend on its primary U.S. securities exchange as to each relevant distribution occurs during the relevant Interest Calculation Period, as determined by the calculation agent.

If any Dividend Amount announced and/or declared by the relevant Reference Share Issuer is not paid as so announced or declared, or is paid in a smaller amount, the calculation agent shall make such adjustments to the interest payments as shall be necessary to reflect the actual amount received by holders of the Reference Shares.

Valuation Date

The valuation date will be September 23, 2020, unless that date is not a trading day as to any Reference Share, in which case the valuation date will be postponed as to that Reference Share to the next trading day. If the calculation agent determines that a market disruption event occurs or is continuing on the valuation date, the Final Share Price of the applicable Reference Share or Reference Shares will be determined according to the calculation in "—Consequences of Market Disruption Events" below.

Maturity Date

The maturity date will be September 30, 2020, unless that date is not a business day, in which case the maturity date will be the next following business day. The maturity date will be postponed by the same number of business days as the valuation date may be postponed, as provided in the prior paragraph, and no interest will be payable as a result of any such postponement.

Certain Definitions

Business Day. A day of the week other than Saturday or Sunday that is neither a legal holiday nor a day on which banking institutions are authorized or obligated by law or executive order to close in New York City, Toronto, or Montreal.

Trading Day. As to any Reference Share, any day, as determined by the calculation agent, on which trading is generally conducted on the relevant primary U.S. exchange for that Reference Share.

Closing Price. The closing price for any Reference Share on any day will equal the closing sale price or last reported sale price, regular way, for the security, on a per-share basis:

- on the principal national securities exchange on which that Reference Share is listed for trading on that day, or
- if that Reference Share is not listed on any national securities exchange on that day, on any other market system or quotation system that is the primary market for the trading of that Reference Share.

If that Reference Share is not listed or traded as described above, then the closing price for that Reference Share on any day will be the average, as determined by the calculation agent, of the bid prices for the security obtained from as many dealers in that security selected by the calculation agent as will make those bid prices available to the calculation agent. The number of dealers need to exceed three and may include the calculation agent, Raymond James, or any of their respective affiliates.

Consequences of Market Disruption Events

If a market disruption event with respect to any of the Reference Shares occurs or is continuing on the pricing date or the valuation date, the price of any affected Reference Share for that date will be based upon its price on the next scheduled trading day on which no market disruption event occurs. In no event, however, will the valuation date be postponed by more than ten trading days. As a result, if a market disruption event occurs or is continuing on the pricing date or the valuation date, the determination of the Initial Share Price or the Final Share Price could also be postponed, although not by more than ten trading days. If the scheduled valuation date is postponed, the maturity date shall be postponed by the same number of business days.

If the pricing date or the valuation date is postponed to the tenth scheduled trading day thereafter, and a market disruption event occurs on that day, then the calculation agent shall determine the value of the applicable Reference Share on that day based upon its good faith estimate, made in its sole discretion, of the value that would have been applicable in the absence of the market disruption event.

Any of the following will be a "market disruption event" as to any Reference Share:

- a suspension, absence or limitation of trading in (i) that security in its primary market, as determined by the calculation agent, or (ii) futures or options contracts relating to that security in the primary market for those contracts, as determined by the calculation agent;

- any event that disrupts or impairs, as determined by the calculation agent, the ability of market participants to (i) effect transactions in, or obtain market values for, the security in its primary market, or (ii) effect transactions in, or obtain market values for, futures or options contracts relating to that security in its primary market;

- the closure on any day of the primary market for that security on a scheduled trading day prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless such earlier closing time is announced by the primary market at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such primary market on such scheduled trading day for such primary market and (ii) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on such scheduled trading day for such primary market;

- any scheduled trading day on which (i) the primary market for that security or (ii) the exchanges or quotation systems, if any, on which futures or options contracts on that security are traded, fails to open for trading during its regular trading session; or

- any other event, if the calculation agent determines that the event interferes with our ability or the ability of any of our affiliates to unwind all or a portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under "Use of Proceeds and Hedging" in this pricing supplement.

Anti-dilution Adjustments

The calculation agent will adjust the Initial Share Price for any Reference Share if any of the dilution events described below occurs with respect to that Reference Share.

The calculation agent will adjust the Initial Share Price for any Reference Share as described below, but only if an event described below under this "—Anti-dilution Adjustments" section occurs with respect to that Reference Share and only if the relevant event occurs during the period described under the applicable subsection. The Initial Share Price for each Reference Share will be subject to the adjustments described below, independently and separately, with respect to the dilution events that affect that Reference Share.

If more than one anti-dilution event requiring adjustment occurs with respect to the Initial Share Price for any Reference Share, the calculation agent will adjust the Initial Share Price of that Reference Share for each event, sequentially, in the order in which the events occur, and on a cumulative basis. As a result, having adjusted the Initial Share Price for a Reference Share for the first event, the calculation agent will adjust the Initial Share Price for that same Reference Share for the second event, applying the required adjustment to the Initial Share Price as already adjusted for the first event, and so on for each event. If an event requiring an anti-dilution adjustment occurs, the calculation agent will make the adjustment in an attempt to offset, to the extent practical, any change in the economic position of the holder and us, relative to the notes, that results solely from that event. The calculation agent may also adjust the Initial Share Price, the Final Share Price or the Dividend Amount of the applicable Reference Share in order to ensure an appropriate result. The calculation agent may, in its sole discretion, modify the anti-dilution adjustments set forth in this section as necessary to ensure an equitable result.

Stock Splits and Stock Dividends

A stock split is an increase in the number of a corporation's outstanding shares of stock without any change in its stockholders' equity. When a corporation pays a stock dividend, it issues additional shares of its stock to all holders of its outstanding stock in proportion to the shares they own. Each outstanding share will be worth less as a result of a stock split or stock dividend.

If a Reference Share is subject to a stock split or receives a stock dividend, then the calculation agent will adjust its Initial Share Price by dividing the prior Initial Share Price — that is, the Initial Share Price before the stock split or stock dividend — by an amount equal to: (1) the number of shares of the applicable Reference Share outstanding immediately after the stock split or stock dividend becomes effective; divided by (2) the number of shares of the applicable Reference Share outstanding immediately before the stock split or stock dividend becomes effective. The Initial Share Price for a Reference Share will not be adjusted, however, unless:

- in the case of a stock split, the first day on which that Reference Share trades without the right to receive the stock split occurs after the pricing date and on or before the valuation date; or

- in the case of a stock dividend, the ex-dividend date occurs after the pricing date and on or before the valuation date.

The ex-dividend date for any dividend or other distribution with respect to a Reference Share is the first day on which that Reference Share trades without the right to receive that dividend or other distribution.

If the holder of a Reference Share is entitled to choose additional shares of stock or a cash payment in lieu of such shares, the dividend in question will be deemed to be made in cash for purposes of this section.

Reverse Stock Splits

A reverse stock split is a decrease in the number of a corporation's outstanding shares of stock without any change in its stockholders' equity. Each outstanding share will be worth more as a result of a reverse stock split.

If a Reference Share is subject to a reverse stock split, then the calculation agent will adjust its Initial Share Price by multiplying the prior Initial Share Price by an amount equal to: (a) the number of shares of that Reference Share outstanding immediately before the reverse stock split becomes effective; divided by (b) the number of shares of that Reference Share outstanding immediately after the reverse stock split becomes effective. The Initial Share Price of a Reference Share will not be adjusted, however, unless the reverse stock split becomes effective after the pricing date and on or before the valuation date.

Transferable Rights and Warrants

If the Reference Share Issuer issues transferable rights or warrants to all holders of that Reference Share to subscribe for or purchase that Reference Share at an exercise price per share that is less than the closing price of the Reference Share on the business day before the ex-dividend date for the issuance, then the applicable Initial Share Price will be adjusted in such manner as the calculation agent reasonably determines to be necessary in order to reflect the economic impact of such transaction.

The Initial Share Price will not be adjusted, however, unless the ex-dividend date described above occurs after the pricing date and on or before the valuation date.

Reorganization Events

If a Reference Share Issuer undergoes a reorganization event in which property other than the applicable Reference Share — e.g., cash and securities of another issuer — is distributed in respect of that Reference Share, then, for purposes of calculating its Reference Share Performance, the calculation agent will determine the closing price of that Reference Share on the valuation date to equal the value of the cash, securities and other property distributed in respect of one share of that Reference Share.

If the calculation agent determines that, by valuing such cash, securities and other property, a commercially reasonable result is not achieved, then the calculation agent will, in its sole discretion, make such other adjustments as it deems to be necessary, or may substitute another stock for that Reference Share.

Each of the following is a reorganization event with respect to a Reference Share:

- the Reference Share is reclassified or changed;
- the Reference Share Issuer has been subject to a merger, consolidation or other combination and either is not the surviving entity or is the surviving entity but all the outstanding stock is exchanged for or converted into other property;
- a statutory share exchange involving the outstanding stock and the securities of another entity occurs, other than as part of an event described in the two bullet points above;

- the Reference Share Issuer sells or otherwise transfers its property and assets as an entirety or substantially as an entirety to another entity;

- the Reference Share Issuer effects a spin-off — that is, issues to all holders of that Reference Share equity securities of another issuer, other than as part of an event described in the four bullet points above;

- the Reference Share Issuer is liquidated, dissolved or wound up or is subject to a proceeding under any applicable bankruptcy, insolvency or other similar law; or

- another entity completes a tender or exchange offer for all of the outstanding stock of the Reference Share Issuer.

Valuation of Distribution Property

If a reorganization event occurs with respect to a Reference Share, and the calculation agent does not substitute another stock for that Reference Share as described in "—Substitution" below, then the calculation agent will determine the applicable closing price on the valuation date so as to equal the value of the property — whether it be cash, securities or other property — distributed in the reorganization event in respect of one share of that Reference Share, as that Reference Share existed before the date of the reorganization. We refer to the property distributed in a reorganization event as distribution property, a term we describe in more detail below. The calculation agent will not make any determination for a reorganization event, however, unless the event becomes effective (or, if the event is a spin-off, unless the ex-dividend date for the spin-off occurs) after the pricing date and on or before the valuation date.

For the purpose of making a determination required by a reorganization event, the calculation agent will determine the value of each type of distribution property, in its sole discretion. For any distribution property consisting of a security, the calculation agent will use the closing price for the security on the relevant date. The calculation agent may value other types of property in any manner it determines, in its sole discretion, to be appropriate. If a holder of a Reference Share may elect to receive different types or combinations of types of distribution property in the reorganization event, the distribution property will consist of the types and amounts of each type distributed to a holder that makes no election, as determined by the calculation agent in its sole discretion.

If a reorganization event occurs and the calculation agent adjusts the closing price of a Reference Share on the valuation date to equal the value of the distribution property distributed in the event, as described above, the calculation agent will make further determinations for later events that affect the distribution property considered in determining the closing price. The calculation agent will do so to the same extent that it would make determinations if that Reference Share were outstanding and were affected by the same kinds of events.

For example, if a Reference Share Issuer merges into another company and each share of that Reference Share is converted into the right to receive two common shares of the surviving company and a specified amount of cash, then on the valuation date the closing price of that Reference Share will be determined to equal the value of the two common shares of the surviving company plus the specified amount of cash. The calculation agent will further determine the common share component of that closing price to reflect any later stock split or other event, including any later reorganization event, that affects the common shares of the surviving company, to the extent described in this "—Anti-dilution Adjustments" section or as described above in the "—Reorganization Events" subsection as if the common shares were that Reference Share. In that event, the cash component will not be redetermined but will continue to be a component of the closing price.

When we refer to "distribution property," we mean the cash, securities and other property distributed in a reorganization event in respect of a Reference Share. If an adjustment resulting from a prior reorganization had occurred, the "distribution property" will mean the cash, securities and other property distributed in respect of any securities whose value determines the closing price of the Reference Share on the valuation date. In the case of a spin-off, the distribution property also includes the Reference Share in respect of which the distribution is made.

If a reorganization event occurs, the distribution property distributed in the event will be substituted for the Reference Share as described above. Consequently, in this pricing supplement, when we refer to a Reference Share, we mean any distribution property that is distributed in a reorganization event in respect of that Reference Share. Similarly, when we refer to a Reference Share Issuer, we mean any successor entity in a reorganization event.

Substitution

If the calculation agent determines that a commercially reasonable result is not achieved by valuing distribution property with respect to the applicable Reference Share upon becoming subject to a reorganization event, then the calculation agent will, in its sole discretion, substitute another stock for that Reference Share. In such case, the adjustments described above under "—Valuation of Distribution Property" will not apply.

If the calculation agent so determines, it may choose, in its sole discretion, the stock of a different company listed on a national securities exchange as a substitute for that Reference Share. For all purposes, the substitute stock will be deemed to be that Reference Share for all purposes of the notes. The calculation agent will determine, in its sole discretion, the Initial Share Price, the Dividend Amount and/or the manner of valuation of the substitute stock. The calculation agent will have the right to make such adjustments to the calculation of the applicable Reference Share Performance and Dividend Amount as it determines in its sole discretion are necessary to preserve as nearly as possible our and your relative economic position prior to the reorganization event.

Other Events and Adjustments

The calculation agent may make such adjustments to the terms of the notes with respect to any of the events described above, as it deems in its discretion is necessary to ensure an equitable result, for example, if an event of the type described in this section occurs on the pricing date or on the valuation date.

Events of Default

In case an event of default with respect to the notes shall have occurred and be continuing, the amount declared due and payable on the notes upon any acceleration of the notes will be determined by the calculation agent and will be an amount of cash equal to the amount payable as described under the caption "—Payment at Maturity," calculated as if the date of acceleration were the valuation date. The Dividend Amount for each Reference Share will only include dividends declared and paid through that date.

If the maturity of the notes is accelerated because of an event of default, we will, or will cause the calculation agent to, provide written notice to the trustee at its New York office, on which notice the trustee may conclusively rely, and to the depositary, of the amount due with respect to the notes as promptly as possible and in no event later than two business days after the date of acceleration.

Role of the Calculation Agent

The calculation agent will make all determinations regarding the prices of the Reference Shares, the Redemption Amount, the Dividend Amounts of the Reference Shares, trading days, business days, market disruption events, any required anti-dilution adjustments, the default amount, and the amounts payable on your notes. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations or calculations by the calculation agent.

Our subsidiary, BMOCM, is expected to serve as the calculation agent for the notes. We may change the calculation agent for your notes at any time after the date of this pricing supplement without notice and BMOCM may resign as calculation agent at any time upon 60 days written notice to us.

Listing

Your notes will not be listed on any securities exchange.

Additional Information About the Notes, the Indenture and Canadian Bank Resolution Powers

Events of Default

Under the indenture, as it will be amended prior to the issue date of the notes, the term "event of default" means *only* any of the following:

- we default in the payment of the principal of, or interest on, any of the notes and, in each case, the default continues for a period of 30 business days; or
- certain bankruptcy, insolvency or reorganization events occur.

Canadian Bank Resolution Powers

General

Under Canadian bank resolution powers, the CDIC may, in circumstances where we have ceased, or are about to cease, to be viable, or in certain other circumstances, assume temporary control or ownership of us and may be granted broad powers by one or more Orders, including the power to sell or dispose of all or a part of our assets, and the power to carry out or cause us to carry out a transaction or a series of transactions the purpose of which is to restructure our business. As part of the Canadian bank resolution powers, certain provisions of, and regulations under, the Bank Act, the CDIC Act and certain other Canadian federal statutes pertaining to banks, which we refer to collectively as the "*bail-in regime*," provide for a bank recapitalization regime for banks designated by the Superintendent as D-SIBs, which include us.

The expressed objectives of the bail-in regime include reducing government and taxpayer exposure in the unlikely event of a failure of a D-SIB, reducing the likelihood of such a failure by increasing market discipline and reinforcing that bank shareholders and creditors are responsible for the D-SIBs' risks and not taxpayers, and preserving financial stability by empowering the CDIC to quickly restore a failed D-SIB to viability and allow it to remain open and operating, even where the D-SIB has experienced severe losses.

Under the CDIC Act, in circumstances where the Superintendent is of the opinion that (a) we have ceased, or are about to cease, to be viable and viability cannot be restored or preserved by exercise of the Superintendent's powers under the Bank Act, or (b) circumstances exist in respect of us that would allow the Superintendent to take control of us and if such control were taken, grounds would exist for the making of a winding-up order in respect of us, the Superintendent, after providing us with a reasonable opportunity to make representations, is required to provide a report to CDIC. Following receipt of the Superintendent's report, CDIC may request the Minister of Finance for Canada (the "Minister of Finance") to recommend that the Governor in Council (*Canada*) make an Order and, if the Minister of Finance is of the opinion that it is in the public interest to do so, the Minister of Finance may recommend that the Governor in Council (Canada) make, and on that recommendation, the Governor in Council (*Canada*) may make, one or more of the following Orders:

· vesting in CDIC, our shares and subordinated debt specified in the Order, which we refer to as a "*vesting order*";

· appointing CDIC as receiver in respect of us, which we refer to as a "*receivership order*";

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if a receivership order has been made, directing the Minister of Finance to incorporate a federal institution designated in the Order as a bridge institution wholly owned by the CDIC and specifying the date and time as of which our deposit liabilities are assumed, which we refer to as a "*bridge bank order*"; or

- if a vesting order or receivership order has been made, directing CDIC to carry out a conversion, by converting or causing us to convert, in whole or in part – by means of a transaction or series of transactions and in one or more steps – our shares and liabilities that are subject to the bail-in regime into our common shares or common shares of any of our affiliates, which we refer to as a "*conversion order*".

Following a vesting order or receivership Order, CDIC will assume temporary control or ownership of us and will be granted broad powers under that Order, including the power to sell or dispose of all or a part of our assets, and the power to carry out or cause us to carry out a transaction or a series of transactions the purpose of which is to restructure our business.

Under a bridge bank order, CDIC has the power to transfer our insured deposit liabilities or certain of our assets and other liabilities to a bridge institution. Upon the exercise of that power, any of our assets and liabilities that are not transferred to the bridge institution would remain with us, which would then be wound up. In such a scenario, any liabilities of ours, including any outstanding notes (whether or not such notes are bail-inable notes) that are not assumed by the bridge institution could receive only partial or no repayment in our ensuing wind-up.

The notes offered hereby are not bail-inable notes.

REFERENCE SHARE SELECTION

The Equity Research Department at Raymond James & Associates, Inc. regularly publishes research regarding securities that are publicly traded in the U.S. The Basket is composed of publicly traded common stocks selected by Raymond James in August 2018. Raymond James' objective was to select common stocks that it had rated "strong buy" or "outperform" which, as of the time they were selected, have (i) current dividend yields greater than 2% and (ii) a positive return on capital for at least two out of the last three years. The Basket also was designed to represent diversified industry sectors.

The components of the Basket were selected by Raymond James based on the above-mentioned criteria, which criteria involve some judgment. Different parties or persons could have different views as to which equity securities would meet the objectives outlined above. The use of solely objective criteria could also result in the selection of different Reference Shares. Neither we nor our affiliates take any responsibility for the selection of the Basket or the identity of the Reference Shares or otherwise endorses such stocks, and none of such entities (or Raymond James) makes any representation as to the performance of any Reference Share or the Basket.

There are a number of risks that affect each of the companies the securities of which comprise the Basket, including industry specific risks, risks relating to major competitors or new product expectations, unforeseen developments with respect to the management, financial condition or accounting policies or practices of such company, and external factors that could affect the U.S. economy, interest rates, the U.S. dollar or particular segments of the economy. Any of these changes may have an adverse effect on the company, the performance of its stock, investor confidence in the stock and the company's business prospects. Please see "Additional Risk Factors— Risks Relating to the Reference Shares—The inclusion of the Reference Shares in the Basket does not guarantee a positive return on the notes" in this pricing supplement.

Additional information regarding Raymond James research analyst ratings is available at http://www.raymondjames.com/rsch_how.htm. Information on that website is not included or incorporated by reference in this pricing supplement. A rating is subject to downward revision at any time, and a broker-dealer may cease to cover a particular security at any time, including during the term of the notes.

The information in this section has been provided by Raymond James.

Description of the Reference Shares

Companies with securities registered under the Exchange Act are required to file periodically financial and other information specified by the SEC. Information provided to or filed with the SEC can be inspected or copied at the SEC's public reference room located at 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. You may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. In addition, information provided to or filed with the SEC by each Reference Share Issuer under the Exchange Act can be located through the SEC's website at *http://www.sec.gov*.

This pricing supplement relates only to the notes offered hereby and does not relate to any Reference Shares or other securities of any Reference Share Issuer. We derived all disclosures in this pricing supplement regarding the Reference Share Issuers from publicly available documents described in the preceding paragraph. In connection with the offering of the notes, none of us, Raymond James, or our respective affiliates have participated in the preparation of such documents or made any due diligence inquiry with respect to any Reference Share Issuer. None of us, Raymond James, or any of our respective affiliates makes any representation that such publicly available documents or any other publicly available information regarding any Reference Share Issuer is current, accurate or complete. None of such documents shall be deemed to be incorporated by reference into this pricing supplement.

The composition of the Basket and the identity of the Reference Shares were selected by Raymond James. Neither we nor our affiliates take any responsibility for the selection of the Basket and the identity of the Reference Shares or otherwise endorses those stocks and none of those entities makes any representation as to the performance of any Reference Share or the Basket.

License Agreement

We have entered into a license agreement with Raymond James, under which we have obtained the right to use the stocks discussed herein in connection with our issuance of the notes. Under the license agreement, we have agreed to pay Raymond James a fee of up to 0.87% of the principal amount of the notes.

The license agreement requires this section to state as follows:

Solely by participating in this offering, Raymond James makes no representation or warranty, express or implied, to the owners of the notes or any member of the public regarding the advisability of investing in securities generally or in the notes particularly or the ability of the Basket to track general or industry-specific stock market performance. Raymond James and its third party licensors have no obligation to take the needs of Bank of Montreal or the owners of the notes into consideration in determining, composing or calculating the Basket. BMOCM is calculation agent for the notes and will have discretion in making various determinations that affect the notes and Raymond James is not responsible for any such calculations or determinations. Raymond James has no obligation or liability in connection with the administration or trading of the notes.

Raymond James has licensed certain of its trademarks to us.

The mark “RAYMOND JAMES” is a trademark of Raymond James & Associates, Inc. and/or its affiliates, and has been licensed for our use.

THE REFERENCE SHARES

Analog Devices, Inc.

Analog Devices, Inc. designs, manufactures, and markets integrated circuits used in analog and digital signal processing. The company's products are used in communications, computer, industrial, instrumentation, military, aerospace, automotive, and consumer electronics applications. Its common stock trades on the Nasdaq Global Select Market ("Nasdaq") under the symbol "ADI."

Historical Information of the Common Stock of Analog Devices, Inc.

The following table sets forth the high and low closing prices of this Reference Share from April 2, 2012 (the date this Reference Share began trading) through September 4, 2018.

		High ($)	Low ($)
2012	Second Quarter	39.90	35.09
	Third Quarter	41.68	35.83
	Fourth Quarter	42.37	37.96
2013	First Quarter	47.01	42.02
	Second Quarter	47.02	42.34
	Third Quarter	49.94	45.31
	Fourth Quarter	50.93	45.69
2014	First Quarter	53.61	47.26
	Second Quarter	55.79	50.74
	Third Quarter	54.83	48.87
	Fourth Quarter	57.49	43.10
2015	First Quarter	64.81	52.11
	Second Quarter	68.75	61.64
	Third Quarter	64.57	50.61
	Fourth Quarter	63.62	54.94
2016	First Quarter	59.19	48.84
	Second Quarter	59.80	52.55
	Third Quarter	65.27	55.36

	Fourth Quarter	74.53	60.71
2017	First Quarter	83.85	71.32
	Second Quarter	85.76	75.51
	Third Quarter	86.17	76.11
	Fourth Quarter	93.07	84.79
2018	First Quarter	97.24	82.68
	Second Quarter	102.10	87.35
	Third Quarter (through September 4, 2018)	100.42	93.74

Aflac Incorporated

Aflac, Inc., through its subsidiaries, provides supplemental insurance to individuals in the United States and Japan. The company's products include accident and disability, cancer expense, short-term disability, sickness and hospital indemnity, hospital intensive care, and fixed-benefit dental plans. Its common stock trades on the New York Stock Exchange ("NYSE") under the symbol "AFL."

Historical Information of the Common Stock of Aflac Incorporated

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	32.78	29.36
	Second Quarter	34.11	31.40
	Third Quarter	32.13	25.63
	Fourth Quarter	29.01	15.19
2009	First Quarter	23.14	5.75
	Second Quarter	18.83	9.38
	Third Quarter	21.51	14.33
	Fourth Quarter	23.57	20.29
2010	First Quarter	27.41	22.98
	Second Quarter	28.28	20.24
	Third Quarter	26.81	21.56
	Fourth Quarter	28.93	25.73
2011	First Quarter	29.64	25.23
	Second Quarter	28.50	22.15
	Third Quarter	23.72	15.73
	Fourth Quarter	23.39	16.79
2012	First Quarter	24.99	21.59
	Second Quarter	23.21	19.23
	Third Quarter	24.83	20.65
	Fourth Quarter	27.35	23.77
2013	First Quarter	27.04	24.33

	Second Quarter	29.10	24.45
	Third Quarter	31.77	28.30
	Fourth Quarter	33.74	31.08
2014	First Quarter	33.08	30.36
	Second Quarter	32.01	30.42
	Third Quarter	31.97	28.93
	Fourth Quarter	31.00	27.90
2015	First Quarter	32.10	28.54
	Second Quarter	32.36	30.72
	Third Quarter	32.46	27.62
	Fourth Quarter	33.00	28.98
2016	First Quarter	31.87	27.78
	Second Quarter	36.08	31.50
	Third Quarter	37.14	35.67
	Fourth Quarter	36.63	34.15
2017	First Quarter	36.49	33.57
	Second Quarter	39.63	36.10
	Third Quarter	42.13	38.56
	Fourth Quarter	44.63	40.99
2018	First Quarter	45.85	41.63
	Second Quarter	45.89	42.97
	Third Quarter (through September 4, 2018)	46.97	42.48

Best Buy Co., Inc.

Best Buy Co., Inc. retails consumer electronics, home office products, entertainment software, appliances, and related services through its retail stores, as well as its website. The company also retails pre-recorded home entertainment products through retail stores. Its common stock trades on the NYSE under the symbol "BBY."

Historical Information of the Common Stock of Best Buy Co., Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	51.22	39.43
	Second Quarter	47.52	39.60
	Third Quarter	46.93	36.58
	Fourth Quarter	36.52	17.42
2009	First Quarter	38.04	24.71
	Second Quarter	41.09	32.97
	Third Quarter	41.14	31.35
	Fourth Quarter	45.37	36.41
2010	First Quarter	43.16	35.40
	Second Quarter	48.58	33.86
	Third Quarter	40.83	31.39
	Fourth Quarter	44.86	33.46
2011	First Quarter	35.91	28.72
	Second Quarter	32.48	28.15
	Third Quarter	32.28	23.30
	Fourth Quarter	28.37	22.12
2012	First Quarter	27.51	23.23
	Second Quarter	23.64	18.02
	Third Quarter	22.20	16.93
	Fourth Quarter	18.40	11.29
2013	First Quarter	23.20	11.59
	Second Quarter	28.06	21.64

	Third Quarter	39.10	28.47
	Fourth Quarter	44.33	35.67
2014	First Quarter	40.68	22.72
	Second Quarter	31.04	24.12
	Third Quarter	34.96	29.03
	Fourth Quarter	39.69	29.72
2015	First Quarter	41.77	34.04
	Second Quarter	38.71	32.61
	Third Quarter	38.96	29.27
	Fourth Quarter	37.78	29.04
2016	First Quarter	34.36	25.87
	Second Quarter	33.48	29.17
	Third Quarter	39.51	30.36
	Fourth Quarter	49.31	37.89
2017	First Quarter	49.15	42.14
	Second Quarter	61.25	47.97
	Third Quarter	62.47	52.59
	Fourth Quarter	68.47	54.65
2018	First Quarter	78.06	66.68
	Second Quarter	78.78	68.18
	Third Quarter (through September 4, 2018)	82.60	73.63

BGC Partners, Inc.

BGC Partners, Inc. is a brokerage company servicing the financial and real estate markets. The company provides inter-dealer broker, trade execution, and commercial real estate services. Its common stock trades on the Nasdaq under the symbol "BGCP."

Historical Information of the Common Stock of BGC Partners, Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	12.47	11.21
	Second Quarter	12.08	7.26
	Third Quarter	7.44	3.59
	Fourth Quarter	4.36	2.43
2009	First Quarter	3.24	1.40
	Second Quarter	4.08	2.18
	Third Quarter	4.74	3.78
	Fourth Quarter	5.66	4.13
2010	First Quarter	6.37	3.73
	Second Quarter	6.96	5.11
	Third Quarter	5.97	4.79
	Fourth Quarter	8.68	6.02
2011	First Quarter	9.92	7.82
	Second Quarter	9.65	7.36
	Third Quarter	8.43	5.92
	Fourth Quarter	7.14	5.43
2012	First Quarter	7.97	6.05
	Second Quarter	7.50	5.76
	Third Quarter	6.19	4.40
	Fourth Quarter	5.11	3.18
2013	First Quarter	4.69	3.47
	Second Quarter	5.91	3.85

	Third Quarter	6.47	5.53
	Fourth Quarter	6.09	5.13
2014	First Quarter	7.26	6.03
	Second Quarter	7.62	6.64
	Third Quarter	7.99	7.16
	Fourth Quarter	9.43	7.16
2015	First Quarter	9.55	7.83
	Second Quarter	10.24	8.40
	Third Quarter	9.91	8.18
	Fourth Quarter	9.83	8.05
2016	First Quarter	9.52	8.41
	Second Quarter	9.44	8.38
	Third Quarter	9.23	8.29
	Fourth Quarter	10.34	8.37
2017	First Quarter	11.79	10.43
	Second Quarter	12.64	10.72
	Third Quarter	14.47	12.46
	Fourth Quarter	16.75	14.81
2018	First Quarter	15.13	13.01
	Second Quarter	13.89	11.09
	Third Quarter (through September 4, 2018)	12.49	10.58

Chemical Financial Corporation

Chemical Financial Corporation is a multi-bank holding company. The banks offer commercial banking and fiduciary services, including accepting deposits, business and personal checking accounts, commercial lending, and consumer financing. The company operates in the lower peninsula of Michigan. Its common stock trades on the Nasdaq under the symbol “CMI.”

Historical Information of the Common Stock of Chemical Financial Corporation

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	27.68	20.40
	Second Quarter	25.30	19.98
	Third Quarter	38.00	20.07
	Fourth Quarter	31.20	20.39
2009	First Quarter	28.16	15.50
	Second Quarter	23.85	18.31
	Third Quarter	22.65	18.68
	Fourth Quarter	24.03	21.06
2010	First Quarter	24.74	20.02
	Second Quarter	25.00	21.36
	Third Quarter	22.92	18.91
	Fourth Quarter	22.96	19.91
2011	First Quarter	23.02	19.43
	Second Quarter	20.47	18.10
	Third Quarter	19.27	14.80
	Fourth Quarter	21.78	14.70
2012	First Quarter	24.19	21.18
	Second Quarter	23.76	19.31
	Third Quarter	24.66	21.54
	Fourth Quarter	24.96	20.76
2013	First Quarter	26.49	23.76

	Second Quarter	26.57	23.74
	Third Quarter	31.03	26.62
	Fourth Quarter	32.37	27.00
2014	First Quarter	32.96	28.14
	Second Quarter	33.15	27.41
	Third Quarter	28.77	26.89
	Fourth Quarter	30.94	26.32
2015	First Quarter	31.36	28.35
	Second Quarter	34.20	30.06
	Third Quarter	34.28	30.32
	Fourth Quarter	37.05	31.67
2016	First Quarter	36.22	29.70
	Second Quarter	39.92	34.66
	Third Quarter	46.72	36.02
	Fourth Quarter	55.44	41.23
2017	First Quarter	54.81	48.42
	Second Quarter	50.71	44.97
	Third Quarter	52.26	44.06
	Fourth Quarter	57.41	51.41
2018	First Quarter	59.18	52.62
	Second Quarter	58.98	53.43
	Third Quarter (through September 4, 2018)	58.55	55.16

Comcast Corporation

Comcast Corporation provides media and television broadcasting services. The company offers video streaming, television programming, high-speed Internet, cable television, and communication services. Its common stock trades on the Nasdaq under the symbol "CMCSA."

Historical Information of the Common Stock of Comcast Corporation

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	10.27	8.31
	Second Quarter	11.36	9.31
	Third Quarter	11.14	9.01
	Fourth Quarter	9.68	6.54
2009	First Quarter	9.00	5.61
	Second Quarter	8.35	6.77
	Third Quarter	8.78	6.63
	Fourth Quarter	8.82	7.03
2010	First Quarter	9.41	7.61
	Second Quarter	10.20	8.39
	Third Quarter	9.78	8.50
	Fourth Quarter	11.13	8.83
2011	First Quarter	12.89	11.19
	Second Quarter	13.34	11.72
	Third Quarter	12.99	9.89
	Fourth Quarter	12.41	10.18
2012	First Quarter	15.18	12.27
	Second Quarter	15.99	14.14
	Third Quarter	18.21	15.55
	Fourth Quarter	19.06	17.57
2013	First Quarter	21.01	18.95
	Second Quarter	21.86	19.45

	Third Quarter	22.92	20.33
	Fourth Quarter	25.98	22.17
2014	First Quarter	27.62	24.55
	Second Quarter	27.05	23.98
	Third Quarter	28.62	26.34
	Fourth Quarter	29.44	24.80
2015	First Quarter	30.29	26.57
	Second Quarter	30.64	28.14
	Third Quarter	32.25	26.93
	Fourth Quarter	31.53	28.20
2016	First Quarter	30.54	26.78
	Second Quarter	32.60	30.13
	Third Quarter	33.96	32.39
	Fourth Quarter	35.51	30.33
2017	First Quarter	38.30	34.53
	Second Quarter	41.99	37.14
	Third Quarter	41.90	36.93
	Fourth Quarter	40.82	35.15
2018	First Quarter	42.99	32.99
	Second Quarter	34.60	30.59
	Third Quarter (through September 4, 2018)	36.99	33.09

CyrusOne Inc.

CyrusOne Inc. owns, operates, and develops of enterprise-class and carrier-neutral data center properties. The company provides data center facilities that are designed to protect and ensure the continued operation of IT infrastructure. Its common stock trades on the Nasdaq under the symbol "CONE."

Historical Information of the Common Stock of CyrusOne Inc.

The following table sets forth the high and low closing prices of this Reference Share from January 18, 2013 (the date this Reference Share began trading) through September 4, 2018.

		High ($)	Low ($)
2013	First Quarter (from January 18, 2013)	23.03	21.08
	Second Quarter	24.23	18.98
	Third Quarter	22.05	17.98
	Fourth Quarter	22.41	18.06
2014	First Quarter	23.08	20.44
	Second Quarter	24.90	19.84
	Third Quarter	26.74	24.04
	Fourth Quarter	28.16	23.94
2015	First Quarter	32.62	27.29
	Second Quarter	32.64	29.22
	Third Quarter	34.85	29.57
	Fourth Quarter	38.13	32.58
2016	First Quarter	45.65	33.61
	Second Quarter	55.66	42.70
	Third Quarter	55.64	47.57
	Fourth Quarter	49.11	39.66
2017	First Quarter	51.47	46.37
	Second Quarter	58.88	50.96
	Third Quarter	64.95	54.02
	Fourth Quarter	64.12	57.41
2018	First Quarter	59.07	48.48
	Second Quarter	58.73	48.72

Third Quarter (through September 4, 2018)	67.87	58.52

Cisco Systems, Inc.

Cisco Systems, Inc. designs, manufactures, and sells Internet Protocol (IP)-based networking and other products related to the communications and information technology (IT) industry and provide services associated with these products and their use. The company provides products for transporting data, voice, and video within buildings, across campuses, and globally. Its common stock is traded on the Nasdaq under the symbol "CSCO."

Historical Information of the Common Stock of Cisco Systems, Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	26.75	22.86
	Second Quarter	27.54	23.11
	Third Quarter	24.91	21.04
	Fourth Quarter	21.95	14.47
2009	First Quarter	17.79	13.62
	Second Quarter	20.10	16.85
	Third Quarter	23.66	18.13
	Fourth Quarter	24.38	22.67
2010	First Quarter	26.65	22.47
	Second Quarter	27.57	21.31
	Third Quarter	24.77	20.05
	Fourth Quarter	24.51	19.07
2011	First Quarter	22.06	17.00
	Second Quarter	18.07	14.85
	Third Quarter	16.67	13.73
	Fourth Quarter	19.12	15.19
2012	First Quarter	21.15	18.66
	Second Quarter	21.20	15.97
	Third Quarter	19.73	15.14
	Fourth Quarter	20.39	16.82
2013	First Quarter	21.94	20.30

	Second Quarter	24.82	20.38
	Third Quarter	26.37	23.31
	Fourth Quarter	23.99	20.24
2014	First Quarter	22.85	21.35
	Second Quarter	25.04	22.46
	Third Quarter	25.98	24.43
	Fourth Quarter	28.46	22.82
2015	First Quarter	30.19	26.37
	Second Quarter	29.76	27.13
	Third Quarter	29.03	24.62
	Fourth Quarter	29.36	25.73
2016	First Quarter	28.47	22.51
	Second Quarter	29.22	26.21
	Third Quarter	31.87	28.33
	Fourth Quarter	31.70	29.25
2017	First Quarter	34.44	29.98
	Second Quarter	34.39	31.21
	Third Quarter	33.76	30.37
	Fourth Quarter	38.74	33.26
2018	First Quarter	45.55	38.77
	Second Quarter	46.30	40.73
	Third Quarter (through September 4, 2018)	47.77	41.78

CVS Health Corporation

CVS Health Corporation is an integrated pharmacy health care provider. The company's offerings include pharmacy benefit management services, mail order, retail and specialty pharmacy, disease management programs, and retail clinics. The company operates drugstores throughout the U.S., the District of Columbia, and Puerto Rico. Its common stock trades on the NYSE under the symbol “CVS.”

Historical Information of the Common Stock of CVS Health Corporation

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	41.25	35.49
	Second Quarter	44.12	39.48
	Third Quarter	39.20	32.67
	Fourth Quarter	33.77	24.42
2009	First Quarter	29.80	23.98
	Second Quarter	32.98	28.10
	Third Quarter	37.52	30.68
	Fourth Quarter	38.01	28.87
2010	First Quarter	37.07	31.07
	Second Quarter	37.37	29.32
	Third Quarter	31.54	27.00
	Fourth Quarter	35.00	29.65
2011	First Quarter	35.71	32.24
	Second Quarter	38.80	34.77
	Third Quarter	38.54	32.06
	Fourth Quarter	41.16	32.97
2012	First Quarter	45.65	41.46
	Second Quarter	46.73	43.25
	Third Quarter	48.61	44.12
	Fourth Quarter	49.24	44.70
2013	First Quarter	55.30	49.68

	Second Quarter	60.35	54.13
	Third Quarter	62.17	56.75
	Fourth Quarter	71.58	56.64
2014	First Quarter	75.30	65.44
	Second Quarter	78.92	72.58
	Third Quarter	82.24	76.04
	Fourth Quarter	98.25	78.81
2015	First Quarter	104.56	94.16
	Second Quarter	106.47	98.74
	Third Quarter	113.45	95.12
	Fourth Quarter	105.29	91.56
2016	First Quarter	104.05	89.65
	Second Quarter	106.10	93.21
	Third Quarter	98.06	88.99
	Fourth Quarter	88.80	73.53
2017	First Quarter	83.92	74.80
	Second Quarter	82.79	75.95
	Third Quarter	83.31	75.35
	Fourth Quarter	80.91	66.80
2018	First Quarter	83.63	60.60
	Second Quarter	72.18	60.71
	Third Quarter (through September 4, 2018)	75.24	63.78

Delta Air Lines, Inc.

Delta Air Lines, Inc. provides scheduled air transportation for passengers, freight, and mail over a network of routes throughout the United States and internationally. Its common stock is traded on the NYSE under the symbol "DAL."

Historical Information of the Common Stock of Delta Air Lines, Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	18.53	8.35
	Second Quarter	10.48	5.00
	Third Quarter	9.94	4.64
	Fourth Quarter	11.52	5.64
2009	First Quarter	12.38	3.93
	Second Quarter	8.11	5.40
	Third Quarter	9.65	5.68
	Fourth Quarter	11.81	6.95
2010	First Quarter	14.65	11.22
	Second Quarter	14.93	11.31
	Third Quarter	12.61	9.97
	Fourth Quarter	14.33	11.24
2011	First Quarter	13.00	9.79
	Second Quarter	11.51	9.00
	Third Quarter	9.41	6.62
	Fourth Quarter	9.02	6.65
2012	First Quarter	11.30	8.01
	Second Quarter	12.10	9.81
	Third Quarter	11.12	8.55
	Fourth Quarter	11.94	9.33
2013	First Quarter	17.07	12.23
	Second Quarter	18.97	14.39
	Third Quarter	24.01	18.41

	Fourth Quarter	29.34	24.02
2014	First Quarter	35.37	27.70
	Second Quarter	42.23	31.73
	Third Quarter	40.93	35.61
	Fourth Quarter	49.23	30.90
2015	First Quarter	50.70	43.42
	Second Quarter	47.40	40.57
	Third Quarter	47.99	40.00
	Fourth Quarter	52.26	44.87
2016	First Quarter	50.12	40.77
	Second Quarter	48.49	33.36
	Third Quarter	40.98	35.58
	Fourth Quarter	51.78	38.94
2017	First Quarter	51.44	45.52
	Second Quarter	53.87	44.03
	Third Quarter	55.48	45.21
	Fourth Quarter	56.43	48.07
2018	First Quarter	60.13	50.46
	Second Quarter	55.87	49.54
	Third Quarter (through September 4, 2018)	58.88	48.78

Delek US Holdings, Inc

Delek US Holdings, Inc., through its subsidiaries, focuses on the petroleum refining, logistics, and convenience store retailing. The company gathers and transports crude oil, as well as markets, distributes, and stores refined production in the Southeast United States and West Texas. Its common stock is traded on the NYSE under the symbol "DK."

Historical Information of the Common Stock of Delek US Holdings, Inc

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	20.18	12.67
	Second Quarter	13.75	9.01
	Third Quarter	10.75	7.42
	Fourth Quarter	8.85	3.85
2009	First Quarter	11.32	5.49
	Second Quarter	11.90	8.01
	Third Quarter	8.90	7.02
	Fourth Quarter	8.54	5.80
2010	First Quarter	8.37	6.79
	Second Quarter	8.17	6.19
	Third Quarter	7.77	6.34
	Fourth Quarter	7.62	6.90
2011	First Quarter	13.62	6.89
	Second Quarter	15.70	12.84
	Third Quarter	17.25	11.27
	Fourth Quarter	16.60	9.88
2012	First Quarter	15.51	11.13
	Second Quarter	17.59	14.87
	Third Quarter	27.39	18.22
	Fourth Quarter	26.74	23.01
2013	First Quarter	40.50	24.83
	Second Quarter	39.48	28.60
	Third Quarter	30.73	20.69
	Fourth Quarter	34.41	20.17

2014	First Quarter	34.48	26.80
	Second Quarter	33.61	28.07
	Third Quarter	35.77	27.60
	Fourth Quarter	33.89	25.87
2015	First Quarter	39.91	26.31
	Second Quarter	40.86	35.40
	Third Quarter	39.99	27.41
	Fourth Quarter	29.72	22.45
2016	First Quarter	23.61	12.87
	Second Quarter	17.14	11.90
	Third Quarter	18.24	11.88
	Fourth Quarter	24.89	15.13
2017	First Quarter	25.54	21.68
	Second Quarter	27.64	21.30
	Third Quarter	27.58	20.88
	Fourth Quarter	35.08	25.23
2018	First Quarter	40.70	31.04
	Second Quarter	59.81	40.00
	Third Quarter (through September 4, 2018)	55.42	46.82

Fastenal Company

Fastenal Company sells industrial and construction supplies on a wholesale and retail basis. The company markets its products and services in the United States, Canada, Mexico, Puerto Rico, Singapore, China, and the Netherlands. Its common stock is traded on the Nasdaq under the symbol "FAST."

Historical Information of the Common Stock of Fastenal Company

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	23.47	16.57
	Second Quarter	25.88	21.58
	Third Quarter	27.75	21.12
	Fourth Quarter	22.63	15.94
2009	First Quarter	18.77	13.08
	Second Quarter	19.37	16.08
	Third Quarter	20.07	15.28
	Fourth Quarter	21.10	17.25
2010	First Quarter	24.50	20.61
	Second Quarter	28.24	24.17
	Third Quarter	26.93	22.55
	Fourth Quarter	30.06	25.61
2011	First Quarter	32.42	28.88
	Second Quarter	36.01	30.97
	Third Quarter	36.65	29.47
	Fourth Quarter	44.32	32.23
2012	First Quarter	54.59	43.76
	Second Quarter	54.65	38.37
	Third Quarter	45.30	39.03
	Fourth Quarter	46.69	40.20
2013	First Quarter	53.18	46.46
	Second Quarter	52.18	44.95

	Third Quarter	50.98	43.99
	Fourth Quarter	51.90	45.62
2014	First Quarter	50.43	42.70
	Second Quarter	51.20	47.80
	Third Quarter	50.08	43.74
	Fourth Quarter	48.21	40.78
2015	First Quarter	47.40	39.82
	Second Quarter	43.41	40.01
	Third Quarter	42.82	36.13
	Fourth Quarter	41.64	35.50
2016	First Quarter	49.87	36.53
	Second Quarter	48.93	42.70
	Third Quarter	45.36	39.92
	Fourth Quarter	49.17	38.16
2017	First Quarter	52.22	46.17
	Second Quarter	51.76	42.10
	Third Quarter	45.73	39.97
	Fourth Quarter	55.14	44.51
2018	First Quarter	58.36	52.06
	Second Quarter	55.59	48.13
	Third Quarter (through September 4, 2018)	60.87	47.69

F.N.B. Corporation

F.N.B. Corporation operates as a diversified financial services company. The company, through its subsidiaries, provides financial commercial banking, consumer banking and wealth management solutions. Its common stock is traded on the NYSE under the symbol "FNB."

Historical Information of the Common Stock of F.N.B. Corporation

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	16.04	13.29
	Second Quarter	16.86	11.78
	Third Quarter	17.50	9.87
	Fourth Quarter	15.95	9.75
2009	First Quarter	13.39	5.38
	Second Quarter	9.30	5.80
	Third Quarter	7.83	5.98
	Fourth Quarter	7.41	6.36
2010	First Quarter	8.57	6.74
	Second Quarter	9.69	7.97
	Third Quarter	8.83	7.53
	Fourth Quarter	10.16	8.24
2011	First Quarter	10.63	9.87
	Second Quarter	11.41	9.85
	Third Quarter	10.61	8.19
	Fourth Quarter	11.46	8.20
2012	First Quarter	12.44	11.36
	Second Quarter	12.32	9.95
	Third Quarter	12.00	10.63
	Fourth Quarter	11.41	10.41
2013	First Quarter	12.10	10.89
	Second Quarter	12.08	11.06

	Third Quarter	13.29	11.96
	Fourth Quarter	13.02	11.75
2014	First Quarter	13.51	11.49
	Second Quarter	13.65	11.98
	Third Quarter	13.02	11.93
	Fourth Quarter	13.48	11.70
2015	First Quarter	13.39	11.89
	Second Quarter	14.58	12.97
	Third Quarter	14.64	12.03
	Fourth Quarter	14.57	12.61
2016	First Quarter	13.39	11.18
	Second Quarter	13.49	11.76
	Third Quarter	13.35	11.92
	Fourth Quarter	16.40	12.09
2017	First Quarter	16.30	14.35
	Second Quarter	14.84	13.20
	Third Quarter	14.42	12.12
	Fourth Quarter	14.47	12.90
2018	First Quarter	14.76	13.11
	Second Quarter	14.11	12.77
	Third Quarter (through September 4, 2018)	13.81	12.67

The Home Depot, Inc.

The Home Depot, Inc. is a home improvement retailer that sells building materials and home improvement products. The company sells a wide assortment of building materials, home improvement and lawn and garden products, and provides a number of services. The company operates in the United States, Canada, China, and Mexico. Its common stock is traded on the NYSE under the symbol "HD."

Historical Information of the Common Stock of The Home Depot, Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	30.67	24.71
	Second Quarter	30.12	23.42
	Third Quarter	30.16	21.46
	Fourth Quarter	25.92	18.51
2009	First Quarter	25.26	18.00
	Second Quarter	26.34	22.68
	Third Quarter	28.23	22.40
	Fourth Quarter	29.29	24.96
2010	First Quarter	32.75	27.34
	Second Quarter	36.49	28.07
	Third Quarter	31.81	27.07
	Fourth Quarter	35.24	30.21
2011	First Quarter	38.49	34.38
	Second Quarter	38.17	33.45
	Third Quarter	37.05	28.51
	Fourth Quarter	42.22	31.59
2012	First Quarter	50.31	42.14
	Second Quarter	52.99	47.02
	Third Quarter	60.37	50.70
	Fourth Quarter	65.07	59.01
2013	First Quarter	71.37	62.85

	Second Quarter	79.82	69.67
	Third Quarter	80.54	72.70
	Fourth Quarter	82.34	74.14
2014	First Quarter	82.91	74.97
	Second Quarter	81.13	75.70
	Third Quarter	93.50	79.40
	Fourth Quarter	104.97	87.85
2015	First Quarter	117.49	100.95
	Second Quarter	115.59	106.98
	Third Quarter	122.80	110.97
	Fourth Quarter	134.74	117.03
2016	First Quarter	133.43	111.85
	Second Quarter	137.51	124.67
	Third Quarter	138.77	125.45
	Fourth Quarter	137.11	119.89
2017	First Quarter	149.60	133.53
	Second Quarter	158.81	145.91
	Third Quarter	163.56	144.58
	Fourth Quarter	190.36	162.71
2018	First Quarter	207.23	171.80
	Second Quarter	201.31	172.51
	Third Quarter (through September 4, 2018)	205.08	193.10

Hewlett Packard Enterprise Company

Hewlett Packard Enterprise Company provides information technology solutions. The company offers enterprise security, analytics and data management, applications development and testing, data center care, cloud consulting, and business process services. Its common stock is traded on the NYSE under the symbol "HPE."

Historical Information of the Common Stock of Hewlett Packard Enterprise Company

The following table sets forth the high and low closing prices of this Reference Share from November 2, 2015 (the date this Reference Share began trading) through September 4, 2018.

		High ($)	**Low ($)**
2015	Fourth Quarter (from November 1, 2015)	9.88	7.68
2016	First Quarter	10.40	7.01
	Second Quarter	11.48	9.11
	Third Quarter	13.51	10.58
	Fourth Quarter	14.34	12.36
2017	First Quarter	14.40	12.87
	Second Quarter	14.82	12.79
	Third Quarter	14.89	12.78
	Fourth Quarter	14.97	13.10
2018	First Quarter	19.41	14.61
	Second Quarter	17.75	14.61
	Third Quarter (through September 4, 2018)	16.79	14.77

Ladder Capital Corp

Ladder Capital Corp is a commercial real estate company. The company offers commercial mortgage lending, investments in securities secured by first mortgage loans, and investments in selected net leased and other commercial real estate assets. The company serves clients in the States of New York, California, and Florida. Its common stock is traded on the NYSE under the symbol "LADR."

Historical Information of the Common Stock of Ladder Capital Corp

The following table sets forth the high and low closing prices of this Reference Share from February 11, 2014 (the date this Reference Share began trading) through September 4, 2018.

		High ($)	Low ($)
2014	First Quarter (from February 11, 2014)	19.00	16.65
	Second Quarter	19.75	16.64
	Third Quarter	19.64	16.89
	Fourth Quarter	20.45	18.02
2015	First Quarter	19.98	17.63
	Second Quarter	18.49	17.16
	Third Quarter	17.33	14.32
	Fourth Quarter	15.17	11.63
2016	First Quarter	12.78	9.60
	Second Quarter	12.96	11.35
	Third Quarter	13.85	11.69
	Fourth Quarter	15.41	12.18
2017	First Quarter	14.91	13.56
	Second Quarter	15.05	13.41
	Third Quarter	13.85	12.90
	Fourth Quarter	13.93	13.41
2018	First Quarter	15.34	13.46
	Second Quarter	16.04	13.77
	Third Quarter (through September 4, 2018)	17.41	15.69

Leggett & Platt, Incorporated

Leggett & Platt, Incorporated manufactures a wide range of engineered products. The company's products include components for bedding, furniture, and other residential furnishings, as well as office and institutional furnishings components, retail store fixtures, and displays, specialty wire products, and automotive seating suspension and lumbar systems. Its common stock is traded on the NYSE under the symbol “LEG.”

Historical Information of the Common Stock of Leggett & Platt, Incorporated

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	19.22	14.88
	Second Quarter	19.34	14.30
	Third Quarter	23.98	14.56
	Fourth Quarter	22.55	12.24
2009	First Quarter	15.68	10.21
	Second Quarter	16.38	13.16
	Third Quarter	19.96	14.05
	Fourth Quarter	20.82	18.28
2010	First Quarter	21.78	18.26
	Second Quarter	25.02	20.06
	Third Quarter	23.05	19.01
	Fourth Quarter	24.08	19.83
2011	First Quarter	24.59	22.37
	Second Quarter	26.37	22.72
	Third Quarter	24.90	17.87
	Fourth Quarter	23.92	18.61
2012	First Quarter	23.60	21.36
	Second Quarter	23.67	19.49
	Third Quarter	25.17	20.85
	Fourth Quarter	27.85	24.45
2013	First Quarter	33.78	27.40
	Second Quarter	34.19	30.09
	Third Quarter	32.34	28.86

	Fourth Quarter	31.08	28.64
2014	First Quarter	32.64	29.06
	Second Quarter	34.80	31.94
	Third Quarter	35.51	32.55
	Fourth Quarter	42.95	33.18
2015	First Quarter	46.42	41.68
	Second Quarter	49.72	42.47
	Third Quarter	51.00	40.68
	Fourth Quarter	47.15	41.65
2016	First Quarter	48.40	37.79
	Second Quarter	51.11	47.24
	Third Quarter	54.53	45.58
	Fourth Quarter	50.40	44.39
2017	First Quarter	50.58	46.99
	Second Quarter	54.04	50.10
	Third Quarter	53.80	43.50
	Fourth Quarter	49.45	45.38
2018	First Quarter	48.80	41.80
	Second Quarter	45.04	40.38
	Third Quarter (through September 4, 2018)	46.25	42.58

Marathon Petroleum Corporation

Marathon Petroleum Corporation refines, supplies, markets, and transports petroleum products. The company serves customers in the United States. Its common stock is traded on the NYSE under the symbol "MPC."

Historical Information of the Common Stock of Marathon Petroleum Corporation

The following table sets forth the high and low closing prices of this Reference Share from June 23, 2011 (the date this Reference Share began trading) through September 4, 2018.

		High ($)	Low ($)
2011	Second Quarter (from June 23, 2011)	20.70	18.63
	Third Quarter	22.49	13.53
	Fourth Quarter	19.46	13.58
2012	First Quarter	22.61	15.48
	Second Quarter	22.46	17.14
	Third Quarter	27.81	21.72
	Fourth Quarter	31.50	26.53
2013	First Quarter	45.57	30.13
	Second Quarter	44.92	35.19
	Third Quarter	37.55	31.50
	Fourth Quarter	45.87	31.05
2014	First Quarter	47.25	41.16
	Second Quarter	48.35	39.04
	Third Quarter	46.20	37.90
	Fourth Quarter	48.46	38.14
2015	First Quarter	53.52	38.43
	Second Quarter	52.44	48.54
	Third Quarter	58.79	43.77
	Fourth Quarter	59.34	46.78
2016	First Quarter	51.24	30.73
	Second Quarter	41.46	32.81
	Third Quarter	43.74	35.48
	Fourth Quarter	51.12	40.96

2017	First Quarter	52.93	47.71
	Second Quarter	55.03	48.19
	Third Quarter	56.53	49.45
	Fourth Quarter	66.84	55.72
2018	First Quarter	73.68	62.79
	Second Quarter	82.93	69.20
	Third Quarter (through September 4, 2018)	84.28	69.60

MSC Industrial Direct Co., Inc.

MSC Industrial Direct Co., Inc. is a direct marketer and supplier of a broad range of metalworking and maintenance and repair supplies. The company markets its products to industrial customers throughout the United States. Its common stock is traded on the NYSE under the symbol "MSM."

Historical Information of the Common Stock of MSC Industrial Direct Co., Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	43.20	35.13
	Second Quarter	54.50	42.60
	Third Quarter	52.14	42.43
	Fourth Quarter	42.54	28.35
2009	First Quarter	38.89	27.43
	Second Quarter	41.45	32.13
	Third Quarter	43.90	34.83
	Fourth Quarter	48.39	41.61
2010	First Quarter	51.40	43.19
	Second Quarter	57.47	49.56
	Third Quarter	54.04	44.57
	Fourth Quarter	65.81	54.00
2011	First Quarter	68.47	58.57
	Second Quarter	75.04	64.33
	Third Quarter	70.48	50.17
	Fourth Quarter	72.20	56.13
2012	First Quarter	84.27	71.49
	Second Quarter	84.27	62.42
	Third Quarter	73.88	61.90
	Fourth Quarter	75.38	67.18
2013	First Quarter	87.79	73.65
	Second Quarter	84.26	76.33

	Third Quarter	84.62	76.00
	Fourth Quarter	83.70	75.55
2014	First Quarter	88.62	80.19
	Second Quarter	96.13	85.80
	Third Quarter	95.53	84.95
	Fourth Quarter	86.07	77.04
2015	First Quarter	81.24	70.97
	Second Quarter	73.02	69.37
	Third Quarter	72.03	61.03
	Fourth Quarter	64.99	55.01
2016	First Quarter	76.31	56.53
	Second Quarter	77.76	69.25
	Third Quarter	74.17	70.73
	Fourth Quarter	94.73	70.28
2017	First Quarter	105.50	90.92
	Second Quarter	103.02	82.15
	Third Quarter	89.04	65.62
	Fourth Quarter	97.26	74.44
2018	First Quarter	99.26	86.52
	Second Quarter	94.86	84.85
	Third Quarter (through September 4, 2018)	88.78	80.86

Old Republic International Corporation

Old Republic International Corporation is an insurance holding company whose subsidiaries market, underwrite, and provide risk management services. The company provides services for a variety of coverages in the property and liability, mortgage guaranty, title, and life and health insurance fields. Its common stock is traded on the NYSE under the symbol "ORI."

Historical Information of the Common Stock of Old Republic International Corporation

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	15.91	12.31
	Second Quarter	15.46	11.84
	Third Quarter	16.50	9.32
	Fourth Quarter	12.07	7.39
2009	First Quarter	12.61	7.40
	Second Quarter	12.17	9.00
	Third Quarter	12.71	9.15
	Fourth Quarter	12.41	10.08
2010	First Quarter	12.68	10.12
	Second Quarter	15.29	12.13
	Third Quarter	13.85	12.04
	Fourth Quarter	14.11	12.52
2011	First Quarter	13.84	11.73
	Second Quarter	13.26	11.62
	Third Quarter	12.20	8.75
	Fourth Quarter	10.16	7.18
2012	First Quarter	11.19	9.00
	Second Quarter	10.76	8.16
	Third Quarter	9.70	7.83
	Fourth Quarter	10.80	9.27
2013	First Quarter	12.71	10.89

	Second Quarter	14.45	12.12
	Third Quarter	15.40	12.99
	Fourth Quarter	17.36	14.55
2014	First Quarter	17.12	14.70
	Second Quarter	17.23	15.79
	Third Quarter	16.82	14.28
	Fourth Quarter	15.36	13.74
2015	First Quarter	15.26	13.87
	Second Quarter	16.23	14.85
	Third Quarter	16.84	15.05
	Fourth Quarter	19.02	15.50
2016	First Quarter	18.68	17.19
	Second Quarter	19.29	17.80
	Third Quarter	19.98	17.61
	Fourth Quarter	19.11	16.58
2017	First Quarter	21.08	18.82
	Second Quarter	20.83	19.42
	Third Quarter	20.15	18.11
	Fourth Quarter	21.46	19.43
2018	First Quarter	22.21	19.76
	Second Quarter	21.84	19.68
	Third Quarter (through September 4, 2018)	22.45	19.81

PS-40

PacWest Bancorp

PacWest Bancorp is a bank holding company. The company, through its banking subsidiary, offers a wide range of commercial banking services. Its common stock is traded on the Nasdaq under the symbol "PACW."

Historical Information of the Common Stock of PacWest Bancorp

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	40.30	24.78
	Second Quarter	28.42	14.88
	Third Quarter	35.25	12.75
	Fourth Quarter	32.10	19.31
2009	First Quarter	26.65	9.75
	Second Quarter	19.41	12.00
	Third Quarter	20.81	11.96
	Fourth Quarter	20.90	15.66
2010	First Quarter	23.43	19.44
	Second Quarter	24.64	18.31
	Third Quarter	21.41	17.06
	Fourth Quarter	22.00	16.82
2011	First Quarter	22.64	19.73
	Second Quarter	23.27	19.33
	Third Quarter	21.13	13.94
	Fourth Quarter	19.43	13.23
2012	First Quarter	24.42	20.20
	Second Quarter	25.32	21.03
	Third Quarter	25.22	22.25
	Fourth Quarter	25.10	21.73
2013	First Quarter	29.11	25.79
	Second Quarter	30.85	26.55
	Third Quarter	36.17	31.51

	Fourth Quarter	42.78	34.40
2014	First Quarter	45.10	38.12
	Second Quarter	47.09	38.57
	Third Quarter	44.39	39.66
	Fourth Quarter	47.58	38.77
2015	First Quarter	47.26	41.61
	Second Quarter	48.35	44.69
	Third Quarter	48.00	40.22
	Fourth Quarter	47.49	42.67
2016	First Quarter	42.15	29.38
	Second Quarter	42.05	35.69
	Third Quarter	43.60	37.86
	Fourth Quarter	55.38	41.31
2017	First Quarter	57.15	50.79
	Second Quarter	52.88	45.68
	Third Quarter	50.55	43.40
	Fourth Quarter	50.75	44.36
2018	First Quarter	54.40	48.17
	Second Quarter	55.62	47.42
	Third Quarter (through September 4, 2018)	51.74	49.02

Plains GP Holdings, L.P.

Plains GP Holdings LP is a holding company. The company, through its subsidiaries, is involved in the transportation, storage, terminalling and marketing of crude oil, refined products and liquefied petroleum gas, as well as develops and operates natural gas storage facilities. Its common shares, representing limited partnership interests, are traded on the NYSE under the symbol "PAGP."

Historical Information of the Common Stock of Plains GP Holdings, L.P.

The following table sets forth the high and low closing prices of this Reference Share from October 21, 2013 (the date this Reference Share began trading) through September 4, 2018.

		High ($)	Low ($)
2013	Fourth Quarter (from October 21, 2013)	71.29	57.28
2014	First Quarter	76.72	65.96
	Second Quarter	85.19	72.65
	Third Quarter	84.76	76.69
	Fourth Quarter	80.10	61.81
2015	First Quarter	76.27	65.30
	Second Quarter	79.01	68.81
	Third Quarter	70.41	43.89
	Fourth Quarter	51.42	19.97
2016	First Quarter	25.78	14.17
	Second Quarter	29.96	21.30
	Third Quarter	34.46	25.78
	Fourth Quarter	36.40	31.40
2017	First Quarter	35.00	30.89
	Second Quarter	31.56	23.39
	Third Quarter	27.60	19.77
	Fourth Quarter	22.20	19.56
2018	First Quarter	24.14	20.19
	Second Quarter	25.72	21.51
	Third Quarter (through September 4, 2018)	26.91	22.93

Union Pacific Corporation

Union Pacific Corporation is a rail transportation company. The company's railroad hauls a variety of goods, including agricultural, automotive, and chemical products. The company offers long-haul routes from all major West Coast and Gulf Coast ports to eastern gateways as well as connects with Canada's rail systems and serves the major gateways to Mexico. Its common stock is traded on the NYSE under the symbol “UNP.”

Historical Information of the Common Stock of Union Pacific Corporation

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	**Low ($)**
2008	First Quarter	32.33	27.26
	Second Quarter	41.16	31.99
	Third Quarter	41.95	34.58
	Fourth Quarter	34.72	21.41
2009	First Quarter	27.01	16.81
	Second Quarter	27.18	20.80
	Third Quarter	31.81	24.45
	Fourth Quarter	33.12	27.53
2010	First Quarter	37.00	30.25
	Second Quarter	38.83	33.97
	Third Quarter	41.15	33.72
	Fourth Quarter	47.28	40.02
2011	First Quarter	49.51	45.74
	Second Quarter	52.49	47.68
	Third Quarter	53.38	40.84
	Fourth Quarter	52.97	39.92
2012	First Quarter	58.06	53.40
	Second Quarter	59.66	52.49
	Third Quarter	64.22	58.15
	Fourth Quarter	63.58	58.73
2013	First Quarter	71.21	64.23

	Second Quarter	79.96	67.88
	Third Quarter	81.69	76.77
	Fourth Quarter	84.00	75.29
2014	First Quarter	94.70	82.58
	Second Quarter	102.42	90.54
	Third Quarter	109.58	97.48
	Fourth Quarter	123.31	98.08
2015	First Quarter	123.83	108.17
	Second Quarter	111.42	95.37
	Third Quarter	98.82	80.56
	Fourth Quarter	97.05	75.43
2016	First Quarter	84.42	68.79
	Second Quarter	89.63	78.00
	Third Quarter	97.53	87.16
	Fourth Quarter	106.33	87.89
2017	First Quarter	110.42	102.13
	Second Quarter	113.53	104.78
	Third Quarter	116.64	101.40
	Fourth Quarter	136.32	110.27
2018	First Quarter	141.97	124.14
	Second Quarter	147.02	130.02
	Third Quarter (through September 4, 2018)	152.78	138.26

Walmart Inc.

Walmart Inc. operates discount stores, supercenters, and neighborhood markets. The company offers merchandise such as apparel, house wares, small appliances, electronics, musical instruments, books, home improvement, shoes, jewelry, toddler, games, household essentials, pets, pharmaceutical products, party supplies, and automotive tools. Its common stock is traded on the NYSE under the symbol "WMT."

Historical Information of the Common Stock of Walmart Inc.

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	53.62	45.72
	Second Quarter	59.80	54.08
	Third Quarter	63.17	56.02
	Fourth Quarter	59.73	49.67
2009	First Quarter	57.18	46.42
	Second Quarter	53.80	47.87
	Third Quarter	51.88	47.57
	Fourth Quarter	54.96	49.00
2010	First Quarter	55.99	52.61
	Second Quarter	55.53	48.07
	Third Quarter	54.08	48.00
	Fourth Quarter	55.36	53.25
2011	First Quarter	57.57	51.37
	Second Quarter	56.06	52.13
	Third Quarter	54.52	48.41
	Fourth Quarter	59.99	51.96
2012	First Quarter	62.48	58.46
	Second Quarter	69.72	57.36
	Third Quarter	75.14	69.35
	Fourth Quarter	77.15	67.61
2013	First Quarter	74.85	68.30

	Second Quarter	79.86	73.03
	Third Quarter	78.77	72.38
	Fourth Quarter	81.21	71.87
2014	First Quarter	78.91	72.66
	Second Quarter	79.76	74.91
	Third Quarter	77.51	73.34
	Fourth Quarter	87.54	73.82
2015	First Quarter	90.47	80.69
	Second Quarter	81.03	70.93
	Third Quarter	73.88	63.10
	Fourth Quarter	66.93	56.42
2016	First Quarter	68.80	60.84
	Second Quarter	73.02	63.15
	Third Quarter	74.30	70.30
	Fourth Quarter	72.01	67.39
2017	First Quarter	72.39	65.66
	Second Quarter	80.26	71.43
	Third Quarter	81.61	73.23
	Fourth Quarter	99.62	78.45
2018	First Quarter	109.55	85.42
	Second Quarter	88.46	82.40
	Third Quarter (through September 4, 2018)	98.64	84.00

Weyerhaeuser Company

Weyerhaeuser Company is an integrated forest products company. The company primarily grows and harvests trees, develops and construct real estate, and makes a range of forest products. Weyerhaeuser is also classified as a REIT. Its common stock is traded on the NYSE under the symbol "WY."

Historical Information of the Common Stock of Weyerhaeuser Company

The following table sets forth the high and low closing prices of this Reference Share from the first quarter of 2008 through September 4, 2018.

		High ($)	Low ($)
2008	First Quarter	29.55	24.14
	Second Quarter	27.70	20.54
	Third Quarter	25.67	19.35
	Fourth Quarter	24.40	11.84
2009	First Quarter	13.11	7.92
	Second Quarter	15.40	11.42
	Third Quarter	16.32	11.33
	Fourth Quarter	18.07	14.28
2010	First Quarter	18.55	16.06
	Second Quarter	21.81	14.41
	Third Quarter	17.50	14.04
	Fourth Quarter	19.00	15.23
2011	First Quarter	25.20	19.55
	Second Quarter	25.14	20.01
	Third Quarter	22.57	15.55
	Fourth Quarter	18.88	15.25
2012	First Quarter	22.28	18.78
	Second Quarter	22.36	18.69
	Third Quarter	27.15	22.16
	Fourth Quarter	28.52	24.99
2013	First Quarter	31.50	28.78
	Second Quarter	32.60	27.01

	Third Quarter	29.86	26.65
	Fourth Quarter	31.57	28.12
2014	First Quarter	31.34	28.84
	Second Quarter	33.09	27.72
	Third Quarter	34.46	31.23
	Fourth Quarter	36.64	31.77
2015	First Quarter	36.69	33.03
	Second Quarter	33.00	31.12
	Third Quarter	32.06	26.87
	Fourth Quarter	32.37	27.00
2016	First Quarter	31.05	22.22
	Second Quarter	32.32	26.77
	Third Quarter	32.91	29.70
	Fourth Quarter	33.12	28.64
2017	First Quarter	34.19	30.21
	Second Quarter	34.96	32.59
	Third Quarter	34.43	31.17
	Fourth Quarter	36.55	34.12
2018	First Quarter	37.85	33.60
	Second Quarter	38.36	34.61
	Third Quarter (through September 4, 2018)	37.27	33.83

Supplemental Tax Considerations

Supplemental Canadian Tax Considerations

In the opinion of Torys LLP, our Canadian federal income tax counsel, the following summary describes the principal Canadian federal income tax considerations generally applicable to a purchaser who acquires from us as the beneficial owner the notes offered by this document, and who, at all relevant times, for purposes of the application of the Income Tax Act (Canada) and the Income Tax Regulations (collectively, the "Tax Act"), (1) is not, and is not deemed to be, resident in Canada; (2) deals at arm's length with us and with any transferee resident (or deemed to be resident) in Canada to whom the purchaser disposes of notes, (3) is not affiliated with us, (4) does not receive any payment of interest on a note in respect of a debt or other obligation to pay an amount to a person with whom we do not deal at arm's length, (5) does not use or hold notes in a business carried on in Canada and (6) is not a "specified shareholder" of ours as defined in the Tax Act for this purpose or a non-resident person not dealing at arm's length with such "specified shareholder" (a "Holder"). Special rules, which are not discussed in this summary, may apply to a non-Canadian holder that is an insurer that carries on an insurance business in Canada and elsewhere.

Please note that this section supersedes and replaces in its entirety the section of the prospectus entitled "Canadian Taxation."

This summary is based on the current provisions of the Tax Act and on counsel's understanding of the current administrative policies and assessing practices of the Canada Revenue Agency published in writing prior to the date hereof. This summary takes into account all specific proposals to amend the Tax Act publicly announced by or on behalf of the Minister of Finance (Canada) prior to the date of this document (the "Proposed Amendments") and assumes that all Proposed Amendments will be enacted in the form proposed. However, no assurances can be given that the Proposed Amendments will be enacted as proposed, or at all. This summary does not otherwise take into account or anticipate any changes in law or administrative policy or assessing practice whether by legislative, administrative or judicial action nor does it take into account tax legislation or considerations of any province, territory or foreign jurisdiction, which may differ from those discussed herein.

This summary is of a general nature only and is not, and is not intended to be, legal or tax advice to any particular holder. This summary is not exhaustive of all Canadian federal income tax considerations. Accordingly, prospective purchasers of the notes should consult their own tax advisors having regard to their own particular circumstances.

Interest paid or credited or deemed to be paid or credited by us on a note (including amounts on account of, or in lieu of, or in satisfaction of interest) to a Holder will not be subject to Canadian non-resident withholding tax, unless any portion of such interest (other than on a "prescribed obligation," as defined in the Tax Act for this purpose) is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class or series of shares of the capital stock of a corporation. The administrative policy of the Canada Revenue Agency is that interest paid on a debt obligation is not subject to withholding tax unless, in general, it is reasonable to consider that there is a material connection between the index or formula to which any amount payable under the debt obligation is calculated and the profits of the issuer. With respect to any interest on a note, or any portion of the principal amount of a note in excess of the issue price, such interest or principal, as the case may be, paid or credited to a Holder should not be subject to Canadian non-resident withholding tax.

Generally, there are no other taxes on income (including taxable capital gains) payable by a Holder on interest, discount, or premium in respect of a note or on the proceeds received by a Holder on the disposition of a note (including redemption, cancellation, purchase or repurchase).

Supplemental U.S. Federal Income Tax Considerations

The following, together with the discussion of U.S. federal income taxation in the accompanying prospectus and prospectus supplement, is a general description of the material U.S. tax considerations relating to the notes. It does not purport to be a complete analysis of all tax considerations relating to the notes. Prospective purchasers of the notes should consult their tax advisors as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Canada and the U.S. of acquiring, holding and disposing of the notes and receiving payments under the notes. This summary is based upon the law as in effect on the date of this pricing supplement and is subject to any change in law that may take effect after such date.

The following section supplements the discussion of U.S. federal income taxation in the accompanying prospectus and prospectus supplement with respect to United States holders (as defined in the accompanying prospectus). It applies only to those holders who are not excluded from the discussion of U.S. federal income taxation in the accompanying prospectus. It does not apply to holders subject to special rules including holders subject to Section 451(b) of the Code. In addition, the discussion below assumes that an investor in the notes will be subject to a significant risk that it will lose a significant amount of its investment in the notes. Bank of Montreal intends to treat contingent interest payments with respect to the notes as U.S. source income for U.S. federal income tax purposes.

You should consult your tax advisor concerning the U.S. federal income tax and other tax consequences of your investment in the notes in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

NO STATUTORY, JUDICIAL OR ADMINISTRATIVE AUTHORITY DIRECTLY DISCUSSES HOW THE NOTES SHOULD BE TREATED FOR U.S. FEDERAL INCOME TAX PURPOSES. AS A RESULT, THE U.S. FEDERAL INCOME TAX CONSEQUENCES OF AN INVESTMENT IN THE NOTES ARE UNCERTAIN. BECAUSE OF THE UNCERTAINTY, YOU SHOULD CONSULT YOUR TAX ADVISOR IN DETERMINING THE U.S. FEDERAL INCOME TAX AND OTHER TAX CONSEQUENCES OF YOUR INVESTMENT IN THE NOTES, INCLUDING THE APPLICATION OF STATE, LOCAL OR OTHER TAX LAWS AND THE POSSIBLE EFFECTS OF CHANGES IN FEDERAL OR OTHER TAX LAWS.

We will not attempt to ascertain whether a Reference Share Issuer would be treated as a “passive foreign investment company” within the meaning of Section 1297 of the Code or a “U.S. real property holding corporation” within the meaning of Section 897 of the Code. If a Reference Share Issuer were so treated, certain adverse U.S. federal income tax consequences could possibly apply. You should refer to any available information filed with the SEC by Reference Share Issuers and consult your tax advisor regarding the possible consequences to you in this regard, if any.

In the opinion of our counsel, Morrison & Foerster LLP, it would generally be reasonable to treat a note with terms described in this document as a pre-paid cash-settled contingent income bearing derivative contract in respect of the Basket for U.S. federal income tax purposes, and the terms of the notes require a holder and us (in the absence of a change in law or an administrative or judicial ruling to the contrary) to treat the notes for all tax purposes in accordance with such characterization. Although the U.S. federal income tax treatment of the interest payments is uncertain, we intend to take the position, and the following discussion assumes, that such interest payments (including any interest payment on or with respect to the maturity date) constitute taxable ordinary income to a United States holder at the time received or accrued in accordance with the holder’s regular method of accounting. If the notes are so treated, subject to the discussion below concerning the potential application of the “constructive ownership” rules under Section 1260 of the Code, it would be reasonable for a United States holder to take the position that it will recognize capital gain or loss upon the sale or maturity of the notes in an amount equal to the difference between the amount a United States holder receives at such time (other than amounts properly attributable to any interest payments, which would be treated, as described above, as ordinary income) and the United States holder’s tax basis in the notes. In general, a United States holder's tax basis in the notes will be equal to the price the holder paid for the notes. Capital gain recognized by an individual United States holder is generally taxed at preferential rates where the property is held for more than one year and is generally taxed at ordinary income rates where the property is held for one year or less. The deductibility of capital losses is subject to limitations. The holding period for notes of a United States holder who acquires the notes upon issuance will generally begin on the date after the issue date (i.e., the settlement date) of the notes. If the notes are held by the same United States holder until maturity, that holder's holding period will generally include the maturity date.

Potential Application of Section 1260 of the Code

While the matter is not entirely clear, to the extent a Reference Share is the type of financial asset described under Section 1260 of the Code (including, among others, any equity interest in pass-thru entities such as regulated investment companies (including certain exchange-traded funds), real estate investment trusts, partnerships, trusts and passive foreign investment companies, each a "Section 1260 Financial Asset"), an investment in the notes will likely, in whole or in part, be treated as a "constructive ownership transaction" to which Section 1260 of the Code applies. If Section 1260 of the Code applies, all or a portion of any long-term capital gain recognized by a United States holder in respect of a note will be recharacterized as ordinary income (the "Excess Gain"). In addition, an interest charge will also apply to any deemed underpayment of tax in respect of any Excess Gain to the extent such gain would have resulted in gross income inclusion for the United States holder in taxable years prior to the taxable year of the sale, exchange, or settlement (assuming such income accrued at a constant rate equal to the applicable federal rate as of the date of sale, exchange, or settlement).

If an investment in a note is treated as a constructive ownership transaction, it is not clear to what extent any long-term capital gain of a United States holder in respect of the note will be recharacterized as ordinary income. It is possible, for example, that the amount of the Excess Gain (if any) that would be recharacterized as ordinary income in respect of the note will equal the excess of (i) any long-term capital gain recognized by the United States holder in respect of the note and attributable to Section 1260 Financial Assets, over (ii) the "net underlying long-term capital gain" (as defined in Section 1260 of the Code) such United States holder would have had if such United States holder had acquired an amount of the corresponding Section 1260 Financial Assets at fair market value on the original issue date for an amount equal to the portion of the issue price of the note attributable to the corresponding Section 1260 Financial Assets and sold such amount of Section 1260 Financial Assets upon the date of sale, exchange, or settlement of the note at fair market value (and appropriately taking into account any leveraged upside exposure). To the extent any gain is treated as long-term capital gain after application of the recharacterization rules of Section 1260 of the Code, such gain would be subject to U.S. federal income tax at the rates that would have been applicable to the net underlying long-term capital gain. United States holders should consult their tax advisors regarding the potential application of Section 1260 of the Code to an investment in the note.

Under Section 1260 of the Code, there is a presumption that the net underlying long-term capital gain is zero (with the result that the recharacterization and interest charge described above would apply to all of the gain from the notes that otherwise would have been long-term capital gain), unless the contrary is demonstrated by clear and convincing evidence. Holders will be responsible for obtaining information necessary to determine the net underlying long-term capital gain with respect to the corresponding Section 1260 Financial Assets, as we do not intend to supply holders with such information. Holders should consult with their tax advisor regarding the application of the constructive ownership transaction to their notes and the calculations necessary to comply with Section 1260 of the Code.

Alternative Treatments

Alternative tax treatments of the notes are also possible and the Internal Revenue Service might assert that a treatment other than that described above is more appropriate. For example, it is possible that a holder would be required to include the Dividend Amount (including any interest earned thereon) in income over the term of the notes even though the holder will not receive any payments from us until maturity of the notes. In addition, it would also be possible to treat the notes, and the Internal Revenue Service might assert that the notes should be treated, as a single debt instrument. Such a debt instrument would be subject to the special tax rules governing contingent payment debt instruments. If the notes are so treated, a United States holder would generally be required to accrue interest currently over the term of the notes irrespective of the contingent interest payments, if any, paid on the notes. In addition, any gain a United States holder might recognize upon the sale or maturity of the notes would be ordinary income and any loss recognized by a holder at such time would be ordinary loss to the extent of interest that same holder included in income in the current or previous taxable years in respect of the notes, and thereafter, would be capital loss.

Because of the absence of authority regarding the appropriate tax characterization of the notes, it is also possible that the Internal Revenue Service could seek to characterize the notes in a manner that results in other tax consequences that are different from those described above. For example, the Internal Revenue Service could possibly assert that any gain or loss that a holder may recognize upon the sale or maturity of the notes should be treated as ordinary gain or loss.

The Internal Revenue Service has released a notice that may affect the taxation of holders of the notes. According to the notice, the Internal Revenue Service and the Treasury Department are actively considering whether the holder of an instrument such as the notes should be required to accrue ordinary income on a current basis irrespective of any interest payments, and they sought taxpayer comments on the subject. It is not possible to determine what guidance they will ultimately issue, if any. It is possible, however, that under such guidance, holders of the notes will ultimately be required to accrue income currently and this could be applied on a retroactive basis. The Internal Revenue Service and the Treasury Department are also considering other relevant issues, including whether additional gain or loss from such instruments should be treated as ordinary or capital and whether the special “constructive ownership rules” of Section 1260 of the Code might be applied to such instruments. Holders are urged to consult their tax advisors concerning the significance, and the potential impact, of the above considerations. We intend to treat the notes for U.S. federal income tax purposes in accordance with the treatment described in this document unless and until such time as the Treasury Department and Internal Revenue Service determine that some other treatment is more appropriate.

Backup Withholding and Information Reporting

Please see the discussion under “United States Federal Income Taxation—Other Considerations—Backup Withholding and Information Reporting” in the accompanying prospectus for a description of the applicability of the backup withholding and information reporting rules to payments made on your notes.

Non-U.S. Holders

The notes are not intended for purchase by any investor that is not a United States person, as that term is defined for U.S. federal income tax purposes, and no dealer may make offers of the notes to any such investor. Notwithstanding this intended restriction on purchases, the following discussion applies to non-U.S. holders of the notes. A non-U.S. holder is a beneficial owner of a note that, for U.S. federal income tax purposes, is a non-resident alien individual, a foreign corporation or a foreign estate or trust.

A "dividend equivalent" payment is treated as a dividend from sources within the U.S. and such payments generally would be subject to a 30% U.S. withholding tax if paid to a non-U.S. holder. Under U.S. Treasury Department regulations, payments (including deemed payments) with respect to equity-linked instruments ("ELIs") that are "specified ELIs" may be treated as dividend equivalents if such specified ELIs reference an interest in an "underlying security," which is generally any interest in an entity taxable as a corporation for U.S. federal income tax purposes if a payment with respect to such interest could give rise to a U.S. source dividend. Internal Revenue Service guidance provides that withholding on dividend equivalent payments will apply to specified ELIs that are delta-one instruments issued on or after January 1, 2017 and to all specified ELIs issued on or after January 1, 2019. Because the delta of the notes with respect to the Basket will be one, dividend equivalent payments will be subject to withholding. The dividend equivalent amounts may not necessarily be the same as the Dividend Amounts. We will not pay any additional amounts in respect of any dividend equivalent withholding.

Payments on the notes will not be subject to withholding if such payments are effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States (in which case, to avoid withholding, the non-U.S. holder will be required to provide a Form W-8ECI). To claim benefits under an income tax treaty, a non-U.S. holder must obtain a taxpayer identification number and certify as to its eligibility under the appropriate treaty's limitations on benefits article, if applicable (which certification may generally be made on an Internal Revenue Service Form W-8BEN or W-8BEN-E, or a substitute or successor form). In addition, special rules may apply to claims for treaty benefits made by corporate non-U.S. holders. A non-U.S. holder that is eligible for a reduced rate of U.S. federal withholding tax pursuant to an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the Internal Revenue Service. Non-U.S. holders must consult their tax advisors in this regard.

Except as discussed below, a non-U.S. holder will generally not be subject to U.S. federal income or withholding tax on any gain (not including for the avoidance of doubt any dividend equivalent withholding, which would be subject to the rules discussed above) upon the sale or maturity of the notes, provided that (i) the holder complies with any applicable certification requirements (which certification may generally be made on an Internal Revenue Service Form W-8BEN or W-8BEN-E, or a substitute or successor form), (ii) the payment is not effectively connected with the conduct by the holder of a U.S. trade or business, and (iii) if the holder is a non-resident alien individual, such holder is not present in the U.S. for 183 days or more during the taxable year of the sale or maturity of the notes. In the case of (ii) above, the holder generally would be subject to U.S. federal income tax with respect to any income or gain in the same manner as if the holder were a U.S. holder and, in the case of a holder that is a corporation, the holder may also be subject to a branch profits tax equal to 30% (or such lower rate provided by an applicable U.S. income tax treaty) of a portion of its earnings and profits for the taxable year that are effectively connected with its conduct of a trade or business in the U.S., subject to certain adjustments. Payments made to a non-U.S. holder may be subject to information reporting and to backup withholding unless the holder complies with applicable certification and identification requirements as to its foreign status.

As discussed above, alternative characterizations of the notes for U.S. federal income tax purposes are possible. Should an alternative characterization, by reason of change or clarification of the law, by regulation or otherwise, cause payments as to the notes to become subject to withholding tax in addition to the withholding tax described above, we will withhold tax at the applicable statutory rate and we will not be required to pay any additional amounts in respect of such withholding. Prospective investors should consult their own tax advisors in this regard.

Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act imposes a 30% U.S. withholding tax on certain U.S. source payments, including interest (and OID), dividends, other fixed or determinable annual or periodical gain, profits, and income, and on the gross proceeds from a disposition of property of a type which can produce U.S. source interest or dividends (“Withholdable Payments”), if paid to a foreign financial institution (including amounts paid to a foreign financial institution on behalf of a holder), unless such institution enters into an agreement with the Treasury Department to collect and provide to the Treasury Department substantial information regarding U.S. account holders, including certain account holders that are foreign entities with U.S. owners, with such institution. A note may constitute an account for these purposes. The legislation also generally imposes a withholding tax of 30% on Withholdable Payments made to a non-financial foreign entity unless such entity provides the withholding agent with a certification that it does not have any substantial U.S. owners or a certification identifying the direct and indirect substantial U.S. owners of the entity.

The U.S. Treasury Department and the IRS have announced that withholding on payments of gross proceeds from a sale or redemption of the notes will only apply to payments made after December 31, 2018. If we determine withholding is appropriate with respect to the notes, we will withhold tax at the applicable statutory rate, and we will not pay any additional amounts in respect of such withholding. Account holders subject to information reporting requirements pursuant to the Foreign Account Tax Compliance Act may include holders of the notes. Foreign financial institutions and non-financial foreign entities located in jurisdictions that have an intergovernmental agreement with the United States governing the Foreign Account Tax Compliance Act may be subject to different rules. Holders are urged to consult with their own tax advisors regarding the possible implications of this legislation on their investment in the notes.

Use of Proceeds and Hedging

We will use the net proceeds we receive from the sale of the notes for the purposes we describe in the accompanying prospectus and the accompanying prospectus supplement under “Use of Proceeds.” We or our affiliates may also use those proceeds in transactions intended to hedge our respective obligations under the notes as described below.

We or our affiliates expect to enter into hedging transactions involving, among other transactions, purchases or sales of one or more of the Reference Shares, or listed or over-the-counter options, futures and other instruments linked to the Reference Shares. In addition, from time to time after we issue the notes, we or our affiliates expect to enter into additional hedging transactions and to unwind those we have entered into in connection with the notes. Consequently, with regard to the notes, we or our affiliates from time to time expect to acquire or dispose of the Reference Shares or positions in listed or over-the-counter options, futures or other instruments linked to one or more of the Reference Shares.

We or our affiliates may acquire a long position in securities similar to the notes from time to time and may, in our or their sole discretion, hold, resell or repurchase those securities.

In the future, we or our affiliates expect to close out hedge positions relating to the notes and possibly relating to other securities or instruments with returns linked to one or more of the Reference Shares. We expect these steps to involve sales of instruments linked to the Reference Shares on or shortly before the valuation date. These steps may also involve transactions of the type contemplated above. Notwithstanding the above, we are permitted to and may choose to hedge in any manner not stated above; similarly, we may elect not to enter into any such transactions. Investors will not have knowledge about our hedging positions.

We have no obligation to engage in any manner of hedging activity and will do so solely at our discretion and for our own account. No holder of any notes will have any rights or interest in our hedging activity or any positions we or any counterparty may take in connection with our hedging activity.

SUPPLEMENTAL PLAN OF DISTRIBUTION (CONFLICTS OF INTEREST)

We, either ourselves or through BMOCM as agent, have entered into an arrangement with Raymond James, whereby Raymond James will act as an agent in connection with the distribution of the notes. Such distribution may occur on or subsequent to the Issue Date. The notes sold by Raymond James to investors will be offered at the issue price of $1,000 per note. Raymond James will receive compensation set forth on the cover page of this pricing supplement. Raymond James will also receive licensing fees for its research related to the Reference Shares, as described in "Description of the Reference Shares—License Agreement."

We own, directly or indirectly, all of the outstanding equity securities of BMOCM, the agent for this offering. In accordance with FINRA Rule 5121, BMOCM may not make sales in this offering to any of its discretionary accounts without the prior written approval of the customer.

We reserve the right to withdraw, cancel or modify the offering of the notes and to reject orders in whole or in part. You may cancel any order for the notes prior to its acceptance.

You should not construe the offering of the notes as a recommendation of the merits of acquiring an investment linked to any of the Reference Shares or investment advice, or as to the suitability of an investment in the notes.

We will deliver the notes on a date that is greater than three business days following the first pricing date. Under Rule 15c6-1 of the Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the notes more than two business days prior to the issue date will be required to specify alternative settlement arrangements to prevent a failed settlement.

BMOCM may, but is not obligated to, make a market in the notes. BMOCM will determine any secondary market prices that it is prepared to offer in its sole discretion.

We may use the final pricing supplement relating to the notes in the initial sale. In addition, BMOCM or another of our affiliates may use the final pricing supplement in market-making transactions in any notes after their initial sale. ***Unless BMOCM or we inform you otherwise in the confirmation of sale, the final pricing supplement is being used by BMOCM in a market-making transaction.***

No Prospectus (as defined in Directive 2003/71/EC (as amended, the "Prospectus Directive")) will be prepared in connection with the notes. Accordingly, the notes may not be offered to the public in any member state of the European Economic Area (the "EEA"), and any purchaser of the notes who subsequently sells any of the notes in any EEA member state must do so only in accordance with the requirements of the Prospectus Directive, as implemented in that member state.

The notes are not intended to be offered, sold or otherwise made available to, and should not be offered, sold or otherwise made available to, any retail investor in the EEA. For these purposes, the expression "offer" includes the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe the notes, and a "retail investor" means a person who is one (or more) of: (a) a retail client, as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, "MiFID II"); or (b) a customer, within the meaning of Insurance Distribution Directive 2016/97/EU, as amended, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (c) not a qualified investor as defined in the Prospectus Directive. Consequently, no key information document required by Regulation (EU) No 1286/2014 (as amended, the "PRIIPs Regulation") for offering or selling the notes or otherwise making them available to retail investors in the EEA has been prepared, and therefore, offering or selling the notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

Additional Information Relating to the Estimated Initial Value of the Notes

Our estimated initial value of the notes on the date of this preliminary pricing supplement, and that will be set forth on the cover page of the final pricing supplement relating to the notes, equals the sum of the values of the following hypothetical components:

- a fixed-income debt component with the same tenor as the notes, valued using our internal funding rate for structured notes; and

- one or more derivative transactions relating to the economic terms of the notes.

The internal funding rate used in the determination of the initial estimated value generally represents a discount from the credit spreads for our conventional fixed-rate debt. The value of these derivative transactions are derived from our internal pricing models. These models are based on interest rates and other factors. As a result, the estimated initial value of the notes on the pricing date will be determined based on market conditions at that time.

Employee Retirement Income Security Act

A fiduciary of a pension, profit-sharing or other employee benefit plan subject to the U.S. Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (each, a “Plan”), should consider the fiduciary standards of ERISA in the context of the Plan’s particular circumstances before authorizing an investment in the notes. Among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan, and whether the investment would involve a prohibited transaction under ERISA or the Code.

Section 406 of ERISA and Section 4975 of the Code prohibit Plans, as well as individual retirement accounts, Keogh plans any other plans that are subject to Section 4975 of the Code (also “Plans”), from engaging in certain transactions involving “plan assets” with persons who are “parties in interest” under ERISA or “disqualified persons” under the Code with respect to the Plan. A violation of these prohibited transaction rules may result in excise tax or other liabilities under ERISA or the Code for those persons, unless exemptive relief is available under an applicable statutory, regulatory or administrative exemption. Employee benefit plans that are governmental plans (as defined in Section 3(32) of ERISA), certain church plans (as defined in Section 3(33) of ERISA) and non-U.S. plans (as described in Section 4(b)(4) of ERISA) (“Non-ERISA Arrangements”) are not subject to the requirements of Section 406 of ERISA or Section 4975 of the Code but may be subject to similar provisions under applicable federal, state, local, non-U.S., or other laws (“Similar Laws”).

The acquisition of notes by a Plan or any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) with respect to which we or certain of our affiliates is or becomes a party in interest or disqualified person may result in a prohibited transaction under ERISA or Section 4975 of the Code, unless the notes are acquired pursuant to an applicable exemption. The U.S. Department of Labor has issued five prohibited transaction class exemptions, or “PTCEs,” that may provide exemptive relief if required for direct or indirect prohibited transactions that may arise from the purchase or holding of notes. These exemptions are PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers), PTCE 90-1 (for certain transactions involving insurance company pooled separate accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 95-60 (for transactions involving certain insurance company general accounts), and PTCE 96-23 (for transactions managed by in-house asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code provide an exemption for the purchase and sale of securities offered hereby, provided that neither the issuer of notes offered hereby nor any of its affiliates have or exercise any discretionary authority or control or render any investment advice with respect to the assets of any Plan involved in the transaction, and provided further that the Plan pays no more and receives no less than “adequate consideration” in connection with the transaction (the “Service Provider Exemption”). Any Plan fiduciary relying on the Service Provider Exemption and purchasing the notes on behalf of a Plan must initially make a determination that (x) the Plan is paying no more than, and is receiving no less than, “adequate consideration” in connection with the transaction and (y) neither we nor any of our affiliates directly or indirectly exercises any discretionary authority or control or renders investment advice with respect to the assets of the Plan which such fiduciary is using to purchase, both of which are necessary preconditions to reliance on the Service Provider Exemption. If we or any of our affiliates provides fiduciary investment management services with respect to a Plan’s acquisition of the notes, the Service Provider Exemption may not be available, and in that case, other exemptive relief would be required as precondition for purchasing the notes. Any Plan fiduciary considering reliance on the Service Provider Exemption is encouraged to consult with counsel regarding the availability of the exemption. There can be no assurance that any of the foregoing exemptions will be available with respect to any particular transaction involving the notes, or that, if an exemption is available, it will cover all aspects of any particular transaction.

Because we or our affiliates may be considered to be a party in interest with respect to many Plans, the notes may not be purchased, held or disposed of by any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCE 96-23, 95-60, 91-38, 90-1, or 84-14 or the Service Provider Exemption, or such purchase, holding or disposition is not otherwise prohibited. Except as otherwise set forth in any applicable pricing supplement, by its purchase of any notes, each purchaser (whether in the case of the initial purchase or in the case of a subsequent transferee) will be deemed to have represented and agreed by its purchase and holding of the notes offered hereby that either (i) it is not and for so long as it holds a note, it will not be a Plan, a Plan Asset Entity, or a Non-ERISA Arrangement, or (ii) its purchase and holding of the notes will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or, in the case of such a Non-ERISA Arrangement, under any Similar Laws.

In addition, any purchaser that is a Plan or a Plan Asset Entity or that is acquiring the notes on behalf of a Plan or a Plan Asset Entity, including any fiduciary purchasing on behalf of a Plan or Plan Asset entity, will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the notes that (a) neither we nor any of our respective affiliates or agents are a “fiduciary” (under Section 3(21) of ERISA), or under any final or proposed regulations thereunder, or with respect to a non-ERISA Arrangement under any Similar Laws with respect to the acquisition, holding or disposition of the notes, or as a result of any exercise by us or our affiliates or agents of any rights in connection with the notes, (b) no advice provided by us or any of our affiliates or agents has formed a primary basis for any investment decision by or on behalf of such purchaser in connection with the notes and the transactions contemplated with respect to the notes, and (c) such purchaser recognizes and agrees that any communication from us or any of our affiliates or agents to the purchaser with respect to the notes is not intended by us or any of our affiliates or agents to be impartial investment advice and is rendered in our or our affiliates’ or agents’ capacity as a seller of such notes and not a fiduciary to such purchaser.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is important that fiduciaries or other persons considering purchasing notes on behalf of or with the assets of any Plan, a Plan Asset Entity or Non-ERISA Arrangement consult with their counsel regarding the availability of exemptive relief under any of the PTCEs listed above, the Service Provider Exemption or the potential consequences of any purchase or holding under Similar Laws, as applicable. Purchasers of notes have exclusive responsibility for ensuring that their purchase and holding of notes do not violate the fiduciary or prohibited transaction rules of ERISA or the Code or any similar provisions of Similar Laws. The sale of any notes to a Plan, Plan Asset Entity or Non-ERISA Arrangement is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by any such Plans, Plan Asset Entities or Non-ERISA Arrangements generally or any particular Plan, Plan Asset Entity or Non-ERISA Arrangement or that such investment is appropriate for such Plans, Plan Asset Entities or Non-ERISA Arrangements generally or any particular Plan, Plan Asset Entity or Non-ERISA Arrangement.

>Continuing intense competition;

- stable customer base;
- significant growth in value added services driven by the introduction of new technologies/new handsets and by increased customer demand; and
- growth in targeted international markets, particularly Brazil.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with Italian GAAP. Our reported financial condition and results of operations are sensitive to the accounting methods, assumptions and estimates that underlie the preparation of financial statements. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing our financial statements. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

We are also required to select accounting principles for the annual reporting of our U.S. GAAP results. Included in the following discussion are the U.S. GAAP principles we have identified that have the potential to generate significant differences from Italian GAAP and for which management is required to make substantial estimates and assumptions.

Revenue recognition

Our primary revenue streams consist of fixed line telecommunication services, mobile telecommunication services, the sale of products including primarily telecommunication (both fixed and mobile) equipment and office products, IT software and services, advertising services, and internet access and related services.

Revenues related to fixed line and mobile telecommunication services, principally network access, long distance, local and wireless airtime usage, are recognized when the services are provided based on the actual minutes of traffic provided and the contracted fee schedule with the customer. Certain revenues derived from telecommunication services, such as installation and activation fees are recognized at the date of installation or activation. Revenues billed in advance are deferred and recognized at the date the related service is provided.

Under U.S. GAAP, we defer recognition of non-refundable connection fees and other initial fees and recognize these over the estimated customer relationship period. We also defer the associated direct expenses over the estimated customer relationship period in an amount equal to or less than the amount of deferred revenues. If the length of the estimated customer relationship period increases or decreases, the amounts of deferred revenue and deferred expense is adjusted over the revised estimated life.

Revenues from the sale of products, including telecommunication equipment and office products, are recognized when title transfers to the customer, which is either at the date the products are shipped or when the products are delivered and accepted by the customer.

IT services and software revenues are recognized at the date the related services are provided.

Advertising revenue from on-line services is recorded on the date the on-line advertisement is posted to the related web site. Advertising revenue from television is recorded on the date at which the advertisement is shown. Revenues from Internet access and related services primarily represent subscription services, which are recognized over the subscription period on a straight-line basis.

In connection with recording revenue, estimates and assumptions are required in determining the expected conversion of the revenue streams to cash collected. The reserve estimation process requires that management make assumptions based on historical results, future expectations, the economic and competitive environment and changes in the credit worthiness of the Telecom Italia Group s customers, and other relevant factors. If these assumptions prove to be incorrect, Telecom Italia s actual conversion rate of recorded revenue to cash may be lower than expected and we would be required to increase our allowance for doubtful accounts.

Accounting for long-lived assets

Property, plant and equipment and purchased intangible assets other than goodwill are recorded at acquisition cost. If such assets are acquired in a business combination, the purchase price is allocated to the estimated fair value of the acquired property, plant and equipment and intangible assets. Property, plant and equipment and intangible assets are depreciated or amortized on a straight-line basis over their estimated useful lives.

Property, plant and equipment are valued at acquisition or construction cost, less accumulated depreciation. Construction costs include directly allocable costs, an appropriate allocation of material and production overhead and interest accruing during the construction related to debt specifically associated with the related construction project.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining the fair value at the acquisition date for assets acquired in a business combination, and the useful lives of the assets over which the costs of acquiring these assets are charged to the statement of operations. The useful lives of long-lived assets are subject to such variables as technological feasibility, obsolescence, changes in consumer demand and strategic management decisions.

When an impairment in the value of assets occurs, nonscheduled write-downs are made. We assess the impairment of identifiable intangibles and long-lived assets whenever there is reason to believe that the carrying value may exceed the fair value and where a permanent impairment in value is anticipated. The determination of impairments of long-lived and intangible assets involves the use of estimates, which include but are not limited to the cause, the expected timing and the amount of the impairment. Impairment is based on a broad measure of factors. In evaluating assets for impairment, we typically consider, among other things, technological obsolescence, discontinuance of services, changes in market prices, significant negative industry or economic trends, significant underperformance relative to expected historical or projected future operating results and other changes in circumstances that may indicate impairment. All of these assessments require the application of management judgment to the facts and circumstances existing at the time.

To assess impairment of property, plant and equipment and amortizing intangible assets for purpose of U.S. GAAP, we use the guidance outlined in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. If, based on the preceding discussion, management has concluded that impairment indicators exist, we will initially review for possible impairment by assessing the undiscounted cash flows expected to be derived from the asset or group of assets, comparing the lowest level of total expected undiscounted cash flow to the carrying value. If the carrying value of the asset or the group of assets exceeds the sum of the undiscounted cash flows, impairment is considered to exist. An impairment charge is assessed by comparing the assets fair value to the carrying value. Fair value can be calculated by a number of different approaches, including discounted cash flow, comparables, market valuations or quoted market prices. The process and steps required to assess the possible impairments of assets, including the identification of possible impairment indicators, assessing undiscounted cash flows, selecting the appropriate discount rate, the calculation of the weighted average cost of capital and the discounts or premiums inherent in market prices requires a substantial amount of management discretion and judgment. If actual results differ from these estimates, or if the Telecom Italia Group adjusts these estimates in future periods, operating results could be significantly affected.

Acquisition accounting

We have entered into certain acquisitions and in the future may make additional acquisitions. We generally account for these acquisitions based on the form of the transaction. Cash exchanged for assets or shares is

110

accounted for at its face value. However, other consideration, such as the fair value of shares exchanged (either Telecom Italia shares or other shares of Telecom Italia Group companies used to effect an acquisition) are generally not accounted for in Italian GAAP. In general, the Company uses carry over basis of the assets acquired and liabilities assumed and allocates the difference between the purchase price paid and the carry over basis to the intangible asset goodwill.

The development of a purchase price, and the subsequent allocation of that purchase price to the fair value of the assets acquired and liabilities assumed, is critical due to the long term impact on the statement of operations. To the extent that other assets (for example, fixed assets or trademarks) are identified that are amortizable over a shorter life than goodwill (for which the major part is 20 years), the allocation of that fair value through the purchase price allocation is fundamental to the statement of operations.

For purposes of our U.S. GAAP reporting, we are required to perform a purchase price allocation under SFAS 141, *Business Combinations*. As part of that allocation, it is necessary to develop a purchase price, which under U.S. GAAP requires that all consideration, including the fair value of exchanged shares, be valued. This purchase price, which is generally higher than that arrived at for the same acquisition using Italian GAAP, is then allocated to the fair value of the assets acquired and liabilities assumed. The allocation requires that all assets and liabilities, including those not reflected in the final financial statements of the acquired entity, be valued. This valuation approach requires that significant estimates be made. For example, in the valuation of intangible assets such as a customer list, estimates and judgment are required for the amount of expected future profitability of customers, the expected churn rates, the discount rate used to present value the earnings and the expected economic life of the asset. All of these factors, which are developed in conjunction with the guidance and input of professional third party evaluation experts, require judgment and estimates. A change in any of these estimates or judgments could change the amount to be allocated to a particular intangible or tangible asset. The resulting change in the purchase price allocation to non-goodwill assets or liabilities has a direct impact on the final amount of the purchase price that cannot be allocated to a particular asset (i.e., goodwill). Under U.S. GAAP, this allocation takes on significant meaning, as under existing U.S. GAAP (see also Valuation of Goodwill below), the asset goodwill is no longer a wasting asset. Therefore, as goodwill is no longer amortized on a periodic basis, the cumulative estimates and judgments made in

- the definition of the purchase price,
- the identification of the assets acquired and liabilities assumed in the acquisition;
- the valuation of these assets and liabilities in the purchase price allocation; and
- the assessment of whether selected assets have an indefinite life or are amortizing;

has a significant impact on both the level of total goodwill and the statement of operations.

Goodwill

Goodwill resulting from business combinations is amortized on a straight-line basis over its estimated useful life.

The determination of goodwill is dependent on the allocation of the purchase price to the tangible and intangible assets acquired and liabilities assumed. Such allocation is often based on judgmental factors and estimates of fair values for assets that may not have a readily determinable market value. In addition, the useful life assigned to goodwill is an estimate based on the judgment of management at the time of acquisition. The estimated useful life is subject to adjustment if facts and circumstances indicate that the assets economic life has been affected by other variables, including technological feasibility, competitive factors and contractual rights. During 2003, management re-assessed the goodwill that originated from the original 1999 acquisition of Old Telecom Italia. That assessment was undertaken based on the input of independent third party professionals and the valuations undertaken as part of the Merger. Based on the re-assessment, we concluded that the remaining goodwill of Old Telecom Italia, which was originally established with a life of 20 years, should be reset as of 2003 to 20 years. The effect of this change in estimate was to reduce goodwill amortization expense in 2003 by 227 million.

Nonscheduled write-downs are provided when an impairment in the value of goodwill occurs. We review on a regular basis the performance of our subsidiaries. When there is reason to believe that the goodwill arising from the acquisition of a business is impaired and that the impairment is of a permanent nature, we compare the carrying amount of that subsidiary or business to its fair value. The determination of the fair value of a subsidiary

Table of Contents

involves extensive use of estimates. Methods commonly used by us for valuations include discounted cash flow methods, comparable market multiples and quoted stock market prices, if available. Factors affecting estimated fair values typically include discount rates, future cash flows, growth rates, weighted average cost of capital, market prices and control premiums. These estimates, including the methodologies used, are important in determining fair value and ultimately the amount of any goodwill impairment.

As of January 1, 2002, we adopted the requirements of SFAS 142, *Goodwill and Other Intangible Assets,* and as a result we ceased amortization of goodwill and indefinite lived intangible assets for U.S. GAAP purposes. The requirements of SFAS 142 include that goodwill be tested for impairment at least annually (and between annual tests when certain triggering events occur) using a two-step methodology. The first step screens for potential impairment at the reporting unit level, while the second step measures the impairment, if any. Under U.S. GAAP, the quoted market price of an asset or other valuation techniques, including discounted cash flow, comparables, etc., are acceptable valuation methodologies to assess fair value. The selection of the various assumptions that are necessary to arrive at the fair value of a reporting unit, including the assumptions used in the underlying business plans, require substantial management judgment and discretion. If actual results differ from these estimates, or if we adjust these estimates in future periods, operating results could be significantly affected.

Deferred taxes

We are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves a jurisdiction-by-jurisdiction estimation of actual current tax exposure and the assessment of the temporary differences resulting from differing treatment of items, such as accruals and amortization, among others, for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must assess in the course of our tax planning process the ability of Telecom Italia and its subsidiaries to obtain the benefit of deferred tax assets based on expected future taxable income and available tax planning strategies. If in management s judgment, the deferred tax assets recorded will not be recovered, a valuation allowance is recorded to reduce the deferred tax asset.

Significant management judgment is required in determining our provision for income taxes, deferred tax assets, deferred tax liabilities and valuation allowances to reflect the potential inability to fully recover deferred tax assets. In our Italian GAAP financial statements the analysis is based on the estimates of taxable income in the jurisdictions in which we operate and the period over which the deferred tax assets and liabilities will be recoverable. If actual results differ from these estimates, or we adjust these estimates in future periods, we may need to establish an additional valuation allowance which could adversely affect our financial position and results of operations.

Under U.S. GAAP, we assess the recoverability of tax assets based on the criteria of more likely than not , that is, a probability of recoverability just over 50%. The probability assessment requires significant judgment regarding the timing of future book and tax reversals, which could be materially different from the actual results.

Accrued liabilities

We exercise considerable judgment in recording our accrued liabilities and our exposure to contingent liabilities related to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation as well as other contingent liabilities.

Judgment is necessary in assessing the likelihood that a pending claim or a liability will arise and to quantify the possible range of the final settlement. In case the occurrence of a contingency or potential liability is more likely than not, we accrue an amount for contingent liabilities that represents management s estimate at that date. Because of the inherent uncertainties in the foregoing evaluation process, actual losses may be different from the original estimated amount accrued.

For purposes of U.S. GAAP, we apply the guidance outlined in SFAS 5, *Accounting for Contingencies*. Under SFAS 5 a loss contingency is considered to exist when a future use of assets to settle a liability or claim is considered probable and can be reasonably estimated. The necessary estimates used by management rely on the analysis of internal specialists, attorneys, actuaries or other external specialists as considered necessary. A revision of the original estimates may significantly affect future operating results.

Financing, acquisition and lease transactions

We have entered into several financing, acquisition and lease transactions that have resulted in material off balance sheet accounting treatment. These transactions include the sale and the subsequent lease of certain real

Table of Contents

estate assets, the sale of a portion of our equity interest in certain satellite sector entities, and the sale of trade accounts receivable under a securitization program.

We have acquired several companies using the shares of listed subsidiaries as a form of currency, often in conjunction with a mix of cash. For purposes of acquisition accounting, no economic value is ascribed to the shares exchanged, therefore the recorded value of the acquired company does not reflect the value of the underlying shares given up. For purposes of U.S. GAAP, the shares of the subsidiaries used to acquire a target are fair valued as part of the purchase price, generally based on the quoted market price of the shares at the date of the announcement. As there is an economic value ascribed to these shares, the total investment in the acquired company is generally larger, including the associated goodwill, on a U.S. GAAP basis. From 2002, as part of the adoption of SFAS 142, this goodwill is no longer amortized, but rather becomes subject to the fair value impairment tests as previously described.

The sale and the subsequent lease of certain real estate assets, the sale of a portion of our equity interest in certain satellite sector entities, and the sale of accounts receivable under securitization programs have been recorded as sale transactions and gains or losses were recognized for the differences between the fair value of the consideration received and the carrying value of the real estate assets, investments, and receivables sold. The real estate assets sold continue to be used in the ordinary course of our operations and are accounted for as operating leases. Management has substantial flexibility in structuring transactions to effect the recognition of assets, liabilities, gains and losses. For purposes of U.S. GAAP, the sale of the real estate portfolio s were not considered to be sales as we maintained a continuing interest in the properties, therefore no gains were recognized and the assets remain on the balance sheet, with the cash received treated as a secured borrowing. Similarly, the securitization of certain equity stakes in the satellite sector with a special purpose entity resulted in that structured entity also being fully consolidated in our U.S. GAAP results.

However, we have deconsolidated the qualified special purpose entity related to the accounts receivable securitization program initiated in 2001.

In general, U.S. GAAP requires a substance over form approach to structured transactions, including real estate, leases, securitizations and other structured finance transactions. For purposes of U.S. GAAP, for entities created or modified after January 31, 2003, we adopted the financial reporting guidelines of FIN No. 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46-R). Consolidation will no longer be determined solely on the majority of voting interests approach, but instead on identifying the primary beneficiary of the variable interest entity. The assessment of which party has the primary benefit will require management to assess each transaction in which it currently holds such financial interests, assessing the probability of expected residual returns and expected losses to arrive at a final decision regarding consolidation.

Derivatives

We enter into several different types of derivative contracts in order to adjust and manage the various cash flows associated with foreign currency and interest rate exposures. For purposes of Italian GAAP, the changes in the fair value of the derivative contract are not accounted for in the statement of operations until the contract has expired. The notional amount of the contracts open at the end of the fiscal year is disclosed. For purposes of U.S. GAAP, we have used the guidance established in SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* . Under U.S. GAAP, we recognize the change in the fair value of the derivative contract in the calculation of net income or loss for the period. The assessment of the fair value of a derivative contract requires the use of quoted market prices, banker price quotations, price quotations for similar instruments traded in different markets and, where applicable, pricing models. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized. As a result, we are required to rely on these pricing models when external fair values are unavailable. The estimates regarding future prices requires estimating several factors, including interest rates, currency values and cash flows. Prices realized in the future will differ from the estimates, therefore producing different financial results.

Adoption of International Accounting Standards

In accordance with the recommendations of the CESR (Committee of European Securities Regulators) published on December 30, 2003 and containing guidelines for companies listed within the EU regarding the transition to IAS/IFRS, (the benchmark regulatory framework) and process of adoption of international accounting standards within the Telecom Italia Group are illustrated below.

Table of Contents

The principal phases which characterized the process of accounting harmonization within the EU are:

- the adoption of Regulation No. 1606 issued by the European Parliament and by the Council of the European Union in July 2002 which provides for the mandatory application of IAS/IFRS, beginning from 2005, for the consolidated financial statements of companies listed in regulated markets of the EU;
- the European Commission s adoption of Regulation No. 1725 dated September 29, 2003, which approved the international accounting standards, and related interpretations, existing at September 14, 2002; IAS 32 and 39, relating to the disclosure and measurement of financial instruments, respectively, and the related interpretations (SIC 5, 16 and 17) were excluded from that approval process as they were in the process of being revised by the IASB;
- the issue, by Italian legislators, of the 2003 EU Law (Law No. 306 dated October 31, 2003) which in Art. 25 provides, moreover, for the obligation of listed companies to draw up not only the consolidated financial statements in accordance with IAS/IFRS (already provided by EU Regulation No. 1606/2002) but also their annual separate financial statements.

Concurrently, the IASB planned a series of projects directed at the implementation of the International Accounting Standards adopted by the EU, including the regulation of transactions not presently covered by IFRS. Certain of these projects have already been concluded whereas others are being completed and/or are at the inception stage.

During 2003, we commenced a specific project relating to the implementation of international accounting standards through the establishment of a dedicated working group which involved the principal companies of the Telecom Italia Group. In particular, an analysis was carried out to identify the principal differences between Italian accounting principles and IAS/IFRS, and to quantify, on the basis of the differences identified, the most significant impacts on the our consolidated financial statements.

The objectives of the project were the following:

- identification of the principal differences between Italian accounting principles and IAS/IFRS, including those for the preparation of the initial opening financial statements (January 1, 2004, the transition date) and quantification of the relative impacts;
- implementation of administrative processes and company information systems to permit the preparation of financial statements and interim accounts in accordance with IAS/IFRS.

In compliance with IAS 1, financial statements in accordance with IAS/IFRS should include, in terms of comparative disclosures, the year previous to the current year. The financial statements as at December 31, 2005 will be the first annual accounts we present in accordance with international accounting standards and, accordingly, will include, for comparative purposes, the financial statements as at December 31, 2004 in accordance with IAS/IFRS.

The analysis conducted thus far has identified certain differences between Italian accounting principles and IAS/IFRS (assuming the endorsement of all the existing Exposure Drafts and excluding the impacts deriving from the first application of international accounting standards), of which the principal differences are described below:

- *goodwill*: goodwill will no longer be amortized annually in the statement of operations but will be subject to a valuation, carried out at least annually, in order to identify any impairment in value (impairment test);

- *treasury stock*: in accordance with IAS/IFRS, treasury stock may not be recorded as an asset and should be cancelled together with the corresponding reserve; furthermore, the amount of treasury stock should be recorded as a reduction of shareholders equity;

- *principles of consolidation*: the possibility of excluding companies that are not significant in size, companies in liquidation and those with dissimilar activities from the scope of consolidation has been eliminated; the shares of consolidated subsidiaries recorded as current assets would be subject to consolidation;

- *stock options*: IFRS 2 classifies stock options within the category of equity settled share-based-payment transactions or rather goods or services received by an entity as consideration for equity instruments of the entity ; in particular, based on this standard, stock options must be valued at their

114

fair value at the time granted (grant date), recording the cost in the statement of operations with an increase in shareholders equity;

- *employee termination indemnities (TFR)*: Italian accounting principles require recognition only of the liability for employee termination indemnities (TFR) on the basis of the nominal liability matured to the end of a reporting period; under IAS/IFRS, TFR fall under the category of defined benefit plans subject to actuarial valuation requiring that the present value of the benefit, payable upon termination of employment, that employees have matured up to the balance sheet date, be recorded;

- *compound financial instruments*: in accordance with IAS 32, the value of compound financial instruments (e.g. convertible notes) should be allocated between financial liabilities and equity instruments (shares, quotas, share purchase options and other equity instruments);

- *derivative financial instruments*: in accordance with IAS/IFRS, all derivatives should be reflected in the financial statements at their fair value. The method of accounting for derivative financial instruments varies based on their characteristics (hedging instruments and non-hedging instruments);

- *asset retirement obligations*: as required by IAS 37, the Telecom Italia Group will record liabilities to be incurred, at the time fixed assets are abandoned, through a legal or constructive obligation assumed upon purchase, construction and development of installations. The liabilities will be recorded at market value, in the period in which they arise, as an accrual, with an offset to the fixed assets to which they refer. Recognition in the statement of operations occurs through the depreciation of the related asset over its estimated useful life;

- *extraordinary items*: there are no extraordinary items under IAS/IFRS;

- *departure from accounting principles envisaged by special laws*: for IAS/IFRS, the accounting treatment of any article or transaction does not take into consideration the effects of special laws or tax laws (e.g. Law No. 58/92).

In relation to the differences identified, projects have been initiated to define the operating procedures for the relative quantification for each company.

Moreover, other differences in accounting principles have been identified, which are being further analyzed, principally relating to provisions for risks, revenue recognition, contract work in process, capitalization of interest, deferred taxes, acquisitions and the recording of dividends in the separate financial statements.

Results of Operations

Reorganization of Business

At the beginning of 2001 we reorganized our businesses into business units and began reporting our results by business unit during 2001. Following the acquisition by Olimpia of its interest in Telecom Italia (formerly Olivetti), and a new management and a new Board of Directors taking control, we implemented a further restructuring plan. This plan included further divestitures of assets, particularly non-strategic international assets. In addition, during 2002 we reorganized our IT and international operations business units and we have continued to reorganize certain of our operations during 2003.

Our businesses are managed and organized on the basis of the following Business Units and the segment disclosure which follows is based on these 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 other (wholesale) providers. On an international level, Wireline develops fiber optic networks for wholesale customers, mainly in Europe and South America.

Mobile. This business unit includes national and international mobile telecommunications businesses which are managed by TIM. Beginning in 2001 international mobile operations were consolidated and managed by TIM, through TIM International. International mobile operations are concentrated in Latin America and in the Mediterranean Basin.

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

Table of Contents

February 29, 2004 and were developed in accordance with our overall strategic plan. In particular, 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 telecommunication. Since March 1, 2004, the Latin America Operations function is no longer operational and the Business Units Wireline and Mobile have been charged with responsibility for the results of the subsidiaries for which they are accountable in Latin America.

Internet and Media. Starting from August 8, 2003, after the proportional spin-off and sale of substantially all of the directories, directories assistance and business information segments, the Internet and Media Business Unit operates in the following segments:

- Internet. Management of access services (ISP), with Tin.it, management and development of portals (Virgilio with Matrix), and web services, where it occupies a leadership position in the Italian market;
- Television. La7 and MTV, both in the sectors of production and broadcasting of publishing content through the use of television transmission networks entrusted under concession and in the marketing of advertising space in TV programming;
- Office Products and Services. Through the distribution of products, services and solutions for the office through the Buffetti retail network; and
- Professional Publishing in the sector of specialized technical publishing.

Information Technology Market. The IT Market Business Unit was created in 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 responsible for organizing the information technology activities of the Group, that are marketed to third parties, in particular, central and local governmental administrations moving towards decentralization and e-government, as well as banks and businesses. The IT Market Business Unit provides consultancy services, system integration, CRM and ERP solutions and web services. It is a full business solution provider for government, banks and enterprise.

Information Technology Group. The IT Group Business Unit was created in 2002 to rationalize the activities previously carried out in the Information Technology Services Business Unit. The Business Unit is responsible for organizing technological innovation and service information technology activities within the Telecom Italia Group and covers the entire range of information services, pursuing objectives to reposition its activities to higher value-added products.

Olivetti Tecnost. Olivetti Tecnost and its subsidiaries (the Olivetti Tecnost Group) offer office products and digital printing systems (Office Products Division), specialized application for service automation in banking, retail, trade industry applications, gaming and lottery management (Systems Division). In addition, the group cooperates with the Industrial Operations Division in the development and production of silicon technology (ink-jet print-heads and MEMS), in document management services and mobile phone repairs. The principal geographic markets of this Business Unit are Europe, Asia and North America.

For a complete description of these Business Units, see Item 4. Information on the Telecom Italia Group Business Units . For purposes of the following discussion selected financial data of each Business Unit has been provided for 2001, 2002 and 2003, consistent with the structure of each Business Unit at December 31, 2003.

Results of Operations for the Three Years Ended December 31, 2003

Change in scope of consolidation and Currency Exchange Rates

Our results of operations fully consolidate all Italian and foreign subsidiaries (other than subsidiaries not material to us) in which we hold, directly or indirectly, more than 50% of the voting stock or has dominant influence (effective control).

Other entities in which we hold, directly or indirectly, between 20% and 50% of the voting rights, including jointly controlled companies, are accounted for under the equity method. These include a number of our international investments. The equity in the earnings of such entities (i.e.: our proportional share in the profits or losses of these entities) is included in financial expense. See Note 22 of Notes to the Consolidated Financial Statements included elsewhere herein.

116

Table of Contents

The following main changes in the scope of consolidation took place during the three year period (2003, 2002 and 2001):

- some investments were disposed of in 2003 and in particular the New SEAT group following the proportional spin-off of the directories and almost all of the directory assistance and business information business segments of SEAT into New SEAT, a newly incorporated company which assumed the current name of Seat Pagine Gialle S.p.A. ; such sale occurred on August 8, 2003 and therefore the activities disposed of were consolidated in the results of operations only for the first seven months of 2003;
- some investments were disposed of in 2002 and were consolidated in the results of operations as follows: the 9Télécom group for the period from January 1, 2002 to June 30, 2002; the former Satellite Business Unit (the Telespazio group) for the period from January 1, 2002 to September 30, 2002 and the company Sogei for the period from January 1, 2002 to June 30, 2002.

Throughout the discussion which follows we use the term organic growth . Organic growth means that the percentage changes provided assume that on a year to year comparison basis the effects of changes in the scope of consolidation are excluded and exchange rates are calculated on a constant currency basis. Constant currency means that the difference in exchange rates between years are eliminated by using the same exchange rate in the later year as in the prior year. Management believes that providing this information enables the reader to better understand the actual operating changes which are impacting the consolidated and business segment results of operations.

Overview of 2003 Results of Operations

As part of our 2003-2005 Industrial Plan we established certain key targets:

- Strengthen our core Italian domestic activities
- Exploit growth opportunities
- Improve cost efficiency

In 2003 we largely met these targets on the basis of some of the key measures we use in monitoring our performance.

With respect to the strengthening of our core Italian domestic activities such key targets were evidenced by:

• Wireline voice market share	plus 0.6 percentage points compared to 2002
• Mobile average revenue per user (ARPU)	plus 1% compared to 2002
• Mobile usage	plus 5.5% compared to 2002

In each case the above reflected a reversal in trends of the prior two years where we had been losing voice market share and the trends in mobile ARPU and usage had also been declining. These improvements must be considered against significant continuing competitive pressures and regulatory developments which have put additional pressure on pricing and pricing strategies which negatively impacted revenue growth in 2003.

In both our core domestic and international markets our strategy has been to focus our investment and significant management time on exploiting growth opportunities. In the domestic market this means our focus has been on value added services and internationally on markets which we consider to have the most potential for growth mobile telecommunications in selected markets, particularly in Latin America, and broadband in selective European markets. We also met certain key performance targets in 2003 as measured by the following:

• *Domestic Value added services*	
• broadband domestic lines	plus 140% over year end 2002
• wireline innovative data services revenues	plus 42.1% compared to 2002
• mobile VAS revenues	plus 36.7% compared to 2002
• *Internationally*	
• Latin America	plus 3.5 million mobile lines
• Europe	selective broadband investments in France and Germany made in 2003

Table of Contents

As discussed under Item 4. Information on the Telecom Italia Group Business Updated Business Plan and Strategy , we have established certain targets under our 2004-2006 Industrial Plan including compound annual revenue growth over the period in excess of 5% and compound annual growth in operating income greater than 10%, in each case assuming no changes in the scope of consolidation and exchange rate impacts. Our ability to achieve these targets will be dependent on maintaining our existing competitive position and successfully growing our revenues with value added services and in our targeted international markets. See Item 3. Key Information Risk Factors . To achieve these goals our capital expenditures will be focused on investments in innovative, value added services and our targeted international investments. See Liquidity and Capital Resources Capital expenditures under the Business Plan . We anticipate that our revenue mix will, as a result, change over time, as the continuing competitive pressures in our core voice markets persist (wireline and mobile), with revenues from domestic innovative services and international expected to reach approximately 38% of total revenues by 2006 compared with 27% in 2003. This is consistent with the trends we have seen in 2003 compared to 2002.

Telecommunications (TLC) License Fee

The impact of certain decisions regarding the TLC License fee had a material one time impact on our 2003 results of operations. After the ruling by the Court of Justice of the European Community stating that the telecommunications license fee established by Italian Law 448/1998, Art. 20, is contrary to EU law, the Telecom Italia Group stopped recording the license fee for 2003 and the financial charges accrued in 2003 on the amount payable for the license fees recorded in previous years. In addition, the statement of income in 2003 benefitted from the reversal of payables and reserves for risks and charges of 1,465 million for the years 2000, 2001 and 2002. Such amount, net of the tax effect of 562 million, contributed to the improvement in net income before minority interests for the year of 903 million.

Moreover, in anticipation of the final ruling by the administrative judge and the subsequent executive order, income has not been credited for the telecommunication license fee of 546 million (362 million by Telecom Italia and 184 million by TIM) paid by the respective companies for the year 1999.

The following table sets forth our Italian GAAP statement of operations for the years ended December 31, 2001, 2002 and 2003.

	2001	2002	2003
		(millions of Euro)	
Operating revenues	32,016	31,408	30,850
Other income	476	504	345
Total revenues	32,492	31,912	31,195
Cost of materials	2,640	2,315	2,081
Salaries and social security contributions	4,919	4,737	4,303
Depreciation and amortization	7,612	7,227	6,779
Other external charges	12,687	12,188	11,934
Changes in inventories	92	62	114
Capitalized internal construction costs	(583)	(675)	(805)
Total operating expenses	27,367	25,854	24,406
Operating income	5,125	6,058	6,789

Financial income	1,446	1,569	992
Financial expense	(6,559)	(4,647)	(3,256)
of which write-downs and equity in losses in affiliated and other companies, net	*(1,771)*	*(487)*	*(91)*
Other income and (expense), net	(3,109)	(5,496)	(1,083)
Income (loss) before income taxes and minority interests	(3,097)	(2,516)	3,442
Income taxes	(579)	2,210	(1,014)
Net income (loss) before minority interests	(3,676)	(306)	2,428
Minority interest	586	(467)	(1,236)
Net income (loss)	(3,090)	(773)	1,192

118

Table of Contents

Business Unit Financial Data

We operate predominantly in Italy and our core business is focused on domestic and international telecommunications services.

The table below sets forth the gross operating revenues, gross operating profit, operating income and other date for our Business Units, for the last three years:

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

(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. BBNed is no longer included in Other Activities. The TILab moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit.

(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 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 8, 2003. As a result of this, the 2003 figures include the results of operations for the first seven months of New SEAT Group, as well as the results of operations for the entire year of the remaining part of Seat Pagine Gialle which was renamed Telecom Italia Media following the spin-off.

(6) The data include the operations of the International Affairs Corporate Function, the TILab, the former 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 9Télécom group sold in the third quarter of 2002 and for which only the statement of operation data was consolidated for the first six months of 2002 -, as well as the finance companies, the centralized group services and the staff functions. See Recent Developments Telecom Italia Group Results for the First Quarter Ended March 31, 2004 compared to March 31, 2003 .

(7) Gross Operating Profit is a non-GAAP financial measure. 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 on a consolidated basis.

Table of Contents

	Year ended December 31,		
	2001	**2002**	**2003**
		(millions of Euro)	
Operating income	5,125	6,058	6,789
Depreciation and Amortization	7,612	7,227	6,779
Other external charges:			
• Provision for bad debts	448	546	471
• Write-downs of fixed assets and intangibles	17	58	6
• Provision for risks	389	114	70
• Other provisions and operating charges	431	466	485
Other income (excluding operating grants, reimbursements for personnel costs and costs of external services rendered)	(367)	(454)	(320)
Gross Operating Profit	**13,655**	**14,015**	**14,280**

Year ended December 31, 2003 compared with Year Ended December 31, 2002.

Consolidated Operating Revenues

Our consolidated operating revenues decreased by 1.8% in 2003 compared to 2002. Organic growth was 5.3% (1,545 million), excluding the negative effect of changes in exchange rates (728 million, of which 641 million was attributable to the Latin American telecommunication companies) and the effect of the change in the scope of consolidation (1,375 million, of which 797 million related to the sale of New SEAT from the Internet and Media Business Unit).

Organic growth in revenues was due largely to the following:

- a significant increase in the revenues of the Mobile Business Unit, which were driven by the domestic market (voice traffic and value-added services) and by the Brazilian market;

- an increase in the revenues of the Wireline Business Unit, which was due to growth in income from basic subscription charges, especially for ADSL, and from the sales of telephone equipment, which more than compensated for the drop in traffic in the retail segment. The decline in retail traffic was offset in part by an increase in the wholesale area; and

- a reduction in the sales of the Olivetti Tecnost Business Unit.

The table below sets forth, for the periods indicated, gross operating revenues and consolidated operating revenues by Business Unit and the percentage contribution of such Business Unit to our consolidated operating revenues.

	Year ended December 31,					
	2002(1)			2003		
	Gross Operating Revenues(2)	Consolidated Operating Revenues(3)	% of Consolidated Operating Revenues	Gross Operating Revenues(2)	Consolidated Operating Revenues(3)	% of Consolidated Operating Revenues
	(millions of Euro, except percentages)					
Wireline(4)(5)	17,047	15,112	48.1%	17,216	15,364	49.8%
Mobile	10,867	10,595	33.7%	11,782	11,562	37.5%
South America(6)	1,409	1,369	4.4%	1,126	1,104	3.6%
Internet and Media(7)	1,991	1,900	6.0%	1,297	1,122	3.6%
IT Market(5)	1,039	926	2.9%	891	804	2.6%
IT Group(5)	996	59	0.2%	1,100	41	0.1%
Olivetti Tecnost	914	906	2.9%	655	637	2.1%
Other activities(5)(8)	1,574	541	1.8%	1,126	216	0.7%
Total operating revenues	**35,837**	**31,408**	**100.0%**	**35,193**	**30,850**	**100.0%**

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

(2) Gross operating revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).

(3) Consolidated operating revenues are revenues recorded by each business area on a consolidated basis after elimination of intercompany sales.

120

(4) As of June 16, 2003, Domestic Wireline changed its name to Wireline.

(5) Starting from January 1, 2003, the Netikos group, the Webegg group, TILab, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNed is no longer included in Other Activities. The TILab moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit.

(6) 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.

(7) New SEAT, the beneficiary company of the spin-off from Seat Pagine Gialle which took place on August 1, 2003, was sold on August 8, 2003. As a result of this, the 2003 figures include the results of operations for the first seven months of New SEAT Group, as well as the results of operations for the entire year of the remaining part of Seat Pagine Gialle that was renamed Telecom Italia Media following the spin-off.

(8) The data include the operations of the International Affairs Corporate Function, the TILab, the former 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 9Télécom group sold in the third quarter of 2002 and for which only the statement of operation data was consolidated for the first six months of 2002 -, as well as the financial companies, the centralized group services and the staff functions.

The table below sets forth, for the periods indicated, consolidated operating revenues by geographic area and the percentage of total consolidated operating revenues:

Geographic Area	Year ended December 31, 2002		2003	
	(millions of Euro, except percentages)			
Italy	25,029	79.7%	24,811	80.5%
Rest of Europe	2,665	8.5%	2,478	8.0%
North America	452	1.4%	589	1.9%
Central and South America	2,805	8.9%	2,566	8.3%
Australia, Africa and Asia	457	1.5%	406	1.3%
Total consolidated operating revenues	**31,408**	**100.0%**	**30,850**	**100.0%**

Operating Expenses

The table below sets forth, for the periods indicated, total consolidated operating expenses by major components and expressed as a percentage of total consolidated operating revenues.

	Year ended December 31, 2002		2003	
	(millions of Euro, except percentages)			
Cost of materials	2,315	7.4%	2,081	6.7%
Other external charges	12,188	38.8%	11,934	38.7%
Personnel costs (salaries and social security contributions)	4,737	15.1%	4,303	13.9%
Changes in inventories	62	0.2%	114	0.4%

Capitalized internal construction costs	(675)	(2.2)%	(805)	(2.6)%
Depreciation and amortization	7,227	23.0%	6,779	22.0%
Total operating expenses	**25,854**	**82.3%**	**24,406**	**79.1%**

Our operating expenses decreased by 1,448 million or 5.6% in 2003 compared to 2002. The decrease was attributable to the lower cost of materials, the elimination of the TLC license fee (included in other external charges), personnel costs, depreciation of fixed assets and amortization of intangible assets (including goodwill).

As a percentage of our operating revenues, operating expenses represented 82.3% and 79.1% in 2002 and 2003, respectively.

Cost of Materials

Cost of materials decreased by 234 million or 10.1% in 2003 compared to 2002, mainly as a result of the continuing action taken to improve efficiency.

Table of Contents

Other External Charges

The table below sets forth, for the periods indicated, consolidated other external charges broken down by major components.

	Year ended December 31,	
	2002	2003
	(millions of Euro)	
Costs of external services rendered	9,407	9,684
Rents and lease payments	1,166	1,156
Provision for bad debts	546	471
Provision for risks	114	70
Write-downs of tangible and intangible fixed assets	58	6
TLC license fee	431	62
Other provisions and operating charges	466	485
Total other external charges	**12,188**	**11,934**

Other external charges decreased by 254 million or 2.1% in 2003 compared to 2002. These charges include costs of external services rendered, write-downs of tangible and intangible fixed assets, provision for bad debts, rents and lease payments, telecommunications license fees and other provisions and operating charges.

- Costs of external services rendered increased by 277 million or 2.9% in 2003 compared to 2002. The increase was principally due to higher costs to operate and develop mobile telecommunications (including the start-up of GSM services in Brazil).

- Provision for bad debts declined by 75 million in 2003 compared to 2002. The provision for bad debts is made to write-down receivables to their expected present realizable value.

- TLC license fee decreased by 369 million or 85.6% in 2003 compared to 2002; such decrease was principally due to the cancellation of the Italian government TLC license fee (355 million in 2002) after such fee was found not permissible as described above. Such cancellation also positively impacted provision for risks in that a provision of 29 million was recorded in 2002 by Old Telecom Italia relating to the TLC license fee.

- Other provisions and operating charges which included losses on disposals and write-offs of tangible and intangible fixed assets (18 million in 2003 compared to 36 million in 2002) and taxes other than income taxes (128 million in 2003 against 123 million in 2002), increased by 4.1% in 2003 compared to 2002.

Personnel Costs

Personnel costs (salaries and social security contributions) decreased by 434 million or 9.2% to 4,303 million in 2003 from 4,737 million in 2002. The decrease was mainly due to the following:

- a reduction in employee costs following layoffs in 2003 in Old Telecom Italia and in the Olivetti Tecnost Business Unit; and
- changes in the scope of consolidation.

As a percentage of the Telecom Italia Group s operating revenues personnel costs declined to 13.9% in 2003 compared to 15.1% in 2002. Employees at December 31, 2003 numbered 93,187 (106,620 as of December 31, 2002). The breakdown is as follows:

	As of December 31,	
	2002	**2003**
Italy	86,286	78,069
Abroad	20,334	15,118
Total employees	**106,620**	**93,187**

The reduction of 13,433 employees, compared to December 31, 2002, was due to operating turnover representing 4,604 units (of which 4,134 units were in Italy and 470 units outside Italy) and the change in the scope of consolidation relating to 8,829 units.

Table of Contents

The reduction due to the changes in the scope of consolidation is mainly attributable to the following:

- the sales of companies included in the Internet and Media Business Unit (a decrease of 5,642 units, of which 5,402 units related to the disposal of New SEAT) and Tess (a decrease of 404 units), the Olivetti Tecnost de Mexico business segment (a decrease of 1,266 units), the spin-offs of the Logistics business segment by Wireline (a decrease of 337 units), the Facility Management business segment by Olivetti Multiservices (a decrease of 208 units), the Desktop Management (a decrease of 582 units in IT Group and 22 units in IT Market) and Corporate Solutions businesses (a decrease of 380 units in IT Group and 21 units in Olivetti Tecnost), the sale of the Netikos group (a decrease 207 units) as well as of other minor companies and activities (a decrease of 130 units); and
- the inclusion of Hansenet (an increase of 381 units), Tm News (an increase of 55 units) and Top Services (an increase of 21 units).

In 1992, the Italian government enacted a law that required that Old Telecom Italia ensure that all personnel employed as of February 20, 1992 be covered by the Fondo Previdenza Telefonici (FPT), for the entire retirement benefit amount, including sums due by any prior employment in related companies. The contributions to cover these costs were computed by INPS (the Italian Social Security Authority), and are to be paid in 15 equal annual deferred installments. A subsequent law required that, for financial statement reporting purposes, the accounting for this liability was to be on a cash basis, which also matched the allowable tax deductibility of the payments.

Upon the acquisition of the controlling interest of Old Telecom Italia by Olivetti in 1999, the liability was estimated in the development of the acquisition price paid (i.e., the fair value of the assets acquired and liabilities assumed). At the time, the estimated liability by management was that the total amount due was less than that described by INPS, for a variety of reasons. Therefore, in recording the liability, the lower amount of the estimated range of the liability was recorded in the purchase accounting.

We have continued to debate the merits of the INPS valuation, with the issue still being debated in the Italian court system. However, in 2003 additional facts came to light, including the loss of some individual employee court cases (but not all cases), which lead to a revision of the estimated liability in 2003. Based on that review, an additional 315 million charge was taken in 2003 to record the full extent of the liability as computed by INPS. The total liability of 802 million recorded in the consolidated financial statements is net of the payments made to date to INPS to fund the liability, as required by the 1992 law. See also Notes 14 and 18 of Notes to the Consolidated Financial Statements included elsewhere herein.

Capitalized Internal Construction Costs

Capitalized internal construction costs represent sales of equipment, installations and services at market prices by Telecom Italia Group companies, principally to Telecom Italia and TIM. Capitalized internal construction costs increased by 130 million or 19.3% from 675 million in 2002 to 805 million in 2003; such increase was principally due to higher levels of capital expenditures spent on products and services purchased from subsidiaries, mainly software products.

Gross Operating Profit

The table below sets forth, for the periods indicated, our Gross Operating Profit (see Business Unit Financial Data Note 7 for the calculation of Gross Operating Profit) and gross operating margin (gross operating profit as a percentage of operating revenues).

	Year ended December 31,			
	2002		2003	
	(millions of Euro, except percentages)			
Gross Operating Profit	14,015	44.6%	14,280	46.3%

Gross Operating Profit increased by 265 million or 1.9% in 2003 compared to 2002 due to the greater percentage reduction in certain expenses in 2003 compared to the decrease in operating revenues in the same period. Excluding the effect of changes in exchange rates (a decrease of 146 million) and the effect of the change in the scope of consolidation (a decrease of 344 million), Gross Operating Profit grew by 755 million or 5.6% compared with 2002. Gross operating margin increased to 46.3% in 2003 from 44.6% in 2002 for the same reasons.

123

Table of Contents

The organic growth in Gross Operating Profit was positively impacted by the cancellation of the Italian government TLC license fee (355 million in 2002), partially offset by the negative impact of the start-up of GSM services in Brazil (131 million).

Depreciation and Amortization

Depreciation and amortization which was recorded on a straight line basis over the estimated useful lives of the assets, decreased by 448 million or 6.2% from 7,227 million in 2002 to 6,779 million in 2003.

Depreciation of tangible fixed assets decreased by 138 million or 3.6% from 3,808 million in 2002 to 3,670 million in 2003 mainly as a result of a lower amount of depreciable assets.

Amortization of intangible assets decreased by 310 million or 9.1% (from 3,419 million in 2002 to 3,109 million in 2003) as a result of the following:

- amortization of goodwill decreased by 316 million from 2,151 million in 2002 to 1,835 million in 2003. The decrease in amortization of goodwill was mainly due to:
  - the write-down of goodwill relating to Seat Pagine Gialle made in the 2002 financial statements and the sale of New SEAT (which reduced goodwill amortization by 304 million),
  - the extension, from 16.5 years to 20 years beginning from January 1, 2003, of the residual estimated period of benefit of the unamortized goodwill which resulted from the acquisition in 1999 of the controlling interest in Old Telecom Italia by Olivetti which reduced goodwill amortization by 227 million.

The foregoing was offset by:

- higher amortization of goodwill arising from the tender offers launched by Olivetti for the ordinary and savings shares of Old Telecom Italia (228 million) and the reclassification, from current to long-term, of the shares held by Olivetti in Old Telecom Italia which were subsequently cancelled as a result of the merger (12 million).

At December 31, 2003, goodwill decreased by 749 million (from 27,894 million as of December 31, 2002 to 27,145 million as of December 31, 2003). The change in goodwill was attributable to the following factors:

  - goodwill recorded following the tender offers by Olivetti for the shares of Old Telecom Italia of 4,551 million,
  -

the reclassification of the shares of Old Telecom Italia from current assets to intangibles made by Olivetti prior to the merger increasing goodwill by an additional 250 million, and

- the exercise of the J.P. Morgan Chase put option increased goodwill by 428 million relating to the acquisition of the additional SEAT shares.

The foregoing was offset by:

- the reduction in goodwill relating to New SEAT and its subsidiaries following their sale (a total of 3,506 million),
- amortization (1,835 million) and write-downs during the period (754 million), and
- amortization of intangible assets (other than goodwill) of 1,274 million in 2003 compared with 1,268 million in 2002.

Operating Income

The table below sets forth, for the periods indicated, our operating income (total revenues less total operating expenses, including depreciation and amortization and other charges).

	Year ended December 31,	
	2002	**2003**
	(millions of Euro)	
Operating income	6,058	6,789

Table of Contents

Our operating income increased by 731 million or 12.1% in 2003 compared to 2002. Excluding the effect of changes in exchange rates and the effect of the change in the scope of consolidation, operating income grew by 15.6%. The growth in operating income takes account of the negative effect of the start-up of GSM services in Brazil (273 million in 2003) as well as the positive impact of the cancellation of the Italian government TLC license fee (395 million in 2002).

The increase in operating income was mainly due to the improvement in Gross Operating Profit described above and the decrease in depreciation and amortization. As a percentage of operating revenues, operating income increased from 19.3% in 2002 to 22.0% in 2003.

Financial Income, Financial Expense, and Other Income and Expense, Net

The table below sets forth, for the periods indicated, the components of financial and other income and expense, net.

	Year ended December 31,	
	2002	**2003**
	(millions of Euro)	
Financial income	1,569	992
Financial expense	(4,647)	(3,256)
of which write-downs and equity in losses in affiliated and other companies, net	*(487)*	*(91)*
Other income and (expense), net	(5,496)	(1,083)
Total financial expense, net and other income and expense, net	**(8,574)**	**(3,347)**

Total *financial expense, net and other income and expense, net* decreased from a net expense of 8,574 million in 2002 to a net expense of 3,347 million in 2003, a 61.0% decrease.

Financial income (which includes interest and other income on securities, interest income from banks, affiliated and other companies, customers and gain on foreign exchange as well as certain other miscellaneous income, including income on hedging contracts) decreased by 577 million or 36.8%. The decrease was principally due to the reduction in gain on foreign exchange which declined 349 million from 508 million in 2002 to 159 million in 2003.

We record monetary assets and liabilities denominated in foreign currencies at the exchange rate in effect at the date of the transaction. We remeasure such assets and liabilities at the prevailing exchange rate on each balance sheet date with unrealized gains included in financial income.

Financial expense (which includes interest expense on financial indebtedness, foreign exchange losses and income or loss from equity investees) decreased by 1,391 million or 29.9%. The decrease was attributable principally to the following:

- a decrease in interest expense, from 2,241 million in 2002 to 2,173 million in 2003, mainly due to the reduction in the level of interest rates as well as to the lower average borrowings outstanding during 2003;

- the reduction of 719 million in losses on foreign exchange (186 million in 2003 compared to 905 million in 2002) which were positively impacted by the exchange rate effect of the companies in South America. As described above under Financial income we remeasure monetary assets and liabilities denominated in foreign currencies on each balance sheet date. If such remeasure results in unrealized losses, such unrealized losses are included in financial expense;

- the expenses of 161 million for the early exercise of the JP Morgan Chase put option on Seat Pagine Gialle shares finalized in August 2003, as well as the expenses connected with the credit lines granted to Olivetti in connection with the Merger to fund the rights of withdrawal and the tender offers (98 million); and

Table of Contents

- the reduction in net write-downs and equity in losses in affiliated and other companies of 396 million, mainly as a result of:

  - the reduction of 67 million in amortization of goodwill in companies accounted for using the equity method (13 million in 2003 compared to 80 million in 2002); and

  - the decrease of 329 million in valuation adjustments to the Telecom Italia Group s share of the equity in the earnings and losses of equity investees and other net write-downs (a loss of 78 million compared to a loss of 407 million in 2002). Such decrease was principally due to the reduction in losses of Sky Italia (formerly Stream) of 150 million and Aria Is Tim of 171 million corresponding to the valuation adjustment made in 2002.

Other income and expense, net decreased from a net expense of 5,496 million in 2002 to a net expense of 1,083 million in 2003. This significant decrease (4,413 million) was mainly due to the reduction in provisions and write-downs of goodwill and equity investments of 5,705 million compared to 2002, partly offset by the decrease in gains on the disposal of equity investments, tangible and intangible assets of 2,448 million compared to 2002, as described below.

- In *2003, provisions and write-downs of goodwill and equity investments* amounted to 879 million:

  - 348 million for the write-down of goodwill on Telecom Italia Media made on the basis of an appraisal of independent advisors;

  - 195 million for the write-down of goodwill on Entel Chile following the implementation of restructuring and reorganization plans;

  - 132 million for the write-down of goodwill on Digitel, in view of the persisting difficult macroeconomic environment in which the company operates;

  - 42 million attributable to the write-down of goodwill on EPIClink in respect of the start of the process to strategically reposition the company within the Group;

  - 59 million related to the dispute with minority shareholders of Digitel;

  - 37 million for the write-down of goodwill related to other minor companies;

  - 36 million related to provisions for risks and other charges on investments; and

  - 30 million to be recognized to Mirror in connection with the recognition of a lower sale price of the investment in Inmarsat with respect to the value assumed in 2001 at the time in which such investment was transferred by Telecom Italia to Mirror.

- In *2002, provision and write-downs of goodwill and equity investments* amounted to 6,584 million and included the following:

  - write-down of the equity investment held in Aria Is Tim, the affiliated mobile telecommunications operator in Turkey (1,491 million) and provision to the reserve for risks and charges related to Aria Is Tim (850 million) for the guarantees provided by the Old Telecom Italia Group to the creditors of Aria Is Tim, and for the loans provided directly by the Old Telecom Italia Group to Aria Is Tim. At that time, Old Telecom Italia concluded that the value of its investments was permanently impaired, since, starting from the awarding of the license, some measures which should have fostered effective competition and guaranteed the full operability of the new entrant, did not effectively take place;

- write-down of Seat Pagine Gialle goodwill (1,544 million) and accrual for the forward purchase commitments of Seat Pagine Gialle shares (1,942 million). The write-down and the provision were made on the basis of the average Seat Pagine Gialle ordinary shares based on trading on the Italian Stock Exchange over the second half of 2002;

- provisions made in conjunction with the disposal of the investment in the 9Télécom Group (316 million);

- reserve provision (43 million), made by Seat Pagine Gialle, for estimated losses arising from the exercise of put options by the founding shareholders of Consodata S.A.; and

- other write-downs of investments of 46 million and of goodwill for 321 million (of which: 103 million for Blu, 75 million for Digitel, 96 million for Netco Redes and 47 million for other minor companies).

126

Table of Contents

- In 2003, restructuring costs amounted to 273 million (of which 196 million was attributable to the parent company Telecom Italia) and were related to expenses and provisions for employee cutbacks and layoffs.

- This compared to restructuring costs of 494 million in 2002 (of which 379 million was attributable to Old Telecom Italia) also related to expenses and provisions for employee cutbacks and layoffs.

- In 2003, charges as required under Law No. 58/1992 in order to cover employees under the former Telephone Employees Pension Fund (FPT) amounted to 387 million, of which 315 million resulted from the redetermination of the liability and 72 million for the related accrued interest. In 2002 accrued interests on the liability to INPS related to the former Telephone Employees Pension Fund (FPT) amounted to 79 million.

- In 2003, gains on the disposal of equity investments, tangible and intangible assets amounted to 105 million compared with 2,553 million in 2002. In 2002 Old Telecom Italia was implementing its strategic plan to sell non-core assets to reduce indebtedness. It had largely completed this plan by the end of 2002. The 2002 gains on the disposal of equity investments, tangible and intangible assets arose from:

  - the sale of our 26.89% interest in AUNA (1,245 million);

  - the sale of our 19.61% interest in Bouygues Décaux Télécom (484 million);

  - the acceptance of the tender offer for Lottomatica shares by the Old Telecom Italia Group (133 million) and by Olivetti and Olivetti International (overall 107 million);

  - the sale of our 25% interest in the Mobilkom Austria group (115 million);

  - the sale of the 40% interest held in Telemaco Immobiliare (110 million);

  - the sale of the 100% interest held in Telespazio (70 million);

  - the concentration of the real-estate assets through the companies IM.SER, Emsa and Telimm into Tiglio I (159 million);

  - the transfer of Old Telecom Italia s Asset Management unit to Tiglio II (60 million);

  - the transfer by Old Telecom Italia of its real estate services businesses (excluding facilities management) to the Pirelli & C. Real Estate Group (15 million);

  - the sale of the 100% interest held in OMS2 to Tiglio I (26 million); and

  - the disposal of other equity investments, fixed assets and business segments (29 million).

- In 2003, other, net (351 million net income) included:

- 1,465 million from the reversal of liabilities and reserves for risks and charges relating to the cancellation of the TLC license fee following the verdict handed down by the European Court of Justice (see Notes 12 and 14 of Notes to the Consolidated Financial Statements for further details);

- 237 million of losses on the disposal of equity investments, tangible and intangible assets (of which 195 million was due to the losses on the sale of the entire stake held in New SEAT after the spin-off);

- 74 million of expenses connected with the spin-off and sale of New SEAT;

- a 55 million payment in contractual settlement with Pagine Italia after the agreement to purchase the Pagine Utili business segment was terminated following our sale of New SEAT;

- 56 million for the additional adjustment made by the parent company Telecom Italia to the estimated value of unused prepaid telephone cards following the start of technical data collection procedures;

- 35 million for the recognition of liabilities referring to prior years on interconnection issues, following clarifications on the part of the regulatory agencies and verifications by the operators involved;

- 295 million for the provisions and write-downs of intangibles and fixed assets made by Latin American Nautilus group (235 million), Telecom Italia Learning Service (27 million), EPIClink (15 million) and other minor companies (18 million) as part of the reorganization transactions;

- 118 million of expenses connected with the Merger principally in respect of fees for advisors, legal and tax consultants, technical experts and expenses for banking charges;

Table of Contents

- 48 million of indirect taxes and prior period taxes mainly for the portion of the cost of the tax amnesty not covered by the reserve for income taxes;
- 49 million for losses arising from the settlement of adjustments on the contribution of the international wholesale business segment in 2002;
- 33 million for prior year s adjustments to income taxes; and
- 100 million of other expenses net, which included write-offs of receivable balances, net of release of reserves, and other miscellaneous income and expense.

- In 2002, other, net (892 million net charges) included:
  - income arising from the recovery of pre-amortization interest on the expenses for employee benefit obligations under Law 58/1992 that were paid, with reserve, to INPS up to 1999 following the termination of litigation after the courts ruled in Old Telecom Italia s favor (131 million);
  - the release of reserves (98 million), primarily set up in 2001 by Old Telecom Italia to cover the expenses connected with the agreement to sell Stream to News Corporation and Vivendi Universal/Canal+ after the agreement was terminated;
  - losses from the sale of a 15% stake in Telekom Austria (135 million) and the sale of the equity investment in Seat P.G. held by Olivetti (62 million);
  - expenses connected with the disposal of equity investments (239 million);
  - the extraordinary contributions to INPS established by the year 2000 Italian Budget for the three years 2000-2002 to meet the higher financial requirements covered by the rules of the FPT that was abolished and became part of the general Employee Pension Fund (74 million);
  - write-downs of tangible and intangible fixed assets (190 million, of which 142 million related to our Brazilian companies);
  - provisions to the reserves for risks and charges (226 million, of which 135 million for guarantees provided for the disposals of equity investments and business segments);
  - adjustment to Old Telecom Italia s payable to customers relating to telephone prepaid cards (158 million);
  - other losses on disposals of equity investments, tangible and intangible fixed assets (39 million); and
  - other miscellaneous expenses, net (29 million).

Income Taxes

Income taxes decreased from a benefit of 2,210 million in 2002 to an expense of 1,014 million in 2003. Our statutory income tax rate was 34% in 2003 compared to 36% in 2002.

The 2003 increase in income taxes of 3,224 million was due to the improvement of the result for 2003 (income in 2003 compared with a loss in 2002) and consequently higher levels of taxable income. The increase in taxes was offset in part by the recording of 1,266 million of additional deferred tax assets in addition to those already recorded by Telecom Italia (formerly Olivetti) in 2002 following the write-downs, for tax purposes only, of the shares of the merged company (Old Telecom Italia) held by Olivetti prior to the Merger, and which became recoverable on completion of the Merger.

Net Income (loss)

Net income (loss) before minority interests recorded an improvement from a loss of 306 million in 2002 to net income of 2,428 million in 2003. In 2003, the improvement in net income before minority interests was principally due to the increase in operating income, the reduction in financial expense, net and in other expense, net offset in part by the increase in income taxes. In 2003 net income after minority interests was 1,192 million compared to a net loss after minority interests of 773 million in 2002. Minority interest increased by 769 million (from 467 million in 2002 to 1,236 million in 2003) mainly as a result of the higher levels of profit at TIM group (647 million) and the effects of the Merger of Old Telecom Italia with and into Olivetti (152 million).

Table of Contents

Results of Operations of Business Units for the Year Ended December 31, 2003 compared with the Year Ended December 31, 2002.

Wireline

The following table sets forth for the periods indicated certain financial and other data for the Wireline Business Unit.

Wireline	**Year ended December 31,**	
	2002(1)	**2003**
	(millions of Euro, except percentage and employees)	
Gross operating revenues	17,047	17,216
Gross operating profit	7,951	8,255
% of gross operating revenues	46.6	47.9
Operating income	4,677	4,969
% of gross operating revenues	27.4	28.9
Number of employees at year-end	53,935	50,766

(1) The 2002 financial and other data have been reclassified and presented consistent with the 2003 presentation.

The following table sets forth for the periods indicated certain statistical data for Wireline.

	Year ended December 31,	
	2002	**2003**
Subscription and Customers:		

Subscriber fixed lines at period-end in Italy (thousands)(1)	27,142	26,596
Subscriber fixed line growth per annum in Italy (%)	(0.8)	(2.0)
ISDN equivalent lines at period-end in Italy (thousands)(2)	5,756	6,027
Broadband Access in Italy and abroad (ADSL + XDSL) (thousands)(3)	850	2,200
Voice Offers in Italy (thousands)(4)	5,224	5,547
Wireline Traffic:		
Wireline total traffic (Retail and Wholesale) (billions of minutes)	214.9	226.6
of which:		
National(5)	*204.7*	*215.2*
International(6)	*10.2*	*11.4*
Retail Traffic(7):		
Average minutes of use per fixed line subscriber in Italy during period(8)	4,292	4,127
of which:		
Local traffic during period (in average minutes)(9)	*3,198*	*2,971*
Long distance traffic during period (domestic and international) (in average minutes)	*1,094*	*1,156*

(1) Data include multiple lines for ISDN and excludes internal lines.
(2) Data exclude internal lines.
(3) Number of contracts.
(4) Number of contracts; includes Teleconomy, Hellò and other Business voice offers.
(5) Data include total retail traffic (international outgoing traffic excluded) and total domestic wholesale traffic.
(6) Data include international retail outgoing traffic and total international wholesale traffic.
(7) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls and calls to mobile phones.
(8) Includes total retail fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).
(9) Includes district and internet dial-up traffic.

The Wireline Business Unit (which, until June 16, 2003, was called Domestic Wireline) accounted for gross operating revenues of 17,216 million in 2003 and 17,047 million in 2002, an increase of 169 million, or

Table of Contents

1.0%. The increase in revenues in 2003 reversed the trend of the prior year when revenues declined (-0.7% in 2002) and is attributable principally to an increase in Internet (broadband) and VAS (Value Added Services) particularly for business customers. Revenues from Retail Telephone decreased and revenues from Data and Wholesale services were relatively stable.

Wireline tracks gross operating revenues in the following business areas: retail telephone, retail internet, data business, retail value added serves (VAS) and wholesale services.

Retail Telephone. Revenues from Retail Telephone were 10,368 million in 2003, a decrease of 179 million, or 1.7% from 10,547 million in 2002. Retail telephone revenues consist mainly of traffic revenues and fee revenues: traffic revenues are directly related to traffic volumes, tariffs and fees for tariff packages; fees are attributable to access fees, fees for additional services and for equipment rental and assurance.

Wireline Business Unit has implemented various strategies to limit the impact of increasing competition, with such strategies designed to retain customers and minimize the impact of tariff reductions. During 2003 Telecom Italia s traffic packages, retention and win back strategies resulted in limited revenues losses while its market share on traffic volumes remained stable: Telecom Italia s market share in retail traffic volumes voice and on line traffic (on line traffic is included in Retail Internet) at December 31, 2003 was 72.0% compared with 71.4% at December 31, 2002 and 72.1% at December 31, 2001.

This result reflects retention and win back policies supported by Teleconomy and Hellò offers, combined with selective marketing strategies for high value customers. Flat Voice Offers (Teleconomy offers and other business customized offers) had more than 5.5 million users at the end of 2003 compared to 5.2 million users at the end of 2002 and 4.1 million users at the end of 2001.

Retail Internet. Revenues from Retail Internet amounted to 709 million in 2003, an increase of 114 million, or 19.2% (595 million in 2002). Revenues from Retail Internet consist primarily of internet dial-up traffic revenues and revenues from ADSL, (mass market broadband access,) for access fees and traffic. Revenues from ADSL were approximately 257 million, increasing strongly by 190% over 2002 (89 million), mainly due to the larger customer base while revenues from internet dial-up traffic decreased due to migration to internet connections using broadband access.

Data Business. Revenues from Data Business (Data services, Leased Lines for retail customers and Data Equipment) were 1,510 million in 2003, an increase of 4.6% over 2002 (1,443 million in 2002). Data services consist primarily of data transmission and network services for business customers and residential customers. Revenues from data services are included primarily in fixed subscription and connection fees. The growth in services revenues was driven mainly by innovative data services increasing by more than 42% (520 million in 2003 compared to 366 million in 2002); revenues from Data equipment increased to 246 million (approximately 220 million in 2002).

Revenues from traditional Data services decreased due to customer migration to broadband services from approximately 400 million in 2002 to approximately 340 million in 2003. Leased Lines decreased due to similar migration from approximately 461 million in 2002 to approximately 406 million in 2003.

Retail Value Added Services (VAS). Revenues from VAS were 1,122 million in 2003, an increase of 13.3% on 132 million over 2002 (990 million). VAS consist of new services for all Wireline customers such as Web Services, Outsourcing and Security for Business customers and SMS (short messages from fixed telephone), Memotel (centralized mailbox) and Chi è (identification of calling number) for residential customers. The increase is attributable to the introduction of additional services and VAS packages and growth in the customer base.

Wholesale Services. Revenues from Wholesale Services were 3,269 million in 2003 and remained substantially stable compared to 2002. Wholesale consists of national and international services to other domestic and international telecommunications operators. Domestic Wholesale Services decreased by approximately 45 million due to a price reduction in interconnection services and reduced volumes of traffic, 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 (approximately one billion minutes or 12%), particularly in traffic carried for other operators.

Table of Contents

In 2003 total Wireline traffic revenues decreased from 8,280 billion in 2002 to 7,948 billion in 2003 with 291 million attributable to retail traffic and 41 million attributable to wholesale traffic. The decrease in retail traffic is a result of:

- commercial policies aimed at customer retention with offers (mainly Teleconomy) which provide discounted tariffs with a monthly fee; offset in part by growth in innovative traffic, Value Added Services, data and ADSL traffic, boosted by the success of Alice offers (ADSL access for mass market) that is now replacing traditional internet traffic (internet dial-up traffic);
- fall in traditional traffic (Voice and Internet dial-up traffic) due to continued price reductions, pushed by competition and by retention policies; and
- to volume reductions in Internet dial-up traffic due to the increasing popularity of ADSL.

The increase in wholesale traffic revenues is due to an increase in revenues from international traffic offset by a decline in national wholesale traffic revenues: revenues from international wholesale traffic increased mainly due to an increase in minutes of traffic carried while revenues from domestic wholesale traffic decreased due to price reductions for interconnection despite an increase in volumes.

The number of subscriber fixed lines in Italy decreased by 2.0% to 26,596 thousands as of December 31, 2003 (27,142 thousand as of December 31, 2002) representing a telecommunications density (fixed line subscribers to total population of Italy) of approximately 47% at December 31, 2003. Such decrease takes into account the increase in ISDN lines (6,027,000 lines at the end of 2003 compared to 5,756,000 lines at the end of 2002 and 5,403,000 lines at the end of 2001). Lines include 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, Wireline had contracts in Italy for approximately 2,040,000 broadband points of access (850,000 at the end of 2002) with approximately 536,000 wholesale points of access (220,000 at the end of 2002) and 1,504,000 retail market points of access (630,000 at the end of 2002). The growth is attributable to the success of various tariff structures geared to the Mass Market (Alice) and to business customers. During 2003 Telecom Italia started the European project International Broadband through:

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

The Wireline Business Unit intends to offer access to innovative broadband services in the main European cities, leveraging on its know-how and technological assets, beginning with France and Germany. As of December 31, 2003, Wireline had approximately 160,000 contracts for broadband access outside of Italy.

The contribution of Wireline Business Unit to our consolidated operating revenues amounted to 15,112 million in 2002 and 15,364 million in 2003.

Gross operating profit increased by 304 million, or 3.8% from 7,951 million in 2002 to 8,255 million in 2003, due to significant reductions in personnel costs and expenses as the result of an efficiency plan that brought savings in discretionary operating expenses of approximately 320 million in 2003 and the cancellation of the TLC license fee (204 million in 2002).

Gross operating margin improved by 1.3% from 46.6% in 2002 to 47.9% in 2003.

Operating income increased by 292 million, or 6.2%, from 4,677 million in 2002 to 4,969 million in 2003, as a result of the improvement in gross operating profit and a significant reduction in depreciation and amortization.

Operating margin increased to 28.9% in 2003 compared with 27.4% in 2002.

Table of Contents

Mobile

The following table sets forth, for the periods indicated, certain financial and other data for Mobile.

Mobile	**Year ended December 31, 2002**	**2003**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	10,867	11,782
Gross operating profit	5,039	5,502
% of gross operating revenues	46.4	46.7
Operating income	3,358	3,786
% of gross operating revenues	30.9	32.1
Number of employees at year-end	18,702	18,888

The following table sets forth for the periods indicated, certain domestic Italian statistical data for TIM.

	Year ended December 31, 2002	**2003**
TIM lines at period-end (thousands)(1)	25,302	26,076
TIM lines growth per annum (%)	5.7	3.1
Average revenue per mobile line per month ( )(2)	28.8	29.1
Cellular penetration at period-end (TIM customers per 100 inhabitants)(%)	43.9	45.3
Cellular market penetration at period-end (customers for the entire market per 100 inhabitants)(%)	93.7	99.2
Total mobile outgoing traffic per month (millions of minutes)	1,960	2,090

(1) Includes lines of TACS and GSM services, including Prepaid Customers and excludes the silent lines.
(2) Including Prepaid Card revenues and non TIM customer traffic revenues and excluding equipment sales.

Gross operating revenues from mobile services increased by 8.4% in 2003 compared to 2002, despite the impact of adverse exchange rates which affected certain companies operating in the Mobile Business Unit in Latin America, in particular Venezuela and Brazil. Excluding the effect of changes in exchange rates, organic growth in revenues would have been 12.6% compared to 2002.

This increase was primarily due to TIM s performance in the Italian market (an increase of 6.2%), despite increasing competition, and was mainly attributable to an increase in revenues relating to value added services, with some contribution from international companies. In particular, operating revenues of STET Hellas, TIM s Greek mobile operator, were approximately 805 million in 2003, a 16.8% increase compared to 2002 mainly due to growth of outgoing traffic.

The contribution of the Mobile Business Unit to our consolidated operating revenues was 10,595 million in 2002 and 11,562 million in 2003.

Gross operating profit was 5,502 million in 2003, up 463 million, or 9.2% compared to 2002. The gross operating margin, however, improved to 46.7% in 2003 compared to 46.4% in 2002. Excluding the effect of changes in exchange rates, the growth in gross operating profit would have been 10.2%. The improvement in gross operating profit can be attributed to the positive performance of the core Italian operations and Greece, which offset both the higher costs of GSM start-up in Brazil and the foreign exchange effect in the South American region. The increase in gross operating profit was positively impacted by TIM S.p.A. no longer having to accrue the TLC license fee, following the verdict of the European Court of Justice which declared the institutional law establishing the fees as unlawful. In 2002, the TLC license fee amounted to 151 million.

Operating income was 3,786 million in 2003, an increase of 428 million, or 12.7%, compared to 2002. Excluding the effect of changes in exchange rates, the growth in operating income would have been 10.8%. Operating margin improved from 30.9% in 2002 to 32.1% in 2003. Growth in operating income is mainly attributable to the increase in gross operating profit.

Table of Contents

TIM (parent company)

TIM, which during 2002 merged Blu S.p.A., the fourth Italian GSM operator, effective January 1, 2002, had operating revenues in 2003 of 9,469 million, an increase of 5.0% over 2002 revenues of 9,022 million (8,915 million net of the merger impact, representing an increase of 6.2% over 2002). Revenues from services increased by 6.8% (net of the merger impact) with a ratio on total revenues of 94.9% (94.3% in 2002). The impact of lower prices was more than offset by greater traffic in minute terms (an increase of 5.5% in 2003 compared to 2002).

TIM lines increased to 26,076,000 lines at December 31, 2003, a 3.1% increase compared to December 31, 2002. TIM s total GSM lines increased by 4.9% in 2003, to 25,501,000 lines at December 31, 2003, while TIM s total TACS lines decreased by 42.2% in 2003, to 575,000 lines at December 31, 2003, in each case compared to December 31, 2002. Due to the termination of the TACS services over the next few years and implementation of mobile number portability, customer transfer to the GSM service is in progress. Approximately 97.8% of TIM s lines are now GSM lines. The continuing growth in GSM lines was attributable principally to the continuing growth of the GSM TIM Card (a prepaid rechargeable GSM card), which had 22,906 thousand lines by December 31, 2003 compared to 21,622 thousand lines at December 31, 2002. Prepaid lines (GSM and TACS) grew by 4.2% in 2003.

At December 31, 2003, TIM had a market share in Italy of approximately 46% (including TACS and GSM) compared to 46.1% at December 31, 2002, and a market share of approximately 45.3% for GSM only compared to 45.1% in 2002. The overall market grew by 3.6% in 2003 from 54.8 million lines at the end of 2002 to 56.8 million lines at the end of 2003. The aggregate number of customers at December 31, 2003 for TIM s analog and GSM services represented a penetration rate of 45.3% compared to 43.9% at December 31, 2002. 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 TIM and the development of the business.

In 2003, TIM traffic volumes increased by 5.5% in terms of minutes and mobile traffic revenues (net of the Blu merger impact) increased by 3.7% in 2003 compared to 2002 (7,099 million against 6,845 million in 2002). The growth in revenues was also due to the net increase in lines (up 3.1% compared to 2002) and mainly to the higher impact of VAS revenues. The average monthly revenue per mobile line (ARPU) (which includes traffic and VAS revenues) increased from approximately 28.80 in 2002 to 29.10 in 2003 (including service revenues from non TIM clients).

TIM revenues from equipment sales decreased by 3.8% in 2003 compared to 2002 (486 million against 505 million in 2002 net of Blu). In particular handset volumes decreased by 9.5% offset in part by a change in the mix of handsets which can take advantage of innovative products (MMS) with a higher price.

Mobile subscription fees decreased by 22.7% in 2003 compared to 2002 (157 million against 203 million in 2002) due to the continuing sharp expansion in the prepaid service customer base, where no subscription fees are paid.

TIM revenues from Value Added Services (VAS) (1,028 million in 2003) increased by 36.7% compared to 2002 excluding Blu. Due to the continuing introduction of new services and the particular success of SMS services, the VAS business grew significantly with revenues from value added services representing 11.4% of services revenues and 10.9% of total revenues in 2003, compared to 8.9% and 8.4%, respectively in 2002. In 2003, TIM actively marketed the increase in use of VAS through promotional campaigns.

Due to effective CRM and innovative offers, TIM s churn rate decreased to 1.1% per month from 1.5% as recorded in 2002.

TIM gross operating profit was 5,035 million in 2003 compared with the gross operating profit, excluding the merger effect (a loss of 125 million), of 4,529 million. 2003 gross operating profit increased by 11.2% compared with the previous year as a result of the increase in operating revenues and actions taken to control operating costs. Gross operating margin was 53.2% (50.8% in 2002, excluding the merger impact). The increase in gross operating profit was positively affected due to TIM S.p.A. no longer having to accrue the TLC license fee, following the verdict of the European Court of Justice which declared the institutional law establishing the fees as unlawful. In 2002, the TLC license fee amounted to 154 million (151 million net of Blu).

Table of Contents

TIM operating income was 3,863 million in 2003 compared with 2002 operating income, excluding the merger effect (a loss of 170 million) of 3,323 million. 2003 operating income increased by 16.3% compared with 2002. Operating margin was 40.8% in 2003 and 37.3% in 2002 (excluding the merger impact).

TIM operating income was positively impacted by the decrease in depreciation and amortization, as a result of the lower depreciation of intangible assets (a decrease of 106 million) due to the change in the method for calculating depreciation of certain intangibles.

Mobile Latin America

The following table sets forth for the periods indicated certain financial and other data for the Mobile business unit in Latin America.

	Year ended December 31,	
Mobile Latin America	**2002**	**2003**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,298	1,547
Gross operating profit	274	196
% of gross operating revenues	21.1	12.7
Operating loss	(98)	(248)
% of gross operating revenues	(7.6)	(16.0)
Number of employees at year-end	7,050	7,502

The gross operating revenues of the Mobile Business Unit in Latin America were 1,547 million in 2003 compared with 1,298 million in 2002, an increase of 19.2%. Excluding the effect of changes in the exchange rates, the growth in gross operating revenues would have been 50.4%.

Gross operating profit amounted to 196 million, a decrease of 78 million, or 28.5%, compared to 2002, mainly due to the start-up costs of certain companies in Brazil.

Operating loss amounted to 248 million compared to an operating loss of 98 million in 2002.

South America

The following table sets forth, for the periods indicated, certain financial and other data for the Entel Chile group, the Entel Bolivia group, the company Telecom Italia America Latina and the South America business segment of Telecom Italia. Certain financial and other data of the Mobile Business Unit in Latin America are described in the section pertaining to the Mobile Business Unit.

	Year ended December 31,	
	2002	2003
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,409	1,126
Gross operating profit	450	400
% of gross operating revenues	31.9	35.5
Operating income	146	137
% of gross operating revenues	10.4	12.2
Number of employees at year-end	5,461	5,049

Gross operating revenues were 1,126 million in 2003, a decrease of 20.1% compared to 2002. The decrease was mainly due to the adverse effect of the change in exchange rates (a decrease of 236 million, of which 190 million relates to the Chilean peso, 43 million to the Bolivian currency and 3 million to the Brazilian currency). On a constant currency basis, gross operating revenues would have decreased by 3.3%, primarily due to the decrease in the revenues of the Entel Chile group (-5.8% in local currency) and to the suspension as of April 1, 2002 of the management fee under the terms of the contract with Telecom Argentina.

Table of Contents

The contribution of South America Business Unit to our consolidated operating revenues was 1,369 million in 2002 and 1,104 million in 2003.

The fluctuations in exchange rates described above affected profitability. In particular, gross operating profit decreased by 50 million, or 11.1%, compared to 2002, of which approximately 87 million was attributable to the weakening of currencies against the euro. Excluding the exchange rate effects, gross operating profit would have increased by 8.2%. As a percentage of revenues, gross operating profit was 35.5% in 2003 (31.9% in 2002).

Operating income was 137 million, a decrease of 9 million or 6.2% compared to 2002, due to the exchange rate effect (approximately 27 million). On a constant currency basis, operating income would have increased by 12.3% compared to 2002. As a percentage of revenues, operating income was 12.2% in 2003 compared to 10.4% in 2002.

In order to give an overall view of LAO, the following table sets forth, for the periods indicated, certain financial and other data for all the companies operating in South America, providing both wireline and mobile phone services.

	Year ended December 31,	
South America	**2002**	**2003**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	2,706	2,669
Gross operating profit	724	596
% of gross operating revenues	26.8	22.3
Operating income (loss)	48	(111)
% of gross operating revenues	1.8	(4.2)
Number of employees at year-end	12,511	12,551

Internet and Media

The following tables set forth, for the periods indicated, certain financial and other data for the Internet and Media business unit (the Telecom Italia Media Group). In order to allow a better understanding of the results of the business managed by the business unit after the SEAT Spin-off, the figures are presented on an historical and pro forma basis.

The historical data reflects full consolidation of the SEAT Group in 2002 and, in 2003, full consolidation of the SEAT Group for the first seven months of 2003, with the last five months only consolidating Telecom Italia Media following the demerger and sale of our stake in New SEAT.

Historical data

	Year ended December 31,	
	2002	2003
Internet and Media	**Historical**	**Historical**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,991	1,297
Gross operating profit	593	322
% of gross operating revenues	29.8	24.8
Operating income	232	63
% of gross operating revenues	11.7	4.9
Number of employees at year-end	7,715	2,029

The pro forma data has been prepared assuming that the demerger and sale of New SEAT occurred as of January 1, 2002 so that the financial data only includes Telecom Italia Media for the 2002/2003 years.

Table of Contents

Pro forma data

Internet and Media	Year ended December 31, 2002 Pro forma	2003 Pro forma
	(millions of Euro, except percentages and employees)	
Gross operating revenues	577	595
Gross operating profit	(28)	12
% of gross operating revenues	(4.8)	2.0
Operating loss	(153)	(103)
% of gross operating revenues	(26.6)	(17.3)
Number of employees at year-end	2,284	2,029

The historical gross operating revenues decreased by 34.8% from 1,991 million in 2002 to 1,297 million in 2003, while the pro forma gross operating revenues increased by 3.0% from 577 million in 2002 to 595 million in 2003. The decline in historical gross operating revenues is attributable to the sale of New SEAT in August 2003, resulting in its deconsolidation. In detail the pro forma gross operating revenues are analyzed as follows:

- the Internet business area made the largest contribution to growth; the related revenues increased by 80.3% from 139 million in 2002 to 251 million in 2003. Such increase was affected by the new revenue share methods for calculating Internet dial-up traffic (Decade 7) introduced in 2003;
- revenues from the Television business area were 113 million, an increase of 25 million or 27.8% confirming the editorial success of the program schedule of the two stations;
- revenues from the Office Products and Services business area decreased by 94 million from 279 million in 2002 to 185 million in 2003 largely due to the deconsolidation of IS Products S.p.A. and Incas Production S.r.l., which were sold in 2003;
- revenues from Professional Publishing business area were 25 million, a decrease of 8 million (-23.9%). This was largely due to the deconsolidation of TTG Italia (5 million), which was sold at the beginning of 2003.

The contribution of the Internet and Media Business Unit to our consolidated operating revenues amounted to 1,900 million in 2002 and 1,122 million in 2003.

Historical gross operating profit decreased by 45.8% to   322 million due principally to the sale of New SEAT. Pro forma gross operating profit increased from a loss of   28 million in 2002 to a profit of   12 million in 2003.

Historical operating income decreased to   63 million in 2003 compared to   232 million in 2002, while pro forma operating income improved from a loss of   153 million in 2002 to a loss of   103 million in 2003. The improvements in the pro forma operating income were due to the implementation of rationalization measures and the increase in efficiency, especially in the Internet and Television Areas.

Total Internet active users grew from 2.2 million at the end of 2002 to 2.5 million at the end of 2003.

Table of Contents

Information Technology Market

The following table sets forth, for the periods indicated, certain financial and other data for the IT Market Business Unit. In order to allow a better understanding of the results of the business managed by the business unit in 2003, the figures are presented on an historical and pro forma basis in order to provide percentages and comparable comparative information for 2002 and 2003.

	Year ended December 31,		
		2002	
Information Technology Market	2002 (1)	Pro forma (2)	2003 (3)
	(millions of Euro, except percentages and employees)		
Gross operating revenues	1,039	777	891
Gross operating profit	114	86	84
% of gross operating revenues	11.0	11.1	9.4
Operating income	64	37	58
% of gross operating revenues	6.2	4.8	6.5
Number of employees at year-end	5,506	5,031	4,827

(1) The 2002 historical financial and other data are consistent with the 2003 scope of consolidation. The 2002 historical data included for the full year 2002 the Finsiel group, the Webegg group, the Netikos group, the company Eustema and Finsiel s Enterprise business segment as well as consolidating for the statement of operations purposes Sogei and Consiel for the first six months of 2002 and for the first eight months of 2002, respectively.

(2) The 2002 pro forma financial and other data has been prepared to be consistent with the 2003 scope of consolidation. As a result Sogei S.p.A. and Consiel S.p.A. have been excluded for the full year 2002. In addition, the 2002 pro forma statement of operations data do not include the Netikos group and Domus Academy, included in the second half of 2002 historical results, and Finsiel s Enterprise business segment has been excluded for the last three months of 2002.

(3) The 2003 historical financial and other data includes:

- the statement of operations data of Domus Academy only for the first six months of 2003, as a result of the transfer by Webegg of its 67.33% stake in Domus Academy to Telecom Italia with effect from July 1, 2003;
- the statement of operations data of Netikos group only for the first six months of 2003, as a result its disposal by IT Telecom to third parties (MyQube S.A.) on July 23, 2003, but with effect from July 1, 2003;

- the statement of operations data of the Enterprise business segment only for the first nine months of 2003, as a result of the transfer by Finsiel to IT Telecom of this business segment on October 1, 2003; the Enterprise business segment is responsible for planning, implementing and selling IT solutions on the enterprise market and managing applications and facilities on this same market.

Historical gross operating revenues decreased by 148 million, from 1,039 million in 2002 to 891 million in 2003. The decrease in gross operating revenues was attributable to the changes in the scope of consolidation between 2002 and 2003. On a comparable consolidation basis, gross operating revenues increased by 14.7% from 777 million in 2002 to 891 million in 2003. This increase is principally due to higher revenues of TSF, Eustema and Agrisian. This increase in revenues more than offset the lower revenues recorded by Finsiel and the Webegg Group.

The contribution of the IT Market Business Unit to our historical consolidated operating revenues amounted to 898 million in 2002 and 804 million in 2003.

Historical gross operating profit declined from 114 million in 2002 to 84 million in 2003, primarily due to the change in scope of consolidation between 2002 and 2003. On a comparable consolidation basis, gross operating profit decreased by 2 million, or 2.3%, compared with the preceding financial year (from 86 million in 2002 to 84 million in 2003). The decrease is principally due to Finsiel s performance, which recorded lower profitability owing to lower volumes recorded in the Government and Enterprise areas, only partially offset by the improved profitability margins recorded by Tele Sistemi Ferroviari on the outsourcing contracts with the State Railways Group companies for the development activities.

Table of Contents

Historical operating income decreased by 6 million, from 64 million in 2002 to 58 million in 2003. On a comparable consolidation basis, operating income for 2003 increased by 21 million, or 56.8%, from pro forma 37 million in 2002 to 58 million in 2003. The improvement in operating income was mainly due to the performance of Tele Sistemi Ferroviari, the Webegg Group and Banksiel. Enhanced overall efficiency, cost reductions and a focus on core business implemented principally by Finsiel beginning in 2002 improved profitability margins with regard to operating income (6.5% in 2003 compared with 4.8% in 2002).

Information Technology Group

The following table sets forth, for the periods indicated, certain financial and other data for the IT Group Operating Activity.

	Year ended December 31,	
Information Technology Group	**2002(1)**	**2003**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	996	1,100
Gross operating profit	98	96
% of gross operating revenues	9.8	8.7
Operating loss	(40)	(36)
% of gross operating revenues	(4.0)	(3.3)
Number of employees at year-end	5,039	4,107

(1) The 2002 financial and other data have been reclassified and presented consistent with the 2003 presentation.

Gross operating revenues increased by 104 million, or 10.4%, from 996 million in 2002 to 1,100 million in 2003 as a result of higher volumes of work on institutional projects for Corporate, such as the SAP Value Program and the development of the Group Portal, projects for the Wireline segment of Telecom Italia on Broadband, CRM and other innovative projects.

The contribution of the IT Group Operating Activity to our consolidated operating revenues was 59 million in 2002 and 41 million in 2003 as substantially all of the business done by this Operating Activity is for Telecom Italia Group companies.

Gross operating profit decreased by 2 million, or 2%, from 98 million in 2002 to 96 million in 2003 as a result of the increase in third party professional services (163 million) associated with higher levels of business activities, partially offset by a decrease in labor cost (4 million).

The operating loss improved by 4 million, or 10%, from 40 million in 2002 to 36 million in 2003 as a result of higher amortization and depreciation (an increase of 4 million) mainly related to capital expenditures made in the second half of 2002.

Olivetti Tecnost group

The following table sets forth, for the periods indicated, certain financial and other data for the Olivetti Tecnost group.

	Year ended December 31,	
Olivetti Tecnost group	**2002**	**2003**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	914	655
Gross operating profit	59	40
% of gross operating revenues	6.5	6.1
Operating income	4	2
% of gross operating income	0.4	0.3
Number of employees at year-end	4,527	2,395

Table of Contents

Gross operating revenues were 655 million in 2003, including 315 million from the Office Products Division, 179 million from the Systems Division and 161 million from other divisions. Such revenues were distributed as follows: 387 million referred to hardware products, 145 million referred to accessories and 123 million to services and others revenues. Gross operating revenues decreased by 259 million, or 28.3%, (down 14.4% net of the exchange rate effect and changes in scope of consolidation). Such decrease was principally attributable to the Office Products Division, following managements decision to reduce the sales of lower margin products and to the significant decrease in sales of Systems Divisions specialized printers in China and to the decrease in Other Divisions, principally the South America region.

The contribution of the Olivetti Tecnost Business Unit to our consolidated operating revenues was 906 million in 2002 and 637 million in 2003.

Gross operating profit and operating income were affected by the sharp reduction in gross operating revenues. Gross operating profit decreased from 59 million in 2002 to 40 million in 2003 and operating income decreased from 4 million in 2002 to 2 million in 2003.

Other Telecom Italia Group Activities

Our Other Activities principally consist of the TILAB Operating Activity, the companies managed by the International Affairs Corporate Function and the companies/Corporate Functions which provide centralized services to the our Business Units/Operating Activities/Companies. These activities are included within other Activities and Eliminations. See Business Unit Financial Data.

Real Estate and General Services

The activities managed by our Real Estate and General Services consisted of the following: to provide asset and property management services and to leverage the value of our real estate properties, to carry out the project design and work on properties and to provide project and facility management services.

As a result of the finalization of the Tiglio Project (See Item 4. Information on the Telecom Italia Group Description of Property), in February 2003, the Real Estate and General Services operating activity was eliminated and the related activities and resources were transferred to the Telecom Italia Purchasing Corporate Function.

The following table sets forth, for the periods indicated, certain financial and other data for the Real Estate and General Services.

	Year ended December 31,	
Real Estate and General Services	**2002**	**2003**

	(millions of Euro, except percentages and employees)	
Gross operating revenues	846	732
Gross operating profit	88	55
% of gross operating revenues	10.4	7.5
Operating loss	(92)	(76)
% of gross operating revenues	(10.9)	(10.4)
Number of employees at year-end	1,393	1,319

Gross operating revenues decreased by 114 million, or 13.5%, from 846 million in 2002 to 732 million in 2003. Such decrease was mainly due to the adjustment of internal charges to other Telecom Italia Group companies to match market rates and the rationalization of premises occupied by clients.

The contribution of Real Estate and General Services to our consolidated operating revenues was 32 million in 2002 and 28 million in 2003.

Gross operating profit decreased by 33 million, or 37.5%, from 88 million in 2002 to 55 million in 2003. Gross operating profit benefited from 81 million of costs savings arising from actions taken to contain operating costs (external charges and personnel costs) which partially offset the reduction in revenues.

Table of Contents

Operating loss improved by 16 million, or 17.4%, from 92 million in 2002 to 76 million in 2003.

Year ended December 31, 2002 compared with Year ended December 31, 2001.

Consolidated Operating Revenues

Our consolidated operating revenues decreased by 1.9% in 2002 compared to 2001. Organic growth was 3.1%, excluding the effect of changes in exchange rates and the effect of the change in the scope of consolidation. In particular, consolidated operating revenues were impacted by the disposition of the 9Télécom group and Sogei (which were consolidated only for the first six months of 2002), as well as by the disposition of the former Satellite Services Business Unit (the Telespazio group) starting from October 1, 2002.

Organic growth in revenues was due principally to:

- the positive contribution made by the Mobile Business Unit, and
- higher revenues from the Internet and Media segment.

These increases were offset in part by a reduction in the amount contributed by the Wireline Business Unit where traffic revenues, despite a 2.4% increase in terms of minutes, decreased by 8.3% as a result of a lower average return on traffic (retail and wholesale). Such decrease was only partially offset by the increase in basic subscription charges.

The table below sets forth, for the periods indicated, gross operating revenues and consolidated operating revenues by Business Unit and the percentage contribution of such Business Unit to our consolidated operating revenues.

	Year ended December 31,					
	2001(1)			2002(1)		
	Gross Operating Revenues(2)	Consolidated Operating Revenues(3)	% of Consolidated Operating Revenues	Gross Operating Revenues(2)	Consolidated Operating Revenues(3)	% of Consolidated Operating Revenues
	(millions of Euro, except percentages)					
Wireline(4)(5)	17,174	15,222	47.5%	17,047	15,112	48.1%
Mobile	10,250	9,963	31.1%	10,867	10,595	33.7%
South America(6)	1,534	1,531	4.8%	1,409	1,369	4.4%
Internet and Media	1,957	1,880	5.9%	1,991	1,900	6.0%
IT Market(5)	1,322	1,197	3.7%	1,039	926	2.9%
IT Group(5)	1,039	120	0.4%	996	59	0.2%
Olivetti Tecnost	1,097	1,076	3.4%	914	906	2.9%

Other activities(5)(7)	1,276	1,027	3.2%	1,574	541	1.8%
Total operating revenues	**35,649**	**32,016**	**100.0%**	**35,837**	**31,408**	**100.0%**

(1) 2001 and 2002 gross operating revenues and consolidated operating revenues for each major business units and our other activities have been reclassified and presented consistent with the 2003 presentation of gross operating revenues and consolidated operating revenues.

(2) Gross operating revenues are total revenues of our various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).

(3) Consolidated operating revenues are revenues recorded by each business area on a consolidated basis after elimination of intercompany sales.

(4) As of June 16, 2003, Domestic Wireline changed its name to Wireline.

(5) Starting from January 1, 2003, the Netikos group, the Webegg group, TILab, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNed is no longer included in Other Activities. TILab moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit.

(6) 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.

(7) The data include the operations of the International Affairs Corporate Function, TILab, the former 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 9Télécom group - sold in the third quarter of 2002 and for which only the statement of operation data was consolidated for the first six months of 2002, - as well as the finance companies, the centralized group services and the staff functions.

Table of Contents

The table below sets forth, for the periods indicated, consolidated operating revenues by geographic area and the percentage of total consolidated operating revenues:

	Year ended December 31,			
Geographic Area	**2001**		**2002**	
	(millions of Euro, except percentages)			
Italy	24,895	77.8%	25,029	79.7%
Rest of Europe	2,495	7.8%	2,665	8.5%
North America	1,088	3.4%	452	1.4%
Central and South America	2,759	8.6%	2,805	8.9%
Australia, Africa and Asia	779	2.4%	457	1.5%
Total consolidated operating revenues	**32,016**	**100.0%**	**31,408**	**100.0%**

Operating Expenses

The table below sets forth, for the periods indicated, total consolidated operating expenses by major components and expressed as a percentage of total consolidated operating revenues.

	Year ended December 31,			
	2001		**2002**	
	(millions of Euro, except percentages)			
Cost of materials	2,640	8.2%	2,315	7.4%
Other external charges	12,687	39.6%	12,188	38.8%
Personnel costs (salaries and social security contributions)	4,919	15.4%	4,737	15.1%
Changes in inventories	92	0.3%	62	0.2%
Capitalized internal construction costs	(583)	(1.8)%	(675)	(2.2%)
Depreciation and amortization	7,612	23.8%	7,227	23.0%
Total operating expenses	**27,367**	**85.5%**	**25,854**	**82.3%**

Our operating expenses decreased by 1,513 million or 5.5% in 2002 compared to 2001. The decrease was attributable to lower costs of materials, costs of external services rendered (included in other external charges), personnel costs and depreciation and amortization.

As a percentage of our operating revenues, operating expenses represented 85.5% and 82.3% in 2001 and 2002, respectively.

Cost of Materials

Cost of materials decreased by 325 million or 12.3% in 2002 compared to 2001, principally as a result of the effect of the changes in the exchange rates which impacted the Latin American companies and the effect of the change in the scope of consolidation (Telespazio and Sogei).

Other External Charges

The table below sets forth, for the periods indicated, consolidated other external charges broken down by major components.

	Year ended December 31,	
	2001	**2002**
Costs of external services rendered	9,782	9,407
Rents and lease payments	1,096	1,166
Provision for bad debts	448	546
Provision for risk	389	114
Write-downs of tangible and intangible fixed assets	17	58
TLC license fee	524	431
Other provisions and operating charges	431	466
Total other external charges	**12,687**	**12,188**

Table of Contents

Other external charges decreased by 499 million in 2002 compared to 2001 or 3.9%.

- Costs of external services rendered decreased by 375 million or 3.8% in 2002 compared to 2001. The decrease was principally due to continuing action taken to improve efficiency and the exit from the scope of consolidation of the Telespazio and 9Télécom groups and the company Sogei, partly offset by an increase in the costs of operating and developing mobile telecommunications services.

- Rents and lease payments increased by 70 million or 6.4% in 2002 compared to 2001, mainly due to higher costs incurred by TIM due to its continued expansion, partly offset by the effect of the change in scope of consolidation.

- The TLC license fee, which was principally payable to the Italian Government and was proportional to revenues, decreased by 93 million or 17.7% in 2002 compared to 2001 due to a reduction in both the revenue base and the rate (the aggregate rate for Old Telecom Italia and TIM declined from 2.5% in 2001 to 2.0% in 2002).

- Other provisions and operating charges, which included losses on disposals and write-offs of tangible and intangible fixed assets (36 million in 2002 compared to 29 million in 2001) and taxes other than income taxes (123 million in 2002 compared to 125 million in 2001), increased by 8.1% in 2002 compared to 2001.

Personnel Costs

Personnel costs decreased by 182 million or 3.7% to 4,737 million in 2002 from 4,919 million in 2001. The decrease was mainly due to the following:

- a decrease in Old Telecom Italia employee costs following layoffs in 2001 previously agreed with Old Telecom Italia s unions and continuing reductions in employee levels particularly at Old Telecom Italia; and

- the changes in the scope of consolidation described above. As a percentage of our operating revenues personnel costs declined to 15.1% in 2002 compared to 15.4% in 2001. Employees at December 31, 2002 numbered 106,620 (116,020 as of December 31, 2001). The breakdown is as follows:

	As of December 31,	
	2001	**2002**
Italy	94,234	86,286
Abroad	21,786	20,334
Total employees	**116,020**	**106,620**

The decrease of 9,400 employees compared to December 31, 2001 was mainly due to the net effect of changes in the scope of consolidation and the reduction related to lower levels of personnel, particularly at Old Telecom Italia (a decrease of 6,376 units from 61,081 units as of December 31, 2001 to 54,705 units as of December 31, 2002 - of which 1,086 units represented the balance of employees transferred to other Telecom

Italia Group companies).

The reduction due to the changes in the scope of consolidation is attributable to the following:

- exits of the 9Télécom group (a decrease of 1,003 units), the Telespazio group (a decrease of 1,168 units) and the companies Sogei and Consiel (a total decrease of 1,538 units); and

- the inclusion of Blu (an increase of 618 units) and the companies Netesi and EPIClink (a total increase of 168 units).

The dispute with INPS concerning the calculation of social security charges to be paid by the companies operating in Italy s telecommunications services of the Telecom Italia Group has been ongoing for many years.

In accordance with accepted accounting principles, a payable for an amount equivalent to the minimum estimated liability was initially recorded in the Telecom Italia (formerly Olivetti) Group s consolidated financial statements at the time of the allocation of the excess of purchase of the Old Telecom Italia acquisition in June 1999. At December 31, 2002, Old Telecom Italia s potential range of liability for principal contribution was estimated to be between 964 million and 1,289 million, of which 409 million had already been paid (for more details see Item 8. Financial Information Legal Proceedings).

142

Table of Contents

Capitalized Internal Construction Costs

Capitalized internal construction costs increased from 583 million in 2001 to 675 million in 2002 (or a 15.8% increase) principally due to higher levels of capital expenditures spent on products and services purchased from subsidiaries.

Gross Operating Profit

The table below sets forth, for the periods indicated, our Gross Operating Profit (see Business Unit Financial Data Note 7 for the calculation of Gross Operating Profit) and gross operating margin.

	Year ended December 31,			
	2001		2002	
	(millions of Euro, except percentages)			
Gross Operating Profit	13,655	42.7%	14,015	44.6%

Gross Operating Profit increased by 360 million or 2.6% in 2002 compared to 2001. The overall increase in Gross Operating Profit was positively impacted by the reduction in costs of external services rendered and cost of materials due to continuing action taken to improve efficiency, as well as lower personnel costs taken together with the modest increase in consolidated operating revenues. The increase in Gross Operating Profit was adversely impacted by the negative effect of the changes in exchange rates and changes in the scope of consolidation. Gross operating margin increased to 44.6% in 2002 from 42.7% in 2001.

Depreciation and Amortization

Depreciation and amortization which was recorded on a straight line basis over the estimated useful lives of the assets, decreased by 385 million or 5.1% from 7,612 million in 2001 to 7,227 million in 2002.

Depreciation of tangible fixed assets decreased by 273 million or 6.7% from 4,080 million in 2001 to 3,807 million in 2002. The decrease in depreciation of tangible fixed assets was principally due to a reduction in the depreciation expense of Old Telecom Italia (251 million), owing to a lower amount of depreciable assets and a change in the mix of depreciable assets.

Amortization of intangible assets decreased by 112 million or 3.2% from 3,532 million in 2001 to 3,420 million in 2002 as a result of the following:

- amortization of goodwill decreased by 143 million from 2,294 million in 2001 to 2,151 million in 2002. The decrease in amortization of goodwill was mainly due to the write-downs of goodwill recorded in 2001. At December 31, 2002 goodwill decreased by 3,993 million (from 31,887 million as of December 31, 2001 to 27,894 million as of December 31, 2002), mainly as a result of the amortization described above as well as the extraordinary write-downs of goodwill on consolidated subsidiaries recorded in 2002 (1,769 million, of which 1,544 million related to Seat Pagine Gialle);

- amortization of intangible assets (other than goodwill) amounted to 1,269 million in 2002 (1,238 million in 2001) and was mainly related to software for telecommunications services.

Operating Income

The table below sets forth, for the periods indicated, our operating income (total revenues less total operating expenses, including depreciation and amortization and other charges).

	Year ended December 31,	
	2001	**2002**
	(millions of Euro)	
Operating income	5,125	6,058

Our operating income increased by 933 million or 18.2% in 2002 compared to 2001. The increase in operating income was mainly attributable to the improvement in gross operating profit described above and the decrease in depreciation and amortization. As a percentage of operating revenues, operating income increased from 16.0% in 2001 to 19.3% in 2002.

Table of Contents

Financial Income, Financial Expense, and Other Income and Expense, Net

The table below sets forth, for the periods indicated, the components of financial and other income and expense, net.

	Year ended December 31,	
	2001	2002
	(millions of Euro)	
Financial income	1,446	1,569
Financial expense	(6,559)	(4,647)
of which writedowns and equity in losses in affiliated and other companies, net	*(1,771)*	*(487)*
Other income and (expense), net	(3,109)	(5,496)
Total financial expense, net and other income and expense, net	**(8,222)**	**(8,574)**

Total financial expense, net and other income and expense, net increased from a net expense of 8,222 million in 2001 to a net expense of 8,574 million in 2002, a 4.3% increase.

Financial income increased by 123 million or 8.5%. The growth was principally due to the increase in gain on foreign exchange (251 million) and income on hedging contracts, partly offset by the decrease in capital gain on sale and other income from equity investments.

Financial expense decreased by 1,912 million or 29.2%. The decrease was attributable principally to the following:

- a decrease in interest expense, from 2,430 million in 2001 to 2,241 million in 2002, due to lower average borrowings outstanding during 2002 as well as lower interest rates and fees;
- the reduction in net write-downs and equity in losses in affiliated and other companies (1,284 million), mainly as a result of:
  - the reduction of 236 million in amortization of goodwill in companies accounted for using the equity method (80 million in 2002 compared to 316 million in 2001) principally due to write-downs of goodwill recorded in 2001;
  - the decrease of 1,048 million in valuation adjustments to the Telecom Italia Group s share of equity in the earnings and losses of equity investees and other net write-downs (a loss of 407 million in 2002 compared to a loss of 1,455 million in 2001). The 2002 valuation adjustments were related to the losses of Sky Italia (formerly Stream) of 246 million (241 million in 2001), of Aria Is Tim of 171 million (334 million in 2001) and the earnings balance of 10 million relating to the earnings (losses) of the other companies.

These decreases were offset in part by:

- the increase in losses on foreign exchange (905 million in 2002 compared to   392 million in 2001) due to the negative performance of the rates of exchange which impacted certain Latin American companies, in particular the companies in Venezuela and Brazil.

In 2001, financial expense was also affected by the negative results of the investments in the Nortel Inversora group (238 million) and in the Auna group (203 million) and the write-down of Astrolink (259 million) by Telespazio as the related project was interrupted. The investment in the Nortel Inversora group, the carrying value of which was written-off in the consolidated financial statements at December 31, 2001, remained unchanged in 2002. In 2003 the investment was transferred to Sofora.

Other income and expense, net increased from a net expense of   3,109 million in 2001 to a net expense of   5,496 million in 2002. This significant increase (2,387 million) was mainly due to the increase in provisions and write-downs of goodwill and equity investments (3,600 million), partly offset by the increase in gains on the disposal of equity investments, tangible and intangible assets (2,088 million), as described below.

- In 2002, provision and write-downs of goodwill and equity investments amounted to   6,584 million and included the following:

  - write-down of the equity investment held in Aria Is Tim (1,491 million) and provision to the reserve for risks and charges related to Aria Is Tim (850 million) for the guarantees provided by the Old Telecom Italia Group to the creditors of Aria Is Tim and the loans provided directly by the Old Telecom Italia Group to Aria Is Tim. At that time, Old Telecom Italia concluded that the value of its investments was permanently impaired, since, starting from the awarding of the license, some measures which should have fostered effective competition and guaranteed the full operability of the new entrant, had not effectively taken place;

- write-down of Seat Pagine Gialle goodwill (1,544 million) and accrual for the forward purchase commitments of Seat Pagine Gialle shares (1,942 million). The write-down and the provision were made on the basis of the average Seat Pagine Gialle ordinary shares based on trading on the Italian Stock Exchange over the second half of 2002;
- provisions made in conjunction with the disposal of the investment in the 9Télécom Group (316 million);
- reserve provision (43 million), made by Seat Pagine Gialle, for estimated losses arising from the exercise of put options by the founding shareholders of Consodata S.A.; and
- other write-downs of investments for 46 million and of goodwill for 321 million (of which: 103 million for Blu, 75 million for Digitel, 96 million for Netco Redes and 47 million for other minor companies).

- In 2001, provision and write-downs of goodwill and equity investments amounted to 2,984 million and consisted of the following:
  - 1,303 million for the write-down of goodwill relating to consolidated companies (9Télécom group, Entel Bolivia, Entel Chile group, Maxitel group, Tele Celular Sul group, Tele Nordeste Celular group, Tim Brazil, Med-1 group and certain companies in the Seat Pagine Gialle group);
  - 1,078 million for the write-down of goodwill relating to companies accounted for by the equity method (GLB Serviços Interativos, Solpart Participaçoes, Telekom Austria and the Nortel Inversora group); and
  - 603 million for other provisions relating to equity investees.
- In 2002, restructuring costs amounted to 494 million (of which 379 million was attributable to Old Telecom Italia) and were related to expenses and provisions for employee cutbacks and layoffs. This compared to restructuring costs of 400 million in 2001 (of which 203 million attributable to Old Telecom Italia) also related to expenses and provisions for employee cutbacks and layoffs.
- In 2002, accrued interests on the liability to INPS related to the former Telephone Employees Pension Fund (FPT) amounted to 79 million. In 2001, accrued interests on the liability to INPS related to the former Telephone Employees Pension Fund (FPT) amounted to 84 million.
- In 2002, gains on the disposal of equity investments, tangible and intangible assets (2,553 million) arose from:
  - the sale of the 26.89% interest in Auna, the Spanish telecommunication companies in which Old Telecom Italia was a joint venture partner and equity holder (1,245 million);
  - the sale of the 19.61% interest in Bouygues Décaux Télécom (484 million), a French telecommunications company;
  - the acceptance of the tender offer for Lottomatica shares by the Old Telecom Italia Group (133 million) and by Olivetti and Olivetti International (overall 107 million);

- the sale of our 25% interest in the Mobilkom Austria group, one of the Austrian mobile operators (115 million);
- the sale of our 40% interest held in Telemaco Immobiliare (110 million);
- the sale of our 100% interest held in Telespazio, the Group s former satellite operator (70 million);
- the concentration of the real-estate assets through the companies IM.SER, Emsa and Telimm into Tiglio I (159 million);
- the transfer of Old Telecom Italia s Asset Management unit to Tiglio II (60 million);
- the transfer by Old Telecom Italia of its real estate services businesses (excluding facilities management) to the Pirelli & C. Real Estate Group (15 million);
- the sale of the 100% interest held in OMS2 to Tiglio I (26 million); and
- the disposal of other equity investments, fixed assets and business segments (29 million).

Table of Contents

- In 2001, gains on the disposal of equity investments, tangible and intangible assets (465 million) arose from the sale of the 70% holding in Mirror International Holding, the company through which the satellite companies were contributed to the Lehman Brothers group (170 million) and the 30% holding in Mediterranean Nautilus S.A. to the Israeli company F.T.T. Investment (94 million), the dilution of the investment in Auna (16 million) and the increase in the net equity of Lottomatica as a result of the capital increase set aside for third parties when it was listed (64 million), the sale of the residual equity investment in Globespan Virata Corp. (43 million), and other minor disposals (78 million).

- In 2002, other, net (892 million net charges) included:

  - income arising from the recovery of pre-amortization interest on the expenses for employee benefit obligations under Law 58/1992 that were paid, with reserve, to INPS up to 1999 following the termination of litigation after the courts ruled in Old Telecom Italia s favor (131 million);

  - the release of reserves (98 million), primarily set up in 2001 by Old Telecom Italia to cover the expenses connected with the agreement to sell Stream to News Corporation and Vivendi Universal/Canal+ after the agreement was terminated;

  - losses from the sale of a 15% stake in Telekom Austria (135 million) and the sale of the equity investment in Seat P.G. held by Olivetti (62 million);

  - expenses connected with the disposal of equity investees (239 million);

  - the extraordinary contributions to INPS established by the year 2000 Italian Budget for the three years 2000-2002 to meet the higher financial requirements covered by the rules of the Fondo Previdenza Telefonici (FPT) that was abolished and became part of the general Employee Pension Fund (74 million);

  - write-downs of tangible and intangible fixed assets (190 million, of which 142 million related to the Brazilian companies);

  - provisions to the reserves for risks and charges (226 million, of which 135 million for guarantees provided for the disposals of equity investments and business segments);

  - adjustment to Old Telecom Italia s payable to customers relating to telephone prepaid cards (158 million);

  - other losses on disposals of equity investments, tangible and intangible fixed assets (39 million); and

  - other miscellaneous expenses, net (29 million).

- In 2001, other, net (106 million net charges) included:

  - income from the release of reserves by Old Telecom Italia recorded in prior years for risks which did not materialize (120 million mainly relating to the reserve for a contract with Iraq of 62 million and the reserve for corporate restructuring of 50 million);

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income (32 million) deriving from the partial cancellation, by the Council of State, of resolution No. 7533/1999 of the Antitrust Authority under which TIM and Vodafone Omnitel were levied administrative fines for the alleged violation of antitrust laws relating to the price fixing of fixed-mobile rates;

- the provision for expenses connected with the Vivendi/Canal Plus agreement for the transfer of the investment in Sky Italia (formerly Stream) (248 million);
- the extraordinary contributions to INPS established by the 2000 Finance Bill for the three years 2000-2002 to meet the higher financial requirements covered by the rules of the Fondo Previdenza Telefonici (FPT) that was abolished and became part of the general Employee Pension Fund (77 million); and
- the costs resulting from the decision to reposition the broadcasting station La7 as a consequence of the closing of a series of contracts (85 million).

Income Taxes

Income taxes represented a benefit of 2,210 million in 2002 compared to a tax expense of 579 million in 2001. The Group s statutory income tax rate for 2002 and 2001 was 36%.

146

Table of Contents

The 2002 decrease in income taxes 2,789 million was due to a reduction in the taxable base caused mainly by the write-downs of equity investments which involved an increase in prepaid income taxes, as well as to certain tax benefits arising from the merger of Blu into TIM.

Net Income (loss)

Net loss before minority interests decreased from a net loss of 3,676 million in 2001 to a net loss of 306 million in 2002. The decrease in net loss before minority interests in 2002 was principally attributable to the income tax benefit in 2002, together with the increase in operating income and the reduction in total financial expense, net, offset in part by the increase in other expense, net. Net loss after minority interests was 773 million in 2002 compared to a net loss of 3,090 million in 2001. Minority interests decreased from a benefit of 586 million in 2001 to a loss of 467 million in 2002 mainly due to higher levels of profit at Old Telecom Italia Group (which reported net income in 2002 compared to a net loss in 2001).

Results of Operations of Business Units for the Year Ended December 31, 2002 compared to the Year Ended December 31, 2001.

Wireline

The following table sets forth, for the periods indicated, certain financial and other data for the Wireline Business Unit.

	Year ended December 31,	
	2001(1)	**2002(1)**
Wireline	**(millions of Euro, except percentages and employees)**	
Gross operating revenues	17,174	17,047
Gross operating profit	7,730	7,951
% of gross operating revenues	45.0	46.6
Operating income	4,338	4,677
% of gross operating revenues	25.3	27.4
Number of employees at year-end	58,112	53,935

(1) The 2001 and 2002 financial and other data have been reclassified and presented consistent with the 2003 presentation.

The following table sets forth for the periods indicated certain statistical data for Wireline.

	Year ended December 31,	
	2001	2002
Subscription and Customers:		
Subscriber fixed lines at period-end in Italy (thousands)(1)	27,353	27,142
Subscriber fixed line growth per annum in Italy (%)	0.7	(0.8)
ISDN equivalent lines at period-end in Italy (thousands)(2)	5,403	5,756
Broadband Access in Italy and abroad (ADSL + XDSL) (thousands)(3)	390	850
Voice Offers in Italy (thousands)(4)	4,094	5,224
Wireline Traffic:		
Wireline total traffic (Retail and Wholesale) (billion of minutes)	209.8	214.9
of which:		
National(5)	201.1	204.7
International(6)	8.7	10.2
Retail Traffic(7):		
Average minutes of use per fixed line subscriber in Italy during period(8)	4,739	4,292
of which:		
Local traffic during period (in average minutes)(9)	3,575	3,198
Long distance traffic during period (domestic and international) (in average minutes)	1,164	1,094

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

147

Table of Contents

(2) Data exclude internal lines.
(3) Number of contracts.
(4) Number of contracts; includes Teleconomy, Hellò and other Business voice offers.
(5) Data include total retail traffic (international outgoing traffic excluded) and total domestic wholesale traffic.
(6) Data include international retail outgoing traffic and total international wholesale traffic.
(7) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls and calls to mobile phones.
(8) Includes total retail fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).
(9) Includes district and internet dial-up traffic.

The Wireline Business Unit accounted for gross operating revenues of 17,047 million in 2002 and 17,174 million in 2001, a decrease of 127 million, or 0.7%. The small decrease in revenues in 2002 is attributable to a decrease in Retail Telephone revenues only partially offset by an increase in VAS (Value Added Services) revenues. Internet and Data revenues were largely unchanged despite significant growth in ADSL revenues in 2002 compared to 2001.

Retail Telephone. Revenues from Retail Telephone were 10,547 million in 2002, a decrease of 446 million, or 4.1% compare to 10,993 million in 2001.

Traffic revenues decreased significantly by more than 12% compared to 2001 due to the continuing decline in prices and lower volumes of 11% compared to 2001. Prices decreased as a result of commercial policies aimed at customer retention with offers such as Teleconomy which provide discounted tariffs with a monthly fee and competition. In addition, further reductions in traffic tariffs were only partially offset by an increase in subscription fees due to the price cap system (adjustments in subscription fees were made on July 1, 2001 and February 1, 2002). Traffic volumes in Retail Telephone decreased as a result of the substitution effect of fixed to mobile traffic (long distance traffic) and competition (local and international outgoing traffic).

The Wireline Business Unit during 2002 began implementing strategies to limit the impact of competition and revenue losses. These strategies slowed further market share losses. Market share on retail traffic volumes voice and on line internet traffic -, at December 31, 2002 was 71.4% in line with December 31, 2001 (72.1%) although market share on voice traffic at December 31, 2002 was 72.8% compared with 75.8% at December 31, 2001.

This result reflected retention and win back policies supported by new Teleconomy offers, combined with selective marketing strategies for high value customers. Flat Voice Offers (Teleconomy offers and other business customized offers) had 5.2 million users at the end of 2002 compared to 4.1 million users at the end of 2001.

Retail Internet. Revenues from Retail Internet were 595 million in 2002 and 599 million in 2001. Growth in ADSL revenues (89 million in 2002 and 9 million in 2001), mainly due to growth in the customer base offset the decrease in on line dial-up traffic revenues which decreased due to reduction in volumes and prices (competition and ADSL substitution).

Data Business. Revenues from Data Business were 1,443 million in 2002, an increase of 1.0% over 2001 (1,429 million in 2001). Growth in services revenues was driven mainly by innovative data services while revenues in traditional data services, leased lines and equipment decreased mainly due to substitution for innovative services and price reductions in leased lines.

Retail Value Added Services (VAS). Revenues from VAS were 990 million in 2002 and increased by 24.4% over 2001 (796 million in 2001). Retail Value Added Services (VAS) increased due to the introduction of new services for all Wireline customers such as Web Services, Outsourcing and Security for Business customers and SMS (short messages from fixed telephone), Memotel (centralized mail box) and Chi é (identification of calling number) for residential customers.

Wholesale Services. Revenues from Wholesale Services were 3,269 million in 2002 and 3,175 million in 2001, a 3.0% increase. Such growth was mainly due to International Wholesale Services, which recorded a significant increase in revenues mainly due to higher volumes. Domestic Wholesale revenues increased mainly in XDSL services and in Traffic revenues, principally due to volume growth in all categories of traffic.

The number of fixed line subscribers in Italy decreased by 0.8% to approximately 27,142 million at December 31, 2002 representing a telecommunications density (fixed line subscribers to total population of Italy) of approximately 48% at December 31, 2002, which remained unchanged compared to December 31, 2001. Such decrease takes into account the increase in ISDN lines (5,403,000 lines at the end of 2001 and 5,756,000 lines at the end of 2002).

The contribution of the Wireline Business Unit to our consolidated operating revenues amounted to 15,222 million in 2001 and 15,112 million in 2002.

Despite the revenue decline, Gross operating profit increased from 7,730 million in 2001 to 7,951 million in 2002, a 2.9% increase compared to 2001, due to significant reductions in personnel costs as well as expenses reduction resulting from an efficiency plan that brought savings in discretionary operating expenses of approximately 500 million.

Gross operating margin improved by 1.6%, from 45.0% in 2001 to 46.6% in 2002 as cost savings made up for the small decline in revenues.

Operating income increased from 4,338 million in 2001 to 4,677 million in 2002, as a result of efforts to contain costs and improve the level of efficiency of invested capital.

Operating margin increased to 27.4% in 2002 compared with 25.3% in 2001, also due to a significant reduction in depreciation and amortization.

Mobile

The following table sets forth, for the periods indicated, certain financial and other data for Mobile.

Mobile	Year ended December 31, 2001	Year ended December 31, 2002
	(millions of Euro, except percentages and employees)	
Gross operating revenues	10,250	10,867
Gross operating profit	4,760	5,039
% of gross operating revenues	46.4	46.4

Operating income	3,136	3,358
% of gross operating revenues	30.6	30.9
Number of employees at year-end	16,721	18,702

The following table sets forth for the periods indicated, certain statistical data for TIM.

	Year ended December 31,	
	2001	2002
TIM lines at period-end (thousands)	23,946	25,302
TIM lines growth per annum (%)	10.9	5.7
Average revenue per mobile line per month ( )(1)	29.1	28.8
Cellular penetration at period-end (TIM customers per 100 inhabitants)(%)	41.6	43.9
Cellular market penetration at period-end (customers for the entire market per 100 inhabitants)(%)	89.0	93.7
Total mobile outgoing traffic per month (millions of minutes)	1,795	1,960

(1) Including Prepaid Customers revenues and non TIM customer traffic and excluding equipment sales.

Gross operating revenues from mobile services increased by 6% in 2002 compared to 2001, despite the impact of adverse exchange rates which affected certain companies included in the Mobile Business Unit in Latin America, in particular Venezuela and Brazil. Excluding the effect of changes in exchange rates, organic growth of revenues would have been 11.9% compared to 2001.

This increase was primarily due to TIM s performance in the Italian market (an increase of 6.7%), despite increasing competition, and was mainly attributable to the increase in revenues relating to value added services,

149

with some contribution from international companies. In particular, operating revenues of STET Hellas were approximately 689 million in 2002, a 31.7% increase compared to 2001 mainly due to growth of outgoing traffic and value added services. The number of mobile lines at STET Hellas increased 17.8%.

The contribution of the Mobile Business Unit to our consolidated operating revenues was 9,963 million in 2001 and 10,595 million in 2002.

Gross operating profit was 5,039 million in 2002, up 279 million, or 5.9% as compared to 2001. The gross operating margin however remained flat at 46.4%. Excluding the effect of changes in exchange rates, the growth in Gross Operating Profit would have been 8.6% and is mainly attributable to the good performance of TIM and STET Hellas as well as improved results of TIM Perù, partially offset by the start-up costs of certain Latin American companies.

Operating income was 3,358 million in 2002, an increase of 222 million, or 7.1%, compared to 2001.

Operating margin improved from 30.6% in 2001 to 30.9% in 2002. Growth in operating income is mainly attributable to the increase in gross operating profit.

TIM (parent company)

TIM, which during 2002 merged Blu S.p.A., the fourth Italian GSM operator effective as of January 1, 2002, had operating revenues in 2002 of 9,022 million, an increase of 8.0% over 2001 (8,915 million net of the merger impact, representing an increase of 6.7% over 2001). Revenues from services increased by 6.5% (net of the merger impact) with the same percentage of 2001 on total revenues (94.3%). The impact of lower prices was more than offset by greater traffic in minute terms (an increase of 7.8%).

TIM lines increased to 25,302,000 lines at December 31, 2002, a 5.7% increase compared to December 31, 2001. TIM s total GSM lines increased by 9.4% in 2002, to 24,307,000 lines at December 31, 2002, while TIM s total TACS lines decreased by 42.6% in 2002, to 995,000 lines at December 31, 2002, in each case compared to December 31, 2001. Due to termination of the TACS services, customer transfer was taking place to TIM s GSM service. Approximately 96% of TIM s lines in 2002 were GSM lines. The continuing significant growth in GSM lines was attributable principally to the continuing growth of the GSM TIM Card (a prepaid rechargeable GSM card), which had 21,622 thousand lines by December 31, 2002 compared to 19,674 thousand lines at December 31, 2001. Prepaid lines grew by 6.3% in 2002.

At December 31, 2002, TIM had a market share in Italy of approximately 46.1% (including TACS and GSM) compared to 46.7% at December 31, 2001, and a market share of approximately 45.1% for GSM only compared to 44.8% in 2001. The overall market grew by 6.8% in 2002 from 51.3 million lines at the end of 2001 to 54.8 million lines at the end of 2002. The aggregate number of customers at December 31, 2002 for TIM s analog and GSM services represented a penetration rate of 43.9% compared to 41.6% at December 31, 2001.

In 2002, TIM traffic volumes increased by 7.8% in terms of minutes and mobile traffic revenues (net of the Blu merger impact) increased by 3.5% in 2002 compared to 2001 (6,845 million in 2002 against 6,613 million in 2001). The net increase in lines (up 5.7% compared to 2001) was partially offset by the continuing decline in ARPU due to increasing competitive pressures and the effect on prices. ARPU per mobile line (which includes traffic revenues and subscription fees) decreased from approximately 29.10 in 2001 to 28.80 in 2002 (including visitors).

TIM revenues from equipment sales increased by 9.3% in 2002 compared to 2001 (505 million net of Blu against 462 million in 2001) as a result of the launch of Multimedia Messaging Services (MMS services) and TIM customers upgrading their phones to be able to utilize such services. Mobile subscription fees decreased by 5.6% in 2002 compared to 2001 (203 million against 215 million in 2001) due to the continuing sharp expansion in the prepaid service customer base, where no subscription fees are paid.

TIM revenues from VAS (752 million in 2002 net of Blu) increased by 41.4% compared to 2001. Due to the continuing introduction of new services and the particular success of SMS services, the VAS business grew significantly with revenues from value added services representing 8.9% of services revenues and 8.4% of total revenues in 2002, compared to 6.7% and 6.4%, respectively in 2001. In 2002, TIM actively marketed the increase in use of VAS through promotional campaigns.

The TIM churn rate, as a result of increased competition, rose to 1.5% per month, up from the 1.3% rate recorded in 2001.

Table of Contents

In 2002, TIM gross operating profit was 4,404 million. Excluding a loss of 125 million due to the merger effect, gross operating profit was 4,529 million, an increase of 7.2% compared with the previous year (4,225 million) as a result of the increase in operating revenues and the actions taken for the containment of operating costs. Excluding the merger impact, gross operating margin was 50.8% (50.6% in 2001).

In 2002, TIM operating income was 3,153 million. Excluding a loss of 170 million due to the merger impact, operating income was 3,323 million, a 2.8% increase compared with 2001. Excluding the merger impact, operating margin was 37.3% in 2002 and 38.7% in 2001.

TIM operating income was impacted by the increase in depreciation and amortization, as a result of the following:

- the amortization only for fiscal purposes of the UMTS license (121 million gross of tax effects of 49 million);

- the higher depreciation of fixed assets (an increase of 53 million) due to the revision of the estimate of the useful life of the depreciable assets.

Mobile Latin America

The following table sets forth for the periods indicated certain financial and other data for Mobile Business Unit in Latin America, coordinated at that time by Latin American Operations.

Mobile Latin America	Year ended December 31, 2001(1)	2002
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,403	1,298
Gross operating profit	355	274
% of gross operating revenues	25.3	21.1
Operating loss	(72)	(98)
% of gross operating revenues	(5.1)	(7.6)

Number of employees at year-end	5,678	7,050

(1) The 2001 financial and other data have been reclassified and presented consistent with the 2002 presentation.

The gross operating revenues of the Mobile Business Unit in Latin America were 1,298 million in 2002 compared with 1,403 million in 2001, a decrease of 7.5%. The decrease was mainly due to the weakening of the Brazilian and Venezuelan currencies against the Euro.

Gross operating profit was 274 million, a decrease of 81 million, or 22.8%, compared to 2001, mainly due to the start-up costs of certain companies.

Operating loss was 98 million in 2002 compared to an operating loss of 72 million in 2001.

Table of Contents

South America

The following table sets forth, for the periods indicated, certain financial and other data for the Entel Chile group, the Entel Bolivia group, the company Telecom Italia America Latina and the South America business segment of Telecom Italia. Certain financial and other data of the Mobile Business Unit in Latin America are described in the section pertaining to the Mobile Business Unit.

	Year ended December 31,	
	2001(1)	2002
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,534	1,409
Gross operating profit	527	450
% of gross operating revenues	34.4	31.9
Operating income	187	146
% of gross operating revenues	12.2	10.4
Number of employees at year-end	5,746	5,461

(1) The 2001 financial and other data have been reclassified and presented consistent with the 2002 presentation.

Gross operating revenues were 1,409 million in 2002, a decrease of 8.1% compared to 2001. The decrease was mainly due to the adverse effect of the change in exchange rates (a decrease of 212 million, of which 182 million related to the Chilean peso and 29 million to the Bolivian currency). On a constant currency basis, gross operating revenues would have increased by 5.7%, primarily due to an increase in the revenues of the Entel Chile group (+12.3% in local currency). This was partially offset by the effects of deregulation in the Bolivian market (Entel Bolivia reported a reduction in revenues of approximately 4.5% in local currency). In addition, revenues also declined due to the suspension as of April 1, 2002 of the management fee under the terms of the contract with Telecom Argentina. Due to general economic conditions in Argentina, Telecom Argentina experienced significant financial difficulties, suspending payment of its outstanding debt and began restructuring its outstanding debt during 2002.

The contribution of South America Business Unit to our consolidated operating revenues was 1,531 million in 2001 and 1,369 million in 2002, respectively.

The fluctuations in exchange rates adversely affected profitability. In particular, gross operating profit decreased by 77 million, or 14.6%, compared to 2001, of which approximately 65 million was attributable to the weakening of local currencies against the Euro. Excluding the exchange effects, the reduction in gross operating profit would have been 2.3%, due primarily to the suspension of the management fee from Telecom Argentina and the lower profit margins in Bolivia partially offset by a recovery in profit margins in the Chilean mobile sector. As a percentage of revenues, gross operating profit was 31.9% in 2002 and 34.4% in 2001.

Operating income is consistent with the trends described with regard to gross operating profit. As a percentage of revenues, in 2002 operating income was 10.4% in 2002 compared to 12.2% in 2001.

Table of Contents

In order to give an overall view of Latin America Operations (LAO), the following table sets forth, for the periods indicated, certain financial and other data for all the companies operating in South America, providing both wireline and mobile phone services.

South America	Year ended December 31, 2001(1)	2002
	(millions of Euro, except percentages and employees)	
Gross operating revenues	2,937	2,706
Gross operating profit	882	724
% of gross operating revenues	30.0	26.8
Operating income	115	48
% of gross operating revenues	3.9	1.8
Number of employees at year-end	11,424	12,511

(1) The 2001 financial and other data have been reclassified and presented consistent with the 2002 presentation.

Internet and Media

The following table sets forth, for the periods indicated, certain financial and other data for the Internet and Media business unit (the SEAT group). As described above, due to the disposition of New SEAT following the demerger transaction completed in August 2003 this business unit has changed significantly and the discussion of 2002/2001 results will not be comparable to 2003. See Results of Operations for the Three Years Ended December 31, 2003 Results of Operations of Business Units for the Year Ended December 31, 2003 compared with the Year Ended December 31, 2002 Internet and Media .

Internet and Media	Year ended December 31, 2001(1)	2002
	(millions of	

Euro, except percentages and employees)		
Gross operating revenues	1,957	1,991
Gross operating profit	444	593
% of gross operating revenues	22.7	29.8
Operating income	31	232
% of gross operating revenues	1.6	11.7
Number of employees at year-end	9,264	7,715

(1) The 2001 financial and other data have been reclassified and presented consistent with the 2002 presentation.

Gross operating revenues increased by 1.7% from 1,957 million in 2001 to 1,991 million in 2002. The Directories business area made the largest contribution to growth with the related revenues increasing by 3.4%.

The contribution of the Internet and Media Business Unit to our consolidated operating revenues amounted to 1,880 million in 2001 and 1,900 million in 2002.

Gross operating profit increased by 33.6% to 593 million (with a gross margin of 29.8%), while operating income increased to 232 million in 2002 compared to 31 million in 2001. These improvements were achieved, despite the poor advertising market, due to implementation of rationalization measures and the improvements achieved in efficiency, especially in the Internet, Directories and Directory Assistance areas (which together represented 73% of combined revenues). In 2002, for the first time, all the business areas made a positive contribution to the consolidated Gross Operating Profit (with the sole exception of television, where reduced losses were recorded compared to 2001).

Table of Contents

Total Internet users grew from 5 million at the end of 2001 to 6.6 million at the end of 2002, of which 2.2 million remained active after 45 days. Average connection time increased by 5.6% in 2002 compared to 2001.

Information Technology Market

The following table sets forth, for the periods indicated, certain financial and other data for the IT Market Business Unit. In order to allow a better understanding of the results of the business managed by the business unit, the figures are presented on an historical and pro forma basis.

	Year ended December 31,			
Information Technology Market	**2001(1)**	**2001 Pro forma(2)**	**2002(1)**	**2002 Pro forma**
	(millions of Euro, except percentages and employees)			
Gross operating revenues	1,322	818	1,039	777
Gross operating profit	181	121	114	86
% of gross operating revenues	13.7	14.8	11.0	11.1
Operating income	133	85	64	37
% of gross operating revenues	10.1	10.4	6.2	4.8
Number of employees at year-end	7,454	5,374	5,506	5,031

(1) The 2002 and 2001 historical financial and other data are consistent with the 2003 scope of consolidation.
(2) The 2001 and 2002 pro forma financial and other data are consistent with the 2003 scope of consolidation.

Gross operating revenues decreased due to a contraction in the revenues of Finsiel, Banksiel and the Webegg Group, resulting from lower volumes, reduction in prices on some contracts which renewed during the year 2002 and lower contract prices on new bids won in 2002.

The contribution of the IT Market Business Unit to our consolidated operating revenues was 1,197 million in 2001 and 898 million in 2002 (historical).

Gross operating profit decreased due to the reduction in prices mentioned above, that were only partly offset by cost cuts and improved level of efficiency.

Information Technology Group

The following table sets forth, for the periods indicated, certain financial and other data for the IT Group Operating Activity.

Information Technology Group	Year ended December 31, 2001(1)	2002
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,039	996
Gross operating profit	198	98
% of gross operating revenues	19.1	9.8
Operating income (loss)	51	(40)
% of gross operating revenues	4.9	(4.0)
Number of employees at year-end	5,127	5,039

(1) The 2001 financial and other data have been reclassified and presented consistent with the 2002 presentation.

Gross operating revenues declined 4.1% from 2001 to 2002 and were mainly affected by a reduction in prices on the services rendered principally to the Wireline Business Unit, continuing with the price reduction policy of the previous year.

The contribution of the IT Group Operating Activity to our consolidated operating revenues was 120 million in 2001 and 59 million in 2002.

Table of Contents

Gross operating profit decreased by 50.5% from 198 million in 2001 to 98 million in 2002. Operating income decreased by 91 million from operating income of 51 million in 2001 to an operating loss of 40 million in 2002.

The decrease in profitability reflects the aforementioned reduction in prices as well as an increase in use of outside services and labor costs.

In 2002, operating loss was also impacted by higher levels of amortization of software licenses as a result of acquisitions made during the year.

Olivetti Tecnost Group

The following table sets forth, for the periods indicated, certain financial and other data for the Olivetti Tecnost group Business Unit.

Olivetti Tecnost Group	**Year ended December 31, 2001**	**2002**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	1,097	914
Gross operating profit	57	59
% of gross operating revenues	5.2	6.5
Operating income	4	4
% of gross operating revenues	0.4	0.4
Number of employees at year-end	4,896	4,527

Gross operating revenues were 914 million in 2002, including 340 million from the Office Products Division, 256 million from the Systems Division and 318 million from other divisions. Such revenues were distributed as follows: 588 million referred to hardware products, 154 million referred to accessories, 73 million referred to services and 99 million referred to other revenues. Gross operating revenues decreased by 16.7% (down 12.7% net of exchange rate effect) from 1,097 million in 2001 to 914 million in 2002. Such decrease was primarily attributable to the office products division where third-party revenues fell sharply (down 19%) and to a lesser extent to the vertical applications division where third-party revenues also fell (down 11.6%).

The contribution of the Olivetti Tecnost Business Unit to our consolidated operating revenues was 1,076 million in 2001 and 906 million in 2002.

Gross operating profit increased from 57 million in 2001 to 59 million in 2002 due to a reduction in operating costs (labor cost, materials and services).

In 2002 and in 2001 operating income remained stable at 4 million.

Other Telecom Italia Group Activities

Our Other Activities of 2002 and 2001 principally included the TILAB Operating Activity, the companies which previously reported to the former International Operations Business Unit and which, following the 2002 reorganization of international activities, were transferred to the Foreign Holdings Corporate Function, and by the companies/Corporate Functions that provide centralized services to the Telecom Italia Group (Business Units/Operating Activities/Companies). Our Other Activities also included the Satellite Business Unit which was disposed of during the 4th quarter of 2002.

Real Estate and General Services

Until December 31, 2002, the range of services offered by the Real Estate and General Services operating activity was directed mainly towards our other Corporate Functions/Business Units. The activities managed by Real Estate and General Services consisted of the following: to provide asset and property management services and to leverage the value of our real estate properties, to carry out the project design and work on properties and to provide project and facility management services.

Table of Contents

As a result of the finalization of the Tiglio Project (See Item 4. Information on the Telecom Italia Group Description of Property), in February 2003, the Real Estate and General Services operating activity was eliminated and the related activities and resources were transferred to the Telecom Italia Purchasing Corporate Function.

The following table sets forth, for the periods indicated, certain financial and other data for Real Estate and General Services.

Real Estate and General Services	Year ended December 31, 2001	2002
	(millions of Euro, except percentages and employees)	
Gross operating revenues	953	846
Gross operating profit	145	88
% of gross operating revenues	15.2	10.4
Operating loss	(65)	(92)
% of gross operating revenues	(6.8)	(10.9)
Number of employees at year-end	1,889	1,393

Gross operating revenues decreased by 107 million, or 11.2%, from 953 million in 2001 to 846 million in 2002. Such decrease was mainly due to the adjustment of internal charges to other Telecom Italia Group companies to match market rates and the rationalization of premises occupied by clients.

The contribution of the Real Estate and General Services to our consolidated operating revenues amounted to 50 million in 2001 and 32 million in 2002.

Gross operating profit decreased by 57 million, or 39.3%, from 145 million in 2001 to 88 million in 2002. Gross Operating Profit benefited from 51 million of costs savings arising from actions taken to contain operating costs (external charges and personnel costs) which partially offset the reduction in revenues.

Operating loss increased by 27 million, or 41.5%, from 65 million in 2001 to 92 million in 2002.

Satellite Services

The former Business Unit, Satellite Services (the Telespazio group), was disposed of during the 4th quarter of 2002 and consolidated in the statement of operations only for the first nine months of 2002. The Satellite Services (the Telespazio group and the Satellite Telecommunications business segment of Telecom Italia) was responsible for developing satellite communication systems for phone and data, radio and television broadcasting and earth-observation.

The following table sets forth, for the periods indicated, certain financial data for Satellite Services.

Satellite Services	Year ended December 31, 2001(1)	2002(1)
	(millions of Euro)	
Gross operating revenues	648	237
Gross operating profit	159	12
Operating income (loss)	60	(6)

(1) The 2002 financial data are related only to the first nine months, while the 2001 financial data refer to the entire year.

Liquidity and Capital Resources

Liquidity

The Telecom Italia Group s primary source of liquidity is cash generated from operations and its principal uses of funds are the payment of operating expenses, capital expenditures and investments, the servicing of debt, the payment of dividends to shareholders and strategic investments, such as international acquisitions.

Table of Contents

The table below summarizes, for the periods indicated, the Telecom Italia Group s cash flows.

	2001	2002	2003
		(millions of euro)	
Net cash provided by operating activities	8,719	9,815	9,921
Net cash provided by (used in) investing activities	(10,384)	840	(9,193)
Net cash provided by (used in) financing activities	2,606	(9,762)	(182)
Effect of exchange rate changes on cash and cash equivalents	(7)	(173)	(35)
Net increase in cash and cash equivalents	**934**	**720**	**511**
Cash and cash equivalents:			
Beginning of the year	**2,772**	**3,706**	**4,426**
End of the year	**3,706**	**4,426**	**4,937**

Net Cash Provided by Operating Activities. Net cash provided by operating activities was 9,921 million in 2003, 9,815 million in 2002 and 8,719 million in 2001.

2003 compared to 2002

The increase in 2003 compared to 2002 of 106 million was primarily due to:

- higher levels of net income before minority interest (2,428 million of income in 2003 compared to a loss of 306 million in 2002), an increase of 2,734 million;
- a decrease in change in deferred tax assets, net equal to 2,225 million (with a negative contribution of 611 million in 2003 compared to a negative contribution of 2,836 million in 2002); and
- 2,382 million attributable to the decrease in gains on disposal of fixed assets and other investments (from a gain of 2,243 million in 2002 to a loss of 139 million in 2003).

Such effects were largely offset by:

- the decrease in the levels of depreciation and amortization of 448 million (from 7,227 million in 2002 to 6,779 million in 2003);

- the lower levels of write-downs of fixed assets and other investments (from 4,387 million in 2002 to 1,188 million in 2003), a decrease of 3,199 million;

- a 16 million decrease in provision for employee termination indemnities (from 216 million in 2002 to 200 million in 2003) and 64 million for the increase in the payment of employee termination indemnities (from 187 million in 2002 to 251 million in 2003); and

- a 3,508 million decrease in the contribution of the change in operating assets and liabilities, which increased cash from operating activities by 3,557 million in 2002 and by only 294 million in 2003, mainly as a result of the provisions recorded in 2002 to the reserve for the put option on SEAT shares (1,942 million) and the reserve for risks and charges related to Aria Is Tim (850 million).

2002 compared to 2001

The increase in 2002 compared to 2001 of 1,096 million was primarily due to:

- significantly lower levels of net loss before minority interest (306 million loss in 2002 compared to a loss of 3,676 million in 2001) an improvement of 3,370 million;

- higher levels of write-downs of fixed assets and other investments of 634 million (from 3,753 million in 2001 to 4,387 million in 2002); and

- 1,695 million increase in the contribution of the change in operating assets and liabilities, which increased cash from operating activities by 1,862 million in 2001 and by 3,557 million in 2002, mainly as a result of the provisions recorded in 2001 and in 2002 to the reserve for the put option on SEAT shares of 569 million and 1,942 million, respectively.

Such effects were only partially offset by:

- the decrease in the levels of depreciation and amortization of 385 million (from 7,612 million in 2001 to 7,227 million in 2002);

Table of Contents

- an increase in change in deferred tax assets, net of 2,305 million (with a negative contribution of 2,836 million in 2002 compared to a negative contribution of 531 million in 2001); and

- a 1,870 million increase in gains on disposal of fixed assets and other investments (from a gain of 373 million in 2001 to a gain of 2,243 million in 2002); and

- a 8 million decrease in provision for employee termination indemnities (from 224 million in 2001 to 216 million in 2002) and 35 million for the increase in the payment of employee termination indemnities (from 152 million in 2001 to 187 million in 2002).

Net Cash Provided by (used in) Investing Activities. Net cash provided by (used in) investing activities was a net cash use of 9,193 million in 2003 compared to net cash provided of 840 million in 2002 and a net cash use of 10,384 million in 2001.

2003 compared to 2002

The net cash use of 9,193 million in 2003 compared to net cash provided of 840 million in 2002 was principally due to:

- capital expenditures that amounted to 4,894 million in 2003 (4,901 million in 2002); in 2003 they included 3,111 million of investments in fixed assets (3,291 million in 2002) and 1,783 million of additions to intangible assets (1,610 million in 2002);

- additions to other investments that decreased by 869 million from 1,563 million in 2002 to 694 million in 2003;

- a cash use of 5,274 million for the voluntary cash tender offers by Olivetti for a portion of the outstanding Old Telecom Italia ordinary shares and savings shares made in connection with the Merger;

- net change in marketable securities with a negative contribution of 1,497 million in 2003 compared to a positive contribution of 1,909 million in 2002;

- the increase in the proceeds from disposal of investments in consolidated subsidiaries, net of cash disposed of, by 2,964 million (from 33 million in 2002 compared to 2,997 million in 2003) mainly as a result of the disposal of New SEAT; and

- the decrease by 4,968 million in the proceeds from sale or redemption value of tangible and intangible assets, and other investments (from 5,736 million in 2002 to 768 million in 2003).

2002 compared to 2001

The net cash provided of 840 million in 2002 compared to net cash use of 10,384 million in 2001 was principally due to:

- capital expenditures that decreased by 2,330 million in 2002 (from 7,231 million in 2001 to 4,901 million in 2002); in 2002 they included 3,291 million of investments in fixed assets (4,317 million in 2001) and 1,610 million of additions to intangible assets (2,914 million in 2001);

- additions to other investments that decreased by 1,800 million from 3,363 million in 2001 to 1,563 million in 2002;

- net change in marketable securities with a positive contribution of 1,909 million in 2002 compared to a negative contribution of 361 million in 2001; and

- the increase in 2002 by 4,252 million in the proceeds from sale or redemption value of tangible and intangible assets, and other investments (from 1,484 million in 2001 to 5,736 million in 2002).

Net Cash Provided by (Used in) Financing Activities. Net cash provided by (used in) financing activities was a net cash use of 182 million in 2003 compared to net cash use of 9,762 million in 2002 and net cash provided of 2,606 million in 2001.

Net cash used in financing activities in 2003 reflected mainly the following:

- an increase in short-term debt of 3,786 million, from 6,827 million at December 31, 2002 (including current portion of long-term debt of 3,450 million) to 10,613 million (including current portion of long-term debt of 9,289 million) at December 31, 2003;

- a decrease of 2,952 million in long-term debt, from 33,804 million at December 31, 2002 to 30,852 million at December 31, 2003, since the issue of new notes for the total principal amount of 6,568 million was more than offset by the increase of 5,839 million in the current portion of long-term debt and the repayments of medium-long term debt; and
- the 2003 payment of dividends on income and reserves of 1,049 million.

Linked to the gross debt change there was an increase in cash and cash equivalents, marketable securities and financial receivables under current assets mainly due to the proceeds arising from the issue of new bonds, the repayments of medium-long term debt maturing by the end of 2003 and the cash of 1,485 million used to partially finance the cash tender offers by Olivetti for a portion of the outstanding Old Telecom Italia shares.

As of December 31, 2003, cash and cash equivalents, marketable securities and financial receivables under current assets were 8,482 million (7,348 million as of December 31, 2002).

Net cash used in financing activities in 2002 reflected mainly the following:

- a decrease in short-term debt of 2,245 million, from 9,072 million at December 31, 2001 (including current portion of long-term debt of 1,939 million) to 6,827 million (including current portion of long-term debt of 3,450 million) at December 31, 2002;
- a decrease of 3,943 million in long-term debt, from 37,747 million at December 31, 2001 to 33,804 million at December 31, 2002; and
- the 2002 payment of dividends of 3,668 million.

Net cash provided by financing activities in 2001 consisted of the followings:

- a decrease in short-term debt of 7,855 million, from 16,927 million at December 31, 2000 (including current portion of long-term debt of 2,750 million) to 9,072 million (including current portion of long-term debt of 1,939 million) at December 31, 2001;
- an increase of 10,262 million in long-term debt, from 27,485 million at December 31, 2000 to 37,747 million at December 31, 2001;
- paid in capital in consolidated subsidiaries of 2,660 million; and
- the 2001 payment of dividends of 2,461 million.

Capital Resources

Gross Financial Debt

On a consolidated basis, at December 31, 2003, our outstanding long-term debt was 30,852 million (33,804 million at December 31, 2002) and our short-term debt was 10,613 million (including current portion of long-term debt of 9,289 million) compared to 6,827 million at December 31, 2002 (including current portion of long-term debt of 3,450 million). At December 31, 2003, short-term debt included 1,500 million of Telecom Italia s floating rate notes maturing June 21, 2005 which were repaid early on March 22, 2004. Interest on our gross financial debt totaled 2,173 million in 2003 compared with 2,241 million in 2002.

In 2003, the increase of 834 million in gross financial debt (from 40,631 million at December 31, 2002 to 41,465 million at December 31, 2003) was more than offset by the increase of 1,134 million in cash and cash equivalents, marketable securities and financial receivables under current assets (from 7,348 million at December 31, 2002 to 8,482 million at December 31, 2003) that principally arose from the difference between the proceeds on new notes issued in 2003 and the repayments of medium and long-term debt falling due during 2003, in addition to cash resources used to partially pay the tender offers (1,485 million).

As of December 31, 2003, approximately 86% of our long-term debt was denominated in Euro, while the remainder was primarily denominated in U.S. Dollars, Pound Sterling, Brazilian Reais, Japanese Yen and Chilean Peso.

Table of Contents

The following table sets out the currency of our gross financial debt:

	As of December 31,							
	2003						2002	
(millions of euro)	Euro	%	Foreign currency	%	Total	%	Total	%
Medium/long-term debt	26,393	72	4,459	90	30,852	74	33,804	83
Short-term debt	10,137	28	476	10	10,613	26	6,827	17
Total gross financial debt	**36,530**	**100**	**4,935**	**100**	**41,465**	**100**	**40,631**	**100**

In 2003, the share of our long-term debt (excluding current portion) as a percentage of total gross financial debt decreased from 83% to 74%. At December 31, 2003, approximately 35% of the long-term debt carried a floating rate.

Long term debt includes notes we have issued in order to reduce our dependence on short-term debt, extend the average life of our financial debt and expand our investor base. To this effect, we issued long-term debt in the capital markets under, among others, the Telecom Italia Euro Medium Term Note Program, the Olivetti EMTN Program and the Old Telecom Italia Global Note Program, the net proceeds of which have been used to repay short-term debt.

As of December 31, 2003, notes and bonds outstanding amounted to 37,365 million (31,805 million at December 31, 2002) and increased by 5,560 million (net of reimbursements and other causes), mainly as a result of the following:

- issue, in January 2003, of fixed-rate notes by Olivetti Finance N.V., under the Euro Medium Term Note (EMTN), in the principal amount of 3,400 million divided into three tranches:
  - notes 2003-2008 issued by Olivetti Finance N.V. in the principal amount of 1,750 million with an annual fixed-rate coupon of 5.875%, maturing in January 2008;
  - notes 2003-2013 issued by Olivetti Finance N.V. in the principal amount of 850 million with an annual fixed-rate coupon of 6.875%, maturing in January 2013;
  - notes 2003-2033 issued by Olivetti Finance N.V. in the principal amount of 800 million with an annual fixed-rate coupon of 7.75%, maturing in January 2033;
- issue, in October 2003, of fixed-rate notes by Telecom Italia Capital S.A., fully and unconditionally guaranteed by Telecom Italia, in the principal amount of U.S.$4,000 million (3,168 million). The issue was divided into three tranches:

- Series A notes in the principal amount of U.S.$1,000 million (792 million) with an annual fixed-rate coupon of 4%, maturing in November 2008;
- Series B notes in the principal amount of U.S.$2,000 million (1,584 million) with an annual fixed-rate coupon of 5.25%, maturing November 2013;
- Series C notes in the principal amount of U.S.$1,000 million (792 million) with an annual fixed-rate coupon of 6.375%, maturing in November 2033.

The issuance of these notes allowed us to complete the repayment of the loan in November 2003 used to fund the tender offers (see below Bank Facilities Term Loan Facility).

Furthermore, on January 29, 2004, Telecom Italia issued 1,000 million principal amount of floating rate notes due October 29, 2007 (Euribor 3 months + 0.33%; issue price 99.927), 750 million principal amount of 4.5% notes due January 28, 2011 (issue price 99.56) and 1,250 million principal amount of 5.375% notes due January 29, 2019 (issue price 99.07). This issue was part of Telecom Italia s 10 billion Euro MTN Program authorized by the Board of Directors of Telecom Italia S.p.A. on October 10, 2003. The notes under this program can be issued by Telecom Italia and/or its subsidiary Telecom Italia Finance, with a guarantee by Telecom Italia.

On April 8, 2004, Telecom Italia issued, at par, 110 million principal amount of Floating Rate Notes due 2009 under the Euro MTN Program. Such notes were subscribed in full, by way of a private placement, by one investor.

Our debt due to banks was 2,460 million at December 31, 2003 (5,776 million at December 31, 2002), of which 1,278 million (3,926 million at December 31, 2002) of short-term debt, including the current portion of long-term debt.

As of December 31, 2003, the amount of unutilized bank lines of credit of Telecom Italia Group was 9,110 million (9,081 million as of December 31, 2002), of which 6,500 million related to the Revolving Credit

Table of Contents

Facility (see below Bank Facilities Revolving Facility). Approximately 98% of our lines of credit were denominated in Euro and had varying interest rates. Of the total amount, 6,153 million were Telecom Italia S.p.A. unutilized bank lines of credit (5,813 million as of December 31, 2002).

Off-Balance Sheet Arrangements

Off-balance sheet arrangements refer to any transaction, agreement, or other contractual arrangement involving an unconsolidated entity (other than contingent liabilities arising from litigation, arbitration or regulatory actions), under which Telecom Italia has:

- Guarantee contracts required to be initially recorded at fair value under FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45);
- retained or contingent interests in transferred assets;
- any obligation under derivative instruments classified as equity; or
- any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging, or research and development arrangements with the company.

As of December 31, 2003, Telecom Italia has the following items that are considered to be off-balance sheet.

As of December 31, 2003, the Telecom Italia Group had a purchase commitment of 72 million for the purchase of buildings leased from Fintecna (which was exercised on April 1, 2004), and Telecom Italia International s commitment of 32 million in order to cover, on a proportional basis through capital increases, the residual amount due by Etec S.A. to the Cuban government in connection with the new license acquired.

As of December 31, 2003, the Telecom Italia Group has given guarantees of 1,631 million, mainly consisting of sureties provided by Telecom Italia and TIM on behalf of affiliated companies. The most significant of these relate to the indebtedness of Aria-Is Tim that is guaranteed by TIM for 672 million. Remaining guarantees consist of medium/long-term loan transactions and guarantees for bids to acquire TLC licenses abroad.

Telecom Italia has also issued support letters totaling 197 million on behalf of affiliated companies to guarantee insurance policies, lines of credit arrangements and overdraft agreements with financial institutions.

Telecom Italia also has a purchase commitment, at fair value, to acquire the outstanding minority interest of the consolidated subsidiaries Mediterranean Nautilus Ltd and Med-1 Submarine Cables Ltd.

See also Note 18 of Notes to the Consolidated Financial Statements included elsewhere herein for a further discussion of commitments and contingencies.

Contractual Obligations and Commitments

In accordance with the requirements of Form 20-F we present our contractual obligations and other commitments in the table that follows. However, our future cash flow prospects cannot solely be assessed on the basis of such obligations.

The following table aggregates our contractual obligations and commitments with definitive payment terms which will require significant cash outlays in the future. As of December 31, 2003, the amounts payable are as follows:

	Year Ended December 31,						
	2004	**2005**	**2006**	**2007**	**2008**	**After 2008**	**Total**
	(millions of Euro)						
Notes and bonds	8,445	1,510	6,073	3,105	2,550	15,682	37,365
Loans and other debt	817	476	406	421	77	424	2,621
Finance lease	27	22	18	19	14	55	155
Total long-term debt	9,289	2,008	6,497	3,545	2,641	16,161	40,141
Operating lease	8	6	4	2			20
Rental obligations to IM.SER60, TIGLIO I, TIGLIO II, FMP Italy 1 (formerly Ireos)(1)	229	229	229	229	229	2,844	3,989
Total contractual obligations and commitments	**9,526**	**2,243**	**6,730**	**3,776**	**2,870**	**19,005**	**44,150**

(1) Aggregate contractual rental payments due between 9 and 21 years.

The table above does not include short-term financial debt of 1,324 million (excluding current portion of long-term debt) outstanding at December 31, 2003.

Total long-term debt of 9,289 million, 14,691 million and 16,161 million is scheduled to become due for repayment during 2004, in the years 2005-2008 and beyond, respectively.

See also Note 18 of Notes to Consolidated Financial Statements for a description of derivatives.

For a discussion of our capital expenditures in 2001, 2002 and 2003 and the Telecom Italia Group s proposed capital expenditure commitments over the next three years, see Capital Expenditures .

Net Financial Debt

On a consolidated basis, at December 31, 2003, net financial debt was 33,346 million compared to 33,399 million at the end of 2002 (a decrease of 53 million). 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 adequacy of a company s financial structure. Therefore, we believe it is useful information for investors to receive and is consistent with how we present ourselves to the analyst community. Net financial debt at December 31, 2003 includes borrowings to finance the effects of the withdrawals and the tender offers (5,285 million) relating to the Merger, the distribution of profits and reserves (1,049 million) in payment of the dividend on Old Telecom Italia shares and the payment for the early exercise of the JP Morgan Chase put option on Seat Pagine Gialle shares (2,272 million). Such requirements were mostly financed by cash generated by operations, the sale of the investment in New SEAT (3,681 million) and the disposal of other investments (768 million).

The following chart summarizes the major components which had an impact on the change in net financial debt during 2003 (in millions of euro):

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(1) For a more detailed description, see Item 4. Information on the Telecom Italia Group Business Significant Developments during 2003 Sale of Telecom Italia s stake in New SEAT .

Furthermore, securitization and factoring arrangements led to an improvement in consolidated net financial debt as of December 31, 2003 of 1,201 million (1,046 million as of December 31, 2002), of which 851 million (826 million as of December 31, 2002) was due to the securitization program.

In particular:

- during 2003 and 2002, Telecom Italia continued a program (the Program) that began in 2001 for the securitization of receivables generated by the services rendered to the customers of the Wireline

162

Table of Contents

business unit and the customers of Path.Net (a wholly-owned subsidiary of Telecom Italia, which provides telephone services to the Public Administration). A first tranche of 700 million of notes was issued by a non-consolidated special purpose vehicle for the Program incorporated pursuant to the Italian securitization law (Law No. 130/1999). The Program allows for the possibility of successive issues of notes, all with the same rights and risk profile, up to a total maximum amount of 2 billion.

The total amount of the trade accounts receivable sold under the securitization transactions in 2003 was 8.9 billion (9 billion in 2002), solely referred to receivables from residential customers generated by Telecom Italia;

- in 2003, Telecom Italia, TIM and Olivetti Tecnost sold trade accounts receivable under non-recourse factoring arrangements in the amount of 3,873 million. In 2002, the Telecom Italia Group sold trade accounts receivable under non-recourse factoring arrangements in the amount of 3,969 million.

Compared to September 2001, the date on which new management took over responsibility for the running of the Telecom Italia Group, net financial debt has decreased by approximately 10 billion as showed in the following table:

The overall reduction is attributable to the following: cash flows generated by operations, proceeds from disposal of tangible assets, investments in consolidated subsidiaries and associated companies and other investing activities for 10 billion and distributions to shareholders (dividends, withdrawals and the tender offers on Old Telecom Italia shares) of 10 billion.

The reduction had no impact on investments and in particular capital expenditures. In fact, the commitment to investments continued in 2003 with total investments of approximately 12 billion that were financed by cash flows provided by operations and which contributed to strengthening our competitiveness.

Our strategic objectives for the three-year period 2004 2006 confirmed that the target is to reduce net financial debt below 30 billion by the end of 2004.

In order to better understand the change in net financial debt, the following table presents details of the changes in our net financial debt between December 31, 2002 and December 31, 2003, taking into account the JP Morgan Chase put option:

	As of December 31,		
(millions of euro)	**2003**	**2002**	**Change**
Old Telecom Italia Group	30,238	18,118	(3,161)
Olivetti Group		15,281	
Effects of withdrawals and tender offers	5,285		5,285
Sale of New SEAT and other disposals	(4,449)		(4,449)

JP Morgan Chase put option	2,272		2,272
Net financial debt as reported in the financial statements	**33,346**	**33,399**	**(53)**
JP Morgan Chase put option		2,417	(2,417)
TOTAL	**33,346**	**35,816**	**(2,470)**

163

Table of Contents

A reconciliation of net financial debt with the financial statement line items is presented in the table below.

	As of December 31,			
	2003			2002
	Maturing			
(millions of euro)	within 12 months	Beyond 12 months	Total	Total
Notes and bonds	6,730	23,323	30,053	24,404
Convertible notes	1,715	5,597	7,312	7,401
Total notes and bonds	**8,445**	**28,920**	**37,365**	**31,805**
Debt to banks	1,278	1,182	2,460	5,776
Debt to other financial institutions	342	670	1,012	1,970
Payables to associated companies	19	23	42	406
Note payables				241
Suppliers	5	4	9	21
Other	524	53	577	412
Total other financial payables	**2,168**	**1,932**	**4,100**	**8,826**
Total gross financial debt	**10,613**	**30,852**	**41,465**	**40,631**
Cash and cash equivalents:				
Bank and postal accounts	(4,870)		(4,870)	(4,363)
Cash and valuables on hand	(7)		(7)	(7)
Receivables for securities held under reverse repurchase agreements	(60)		(60)	(56)
Marketable securities (*)	(2,719)		(2,719)	(1,927)
Financial accounts receivable (included under Receivables and Other current assets)	(826)		(826)	(995)
Total cash and cash equivalents, marketable securities and financial receivables under current assets	**(8,482)**		**(8,482)**	**(7,348)**
Financial prepaid expense/deferred income, net and accrued financial income/expense, net	**670**	**(307)**	**363**	**116**
Net financial debt	**2,801**	**30,545**	**33,346**	**33,399**

(*) As of December 31, 2003, marketable securities include: Euro commercial paper (735 million), own notes (1,341 million), notes and bonds (583 million) and other securities (60 million). As of December 31, 2002 marketable securities include Old Telecom Italia shares held by Olivetti (299 million).

At December 31, 2003, we had cash and cash equivalents, marketable debt securities and financial accounts receivable in excess of 8,482 million (7,348 million at December 31, 2002). We believe that these financial assets together with our bank facilities, as well as the proceeds that arose from the issuance of notes in January 2004, mentioned above, and the disposal of Telekom Austria (770 million) in January 2004 will make it possible to meet our debt obligations maturing in 2004 and 2005, detailed below.

	Financial debt maturing in 2004 and 2005		
(millions of euro)	**Notes and Bonds**	**Loans, other debt and finance lease**	**Total**
Year 2004	8,445	844	9,289
Year 2005	1,510	498	2,008
Total	**9,955**	**1,342**	**11,297**

Notes and bonds

In July 1999, the Telecom Italia Group (formerly the Olivetti Group) established the Olivetti EMTN Program, as updated and amended on June 8, 2001 and May 14, 2002, which allowed for the issuance of a total amount of 15 billion in debt (or the equivalent in other currencies), at various terms, rates and maturities.

At the end of 2000, the Old Telecom Italia Group established a Global Medium Term Note Program, which allowed for the issuance of a total amount of U.S.$10 billion in debt (or the equivalent in other currencies), at

Table of Contents

various terms, rates and maturities. On December 18, 2001, the Old Telecom Italia s Board of Directors authorized the increase of the Global Medium Term Note Program to up to U.S.$12 billion (or the equivalent in other currencies).

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 creation of the Euro MTN Program up to a maximum amount of 10 billion. These notes can be issued by Telecom Italia and/or its subsidiary Telecom Italia Finance, with a guarantee by Telecom Italia.

As of December 31, 2003, total notes and bonds amounted to 37,365 million (31,805 million at December 31, 2002) and consisted of the followings:

- convertible notes of 7,312 million (7,401 million at December 31, 2002), detailed as follows:

Original Currency	Amount (million)	Coupon	Convertible into shares of	Issue date	Maturity date	Issue price (%)
Convertible notes issued by Telecom Italia S.p.A.						
Euro	1,331(1)	1.50%	TI S.p.A.	03/09/01	01/01/04	100
Euro	2,829	1.50%	TI S.p.A.	11/23/01	01/01/10	100
Convertible notes issued by Telecom Italia Finance S.A. guaranteed by Telecom Italia S.p.A.						
Euro	1,964	1.00%	TIM/Telecom Italia Media	03/15/01	03/15/06	100
Convertible notes issued by Olivetti Finance N.V. guaranteed by Telecom Italia S.p.A.						
Euro	385(2)	0.00%	TI S.p.A.	09/20/02	03/19/04	100
Euro	803	1.00%	TI S.p.A.	11/03/00	11/03/05	100
Total	**7,312**					

(1) These notes were repaid on January 1, 2004, their maturity date.

(2) On March 19, 2004, Olivetti Finance N.V., S.A. redeemed 385 million in principal amount of notes on their maturity date.

Table of Contents

For a more detailed description of these convertible notes see Note 11 of Notes to the Consolidated Financial Statements included elsewhere herein;

- notes and bonds of 30,053 million (24,404 million at December 31, 2002), detailed as follows:

Original Currency	Amount in original currency (million)	Amount in Euro (million)	Coupon	Issue date	Maturity date	Issue price (%)
Notes and bonds issued by Telecom Italia S.p.A.						
Euro	1,500(1)	1,500	Euribor 3 months + 0.95%	12/21/01	06/21/05	99.837
Euro	1,250	1,250	5.625%	02/01/02	02/01/07	99.841
Euro	1,250	1,250	6.250%	02/01/02	02/01/12	98.952
Euro	215	215	Euribor 6 months	01/01/02	01/01/22	100
Sub Total		**4,215**				
Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.						
Euro	1,000(2)	1,000	Euribor 3 months + 1.125%(a)	04/20/01	04/20/04	99.514
Euro	3,000(2)	3,000	6.125%(a)	04/20/01	04/20/06	99.937
Euro	1,500	1,500	5.15%(b)	02/09/99	02/09/09	99.633
Euro	2,000(2)	2,000	7.00%(a)	04/20/01	04/20/11	99.214
CHF	100	64	5.625%	06/12/86	06/12/46	99.000
Sub Total		**7,564**				
Notes and bonds issued by Olivetti Finance N.V. and guaranteed by Telecom Italia S.p.A.						
Euro	4,200	4,200	5.825%	07/30/99	07/30/04	99.786
Euro	200	200	EONIA + 1.45%	08/07/02	02/07/05	99.900
Euro	500	500	Euribor 3 months + 1.3%	03/14/02	03/14/05	100
Euro	1,100	1,100	Euribor 3 months + 1.25%	05/29/02	01/03/06	99.6673
Euro	1,750	1,750	6.500%	04/24/02	04/24/07	99.637
Euro	1,750	1,750	5.875%	01/24/03	01/24/08	99.937
Euro	2,350	2,350	6.575%(c)	07/30/99	07/30/09	99.272
Euro	1,000	1,000	7.25%	04/24/02	04/24/12	99.602
Euro	850	850	6.875%	01/24/03	01/24/13	99.332
JPY	20,000	148	3.550%	04/22/02	05/14/32	99.25
Euro	250	250	7.770%	08/09/02	08/09/32	100.2
Euro	800	800	7.750%	01/24/03	01/24/33	99.239
Sub-Total		**14,898**				
Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.						
USD	1,000	792	4.000%	10/29/03	11/15/08	99.953
USD	2,000	1,584	5.250%	10/29/03	11/15/13	99.742
USD	1,000	792	6.375%	10/29/03	11/15/33	99.558
Sub-Total		**3,168**				
Notes and bonds issued by Entel Chile						
CLP	156,820	208	From 5.93 % to 8.06 %			

		From 2000 to 2002	From 2004 to 2023
Sub-Total	**208**		
Total	**30,053**		

Note (a), (b) and (c): see the next paragraph Ratings Triggers

(1) These notes were repaid in advance, at par, on March 22, 2004, in accordance with a resolution approved by the Telecom Italia Board of Directors on February 17, 2004.
(2) On April 20, 2004, the first tranche of 1,000 million was paid. On the same date, the 0.25% step-up took effect on the annual coupon for the remaining two tranches: 3,000 million (6.125% + 0.25%), maturing April 2006; 2,000 million (7% + 0.25%), maturing April 2011.

For a more detailed description of the notes and bonds summarized in the table above see Note 11 of Notes to the Consolidated Financial Statements included elsewhere herein.

Table of Contents

Ratings Triggers

Certain of the notes and bonds we have issued provide certain protections to investors in the event that our debt ratings are downgraded.

The ratings assigned to Telecom Italia by the various agencies are the following:

Standard & Poor s:	BBB+	positive outlook
Moody s:	Baa2	stable outlook
Fitch IBCA:	A-	stable outlook

A securities rating is not a recommendation to buy, sell or hold securities. Ratings may be subject to revision or withdrawal at any time by the assigning rating organization. Each rating should be evaluated independently of any other rating.

(a) Telecom Italia Finance S.A. Notes:

- 1,000 million, Euribor 3M + 1.125% interest, maturing April 2004
- 3,000 million, 6.125% interest, maturing April 2006
- 2,000 million, 7% interest, maturing April 2011

These notes carry protection for investors which would be triggered by a change in the rating assigned to Telecom Italia to below the Baa1/BBB+ ratings (by Moody s and S&P s, respectively): each reduction in the rating by one notch by either of the two agencies to below the stated thresholds would cause an increase in the interest coupon (or in the spread above the Euribor in the case of floating-rate securities) of 0.25%, starting from the interest payment date subsequent to the downgrade in the rating.

Any change in the rating is evaluated at the end of each interest period and, on the basis of the then applicable rating, the interest for the next coupon is fixed; therefore, changes in the ratings during the interest period would have no impact on the determination of the coupon except for the applicable ratings immediately prior to the beginning of the new interest period.

Therefore, the step-up/down will only be applied when the rating at the end of a coupon period is different from the rating at the end of the preceding coupon period.

As a result, these securities are currently subject to an 0.25% increase in interest due to the assignment of a Baa2 rating by Moody s in August 2003. In the case of the floating-rate security, this increase was applied to the coupon for the period beginning October 2003; in the case of the two fixed-rate securities, the increase has been applied beginning with the interest period which started in April 2004.

(b) Telecom Italia Finance S.A. Notes: 1,500 million, 5.15% interest, maturing February 2009.

These notes carry protection for investors which would be triggered by a downgrade in the minimum rating (among those assigned by the various agencies, specifically in reference to the Baa2 rating by Moody s).

At the beginning of every coupon period, this minimum rating is checked, and depending upon the rating, the interest coupon will be fixed; once fixed, changes in the minimum rating during the interest period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of the interest coupon at issue (5%), a 0.15% increase in interest was granted to investors to the maturity date, bringing the current coupon interest rate to 5.15%.

This current coupon can be further increased in relation to the level of the minimum rating:

- if, at the time the interest coupon is fixed, the minimum rating is Ba1/BB+ or less, 1.50% will be added to the original coupon;
- if, at the time the interest coupon is fixed, the minimum rating is Baa3/BBB-, 0.5% will be added to the original coupon;
- higher levels of minimum ratings do not involve increases in the current coupon.

Table of Contents

Therefore, only future downgrades in the minimum rating could cause an increase in the current coupon; this coupon cannot be reduced because of upgrades in the ratings.

(c) Olivetti Finance N.V. Notes: 2,350 million, 6.575% interest, maturing July 2009.

These notes carry protection for investors which would be triggered by a change in the minimum rating (among those assigned by the various agencies, specifically the Baa2 rating by Moody s).

At the beginning of each interest period, this minimum rating is checked, and depending upon the rating, the interest coupon will be fixed; once fixed, changes in the minimum rating during the interest period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of interest at issue (6.125%), the coupon that will effectively be paid will be increased in relation to the level of the minimum rating:

- if, at the time the interest coupon is fixed, the minimum rating is Ba1/BB+ or less, 1.95% will be added to the original coupon;
- if, at the time the interest coupon is fixed, the minimum rating is Baa3/BBB-, 0.95% will be added to the original coupon;
- if, at the time the interest coupon is fixed, the minimum rating is Baa2/BBB, 0.45% will be added to the original coupon;
- higher levels of minimum ratings do not involve increases in the original coupon.

In line with this mechanism, starting October 2000 (date of the introduction of this mechanism), the original coupon was increased by 0.45% (reaching the current 6.575%).

Future upgrades/downgrades in the minimum rating might cause decreases/increases in the coupons according to the mechanism described above.

Financial covenants / other covenants / other features

The notes and bonds summarized above contain customary covenants and events of default but do not contain financial covenants or covenants which would force the notes to be repaid at an earlier date as a result of events other than the insolvency of the Telecom Italia Group. However, certain of the Olivetti Group notes and bonds contain cross defaults to subsidiary indebtedness.

For example, there are no clauses which would cause the notes to be repaid due to a downgrade in the ratings to below the established thresholds.

The guarantees provided by Telecom Italia S.p.A. on notes issued by foreign subsidiaries are all full and unconditional.

None of the notes summarized above carry any other interest rate structures or structural complexities.

Since these transactions have principally been placed with institutional investors on major world capital markets (the Euro market and the U.S.A.), the terms which regulate the notes are in line with the market practice for similar transactions effected on the same markets.

For the U.S.$4,000 million principal amount of Notes issued by Telecom Italia Capital S.A. in October 2003, guaranteed by Telecom Italia, there is a covenant requiring that Telecom Italia Capital and Telecom Italia complete an exchange offer registered with the SEC in order to allow investors to exchange their notes originally purchased for registered notes which will be freely saleable without restrictions. Should Telecom Italia Capital not complete the registered exchange offer by October 31, 2004, this would result in an increase in the coupon by 0.50% until the exchange offer was completed.

Table of Contents

Bank Facilities

In connection with the Merger, Telecom Italia (formerly Olivetti) mandated a group of Mandated Lead Arrangers to arrange and underwrite 15.5 billion of senior credit facilities (the Facilities). The Facilities, which were subsequently fully syndicated, consisted of:

- a 9.0 billion senior term loan (the Term Loan Facility) to fund both the cash out payment to dissenting Olivetti shareholders and the cash consideration payable upon completion of Olivetti s voluntary partial cash tender offers for Old Telecom Italia Shares and Savings Shares, and
- a 6.5 billion senior revolving credit facility (the Revolving Credit Facility) to fund the needs for working capital and general corporate purposes of Old Telecom Italia and, following the Merger, of the new merged entity, and the refinancing of Old Telecom Italia s existing 7.5 billion facility.

Details of the facilities were as follows:

Term Loan Facility

On April 24, 2003, Telecom Italia (formerly Olivetti) entered into the 9 billion Term Loan Facility with Banca Intesa S.p.A., Barclays Capital, BNP Paribas, HSBC Bank plc, J.P.Morgan plc, The Royal Bank of Scotland plc, Unicredit Banca Mobiliare S.p.A. (as mandated lead arrangers), and J.P.Morgan Europe Limited (as agent).

Pursuant to the Term Loan Facility, up to 9 billion was available to finance:

(i) the cash-out payment to Olivetti shareholders who exercised their withdrawal right; and, for the amounts not used to finance the cash-out payment, and

(ii) the partial voluntary cash tender offers made by Olivetti for a portion of the Old Telecom Italia shares and savings shares.

The Term Loan Facility was divided into the following three tranches aggregating 9 billion.

	Amount (millions of euro)	Tenor	Term out
Tranche A	3,600	364 days	6 months
Tranche B	3,600	18 months(1)	6 months

Tranche C	1,800	2 years	12 months

(1) Less one day.

5,274 million of the Term Loan Facility was utilized in connection with the Merger. 1,474 million of this amount was repaid in August with the liquidity available, while the residual amount (3,800 million) was repaid in advance, as follows:

- 2,000 million in October 2003 (the due date was October 2004); and
- 1,800 million in November 2003 (the due date was April 2005), following the issuance of notes by Telecom Italia Capital in the principal amount of U.S.$4 billion on October 29, 2003.

Revolving Facility

On April 24, 2003, Telecom Italia (formerly Olivetti) received a binding offer from Banca Intesa S.p.A., Barclays Capital, BNP Paribas, HSBC Bank plc, J.P.Morgan plc, The Royal Bank of Scotland plc, Unicredit Banca Mobiliare S.p.A. (as mandated lead arrangers), and J.P.Morgan Europe Limited (as agent) to enter into the 6.5 billion multicurrency Revolving Credit Facility with:

- Telecom Italia and Telecom Italia Finance Société Anonyme (with the guarantee of Telecom Italia) if the Merger would have been effective prior to August 8, 2003; or
- Old Telecom Italia and Telecom Italia Finance Société Anonyme (with the guarantee of Old Telecom Italia) if the Merger would have not been effective prior to August 8, 2003.

The Revolving Credit Facility was divided into the following two tranches aggregating 6.5 billion.

	Amount (millions of euro)	Tenor	Term out
Tranche D	4,500	364 days	12 months
Tranche E	2,000	3 years	None

169

Under the terms and conditions of the Revolving Credit Facility the borrower or borrowers (as defined therein) were entitled to use funds available for the short-term financial requirements of the Telecom Italia Group, including repayments of commercial paper issued by any member of the Telecom Italia Group, to refinance existing debt and for the general corporate purposes of the Telecom Italia Group.

On March 30, 2004, the Tranche D (4,500 million), maturing on April 2004, and the Tranche E (2,000 million), maturing on April 2006, were replaced by a new facility (the New Facility) of 6.5 billion with a three year maturity. The New Facility does not contain any financial covenants and does not place any constraints on how we operate our business.

The agreement includes customary representations and warranties and events of default for a revolving credit agreement of this type. However, according to the terms of the agreement, the Telecom Italia Group is not required to represent that there has been no material adverse change in the business or financial condition of the Telecom Italia Group at the time of any drawdown.

Debt to Equity Ratio

The Telecom Italia Group s debt to equity ratio, calculated as the ratio of consolidated net financial debt to total stockholders equity (including minority interest), was 162.0% and 161.9% as of December 31, 2003 and December 31, 2002 , respectively.

Centralized Treasury. Telecom Italia has a centralized treasury that provides financial assistance to the Telecom Italia Group including TIM, and generally operates as the Telecom Italia Group s principal banker, allocating cash where needed and collecting the liquid resources of the members of the Telecom Italia Group. As a result, Telecom Italia is able to ensure that its subsidiaries have adequate liquidity to satisfy their requirements. Telecom Italia also acts on behalf of its subsidiaries in negotiating bank lines of credit and provides financial consultancy services to its subsidiaries.

The central treasury function reduces the need of the members of the Telecom Italia Group to utilize banks, enables members of the Telecom Italia Group to obtain more favorable terms from banks when needed and enables Telecom Italia to maintain control over cash flows and to assure better utilization of surplus liquidity.

Cash Management. Telecom Italia utilizes short-term credit lines to support expenses and disbursements that occur in the ordinary course of business, using free cash flow generated by its business to fund capital expenditures and acquisitions and to repay long-term debt.

Lines of Credit. Short-term lines of credit granted to the Telecom Italia Group by banks, according to standard money market terms and conditions, consist partly of lines of credit with specified maturities and partly of lines of credit callable upon notice. All of the Company s medium and long-term lines of credit relate to specific loans drawn down to fund the Company s activities.

Table of Contents

Capital Expenditures

The table below sets forth, for the periods indicated, our total capital expenditures based on the organization by Business Unit at December 31, 2003.

	Year ended December 31,		
	2001	2002	2003
	(millions of Euro)		
Fixed assets:			
Wireline(1)	1,979	1,837	1,497
Mobile	1,530	1,075	1,244
South America(2)	351	201	116
Internet and Media	82	28	32
IT Market(1)	20	13	13
IT Group(1)	84	83	106
Olivetti Tecnost	42	26	14
Other activities(1)(3)	229	28	89
Total fixed assets(4)	4,317	3,291	3,111
Intangible assets (other than goodwill)(5)	2,914	1,610	1,783
Total capital expenditures(6)	**7,231**	**4,901**	**4,894**

(1) Since January 1, 2003, the Netikos group, the Webegg group, the TILab, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNed is no longer included in Other Activities. The TILab moved to Other activities and Loquendo and BB Ned became part of Wireline, whereas the other companies moved to the IT Market Business Unit.

(2) 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.

(3) The data presented include the additions to fixed assets of the International Affairs Corporate Function, the TILab, the 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 9Télécom 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.

(4) Capital expenditures in fixed assets are mainly related to local and long distance networks, exchange equipment, investment in subscribers equipment, radio and transmission equipment.

(5) Intangible assets, other than goodwill, include investments such as software for telecommunications systems and licenses.

(6) Intercompany capital expenditures are adjusted to eliminate intercompany profit.

In the three years ended December 31, 2003, cash flows from operating activities (9,921 million in 2003, 9,815 million in 2002 and 8,719 million in 2001) exceeded capital expenditures in fixed and intangible assets (4,894 million in 2003, 4,901 million in 2002 and 7,231 million in 2001).

Capital expenditures under the Business Plan

The capital expenditures 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 Capital Expenditures
Wireline	42%
Mobile	47%
Telecom Italia Media	1%
Other	10%

Approximately two thirds of the total of our capital expenditures planned for the period 2004-2006 (15 billion) will be invested in new products and market innovation and development.

Table of Contents

Wireline

The Wireline Business Unit plans to invest approximately 6.3 billion of capital expenditures for the 2004-2006 period in order to continue the development of broadband services both in the domestic market and in other selected European countries (France and Germany, where operations are already on going) and to invest in infractructures and systems of innovation.

Mobile

The Mobile Business Unit, will invest approximately 40% of the 7 billion planned for the 2004-2006 period for international development, mainly in Brazil. It will continue the start-up of the PCS operations and the GSM overlay in areas previously covered with TDMA.

In Italy, TIM has planned the commercial launch of innovative services based on EDGE technology and, afterwards, of UMTS.

Telecom Italia Media

Telecom Italia Media will focus its investments on Internet services and the Television business. In this sector, it is planned also the launch of the Digital Terrestrial Television .

Research and Development Activities

The Group spent 204 million, 151 million and 148 million on research and development in 2001, 2002 and 2003 respectively. The Group also receives grants from research and development national and international programs.

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 area in partnership with Pirelli Labs.

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

- Terminal and user interfaces,

- Applications and Services,
- Service control,
- Access, metro and core network,
- 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.

In 2003 TILAB s research was based on three macro areas: Broadband Services, Mobile Services, Network Innovation.

172

Table of Contents

Consolidated Financial Statements as of and for the three Year period Ended December 31, 2003 Reconciliation of Italian GAAP to U.S. GAAP.

During the three year period between 2001 to 2003 the Telecom Italia Group engaged in certain significant transactions which, under U.S. GAAP give rise to material differences in net income, shareholders equity and indebtedness when compared to Italian GAAP. In addition, adoption and application of certain U.S. GAAP accounting principles has resulted in material adjustments to U.S. GAAP net income and shareholders equity when compared to Italian GAAP. In the course of 2001, 2002 and 2003, the following transactions and application of U.S. GAAP accounting principles have given rise to the most significant differences:

- the Merger;
- the differences in the accounting for the 2000 acquisition of SEAT required significant impairment charges when compared to Italian GAAP;
- the significant number of acquisitions made by SEAT using its ordinary shares as consideration for such acquisitions;
- adoption of SFAS 142 under U.S. GAAP, which requires that amortization of goodwill and indefinite lived intangibles be eliminated, and instead reviewed annually for impairment based on fair value;
- the sale of certain real estate properties to IM.SER, at that time a wholly owned subsidiary of the Telecom Italia Group, the subsequent sale of 60% of IM.SER to third parties and the transfer of these interests and other real estate assets as part of the Tiglio transactions;
- restructuring of certain real estate properties within the Tiglio I and the Tiglio II framework;
- fair value accounting for the various derivative positions of the Telecom Italia Group, including the original and significant derivative positions of Olivetti that came about from the 1999 controlling interest acquisition by Olivetti of Old Telecom Italia;
- the substantial decrease in asset valuations in the Telecom and Internet sectors in general;
- the capitalization of interest expense based on the average value of the assets under construction, as opposed to the specific borrowings related to an asset;
- the accounting for deferred income tax asset and liability recognition; and
- the sale of certain equity investments in the satellite sector, with the Telecom Italia Group recognizing gains on the sale of an entity for which it still has a continuing ownership interest.

As a result of the foregoing transactions there are material differences for the three year period ended December 31, 2003 in reconciling Italian GAAP net income and stockholders equity to U.S. GAAP. The following is a discussion of the U.S. GAAP treatment of such transactions and the application of the described U.S. GAAP accounting principles and the impact on net income or loss and stockholders equity under Italian GAAP for the three year period ended December 31, 2003. For a complete description of the Telecom Italia Group s reconciliation and other required U.S. GAAP disclosures see Notes 27, 28 and 29 of the Notes to the Consolidated Financial Statements included elsewhere herein.

Year ended December 31, 2003

Net Income, net of minority interests

Under Italian GAAP, net income was 1,192 million, compared to 1,841 million under U.S. GAAP. The increase in net income of 649 million is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above which resulted in material adjustments to the Italian GAAP operating results. A description of such transactions and accounting differences and their impact on 2003 are described below:

- As discussed in Note 29 (i) of the Notes to the Consolidated Financial Statements, the Telecom Italia Group adopted the accounting and presentation requirements of SFAS 142 as of January 1, 2002 for accounting applicable to goodwill and indefinite-lived intangible assets. The requirements of SFAS 142 are such that goodwill and certain non-amortizing intangibles are no longer considered to be wasting assets. Instead, it is necessary to apply a fair value approach to goodwill on an annual basis. The total adjustment deriving from the application of SFAS 142 in 2003 was 268 million (which includes the amortization of goodwill under Italian GAAP and is net of the reversal of accumulated amortization of goodwill pertaining to New SEAT, reclassified to discontinued operations). For U.S. GAAP purposes, applying SFAS 142, this amount has been reversed, increasing operating income under U.S. GAAP by the same amount.

Table of Contents

- As discussed in Note 27 of the Notes to the Consolidated Financial Statements, the Merger has been accounted for as the acquisition of a minority interests under U.S. GAAP. Therefore the basis of accounting, including the exchange of Olivetti (now Telecom Italia) shares for Old Telecom Italia shares, has been determined on the basis of fair value, generating substantially higher amounts of intangibles, goodwill, other assets and shareholders equity compared to Italian GAAP. Similar U.S. GAAP accounting treatment was also applied to Olivetti s 1999 acquisition of control of Old Telecom Italia. As a result, these transactions gave rise to classes of assets, in particular other tangible and intangible assets besides goodwill, that are being amortized. These accounting principle differences accounted for approximately 946 million in additional income gross of taxes in 2003.

- Telecom Italia, due to its high levels of gross debt, has entered into significant interest rate and currency swaps in order to hedge the economic risk associated with those positions. From the perspective of U.S. GAAP, these transactions have not met the accounting requirements to allow the Telecom Italia Group to utilize hedge accounting. Therefore, the fair values of the Telecom Italia Group s derivatives have been marked to market with the change in the fair values being charged to income. In 2003, pre-tax expense for the Telecom Italia Group was 171 million.

- In 2003, for Italian GAAP purposes, Olivetti (now Telecom Italia) recognized an additional tax benefit of 1,266 million related to the write-down taken in the tax basis of the investment in Old Telecom Italia in 2002. The tax benefit arising from this write-down (totaling 2,397 million), was not fully recognized in the Italian GAAP financial statements of Olivetti at December 31, 2002, as the use of the tax benefit was subject to, among other things, the completion of the Merger. However, for U.S. GAAP purposes, the Merger was considered to be a tax planning strategy that would, more likely than not, allow the recognition of the tax asset. Therefore, for U.S. GAAP accounting purposes the entire deferred tax asset was recognized in the 2002 U.S. GAAP net income.

- As a result of the sale of New SEAT in August 2003, the activities of New SEAT are treated as a discontinued operation for U.S. GAAP. During 2003 there were significant U.S. GAAP adjustments relating to New SEAT which are the results of transactions which are described in more detail in the discussion for the year ended December 31, 2002 and the year ended December 31, 2001. The adjustments, which are included in the discontinued operation line of the U.S. GAAP reconciliation, resulted in an increase in U.S. GAAP net income of 473 million.

Stockholders Equity, net of minority interests

Stockholder s equity under U.S. GAAP at December 31, 2003 was 35,067 million, compared to 16,092 million under Italian GAAP. The overall impact of the U.S. GAAP adjustments was to increase stockholders equity net of minority interests by 18,975 million.

Total assets as of December 31, 2003 under Italian GAAP were 80,501 million, compared to 108,093 million included in the U.S. GAAP balance sheet, an increase under U.S. GAAP in total assets of 27,592 million. The difference can be attributed to the following:

- As described above and in Note 27 of the Notes to the Consolidated Financial Statements, the differences in accounting principles for the acquisition of the minority interests in Old Telecom Italia, in particular the valuation of Olivetti (now Telecom Italia) shares exchanged for the Old Telecom Italia minority interests shares, increased the book value of the U.S. GAAP equity by 24,161 million. Approximately 17,927 million of this increase came from the value of the shares exchanged, which for Italian GAAP purposes have not been accounted for at fair value.

- Approximately 364 million related to the capitalization of interest expense on construction in progress. For U.S. GAAP purposes, the Telecom Italia Group capitalizes interest on the average amount of construction in progress throughout the year; however for Italian GAAP purposes only interest expense on specific borrowings related to fixed assets are capitalized.

- For purposes of U.S. GAAP, the Telecom Italia Group has not amortized goodwill since January 1, 2002. The effect on shareholders equity has been an increase of 364 million compared to Italian GAAP shareholders equity.

- For purposes of U.S. GAAP, the Telecom Italia Group accounted for 4,982 million of additional deferred tax liabilities principally in connection with the purchase accounting mentioned above and other business combinations.

Table of Contents

Total liabilities as of December 31, 2003 under Italian GAAP were 59,912 million, compared to 67,946 million under U.S. GAAP. In particular, total long-term debt increases from 30,852 million under Italian GAAP to 32,586 million under U.S. GAAP, due to the following items:

- Telecom Italia has entered into a series of leasing arrangements whereby selected properties have been transferred to certain equity method investees. Prior to these arrangements Telecom Italia had owned these properties. Under Italian GAAP, the transfers of the assets and the subsequent lease agreements have been accounted for as a sale and operating lease. Under U.S. GAAP, the fixed assets remain on the balance sheet, with the lease agreements included in long-term debt. The long-term debt at the end of 2003 includes an additional 2,071 million related to the effects of the leasing agreements.

- In 2001 Telecom Italia entered into an arrangement whereby certain securities were transferred to an existing wholly owned entity, this entity was then partially sold after incurring non-recourse indebtedness. Under U.S. GAAP the transaction did not qualify for sale accounting, therefore at the end of 2003 an additional 191 million is still included in long-term debt.

Year ended December 31, 2002

Net Income, net of minority interests

Under Italian GAAP, the net loss for the year ended December 31, 2002 was 773 million, whereas under U.S. GAAP the result was net income of 1,956 million. In 2002, the 2,729 million improvement in net result from Italian to U.S. GAAP is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above that have resulted in material adjustments to the Italian GAAP operating results. A description of such transactions and accounting differences and their impact on 2002 are described below:

- The adoption of SFAS 142 decreased pre-tax loss by 524 million.

- In 2000 Telecom Italia entered into a series of transactions whereby certain real estate assets were transferred to a related party and subsequently partially sold. Telecom Italia retained an interest in the vehicle that held the real estate assets and, concurrent with the transaction, entered into long-term leases for the assets. In 2002, those same assets, in conjunction with other real estate assets of the Telecom Italia Group, were again transferred through a complex series of contributions, acquisitions and disposals (collectively referred to as the Tiglio transactions). The result of the Tiglio transactions was that, under U.S. GAAP, the Telecom Italia Group was still considered to retain an interest in the underlying real estate assets. Therefore they failed the requirements under U.S. GAAP to recognize any gains on the sales and the Telecom Italia Group was not allowed, under U.S. GAAP, to deconsolidate the assets and liabilities associated with the Tiglio structuring. Under U.S. GAAP in 2002, the increase in pre-tax loss of 153 million is due to the reversal of the gain recognized in the underlying Italian GAAP financial statements for the Tiglio transactions, net of the continuing impact of the original real estate transaction in 2000.

- Telecom Italia considers a certain amount of shares in its controlled subsidiaries to be available for sale , meaning that those shares are available to be sold on the open market when the proper conditions exist. These shares are accounted for in marketable securities at the lower of cost or market for Italian GAAP purposes. For purposes of U.S. GAAP, it is not possible to allocate a portion of the shares held in the consolidated subsidiary as marketable securities in the balance sheet, instead, all of the shares must be consolidated. The effect on the consolidation of the Telecom Italia Group is to decrease the net income attributable to minority interests and to decrease the associated minority interest liability on the U.S. GAAP balance sheet. In 2002, the minority interests allocation performed under Italian GAAP was decreased by 83 million pre-tax, representing the fact that the Telecom Italia Group actually holds a higher percentage of shares in the controlled subsidiary than is accounted for in the Italian GAAP consolidation, therefore the earnings allocated to the minority interest is less in the U.S. GAAP results.

- U.S. GAAP requires that interest expense be capitalized on all qualified borrowings for assets under construction. Italian GAAP requires that interest expense only be capitalized on assets that have a specific borrowing. During 2002, the Group continued to maintain the UMTS licenses acquired between 2000 to 2002 in construction in progress while the supporting networks are implemented. Under U.S. GAAP, an additional 127 million in interest expense was capitalized as the financing costs associated with constructing these assets. Interest capitalization will cease on these assets when they are ready for use. The higher level of capitalized interest results in higher levels of depreciation charges in the future.

Table of Contents

- As described above, certain derivative instruments intended to hedge the economic risks of Telecom Italia s high levels of debt do not satisfy the hedge accounting treatment required under U.S. GAAP. In 2002 the fair value of these derivative instruments increased net income by 319 million.

- In 2002, for U.S. GAAP purposes, Olivetti (now Telecom Italia) took a tax only write-down of its existing investment in Old Telecom Italia, with a total tax benefit of 2,397 million being created. For Italian financial reporting purposes, this tax asset was reserved for 1,266 million as the recognition of the tax benefit was dependent upon, among other things, the Merger being consummated. For U.S. GAAP purposes, the tax asset was considered more likely than not to be recovered due to the use of the Merger as a tax planning strategy that could reasonably be considered to be consummated. Therefore, for U.S. GAAP purposes, the 2,397 million asset was fully recognized in 2002 net income, whereas for Italian GAAP it was recognized in part in 2002 and in part in 2003.

As a result of the sale of New SEAT in August 2003, the activities of New SEAT are treated as a discontinued operation for U.S. GAAP. During 2002 there were significant U.S. GAAP adjustments relating to New SEAT which are consolidated into the gross adjustment in the discontinued operation line of the U.S. GAAP reconciliation. The most significant of these adjustments included:

- Telecom Italia entered into a simultaneous put and call arrangement with a minority interest shareholder in its 2000 acquisition of SEAT. Under U.S. GAAP, that transaction was considered the acquisition of a minority interest, and the entire agreement was accounted for in the 2000 U.S. GAAP financial statements. A significant portion of that acquisition was also written-off in the 2000 U.S. GAAP financial statements. In 2000 there was no accounting recognition for this agreement in the Italian GAAP financial statements. In the 2002 Italian GAAP financial statements, Telecom Italia accrued for an additional 1,942 million of the estimated amount of the put/call transaction, representing the estimated amount of the required future payment that will not be recoverable from the operations of SEAT. As the entire put/call financing, including the associated goodwill and impairment, had already been accounted for in the U.S. GAAP financial statements, the 2002 recognition of the same event in the underlying Italian GAAP financial statements requires that the 2002 recognition of the impairment be reversed, increasing U.S. GAAP net income.

- In 2002, Telecom Italia recorded additional impairments to its SEAT investment. As discussed in the accompanying financial statements as of December 31, 2002, Telecom Italia reviewed the carrying value of its investment in the Internet and Media operating segment as of December 31, 2002. That analysis resulted in an additional impairment charge for U.S. GAAP of 1,808 million. This difference is due to the fact that, because a different basis of accounting under Italian and U.S. GAAP was used for the original acquisition of SEAT, the carrying values of the reporting units impaired in 2002 were different, therefore leading to different impairment amounts.

Stockholders Equity, net of minority interests

Stockholder s equity under U.S. GAAP at December 31, 2002 was 15,224 million, compared to 11,640 million under Italian GAAP. The overall impact of the U.S. GAAP adjustments was a material increase in stockholders equity net of minority interests of 3,584 million, with the net increase due to certain material adjustments in certain line items of the U.S. GAAP condensed consolidated balance sheet.

Total assets as of December 31, 2002 under Italian GAAP were 83,384 million, compared to 92,911 million included in the U.S. GAAP balance sheet, an increase in total assets of 9,527 million. The difference can be attributed to the following:

- at the end of 2002, there was a total of 31,065 million of goodwill recorded under U.S. GAAP, compared to 27,894 million for Italian GAAP, an increase of 3,171 million. The higher level of goodwill is primarily attributable to the differences in accounting principles related to accounting for acquisition transactions that involve share exchanges and the discontinuance of goodwill amortization for U.S. GAAP purposes. The most significant difference is attributable to the 1999 acquisition by Olivetti (now Telecom Italia) of its controlling stake in Old Telecom Italia;

- net fixed assets on the U.S. GAAP balance sheet are higher due to the inclusion of the real estate transferred to IM.SER in 2000 and Tiglio I and Tiglio II in 2002, which under U.S. GAAP have a book value of 1,907 million as of December 31, 2002, whereas under Italian GAAP these fixed assets are not recorded. Instead, the vehicles that own the assets and for which the Telecom Italia Group holds a minority interest stake are recognized on the equity basis of accounting; and

- other various items including intangibles arising from purchase accounting under U.S. GAAP, capitalization of interest on tangible and intangible assets under construction and deferred tax assets.

Table of Contents

Total liabilities as of December 31, 2002 under Italian GAAP were 62,760 million, compared to 68,314 million under U.S. GAAP. With respect to liabilities, the material impact from the U.S. GAAP adjustments relates to long-term debt. Total long-term debt increases from 33,804 million under Italian GAAP to 38,375 million under U.S. GAAP, due to the following items:

- SEAT Put/Call Option Financing pursuant to the various transactions relating to the arrangements between Huit II and the J.P. Morgan Chase Group, in which J.P. Morgan Chase had a put option to Telecom Italia for approximately 710 million SEAT shares at a price of 4.20 per share and Telecom Italia had a call option on approximately 660 million SEAT shares for the same price. The strike price was subsequently renegotiated to 3.40 per share. U.S. GAAP considers this transaction as the acquisition financing of a minority equity interest. As a result, U.S. GAAP required Telecom Italia to record additional long-term debt of 2,417 million. Telecom Italia accrued 569 million of the obligation in 2001 which was paid in 2002 at its present value (500 million), and 1,942 million in 2002. The amount accrued under Italian GAAP in 2002 is included under Other Liabilities in the accompanying financial statements, leaving an unrecognized liability of 475 million of the put/call transaction.

- Sale of Real Estate to IM.SER and Tiglio Projects In 2000 Telecom Italia transferred certain properties to a wholly owned subsidiary, IM.SER, after which Telecom Italia sold 60% of the shares to third party investors. After the sale of the majority stake in IM.SER, it subsequently borrowed 2,427 million and distributed the cash to the shareholders as an extraordinary dividend. Telecom Italia received, from both the divested equity ownership stake and the special dividend from IM.SER, approximately 2,700 million in cash receipts. Under Italian GAAP the Group recognized a gain on the partial sale of the ownership interest, removed the historical cost of the real estate from the balance sheet and IM.SER s debt was not recognized. Telecom Italia subsequently leased the assets back from IM.SER. For purposes of U.S. GAAP, the continuing economic interest of the Group in IM.SER requires that the real estate remain on the consolidated balance sheet, along with the associated debt. In 2002, as discussed above, the Telecom Italia Group also entered into a series of transactions with related parties and affiliates whereby certain real estate assets were transferred in exchange for ownership interests in two new companies (Tiglio I and Tiglio II) and the right to share in future sales of real estate property (also referred to as the Tiglio transactions). Therefore, under U.S. GAAP, similar to IM.SER, the assets and debt associated with the Tiglio transactions must remain on the consolidated balance sheet of the Telecom Italia Group. The debt on the consolidated U.S. GAAP balance sheet at the end of 2002 for these transactions (IM.SER and Tiglio) was 2,366 million.

Year Ended December 31, 2001

Net Loss, net of minority interests

Under Italian GAAP, the net loss for the year ended December 31, 2001 was 3,090 million and under U.S. GAAP the net loss was 4,006 million. In 2001, the 916 million increase in net loss from Italian to U.S. GAAP is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above that resulted in certain material adjustments. A description of such transactions and accounting differences and their impact on 2001 are described below:

- In 2001 the net effect of applying the purchase method of accounting relating to the acquisition of Old Telecom Italia resulted in an increase of the loss for U.S. GAAP reporting purposes of 483 million, principally as a result of higher amortization expense for U.S. GAAP purposes (where the purchase price allocation included also the identification of intangible assets in addition to goodwill). Under Italian GAAP all the excess of the purchase price was allocated to goodwill resulting in lower amortization expense.

- In 2001 Telecom Italia sold certain non-core investments in satellite sector companies, transferring its equity interests to Mirror, a wholly owned company, at fair value. Mirror borrowed 217 million in non-recourse debt to acquire these assets. Subsequent to the transfer, Telecom Italia sold 70% of Mirror to a merchant bank for 233 million. For purposes of Italian GAAP the Company recognized a gain of 170 million, with no additional debt recorded on the balance sheet. For Italian GAAP purposes the remaining equity investment was impaired for 40 million at December 31, 2001. For purposes of U.S. GAAP, Mirror was deemed to be a non-qualified special purpose entity, therefore the accounts of Mirror were required to be consolidated within the Telecom Italia Group. The effects of consolidating Mirror into the Telecom Italia Group s U.S. GAAP financial statements was to reverse the gain and the impairment recognized and increase the U.S. GAAP net loss by 130 million, and to place an

177

Table of Contents

additional 450 million in debt on the balance sheet, 217 million as bank debt and 233 million as additional minority interest.

- Certain subsidiaries of the Telecom Italia Group have their own publicly traded shares, which they use from time to time to effect acquisitions. Under Italian GAAP the reduction of the Telecom Italia Group s ownership interest in a subsidiary is accounted for as an adjustment to stockholders equity. Under U.S. GAAP, the Telecom Italia Group consistently accounts for these types of dilutions as a non-operating gain or loss through the statement of operations. In 2001, 325 million in gains were recorded in the U.S. GAAP results due to these types of transactions.

Partially offsetting the effects of the foregoing was the capitalization of interest expense on construction in progress (including the UMTS licenses and their supporting networks) which reduced the U.S. GAAP loss by 124 million pre-tax.

As a result of the sale of New SEAT in August 2003, as noted above, the activities of New SEAT are treated as a discontinued operation and adjustments related to New SEAT are included in the gross adjustment under the discontinued operation line. The most significant of these adjustments included:

- *SEAT acquisition* In late 2000 and into 2001, SEAT acquired a significant number of companies using SEAT s own shares as consideration. Under Italian GAAP there is no economic value assigned to the use of stock in a transaction, therefore the purchase price of these transactions on an Italian GAAP basis is considerably lower. For purposes of U.S. GAAP, these transactions have also been treated as acquisitions; however, the fair value of the consideration given is used as the basis to assign the purchase price to the fair value of the assets acquired and liabilities assumed. In general, higher levels of intangible assets, including goodwill, exist in these transactions. For U.S. GAAP purposes, SEAT added additional goodwill of 810 million in 2001 due to the use of its stock as the acquisition currency. In 2001, 184 million of this goodwill was amortized in the statement of operations.

- In 2001, the Telecom Italia Group recorded 2,381 million in impairment charges under Italian GAAP. For purposes of U.S. GAAP, an additional 2,641 million in impairment charges were recorded, for a total charge of 5,022 million. For purposes of Italian GAAP the Telecom Italia Group used the fair value of the individual entities reviewed, with fair value generally being based on a discounted cash flow model. For purposes of U.S. GAAP, the process of reviewing assets for possible impairments requires the review of assets assuming the lowest level of cash flows . Therefore, for purposes of U.S. GAAP, the Telecom Italia Group was required to review certain assets for impairment at a lower level of analysis than that performed in the Italian GAAP review. Of the total charges under U.S. GAAP for impairment in 2001, 2,338 million was related to SEAT and SEAT subsidiaries. The remaining amount of the impairment charge is related to investments in Austria and Latin America.

- Telecom Italia entered into a simultaneous put and call arrangement with a minority interest shareholder in its 2000 acquisition of SEAT. The U.S. GAAP treatment of the transaction is described above. In 2001, the Telecom Italia Group re-negotiated certain terms with the option holder, with an agreement to reduce the option put price. However, the Telecom Italia Group was still required to pay the difference in the strike price reduction to the holder. For purposes of Italian GAAP, an accrual of 569 million was made to record this portion of the obligation in 2001, with a comparable charge to the statement of operations. For purposes of U.S. GAAP, since the transaction is recorded as debt on the U.S. GAAP balance sheet and accounted for in the SEAT purchase accounting the charge is reversed under U.S. GAAP and reduces the U.S. GAAP loss by 569 million before tax.

Stockholders Equity, net of minority interests

Stockholders equity under U.S. GAAP at December 31, 2001 was 13,612 million, compared to 12,729 million under Italian GAAP. Although the overall impact on stockholders equity of the U.S. GAAP adjustments was to increase stockholders equity net of minority interests by only 883 million, certain adjustments were material and certain line items of the U.S. GAAP condensed consolidated balance sheet were materially impacted.

Total assets as of December 31, 2001 under Italian GAAP were 94,227 million, compared to 103,588 million on the U.S. GAAP balance sheet, an increase in total assets of 9,361 million. The difference can be attributed to three asset classes:

- at the end of 2001, there was a total of 34,323 million in goodwill recorded under U.S. GAAP, compared to 31,887 million for Italian GAAP, an increase of 2,436 million. The higher level of

178

Table of Contents

goodwill is attributable to the continuing effects of both the SEAT acquisition and the subsequent acquisitions done by SEAT, generally using their stock as the acquisition consideration, as well as the residual amount of goodwill from the STET-Telecom Italia Merger;

- net fixed assets on the U.S. GAAP balance sheet are higher due to the inclusion of the real estate transferred to IM.SER in 2000 which under U.S. GAAP have a book value of 2,202 million as of December 31, 2001; and

- other intangibles arising from the purchase accounting under U.S. GAAP for 2,698 million.

With respect to liabilities, the material impact from the U.S. GAAP adjustments relates to long-term debt. Long-term debt increased from 37,747 million to 43,117 million, due to the following items:

- SEAT Put/Call Option Financing pursuant to the various transactions relating to the arrangements between Huit II and the J.P. Morgan Chase group, in which J.P. Morgan Chase had a put option to Telecom Italia for approximately 710 million SEAT shares at a price of 4.20 per share and Telecom Italia has a call option on approximately 660 million SEAT shares for the same price. U.S. GAAP considers this transaction as the acquisition financing of a minority equity interest. As a result, U.S. GAAP required Telecom Italia to record additional long-term debt of 2,985 million.

- Sale of Real Estate to IM.SER See a description of these transactions above under Sale of Real Estate to IM.SER and Tiglio Projects . As described above, for purposes of U.S. GAAP, the continuing economic interest of the Telecom Italia Group in IM.SER requires that the real estate remain in the consolidated balance sheet, along with the associated debt. The debt on the consolidated U.S. GAAP balance sheet at the end of 2001 for this transaction was 2,520 million.

As a result of the demerger and sale of New SEAT, the J.P. Morgan put and call arrangements were settled during 2003, so that the adjustments made during 2001 and 2002 were no longer required in 2003.

Table of Contents

Recent Developments Telecom Italia Group Results for the First Quarter Ended March 31, 2004 compared to March 31, 2003

The information in this section should be read in conjunction with the Telecom Italia Group s consolidated financial statements, and the notes thereto, included elsewhere in this Annual Report.

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.

	Three Months ended March 31,	
	2003	**2004**
	(Unaudited)	
	(millions of Euro)	
Statement of Operations Data:		
Operating revenues	7,291	7,418
Other income	69	58
Total revenues	7,360	7,476
Cost of materials	415	452
Salaries and social security contributions	1,115	1,033
Depreciation and amortization	1,653	1,590
Other external charges	2,813	2,813
Changes in inventories	(18)	(44)
Capitalized internal construction costs	(145)	(156)
Total operating expenses	5,833	5,688
Operating income	1,527	1,788
Financial income	288	292
Financial expense	(940)	(722)
of which writedowns and equity in losses in affiliated and other companies, net	*(82)*	*(14)*
Other income and expense, net	(7)	(14)
Income before income taxes and minority interests	868	1,344
Income taxes	(713)	(809)
Net income before minority interests	155	535
Minority interest	(552)	(258)
Net income (loss)	(397)	277

	As of December 31, 2003	As of March 31, 2004
		(Unaudited)
	(millions of Euro)	
Balance Sheet Data:		
Total current assets	22,498	22,082
Fixed assets, net	18,324	17,977
Intangible assets, net	33,853	33,474
Total assets	80,501	79,537
Short-term debt	10,613	6,863
Total current liabilities	23,373	19,222
Long-term debt	30,852	33,071
Total liabilities	59,912	58,358
Total stockholders equity before minority interest	16,092	16,390
Total stockholders equity	20,589	21,179

180

Table of Contents

Business Unit Financial Data

The following table sets forth operating revenues, gross operating profit and operating income by Business Unit.

	Operating Revenues		Gross Operating Profit		Operating Income	
	Three months ended March 31,		Three months ended March 31,		Three months ended March 31,	
	2003	2004	2003	2004	2003	2004
	(Unaudited) (millions of Euro)					
Wireline(1)(2)	4,242	4,303	1,970	2,037	1,228	1,315
Mobile	2,616	2,937	1,262	1,425	897	955
South America(2)	291	264	106	101	41	37
Internet and Media(3)	345	149	47	3	(35)	(24)
IT Market	156	169	10	11	0	3
IT Group	229	225	11	15	(22)	(15)
Olivetti Tecnost	158	144	2	7	(5)	2
Other activities and elimination(2)(4)	(746)	(773)	(100)	(105)	(577)	(485)
Total	**7,291**	**7,418**	**3,308**	**3,494**	**1,527**	**1,788**

(1) Starting from January 1, 2004, the company Telefonia Mobile Sanmarinese S.p.A., 51% owned by Intelcom San Marino, is consolidated on a line by line basis in the Wireline Business Unit.

(2) The data refer to Entel Chile Group and Entel Bolivia Group. On March 1, 2004, the Latin America Operations function was disbanded. This function was set up in 2002 and reported to the head of the Mobile Business Unit for mobile telecommunications and to the CEO Carlo Buora for wireline telecommunications and was responsible for the global coordination of all the activities of the Group in Latin America. Telecom Italia Latam S.A. has now taken over the new role of the delocalized Corporate function in Latin America, consistent with our chosen strategy to consolidate and develop our international presence in the Latin America geographical area. The Wireline and Mobile business units with their present corporate organizational structure are nevertheless responsible for the results of the subsidiaries in Latin America under their control. As a result of this reorganization and with effect on January 1, 2004, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia are included in other activities. The data relating to the first quarter ended March 31, 2003 has been reclassified and presented consistent with the first quarter ended March 31, 2004 presentation. This represents a change in this reported segment compared to the South America segment as reported for the three years in the period ended December 31, 2003.

(3) New SEAT, the beneficiary company of the spin-off from Seat Pagine Gialle which took place on August 1, 2003, was sold on August 8, 2003. As a result of this, the figures related to the three months ended March 31, 2003 include the results of operations of New SEAT Group that was subsequently disposed of, as well as the results of operations of the remaining part of Seat Pagine Gialle that after the spin-off was renamed Telecom Italia Media.

(4) The data refer to the activities managed by International Affairs Corporate Function, TILab, the centralized Group services and the staff functions, the financial companies, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia.

Telecom Italia Group Consolidated Results

For the three months ended March 31, 2004, our consolidated net income after minority interests was 277 million (535 million before minority interests) compared to a loss of 397 million (income of 155 million before minority interests) for the first three months of 2003. Our consolidated net income (loss) for the three months ended March 31, 2003 would have been a loss of 88 million, attributing to Olivetti the minority interest in the result of the Old Telecom Italia, acquired following the merger of Old Telecom Italia into Olivetti.

The improvement in our consolidated net income (loss) (+ 674 million) was due to the following factors:

- the increase in operating income (+ 261 million, of which 75 million is attributable to the cancellation of the TLC license fee following the verdict handed down by the European Court of Justice in September 2003);
- the reduction in financial expense, net of 222 million; and
- the lower minority interests in earnings of 294 million due to the Merger.

181

Table of Contents

These factors were offset in part by higher income taxes of 96 million.

Our consolidated operating revenues for the three months ended March 31, 2004 were 7,418 million, an increase of 127 million or 1.7% compared to the same period in 2003. Excluding the negative effects of exchange rate fluctuations (10 million) and changes to the consolidation area (231 million, of which 185 million related to the sale of New SEAT from the Internet and Media Business Unit which occurred in August 2003), organic growth reached 5.2% (an increase of 368 million). Organic growth of consolidated operating revenues reflected:

- a significant increase in the revenues of the Mobile Business Unit (+ 326 million), which were driven by the domestic market (voice traffic and value-added services) and by the South-American market;
- an increase in the revenues of the Wireline Business Unit (+ 42 million), which was achieved due to the effective management of the core telephone services market and the growth in innovative business segments such as Broadband, innovative data transmission and data and Web VAS for the business clientele;
- an increase in the revenues of the IT Market Business Unit (+ 23 million) and Internet and Media (+ 23 million); and
- a decrease in the revenues of wireline/integrated companies in South America (- 35 million), mainly due to the Entel Chile Group).

As of March 31, 2004, Telecom Italia had 26.4 million domestic subscriber fixed lines, including ISDN equivalent lines (compared to 26.6 million as of December 31, 2003 and 27.1 million as of March 31, 2003). As of March 31, 2004, TIM had 26.0 million domestic mobile lines in Italy (substantially in line with those as of December 31, 2003; as of March 31, 2003, TIM had 25.7 million domestic mobile lines).

Our consolidated Gross Operating Profit, as calculated below, was 3,494 million for the three months ended March 31, 2004 compared to 3,308 million for the three months ended March 31, 2003 (please see table below), an increase of 186 million or 5.6%. In the three months ended March 31, 2004, gross operating profit was positively impacted, other than by the increase in consolidated operating revenues, by the lower costs of personnel (a decrease of 82 million, from 1,115 million in the three months ended March 31, 2003 to 1,033 million in the three months ended March 31, 2004) and the cancellation of the TLC license fee (66 million in the three months ended March 31, 2003).

As 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. 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:

	Three Months ended March 31,	
	2003	2004
	(Unaudited) (millions of Euro)	
Operating income	1,527	1,788
Depreciation and Amortization	1,653	1,590

Other external charges:		
• Provision for bad debts	75	51
• Write-downs of fixed assets and intangibles		1
• Provision for risks	32	12
• Other provisions and operating charges	83	106
Other income (excluding operating grants, reimbursements for personnel costs and costs of external services rendered)	(62)	(54)
Gross Operating Profit	**3,308**	**3,494**

We believe that Gross Operating Profit (as calculated above) provides the best indication of our operating performance and is meaningful information for investors. In addition, we also believe (although other telecommunication 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.

Table of Contents

Excluding the charges for the TLC license fee (66 million) recorded in the three months ended March 31, 2003, Gross Operating Profit increased by 120 million or 3.6%. Moreover, excluding the negative effects of exchange rate fluctuations (4 million) and changes to the consolidation area (46 million, mainly due to the disposal of the New SEAT) organic growth of Gross Operating Profit was 5.1% (an increase of 170 million) and arose principally from the Mobile Business Unit (+ 138 million) and the Wireline Business Unit (+ 28 million).

Gross operating margin was 47.1% in the three months ended March 31, 2004 compared to 45.4% in the three months ended March 31, 2003 (46.3% excluding from the first quarter of 2003 the charges for the TLC license fee).

Our consolidated operating income amounted to 1,788 million for the three months ended March 31, 2004 compared to 1,527 million for the three months ended March 31, 2003 (an increase of 261 million or 17.1%).

Excluding the charges for the TLC license fee (75 million, which includes a provision for the reserves for risks and charges of 9 million) recorded in the three months ended March 31, 2003, operating income increased by 186 million or 11.6%. Organic growth was 184 million or 11.5%.

The increase in operating income was largely due to the decrease of 63 million in depreciation and amortization (from 1,653 million in the three months ended March 31, 2003 to 1,590 million in the three months ended March 31, 2004) principally as a result of the following factors:

- the decrease of 106 million in amortization of goodwill (from 492 million in the three months ended March 31, 2003 to 386 million in the three months ended March 31, 2004), mainly due to the disposal of New SEAT and the write-downs of goodwill made in 2003;
- the increase in amortization and depreciation of fixed intangible (other than goodwill) and tangible assets of 43 million (from 1,161 million in the three months ended March 31, 2003 to 1,204 million in the three months ended March 31, 2004), of which 34 million relates to the amortization of the UMTS license by TIM S.p.A..

As a percentage of operating revenues, operating income was 24.1% in the three months ended March 31, 2004 compared to 20.9% in the three months ended March 31, 2003 (22.0% excluding from the first quarter of 2003 the charges for the TLC license fee).

Total financial income and expense, net decreased by 222 million or 34.0%, from a net expense of 652 million in the three months ended March 31, 2003 to a net expense of 430 million in the three months ended March 31, 2004, mainly as a result of the following:

- a decrease in interest expense mainly due to the reduction in the level of interest rates as well as to the lower average borrowings outstanding during the three months ended March 31, 2004, partially offset by the excess of losses on foreign exchange over the positive effect of the monetary correction incurred by Digitel;
- the reduction in net write-downs and equity in losses in affiliated and other companies of 68 million (from 82 million in the three months ended March 31, 2003 to 14 million in the three months ended March 31, 2004);

- the gain of 62 million arising from the sale in January 2004 of the residual stake (14.78%) held by the Group in Telekom Austria.

Our gross debt decreased by 1,531 million, from 41,465 million at December 31, 2003 to 39,934 million at March 31, 2004 and our net financial debt decreased by 2,560 million, from 33,346 million as of December 31, 2003 to 30,786 million as of March 31, 2004. See the reconciliation of gross debt and net financial debt below. Net financial debt decreased mainly as a result of the followings:

- cash flow from operating activities was higher than capital expenditures (826 million) and other investing activities (36 million) totaling 862 million (860 million in the three months ended March 31, 2003);

- proceeds from the sale of tangible and intangible assets and other investing activities of 100 million.

- net proceeds from the sale of Telekom Austria of 768 million.

183

Table of Contents

Net financial debt is determined as follows:

	As of December 31, 2003	As of March 31, 2004
		(Unaudited)
	(millions of Euro)	
Short-term debt, including current portion of long-term debt	10,613	6,863
Long-term debt	30,852	33,071
Gross Debt	41,465	39,934
Cash and cash equivalents:		
• Bank and postal accounts	(4,870)	(7,514)
• Cash and valuables on hand	(7)	(6)
• Receivables for securities held under reverse repurchase agreements	(60)	(12)
• Marketable debt securities	(2,719)	(1,456)
Financial accounts receivable (included under Receivables and Other Current Assets)	(826)	(446)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net (long-term)	(307)	(265)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net (short-term)	670	551
Net Financial Debt(1)	**33,346**	**30,786**

(1) 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. Therefore, we believe it is useful information for investors to receive and is consistent with how we present ourselves to the analyst community.

The portion of gross financial debt due beyond twelve months rose from 74% at December 31, 2003 to 83% at March 31, 2004. On March 31, 2004, short-term debt included 5,878 million as current portion of long-term debt (9,289 million at December 31, 2003). See, however, Liquidity and Capital Resources Capital Resources.

In the first quarter of 2004, we repaid notes with a total principal amount of 3,225 millions, as follows:

- on January 1, 2004, 1,331 million principal amount of convertible notes 2001-2004 issued by Telecom Italia S.p.A.;
- on March 19, 2004, 385 million principal amount of convertible notes 2002-2004 issued by Olivetti Finance N.V. with the guarantee by Telecom Italia S.p.A.;
- on March 22, 2004, 1,500 million principal amount of notes issued by Telecom Italia S.p.A., originally maturing on June 21, 2005, repaid in advance, at par, in accordance with the terms of the notes;

- 9 million principal amount of notes 2002-2022 issued by Telecom Italia S.p.A. and reserved for subscription by employees (at March 31, 2004, the residual amount was 206 million).

On March 26, 2004, 850 million principal amount of notes were cancelled by Olivetti Finance N.V. after their buy-back:

- 650 million principal amount of notes that are part of the Olivetti Finance N.V. S.A. (originally Olivetti International Finance N.V.) 4,200 million Notes (1999-2004) with a fixed annual 5 3/8% coupon +0.45% step-up maturing in July 2004. As a result of this cancellation, notes in the principal amount of 3,550 million remain outstanding;

- Olivetti Finance N.V. S.A. 200 million principal amount of notes (2002-2005) with a floating rate coupon of 1.45% over the EONIA maturing in February 2005. As a result of this transaction none of these notes remain outstanding.

The Program, also continued for trade accounts receivable generated by the services rendered to residential customers of Telecom Italia S.p.A.. The securitization and the factoring arrangements led to an improvement in consolidated net financial debt as of March 31, 2004 of 833 million (1,201 million as of December 31, 2003).

Table of Contents

As of March 31, 2004, the Telecom Italia Group had 93,036 employees, a decrease of 151 units compared to December 31, 2003. The fall is due to the changes to the area of consolidation (a decrease of 455 units, of which 188 units relating to the sale of CIPI by Internet and Media and 257 units as a result of the outsourcing of the Document management activities by Telecom Italia and Emsa Servizi) partially offset by increased hiring in the operating businesses (an increase of 304 units).

Business Units

The following discussion relates to our principal Business Units as they were organized in the first quarter of 2004.

In particular, on March 1, 2004, the Latin America Operations function was disbanded. This function was set up in 2002 and reported to the head of the Mobile Business Unit for mobile telecommunications and to the CEO Carlo Buora for wireline telecommunications and was responsible for the global coordination of all the activities of the Group in Latin America. Telecom Italia Latam S.A. has now taken over the new role of the delocalized Corporate function in Latin America, consistent with our chosen strategy to consolidate and develop our international presence in the Latin America geographical area. The Wireline and Mobile Business Units with their present corporate organizational structure are nevertheless responsible for the results of the subsidiaries in Latin America under their control.

As a result of this reorganization and with effect on January 1, 2004, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia are included in other activities.

Wireline

The following table sets forth, for the periods indicated, certain financial and other data for the Wireline Business Unit.

	Three Months ended March 31,	
Wireline	**2003(1)**	**2004(1)**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	4,242	4,303
Gross operating profit	1,970	2,037
% of gross operating revenues	46.4	47.3
Operating income	1,228	1,315
% of gross operating revenues	28.9	30.6

Number of employees at period-end	(2) 50,766	51,025

(1) The three months ended March 31, 2003 financial and other data have been reclassified and presented consistent with the three months ended March 31, 2004 presentation.
(2) Number of employees at December 31, 2003.

Wireline gross operating revenues for the three months ended March 31, 2004 were 4,303 million, an increase of 61 million or 1.4% compared to 4,242 million for the three months ended March 31, 2003; organic growth was 1% (+ 42 million). This increase was achieved mainly due to effective support of the core telephony market and to significant continuing growth of the broadband markets, innovative data services and value-added services.

In particular, Retail Internet revenues increased by 69 million or 39.9% (from 173 million in the three months ended March 31, 2003 to 242 million in the three months ended March 31, 2004), mainly achieved through the ADSL Alice and Smart offers (an increase of 76 million or 155%). Data Business revenues increased by 5 million or 1.4% (from 370 million in the three months ended March 31, 2003 to 375 million in the three months ended March 31, 2004). The growth in these revenues has been driven by innovative data services (+ 25 million or 21.0% compared to the three months ended March 31, 2003) which offset the decrease in the revenues from traditional Data services and Leased Lines, that are subject to regulated prices and to the effect of migration to innovative services.

Table of Contents

In addition, the success and growth of new value-added service packages (Tutto 4* and Chat SMS), which rose to 589,000 units at March 31, 2004, contributed together with a stable market share on traffic to stabilizing revenues in the Retail Telephone segment. With regard to the Internet segment, broadband accesses at March 31, 2004 rose to 2,800,000, of which 2,575,000 are attributable to the domestic market, with an increase of 535,000 accesses in the three months ended March 31, 2004 (+114% compared to March 31, 2003). Accesses in the European markets of Germany, France and The Netherlands totaled 225,000 and increased by 65,000 accesses compared to December 31, 2003.

Gross operating profit increased by 67 million or 3.4% from 1,970 million in the three months ended March 31, 2003 to 2,037 million in the three months ended March 31, 2004 (excluding the charges for the TLC license fee recorded in the three months ended March 31, 2003 of 37 million, gross operating profit increased by 1.5%).

Gross operating margin was 47.3% in the three months ended March 31, 2004 and remained substantially stable with respect to the corresponding period of the previous year (excluding the charges for the TLC license fee). Gross operating margin benefitted also from the reductions in personnel costs.

Operating income improved by 87 million or 7.1% from 1,228 million in the three months ended March 31, 2003 to 1,315 million in the three months ended March 31, 2004 (excluding the charges for the TLC license fee recorded in the three months ended March 31, 2003, operating income increased by 3.2%). Operating income was also positively impacted by lower levels of depreciation and amortization and provision for bad debts.

As of March 31, 2004, the Wireline Business Unit had 51,025 employees, an increase of 259 units compared to December 31, 2003.

Mobile (TIM group)

The following table sets forth, for the periods indicated, certain financial and other data for the Mobile Business Unit.

Mobile	Three Months ended March 31, 2003	Three Months ended March 31, 2004
	(millions of Euro, except percentages and employees)	
Gross operating revenues	2,616	2,937
Gross operating profit	1,262	1,425
% of gross operating revenues	48.2	48.5

Operating income	897	955
% of gross operating revenues	34.3	32.5
Number of employees at period-end	(1)18,888	18,936

(1) Number of employees at December 31, 2003.

TIM group gross operating revenues for the three months ended March 31, 2004 were 2,937 million, an increase of 321 million or 12.3% compared to 2,616 million for the three months ended March 31, 2003. Excluding the negative effects of exchange rate fluctuations, growth was 326 million or 12.5%. Part of this increase was attributable to the international operations and in particular to the development of mobile activities in Brazil.

Consolidated Gross Operating Profit increased by 163 million or 12.9% from 1,262 million for the three months ended March 31, 2003 to 1,425 million for the three months ended March 31, 2004. Excluding the effects of exchange rate fluctuations and the charges related to the TLC license fee of 29 million recorded in the three months ended March 31, 2003, organic growth reached 10.7%. The improvement in gross operating profit was attributable principally to positive performance in Italy, offset in part by the negative impact of the Brazilian companies in the start-up phase.

Gross operating margin was 48.5% in the three months ended March 31, 2004 (49.4% in the three months ended March 31, 2003, determined by excluding the charges related to the TLC license fee).

Table of Contents

TIM group operating income for the three months ended March 31, 2004 increased by 58 million or 6.5% from 897 million in the three months ended March 31, 2003 to 955 million in the three months ended March 31, 2004; organic growth was 3.0%. Consolidated operating margin was 32.5% in the three months ended March 31, 2004 (35.4% in three months ended March 31, 2003, determined by excluding the charges related to the TLC license fee). The lower operating margin is mainly due to the start in January 2004 of amortization of the UMTS license of TIM S.p.A.. Consolidated operating income for the first quarter of 2004 was adversely affected by this larger amortization amount of 34 million.

As of March 31, 2004, the TIM Group had a total of 47.6 million mobile lines, not including Telecom Italia Group mobile lines, an increase of 7.0% compared to December 31, 2003 (a total of 44.5 million mobile lines). The Brazilian mobile lines as of March 31, 2004, totaled 9.1 million (of which 3.5 million were GSM lines), an increase of approximately 800,000 mobile lines compared to the end of 2003.

As of March 31, 2004, the Mobile Business Unit had 18,936 employees, an increase of 48 units compared to December 31, 2003.

For TIM, operating revenues for the three months ended March 31, 2004 were 2,303 million, an increase of 154 million or 7.2% over the three months ended March 31, 2003. The growth in operating revenues is due not only to the positive trend in traffic revenues, totaling 1,718 million and up 3.3% compared to the first quarter of 2003 (1,663 million) but also to the significant contribution made by the growth in revenues from value-added services. The operating revenues from VAS amounted to 299 million, a 28.3% increase compared to the first quarter of 2003; in the first quarter of 2004 the ratio of operating revenues from VAS to total service revenues was 13.4% compared to 11.1% in the first quarter of 2003.

TIM Gross Operating Profit for the three months ended March 31, 2004 was 1,289 million, a 13.5% increase compared to the first three months of 2003 (1,136 million). Excluding the charges related to the TLC license fee recorded in the three months ended March 31, 2003 (29 million), the growth in Gross Operating Profit reached 10.6%.

TIM operating income amounted to 1,004 million and increased by 124 million or 14.1% compared to the first quarter of 2003 (880 million). Excluding the charges related to the TLC license fee recorded in the three months ended March 31, 2003, growth in operating income was 10.5%.

South America (Chile and Bolivia)

The following table sets forth, for the periods indicated, certain financial and other data for the Entel Chile group and Entel Bolivia group.

	Three Months ended March 31,	
South America (Chile and Bolivia)	**2003(1)**	**2004(1)**
	(millions of	

	Euro, except percentages and employees)	
Gross operating revenues	291	264
Gross operating profit	106	101
% of gross operating revenues	36.4	38.3
Operating income	41	37
% of gross operating revenues	14.1	14.0
Number of employees at period-end	(2) 4,953	4,981

(1) The data relating to the first quarter ended March 31, 2003 has been reclassified and presented consistent with the first quarter ended March 31, 2004 presentation.
(2) Number of employees at December 31, 2003.

South America gross operating revenues for the three months ended March 31, 2004 were 264 million, a decrease of 27 million or 9.3% compared to 291 million for the three months ended March 31, 2003. The decrease in gross operating revenues was mainly attributable to the reduction in the revenues of the wireline telecommunications services of the Entel Chile Group. The exchange rate fluctuations had a positive impact of approximately 8 million (a positive effect of 16 million for Chilean Peso partly offset by a negative effect of 8 million for the Boliviano). Excluding this effect, 35 million or a 12% of decrease would have been recorded.

Gross operating profit decreased by 5 million or 4.7% from 106 million in the three months ended March 31, 2003 to 101 million in the three months ended March 31, 2004. Excluding the positive effects of exchange rate fluctuations (2 million), organic decrease was 7 million, or 6.6%.

Gross operating margin increased from 36.4% in the three months ended March 31, 2003 to 38.3% in the three months ended March 31, 2004.

Operating income decreased by 4 million or 9.8% from 41 million in the three months ended March 31, 2003 to 37 million in three months ended March 31, 2004. The positive impact due to exchange rate fluctuations was 2 million.

The following table sets forth, for the periods indicated, certain financial data on a stand alone basis for Entel Chile group and Entel Bolivia group for wireline and mobile phone services.

	Three Months ended March 31,							
South America	**2003**				**2004**			
	(millions of Euro, except percentages)							
	Wireline	**Mobile**	**Elimination**	**Total**	**Wireline**	**Mobile**	**Elimination**	**Total**
Gross operating revenues	199	123	(31)	291	169	129	(34)	264
Gross operating profit	51	55		106	47	54		101
% of gross operating revenues	25.6	44.7		36.4	27.8	41.9		38.3
Operating income	9	32		41	6	31		37
% of gross operating revenues	4.5	26.0		14.1	3.6	24.0		14.0

Internet and Media (Telecom Italia Media Group)

The following table sets forth, for the periods indicated, certain financial and other data for the Internet and Media Business Unit. In order to allow a better understanding of the results of the businesses managed by the business unit, the figures for the first quarter of 2003 are presented on an historical and pro forma basis, taking into account both the Seat spin-off and the changes in the scope of consolidation.

Internet and Media (Telecom Italia Media Group)	Three Months ended March 31, 2003(1)	2003 Pro Forma (2)	2004
	(millions of Euro, except percentages and employees)		
Gross operating revenues	345	126	149
Gross operating profit	47	(2)	3
% of gross operating revenues	13.6	(1.6)	2.2
Operating loss	(35)	(29)	(24)
% of gross operating revenues	(10.1)	(23.4)	(15.9)
Number of employees at year-end	2,029(3)	2,029(3)	1,882

(1) First quarter 2003 historical financial and other data.
(2) The pro forma first quarter 2003 financial and other data have been prepared to be consistent with the 2004 scope of consolidation and taking into account the Seat Spin-off.
(3) Number of employees at December 31, 2003.

The gross operating revenues for the three months ended March 31, 2004 were 148.5 million, an increase of 22.8 million or 18.1% compared to 125.7 million for the pro forma three months ended March 31, 2003.

Table of Contents

The organic growth was mainly influenced by the performance of the Internet business area, which recorded a 32.1% increase in operating revenues and the Television business area, which recorded a 23.7% increase in operating revenues.

In particular gross operating revenues are analyzed as follows:

- the Internet business area made the largest contribution to growth with the related revenues increasing by 32.2% from 56.8 million for the pro forma three months ended March 31, 2003 to 75.1 million for the three months ended March 31, 2004. Such increase was due to the positive trend in use of the portal Virgilio and the Internet activities, and to the improvement of operating revenues related to ADSL products;

- revenues from the Television business area were 26.4 million for the three months ended March 31, 2004 compared to 21.3 million for the pro forma three months ended March 31, 2003, an increase of 5.1 million or 23.9% evidencing the success of the program schedule of the two stations which is attracting larger numbers of viewers;

- revenues from the Office Products and Services business area were 38.2 million for the three months ended March 31, 2004 and remained substantially stable with respect to the pro forma amounts of the corresponding period of the previous year.

Gross operating profit was 3.2 million in the three months ended March 31, 2004 compared to a gross operating loss of 2.0 million in the pro forma three months ended March 31, 2003, an increase of 5.2 million. The improvement was mainly due to the above mentioned increase in operating revenues.

Operating loss decreased by 5.8 million or 19.7% from 29.4 million in the pro forma three months ended March 31, 2003 to 23.6 million in three months ended March 31, 2004.

As of March 31, 2004, Internet and Media had 1,882 employees, with a reduction of 147 units compared to December 31, 2003.

Information Technology Market

The following table sets forth, for the periods indicated, certain financial and other data for the Information Technology Market Business Unit.

	Three Months ended March 31,		
	2003(1)	2003 Pro Forma (2)	2004

	(millions of Euro, except percentages and employees)		
Gross operating revenues	156	146	169
Gross operating profit	10	11	11
% of gross operating revenues	6.4	7.5	6.5
Operating income		1	3
% of gross operating revenues		0.7	1.8
Number of employees at year-end	(3) 4,827	(3) 4,827	4,806

(1) Historical financial and other data.

(2) The pro forma first quarter 2003 financial and other data has been prepared to be consistent with the 2004 scope of consolidation. As a result of this, NETikos Group, Domus Academy and Finsiel s Enterprise business segment, which were sold during 2003, have been excluded.

(3) Number of employees at December 31, 2003.

Gross operating revenues for the three months ended March 31, 2004 were 169 million, an increase of 23 million or 15.8% compared to 146 million for the pro forma three months ended March 31, 2003. The growth was mainly attributable to the increase in the revenues of TSF (Tele Sistemi Ferroviari), Agrisian and of Finsiel.

Gross operating profit amounted to 11 million in the three months ended March 31, 2004 and remained unchanged with respect to the pro forma amounts of the corresponding period of the previous year. However, gross operating margin decreased from 7.5% in the pro forma three months ended March 31, 2003 to 6.5% in the three months ended March 31, 2004.

Table of Contents

Operating income increased by 2 million from 1 million in the pro forma three months ended March 31, 2003 to 3 million in three months ended March 31, 2004. This increase was principally attributable to Finsiel and TSF.

As of March 31, 2004, the Information Technology Market Business Unit had 4,806 employees, with a reduction of 21 units compared to December 31, 2003.

Information Technology Group

The following table sets forth, for the periods indicated, certain financial and other data for the Information Technology Group.

Information Technology Group	Three Months ended March 31, 2003	Three Months ended March 31, 2004
	(millions of Euro, except percentages and employees)	
Gross operating revenues	229	225
Gross operating profit	11	15
% of gross operating revenues	4.8	6.7
Operating loss	(22)	(15)
% of gross operating revenues	(9.6)	(6.7)
Number of employees at period-end	(1) 4,107	4,053

(1) Number of employees at December 31, 2003.

Gross operating revenues for the three months ended March 31, 2004 were 225 million, a decrease of 4 million or 1.7% compared to 229 million for the three months ended March 31, 2003.

Gross operating profit increased by 4 million or 36.4% from 11 million in the three months ended March 31, 2003 to 15 million in the three months ended March 31, 2004. This improvement was principally due to the increase in the value of production (+ 20 million) arising from the advancement of development activities for Corporate and Wireline, partially offset by an increase of 12 million in operating expenses.

Gross operating margin increased from 4.8% in the three months ended March 31, 2003 to 6.7% in the three months ended March 31, 2004.

Operating loss decreased by 7 million from a loss of 22 million in the three months ended March 31, 2003 to a loss of 15 million in three months ended March 31, 2004.

As of March 31, 2004, the Information Technology Group had 4,053 employees, with a reduction of 54 units compared to December 31, 2003.

Olivetti Tecnost Group

The following table sets forth, for the periods indicated, certain financial and other data for the Olivetti Tecnost Business Unit.

	Three Months ended March 31,	
Olivetti Tecnost Group	**2003**	**2004**
	(millions of Euro, except percentages and employees)	
Gross operating revenues	158	144
Gross operating profit	2	7
% of gross operating revenues	1.3	4.9
Operating income (loss)	(5)	2
% of gross operating revenues	(3.2)	1.4
Number of employees at period-end	(1) 2,395	2,346

(1) Number of employees at December 31, 2003.

190

Table of Contents

Gross operating revenues for the three months ended March 31, 2004 were 144 million, a decrease of 14 million or 8.9% compared to 158 million for the three months ended March 31, 2003. Excluding the effect of exchange rate fluctuations and changes in the scope of consolidation (referring in particular to the termination of activities in Latin America), organic growth was 3.6% (an increase of 5 million).

Gross operating profit increased by 5 million from 2 million in the three months ended March 31, 2003 to 7 million in the three months ended March 31, 2004, principally due to the restructuring operations implemented during 2003 which resulted in a decrease in overheads. As a result, gross operating margin increased from 1.3% in the three months ended March 31, 2003 to 4.9% in the three months ended March 31, 2004.

Operating loss in the three months ended March 31, 2003 was 5 million compared with an operating income of 2 million in the three months ended March 31, 2004.

As of March 31, 2004, the Olivetti Tecnost Business Unit had 2,346 employees, with a reduction of 49 units compared to December 31, 2003.

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

The foregoing discussion in Item 5. Operating and Financial Review and Prospects and the following discussion under Item 11. Quantitative and Qualitative Disclosures About Market Risk contains forward-looking statements which reflect management s current views with respect to certain future events, trends and financial performance. Actual results may differ materially from those projected or implied in the forward-looking statements. Further, certain forward-looking statements are based upon assumptions of future events and trends which may not prove to be accurate. The following important factors could cause our actual results to differ materially from those projected or implied in any forward-looking statements:

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

191

Table of Contents

- 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.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The following discussion should be read in conjunction with the Summary of Accounting Polices in the Notes to the Consolidated Financial Statements and in conjunction with Note 29 of Notes to the Consolidated Financial Statements, which provides a summarized comparison of the nominal amounts, carrying values and market values of derivative and non-derivative financial instruments and other information relating to those instruments. In the normal course of business, the financial position of the Telecom Italia Group is subject to interest rate and foreign exchange rate risks. These market risks principally relate to the Telecom Italia Group s outstanding debt and non-Euro denominated assets and liabilities. The Telecom Italia Group uses derivatives mainly for the management of its debt positions, primarily interest rate swaps (IRS) and interest rate options (IRO) to reduce interest rate exposure on fixed-rate and floating-rate bank loans and bonds, and cross-currency and interest rate swaps (CCIRS) and currency forwards to convert various currency loans mainly in U.S. dollars into the functional currencies of the various subsidiaries. The following discussion is based on the amounts of indebtedness as derived from our Italian GAAP financial statements. See Note 29 of Notes to the Consolidated Financial Statements for a further discussion of items which, for purposes of U.S. GAAP, are considered to be debt.

Debt Policy

The Telecom Italia Group s debt used to support the financing of its domestic and international businesses contains an element of market risk from changes in interest and currency rates. With respect to interest rates applicable to medium and long-term debt, the Telecom Italia Group s policy is to utilize both floating rate and fixed rate with a different range of maturities. The Telecom Italia Group s policy is intended to optimize the cost of funding/risk exposure mix, utilizing as providers of funds domestic and international capital markets and supranational agencies such as the European Investment Bank. The Telecom Italia Group policies address the use of financial derivatives, including the approval of counterparties and the investment of excess liquidity. These policies are intended to minimize financial risks and obtain more favorable terms from the counterparts. In addition, Telecom Italia has a centralized treasury that provides assistance to its subsidiaries worldwide and usually operates as the Telecom Italia Group s main banker, allocating resources according to needs. The centralized treasury also gives support in negotiating credit lines and financial operations in general.

The table below sets forth, for the periods indicated, the aggregate principal amount of long-term debt (including current portion) payable in each year through 2008 and thereafter.

	2004	2005	2006	2007	2008	Thereafter	As of December 31, 2003 Total	As of December 31, 2002 Total
					(millions of Euro)			
Fixed Rate Debt	3,801	1,640	5,824	3,155	518	11,050	25,988	28,922
Floating Rate Debt	5,488	368	673	390	2,123	5,111	14,153	8,332
Total	**9,289**	**2,008**	**6,497**	**3,545**	**2,641**	**16,161**	**40,141**	**37,254**

As of December 31, 2003, the fair value of such outstanding debt amounted to approximately 42,689 million. The financial debt s market value is estimated on the basis of the present value as of December 31, 2003 of the future cash flows.

The table below sets forth, for the periods indicated, the aggregate principal amount of long-term debt outstanding at year-end (excluding current portion of long-term debt) and the average interest rate, broken down into fixed and floating.

	Year ended December 31,						
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**Thereafter**
	(millions of Euro, except for percentages)						
Long-Term Fixed Rate Debt	20,995	19,920	14,698	11,547	11,032	8,171	5,338
Average Fixed Rate	4.95%	4.77%	4.18%	5.01%	5.06%	4.78%	5.13%
Long-Term Floating Rate Debt Swapped into Fixed Rate Debt	1,162	600					
Average Swapped into Fixed Rate	3.01%	3.50%					
Average Total Fixed Rate	4.85%	4.73%	4.18%	5.01%	5.06%	4.78%	5.13%
Floating Rate Debt	8,567	8,218	7,561	7,186	5,074	4,063	4,041
Total Long-Term Debt	**30,724**	**28,738**	**22,259**	**18,733**	**16,106**	**12,234**	**9,379**

193

Table of Contents

As of December 31, 2003, approximately 86% of the Telecom Italia Group s long-term debt was denominated in Euro, while the remainder, 4,459 million, was denominated in foreign currencies primarily US dollars, Pound Sterling, Brazilian Reais, Chilean Peso and Japanese Yen. After taking into account the Company s derivative financial instruments, the Company s long-term debt is not materially exposed to fluctuations in foreign exchange rates. At December 31, 2003, approximately 35% of the long-term debt carried a floating rate.

Market Risk Policy

The Telecom Italia Group s policies regarding market risk consists of the following:

- the Centralized Treasury determines the maximum level of interest rate and foreign exchange rate risk to which the Telecom Italia Group should be exposed. An internal committee meets on a regular basis to monitor the activities and the level and value of the current market risk exposures. The Centralized Treasury, operating as a service center, supplies financial services and actively supports the Telecom Italia Group subsidiaries according to their requirements and local circumstances;
- the Telecom Italia Group uses derivative financial instruments to manage these financial market risks, and has established polices to handle and mitigate the adverse effects of these exposures; and
- the Telecom Italia Group continually evaluates the credit quality of counterparties to minimize the risk of non-performance. The counterparties to derivative contracts are generally highly rated banks and financial institutions and such counterparties are continually monitored in order to minimize the risk of non-performance.

Financial Instruments

Interest Rate and Foreign Exchange Risk Management

The Telecom Italia Group seeks to minimize market risk of its operating and financing activities and according to the evaluation of its exposures, selectively enters into derivatives instruments. Since Telecom Italia s corporate objective is pursued through its commercial operations, meaning the sale of telecommunications and media services, unwanted foreign exchange and interest rate exposures are normally hedged, provided the risks would affect Telecom Italia s cash flows.

The Telecom Italia Group is exposed to market risks arising from changes in interest rates, primarily in the Euro zone, in the United States and in Latin America. The Telecom Italia Group defines the optimal mixture of fixed and floating-rate debt in each currency and enters into financial derivatives to adjust the risk profile to the defined target mixture. Interest rate swaps IRS and IRO are therefore used to reduce the interest rate exposure on fixed-rate and floating-rate notes, bonds and bank loans. The Telecom Italia Group uses CCIRS and foreign currency forwards to convert foreign currency loans mainly in US dollars and Euro into the functional currencies of the various subsidiaries. As a result of these hedge activities, the Telecom Italia Group as of December 31, 2003 was not subject to any material foreign exchange risk in its financial debt nor in its commercial operations.

To determine the market value of the financial derivatives, the Telecom Italia Group uses various pricing models. The market value of interest rate swaps and of cross currency and interest rate swaps reflects the difference between the fixed rate to be paid/received and the interest rate (having the same expiry date as the swap) assessed on the basis of the market environment on the evaluation date. The market value of the cross currency and interest rate swaps depends also on the difference between the reference foreign exchange rate on the trade date and the foreign exchange rate on the valuation date.

With regard to IRSs and IROs, they involve or can involve the exchange of flows of interest calculated on the applicable notional principal amount at the agreed fixed or variable rates at the specified maturity date with the counterparties. This principal amount does not represent the amount exchanged between the parties and therefore does not constitute a measure of exposure to credit risk, which is instead limited to the amount of interest or interest differentials to be received at the interest date.

The same applies to CCIRSs which involve the exchange of capital, in the respective currencies of denomination, in addition to the settlement of periodic interest flows, at maturity and eventually at another date.

Table of Contents

Derivative instruments on debt positions

The following tables give a description of the Telecom Italia Group financial derivative contracts outstanding as of December 31, 2003 to manage the debt positions. The notional amount is net of compounded derivatives. Whenever a derivative is set up on another derivative, the notional amount is reported once and the net effect of the two compounded derivatives is considered. The notional amount of closed or maturing transactions (i.e.: transactions for which cash flows are certain) is not reported since cash flows are not at risk any longer. However the mark to market valuation includes the contribution of the above mentioned transactions.

	Notional amount/ Capital exchanged at 12/31/2003	Market value of derivatives at 12/31/2003 (a)	Market value of underlying debt positions at 12/31/2003 (b)	Market value of debt including related derivatives at 12/31/2003 (c)=(b-a)	Market value of derivatives at 12/31/2002
			(millions of Euro)		
Interest rate swaps and interest rate options	9,665	(16)	9,884	9,900	120
Cross-currency and interest rate swaps and Currency forward	4,217	(349)	4,063	4,412	38
Total	13,882	(365)	13,947	14,312	158

As of December 31, 2003, derivative instruments on debt positions, are classified as follows by maturity:

	2004	2005	2006	2007	2008	Thereafter	Total	Market value of underlying debt positions at 12/31/2003

					(millions of Euro)			
Derivatives on Debt Positions	2,710	843	1,234	1,300	1,100	6,695	13,882	13,947

195

Table of Contents

The following tables set forth a description of the Telecom Italia Group financial derivative contracts outstanding as of December 31, 2003 used to hedge debt positions.

Interest rate swaps and interest rate options

At December 31, 2003, the Telecom Italia Group companies had IRS and IRO contracts relating to financial liabilities recorded in the financial statements, for total principal equal to the notional principal amount of 9,665 million. Details of such contracts are set forth in the table below. References to CHF are to Swiss Francs.

Interest Rate Derivatives	Maturities 2004	2005	2006	2007	2008	Thereafter	Total	Mark to Market
				(millions of Euro)				
Euro Interest Rate Swaps								
Receive variable, pay fixed								
Amount	1	12	300				**313**	**-2**
Average pay rate	4.25%	4.71%	2.87%					
Average receive rate	Euribor 3 M	Euribor 3 M	3m Euribor					
Euro Interest Rate Swaps								
Receive variable, pay variable								
Amount	69	121	132				**322**	**2**
Average pay rate	6m Euribor + 24 bp	6m Euribor - 3 bp	6m Euribor - 2 bp					
Average receive rate	Rendiob, Euribor (1)	Rendiob, Bot, Rendistato(1)	Rendiob, Bot, Rendistato(1)					
Euro Interest Rate Swaps								
Receive fixed, pay fixed								
Amount						500	500	
Average pay rate						4.75% until Feb. 2004; 4.71% thereafter		
Average receive rate						5%(2)		
Amount						1,000	1,000	
Average pay rate						5.73%(3)		
Average receive rate						6.12%		
Amount						500	500	
Average pay rate						2.65%(4)		
Average receive rate						5%(5)		
Amount						500	500	
Average pay rate						6.06%(6)		
Average receive rate						7.25%(7)		
Amount						250	250	
Average pay rate						4.33% until Feb. 2004; thereafter 4.08%(8).		
Average receive rate						5%(9)		
Sub-total						**2,750**	**2,750**	**19**

CHF Interest Rate Swaps					
Receive fixed, pay variable					
Amount			64	**64**	**-6**
Average pay rate			6m CHF Libor + 230 bp.		
Average receive rate			5.62%		
Euro Interest Rate Swaps					
Receive fixed, pay variable					
Amount	1,500	450	750	2,700	
Average pay rate	2Y Euro swap in arrears + 178 bp	3 m Euribor + 362 bp (10)	CMS 2 Y Euro in arrears + 115.22 bp (11).		
Average receive rate	5.37%	6.5%	6.12%		
Amount			250	250	
Average pay rate			6m Euribor in arrears + 240.5 bp(12).		
Average receive rate			6.57%(13)		
Amount	500			500	
Average pay rate	3m Euribor in arrears + 159.3 bp (14)				
Average receive rate	5.37%				
Sub-total	**2,000**	**450**	**1,000**	**3,450**	**11**

196

Table of Contents

Interest Rate Derivatives	2004	2005	2006	2007	2008	Thereafter	Total	Mark to Market
	Maturities							
				(millions of Euro)				
Quanto Swaps								
Amount	200	500	600	350			**1,650**	**-30**
Average pay rate	2Y Usd CMS in arrears + 99 bp	2Y Usd CMS in arrears (15)	6m USD Libor + 94.5 bp (16)	6 m USD Libor in arr. + 331.6 bp (17)				
Average receive rate	5.37%	3m Euribor	3m Euribor	6.5% for each week in which 10Y $CMS>3.5 %				
USD Euro Quanto Spread Option								
Amount			200	500			**700**	**-8**
Average pay rate			3m Euribor + 59.5 bp (19).	5.19% (18)				
Average receive rate			3m Euribor + 125bp	6.5% (20)				
CHF Euro Quanto Spread Option								
Amount					250		**250**	**3**
Average pay rate					min (2*12m CHF arr., 12m Eur arr).			
Average receive rate					5.87%			
USD Interest Rate Swaps Receive variable, pay fixed								
Amount		107					**107**	**-4**
Average pay rate		5.0%						
Average receive rate		USD Libor						
USD Interest Rate Collar								
Amount		59					**59**	**-1**
Average cap strike rate (purchased)		7.1%						
Average floor strike rate (sold)		4.0%						
Total	**2,270**	**799**	**1,232**	**1,300**	**250**	**3,814**	**9,665**	**-16**

(1) Rolint, Robot, Rendint and Rendibot are customary domestic Italian measures for medium/long-term debt.
(2) With the additional sale of a cap at 7.10% on the six month Libor in USD effective from August 2007.
(3) Sale of a cap at 7.75% starting July 2007; sale of a floor at 3.25% starting July 2007.
(4) Starting February, 2005 the quarterly fixed rate (2.65%) could be replaced by the 3M Libor set in arrears whenever the latter exceeds 7%.
(5) Starting February, 2006: 5.00% for each week in which 5Y Euro Swap > 1Y Eur Swap.
(6) On 100 million 5.48% until April 2006 and thereafter 5.48% if 3m USD Libor <= 8% otherwise 3m USD Libor + 40.63 bp.
(7) Starting April 2005 7.25% accruing for each week in which 10Y CMS >= 2Y CMS.
(8) Alternatively, 3m GBP Libor in arrears -63.8 bp if 3m GBP Libor in arrears <= 7%.
(9) Starting February, 2005: 5% for each week in which (5Y USD CMS 5Y GBP CMS)<100 bp.
(10) 5.78% until January 2004, 5.86% until July 2004.

(11) Purchase of a cap at 5.29% set in arrears semiannually; sale of a cap at 7.75% on the 2Y USD swap rate set in arrears semiannually starting July 2005; sale of a floor with an annual rising rate from 3.25% to 4.25% set in arrears semiannually starting July 2004.
(12) 5.638% until Jan. 2004; 6 m Euribor + 263 bp from Jan. 2004 to Jul. 2004; purchase of a cap on 6 m Euribor at 4.15%; sale of a cap on 6 m USD Libor at 7.70%; sale of a floor on 6 m Euribor with an annual rising rate from 2.5% to 3.5%.
(13) Starting July 2005 6.575% for each week in which 5Y CMS > 1Y CMS.
(14) Sale of a floor for 450 million at 3.25%.
(15) 3,53% up to March, 2004.
(16) Starting January 2004 6 m USD Libor + 53.925 bp; purchase of a digital cap triggered when the semiannual rate in USD set in arrears is higher than 3.75%; sale of a cap at 4.25% on the semiannual rate in USD set in arrears; sale of a floor on the semiannual rate in USD set in arrears and with annual rising interest rates.
(17) 5.61% until April 2004.
(18) Starting April 2004, the higher between 6 m Euribor in arrears and 6 m USD Libor in arrears, + 216.32 bp.
(19) Starting January 2004, the higher between 12 m Euribor in arrears and 12 m USD Libor in arrears, + 52.5 bp.
(20) Starting April 2004 6.5% for each week in which 10Y $ CMS > 3.5%.

Table of Contents

Cross-currency and interest rate swaps and Currency forward

At December 31, 2003, the Telecom Italia Group companies had CCIRS and Currency Forward contracts relating to financial liabilities recorded in the financial statements, for total principal equal to a notional principal amount of 4,217 million. Details of such contracts are set forth in the table below. References to JPY are to Japenese Yen, BRL to Brazilian Reais, CLP to Chilean Pesos, and PEN to Peruvian Nuevo Sol.

	Maturities							
Foreign Exchange Derivatives	**2004**	**2005**	**2006**	**2007**	**2008**	**Thereafter**	**Total**	**Mark to Market**
				(millions of Euro)				
CCIRS								
Receive fixed USD, pay variable Euro								
Amount					851		**851**	**-63**
Average pay rate					3m Euribor +52.9 bp			
Average receive rate					4.0%			
CCIRS								
Receive fixed USD, pay fixed Euro								
Amount						2,558	**2,558**	**-233**
Average pay rate						5.4%		
Average receive pay						5.6%		
CCIRS								
Receive dual currency (fixed USD rate, JPY principal at maturity), pay fixed Euro(2)								
Amount						174	**174**	**-20**
Average pay rate						6.08%(1)		
Average receive rate						5.0%		
CCIRS								
Receive fixed Yen, pay variable Euro(2)								
Amount						148	**148**	**6**
Average pay rate						6m Euribor + 224 bp		
Average receive rate						3.6%		
CCIRS								
Receive variable GBP, pay variable Euro								
Amount	79						**79**	**-6**
Average pay rate	3m Euribor + 11 bp							
Average receive rate	3m GBP Libor +10 bp							
CCIRS								
Receive fixed USD, pay variable BRL								
Amount	51	17	2				**70**	**3**
Average pay rate	CDI(3)	CDI(3)	CDI(3)					
Average receive rate	exchange rate variation + spread	exchange rate variation + spread	exchange rate variation + spread					
Currency Forwards Buy USD, Sell CLP								
Amount	151						**151**	**-12**
Average Contractual Exchange Rate	649							

Currency Forwards Buy USD, Sell UF(4)								
Amount	118	10					**128**	**-22**
Average Contractual Exchange Rate	0.042	0.042						
Currency Forwards Buy USD, Sell PEN								
Amount	41	17					**58**	**-2**
Average Contractual Exchange Rate	3.5	3.5						
Total	**440**	**44**	**2**	**0**	**851**	**2,880**	**4,217**	**-349**

(1) 6.13% until October, 2004.
(2) The cross currency protection structure is conditional on Telecom Italia S.p.A. being in good standing.
(3) The CDI is the customary domestic Brazilian measure of overnight interest rate. As of December 31, 2003 this rate was around 16.27%.
(4) The UF (Unidad de Fomento) is the customary domestic Chilean measure of interest rates linked to the inflation rate.

Table of Contents

Derivative instruments on financial assets and on short-term treasury operations

The Telecom Italia Group also entered into derivative contracts to manage the interest rate and foreign currency risk on its financial assets (bonds, bonds bought back and intercompany loans) and on short-term treasury operations for a principal amount of approximately 1,529 million.

Description	**Equivalent notional amount (millions of euro)**
Currency Forward transactions finalized by Olivetti International S.A.	294
Currency Forward transactions finalized by Olivetti Finance N.V. (on bonds of Japanese yen 20 billion 2002/2032)	162
Currency Forward transactions finalized by Telecom Italia Finance S.A.	190
Currency Forward transactions finalized by Telecom Italia S.p.A.	241
Currency Forward transactions finalized by TIM S.p.A.	7
IRS and Currency Forward transactions finalized by Telecom Italia Finance, Olivetti Finance N.V. and Olivetti International S.A.	635
Total	**1,529**

The market value of derivatives on financial assets and short-term treasury operations as of December 31, 2003 was a net realized loss of approximately 13 million compared to a net realized gain of 53 million as of December 31, 2002. Such market value has been measured by discounting at December 31, 2003, for each transaction, the product between (i) the amount purchased/sold and (ii) the difference between the contractual exchange rate and the forward exchange rate as of December 31, 2003 having the same maturity date.

Table of Contents

Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors

The following are the members of the Board of Directors of Telecom Italia as of June 1, 2004. All of them were elected at the Telecom Italia shareholders meeting held on May 6, 2004 for a three-year term, which will expire at the annual shareholders meeting to be called to approve the Company s financial statements for the year ended December 31, 2006. At the May 6, 2004 shareholders meeting the number of directors was set at 19.

Name	Age	Position	Appointed
Marco Tronchetti Provera	56	Chairman(1)	2004
Gilberto Benetton	62	Deputy Chairman(1)	2004
Carlo Orazio Buora	58	Managing Director(1)	2004
Riccardo Ruggiero	43	Managing Director General Manager(2)	2004
Paolo Baratta(3)	64	Director	2004
John Robert Sotheby Boas(3)	67	Director	2004
Giovanni Consorte	56	Director	2004
Domenico De Sole(3)	60	Director	2004
Francesco Denozza(3)	56	Director	2004
Luigi Fausti(3)	74	Director	2004
Guido Ferrarini(3)	53	Director	2004
Jean Paul Fitoussi(3)	62	Director	2004
Gianni Mion	60	Director	2004
Massimo Moratti	58	Director	2004
Marco Onado(3)	63	Director	2004
Renato Pagliaro	47	Director	2004
Pasquale Pistorio(3)	68	Director	2004
Carlo Alessandro Puri Negri	51	Director	2004
Luigi Roth(3)	63	Director	2004

(1) Appointed by the Board of Directors on May 6, 2004.
(2) Appointed as General Manager by the Board of Directors on August 4, 2003. Appointed as Managing Director by the Board of Directors on May 6, 2004.
(3) Independent Director. For details on the criteria applied to determine independence, see Item 10. Additional Information Corporate Governance Board of Directors Independent Directors .

As of June 1, 2004, the Secretary of the Board of Directors was Francesco Chiappetta.

According to article 13 of the Bylaws, the Board set up two committees from among its members: the Internal Control and Corporate Governance Committee and the Remuneration Committee. Both these committees are charged with giving advice and making proposals to the Board as a whole.

The members of the Internal Control and Corporate Governance Committee are Guido Ferrarini, Francesco Denozza, Domenico De Sole and Marco Onado.

The members of the Remuneration Committee are Luigi Fausti, Pasquale Pistorio and Paolo Baratta.

For a detailed description of Telecom Italia s corporate governance, including activities, responsibilities and organization of the Board of Directors, see Item 10. Additional Information Corporate Governance .

Biographical Data

The following are the selected biographical data of the Directors.

Marco Tronchetti Provera: Marco Tronchetti Provera was born in Milan, in 1948. Mr. Tronchetti Provera has been Telecom Italia Chairman since September 27, 2001. Mr. Tronchetti Provera began his career in 1973 working in the family maritime transport business and establishing a financial holding company. In 1986 he joined the Pirelli Group, a world leader in the production of tyres, energy and telecommunications infrastructure. In 1992 he took over responsibility for operations. Mr. Tronchetti is also Chairman of Pirelli & C. S.p.A., of Olimpia S.p.A. and of Camfin S.p.A., Deputy Chairman of Confindustria, a Director of Luigi Bocconi University, of Teatro alla Scala Foundation, Chairman of the Council for Relations between Italy and the United States, of the Silvio Tronchetti Provera Foundation, member of the European Round Table of Industrialists, of the Italian Group of the Trilateral Commission, of the International Advisory Board of Allianz, of the

Table of Contents

International Council of J.P. Morgan, of the New York Stock Exchange European Advisory Committee and of the Assonime Steering Committee.

Gilberto Benetton: Gilberto Benetton was born in Treviso, in 1941. Mr. Benetton has been Telecom Italia Deputy Chairman since September 27, 2001. He began his activity in 1965 with his brothers Giuliana, Luciano and Carlo. The Benetton Group is now active in 120 countries in the world. Mr. Benetton is also Deputy Chairman of Olimpia S.p.A, Chairman of Edizione Holding S.p.A., Autogrill S.p.A., Ragione s.a.p.a., Verde Sport S.p.A., Vice Chairman of Fondazione Benetton, Director of Benetton Group S.p.A., Area Nord Concessionaria di Pubblicità, Banca Antonveneta, Pirelli S.p.A., Mediobanca S.p.A., Schemaventotto S.p.A., Sep S.p.A., HMS Host Corp., Lloyd Adriatico S.p.A., Autostrade S.p.A., Beni Stabili S.p.A., and Abertis Infraestructuras S.A..

Carlo Orazio Buora: Carlo Orazio Buora was born in Milan, in 1946. Mr. Buora has been Chief Executive Officer of Telecom Italia since November 7, 2001, and currently is Chairman of TIM S.p.A. He is also Managing Director of Pirelli & C. S.p.A. He began working in finance with the BNL Group. Afterwards he became head of Finance and Administration at Merloni Finanziaria and Chief Financial Officer at Snia Viscosa. In 1984 he joined the Fiat Group. In 1989 he was appointed Deputy General Manager of Telettra and subsequently General Manager of the Benetton Group, a position he held until 1991. In November 1991 he joined the Pirelli Group as central manager for finance and administration and was appointed General Manager in 1992. In 1999 he became a general partner of Pirelli & C. S.a.p.a. and in 2001 was appointed Managing Director of Pirelli & C. S.p.A. Mr. Buora is also a Director of Pirelli & C. Real Estate S.p.A., of Olimpia S.p.A., of RCS Mediagroup S.p.A., of Ras S.p.A., and of Mediobanca S.p.A. Mr. Buora has been Deputy Chairman of F.C. Internazionale S.p.A. since January 2004.

Riccardo Ruggiero: Riccardo Ruggiero was born in Naples, Italy, in 1960. Since October 1, 2001 Mr. Ruggiero has been Head of the Telecom Italia Group Wireline Business Unit. On May 7, 2002 he was appointed General Manager of Telecom Italia and on September 5, 2002 he was appointed Managing Director. He began his career in 1986 as sales manager of Fininvest S.p.A. Between 1988 and 1990 he was sales and marketing manager of the Italian branch of AT&T. In 1990 he joined the Olivetti Group, where he held various positions: in 1992 he was appointed Vice President of Organizzazione Oliservice, with responsibility for international clients and the commercial development of telecommunications services worldwide, and in 1994 of Olivetti Telemedia, with responsibility for commercial development and market expansion. In 1996 he was appointed managing director of Infostrada S.p.A. (with responsibility for the market, infrastructure and personnel functions) and was later appointed Managing Director of Italia On Line. In July 2001, Mr. Ruggiero joined the Telecom Italia Group as Head of the Telecom France Business Unit, with the brief of managing and developing Group business on the French market through the company s participating interests.

Paolo Baratta: Paolo Baratta was born in Milan in 1939. Mr. Baratta has been Director of Telecom Italia since May 6, 2004. In 1967 he began doing economic research at the Associazione per lo sviluppo dell industria nel Mezzogiorno (Svimez) in Rome. In 1979 he became a Director of the Istituto per il Credito alle Imprese di Pubblica Utilità (ICIPU) and then Deputy Chairman. From 1980 to 1992 he was Chairman of ICIPU, Consorzio di Credito per le Opere Pubbliche (CREDIOP), Deputy Chairman of Nuovo Banco Ambrosiano (later Banco Ambrosiano Veneto) and the Italian Bankers Association (ABI). In addition to being a Director of various companies, he was Chairman of the Centro Beneduce per gli Studi in Campo Bancario e Assicurativo. In 1993 he became Minister for Privatizations with responsibility for the reorganization of the system of state holdings. In 1993-94 he was Minister for Foreign Trade and Minister for Industry ad interim. In 1995-96 he was Minister for Public Works and Minister for the Environment. From 1997 to 2000 he was chairman of Bankers Trust S.p.A. and from 1998 to 2000 Chairman of the Venice Biennale. He is a member of the Società Italiana degli Economisti and currently is Chairman of the Comitato Venezia Internazionale, the Centro per la Proprietà Intellettuale di Venezia and the Fondazione Lorenzo Valla. He is also a Director of Banca Finmat Euroamerica, Svimez-Roma, the Fondo per l Ambiente Italiano (FAI) and the Istituto per gli Studi Storici in Naples.

John Robert Sotheby Boas: John Robert Sotheby Boas was born in London in 1937. Mr. Boas has been Director of Telecom Italia since May 6, 2004. He joined Price Waterhouse & Co. in 1964 as a chartered accountant. From 1965-66 he worked for ICI in the Overseas Treasurer s Department and in 1966 he moved to SGWarburg & Co., where he was concerned with mergers and acquisitions, IPOs and bond issues. He was appointed Director in 1971 and Deputy Chairman in 1990. During the 1990s he worked on developing the company s business in continental

Europe, with specific responsibility for Italy. Following the acquisition of SGWarburg by Swiss Bank Corporation, he was Managing Director of SBC Warburg until he retired in 1997. He continued to act as a consultant for UBS Warburg until April 30, 2004. At present he is a non-executive Director of Invesco Continental Smaller Companies Trust PLC.

Table of Contents

Giovanni Consorte: Giovanni Consorte was born in Chieti, in 1948. Mr. Consorte has been Director of Telecom Italia since August 4, 2003. He began working in 1973 with the Montedison Group in the analysis, budget and investment control field. In 1976 he was hired by the Cooperatives League, where he coordinated projects for reorganization and change management at consumer cooperatives and the development of new business initiatives. In 1979 he joined the Planning, Organization and Control Department of Unipol Assicurazioni S.p.A. Where he was promoted from manager to central manager and subsequently to general manager. He was subsequently appointed Deputy Chairman and Managing Director and, in July 1996, Chairman and Managing Director. In addition to the positions of Chairman and Managing Director of Unipol Assicurazioni and Finsoe S.p.A., he is Deputy Chairman and Managing Director of Unipol Banca S.p.A. and Unipol Merchant Banca per le Imprese, Chairman of MeieAurora S.p.A., Deputy Chairman of Winterthur Assicurazioni S.p.A., Winterthur Vita S.p.A. and Hopa S.p.A.; he is also a Director of Carisbo S.p.A., Snia S.p.A., Sorin Group, Euresa Holding S.p.A. and as from 2003 Telecom Italia. Mr. Consorte is a member of the Executive Committee of A.N.I.A. (the Italian Association of Insurance Companies), the Management and Board of the Lega Nazionale Cooperative e Mutue, and the Scientific Committee of Nomisma. He is also a member of the General Council of Assonime (the Association for Italy s Limited Liability Companies) and a Director of the Ramazzini European Foundation.

Domenico De Sole: Domenico De Sole was born in Rome in 1944. Mr. De Sole has been Director of Telecom Italia since May 6, 2004. In 1970 he moved to the United States, where he became a partner with the law firm Patton, Boggs & Blow. In 1984 he joined the Gucci Group as Chief Executive Officer of Gucci America Inc. and in 1995 he became head of operations for the entire Gucci Group as President and Chief Executive Officer of Gucci Group NV until April 2004. During this period Gucci Group was listed on the New York and Amsterdam stock exchanges (1995), beat off a hostile takeover bid (1999), acquired Yves Saint Laurent, Sanofi Beauté and Sergio Rossi in 1999, Boucheron, Alexander McQueen and Bedat & Co in 2000 and Bottega Veneta, Stella McCartney and Balenciaga in 2001. Mr. De Sole is a Director of Procter & Gamble (member of Audit and Governance and Nominating Committees) and Bausch & Lomb (member of Audit and Management Committees). He is a member of the Advisory Board of the Harvard Law School.

Francesco Denozza: Francesco Denozza was born in Turin, in 1946. Mr. Denozza has been Director of Telecom Italia since November 7, 2001. Mr. Denozza is also Professor of Commercial Law at the University of Milan, lawyer and Co-editor of the legal review Giurisprudenza Commerciale . Mr. Denozza is author of several publications.

Luigi Fausti: Luigi Fausti was born in Ancona, in 1929. Mr. Fausti has been Director of Telecom Italia since November 7, 2001. He is also Director of MONRIF S.p.A., of Poligrafici Editoriale S.p.A. di Bologna and Chairman of Patrimonio Immobiliare dello Stato S.p.A. Mr. Fausti began his career in 1947 in Banca Commerciale Italiana where he was Executive Officer and General Director of several branches and in 1990 he became Chief Executive Officer of the bank, in 1994 Vice-Chairman and Chief Executive Officer, in 1997 Chairman and in 1999 Honorary Chairman. He received an honoris causa economics degree from Naples University.

Guido Ferrarini: Guido A. Ferrarini was born in Genoa in 1950. Mr. Ferrarini has been Director of Telecom Italia since June 12, 2001. Mr. Ferrarini is also Director of Autostrade S.p.A. and Deputy Chairman of the European Corporate Governance Institute, Bruxelles. He is professor of Financial Markets Law at the University of Genova School of Law, Director of Center of Law and Finance, legal expert and lawyer, Member of Board of Trustees IASC Foundation of London, Advisor of the Corporate Governance Committee of Borsa Italiana S.p.A., Chairman of TLX S.p.A. (a new Italian investment exchange), Co-director of Rivista delle Società (Giuffrè) and honorary professor of University College School of Law, London. Mr. Ferrarini is the author of several publications.

Jean Paul Fitoussi: Jean-Paul Fitoussi was born in la Goulette (Tunisia) in 1942. Mr. Fitoussi has been Director of Telecom Italia since May 6, 2004. Mr. Fitoussi is Professor of Economics at the Institut d Études Politiques in Paris, where has taught since 1982 and whose Scientific Committee he now chairs. He is currently President of the Observatoire Français des Conjonctures Economiques (OFCE), an economic research and forecasting institute. Mr. Fitoussi graduated *cum laude* in Law and Economics from the University of Strasbourg with a thesis on inflation, equilibrium and unemployment. He began his academic career as an assistant professor at the University of Strasbourg. Between 1979 and 1983 he taught at the European University Institute, Florence, and in 1984 was visiting professor at the University of California, Los Angeles. Since 1998 he has been a member of the board of the École Normale Supérieure. In 1997 he became a member of the Prime Minister s Council for Economic Analysis. In 1996 he was named to the Commission Économique de la Nation. He was secretary of the International Economic

Association beginning in 1984 and has been an expert for the Economic

202

Table of Contents

and Monetary Committee of the European Parliament. Between 1990 and 1993 he was Chairman of the Economic Council of the European Bank for Reconstruction and Development. In the field of publishing, Mr. Fitoussi is managing editor of the Revue et Lettre de L OFCE and serves on the scientific committee of the Revue Française d Economie, the editorial board of Labour and of The International Journal of Development Planning Literature, and the scientific committee of International Labour Review and Critique Internationale. His writing appears regularly in newspapers in France and abroad and he is commentator for La Repubblica and Le Monde. Since 2002 he has been Director of the Fondation Nationale des Sciences Politiques. In the field of research, Mr. Fitoussi has concentrated on inflation theory, unemployment, foreign trade and the role of macroeconomic policy. As president of the OFCE and founder of its International Economic Policy Group (of which he is a member alongside Anthony Atkinson, Olivier Blanchard, John Flemming, Edmond Malinvaud, Edmund Phelps and Robert Solow), he has made numerous contributions to the current economic policy debate, particularly on the issues of economic integration and transition.

Gianni Mion: Gianni Mion was born in Vó, a town near Padua, in 1943. Mr. Mion has been Director of Telecom Italia since November 7, 2001. He is currently Vice President of TIM S.p.A., Director of Telecom Italia Media S.p.A. and Olimpia, Chief Executive Officer of Edizione Holding S.p.A., Director of Benetton Group S.p.A., Autogrill S.p.A., 21 Investimenti, Autostrade S.p.A., Sagat S.p.A., and Banca Antonveneta S.p.A. Mr. Mion is also a Registered Auditor.

Massimo Moratti: Massimo Moratti was born in Boscochiesanuova, a town near Verona, in 1945. Mr. Moratti has been Director of Telecom Italia since November 7, 2001. He is also Director of Angelo Moratti di Gianmarco e Massimo Moratti & C. S.a.p.a., Chief Executive Officer of Saras S.p.A. Raffinerie Sarde, Chairman of Sarint S.A., Director of Interbanca S.p.A., and of Pirelli S.p.A..

Marco Onado: Marco Onado was born in Milan in 1941. Mr. Onado has been Director of Telecom Italia since May 6, 2004. He was a professor at the University of Modena from 1972 to 1984, then at the University of Bologna until 2001. Currently he teaches at Bocconi University. He has been a Visiting Professor at the University College of North Wales and Brown University in Providence, Rhode Island. From 1993 to 1998 he was a CONSOB Commissioner and in this capacity he was a member of the Draghi Committee for the reform of company law and of the Euro Committee. He also participated in the work of the International Organization of Securities Commissions (IOSCO). He was also a member of the Preda Committee, which drafted the Code of Conduct for listed companies in 2000 and the updated version in 2002. He is a member of the Società Italiana degli Economisti, the Scientific Committee of the Ente per gli Studi Monetari, Bancari e Finanziari Luigi Einaudi, and Prometeia Associazione per le Previsione Econometriche. He also sits on the editorial board of several specialized reviews and is a columnist for the financial newspaper Il Sole 24 Ore . During his career he has been a director of various financial institutions. At present he is a member of the Council of the Consiglio Nazionale dell Economia e del Lavoro (CNEL), designated by the President of the Republic.

Renato Pagliaro: Renato Pagliaro was born in Milan in 1957. Mr. Pagliaro has been Director of Telecom Italia since May 6, 2004. A registered auditor, in 1981 he joined Mediobanca Banca di Credito Finanziario S.p.A., where he has held positions of increasing responsibility. In April 2003 he was appointed Co-General Manager and Secretary to the Board of Directors of Mediobanca. Mr. Pagliaro is a Director and member of the Executive Committee of RCS Mediagroup S.p.A. and Compass S.p.A. He is also a Director of Ferrari S.p.A., SelmaBipiemme Leasing S.p.A. and Cofactor S.p.A.. Since 1993 he has been a member of the Board of Auditors of Istituto Europeo di Oncologia S.r.l..

Pasquale Pistorio: Pasquale Pistorio was born in Agira, Enna Province, in 1936. Mr. Pistorio has been Director of Telecom Italia since May 6, 2004. Mr. Pistorio graduated in Electronic Engineering, with a specialization in electronics from the Polytechnic Institute of Turin in 1963. He began his career as a salesman and in 1967 he joined Motorola in Italy, rising through the ranks to become Director of International Marketing in 1977. Based in Phoenix, Arizona, he was appointed Vice President of Motorola Corporation and in 1978 he was promoted to General Manager of Motorola s International Semiconductor Division, responsible for the design, manufacturing and marketing activities for all regions outside of the United States. In July 1980 Mr. Pistorio returned to Italy to become President and Chief Executive Officer of the SGS Group, Italy s only microelectronics company. His success in transforming the company into a profitable, versatile maker of semiconductors led the SGS Group in May 1987 to its merger with Thomson Seminconducteur to form SGS-Thomson Microelectronics. As President and Chief Executive Officer of the new company, Mr. Pistorio was responsible for developing a diversified portfolio of products concentrated on high-growth applications and creating a global network of strategic alliances. The company was listed on the New York and Paris stock exchanges in December 1994 and in Milan in June 1998. He currently serves on the board of MEDEA+, the European programme for advanced technological research that is the successor to MEDEA (Microelectronics for

203

Table of Contents

European Applications), and of JESSI (Joint European Sub-micron Silicon Initiative). Mr. Pistorio has been an ardent environmentalist throughout his career: his advocacy of the social responsibility of business also extends to his efforts against the Digital Divide. As a member of the Information and Communications Task Force created by the United Nations, he is helping to develop proposals to draw firms attention and resources to meeting this new global challenge.

Carlo Alessandro Puri Negri: Carlo Alessandro Puri Negri was born in Genoa, in 1952. Mr. Puri Negri has been Director of Telecom Italia since November 7, 2001. Mr. Puri Negri is also Director of Aon Italia S.p.A., Grandi Stazioni S.p.A., Olimpia S.p.A. and Permasteelisa S.p.A.. He is Deputy Chairman and Chief Executive Officer of Pirelli & C. Real Estate S.p.A., Deputy Chairman of Camfin S.p.A. and Pirelli & C. S.p.A. and is Chairman of Pirelli & C. Ambiente S.p.A. Since 2003 Mr. Puri Negri has been a Director of Istituto Europeo di Oncologia S.r.l. and a member of Real Estate Int. Advisory Board of Harvard University. He is also Director and Executive Committee member of Capitalia S.p.A..

Luigi Roth: Luigi Roth was born in Milan in 1940. Mr. Roth has been Director of Telecom Italia since May 6, 2004. He began his career with various tasks in the Pirelli Group, which he left to join Metropolitana Milanese as head of the Planning Department. From 1980 onwards he ran a number of medium-sized firms in the manufacturing and property sectors as General Manager or Managing Director. From 1986 until 1993 he was Managing Director of Finanziaria Ernesto Breda S.p.A. and then, until 2001, Chairman and Managing Director of Breda Costruzioni Ferroviarie S.p.A. In addition, from 1996 to 1998 he was also Chairman of Società Ferrovie Nord Milano S.p.A. and Società Ferrovie Nord Milano Esercizio S.p.A. From May 1998 to December 2000, Mr. Roth was also managing director of Ansaldo Trasporti S.p.A. and set up the Transport Sector of Finmeccanica S.p.A. In January 2001 he became Chairman of the Milan Fair Foundation, which controls Fiera Milano S.p.A. and Sviluppo Sistema Fiera. He is Chairman of CartaFacile S.p.A., Deputy Chairman of Cassa Depositi e Prestiti S.p.A. and Director of IntesaBCI Gestione Crediti S.p.A., Banca BMB S.p.A. and Bocconi University in Milan.

Executive Officers

As of May 31, 2004, the executive officers of Telecom Italia and their respective ages, positions and year of appointment as executive officers were as follows:

Name	Age	Position	Appointed
Marco Tronchetti Provera	56	Executive Chairman (1)	2001
Carlo Orazio Buora	58	Managing Director (1)	2001
Riccardo Ruggiero	43	Managing Director (1)	
		General Manager of Telecom Italia	2002
			2002
		Head of Wireline Business Unit	2001
Giuseppe Sala	46	General Manager of Telecom Italia	2003
Central Functions:			
Gustavo Bracco	56	Head of Human Resources	2001
Enrico Parazzini	60	Head of Finance, Administration and Control	2001
Francesco Chiappetta	43	General Counsel	2002
Germanio Spreafico	51	Head of Purchasing	2001
Business Units:			
Enrico Parazzini	60	Head of Internet and Media Business Unit	

		Managing Director of Telecom Italia Media	2003
Marco De Benedetti	41	Head of Mobile Business Unit	2003
		Managing Director of TIM	1999
			1999
Giuseppe Nino Tronchetti Provera (2)	36	Head of Information Technology Market Business Unit	2002
		Deputy Chairman of Finsiel	2002

(1) Confirmed in the office by the Board of Directors on May 6, 2004.

(2) As of June 1, 2004 Salvatore Pinto took over as Head of the Information Technology Market Business Unit.

The following are the selected biographical data of the executive officers, other than Directors:

For the biographical data of Mr. Ruggiero please see above under Directors .

Gustavo Bracco: Mr. Bracco was born in Turin, Italy, on May 18, 1948. On October 1, 2001, he became Head of Telecom Italia Group Human Resources. Mr. Bracco began his career at Fiat in 1972, working for the

204

Table of Contents

Trade Union Relations Central Management. In 1976, he was appointed Personnel Manager at the Mirafiori factory. In 1977, he transferred to Toro Assicurazioni as Head of Industrial Relations and Labour Disputes, under the aegis of Central Personnel Management. He joined the Turin Industrial Union in 1979, where he worked until 1982, initially at the Research Office before moving to the Trade Union Service, where he rose through the ranks to the position of Head. Between 1983 and 1987, he worked at Cinzano, Saiag and Carello, with responsibility for Personnel and External Relations. In 1988, he returned to the Fiat Group as Head of Personnel and Organization at the Engine Control Division. He took on the same role at CEAC in 1991 and at Fidis in 1994. He was appointed Head of Group Trade Union Relations in 1996. In 1998, Mr. Bracco went to work in London for New Holland as Head of Personnel and Organization, a position he subsequently filled in Chicago for Case-New Holland. He joined Pirelli in December 2000 as Group Head of Human Resources.

Francesco Chiappetta: Mr. Chiappetta was born in Rome, Italy, on September 13, 1960. Mr. Chiappetta was appointed Telecom Italia S.p.A General Counsel on August 1, 2002. He is also the Secretary to the Telecom Italia Board of Directors. Mr. Chiappetta began his career in 1983 at CONSOB, Italy s stock market and corporate regulatory body. Over the next ten years he held a number of positions at this organization, including Chief of the Regulation Office. Between 1998 and July 2001 he worked as Deputy General Manager for Assonime, the Association of Italian corporations, with responsibility for company law and capital market. In August 2001 he joined the Pirelli & C. Group as Head of Legal and Corporate Affairs, a position he filled until joining the Telecom Italia Group. From 1989 to 2003 he worked in academia, holding courses and lectures at leading Italian universities including La Sapienza in Rome, Università di Roma Tre and the Luigi Bocconi University in Milan. Mr. Chiappetta has widely published both on company and securities law. At the present time he his also Chairman of the Company Law Working Group of Unice (Union of Industrial and Employers Confederation of Europe).

Marco De Benedetti: Mr. De Benedetti was born in Turin, Italy on September 9, 1962. On July 2, 1999 he was appointed TIM Chief Executive Officer. Mr. De Benedetti began his career with the marketing department of Procter & Gamble. From 1987 to 1989, he worked in Merger and Acquisitions for Wasserstein, Perella & Co., a New York merchant bank. He joined Olivetti in 1990 as assistant to the Chief Executive Officer of Olivetti System & Networks. He was later promoted to Marketing and Services Manager. In December 1992, he was appointed General Manager of Olivetti Portugal. In September 1994, he became Chief Executive Officer of Olivetti Telemedia, subsequently also taking on the chairman s role. In October 1996, he was named Chairman of Infostrada. In 1997, he was appointed Chief Executive Officer. Since March 1998 he has served as Olivetti Group Central Manager for Telecommunications Strategies. Mr. De Benedetti is also Chairman of TIM Brasil Serviços e Partecipaçoes S.A., Director of TIM International N.V., TT & TIM, Iletisim Hizmetleri A.S., Telecom Italia America Latina S.A., and also Director of Cofide S.p.A..

Enrico Parazzini: Mr. Parazzini was born in Milan, Italy, on March 18, 1944. He became Head of Telecom Italia Group Finance, Administration and Control on October 1, 2001. Mr. Parazzini began his career in 1968 as a Junior Auditor at Arthur Andersen. In 1969, he was hired by the Finance Department at General Electric. In 1970, he joined Honeywell Information Systems Italia. Over the next 20 years he was promoted through the company, holding the positions of Financial Planning Manager from 1975 to 1980, Administration and Control Manager from 1981 to 1986, and Chief Financial Officer from 1987 to 1990. In 1991, after Honeywell sold its business to the Bull Group, Mr. Parazzini was appointed General Manager of Administration, Control, IT Systems and Logistics. He joined Pirelli as Group Controller in May 1992. He took active part in the process of group restructuring, with special reference to reform of the planning and control system. Between 1996 and 1999, he was Head of Administration, Group Acquisitions and Risk Management. He was appointed Chief Financial Officer of the Cables and Systems division in 2000. Mr. Parazzini is currently Managing Director of Telecom Italia Media, Chairman of Telecom Italia International, Holding Media e Comunicazione, LA 7 Televisioni, MTV Italia, Matrix, Webfin Finanziaria Web and Board member of TM news, TI Latam, Finsiel, TI Audit, Italtel Holding, Italtel. Since 1994 he has worked as a visiting lecturer on the Multinational Group Planning and Control Course at the Luigi Bocconi University of Milan.

Giuseppe Sala: Mr. Sala was born in Milan, Italy, on May 28, 1958. Mr. Sala was appointed General Manager of the Wireline Business Unit of Telecom Italia on June 16, 2003. In 1994 he was appointed Head of Strategic Planning and Control of Pirelli s Tyres Sector. In 1998, Mr. Sala became Managing Director of Italian Tyres Division Pirelli S.p.A., and in 2001 he filled the position of Senior Vice President Operations Tyres Sector of Pirelli s Group. From March 2002 until September 2002 Mr. Sala held the position of Chief Financial Officer of TIM S.p.A.. In October 2002 he was appointed Assistant to the Chairman of the Telecom Italia Group.

Germanio Spreafico: Mr. Spreafico was born in Lecco, Italy on September 20, 1952. He was appointed Head of Telecom Italia Group Purchasing on October 1, 2001. He began his career in 1977 at the Pirelli Financial Division, where he worked for 10 years, during which time he was promoted through various positions in domestic and international finance and ultimately took charge of Italian market financial operations. Subsequent

Table of Contents

to this he moved to the Cable sector, initially as Chief Financial Officer of the Italian company, before taking on the same role for the French company. In 1997, he became Chief Financial Officer of the Group Cable Industry Holding Company, where he also took on the position of Chief Purchasing Officer. At the present time, Mr. Spreafico is Chairman of Telenergia S.r.l., Consorzio Energia, and Deputy Chairman of Pirelli Cavi & Sistemi S.p.A., the holding company for the Pirelli Group Cable division, of which he was Head of Administration and Control and, from February 2000, Head of Purchasing.

Giuseppe Tronchetti Provera: Mr. Tronchetti Provera was born in Rome, Italy, on April 3, 1968. He has been head of the Telecom Italia Group Information Technology Market Business Unit since January 15, 2002 until June 1, 2004. Mr. Tronchetti Provera began his career at McKinsey & Company, where for five years he worked as a Senior Management Consultant at a number of offices across Europe, working in industries such as air transport, energy, mobile telephony, steel, television media and insurance. In 1997, he founded Cam Tecnologie, of which he is Deputy Chairman. The company develops technologies and products for the Energy Industry and the Environment. He is also Director of Camfin S.p.A.. Since 1999, he has served as Deputy Chairman of the Kyoto Club. He sits on the boards of Malgara Chiari & Forti S.p.A. and MCC Capitalia. He is currently Board member of Banksiel, Insiel and, since November 2003, Olivetti Tecnost S.p.A., where he is in charge of several strategic projects such as the re-launching of the I-Jet Division and enhancing the value of the brand name. In February 2003 he was appointed President of the Rome District of Audiovisuals and ICT.

Board of Auditors

The following table lists the members of the Telecom Italia Board of Auditors, as of May 21, 2004, including the Alternate Auditors, with their respective positions and year of appointment. The current Telecom Italia Board of Auditors was appointed by the Olivetti General Meeting on May 26, 2003.

Name	Position	Appointed
Ferdinando SUPERTI FURGA	Chairman	2003
Rosalba CASIRAGHI(1)	Auditor	2003
Paolo GOLIA(1)(2)	Auditor	2003
Salvatore SPINIELLO	Auditor	2003
Gianfranco ZANDA(3)	Auditor	2003
Enrico LAGHI	Alternate Auditor	2003
Enrico Maria BIGNAMI(1)(2)	Alternate Auditor	2003

(1) Elected by minority shareholders.
(2) Reappointed in 2003; member of the Board of Auditors since 2000.
(3) Reappointed in 2003; member of the Board of Auditors since 1997.

The positions held by the members of the Board of Auditors in other listed companies are shown below:

Ferdinando Superti Furga	Director of Ipi S.p.A. and Risanamento S.p.A.; member of the Board of Auditors of Arnoldo Mondadori Editore S.p.A. and Edison S.p.A.
Rosalba Casiraghi	
Paolo Golia	
Salvatore Spiniello	

	Director of Fondiaria Sai S.p.A.; Chairman of the Board of Auditors of Immobiliare Lombarda S.p.A.; member of the Board of Auditors of Edison S.p.A.
Gianfranco Zanda	Member of the Board of Auditors of Tim S.p.A.

For a detailed description of Telecom Italia s corporate governance, including activities and responsibilities of the Board of Auditors (acting as Audit Committee of the Company), see Item 10. Additional Information Corporate Governance .

External Auditors

According to Italian law, the Shareholders Meeting held on May 6, 2004 appointed Reconta Ernst & Young as the audit firm of the Company, taking into consideration the favorable opinion of the Board of Auditors.

Italian audit principles require that, in cases of corporate groups, the audit firm of the parent company should carry out the audit of the group s most important entities in terms of the nature of operations, in such a way that it can act as the main group audit firm and express a professional evaluation of the financial statements in their entirety. In addition, the specific procedure set forth by the Company (the Group Procedure for the

206

Table of Contents

Appointment of External Auditors) provides that the auditor of Telecom Italia is the principal auditor of the entire group headed by Telecom Italia and consequently is the auditor to be preferred in conferral of appointments by subsidiaries for mandatory auditing.

As a result, as of May 6, 2004 the Ernst & Young audit network has been selected according to applicable rules and procedures as the only audit firm for all of the companies of the Telecom Italia Group.

Employees

The following table sets out the number of employees of the Telecom Italia Group at December 31, 2003 by Business Unit:

	Number of employees at end of period	
	2002	**2003**
Wireline	53,935	50,766
Mobile	18,702	18,888
South America(1)	5,461	5,049
Internet & Media	7,715	2,029
IT Market	5,506	4,827
IT Group	5,039	4,107
Olivetti Tecnost	4,527	2,395
Other Activities	5,735	5,126
Consolidated Total	**106,620**	**93,187**

(1) The data refers to Entel Chile group, Entel Bolivia group, the company Telecom Italia America Latina and the Business Segment South America of Telecom Italia.

As of December 31, 2003, the Telecom Italia Group employed 93,187 persons. Compared to December 31, 2002 total employment was lower by 13,433 units, due to turnover which reduced personnel by 4,604 units and changes in the scope of consolidation which reduced personnel by 8,829 units. The reductions attributable to the change in the scope of consolidation were mainly due to:

- the disposals in the Internet and Media Business Unit (a total decrease of 5,686 units, 5,402 units of which related to the disposal of New Seat);
- the disposals in the Olivetti Tecnost Business Unit (a total decrease of 2,132 units, of which 1,266 units relating to the sale of a factory in Mexico and 474 units relating to the closing of operations in Latin America);
- the sale of Netikos (207 units), included in IT Market Business Unit;

- the sale of TE.SS (404 units), included in Other Activities;

- the outsourcing of the logistics business segment of the Wireline Business Unit (337 units), the facility s activities of Olivetti Multiservices (208 units in Other Activities), the Information Technology activities of the Desktop Management (582 units in IT Group and 22 units in IT Market) and Corporate Solutions (380 units in IT Group and 21 units in Olivetti Tecnost).

Such decrease was partly offset by the Group s acquisitions of HanseNet (381 units, included in Wireline), Tm News (55 units, included in Internet and Media) and Top Services (21 units in Olivetti Tecnost).

The following table set out the number of employees of the Telecom Italia Group at December 31, 2003 broken down by geographical area and function:

	Manager	Professional	White-collar	Blue-collar	Total
Italy	1,727	4,847	70,089	1,406	78,069
Rest of Europe	44	319	1,930	1	2,294
North America	15	38	206	2	261
Central and South America	154	724	11,591	43	12,512
Australia, Africa and Asia	5	23	23	0	51
Telecom Italia Group Total	**1,945**	**5,951**	**83,839**	**1,452**	**93,187**

207

Table of Contents

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

Approximately 2% of the Telecom Italia Group s employees held executive positions as of December 31, 2003.

Employment contracts for managerial staff are ruled by a national collective agreement that expired in December 2003 and is presently under renewal. National collective agreement compensation clauses were renewed in March 2003.

The compensation clauses of the national collective agreement for non-managerial staff were renewed in July 2003 and the rest of the agreement will expire in December 2004. The compensation provisions of these collective agreements cover all employees rather than those of Information Technology Market, Olivetti Tecnost Group and Telecom Italia Media Group.

As for Telecom Italia, in July 2003 an agreement was reached about the collective bonus for years 2003-2006.

A major agreement, signed in June 2003, permits the collective dismissal of 2,500 employees during 2003 and 2004, on an individual consensus basis. The agreement is related to the implementation of the Industrial Plan.

These agreements confirm a tradition of constructive relations with the labour unions.

In Italy all employees are covered by public health care and pension schemes. Telecom Italia Group employees may elect to be covered by additional health care and pension plans. Assilt, the health care fund for Telecom Italia Group employees, reimburses the medical expenses of 220,000 people (employees, retirees and their families).

Telemaco, previously the pension fund of the Telecom Italia Group, has become in 2003 the pension fund of the companies which apply the National Collective Agreement for Telecommunications, with more than 58.000 members.

Table of Contents

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

Compensation of Directors

Prior to the Merger, Old Telecom Italia and Olivetti were managed by their own Board of Directors.

Olivetti s directors, recognizing that Telecom Italia would have been inherently different from Olivetti, determined that it would be appropriate that the direction of Telecom Italia remain entrusted essentially to the directors of Old Telecom Italia. Accordingly, the members of the Olivetti Board of Directors declared that, upon effectiveness of the Merger, they would consider their mandate as directors of Olivetti to be essentially completed. At the April 15, 2003 meeting of the Olivetti Board of Directors, the members of the Olivetti Board of Directors tendered their resignation with effect from the date of effectiveness of the Merger (apart from one director who resigned effective as of April 16, 2003).

At the Olivetti shareholders meeting held on May 26, 2003, the Olivetti shareholders appointed a new Board of Directors that essentially reproduced the Old Telecom Italia Board at the time and, upon effectiveness of the Merger, became the Board of Directors of Telecom Italia. The term of such Board of Directors expired in 2004 after the approval of the 2003 financial statements. On May 6, 2004 a new Board of Directors was elected. See above under Directors .

Below we set forth the compensation paid in 2003 to (i) Directors of Old Telecom Italia; (ii) Directors of Olivetti; (iii) Directors of Telecom Italia in office during fiscal year 2003 who were not confirmed by the Telecom Italia s shareholders meeting of May 6, 2004 and (iv) Directors elected on May 6, 2004 who were also Directors of Telecom Italia in office at the end of 2003.

(i) The total compensation paid to the Board of Directors of Old Telecom Italia from January 1 to August 3, 2003 was 9,593 thousand.

(ii) The total compensation paid to the Board of Directors of Olivetti from January 1 to August 3, 2003 was 2,109 thousand.

(iii) The total compensation paid for the fiscal year 2003 to Directors in office from the date of effectiveness of the Merger and who have not been confirmed by the General Meeting of May 6, 2004 was 238 thousand.

The following table lists the Directors appointed by the Telecom Italia s Shareholders meeting of May 6, 2004 who were in office at the end of 2003 and the compensation they received for the fiscal year 2003:

Name	Position	Period	Compensation base	Bonus	Non cash benefit	Other Compensation

				(thousands of euro)		
Marco TRONCHETTI PROVERA	Chairman	1/1 -12/31/2003	3,094(1)	1,200(2)		
Gilberto BENETTON	Deputy Chairman	1/1 -12/31/2003	134(3)			
Carlo Orazio BUORA	Managing Director	1/1 -12/31/2003	3,654(4)	2,200(5)		80(6)
Riccardo RUGGIERO	Managing Director	1/1 -12/31/2003	324(7)			
	General Manager	1/1 -12/31/2003		1,844(8)	8(9)	934(10)
Giovanni CONSORTE	Director	4/8 -12/31/2003	43			
Francesco DENOZZA	Director	1/1 -12/31/2003	103(11)			
Luigi FAUSTI	Director	1/1 -12/31/2003	186(12)			
Guido FERRARINI	Director	1/1 -12/31/2003	155(13)			
Gianni MION	Director	1/1 -12/31/2003	134(14)			157(15)
Massimo MORATTI	Director	1/1 -21/31/2003	103(11)			
Carlo A. PURI NEGRI	Director	1/1 -12/31/2003	134(16)			

(1) 1,607 thousand for the office of Chairman of Old Telecom Italia; 338 thousand for the office of Deputy Chairman and Managing Director in Olivetti; 1,149 thousand for the office of Chairman in Telecom Italia.

(2) Remuneration for the office of Chairman in Old Telecom Italia.

(3) 60 thousand for the office of Deputy Chairman in Old Telecom Italia; 31 thousand for the office of Deputy Chairman in Olivetti; 43 thousand for the office of Deputy Chairman in Telecom Italia.

(4) 1,934 thousand for the office of Managing Director in Old Telecom Italia; 338 thousand for the office of Managing Director in Olivetti; 1,382 thousand for the office of Managing Director in Telecom Italia.
(5) 1,200 thousand for the office of Managing Director in Old Telecom Italia and 1,000 thousand for the office of Managing Director in Telecom Italia.
(6) Remuneration for the office of Chairman in the subsidiary TIM not received but paid over to Telecom Italia.
(7) 189 thousand for the office of Managing Director in Old Telecom Italia (approximately 60 thousand of which was not received by Mr. Ruggiero) and 135 thousand for the office of Managing Director in Telecom Italia (approximately 43 thousand of which was not received by Mr. Ruggiero).
(8) 694 thousand for the office of General Manager in Old Telecom Italia and 1,150 thousand for the office of General Manager in Telecom Italia.
(9) 5 thousand for the office of General Manager in Old Telecom Italia and 3 thousand for the office of General Manager in Telecom Italia.
(10) Compensation for employment, of which 545 thousand paid by Old Telecom Italia and 389 thousand paid by Telecom Italia.
(11) 60 thousand paid by Old Telecom Italia and 43 thousand paid by Telecom Italia.
(12) The amount includes remuneration received as a member of the Remuneration Committee and of the Internal Audit and Corporate Governance Committee and consists of 90 thousand (for the office of Director and member of the Remuneration Committee of Old Telecom Italia) and 96 thousand (for the office of Director and member of the Remuneration Committee and Internal Audit and Corporate Governance Committee of Telecom Italia).
(13) The amount includes remuneration received as a member of the Internal Audit and Corporate Governance Committee and is composed of 90 thousand paid by Old Telecom Italia and 65 thousand paid by Telecom Italia.
(14) Remuneration not received but paid over to Edizione Holding; of which 60 thousand was paid by Old Telecom Italia; 31 thousand by Olivetti and 43 thousand by Telecom Italia.
(15) Remuneration for the office of Director in the subsidiary Telecom Italia Media and of Deputy Chairman in the subsidiary TIM not received but paid over to Edizione Holding.
(16) 60 thousand was paid by Old Telecom Italia, 31 thousand by Olivetti and 43 thousand by Telecom Italia.

All of the executive officers contracts (with the exception of those of Messrs. Marco Tronchetti Provera, Carlo Orazio Buora, Riccardo Ruggiero and Giuseppe Nino Tronchetti Provera) contain the following clauses:

- if the Company terminates the work relationship (with the exception of a termination for good cause) and the executive officer waives certain rights to which he is entitled pursuant to applicable Italian law, the Company will pay to the executive officer a separation allowance providing for between two and four years of salary plus, in certain cases, a lump sum corresponding to the average of bonus compensation received in the three years (or shorter period) preceding his termination; and

- if the executive officer terminates the work relationship for good cause determined by a change reducing the responsibilities and tasks assigned to the executive officer, then such executive officer will be entitled to an amount corresponding to 50% of the amount as calculated above.

Table of Contents

The following tables list the stock options held by Mr. Riccardo Ruggiero and Mr. Giuseppe Sala as General Managers of Telecom Italia. Applicable Italian law requires disclosure of individual compensation in the form of stock options for members of the Board of Directors and for General Managers. The compensation in the form of stock options for Mr. Ruggiero and Mr. Sala were disclosed pursuant to legislative Decree No. 58/98 in the Telecom Italia Group s home jurisdiction Annual Report for the year ended December 31, 2003. See also below Options to Purchase Securities from Registrant .

		Options existing at 1/1/2003			New options granted during the year			Options exercised during the year			Options expired during the year	Options existing at 12/31/2003		
(A)	(B)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)=1+ 4-7-10	(12)	(13)
First and last name	**Post held**	**No. options**	**Exercise average price**	**Average expiration date**	**No. options**	**Exercise average price**	**Average expiration date**	**No. options**	**Exercise average price**	**Market average price at exercise**	**No. options**	**No. options**	**Exercise average price(*)**	**Average expiration date**
Riccardo Ruggiero	A.D./ D.G.	750,000	3.177343	2007								750,000	3.177343	2007
		750,000	3.177343	2008							750,000			
		150,000	2.788052	2008								150,000	2.788052	2008
		150,000	2.788052	2009								150,000	2.788052	2009
		200,000	2.788052	2010								200,000	2.788052	2010

(*) Average subscription price of the shares resulting from the exercise of the options.

Following the Merger, each option entitles the holder to subscribe to 3.300871 Shares; the subscription price of the Shares has been modified, dividing the original exercise price by the assignment ratio (3.300871). To understand the table, the value of the average subscription price of the Shares referred to dates preceding the date of effectiveness of the Merger (August 4, 2003) has been adjusted on the basis of the assignment ratio and is, therefore, homogeneous with the price regarding the Shares of Telecom Italia.

		Options existing at 1/1/2003			New options granted during the year			Options exercised during the year			Options expired during the year	Options existing at 12/31/2003		
(A)	(B)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)=1+ 4-7-10	(12)	(13)
First and last name	**Post held**	**No. options**	**Exercise average price**	**Average expiration date**	**No. options**	**Exercise average price**	**Average expiration date**	**No. options**	**Exercise average price**	**Market average price at exercise**	**No. options**	**No. options**	**Exercise average price(*)**	**Average expiration date**
Giuseppe Sala	General Manager	480,000(*)	5.07	1/3 up until May 2008, 1/3 up until May 2009 and 1/3 up until May 2010								480,000	5.07	1/3 up until May 2008, 1/3 up until May 2009 and 1/3 up until May 2010

(*) Relates to TIM options regarding a stock option plan allotted to the Director of Finance and Control of TIM.

Compensation of Executive Officers

The total compensation paid by Telecom Italia or by any of the Telecom Italia Group subsidiaries in 2003 to the executive officers was 10,299,572.

Compensation of Members of the Board of Auditors

In accordance with Italian law, there was no requirement to change the members of the Olivetti Board of Auditors pursuant to the Merger. At the Olivetti shareholders meeting of May 26, 2003, the Olivetti shareholders elected a new Board of Auditors which was the same as the Board of Auditors of Old Telecom Italia. As a result of the Merger and Old Telecom Italia not being the surviving company, the Board of Auditors of Olivetti, as elected on May 26, 2003, became the Board of Auditors of Telecom Italia.

Table of Contents

The table below sets forth compensation paid to the Board of Auditors of Old Telecom Italia, of Olivetti and of Telecom Italia.

The total compensation paid to the Board of Auditors of Old Telecom Italia from January 1, 2003 until and including August 3, 2003 was 481 thousand.

The total compensation paid to the Board of Auditors of Olivetti from January 1, 2003 until and including May 26, 2003 was 152 thousand.

The members of the Board of Auditors who were appointed by the Olivetti shareholders meeting on May 26, 2003 and upon effectiveness of the Merger become the Auditors of Telecom Italia received the following compensation:

Name	Position	Period	Compensation base	Bonus	Non cash benefit	Other Compensation
Ferdinando SUPERTI FURGA	Chairman	5/27-12/31/2003	93			
Rosalba CASIRAGHI	Acting Auditor	5/27-12/31/2003	70			
Paolo GOLIA	Acting Auditor	5/27-12/31/2003	70			
Salvatore SPINIELLO	Acting Auditor	5/27-12/31/2003	70			
Gianfranco ZANDA	Acting Auditor	5/27-12/31/2003	70			35(1)

(1) Remuneration for the office of Chairman of the Board of Statutory Auditors in the subsidiary IT Telecom and Acting Auditor in the subsidiaries Finsiel and TIM.

212

Table of Contents

OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT

The Board of Directors of Old Telecom Italia during 2003 acknowledged:

- the forfeiture, as of April 2003, of the options remaining from the second lot of the 2001 Stock Option Plan (30,855,000 options remaining) following failure to reach the performance criteria calculated on the basis of the stock price of the Old Telecom Italia ordinary shares during the months of March 2002 and March 2003 and the corresponding values of the Dow Jones Eurostoxx TLC Index;

- the forfeiture, as of July 2003, of the options remaining from the third lot of the 2000 Stock Option Plan (9,900,004 options remaining) following failure to reach the performance criteria calculated on the basis of the stock price of the Old Telecom Italia ordinary shares during the months of June 2002 and June 2003 and the corresponding values of the Dow Jones Eurostoxx TLC Index.

The exercise of all Old Telecom Italia options was suspended from May 12, 2003, the 10th day of trading on the stock exchange preceding the date of the first call of the Shareholders Meeting with respect to the Merger, until August 4, 2003, the date of effectiveness of the Merger.

With reference to the Merger, Telecom Italia succeeded to all the stock option plans previously in force at Old Telecom Italia and Olivetti: the 1999 Stock Option Plan , the 2000 Stock Option Plan , the 2001 Stock Option Plan , the 2002 Stock Option Plan and the 2002 Top Stock Option Plan for Old Telecom Italia and the Three year 2002-2004 Stock Option Plan and the Three year February 2002 December 2004 Stock Option Plan for Olivetti.

Holders of the corresponding options have retained the right to subscribe at the price established at the time of the grant, the original number of shares stated in the respective regulations, adjusted to give effect to the Merger. The Merger assignment ratio established for the shareholders of the two companies is equal to 0.471553 ordinary shares for each Olivetti ordinary share and 3.300871 shares for each Old Telecom Italia share.

Therefore, although the price per option did not change, the number of underlying shares (previously corresponding to one ordinary share for each option) that can be subscribed to by exercising each option was adjusted by multiplying the number of shares by the Merger assignment ratio.

As a consequence of this, the subscription price of each ordinary share resulting from the exercise of the options for each Plan has also been adjusted by dividing the exercise price already established by the Merger assignment ratio.

In cases in which the application of the Merger assignment ratio to the various lots results in less than a whole number of shares, the holder of the options has the right to subscribe for each lot up to the full amount of shares rounded down to the nearest unit, exercising only a corresponding quota-part of the options. Following the exercises of options after the date of the Merger, residual options with fractional parts now exist.

On December 31, 2003 the exercise period of the first lot of the 1999 Stock Option Plan expired. The lot was fully exercised, with the exception of the residual options with fractional parts resulting from the above described operations which, as of the same date, consequently expired.

In compliance with the recommendations contained in CONSOB Communication No. 11508 of February 15, 2000, the key features of the stock option plans in force during 2003 are summarized in the following table. In order to ensure understanding in the reading thereof the values indicated (market prices and subscription prices of the shares resulting from the exercise of the options) regarding the amounts, exercises, forfeitures, expirations before the date of effectiveness of the Merger, have been adjusted on the basis of the Merger assignment ratios and thus made consistent with the prices regarding the ordinary shares of Telecom Italia.

Table of Contents

	(Amount in euro)	Options existing at 1/1/2003	New options granted during the year	Options exercised during the year	Options expired and not exercised or forfeited during the year	Options extinguished during the year due to termination of service	Options existing at 12/31/2003	of which exercisable at 12/31/2003
1999 Plan	No. of options	8,471,500		3,959,579.956	18.801		4,511,901.243	4,511,901.243
	Merger Assignment ratio	3.300871		3.300871	3.300871		3.300871	3.300871
	Subscription price	2.057033		2.057033	2.057033		2.057033	2.057033
	Market price	2.182		2.390(*)	2.374		2.374	
2000 Plan	No. of options	20,600,000			9,900,004		10,699,996	10,699,996
	Merger Assignment ratio	3.300871			3.300871		3.300871	3.300871
	Subscription price	4.185259			4.185259		4.185259	4.185259
	Market price	2.182			2.376		2.374	
2001 Plan	No. of options	63,507,500			30,855,000	312,500	32,340,000	32,340,000
	Merger Assignment ratio	3.300871			3.300871	3.300871	3.300871	3.300871
	Subscription price	3.177343			3.177343	3.177343	3.177343	3.177343
	Market price	2.182			1.952	2.060(*)	2.374	
2002 Plan	No. of options	28,076,000				1,789,500	26,286,500	8,065,500
	Merger Assignment ratio	3.300871				3.300871	3.300871	3.300871
	Average subscription price	2.908293				2.928015	2.906951	2.907420
	Market price	2.182				2.258(*)	2.374	
TOP 2002 Plan	No. of options	11,800,000				460,000	11,340,000	3,465,000
	Merger Assignment ratio	3.300871				3.300871	3.300871	3.300871
	Subscription Price	2.788052				2.788052	2.788052	2.788052
	Market price	2.182				2.070(*)	2.374	
2002 2004	No. of options (**)	800,000					800,000	533,332
	Merger Assignment ratio	0.471553					0.471553	0.471553
		7.015118					7.015118	7.015118
		2.075					2.374	

Plan					
	Subscription Price				
	Market price				
Feb.2002 - Dec.2004 Plan	No. of options (***)	7,030,000	1,090,000	5,940,000	3,960,008
	Merger Assignment ratio	0.471553	0.471553	0.471553	0.471553
		5.333441	5.333441	5.333441	5.333441
	Subscription price	2.075	2.299(*)	2.374	
	Market price				

(*) Weighted average price.
(**) Refers to 1,330,000 warrants assigned.
(***) Refers to 29,000,000 warrants authorized of which 26,475,000 assigned.

214

Table of Contents

Plan	Merger Assignment ratio	Subscription price of the resulting shares (euro)	Number of options granted at 12/31/2003 and exercisable from 2001	2002	2003	2004	2005	Total	Maximum period of options
1999	3.300871	2.057033		4,511,901.243				4,511,901.243	December 31, 2004
2000	3.300871	4.185259	5,349,998	5,349,998				10,699,996	5 years beginning from each year
2001	3.300871	3.177343		32,340,000				32,340,000	April 15, 2007
2002	3.300871	2.928015			7,753,500	7,497,000	9,996,000	25,246,500	5 years beginning from each year
	3.300871	2.409061			252,000	252,000	336,000	840,000	
	3.300871	2.339080			60,000	60,000	80,000	200,000	
2002 TOP	3.300871	2.788052			3,465,000	3,375,000	4,500,000	11,340,000	5 years beginning from each year
2002 -2004	0.471553	7.015118		266,666(1)	266,666(1)	266,668(1)		800,000	December 15, 2004
Feb. 2002 Dec. 2004	0.471553	5.333441		1,980,004(2)	1,980,004(2)	1,979,992(2)		5,940,000	December 31, 2004

(1) Exercisable during the period from November 1 to December 15 of each year, or could be also accumulated and exercised at any time following each annual exercise period until the exercise period expiry date.

(2) Exercisable during the period December 1 to December 31 of each year, or could be also accumulated and exercised at any time following each annual exercise period until the exercise period expiry date.

Table of Contents

Item 7. MAJOR SHAREHOLDERS AND RELATED-PARTY TRANSACTIONS

MAJOR SHAREHOLDERS

The Olimpia Shareholders Agreements.

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

There are shareholders agreements among Olimpia s shareholders.

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

The Agreements and the Agreements with the Banks have a duration of three years and can be renewed at each expiration date. The renewal period is three years for the Agreements and two years for the Agreements with the Banks. On April 24, 2004, a notice was published stating that the Agreements with the Banks were renewed until October 4, 2006. The Agreements with Hopa have a three-year term as from May 9, 2003, subject to extension by mutual agreement of the parties thereto. If the Agreements with Hopa are not renewed, the partial demerger of Olimpia and Holinvest will occur, according to terms and conditions set forth in the Agreements with Hopa, and Hopa will receive a premium of at least 0.35 per Olivetti share (or financial instrument), such a sum to be updated in order to take into account the Merger.

The Agreements and the Agreements with the Banks deal with the nomination of the Board of Directors of Olimpia, Olivetti, Old Telecom Italia (now Telecom Italia, as the company resulting from the Merger), TIM and SEAT (now Telecom Italia Media: please see Item 4. Information on the Telecom Italia Group Business Significant Developments during 2003). They identify the key issues on which the board resolutions of such companies have to decide in accordance with the Agreements and the Agreements with the Banks. The Agreements and the Agreements with the Banks also discuss the rules for the resolution of disagreements among the contracting parties on key issues (the so-called deadlock situations). In addition, the Agreements and the Agreements with the Banks govern the consequences among the parties of any change in the structure of control of Pirelli (in the Agreements with the Banks) and of Edizione or of Pirelli (in the Agreements); and grant the parties the right to purchase or sell (puts and calls) Olimpia shares in the event of withdrawal from the agreements themselves.

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

the nomination by Edizione of one-fifth of the Boards of Directors, without taking into account the directors whose designation is reserved by law or applicable bylaws to the market or other parties;

- the nomination of one director by Intesa;
- the nomination of one director by Unicredito;
- the nomination of the vice-president of the Boards of Directors from among the directors nominated by Edizione; and
- in the event of the establishment of an Executive Committee, the election of one member of the Executive Committee from among the directors nominated by Edizione. See Item 6. Directors, Senior Management and Employees Directors .

216

Table of Contents

Under the Agreements with Hopa, Hopa has the right to appoint one Olimpia director and the Former Olimpia Shareholders must use their best efforts in order to cause a director designated by Hopa nominated to the Board of Directors of Olivetti, Old Telecom Italia, TIM and SEAT, with a corresponding reduction in the number of Pirelli nominees. See Item 6. Directors, Senior Management and Employees Directors .

Hopa does not have the right to veto any decision taken by the board of directors or shareholders of Olimpia. In the event of a disagreement between the former Olimpia Shareholders and Hopa with respect to the passage of a resolution by either the Extraordinary Shareholders Meeting or the Board of Directors of Olimpia concerning certain matters (including (i) the determination as to how Olimpia will vote its Olivetti, and now Telecom Italia, shares at an Extraordinary Shareholders Meeting of the Company, (ii) the purchase or sale of securities exceeding a certain amount and (iii) failure of Olimpia to maintain a debt to equity ratio of 1:1), Hopa may cause the partial demerger of Olimpia, in which event Olimpia may cause the partial demerger of Holinvest. In the event of any such partial demerger transactions, Hopa would receive its proportional share of Olimpia s assets and liabilities (determined in accordance with the Agreements with Hopa) and Olimpia will receive its proportional share of Holinvest s assets and liabilities (determined in accordance with the Agreements with Hopa). Except under certain extraordinary circumstances (including the failure of Olimpia to hold at least 25% of Olivetti s share capital now the corresponding stake in Telecom Italia s ordinary share capital or to maintain a debt to equity ratio of 1:1 after a specified cure period), no such partial demerger transactions may be implemented prior to the third anniversary of the merger of Holy S.r.l. (a wholly-owned subsidiary of Hopa) into Olimpia, which took place on May 9, 2003.

Hopa is granted certain co-sale rights in the event Pirelli reduces its equity interest in Olimpia.

Hopa, Holinvest and Hopa controlling companies (the Hopa companies), the Former Olimpia Shareholders and their respective controlling and controlled companies agreed not to acquire any additional Olivetti Shares except (i) in the case of Pirelli, in connection with the exercise of certain existing call options and swap agreements referred to in the Agreements with Hopa, (ii) in the case of Edizione, Unicredito and Intesa, as currently permitted, respectively, under the Agreements and the Agreements with the Banks, and (iii) in the case of the Hopa companies, as permitted under the Agreements with Hopa.

As a result of the Merger no shareholder controls the Company. Olimpia is the largest shareholder in Telecom Italia, with a stake equal to as of May 6, 2004 approximately 17%. Under the voto di lista system for the election of directors, a greater than 1% shareholder or group of shareholders may put forward a slate of directors for election to the Board. As a result of this system 15 of the directors elected at the shareholders meeting of May 6, 2004 are candidates put forward by Olympia. See Item 10. Additional Information Corporate Governance Board of Directors Appointment .

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

Shareholders Ownership

Board of Directors

The following table shows the ownership, as of August 3, 2003, of the Telecom Italia Group s shares by the Directors of Olivetti :

Olivetti ordinary shares	11,711
Old Telecom Italia Shares	550
Old Telecom Italia Savings Shares	6,839
TIM ordinary shares	9,155

The Directors of Old Telecom Italia and Telecom Italia who were not reappointed by the General Meeting of May 6, 2004 held the following shares, as of December 31, 2003:

TIM ordinary shares	10,000

217

Table of Contents

The following table shows the ownership of Telecom Italia and TIM shares, as of May 6, 2004, by the Directors of Telecom Italia who were reappointed (or appointed) by the General Meeting of May 6, 2004:

Name	Company	Number of shares held as of August 4, 2003	Number of shares purchased	Number of shares sold	Number of shares held as of May 6, 2004
Giovanni CONSORTE	Telecom Italia Savings Shares	33,088		33,088	0
	Telecom Italia Media ordinary shares	40,183			40,183
Luigi FAUSTI	TIM ordinary shares	50,000			50,000
Luigi ROTH (appointed)	Telecom Italia Shares(1)				11,553
	TIM ordinary shares(1)				14,300
	Telecom Italia Media ordinary shares(1)				726
Pasquale PISTORIO	Telecom Italia Shares				889,000
	Telecom Italia Shares(1)				660,000

(1) Shares held indirectly.

Board of Auditors

The following table shows the ownership, as of May 26, 2003 of the Old Telecom Italia Group s shares by the Members of the Board Auditors of Olivetti (in office from January 1 until and including May 26, 2003):

Old Telecom Italia Shares	15,650
Old Telecom Italia Saving Shares	20,000
TIM ordinary shares	26,206

The following table shows certain information, as of the date of respective appointment, of ownership of the Old Telecom Italia Group s shares by the Members of the Board Auditors of Olivetti (in office as of May 26, 2003) and of Old Telecom Italia (in office as of May 24, 2003):

Old Telecom Italia Shares	18,000
Old Telecom Italia Savings Shares	68,000
TIM ordinary shares	16,270
TIM savings shares	10,000

The following table shows certain information, as of May 6, 2004 of ownership of the Telecom Italia Group s shares by the Auditors of Telecom Italia:

Name	Company	Number of shares held as of August 4, 2003	Number of shares acquired	Number of shares sold	Number of shares held as of May 6, 2004

Paolo GOLIA	TIM ordinary shares	0	15,555	0	15,555
Salvatore SPINIELLO	Telecom Italia Shares(1)	59,415	23,577	0	82,992
	Telecom Italia Savings Shares(1)	224,458	10,000	0	234,458
	TIM ordinary shares	10,000(2)	0	0	10,000
	TIM savings shares	10,000(2)	0	10,000	0
Ferdinando SUPERTI FURGA	TIM ordinary shares	6,270(2)	0	0	6,270

(1) Resulting from the application of the exchange ratio between Old Telecom Italia and Telecom Italia shares.
(2) Shares held as of the date of appointment (May 24, 2003).

As of May 6, 2004 no member of the Board of Directors or Board of Auditors beneficially owned more than 0.00331% of the Shares or Savings Shares.

Table of Contents

The following table shows certain information, as of May 6, 2004, about the ownership of the Company s Shares and Savings Shares by the Company s directors and executive officers as a group and by the members of the Board of Auditors as a group.

Title of Class	Owner	Number Owned	% of class
Shares	Directors and executive officers as a group (19 Directors and 8 Executive Officers)	1,566,020	0.01519
	Board of Auditors as a group (5 persons)	82,992	0.00081
Savings Shares	Directors and executive officers as a group (19 Directors and 8 Executive Officers)	98,693	0.00170
	Board of Auditors as a group (5 persons)	234,458	0.00404

Telecom Italia has a Code of Conduct for Insider Dealing that sets out the disclosure requirements and rules applicable to transactions involving financial instruments issued by the Company and its subsidiaries carried out by persons who, as a consequence of their position in the Company, have access to material information (taken to mean information on matters capable of producing significant changes in the outlook for the profitability, financial position and/or balance sheet of the Company and the Telecom Italia Group and likely, if made public, to have a significant effect on the price of the listed securities in question). To this end the relevant persons include amongst others Directors, executive officers and Statutory Auditors.

The criteria applied in drafting the Code are consistent with the basic principles underpinning the Company s system of corporate governance: rigour, transparency and alignment with best international practice. The key features of the Code are:

- flexibility in identifying the persons subject to the disclosure obligations, to take account of situations where persons may have temporary access to inside information;
- immediate disclosure to the market of transactions whose amount, aggregated with the amounts of other transactions carried out in the three preceding months and not yet declared to the Company, exceeds 80,000;
- quarterly disclosure of transactions whose cumulative amount is more than 35,000 and less than 80,000;
- extension of the disclosure obligations to the exercise of stock options and pre-emption rights and all transactions involving securities issued by companies belonging to the Telecom Italia Group, even when carried out under a contract for the management of an investment portfolio under which the investor renounces the right to give instructions;
- black-out periods during which, in general, persons subject to the disclosure obligations may not carry out transactions.

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

Continuing Relationship with the Treasury

Since December 9, 2002, the Treasury has not held a direct holding in Telecom Italia. However, the Treasury continues to be in a position to exert certain powers with respect to Telecom Italia through the exercise of the special powers included in Telecom Italia s Bylaws. Such powers were established in 1997 according to Law 474/1994, when Telecom Italia formerly controlled by the Italian Treasury was privatized.

On May 22, 2003, taking into account the proposed Merger, a Decree by the Minister for Economy and Finance, in agreement with the Minister for Productive Activities, stated the exact wording of Telecom Italia s bylaws to be adopted in connection with Merger with reference to the special powers: in particular, the decree maintained the power of approving the acquisition of major shareholdings in the company s voting capital and the power of veto as currently provided for in Telecom Italia s bylaws. On the other hand the power of approving major shareholders agreements and the power of appointment by the Treasury of one Director and one Statutory Auditor were relinquished.

Table of Contents

According to the aforementioned decree, the special powers included in Telecom Italia s Bylaws as adopted in connection with the Merger are as follows:

- *Approval of Material Acquisitions of Shares.* The State has the authority to approve/disapprove of the acquisition of material interests in the share capital of Telecom Italia (which is defined as 3% of the voting share capital). The Board of Directors is required to notify all such acquisitions to the Ministry for Economy and Finance. Until approval, the purchaser of the Shares may not vote the Shares and, in case of disapproval or the expiration of the 60-day term within which the Minister has to make a decision, the purchaser is obligated to resell the Shares within one year.

- *Veto Power over Major Changes.* The State has veto power on resolutions to dissolve the company, approve mergers, demergers or disposition of the business, transfer the registered office abroad, change the corporate purposes or amend or modify the special powers.

Presently, the exercise of special powers by the Government with respect to privatized companies (including Telecom Italia) is governed by an ad hoc decree (the Golden Share Decree).

In particular, following the issuance by the EU of a directive on May 4, 1999, on February 11, 2000, the Italian Government issued the Golden Share Decree. Pursuant to the Golden Share Decree, the Italian Government can use its special powers to protect the vital interests of the State and respond to indispensable reasons of general interest, including public law and order, public security, public health and national defense. The Italian Government will exercise such special powers in compliance with the principles of Italian and European Community laws, and in any case in line with the objectives of the privatization process, and the protection of competition and the market and having regard for non-discrimination principles. Such powers must be suitable and proportional to achieving the indispensable objectives of general interest described above. The Golden Share Decree provides that the Italian Government may exercise its special powers to prevent acquisitions of shares of privatized companies if such acquisitions (i) are not transparent and would not ensure full disclosure with respect to controlling share ownerships of the companies whose shares are being acquired and the objectives and industrial plans proposed by the buyers of the target companies, (ii) compromise the liberalization and market competition or are not in line with the company s privatization goals, or entails situations of conflict of interests which could compromise the company s mission with respect to the objectives of public interest, (iii) entail objective risks of being affected by criminal organizations, or involve the company in unlawful activities, (iv) jeopardize conservation of the special powers of the State, or (v) represent a considerable risk of serious harm to the vital interests of the State described above, including the supply of essential raw materials and goods, the supply of essential public services and the security of related installations and networks and, further, the development of advanced technological sectors.

In December 2003, Law 350/2003 significantly modified the rules governing the special powers of the Italian Government with respect to privatized companies. In particular, the Government will no longer have the power to approve/disapprove of the acquisition of material interests in the share capital of such companies, but will be able to object to it only within a ten-day time limit, in case of prejudice caused to vital State interests and every time there is the need to defend subsequent undeniable reasons of public interest. The new rules are not effective and require implementation through decrees still to be issued which amongst others will specify to which privatized companies the special powers will continue to apply.

According to the powers entrusted to the Board of Directors pursuant to article 12 of the Bylaws, Telecom Italia s Bylaws will be amended at such time in order to conform to the new statutory provisions regarding special powers, as soon as the aforementioned decrees are issued.

Table of Contents

RELATED-PARTY TRANSACTIONS

The Telecom Italia Group enters into transactions with affiliates, and various related parties. The following related party transactions relate to transactions between Telecom Italia and its subsidiaries and the Telecom Italia Group s affiliates as well as the members of the Board of Directors and the companies in which they hold corporate office or significant responsibility. Transactions between members of the Telecom Italia Group are excluded as they are eliminated on consolidation. All such transactions are within the Telecom Italia Group s normal operations and were conducted on an arm s length basis in accordance with specific regulatory provisions.

The following related party transactions are reflected in the statement of operations for the years ended December 31, 2001, 2002 and 2003, respectively:

	Related party transactions in the year ended December 31,					
	2001		2002		2003	
Items	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**
Operating revenues	954 million	Refers mainly to: Astrolink (296 million), Brasil Telecom (120 million), Nortel Inversora group (119 million), Teleleasing (82 million), Auna group (63 million), Sky Italia (formerly Stream) (55 million) and Lottomatica (123 million)	306 million	Refers mainly to: Teleleasing (105 million), Brasil Telecom (48 million), Sky Italia (formerly Stream) (42 million), Auna group (18 million), Telecom Argentina (18 million) and Telekom Srbija (17 million)	275 million	Refers mainly to: Teleleasing (166 million), Sky Italia (formerly Stream) (22 million), Shared Service Center (21 million), Telecom Argentina (12 million) and Telekom Austria (12 million)
Cost of materials and other external charges	596 million	Refers mainly to: rent payable to IM.SER (199 million) and Telemaco Immobiliare (77 million); and TLC service costs from ETEC S.A. Cuba (79 million)	475 million	Refers mainly to: rent payable to IM.SER (153 million) and Telemaco Immobiliare (37 million); TLC service costs from ETEC S.A. Cuba (77 million); and maintenance and assistance contracts from Italtel (40 million) and Siemens Informatica (24 million)	399 million	Refers mainly to: rent payable to Tiglio I (81 million) and Tiglio II (24 million); TLC service costs to ETEC S.A. Cuba (112 million) and Telekom Austria (22 million); and maintenance and assistance contracts from Shared Service Center (45 million), Siemens Informatica (34 million), Teleleasing (11 million) and Italtel (22 million)

Table of Contents

Items	Related party transactions in the year ended December 31, 2001 — In the aggregate	2001 — Main transactions with affiliates	2002 — In the aggregate	2002 — Main transactions with affiliates	2003 — In the aggregate	2003 — Main transactions with affiliates
Other income, net	25 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates	9 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates	14 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates
Financial income and expense, net	Expense for 8 million	Includes accrued interest income on loans made to certain affiliates (22 million); interest expense payable to Teleleasing for financial leasing transactions (30 million)	Expense for 9 million	Includes accrued interest income on loans made to certain affiliates (14 million); interest expense payable to Teleleasing for financial leasing transactions (23 million)	Income for 13 million	Includes accrued interest income on loans made to certain affiliates (24 million); interest expense payable to Teleleasing for financial leasing transactions (11 million)

The following related party transactions are reflected on the balance sheets as of December 31, 2002 and 2003:

Items	Related party transactions in the year ended December 31, 2002 — In the aggregate	2002 — Main transactions with affiliates	2003 — In the aggregate	2003 — Main transactions with affiliates
Loans in long-term investments	456 million	Refers mainly to medium/long term loans made to Aria Is Tim (313 million), Tiglio I (70 million), Telegono (34 million) and Tiglio II (30 million)	122 million	Refers mainly to medium/long term loans made to Aria-Is Tim (336 million written down by 279 million), Aree Urbane (31 million) and Telegono (15 million)
Trade accounts receivables and other current assets	222 million	Comprises mainly receivables from Sky Italia (formerly Stream) (71 million), Telekom Srbija (21 million net of provision), Teleleasing (38 million) and Consorzio Telcal (14 million)	149 million	Comprises mainly receivables from Sky Italia (formerly Stream) (44 million written down by 27 million), Teleleasing (49 million) and Shared Service Center (11 million)

Trade accounts payable and other current liabilities	405 million	Refers to payables for supply contracts connected with operating and investment activities. They include: payables to the Italtel Group (150 million), Siemens Informatica (40 million), Teleleasing (17 million) and advances from Consorzio Telcal (103 million)	146 million	Refers to payables for supply contracts connected with operational and investment activities. They include: payables to the Italtel group (54 million), Siemens Informatica (23 million) and Mirror International Holding (24 million) for capital subscribed and not yet paid

222

Table of Contents

	Related party transactions in the year ended December 31,			
	2002		2003	
Items	In the aggregate	Main transactions with affiliates	In the aggregate	Main transactions with affiliates
Long-term and short-term debt	406 million	Refers mainly to payables for finance leases to Teleleasing (393 million)	42 million	Refers mainly to payables for finance leases to Teleleasing (26 million), Shared Service Center (6 million) and Edotel (4 million)
Short-term financial receivables	35 million	Comprises short-term loans made to TI Sparkle (formerly TMI) group companies (14 million) and Golden Lines (10 million net of provisions)	30 million	Comprises short-term loans made to Teleleasing (13 million), TMI Canada (8 million) and TIN Web (5 million)
Long-term and short-term contracts	110 million	Refers mainly to activities on behalf of Consorzio Telcal for the Telematico Calabria Plan		
Guarantees and collateral	935 million	Comprises sureties provided on behalf of Aria Is Tim (537 million), Consorzio Csia (85 million) and Sky Italia (formerly Stream) (72 million), Tiglio I (27 million) as well as collateral on behalf of Aria Is Tim (110 million)	976 million	Comprises sureties provided on behalf of Aria Is Tim (672 million), Consorzio Csia (81 million), Tiglio I (46 million) as well as collateral on behalf of Aria Is Tim (107 million)
Capital expenditures	441 million	Mainly consists of acquisitions of telephone exchanges from the Italtel group (406 million) and computer projects from Siemens Informatica (19 million)	403 million	Mainly consists of acquisitions of telephone exchanges from the Italtel group (346 million) and computer projects from Siemens Informatica (13 million)

Moreover, related party transactions in the year ended December 31, 2003 include:

Items	In the aggregate	Nature of the transaction
Purchases and sales commitments	37 million	

Refers to commitments with Teleleasing (5 million) under operating leases and with ETEC S.A. Cuba (32 million) for the capital increases

In addition, during 2003, the buildings leased from Teleleasing under financial leasing contracts, already recorded in tangible assets in the preceding financial statements, were purchased.

Table of Contents

Other related party transactions for the year ended December 31, 2003: Pirelli group, Edizione Holding group, Unipol group, Banca Intesa group, Unicredito group and others

Related party transactions, excluding transactions among group companies, also include transactions entered into during 2003 between the Telecom Italia Group with the Pirelli group, the Edizione Holding group, the Unipol group, the Banca Intesa group, the Unicredito group and the companies associated with Director Mr. Massimo Moratti as follows.

The following related party transactions are reflected in the statement of operations for the year ended December 31, 2003:

Items	In the aggregate	Nature of the transaction
Operating revenues	63 million	Refers mainly to computer services and the supply of energy services to the Pirelli group (34 million) and telephone services to the Pirelli group (5 million), the Edizione Holding group (9 million), the Banca Intesa group (4 million), the Unicredito group (2 million), the Unipol group (8 million) and companies associated with Director Mr. Massimo Moratti (1 million)
Cost of materials and other external charges	55 million	Refers mainly to R&D expenditures and information technology and tax consulting services and matters regarding intellectual property rendered by the Pirelli group (44 million), insurance services to the Unipol group (10 million) and the commissions paid to the Edizione Holding group for the sale of prepaid telephone cards (1 million)

The following related party transactions are reflected on the balance sheet as of December 31, 2003:

Items	In the aggregate	Nature of the transaction
Trade accounts receivables and other current assets	20 million	Refers mainly to the above-mentioned telephone services rendered to the Pirelli group (13 million), to the Edizione Holding group (3 million), to the Banca Intesa group (2 million) and to the Unipol group (2 million)
Trade accounts payable and other current liabilities	30 million	Mainly includes supply transactions connected with services rendered and investment activities with the Pirelli group (principally cables)
Capital expenditures	30 million	Refers to purchases of telecommunications cables (27 million) and leasehold improvements (3 million) from the Pirelli group

Short-term financial receivables	707 million	Refers to the liquid assets of the Group deposited with the Banca Intesa group (608 million) and the Unicredito group (99 million)
Financial debt	392 million	Financial exposure of the Group to the Banca Intesa group (341 million) and the Unicredito group (51 million)
Acquisition of investments	2 million	Purchase by Telecom Italia S.p.A of a 5% stake in EPIClink S.p.A. from Pirelli S.p.A.
Disposal of business segments	4 million	Gain on contribution, by Olivetti, of the Facility Management business segment to Pirelli & C. Real Estate
Derivatives	88 million	Hedging contracts and forward currency agreements put into place with the Banca Intesa group

Table of Contents

Moreover, there were the following transactions:

- in 2003, TIM and Telecom Italia disposed of telephone cards to Autogrill S.p.A. (Edizione Holding group) for subsequent sale to the general public for an equivalent amount of 22 million, the commission due to Edizione Holding group for the sale of telephone cards amounted to 1 million;
- on July 28, 2003, IT Telecom S.p.A. contributed its business segment Corporate Solution to Pirelli Informatica s share capital. Pirelli Informatica changed in Shared Service Center (SCC), a consortium with limited liability held as of December 31, 2003 by IT Telecom S.p.A. (45%), Olivetti Tecnost S.p.A. (5%) and Pirelli S.p.A. (50%);
- on July 21, 2003, the spin-off of Tiglio I and Tiglio II in Ortensia was concluded. Such transaction became effective on July 25, 2003;
- in March 2004 TIM conferred to Shared Service Center a business segment operating in the development and maintenance of SAP applications.

Other related party transactions for the years ended December 31, 2002 and 2001: Pirelli group and Edizione Holding group

Related party transactions, excluding transactions among group companies, also included transactions between the Telecom Italia Group with the Pirelli group and the Edizione Holding group in 2002 as follows.

The following related party transactions were reflected in the statement of operations for the year ended December 31, 2002:

Items	In the aggregate	Nature of the transaction
Operating revenues	26 million	Mainly refers to telephone services to Pirelli group (8 million) and to Edizione Holding (16 million) and to information services to Pirelli group (2 million)
Cost of materials and other external charges	23 million	These essentially refer to R & D expenditures and the supply of services in the IPR field to Pirelli group (21 million) and to Edizione Holding group (2 million)

The following related party transactions were reflected on the balance sheet as of December 31, 2002:

Items	In the aggregate	Nature of the transaction

Trade accounts receivables and other current assets	3 million	These mainly refer to the above-mentioned services to Pirelli group (1.6 million) and to Edizione Holding group (1.5 million)
Trade accounts payable and other current liabilities	9 million	These mainly refer to the supply contracts connected with investment activities to Pirelli group (8 million) and to Edizione Holding group (1 million)
Capital expenditures	32 million	These mainly refer to purchases of telecommunications cables from Pirelli group
Acquisition of investments and purchases commitments	21 million	Purchase of 25.3% stake in EPIClink by Old Telecom Italia from Pirelli S.p.A. (18 million) and purchase commitment for the remaining 5% (3 million)
	35 million	Purchase by TIM of Blu S.p.A. shares, stake from Edizione Holding S.p.A. and Autostrade S.p.A.
Acquisition of business segments	3 million	Purchase of a business segment by EPIClink S.p.A. from Pirelli Informatica
Disposal of business segments	19 million	Gain on the sale of non-facility business segments to Pirelli Real Estate from the Old Telecom Italia Group and of Property and Project business from Olivetti Multiservices

Moreover in 2002, 20 million of telephone cards, mostly for mobile phones, were sold to Autogrill S.p.A. (Edizione Holding group).

Related party transactions in 2001 also included those by Telecom Italia (formerly Olivetti) with the Pirelli group. Such items include:

- *Operating revenues:* mainly related to telephone services (6.9 million).
- *Capital expenditures:* mainly related to purchases of telecommunications cables (21.5 million).

The following related party transactions are reflected in the statement of operations for the three months ended March 31, 2004:

	Related party transactions for the three months ended March 31, 2004	
Items	**In the aggregate**	**Main transactions with affiliates**
Operating revenues	32 million	Refers mainly to: Shared Service Center (9 million), Teleleasing (8 million) and Telecom Argentina (2 million)
Cost of materials and other external charges	96 million	Refers mainly to: rent payable to Tiglio I (21 million) and Tiglio II (7 million); TLC service costs to Etec S.A. Cuba (28 million); and maintenance and assistance contracts from Shared Service Center (23 million), Siemens Informatica (6 million) and Italtel (1 million)
Other income, net	1 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates
Financial income and expense, net	Positive for 1 million	Includes accrued interest income on loans made to certain affiliates

The following related party transactions are reflected on the balance sheet as of March 31, 2004:

	Related party transactions as of March 31, 2004	
Items	**In the aggregate**	**Main transactions with affiliates**
Loans under long-term investments	109 million	Refers mainly to medium/long term loans made to TT & TIM Turchia (formerly Aria-Is Tim) (52 million), Aree Urbane (31 million) and Telegono (6 million)

Trade accounts receivables and other current assets	149 million	Comprises mainly receivables from Sky Italia (formerly Stream) (14 million net of the related write-offs), Teleleasing (44 million), Lombardia Integrata Servizi Informatici (26 million) and Shared Service Center (16 million)
Trade accounts payable and other current liabilities	125 million	Refers mainly to payables for supply contracts connected with operational and investment activities. They include: payables to the Italtel group (40 million), Shared Service Center (27 million) and Siemens Informatica (20 million).

226

Table of Contents

Items	**Related party transactions as of March 31, 2004**	
	In the aggregate	**Main transactions with affiliates**
Long-term and short-term debt	57 million	Refers mainly to payables for finance leases to Teleleasing (29 million), Shared Service Center (6 million), Alladium (7 million) and Edotel (4 million)
Short-term financial receivables	1 7 million	Comprises short-term loans made to TMI Canada (9 million) and TIN Web (5 million)
Guarantees and collateral	975 million	Mainly comprises sureties provided on behalf of TT & TIM Turchia (formerly Aria-Is Tim) (652 million), Consorzio Csia (81 million), Tiglio I (46 million) as well as collateral on behalf of TT & TIM Turchia (formerly Aria-Is Tim) (117 million)
Capital expenditures	44 million	Consists mainly of acquisitions of telephone exchanges from the Italtel group (40 million) and computer projects from Shared Service Center (3 million) and from Siemens Informatica (1 million)

Moreover, related party transactions for the three months ended March 31, 2004 include:

Items	**Related party transactions as of March 31, 2004**	
	In the aggregate	**Main transactions with affiliates**
Purchases and sales commitments	32 million	Refers to commitments with Teleleasing (4 million) under operating leases and with Etec S.A. Cuba (28 million) for the capital increases

Other related party transactions for the three months ended March 31, 2004: Pirelli group, Edizione Holding group, Unipol group, Banca Intesa group, Unicredito group and others

Related party transactions, excluding transactions among group companies, also include transactions entered into during the three months ended March 31, 2004 between the Telecom Italia Group with the Pirelli group, the Edizione Holding group, the Unipol group, the Banca Intesa group, the Unicredito group as follows.

The following related party transactions are reflected in the statement of operations for three months ended March 31, 2004:

Items	**In the aggregate**	**Nature of the transaction**
Operating revenues	15 million	Mainly refers to computer services and the supply of energy services to the Pirelli group (1 million) and telephone services to the Pirelli group (1 million), the Edizione Holding group (1 million), the Banca Intesa group (3 million), the Unipol group (1 million) and the Unicredito group (8 million).
Cost of materials and other external charges	19 million	Mainly refers to R&D expenditures and information technology and tax consulting services and matters regarding intellectual property rendered by the Pirelli group (15 million), insurance services to the Unipol group (2 million) and the commissions paid to the Autogrill S.p.A. (Edizione Holding group) for the sale of prepaid telephone cards (1 million), sponsorship and content provider costs from F.C. Internazionale Milano S.p.A. company associated with Director Mr. Massimo Moratti (1 million).

227

Table of Contents

The following related party transactions are reflected on the balance sheet as of March 31, 2004:

Items	In the aggregate	Nature of the transaction
Trade accounts receivables and other current assets	227 million	Mainly refers to the above-mentioned telephone services rendered to the Pirelli group (6 million) and to the Unicredito group, Banca Intesa group and Unipol group (5 million). Refers also to receivables from the Banca Intesa group related to accounts receivable sold without recourse (216 million)
Trade accounts payable and other current liabilities	31 million	Mainly includes supply transactions connected with services rendered and investment activities with the Pirelli group principally cables (28 million), sponsorship costs from F.C. Internazionale Milano S.p.A. (2 million), commissions paid to the Autogrill S.p.A. (Edizione Holding group) for the sale of prepaid telephone cards (1 million)
Capital expenditures	4 million	Mainly refers to purchase of telecommunications cables from the Pirelli group.
Short-term financial receivables	932 million	Refers to the liquid assets of the Group deposited with the Banca Intesa group (589 million) and the Unicredito group (343 million)
Financial debt	317 million	Financial exposure of the Group to the Banca Intesa group (247 million) and the Unicredito group (70 million)

Moreover, there were the following transactions:

- In the first quarter of 2004, TIM and Telecom Italia disposed of telephone cards to Autogrill S.p.A. (Edizione Holding group) for subsequent sale to the general public for an equivalent amount of 5 million, the commission due to Edizione Holding group for the sale of telephone cards amounted to 1 million;
- In March 2004, TIM conferred to Shared Service Center (a consortium with limited liability) a business segment operating in the development and maintenance of SAP applications and obtained a 4.55% stake in Shared Service Center. The value of the business segment was 65,000.

Table of Contents

Item 8. FINANCIAL INFORMATION

Historical Financial Statements

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

Unaudited Pro Forma Condensed Consolidated Financial Data

The following unaudited pro forma condensed consolidated statement of operations for the year ended December 31, 2003 was prepared on the basis that the Merger occurred on January 1, 2003, instead of the effective date of August 4, 2003.

Under U.S. GAAP Olivetti was identified as the acquiring company based upon the requirements of SFAS 141 and the acquisition of the minority interest was accounted for under the purchase method, using fair value as the measure.

The pro forma information is intended to give a better understanding of the impact of the Merger on the full year results of the Group. The presentation includes more detailed discussions below regarding the adjustments made to illustrate these effects. The notes to the unaudited pro forma condensed consolidated statement of operations describe the adjustments made to the pro forma condensed consolidated statement of operations to illustrate the pro forma effects had the Merger occurred on January 1, 2003.

You should read the following unaudited pro forma condensed consolidated statement of operations in conjunction with the Telecom Italia Group s audited consolidated financial statements and notes thereto included elsewhere herein.

The following unaudited pro forma condensed consolidated statement of operations for the year ended December 31, 2003 is presented to the level of Income Before Discontinued Operations and Accounting Change. Discontinued operations relate to New SEAT, whose stake was sold on August 8, 2003.

The unaudited pro forma condensed consolidated financial information is presented in accordance with U.S. GAAP and includes the following:

1. The extract from the audited consolidated statement of operations of the Telecom Italia Group on a U.S. GAAP basis included elsewhere herein, which reports the operations of New SEAT, whose stake was sold on August 8, 2003, as discontinued operations.

2. The unaudited pro forma adjustments for computing:

i) depreciation and amortization charges on the step up to reflect the fair values of fixed assets and intangible assets and the amortization to income of the step up to reflect the fair value of long-term debt deriving from the purchase price allocation of the Merger, had the Merger occurred on January 1, 2003;

ii) the related tax effects; and

iii) the effect on minority interests had the Merger and, accordingly, the acquisition of the minority interests, occurred on January 1, 2003.

3. The unaudited pro forma consolidated financial information of the Telecom Italia Group.

The unaudited pro forma condensed consolidated financial information is presented for informational purposes only and, because of its nature, is not necessarily indicative of the results of operations and the financial position of the Telecom Italia Group, had the Merger in fact occurred on January 1, 2003, nor of the results of operations of the Telecom Italia Group for any future period.

You should read this section in conjunction with the Telecom Italia Group s audited consolidated financial statements and notes thereto included elsewhere herein.

229

Table of Contents

STATEMENTS OF OPERATIONS

	Year ended December 31, 2003		
		Unaudited Pro Forma	
	Telecom Italia U.S. GAAP	Effect of Merger (1)	Pro Forma Telecom Italia U.S. GAAP
		(millions of Euro, except per share amounts)	
Operating revenues	30,176		30,176
Other revenues	343		343
Total revenues	**30,519**		**30,519**
Operating expenses	(22,424)	(301)	(22,725)
Operating income	**8,095**	**(301)**	**7,794**
Financial income and expenses and other income and expenses, net	(3,140)	81	(3,059)
Income (loss) from continuing operations before income taxes	**4,955**	**(220)**	**4,735**
Income taxes	(1,820)	86	(1,734)
Income before minority interests	**3,135**	**(134)**	**3,001**
Minority interests	(1,523)	317	(1,206)
Income before discontinued operations and accounting change	**1,612**	**183**	**1,795**
Net income before discontinued operations per Ordinary Share Basic	0.18		0.20
Net income before discontinued operations per Ordinary Share Diluted	0.18		0.20
Net income before discontinued operations per Savings Share Basic	0.19		0.21
Net income before discontinued operations per Savings Share Diluted	0.19		0.21

Notes to the Unaudited Pro Forma Condensed Consolidated Statement of Operations

Under U.S. GAAP, the combination of Old Telecom Italia and Olivetti has been accounted for under the purchase method of accounting for business combinations, with Olivetti treated as the acquiror.

1. The unaudited pro forma adjustments relate to the computation of :

i) depreciation and amortization charges on the step up to reflect the fair values of fixed assets and intangible assets, for approximately 301 million, the amortization to income of the step up to reflect the fair value of long-term debt, for approximately 81 million, deriving from the purchase price allocation of the Merger, had the Merger occurred on January 1, 2003;

ii) the related tax effects for approximately 86 million; and

iii) the effect on minority interests had the Merger and, accordingly, the acquisition of the minority interests, occurred on January 1, 2003, for approximately 317 million.

Table of Contents

LEGAL PROCEEDINGS

General

The main disputes, litigations and arbitration proceedings in which we are involved as at December 31, 2003, are listed herein below. Except where specifically mentioned we did not make any provisions to the risk reserves because of the absence of definite and certain elements and/or because a negative outcome to the litigation is considered unlikely. In addition, proceedings involving alleged abuses of market dominating positions against us and other antitrust proceedings are pending before the Italian competition and regulatory authority. Other than as described herein, neither we nor any of our subsidiaries is a party to any proceedings and no such proceedings are known to us to be contemplated by governmental authorities or third parties, which, if adversely determined, could have a material adverse effect on our consolidated financial position or results of operations.

Personal Computers Business

In relation to the disposal by Olivetti (now Telecom Italia) of the personal computers business unit in 1997, lawsuits brought by the following parties are still pending before Ivrea s Court:

- by Centenary Corporation and Centenary International (purchasers of OP Computers S.p.A, in which the business unit personal computers has been merged) for damages estimated to be approximately 130 million;
- by ICS S.p.A. (next transferee of the aforesaid business unit) for damages, jointly with the OP Computers bankruptcy, of approximately 16 million; and
- by ex-employees of OP Computers S.p.A. to ascertain that the contracts relating to the disposal of the business unit are null and void and to obtain reinstatement as employees of Olivetti with payment of salary differences and damages of an estimated amount of about 210 million. On March 31, 2004, a settlement has been agreed with most of the plaintiffs, to each of whom a gross amount of 12,000 plus 1,100 for contribution to expenses has been recognized, for a total amount of about 5,300,000. The proceeding is still pending with the remaining plaintiffs, but the settlement reduces materially the amount required.

Galactica

At the end of May 2001, a dispute arose between Telecom Italia and the Internet Service Provider Galactica S.p.A. (currently in liquidation under the name Servinternet S.p.a.) for wrongful termination by Telecom Italia of an agreement concerning the testing of an Internet flat-rate access service. Galactica sued Telecom Italia for the alleged illegality of withdrawal, claiming damages and challenging Telecom Italia not to interrupt the distribution of the service. In February 2002, in a separate claim, Galactica claimed further damages caused by the alleged unfair competition practices of Telecom Italia. In May 2002, the competent Italia court combined the two cases. On October 16, 2002, Servinternet presented another claim against Telecom Italia. This case has also been combined with the other two cases pending before the same court. In addition, the proceedings brought before the National Regulatory Authority concluded with no agreement having been reached. After the rejection of some of the precautionary petitions, Servinternet has claimed damages for approximately 90 million.

Teleque Communications

On November 6, 2002, Teleque Communications S.p.A., a company operating in the sector of prepaid telephone cards for international telephone services, has brought suit to summon Telecom Italia before the Rome Court of Appeal claiming alleged unfair trade practices and asking for damages of 65 million. Teleque Communications (which filed for bankruptcy in December 2003) claims that Telecom Italia acquired a competitive advantage by adding, for the supply of its interconnecting services, additional costs which, vice-versa, were not charged to Telecom Italia s final customers of prepaid international services.

De Agostini

De Agostini initiated arbitration proceedings against SEAT (now Telecom Italia Media), Matrix, Buffetti Group and Finanziaria Web for the alleged nonfulfillment of the framework agreement of September 20, 2000, with regard to SEAT s obligation to acquire the Finanziaria Web S.p.A. s shares still held by the De Agostini

Table of Contents

group. Effectively, the De Agostini group maintains that all the conditions stipulated in the contract for executing the agreement were fulfilled, whereas Telecom Italia Media maintains that this is not true and that, in any case, the fact that market conditions changed rendered the acquisition excessively onerous. The De Agostini group is asking for specific performance of the framework agreement and that the Finanziaria Web shares should be transferred to Telecom Italia Media for the amount originally agreed of 700 million, as well as the payment of unspecified damages.

De Agostini also requested that the contract should be reduced to fair value, indicating the sum of 630 million as being fair consideration for the purchase of 40% of Finanziaria Web, or as a further condition the sum be decided by the Arbitration Board. During the course of the arbitration proceedings Telecom Italia Media presented further grounds, claiming a conflict of interests in the finalization of the agreement, in addition to the request of the annulment of the agreement. On request by the Arbitration Board, the deadline for the decision has been extended up until November, 2004.

Meanwhile, on March 24, 2004, the Arbitration Board invited the parties to evaluate the existence of conditions to reach an out of court settlement. As a result, contacts among the parties legal counsels are currently in progress.

Cecchi Gori Group

Arbitration. On October 1, 2003, an arbitration panel announced the award in the proceedings initiated in August 2001 by Cecchi Gori Group Fin.Ma.Vi. S.p.A.(Fin.Ma.Vi.) and Cecchi Gori Group Media Holding S.r.l. (Cecchi Gori Media Holding and, together with Fin.Ma.Vi., Cecchi Gori Group) against SEAT at this date against Telecom Italia Media claiming the rescission or the invalidity of the August 7, 2000 contract for the acquisition by SEAT of 75% of the share capital of Cecchi Gori Communications S.p.A. (now called Holding Media Comunicazione, parent company of the companies owning La7 and MTV) and obtain compensation for damages incurred, of 387 million. The panel rejected all the claims, stating substantially the legitimacy of the acts which led SEAT to become the sole shareholder of Cecchi Gori Communications.

Litigation. Litigations still pending are as follows:

- before the Rome Court of Appeal:
    - appeal by the Cecchi Gori Group against the decision which rejected its request to find the August 11, 2000 resolution of the Extraordinary Shareholders Meeting of Cecchi Gori Communications null and void. The resolution regards certain amendments to the bylaws;
    - appeal by the Cecchi Gori Group against the decision which rejected the request for the annulment of the resolutions approving the financial statements and related balance sheet of Cecchi Gori Communications at December 31, 2000. In view of the losses resulting in the balance sheet at that date, the Shareholders Meeting held on April 27, 2001, wrote off and then recapitalized the share capital of Cecchi Gori, entirely subscribed only by SEAT;
- before the Milan Courts:
    -

claims for damages caused to Cecchi Gori Group and Vittorio Cecchi Gori as a result of the alleged illegal conduct by SEAT and the directors which it appointed in Cecchi Gori Communications. Such conduct was alledgedly aimed at removing Cecchi Gori Group Media Holding as minority shareholder;

- appeal against the decision with which the Milan Courts rejected, over the merits, the request for the annulment or cancellation of the deed under which the Cecchi Gori Communications shares belonging to Cecchi Gori Group Media Holding were pledged to SEAT.

Universal Service

In January 2002, the TAR of Lazio ruled in favor (only with respect to procedural issues) of the appeal presented by Omnitel to obtain the annulment of the resolution passed by the National Regulatory Authority on Application of the sharing mechanism for the net cost of the universal service for 1999 , a resolution which was also contested by Infostrada.

As a consequence, Omnitel filed an appeal with the Italian administrative courts of appeal (Consiglio di Stato) and did not pay its share of the universal service (approximately 9 million). On November 12, 2003, the

Consiglio di Stato partially accepted the appeal, ruling that the resolution passed by the National Regulatory Authority was invalid due to a lack of investigations in relation to the effective competitiveness in the telecommunications market in 1999.

In the meanwhile Vodafone Omnitel also filed an appeal before the TAR of Lazio to annul the resolution under which the National Regulatory Authority, in executing the sentence by the TAR of Lazio in January 2002 to revise the procedure with regard to the sharing of the net cost of the universal service for 1999, recalculated the amount due as contribution from Vodafone Omnitel for its share.

The appeals made at the beginning of 2002 to annul the resolution containing the regulations on the Universal Service: Application of the sharing mechanism for the net cost of the universal service for 2000 are still pending. In particular, Omnitel has requested the suspension of the efficacy of the resolution and that the case be referred to the Court of Justice of the European Community in order to ascertain the correct interpretation of the EU directives. As a result of the appeal, Omnitel and Wind did not pay their contribution share for the supply of the universal service for 2000 for a total amount of 12 million.

In May 2003, Vodafone Omnitel also contested, before the TAR of Lazio, the communication dated April 29, 2003 in which the Ministry of Communications ordered Omnitel to pay the amount of the contribution to finance the universal service for the year 2000.

Fee concerning article 20, paragraph 2, law No. 448 of 23.12.1998

Telecom Italia, Tim, Wind and Omnitel (before the TAR of Lazio) as well as Infostrada and Albacom (through an extraordinary appeal to the President of the Republic of Italy) contested the Ministerial Decree of March 21, 2000, introducing Italian Law No. 448 dated December 23, 1998, which as of January 1, 1999 established a new license fee (in place of the concession fee) to be paid by telecommunication operators, the amount of which is based upon a declining percentage from 1999 to 2003 (from 3% to 1.5%) on revenues generated in the year prior to the expected payment. The appeal contested the compatibility of Article 20 of the above-mentioned ministerial decree with EU regulations relating to telecommunications, and, in particular, the principle that telecommunications companies cannot be charged further fees other than those provided for in the same EU regulations (hearing expenses, utilization of the so-called scarce resources and financing of the universal service).

Both the Consiglio di Stato (in expressing its opinion to the Head of State of Italy on the extraordinary appeal made by Infostrada and Albacom) and the TAR of Lazio raised the preliminary question before the Court of Justice of the European Community, which, on September 18, 2003, in announcing its decisions on the appeals presented by Albacom and Infostrada, stated that the fee is incompatible with EU regulations.

In a meeting held on November 18, 2003, the Consiglio di Stato did not express any final opinion on the extraordinary appeals made by Infostrada and Albacom. The Consiglio di Stato ordered the transfer of the Court of Justice ruling to the Prime Minister offices and to the Ministry of the Economy, for forwarding to the appealing companies. The Ministry of the Economy must draw up its final considerations with a specific full report, after which the case will be submitted once again to the Consiglio di Stato for its final opinion.

In addition the Court of Justice announced to the TAR of Lazio that it would confirm its decisions of September 18, 2003. The TAR must issue a ruling on the appeals made by Telecom Italia, TIM, WIND and Omnitel and has asked for a specific decision to the same Court of Justice.

In light of the above, the Telecom Italia Group reversed liabilities and reserves for risks and charges for an amount of 1,465 million with respect to the years 2000, 2001 and 2002.

While waiting for the final ruling by the administrative judge, the TLC license fee paid by the Telecom Italia Group for the year 1999 of 546 million has not been credited to income.

* * *

Moreover, in March 2003, Telecom Italia and TIM brought suit before the TAR of Lazio in order to obtain the restitution of the concession fee paid for the year 1998 amounting to 529 million. The request is founded upon the illegitimacy of the provision of Article 21 of D.P.R. 318/97 which kept the fee in force even after the EU Directive 97/13 came into effect and the term expired for its introduction into Italian law.

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233

Table of Contents

With the filing of an appeal in November 2003, with the TAR of Lazio, Telecom Italia asked to ascertain its right not to make any payment of the concession fee for 1998 and for the cancellation of the communication issued by the Ministry of Communications on July 9, 2003, in which the exclusion of several revenue items in the income subject to fee for the years 1997 and 1998 was contested. The adjustment resulting from a recalculation would stand at 31 million for 1997 and 41 million for 1998.

These proceedings follow other proceedings already filed by Telecom Italia from 2000 regarding the method of calculating the concession fee in relation to the gradual process of liberalizing the telecommunications sector.

An amount of 64 million has been provided for in the financial statements for such disputed charges.

Alleged Violations Of Regulations Governing Competition

On April 27, 2001, the Italian Antitrust Authority, pursuant to a complaint made by Wind (formerly Infostrada) alleging unfair practices of Telecom Italia relating to ADSL technologies, ruled that Telecom Italia had abused its dominant position in the ADSL and xDSL market and fined Telecom Italia 59 million. Telecom Italia appealed the ruling and the fine to the Regional Administrative Tribunal, or TAR, of Lazio. The TAR of Lazio dismissed the appeal but reduced the fine to 29 million. Although Telecom Italia has paid the fine, it appealed the ruling to the Consiglio di Stato; in order to obtain the annulment of the ruling which was disputed on the basis of general unreasonableness and lack of motivation and preliminary investigation.

During the period from 2001 to date, certain telecommunications operators have claimed that they suffered damages as a consequence of Telecom Italia s alleged unfair trade practices: on January 2003 the Court of Appeals of Rome ordered Telecom Italia to pay 2 million as a refund for Albacom, Wind, Cable & Wireless (formerly Unidata) and Data Service.

Claims brought by other operators for similar reasons are pending for approximately 120 million; their probable result, given the notable similarity to the previous actions and the identity of the judging body, is considered to be analogous to that of the first proceedings. Based on this evaluation, Telecom Italia has provided approximately 4.2 million in the reserve for risks.

* * *

Following a petition by competing operators, in 2003 the National Regulatory Authority alleged that Telecom Italia conducted unfair trade in 2003 practices which harmed the development of a competitive market (Resolution No. 179/01/CONS) and has subsequently started the relative proceedings for sanctions. A counter-claim is pending before the TAR of Lazio for both the presumed proceeding and the subsequent resolutions.

* * *

In June 2003, the Antitrust Authority began proceedings against Telecom Italia for alleged abuse of dominant position claiming the illegality of certain commercial agreements relating to business customers. In particular, the abusive conduct by Telecom Italia specifically would refer to having established service prices for the wireline network, with the intent to exclude competitors who would not be able to replicate such prices due to the interconnection costs charged by Telecom Italia.

In September 2003, the Company contested the proceedings before the TAR of Lazio, with reference to the dispute of the legality of the offer made in the public bid announced by CONSIP in 2002. The appeal was ruled against in March 2004. The ruling has not been deposited yet, and therefore the reasons of the decision are not yet available.

Disputes Concerning Orders By The National Regulatory Authority

In March 2003, the National Regulatory Authority and Wind were notified of the appeal presented before the TAR against the resolution regarding Current cost accounting guidelines for notified operations of wireline and wireless networks which constitutes the basis for establishing the prices to be applied to operators which make request to use the network.

Telecom Italia has contested the part of the resolution in which the National Regulatory Authority establishes that the current cost method (adopted to replace the historical cost method) should not be applied to the so-called access network for which the National Regulatory Authority has reserved the right to make future judgements and with reference to which it should continue, therefore, to apply the historical cost method.

* * *

On April 14, 2003, Telecom Italia challenged the National Regulatory Authority Resolution 02/03/CIR (Valuation and request to change the rates of reference for 2002 by Telecom Italia) and Resolution 03/03/CIR (Criteria for the preparation of the rates of reference for 2003 by introducing a programmed system to adjust the maximum applicable rates).

In particular, the dispute concerns (i) the improper reduction of the prices for interconnection service proposed by Telecom Italia for the year 2002, which would derive from the application with retroactive effect of new criteria for the distribution of costs, considered to be unjustifiable from an economic standpoint, and (ii) the obligation to present the rates of reference for 2003 in a very short time frame (30 days) on the basis of criteria that were never discussed during the preliminary discussions.

* * *

In May 2003, the National Regulatory Authority identified Telecom Italia, TIM and Vodafone as telecommunication bodies having considerable market power for the year 2001 . The National Regulatory Authority, in order to determine which operators were to be notified in the interconnection market, separated the fixed interconnection market from the mobile interconnection market according to criteria which are neither based on the law governing the sector nor conform with the segmentation as provided by the EU regulatory framework.

As a consequence, TIM filed an appeal before the TAR of Lazio against this resolution, in the part in which it did not also include Wind in the group of operators.

* * *

In October 2003, Telecom Italia asked the TAR of Lazio to cancel, upon suspension, the resolution of the National Regulatory Authority of June 2003, which accuses the Company of having made, in the public bid announced by CONSIP in 2002, a wireline phone service offer which did not comply with the contents of the individual license. The Company concurrently contested the minutes in which the Authority ascertained that the aforementioned facts violated art. 7, paragraph 1, of D.P.R. No. 318/97 (Economic conditions of the offer) which calls for a pecuniary administration fine of between approximately 5,000 and 52,000.

In December the Authority decided to suspend the proceedings in order to forward a request to the Consiglio di Stato for its opinion on the matter.

In March 2004, the TAR of Lazio ruled against Telecom Italia s appeal. The ruling has not been deposited yet, and therefore the reasons of the decision are not yet available.

Ministry Of Defence

The Ministry of Defence and the Ministry of Communications, with the regulations formalized in 2001, have quantified the expenses to liberate the 900 Mhz frequency band in approximately 52 million for the four year period 1998-2001, charging such expenses entirely to TIM as license holder of the TACS service. The liberation of the band in question, instead, was aimed at amplifying the frequency resources to be destined to GSM and, as such, to be allocated among all the beneficiary operators.

TIM has consequently asked the TAR of Lazio to annul such decisions. The amounts corresponding to the disputed charges have been provided for in the financial statements.

STET Hellas

In December 1996, Mobitel, a company of the Greek Interamerican group (now Demco Reinsurance), a minority shareholder of STET Hellas and, at that time, its exclusive representative, initiated arbitration proceedings at the Paris International Chamber of Commerce. Mobitel claims its right to receive commissions on outgoing traffic generated by the subscribers it had signed up and on incoming traffic generated by calls received by STET Hellas customers from the fixed telephone network of OTE and that was generated by customers in default of payment allegedly derived from negligent behavior of Stet Hellas in dealing with customers. The alleged total loss is approximately U.S.$38 million. Mobitel and the Greek Interamerican group have also requested damages for a total of U.S.$172 million following the dissolution of their exclusive representative contract.

STET Hellas and Telecom Italia, which took over from Stet International (formerly the guarantor of STET Hellas and, as such, a party to the contracts) presented a counterclaim for an amount of about U.S.$210 million, mainly to cover the damages suffered as a result of the loss of the acquisition of market share caused by Mobitel s breach.

In October 2000, a partial award was given which, in principle, agreed with Mobitel s request for commissions on STET Hellas s revenues from incoming traffic; in November 2001, the Board of Arbitration rejected Telecom Italia and STET Hellas claim that the Board of Arbitration did not have jurisdiction but that the ordinary Greek courts had exclusive jurisdiction concerning the decision over the amounts claimed, since the Arbitration Board had only been asked to decide on the obligation to pay, a matter which the Board of Arbitration had already decided.

Afterwards, a series of legal actions took place and on January 15 and 31, 2002, Mobitel claimed damages as follows: U.S.$19.6 million plus interest of U.S.$9.6 million for the commission on revenues generated by all calls (including incoming calls) made by customers acquired by Mobitel; U.S.$8.8 million plus interest for the Company s failure to achieve a 45% market share; and a claim for damages as a result of the breach of the agreement amounting to U.S.$109.4 million.

STET Hellas quantified its claim against Mobitel as follows: U.S.$22.7 million for bad debts; U.S.$255.4 million for the loss of market share as a result of the failure of Mobitel and Interamerican to fulfill their obligations; and U.S.$611.2 million plus the legal interest for damages and loss of income incurred for the illegal termination by Mobitel of the distribution and sales agreement with the Company.

Although Stet Hellas considers its defensive line well founded, it has set up a provision in the fund for risks and charges relating to the litigation.

Telekom Srbija

In the first quarter of 2001 Italian newspaper reports alleged that improper payments were made in connection with the Company investment in Telekom Srbija. On June 9, 1997, Telecom Italia and OTE, the Greek telecommunications company, entered into a stock purchase agreement with Serbian PTT, at that time the sole shareholder of Telekom Srbija, as part of the privatization of the Serbian telecommunications sector. At that time Telecom Italia was controlled by the Italian government. Under the terms of the contract, Telecom Italia acquired a 29% interest in Telekom Srbija for approximately 457 million and OTE acquired a 20% interest for approximately 345 million.

At the end of May 2003, OTE served upon Telecom Italia two notices of arbitration pursuant to the shareholder agreement dated June 9, 1997 and the bilateral agreement between Telecom Italia and OTE dated June 4, 1997, respectively, alleging breaches of these agreements, as a result of the re-sale of 29% interest in Telekom Srbija to Serbian PTT. OTE alleges that, as a result of this sale, Telecom Italia (i) violated the preemptive right to which it was entitled according to the agreement (a right, however, that was subject to the consent of the Serbian government which, in this case, was denied), (ii) would not have proceeded to pay fully the percentage of management fees to which it was entitled and which was referred to in the technical assistance contract mentioned in the agreement and (iii) would have violated the shareholder agreement by selling its investment without the consent of the other shareholders.

OTE also presented two requests for arbitration to PTT Serbia for different reasons.

Under the sale agreements, PTT Serbia agreed to relieve Telecom Italia of any and all responsibilities with regard to OTE resulting from the shareholder agreement of June 9, 1997, the technical assistance agreement and any other contract related thereto.

The arbitration panel composed of three arbitrators has been recently appointed.

The balance sheets of Telecom Italia International contain a specific provision fund for risks.

Table of Contents

Is TIM

On March 31, 2003, a request for arbitration was filed with the Paris International Chamber of Commerce by IS TIM against the Turkish telecommunications regulatory agency claiming violation of the concession granted in October 2000 wherein it is stated that the agency has the obligation to create and maintain market conditions such as to permit effective competition among the providers.

IS TIM asked for compensatory damages of U.S. $ 2.5 billion and which were to be decided on during the course of the case. Moreover, the company expressly reserved to ask for the resolution of the concession contract and the consequent restitution of the price paid at the time.

Subsequently, in February 2004, the merger of IS TIM and the Turkish radiomobile operator Aycell, controlled by Turk Telecom, took place. Concurrently, an agreement was reached with the Turkish telecommunications regulatory agency which led to the discontinuation of the arbitration proceedings.

Med Nautilus

On June 30, 2003, Telecom Italia International received from the minority shareholders of Mediterranean Nautilus Ltd, (51% of which is controlled by Mediterranean Nautilus S.A.) notice of exercise of a put option for an overall number of 24,500 shares of the same Mediterranean Nautilus Ltd, with an invitation to start negotiations to determine their fair market value. Telecom Italia International communicated that it had no obligation to purchase, having at the time transferred to Mediterranean Nautilus SA its stake in Mediterranean Nautilus Ltd. and all the connected obligations (including the put option) provided for in the shareholders agreement of Mediterranean Nautilus Ltd dated June 29, 2000.

Subsequently, in October 2003, FTT Investments (the minority shareholder of Mediterranean Nautilus S.A.) notified Telecom Italia, Telecom Italia International and Mediterranean Nautilus S.A. of a request for international arbitration for the cancellation of the agreement signed in March 2001 regarding the transfer from Telecom Italia International to FTT Investments of 30% of the share capital of Mediterranean Nautilus S.A..

FTT investments claims it was misled in purchasing the investment on the basis of a false representation (specifically, information was omitted concerning the existence of a put option versus Mediterranean Nautilus S.A. on the Mediterranean Nautilus Ltd. shares owned by the minority shareholders). Accordingly, FTT invokes invalid consent as a result of fraudulent intent on the part of the Telecom Italia Group, or, in any case, invokes that it was led into error over the subject of the contract, asking for the restitution of the price paid (approximately US $ 98 million) in addition to interest and save the right to make additional claims.

Telecom Italia has requested its dismissal out of the arbitration proceedings as FTT Investments did not address to Telecom Italia any specific request. On the contrary, in May 2004, FTT amended its request by extending it also to Telecom Italia.

Iridium

A complaint was filed in June 2000, with the U.S. District Court for the District of Delaware by The Chase Manhattan Bank (Chase), now JPMorgan Chase Bank, in connection with an U.S.$800 million financing granted by Chase to Iridium Operating LLC, a subsidiary of Iridium LLC in 1998. Iridium LLC filed for Chapter 11 bankruptcy protection on August 13, 1999. The complaint seeks to enforce a commitment to purchase, under certain circumstances, additional capital of Iridium LLC by certain interest holders of Iridium LLC. The complaint asserts that the commitment to purchase additional capital was pledged as collateral to Chase in connection with the above referenced financing. Chase amended its complaint in February 2001, to assert additional claims for alleged fraud and misrepresentation against the defendants.

Telecom Italia directly held approximately a 3.8% interest in Iridium LLC until October 1996. In November 1996 Telecom Italia contributed its interest in Iridium LLC to Iridium Italia S.p.A., a company owned by Telecom Italia (30% interest), TIM (35% interest) and Telespazio (35% interest).

On April 5, 2002, the Magistrate Judge issued an Order granting Telecom Italia s motion to dismiss from the claim filed by the Chase Manhattan Bank, as it retains no direct interest in Iridium LLC. Such Order has been objected by Chase on April 19, 2002. Thereafter, Chase named Iridium Italia (in liquidation) as defendant.

In March, 2004, the Court rejected the recommendations of the Magistrate Judge and the defense of the defendants and qualified the claim for a decision on the merits. Telecom Italia filed a preliminary appeal prior to the final decision on the merits, objecting to the Court not considering the defense arguments presented.

Table of Contents

Brasil Telecom

In April 2001, the Brazilian company Brasil Telecom S.A. (BT , affiliated to Telecom Italia International through its holding Solpart Participações) brought two lawsuits before the Civil Court of Rio de Janeiro (Brazil) against, (i) Telecom Italia and Telecom Italia International and (ii) two directors of BT appointed by Telecom Italia International. BT claims damages suffered as a result of the acquisition of Companhia Riograndense de Telecomunicaçoes (CRT) and the failure to participate in the auction of the SMP (Serviço Movil Pessoal) radiomobile licenses. Such damages are supposedly the result of (i) in the case of CRT, alleged abuse by Telecom Italia and Telecom Italia International, who are accused of interfering with the negotiations for the purchase of the company and the determination of the sale price; (ii) in the case of the SMP auction, the impossibility of BT to take part in the auction owing to the alleged restrictions placed by the directors appointed by Telecom Italia International, under the supposition of favoring the subsidiaries of TIM in the assignment of the licenses.

Both cases are still in the preliminary investigation stages. The Judge appointed an expert to determine the value of the damages allegedly suffered by BT.

As far as the purchase of CRT is concerned, BT claims that Telecom Italia International started a series of activities to recognize an unjustified extra charge to the sale price to the sellers (including Telefonica de Espana). This undue interference compromised the negotiations between BT and the sellers freezing them on a price of U.S.$850 million which, only after considerable efforts made by the BT representatives, the sellers agreed to reduce to U.S.$800 million, the price at which BT concluded the sale. BT is, therefore, asking for payment of damages incurred for an amount equal to the difference between the price paid for the purchase of the stake in CRT and the value of the stake at that time.

Telecom Italia considers BT s claims groundless as they are based on a partial and incomplete reconstruction of facts and are not supported legally or by any forms of proof. In particular:

- there is no proof of the undue assumption or exercise by any of the defendants of any powers to represent the plaintiff company in negotiations with the sellers of the controlling stake in CRT;
- on the contrary, all the stages of the negotiations which led to the purchase of the shares of CRT by BT were duly approved by the competent corporate bodies of BT itself and its controlling companies, on the basis of the evaluations acquired by third party consultants specifically appointed by BT.

As far as the auction of SMP is concerned, BT is claiming damages (to be determined by the judge) for not being in a position to take part in the auction itself as a result of the illegitimate conduct of Telecom Italia, Telecom Italia International and the Directors appointed by it. The lawsuit (started together with the lawsuit regarding the purchase of CRT) is considered by Telecom Italia to be without merit.

TIM took part in the SMP auction in 2001 and was awarded the license to offer mobile telephony services on the whole of the national territory in GSM technology. TIM s participation in the auction was disclosed at the proper time by the representatives of Telecom Italia International to the representatives of the Opportunity Group (indirect controlling company of BT). The Opportunity Group decided to let BT participate in the auction, even though its activities were focused traditionally on the fixed wireline and Opportunity and BT managers (appointed by Opportunity) were aware of the fact that:

- BT would have been able to compete exclusively for the mobile telephony license in a limited geographical area, not having satisfied yet the universal service objectives assigned to it at the time, and

- according to Brazilian regulations, BT would have been prevented from purchasing a license for the performance of mobile telephony services in the region in which it operates due to ownership by its indirect shareholders (Telecom Italia itself through several Brazilian subsidiaries of TIM and the Opportunity Group) of licenses for the performance of mobile telephony services in territories including the region itself.

BT s Board of Directors was informed of BT s intention to participate in the SMP auction only a few days before the close of the auction itself. Despite this, Telecom Italia did not interfere with BT s participation nor did it ever impose any conditions to the BT offer.

On April 7, 2004, BT filed a lawsuit against Telecom Italia International before the Court of Rio de Janeiro, claiming damages allegedly deriving from abuse of control power by Telecom Italia International. In particular,

Table of Contents

BT alleges to have incurred damages in three different circumstances: (i) failure to acquire a company (namely, Vicom) in 1999, (ii) financing from BNDES at certain terms and conditions in 1999, and (iii) failure to obtain financing through issuance of debentures in 2001.

Solpart

On August 27, 2002, Telecom Italia International reached an agreement with the shareholders of Solpart for a reduction of its stake from 37.29% to 19% of the ordinary share capital, through the transfer of 18.29% of the ordinary share capital to Timepart Participações and to Techold Participações. This reduction, together with the suspension of certain governance rights assigned by agreement to Telecom Italia International, enabled amongst other things TIM to overcome certain regulatory impediments which had blocked the start of the GSM commercial offer by the local subsidiaries of TIM. In order to be restored to its original ownership position, within the framework of the original transaction, a right of resale/repurchase was provided in the agreement between Telecom Italia International and the shareholders of Solpart which could only be exercised upon the occurrence of certain conditions.

In November 2002, the local operators Telesp Celular and BCP asked for the suspension of the effectiveness of the above-mentioned share transfer as well as the related administrative orders. Following the rejection of the request for precautionary measures, BCP filed a law suit before the Federal Court of Brazil, against ANATEL, the Brazilian Telecommunications Agency, in order to obtain the annulment of the assignment of the GSM frequencies to TIM s subsidiaries in Brazil. The case is currently pending.

In December 2003, Telecom Italia International was notified of a request for international arbitration made by Techold and Timepart before the Paris International Chamber of Commerce. The request for arbitration was also made to Telecom Italia who was notified on January 29, 2004. The request for arbitration is essentially aimed at obtaining a pronouncement of the non implementation of several clauses contained in the agreement of August 2002, regarding the retransfer of the stake transferred to Techold and Timepart, as well as the exercise of governance powers as provided for by the shareholders agreement currently existing between the Solpart shareholders.

On January 19, 2004, the Brazilian Telecommunications Agency, Anatel, authorized subject to certain conditions Telecom Italia International to repurchase its stake in Solpart transferred at the time to Techold and Timepart, as well as to exercise, once again, its governance rights.

Consequently, Telecom Italia International has formally asked that the retransfer of the above mentioned stake, as the conditions precedent are satisfied, be made, as well as to be allowed to exercise its governance rights.

Techold and Timepart have refused to comply.

As a result, on January 23, 2004, Telecom Italia International filed, with the Rio de Janeiro Civil Court a petition to obtain an immediate order protecting its right to have the fulfillment of the contractual obligations made at the time by Techold and Timepart, binding as well on Solpart, Brasil Telecom Participações and BT, pursuant to Brazilian law. The judge responsible for the proceedings has not yet issued decision.

Pending the foregoing decision, Telecom Italia International has begun the merit phase requesting as permitted by Brazilian law a provisional decision to anticipate the final ruling.

Finally, Animec (a national Brazilian association which represents the minority shareholders of listed companies) presented the antitrust authorities with a petition to block the retransfer of the stake in Solpart, and the exercise of Telecom Italia International s governance rights, claiming that this would damage the overall competitive framework. On March 17, 2004, the antitrust authorities provisionally suspended the repurchase and the effective exercise of governance rights, in order to evaluate the possible existence of unfair trade practices. Telecom Italia asked the antitrust authority to reconsider its decision. The reconsideration proceeding is currently pending.

Telecom Argentina

On April 24, 2003, Telecom Italia filed a notice with the relevant Argentine authorities to start proceedings to resolve the disputes which arose between Telecom Italia and the Argentine State, pursuant to the Bilateral

Table of Contents

agreement between Italy and Argentina concerning the promotion and protection of investments . The proceedings are aimed at receiving compensation for damages deriving from the issuance, by the Argentinian government, of measures considered to be detrimental to the investment made in Telecom Argentina by Telecom Italia.

In particular, the notice is required in order to start the period established by law in which to effect an attempt at a settlement. If no decision is reached during this period, Telecom Italia will have the right to start specific arbitration proceedings.

Digitel

In 2002 Digitel, of which 67.12% of its share capital is owned by TIM International, as a consequence of the devaluation of the Venezuelan currency against the U.S. dollar, recorded an operational loss equal to approximately 120% of its share capital.

According to Venezuelan law, a more than two thirds decrease in the share capital as a result of losses can result in the liquidation of the company if once the loss is ascertained the shareholders do not provide for the replenishment of such loss.

According to the same law, the losses can be offset through contributions, without reduction of the share capital. Those shareholders who do not contribute, pro quota, to the replenishment of the losses are entitled to a right of withdrawal, with a reimbursement of the stake in proportion to the percentage of the net equity resulting from the last approved financial statements. As the equity is negative, the withdrawing shareholders would not be entitled to anything.

In February 2003, Digitel s Board of Directors approved the financial statements for the fiscal year 2002, ascertaining a decrease in the share capital due to losses in excess of two thirds as provided for by local legislation.

Following the approval of the draft financial statements, during the period from March to June 2003, in order to avoid participating in the replenishment of the losses, some minority shareholders started legal actions before the Venezuelan judicial authorities against Digitel and TIM International, in order to obtain the cancellation of the resolutions approving the 2002 financial statements and the issue of urgent measures to prevent the losses replenishment. Another minority shareholder requested, on the basis of the losses resulting from the financial statements, the winding-up of the company.

Between May and June 2003, the Venezuelan courts rejected some of the appeals presented by the minority shareholders and revoked the precautionary provisions previously issued.

On June 6, 2003, the Digitel shareholders meeting, in order to avoid the winding-up of the company on the basis of opinions issued by Venezuelan legal consultants who assist TIM International, approved with a contrary vote of the minority shareholders present at the meeting and the favorable vote of TIM International the financial statements for the year 2002 and the losses replenishment. On the same date, TIM International contributed, as its share, to such replenishment with a financial credit it had towards Digitel of approximately U.S.$ 45 million, resulting from a loan previously granted to the Venezuelan company.

At the deadline set for payment, some minority shareholders did not pay their share to replenish the losses. In particular, on July 11, 2003, the deadline set by the Board of Directors for the losses replenishment, the shareholders of the Santander Group and LAIB made their payment contesting, however, the legitimacy of the operation and reserving the right to claim their payment back in the case it was considered judicially illegitimate, whilst other shareholders did not make any payments, contesting the legitimacy of the resolutions of the Shareholders Meeting of June 6, 2003.

Subsequently, on the basis of the actions taken by the minority shareholders, local judicial authorities have taken precautionary measures, opposed by Digitel, which have for the time being prevented the completion of the replenishment operations.

In addition, since May 2003, arbitration proceedings have been underway before the International Chamber of Commerce between TIM International and Venconsul, another shareholder of Digitel, in which the two parties have each alleged violations of the shareholder agreements. These shareholder agreements, signed by TIM

Table of Contents

International and by the main shareholders of Digitel upon acquisition of the stake by TIM International (November 2000) entitle the above-mentioned minority shareholders, amongst other things, to certain veto rights on specific important matters relating to the management of the company.

Finally, in November 2003, the minority shareholders of Digitel who agreed to the afore-mentioned shareholder agreements, exercised the sale rights (Put Option) provided for in the agreement, with respect to the total amount of shares they owned. The procedure for the exercise of the Put Option provides, in short, that after an initial negotiation phase for the purpose of jointly establishing the exercise price, the determination of the price is assigned to two investment banks.

Without reaching agreement in the initial negotiation phase, the shareholders who exercised the Put Option and TIM International appointed investments banks to represent them and, in February 2004, the parties exchanged the valuations made by their respective investment banks in order to determine the fair market value of Digitel on the basis of which the price of the Put Option could be established. As the evaluations made differed significantly as far as the amount was concerned, the final phase of the procedure was implemented, which involved the appointment by the two evaluators of a third independent investment bank which must establish in a mandatory manner the fair market value of the stake subject to the Put Option.

The two investment banks were unable to agree on the appointment of the third independent evaluator. However, in the meantime TIM International has signed a settlement agreement to purchase the shares owned by all the minority shareholders of Digitel (32.88% of Digitel equity) including those that had exercised the put option. The closing of this settlement agreement is subject to the fulfilment of certain conditions, the main one being the definitive, irrevocable and unconditional dismissal of all pending claims against TIM/Digitel and the definitive, irrevocable and unconditional dismissal of the arbitration proceeding between TIM International and Venconsul pending in New York under the ICC rules. Once the closing takes place, TIM international (that for this transaction will pay about U.S.$110 million) will become the owner of 100% of Digitel.

Table of Contents

Item 9. LISTING

Trading of Telecom Italia Shares and Savings Shares

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

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

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

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

	Telematico		NYSE	
	High	Low	High	Low
	( )		(U.S.$)	
2003:				
Third quarter from August 4 to September 30(1)	2.3240	2.1040	26.31	23.57
Fourth quarter	2.4390	2.1130	29.92	24.75
2004:				
January	2.6160	2.4030	33.24	30.53
February	2.6170	2.4720	33.18	30.91
March	2.5950	2.3870	32.13	29.38
April	2.6970	2.561	32.03	30.97
May	2.703	2.452	32.80	29.74
June (through June 1, 2004)	2.493	2.493	30.84	30.84

Source: Bloomberg data

(1) The official prices of Shares for the periods prior to August 4, 2003 are not comparable to the official prices of these shares in the following periods due to the effect of the incorporation of Telecom Italia S.p.A. with and into Olivetti S.p.A., which became effective on August 4, 2003. See below Trading of Shares and Savings Shares of Old Telecom Italia.

At the close of business on June 1, 2004 there were 18,771,578 Ordinary Share ADSs outstanding held by 150 registered holders.

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

	Telematico		NYSE	
	High	Low	High	Low
	( )		(U.S.$)	
2003:				
Third quarter from August 4 to September 30 (1)	1.5760	1.4320	19.00	16.09
Fourth quarter	1.6460	1.4650	20.90	17.33
2004:				
January	1.7890	1.6340	22.84	20.98
February	1.8470	1.7040	23.54	21.28
March	1.8620	1.7240	22.90	20.78
April	1.974	1.860	23.68	22.44
May	1.967	1.765	23.20	21.46
June (through June 1, 2004)	1.773	1.773	22.15	22.15

Source: Bloomberg data

(1) The official prices of the Savings Shares for the periods prior to August 4, 2003 are not comparable to the official prices of these shares in the following periods due to the effect of the incorporation of Telecom Italia S.p.A. with and into Olivetti S.p.A., which became effective on August 4, 2003. See below Trading of Shares and Savings Shares of Old Telecom Italia.

Table of Contents

At the close of business on June 1, 2004, there were 1,232,941 Savings Share ADSs outstanding held by 9 registered holders.

Fluctuations between the euro and the U.S. dollar will affect the dollar equivalent of the price of the Share and the Savings Shares on Telematico and the price of the Ordinary Share ADSs and the Savings Share ADSs on the New York Stock Exchange. On June 1, 2004, the Noon Buying Rate for the euro was U.S.$1.2210 = 1.00.

Trading of Old Telecom Italia Shares and Savings Shares

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

	Telematico		NYSE	
	High	Low	High	Low
	( )		(U.S.$)	
2000:				
First Quarter	19.12	11.81	195	121 9/16
Second Quarter	16.08	12.78	150 6/16	117 7/16
Third Quarter	14.93	11.68	145 1/16	105
Fourth Quarter(1)	13.67	11.24	121 14/16	97 8/16
2001:				
First Quarter	13.42	10.50	127.50	95.55
Second Quarter	12.34	9.52	113.25	83.00
Third Quarter	10.74	6.40	94.50	60.00
Fourth Quarter	9.82	8.00	90.35	75.50
2002:				
First Quarter	9.73	8.55	88.75	75.18
Second Quarter	9.21	7.49	85.00	74.60
Third Quarter	8.35	7.08	83.20	71.35
Fourth Quarter	8.31	7.03	85.25	70.45
2003:				
First Quarter	7.53	5.31	80.19	58.65
Second Quarter	8.14	6.61	94.43	70.14
Third Quarter (until August 1, 2003)	8.05	7.47	91.10	84.30

Source: Reuters data

(1) The official prices of Shares and Savings Shares and Ordinary and Savings Share ADSs for the periods prior to and including November 10, 2000 are not comparable to the official prices of these shares and ADSs in the following periods due to the effect of the demerger of Tin.it, which became effective on November 10, 2000.

Table of Contents

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

	Telematico		NYSE	
	High	Low	High	Low
	( )		(U.S.$)	
2000:				
First Quarter	8.38	5.39	82 11/16	58 10/16
Second Quarter	6.85	5.94	67 2/16	56 14/16
Third Quarter	7.15	5.79	71	55
Fourth Quarter(1)	6.29	5.50	58 8/16	52 4/16
2001:				
First Quarter	6.84	5.44	63.38	52.50
Second Quarter	6.89	5.05	61.00	45.94
Third Quarter	5.83	3.63	50.50	37.50
Fourth Quarter	5.85	4.44	52.29	49.00
2002:				
First Quarter	6.20	5.21	55.96	47.51
Second Quarter	6.14	4.94	57.00	50.32
Third Quarter	5.50	4.80	56.50	53.00
Fourth Quarter	5.38	4.77	56.33	48.67
2003:				
First Quarter	4.90	3.35	52.00	37.50
Second Quarter	4.96	3.94	57.59	42.50
Third Quarter (until August 1, 2003)	5.08	4.64	53.75	52.92

Source: Reuters data

(1) The official prices of the Shares and Savings Shares and Ordinary and Savings Share ADSs for the periods prior to and including November 10, 2000 are not comparable to the official prices of these shares and ADSs in the following periods due to the effect of the demerger of Tin.it, which became effective on November 10, 2000.

Securities Trading in Italy

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

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

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

Residents of Italy and non-residents through their authorized agents may purchase or sell shares on Telematico, subject to satisfying (i) in case of sales, either the Margin or the Deposit, and (ii) in case of purchases, the Margin. Margin means a deposit equal to 100% of the agreed price, and Deposit means a deposit of an equal number of the same shares as those sold. If in the course of a trading day the maximum price variation between two consecutive contracts is ±5%, or maximum price variation of the contracts with respect to the control price(3) is ±10% an automatic five-minute suspension is declared. In the event of such a suspension, effect is not given to trades agreed but not confirmed before the suspension. In addition, Borsa Italiana has the authority to suspend trading in any security in response to extreme price fluctuations or for other reasons.

Table of Contents

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

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

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

Clearance and Settlement of Telecom Italia Shares

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

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

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

Table of Contents

Item 10. ADDITIONAL INFORMATION

CORPORATE GOVERNANCE

Differences in Telecom Italia s corporate governance and New York Stock Exchange corporate governance practices

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

Independent Directors. Under NYSE listing rules applicable to US companies, independent directors must comprise a majority of the board of directors. As of May 6, 2004, with the election of a New Board of Directors, Telecom Italia s Board now has a majority of independent directors (10 out of 19), with the status of independence determined under Italian Listing Standards and Telecom Italia Internal Regulations (Self-Regulatory Code). See also below under Board of Directors Independent Directors .

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

Nominating/Corporate Governance Committee. Under NYSE standards, US companies listed on the NYSE are required to have a nominating/corporate governance committee composed entirely of independent directors. In addition to identifying individuals qualified to become board members, this committee must develop and recommend to the board a set of corporate governance principles. Pursuant to NYSE standards, this committee should also adopt a written charter. Telecom Italia does not have a nominating committee. Directors are appointed by shareholders through the voto di lista system which permits shareholders, who alone or together, hold shares representing at least 1% of the share capital to put forward slates of directors. The system is intended to ensure that minority shareholders will have representation on the Board. Telecom Italia does have an Internal Control and Corporate Governance Committee made up solely of independent directors. Among its other activities, this committee actively participated and assisted in developing and implementing the corporate governance procedures adopted by Telecom Italia. See also below under Board of Directors Internal Committees .

Compensation Committee. Under NYSE standards, US companies listed on the NYSE are required to establish a compensation committee composed entirely of independent directors. In addition to the review and approval of corporate goals relevant to CEO compensation and evaluation of the CEO performance in light of those given, this committee must determine and approve the CEO s compensation and make recommendations to the Board of Directors with respect to non-CEO compensation, incentive-compensation plans and equity-based plans. In accordance with Telecom Italia s by-laws and the Self-Regulatory Code, the Board of Directors determines the remuneration of the Chairman and the Managing Directors. Such determination is made after consultation with the Remuneration Committee, which is composed solely of independent directors. The Remuneration Committee provides advice regarding remuneration criteria for the Company s senior management. See also below under Board of Directors Internal Committees .

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

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

Table of Contents

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

Annual Certification by The Chief Executive Officer. A chief executive officer of a US company listed on the NYSE must annually certify that he or she is not aware of any violation by the company of NYSE corporate governance standards. In accordance with NYSE listing rules applicable to foreign private issuers, Telecom Italia is not required to provide the NYSE with this annual compliance certification. However, in accordance with rules applicable to both US companies and foreign private issuers, the Chairman of the Board of Directors is required to promptly notify the NYSE in writing after any executive officer becomes aware of any material non-compliance with the NYSE corporate governance standards applicable to Telecom Italia.

General

In general, the Company s corporate governance system is based on the central role of the Board of Directors, transparency in operational decisions, effective internal controls and rigorous rules governing conflicts of interest. This system, designed and constructed bearing in mind the principles formulated by the Committee for Corporate Governance of Borsa Italiana (known as the Preda Code), has been implemented with the adoption of codes, rules and procedures covering the activity of all the organizational and operational components of the Company. These documents (available in an English language version on the Internet at www.telecomitalia.it under Investor Relations, with the exclusion of the Procedure for the Disclosure of Price-sensitive Information only) are:

- the Group Code of Ethics and Conduct;
- the Company s Self-Regulatory Code;
- the Guidelines for Transactions with Related Parties;
- the Procedure for Compliance with the Requirements of Article 150.1 of Italian Legislative Decree 58/1998;
- the Disclosure Committee Rules;
- the Group Procedure for the Appointment of External Auditors;
- the Code of Conduct for Insider Dealing; and
- the Procedure for the Disclosure of Price-sensitive Information.

The documents mentioned above are reviewed regularly and updated to reflect legislative and regulatory developments and changes in operational practice.

Code of Ethics and Conduct

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

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

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

Table of Contents

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

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

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

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

Board of Directors

The Company s Self-Regulatory Code supplements the applicable rules concerning the tasks and functioning of the Board of Directors of Telecom Italia. All the Company s directors are required to comply with the Self-Regulatory Code, without prejudice to the fact that it has been adopted by the Board of Directors as a self-regulatory measure only and can therefore be amended at any time with a resolution adopted by the Board and promptly disclosed to the market.

Role and tasks

The Board of Directors has the power (and the duty) to lead the Company by pursuing the primary objective of creating value for its shareholders; to that end it takes all the decisions needed to achieve the corporate purpose (Article 2 of the Company s Self-Regulatory Code). The Company s Self-Regulatory Code reserves several especially important tasks exclusively to the Board, including those of:

(i) examining and approving the strategic, business and financial plans of the Company and the Group;

(ii) evaluating and approving the annual budget of the Company and the Group;

(iii) examining and approving transactions including investments and divestments with a substantial impact on the Company s activity in view of their nature, strategic importance or size;

(iv) verifying the adequacy of the general organizational and administrative structure of the Company and the Group;

(v) preparing and adopting the Company s corporate governance rules and the Group s governance guidelines;

(vi) nominating the persons who are to hold the offices of Chairman and Managing Director in strategic subsidiaries, except companies controlled by listed subsidiaries;

(vii) evaluating and approving the periodic reports required by the applicable legislation.

Meetings

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

In 2003 the Board of Directors met 11 times (the Board of Directors of Olivetti met 5 times before the Merger). Board meetings were always well attended, with 81% of the directors being present on average. The independent directors were assiduous participants, with an overall attendance rate of 76%.

In November 2003 the Company disclosed a calendar scheduling at least 7 meetings for 2004.

Appointment

Pursuant to Article 9 of Telecom Italia s Bylaws the Board of Directors is appointed by the Shareholders Meeting through the *voto di lista* system. The Board of Directors has not less than 7 and not more than 23 members; it is up to the shareholders meeting to decide the exact number.

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

248

Table of Contents

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

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

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

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

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

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

Impact of Shareholders Agreements over the Nomination of Telecom Italia Group s Companies Boards

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

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

Table of Contents

In addition, under the Agreements with Hopa, the Former Olimpia Shareholders must use their best efforts in order to cause a director designated by Hopa to be appointed to the Company s Board of Directors.

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

- individual investments greater than 250 million;
- purchase, sale and deeds of disposition for any reason whatsoever of controlling and connecting shareholdings with an individual value of more than 250 million;
- deeds of disposition for any reason whatsoever of businesses or assets individually greater than 250 million;
- proposals to call a Shareholders Extraordinary Meeting;
- transactions between the Olivetti group (and therefore now, after the Merger, the Telecom Italia group) and the Pirelli group for amounts individually greater than 50 million; and
- transactions with related parties.

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

Independent directors

The Company has adopted specific criteria conforming with international best practice and the Preda Code to qualify directors as independent . On the basis of these criteria and in the light of the declarations by the candidates filed together with the slates in view of the aforementioned Shareholders Meeting which appointed them, 10 out of the 19 directors are considered independent, namely Paolo Baratta, Francesco Denozza, Domenico De Sole, Luigi Fausti, Guido Ferrarini, Jean Paul Fitoussi, Marco Onado, Pasquale Pistorio, Luigi Roth and John Robert Sotheby Boas.

Telecom Italia independent directors:

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

(ii) do not hold, directly, indirectly or on behalf of third parties, equity interests allowing them to control the Company or exercise a significant influence over it;

(iii) do not participate in shareholders agreements to control the Company or containing clauses regarding the composition of the Board of Directors or its decisions. This requirement is interpreted broadly, with an eye to the substantial independence that an independent director must enjoy. Accordingly, participation in shareholders agreements precludes independence not only when a natural person, a director of the Company, participates directly in such an agreement but also when he has significant relationships with the natural or legal persons participating therein and is thus to be considered a representative of (some of) the parties to the agreements;

(iv) are not close relatives of executive directors of the Company or of persons in the situations indicated above (i.e. persons tied to the Group by significant business dealings; shareholders or groups of shareholders who control the Company or have a significant influence over it; participants in shareholders agreements to control the Company or containing clauses regarding the composition of the Board of Directors or its decisions).

Executive directors and activities of the Board

The authority to grant delegated powers to directors and revoke such mandates is reserved to the Board of Directors, which also establishes the limits of such powers, the manner in which they may be exercised and the quarterly or shorter intervals at which persons with delegated powers must report to the Board of Directors and

250

Table of Contents

the Board of Auditors on the activity performed under the mandates conferred on them. The authority to determine the duties and responsibilities of the general managers is also reserved to the Board of Directors.

The Company has adopted an ad hoc procedure formalizing the rules for gathering and transmitting information to the Board of Auditors and the Board of Directors on the activity performed, transactions with major implications for the profitability, financial position and/or balance sheet of the Company and the Telecom Italia Group, transactions with related parties (including intra-group dealings) and atypical or unusual transactions (the Procedure for Compliance with the Requirements of Article 150.1 of Italian Legislative Decree 58/1998). This procedure generates the information flows by means of which the directors with delegated powers periodically report to the Board of Directors and the Board of Auditors not only on the steps they have taken under their mandates, through the organizational structure of the Company and its subsidiaries or otherwise, including the decisions adopted and the projects launched, but also on the implementation of transactions already approved by the Board of Directors.

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

- the activity carried out by the Company, with special reference to the implementation of transactions already approved by the Board of Directors and the action taken by executive directors in the exercise of their delegated powers, including the projects launched;
- the transactions of greatest significance for the Company s profitability, financial position and balance sheet, highlighting the strategic goals, consistency with the budget and the business plan, the manner of implementation and developments, and any resulting constraints on or implications for the activity of the Telecom Italia Group;
- any transactions potentially involving a conflict of interest, i.e. intra-group transactions and transactions with related parties other than those of an intra-group nature. The information on such transactions must indicate the underlying interest for the Company (and in the case of intra-group transactions their rationale within the context of the Telecom Italia Group), as well as the manner of implementation and the evaluation procedures followed;
- atypical and unusual transactions, taken to mean those in which the subject or the nature of the transaction falls outside the normal sphere of the Company s business and those that have particularly critical aspects in relation to their nature, the risks inherent in the type of the counterparty or the time of their implementation. Here again the information provided must indicate the underlying interest for the Company and describe the manner of implementation of the transactions, with special reference to the evaluation procedures followed.

On May 6, 2004, the Board of Directors of Telecom Italia appointed Marco Tronchetti Provera as Chairman of the Company, Gilberto Benetton as Deputy Chairman, Carlo Buora and Riccardo Ruggiero as Managing Directors, and confirmed Riccardo Ruggiero and Giuseppe Sala as General Managers.

The powers delegated to the Company s executive directors (the Chairman and Managing Directors) are as follows:

- Marco Tronchetti Provera (Chairman) is entrusted with the powers needed to carry out every transaction relating to the Company s activity, except for acquisitions and disposals of shareholdings involving control or affiliation, and of businesses or business segments where the value of the transaction exceeds 250 million. Moreover, the Chairman must sign jointly with a Managing

Director for the issue of guarantees in the interest of Telecom Italia or its subsidiaries where the amount exceeds 250 million and in the interest of third parties where the amount exceeds 100 million. The Chairman is authorized to act as a matter of urgency in the matters for which the Board of Directors is competent and is entrusted with the tasks of overseeing the management of confidential information and ensuring the effectiveness and adequacy of the internal control system.

- Carlo Buora (Managing Director) is authorized to carry out every transaction relating to the Company s activity, except for acquisitions and disposals where the amount of the transaction exceeds 150 million. Mr. Buora may issue guarantees in the interest of Telecom Italia or its subsidiaries where the amount does not exceed 150 million and in the interest of third parties where the amount does not exceed 50 million. Mr. Buora must sign jointly with Mr. Ruggiero for the issue of guarantees in the interest of Telecom Italia or its subsidiaries where the amount exceeds 150 million and is below 250 million and in the interest of bonds of third parties where the amount exceeds 50 million and is below 100 million.

Table of Contents

- Riccardo Ruggiero (Managing Director) is authorized to carry out every transaction relating to the Company s activity, except for acquisitions and disposals where the amount of the transaction exceeds 75 million. Mr. Ruggiero may issue guarantees in the interest of Telecom Italia or its subsidiaries where the amount does not exceed 75 million and in the interest of third parties where the amount does not exceed 25 million.

For the purposes of compliance with the above-mentioned thresholds, a set of transactions that individually fall below the relevant threshold but are interconnected within the same strategic or executive structure are considered to constitute a single transaction.

On the other hand, in practice, transactions of particular significance are submitted to the Board of Directors for approval even though the authorization theoretically falls within the scope of the executive directors delegated powers. In fact, the examination and approval of transactions likely to have a substantial impact on the Company s activity in view of their nature (e.g. transactions with related parties and atypical or unusual transactions), strategic importance or size are reserved to the Board of Directors.

In particular, the Company has adopted a series of guidelines on the way transactions with related parties are to be carried out (the Guidelines for Transactions with Related Parties). Their aim is to ensure both procedural and substantial fairness and transparency and to involve the Board of Directors as a whole in the relevant decisions.

Under the Guidelines, the Board of Directors is required to give advance approval to transactions with related parties, including intra-group transactions apart from those of a customary nature to be concluded at standard conditions. To this end, provision is made for the Board of Directors to be adequately informed of all the relevant aspects (the nature of the relationship, the manner of carrying out the transaction, the economic and other conditions, the evaluation procedures used, the rationale for the transaction and the Company s interest in its implementation and the associated risks). Moreover, if the related party is a director or a third party that is related via a director, the director concerned may only provide clarifications and must leave the meeting when the motion is examined and voted upon. Depending on the nature, value and other characteristics of related-party transactions, the Board may be assisted by one or more outside experts engaged to give an opinion on their economic clauses and/or legitimacy and/or technical aspects, in order to prevent their being concluded at inappropriate conditions. Such experts must have suitable professional experience and qualifications in the relevant field and their independence and freedom from conflicts of interests must be carefully assessed.

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

Internal Committees

According to article 13 of the Bylaws, the Board may set up committees from among its members charged with giving advice and making proposals and shall establish their powers and duties. Currently, the Board has established two committees: the Internal Control and Corporate Governance Committee and the Remuneration Committee.

Internal Control and Corporate Governance Committee

Pursuant to article 12 of the Self-Regulatory Code the Board of Directors of Telecom Italia established a Committee for Internal Control and Corporate Governance, charged with advisory functions and the formulation of proposals. The Committee:

(i) evaluates the adequacy of the internal control system;

(ii) evaluates the work plan prepared by the person in charge of the oversight of the internal control system, from whom it receives periodic reports;

(iii) assesses, together with the heads of the Company s administrative departments and the external auditors, whether the accounting policies have been correctly applied and are homogeneous for the purpose of preparing the consolidated accounts;

(iv) evaluates the proposals made by the external auditors in order to be awarded the appointment, the audit plan and the results set out in the letter of suggestions;

252

(v) reports to the Board of Directors at least once every half year on the activity performed and the adequacy of the internal control system;

(vi) performs the additional tasks that may be assigned to it by the Board of Directors, particularly as regards relations with the external auditors;

(vii) monitors compliance with the rules of corporate governance and the periodic updating thereof.

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

In 2003 this Committee held seven meetings. Committee meetings are also attended by the Chairman of the Board of Auditors or such other member of the Board of Auditors he designates. Where it is deemed desirable in the light of the issues on the agenda, the Committee for Internal Control and Corporate Governance and the Board of Auditors may hold joint meetings.

In 2003 the Committee contributed significantly to the process of implementing the Company s system of corporate governance, taking part in the analysis and drafting of the documents that the Company adopted. Following the Merger the Committee participated actively in revising and updating the governance procedures originally put in place by Old Telecom Italia, paying constant attention to legislative and regulatory changes and to developments in the field of self-regulation. The Committee periodically checked the activities performed by the internal auditor and examined the request the external auditors submitted after the Merger for an increase in the fees that the Olivetti Shareholders Meeting had originally approved.

Remuneration Committee

According to Telecom Italia Self-Regulatory Code it is left to the Board of Directors to determine the remuneration of the Chairman and the Managing Directors, after examining the proposals of the Board s Remuneration Committee and consulting the Board of Auditors. The Board is also required to allocate the total compensation to be paid to the individual members of the Board and its committees if the shareholders meeting has not already done so. Telecom Italia Shareholders Meeting on May 6, 2004 fixed the overall compensation for the whole Board of Directors.

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

The Committee (which held two meetings in 2003) is composed of non-executive/independent directors; it was appointed on May 6, 2004 and is made up of Directors Luigi Fausti (Chairman of the Committee), Paolo Baratta and Pasquale Pistorio.

Internal Control System

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

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

(i) separation of roles in the performance of the principal activities involved in each operating process;

(ii) traceability and constant visibility of decisions, so that responsibility can be pinpointed and the rationale identified;

(iii) decision-making on an objective basis, so that purely subjective considerations are set aside and decisions are taken according to criteria that are established in advance and can be verified.

The Board of Directors is responsible for the internal control system. It establishes the guidelines for the system and verifies that it is adequate and works effectively, making sure that the main corporate risks are appropriately identified and managed. To verify the correct operation of the internal control system the Board uses the Internal Control and Corporate Governance Committee and a suitably independent person endowed with

Table of Contents

sufficient resources to perform the internal control function: such person verifies the adequacy and effectiveness of the system and, where problems are identified, recommends the necessary remedies. In conformity with this approach, Telecom Italia has appointed the Company s internal auditor (Telecom Italia Audit Società Consortile a r.l., formerly In.Tel.Audit Società Consortile a r.l.), in the person of the Telecom Italia Audit s director assigned to the task, to be responsible for the oversight of its internal control system.

Internal auditing has been entrusted by the Telecom Italia Group to a consortium company called Telecom Italia Audit, in which Tim and Telecom Italia Media also hold equity interests. The organizational solution adopted maximizes the independence of the appointed company in the performance of the internal audit function within Telecom Italia. Audit reports are submitted to the competent Telecom Italia Director (that is the Chairman of the Board), the Internal Control and Corporate Governance Committee and the Board of the Auditors.

A director appointed for the purpose (currently the Chairman of the Board) determines the mechanisms of the internal control system and the manner in which it is to be implemented under the guidelines established by the Board, and ensures the system s overall adequacy, its effectiveness and its adaptation to changes in operating conditions and the legislative and regulatory framework. Any maintenance work that the person in charge of the oversight of the internal control system may recommend is performed by the competent sectors of the Company or Telecom Italia Group companies. The efficient operation of the system is promoted by the appointment of managers of particular standing and authority within the organization as persons in charge of implementation .

This organizational solution has been submitted to PriceWaterhouseCoopers for strategic analysis. In addition, the Institute of Internal Auditors will conduct an independent quality assessment of Telecom Italia Audit to verify its operating capacity in terms of organization, methods and professional resources and the degree of assurance it provides.

The Telecom Italia Group s internal control system was implemented during 2003 through the adoption of an ad hoc organizational model designed in particular to meet the needs arising from Legislative Decree 231/2001 concerning the administrative liability of companies for crimes committed by their employees or collaborators. The organizational model is based on the principles of the Group s Code of Ethics and focused on situations where there is a significant risk of crime (corruption, extortion, misappropriation, undue receipt of disbursements, fraud against the State, etc.). In particular, it consists of rules for dealings with representatives of governmental bodies that apply the principles of the Code of Ethics at the operational level and internal control checklists that list the rules for identifying the principal phases of every process, the possible crimes in connection with the individual processes, and the control activities for preventing the related risks.

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

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

Board of Auditors

Tasks and role

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

In order to make available the broad range of information needed by the Board of Auditors to perform its control function effectively, the Procedure for Compliance with the Requirements of Article 150.1 of Italian Legislative Decree 58/1998 has been put in place, as described above.

Table of Contents

Appointment

Telecom Italia s Board of Auditors is composed of either five or seven regular auditors, as determined by a resolution of the shareholders meeting; two alternate auditors are also appointed. Pursuant to Article 17 of Telecom Italia s Bylaws the Board of Auditors is appointed by the Shareholders Meeting through the voto di lista system, as described above.

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

In case an auditor chosen from the majority list or one of the minority lists ceases for any reason to serve in such capacity, the alternate chosen respectively from the majority list or the slate that obtained the second largest number of votes shall take his/her place, until the next Shareholders Meeting, at which a replacement will be appointed by the shareholders.

The Board of Auditors appoints among its members a Chairman.

The Company s auditors cannot be members of more than five Boards of Auditors of companies listed on the Italian Stock Exchange (excluding Telecom Italia and its subsidiaries). They serve for a three-year term, may be reappointed and may be removed from their office for just cause and upon a resolution approved by the competent court.

Audit Committee

As described above, the Board of Auditors plays a key role in the Company s system of corporate governance. This is confirmed not only by the number of meetings in 2003 (no less than 25 meetings, of which some, as mentioned earlier, were held jointly with the Committee for Internal Control and Corporate Governance) but also by the Company s choices relating to US law.

More specifically, according to Rule 10A-3 and NYSE listing standards, the Board of Auditors has been identified to act as Telecom Italia s Audit Committee, since it meets the following requirements:

- the Board of Auditors is established pursuant to applicable Italian law and Telecom Italia s Bylaws;
- under Italian legal requirements, the Board of Auditors is separate from the Board of Directors and is not elected by the management of the Company;

- no executive officer is a member of the Board of Auditors;
- all of the members of the Board of Auditors meet specific independence requirements from the Company and its Group, the management and the auditing firm, as set forth by Italian legal provisions;
- the Board of Auditors, in accordance with and to the extent permitted by Italian law, is responsible for the appointment, retention and oversight of the work of the Company s external auditors engaged for the purpose of issuing the audit report on the annual financial statements;
- the Board of Auditors is authorized to engage independent counsel and other advisers, as it deems appropriate;
- the Board of Auditors, together with the Company, is currently preparing a complaints procedure to be adopted in accordance with Rule 10A-3 of the 1934 Act.

With specific reference to the pre-approval requirement of all audit and permitted non-audit services to be rendered by the auditing firm (and associated persons) to the Company and its subsidiaries, according to Section 202 of the Sarbanes-Oxley Act, Telecom Italia adopted a Group Procedure for the Appointment of Auditors in October 2003. The procedure (which is posted on the Company s website) regulates the engagement of auditing firms and persons (consulting firms, law firms, etc.) associated with the auditing firm on a continuous basis and significantly limits the power of the Board of Directors (and the management) while enhancing the control

Table of Contents

function performed by Telecom Italia s Board of Auditors. According to this procedure, as a rule, the engagement of external auditors requires a previous binding opinion by the Board of Auditors, unless the service to be rendered falls within a specified list of services, which has already been approved by the Board of Auditors (and which is subject to annual review).

Shareholders Meetings

Meetings of Ordinary Shareholders

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

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

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

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

Shareholders are informed of all Shareholders Meetings to be held by publication of a notice in *Gazzetta Ufficiale* at least 30 days before the date fixed for the meeting. In the case of a Shareholders Meeting that is called at the request of the minority shareholders or a Shareholders Meeting called to approve the liquidation of the Company, the notice period is reduced to 20 days. The notice period is reduced to 15 days if the Company is subject to a tender offer and a Shareholders Meeting is called to consider defensive actions against such tender offer (in which case resolutions must be approved by at least 30% of the holders of the voting shares outstanding at all calls of the Shareholders Meeting). The notice must also be published in at least one national daily newspaper. The notice of a Shareholders Meeting may specify up to two meeting dates for an ordinary Shareholders Meeting and up to three meeting dates for an extraordinary Shareholders Meeting (calls).

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

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

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

256

Table of Contents

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

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

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

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

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

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

Meetings of Savings Shareholders

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

The Joint Representative, who is appointed by the Special Meeting or, in default, by the President of the Court, is entitled to (i) inspect certain corporate books of the Company, (ii) to attend the Shareholders Meetings and (iii) to challenge in court the resolutions adopted by such meetings. The Joint Representative is appointed for a maximum three-year term and, according to the Bylaws, is kept informed by the Company regarding corporate events that can affect the price trend of Savings Shares. The savings shareholders Meeting held on October 31, 2001 appointed Mr. Carlo Pasteris as joint Representative for a three year period ending on October 31, 2004.

Special Meetings may be called when deemed necessary or upon request by savings shareholders representing at least 1% of the outstanding Savings Shares either by the Joint Representative or by the Company s Board of Directors in order to (a) appoint and revoke the Joint Representative, (b) approve the

257

Table of Contents

resolutions of the Shareholders Meetings that may affect the rights of Savings Shares, (c) set up an expense fund for the coverage of costs incurred in protecting rights of the Savings Shareholders, (d) negotiate possible disputes with the Company; and (e) resolve other issues relating to their position as holders of Savings Shares. To adopt resolutions related to (a), (c) and (e) above, a favorable vote of at least 20% of the Savings Shares is required at Special Meetings held on the first call, a favorable vote of at least 10% is required at Special Meetings held on the second call, and a favorable vote of at least a majority of the Savings Shares present is required at Special Meetings held on the third call. To adopt resolutions related to (b) and (d) above, a favorable vote of at least 20% of the Savings Shares is required at all calls of the Special Meetings.

To attend any Special Meeting, the holders of Savings Shares must be in possession of an appropriate certification issued by an authorized intermediary. Special arrangements with the Depositary may be required for the beneficial owner of ADRs representing Savings Share ADSs to attend Special Meetings and exercise voting rights with respect to underlying Savings Shares. See Description of American Depositary Receipts Voting of Deposited Securities .

Disclosure

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

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

A special procedure establishes the ways in which price-sensitive information is to be communicated to the market (Procedure for the Disclosure of Price-sensitive Information). It identifies the units of the Company s organization involved and lays down guidelines for the action to be taken in the presence of market rumors and in response to requests for information from those responsible for supervising and operating the markets (CONSOB and Borsa Italiana). The procedure also lays down guidelines for meetings with the financial community and the press, to ensure that information concerning the Company and the Telecom Italia Group is not disclosed selectively.

The Company has also established a Disclosure Committee to provide assistance to the Board of Directors and top management as regards the processing and handling of data and news necessary for the correct provision of information. The main tasks of the Committee are:

(i) to assist the Board in the preparation of corporate communications (including preparation of the Annual Report on Form 20-F), the Senior Officers (as defined below) in the certification of the Annual Report of Form 20-F filed with the SEC in accordance with the Sarbanes-Oxley Act, and the director appointed to handle price-sensitive information;

(ii) to ensure that corporate communications are prepared correctly with a view to their approval by the competent body;

(iii) to monitor the application of the procedures and controls for the collection, analysis and retention of data and information for publication and filing, verify their adequacy and effectiveness and propose corrective measures;

(iv) to propose corrections to existing procedures and/or controls where appropriate;

(v) to verify the correct application and need for updating of the Procedure for communicating price-sensitive information and suggest improvements where appropriate;

(vi) to supervise the structure and updating of the Company s website as regards its institutional contents.

The Disclosure Committee was not established in time to participate in the preparation of this Annual Report on Form 20-F. As a result, the Charter for Disclosure Procedures (the Charter) which was adopted by the Executive Chairman, the CEO and the CFO (the Senior Officers) in connection with the preparation of the 2002 Annual Report on Form 20-F, as amended consistent with the updated scope of the certifications to be issued by them, governed the preparation of the present 2003 Annual Report.

Table of Contents

The Charter assigns certain review responsibilities to the Management Committee and to the Controllers Committee (the Committees) and certain heads of Corporate Functions. Presently the Management Committee includes, in addition to the Executive Chairman, the CEO and the CFO (who is also in charge of the Internet & Media Business Unit), the following members: Riccardo Ruggiero (in charge of the Wireline Business Unit), Marco De Benedetti (in charge of the Mobile Business Unit), Giuseppe Tronchetti Provera (in charge of Olivetti Tecnost Business Unit), Ottaviano Autelli (in charge of the Olivetti Tecnost Business Unit), Arrigo Andreoni (in charge of the Information Technology Group corporate function), Riccardo Perissich (in charge of the Public and Economic Affairs corporate function), Giancarlo Rocco di Torrepadula (in charge of the Communication and Image corporate function), Gustavo Bracco (in charge of the Human Resources corporate function), Germanio Spreafico (in charge of the Purchasing corporate function), Francesca Di Carlo (in charge of the Corporate Development and Investor Relations corporate function), Giampaolo Zambeletti (in charge of the International Affairs corporate function), Aldo Olivari (in charge of the Telecom Italia Lab corporate function), Armando Focaroli (CEO of Telecom Italia Audit), Giuseppe Sala (in charge of the Wireline Business Unit), Mauro Sentinelli (in charge of the Mobile Business Unit), Salvatore Pinto (in charge of the Information Technology Market Business Unit), Paolo Dal Pino (in charge of Telecom Italia Latam), Francesco Chiappetta (General Counsel of Telecom Italia) and Filippo Bettini (Assistant to the Chairman). The Controllers Committee includes Stefano Ciurli (Chief Financial Officer of the Mobile Business Unit), Franco De Battista (Chief Financial Officer of the Olivetti Tecnost Business Unit), Gabriella Fabotti (Chief Financial Officer of Information Technology Group), Adelfo Paternó (Chief Financial Officer of the Information Technology Market Business Unit), Amandino Pavani (Chief Financial Officer of the Wireline Business Unit), Mariateresa Benetti (Chief Financial Officer of Telecom Italia Learning Services) and Paolo Serra (Chief Financial Officer of the Internet and Media Business Unit).

Pursuant to the Charter, the Committees and certain heads of Corporate Functions (presently Roberto Moro - Head of Tax Corporate Function under Finance, Administration and Control of Telecom Italia; Francesco Tanzi - Head of Finance Corporate function under Finance, Administration and Control of Telecom Italia; Riccardo Taranto - Head of Planning and Control Corporate Function under Finance, Administration and Control of Telecom Italia; Riccardo Varetto - Head of Financial Statements Corporate Function under Finance, Administration and Control of Telecom Italia; Michele Marcante - Head of International Subsidiaries Corporate Function under Finance, Administration and Control of Telecom Italia; John Peter Savi - Head of Administrative Services Centre Corporate Function under Finance, Administration and Control of Telecom Italia; Aldo Cappuccio - Head of Corporate and Legal Affairs Corporate Function; Nicola Verdicchio - Head of International Legal Affairs Corporate Function; Marco Patuano - General Manager of Telecom Italia Latam) assist the Senior Officers in fulfilling their responsibility for oversight of the accuracy and timeliness of certain disclosures made by the Company. Among others, the Committees and the aforementioned heads of Corporate Functions are responsible for the following tasks:

- Design and establish controls and other procedures (which may include procedures currently used by the Company) that are designed to ensure that (i) information required by the Company to be disclosed to the regulatory authorities is recorded, processed, summarized and reported accurately and on a timely basis and (ii) information is accumulated and communicated to management, including the Senior Officers, as appropriate to allow timely decisions regarding such required disclosure (Disclosure Controls).

- Monitor the integrity and effectiveness of the Company s Disclosure Controls.

- Review and supervise the preparation of the Company s Annual Report on Form 20-F and other periodic and current reports.

Moreover, the Committees and the heads of Corporate Functions evaluated the effectiveness of the Company s Disclosure Controls as of December 31, 2003. See Item 15. Controls and Procedures .

Table of Contents

EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Foreign Investment and Exchange Control Regulations in Italy

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

Updated reporting and record-keeping requirements are contained in recent Italian legislation which implements an EU Directive regarding the free movement of capital. Such legislation requires that transfers into or out of Italy of cash or securities in bearer form in excess of 10,329.14 be reported in writing to the Ufficio Italiano Cambi (the Italian Exchange Office) by residents or non-residents that effect such transfers, or by credit institutions or other intermediaries that effect such transactions on their behalf. In addition, credit institutions and other intermediaries effecting such transactions on behalf of residents or non-residents of Italy are required to maintain records of such transactions for five years, which may be inspected at any time by Italian tax and judicial authorities. Non-compliance with these reporting and record-keeping requirements may result in administrative fines or, in the case of false reporting and in certain cases of incomplete reporting, criminal penalties. The Ufficio Italiano Cambi will maintain reports for a period of ten years and may use them, directly or through other government offices, to police money laundering, tax evasion and any other crime or violation.

Certain additional procedural requirements are imposed for tax reasons. Non-corporate residents of Italy effecting transfers to and from Italy in excess of 10,329.14 in one year must disclose them in their annual tax declarations. Non-corporate residents must also give details in their tax declarations of financial assets held outside Italy at the end of the fiscal year and of transfers in excess of 10,329.14 to, from, within and between foreign countries in connection with such assets during the fiscal year. No declaration is required in respect of foreign investments and foreign income-earning assets that are exempt from income tax or subject to withholding tax in Italy. Such disclosure requirements do not apply (i) if the total value of the investments and assets at the end of the taxable period or the total amount of the transfers effected during the year is not greater than 10,329.14 or (ii) in respect of foreign investments, foreign assets or transfers within the EU (except for transfer from or to Italy). For corporate residents there is no requirement for such a declaration because their financial statements (on the basis of which their tax returns are prepared) already contain the information.

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

Table of Contents

DESCRIPTION OF BYLAWS

An extensive reform of Italian corporate law became effective in January 2004, pursuant to Legislative Decree n. 6/2003 (the Vietti Law). The Vietti Law calls for joint stock companies bylaws to be amended and certain decisions being taken to this end. The relevant resolutions were approved by the shareholders meeting on May 6, 2004.

Object

Telecom Italia s objects are described in Article 3 of the Bylaws. Such objects are:

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

Directors

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

For a description of a Director s power to vote on matters in which he may be materially interested, and to vote on compensation issues, please see Board of Directors Executive Directors and activities of the Board and Internal Committees Remuneration Committee , respectively.

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

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

261

Table of Contents

DESCRIPTION OF CAPITAL STOCK

As of June 1, 2004, the full paid-in capital stock amounted to 8,857,247,392.40 and was constituted by 10,308,165,099 Shares and 5,795,921,069 Savings Shares, each of 0.55 par value.

The Olivetti Extraordinary Shareholders Meeting of October 4, 2000 approved the increase, in one or more steps, of the share capital by up to a maximum amount now remaining partly as a consequence of the resolution adopted by the Extraordinary Shareholders Meeting of May 26, 2003 of 39,898,601.60, which is reserved exclusively for the exercise of the Warrant Tecnost 1999-2004 (now Warrant Azioni Ordinarie Telecom Italia ex Olivetti 1999-2004) warrants, by means of the issue of up to a maximum of 72,542,912 Shares.

The Olivetti Shareholders Meeting of May 26, 2003, reiterating, updating and, where necessary, renewing earlier resolutions of the Olivetti Shareholders Meeting and its Board of Directors resolved to increase the share capital by the following divisible amounts:

1. up to a maximum of 344,941.30 (at May 6, 2004, 207,482.55), by means of the issue of up to a maximum of 627,166 (377,241 at May 6, 2004) Shares for the exercise of the Piano triennale Stock Option 2002-2004 stock options, increase to be implemented by December 15, 2004;

2. up to a maximum of 7,521,270.90 (at May 6, 2004, 1,514,612.00), by means of the issue of up to a maximum of 13,675,038 (at May 6, 2004, 2,753,840) Shares for the exercise of the Piano triennale Stock Option febbraio 2002-dicembre 2004 stock options, increase to be implemented by December 31, 2004;

3. up to a maximum of 624,936,779.50 (at May 6, 2004, 619,650,312.60), by means of the issue of up to a maximum of 1,136,248,690 (at May 6, 2004, 1,126,636,932) Shares to be reserved irrevocably and exclusively for the conversion of the Olivetti 1,5% 2001-2010 convertibile con premio al rimborso (now Prestito Telecom Italia 1,5% 2001-2010 convertibile con premio al rimborso) convertible bonds, on the basis of 0.471553 Shares for each bond presented for conversion.

The Olivetti Shareholders Meeting of May 26, 2003 also resolved to increase the share capital by up to a maximum of 183,386,986.75 (at May 6, 2004, 149,464,221.50), by means of the issue of up to a maximum of 333,430,885 (at May 6, 2004, 271,753,130) Shares, divided into the following divisible tranches:

1. a tranche of up to a maximum of 15,379,830.95 (at May 6, 2004, 6,234,122.40) for the exercise of the Piano di Stock Option 1999 stock options, increase to be implemented by January 31, 2005 by means of the issue of up to a maximum of 27,963,329 (at May 6, 2004, 11,334,768) Shares, to be subscribed for at a total price of 6.79 per option held (i.e. at a price of 2.057033 for each newly-issued Share);

2. a tranche of up to a maximum of 37,398,868.65 (at May 6, 2004, 19,425,568.80) for the exercise of the Piano di Stock Option 2000 stock options, increase to be implemented by July 30, 2008 by means of the issue of up to a maximum of 67,997,943 (at May 6, 2004, 35,319,216) Shares, to be subscribed for at a total price of 13.815 per option held (i.e. at a price of 4.185259 for each newly-issued Share);

3.

a tranche of up to a maximum of 58,916,834.35 (at May 6, 2004, 58,439,923.85) for the exercise of the Piano di Stock Option 2001 stock options, increase to be implemented by April 30, 2008 by means of the issue of up to a maximum of 107,121,517 (at May 6, 2004, 106,254,407) Shares, to be subscribed for at a total price of 10.488 per option held (i.e. at a price of 3.177343 for each newly-issued Share);

4. a tranche of up to a maximum of 21,422,652.90 (at May 6, 2004, 20,424,129.00) for the exercise of the Piano di Stock Option Top 2002 stock options, increase to be implemented by February 28, 2010 by means of the issue of up to a maximum of 38,950,278 (at May 6, 2004, 37,134,780) Shares, to be subscribed for at a total price of 9.203 per option held (i.e. at a price of 2.788052 for each newly-issued Share);

5. a tranche of up to a maximum of 50,268,799.90 (at May 6, 2004, 44,940,477.45) for the exercise of the Piano di Stock Option 2002 stock options, increase to be implemented by March 31, 2008 for the first lot, by March 31, 2009 for the second lot and by March 31, 2010 for the third lot, by means of the issue of up to a maximum of 91,397,818 (at May 6, 2004, 81,709,959) Shares, to be subscribed for at a total price for the different options of respectively 9.665, 7.952 and 7.721 per option held (i.e. at a price for the different options of respectively 2.928015, 2.409061 and 2.339080 for each newly-issued Share).

Table of Contents

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

(i) to be offered with the right of pre-emption to shareholders and holders of convertible bonds; or

(ii) to be offered for subscription to employees of Telecom Italia S.p.A. or its subsidiaries, with the exclusion of the right of pre-emption, provided such increase in capital does not exceed 1% of the capital attested at the date of the offering, pursuant to the combined effects of Article 2441, last paragraph, of the Civil Code and Articles 134(2) of Legislative Decree 58/1998.

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

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

Classes of shares

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

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

Form and Transfer

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

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

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

Each person owning a beneficial interest in Shares and Savings Shares held through Euroclear or Clearstream must rely on the procedures of Euroclear or Clearstream, respectively, and of institutions that have accounts with Euroclear or Clearstream to exercise any rights of a holder of shares. Holders may request Euroclear or Clearstream to transfer their Shares and Savings Shares to an account of such holder with a participant of Monte Titoli, in which case such holders may transfer their shares, collect dividends and exercise other shareholder rights through that participant. Any such transfer through that participant is not subject to Italian transfer tax if non-Italian parties are involved. See Taxation.

Table of Contents

Dividend Rights

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

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

Subscription Rights

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

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

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

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

Liquidation Rights

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

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

Purchase of Shares or Savings Shares by the Company

The Company may purchase its own Shares or Savings Shares subject to certain conditions and limitations. Such purchases must be authorized by a Shareholders Meeting and made only out of retained earnings or distributable reserves as shown on the most recent financial statements approved by the Shareholders Meeting. The par value of the Shares or Savings Shares purchased by the Company, including the Shares or Savings Shares, if any, held by the Company s subsidiaries, may not exceed 10% of the Company s share capital. The Company may purchase its own Shares or Savings Shares either on the market or through a tender offer, according to the terms and conditions agreed with Borsa Italiana.

A corresponding reserve equal to the purchase price of such Shares or Savings Shares has to be created on the Company s balance sheet. Such reserve is not available until such Shares or Savings Shares are sold or disposed of or canceled by the Company. Shares or Savings Shares purchased and held by the Company or one of its subsidiaries may be disposed of only pursuant to a resolution of the Company s or, if applicable, its subsidiary s shareholders meeting.

Neither the Company nor any company under its control may vote or subscribe for new Shares or Savings Shares of the Company. These subscription rights accrue to the other holders so long as such Shares or Savings Shares are held by the Company or a company under its control. The Shares or the Savings Shares, as long as they are owned by the Company, are not entitled to receive dividends.

Table of Contents

As of June 1, 2004, Telecom Italia owns 1,272,014 of its own Shares, coming from the substitution of Olivetti ordinary shares treasury stock, according to the mechanism described under Item 4 Information on the Telecom Italia Group-Significant Developments during 2003-Merger of Old Telecom Italia into Olivetti. As a result of the Merger, the ordinary and savings shares treasury stock owned by Old Telecom Italia were cancelled.

Reporting Requirements and Restrictions on Acquisitions of Shares

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

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

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

Shareholder agreements concerning the voting shares of a listed company must be notified to CONSOB and to the company if they include agreements on the exercise of voting rights and/or duties of consultation before voting. The same rule applies when the shareholder agreements concern the shares issued by a non-listed company that controls a listed company. The notification must include the share ownership of all parties filing it. When listed companies change their share capital, they must notify CONSOB and Borsa Italiana of the amount of the share capital and the number and classes of shares into which it is divided. CONSOB and Borsa Italiana must make the information available to the public no later than the day following the notification. The notification shall be made no later than the day following the event causing such modification or the day following the filing of the amended bylaws.

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

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

Limitations on Voting and Shareholdings

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

265

DESCRIPTION OF AMERICAN DEPOSITARY RECEIPTS

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

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

Deposit, Issuance, Transfer and Withdrawal

In connection with the deposit of Shares under the Deposit Agreement, the Depositary or the Custodian may require the following in form satisfactory to it: (a) a written order directing the Depositary to issue or execute and deliver to, or upon the written order of, the person or persons designated in such order an ADR or ADRs evidencing the number of ADSs representing such Deposited Securities (a Delivery Order); (b) proper endorsements or duly executed instruments of transfer in respect of such Deposited Securities; and (c) instruments assigning to the Custodian or its nominee any distribution on or in respect of such Deposited Securities until the Shares are registered in the name required by the Depositary or indemnity therefor. As soon as practicable after the Custodian receives Deposited Securities pursuant to any such deposit or pursuant to any distribution upon Deposited Securities or change affecting Deposited Securities, the Custodian shall present such Deposited Securities for registration of transfer into the name of the Custodian or its nominee, to the extent such registration is practicable, at the cost and expense of the person making such deposit (or for whose benefit such deposit is made) and shall obtain evidence satisfactory to it of such registration. Deposited Securities shall be held by the Custodian for the account and to the order of the Depositary at such place or places and in such manner as the Depositary shall determine. The Depositary agrees to instruct the Custodian to place all Shares accepted for deposit into a segregated account separate from any Shares of the Company that may be held by such Custodian under any other depositary receipt facility relating to the Shares. Deposited Securities may be delivered by the Custodian to any person only under the circumstances expressly contemplated in the Deposit Agreement. To the extent that the provisions of or governing the Shares make delivery of certificates therefor impracticable, Shares may be deposited by such delivery thereof as the Depositary or the Custodian may reasonably accept, including, without limitation, by causing them to be credited to an account maintained by the Custodian for such purpose with the Company or an accredited intermediary, such as a bank, acting as a registrar for the Shares, together with delivery of the documents, payments and Delivery Order referred to herein to the Custodian or the Depositary. Neither the Depositary nor the Custodian shall lend Deposited Securities.

Table of Contents

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

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

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

Distributions on Deposited Securities

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

(a) Cash. Any U.S. dollars available to the Depositary resulting from a cash dividend or other cash distribution or authorized portion thereof (Cash), on an averaged, if possible, or other practicable basis, subject to appropriate adjustments for (i) appropriate adjustments for taxes withheld, (ii) such distribution being impermissible or impracticable with respect to certain Holders, and (iii) deduction of the Depositary s expenses in (1) converting any foreign currency to U.S. dollars by sale or in such other manner as the Depositary may determine to the extent

that it determines that such conversion may be made on a reasonable basis, (2) transferring foreign currency or U.S. dollars to the United States by such means as the

Table of Contents

Depositary may determine to the extent that it determines that such transfer may be made on a reasonable basis, (3) obtaining any approval or license of any governmental authority required for such conversion or transfer, which is obtainable at a reasonable cost and within a reasonable time and (4) making any sale by public or private means in any commercially reasonable manner.

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

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

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

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

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

Disclosure of Interests

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

Record Dates

The Depositary shall, to the extent necessary, after consultation with the Company, if practicable, fix a record date (which shall be as near as practicable to any corresponding record date set by the Company) for the determination of the Holders who shall be entitled to receive any distribution on or in respect of Deposited Securities, to give instructions for the exercise of any voting rights, to receive any notice or to act in respect of other matters and only such Holders at the close of business on such record date shall be so entitled.

Table of Contents

Voting of Deposited Securities

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

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

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

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

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

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

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

Inspection of Transfer Books

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

Reports and Other Communications

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

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

Changes Affecting Deposited Securities

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

Amendment and Termination of Deposit Agreement

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

Upon any resignation of the Depositary which does not become effective during the earlier of (i) 90 days from the date of the Depositary shall have resigned as such and (ii) the date on which the Company shall have appointed a successor depositary or on any removal of the Depositary pursuant to the Deposit Agreement, the Depositary may, and shall at the written direction of the Company, terminate the Deposit Agreement and this ADR by mailing notice of such termination to the Holders at least 30 days prior to the date fixed in such notice

Table of Contents

for such termination. After the date so fixed for termination, the Depositary and its agents will perform no further acts under the Deposit Agreement and this ADR, except to receive and hold (or sell) distributions on Deposited Securities and deliver Deposited Securities being withdrawn. As soon as practicable after the expiration of six months from the date so fixed for termination, the Depositary shall sell the Deposited Securities and shall thereafter (as long as it may lawfully do so) hold in a segregated account the net proceeds of such sales, together with any other cash then held by it under the Deposit Agreement, without liability for interest, in trust for the pro rata benefit of the Holders of ADRs not theretofore surrendered. After making such sale, the Depositary shall be discharged from all obligations in respect of the Deposit Agreement and this ADR, except to account for such net proceeds and other cash. After the date so fixed for termination, the Company shall be discharged from all obligations under the Deposit Agreement except for its obligations to the Depositary and its agents.

Charges of Depositary

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

Liability of Holders for Taxes

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

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

Depositary deems necessary and practicable to pay such taxes, by public or private sale, and the Depositary shall distribute the net proceeds of any such sale or the balance of any such property after deduction of such taxes to the Holders entitled thereto.

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

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

General Limitations

The Depositary, the Company, their agents and each of them shall: (a) incur no liability (i) if any present or future law, regulation, the provisions of or governing any Deposited Securities, act of God, war or other circumstance beyond its control shall prevent, delay or subject to any civil or criminal penalty any act which the Deposit Agreement or this ADR provides shall be done or performed by it, or (ii) by reason of any exercise or failure to exercise any discretion given it in the Deposit Agreement or this ADR; (b) assume no liability except to perform its obligations to the extent they are specifically set forth in this ADR and the Deposit Agreement without gross negligence or bad faith; (c) in the case of the Depositary and its agents, be under no obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any Deposited Securities or this ADR; (d) in the case of the Company and its agents hereunder be under no obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any Deposited Securities or this ADR, which in its opinion may involve it in expense or liability, unless indemnity satisfactory to it against all expense (including fees and disbursements of counsel) and liability be furnished as often as may be required; or (e) not be liable for any action or inaction by it in reliance upon the advice of or information from legal counsel, accountants, any person presenting Shares for deposit, any Holder, or any other person believed by it in good faith to be competent to give such advice or information. The Depositary, its agents and the Company may rely and shall be protected in acting upon any written notice, request, direction or other document believed by them in good faith to be genuine and to have been signed or presented by the proper party or parties. The Depositary and its agents will not be responsible for any failure to carry out any instructions to vote any of the Deposited Securities (provided that such act or omission to act is in good faith), for the manner in which any such vote is cast or for the effect of any such vote. The Depositary and its agents may own and deal in any class of securities of the Company and its affiliates and in ADRs. Neither the Company, the Depositary nor any of their respective agents shall be liable to Holders or beneficial owners of interests in ADSs for any indirect, special, punitive or consequential damages.

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

Table of Contents

Governing Law

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

JPMorgan Chase Bank

The Depositary is JPMorgan Chase Bank, a New York banking corporation, which has its principal office located in New York, New York. JPMorgan Chase Bank is a commercial bank offering a wide range of banking and trust services to its customers in the New York metropolitan area, throughout the United States and around the world.

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

The Articles of Association of JPMorgan Chase Bank and Bylaws together with the annual report, Form 10-K and Form 10-Q of J.P. Morgan are available for inspection at the Principal New York Office of the Depositary.

273

Table of Contents

TAXATION

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

Italian Taxation

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

Income Tax

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

With respect to dividends paid to beneficial holders of Shares and applicable ADRs who are not Italian residents and do not have a permanent establishment in Italy to which dividends are connected, Italian law provides for a 27% withholding tax on dividends paid.

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

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

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

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

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

(i) a declaration by the beneficial owner containing all the data identifying this person as the beneficial owner and establishing the existence of all the conditions necessary for the application of the Treaty; and

(ii) a certification (Form 6166) issued by the U.S. Internal Revenue Service that states that the beneficial owner is a U.S. resident for tax purposes. The certification is valid until March 31 of the year following the submission.

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

Table of Contents

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

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

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

Transfer Tax

No transfer tax is payable upon the transfer of Telecom Italia shares or ADSs through Telematico or any other regulated financial market. Transfers of shares or ADSs which occur outside a regulated financial market are exempted from the payment of transfer tax provided that the parties entering into the agreement pursuant to which the transfer takes place are all non-resident in Italy and the relevant shares or ADSs are not deposited at an Italian intermediary. Other types of transfers of shares listed on Telematico or any other regulated financial market which occur outside a regulated financial market are also exempted from the payment of transfer tax provided that the parties entering into the agreement pursuant to which the transfer taxes take place are (i) banks, Italian securities dealing firms (SIMs) or exchange agents or (ii) banks, SIMs or exchange agents on the one hand, and non-residents on the other hand or (iii) banks, SIMs or resident or non-resident exchange agents, on the one hand, and investment funds on the other hand. In any other case, transfer tax is currently payable at the following rates:

- 0.072 per 51.65 (or any fraction) of the price at which the shares or ADSs are transferred when the transfer is made directly between the parties or through an intermediary that is not a bank, SIM or broker; and

- 0.0258 per 51.65 (or any fraction) of the price at which the shares or ADSs are transferred when the transfer is made either (i) between a bank, SIM or broker and a private party or (ii) between private parties through a bank, SIM or broker.

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

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

Capital Gains Tax

Under Italian law, capital gains tax (CGT) is levied on capital gains realized by non-residents from the disposition of shares in companies resident in Italy for tax purposes even if those shares are held outside of Italy. For the purposes of CGT, the exchange of shares under a merger or demerger of Italian companies does not constitute a disposition of shares. In such transactions, the tax value and the holding period of the exchanged shares is rolled over to the shares received in exchange. Capital gains realized by non-resident holders on the sale of non-qualified shareholdings (as defined below) in companies listed on a stock exchange and resident in Italy for tax purposes are not subject to CGT.

A qualified shareholding consists of securities (except for Saving Shares and applicable ADR s) that (i) entitle the holder to exercise more than 2% of the voting rights of a company with shares listed on a stock

275

Table of Contents

exchange (as is Telecom Italia s case) or 20% of the voting rights of other companies, in each case in the ordinary meeting of the shareholders or (ii) represent more than 5% of the share capital of a company with shares listed on a stock exchange (as is Telecom Italia s case) or 25% of the share capital of other companies. A non-qualified shareholding is any shareholding which is not a qualified shareholding .

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

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

Inheritance and Gift Tax

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

However, for donees other than spouses, direct descendants or ancestors and other relatives within the fourth degree, if and to the extent that the value of the gift to any such donee exceeds 180.759,91, the gift of shares may be subject to the ordinary transfer taxes that would apply if the shares had been transferred for consideration (i.e. registration tax at the flat rate of 129.11).

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

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

United States Federal Income Taxation

The following summary describes the material U.S. federal income tax consequences of the acquisition, ownership and sale of Telecom Italia Shares, including Telecom Italia Shares represented by American Depositary Shares evidenced by ADRs, that are generally applicable to the U.S. holders described herein who own Telecom Italia Shares or ADRs as capital assets for U.S. federal income tax purposes. For these purposes, you are a U.S. holder if you are for U.S. federal income tax purposes:

- a citizen or resident of the United States;

- a corporation, or other entity taxable as a corporation, organized under the laws of the United States or of any political subdivision of the United States; or
- an estate or trust the income of which is includible in gross income regardless of its source.

This discussion is based on the tax laws of the United States currently in effect, including the Internal Revenue Code of 1986, as amended, Treasury Regulations, administrative announcements, and judicial decisions, as well as the Italian-U.S. income tax convention (the Treaty). These laws may change, possibly with retroactive effect. This discussion does not address U.S. state, local or non-U.S. tax consequences. This discussion is based in part upon representations of the Depositary and assumes that each obligation provided for in, or otherwise contemplated by, the Deposit Agreement and any related agreement will be performed in accordance with its respective terms. The U.S. Treasury has expressed concerns that parties to whom ADRs are pre-released may be taking actions that are inconsistent with the claiming, by U.S. holders of ADRs, of foreign tax credits for U.S. federal income tax purposes. Accordingly, the analysis of the creditability of Italian taxes by ADR holders described below could be affected by future actions that may be taken by the U.S. Treasury.

Table of Contents

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

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

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

This discussion assumes that the Company was not a passive foreign investment company for 2003 (as discussed below).

Taxation of dividends

Distributions made with respect to the Telecom Italia Shares or ADRs (other than certain pro rata distributions of Telecom Italia Shares or ADRs), including any Italian tax withheld, will generally constitute foreign source dividend income for U.S. federal income tax purposes to the extent such distributions are made from the Company s current or accumulated earnings and profits, as determined in accordance with U.S. federal income tax principles. Subject to applicable limitations that may vary depending on a U.S. holder s individual circumstances, dividends paid to noncorporate U.S. holders in taxable years beginning before January 1, 2009 will be taxable at a maximum tax rate of 15%. Noncorporate U.S. holders should consult their own tax advisors to determine whether they are subject to any special rules that may limit their ability to be taxed at this favourable rate.

You will not be entitled to claim a dividends-received deduction for dividends paid on the Telecom Italia Shares or ADRs. The amount of any cash distribution paid in euros, including the amount of any Italian tax withheld, will be equal to the U.S. dollar value of such euros on the date of receipt by the Depositary in the case of U.S. holders of ADRs, or by the U.S. holder in the case of U.S. holders of Telecom Italia Shares, regardless of whether the payment is in fact converted into U.S. dollars. Gain or loss, if any, recognized on the sale or other disposition of such euros will be U.S. source ordinary income or loss. The amount of any distribution of property other than cash will be the fair market value of such property on the date of distribution.

Subject to certain limitations and restrictions, Italian taxes withheld from distributions at the rate provided in the Treaty will be eligible for credit against a U.S. holder s U.S. federal income tax liability. Italian taxes withheld in excess of the rate provided in the Treaty will generally not be eligible for credit against a U.S. holder s federal income tax liability.

The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends the Company distributes with respect to the Telecom Italia Shares or ADRs will generally constitute passive income. You should consult your tax advisor concerning the foreign tax credit implications of the payment of these withholding taxes.

Table of Contents

Taxation of capital gains

You will recognize capital gain or loss for U.S. federal income tax purposes on the sale or exchange of Telecom Italia Shares or ADRs in the same manner as you would on the sale or exchange of any other shares of stock held as capital assets. As a result, you will generally recognize capital gain or loss for U.S. federal income tax purposes equal to the difference between the amount realized and your adjusted basis in the Telecom Italia Shares or ADRs. The gain or loss will generally be U.S. source income or loss. You should consult your own tax advisor about the treatment of capital gains, which may be taxed at lower rates than ordinary income for non-corporate taxpayers, and capital losses, the deductibility of which may be limited.

Passive Foreign Investment Company Rules

The Company believes that it was not a passive foreign investment company (PFIC) for United States federal income tax purposes for 2003. However, since PFIC status depends upon the composition of the Company s income and assets and the market value of the Company s assets (including, among others, less than 25 percent owned equity investments) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a U.S. holder held Telecom Italia Shares or ADRs, certain adverse consequences could apply to the U.S. holder.

Information Reporting and Backup Withholding

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

- are a corporation or come within certain other exempt categories, and, when required, demonstrate this fact, or
- in the case of back up withholding, provide a correct taxpayer identification number, certify that you are not subject to backup withholding and otherwise comply with applicable requirements of the backup withholding rules.

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

Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Item 5. Operating and Financial Review and Prospects Quantitative and Qualitative Disclosure About Market Risk .

Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

Table of Contents

PART II

Item 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

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

Not applicable.

Item 15. CONTROLS AND PROCEDURES

As of December 31, 2003, the Company, under the supervision and with the participation of the Company s management, including the Executive Chairman, Chief Executive Officer and the Chief Financial Officer, performed an evaluation of the effectiveness of the Company s disclosure controls and procedures. The Company s management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which by their nature can provide only reasonable assurance regarding management s control objectives. Based on this evaluation, the Company s Executive Chairman, Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective at the reasonable assurance level for gathering, analyzing and disclosing the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC s rules and forms.

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

Item 16. [RESERVED]

Item 16A. AUDIT COMMITTEE FINANCIAL EXPERT

The Board of Auditors has determined that each of its members is an audit committee financial expert as defined in Item 16A of Form 20-F. For the names of the members of the Board of Auditors, see Item 10. Additional Information Corporate Governance Board of Auditors .

Item 16B. CODE OF ETHICS AND CONDUCT

On March 23, 2004, Telecom Italia adopted a new Code of Ethics and Conduct which applies to the Executive Chairman, the Chief Executive Officer, the Chief Financial Officer, as well as to all the Group s employees in and outside Italy. The Code of Ethics and Conduct is available on Telecom Italia s website at www.telecomitalia.it. See also above under Item 10. Additional Information Corporate Governance Differences in Italian/New York Stock Exchange Corporate Governance Practices and Code of Ethics and Conduct .

Item 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Ernst & Young[1] served as Telecom Italia s primary independent auditors for the years ended on December 31, 2001, 2002 and 2003, for which audited financial statements appear in this Annual Report on Form 20-F.

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

Table of Contents

The following table sets forth the aggregate fees for professional services and other services rendered by Ernst & Young in 2003 and 2002.

Type of Fees	For fiscal year ended December 31, 2002	2003
	(in thousands)	
Audit Fees(1)	6,636	11,659
Audit-related Fees(2)	1,232	2,375
Tax Fees(3)	1,448	777
All Other Fees(4)	458	2,146
Total	**9,774**	**16,957**

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

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

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

(4) All other fees consist primarily of benchmarking studies, assistance in the review of the management controls procedures and support for external management control related projects at Finsiel Group.

Audit Committee s Pre-Approval Policies and Procedures

The Board of Auditors (also in its role as Telecom Italia s Audit Committee), in accordance with and to the extent permitted by applicable Italian law, is responsible for the appointment, retention and oversight of the work of the Company s external auditors engaged for the purpose of issuing the audit report on the annual financial statements. To this effect, the Board of Auditors makes a recommendation to the Shareholders Meeting which appoints the external auditors and determines their compensation. On May 6, 2004, the Telecom Italia Shareholders Meeting appointed Reconta Ernst & Young S.p.A. (E&Y) as external auditors for the three-year period 2004, 2005 and 2006.

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

Audit Services:

1. Audit of annual and interim financial statements on the basis of applicable laws and regulations (including the audit of SEC registered companies annual report).

2. Audit of annual and interim financial consolidated reporting packages.

3. Audit conformity of the Telecom Italia Group s sustainability reports or social reports.

4. Reports or opinions required by law for specific transactions from the auditor appointed to audit the annual financial statements, to the extent permitted.

5. Audits governed by the principles of national and international auditing such as:

- audits performed in relation to the issuance of a comfort letter (including for pro forma accounts and/or balance sheets) in relation to the carrying out of extraordinary financial operations;

- audits agreed with management covering specific areas or accounts or accounting situations, to support the audit of periodic statements;

- auditing of subsidiaries and associated companies (including review of the working papers of other auditors) made necessary for the purpose of auditing the periodic statements of the company being audited.

6. Audit of annual accounts and/or balance sheets to be published in prospectuses, information documents, offering memoranda and similar documents.

7. Services required by regulatory authorities and agencies (such as, for example, those connected with so-called regulatory accounting).

8. Audit of statements required by national or supranational administrations (e.g. the EU) for the concession of grants or loans for specific actions or projects.

9. Audits aimed at issuance of an attestation of the system of internal control under Section 404 of the Sarbanes-Oxley Act.

Permitted Non-audit Services:

1. Audits in the following areas:

- procedures for auditing associated companies provided for by agreements between shareholders (in relation to so-called audit rights);
- financial due diligence procedures on companies to be bought or sold;
- procedures performed in the area of regulatory accounting;
- procedures performed on areas related to internal control in support of the internal auditor.

2. Opinions on accounting and reporting including those regarding (i) application of new accounting principles and new regulations on accounting and regulatory reporting, (ii) implementation of accounting principles current in other countries, (iii) implementation of rules and regulations issued by the SEC, CONSOB and similar bodies; and

3. Assistance to the internal audit department within the limits imposed by SEC regulations.

The pre-approved services listed above are in all cases subject to scrutiny by the Director with delegated powers for internal controls by the Board of Directors who may (by his own initiative or on request by the Committee for Internal Control and Corporate Governance or by the Board of Auditors) request supplementary documentation to verify the independent status of the auditor and take appropriate action if necessary.

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

Between May 6, 2003, and the adoption of the Group Procedure there were no non-audit services engagements undertaken by E&Y that required pre-approval of the Company s audit committee.

281

Table of Contents

PART III

Item 17. FINANCIAL STATEMENTS

Not applicable.

Item 18. FINANCIAL STATEMENTS

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

Item 19. FINANCIAL STATEMENTS AND EXHIBITS

(a) Financial Statements

(1) Included to satisfy certain significance tests under Rule 3.09 of Regulation S-X (Separate Financial Statements of Subsidiaries Not Consolidated And 50% - or Less - Owned By Persons) for 2001 as a result of reclassification under U.S. GAAP of financial statements to give effect to discontinued operations (New SEAT) in 2003.

(b) Exhibits

1.1 Bylaws of the Company.

2.1 Deposit Agreements.

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

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

2.2 Trust deed dated January 23, 2004, between Telecom Italia (as Issuer and Guarantor), Telecom Italia Finance (as Issuer) and J.P. Morgan Corporate Trustee Services Limited relating to a 10 billion Euro Medium Term Note Programme. We hereby agree to furnish to the Commission, upon its request, a copy of any instrument defining the rights of holders of our long-term debt or that of our subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.

4.1 Public Telecommunications License.(3)

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

4.2 Stock Option Plans.

(a) 2002 Top Plan regulations and from of Letter of Assignment addressed to participants of the plan.(4)

(b) 2002 Plan regulations and form of Letter of Assignment addressed to participants of the plan.(4)

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

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

7.1 Statement explaining computation of ratio of earning to fixed charges.

8.1 List of Subsidiaries.

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

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

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

282

Table of Contents

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

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

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

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

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

Table of Contents

SIGNATURE

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

TELECOM ITALIA S.p.A

By: /s/ CARLO ORAZIO BUORA

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

Dated June 10, 2004

Table of Contents

TELECOM ITALIA S.P.A. CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

REPORT OF INDEPENDENT AUDITORS

To the Stockholders of

Telecom Italia S.p.A.

We have audited the accompanying consolidated balance sheets of Telecom Italia S.p.A. and subsidiaries (the Company) as of December 31, 2002 and 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain subsidiaries and equity method investees, which statements reflect aggregated total assets of approximately 3% and 3% of the Company s consolidated assets as of December 31, 2002 and 2003, respectively, and aggregated total revenues of approximately 7%, 7%, and 6% of the Company s consolidated revenues for the years ended December 31, 2001, 2002, and 2003, respectively. These statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those companies, is based solely on the reports of those other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telecom Italia S.p.A. and subsidiaries at December 31, 2002 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in Italy, which differ in certain respects from U.S. generally accepted accounting principles (see notes 27, 28 and 29 to the consolidated financial statements).

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

Turin, Italy

April 15, 2004,

except for notes 27, 28 and 29, as to which the date is

June 4, 2004

Table of Contents

TELECOM ITALIA S.P.A.

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2002 AND 2003

	December 31, 2002	December 31, 2003
	(millions of euro)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents (Note 4)	4,426	4,937
Marketable securities (Note 4)	2,100	3,597
Receivables (Note 5)	8,381	7,351
Inventories (Note 6)	584	426
Other current assets (Note 7)	7,106	6,187
TOTAL CURRENT ASSETS	22,597	22,498
Fixed assets	65,152	65,943
Less Accumulated depreciation	(45,703)	(47,619)
Fixed assets, net (Note 8)	19,449	18,324
Intangible assets, net (Note 9)	34,412	33,853
Other assets (Note 10):		
Investments in affiliates	2,576	1,470
Treasury stock	393	393
Securities	304	12
Other receivables	3,653	3,951
TOTAL ASSETS	**83,384**	**80,501**
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Short-term debt (Note 11)	6,827	10,613
Payables, trade and other (Note 12)	10,270	8,662
Accrued payroll and employee benefits	977	1,152
Accrued income taxes	244	824
Other accrued liabilities (Note 13)	2,067	2,122
TOTAL CURRENT LIABILITIES	20,385	23,373
Long-term debt (Note 11)	33,804	30,852
RESERVES AND OTHER LIABILITIES:		
Deferred income taxes	40	252
Other liabilities (Note 14)	7,167	4,139
Employee termination indemnities (Note 15)	1,364	1,296
TOTAL LIABILITIES	62,760	59,912
STOCKHOLDERS EQUITY:		
Share capital (Note 16)	8,845	8,854

Additional paid-in capital (Note 17)	3,765	88
Reserves, retained earnings (deficit) and profit (loss) of the year (Note 17)	(970)	7,150
TOTAL STOCKHOLDERS EQUITY BEFORE MINORITY INTERESTS	11,640	16,092
Minority interests	8,984	4,497
TOTAL STOCKHOLDERS EQUITY	20,624	20,589
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**83,384**	**80,501**

The accompanying notes are an integral part of these financial statements

Table of Contents

TELECOM ITALIA S.P.A.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2001, 2002 AND 2003

	2001	2002	2003
		(millions of euro)	
Operating revenues	32,016	31,408	30,850
Other income (Note 19)	476	504	345
Total revenues	**32,492**	**31,912**	**31,195**
Cost of materials	2,640	2,315	2,081
Salaries and social security contributions	4,919	4,737	4,303
Depreciation and amortization	7,612	7,227	6,779
Other external charges (Note 20)	12,687	12,188	11,934
Changes in inventories	92	62	114
Capitalized internal construction costs	(583)	(675)	(805)
Total operating expenses	**27,367**	**25,854**	**24,406**
Operating income	**5,125**	**6,058**	**6,789**
Financial income (Note 21)	1,446	1,569	992
Financial expense (Note 22)	(6,559)	(4,647)	(3,256)
Other income and (expense), net (Note 23)	(3,109)	(5,496)	(1,083)
Income (loss) before income taxes and minority interests	**(3,097)**	**(2,516)**	**3,442**
Income taxes (Note 24)	(579)	2,210	(1,014)
Net income (loss) before minority interests	**(3,676)**	**(306)**	**2,428**
Minority interests	586	(467)	(1,236)
Net income (loss)	**(3,090)**	**(773)**	**1,192**

The accompanying notes are an integral part of these financial statements

Table of Contents

TELECOM ITALIA S.P.A.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2001, 2002 AND 2003

	2001	2002	2003
		(millions of euro)	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss) after minority interests	(3,090)	(773)	1,192
Adjustments to reconcile net income (loss) after minority interests to net cash provided by operating activities:			
Minority interests	(586)	467	1,236
Depreciation and amortization	7,612	7,227	6,779
Change in deferred tax assets, net	(531)	(2,836)	(611)
Losses (gains) on disposal of fixed assets and other investments	(373)	(2,243)	139
Write-down of fixed assets and other investments	3,753	4,387	1,188
Provision for employee termination indemnities	224	216	200
Payment of employee termination indemnities	(152)	(187)	(251)
Change in operating assets and liabilities:			
Receivables	(46)	475	1,030
Inventories	107	277	158
Payables, trade and others	520	(700)	(1,608)
Accrued payroll and employee benefits	(170)	34	175
Net change in other assets and liabilities	1,451	3,471	294
NET CASH PROVIDED BY OPERATING ACTIVITIES	**8,719**	**9,815**	**9,921**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investments in fixed assets	(4,317)	(3,291)	(3,111)
Additions to intangible assets	(2,914)	(1,610)	(1,783)
Additions to other investments	(3,363)	(1,563)	(694)
Acquisition of investments in consolidated subsidiaries, net of cash acquired	(913)	(374)	(599)
Cash paid for tender offers			(5,274)
Net change in marketable securities	(361)	1,909	(1,497)
Proceeds from disposal of investments in consolidated subsidiaries, net of cash disposed of		33	2,997
Proceeds from sale or redemption value of tangible and intangible assets, and other investments	1,484	5,736	768
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	**(10,384)**	**840**	**(9,193)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in short-term debt	(7,855)	(2,245)	3,786
Net change in long-term debt	10,262	(3,943)	(2,952)
Paid-in capital in consolidated subsidiaries	2,660	94	33
Dividends paid on income and reserves to minorities	(2,461)	(3,668)	(1,049)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	**2,606**	**(9,762)**	**(182)**
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(7)**	**(173)**	**(35)**

NET INCREASE IN CASH AND CASH EQUIVALENTS	**934**	**720**	**511**
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	**2,772**	**3,706**	**4,426**
CASH AND CASH EQUIVALENTS, END OF THE YEAR	**3,706**	**4,426**	**4,937**
SUPPLEMENTAL CASH FLOW DISCLOSURES:			
Interest paid	2,147	1,836	2,016
Income taxes paid	2,080	725	957

The accompanying notes are an integral part of these financial statements

Table of Contents

TELECOM ITALIA S.P.A.

STATEMENTS OF CONSOLIDATED STOCKHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2001, 2002 AND 2003

	Attributable to Telecom Italia				Attributable to minority interest	
	Share Capital	Additional Paid in Capital	Reserves, retained earnings (deficit) and net income (loss) of the year	Total	Reserves, retained earnings (deficit) and net income (loss) of the year	TOTAL
			(millions of euro)			
BALANCE AS OF JANUARY 1, 2001	**6,914**	**3,196**	**3,746**	**13,856**	**17,510**	**31,366**
Dividend distribution			(255)	(255)	(2,206)	(2,461)
Conversion of Olivetti 1998-2002 bonds	9		(4)	5		5
Exercise of Olivetti common shares 1998-2002 warrants	4		(2)	2		2
Exercise of 1999-2001 Olivetti stock option plan	17	12	(8)	21		21
Share capital increase in March 2001	349	557		906		906
Share capital increase in November 2001	1,492			1,492		1,492
Cancellation of Telecom Italia savings shares			(277)	(277)	(434)	(711)
Effect of change in method of accounting for the investments in the Nortel Inversora Group					(837)	(837)
Entel Chile group acquisitions					358	358
Translation adjustments and other			69	69	(181)	(112)
Net loss for the year 2001			(3,090)	(3,090)	(586)	(3,676)
BALANCE AS OF DECEMBER 31, 2001	**8,785**	**3,765**	**179**	**12,729**	**13,624**	**26,353**
Dividend distribution					(2,357)	(2,357)
Extraordinary dividend distribution of reserves					(1,311)	(1,311)

Conversion of Olivetti 1998-2002 bonds	29		(14)	15		15
Exercise of Olivetti common shares 1998-2002 warrants	23		(11)	12		12
Exercise of 1999-2001 Olivetti stock option plan	5			5		5
Conversion of Olivetti 2001-2010 bonds	3			3		3
Translation adjustments and other			(351)	(351)	(1,439)	(1,790)
Net income (loss) for the year 2002			(773)	(773)	467	(306)
BALANCE AS OF DECEMBER 31, 2002	**8,845**	**3,765**	**(970)**	**11,640**	**8,984**	**20,624**
Dividend distribution					(1,049)	(1,049)
Conversion of Telecom Italia 2001-2004 bonds		1		1		1
Conversion of Telecom Italia 2001-2010 bonds	14	6		20		20
Exercise of stock option plan	6	17		23		23
Absorption of the accumulated deficit of Telecom Italia (formerly Olivetti)		(3,701)	3,701			
Exercise of the withdrawal rights by shareholders of the company, cancellation of the Old Telecom Italia treasury stocks as well as the Old Telecom Italia shares recorded under current assets in the 2002 financial statements	(11)		(168)	(179)	(938)	(1,117)
Merger impact			3,424	3,424	(3,424)	
Disposal of New SEAT					(126)	(126)
Translation adjustments and other			(29)	(29)	(186)	(215)
Net income for the year 2003			1,192	1,192	1,236	2,428
BALANCE AS OF DECEMBER 31, 2003	**8,854**	**88**	**7,150**	**16,092**	**4,497**	**20,589**

The accompanying notes are an integral part of these financial statements

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Form and Content of the Consolidated Financial Statements

Form and Content

The consolidated financial statements of Telecom Italia S.p.A. (**Telecom Italia**) and its consolidated subsidiaries (collectively the **Group**) are prepared on the basis of the accounts of Telecom Italia and the financial statements of the individual consolidated companies as of December 31, 2003 as approved by their respective Boards of Directors, adjusted, where necessary, to conform with the accounting policies adopted by Telecom Italia. As fully described below, these financial statements take into account the effects of the merger, as defined, of Telecom Italia S.p.A. and its consolidated subsidiaries as it existed prior to the effective date of the Merger (Old Telecom Italia) with and into Olivetti S.p.A. (Olivetti) (the **Merger**), as well as the related transactions. 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. ; for accounting and tax purposes the Merger was effective as from January 1, 2003. Olivetti was a listed company on the Italian Stock Exchange.

The accounting policies are consistent with the Italian law related to consolidated financial statements interpreted and integrated by the accounting principles established or adopted by the Italian Accounting Profession (collectively, **Italian GAAP**).

Italian GAAP differs in certain material respects from U.S. generally accepted accounting principles (**U.S. GAAP**). The effects of these differences on stockholders equity as of December 31, 2002 and 2003 and on the consolidated net results for the each of the three years in the period ended December 31, 2003 are set forth in Note 27.

The consolidated financial statements and related notes are presented in a reclassified format, which differs from Telecom Italia s financial statements and disclosures which are prepared in accordance with Italian legal requirements. The format presented does not result in any modification of the portions attributable to Telecom Italia stockholders equity and net income (loss) as reported on an Italian GAAP basis.

The consolidated financial statements of the Group include the accounts of Telecom Italia and all Italian and foreign subsidiaries in which Telecom Italia holds, directly or indirectly, more than 50% of the voting capital or has dominant influence (effective control) of the entity. The equity method of accounting is used for affiliated companies and other investments in which the Group has significant influence; generally this is represented by a level of voting control of at least 20% and not more than 50%. The purchase price paid over the fair value of the net assets acquired for affiliates and equity investees is amortized over its useful live. Investments held at a less than 20% level are accounted for at historical cost. The Group has made a number of acquisitions and disposals over the past three years that have had an impact on the comparability of the accompanying financial statements. To assist the reader of these financial statements and related notes with comparability, the Group has disclosed certain financial information throughout these footnotes to highlight those changes.

In 1999, Olivetti, through its 72.9% owned subsidiary, Tecnost S.p.A. (**Tecnost**), made a tender offer for the majority of the Old Telecom Italia ordinary shares. The transaction was announced at the end of February 1999, when Tecnost and Olivetti declared their intention to proceed with a joint public tender and exchange offer for 100% of Telecom Italia ordinary shares. The tender offer took place in May 1999 and was completed on June 23, 1999, giving Tecnost a 52.12% controlling interest in Old Telecom Italia ordinary shares. The tender offer was financed through a combination of cash, bonds and shares for a total acquisition price of 31,501 million. The cash component, accounting for a total of 18,955 million, was financed mainly through: (i) the disposal to Mannesman by Olivetti of its stake in OliMan (controlling the telecommunication companies Omnitel and Infostrada), (ii) a share capital increase, and (iii) borrowings under a bank facility, reimbursed in July 1999 with the issuance of two tranches of notes under an Euro Medium Term Note Program. The bond component, amounting to 7,944 million, was represented by Floating Rate Notes offered in exchange to shareholders tendering the Old Telecom Italia shares. The shares component, valued at 4,602 million, was represented by new Tecnost shares issued and offered in exchange to tendering shareholders. During 1999, Tecnost increased its controlling interest in Old Telecom Italia to 54.16% acquiring an additional interest of 2.04%, as a result of certain cash transactions. Total consideration amounted to approximately 32,506 million, including direct acquisition costs. The excess of the purchase price over the adjusted net book value of assets acquired, amounting to approximately 26,208 million, was allocated to goodwill and amortized over a period of 20 years. The

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

adjustments to the net book value of the assets acquired to determine the excess purchase price related principally to: i) the recognition of the estimated minimum liability to the Italian National Social Security Agency (see Notes 14 and 18) in connection with the telephone workers social security obligations and the related tax effect, ii) the elimination of goodwill recorded in the accounts of Old Telecom Italia, and iii) dividends subsequently paid.

In 2000, to rationalize the organizational structure of the Olivetti Group, the 72.9% owned subsidiary Tecnost was merged into Olivetti. The merger was announced on May 15, 2000 and the Boards of Directors of the companies involved in the merger, with the assistance of their advisors, fixed an exchange ratio of 1.12 Olivetti shares for each Tecnost share, both with a par value of 1.00 per share. No cash consideration was involved. The merger was effective from December 31, 2000, with the cancellation of all the Tecnost shares previously held by Olivetti and with the issue of 1,999,439,092 Olivetti shares, par value 1.00, to minority shareholders in exchange for their 1,785,213,475 Tecnost shares. The merger was accounted for at book value. Included in the minority shareholders was Olivetti s subsidiary, Olivetti International S.A., which owned 3.2% of the issued and outstanding Tecnost shares which were obtained in exchange for Olivetti shares (thus becoming treasury shares at the Olivetti consolidated level) carried at a total value of 391 million, the original book value of the Tecnost shares (for further details as of December 31, 2003, see Note 10).

As of December 31, 2001 and 2002 Olivetti owned 2,850,255,432 Old Telecom Italia ordinary shares, equal to 54.17% and 54.16%, respectively, of total Old Telecom Italia ordinary shares and to 38.97% and 38.96%, respectively, of total share capital.

The Merger

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 s ordinary shares with the aim of focusing on core businesses, improving the corporate structure of the Group and reducing its debt. Immediately prior to the Merger and the cash tender offers described below, Olivetti had a 54.94% controlling interest in Old Telecom Italia; such increase in ownership was due to the reclassification during the first quarter of 2003 of 41,401,250 Old Telecom Italia ordinary shares from marketable securities to other long-term assets in connection with the merger with Old Telecom Italia, which provided for the cancellation of all Old Telecom Italia shares held by Olivetti. Before the Merger, Old Telecom Italia 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 Securities Exchange Act of 1934 (the Exchange Act) registration of Old Telecom Italia and became subject to the foreign private issuer reporting requirements of the Exchange Act. Telecom Italia completed the listing of its Ordinary Share American Depositary Shares (ADSs) and Savings Share ADSs on the New York Stock Exchange concurrently with the effectiveness of the Merger. Telecom Italia s Ordinary Shares and Savings Shares are also listed on the automated screen-based trading system (Mercato Telematico Azionario) of the 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 under Italian law due to the change in the corporate objectives of Olivetti, which were adopted in connection with the approval of the Merger. Olivetti shareholders exercised such right with respect to 10,958,057 shares representing 0.12% of the outstanding ordinary shares. Those Olivetti shareholders received an aggregate payment of 10,940,524 when the Merger became effective.

- Voluntary cash tender offers (from June 23, 2003 to July 18, 2003) 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).

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 cash consideration paid for the tender offers was 5,274 million.

The Merger resulted in the cancellation of Olivetti s investment in Old Telecom Italia. Olivetti s share capital, as of the date the Merger became effective, was redistributed on the basis of changing the par value of the shares (from 1.00 to 0.55), of the share capital being allocated to ordinary and savings shares (the savings shares being introduced in the new by-laws of the surviving company as a result of the Merger) and of the necessity to maintain the nominal value of the share capital unchanged on conclusion of the Merger. After the allocation, the capital of the company resulting from the Merger was distributed to the shareholders of Olivetti and those of Old Telecom Italia on the basis of a distribution ratio which reflected the exchange ratio of Olivetti s shares with the ordinary and savings shares of Old Telecom Italia (7 Olivetti ordinary shares, of par value 1.00 each for every ordinary share of Old Telecom Italia of par value 0.55 each and 7 Olivetti savings shares, of par value 1.00 each for every savings share of Old Telecom Italia of par value 0.55 each). The re-distribution of Olivetti s share capital consisted of the allocation of Olivetti s share capital, as the surviving company in the Merger, among the shareholders of Olivetti and Old Telecom Italia, on the basis of the so called natural exchange ratio, that is, the approximate ratio between the market prices of the two entities stock for an extended period of time immediately prior to the Merger announcement.

The aforementioned exchange ratio was met by redistributing the capital of Olivetti resulting at the time the Merger was completed, after changing the par value of the ordinary and savings shares of Olivetti to 0.55 (equal to the par value of the shares of Old Telecom Italia, in lieu of the original par value of 1.00). Accordingly, starting on August 4, 2003, the issued shares of Olivetti and Old Telecom Italia were withdrawn and new shares of the company resulting from the Merger, Telecom Italia, were issued according to the following ratio:

i) 0.471553 Telecom Italia ordinary shares of par value 0.55 for each Olivetti ordinary share of par value 1.00;

ii) 3.300871 Telecom Italia ordinary shares of par value 0.55 for each Old Telecom Italia ordinary share of par value 0.55;

iii) 3.300871 Telecom Italia savings shares of par value 0.55 for each Old Telecom Italia savings share of par value 0.55.

In accordance with the combined provisions of articles 2504-bis, paragraph 3, and 2501-bis, paragraph 1, point 6, of the Italian Civil Code, the Merger was accounted for by Olivetti beginning January 1, 2003, the date also considered for tax purposes, pursuant to article 123, paragraph 7, of D.P.R. (Presidential Decree) No. 917 dated December 22, 1986.

Following the above transactions, the share capital of Telecom Italia resulting from the Merger was equal to 8,845,640,559.40 divided into 10,287,061,839 ordinary shares and 5,795,921,069 savings shares, all with a par value of 0.55 each.

For Italian GAAP purposes the Merger was accounted for at the historical values taken from the financial statements of the companies that were merged. The Merger differences (excess of the carrying value of the investment of Olivetti in Old Telecom Italia over the net equity of Old Telecom Italia and the exchange surplus arising from the application of the mechanism for the redistribution of the shares described above) were accounted for as follows:

i) excess of the carrying value of the investment over the net equity, equal to a total of 4,801 million (net of 240 million amortization) was recorded in the line item *goodwill* since it represented the goodwill paid for the acquisition of an additional stake in a company already consolidated. This difference is being amortized over 20 years;

ii) exchange surplus arising from the application of the mechanism for the redistribution of the shares described above: the Merger gave rise to an increase in Telecom Italia interest in shareholders equity of 3,424 million with a reduction, of the same amount, in minority interest.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As Old Telecom Italia was fully consolidated in each of the years included in these financial statements, the financial data for the year 2003 is comparable to the financial data for the previous years.

The significant changes in the composition of the Group in 2003, 2002 and 2001 are as follows:

Year 2003

- In January 2003, the procedures were completed for the early purchase of 12 property units (totaling about 300,000 square meters) from Teleleasing S.p.A. that are used by Telecom Italia S.p.A. and other Telecom Italia Group companies under lease contracts (the Dedalo project). The deal involved a total financial payment of approximately 369 million for the entire Telecom Italia Group.

Following a binding offer by the 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 the most of above mentioned property units, with a sale price of approximately 355 million; Telecom Italia moreover signed lease agreements on the same units to guarantee their utilization. On June 30, 2003, all property units subject to the binding offer were concentrated into a vehicle company, FMP Italy 1 S.r.l. , 100% owned by Telecom Italia. On July 21, 2003, the entire FMP Italy 1 s.r.l. stake was transferred from Telecom Italia to Lastra Holding B.V. for 45,000.

- On February 20, 2003, Telecom Italia International N.V. executed a Share Purchase Agreement (SPA), for the sale of its entire ownership in Telekom Srbija, corresponding to 29% of the Telekom Srbija s 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, however, remain deposited in an escrow account until full payment of the remaining 75 million is received, which constitutes the second tranche of the transaction.

- On April 1, 2003, the Board of Directors of SEAT, a controlled subsidiary of Telecom Italia, 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. The shares of both companies are listed on the automated screen-based trading system (Mercato Telematico Azionario) of Borsa Italiana.

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 Old Telecom Italia Group was expected to receive after the spin-off transaction creating New SEAT, including the shares resulting from the exercise of the J.P. Morgan Chase put option for which Old Telecom Italia paid 2,272 million in 2003. 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 consideration New SEAT s net financial indebtedness (defined as long-term debt and short-term debt less cash and cash equivalents, maketable debt securities and financial receivables) 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.

The agreements relating to the sale of Telecom Italia s stake in New SEAT include Telecom Italia s commitment to Telecom Italia Media to provide, on an ongoing basis, 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 commitment provides for Telecom Italia Media to have funds sufficient to meet such liabilities and indemnifies New SEAT from potential liabilities to any creditors of Telecom Italia Media deriving from New SEAT s statutory joint liability for such obligations.

- In September 2003, the acquisition of 100% of the stake in HanseNet Telekommunikation GmbH (HanseNet), a broadband operator in the Hamburg, Germany area, from e.Biscom was finalized by Telecom Italia for a total investment of 243 million.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Year 2002

- In February 2002, Olivetti and Finsiel S.p.A. accepted the tender offer from Tyche S.p.A. (De Agostini group), for their 34% investment in Lottomatica S.p.A.. Total proceeds were 391 million, which contributed a 105 million gain to the consolidated net result of the Telecom Italia Group.

- In March 2002, the Group disposed of its 19.61% stake held by TIM International in BDT (Bouygues Decaux Telecom), parent company of the French operator Bouygues Telecom, generating proceeds of 750 million, which contributed a 104 million gain to the consolidated net result of the Telecom Italia Group.

- On June 28, 2002, TIM International N.V. disposed of its entire 25% stake in the Mobilkom Austria group to Telekom Austria (a company 14.78% owned by Telecom Italia International as of December 31, 2002), generating proceeds of 756 million, which contributed a 25 million gain to the consolidated net result of the Telecom Italia Group.

- On July 31, 2002, Finsiel disposed of its 100% stake in Sogei to the Ministry of Economy and Finance, which had the effect of reducing the Old Telecom Italia Group net financial debt by 176 million.

- On August 1, 2002, the Group concluded the sale of Auna to Endesa, Union Fenosa and Banco Santander Central Hispano. The transfer of the entire 26.89% interest held by the Telecom Italia Group resulted in proceeds of 1,998 million and contributed 402 million to the consolidated net result of the Telecom Italia Group.

- On August 1, 2002, the Group sold the 40% interest held in Telemaco Immobiliare to Mirtus, an indirect subsidiary of the American real estate fund Whitehall promoted by the Goldman Sachs group, for net proceeds of 192 million. The net gain realized by the Telecom Italia Group was 25 million.

- On August 26, 2002, the Group completed, with the Louis Dreyfus Communication Networks Group (LDCom), the sale of the Telecom Italia Group s investment in 9Télécom and the concurrent purchase of approximately 7% of LDCom by the Telecom Italia Group. The net impact on the Telecom Italia Group s results was a loss of 104 million. LDCom was part of the Louis Dreyfus Group, a leading French holding company with international operations in telecommunications, energy, oil, maritime and agricultural commodities trading.

- In August 2002, TIM International N.V., a subsidiary of TIM, purchased from the Verizon Europe Holding II group, a 17.45% stake in the share capital of Stet Hellas, in which it already owned a 63.95% interest, for a price of 108 million. The transaction, which in effect makes TIM International N.V. the only industrial partner and strategic shareholder in the company, falls within the framework of the Group s strategy to rationalize its international portfolio and consolidate its position in the Mediterranean Basin.

- On October 7, 2002, TIM finalized the preliminary contract signed on August 7, 2002 with the Blu S.p.A. shareholders for the purchase of 100% of the company, subsequently merged with TIM S.p.A.. The deed of merger was registered on December 18, 2002; on the same date the definitive price of 83 million was established. The merger became effective on December 23, 2002.

- On October 29, 2002, the transaction envisaged by the framework agreement between Pirelli, the Group and the Morgan Stanley Real Estate Funds was finalized, allowing the integration of certain of the real estate properties of the companies involved, as well as the entities that provide real estate services to the same companies or to their subsidiaries. Under the framework agreement the Group transferred assets to Tiglio I and Tiglio II in various corporate forms. The market value of these assets was 1,585 million, of which 50 million was related to Seat Pagine Gialle, approximately 1,310 million to real estate from Old Telecom Italia and approximately 225 million for Olivetti. The transaction had a net impact on the consolidated statement of operations of approximately 121 million for the Group.

- In November 2002, the Group finalized the agreement that was initially signed on August 2, 2002 with Finmeccanica for the sale of Telespazio (the satellite service provider of the Group). The total impact on the net financial debt of the Group was 239 million with a net gain for the Group of 14 million.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- In November 2002, Telecom Italia International N.V. closed the private placement of 75 million Telekom Austria A.G. shares. The placement price was set at 7.45 per share, generating gross proceeds of 559 million and a net loss of 53 million. After this transaction, Telecom Italia Group s stake in Telekom Austria decreased from 29.78% to 14.78%.

- On November 22, 2002, Old Telecom Italia disposed of its 45% stake in IMMSI to Omniapartecipazioni S.p.A. for a consideration of 69 million.

Year 2001

- In December 2001, Old Telecom Italia s stakes in the former satellite consortia companies Eutelsat, Intelsat, Inmarsat and New Skies Satellites were transferred to a new company (Mirror International Holding S.a.r.l., **Mirror**), of which 70% was subsequently acquired by the Lehman Brothers Merchant Banking II L.P. closed fund with a minority stake acquired by IntesaBci S.p.A. (now Banca Intesa S.p.A.) and Interbanca. As a result of the sale, Telecom Italia received 450 million in cash and recorded in the consolidated financial statements a capital gain, before taxes, of 170 million. The remaining interest in Mirror is accounted for using the equity method of accounting.

- In December 2000, the Old Telecom Italia Group signed an agreement to increase its investment in Entel Chile from 26.16% to 54.76% by purchasing shares held by the Chilquinta and Matte groups in a cash transaction. Entel Chile operates in the sectors of fixed and mobile telephone services, data- transmissions and Internet-access services. The overall cost of the acquisition was U.S.$905 million, with the acquisition completed in the early months of 2001.

The following significant operations were consolidated in the statement of operations during their year of disposal, as follows:

- during the fiscal year 2003, New SEAT was consolidated in the statement of operations for the period from January 1, 2003 to July 31, 2003;

- during the fiscal year 2002, the following have been consolidated in the statement of operations: the 9Télécom group for the period from January 1, 2002 to June 30, 2002; the Telespazio group for the period from January 1, 2002 to September 30, 2002 and the company Sogei for the period from January 1, 2002 to June 30, 2002.

Note 2 Regulation

The legal framework for the regulation of the telecommunications sector in Italy was substantially revised in 2003 with the incorporation of the EU Directives of the review package (the Framework directive together with three others on Access , Authorization and Universal Service , collectively referred to as the Code). In this regard, 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, effective since September 16, 2003, 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 Presidential Decree No. 318 of September 19, 1997, 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 threshold 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 ;

F-12

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- 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 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.

Note 3 Accounting Policies

The principal accounting policies applied are as follows:

Consolidation

The consolidation principles applied by Telecom Italia are as follows:

- The assets and liabilities of the companies consolidated on a line-by-line basis are included in the consolidated financial statements after eliminating the carrying value of the investments against the related stockholders equity.

- Differences arising on elimination of the investments against the fair value of the related stockholders equity of the subsidiaries at the date of acquisition are treated as follows:

  - if positive, they are recorded as goodwill in intangible assets and amortized on a straight line basis over the estimated period of benefit but not to exceed a period of 20 years. During 2003, the residual period of benefit of the unamortized goodwill, which resulted from the acquisition of the controlling interest in Old Telecom Italia by Olivetti in 1999 was reconsidered. Specifically, the residual period of benefit of goodwill was extended from 16.5 years to 20 years beginning from January 1, 2003. This extension aligns the residual period of benefit to the period of benefit (20 years) determined on the additional goodwill that emerged following both the tender offers launched by Olivetti for the ordinary and savings shares of Old Telecom Italia, and the reclassification, from current to long-term, of the shares held by Olivetti in Old Telecom Italia which were subsequently cancelled as a result of the Merger. This change in the period of benefit of the residual goodwill resulted in a decrease in the amortization charge of 227 million;

  - if negative, they are recorded in stockholders equity as consolidation reserve , or, when the amount is due to expectations of unfavorable financial results, to other liabilities (consolidation reserve for future risks and charges) .

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- All significant intercompany transactions are eliminated, together with the unrealized intercompany profits included in inventory.
- Unrealized intercompany profits, included in fixed assets and intangible assets, which arise from intraGroup sales of goods and services at market prices are eliminated, along with the related tax effects. Such sales, net of intercompany profits, are reclassified under the heading of capitalized internal construction costs in the accompanying consolidated statements of operations.
- Accruals and adjustments made in the individual financial statements of the consolidated companies in accordance with the current tax legislation in order to obtain tax benefits otherwise not obtainable are eliminated.
- The minority stockholders share of the equity and net income (loss) of consolidated subsidiaries, calculated using financial statements reflecting the Telecom Italia Group s accounting principles, are classified separately in the consolidated stockholders equity and the statement of operations for the year.

The financial statements expressed in foreign currency have been translated into Euro by applying the average annual exchange rate to the individual items of the statement of operations and the year-end exchange rate to the items of the balance sheet. The difference arising from the translation of beginning stockholders equity and the net result for the year at the year-end exchange rate is recorded in the reserves under consolidated stockholders equity.

For those consolidated subsidiaries and affiliated companies that use inflation accounting to eliminate distorting effects of inflation on the financial statements, these inflation adjusted financial statements have been translated at the year-end exchange rates for inclusion in the consolidation. For the year 2003, the companies in the Group that apply inflation accounting principles are Corporacion Digitel C.A. (Venezuela), Finsiel Romania S.R.L. (Romania), Mediterranean Nautilus Telekomunikasyon Hizmetleri Ticaret A.S. (Turkey) and Is TIM Telekomunikasyon Hizmetleri A.S. (Turkey).

Cash and cash equivalents

Cash and cash equivalents represent highly liquid investments that are readily convertible to cash and have original maturities of ninety days or less.

Securities

Debt securities included under current assets are valued at the lower of cost of acquisition or net realizable value based on market prices.

Debt securities acquired under repurchase agreements , for which the obligation exists to resell them at maturity, are included under current assets at purchase cost. The difference between the sales price and the purchase price is allocated to the statement of operations as it accrues.

Debt securities classified under non current assets (other assets) are held to maturity and recorded at purchase cost adjusted for the unamortized discount or premium. They are also adjusted for any permanent impairment in value.

Equity investments considered long-term in nature are recorded under non current assets (other assets) or, if acquired for subsequent sale, recorded under current assets.

Equity investments included under current assets, consisting mainly of shares of consolidated listed subsidiaries anticipated to be sold, are stated at the lower of cost and realizable value, based on the year-end stock market prices.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Contracts for the loan of securities are represented in the financial statements as two functionally related transactions: a loan and a repurchase transaction on the securities with the obligation of the borrower to resell them at maturity. Accordingly, other current assets and short term debt include, respectively, a receivable and a payable of the same amount at the fixed amount of the contract.

Other long-term equity investments are recorded at acquisition or subscription cost, including incidental costs, adjusted for any reasonable expectations of a decline in profitability or recoverability in future years.

In the case of a permanent impairment, the value of long-term equity investments is written down and the impairment in value in excess of the corresponding carrying value is recorded under reserves and other liabilities other liabilities (reserve for contract and other risks and charges) .

Write-downs of securities are reversed if the reason for the write-down no longer exists. The subsequent reversal of the previous write-down cannot exceed the original carrying value.

Accounts receivable and payable

Accounts receivable and payable are recorded at their nominal value. Where required, provisions are made to write-down the receivables to their estimated realizable value. The Group generally does not require collateral for receivables subject to credit risk.

Identifiable individual risks are accounted for through appropriate individual valuation adjustments, and general credit risks through general valuation adjustments of receivables. Low-interest and non-interest bearing items with more than one year to maturity are discounted.

Foreign currency transactions

Monetary assets and liabilities denominated in foreign currencies have been recorded at the exchange rate in effect at the date of the transaction; such assets and liabilities denominated in foreign currencies are remeasured at the prevailing rate at the balance sheet date, and any resulting unrealized losses are charged to the statement of operations as financial expense and unrealized gains are credited to the statement of operations as financial income .

Inventories

Inventories are valued at the lower of cost or market. Cost is determined using the LIFO method for raw materials and finished products; the manufacturing cost for work in progress and semi-finished products and the weighted average method for purchased finished goods. Provisions are made for potential losses on obsolete or slow-moving raw materials, finished products and other inventories, taking into account their expected future use and estimated realizable value.

Fixed assets

Fixed assets are stated at purchase or construction cost including directly related costs and attributable expenses. The values are periodically adjusted in those jurisdictions where the assets are located that allow or require monetary revaluations.

F-15

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets using the following annual rates applied to the historical or revalued costs:

Buildings	3 - 7%
Telecommunication systems and equipment	3 - 33%
Machinery and installations	20 - 33%
Industrial and commercial equipment	15 - 25%
Other fixed assets	6 - 33%

Construction in progress is stated at cost. Ordinary repair and maintenance costs are charged to the statement of operations in the year they are incurred. Alterations and major overhauls that extend the life or increase the capacity of the asset are capitalized.

Retirements, sales or disposals of assets are recorded by removing the cost and accumulated depreciation from the accounts with any resulting gain or loss reflected in the statement of operations.

Capital grants

Capital grants provided by the Italian government or other public agencies in connection with investments in fixed assets are recorded in the year the grant is formally approved and, in any event, when the right to their receipt is definite. The grants are not subject to any restriction as to use and may not be reclaimed by the government. Capital grants are included in deferred income and recorded in the statement of operations in connection with the gradual depreciation of the assets they refer to.

Intangible assets

Intangible assets are recorded at cost, and amortized on a straight line basis over the period of expected future benefit as follows:

Licenses, trademarks and similar rights	Contract duration
Goodwill	Years of benefit
Software	Principally in 3 years
Leasehold improvements	The shorter of the period of future economic benefit or the residual lease period

Software costs capitalized represent only those costs associated with the development of new software or the enhancement of software when additional functionality is provided. The Company applies the same policy in accounting for web site development costs and for costs of computer software developed or obtained for internal use. All costs of maintaining existing software, costs for the enhancement of software that does not provide for additional functionality, and costs pertaining to the preliminary stage of software development are expensed as incurred.

Write-down of long-lived assets

The Group periodically evaluates potential impairment loss relating to long-lived assets (fixed assets, intangible assets, including goodwill, and equity investees) when a change in circumstances occurs by assessing whether permanent diminution in value has occurred. Impairment is recognized if the recoverable amount falls below its carrying value. In that event, an impairment loss is recognized based on the amount by which the net carrying value exceeds the recoverable amount, pursuant to Article 2426, Section 1, item 3 of the Italian Civil Code. Write-downs are reversed if the reason for the write-down no longer exists.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee termination indemnities

The amount of this reserve is determined in accordance with current laws and collective bargaining agreements. The reserve for termination indemnities shown in the consolidated balance sheets reflects the total amount of the indemnities, net of any advances taken, that each employee in the Italian consolidated companies would be entitled to receive if termination were to occur as of the balance sheet date.

Reserves for risks and other charges

Reserves for risks and other charges are recognized when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefit will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Research and development costs

Research and development costs are charged to the statement of operations as incurred. In 2001, 2002 and 2003 gross research and development costs charged to the statement of operations (before revenue grants) amounted to 204 million, 151 million and 148 million, respectively.

Advertising Expenses

Advertising expenses are charged to the statement of operations as incurred.

Revenue grants

Revenue grants represent contributions against operating costs mainly provided by the government or other public agencies in connection with research and development costs. They are recorded in the statement of operations in the year they are formally approved and, in any event, when the right to their receipt is definite.

These grants are not subject to any restriction as to use and they may not be reclaimed by the government. Revenue grants are included in other income and are recorded as part of total revenues in the accompanying statement of operations.

Recognition of revenues and expenses

Revenues and expenses are recorded on the accrual basis.

Revenues are recorded in the statements of operations as follows:

(i) for telecommunication services companies (both fixed and mobile providers), in the year in which the services are provided. Revenues from telecommunication traffic are reported gross of the amounts belonging to other operators and service providers; the amounts due to the other operators are recorded under operating expenses (other external charges).

Certain revenues deriving from fixed telephone and mobile services are billed in advance and are recognized when services are provided. Revenues deriving from other telecommunications services, principally network access, long distance, local and wireless airtime usage, are recognized based on minutes of traffic processed or contracted fee schedules. Revenues from installation and activation activities are recognized at the date of the installation or activation;

(ii) for IT software and services and other activities, on the basis of the services rendered during the year; and

(iii) revenues of the Internet and Media segment are primarily derived from advertising and publishing (the latter discontinued on August 1, 2003), sale of office and related products, and internet access and related services. Revenues from the sale of advertising and publishing are recognized in the statement of operations according to the date of publication, which corresponds to the time at which the directories are printed and delivered. Advertising revenue from on-line services is recorded on the date the on-line advertisement is posted to the related web site and advertising revenue from television is recorded on the date at which the advertisement is shown. Revenues from the sale of office and related products are recognized when title transfers, which generally corresponds to the date when products are shipped. Revenues from internet access and related services, primarily subscription services, are recognized over the subscription period on a straight line basis.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Capitalization of interest policy

Interest on construction projects is capitalized when specific borrowings can be attributed to the project.

Income taxes

The companies within the Group are required to pay taxes on a separate company basis. Income taxes currently payable, recorded in accrued income taxes, are provided on the basis of a reasonable estimate of the tax liability for the year of all consolidated companies.

The Group also recognizes deferred income tax assets and liabilities that are determined under the liability method. Deferred income taxes represent the tax effect of temporary differences between the tax and financial reporting bases of assets and liabilities, using enacted tax rates, and the expected future benefit of net operating loss carry-forward. The tax benefit of tax loss carry-forwards is recorded only when there is a reasonable expectation of realization.

Deferred tax assets and deferred tax liabilities are offset whenever allowed by local tax laws.

No deferred taxes are established on certain equity reserves, as management s intent is not to distribute these reserves. Taxes would need to be provided for on these reserves if management expects to utilize or distribute them in the future.

Accounting for leases

Assets covered by finance lease contracts are recorded in fixed assets and depreciated from the date of the lease contract. The corresponding liability is allocated between short and long-term debt. The interest element of financial leases and the related depreciation charge are recorded in the statement of operations. Depreciation is calculated on the same basis as that for similar owned assets.

All other leases are accounted for as operating leases.

Financial derivatives

Financial derivative contracts are used by the Group to hedge exposure to interest rate and foreign currency exchange risks.

For financial instruments used to hedge interest rate risks, the interest differentials are recorded in the statement of operations in financial income or financial expense based on the accrual principle. The fair values of the outstanding contracts at year-end are not reflected in the accompanying financial statements.

For financial instruments used to hedge exchange rate risks, the cost (or financial component calculated as the difference between the rate at the date of entering into the contract and the forward rate) is recorded in the statement of operations in financial income or financial expense based on the accrual principle.

Premiums collected (paid) on the sale or purchase of put and call options are classified under other payables or receivables due from others . If the option is exercised, the premium collected (paid) is treated as an accessory component of the strike price of the underlying instruments; if the option is not exercised, the premium collected (paid) is recorded under financial income (financial expense). Put and call options are valued consistently with the underlying asset and liability positions and any net expense connected with each single transaction is recognized in the statement of operations.

Put and call options outstanding at year-end are stated at the lower of cost or market value at the balance sheet date.

Securitization of accounts receivable

Upon the sale of receivables to TI Securitization Vehicle S.r.l. (the **Vehicle**), the underlying receivables are removed from the balance sheet. The difference between the carrying value of the receivables sold and the

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

consideration received (including the deferred consideration under the deferred purchase price) is charged on the accrual basis to the consolidated statement of operations in other external charges or in financial expense . All expenses to initiate and operate the program are charged to other external charges . The notes issued under the program are not included in the consolidated balance sheet of Telecom Italia, as they are considered to be legal obligations of the Vehicle (see Note 5).

Note 4 Cash and Cash Equivalents and Marketable Securities

Cash and Cash Equivalents

	As of December 31,	
	2002	2003
	(millions of euro)	
Bank and postal accounts	4,363	4,870
Cash and valuables on hand	7	7
Receivables for securities held under reverse repurchase agreements	56	60
	4,426	**4,937**

Bank and postal accounts consist mainly of funds on deposit in Italian and foreign banks in current accounts. As of December 31, 2003, 160 million was reserved for as a guarantee provided by Royal Bank of Scotland to Mediobanca on behalf of Aria-Is TIM Telecom Italia s mobile investment in Turkey. Therefore, as of December 31, 2003 a total of 160 million (498 million as of December 31, 2002) in cash was restricted. This guarantee was released in February 2004.

Marketable Securities

	As of December 31,	
	2002	2003
	(millions of euro)	
Marketable equity securities	472	878

Marketable debt securities	1,628	2,719
	2,100	**3,597**

As of December 31, 2003, marketable equity securities included 170 million of equity investments in consolidated subsidiaries related to listed shares purchased for trading and 708 million related to the investment held in Telekom Austria which was sold in January 2004. As of December 31, 2002, marketable equity securities included 299 million of Old Telecom Italia ordinary shares and 169 million of equity investments in other consolidated subsidiaries related to listed shares purchased for trading.

Marketable debt securities are mainly held by the Group finance companies in connection with trading activities. As of December 31, 2003, they consisted of acquired own notes held by Olivetti Finance (1,333 million) and Olivetti International (8 million), of other securities held by Olivetti International (500 million), Telecom Italia Finance (38 million), Olivetti Finance (76 million), Telecom Italia (16 million) and other companies (16 million) and of commercial paper held by Olivetti International (607 million) and Telecom Italia Finance (125 million). As of December 31, 2002, marketable debt securities included 278 million of securities held by the Old Telecom Italia Group (consisting of bank certificates of deposits held by the Tele Nordeste Celular group and of bonds held by Telecom Italia Finance) and 1,350 million for securities held by other Olivetti Group companies (in particular: bonds of 517 million, acquired own bonds of 649 million and other securities of 184 million).

The carrying values of certain marketable equity and debt securities have been written-down in aggregate by 14 million (259 million in 2002) to reflect market values at year end.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5 Receivables

	As of December 31,	
	2002	**2003**
	(millions of euro)	
Trade	8,966	7,905
Reserve for bad debt	(847)	(790)
	8,119	7,115
Affiliated companies and others	262	236
	8,381	**7,351**

Gross trade accounts receivable at December 31, 2003 totaled 7,905 million (8,966 million at December 31, 2002) and consist, for the most part, of receivables for telecommunications services. Receivables are adjusted to estimated realizable value through write-downs. Such write-downs mainly relate to the telecommunications companies. Trade accounts receivable are primarily held by Telecom Italia (4,021 million) and TIM (1,437 million). Trade accounts receivable decreased by 1,004 million compared to December 31, 2002 mainly as a result of the disposition of New SEAT and companies in the IT sector.

Trade accounts receivable also include 1,169 million of receivables from other telecommunications carriers.

In 2003, Telecom Italia, TIM and Olivetti Tecnost sold trade accounts receivable under non-recourse factoring arrangements in the amount of 3,873 million, of which 665 million was not yet due at December 31, 2003. In 2002 the Group sold trade accounts receivable under non-recourse factoring arrangements in the amount of 3,969 million, of which 585 million was not yet due at December 31, 2002.

During 2001, Old Telecom Italia began a program (the **Program**) for the securitization of receivables generated by the services rendered to the customers of the Telecom Italia Wireline (TIW) business unit and the customers of Path.Net (a wholly-owned subsidiary of Telecom Italia, which provides telephone services to the Italian Public Administration). The first tranche of 700 million of notes was issued in June 2001 by the Vehicle, a non-consolidated qualified special purpose vehicle for the Program which operates under Law No. 130/1999. The Program allows for the possibility of successive issues of notes, all with the same rights and risk profile, up to a total maximum amount of 2 billion. This program continued in 2002 and 2003.

The Program, regulated by the aforementioned law, allows the transfer of trade receivables, on a non-recourse basis, between Telecom Italia and Path.Net (assignors) and the Vehicle (assignee). The cash flows from the trade accounts receivable covered by the Program constitute the funds that the securitization vehicle uses to pay the interest and the principal to the noteholders. Within the framework of the Vehicle s disbursement plans and the time frame for the collection of the receivables, the sums received are also used to purchase new receivables generated by the normal operating activities of the assignors.

The price for this transaction, equal to the nominal value of the receivables, less a discount which takes into account the expenses that the Vehicle must bear, is paid to the respective assignor partly as an advanced purchase price, at the time of sale, and partly as a deferred purchase price. The deferred portion, which constitutes the credit enhancement under the Program, is paid to the assignor each time new receivables are sold, subject to the collection of the receivables, and is calculated by the rating agencies on the basis of pre-established estimates of the collection times and the amounts of the credit notes that will eventually be issued. Such estimates, and therefore also the deferred purchase price, is adjusted monthly on the basis of the effective performance of the receivables (i.e., a dynamic credit enhancement).

In regards to the risk of non-collectibility, the respective assignor is responsible for the ultimate recovery from the debtors on the receivables sold, up to the limit of the amount of the deferred purchase price. The Vehicle absorbs any uncollected amounts over the deferred purchase price.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The first issue of notes backed by the securitization of receivables (called Series 2001-1) of 700 million was divided into three classes having the following characteristics:

- Class A1: 100 million variable rate notes denominated in euro with a maturity of approximately 18 months (maturing January 25, 2003) with a margin of 19 basis points over the 3-month Euribor. On January 22, 2003, the Vehicle reimbursed the first tranche of notes denominated Series 2001-1, Class A1. At the same time, the Vehicle issued a new tranche of notes for the same amount denominated Series 2003-1, Class A1, at a variable interest rate with a 27 basis point margin on the 3-month Euribor maturing July 25, 2004;

- Class A2: 150 million variable rate notes denominated in euro with a maturity of approximately 3 years (maturing July 25, 2004) with a margin of 27 basis points over the 3-month Euribor;

- Class A3: 450 million variable rate notes denominated in euro with a maturity of approximately 5 years (maturing July 25, 2006) with a margin of 34 basis points over the 3-month Euribor.

At issuance these notes were rated by Fitch, Moody s and Standard & Poor s at AAA/Aaa/AAA, respectively. The high ratings reflect the quality and diversification of the underlying receivable portfolio, the element of over collateralization represented by the dynamic credit enhancement, the legal structure of the transaction and other qualifying aspects of the program.

The total amount of the trade accounts receivable sold under the securitization transactions in 2003 was 8.9 billion (9 billion in 2002) and solely referred to receivables from residential customers generated by Telecom Italia. As of December 31, 2003, the receivables sold and not yet collected amounted to 874 million (849 million as of December 31, 2002), of which 762 million (757 million as of December 31, 2002) were not yet due.

The securitization and the factoring arrangements led to an improvement in consolidated net financial debt as of December 31, 2003 of 1,201 million (1,046 million as of December 31, 2002), of which 851 million (826 million as of December 31, 2002) was due to the securitization Program.

Under the securitization Program, the Vehicle can invest the temporary excess liquidity from the Program by lending the excess cash to Telecom Italia. As of December 31, 2003, the balance of such loans to the Telecom Italia Group totaled 232 million (165 million as of December 31, 2002). The Telecom Italia Group has recorded these amounts as financial payables included under short term debt in the accompanying consolidated balance sheet.

Note 6 Inventories

	As of December 31,	
	2002	**2003**
	(millions of euro)	
Raw materials and supplies	30	24
Purchased finished goods	321	267
Work in progress and semi-finished products	206	127
Finished products	25	7
Advances to suppliers	2	1
	584	**426**

At December 31, 2003, inventories of 203 million (193 million as of December 31, 2002) are held by companies providing telecommunications services, 83 million (167 million as of December 31, 2002) by companies providing information technology services, 91 million by the Olivetti Tecnost group and 49 million by other minor subsidiaries.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7 Other Current Assets

	As of December 31,	
	2002	2003
	(millions of euro)	
Receivables from banks and other loans	958	796
Cash receipts in transit	98	91
Tax receivables	2,092	1,653
Deferred tax assets	2,151	1,841
Accrued income	367	495
Prepaid expenses	373	303
Other	1,067	1,008
	7,106	**6,187**

At December 31, 2003, receivables from banks and other loans are mainly due to the deferred purchase price due from the securitization Vehicle (370 million) and to a bond lending agreement (300 million) entered by Olivetti Finance N.V. with a financial institution, for which a short-term liability is also recognized for an equal amount.

The 439 million decrease in tax receivables is principally due to current tax receivables (482 million) at TIM which resulted at the end of 2002 as a consequence of excess taxes paid, as well as to the change in the scope of consolidation due to the disposal of New SEAT (110 million).

Deferred tax assets, including those under Other assets (see Note 10), increased from 4,190 million at December 31, 2002 to 5,013 million at December 31, 2003 mainly as a result of the recording of additional deferred tax assets, compared to those already recorded by Olivetti in the 2002 financial statements. Deferred tax assets increased as a result of the tax basis only write-down taken on the Old Telecom Italia investment by Olivetti in 2002. In 2003, the subsequent Merger allowed the full recovery of this asset.

Net deferred tax assets are detailed by component under Note 24 below.

Other current assets include miscellaneous receivables due from the Italian government and other public institutions and advances to personnel.

Note 8 Fixed assets, net

Fixed asset balances, net of accumulated depreciation and write-downs are detailed as follows:

	As of December 31, 2003							As of December 31, 2002
	Owned assets			Leased assets				
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value	Total Net Book Value	Total Net Book Value
	(millions of euro)							
Land and buildings	3,111	1,435	1,676	160	22	138	1,814	2,245
Telecommunications systems and equipment, machinery and installations	58,079	43,780	14,299	18	15	3	14,302	14,958
Industrial and commercial equipment	949	903	46				46	60
Other	1,996	1,435	561	65	29	36	597	691
Construction in progress and advances to suppliers	1,565		1,565				1,565	1,495
Total	**65,700**	**47,553**	**18,147**	**243**	**66**	**177**	**18,324**	**19,449**

F-22

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fixed assets, net decreased by 1,125 million compared to December 31, 2002, mainly as a result of the balance between investments and depreciation for the year 2003.

Accumulated depreciation covered 74.0% of gross fixed assets, compared to 71.8% at the end of 2002.

The decrease in leased assets from 537 million at December 31, 2002 to 177 million is due to the early purchase of certain fixed assets from Teleleasing, during January 2003, by Telecom Italia and other Group companies.

An analysis of movements in fixed assets for each of the years is as follows:

	As of December 31,	
	2002	2003
	(millions of euro)	
Balance, at the beginning of the year	**22,097**	**19,449**
Investments in fixed assets	3,291	3,111
Disposals	(541)	(404)
Depreciation (1)	(3,808)	(3,670)
Changes in consolidation area	(313)	(197)
Translation adjustments and other	(1,277)	35
Balance, at the end of the year	**19,449**	**18,324**

(1) A breakdown of depreciation is as follows:

	As of December 31,	
	2002	2003
	(millions of euro)	
Buildings	155	121
Telecommunications systems and equipment, machinery and installations	3,336	3,255
Industrial and commercial equipment	38	31
Other	279	263

	3,808	**3,670**

As of December 31, 2002, the item translation adjustments and other included 1,168 million for translation adjustments associated with the Mobile segment (674 million), the Entel Chile group (305 million), the Entel Bolivia group (111 million) and other minor subsidiaries (78 million).

A detail of investments in fixed assets by segment during each of the years is as follows:

	As of December 31,	
	2002	**2003**
	(millions of euro)	
Wireline	1,837	1,497
Mobile	1,075	1,244
South America	201	116
Internet and Media	28	32
IT Market	13	13
IT Group	83	106
Olivetti Tecnost	26	14
Other activities and intercompany eliminations	28	89
	3,291	**3,111**

F-23

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9 Intangible assets

	As of December 31,	
	2002	2003
	(millions of euro)	
Licenses, trademarks and similar rights	3,995	3,761
Goodwill	27,894	27,145
Software and other rights	1,269	1,850
Leasehold improvements	222	166
Work in progress and advances	832	742
Other	200	189
	34,412	**33,853**

- Licenses, trademarks and similar rights are primarily attributable to the Mobile segment (3,413 million), mainly in respect to the remaining unamortized cost of UMTS and PCS licenses (of which 2,417 million relate to TIM), and other Telecom Italia Group companies (348 million), principally for Indefeasible Rights of Use (IRU) that have been granted to the Group and capitalized. Licenses, trademarks and similar rights decreased by 234 million mainly due to the impairment of the installed fiber optic ring by Latin America Nautilus for 235 million.

- Goodwill decreased by 749 million compared to December 31, 2002 (net of amortization and write-downs). The change in goodwill was mainly due to increased goodwill recorded following the tender offers by Olivetti for the shares of Old Telecom Italia (4,551 million), the reclassification of the shares of Old Telecom Italia from current assets to intangibles made by Olivetti prior to the merger (250 million), as well as to the exercise of the J.P. Morgan Chase put option (428 million), but these increases were more than offset by the reduction in goodwill due to the disposal of New SEAT and its subsidiaries (a total of 3,506 million), as well as the amortization (1,835 million) and the write-downs during the period (754 million). These write-downs were principally related to TI Media (348 million), Entel Chile (195 million) and Corporacion Digitel (132 million).

As of December 31, 2003, the residual amount of goodwill is detailed as follows:

	(millions of euro)
Old Telecom Italia	24,845
TIM	688
TI Media	516
Entel Chile	485

Holding Media e Comunicazione	144
Corporacion Digitel	113
Other companies	354
	27,145

- Software and other rights principally include software for telecommunications services.

- Work in progress and advances relate primarily to costs of developing software projects incurred by Telecom Italia, mainly for internal use.

Changes in intangible assets during the years 2002 and 2003 are as follows:

	2002	**2003**
	(millions of euro)	
Balance, at the beginning of the year	**39,220**	**34,412**
Goodwill	346	5,096
Other additions	1,610	1,783
Amortization	(3,419)	(3,109)
Write-downs	(2,004)	(1,022)
Disposals, translation adjustments and other	(1,341)	(3,307)
Balance, at the end of the year	**34,412**	**33,853**

F-24

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2003 and 2002 other additions mainly related to capitalization of costs for telecommunications software.

The write-downs made in 2003 are substantially related to goodwill already detailed above. In 2002, write-downs were principally attributable to Seat Pagine Gialle goodwill.

Note 10 Other assets

	As of December 31,	
	2002	**2003**
	(millions of euro)	
Equity investments in:		
• Affiliated companies	2,101	955
• Other companies	475	506
• Advances on future capital contributions		9
Total Investments	2,576	1,470
Treasury stock	393	393
Other securities	304	12
Deferred tax asset	2,039	3,172
Other receivables	1,614	779
	6,926	**5,826**

Investments in affiliated companies (2,101 million and 955 million, respectively, as of December 31, 2002 and 2003) comprised:

	As of December 31,	
	2002	**2003**
	(millions of euro)	

Aria Is TIM.		
Etec S.A.	467	392
GLB Serviços Interativos	13	
IM.SER	12	
Italtel Holding	43	35
LI.SIT Lombardia Integrata		49
Mirror International Holding	94	48
Netco Redes	22	24
Solpart Participações	142	
Sky Italia (formerly Stream)	19	44
Telekom Austria	708	
Telekom Srbija	187	
Tiglio I	242	234
Tiglio II	74	78
Other	78	51
	2,101	**955**

The investment held in Aria Is TIM was completely written-off in 2002; furthermore, the reserve for risks and charges include a provision related to Aria Is TIM of 572 million for the guarantees provided by the Group to financial institutions on behalf of Aria Is TIM. Such provision will be reassessed as soon as the effects from the merger between the two operators Aria Is TIM and Aycell are available.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Investments in affiliated companies as of December 31, 2003 decreased by 1,146 million compared to December 31, 2002, as a result of the following:

	(millions of euro)
Balance, at the beginning of the year	**2,101**
Additions	417
Disposals	(33)
Valuation using equity method (*)	(493)
Reclassifications	(1,037)
Balance, at the end of year	**955**

(*) Includes the share of earnings or losses for the period, amortization of goodwill and adjustments on the translation of foreign currency financial statements.

The investments valued by the equity method include the remaining unamortized portion of goodwill relating to such investments (101 million, compared to 504 million as of December 31, 2002). As of December 31, 2003, goodwill is mainly associated with Etec S.A. for 94 million.

Additions of 417 million mainly relate to equity investments in Sky Italia (formerly Stream) for 324 million, LI.SIT Lombardia Integrata for 54 million and Mirror International Holding for 24 million.

Reclassifications, during the year 2003, of 1,037 million primarily relate to:

- current assets of certain equity investments in affiliated companies, since they were earmarked for sale within twelve months. These reclassifications were related to Telekom Austria (708 million), which was sold in January 2004, and Telekom Srbija (187 million), which was sold in July 2003;
- other companies, under other long-term assets, of Solpart Participações (which has indirect control of Brasil Telecom), as a result of the sale of 18.29% of its ordinary share capital to Timepart Participações and to Techold Participações. Such a sale involved a reduction of the Group s stake in Solpart Participações from 37.29% to 19% of ordinary share capital. The amount reclassified was equal to 142 million.

Investments in other companies (475 million and 506 million, respectively, as of December 31, 2002 and 2003) are comprised of:

	As of December 31,	
	2002	2003
	(millions of euro)	
Mediobanca	113	113
Solpart Participações		111
LDCom	51	51
Cirsa	81	41
MCC	36	36
Euskaltel	61	27
Consortium	20	20
Fin. Priv.	15	15
Pirelli Real Estate		15
Forthnet	8	14
Intelsat	14	12
Sia	11	11
Other	65	40
	475	**506**

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Treasury stock originally referred to 214,628,828 Olivetti shares (now 101,208,867 Telecom Italia ordinary shares after the redistribution of the share capital in connection with the Merger), comprising 2,697,500 Olivetti shares (now 1,272,014 Telecom Italia shares) held by Telecom Italia, which had been purchased in previous years, and originally 211,931,328 Olivetti shares (now 99,936,853 Telecom Italia shares) held by Olivetti International S.A., which had been received in exchange for the shares of Tecnost S.p.A. following the merger by incorporation of Tecnost S.p.A. with and into Olivetti in 2000.

Other securities decreased by 292 million from December 31, 2002, essentially due to the cancellation, upon the Merger, of the ordinary and savings shares held as treasury stock by Old Telecom Italia (287 million).

Other receivables decreased by 835 million mainly as a result of the exercise of the JP Morgan put option on Seat Pagine Gialle shares in 2003 in connection with the demerger and sale of New SEAT which included a charge to the statement of operations for the residual amount of the capitalized premium paid, as well as the write-down of receivables from equity investee Aria Is TIM through the utilization of part of the reserve for risks and charges (279 million) recorded in 2002. Other receivables include receivables from affiliated companies, the tax receivable from the prepayment of tax on the reserve for employee severance indemnities, loans to employees, loans to third parties (including the receivable from PTT Srbija arising from the disposal of Telekom Srbija), security deposits and the cost of 49 million for the call options acquired on the share capital of Sofora Telecomunicaciones S.A. (Sofora).

Note 11 Financial Debt

	As of December 31, 2002	As of December 31, 2003		
	Total	Denominated in euro	Denominated in Foreign currency	Total
Short-term debt(1)	6,827	10,137	476	10,613
Long-term debt	33,804	26,393	4,459	30,852
	40,631	**36,530**	**4,935**	**41,465**

(1) Including current portion of long-term debt.

The total financial debt increased by 834 million compared to the end of 2002, after the distribution of profits and reserves (1,049 million), the payment for the early exercise of the JP Morgan Chase put option on Seat shares (2,272 million) and the repayment in advance (3,800 million) of a portion of the financings incurred in 2003 in connection with the voluntary partial cash tender offers made by Olivetti for a portion of the Old Telecom Italia shares (5,274 million). The repayment was made with a portion of the net proceeds of a note offering completed in October 2003. The total financial debt as of December 31, 2003 was reduced by cash-flows from operations as well as by the effects of the spin-off and sale of the investment in New SEAT (3,681 million).

The portion of financial debt due beyond one year as a percentage of total debt decreased from 83% at December 31, 2002 to 74% at December 31, 2003. Short-term debt at December 31, 2003 included current portion of long-term debt of 9,289 million (3,450 million at December 31, 2002), of which 1,500 million related to an outstanding series of Telecom Italia floating rate notes (with original maturity on June 21, 2005) which on March 22, 2004 was fully repaid in advance.

As of December 31, 2003, the amount of unutilized bank lines of credit was 9,110 million (9,081 million as of December 31, 2002). Approximately 98% of these lines of credit were denominated in Euro and had varying interest rates.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial debt denominated in foreign currency as of December 31 of each year is as follows:

	2002	2003	2002	2003
	(millions of foreign currency)		(millions of euro)	
U.S.$	1,073	4,952	1,023	3,921
GBP	271	56	417	79
BRL (Brazil)	1,072	675	290	185
CLP (Chile)	200,848	201,266	266	269
NUEVO SOL (Perù)	258	101	70	23
YEN	42,302	37,139	338	275
Other			112	183
			2,516	**4,935**

A grouping of the financial debt by interest rates is as follows:

	As of December 31,	
	2002	2003
	(millions of euro)	
Up to 2.5%	4,779	9,241
From 2.5% to 5%	15,941	17,745
From 5% to 7.5%	17,370	11,810
From 7.5% to 10%	738	1,371
Over 10%	935	613
	39,763	40,780
Non-interest bearing	868	685
	40,631	**41,465**

As of December 31, 2003, the non-interest bearing financial payables relate to certain agreements entered into by Olivetti Finance N.V. with a financial institution for the lending of bonds.

Long-term debt as of December 31, 2003 classified by maturity is as follows (in millions of euro):

2004 (current portion of long-term debt)(1)	9,289
2005	2,008
2006	6,497
2007	3,545
2008	2,641
Beyond 2008	16,161
	40,141

(1) 1,500 million was repaid on March 22, 2004 with the proceeds of long-term borrowing.

Long-term debt includes notes issued by the Group in order to reduce its dependence on short-term debt, lengthen the average life of its financial debt and diversify its investor base. The Group has issued long-term debt in the capital markets under, among the others, the Olivetti Euro Medium Term Note Program (the EMTN Program) and the Telecom Italia Global Medium Term Note Program, the net proceeds of which have been used to repay short-term debt.

In July 1999, the Group (formerly the Olivetti Group) established the EMTN Program, as updated and amended on June 8, 2001 and May 14, 2002, which allows for the issuance of a total amount of 15 billion in debt (or the equivalent in other currencies), at various terms, rates and maturities.

Furthermore, at the end of 2000, the Old Telecom Italia Group established a Global Medium Term Note Program, which allowed for the issuance of a total amount of U.S.$10 billion in debt (or the equivalent in other

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

currencies), at various terms, rates and maturities. On December 18, 2001, the Old Telecom Italia s Board of Directors authorized the increase of the above-mentioned Global Medium Term Note Program up to U.S.$12 billion.

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 voted to set-up a Euro Medium Term Note Program for a maximum amount of 10 billion. These notes can be issued by Telecom Italia and/or its subsidiary Telecom Italia Finance, with a guarantee by Telecom Italia.

Financial debt consists of the following:

	As of December 31,			
	2002	2003		
	Total	Long-term debt	Short-term debt(1)	Total
	(millions of euro)			
Debt to banks	5,776	1,182	1,278	2,460
Debt to other financial institutions	1,970	670	342	1,012
Convertible notes	7,401	5,597	1,715	7,312
Notes and bonds	24,404	23,323	6,730	30,053
Payables to associated companies	406	23	19	42
Note payables	241			
Suppliers	21	4	5	9
Other	412	53	524	577
	40,631	**30,852**	**10,613**	**41,465**

(1) Including current portion of long-term debt.

- Debt to banks of 2,460 million, decreased by 3,316 million compared to December 31, 2002. Certain bank borrowings are secured by collateral of 149 million mainly related to Maxitel. Furthermore, TIM has pledged Digitel shares as a guarantee for a credit facility granted to the same company in 2002.

- Debt to other financial institutions, of 1,012 million, decreased by 958 million compared to December 31, 2002. This debt is mainly related to:

- short-term loans received by Telecom Italia from TI Securitisation Vehicle S.r.l. from the excess liquidity generated by the securitization of receivables (233 million);

- loans received by Telecom Italia from the Cassa Depositi e Prestiti (213 million);

- a loan contract received by Telecom Italia Finance (originally Olivetti International Finance N.V.) from a Japanese investor, maturing on October 29, 2029, and originally set up in the form of notes (174 million).

- Convertible notes of 7,312 million, decreased by 89 million compared to December 31, 2002 and are detailed as follows:

  - notes 2001-2004 issued by Telecom Italia S.p.A. (originally Olivetti) for a face value of 1,267 million convertible into Telecom Italia (originally Olivetti) shares, with an annual fixed-rate coupon of 1.5% and a premium on redemption of 105.07759% of the issue price (2.6 per note), maturing in January 2004. As of December 31, 2003, those notes represented a total liability of 1,331 million. The annual yield upon maturity was 3.25% and the conversion was at a rate of 0.471553 newly issued Telecom Italia shares for each note held;

  - notes 2001-2010 issued by Telecom Italia S.p.A (originally Olivetti) for a face value of 2,390 million convertible into Telecom Italia (originally Olivetti) shares, with an annual fixed-rate coupon of 1.5% and a premium on redemption of 118.37825% of the issue price, maturing in January 2010. As of December 31, 2003, those notes resulted in a total liability of 2,829 million. The annual yield upon maturity is 3.5% and the conversion will be at a rate of 0.471553 Telecom Italia shares for each note held;

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- 2,500 million notes originally issued in March 2001 by Sogerim (merged in 2002 into Telecom Italia Finance), convertible into TIM or Seat Pagine Gialle shares, with the right of the issuer to pay off the amount due in cash. The spin-off transaction and the subsequent disposal of the equity investment in the beneficiary company, New SEAT, did not result in any changes in the terms of the notes since the terms and conditions contemplated possible dispositions for purposes of settlement. These are five-year notes and can be redeemed by the note holders before maturity at the end of the third year after issue. The notes decreased in September 2002 by 536 million due to the purchase in the market by Telecom Italia Finance of a portion of the notes, which were subsequently cancelled, therefore leaving a balance of 1,964 million at December 31, 2003;

- zero-coupon notes 2002-2004 issued by Olivetti Finance N.V. for 385 million maturing in March 2004. The notes were convertible into 136,656,060 newly issued Telecom Italia ordinary shares (exercise price of 2.8174 per share), with the right of the issuer to pay off the amount due in cash;

- notes 2000-2005 issued by Olivetti Finance N.V. for 708 million, redeemable in Telecom Italia ordinary shares, with the right of the issuer to pay off the amount due in cash, an annual fixed-rate coupon of 1% and a premium on redemption of 113.41% of the issue price, maturing in November 2005. Those notes, which, accordingly, result in a total liability of 803 million, are convertible into 153,584,699 shares (exercise price of approximately 4.61 per share). The annual yield upon maturity is 3.5% and the conversion will be at a rate of 216.825865 newly issued Telecom Italia shares for each 1,000 note held.

Original Currency	Amount (million)	Coupon	Convertible into shares of	Issue date	Maturity date	Issue price (%)
Convertible notes issued by Telecom Italia S.p.A.						
Euro	1,331	1.50%	TI S.p.A.	03/09/01	01/01/04	100
Euro	2,829	1.50%	TI S.p.A.	11/23/01	01/01/10	100
Convertible notes issued by Telecom Italia Finance S.A. guaranteed by Telecom Italia S.p.A.						
Euro	1,964	1.00%	TIM / TI Media	03/15/01	03/15/06	100
Convertible notes issued by Olivetti Finance N.V. guaranteed by Telecom Italia S.p.A.						
Euro	385	0.00%	TI S.p.A.	09/20/02	03/19/04	100
Euro	803	1.00%	TI S.p.A.	11/03/00	11/03/05	100
Total	**7,312**					

- Notes and bonds of 30,053 million, increased by 5,649 million compared to December 31, 2002 and are detailed as follows:

Notes and bonds issued by Telecom Italia S.p.A. (a total of 4,215 million)

- floating rate notes of 1,500 million issued by Old Telecom Italia (the first issue under the Global Medium Term Note Program with Old Telecom Italia as the issuer). The maturity date was June 21, 2005 and the issuer may redeem the notes at an earlier date at face value beginning from the end of the second year and at every coupon date for interest thereafter; these notes were repaid in advance, at par, on March 22, 2004 in accordance with a resolution approved by the Telecom Italia Board of Directors on February 17, 2004;

- notes issued by Old Telecom Italia, on February 1, 2002 in the principal amount of 2,500 million, divided into two tranches of 1,250 million each, at fixed interest rates, maturing on February 1, 2007 and February 1, 2012, respectively. The issue was part of the Global Medium Term Note Program ;

- notes 2002-2022 reserved for subscription by employees, in service and retired, of companies directly and indirectly controlled by Telecom Italia S.p.A., with headquarters in Italy, for 215 million.

Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A. (total of 7,564 million)

- notes originally issued by Sogerim (merged in 2002 into Telecom Italia Finance S.A.) on international markets in the principal amount of 6,000 million. The issue was divided into three tranches: 1,000

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

million of floating rate notes, maturing on April 20, 2004; 3,000 million of fixed-rate notes, maturing on April 20, 2006; 2,000 million of fixed-rate notes, maturing on April 20, 2011;

- notes 1999-2009 issued by Telecom Italia Finance S.A. (originally Olivetti International N.V.) in the principal amount of 1,500 million with an annual fixed-rate coupon of 5% + a 0.15% step-up, maturing in February 2009;
- notes in Swiss Francs 1986-2046 issued by Telecom Italia Finance S.A. (originally Olivetti International N.V.) in the principal amount of CHF 100 million (64 million) with an annual fixed-rate coupon of 5.625%, maturing in June 2046.

Notes and bonds issued by Olivetti Finance N.V. and guaranteed by Telecom Italia S.p.A. (a total of 14,898 million)

- notes 1999-2004 issued by Olivetti Finance N.V. (originally Olivetti International Finance N.V.) in the principal amount of 4,200 million with an annual fixed-rate coupon of 5 3/8% + a 0.45% step-up, maturing in July 2004. On March 26, 2004, 650 million of these notes were cancelled by Olivetti Finance N.V. after their buy-back; consequently the outstanding debt decreased to 3,550 million. The effect of this cancellation has already been reflected in the 2003 consolidated financial statements;
- notes 2002-2005 issued by Olivetti Finance N.V. in the principal amount of 200 million with a floating rate coupon indexed to EONIA (Euro OverNight Index Average) plus 1.45%, maturing in February 2005. On March 26, 2004, these notes were cancelled by Olivetti Finance N.V. after their complete buy-back. The effect of this cancellation has already been reflected in the 2003 consolidated financial statements;
- notes 2002-2005 issued by Olivetti Finance N.V. in the principal amount of 500 million with a quarterly coupon indexed to the Euribor 3-month rate + 130 basis points, maturing in March 2005. The noteholder has the option to extend the maturity for successive periods of 21 months up to a total maximum tenor of 10 years;
- notes 2002-2006 issued by Olivetti Finance N.V. in the principal amount of 1,100 million with a quarterly coupon indexed to the Euribor 3-month rate plus a spread of 1.25%, maturing in January 2006;
- notes 2002-2007 issued by Olivetti Finance N.V. in the principal amount of 1,750 million with an annual fixed-rate coupon of 6.5%, maturing in April 2007;
- notes 2003-2008 issued by Olivetti Finance N.V. in the principal amount of 1,750 million with an annual fixed-rate coupon of 5.875%, maturing in January 2008;
- notes 1999-2009 issued by Olivetti Finance N.V. (originally Olivetti International Finance N.V.) in the principal amount of 2,350 million with an annual fixed-rate coupon of 6 1/8% + a 0.45% step-up, maturing in July 2009;

- notes 2002-2012 issued by Olivetti Finance N.V. in the principal amount of 1,000 million with an annual fixed-rate coupon of 7.25%, maturing in April 2012;

- notes 2003-2013 issued by Olivetti Finance N.V. in the principal amount of 850 million with an annual fixed-rate coupon of 6.875%, maturing in January 2013;

- notes 2002-2032 issued by Olivetti Finance N.V. in the principal amount of Yen 20 billion (148 million) with a six-month fixed-rate coupon of 3.55%, maturing in May 2032 (callable by the issuer annually beginning from the tenth year);

- notes 2002-2032 issued by Olivetti Finance N.V. in the principal amount of 250 million with an annual fixed-rate coupon of 7.77%, maturing in August 2032;

- notes 2003-2033 issued by Olivetti Finance N.V. in the principal amount of 800 million with an annual fixed-rate coupon of 7.75%, maturing in January 2033.

All the above Olivetti Finance N.V. notes and bonds were issued under the EMTN Program.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A. (total of 3,168 million)

- issue of fixed-rate multi-tranche notes by Telecom Italia Capital S.A. in the principal amount of U.S.$4,000 million (3,168 million). The issue was divided into three tranches:
  - Series A notes in the principal amount of U.S.$1,000 million (792 million) with an annual fixed-rate coupon of 4%, maturing in November 2008;
  - Series B notes in the principal amount of U.S.$2,000 million (1,584 million) with an annual fixed-rate coupon of 5.25%, maturing November 2013;
  - Series C notes in the principal amount of U.S.$1,000 million (792 million) with an annual fixed-rate coupon of 6.375%, maturing November 2033.

Notes and bonds issued by Entel Chile (a total of 208 million)

- notes maturing between 2004 and 2023 issued by Entel Chile in the principal amount of 208 million.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the outstanding Group s notes and bonds as of December 31, 2003 broken-down by issuer.

Original Currency	Amount in original currency (million)	Amount in Euro (million)	Coupon	Issue date	Maturity date	Issue price (%)
Notes and bonds issued by Telecom Italia S.p.A.						
Euro	1,500	1,500	Euribor 3 months + 0.95%	12/21/01	06/21/05	99.837
Euro	1,250	1,250	5.625%	02/01/02	02/01/07	99.841
Euro	1,250	1,250	6.250%	02/01/02	02/01/12	98.952
Euro	215	215	Euribor 6 months	01/01/02	01/01/22	100
Sub-Total		**4,215**				
Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.						
Euro	1,000	1,000	Euribor 3 months + 1.125% **(a)**	04/20/01	04/20/04	99.514
Euro	3,000	3,000	6.125% **(a)**	04/20/01	04/20/06	99.937
Euro	1,500	1,500	5.15% **(b)**	02/09/99	02/09/09	99.633
Euro	2,000	2,000	7.00% **(a)**	04/20/01	04/20/11	99.214
CHF	100	64	5.625%	06/12/86	06/12/46	99.000
Sub-Total		**7,564**				
Notes and bonds issued by Olivetti Finance N.V. and guaranteed by Telecom Italia S.p.A.						
Euro	4,200	4,200	5.825%	07/30/99	07/30/04	99.786
Euro	200	200	EONIA + 1.45%	08/07/02	02/07/05	99.900
Euro	500	500	Euribor 3 months + 1.3%	03/14/02	03/14/05	100
Euro	1,100	1,100	Euribor 3 months + 1.25%	05/29/02	01/03/06	99.6673
Euro	1,750	1,750	6.500%	04/24/02	04/24/07	99.637
Euro	1,750	1,750	5.875%	01/24/03	01/24/08	99.937
Euro	2,350	2,350	6.575% **(c)**	07/30/99	07/30/09	99.272
Euro	1,000	1,000	7.25%	04/24/02	04/24/12	99.602
Euro	850	850	6.875%	01/24/03	01/24/13	99.332
JPY	20,000	148	3.550%	04/22/02	05/14/32	99.25
Euro	250	250	7.770%	08/09/02	08/09/32	100.2

Euro	800	800	7.750%	01/24/03	01/24/33	99.239
Sub-Total		**14,898**				
Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.						
USD	1,000	792	4.000%	10/29/03	11/15/08	99.953
USD	2,000	1,584	5.250%	10/29/03	11/15/13	99.742
USD	1,000	792	6.375%	10/29/03	11/15/33	99.558
Sub-Total		**3,168**				
Notes and bonds issued by Entel Chile						
CLP	156,820	208	From 5.93% to 8.06%	From 2000 to 2002	From 2004 to 2023	
Sub-Total		**208**				
Total		**30,053**				

F-33

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Protection mechanisms of step-up/step-down relating to the coupon of certain notes and bonds due to the changes in the rating

Certain of the notes and bonds we have issued provide certain protections to investors in the event that our debt ratings are downgraded. The ratings assigned to Telecom Italia by the various agencies are the following:

Standard & Poor s: BBB+, positive outlook

Moody s: Baa2, stable outlook

Fitch IBCA: A-, stable outlook

(a) Telecom Italia Finance S.A. Notes:

- 1,000 million, Euribor 3M + 1.125% interest, maturing April 2004
- 3,000 million, 6.125% interest, maturing April 2006
- 2,000 million, 7% interest, maturing April 2011

These notes carry protection for investors which would be triggered by a change in the rating assigned to Telecom Italia to below the Baa1/BBB+ ratings (by Moody s and S&P s, respectively): each reduction in the rating by one notch by each of the two agencies to below the stated thresholds would cause an increase in the interest coupon (or in the spread above Euribor in the case of floating-rate securities) of 0.25%, starting from the interest payment date subsequent to the downgrade in the rating. Any change in the rating is evaluated at the end of each interest period and, on the basis of the then applicable rating, the interest for the next coupon is fixed; therefore, changes in the ratings during the interest period would have no impact on the determination of the coupon except for the applicable ratings immediately prior to the beginning of the new interest period.

Therefore, the step-up/down will only be applied when the rating at the end of the coupon period is different from the rating at the end of the preceding coupon period.

As a result, these securities are currently subject to an 0.25% increase in interest due to the assignment of a Baa2 rating by Moody s in August 2003. In the case of the floating-rate security, this increase has been applied to the coupon for the period beginning October 2003; in the case of the two fixed-rate securities, the increase will be applied beginning with the interest period, which starts in April 2004.

(b) Telecom Italia Finance S.A. Notes: 1,500 million, 5.15% interest, maturing February 2009

These notes carry protection for investors which would be triggered by a downgrade in the minimum rating (among those assigned by the various agencies, specifically in reference to the Baa2 rating by Moody s).

At the beginning of every coupon period, this minimum rating will be checked, and depending upon the rating, the interest coupon will be fixed; once fixed, changes in the minimum rating during the interest period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of the interest coupon at issue (5%), a 0.15% increase in interest was granted to investors to the maturity date, bringing the current coupon interest rate to 5.15%.

This current coupon can be further increased in relation to the level of the minimum rating:

- if, at the time the interest coupon is fixed, the minimum rating is Ba1/BB+ or less, 1.50% will be added to the original coupon;
- if, at the time the interest coupon is fixed, the minimum rating is Baa3/BBB-, 0.5% will be added to the original coupon;
- higher levels of minimum ratings do not involve increases in the current coupon.

Therefore, only future downgrades in the minimum rating could cause an increase in the current coupon; this coupon cannot be reduced because of upgrades in the ratings.

F-34

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(c) Olivetti Finance N.V. Notes: 2,350 million, 6.575% interest, maturing July 2009

These notes carry protection for investors which would be triggered by a change in the minimum rating (among those assigned by the various agencies, specifically the Baa2 rating by Moody s).

At the beginning of each interest period, this minimum rating will be checked, and depending upon the rating, the interest coupon will be fixed; once fixed, changes in the minimum rating during the interest period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of interest at issue (6.125%), the coupon that will effectively be paid will be increased in relation to the level of the minimum rating:

- if, at the time the interest coupon is fixed, the minimum rating is Ba1/BB+ or less, 1.95% will be added to the original coupon;
- if, at the time the interest coupon is fixed, the minimum rating is Baa3/BBB-, 0.95% will be added to the original coupon;
- if, at the time the interest coupon is fixed, the minimum rating is Baa2/BBB, 0.45% will be added to the original coupon;
- higher levels of minimum ratings do not involve increases in the original coupon.

In line with this mechanism, starting October 2000 (date of the introduction of this mechanism), the original coupon was increased by 0.45% (reaching the current 6.575%).

Future upgrades/downgrades in the minimum rating might cause decreases/increases in the coupons according to the mechanism described above.

Financial covenants / other covenants / other features

The notes and bonds summarized above contain customary covenants and events of default but do not contain financial covenants or covenants which would force the notes to be repaid at an earlier date as a result of events other than the solvency of the Telecom Italia Group. However, certain of the Olivetti Group notes and bonds contain cross defaults to subsidiary indebtedness.

There are no clauses which would cause the notes to be repaid due to a downgrade in the ratings to below the established thresholds.

The guarantees provided by Telecom Italia S.p.A. on notes issued by foreign subsidiaries are all full and unconditional.

None of the notes summarized above carry any other interest rate structures or structural complexities.

Since these transactions have principally been placed with institutional investments on major world capital markets (the Euro market and the U.S.A.), the terms which regulate the notes are in line with the market practice for similar transactions effected on the same markets.

For the U.S.$4,000 million principal amount of Notes issued by Telecom Italia Capital S.A. in October 2003, guaranteed by Telecom Italia, there is a covenant requiring that Telecom Italia Capital and Telecom Italia complete an exchange offer registered with the SEC in order to allow investors to exchange their notes originally purchased for registered notes which will be freely saleable without restrictions. Should Telecom Italia Capital not complete the registered exchange offer by October 31, 2004, this would result in an increase in the coupon by 0.50% until the exchange offer was completed.

- Payables to associated companies, of 42 million, decreased by 364 million compared to the end of 2002 mainly due to the early redemption, in January 2003, of certain financial lease contracts with Teleleasing.

- Notes payable at December 31, 2003 were nil (241 million as of December 31, 2002) following the reimbursement by Seat Pagine Gialle on June 30, 2003 of investment certificates underwritten by Seat Pagine Gialle Finance S.r.l. under Law No. 130/99 on securitization.

- Other, of 577 million, decreased by 165 million compared to the end of 2002. The 2003 amounts were mainly due to the bond lending agreement (300 million) carried out by Olivetti Finance N.V., 58 million for medium/long-term financial debt relating to the agreement reached with the Tax Administration over the

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assessments received in 2002 by Telecom Italia as well as for the residual liability deriving from the tax amnesty requested under Law No. 289 dated December 27, 2002 and 83 million for the residual liabilities of the Mobile Business Unit on the UMTS license acquired in Greece and the GSM license acquired in Brazil.

Note 12 Payables, trade and other

	As of December 31,	
	2002	2003
	(millions of euro)	
Advances from customers	270	141
Trade payables	5,649	5,848
Payables to associated companies	259	146
Other taxes payable	628	592
Payables to customers	1,604	1,672
Other	1,860	263
	10,270	**8,662**

Advances from customers, which totaled 141 million, decreased by 129 million compared to December 31, 2002 due to the completion of the activities performed on behalf of Consorzio Telcal for the Telemaco Calabria Plan (103 million).

Trade payables increased by 199 million from December 31, 2002, mainly as a result of the growth in payables within Telecom Italia, the Mobile Business Unit as well as the IT Group Operating Activity, partly offset by the changes in the scope of consolidation due to the sale of New SEAT. This item also includes 573 million of amounts due to other telecommunications operators. Furthermore, the Tim group pledged Maxitel shares to guarantee the supply contract between Maxitel and Ericsson.

Other taxes payable amounted to 592 million and decreased by 36 million compared to December 31, 2002. This item includes indirect taxes and withholdings made by the companies as substitute taxpayers.

Payables to customers consist of deposits paid by customers and pre-billed basic subscriber charges, as well as prepaid traffic.

Other payables decreased from 1,860 million at December 31, 2002 to 263 million at December 31, 2003 and included payables for the telecommunications license fee totaling 24 million (1,394 million as of December 31, 2002). Such a decrease was due to the inclusion of payables for the telecommunications license fee at December 31, 2002. The fee has been declared incompatible with Community Law by the Court of Justice of the European Community, with regards to the measure introduced in national law by article 20 of Law No. 448/1998. The payable for the telecommunications license fee has been reversed to income in 2003.

Note 13 Other accrued liabilities

As of December 31, 2003 other accrued liabilities amounts to 2,122 million (2,067 million as of December 31, 2002). They consist of accrued expenses (primarily interest) of 1,168 million as of December 31, 2002 and 1,298 million as of December 31, 2003 and deferred income of 899 million as of December 31, 2002 and 824 million as of December 31, 2003. Deferred income includes, among other things, the pre-billed basic charges and rentals of telephone equipment and the deferred portion of capital grants received.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14 Other liabilities

	As of December 31, 2002	As of December 31, 2003
	(millions of euro)	
Reserve for taxes	344	152
Reserves for pensions and similar obligations	67	42
Reserve for restructuring costs	299	184
Reserve for forward purchase commitments (Put option on SEAT s shares)	1,942	
Reserve for risks and charges related to Aria Is Tim	850	572
Reserve for contract and other risks and charges	2,284	1,721
Payable to INPS and other accruals	1,381	1,468
	7,167	**4,139**

- The reserve for taxes mainly consists of estimated tax liabilities on positions still to be agreed upon or in dispute. The decrease of 192 million is principally due to the reclassification to deferred income taxes of the withholding tax related to financial companies.

- The reserves for pensions and similar obligations, amounting to 42 million (67 million at December 31, 2002), included the reserve for agents leaving indemnities and reserves for potential liabilities related to pension funds set up for the employees of certain foreign subsidiaries.

- As of December 31, 2003, the reserve for restructuring costs includes 121 million related to Telecom Italia.

- As of December 31, 2003, the reserve for forward purchase commitments was nil (1,942 million as of December 31, 2002) as a result of the early exercise of the JP Morgan Chase put option on Seat Pagine Gialle shares. This reserve was recorded in 2002 in connection with the costs to be incurred against the contractual commitments to acquire the additional Seat Pagine Gialle shares (see also Note 18).

- The reserve for risks and charges related to Aria Is TIM was originally recorded in 2002. The amount of 572 million included in this reserve at December 31, 2003 is against the guarantees provided by the Group to financial institutions on behalf of Aria Is TIM. An additional reserve of 279 million is included in other assets as a provision for a certain outstanding receivables from Aria Is TIM.

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The reserve for contract and other risks and charges (1,721 million as of December 31, 2003;   2,284 million as of December 31, 2002) includes:

- the reserves for contractual risks and other risks, related to Telecom Italia, in the amount of   496 million (946 million as of December 31, 2002), of which   456 million arises from operating activities and   40 million relates to extraordinary accruals for contractual risks, provided in previous years and in the current year. The decrease in the reserves for contractual risks and other risks was in part due to the reversal of the reserve for the telecommunication licensee fee to the statement of operations (112 million accrued at December 31, 2002), following the opinion of the Court of Justice of the European Community (see also Note 12);

- reserves related to the Digitel dispute (59 million) and TIM Celular (117 million), recorded by the Mobile Business Unit;

- reserves for the risks of technological revisions and future risks inherent in the regulatory framework of TIM for   404 million (453 million as of December 31, 2002);

- reserve of   194 million (124 million as of December 31, 2002) relating to the financial expenses for the premium on the redemption of notes issued by Telecom Italia Finance; and

- reserve for the losses of subsidiaries and affiliates of   184 million and for the expenses connected with extraordinary transactions of   266 million.

- Payable to the Italian Social Security Agency (**INPS**) and other accruals includes the non current portion of the contributions due to INPS for the remaining balance of the charges estimated pursuant to Law No. 58/1992 (see Note 18), as well as the deferred revenue from the capital grants provided by the government. Pursuant to Law No. 58/1992, Telecom Italia is required to provide full national insurance

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

coverage for all employees on the payrolls of STET, SIP, Italcable and Telespazio as of February 20, 1992, as well as for all employees transferred from the Public Administration to the former Iritel, through the Telephone Companies Employees Social Security Fund (Fondo Previdenza Telefonici, FPT) which on January 1, 2000 became part of the general Employees Pension Fund. This coverage also extends to previous periods of employment in other companies. The amounts due were calculated by the Italian National Social Security Agency (INPS) and are to be paid in 15 equal annual deferred installments (including annual interest of 5%), starting when INPS formally submits its requests. Subsequently, article 66 of Law No. 427/1993 ruled that these costs be recorded in the financial statements and deducted against taxes for the years in which the payments are made.

In accordance with Italian GAAP, a payable for an amount equivalent to the minimum estimated liability was initially recorded in the Olivetti Group s consolidated financial statements at the time of the allocation of the excess of the purchase price of the Old Telecom Italia acquisition in June 1999.

The amount of the liability is uncertain, since Telecom Italia and the INPS do not agree on the calculation methods to be used. The matter is being considered by the Courts.

In the 2003 Telecom Italia consolidated financial statements, the amount to be paid, net of payments up to December 31, 2003, has been revised consistently with the amounts already paid to INPS taking also into account the current status of the dispute with INPS.

The change in estimate involved a provision of 315 million recorded under other income and (expense), net .

Therefore, the principal amount of the liability attributable to Telecom Italia (excluding the part relating to the former Iritel employees) as of December 31, 2003 is 802 million (including the part under payables, trade and other). The accrued interest for the year 2003 (72 million) has been recorded under other income and (expense), net on the basis of the positions notified by INPS up to December 31, 2003 and its interpretation of the law.

A dispute concerning the application and interpretation of the Law No. 58/1992 arose with INPS regarding the exclusion from the estimates under this law of all employees (except for employees of the former Iritel) who had already filed an application to join pursuant to Law No. 29/1979 before February 20, 1992, even though that application had not been processed by INPS. The position of the Company is that the criteria set forth in Law No. 29/1979 and, therefore, payment of the respective obligations apply to these employees. At the present time, the parties have agreed that the differences in interpretation shall be settled through test appeals, with recourse to the Court of Appeals being waived for a final determination of the correct interpretation of the law in question. While the proceedings are pending, Telecom Italia has agreed to pay, with reservation, the amounts requested by INPS based on the criteria determined by the latter, subject to subsequent equalization adjustments, if the Courts ultimately accept the Company s interpretation. In this case, the principal amount of the liability, net of payments up to December 31, 2003 would decrease to 478 million.

Furthermore, the consolidated balance sheet includes 536 million (including the part under payables, trade and other) of residual payables to INPS relating to the estimate made for the employees of the former State Company for Telephone Services (ASST) by the special Ministerial Commission established under Law No. 58/1992 upon the transfer of the assets of the Post and Telecommunications Administration to the former Iritel, and recorded by the latter company in its financial statements at December 31, 1993.

Note 15 Employee termination indemnities

Under Italian labor laws and regulations all employees are entitled to an indemnity upon termination of their employment relationship for any reason. The benefit accrues to the employees on a pro-rata basis during their employment period and is based on the individuals salary. The vested benefit payable accrues interest, and employees can receive advances thereof in certain specified situations, all as defined in the applicable labor contract regulations. The reserve for termination indemnities shown in the consolidated financial statements reflects the total amount of the indemnities, net of any advances taken, that each employee would be entitled to receive if termination were to occur as of the balance sheet date.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The reserve for employee termination indemnities decreased by 68 million compared to the end of 2002, as a result of the followings:

	(millions of euro)
Balance, at the beginning of the year	**1,364**
Provision for the year	200
Utilizations:	
• indemnities paid	(212)
• advances	(16)
• pension funds	(23)
Other variations	(17)
Balance, at the end of the year	**1,296**

Other variations mainly refer to the changes in the scope of consolidation.

Note 16 Share capital

As of December 31, 2003, the share capital of Telecom Italia S.p.A. amounted to 8,854 million and consisted of 10,302,243,740 ordinary shares and 5,795,921,069 savings shares, all with a par value of 0.55 each.

At December 31, 2002, the share capital of the merging company Olivetti amounted to 8,845 million (including 200 thousand for capital increases that were awaiting registration in the Companies Register) and consisted of 8,845,439,830 ordinary shares of par value 1 each.

The increase in the year 2003 (including the effects of the merger) of 9 million was due to the following changes:

- Merger adjustments:
  - reduction in share capital by 11 million following the exercise of the withdrawal rights by shareholders of the company;

  - reduction in share capital of 3 thousand with a credit to the legal reserve for the roundings necessary for the redistribution of the shares upon the issue of new ordinary and savings shares of par value 0.55 each;

- other variations:

  - capital increases occurred before the Merger of par value 81 thousand following the conversion of 80,421 Telecom Italia 1.5% 2001 - 2004 convertible notes with a premium on redemption , as renamed after the Merger;

  - capital increases occurred after the Merger of par value 79 thousand following the conversion of 305,310 Telecom Italia 1.5% 2001 - 2004 convertible notes with a premium on redemption , as renamed after the Merger;

  - capital increases occurred before the Merger of par value 11 million following the conversion of 11,081,121 Telecom Italia 1.5% 2001 - 2010 convertible notes with a premium on redemption , as renamed after the Merger;

  - capital increases occurred after the Merger of par value 2 million following the conversion of 8,542,689 Telecom Italia 1.5% 2001 - 2010 convertible notes with a premium on redemption , as renamed after the Merger;

  - capital increase of par value 6 million following the warrants exercised for the stock option plans reserved for the employees of Company.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 17 Additional paid-in capital and reserves, retained earnings (deficit) and net income (loss) of the year

Additional paid-in capital

Additional paid-in capital at December 31, 2003 amounted to 88 million, with a decrease compared to December 31, 2002 of 3,677 million. The following movements contributed to the change in additional paid-in capital:

- decreases:
  - 3,401 million for the absorption of the 2002 loss of Telecom Italia S.p.A. (formerly Olivetti S.p.A.) as voted by the Shareholders Meeting of May 26, 2003;
  - 300 million for the absorption of the accumulated deficit of Telecom Italia S.p.A. (formerly Olivetti S.p.A.) as voted by the Shareholders Meeting of May 26, 2003;
- increases:
  - 129 thousand for the additional paid-in capital relating to the capital increases subscribed before the merger as a result of the conversion of 80,421 Telecom Italia 1.5% 2001 - 2004 convertible notes with a premium on redemption , as renamed after the Merger;
  - 714 thousand for the additional paid-in capital relating to the capital increases subscribed after the merger as a result of the conversion of 305,310 Telecom Italia 1.5% 2001 - 2004 convertible notes with a premium on redemption , as renamed after the Merger;
  - 6 million for the additional paid-in capital relating to the capital increases subscribed after the merger as a result of the conversion of 8,542,689 Telecom Italia 1.5% 2001 - 2010 convertible notes with a premium on redemption , as renamed after the Merger;
  - 17 million for the additional paid-in capital relating to the capital increases following the warrants exercised for the stock option plans reserved for the employees of Company.

Reserves, retained earnings (deficit) and profit (loss) of the year

	As of December 31,	
	2002	2003
	(millions of euro)	
Reserves and retained earnings (deficit)	(197)	5,958
Net income (loss) of the year	(773)	1,192
	(970)	**7,150**

Reserves, retained earnings (deficit) and net result of the year increased by 8,120 million compared to December 31, 2002. The increase was due to the effect of the Merger, offset by the reduction for the absorption of losses for the year 2002.

Included in reserves and retained earnings (deficit) are retained earnings of subsidiaries, legal reserves, revaluation reserves and the reserves held on a tax-deferred basis. No income taxes have been provided with respect to such reserves either because they are considered permanently reinvested in the subsidiaries or because the conditions, which could give rise to a tax liability, are not expected to occur. Legal reserves are not available for payment of dividends.

Note 18 Commitments, Guarantees and Contingent Liabilities

Purchase commitments

As of December 31, 2003, the Group had purchase commitments totaling 184 million (2,905 million as of December 31, 2002). The reduction in the purchase commitments of 2,721 million from December 31, 2002 was mainly due to the early exercise of the JP Morgan Chase put option on Seat Pagine Gialle shares.

F-40

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In particular, as of December 31, 2003, the purchase commitments included:

- Telecom Italia s commitment of 72 million for the purchase of buildings leased by Fintecna. On April 1, 2004, Telecom Italia exercised its right to buy all the property units;
- Telecom Italia International s commitment of 32 million in order to cover, on a proportional basis through capital increases, the residual amount due by Etec S.A. to the Cuban government in connection to the new license acquired;
- operating lease commitments, including the purchase option price, of 20 million (34 million as of December 31, 2002), of which 5 million (17 million as of December 31, 2002) relates to Teleleasing.

Furthermore, there were commitments for the purchase from the minority shareholders of the 49% stakes in Mediterranean Nautilus Ltd and Med-1 Submarine Cables Ltd based on the fair market value of these companies.

As of December 31, 2002, Old Telecom Italia s commitment for the put option on Seat Pagine Gialle shares amounted to 2,417 million. Under the contract agreed on March 15, 2000 (as subsequently amended), Old Telecom Italia gave Huit II a put option on 710,777,200 Seat Pagine Gialle shares at a strike price of 4.2 per share. The contract provided for the exercise of such option after the deed of merger between Seat Pagine Gialle and Tin.it was recorded in the Companies Register. Huit II later transferred the put option to JP Morgan Chase Equity Limited (JPMCEL), together with the ownership of the corresponding Seat Pagine Gialle shares. On December 4, 2000, JPMCEL renegotiated the contract with Old Telecom Italia, extending the period to five years, with the possibility of exercising the option at an earlier date. The time extension made it possible to defer the financial impact of acquiring the shares.

Telecom Italia International then purchased from JPMCEL, a call option on 660,777,200 Seat Pagine Gialle ordinary shares with the same expiry date and strike price as the put option, paying a total premium of 747 million. Moreover, for the purpose of transferring the effects of this latter transaction to Old Telecom Italia, an identical call option agreement was then entered into, with the same features, between Old Telecom Italia and Telecom Italia International. On February 25, 2002, Old Telecom Italia concluded the renegotiation of the December 4, 2000 put and call options with the JPMorgan Chase group. In particular, a decision was made to reduce the exercise price of the aforementioned options from 4.20 to 3.40 per share; in view of the reduction, Old Telecom agreed to pay JPMorgan Chase 569 million at the original expiration date of December 2005. To guarantee the performance of the obligations relating to the put option on Seat Pagine Gialle shares, TI Finance provided a guarantee (1,940 million) in the form of a Direct Participation Letter of Credit to JPMCEL.

As a result of such renegotiation, the aforementioned expense connected with the revision of the strike price of the options (569 million) was accounted for in the caption due to other financial institutions and had no effect on the statement of operations for the year 2002 after utilization of the reserve for forward purchase commitments of Seat Pagine Gialle shares accrued for the same amount at the end of 2001. In November 2002, the renegotiated debt was settled with the payment to JP Morgan Chase of 500 million, corresponding to the present value of the debt.

Following an additional assessment as of December 31, 2002, a reserve for forward purchase commitments of Seat Pagine Gialle Shares of 1,942 million was recorded for the estimated non recoverability of the original price of the put option; this was done to reflect that the Group no longer considered its Directories business to be a core, strategic business.

On August 1, 2003, Telecom Italia purchased, for a total payment of 2,272 million, including 17 million to hedge interest rate exposure, the Seat Pagine Gialle shares relating to the JP Morgan Chase put option.

Sale commitments

As of December 31, 2003, the Group has sale commitments totaling 24 million (219 million as of December 31, 2002).

Guarantees

As of December 31, 2003, the Group has given guarantees of 1,155 million (1,227 million as of December 31, 2002). The amount of the guarantees provided is presented net of counter-guarantees received amounting to

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

476 million (596 million as of December 31, 2002). Guarantees provided mainly consist of sureties provided by Telecom Italia and TIM on behalf of affiliated companies (of which 672 million on behalf of Aria Is Tim) and others for medium/long-term loan transactions and guarantees on bids to acquire TLC licenses abroad.

Collateral

As of December 31, 2003, the Group has given collateral of 114 million (111 million as of December 31, 2002). Collateral provided mainly refers to Aria Is Tim shares pledged as guarantees by TIM International for the performance of the obligations covered by the supply contracts signed by Aria Is TIM with Ericsson and Siemens.

Other memorandum accounts

Other memorandum accounts of 105 million (93 million as of December 31, 2002) referred mainly to third-party assets held by the individual consolidated companies, principally those in the information technology sector and Olivetti Tecnost group.

Furthermore, as of December 31, 2003:

- the consolidated companies of the Group issued patronage letters, that do not constitute guarantees, totaling 197 million chiefly on behalf of affiliated companies to support insurance polices, lines of credit and overdraft arrangements;
- the total amount of Telecom Italia s commitments at December 31, 2003 for lease obligations on buildings to be paid to IMSER 60, Tiglio I, Tiglio II and FMP Italy 1 (formerly Ireos) on contracts of a duration of 9 to 21 years, was 3,989 million.

Legal proceedings

The Group is a party to various legal actions. However, in the opinion of the Group s management, although the outcome of such actions cannot be determined, such matters will not materially affect the Telecom Italia Group s financial position or statement of operations.

Pursuant to a law enacted in 1992, Telecom Italia is required to ensure that all personnel employed on February 20, 1992 are covered by the Fondo Previdenza Telefonici (FPT), the telephone workers social security fund, for their entire retirement benefit, including sums due in respect to prior employment in other companies. The contributions to cover these benefits are to be computed by INPS (the Italian social security institution), and would be paid in 15 equal annual installments. A subsequent law established that the cost for such contributions should be recorded in the financial statements and be deductible for tax purposes in the respective years as paid. The amount of the liability for the contributions due is not certain as there is disagreement between the Group and INPS as to the computation of the amounts due. The issues are presently being debated in legal proceedings between the parties involved pending in front of the Italian judicial courts.

In compliance with Italian GAAP, a provision for an amount in line with the maximum estimated liability has been recorded in the consolidated financial statements of the Telecom Italia Group at December 31, 2003 (for further details see Note 14).

Pre-amortization interest (including that relating to the employees of the former Iritel), subsequent to the agreement between INPS and Old Telecom Italia, was paid by the latter with reservation in fifteen equal annual deferred installments, including interest at an annual rate of 5%, up to the end of 1999, for a total amount of 110 million, net of interest adjustments and certain reimbursements made by INPS. The dispute was resolved in Old Telecom Italia s favor in order No. 3398/2002 decided by the Supreme Court, conforming to the previous order No. 4242/2000 that was handed down (by which the payment of the above interest and accrued interest related thereto was suspended as from June 2000). As a result of the above, Old Telecom Italia recorded a receivable of 131 million (including interest at 5%) in 2002.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Management also believes that the other contributions eventually due will not significantly affect the Group s financial position or future results of operations since, as provided for by the pertinent law, any costs required to be paid will be paid over a period of fifteen years.

De Agostini initiated arbitration proceedings against SEAT (now Telecom Italia Media), Matrix, Buffetti Group and Finanziaria Web for the alleged nonfulfillment of the framework agreement of September 20, 2000, with regard to SEAT s obligation to acquire the Finanziaria Web S.p.A. s shares still held by the De Agostini group.

Effectively, the De Agostini group maintains that all the conditions stipulated in the contract for executing the agreement were fulfilled, whereas Telecom Italia Media maintains that this is not true and that, in any case, the fact that market conditions changed rendered the acquisition excessively onerous. The De Agostini group is asking for specific performance of the framework agreement and that the Finanziaria Web shares should be transferred to Telecom Italia Media for the amount originally agreed of 700 million, as well as the payment of unspecified damages.

De Agostini also requested that the contract should be reduced to fair value, indicating the sum of 630 million as being fair consideration for the purchase of 40% of Finanziaria Web, or as a further condition the sum be decided by the Arbitration Board. During the course of the arbitration proceedings Telecom Italia Media presented further grounds, claiming a conflict of interests in the finalization of the agreement, in addition to the request of the annulment of the agreement. On request by the Arbitration Board, the deadline for the decision has been extended to November, 2004.

Meanwhile, on March 24, 2004, the Arbitration Board invited the parties to evaluate the existence of conditions to reach an out of court settlement. As a result, contacts among the parties legal counsels are currently in progress.

Derivative Financial Instruments

Derivative financial instruments are used by the Group to manage its exposure to foreign exchange rate and interest rate risks and to diversify the parameters of debt so that costs and volatility can be reduced to within prefixed operational limits.

Derivative financial instruments at December 31, 2003 are principally used by the Group for the management of its debt positions. They include interest rate swaps (IRS) and interest rate options (IRO) to reduce interest rate exposure on fixed-rate and floating-rate bank loans and bonds and cross currency and interest rate swaps (CCIRS) and currency forwards to convert loans secured in different foreign currencies to the functional currencies of the various companies of the Group.

IRSs and IROs involve or can involve, at specified maturity dates, the exchange of flows of interest calculated on the notional amount at the agreed fixed or floating rates, with the counterparts.

The same also applies to CCIRSs which, in addition to the settlement of periodic interest flows, can involve the exchange of principal, in the respective currencies of denomination, at maturity and eventually at another date.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- **Foreign exchange risk**

At December 31, 2003, the Telecom Italia Group companies had forward foreign exchange contracts and options outstanding for the purchase and sale of foreign currency at specified exchange rates for an equivalent amount of 1,231 million, of which:

European companies

Description	Equivalent notional amount
	(millions of euro)
Transactions finalized by Olivetti International S.A.	294
Transactions finalized by Olivetti Finance N.V. (on bonds of Japanese yen 20 billion 2002/2032)	162
Transactions finalized by Telecom Italia Finance S.A.	190
Transactions finalized by Telecom Italia S.p.A.	241
Transactions finalized by TIM S.p.A.	7
Total European companies	**894**

Latin American companies

Description	Equivalent notional amount
	(millions of euro)
Currency forward transactions finalized by Entel Chile S.A.	279
Currency forward transactions finalized by TIM Perù S.A.C.	58
Total Latin American companies	**337**

Given the limited liquidity of the currency market on Latin American currencies, the contracts are often carried out for short-terms and then renewed each time for successive maturity dates.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- **Interest rate risk**

At December 31, 2003, the Group companies had contracts relating to financial liabilities recorded in the financial statements, for total principal equal to notional principal amount of 13,546 million. Details by European companies and Latin American companies are the following:

European companies

Description	Equivalent notional amount
	(millions of euro)
Floating to fixed IRS transactions finalized by Telecom Italia S.p.A.	13
Floating to floating IRS transactions finalized by Telecom Italia S.p.A.	322
CCIRS transactions finalized by Telecom Italia S.p.A.	3,810
IRS transactions with cap structures maturing February 2009 by Olivetti International S.A. and Olivetti Finance N.V. on bonds of 1,500 million (1999-2009) carried by Telecom Italia Finance S.A., originally issued by Olivetti International N.V.	1,250
IRS transactions maturing June 2046 effected by Olivetti International S.A. on bonds of Swiss francs 100 million (1986-2046) carried by Telecom Italia Finance S.A., originally issued by Olivetti International N.V.	64
IRS transactions (with cap and floor structures) effected by Olivetti Finance N.V. maturing July 2009 on Olivetti Finance N.V. bonds of 2,350 million, originally issued by Olivetti International Finance N.V. (1999-2009)	2,000
IRS transactions (with cap and floor structures) effected by Olivetti Finance N.V. maturing July 2004 on Olivetti Finance N.V. bonds of 4,200 million, originally issued by Olivetti International Finance N.V. (1999-2004)	2,200
IRS transactions effected by Olivetti Finance N.V. maturing March 2005 on bonds of 500 million issued by Olivetti Finance N.V. (2002-2005)	500
IRS transactions (with cap and floor structures) effected by Olivetti Finance N.V. maturing January 2006 on bonds of 1,100 million issued by Olivetti Finance N.V. (2002-2006)	1,100
IRS transactions effected by Olivetti Finance N.V. maturing April 2007 on bonds of 1,750 million issued by Olivetti Finance N.V. (2002-2007)	1,300
IRS transactions effected by Olivetti Finance N.V. maturing January 2008 on bonds of 1,750 million issued by Olivetti Finance N.V. (2003-2008)	250
IRS transactions effected by Olivetti Finance N.V. maturing April 2012 on bonds of 1,000 million issued by Olivetti Finance N.V. (2002-2012)	500
Total European companies	**13,309**

The underlying transactions are analyzed below, in addition to transactions that are largely extinguished (because of certainty of all the remaining financial flows), but not yet matured:

- the floating to fixed IRS transactions (4.68%) finalized by Telecom Italia S.p.A. for a notional amount of 13 million refer to EIB loans at floating rates;

- the floating to floating IRS transactions finalized by Telecom Italia S.p.A. for a notional amount of 322 million refer to indexed loans at domestic parameters (Rendint, Rolint, Robot) with conversion to the six month EURIBOR;

- CCIRS transactions finalized by Telecom Italia S.p.A. and amounting to 3,810 million refer to:

  - 3,409 million with reference to the floating rate intragroup loan in U.S. dollars, received from the subsidiary Telecom Italia Capital S.A. following the bonds issued in October 2003 for a total amount of U.S.$ 4,000 million, with conversion of the loan to:

    - quarterly floating rate in euro maturing November 2008 for 851 million;

    - semiannual average 5.04% fixed rate in euro maturing November 2013 for 1,709 million, of which 470 million through two distinct and linked transactions;

    - semiannual 5.99% fixed rate in euro maturing November 2033 for 849 million.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

With regard to the bond issue of U.S.$ 4,000 million (3,168 million at the euro/U.S. dollar exchange rate at December 31, 2003), Telecom Italia Capital S.A. put IRS contracts into place to convert the semiannual fixed rate coupon interest of 4% on U.S.$ 1,000 million maturing November 2008, of 5.25% on U.S.$ 2,000 million maturing November 2013, of 6.375% on U.S.$ 1,000 million maturing November 2033 to quarterly floating interest rates in U.S. dollars;

- 174 million, with reference to the Dual Currency loan with a notional principal of Japanese yen 20 billion and a 5% fixed interest rate with a step-up of +0.45% in U.S. dollars maturing October 2029, originally received by Olivetti International Finance N.V., now carried by Telecom Italia Finance S.A., the following was put into place:
  - by Olivetti Finance N.V., an IRS in which Olivetti Finance N.V. converts the 5% fixed rate in U.S. dollars to the six month LIBOR in Japanese yen;
  - by Telecom Italia S.p.A., a CCIRS in which Telecom Italia S.p.A., with regard to the intragroup loan in Japanese yen, receives six month LIBOR in Japanese yen and pays six month EURIBOR. The cross currency protection structure is conditional on Telecom Italia S.p.A. being in good standing;
  - by Telecom Italia S.p.A., an IRS with the conversion of the semiannual floating rate in euro to a 6.13% fixed rate up to October 2004 and after that to an annual 6.68% fixed rate (or a semiannual floating rate in euro as elected by the counterpart) up to maturity;
- 148 million, with reference to the bonds 2002/2032 in Japanese yen 20 billion (at the December 31, 2003 exchange rate) with a 3.55% fixed rate coupon maturing May 2032 issued by Olivetti Finance N.V., the following was put into place:
  - by Olivetti Finance N.V., an IRS contract in which Olivetti Finance N.V. receives the semiannual coupon of 3.55% in Japanese yen and pays a semiannual 2.37% fixed rate in Japanese yen up to 2012 and after that a semiannual floating rate in Japanese yen;
  - by Olivetti Finance N.V., a CCIRS contract for 171 million in which Olivetti Finance N.V. receives six month EURIBOR and pays six month LIBOR in Japanese yen;
  - by Telecom Italia S.p.A., a CCIRS contract for 171 million on a floating rate infragroup loan in Japanese yen in which Telecom Italia S.p.A. receives six month LIBOR in Japanese yen and pays six month EURIBOR. The cross currency protection structure is conditional on Telecom Italia S.p.A. being in good standing;
- for the remaining 79 million, there is a CCIRS linked to an EIB loan in British pounds with conversion to a floating rate in euro;

- on the bonds 1999/2009 of 1,500 million at a 5% fixed rate with a step-up of +0.15% (the coupon is equal to 5.30% in the period between May 26, 2003 and February 9, 2004) maturing February 2009, carried by Telecom Italia Finance S.A., originally issued by Olivetti International N.V., the companies Olivetti International S.A. and Olivetti Finance N.V. put into place the following transactions totaling 1,250 million:

  - an IRS for 500 million with conversion of the annual 5% fixed rate to a semiannual 4.75% fixed rate up to February 2004 and after that to 4.71% with the additional sale of a cap at 7.10% on the six month LIBOR in U.S. dollars effective from August 2007;

  - IRSs for 500 million with conversion of the annual fixed rate to a quarterly 2.65% fixed rate. Starting February 2006, the receipt of the annual 5% fixed rate is conditional on the 5-year swap rate in euro not being below the 1-year swap rate in euro; starting February 2005, the quarterly fixed rate (2.65%) can be replaced by the three month LIBOR in U.S. dollars set in arrears whenever the latter exceeds 7%;

  - IRSs for 250 million with conversion of the annual 5% fixed rate to a semiannual 4.33% fixed rate up to February 2004 and after that at 4.08% or at the floating rate indexed to the three month LIBOR in British pounds whenever the latter exceeds 7%; the receipt of the annual 5% fixed rate is applicable as long as the 5-year swap rates in U.S. dollars remain below the 5-year swap rates in British pounds plus 1%;

- on the bonds 1986/2046 of Swiss francs 100 million (equal to 64 million) at a 5.625% fixed rate maturing June 2046 carried by Telecom Italia Finance S.A., originally issued by Olivetti International N.V., the company Olivetti International S.A. put an IRS contract into place with the same amount and maturity date by which the annual fixed rate was converted to a semiannual floating rate in Swiss francs;

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- on the bonds 1999/2009 of 2,350 million at an annual 6.125% fixed rate with a step-up of +0.45% carried by Olivetti Finance N.V., originally issued by Olivetti International Finance N.V., the company Olivetti Finance N.V. put IRS contracts (totaling 2,000 million) into place with the same maturity dates by which the annual fixed rate was converted as described below:
  - to a semiannual 2.79% fixed rate up to January 2004 and after that to a semiannual 5.73% fixed rate for 1,000 million with the following additional transactions with reference to the six month LIBOR in U.S. dollars set in arrears:
    - sale of a cap at 7.75% starting July 2007;
    - sale of a floor at 3.25% starting July 2007;
  - to a semiannual 3.96% fixed rate up to January 2004 and after that to a semiannual floating rate set in arrears indexed to the two-year swap rate in euro for 750 million with the following additional transactions:
    - purchase of a cap at 5.29% on the same two-year swap rate in euro set in arrears semiannually;
    - sale of a cap at 7.75% on the two-year swap rate in U.S. dollars set in arrears semiannually starting July 2005;
    - sale of a floor with an annual rising rate from 3.25% to 4.25% on the two-year swap rate in euro set in arrears semiannually starting July 2004;
  - to a semiannual 5.64% fixed rate up to January 2004 for 250 million and after that at a semiannual floating rate set in arrears indexed to the six month EURIBOR floating rate (with receipt of the annual fixed rate whenever the 5-year swap rate in euro is higher than the 1-year swap rate in euro), with the following additional contracts starting January 2004:
    - purchase of a cap on the semiannual rate in euro at 4.15%;
    - sale of a cap on the semiannual rate in U.S. dollars at 7.70%;
    - sale of a floor on the semiannual rate in euro with an annual rising rate from 2.5% to 3.5%;
- on the bonds 1999/2004 of 4,200 million at an annual 5.375% fixed rate with a step-up of +0.45% carried by Olivetti Finance N.V., originally issued by Olivetti International Finance N.V., maturing July 2004, the company Olivetti Finance N.V. put into place the following contracts totaling 2,200 million:

- for 500 million with conversion of the annual fixed rate to a semiannual 3.85% fixed rate up to January 2004 and after that to a two-year floating rate in euro set in arrears;
- for 1,000 million with conversion of the annual fixed rate to a semiannual 5.36% fixed rate up to January 2004 and after that to a semiannual floating rate set in arrears indexed to the two-year swap rate in euro;
- for 500 million with conversion of the annual fixed rate to the three month EURIBOR set in arrears and with the sale of a floor for 450 million at 3.25% rate;
- for 200 million with conversion of the annual fixed rate to a semiannual 4.98% fixed rate up to January 2004 and after that to a semiannual floating rate set in arrears indexed to the two-year swap rate in U.S. dollars;

- on the bonds 2002/2005 of 500 million at a quarterly floating rate issued by Olivetti Finance N.V. maturing March 2005, the company Olivetti Finance N.V. put into place:
  - IRS contracts for 500 million, on which Olivetti Finance N.V. receives a quarterly floating rate in euro and pays a quarterly 4.36% fixed rate;
  - an IRS contract for 500 million on which it receives a quarterly 4.36% fixed rate and pays a 3.53% fixed rate up to March 2004 and after that the floating rate indexed to the two-year swap rate in U.S. dollars set in arrears;
- on the bonds 2002/2006 of 1,100 million at the quarterly floating rate issued by Olivetti Finance N.V. maturing January 2006, the company Olivetti Finance N.V. put IRS contracts into place for 1,100 million with the same maturity with which the three month EURIBOR floating rate was converted:
  - for 200 million, to the higher of the 12-month interest rate in U.S. dollars or the one year EURIBOR set in arrears and starting January 2004;

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

    - for 600 million, to indexing at the semiannual rate in U.S. dollars set in arrears, with the following additional contracts:
        - purchase of a digital cap which can be made when the semiannual rate in U.S. dollars set in arrears is higher than 3.75%;
        - sale of a cap at 4.25% on the semiannual rate in U.S. dollars set in arrears;
        - sale of a floor on the semiannual rate in U.S. dollars set in arrears and with annual rising interest rates;
    - for 300 million, to a 2.87% fixed rate starting January 2004;
- on the bonds 2002/2007 of 1,750 million with a 6.50% fixed rate coupon issued by Olivetti Finance N.V. maturing April 2007, the company Olivetti Finance N.V. put IRS contracts into place for 1,300 million with the same maturity dates by which the annual fixed rate was converted:
    - for 350 million, to a semiannual 5.57% fixed rate up to April 2004, 5.62% up to October 2004 and after that to a floating rate set in arrears semiannually on the rate in U.S. dollars with receipt of the annual 6.50% fixed rate as long as the 10-year swap rate in U.S. dollars remains higher than 3.50%;
    - for 500 million, to the semiannual 5.19% fixed rate up to April 2004 and after that with indexing at the higher of the rate in U.S. dollars and the six month EURIBOR set in arrears;
    - for 450 million, to the quarterly 5.78% fixed rate up to January 2004 and 5.86% up to July 2004 and after that to the three month EURIBOR set in advance;
- on the bonds 2003/2008 of 1,750 million with a 5.875% fixed rate coupon issued by Olivetti Finance N.V. maturing January 2008, the company Olivetti Finance N.V. put IRS contracts into place for 250 million with conversion of the annual fixed rate to the floating rate indexed semiannually at the lower of the annual rate in Swiss francs and the one year EURIBOR set in arrears through two distinct and linked transactions for 250 million each;
- on the bonds 2002/2012 of 1,000 million with a 7.25% fixed rate issued by Olivetti Finance N.V. maturing April 2012, the company Olivetti Finance N.V. put IRS contracts (totaling 500 million) into place with the same maturity dates with which the annual fixed rate was converted using the following structures (the receipt of the annual fixed rate is conditional upon the fact that the 10-year swap rate in euro remains higher than the two-year swap rate):
    - for 400 million, to the quarterly 6.06% fixed rate up to maturity;

- for 100 million, to the 5.49% fixed rate or starting April 2006 to a quarterly floating rate in U.S. dollars should the latter exceed 8%.

Latin American companies

Description	Equivalent notional amount
	(millions of euro)
CCIRS transactions finalized by Tele Celular Sul Participaçoes S.A.	11
CCIRS transactions finalized by Tele Nordeste Celular Participaçoes S.A	17
CCIRS transactions finalized by TIM Celular S.A.	8
CCIRS transactions finalized by Maxitel S.A.	34
IRS transactions finalized by Entel Chile S.A.	107
IRO transactions finalized by Entel Chile S.A.	60
Total Latin American companies	**237**

In addition to the derivative financial instruments managing indebtedness, at December 31, 2003, the Luxembourg subsidiary Telecom Italia Finance, the Dutch subsidiary Olivetti Finance and the Luxembourg subsidiary Olivetti International S.A. put IRSs and Currency Forwards into place on financial assets with a notional amount of approximately 635 million.

Consistent with the accounting principles disclosed previously, the above detailed derivative financial instruments are recorded at fair value and the negative difference, if any, was recognized in the statement of operations under financial expenses.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 19 Other revenues

	Year ended December 31,		
	2001	**2002**	**2003**
	(millions of euro)		
Operating grants	26	20	14
Gains on disposal of fixed intangible and tangible assets	12	6	11
Amount credited to income for grants related to assets	73	65	64
Miscellaneous income	365	413	256
	476	**504**	**345**

In particular:

- operating grants refer chiefly to the amounts received from government agencies to cover the costs of research, development and technological innovation;
- capital grants recorded in the consolidated statement of operations represent the portion that became available during the year based on the depreciation pattern of the underlying fixed asset;
- miscellaneous income from operations includes, among other things, late payment fees charged to customers of the telecommunications services companies for the late payment of telephone bills (91 million in 2003, 106 million in 2002 and 112 million in 2001).

Note 20 Other external charges

	Year ended December 31,		
	2001	**2002**	**2003**
	(millions of euro)		
Cost of external services rendered	9,782	9,407	9,684
Rents and lease payments	1,096	1,166	1,156

Provision for bad debts	448	546	471
Provisions for risk	389	114	70
Write-downs of fixed intangible and tangible assets	17	58	6
TLC license fee	524	431	62
Other provisions and operating charges	431	466	485
	12,687	**12,188**	**11,934**

The 2003 decrease in other external charges of 254 million was mainly due to the cancellation of the Italian government TLC license fee (355 million in 2002; for further details please see Note 12) partially offset by the higher costs for the operation and development of mobile telecommunications (including the start-up of GSM services in Brazil) reflected in the increase of cost of external services rendered (277 million).

The 2002 decrease in other external charges of 499 million was principally due to the reduction in costs of external services rendered (375 million); such decrease was substantially due to the deconsolidation of the Telespazio and 9Télécom groups and Sogei partly offset by the higher costs for the operation and development of mobile telecommunications.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 21 Financial income

	Year ended December 31,		
	2001	2002	2003
	(millions of euro)		
Dividends	30	46	9
Capital gain on sale and other income from equity investments	191	11	8
Interest and capital gains on fixed-income securities	295	238	174
Interest and commission from:			
affiliated companies and others	24	14	24
banks	197	185	192
customers	2	5	4
Gain on foreign exchange	257	508	159
Other	450	562	422
	1,446	**1,569**	**992**

Other includes 338 million (404 million in 2002 and 298 million in 2001) of income on hedging contracts and income from the application of inflation accounting principles.

Note 22 Financial expense

	Year ended December 31,		
	2001	2002	2003
	(millions of euro)		
Interest and commission paid to:			
banks and other financial institutions, on short and long term loans	855	454	303
suppliers	10	12	7
affiliated companies and others	31	24	11
Interest and other charges on debenture loans	1,534	1,751	1,852

Losses on foreign exchange	392	905	186
Write-downs and equity in losses in affiliated and other companies, net	1,771	487	91
Write-downs of marketable debt and equity securities	376	259	14
Other	1,590	755	792
	6,559	**4,647**	**3,256**

Financial expense in 2003 decreased by 1,391 million compared to 2002 as a result of the followings:

- the decrease in interest expense mainly due to the reduction in the level of interest rates, as well as to the lower average borrowings outstanding during 2003;
- the improvement of losses on foreign exchange which was positively impacted by the exchange rate effect of the companies in South America; and
- the reduction in net write-downs and equity in losses in unconsolidated subsidiaries, affiliated and other companies of 396 million mainly due to:
  - the reduction of 67 million in amortization of goodwill in companies accounted for using the equity method (13 million compared to 80 million in 2002);
  - the decrease of 329 million in valuation adjustments to the Group s share of the equity in the earnings and losses of equity investees and other net write-downs (a loss of 78 million compared to a loss of 407 million in 2002). Such decrease was principally due to the reduction in losses of Sky Italia (formerly Stream) of 150 million and Aria Is Tim of 171 million corresponding to the valuation adjustment made in 2002.

These lower amounts were offset in part by the expenses of 161 million for the early exercise of the JP Morgan Chase put option on Seat Pagine Gialle shares finalized in August 2003, as well as the expenses connected with the credit lines granted to Olivetti in connection with the Merger to fund the rights of withdrawal and the tender offers (98 million).

F-50

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial expense in 2002 decreased by 1,912 million compared to 2001 as a result of the followings:

- the decrease in interest expense due to the lower average borrowings outstanding during 2002;
- the increase in losses on foreign exchange due to the adverse movements in the rates of exchange against the euro which impacted some Latin American companies, in particular Venezuela and Brazil;
- the reduction of 1,284 million in net write-downs and equity in losses in affiliated and other companies mainly due to:
  - the reduction of 236 million in amortization of goodwill in companies accounted for using the equity method (80 million compared to 316 million in 2001) as a result of the write-downs of goodwill taken in the 2001 financial statements;
  - the decrease of 1,048 million in valuation adjustments to the Group s share of the equity in the earnings and losses of equity investees and other net write-downs (a loss of 407 million compared to a loss of 1,455 million in 2001). Such value adjustments refer to the losses of Sky Italia (formerly Stream) for 246 million (241 million in 2001), of Aria Is Tim for 171 million (334 million in 2001) and the earnings balance of 10 million relating to the earnings (losses) of the other companies.

In 2001 this item was also affected by the negative results of the investments in the Nortel Inversora group (238 million) and in the Auna group (203 million) and the write-down of Astrolink (259 million) by Telespazio as the related project was interrupted. The investment in the Nortel Inversora group, the carrying value of which was written-off in the consolidated financial statements at December 31, 2001, remained unchanged in 2002. In 2003 the investment was transferred to Sofora;

- the decrease in other of 834 million mainly as a result of the provision of 569 million recorded in 2001 for the JP Morgan Chase put option on Seat Pagine Gialle shares connected with the estimated non recoverability of the original price to exercise the option. The provision for the year 2002 was recorded in other income and (expense), net .

Note 23 Other income and (expense), net

	Year ended December 31,		
	2001	2002	2003
	(millions of euro)		
Provisions and write-downs of goodwill and equity investments	(2,984)	(6,584)	(879)
Restructuring costs	(400)	(494)	(273)

Charges as required under Law No. 58/1992	(84)	(79)	(387)
Gains on the disposal of equity investments, tangible and intangible assets	465	2,553	105
Other, net	(106)	(892)	351
	(3,109)	**(5,496)**	**(1,083)**

In 2003, provision and write-downs of goodwill and equity investments amounted to 879 million (a decrease of 5,705 million compared with 2002). In 2003 it consisted of the following:

- 348 million for the write-down of goodwill on Telecom Italia Media made on the basis of an appraisal of independent advisors;
- 195 million for the write-down of goodwill on Entel Chile following the implementation of restructuring and reorganization plans;
- 132 million for the write-down of goodwill on Digitel Venezuela, in view of the persisting difficult macroeconomic environment in which the company operates;
- 42 million for the write-down of goodwill on EPIClink in respect of the start of the process to strategically reposition the company within the Group;
- 37 million for the write-down of goodwill related to other minor companies;

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- 59 million related to the dispute with minority shareholders of Digitel Venezuela;
- 30 million to be recognized to Mirror in connection with the recognition of a lower sale price of the investment in Inmarsat with respect to the value assumed in 2001 at the time in which such investment was transferred by Telecom Italia to Mirror; and
- 36 million related to provisions for risks and other charges on investments.

In 2002, provision and write-downs of goodwill and equity investments amounted to 6,584 million (an increase of 3,600 million compared with 2001). In 2002 it included the following:

- write-down of the equity investment held in Aria - Is Tim (1,491 million) and provision to the reserve for risks and charges related to Aria - Is Tim (850 million) for the guarantees provided by the Old Telecom Italia Group to the creditors of Aria - Is Tim. It also includes the provision for the loans to Aria Is Tim extended by the Old Telecom Italia Group. At that time, Old Telecom Italia concluded that the value of its investments was permanently impaired, since, starting from the awarding of the license, some measures which should have fostered effective competition and guaranteed the full operability of the new entrant, did not effectively take place;
- write-down of the Seat Pagine Gialle goodwill (1,544 million) and accrual for the forward purchase commitments of Seat Pagine Gialle shares (1,942 million). The write-down and the provision were made on the basis of the average Seat Pagine Gialle ordinary shares based on trading on the Italian Stock Exchange over the second half of 2002;
- the provisions made in conjunction with the disposal of the investment in the 9Télécom Group (316 million);
- reserve provision (43 million), made by Seat Pagine Gialle, for the estimated losses arising from the exercise of put options by the founding shareholders of Consodata S.A.; and
- other write-downs of investments for 46 million and of goodwill for 321 million (of which: 103 million for Blu, 75 million for Digitel Venezuela, 96 million for Netco Redes and 47 million for other minor companies).

In 2001, provision and write-downs of goodwill and equity investments amounted to 2,984 million. In 2001 it included the following:

- 1,303 million for the write-down of goodwill relating to consolidated companies (9Telecom group, Entel Bolivia, Entel Chile group, Maxitel group, Tele Celular Sul group, Tele Nordeste Celular group, Tim Brasil, Med-1 group and certain companies in the Seat Pagine Gialle group);

- 1,078 million for the write-down of goodwill relating to companies accounted for by the equity method (GLB Serviços Interativos, Solpart Participacoes, Telekom Austria and the Nortel Inversora group); and
- 603 million for other provisions relating to equity investees.

In 2003 restructuring costs amounted to 273 million (of which 196 million was attributable to Telecom Italia) and were related to expenses and provisions for employee cutbacks and layoffs.

In 2002 restructuring costs amounted to 494 million (of which 379 million was attributable to Old Telecom Italia) and were related to expenses and provisions for employee cutbacks and layoffs.

In 2001 restructuring costs amounted to 400 million (of which 203 million was attributable to Old Telecom Italia) and were related to expenses and provisions for employee cutbacks and layoffs.

In 2003 charges as required under Law No. 58/1992 in order to cover employees under the former Telephone Employees Pension Fund (FPT) amounted to 387 million, of which 315 million was the result of the redetermination of the liability (see Note 14 for further details) and 72 million for the related accrued interest.

In 2002 accrued interest on the liability to INPS related to the former Telephone Employees Pension Fund (FPT) amounted to 79 million.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2001 accrued interest on the liability to INPS related to the former Telephone Employees Pension Fund (FPT) amounted to 84 million.

In 2003, gains on the disposal of equity investments, tangible and intangible assets amounted to 105 million.

In 2002, gains on the disposal of equity investments, tangible and intangible assets (2,553 million) arose from:

- the sale of the 26.89% interest in Auna (1,245 million);
- the sale of the 19.61% interest in Bouygues Décaux Télécom (484 million);
- the acceptance of the tender offer for Lottomatica shares by the Old Telecom Italia Group (133 million) and by Olivetti and Olivetti International (overall 107 million);
- the sale of the 25% interest in the Mobilkom Austria group (115 million);
- the sale of the 40% interest held in Telemaco Immobiliare (110 million);
- the sale of the 100% interest held in Telespazio (70 million);
- the concentration of the real-estate assets through the companies IM.SER, Emsa and Telimm into Tiglio I (159 million);
- the transfer of the Old Telecom Italia s Asset Management unit to Tiglio II (60 million);
- the transfer by Old Telecom Italia of its real estate services businesses (excluding facilities management) to the Pirelli & C. Real Estate Group (15 million);
- the sale of the 100% interest held in OMS2 to Tiglio I (26 million); and
- the disposal of other equity investments, fixed assets and business segments (29 million).

In 2001, gains on the disposal of equity investments, tangible and intangible assets (465 million) arose from the sale of the 70% holding in Mirror International Holding, the company through which the satellite companies were contributed to the Lehman Brothers group (170 million) and the 30% holding in Mediterranean Nautilus S.A. to the Israeli company F.T.T. Investment (94 million), the dilution of the investment in Auna (16 million) and the increase in the net equity of Lottomatica as a result of the capital increase set aside for third parties when it was listed (64 million), the sale of the residual equity investment in Globespan Virata Corp. (43 million), and other minor disposals (78 million).

In 2003, other, net (351 million net income) included:

- 1,465 million from the reversal of liabilities and reserves for risks and charges relating to the cancellation of the TLC license fee following the verdict handed down by the European Court of Justice (see Notes 12 and 14 for further details);
- 237 million of losses on the disposal of equity investments, tangible and intangible assets (of which 195 million due to the losses on the sale of the entire stake held in New SEAT after the spin-off);
- 74 million of expenses connected with the spin-off and sale of New SEAT;
- 55 million on the settlement with Pagine Italia after the agreement was terminated without the purchase of the Pagine Utili business segment;
- 56 million for the additional adjustment made by the parent company Telecom Italia to the estimated value of unused prepaid telephone cards following the start of technical data collection procedures;
- 35 million for the recognition of liabilities referring to prior years on interconnection issues, following elucidations on the part of the regulatory agencies and verifications by the operators involved;
- 295 million for the provisions and write-downs of intangibles and fixed assets made by Latin American Nautilus group (235 million), Telecom Italia Learning Service (27 million), EPIClink (15 million) and other minor companies (18 million) as part of the reorganization transactions;

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- 118 million of expenses connected with the above mentioned Merger principally in respect of fees for advisors, legal and tax consultants, technical experts and expenses for banking charges;
- 48 million of indirect taxes and prior period taxes mainly for the portion of the cost of the tax amnesty not covered by the reserve for income taxes;
- 49 million for losses arising from the settlement of adjustments on the re-organization of the international wholesale business segment in 2002;
- 33 million for prior year s adjustments to income taxes; and
- 100 million of other expenses net, which included write-offs of receivable balances, net of release of reserves, and other miscellaneous income and expense.

In 2002, other, net (892 million net charges) included:

- income arising from the recovery of pre-amortization interest on the expenses for employee benefit obligations under Law No. 58/1992 that were paid, with reserve, to INPS up to 1999 following the termination of litigation after the courts ruled in Old Telecom Italia s favor (131 million);
- the release of reserves (98 million), primarily set up in 2001 by Old Telecom Italia to cover the expenses connected with the agreement to sell Stream to News Corporation and Vivendi Universal/Canal+ after the parties did not go through with the agreement;
- losses on the sale of the 15% stake in Telekom Austria (135 million) and for the sale of the whole equity investment in Seat P.G. held by Olivetti (62 million);
- expenses connected with the disposal of equity investments (239 million);
- the extraordinary contributions to INPS established by the year 2000 Italian Budget for the three years 2000-2002 to meet the higher financial requirements covered by the rules of the Fondo Previdenza Telefonici (FPT) that was abolished and became part of the general Employee Pension Fund (74 million);
- write-downs of tangible and intangible fixed assets (190 million, of which 142 million related to the Brazilian companies);
-

provisions added to the reserves for risks and charges (226 million, of which 135 million for guarantees provided for the disposals of equity investments and business segments);

- adjustment to Old Telecom Italia s payable to customers relating to telephone prepaid cards (158 million);
- other losses on disposals of equity investments, tangible and intangible fixed assets (39 million); and
- other miscellaneous expenses, net (29 million).

In 2001, other, net (106 million net charges) included:

- income from the release of reserves by Old Telecom Italia recorded in prior years for risks which did not materialize (120 million mainly relating to the reserve for the contract with Iraq of 62 million and the reserve for corporate restructuring of 50 million);
- income (32 million) deriving from the partial cancellation, by the Council of State, of resolution No. 7533/1999 of the Antitrust Authority under which TIM and Vodafone Omnitel were levied administrative fines for the alleged violation of antitrust laws relating to the price fixing of fixed-mobile rates;
- the provision for expenses connected with the Vivendi/Canal Plus agreement for the transfer of the investment in Sky Italia (formerly Stream) (248 million); and
- the extraordinary contributions to INPS established by the 2000 Finance Bill for the three years 2000-2002 to meet the higher financial requirements covered by the rules of the Fondo Previdenza Telefonici (FPT) that was abolished and became part of the general Employee Pension Fund (77 million); and the costs resulting from the decision to reposition the broadcasting station La7 as a consequence of the closing of a series of contracts (85 million).

F-54

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 24 Income taxes

Income taxes include the current income taxes of the individual consolidated companies and the deferred income tax expense and benefit with respect to the individual consolidated companies and to the consolidation adjustments.

In 2003, an income tax expense of 1,014 million was recognized (compared to a benefit of 2,210 million in 2002 and an expense of 579 million in 2001) as a result of a current income tax expense of 1,886 million and a deferred income tax benefit of 872 million. The 2003 income tax expense represented an effective tax rate of 29% compared with a statutory rate of 34%.

The 2003 increase in income taxes of 3,224 million was due to the improvement of the result of the year and, consequently, higher levels of taxable income. The increase was offset by the recognition of 1,266 million of additional deferred tax assets in addition to those already recorded by Telecom Italia (formerly Olivetti) in 2002 following the tax basis only write-down of the investment in Old Telecom Italia. The full benefit of this tax asset was not fully recognized until 2003, at which time the finalization of the Merger allowed the recoverability of the tax asset.

The 2002 decrease in income taxes (2,789 million) was due to a reduction in the taxable income deriving from the write-down for tax purposes only of the investment in Old Telecom Italia and of equity investees which involved a tax benefit, as well as to the tax benefits arising from the merger of Blu into TIM.

Italian and Foreign income (loss) before taxes are as follows:

	Year ended December 31,		
	2001	**2002**	**2003**
	(millions of euro)		
Italy	234	(232)	3,836
Foreign	(3,331)	(2,284)	(394)
	(3,097)	**(2,516)**	**3,442**

The provision for income taxes consisted of the following in the years ended December 31, 2001, 2002 and 2003:

	Year ended December 31,		
	2001	**2002**	**2003**
	(millions of euro)		
Current tax expense:			
Italy	1,258	1,413	1,703
Foreign	33	172	183
Total current tax expense	1,291	1,585	1,886
Deferred tax expense (benefit):			
Italy	(785)	(3,866)	(949)
Foreign	73	71	77
Total deferred tax benefit, net	(712)	(3,795)	(872)
Total income tax expense (benefit)	**579**	**(2,210)**	**1,014**

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2003, the reconciliation between the Group s statutory tax rate (34% for the 2003 income taxes) and the effective tax rate is as follows:

	Year ended December 31, 2003	
	(millions of euro)	%
Income before income taxes	**3,442**	
Taxes at statutory rate	**1,170**	**34%**
• Recognition in 2003 of the portion of the deferred tax assets related to the write-down, for tax purposes only, of the shares of the merged company (Old Telecom Italia) recorded in 2002 by Olivetti for which a valuation allowance was set-up	(1,266)	(37)%
• Operating losses of the year 2003 not considered recoverable and for which a valuation allowance was set-up in 2003	213	6%
• Recognition in 2003 of operating losses of prior years for which a valuation allowance was set-up in prior years	(72)	(2)%
• Write-down of investments eliminated in consolidation	(599)	(17)%
• Amortization of consolidation goodwill	600	17%
• Permanent differences:		
non deductible expenses	313	9%
non taxable revenue	(224)	(6)%
• Others	165	5%
	300	9%
• IRAP and other taxes calculated on a different taxable basis with respect to the income before income taxes	714	20%
Total income tax expense	**1,014**	**29%**

In 2002, the reconciliation between the Group s statutory tax rate (36% for the 2002 income taxes) and the effective tax rate is as follows:

	Year ended December 31, 2002	
	(millions of euro)	%
Loss before income taxes	**(2,516)**	

Taxes at statutory rate	**(906)**	**(36)%**
• Deferred tax assets related to the write-down, for tax purposes only, made by the merging company on the Old Telecom Italia s shares	(1,075)	(43)%
• Operating losses of the year 2002 not considered recoverable and for which a valuation allowance was set-up in 2002	218	9%
• Recognition in 2002 of operating losses of prior years for which a valuation allowance was set-up in prior years	(212)	(8)%
• Non taxable gains on disposals	(744)	(30)%
• Write-down of investments eliminated in consolidation	(782)	(31)%
• Tax benefit connected to the acquisition of business	(453)	(18)%
• Amortization of consolidation goodwill	808	32%
• Permanent differences:		
non deductible expenses	391	15%
	(2,755)	(110)%
• IRAP and other taxes calculated on a different taxable basis with respect to the loss before income taxes	545	22%
Total income tax benefit	**(2,210)**	**(88)%**

F-56

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2001, the reconciliation between the Group s statutory tax rate (36% for the 2001 income taxes) and the effective tax rate is as follows:

	Year ended December 31, 2001	
	(millions of euro)	%
Loss before income taxes	**(3,097)**	
Taxes at statutory rate	**(1,115)**	**(36)%**
• Operating losses of the year 2001 not considered recoverable and for which a valuation allowance was set-up in 2001	333	11%
• Amortization of consolidation goodwill	821	27%
• Permanent differences:		
non deductible expenses	69	2%
• Others	(3)	
	105	4%
• IRAP and other taxes calculated on a different taxable basis with respect to the income before income taxes	474	15%
Total income tax expense	**579**	**19%**

Net deferred tax assets are detailed as follows:

	As of December 31,	
	2002	2003
	(millions of euro)	
Deferred tax assets	4,190	5,013
Deferred tax liabilities	(40)	(252)
	4,150	**4,761**

The main components of the net deferred tax assets are the followings:

	As of December 31,	
	2002	2003
	(millions of euro)	
Write-downs	2,620	3,260
Net operating losses	208	663
Provisions for risks and charges	621	428
Telephone companies employees social security fund	211	265
Reserve for bad debt	228	179
Unrealized intercompany profits	69	78
Other deferred tax assets	233	140
Withholding tax on interests		(132)
Other deferred tax liabilities	(40)	(120)
	4,150	**4,761**

At December 31, 2003, the Group has net operating loss carryforwards of 8,611 million, of which 2,908 million are without expiration while the remaining expire within 5 years (i.e. by year-end 2008). The tax benefit relating to net operating loss carryforwards is recorded only when there is reasonable certainty of recovery. At December 31, 2002 and 2003, the Group has net operating loss carry-forwards of 3,208 million and 6,600 million, respectively, for which no deferred tax asset has been provided. Net operating losses in Italy expire within five years.

Furthermore, at December 31, 2003, approximately 520 million of deferred tax assets have not been recorded since their future recovery is not assured.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

No provision has been made for Italian taxes, or foreign taxes that may result from future remittances of undistributed earnings of foreign subsidiaries, because it is expected that all such earnings will be permanently reinvested in these foreign operations. It is not practical to estimate the amount of taxes that might be payable on the eventual remittance of these earnings due to the complexities associated with its hypothetical calculation.

Note 25 Other information

(a) Segment information

The businesses of the Group are managed and organized on the basis of the following Business Units and the segment disclosure which follows is based on these Business Units. There were no significant changes in the organization of the businesses during 2003 that would affect the comparability of segment disclosures except for the disposal of New SEAT which has decreased the significance of the Internet and Media segment but not the reporting structure.

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 other (wholesale) providers. On an international level, Wireline develops fiber optic networks for wholesale customers, mainly in Europe and South America.

Mobile. This business unit includes national and international mobile telecommunications businesses which are managed by TIM. Beginning in 2001 international mobile operations were consolidated and managed by TIM, through TIM International. International mobile operations are concentrated in Latin America and the Mediterranean Basin.

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 Group s overall strategic plan. In particular, 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 telecommunication. Starting from March 1, 2004, the Latin America Operations function is no longer operational and the Business Units have been charged with responsibility for the results of the subsidiaries for which they are accountable in Latin America.

Internet and Media. Starting from August 8, 2003, after the proportional spin-off and sale of substantially all of the directories, directories assistance and business information segments, the Internet and Media Business Unit operates in the following segments:

- Internet, in the management of access services (ISP), with Tin.it, in the management and development of portals, Virgilio with Matrix, and in web services, where it occupies a leadership position in the Italian market;

- Television, La7 with MTV, both in the sectors of production and broadcasting of publishing content through the use of television transmission networks entrusted under concession and in the marketing of advertising space in TV programming;

- Office Products and Services through the distribution of products, services and solutions for the office through the Buffetti retail network; and

- Professional Publishing in the sector of specialized technical publishing.

Information Technology Market. The Information Technology Market Business Unit was created in 2002 with the aim of focusing the activities previously concentrated in the Information Technology Services Business Unit by type of customer. The Information Technology Market Business Unit is responsible for organizing the information technology activities of the Group, that are marketed to third parties, in particular, central and local governmental administrations moving towards decentralization and e-government, as well as banks and businesses. The Information Technology Market Business Unit provides a full range of IT services, including consultancy services, system integration, CRM and ERP solutions and web services. It is a full Business Solution Provider for government, banks and enterprise.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Information Technology Group. The IT Group Operating Activity was created in 2002 to rationalize the activities previously carried out in the Information Technology Services Operating Activity. The Operating Activity is responsible for organizing technological innovation and service information technology activities within the Telecom Italia Group and covers the full range of information services, pursuing objectives to reposition its activities to higher value-added products.

Olivetti Tecnost. Olivetti Tecnost and its subsidiaries (the Olivetti Tecnost Group) offer office products and digital printing systems (Office Products Division), specialized application for service automation in banking, retail, trade industry applications, gaming and lottery management (Systems Division). In addition, the group operates with the Industrial Operations Division in the development and production of silicon technology (ink-jet print-heads and MEMS), in document management services and mobile phone repairs. The principal geographic markets of this Business Unit are Europe, Asia and North America.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For purposes of the following discussion selected financial data of each Business Unit has been provided for 2001, 2002 and 2003, consistent with the structure of each Business Unit at December 31, 2003.

	Wireline (2)(3)	Mobile	South America (4)	Internet and Media (5)	IT Market (3)	IT Group (3)	Olivetti Tecnost	Other Activities (3)(6)	Elimination and consolidation adjustments	Consolidated
2001(1)										
Operating revenues										
-Third parties	15,222	9,963	1,531	1,880	1,197	120	1,076	1,027	0	32,016
-Intersegment(7)	1,952	287	3	77	125	919	21	249	(3,633)	0
	17,174	10,250	1,534	1,957	1,322	1,039	1,097	1,276	(3,633)	32,016
Gross operating profit(8)	7,730	4,760	527	444	181	198	27	(340)	128	13,655
Operating income	4,338	3,136	187	31	133	51	(26)	(1,257)	(1,468)	5,125
Depreciation and amortization	3,199	1,469	253	320	29	134	57	395	1,756	7,612
Investments in fixed assets	1,979	1,530	351	82	20	84	42	229	0	4,317
Identifiable assets	20,326	17,036	3,242	4,072	1,562	1,066	990	51,295	(5,362)	94,227
2002(1)										
Operating revenues										
-Third parties	15,112	10,595	1,369	1,900	926	59	906	541	0	31,408
-Intersegment(7)	1,935	272	40	91	113	937	8	1,033	(4,429)	0
	17,047	10,867	1,409	1,991	1,039	996	914	1,574	(4,429)	31,408
Gross operating profit(8)	7,951	5,039	450	593	114	98	59	(261)	(28)	14,015
Operating income	4,677	3,358	146	232	64	(40)	4	(703)	(1,680)	6,058
Depreciation and amortization	2,940	1,512	252	280	40	133	34	371	1,665	7,227
Investments in fixed assets	1,837	1,075	201	28	13	83	26	28	0	3,291
Identifiable assets	19,472	14,211	2,590	3,876	1,365	1,343	772	46,333	(6,578)	83,384
2003										
Operating revenues										
-Third parties	15,364	11,562	1,104	1,122	804	41	637	216	0	30,850
-Intersegment(7)	1,852	220	22	175	87	1,059	18	910	(4,343)	0
	17,216	11,782	1,126	1,297	891	1,100	655	1,126	(4,343)	30,850
Gross operating profit(8)	8,255	5,502	400	322	84	96	40	(415)	(4)	14,280
Operating income	4,969	3,786	137	63	58	(36)	2	(760)	(1,430)	6,789
Depreciation and amortization	2,907	1,543	214	199	34	137	23	295	1,427	6,779
Investments in fixed assets	1,497	1,244	116	32	13	106	14	89	0	3,111
Identifiable assets	19,013	14,773	2,385	854	831	1,241	841	51,318	(10,755)	80,501

(1) The data relating to 2002 and 2001 have been reclassified and presented consistent with the 2003 presentation.
(2) As of June 16, 2003, Domestic Wireline changed its name to Wireline.
(3) Starting from January 1, 2003, the Netikos group, the Webegg group, the TILab group, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNed is no longer included in Other Activities. The TILab group moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit. The effects of such reclassifications were not material.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) The data refer to the Entel Chile group, the Entel Bolivia group and the company Telecom Italia America Latina.

(5) New SEAT, the beneficiary company of the spin-off from Seat Pagine Gialle which took place on August 1, 2003, was sold on August 8, 2003. As a result of this, the 2003 figures include the results of operations for the first seven months of New SEAT Group, as well as the results of operations for the entire year of the remaining part of Seat Pagine Gialle that, after the spin-off, was renamed Telecom Italia Media.

(6) The data include the operations of the International Affairs Corporate Function, the TILab group, the former 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 operation 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) Intersegment sales consist of sales made between consolidated subsidiaries of the Group belonging to different segments. Such sales between segments are accounted for at selling prices which generally approximate prices to unaffiliated customers.

(8) Gross Operating Profit was 13,655 million, 14,015 million and 14,280 million in each of 2001, 2002 and 2003, 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 of the 1934 Act. Telecom Italia believes that Gross Operating Profit provides the best indication of the Telecom Italia Group s operating performance and is meaningful information for investors. In addition the Group also believes (although other telecommunication 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. 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.

	Year ended December 31,		
	2001	**2002**	**2003**
	(millions of Euro)		
Operating income	5,125	6,058	6,789
Depreciation and Amortization	7,612	7,227	6,779
Other external charges:			
Provision for bad debts	448	546	471
Write-downs of fixed assets and intangibles	17	58	6
Provision for risks	389	114	70
Other provisions and operating charges	431	466	485
Other income (excluding operating grants, reimbursements for personnel costs and costs of external services rendered)	(367)	(454)	(320)
Gross Operating Profit	**13,655**	**14,015**	**14,280**

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Information about the Group s segments by geographic area for the year ended December 31, 2001, 2002 and 2003 is as follows (in millions of euro):

	Italy	Rest of Europe	North America, Central and South America	Australia, Africa and Asia	Consolidated
2001					
Operating revenues	24,895	2,495	3,847	779	32,016
Identifiable assets	57,242	29,869	6,913	203	94,227
Investments in fixed assets	2,940	390	961	26	4,317
2002					
Operating revenues	25,029	2,665	3,257	457	31,408
Identifiable assets	53,809	24,703	4,710	162	83,384
Investments in fixed assets	2,464	207	610	10	3,291
2003					
Operating revenues	24,811	2,478	3,155	406	30,850
Identifiable assets	44,041	31,661	4,703	96	80,501
Investments in fixed assets	2,288	176	646	1	3,111

(b) Related party transactions

The Group enters into transactions with affiliates, and various related parties. The following related party transactions relate to transactions between Telecom Italia and its subsidiaries and the Group s affiliates as well as the members of the Board of Directors and the companies in which they hold corporate office or significant responsibility. Transactions between members of the Group are excluded as they are eliminated on consolidation. All such transactions are within the Group s normal operations and were conducted on an arm s length basis in accordance with specific regulatory provisions.

The following related party transactions are reflected in the statement of operations for the years ended December 31, 2001, 2002 and 2003, respectively:

	Related party transactions in the year ended December 31,					
	2001		2002		2003	
Items	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**
Operating revenues	954 million	Refers mainly to: Astrolink (296 million), Brasil Telecom (120 million), Nortel Inversora group (119 million), Teleleasing (82 million), Auna group (63 million), Sky Italia (formerly Stream) (55 million) and Lottomatica (123 million)	306 million	Refers mainly to: Teleleasing (105 million), Brasil Telecom (48 million), Sky Italia (formerly Stream) (42 million), Auna group (18 million), Telecom Argentina (18 million) and Telekom Srbija (17 million)	275 million	Refers mainly to: Teleleasing (166 million), Sky Italia (formerly Stream) (22 million), Shared Service Center (21 million), Telecom Argentina (12 million) and Telekom Austria (12 million)

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Related party transactions in the year ended December 31,					
	2001		2002		2003	
Items	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**
Cost of materials and other external charges	596 million	Refers mainly to: rent payable to IM.SER (199 million) and Telemaco Immobiliare (77 million); and TLC service costs from Etec S.A. Cuba (79 million)	475 million	Refers mainly to: rent payable to IM.SER (153 million) and Telemaco Immobiliare (37 million); TLC service costs from Etec S.A. Cuba (77 million); and maintenance and assistance contracts from Italtel (40 million) and Siemens Informatica (24 million)	399 million	Refers mainly to: rent payable to Tiglio I (81 million) and Tiglio II (24 million); TLC service costs to Etec S.A. Cuba (112 million) and Telekom Austria (22 million); and maintenance and assistance contracts from Shared Service Center (45 million), Siemens Informatica (34 million), Teleleasing (11 million) and Italtel (22 million)
Other income, net	25 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates	9 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates	14 million	Mainly relates to cost recoveries for personnel on loan to certain affiliates
Financial income and expense, net	Expense for 8 million	Includes accrued interest income on loans made to certain affiliates (22 million); interest expense payable to Teleleasing for financial leasing	Expense for 9 million	Includes accrued interest income on loans made to certain affiliates (14 million); interest expense payable to	Income for 13 million	Includes accrued interest income on loans made to certain affiliates (24 million); interest expense payable to

		transactions (30 million)		Teleleasing for financial leasing transactions (23 million)		Teleleasing for financial leasing transactions (11 million)

F-63

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following related party transactions are reflected on the balance sheets as of December 31, 2002 and 2003:

	Related party transactions as of December 31,			
	2002		2003	
Items	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**
Loans in long-term investments	456 million	Refers mainly to medium/long term loans made to Aria Is Tim (313 million), Tiglio I (70 million), Telegono (34 million) and Tiglio II (30 million)	122 million	Refers mainly to medium/long term loans made to Aria Is Tim (336 million written-off by 279 million), Aree Urbane (31 million) and Telegono (15 million)
Trade accounts receivables and other current assets	222 million	Comprises mainly receivables from Sky Italia (formerly Stream) (71 million), Telekom Srbija (21 million net of provision), Teleleasing (38 million) and Consorzio Telcal (14 million)	149 million	Comprises mainly receivables from Sky Italia (formerly Stream) (44 million written-off by 27 million), Teleleasing (49 million) and Shared Service Center (11 million)
Trade accounts payable and other current liabilities	405 million	Refers to payables for supply contracts connected with operating and investment activities. They include: payables to the Italtel Group (150 million), Siemens Informatica (40 million), Teleleasing (17 million) and advances from Consorzio Telcal (103 million)	146 million	Refers to payables for supply contracts connected with operational and investment activities. They include: payables to the Italtel group (54 million), Siemens Informatica (23 million) and Mirror International Holding (24 million) for capital subscribed and not yet paid
Long-term and short-term debt	406 million	Refers mainly to payables for finance leases to Teleleasing (393	42 million	Refers mainly to payables for finance leases to Teleleasing (26

		million)		million), Shared Service Center (6 million) and Edotel (4 million)
Short-term financial receivables	35 million	Comprises short-term loans made to TI Sparkle (formerly TMI) group companies (14 million) and Golden Lines (10 million net of provisions)	30 million	Comprises short-term loans made to Teleleasing (13 million), TMI Canada (8 million) and TIN Web (5 million)

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Related party transactions as of December 31,			
	2002		2003	
Items	**In the aggregate**	**Main transactions with affiliates**	**In the aggregate**	**Main transactions with affiliates**
Long-term and short-term contracts	110 million	Refers mainly to activities on behalf of Consorzio Telcal for the Telematico Calabria Plan		
Guarantees and collateral	935 million	Comprises sureties provided on behalf of Aria Is Tim (537 million), Consorzio Csia (85 million) and Sky Italia (formerly Stream) (72 million), Tiglio I (27 million) as well as collateral on behalf of Aria Is Tim (110 million)	976 million	Comprises sureties provided on behalf of Aria-Is Tim (672 million), Consorzio Csia (81 million), Tiglio I (46 million) as well as collateral on behalf of Aria-Is Tim (107 million)
Capital expenditures	441 million	Mainly consists of acquisitions of telephone exchanges from the Italtel group (406 million) and computer projects from Siemens Informatica (19 million)	403 million	Mainly consists of acquisitions of telephone exchanges from the Italtel group (346 million) and computer projects from Siemens Informatica (13 million)

Moreover, related party transactions in the year ended December 31, 2003 include:

Items	**In the aggregate**	**Nature of the transaction**
Purchases and sales commitments	37 million	Refers to commitments with Teleleasing (5 million) under operating leases and with Etec S.A. Cuba (32 million) for the capital increases

In addition, during 2003, the buildings leased from Teleleasing under financial leasing contracts, already recorded in tangible assets in the preceding financial statements, were purchased.

- **Other related party transactions for the year ended December 31, 2003: Pirelli group, Edizione Holding group, Unipol group, Banca Intesa group, Unicredito group and others**

Related party transactions, excluding transactions among group companies, also include transactions entered into during 2003 between the Group with the Pirelli group, the Edizione Holding group, the Unipol group, the Banca Intesa group, the Unicredito group and the companies associated with Director Mr. Massimo Moratti as follows.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following related party transactions are reflected in the statement of operations for the year ended December 31, 2003:

Items	In the aggregate	Nature of the transaction
Operating revenues	63 million	Refers mainly to computer services and the supply of energy services to the Pirelli group (34 million) and telephone services to the Pirelli group (5 million), the Edizione Holding group (9 million), the Banca Intesa group (4 million), the Unicredito group (2 million), the Unipol group (8 million) and companies associated with Director Mr. Massimo Moratti (1 million)
Cost of materials and other external charges	55 million	Refers mainly to R&D expenditures and information technology and tax consulting services and matters regarding intellectual property rendered by the Pirelli group (44 million), insurance services to the Unipol group (10 million) and the commissions due to the Edizione Holding group for the sale of prepaid telephone cards (1 million)

The following related party transactions are reflected on the balance sheet as of December 31, 2003:

Items	In the aggregate	Nature of the transaction
Trade accounts receivables and other current assets	20 million	Mainly refers to the above-mentioned telephone services rendered to the Pirelli group (13 million), to the Edizione Holding group (3 million), to the Banca Intesa group (2 million) and to the Unipol group (2 million)
Trade accounts payable and other current liabilities	30 million	Mainly includes supply transactions connected with services rendered and investment activities with the Pirelli group (principally cables)
Capital expenditures	30 million	Refers to purchases of telecommunications cables (27 million) and leasehold improvements (3 million) from the

		Pirelli group
Short-term financial receivables	707 million	Refers to the liquid assets of the Group deposited with the Banca Intesa group (608 million) and the Unicredito group (99 million)
Financial debt	392 million	Financial exposure of the Group to the Banca Intesa group (341 million) and the Unicredito group (51 million)
Acquisition of investments	2 million	Purchase by Telecom Italia S.p.A of a 5% stake in EPIClink S.p.A. from Pirelli S.p.A.
Disposal of business segments	4 million	Gain on contribution, by Olivetti, of the Facility Management business segment to Pirelli & C. Real Estate
Derivatives	88 million	Hedging contracts and forward currency agreements put into place with the Banca Intesa group

F-66

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Moreover, there were the following transactions:

- in 2003, TIM and Telecom Italia disposed of telephone cards to Autogrill S.p.A. (Edizione Holding group) for subsequent sale to the general public for an equivalent amount of 22 million; the commission due to Edizione Holding group for the sale of telephone cards amounted to 1 million;
- on July 28, 2003, IT Telecom S.p.A. contributed its business segment Corporate Solution to Pirelli Informatica s share capital. Pirelli Informatica changed in Shared Service Center (SCC), a consortium with limited liability held as of December 31, 2003 by IT Telecom S.p.A. (45%), Olivetti Tecnost S.p.A. (5%) and Pirelli S.p.A. (50%);
- on July 21, 2003, the spin-off of Tiglio I and Tiglio II in Ortensia was concluded. Such transaction became effective on July 25, 2003;
- in March 2004 TIM conferred to Shared Service Center a business segment operating in the development and maintenance of SAP applications.

- **Other related party transactions for the years ended December 31, 2002 and 2001: Pirelli group and Edizione Holding group**

Related party transactions, excluding transactions among group companies, also included transactions between the Telecom Italia Group with the Pirelli group and the Edizione Holding group in 2002 as follows.

The following related party transactions were reflected in the statement of operations for the year ended December 31, 2002:

Items	**In the aggregate**	**Nature of the transaction**
Operating revenues	26 million	Mainly refers to telephone services to Pirelli group (8 million) and to Edizione Holding (16 million) and to information services to Pirelli group (2 million)
Cost of materials and other external charges	23 million	Essentially refer to R & D expenditures and the supply of services in the IPR field to Pirelli group (21 million) and to Edizione Holding group (2 million)

The following related party transactions were reflected on the balance sheet as of December 31, 2002:

Items	**In the aggregate**	**Nature of the transaction**
Trade accounts receivables and other current assets		
	3 million	Mainly refer to the above-mentioned services to Pirelli group (1.6 million) and to Edizione Holding group (1.5 million)
Trade accounts payable and other current liabilities		
	9 million	Mainly refer to the supply contracts connected with investment activities to Pirelli group (8 million) and to Edizione Holding group (1 million)
Capital expenditures	32 million	Mainly refer to purchases of telecommunications cables from Pirelli group

F-67

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Items	In the aggregate	Nature of the transaction
Acquisition of investments and purchases commitments		
	21 million	Purchase of 25.3% stake in EPIClink by Old Telecom Italia from Pirelli S.p.A. (18 million) and purchase commitment for the remaining 5% (3 million)
	35 million	Purchase by TIM of Blu S.p.A. shares, stake from Edizione Holding S.p.A. and Autostrade S.p.A.
Acquisition of business segments	3 million	Purchase of a business segment by EPIClink S.p.A. from Pirelli Informatica
Disposal of business segments	19 million	Gain on the sale of non-facility business segments to Pirelli Real Estate from the Old Telecom Italia Group and of Property and Project business from Olivetti Multiservices

Moreover in 2002, 20 million of telephone cards, mostly for mobile phones, were sold to Autogrill S.p.A. (Edizione Holding group).

Related party transactions in 2001 also included those by Telecom Italia (formerly Olivetti) with the Pirelli group. Such items include:

- *Operating revenues:* mainly related to telephone services (6.9 million).
- *Capital expenditures:* mainly related to purchases of telecommunications cables (21.5 million).

(c) Changes in accounts receivable allowances

The following table summarizes the changes in accounts receivable allowances for each of the three years ended December 31, 2003.

Trade accounts

	receivables, accounts receivables from affiliated companies and others
	(millions of euro)
Year ended December 31, 2001:	
Balance at beginning of period	**725**
• Charged to costs and expenses	448
• Deductions (1)	(288)
Balance at end of period	**885**
Year ended December 31, 2002:	
Balance at beginning of period	**885**
• Charged to costs and expenses	546
• Deductions (1)	(438)
Balance at end of period	**993**
Year ended December 31, 2003:	
Balance at beginning of period	**993**
• Charged to costs and expenses	471
• Deductions (1)	(625)
Balance at end of period	**839**

(1) They refer to: uncollectible accounts written-off, net of recoveries, changes in the scope of consolidation and translation adjustments.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 26 Subsequent events

Sale of shares in Telekom Austria

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

Issue of Notes

On January 29, 2004, Telecom Italia issued 1,000 million principal amount of floating rate notes due October 29, 2007 (Euribor 3 months + 0.33%; issue price 99.927), 750 million principal amount of 4.5% notes due January 28, 2011 (issue price 99.56) and 1,250 million principal amount of 5.375% notes due January 29, 2019 (issue price 99.07).

The issue is part of Telecom Italia s 10,000,000,000 Euro Medium Term Note (EMTN) Program authorized by the Board of Directors of Telecom Italia S.p.A. on October 10, 2003 and has been jointly arranged by Barclays Capital, BNP Paribas, Caboto, Deutsche Bank, JP Morgan, MCC, Mediobanca and UBM as *Lead Arrangers* and *Book Runners.* The notes are listed on the Luxembourg Stock Exchange and are expected to be listed on *Mercato Obbligazionario Telematico*, managed by Borsa Italiana S.p.A..

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 with a capital gain of 4.9 million for Telecom Italia Media S.p.A..

Merger of the Tele Nordeste Celular Participações group companies

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

The objective of the merger of the operating companies by Telpe 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 Telpe 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.

Early reimbursement of Telecom Italia floating rate note for 1,500 million

On February 17, 2004, the Telecom Italia Board of Directors, in accordance with the terms of the notes, authorized the early repayment in full, at par, of the Telecom Italia floating rate note for 1,500,000,000, with original maturity on June 21, 2005 (issue date December 21, 2001). This repayment occurred on March 22, 2004 through the utilization of part of the proceeds that arose from the issuance of notes in January 2004.

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 at a total price of 13.6 million. The closing took place on February 19, 2004, after the deadline had passed for exercising the 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 consideration of 12.1 million and 18,719 shares sold to Iberdrola for consideration of 1.5 million). Upon completion of the transaction, Telecom Italia International retained a 3% stake in Euskaltel.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Sale of Netco Redes

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 interests to be paid in three annual installments starting from December 2006. The closing will take place within a few months soon after antitrust clearance.

Cancellation of Olivetti Finance N.V., S.A. Notes after their buy-back

In order to bring the gross levels of debt and liquidity in line with actual financial requirements, on March 26, 2004 the Group cancelled the following notes, which had been purchased in market transactions over the past years by Olivetti Finance N.V., S.A.:

- 650 million principal amount of Notes that are part of the Olivetti Finance N.V., S.A. (originally Olivetti International Finance N.V.) 4,200 million Notes (1999-2004) with a fixed annual 5 3/8% coupon + 0.45% step-up maturing in July 2004. As a result of this cancellation, the Notes in the principal amount of 3,550 million remain outstanding;
- Olivetti Finance N.V., S.A. - 200 million principal amount of Notes (2002-2005) with a floating rate coupon of 1.45% over the EONIA maturing in February 2005. As a result of this transaction none of these notes remain outstanding.

The effects of these cancellations were already reflected in the 2003 consolidated financial statements.

Renewal of Bank Facility

In April 2004, the first tranche (4,500 million) of the syndicated credit facility totaling 6,500 million agreed by Olivetti in relation to the Merger would have expired. In view of this deadline and for purposes of the renewal of the full facility including the residual amount of 2,000 million falling due in April 2006, on March 30, 2004 a New Credit Facility (the New Facility) for the same amount of 6,500 million with a three year maturity was signed. The New Facility does not contain any financial covenants and does not place any constraints on how we operate our business.

Issue of Notes

On April 8, 2004, Telecom Italia issued, at par, 110 million principal amount of floating rate notes due March 30, 2009 (Euribor 3 months + 0.60%) under the EMTN Program. Such notes have been subscribed in full, by way of a private placement, by one single investor.

Note 27 Reconciliation to Accounting Principles Generally Accepted in the United States

The consolidated financial statements of the Group are prepared in accordance with accounting principles established or adopted by the Italian Accounting Profession as described in Notes 1, 2 and 3, which differ in certain significant respects from U.S. GAAP. A summary of the significant differences is as follows:

Business combinations

The accounting for business combinations and goodwill differs between Italian and U.S. GAAP for various reasons, which include but are not limited to the following:

- Italian GAAP allows, for certain transactions that use shares for part or all of the consideration, that the shares exchanged be accounted for as a pooling of interest. U.S. GAAP requires that an acquirer be determined, the fair value of the consideration exchanged be accounted for, and that the purchase method of accounting be used for all business combinations (subsequent to the adoption of Statement of Financial Accounting Standards (SFAS) 141, Business Combinations);

- in valuing stock-based consideration U.S. GAAP requires that the average stock price be used for a reasonable period of time before and after the date of announcement (or date of exchange, if applicable); Italian GAAP often does not account for the value of the securities exchanged;

F-70

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- Italian GAAP does not provide specific guidance as to the effective date, and therefore, the date from which the results of operations can be included in the results of the Group, U.S. GAAP requires that the acquisition be accounted for as of the effective date;
- a detailed allocation of the purchase price of a company is required under U.S. GAAP;
- under U.S. GAAP certain put and call arrangements are considered to be acquisition financing and, therefore, part of the original purchase price. Under Italian GAAP they are not recorded until the amounts are paid; and
- the amortization of goodwill is required under Italian GAAP. For purposes of U.S. GAAP, subsequent to adoption of SFAS 142, goodwill is not subject to amortization but is tested at least annually for impairment.

As discussed further in U.S. GAAP accounting policy Note 29 (c), the Group ceased amortization on all goodwill and indefinite-lived assets associated with all acquisitions and equity investees, including those transactions below that have given rise to U.S. GAAP reconciling differences.

1. Purchase method of accounting related to Old Telecom Italia acquisition

As reported in Note 1, in 1999 Telecom Italia (formerly Olivetti), through its 72.9% owned subsidiary Tecnost, made a tender offer for the majority of the ordinary shares of Old Telecom Italia. The transaction was announced at the end of February 1999. The tender offer took place in May 1999 and was completed on June 23, 1999 giving Tecnost a 52.12% controlling interest in Old Telecom Italia s ordinary shares. The tender offer was financed through a combination of cash, bonds and shares for a total amount equal to 31,501 million. During 1999 Tecnost increased its controlling interest in Old Telecom Italia acquiring an additional interest of 2.04%, as a result of certain cash transactions. Total consideration amounted to approximately 32,506 million including direct acquisition costs, for the acquisition of a total of 2,850,255,432 ordinary shares of Old Telecom Italia, equal to 54.16% of total ordinary shares and to 38.96% of total share capital.

Under Italian GAAP, as reported in Note 1, the excess of the purchase price was computed with respect to the book value of the net assets acquired, adjusted for certain specific items, related principally to: (i) the recognition of the estimated minimum liability to the Italian National Social Security Agency (see Notes 14 and 18), in connection with the telephone workers social security obligations and the related tax effect, (ii) the elimination of goodwill recorded in Old Telecom Italia, and (iii) dividends paid. Such excess of purchase price, amounting to approximately 26,208 million, was allocated to goodwill and amortized over a period of 20 years.

Under U.S. GAAP, the Old Telecom Italia acquisition was accounted for by the purchase method with July 1, 1999 designated as the effective date of the acquisition. The tangible and intangible assets acquired and liabilities assumed were recorded at estimated fair values, as determined by the Telecom Italia (formerly Olivetti) Group s management.

In 2000, to rationalize the organizational structure of the Telecom Italia (formerly Olivetti) Group, the 72.9% owned subsidiary Tecnost was merged into Olivetti. The merger was announced on May 15, 2000 and the Boards of Directors of the companies involved in the merger, with the assistance of their advisors, fixed an exchange ratio of 1.12 Olivetti shares for each Tecnost share, both with a par value of 1.00 per share. No cash consideration was involved. The merger was effective from December 31, 2000, with the cancellation of all the Tecnost shares previously held by Olivetti and with the issue of 1,999,439,092 Olivetti shares, par value 1.00 to minority shareholders in exchange for their 1,785,213,475 Tecnost shares.

Under Italian GAAP the merger was accounted for at book value. Included in the minority shareholders was the Olivetti subsidiary Olivetti International S.A. (in 2004 merged with and into TI Finance) which owned 3.2% of the total Tecnost shares and obtained in exchange the Olivetti shares (thus becoming treasury shares at consolidated level) carried at a total value of 391 million, the original book value of the Tecnost shares (for further details as of December 31, 2003, see Note 10).

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under U.S. GAAP the acquisition of the minority interests through the merger was accounted for under the purchase method, at fair value. Accordingly the acquisition of the 27.1% minority interests from third parties was accounted for at the fair value of the Olivetti shares, determined as the average of the quoted market prices of the shares on the date of the announcement of the transaction and two days before and two days after such date. In addition, for U.S. GAAP purposes, the Olivetti treasury shares decreased consolidated shareholders equity. The excess of cost of the acquisition of the minority interests over the fair value of the net assets acquired amounted to 2,774 million, which was recorded as additional goodwill.

As reported in Note 4, under Italian GAAP Telecom Italia (formerly Olivetti) classified certain shares of Old Telecom Italia in marketable securities and these shares were not eliminated in consolidation. Under U.S. GAAP the shares were consolidated together with the other shares representing 39.86% of total Old Telecom Italia capital stock. These 41,401,250 shares, which corresponded to approximately 0.57% of the share capital of Old Telecom Italia, were acquired by Olivetti, through its subsidiary Olivetti Finance N.V., during 2000 and 2001 for a cash consideration of 515 million.

Under Italian GAAP these shares were accounted for at the lower of cost or market. At December 31, 2001, Olivetti Finance N.V. recognized a write-down of the value of these shares in the statement of operations of 18 million. During the year 2002 Olivetti Finance N.V. sold these shares to Telecom Italia (formerly Olivetti) and as of December 31, 2002 an additional write-off of 98 million was recognized, thus reducing the carrying value of the shares to 299 million. During the first quarter of 2003 Telecom Italia (formerly Olivetti) reclassified the 41,401,250 Old Telecom Italia ordinary shares from marketable securities to other long-term assets in connection with the Merger which provided for the cancellation of all Old Telecom Italia shares held by Telecom Italia (formerly Olivetti).

Under U.S. GAAP the Old Telecom Italia shares classified in marketable securities, up to December 31, 2002, were accounted for under the purchase method and consolidated starting on December 31, 2000, resulting in the recognition of an additional goodwill of 400 million. The accounting entries provided for Italian GAAP purposes were reversed. Starting from December 31, 2000, the Olivetti interest in Old Telecom Italia for U.S. GAAP consolidation purposes has been increased by approximately 0.57%, to 39.53%.

As reported in Note 1, on March 12, 2003, the Boards of Directors of Old Telecom Italia and Olivetti met and agreed to propose the Merger to the Shareholders. The Merger was effective on August 4, 2003. Under Italian GAAP, the Merger was effected as a pooling of interest with the two companies being combined at book value. Under U.S. GAAP Olivetti was identified as the acquiring company based upon the requirements of SFAS 141 and the acquisition of the minority interests was accounted for under the purchase method, using fair value as the measure. Accordingly, the acquisition of the 60.47% minority interests from third parties, consisting of cash purchase price paid in the tender offer, fair value of the Olivetti shares exchanged (determined as the average of the quoted market prices of the shares on the date of the announcement of the transaction and two days before and two days after such date) and fair value of the employees stock options exchanged, amounted to 23,255 million.

The following represents the calculation of the total consideration:

	(millions of euro)
Cash purchase price paid in the tender offer	5,274
Fair value of Olivetti shares exchanged	17,927
Telecom Italia employees stock options exchanged for Old Telecom employees stock options	54
Total purchase price to be allocated	**23,255**

Telecom Italia has performed a preliminary allocation of the purchase price above to the fair value of the acquired tangible and intangible assets and liabilities assumed as of July 31, 2003, considered the effective date of the Merger for accounting purposes, with respect to the 60.47% minority interests acquired. The following represents the preliminary allocation of the above purchase price, principally pending finalization of the valuation of certain fixed assets. Telecom Italia does not expect there will be material changes to the final purchase accounting, upon completion of the allocation exercise.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Fair Value of Old Telecom Italia Assets and Liabilities at date of acquisition	Assets and Liabilities Acquired
	millions of Euro (Unaudited)	
Current assets	18,570	11,188
Property, plant, and equipment	21,966	13,431
Intangible assets subject to amortization:		
• Customer list (20 years weighted-average useful life)	20,728	9,806
• Distribution network (7 years weighted-average useful life)	1,033	421
• Licenses (20 years weighted-average useful life)	7,115	3,511
• Other (3 years weighted-average useful life)	2,566	1,581
Intangible assets with indefinite useful life:		
• Brand name	3,313	1,556
Goodwill		12,527
Total assets		**54,021**
Current liabilities	(24,394)	(13,188)
Long-term liabilities	(24,375)	(14,774)
Total liabilities		**(27,962)**
Minority interests		**(2,804)**
Fair value of net assets acquired		**23,255**

The 12,527 million of goodwill has been assigned to each of the Old Telecom Italia segments based upon the relative fair value of each reporting unit to the fair value of the acquired minority interests as a whole. On the total amount of 12,527 million, 8,323 million have been allocated to the Wireline segment and 4,169 million to the Mobile segment, with the residual to the other Group s segments. Goodwill is not deductible for tax purposes.

The purchase price allocation, for the allocation of the 60.47% acquisition of minority interests, was carried out by involving external experts and specialists in addition to internal experts and specialists with respect to the valuation process.

Current assets at fair value, reported in the table above, consist principally of cash and banks, assets held for sale, marketable debt and equity securities, accounts receivable and other assets. With respect to assets held for sale, they are reported at fair value. Marketable debt and equity securities are at fair value determined by either using stock market price and external and internal valuations. Accounts receivable to be recovered in the short-term are at fair value, based on estimated net realizable value.

Property, plant and equipment at fair value consist principally of fixed assets utilized for the Group s operations and of real estate. Fair value for fixed assets utilized for the Group operations is based on replacement costs and fair value for real estate is based on appraisals from independent experts.

Intangible assets at fair value include those assets which have been identified by the external qualified experts and valued in accordance with the valuation criteria methods developed by them. The significant identified intangible assets include: customer lists of Wireline, Mobile and Internet segments, brand names of Wireline and Mobile segments, distribution network and licenses of the Mobile segment and portals and contracts of the Internet segment. Other intangible assets at fair value include principally software.

Current liabilities and long-term liabilities at fair value consist principally of short-term borrowings and long-term debt assumed at fair value, accounts payable trade, deferred tax liabilities set-up in connection with the fair value allocation and other miscellaneous liabilities, including deferred revenue recorded at fair value and recognized only for revenue associated with legal performance obligations and asset retirement obligations.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Certain historical U.S. GAAP adjustments that are included in the reconciliation from Italian to U.S. GAAP prior to the acquisition of the minority interests of Telecom Italia by Olivetti no longer exist after the application of purchase accounting. As such, certain U.S. GAAP differences for the period ended December 31, 2003 and further described under paragraphs 27.2 to 27.15 are presented with the effects of the purchase accounting.

The following table represents the pro-forma results of operations, net income before discontinued operations and cumulative effect of accounting changes and net income, as if the acquisition of the 60.47% minority interests had occurred as of January 1, 2002, and as of January 1, 2003 instead of the effective date of July 31, 2003. In both years, revenue would not have been affected by the acquisition of the minority interests. Pro-forma adjustments are principally related to the amortization of the fair value adjustments on the acquired tangible and intangible assets, the reduction in amounts attributable to minority interests and the change in fair value of debt assumed.

	2002	2003
	(millions of euro except for share amounts)	
	Unaudited	
Net income in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes	3,637	1,795
Net income in accordance with U.S. GAAP	2,378	2,024
Earnings per Share		
Basic EPS per Ordinary Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes	0.90	0.20
Diluted EPS per Ordinary Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes	0.90	0.20
Basic EPS per Ordinary Share amounts in accordance with U.S. GAAP	0.59	0.22
Diluted EPS per Ordinary Share amounts in accordance with U.S. GAAP	0.59	0.22
Basic EPS per Savings Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes		0.21
Diluted EPS per Savings Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes		0.21
Basic EPS per Savings Share amounts in accordance with U.S. GAAP		0.23

Diluted EPS per Savings Share amounts in accordance with U.S. GAAP	0.23

2. Purchase method of accounting for other transactions

Several acquisitions, which are required to be accounted for under the purchase method of accounting for U.S. GAAP purposes, have been recorded differently under Italian GAAP. Such acquisitions relate principally to Telecom Italia Media S.p.A. (formerly SEAT) which made several acquisitions since it was acquired in 2000. Certain of these acquisitions were made through the issuance of additional shares for the targets stock. For purposes of Italian GAAP, these transactions were recorded as changes in equity. For purposes of U.S. GAAP, the fair value of the stake received is used to determine the purchase price and if not readily determinable, the fair value of SEAT s shares were used to measure the acquisition price.

The largest of the acquisitions was made in 2000 and 2001 for Buffetti for an additional purchase price of 716 million under U.S. GAAP.

3. Reversal of goodwill amortization

Italian GAAP requires that goodwill related to assets be amortized over the assets estimated economic life. Upon the adoption of SFAS 142 on January 1, 2002, the Group ceased amortizing goodwill associated with both subsidiaries and equity investees. Instead, goodwill is assessed at least on an annual basis for impairment. If there are indicators of impairment before the annual test, then an impairment review is conducted before the annual review.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Revaluation of fixed assets

The Group has periodically revalued its fixed assets as permitted by Italian law. Under Italian GAAP the depreciation charge is based on the revalued amounts. U.S. GAAP does not permit revaluation of fixed assets and requires depreciation based on historical acquisition cost.

5. Capitalization of interest on tangible and intangible assets under construction and related depreciation

Telecom Italia capitalizes interest on construction projects only when specific borrowings can be attributed to the project. U.S. GAAP requires interest to be capitalized on both tangible and intangible fixed assets regardless of whether specific borrowings relate to the project. The capitalized interest is amortized over the remaining useful life of the assets.

6. Sale of real estate properties

In 2000, the Group transferred certain real estate properties to a wholly-owned subsidiary (IM.SER), 60% of which was then sold to third parties. Concurrent with the sale, the Group entered into long-term lease agreements for a portion of the real estate portfolio. Concurrent with the partial sale of the subsidiary, IM.SER borrowed funds from a syndicate of banks, with the funds being dispersed to the shareholders as a special dividend. For purposes of Italian GAAP, a gain was recognized to the extent of the fair market value of the transferred property over its historical cost for that portion sold to third parties. For purposes of U.S. GAAP, the transfer of the assets to the wholly-owned subsidiary, the subsequent lease agreement, the receipt of cash by the Group from the partial sale of the subsidiary and the special dividend are treated as a secured borrowing; therefore the gain recorded has been reversed and the real estate retained, along with the additional indebtedness, has been recorded at historical cost.

In 2002 and 2003, the Group entered into a series of other transactions that involved IM.SER, Pirelli and SEAT. Under U.S. GAAP these transactions did not meet certain of the sale/ leaseback criteria; therefore the assets and certain debts of the special purpose entities are included in the U.S. GAAP financial statements.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Securitization of satellite investments

In late 2001, Telecom Italia formed a wholly-owned subsidiary domiciled in Luxembourg (Mirror International Holding, or Mirror) to which it transferred its non-controlling investments in certain entities in the satellite communications sector at an amount equal to the fair value of the investments contributed. Subsequently, 70% of the interest in Mirror was sold to Lehman Brothers Merchant Bank (LBMB), with Mirror subsequently obtaining debt financing. For Italian GAAP purposes this transaction was accounted for as a partial sale of financial assets with a pre-tax gain of 170 million being recorded. For U.S. GAAP purposes, Mirror is deemed a non-qualified special purpose entity and the transaction is not accounted for as a sale. Instead, the accounts of Mirror have been consolidated by the Group with an elimination of the related step-up of the assets and an elimination of the gain. The cash received from the debt financing of Mirror has been reflected as debt on the Group s balance sheet and the cash received from the partial sale of the investment has been reflected as minority interests in Mirror.

8. Elimination of intercompany profit on sales of intangible and tangible assets and related depreciation

Until 1993, the Group did not eliminate intercompany profit on sales of intangible and tangible assets within the Old Telecom Italia Group. Therefore, certain intangible and tangible assets are valued at the sales amount instead of historical book value. The amounts, principally from Group manufacturing and installation companies to telecommunication companies, are being depreciated over the useful life of the assets. U.S. GAAP requires the elimination of intercompany profits and requires depreciation based on historical cost.

9. Investment in stock of subsidiary companies

Telecom Italia records a portion of the total stock owned in certain consolidated subsidiaries within current assets. These shares can be traded by the Group when market conditions allow. The portion of the earnings, losses and the ownership interest in the net assets associated with such stock is not consolidated under Italian GAAP, and the shares of the subsidiary are recorded at the lower of historical cost or fair value within current assets. Write-downs below historical cost are reversed in subsequent periods up to the original cost, if the fair value of the equity securities increases. Write-downs and any subsequent reversals are recorded in the statement of operations.

Under U.S. GAAP shares in consolidated subsidiaries cannot be treated as marketable securities, but rather must be consolidated. The value of the investment in subsidiary stock has been adjusted to original cost and has been eliminated upon consolidation. This has resulted in the elimination of the investment results in additional goodwill, the reversal of any write-downs or write-ups taken under Italian GAAP, and the accrual of the incremental income or losses from the additional ownership percentage being consolidated.

10. Common control transactions

During 2000, Telecom Italia acquired an additional ownership percentage in TIM by contributing its ownership of SMH (renamed TIM International) to TIM in exchange for new shares issued by TIM. Under Italian GAAP, this transaction resulted in an increase in equity and goodwill. As the timing of this transaction was near December 31, 2000, no amortization of the goodwill was recognized in the Italian GAAP financial statements.

Under U.S. GAAP, transactions between entities under common control require predecessor basis accounting. Therefore, the increase in equity and goodwill has been reversed. For periods subsequent to 2000, the annual amortization of the goodwill arising from this transaction is reversed for U.S. GAAP purposes.

11. Non-capitalizable expenses

The Group entered into several transactions for which certain costs were capitalized under Italian GAAP. These costs include expenses related to the SMH (renamed TIM International) reorganization, start-up and

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

expansion costs and other costs associated with certain intangible assets. For purposes of U.S. GAAP, these costs cannot be capitalized and have therefore been expensed. Subsequent periods amortization of these expenses under Italian GAAP is reversed for U.S. GAAP purposes.

12. Reversal of provisions

During the year 2000, due to the technological changes in the mobile phone industry, TIM determined that the invested cost related to analogic services, and the related network plants and billing systems, was rapidly approaching obsolescence due to the evolution of third generation services. The 2003 Italian GAAP financial statements reflect reserves for 290 million recorded to accrue the estimated costs to modify these systems and/or to reflect their potentially reduced lives. U.S. GAAP requires that certain conditions must be met before reserves can be established and that the lives of fixed assets be evaluated to consider potential changes in the related depreciation period. The conditions required under U.S. GAAP to accrue this provision have not been met. As a result, in the U.S. GAAP reconciliation these provisions have been reversed and the remaining lives and related depreciation expense have been revised to reflect the expected remaining useful lives of the assets. For 2001, 2002 and 2003 charges and reversals of the reserve and the modified depreciation are treated as expenses under U.S. GAAP.

In 2001, Telecom Italia (formerly Olivetti), for Italian GAAP purposes, accounted for a provision for risks on various subsidiaries of 200 million, principally in connection with certain estimated liabilities of Olivetti Tecnost and the eventual disposal of the same Olivetti Tecnost. This provision did not meet the U.S. GAAP requirements for being accrued and, therefore, it has been reversed in the statement of operations. In 2002, Telecom Italia (formerly Olivetti), for Italian GAAP purposes, utilized 87 million of the 2001 provision with respect to certain losses incurred by Olivetti Tecnost and 67 million with respect to certain cash payments for the settlement of a dispute with Verizon (previously Bell Atlantic), while the remaining portion of the 2001 provision of 46 million was maintained to cover certain estimated liabilities of the subsidiaries Olivetti Tecnost and Olivetti Finance. Since the 2001 provision did not meet the U.S. GAAP requirements, these transactions were reversed in the statement of operations for U.S. GAAP purposes. At December 31, 2003, the remaining portion of the provision amounts to 34 million.

Restructuring reserve

The Italian GAAP financial statements include a restructuring reserve. U.S. GAAP requires that certain conditions must be met before a restructuring accrual can be established, as well as the type of costs that can be accrued. In 2003 the Group approved a retirement plan for which a provision amounting to 98 million was recorded. Such accrual does not meet the conditions required by U.S. GAAP for recognizing a liability and therefore it has been reversed.

13. Revenue recognition

Under Italian GAAP, non-refundable activation and installation fees, and their related costs, are generally charged and recognized at the outset of a service contract. Additionally, on-line advertising revenues are recognized at the date the advertisement is first posted. Under U.S. GAAP, up front revenues related to non-refundable fees and certain related direct costs are deferred and recognized over the expected customer relationship period estimated as 8 years, and on-line advertising revenues are recognized over the life of the advertising period on a straight-line basis.

14. Derivative financial instruments

The Group enters into a number of derivative agreements to manage its risks related to changes in interest rates, foreign currency exchange rates and values of equity investments. The Group s derivative instruments include interest rate swap and collar agreements, cross currency and interest rate swaps, foreign currency options and forward contracts and equity securities options.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Group s accounting policies related to its derivative financial instruments under Italian GAAP are reported in Note 3 Accounting Policies. Below is a further description of the applied policies:

- *Interest rate swap and collar agreements* the Group enters into interest rate swap and collar agreements as part of the management of its interest rate exposures. Interest rate differentials to be paid or received as a result of interest rate swap and collar agreements are accrued and recognized as an adjustment of interest expense related to the designated debt.

- *Cross currency and interest rate swaps* the Group enters into cross currency and interest rate swap agreements to manage its interest rate and foreign currency exchange exposures related to foreign currency denominated debt. The related foreign currency denominated debt and the foreign currency portion of the cross currency and interest rate swap agreements are adjusted using foreign currency exchange rates as of the related balance sheet date. Interest rate differentials to be paid or received as a result of cross currency and interest rate swap agreements are accrued and recognized as an adjustment of interest expense related to the designated debt.

- *Foreign currency options and forward contracts* The Group enters into foreign currency forward exchange contracts as part of the management of its foreign currency exchange rate exposures related to existing foreign currency denominated assets and liabilities or firm commitments denominated in foreign currencies. The foreign currency forward exchange contracts and the related hedged positions are adjusted using foreign currency exchange rates as of the related balance sheet date and any net expense connected with each single transaction is recognized in the statement of operations. Discounts or premiums on forward contracts are recorded in the statement of operations using the straight-line method over the term of the related contract.

Effective January 1, 2001, the Group for U.S. GAAP purposes adopted the provisions of SFAS 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). SFAS 133 requires the Group to recognize all of its derivative instruments as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Group must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings during the period of the change in fair values.

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument, if any, is recognized in current earnings during the period of change.

For derivative instruments that are designated and qualify as a hedge of a net investment in a foreign operation, the gain or loss is reported in other comprehensive income as part of the cumulative translation adjustment to the extent it is effective. Any ineffective portions of net investment hedges are recognized in current earnings during the period of change.

For derivative instruments not designated or qualifying as hedging instruments, the gain or loss is recognized in current earnings during the period of change. The Group did not apply hedge accounting as of December 31, 2002 and 2003.

15. Other

Other is comprised of the following:

Stock options

From time to time companies within the Group award shares and stock options to certain employees. For purposes of Italian GAAP, the Group treats the exercise of stock options as increases in share capital and

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

additional paid-in-capital upon exercise. For U.S. GAAP purposes the Group applies Accounting Principles Board Opinion (APB) 25, Accounting for Stock Issued to Employees and its related interpretations. Under APB 25, these transactions are treated as compensation expense for the difference between the quoted market price of the shares and the cost of those shares to the employees. This difference is determined on the measurement date , which is the first date on which both the ultimate number of shares and the option or award prices are known. As a consequence of the Merger terms, options in Old Telecom Italia were deemed exchanged for options of Telecom Italia and, accordingly, accounted for as part of the Merger consideration. Similarly, options of Olivetti were deemed exchanged for options of Telecom Italia, which resulted in a modification under FIN 44 (Accounting for Certain Transactions involving Stock Compensation on Interpretation of APB Opinion No. 25) (FIN 44) requiring variable accounting.

Investments in marketable securities

The Group holds marketable securities both for the purpose of selling them in the near term as well as holding them to take advantage of investment opportunities. As described in Note 3, under Italian GAAP, all investments are carried at the lower of cost or market value. Write-downs below historical cost are reversed in subsequent periods up to original cost if the fair market value of the securities increases.

Under U.S. GAAP, the securities must be classified into various categories depending on the intent of management. Under U.S. GAAP the securities are classified as either trading or available for sale. The Group s trading securities are recorded at fair value, with unrealized gains and losses included in earnings. Available for sale securities are carried at fair value, with any unrealized gains or losses reflected in other comprehensive income on a net of tax basis. Declines in fair value of available for sale securities that are other than temporary are reflected in current period earnings.

Equity investees

The Group has certain investments in equity investees whereby the periodic accrual of income or loss is recorded on the basis of the Group accounting policies. For purposes of U.S. GAAP, the results of the equity investees are recognized on a U.S. GAAP basis.

Universal service

Telecom Italia provides certain services, known as universal services , which essentially requires Telecom Italia to offer telephony services to remote and difficult areas, thereby generating losses due to the high fixed and maintenance costs not being offset by an adequate revenue stream. These universal services have been deemed by the National Regulatory Authority to have benefited new fixed and mobile competitors who have entered the marketplace after the deregulation of the industry. Consequently, the National Regulatory Authority determined the costs of providing these services, based on data provided by Telecom Italia, and allocated a pro rata portion of the costs to various competitors, who were requested to pay such allocated amounts to a fund, a portion of which should be remitted to Telecom Italia. The legality and propriety of the allocated charge has been disputed by the competitors who have initiated legal proceeding with the National Regulatory Authority. Under Italian GAAP, Telecom Italia has accrued revenues related to universal service as other income in the accompanying statements of operations. Under U.S. GAAP the revenues for universal services will not be recognized until collected due to the uncertainty surrounding the amount and the collectibility of the revenues.

Impairment of long-lived assets and goodwill

Under Italian GAAP, the Group recognizes impairments of fixed and long-lived assets when it becomes apparent that there has been a permanent diminution in value. Due to a strategic shift in the Group s priorities in 2001, coupled with a general decrease in asset values in the telecommunications sector as a whole, the Group recorded significant write-downs to investments, including equity investees, in 2001, 2002 and 2003. See Note 29 (h) for the related discussion.

For U.S. GAAP, the Group follows the guidance provided in SFAS 142, as discussed previously, for all goodwill and indefinite lived assets beginning from 2002. For 2001, the Group used the guidance as outlined in SFAS 121, Accounting for the Impairment of Long-lived Assets and for Long-Lived Assets to be Disposed Of . The application of SFAS 121 required, among other things, that an asset be identified and measured at its lowest

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

level of cash flows for impairment. For purposes of recognizing impairment, the use of both SFAS 121 and SFAS 142 resulted in differences from the impairment amounts recognized under Italian GAAP. See Note 29 (i) for further details. Beginning in 2002, the Group has applied SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets , as discussed at Note 29 (h).

16. Deferred tax adjustments

The differences between Italian GAAP and U.S. GAAP are primarily related to the recognition of certain deferred tax assets, including net operating losses and the deferred taxes established for the basis differences of assets and liabilities. With respect to the deferred tax benefit of net operating losses or other deferred tax assets, the Group under Italian GAAP generally recognizes such deferred tax assets when they are reasonably certain to be realized. Under U.S. GAAP the deferred tax assets related to net operating losses and other deferred tax asset are always recognized but are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (i.e. a likelihood of more than 50 per cent.), that some portion or all of the deferred tax asset will not be realized. Therefore the valuation allowance is sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.

17. Discontinued operations New SEAT Activities

As described in Note 1, the Group separated its Internet and Media segment into two companies, New SEAT and Telecom Italia Media (formerly SEAT), as of August 1, 2003. Telecom Italia s interest in New SEAT was sold to a consortium of private equity investors on August 8, 2003. The purchase accounting upon the original acquisition between Italian and U.S. GAAP differed and, as such, the loss recorded on the sale of New SEAT for U.S. GAAP purposes was lower by 174 million, due to the differences in the carrying values of New SEAT. Also, under U.S. GAAP, New SEAT is presented as a discontinued operation in accordance with the guidance of SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). Based upon this guidance, the results for all periods, including revenues and costs, of the sold businesses are removed from the consolidated statements of operations and reported after income from continuing operations. The accompanying reconciliation includes, in the discontinued operations line, the effect of all reconciling items associated with the disposed New SEAT business.

At the time of its sale on August 8, 2003, New SEAT s net assets consisted of:

	(millions of euro)
Current assets	779
Fixed assets, net	47
Goodwill and other intangibles, net	3,567
Total assets disposed of	**4,393**

Current liabilities	1,041
Long-term liabilities	204
Minority interests	114
Total liabilities disposed of	**1,359**
Net assets disposed of	**3,034**

New SEAT contributed revenue and net income to Telecom Italia of 711 million and 250 million, respectively, for the period from January 1, 2003, to the date of disposal.

18. Treasury stock

Telecom Italia (formerly Olivetti) and its subsidiary Olivetti International S.A. (now merged with and into TI Finance) purchased its own ordinary shares. Under Italian GAAP, these ordinary shares have been recorded at historical cost within long-term assets, while under U.S. GAAP, the cost of the acquired shares is shown as a deduction from stockholders equity.

19. Asset retirement obligations

Effective January 1, 2003, the Group adopted SFAS 143 Accounting for Asset Retirement Obligations (SFAS 143). SFAS 143 applies to legal obligations associated with the retirement of long-lived assets that

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

result from the acquisition, construction, development and/or normal operation of the long-lived asset. This Asset Retirement Obligation, or ARO has been reported at fair value as of January 1, 2003, as a cumulative effect of an accounting change under U.S. GAAP, net of its related tax effect. Under Italian GAAP, asset retirement liabilities are not recognized.

20. Comprehensive income

SFAS 130 Reporting Comprehensive Income requires disclosure of the components of and total comprehensive income in the period in which net of its related tax effect, such components are recognized in the consolidated financial statements. Comprehensive income is defined as the change in equity of a business enterprise arising from transactions and other events and circumstances from non-owner sources. It includes all changes in stockholders equity during the reporting period except those resulting from investments by and distributions to owners. Unrealized gains and losses on investments classified as available for sale securities under U.S. GAAP, the cumulative effect of translation adjustments of foreign subsidiaries and the impact of adopting SFAS 133 related to derivatives have been recognized as a component of comprehensive income.

21. Reclassifications

Certain amounts in the presentation of the 2001 and 2002 reconciliations of net income (loss) and stockholders equity, from Italian GAAP to U.S. GAAP have been reclassified to conform to the 2003 presentation.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Significant differences and the effect of the above on consolidated net (income) loss and stockholders equity are set out below:

		Years ended December 31,		
		2001	**2002**	**2003**
		(millions of euro)		
NET INCOME (LOSS)				
Net income (loss) as reported in the consolidated statements of operations		(3,676)	(306)	2,428
Minority interests		586	(467)	(1,236)
Net income (loss), net of minority interests applicable for U.S. GAAP purposes	**A)**	**(3,090)**	**(773)**	**1,192**
Items increasing (decreasing) reported net income (loss):				
1. Purchase method of accounting related to Old Telecom Italia acquisition		(483)	512	946
2. Purchase method of accounting for other transactions			243	50
3. Reversal of goodwill amortization			524	268
4. Revaluation of fixed assets		61	155	59
5. Capitalization of interest on tangible and intangible assets under construction and related depreciation		124	127	60
6. Sale of real estate properties		(34)	(153)	9
7. Securitization of satellite investments		(130)		6
8. Elimination of intercompany profit on sales of intangible and tangible assets and related depreciation		54	34	25
9. Investment in stock of subsidiary companies		65	83	3
10. Common control transactions		14	14	11
11. Non-capitalizable expenses		71	82	51
12. Reversal of provisions		(24)	(139)	84
13. Revenue recognition		(9)	(86)	(120)
14. Derivative financial instruments		(138)	319	(171)
15. Other		(225)	161	(94)
	B)	**(654)**	**1,876**	**1,187**
U.S. GAAP income (loss) before reconciliation effects of income taxes, minority interests, discontinued operations and cumulative effect of accounting changes	**C = A + B)**	**(3,744)**	**1,103**	**2,379**
Income taxes:				
• Deferred tax adjustments (see Note 27.16)		(55)	1,386	(813)
• Tax effect on reconciling items		449	97	129
U.S. GAAP income (loss) before reconciliation effects of minority interests, discontinued operations and cumulative effect of accounting changes	**D)**	**(3,350)**	**2,586**	**1,695**
Minority interests on reconciling items	**E)**	**38**	**(635)**	**(306)**
Total effect of the reconciling differences on discontinued operations New SEAT activities (see Note 27.17):				
• Gross adjustments (purchase method of accounting and other)		(2,285)	540	(1,498)

• Tax effects		(75)	(517)	1,685
• Minority interests		1,646	(18)	286
Total effect Discontinued Operations New SEAT Activities	**F)**	**(714)**	**5**	**473**
Net income (loss) in accordance with U.S. GAAP, before cumulative effect of accounting changes	**G = D + E + F)**	**(4,026)**	**1,956**	**1,862**
Cumulative effect of accounting changes, net of tax (*)	**H)**	20		(21)
Net income (loss) in accordance with U.S. GAAP	**I = G + H)**	**(4,006)**	**1,956**	**1,841**

(*) See Note 27.14 and Note 27.19.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Earnings Per Ordinary Share Amounts in Accordance with U.S. GAAP (*)

	Years ended December 31,		
	2001	2002	2003
		(euro)	
Basic EPS per Ordinary Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes	(0.85)	0.79	0.18
Diluted EPS per Ordinary Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes	(0.85)	0.79	0.18
Basic EPS per Ordinary Share amounts in accordance with U.S. GAAP from discontinued operations	0.01	0.00	0.00
Diluted EPS per Ordinary Share amounts in accordance with U.S. GAAP from discontinued operations	0.01	0.00	0.00
Basic EPS per Ordinary Share amounts in accordance with U.S. GAAP from cumulative effect of accounting changes	0.01	0.00	(0.00)
Diluted EPS per Ordinary Share amounts in accordance with U.S. GAAP from cumulative effect of accounting changes	0.01	0.00	(0.00)
Basic EPS per Ordinary Share amounts in accordance with U.S. GAAP	(1.17)	0.48	0.20
Diluted EPS per Ordinary Share amounts in accordance with U.S. GAAP	(1.17)	0.48	0.20

Earnings Per Savings Share Amounts in Accordance with U.S. GAAP (*)

	Years ended December 31,		
	2001	2002	2003
		(euro)	
Basic EPS per Savings Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes			0.19

Diluted EPS per Savings Share amounts in accordance with U.S. GAAP before discontinued operations and cumulative effect of accounting changes			0.19
Basic EPS per Savings Share amounts in accordance with U.S. GAAP from discontinued operations			0.01
Diluted EPS per Savings Share amounts in accordance with U.S. GAAP from discontinued operations			0.01
Basic EPS per Savings Share amounts in accordance with U.S. GAAP from cumulative effect of accounting changes			0.01
Diluted EPS per Savings Share amounts in accordance with U.S. GAAP from cumulative effect of accounting changes			0.01
Basic EPS per Savings Share amounts in accordance with U.S. GAAP			0.21
Diluted EPS per Savings Share amounts in accordance with U.S. GAAP			0.21

(*) The earnings per share amounts have been calculated as set forth in SFAS 128, *Earnings Per Share*. Also refer to Note 29 (q) for additional information on earnings per share. 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 the dividends paid on the ordinary shares. For purposes of these calculations the weighted average number of shares was 3,424,694,178, 4,054,375,543 and 9,035,480,606 as of December 31, 2001, 2002 and 2003, respectively.

Telecom Italia (formerly Olivetti) did not have savings shares before the Merger of August 4, 2003. Each ADS represents 10 Shares or 10 Savings Shares, as applicable.

F-83

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	As of December 31, 2002	As of December 31, 2003
	(millions of euro)	
STOCKHOLDERS EQUITY		
Stockholders equity as reported in the consolidated balance sheets	20,624	20,589
Minority interests	(8,984)	(4,497)
Stockholders equity, net of minority interests	**11,640**	**16,092**
Items increasing (decreasing) reported stockholders equity:		
1. Purchase method of accounting related to Old Telecom Italia acquisitions in 1999 and 2003	3,534	24,161
2. Purchase method of accounting for other transactions	12	472
3. Reversal of goodwill amortization	524	364
4. Revaluation of fixed assets	(495)	(178)
5. Capitalization of interest on tangible and intangible assets under construction and related depreciation	802	364
6. Sale of real estate properties	(502)	(210)
7. Securitization of satellite investments	111	50
8. Elimination of intercompany profit on sales of intangible and tangible assets and related depreciation	(143)	(43)
9. Investment in stock of subsidiary companies	213	86
10. Common control transactions	(183)	(67)
11. Non-capitalizable expenses	(144)	(60)
12. Reversal of provisions	374	275
13. Revenue recognition	(187)	(200)
14. Derivative financial instruments	213	20
15. Other	(100)	(80)
16. Deferred tax adjustments	1,165	468
17. Discontinued operations New SEAT activities	(473)	
18. Treasury stock	(393)	(393)
19. Cumulative effect of accounting changes, net of tax		(21)
Tax effect on reconciling items	(761)	(5,450)
Minority interests on reconciling items	17	(583)
Stockholders equity in accordance with U.S. GAAP	**15,224**	**35,067**

F-84

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 28 Condensed U.S. GAAP consolidated financial statements

The condensed consolidated financial statements as of December 31, 2002 and 2003 and for the three years in the period ended December 31, 2003 presented below have been prepared to reflect the principal differences between the Telecom Italia Group s accounting policies and U.S. GAAP discussed above.

	As of December 31,	
	2002	2003
	(millions of euro)	
ASSETS		
Current assets	21,599	21,342
Fixed assets, net	21,503	21,593
Goodwill	31,065	37,837
Other intangible assets, net	10,105	20,642
Other long-term assets:		
Deferred tax assets	3,950	3,956
Other	4,689	2,723
Total assets	**92,911**	**108,093**

	As of December 31,	
	2002	2003
	(millions of euro)	
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities	18,599	23,196
Long-term debt	38,375	32,586
Reserves and other liabilities:		
Deferred tax liabilities	2,560	6,376
Other liabilities	7,416	4,491
Employee termination indemnities	1,364	1,297
Total liabilities	68,314	67,946
Minority interests	9,373	5,080
Stockholders equity	15,224	35,067
Total liabilities and stockholders equity	**92,911**	**108,093**

	Years ended December 31,		
	2001	2002	2003
	(millions of euro)		
STATEMENTS OF OPERATIONS			
Operating revenues	30,381	29,942	30,176
Other revenues	468	490	343
Total revenues	**30,849**	**30,432**	**30,519**
Operating expenses	(27,188)	(23,207)	(22,424)
Operating income	**3,661**	**7,225**	**8,095**
Financial income and expenses and other income and expense, net	(6,317)	(4,146)	(3,140)
Income (loss) from continuing operations before income taxes	**(2,656)**	**3,079**	**4,955**
Income taxes	(276)	3,152	(1,820)
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), after minority interests	**(4,006)**	**1,956**	**1,841**

F-85

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

	Share Capital	Additional Paid in Capital	Reserves, Retained Earnings and Net Income (Loss) of the Year	Total
		(millions of euro)		
Balance as of January 1, 2001	**6,914**	**2,773**	**5,854**	**15,541**
Dividends paid			(255)	(255)
Capital increases for exercise of conversion of bonds, exercise of warrants and stock options	30	12	(14)	28
Capital increases in March and November 2001	1,841	557		2,398
Available for sale securities			(91)	(91)
Other movements			(53)	(53)
Translation adjustments on foreign currency financial statements during the year			50	50
Net loss for the year 2001			(4,006)	(4,006)
Balance as of December 31, 2001	**8,785**	**3,342**	**1,485**	**13,612**
Capital increases for exercise of conversion of bonds, exercise of warrants and stock options	60		(25)	35
Available for sale securities			(40)	(40)
Other movements			12	12
Translation adjustments on foreign currency financial statements during the year			(351)	(351)
Net income for the year 2002			1,956	1,956
Balance as of December 31, 2002	**8,845**	**3,342**	**3,037**	**15,224**
Capital increases for exercise of conversion of bonds, exercise of warrants and stock options	20	24		44
Available for sale securities			5	5
Exercise of the withdrawal rights	(11)			(11)
Merger impact		17,981		17,981
Translation adjustments on foreign currency financial statements during the year			(17)	(17)
Net income for the year 2003			1,841	1,841
Balance as of December 31, 2003	**8,854**	**21,347**	**4,866**	**35,067**

	2001	2002	2003
	(millions of euro)		
Other Comprehensive Income:			
Net income (loss) for the year under U.S. GAAP	**(4,006)**	**1,956**	**1,841**
Translation adjustments on foreign currency financial statements during the year	50	(351)	(17)
Unrealized gains/(losses) on available for sale securities during the year	(91)	(40)	5
Adoption of derivative accounting (net of tax of 1 million in 2001, 2002 and 2003)	2	1	2
Total comprehensive income (loss) under U.S. GAAP	**(4,045)**	**1,566**	**1,831**

F-86

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 29 Additional U.S. GAAP Disclosures

(a) Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) New U.S. GAAP accounting standards

(i) Guarantees

Effective January 1, 2003, the Group adopted FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). The Interpretation requires expanded disclosure to be made in the guarantor s financial statements in regards to the guarantees and obligations under certain agreements. It also requires that a guarantor recognizes, as of the inception of the guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The recognition requirements of FIN 45 were applicable for guarantees issued or modified after December 31, 2002. This new Interpretation did not have a significant effect on the Group s results of operations, financial position or cash flows upon adoption.

(ii) Variable Interest Entities

Effective February 1, 2003, the Group adopted FASB Interpretation No. 46 Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 (FIN 46) for all Variable Interest Entities (VIE). Under FIN 46, an entity is considered a VIE (and subject to consolidation) if its total equity at risk is determined insufficient to finance its activities without additional subordinated financial support, or if its equity investors lack certain characteristics that represent a controlling financial interest. An entity that is considered a VIE would be required to be consolidated by the variable interest holder that holds a majority of the risks and rewards from changes in the fair values of the VIE s assets and liabilities. Currently, entities are generally consolidated by an enterprise when it has a controlling financial interest through ownership of a majority voting interest in the entity. The Group has adopted FIN 46 s disclosure provisions in 2003 which requires the disclosure of the nature, purpose, size and activities of any VIEs in which the Group has a significant variable interest, including the maximum exposure to losses. The consolidation requirements apply immediately to all new VIEs created on or after February 1, 2003 with transitional provisions for VIEs that existed prior to that date.

In December 2003, the FASB issued a revised interpretation to FIN 46 (FIN 46R) to modify some of the provisions of FIN 46 and to exempt certain entities from its requirements. Adoption of FIN 46 did not have a material impact on the financial position or results of operations of the Group. Telecom Italia adopted FIN 46R as of March 31, 2004.

(iii) Asset Retirement Obligations

Effective January 1, 2003, the Group changed its method of accounting for asset retirement obligations in accordance with FASB Statement No. 143, Accounting for Asset Retirement Obligations . Upon adoption, the Group recorded the fair value of the liabilities for existing asset retirement obligations and increased the carrying amount of the associated long-lived asset. The liability is being accreted to its present value each period through charges to operating expense. The capitalized asset retirement is being depreciated over the shorter of the related assets useful life or the period to the expected settlement of the retirement obligation. Previously, the Group had not been recognizing amounts related to asset retirement obligations. Under the new accounting method, the Group now recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of a fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. See Note 29 (s) for further details.

(iv) Exit and Disposal Costs

Effective January 1, 2003, the Group adopted SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities , which addresses financial accounting and reporting for costs associated with exit or disposal activities, which effectively nullifies EITF 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit Activity Including Certain Costs Incurred in a Restructuring . The principal differences between SFAS 146 and EITF 94-3 relates to SFAS 146 s requirements for recognition of a liability for a cost associated with an exit or disposal activity. SFAS 146 requires that a liability for a cost

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of an entity s commitment to an exit plan. A fundamental conclusion reached by the FASB in SFAS 146 is that an entity s commitment to a plan, in and of itself, does not create an obligation that meets the definition of a liability. Therefore, this statement eliminates the definition and requirements for recognition of exit costs in EITF 94-3. This Statement also establishes that fair value is the objective for initial measurement of the liability. SFAS 146 changes the accounting recognition of one-time termination benefits, requiring that those costs be recognized over the period of the employees service beyond a minimum retention period. Under EITF 94-3, these costs were accrued upfront when all the criteria of EITF 94-3 were met. This new Standard did not have a significant effect on the Group s results of operations, financial position or cash flows upon adoption.

(v) Multiple Element Deliverables and Revenue Recognition

In November 2002, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on EITF 00-21, Accounting for Revenue Arrangements with Multiple Element Deliverables . On December 17, 2003, the SEC issued SEC Staff Accounting Bulletin (SAB) No. 104 Revenue Recognition (SAB 104) which has effectively codified EITF 00-21 to a higher level of GAAP. SAB 104 and EITF 00-21 address how to account for arrangements that may involve the delivery or performance of multiple products, services and / or rights to use assets. Revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet certain criteria. Arrangement consideration should be divided into separate units of accounting based on their relative fair values. The Issue also supersedes certain guidance set forth in SAB 101. The Group is required to adopt the provision of EITF 00-21 for revenue arrangements entered into on or after January 1, 2004. Additionally, companies are permitted to apply the consensus guidance to all existing arrangements as a cumulative effect of a change in accounting principle. The Group is currently evaluating the impact of the Issue on results of operations, financial position and cash flows.

(vi) Accounting for Stock-Based Compensation

In December 2002, the FASB issued SFAS 148 Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of SFAS 123 . SFAS 148 is applicable to those entities that decide to adopt the fair value stock based compensation as their primary accounting policy, as opposed to APB 25. The Group has adopted the additional disclosure requirements of SFAS 148.

(vii) Liabilities and Equity

The Group adopted Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150) for financial instruments entered into or modified after May 31, 2003. SFAS 150 established standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity, including certain obligations that can or must be settled by issuance of a company s own equity shares. SFAS 150 requires that certain financial instruments which were previously classified as equity, be classified as liabilities or assets. The adoption of SFAS 150 did not have a material impact on the Group s results of operations, financial position or cash flows.

(c) Acquisitions

(i) Business combinations

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141, Business Combinations (SFAS 141). The Statement requires the use of the purchase method of accounting for all business combinations initiated after June 30, 2001, thereby eliminating the use of the pooling of interest method of accounting for business combinations. In addition, SFAS 141 requires that intangible assets be recorded apart from goodwill if they meet certain criteria. This standard had a significant impact on the Group s financial statements due to the purchases of Old Telecom Italia by Olivetti as described in Note 1 and Note 27.

(ii) Accounting for goodwill and other intangible assets

In June 2001, the FASB issued SFAS 142 effective for fiscal years beginning after December 15, 2001. SFAS 142 changed the accounting for goodwill from an amortization method to an impairment-only approach based on the supposition that goodwill is not a wasting asset that requires periodic cost allocation. Thus,

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

amortization of goodwill, including goodwill recorded in past business combinations and amortization of intangibles with an indefinite life, ceased upon adoption of SFAS 142. The Group adopted the provisions of SFAS 142 effective January 1, 2002.

The Group completed the SFAS 142 transitional impairment test during the second quarter of 2002 and concluded that there was no impairment of goodwill at that time, as the fair value of its reporting units exceeded their carrying amounts as of January 1, 2002. Therefore, the second step of the transitional impairment test required under SFAS 142 was not necessary.

As required under SFAS 142, the Group performed the required impairment testing as of December 31, 2002. Based on that assessment, it was determined that certain reporting units within the Internet and Media segment were impaired. As a result, the Group recorded a goodwill impairment charge of 3,352 million. See also Note 29 (i) for further information on the impairment charge.

The Group s 2001 results of operations do not reflect the provisions of SFAS 142. Had the Group adopted SFAS 142 as of January 1, 2001, the net loss and basic and diluted net loss per ordinary share would have been the adjusted pro forma amounts indicated below:

	2001
	(millions of euro, except per share amounts)
Net loss for the year 2001 under U.S. GAAP	(4,006)
Positive adjustment to net loss for amortization of goodwill	3,841
Adjusted net loss for the year 2001 under U.S. GAAP	(165)
Reported Basic EPS per Ordinary Share	(0.05)
Reported Diluted EPS per Ordinary Share	(0.05)
Adjusted Basic EPS per Ordinary Share	(0.04)
Adjusted Diluted EPS per Ordinary Share	(0.04)

2003

The Group uses SFAS 141, Business Combinations to account for acquisitions. Under SFAS 141, in every business combination an acquirer must be identified based on an overall assessment of the facts in each situation. Periodically the Group also acquires shares or companies from related parties. The purchase accounting treatment for these acquisitions depends on an overall assessment of the share ownership before and after the transaction. In general, if the Group or an affiliate owns 50% or more of the shares before and after the transaction it is accounted for based on common control, and therefore historical basis accounting is used.

The Group made several insignificant acquisitions in 2003. Excluding the Olivetti-Telecom Italia acquisition, as described in Note 1 and Note 27, the other acquisitions have not had a material impact on consolidated operating revenues, income before income tax, net income or earning per share.

HanseNet

As described in Note 1, in September 2003, the Group acquired 100% of the stake in HanseNet, a broadband operator in the Hamburg, Germany area, from e.Biscom. The total consideration paid by Telecom Italia amounted to 243 million (50 million cash payment and 193 million in debt of HanseNet).

F-89

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

	(millions of euro)
Current assets	13
Property, plant, and equipment	166
Intangible assets subject to amortization:	
• Brand name (7.25 year weighted-average useful life)	36
• Customer list (8.25 year weighted-average useful life)	26
• Right of use (20 year weighted-average useful life)	11
• Patent rights and licenses (6 year weighted-average useful life)	6
Goodwill	63
Total assets acquired	**321**
Current liabilities	(68)
Long-term liabilities	(203)
Total liabilities assumed	**(271)**
Net assets acquired	**50**

The 63 million of goodwill has been assigned to the Wireline Business Unit segment as it operates in the international broadband business.

2002

Blu

On October 7, 2002, TIM purchased the number four wireless operator in Italy, Blu S.p.A. (Blu), with Blu being merged into TIM S.p.A. on December 23, 2002 (effective date). Immediately prior to the acquisition, Blu sold off most of its core assets to the other rival phone companies in Italy, as called for in the final anti-trust resolution that allowed the sale to go forward. TIM paid approximately 84 million in cash to receive 100% of the shares of Blu, assumed approximately 546 million in debt and forfeited approximately 90 million in net receivables from Blu for a total purchase price under U.S. GAAP of 720 million. The Italian anti-trust authorities requirement that Blu be acquired in pieces by all of the Italian market operators immediately before TIM acquired the stock, resulted in the assessment that, under SFAS 141 and EITF 98-3, Determining Whether Non monetary Transactions Involves Receipt of Productive Assets or of a Business , Blu did not represent a business as defined and, therefore, no goodwill could be assigned based on the purchase price. As the acquisition of Blu did not qualify as a business as required under SFAS 141, the Group applied the guidance as established in EITF 98-11, Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations . Based on the guidance in EITF 98-11, the acquisition of Blu has been treated as the acquisition of a collection of assets, including a part of the benefit of the net operating losses (NOL s) acquired. In accordance with this guidance, part of the deferred tax assets related to the NOL s of Blu were not recorded at the acquisition date, as these items were not known at the time of the acquisition. In accordance with EITF 98-11, the NOL s first reduced long-lived assets to zero, prior to being recorded in the statement of operations. The benefit of the deferred tax assets was recognized in 2002, along with the deferred credit. The benefit from both the NOL s and the deferred credit were recognized in the tax expense line of the condensed financial statements. The following represents the allocation of the purchase price paid for Blu:

	(millions of euro)
Current assets, net	617
Long-term assets	53
Intangibles	22
Deferred tax on assets purchased	2
Tax net operating losses	103
Deferred credit	(77)
Net assets acquired	**720**

F-90

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

EPIClink

On August 2, 2002, Telecom Italia reached an agreement with EPIClink S.p.A. (EPIClink) shareholders for the purchase of 86% of the outstanding shares of EPIClink. EPIClink is a company operating as a specialized operator in outsourcing services in information and communication technology for small and medium sized businesses. In particular it provides communication and Internet hosting and servicing management. The price paid for the controlling interest in EPIClink was 60.2 million. The allocation of the purchase price paid for the controlling interest in EPIClink resulted in additional goodwill of 49 million. The Group was granted a call option, exercisable in the first two years following the acquisition, by which the Group can acquire the remaining shares for the higher of either 10 million or the fair value of the minority interests. After the expiration of the call option, the minority interests will have a put option by which they can put the remaining shares to the Group based on substantially the same terms. In 2003 the Group increased its ownership in EPIClink to 100%. The results of EPIClink have been included on a consolidated basis since June 2002.

Stet Hellas

In 2002, the Group increased its controlling interest in its Greek mobile subsidiary, Stet Hellas. The Group purchased from Verizon Europe Holding II group an additional 17.45% interest in Stet Hellas for 108 million in cash, increasing its total percentage to 81.40%. The acquisition has been accounted for under SFAS 141 using step acquisition accounting. An additional 66 million of goodwill was associated with the additional ownership acquired.

2001

Entel Chile

In December 2000, the Group signed an agreement to increase its investment in Entel Chile (Entel) from 26.16% to 54.76% by purchasing shares held by the Chilquinta Group and the Matte Group in a cash transaction. Entel operates in the sectors of fixed and mobile telephone services, data-transmission and Internet-access services. Previous to this investment the Group had owned a 26.16% interest in Entel, which in accordance with U.S. GAAP was accounted for using the equity method. The overall cost of the acquisition was 970 million, with the acquisition completed and accounted for as of April 1, 2001.

Under Italian GAAP, the Entel acquisition was accounted for by the purchase method, with the date of effective control designated as of January 1, 2001. The excess of the acquisition cost over the equity in the net book value of net assets acquired was allocated to goodwill, which was being amortized by the straight-line method over 15 years. Entel has been included in the consolidated financial statements of Telecom Italia from January 1, 2001.

Under U.S. GAAP, the Entel acquisition was accounted for by the purchase method with April 1, 2001 designated as the effective date of the acquisition. The tangible and intangible assets acquired and liabilities assumed were recorded at estimated fair values. The following represents the purchase price allocation to the fair value of assets acquired and liabilities assumed:

	(millions of euro)
Purchase price	970
Net tangible and intangible assets acquired	(342)
Goodwill from acquisition	**628**

The amortization of costs assigned to intangible assets and goodwill is computed by the straight-line method over the expected period to be benefited, which is 5 years for software and 15 years for licenses and goodwill. Goodwill ceased being amortized as of January 1, 2002, the date that the Telecom Italia Group adopted SFAS 142.

For U.S. GAAP purposes, Entel has been included in the consolidated financial statements of Telecom Italia by the equity method of accounting for the 26.16% interest through March 31, 2001 and fully consolidated from April 1, 2001.

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(d) Marketable securities

The Group s investments consist primarily of investment grade marketable debt and equity securities. For purposes of U.S. GAAP these securities are classified as either held to maturity, trading or available for sale. Held to maturity securities are securities that the Group has the ability and positive intent to hold until maturity, therefore they are carried at amortized cost. Trading securities are recorded at fair value with unrealized gains and losses included in the statement of operations. Available for sale securities are recorded at fair value with the net unrealized gains or losses reported, net of tax, in other comprehensive income. Prior to December 31, 2002, virtually all of the Group s marketable securities were classified as trading. Given the prolonged drop in security valuations over the last two years, and the adequate liquidity generated by the Group operations, the Group reclassified the portfolio of Telecom Italia to available for sale. The transfer was made at market value, resulting in a loss of 169 million as of December 31, 2002. For the year ended December 31, 2003, the available for sale portfolio has resulted in unrealized gains of 28 million. For purposes of Italian GAAP, investments are carried at the lower of cost or market value, with any gains or losses reflected in the statement of operations.

The fair value of all portfolios is determined by quoted market prices.

December 31, 2002	Amortized cost	Unrealized gains	Unrealized losses	Fair value
		(millions of euro)		
Trading securities	878	3	(1)	880
Available for sale	447		(168)	279
Total marketable securities	1,325	3	(169)	1,159

December 31, 2003	Amortized cost	Unrealized gains	Unrealized losses	Fair value
		(millions of euro)		
Trading securities	8			8
Available for sale	2,045	28		2,073
Total marketable securities	2,053	28		2,081

Marketable securities as of December 31, 2003 include debt securities of 1,294 million, classified by maturity as follows (in millions of euro):

2004	826
2005	39
2006	25
2007	10
2008	69
Beyond 2008	325
	1,294

(e) Securitization of accounts receivable

As discussed in Note 5 the Group entered into certain transactions for the sale of trade accounts receivable to a Qualified Special Purpose Entity (the Vehicle) in a securitization Program. In order to fund the purchase of the accounts receivable, the Vehicle issued Euro Medium Term Asset Backed Notes (the Notes) in the amount of 700 million which are secured by the accounts receivable acquired. The Vehicle has the ability to issue additional Notes up to an aggregate amount of 2 billion. Funds received from the collection of sold accounts receivable may be used to acquire additional accounts receivable from the Group.

Under Italian GAAP, the determination of whether the transfer of accounts receivable represents a sale, the inclusion or exclusion of the SPE in the consolidated financial statements of the Group and the determination of the amount of gain or loss on the sale is determined by the legal and contractual provisions of the agreement. For U.S. GAAP, the accounting for the transaction is primarily governed by SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . Under the provisions of SFAS 140, the

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

agreement must meet certain defined criteria to qualify as a sale of financial assets, the SPE must meet certain defined criteria to preclude consolidation, and the amount of gain or loss on the sale is determined based on the consideration received, the carrying value of the underlying financial components sold and the fair value of the financial components retained. Even though the underlying accounting principles differ, there was no material difference in the accounting treatment of this transaction between Italian and U.S. GAAP.

Under the terms of the agreement, the Vehicle charges the Group an initial discount which varies based on the credit profile and other characteristics of each tranche of accounts receivable sold. Additionally, for the purposes of credit enhancement, the Vehicle withholds a portion of the purchase price as a deferred payment, representing the Group s retained interest in the sold receivables. The amount of deferred payment withheld is adjusted on a monthly basis based on an evaluation of actual collections, delinquencies and other factors. The Group retains the servicing responsibility related to the sold receivables and receives a servicing fee from the Vehicle which is estimated to approximate the fair value of providing such services.

During 2003, 2002 and 2001 the following cash flows were received from and paid to the Vehicle:

	December 31,		
	2001	**2002**	**2003**
	(millions of euro)		
Gross trade receivables sold to the Vehicle	5,907	9,003	8,994
Collections remitted to the Vehicle	(5,030)	(8,155)	(8,119)
Discount	(44)	(65)	(74)
Remaining retained interest	(337)	(394)	(367)
Net cash received in advance from the Vehicle	**496**	**389**	**434**

The amounts recorded in the balance sheets and statements of operations for 2003, 2002 and 2001 are as follows:

	December 31,		
	2001	**2002**	**2003**
	(millions of euro)		
Receivables to be collected still held by the Vehicle	877	849	874
Retained interest	337	394	367
Allowance for bad debts	29	24	23

Loss recognized in the statement of operations	73	89	96

The losses on the sales of receivables to the Vehicle are due to the discount charged by the Vehicle and the bad debt provisions to adjust the retained risks to fair value. The retained interests represent the deferred purchase price that has yet to be received from the Vehicle and are included under other current assets.

(f) Securitization of satellite investments

In 2001 Telecom Italia formed a wholly-owned subsidiary domiciled in Luxembourg, Mirror, to which it transferred certain investments in entities in the satellite communications sector at their fair market values of 550 million. Mirror subsequently obtained a non-recourse loan of 217 million from a merchant bank, which was subsequently disbursed to Telecom Italia, leaving Telecom Italia with net equity of 333 million in Mirror under Italian GAAP. Subsequent to the loan, 70% of the equity in Mirror was sold to the same merchant bank for a total of 233 million, providing Telecom Italia a total of 450 million in cash from the partial disposal of the satellite shareholdings. In the consolidated Italian GAAP financial statements the transaction has been accounted for as a sale, with a gain of 170 million being recognized on the sale of 70% of the assets and the remaining 30% interest in Mirror being recorded as an equity investment. For Italian GAAP purposes the remaining equity investment was considered impaired for 40 million at December 31, 2001.

Under U.S. GAAP the structuring of the transaction was considered a securitization, with Mirror being deemed a non-qualified special purpose entity, therefore the requirements for sales recognition accounting were not met. Consequently, U.S. GAAP requires that (i) the equity securities transferred to Mirror should continue to

F-93

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

be reflected in the consolidated financial statements of Telecom Italia at historical cost, (ii) the gain of 170 million and the valuation allowance of 40 million recognized for Italian GAAP purposes should not be recognized and (iii) the accounting for the 450 million of cash received by Telecom Italia be reflected in the consolidated balance sheet as additional bank debt of 217 million and minority interests of 233 million, representing the debt of Mirror and the cash received from Lehman Brothers Merchant Bank for its purchase of 70% of Mirror from Telecom Italia, respectively.

In 2003, the Group sold a part of its interest in Inmarsat, a company in which Mirror has a minority interest, for 24 million. As part of the transaction, the Group is required, in January 2004, to make a capital contribution to Mirror of the same 24 million, which Mirror must use for debt reduction. Under Italian GAAP, the gain on the sale was considered in the equity method accounting for Mirror and the capital contribution was considered as an increase to investment value of Inmarsat. An impairment of 30 million was also recorded to reduce the value of Inmarsat to fair value. Under U.S. GAAP, the 24 million sale reduced the value of the Group s investment in Inmarsat and the subsequent payment to Mirror will be considered as a reduction in Mirror s debt, which at December 31, 2003 for U.S. GAAP purposes includes an additional amount of 191 million.

(g) Sale of real estate properties

In late 2000, the Group transferred a going concern including a portion of their real estate portfolio to a wholly-owned subsidiary, IM.SER, at the fair market value of 2,900 million. The assets net book value on the date of transfer was 2,392 million. Subsequently, the Group sold 60% of their interest in IM.SER to third parties for cash in the amount of 1,740 million. Telecom Italia subsequently leased back 90% of the buildings contributed to IM.SER on long-term contracts. In total Telecom Italia received cash in the amount of 2,700 million, which came from both the sale of the investment and a cash dividend distribution from IM.SER, with the distribution of funds being provided by IM.SER s borrowing from a consortium of banks. Under Italian GAAP, a pre-tax gain for the amount of 312 million was recorded in the consolidated financial statements. Under U.S. GAAP, the transfer of the assets to the wholly-owned subsidiary, the subsequent lease agreement, the receipt of cash by the Group from the partial sale and the special dividend are considered to be secured borrowings. This type of accounting treatment requires that the real estate continue to be reflected in the consolidated financial statements and depreciated based on its historical net book value. Additionally, the gain recognized under Italian GAAP on the partial sale of the subsidiary is reversed for U.S. GAAP purposes. The balance sheet of the Group at December 31, 2002 under U.S. GAAP reflects an increase in long-term debt of 2,366 million, an increase in real estate of 1,907 million (net of the depreciation from the date of transfer) and a reduction in investments for 271 million.

In 2002, the Group entered into additional arrangements in relation to its real estate assets. Through a series of assets contributions, transfers and partial sales, the Group re-packaged selected real estate assets with investors, recognizing a net gain of approximately 150 million in the consolidated statement of operations under Italian GAAP. For purposes of U.S. GAAP, significant portions of these transactions were considered to be either failed-sale leasebacks or failed sales . These transactions, including those related to Tiglio I and IM.SER, did not meet the accounting requirements for sale under either SFAS 98 Accounting for Leases or FAS 66 Accounting for Sales of Real Estate , requiring that assets continue to be accounted for on the balance sheet. The transactions under Tiglio II are newly contributed assets and were also considered failed sales requiring similar accounting to the aforementioned IM.SER transaction in 2000. As a result, in 2002, a significant portion of the gains recognized under Italian GAAP were reversed for U.S. GAAP and the additional assets and liabilities consolidated.

In 2003, Telecom Italia spun off its interest in Tiglio I and Tiglio II into a new entity called Ortensia. The Group entered into these additional arrangements through a series of assets contributions, transfers and partial sales; the Group re-packaged selected real estate assets with investors. For purposes of U.S. GAAP, significant portions of these transactions were considered to be either failed-sale leasebacks or failed sales and required similar accounting to the abovementioned Tiglio transactions. The result in 2003 was that assets and liabilities remained consolidated while gains recognized under Italian GAAP were reversed.

Also in 2003, the Group reacquired some assets that it had been leasing from a 20% owned investment named Teleleasing. These assets, along with others assets owned by the Group, were then subsequently sold

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

through a series of transactions to Lastra Holdings. During the series of transactions, secured debt was obtained by the rental payment and the proceeds of the debt were paid to Telecom Italia as the sales price. Telecom Italia has then guaranteed the value of these rental payments. The accounting treatment, similar to the accounting described above, requires that the real estate continue to be reflected in the consolidated financial statements and depreciated based on its historical net book value. The balance sheet of the Group at December 31, 2003 under U.S. GAAP reflects an increase in long-term debt of 2,071 million, an increase in real estate of 1,578 million (net of depreciation from the date of transfer) and a reduction in investments of 268 million.

(h) Impairment or disposal of long-lived assets (plant and equipment and acquired technology)

In August 2001, the FASB issued SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Statement applies to certain long-lived assets, including those reported as discontinued operations, and develops one accounting model for long-lived assets to be disposed of by sale. SFAS 144 supersedes SFAS 121 Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of , and APB 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions , for the disposal of a segment. The Group adopted the provisions of SFAS 144 effective January 1, 2002.

The Statement requires that long-lived assets to be disposed of by sale be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. The new statement also changes the measurement criteria for discontinued operations. SFAS 144 broadens the reporting of discontinued operations to include the disposal of a component of an entity provided that the operations and cash flows of the component will be eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations of the component. The Statement does not apply to investments in equity investees. No write-downs of long-lived assets were recorded under SFAS 144 in 2002. In 2003, as further discussed in Note (i), an indicator of impairment on goodwill and intangibles related to the Buffetti reporting unit was identified as of July 31, 2003. Prior to the performance of the goodwill impairment test, the Group performed a FAS 144 impairment analysis on its long lived assets, including identified intangibles. It was determined that the carrying value of the intangible assets were less than the undiscounted cash flows for such intangibles. These assets were subsequently written-down to fair market value, with a charge of 48 million recorded as of July 31, 2003.

As discussed above, the Group changed its method of accounting for long-lived assets, including goodwill, in 2002. Prior to 2002, the Group applied SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of , to all long-lived assets, including goodwill.

Under both SFAS 121 and SFAS 144, the Group assesses potential impairments whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable or if the price of the asset has had considerable market depreciation. The recoverability of an asset s carrying value is initially determined by comparing the undiscounted cash flows of the asset to its carrying value. If, after the initial assessment, impairment is deemed to exist, then the Group estimates the fair value of the asset based on discounted cash flows, independent appraisals or quoted market prices, if available. Any excess of carrying value over estimated fair value is written-off and recorded as an expense in current period earnings.

(i) Goodwill and other intangible assets

As a technology, media and information company, the Group creates, distributes and manages information with inherent value. The Group does not recognize the fair value of internally generated intangible assets. However, intangible assets acquired in business combination accounted for under the purchase method of accounting are recorded at fair value in the consolidated balance sheet. As discussed previously, SFAS 142 was adopted by the Group as of January 1, 2002, and required that goodwill and certain other intangible assets deemed to have an indefinite life cease being amortized.

The Group annually reviews the carrying value of acquired indefinite-lived intangible assets, including goodwill, to determine if impairment may exist. An interim assessment of goodwill may be necessary if an impairment indicator exists that suggests that the fair value of a reporting unit may have decreased. The

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

requirements of SFAS 142 include that indefinite-lived intangible assets be assessed for impairment using fair value measurement techniques, and, specifically, a two-step process must be utilized. The first step is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired and the second part of the test is not considered necessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of the loss, if any. The second part of the goodwill impairment test compares the implied value of the operating unit s goodwill with the carrying amount of that goodwill. The excess of the carrying value over the implied value is then written-off in the period. Implied value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the asset and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized equal to that excess.

In accordance with the requirements of SFAS 142, the annual impairment test of goodwill was conducted as of December 31, 2002 and 2003. As part of that assessment in 2002, it was determined that certain reporting units within the Internet and Media reporting segment contained goodwill that was potentially impaired. The annual reviews incorporated into the analysis all of the known facts and management strategies at the time, including the possibility that the assessment that the ownership levels of certain businesses may change in the future. In particular, management had been assessing the structure and benefits of having the Internet and Media segment constituted as a single business. Although management had not committed to a plan regarding the disposal of certain reporting units of SEAT until after December 31, 2002, and therefore the requirements to meet discontinued operations or assets held for sale accounting criteria were not met at that time, the probability that a realignment of the business would take place, including the possible disposal valuations of those businesses, were considered. The 2001 valuation approach was based on a discounted cash flow model, using the best estimates of management at that time, including the intention to keep SEAT together as an integrated asset for the foreseeable future. In 2002 the fair value of the affected reporting units, in particular the Directories, Directory Assistance and Business Information, were derived based on an assessment of recent trading multiples for other similar assets. This approach was used as, given the increasing likelihood that Telecom Italia would sell these assets, the use of multiples for recent transactions for similar assets was considered more indicative of fair value than a discounted cash flow analysis. The remaining businesses of the Internet and Media segment that were not being sold were valued based on a combination of both multiples and the discounted cash flow method, with impairments identified recorded at the SEAT level and included as part of the Group s reconciliation to U.S. GAAP. Using the comparables approach to the valuation, Telecom Italia identified that the fair value of the reporting units implied goodwill, after performing a hypothetical purchase price allocation, including intangibles, was 3,352 million less than these assets carrying value. This charge was taken as of December 31, 2002.

As of July 31, 2003 the Group identified two reporting units, Buffetti and Entel Chile, for which an indicator of impairment existed as the fair value of the reporting units determined during the purchase accounting was less than the carrying value.

In the case of Buffetti, the sale of New SEAT resulted in a re-alignment of the business model. Buffetti is the retail franchise chain previously acquired by SEAT, selling business periodicals, office supplies and other business information. The sale of the Directories, Directories Assistance and Business Information components of SEAT was expected to impact Buffetti. The Group performed the second step of FAS 142 and determined that the goodwill and other intangible assets allocated to Buffetti were impaired resulting in a charge of 264 million.

During the purchase accounting the Group noted that the fair value of Entel Chile was less than its carrying value. As part of the change in reporting responsibilities, the previous reporting units were combined into one. Based upon the results of step two of FAS 142 an impairment charge of 395 million was taken as of July 31, 2003.

No additional impairments were required during the annual impairment testing as of December 31, 2003.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The roll-forward schedule of goodwill by Business Unit from January 1, 2002, to December 31, 2003, is as follows:

(millions of euro)	BUSINESS UNITS								
	Wireline	Mobile	South America	Internet and Media	IT Market	IT Group	Olivetti Tecnost	Other Activities	CON-SOLIDATED
Goodwill as of January 1, 2002	**16,140**	**9,507**	**897**	**7,761**	**2**	**0**	**7**	**9**	**34,323**
Acquisitions and disposals, net	(47)	281		28	74	49		(4)	381
Impairment charges	(134)	(178)		(3,352)				(24)	(3,688)
Other	(27)	(62)	(19)	152	(6)	(8)		19	49
Goodwill as of December 31, 2002	**15,932**	**9,548**	**878**	**4,589**	**70**	**41**	**7**	**0**	**31,065**
Effects of the Merger	8,249	3,410	(331)	(188)					11,140
SEAT disposal				(3,995)					(3,995)
Acquisitions and disposals, net	66	7		95	(47)	(7)		10	124
Impairment charges			(395)	(235)		(38)			(668)
Other	237	(71)				4		1	171
Goodwill as of December 31, 2003	**24,484**	**12,894**	**152**	**266**	**23**	**0**	**7**	**11**	**37,837**

(j) Exchangeable Opera Notes

In March 2001 the Group issued, through its 100% owned finance subsidiary Sogerim (merged in 2002 into TI Finance), Senior Unsecured Guaranteed Exchangeable Out Performance Equity, Redeemable in Any-Asset (Opera) Notes, which bear interest at 1% per year, mature in 2006 and are fully and irrevocably guaranteed by Telecom Italia S.p.A. The Opera Notes are exchangeable for ordinary shares in Telecom Italia s controlled subsidiaries TIM or SEAT. The spin-off transaction and the subsequent disposal of the equity investment in the beneficiary company, New SEAT, did not result in any changes in the terms of the notes since the terms and conditions contemplated possible dispositions for purposes of settlement. During the exchange period ending 10 business days before March 15, 2006, the holders of the Opera Notes have the right to exchange such notes for either SEAT or TIM shares, with the initial exchange ratios being 1,000 nominal amount of Opera Notes for 232.5581 SEAT ordinary shares (giving the SEAT shares an exchange ratio value of 4.30 per share) or 91.4795 TIM ordinary shares (giving TIM share an exchange ratio value of 10.93 per share). On March 15, 2004 (with an exercise period comprised between 60 and 30 days before March 15, 2004), the holders of Opera Notes have an option to cause any remaining Opera Notes then outstanding to be redeemed, at the Accreted Principal amount, plus accrued interest. At maturity any remaining outstanding Opera Notes will be redeemed at 117.69% of their original principal amount, representing a yield to maturity of 4.25% for unredeemed notes.

TI Finance has the option of honoring the exchange request in shares made by the holders of the Opera Notes, or giving in exchange the cash value of the shares calculated at 95% of the simple arithmetic average of the quoted market price of the shares, or settle the exchange in any combination thereof.

TI Finance has the option to call the Opera Notes in whole, but not in part, after March 15, 2004 at the accreted principal amount plus accrued interest up to, but excluding the date of the redemption, if the cash value of either the TIM exchange property or the SEAT exchange property is equal to or greater than 120% of the aggregate accreted principal amount of the Opera Notes for at least 20 dealing days during any 30 consecutive dealing days.

The notes contain certain restrictive covenants including, but not limited to, restrictions related to the Company s ability to incur debt senior to the Opera Notes. The covenants do not restrict dividends or loans to the Company.

The notes decreased in September 2002 by 536 million due to the purchase in the market by TI Finance of a portion of the notes, which were subsequently cancelled, therefore leaving a balance of 1,964 million at December 31, 2002 and 2003.

At December 31, 2003, no holders of the Opera Notes has requested exchange of the Notes for either the shares of SEAT or TIM. For the years ended December 31, 2001, 2002 and 2003 TI Finance accrued interest on

F-97

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the nominal amount of the Opera Notes outstanding at the rate of 4.25%, the stipulated yield rate assuming the Opera Notes will be held to maturity in 2006.

In March 2004, the exercise of the put option by bondholders of 466 thousand reduced the outstanding amount to 1,964,034 thousand.

(k) Derivative financial instruments

The Group derivative financial instruments at December 31, 2003 consist of interest rate swap and collar agreements, cross currency and interest rate swaps, foreign currency options and forward contracts and equity securities options. Under SFAS 133, effective January 1, 2001, all such derivatives have been recognized on the balance sheet at fair value. Under the transition provisions of SFAS 133, the initial recognition of the fair value of derivative instruments was treated as a cumulative effect of a change in accounting principle in either current period earnings or as other comprehensive income depending on the previous nature and hedge designation of the derivative. As the Group did not formally designate its derivative instruments as hedges upon the adoption of SFAS 133, subsequent changes in the fair value of the derivative instruments have been recognized as a component of current period earnings according to the requirements of SFAS 133 described above. The cumulative effect upon adoption was 20 million benefit for the year 2001.

In the statements of operations, under the line item financial income and expenses, the Group recognized pre-tax losses in current period earnings related to changes in the fair value of its derivative financial instruments of 195 million in 2003, 326 million in gains in 2002 and losses of 155 million in 2001, and pre-tax gains of 3 million in current period earnings, 3 million and 4 million of gains in 2002 and 2001, respectively. The net loss of 192 million, the net gain of 329 million and the net loss of 151 million is included in the accompanying 2003, 2002 and 2001 U.S. GAAP basis statement of operations. For U.S. GAAP purposes, as of December 31, 2003, 2002 and 2001 the Group has recorded in the balance sheets net derivative assets, under the line item current assets, of 12 million, net derivative assets of 216 million and net derivative liabilities, under the line item current liabilities, of 88 million, respectively. In addition, the Group recorded pre-tax accumulated comprehensive income of 3 million, 2 million and 3 million in 2003, 2002 and 2001, respectively, under the requirements of SFAS 133 with respect to the transition provisions.

(l) Fair value of financial instruments

As required by SFAS 107, Disclosures about Fair Value of Financial Instruments , the Group has estimated, where possible, the fair values of the most significant financial instruments held. The Group has not estimated the value of certain unlisted long-term investments, primarily relating to investments in affiliated companies. The fair value for marketable securities and long-term investments are based on quoted market prices for those instruments or discounted cash flow analysis.

For cash and cash equivalents, financial receivables from banks and short-term debt, as well as for the accounts receivables and payables, the amounts reflected in the consolidated financial statements are reasonable estimates of fair value because of the relatively short period of time between the origination and the expected realization.

For long-term debt, the fair value was determined by discounting contractual future cash flows using the Group s incremental borrowing rates for similar types of borrowing arrangements. The Group has certain investments for which it is not practicable to estimate fair value due to the lack of quoted market prices and the inability to estimate fair value without excessive costs. These investments are recorded at historical cost.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The fair values and carrying amounts of financial instruments are as follows:

	As of December 31,			
	2002		2003	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(millions of euro)			
Cash and cash equivalents	4,426	4,426	4,937	4,937
Marketable securities	1,159	1,159	2,081	2,081
Long term investments:				
Affiliates:				
Practicable to determine	222	236		
Not practicable	2,283		1,311	
Other:				
Practicable to determine	126	126	154	154
Short-term debt (excluding current portion of long-term debt)	3,377	3,377	1,324	1,324
Long-term debt (current portion included):				
Floating rates	8,096	8,088	16,505	16,505
Fixed rates	33,729	34,352	25,370	27,448
	41,825	42,440	41,875	43,953

(m) Stock-Based Compensation

The Group accounts for all stock-based compensation issued under the provisions and related interpretations of Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees* . Certain companies within the Group that have publicly traded stock also issue options to their employees. At the end of 2003, TI Media (formerly SEAT), and TIM all have some form of stock-based compensation program for employees. These plans are all accounted for under APB No. 25. Stock-based compensation expense/(benefit) of 43 million, (28) million and 1 million was recognized in 2001, 2002 and 2003, respectively, under all of the companies plans.

In connection with the purchase of Old Telecom Italia, Olivetti, as the surviving company, renamed Telecom Italia after the Merger, succeeded in all the Stock Option Plans previously in force in Old Telecom Italia and Olivetti. Holders of the corresponding options have maintained the right to subscribe at the original exercise price and the original number of options. However, the original number of shares stated in the respective regulations (corresponding to one share for each option), in which the options are exercisable has changed, based on the Merger assignment ratio. Each option under the Old Telecom Italia plans is exercisable into 3.300871 shares of Telecom Italia, and each option under the Olivetti plans is exercisable into 0.471553 shares of Telecom Italia. As a consequence of this, the subscription price of each ordinary share resulting from the exercise of the options for each Plan is now equal to the original grant exercise price divided by the Merger assignment ratio. As a consequence of the Merger terms, options in Old Telecom Italia were deemed exchanged for options of Telecom Italia and, accordingly, accounted for as part of the Merger consideration. Similarly, options of Olivetti were deemed exchanged for options of Telecom Italia, which resulted in a modification under FIN 44 (Accounting for Certain Transactions involving Stock Compensation on Interpretation of APB Opinion No. 25) (FIN 44) requiring variable accounting. In the description below of the Old Telecom Italia and Olivetti Plans, the values indicated (grant prices, weighted average prices, strike prices, exercise prices) are stated as prices per equivalent option , representing the new issuable shares.

The stock compensation plans of the Group are described below:

Old Telecom Italia Plans

The 2002 plan for management (the 2002 Plan) was granted on March 26, 2002, granting 29,958,000 options, corresponding to 98,887,493 equivalent options, at a strike price of 2.928 per equivalent option to each

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

participant. The options vest annually over a period of three years, beginning in March 2003 and ending in March 2005. The 2002 Plan terminates in March 2010. Total options outstanding under this plan at the end of 2003 were 25,246,500, corresponding to 83,334,972 equivalent options. The market value of the underlying shares at the date of grant was below the strike price; therefore no compensation expense has been recognized for this plan.

For selected senior managers, the Top Plan was introduced in 2002, granting 11,800,000 options, corresponding to 38,950,278 equivalent options, at a strike price of 2.788 per equivalent option. The options vest annually starting in February 2003 over a three-year period; the plan terminates in February 2010. Total options outstanding under this plan at the end of 2003 were 11,340,000, corresponding to 37,431,858 equivalent options. The fair market value of the underlying shares was below the options strike price at the date of grant, therefore no compensation expense has been recognized under this plan.

The remaining two plans (the Other 2002 Plans) have a combined total of nine participants. The plans at the end of 2003 have granted a total of 1,040,000 options, corresponding to 3,432,896 equivalent options, to the participants, at a strike price ranging from 2.339 to 2.409 per equivalent option. Both plans vest over a period of three years, terminating in March 2010. The fair market value of the underlying shares was below the options strike price at the grant and measurement dates, therefore no compensation expense has been recognized under this plan.

In 2001 the Board of Directors approved the 2001 Plan consisting of 67,025,000 options, corresponding to 221,240,879 equivalent options, with an exercise price of 3.177 per equivalent option. This plan is subject to certain performance criteria similar to the 2000 Plan with vesting through April 2003. As such, the plan has been accounted for as a variable compensation plan. However, as a result of the purchase of Old Telecom Italia by Olivetti during 2003, the variable accounting treatment does not carry-forward after the acquisition date. The first lot met these performance criteria in 2002 and vested. The second lot did not meet these criteria and were forfeited during 2003. Total options outstanding under this plan at the end of 2003 were 32,340,000, corresponding to 106,749,534 equivalent options. No compensation expense was recorded in 2002 or 2001 for this plan as the exercise price was above the market price on each respective year end.

In 2000 the Board of Directors authorized the 2000 Plan under which a total of 51,430,000 options, corresponding to 169,763,796 equivalent options, were granted at a strike price of 4.185 per equivalent option. The options vest ratably in three lots of 15,460,000 in July of 2001, 2002 and 2003, with an extraordinary lot of 5,050,000 vesting in July 2003. The plan expires on June 30, 2008. The 2000 plan is also performance based, with the performance criteria based on the ratio of the arithmetic mean of Telecom Italia s ordinary shares to the ratio of the Dow Jones Eurostoxx Indexes for the Telecommunications sector. If the performance criteria for an option lot is not met in any particular year, but the performance criteria is met in the subsequent year, the options that had not initially met the performance criteria will be considered vested at the time the performance criteria is met in the subsequent year. The first and second lots of options have met the performance criteria; therefore, these options have vested. The third and extraordinary lots have not met the performance criteria; therefore, these options did not vest and were forfeited during 2003. At the end of 2003, 10,699,996 options, corresponding to 35,319,216 equivalent options, were outstanding under this plan. This plan was accounted for as variable, however no compensation expense has been recognized in any period presented as the exercise price of the options is above the market price for all measurement dates and as a result of the purchase, the variable accounting treatment did not continue in 2003.

In 1999 the Company adopted the 1999 Stock Option Plan (the 1999 Plan), under which 16,595,400 options, corresponding to 54,779,275 equivalent options, were granted at an exercise price of 2.057 per equivalent option to key employees. The options issued under the 1999 plan vested annually in three year lots starting in October 1999 and ending in January 2002, expiring on December 31, 2004. The options granted under this plan were performance based. As of December 31, 2003, the first and second lots had been vested and exercised, with the third lot becoming exercisable as the vesting requirements had been met. A total of 4,511,901 options, corresponding to 14,893,133 equivalent options, were outstanding at December 31, 2003. Compensation expense / (benefit) totalling (16) million in 2002 and 1.6 million in 2001 has been recorded with this option plan, respectively. No amounts were recognized in 2003 as a result of the purchase accounting.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The status of the stock options granted under the 1999, 2000, 2001, 2002, 2002 Top, and Other 2002 stock option plans are as follows. As disclosed above, the equivalent options in the table below represent the options converted into shares of Telecom Italia using the 3.300871 ratio.

	Number of equivalent options	Weighted Average price per equivalent options
Outstanding at December 31, 2000	**207,431,685**	**3.80**
Granted	221,240,879	3.17
Exercised	(4,939,258)	2.06
Forfeited	(4,962,860)	3.70
Outstanding at December 31, 2001	**418,770,446**	**3.49**
Granted	141,270,677	2.88
Exercised	(4,539,193)	2.06
Forfeited	(112,581,157)	4.05
Expired on December 31, 2002	(5,703,905)	3.04
Outstanding at December 31, 2002	**437,216,868**	**3.17**
Exercised	(13,070,063)	2.06
Forfeited	(141,824,448)	3.40
Cancelled	(1,160,748)	2.93
Outstanding at December 31, 2003	**281,161,609**	**3.11**

The following table summarizes certain information for the stock options granted under the stock option plans, which are outstanding at December 31, 2003:

Range of Grant Prices	Equivalent Options Outstanding			Equivalent Options Exercisable	
	Equivalent Options	Weighted Average Remaining Life	Weighted Average Grant Price	Equivalent Options	Weighted Average Grant Price
(euro)			(euro)		(euro)
2.05-2.41	18,326,039	1.80	2.12	15,923,002	2.08
2.78-2.93	120,766,820	5.23	2.88	37,030,674	2.88

3.17-4.19	142,068,750	3.28	3.43	142,068,750	3.43
	281,161,609			195,022,426	

Olivetti Plans

On June 9, 1999, the 1999 Olivetti stock option plan (Plan I) was authorized by the board of directors and 30,000,000 of options were granted under this plan. On November 29, 1999, 18,000,000 of additional options were granted. All options were granted at an exercise price of 1.198 which was based on the average price of the stock during the six month period from June 1998 to November 1998. Exercise of the options is contingent upon stock price performance. The plan was accounted for as a variable plan from the date of authorization due to its performance based features. At December 31, 2003, no options are outstanding under this plan.

On February 24, 2000, 29,500,000 options, corresponding to 13,910,814 equivalent options, were awarded under an Olivetti option plan (Plan II) to employees by authorization of the board of directors at an exercise price of 7.857 per equivalent option which represented the average stock price over the 30 days preceding the authorization of the plan. Equivalent option prices were adjusted downward to 7.015 in accordance with plan terms on February 19 and November 5, 2001 as a result of equity increase. One-third of the options fully vest after 34, 46 and 58 months. The contractual and expected lives of the options is 58 months. At the date of grant, the market price exceeded the exercise price and compensation expense was recorded at the balance sheet dates accordingly. On February 9, 2001, 28,170,000 of these options were cancelled and replaced with options in Plan III. The remaining 1,330,000 options remained outstanding, due to managers who had left Olivetti during the period, and from this date forward the new plan and remaining outstanding options were accounted for as variable plan. No compensation expense was recorded in any period presented as the market price of the stock was less than the exercise price. At December 31, 2003, there were 800,000 options outstanding under Plan II, corresponding to 377,241 equivalent options.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On February 9, 2001, the board of directors authorized the issuance of 29,000,000 options (Plan III), corresponding to 13,675,037 equivalent options, at an exercise price of 5.959 per equivalent option in replacement of options awarded under Plan II as noted above which were cancelled at that date. The exercise price represented the average stock price over the 30 days preceding the authorization of the plan. Share prices were adjusted downward in accordance with plan terms on February 19 and November 5, 2001 as a result of equity increase to 5,333. One-third of the options fully vest after 23, 35 and 47 months. The contractual and expected lives of the options is 47 months. At the date of grant, the market price exceeded the exercise price and compensation expense has been recorded for the original intrinsic value. Additionally, due to the fact that Plan III replaced and cancelled Plan II, the plan is accounted for as a variable plan in accordance with APB 25. However, no additional compensation expense was recorded in any period presented as the market price of the stock was less than the exercise price at the balance sheet dates. At December 31, 2003 there were 5,940,000 options outstanding under Plan III, corresponding to 2,800,995 equivalent options.

The status of the stock options granted under Plan I, Plan II, and Plan III stock option plans are as follows. As disclosed above, the equivalent options in the table below represent the options converted into shares of Telecom Italia using the 0.471553 ratio.

	Number of equivalent options	Weighted Average price per equivalent option
		(euro)
Outstanding at December 31, 2000	**26,291,438**	**5.34**
Granted	12,484,366	5.34
Exercised	(8,590,132)	2.44
Forfeited	(19,899,537)	6.45
Outstanding at December 31, 2001	**10,286,135**	**4.52**
Granted	(2,666,624)	2.12
Forfeited	(1,204,818)	5.34
Cancelled	(2,722,432)	2.12
Outstanding at December 31, 2002	**3,692,261**	**5.51**
Forfeited	(342,663)	5.34
Cancelled	(171,362)	5.34
Outstanding at December 31, 2003	**3,178,236**	**5.53**

The following table summarizes certain information for the stock options granted under the stock option plans, which are outstanding at December 31, 2003:

Range of Grant Prices	Equivalent Options Outstanding			Equivalent Options Exercisable	
	Equivalent Options	Weighted Average Remaining Life	Weighted Average Grant Price	Equivalent Options	Weighted Average Grant Price
(euro)			(euro)		(euro)
5.33	2,800,995	1.00	5.33	1,867,354	5.33
7.02	377,241	1.00	7.02	251,494	7.02
	3,178,236			2,118,848	

Telecom Italia Media (formerly SEAT)

Telecom Italia Media (formerly SEAT) 1999 Plan Under the terms of the incentive stock option plan, certain key employees identified by the Board of Directors of Telecom Italia Media were eligible to participate in the plan. Options granted under the plan had an exercise price determined by the Board of Directors and executive management in accordance with the plan. As the vesting of the options was dependent on the achievement of defined financial objectives, the plan was considered to be variable. Accordingly, changes in the quoted market price of the underlying stock from the grant date to the date at which the final number of shares to be granted is determined is recorded as an adjustment to compensation expense over the related service period. At December 31, 2003, all options under the plan had been forfeited or exercised and the plan ceased to exist.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Telecom Italia Media (formerly SEAT) 2000-2002 Plan On November 20, 2000 SEAT s extraordinary shareholder s meeting approved a share capital increase for a maximum of 127,000,000 ordinary shares reserved for employees and directly or indirectly-controlled subsidiaries. The 2000-2002 Plan provided for the allocation of options in three annual installments following attainment of Corporate and personal objectives according to the guidelines as defined in the Plan. The exercise price of stock options granted under this Plan approximated the fair market value on the grant date. The 2000-2002 Plan expires on December 31, 2008. As a result of the spin-off of certain SEAT businesses during 2003, most options were forfeited. At December 31, 2003, 3,369,299 options were outstanding.

Telecom Italia Media (formerly SEAT) Top Plan and Key People Stock Option Plans The Board of Directors of Telecom Italia Media on May 17, 2002, approved the implementation of two new stock option plans, offered to directors and employees who hold key positions in the group due to their particular responsibility and/or skills. The Top Plan and the Key People Plan provide for the allocation of options in three annual installments. The exercise price of stock options granted under the new Plans approximated the fair market value on the grant date. Both plans expire on May 31, 2008. The Key People Plan led to the allocation of 46,400,000 options, of which 2,500,000 reserved for B Beneficiaries and 43,900,000 reserved for C Beneficiaries. The Top Plan led to the allocation of 1,500,000 options. No compensation expense was recognized for options granted under the Key People Plan or Top Plan, as the stock price was below the exercise price at the date of grant and the awards were deemed to be fixed under APB 25. At December 31, 2003, 16,750,000 and none options were outstanding under the Key People and Top plans, respectively.

Telecom Italia Media (formerly SEAT) Telegate Stock Option Plan During November 2000, SEAT acquired 51.37% of Telegate GmbH and the remaining 48.63% in April 2001. Telegate AG, a majority owned subsidiary of Telegate GmbH had, at the date of each acquisition, 200,000 shares of its common stock reserved under its 1999 stock option plan. The options are exercisable into shares of Telegate, not Telecom Italia Media. As a result of the spin-off of certain SEAT businesses during 2003, this plan was transferred with those businesses. As a result, the options are treated as forfeited by the company. Included in the rollforward below are outstanding options of 26,875, 34,825, 39,835 and none, and weighted average prices per option of 55.86, 57.45, 5.89 and zero at December 31, 2000, 2001, 2002 and 2003, respectively.

The following table summarizes the Telecom Italia Media 1999, 2001, Top, Key People, and Telegate stock option plans activity:

	Number of options	Weighted Average price per option
		(euro)
Outstanding at December 31, 2000	**24,352,396**	**0.09**
Granted	97,066,566	1.23
Exercised	(5,246,835)	0.03
Forfeited	(34,440,649)	1.14
Outstanding at December 31, 2001	**81,731,478**	**1.00**
Granted	47,936,110	0.85
Exercised	(18,055)	56.29

Forfeited	(26,314,590)	0.98
Outstanding at December 31, 2002	**103,334,943**	**0.93**
Exercised	(10,725,132)	0.03
Forfeited	(20,794,835)	0.86
Cancelled	(51,695,677)	1.15
Outstanding at December 31, 2003	**20,119,299**	**0.91**

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes certain information for the stock options granted under the stock option plans, which are outstanding at December 31, 2003:

Range of Grant Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life	Weighted Average Grant Price	Shares	Weighted Average Grant Price
(euro)			(euro)		(euro)
0.85	16,750,000	4.4	0.85	5,025,000	0.85
1.22	3,369,299	1.3	1.22	3,369,299	1.22
	20,119,299			8,394,299	

Telecom Italia Mobile (TIM)

At its meeting of December 22, 1999, the Board of Directors of TIM approved the 2000-2002 Plan. The options confer the right to acquire one TIM ordinary share for each option exercised upon the certified achievement of the market objective (E.V.A.) on which basis the option may be exercised (April 13, 2000). The company granted 21,210,000 shares at the exercise price of 6.42. The first lot vested and was exercised during 2000 (May 15-June 2). The remaining options are vested and exercisable. The plan expires at December 31, 2008. This date was extended from the original date of December 31, 2005. As such, a new measurement date was established under FIN 44. However, no compensation expense was recorded as the market price was less than the exercise price on the modification date.

The Board of Directors of TIM, on December 19, 2000, approved a stock plan, targeted at 183 executives and 148 non-executive employees, with the assignment of a total number of 44,790,000 options (2001-2003 Plan). They confer the right to acquire one TIM ordinary share for each option exercised upon the certified achievement of the market objective on which basis the option may be exercised (Dow Jones Eurostoxx TLC). The options vest in 3 lots based on performance objectives. The 2001-2003 Plan was partially absorbed by the 2003-2005 Plan. At present, 7 staff members continue to hold 1,190,000 options under the 2001-2003 Plan.

The Board of Directors Meeting of TIM on May 10, 2001 approved an additional supplement to the 2001-2003 Plan consisting of a new grant of options (the 2001-2003 Supplementary Plan). The option exercise price for the new offer was 7.526. The options have the same features and are subject to the same conditions as the 2001-2003 Plan. This plan was also partially absorbed by the 2003-2005 Plan. At present, 7 staff members continue to hold 499,000 options under the 2001-2003 Supplementary Plan.

On February 12, 2002, the Board of Directors of TIM approved a stock option plan for the 2002-2003 period: targeted at 193 executives and 173 non-executive employees, entailing the assignment of a total of about 25.5 million options (the 2002-2003 Plan) at a grant price of 5.67. At December 31, 2003, 24,030,000 options were outstanding and exercisable.

On May 6, 2002, the Board of Directors of TIM partially implemented the decision of the Shareholders Meeting of 2000 approving a new Stock Option Plan for the 2003-2005 period (2003-2005 Plan). At the same meeting, the Board of Directors approved the withdrawal, on a voluntary basis, of the previous 2001-2003 Plan and the 2001-2003 Supplementary Plan and therefore the related options. The offer was targeted at the holders of 2001-2003 Options employed with the company as at the date of the offer, as well as to new beneficiaries. With regard to the above 2003-2005 Plans, the Board of Directors of TIM granted 50,057,000 options at 5.07, of which 48,142,000 options were granted to the original assignees and 1,915,000 were granted to new assignees. The 2003-2005 Plan is composed of three annual lots that can be exercised respectively one, two and three years following their grant. For each lot of options, there will be an ongoing exercise period of five years after the vesting elapses and therefore, the lots can be exercised until 2008, 2009 and 2010, respectively. At December 31, 2003, 15,344,010 of the options were exercisable, and 46,497,000 were outstanding. Due to the fact that this plan replaced and cancelled a portion of the 2001-2003 and 2001-2003 Supplementary Plans, the 2003-2005 Plan is accounted for as a variable plan in accordance with APB 25. No compensation expense has been recorded for 2002 or 2003 as the market price is less than the exercise price for both periods.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stet Hellas, a subsidiary of TIM, approved on March 30, 2000, by the Stet Hellas s Shareholders General Assembly, the 1st Plan . Stet Hellas issued 1,300,000 option rights, which entitle the bearer to purchase shares of Stet Hellas at a price equal to the listed market price of Stet Hellas on the NASDAQ Stock Exchange as of the above date, which was U.S.$28.375. Included in the rollforward below are outstanding options of 1,205,000, 827,000, 535,000 and none, and weighted average prices per option of 27.06, 31.88, 27.28 and zero at December 31, 2000, 2001, 2002 and 2003, respectively.

Stet Hellas approved on December 11, 2000, by Stet Hellas s Shareholders Extraordinary General Assembly, the 2nd Plan . Stet Hellas was authorized to issue 1,000,000 option rights, which entitle the bearer to purchase shares of Stet Hellas at a price equal to the listed market price of Stet Hellas on the NASDAQ Stock Exchange as of such date, which was U.S.$12.532. Under the second plan, 760,000 option rights were issued during the year ended December 31, 2000, 175,000 during the year ended December 31, 2001, and 177,500 during the year ended December 31, 2003. No option rights were issued during the year ended December 31, 2002. Included in the rollforward below are outstanding options of 760,000, 935,000, 569,000 and 698,000 and weighted average prices per option of 21.76, 15.88, 11.73 and 9.94 at December 31, 2000, 2001, 2002 and 2003, respectively.

The status of the stock options granted under the 2000-2002, 2001-2003, 2001-2003 Supplementary, 2002-2003, 2003-2005, Stet Hellas 1st and Stet Hellas 2nd stock option plans are as follows:

	Number of options	Weighted Average price per option
		(euro)
Outstanding at December 31, 2000	**16,104,985**	**8.69**
Granted	57,012,000	8.45
Exercised	(357,668)	6.42
Forfeited	(2,797,000)	11.09
Cancelled	(728,997)	6.42
Outstanding at December 31, 2001	**69,233,320**	**8.43**
Granted	75,552,000	5.27
Forfeited	(404,335)	6.42
Cancelled	(55,492,000)	8.45
Outstanding at December 31, 2002	**88,888,985**	**5.67**
Granted	177,500	11.73
Forfeited	(3,503,500)	9.05
Cancelled	(46,667)	6.42
Outstanding at December 31, 2003	**85,516,318**	**5.54**

The following table summarizes certain information for the stock options granted under the stock option plans, which are outstanding at December 31, 2003:

Range of Grant Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life	Weighted Average Grant Price	Shares	Weighted Average Grant Price
(euro)			(euro)		(euro)
5.07-5.67	70,527,000	5.66	5.27	39,374,010	5.54
6.42-8.67	14,291,318	4.65	6.65	14,291,318	6.65
9.94	698,000	1.00	9.94	232,667	9.94
	85,516,318			53,897,995	

SFAS 123, *Accounting for Stock-Based Compensation* requires the disclosure of pro forma net income per share as if the Group had adopted fair-value accounting for stock-based awards.

Prior to 2002, the Group had used the Black-Scholes option pricing model to estimate the fair value of stock options granted to employees. Starting in 2002, the Group revisited the use of the Black-Scholes option-pricing

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

model and concluded that certain other option-pricing models, in particular binomial models, were better adapted to capturing the complexity of the fair value of these options. Therefore, effective January 1, 2002, the Group adopted the Cox-Ross-Rubenstein (CRR) binomial model for estimating the fair value of employee stock options. The CRR model uses a binomial tree to assess the probabilities that the price of the underlying stock might follow over the life of the option.

In contrast to the Black-Scholes model, the CRR model takes into account possible future stock prices at specified times between the grant date and the option maturity. An additional strength of the CRR model is that it is specifically designed to value options that can be exercised at any time (so called American options), as opposed to those that can only be exercised at the end of their maturity (so called European options). The Group s employees are free to exercise their vested stock options once they are vested, therefore they are considered to be American type call options. Also, the Group has historically paid dividends, which it anticipates doing in the future. The CRR model also has the flexibility to incorporate assumptions related to the payment level of future dividends. The CRR model was designed for these types of options, therefore it provides more useful fair value information. The following pro forma information has been derived using the Black-Scholes option pricing model for 2001 and the CRR model for 2002 and 2003.

The weighted average estimated fair value at the date of grant, as defined by SFAS 123, for options granted in 2001, 2002 and 2003 was 1.87, 1.43 and 1.19 per option, respectively.

The following weighted average assumptions were used in the estimated grant date fair value calculations for all stock option awards:

	2001	2002	2003
Expected life (years)	2.34	3.35	2.0
Expected volatility	60%	41%	68%
Risk free interest rate	4.71%	4.64%	2.70%
Expected dividend yield	1.02%	2.56%	0.93%

The Group s pro forma earnings (loss) per share, had compensation costs been recorded in accordance with SFAS 123, are presented below, for all plans:

	2001	2002	2003
	(millions of euro, except per share amounts)		
Net income (loss) in accordance U.S. GAAP	(4,006)	1,956	1,841
Add: Stock-based compensation expense (benefit) recognized under intrinsic value method	43	(28)	1
	(344)	(127)	38

Deduct: Total stock-based employee compensation (expense) benefit determined under fair value based method for all awards, net of related tax effects			
Pro forma net income (loss) available to each class of shares	**(4,307)**	**1,801**	**1,880**
Earning (Loss) per share:			
Basic EPS per Ordinary share as reported	(1.17)	0.48	0.20
Basic EPS per Ordinary share pro forma	(1.26)	0.44	0.21
Diluted EPS per Ordinary share as reported	(1.17)	0.48	0.20
Diluted EPS per Ordinary share pro forma	(1.26)	0.44	0.21

The effects of applying SFAS 123 in this pro forma disclosure should not be interpreted as being indicative of future effects.

(n) Capitalization of interest expense

The Group capitalizes interest expense on both tangible and intangible assets under construction. The Group is currently capitalizing interest expense on acquired UMTS licenses, which under U.S. GAAP are considered as construction in progress. Amortization of the assets, including the capitalized interest costs, will begin when the

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assets are put in service. The Group incurred interest expense of 2,395 million, 2,677 million and 2,912 million in 2003, 2002 and 2001, respectively, of which 163 million, 236 million and 239 million was capitalized in 2003, 2002 and 2001, respectively.

(o) Accounting for income taxes

For U.S. GAAP reporting purposes, the Telecom Italia Group follows the provisions of SFAS 109, Accounting for Income Taxes . In accordance with SFAS 109, the Telecom Italia Group has recognized deferred tax assets and liabilities based on the difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect in the years when those temporary differences are expected to reverse. The effect on the deferred taxes of changes in tax rates is recognized in income in the period that includes the enactment date. Where it is more likely than not that all or a portion of a deferred tax asset will not be realized, a valuation allowance has been recorded against it in order to reduce the deferred tax asset to the amount that is more likely than not to be realized.

The provision (benefit) for income taxes consisted of the following in the years ended December 31, 2001, 2002 and 2003:

	Year ended December 31,		
	2001	**2002**	**2003**
		(millions of euro)	
Income (loss) before income taxes:			
• from continuing operations	(2,656)	3,079	4,955
• from discontinued operations	(3,400)	(3,179)	(1,790)
Total income (loss) before income taxes	**(6,056)**	**(100)**	**3,165**
Current tax expense:			
Italy	1,258	1,413	1,736
Foreign	33	172	183
Total current tax expense	1,291	1,585	1,919
Deferred tax expense (benefit):			
Italy	(1,083)	(4,812)	(1,924)
Foreign	32	51	52
Total deferred tax benefit, net	(1,051)	(4,761)	(1,872)
Total income tax expense (benefit)	**240**	**(3,176)**	**47**

Income taxes are further detailed as follows:

	Year ended December 31,		
	2001	2002	2003
	(millions of euro)		
Income taxes:			
• from continuing operations	276	(3,152)	1,820
• from discontinued operations	(36)	(24)	(1,773)
Total income tax expense (benefit)	**240**	**(3,176)**	**47**

F-107

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The actual provision for income taxes is different from income taxes computed by applying the Italian statutory tax rate (40.25% in 2001 and 2002 and 38,25% in 2003, consisting of IRPEG taxes at 34% and IRAP taxes at 4.25% computed on a higher taxable income) for the reasons explained in the following tables:

	Year ended December 31, 2003	
	(millions of euro)	%
Income before income taxes under U.S. GAAP	**3,165**	
Taxes at statutory rate	**1,076**	**34%**
• Operating losses of the year 2003 not considered recoverable and for which a valuation allowance was set-up in 2003	213	7%
• Recognition in 2003 of operating losses of prior years for which a valuation allowance was set-up in prior years	(72)	(2%)
• Write-down of investments eliminated in consolidation	(599)	(19%)
• SEAT purchase accounting	(1,141)	(36%)
• Other, primarily effect of different tax rates in foreign countries	12	
• Recognition of deferred tax assets under FAS 109	(453)	(15%)
• Permanent differences:		
non deductible expenses	313	10%
non taxable revenue	(224)	(7%)
• Others	198	6%
	(677)	(22%)
• IRAP and other taxes calculated on a different taxable basis with respect to the income before income taxes	724	23%
Total income tax expense	**47**	**1%**

In 2002, the reconciliation between the Group s statutory tax rate (36% for the 2002 income taxes) and the effective tax rate is as follows:

	Year ended December 31, 2002	
	(millions of euro)	%

Loss before income taxes under U.S. GAAP	**(100)**	
Taxes at statutory rate	**(36)**	**(36%)**
• Deferred tax assets related to the write-down, for tax purposes only, made by the merging company on the Old Telecom Italia s shares	(2,397)	(2,397%)
• Operating losses of the year 2002 not considered recoverable and for which a valuation allowance was set-up in 2002	218	218%
• Recognition in 2002 of operating losses of prior years for which a valuation allowance was set-up in prior years	(212)	(212%)
• SEAT purchase accounting	393	393%
• Non taxable gains on disposals	(744)	(744%)
• Write-down of investments eliminated in consolidation	(782)	(782%)
• Tax benefit connected to the acquisition of business	(453)	(453%)
• Recognition of deferred tax assets under FAS 109	(65)	(65%)
• Others	(34)	(34%)
• Permanent differences:		
non deductible expenses	391	391%
	(3,721)	(3,721%)
• IRAP and other taxes calculated on a different taxable basis with respect to the loss before income taxes	545	545%
Total income tax benefit	**(3,176)**	**(3,176%)**

F-108

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2001, the reconciliation between the Group s statutory tax rate (36% for the 2001 income taxes) and the effective tax rate is as follows:

	Year ended December 31, 2001	
	(millions of euro)	%
Loss before income taxes under U.S. GAAP	**(6,056)**	
Taxes at statutory rate	**(2,180)**	**(36%)**
• Operating losses of the year 2001 not considered recoverable and for which a valuation allowance was set-up in 2001	333	5%
• SEAT purchase accounting	705	12%
• Goodwill amortization	821	14%
• Others	18	
• Permanent differences:		
non deductible expenses	69	1%
	(234)	(4%)
• IRAP and other taxes calculated on a different taxable basis with respect to the loss before non deductible expenses	474	8%
Total income tax expense	**240**	**4%**

The components of the net deferred tax assets (liabilities) as of December 31, 2002 and 2003 are as follows:

	2002	2003
	(millions of euro)	
Deferred tax assets:		
Intercompany profits	69	119
Accrued pension obligation	211	265
Revaluation of fixed assets	223	142
Provisions	2,073	679
Net operating losses	2,406	2,886
Write-down of investment for tax purposes	1,931	3,552
Other	1,417	642

Subtotal	8,330	8,285
Less valuation allowance	(2,364)	(2,223)
	5,966	6,062
Deferred tax liabilities:		
Capitalization of interest on assets	(175)	(276)
Intangible assets	(1,585)	(5,412)
Tax suspended reserves in equity	(253)	(191)
Withholding tax on interest		(132)
Other	(994)	(388)
Subtotal	(3,007)	(6,399)
Net deferred tax asset/(liability)	**2,959**	**(337)**

F-109

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At December 31, 2003, the Group has net operating loss carryforwards of 8,611 million. Net operating losses in Italy expire within five years. The following outlines the scheduled expiration periods for the aforementioned net operating losses:

	(millions of euro)
2004	330
2005	982
2006	953
2007	709
2008	2,237
After 2008	492
Without expiration	2,908
Total NOL s	**8,611**

No provision has been made for Italian taxes, or foreign taxes that may result from future remittances of undistributed earnings of foreign subsidiaries, because it is expected that all such earnings will be permanently reinvested in these foreign operations. It is not practical to estimate the amount of taxes that might be payable on the eventual remittance of these earnings due to the complexities associated with its hypothetical calculation.

In accordance with SFAS 109, no deferred tax liabilities are to be provided on the portions of the equity reserves, which are subject to taxes in case of distribution if such reserves relate to years prior to 1992. The amount of such taxable portion of the reserves is 1,124 million and the related deferred tax liability is 371 million.

During 2003 the Italian corporate income tax rate was reduced from 34% to 33%, effective January 1, 2004. The impact of the tax rate reduction on the net components of deferred taxes at December 31, 2002 was not significant.

Total income taxes paid in 2001, 2002 and 2003 amount to 2,080 million, 725 million, 957 million, respectively.

The Group, in connection with the introduction in Italy of the new tax consolidation, will elect to apply the new tax regime in order to allow the Group to utilize certain net operating loss carryforwards that might otherwise expire.

In connection with the acquisition of the minority interest in Old Telecom Italia, described in Note 27.1. above, a portion of the existing net operating losses carry-forwards related to Old Telecom Italia (related to the 60.47% acquisition from the minorities) covered by a valuation allowance at the date of acquisition, if subsequently recognized will be allocated to reduce goodwill or other non current intangible assets. Such portion amounts to approximately 2,830 million.

(p) Transactions with subsidiary and equity investee stock

Occasionally Telecom Italia sells shares in its controlled subsidiaries or equity investees in the public market or through private placements. Gains and losses recognized on these transactions are recognized as non-operating in the statement of operations.

(q) Earnings per Share

In accordance with SFAS 128, Earnings per Share , basic earnings per share is computed by dividing income available to ordinary shareholders by the weighted average number of ordinary shares outstanding. The computation of diluted earnings per share is increased to include any potential ordinary shares. Potential ordinary shares are those securities that, if converted into shares, would increase the total number of shares outstanding and reduce the earnings attributable to each share. The effects of any potential ordinary shares are omitted when the effects of including them is anti-dilutive. Potential ordinary shares include options, warrants and convertible securities. In 2001, 2002 and 2003, no potential ordinary shares were considered dilutive, therefore basic and diluted shares were the same.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The computations of basic and diluted earnings per share for the years ended December 31, 2001, 2002 and 2003, prepared in accordance with U.S. GAAP, are as follows:

	2001	2002	2003
	(Million of euro, except per share amounts)		
Basic EPS(*)			
Net Income (loss) under U.S. GAAP	(4,006)	1,956	1,841
Less: 0.011 in 2003 premium payable to savings shares (**)			(26)
	(4,006)	1,956	1,815
Weighted average number of shares (millions)	3,425	4,054	9,035
Basic EPS ordinary shares	(1.17)	0.48	0.20
Add: 0.011 in 2003 premium payable to savings shares (**)			0.01
Basic EPS savings shares			0.21
Diluted EPS(*)			
Weighted average number of shares (millions)	3,425	4,054	9,035
Dilutive effect of stock options (millions)			
Diluted weighted average number of shares (millions)	3,425	4,054	9,035
Diluted EPS ordinary shares			0.20
Add: 0.011 in 2003 premium payable to savings shares (**)			0.01
Diluted EPS savings shares			0.21

(*) Calculated under the two class method considering distributed and undistributed earnings.
(**) This takes into account the par value per share as of December 31, 2003 equal to 0.55.

The total number of potentially dilutive shares not included in 2001, 2002 and 2003 due to their anti-dilutive impact was 1,382 million, 1,366 million and 1,647 million respectively.

(r) Effects of Regulation

As discussed in Note 2, Telecom Italia is subject to the regulatory control of the National Regulatory Authority with additional oversight provided by numerous laws, decrees and codes. The regulatory framework in Italy is constantly under review and takes into consideration EU requirements. It is anticipated that the regulators will allow Telecom Italia to recover a certain level of costs (subject to price caps), but not necessarily its specific cost of providing service. Accordingly, U.S. GAAP, as described in SFAS 71, Accounting for the Effects of Certain Types of Regulation , which relates to an entity whose rates are regulated on an actual cost basis, is not currently applicable to these financial statements.

(s) Asset Retirement Obligation

Effective January 1, 2003, Telecom Italia changed its method of accounting for asset retirement obligations in accordance with FASB Statement No. 143, Accounting for Asset Retirement Obligations . Previously, the Group had not been recognizing amounts related to asset retirement obligations. Under the new accounting method, the Group now recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of a fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset.

The cumulative effect of the change on prior years resulted in a charge to income of 21 million (net of income taxes of 11 million), which is included in income for the year ended December 31, 2003. The effect of the change on the year ended December 31, 2003 was to decrease income before the cumulative effect of the accounting change by 13 million. The pro forma effects of the application of Statement No. 143 as if the Statement had been adopted on January 1, 2001 (rather than January 1, 2003) are presented below:

Pro forma amounts assume the accounting change had been applied retroactively, net of tax:

	2001	2002	2003
	(millions of euro)		
Net income (loss) under U.S. GAAP	(4,012)	1,948	1,831
Net income (loss) per ordinary share	(1.17)	0.48	0.20

F-111

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Group s subsidiaries, through primarily its Italian mobile subsidiary, Telecom Italia Mobile, have leased buildings or land upon which it constructs its transmission and relay towers. The Group enters into new leases each year and, in most cases, has the right to renew the initial lease term. The Group is legally required to dismantle the towers and, where necessary, recondition the building at the end of the lease life.

Telecom Italia recognized the fair value of a liability for the asset retirement obligations and capitalized that cost as part of the cost basis of the leasehold improvement and depreciates it on a straight-line basis over the expected life of the leasehold. The following table describes all the changes to the Group s asset retirement obligation liability:

	2003
	(millions of euro)
Asset retirement obligation at the beginning of the year	
Liability recognized in transition	142
Accretion expense	5
Additional liability recognized in 2003	31
Asset retirement obligation at the end of the year	**178**

The pro forma asset retirement obligation liability balances as if Statement No. 143 had been adopted on January 1, 2001 (rather than January 1, 2003) are as follows:

	2001	2002	2003
	(millions of euro)		
Pro forma amounts of liability for asset retirement obligation at beginning of the year	86	110	139
Pro forma amounts of liability for asset retirement obligation at the end of the year	110	139	178

(t) Lease commitments

The following is a summary of all future minimum lease payments as of December 31, 2003 (in millions of euro):

	Finance Leases	Operating Leases
2004	36	8
2005	29	6
2006	24	4
2007	24	2
2008	17	
Thereafter	64	
Total	194	20
Less current portion	(36)	(8)
Long-term portion	**158**	**12**

(u) Aria Is TIM investment

On May 13, 2003, TIM International signed a term sheet with Turk Telekom (the Turkish fixed line operator) outlining a set of guidelines for the integration of Telekomunikasyon Hizmetleri A.S. (Aria Is TIM), TIM s mobile telecom equity investee in Turkey 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 the required regulatory approvals. Turk Telekom and TIM International each hold a 40% stake in the new company and Is Bank Group, TIM s original investment partner, holds the remaining 20%. Together the two companies have a joint customer base of about 4.5 million customers representing approximately 15% of the total market. This agreement resulted in part from the events that occurred during 2002 which resulted in the charges described below.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During 2002, the Group continued to make investments in Aria Is TIM. At December 31, 2002, the Group owned 49% of the voting stock of Aria Is TIM. Since being awarded its license in April 2000, measures which should have fostered effective and open competition and permitted a new entrant to compete against the incumbent operators (roaming arrangements in particular), have not occurred. The de-regulation of the Turkish market did not occurr for a variety of reasons, including apparent opposition to the necessary changes by the incumbent operators and the regulatory approach of the competent institutions. In order to effectively compete in this and other markets, it is essential that new entrants be allowed to have access to the existing incumbent operators networks, in this case that includes the ability to have effective roaming coverage over a vast terrain.

Since its inception, Aria Is TIM and its shareholders made repeated and formal efforts to have this situation rectified but were de facto prevented from entering the Turkish mobile telephony market, thereby infringing the terms and conditions of the tender made for the license. As a result of the necessary conditions to open the mobile telecommunications market in Turkey to competition not having occurred, Aria Is TIM suffered significant losses and was unable to effectively compete against the two much larger incumbent operators. Due to the considerable damages suffered by the Group s investee, Aria Is TIM filed a Request for Arbitration against the local telecommunications authority, requesting a refund reflecting damages in the amount of U.S.$2.5 billion. In conjunction with the arbitration claim, TIM undertook a full review of the investment at year end December 31, 2002. That review included two appraisals, one from an independent major investment bank, to assess the fair value of the equity investee. The review encompassed all of the investments to date in Aria Is TIM, including the original 1.7 billion in convertible loans and the 850 million relating to the Group s exposure with the same investee. Based on the fair value report of the investment bank and the independent analysis of the Group, a charge of 2,341 million was taken. This charge together with the 171 million accrual for losses of Aria Is TIM resulted in total charges related to the equity investee in 2002 of approximately 2.5 billion.

As is customary for significant investees, the Group attempted to obtain the audited financial statements of Aria Is TIM as of December 31, 2002. Due to an impasse at the investee s Board of Directors level relating to the valuation of the assets of Aria Is TIM, TIM was not able to obtain these financial statements. Set forth below is a list of some of the pertinent facts related to the structure of the joint venture arrangements between TIM and IS Bank Group, which sets out certain of the reasons why TIM was unable to resolve the impasse and obtain audited financial statements:

- under the telecom sector rules of Turkey, TIM is not allowed to control more than 49% of Aria Is TIM as at least 51% must be owned by a Turkish company;
- Board of Directors: 4 IS Bank, 3 from TIM; and
- based on the shareholders agreement, all resolutions of the Board of Directors require the affirmative vote of the majority of the total Directors present at the meeting but the affirmative vote of at least two Directors designated by TIM and two Directors designated by IS Bank is required to adopt a resolution approving the balance sheet and the statement of operations of the company.

(v) Subsequent events

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 own 100% 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 for a reserve for risks and charges.

Table of Contents

TELECOM ITALIA S.p.A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Decrease in share capital of Solpart Participaçoes (Solpart)

At the Extraordinary Shareholders Meeting of Solpart, the holding company of Brasil Telecom Partecipaçoes (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, 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 Participaçoes. 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.

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.

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.

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 synergistic 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.

Table of Contents

REPORTS OF OTHER INDEPENDENT AUDITORS

Table of Contents

Deloitte & Touche
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Av. Providencia 1760
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INDEPENDENT AUDITORS REPORT

To the Board of Directors and Shareholders

Empresa Nacional de Telecomunicaciones S.A.

We have audited the accompanying consolidated balance sheets of Empresa Nacional de Telecomunicaciones S.A. and subsidiaries as of December 31, 2002 and 2003 and the related consolidated statements of income and cash flows for each of the three years in the period then ended, all expressed in thousands of Chilean pesos. These financial statements (including the related notes) are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Chile and in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements referred to above present fairly, in all material respects, the financial position of Empresa Nacional de Telecomunicaciones S.A. and subsidiaries at December 31, 2002 and 2003 and the results of their operations and their cash flows for each of the three years in the period then ended, in conformity with accounting principles generally accepted in Chile.

Accounting principles generally accepted in Chile vary in certain significant respects from accounting principles generally accepted in the United States of America. The application of the latter would have affected the determination of net income for each of the three years in the period ended December 31, 2003 and shareholders equity as of December 31, 2002 and 2003 to the extent summarized by the Company in Note 38 to the consolidated financial statements.

Our audits also comprehended the translation of constant Chilean pesos amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 38. Such U.S. dollar amounts are presented solely for the convenience of readers in the United States of America.

/s/ Deloitte

Santiago, Chile

January 26, 2004

except for Note 38 for which the date is March 31, 2004

Una firma miembro de

Deloitte Touche Tohmatsu

Table of Contents

PricewaterhouseCoopers SpA

To the Shareholders of

Finsiel SpA

We have audited the consolidated balance sheets of Finsiel SpA (an Italian corporation) and its subsidiaries (the Company) as of December 31, 2003, 2002 and 2001 (all expressed in Euro) and the related consolidated statements of income for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company s Directors. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Finsiel SpA and its subsidiaries as of December 31, 2003, 2002 and 2001, and the results of their income for each of the three years in the period ended December 31, 2003, in conformity with the law governing consolidated financial statements and generally accepted accounting principles in Italy.

Accounting principles generally accepted in Italy vary in certain significant respects from accounting principles generally accepted in the United States.

PricewaterhouseCoopers SpA

/s/ Corrado Testori

Corrado Testori

(Partner)

Rome, 5 March 2004

Sede legale: Milano 20124 Via Vittor Pisani 20 Tel. 0267831 Fax 0266981433 Cap. Soc. 3.754.400,00 Euro i.v., C.F. e P. IVA e Reg. Imp. Milano 12979880155 Iscritta all Albo Consob Altri uffici: **Ancona** 60123 Via Corridoni 2 Tel. 07136881 **Bari** 70125 Viale della Repubblica 110 Tel. 0805429863 **Bologna** 40122 Via delle Lame 111 Tel. 051526611 **Brescia** 25124 Via Celalonia 70 Tel. 0302219811 **Firenze** 50129 Viale Milton 65 Tel. 0554627100 **Genova** 16121 Piazza

Dante 7 Tel. 01029041 **Milano** 20122 Corso Europa 2 Tel. 0277851 **Napoli** 80121 Piazza dei Martiri 30 Tel. 0817644441 **Padova** 35137 Largo Europa 16 Tel. 0498762677 **Palermo** 90141 Via Marchese Ugo 60 Tel. 091349737 **Parma** 43100 V.le Tanara 20/A Tel. 0521242848 **Roma** 00154 Largo Fochetti 29 Tel. 06570251 **Torino** 10129 Corso Montevecchio 37 Tel. 011556771 **Trento** 38100 Via Manzoni 16 Tel. 0461237004 **Treviso** 31100 Piazza Crispi 8 Tel. 0422542726 **Trieste** 34125 Via Cesare Battisti 18 Tel. 0403480781 **Udine** 33100 Via Marinoni 12 Tel. 043225789 **Verona** 37122 Corso Porta Nuova 125 Tel. 0458002561

Table of Contents

Independent auditors report

The Supervisory Board and Stockholders

Mobilkom Austria AG & Co KG and

Mobilkom Austria AG:

We have audited the accompanying combined consolidated balance sheets of Mobilkom Austria AG & Co KG and Mobilkom Austria AG (the Company or Mobilkom) as of December 31, 2001 and 2000, and the related combined consolidated statements of operations, cash flows and changes in stockholders equity for each of the years in the three year period ended December 31, 2001. These combined consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these combined consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mobilkom as of December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton Jonasch & Platzer Wirtschaftsprüfungs- und Steuerberatungs-OHG	KPMG Austria GmbH Wirtschaftsprüfungs- und Steuerberatungsgesellschaft
/s/ Grant Thornton Jonasch & Platzer	/s/ KPMG Austria GmbH

Vienna

March 15, 2002

Table of Contents

Independent auditors report

The Supervisory Board and Stockholders

Telekom Austria Aktiengesellschaft:

We have audited the accompanying consolidated balance sheets of Telekom Austria Aktiengesellschaft (Telekom Austria) as of December 31, 2001 and 2000, and the related consolidated statements of operations, cash flows and changes in stockholders equity for each of the years in the three year period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Telekom Austria as of December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton Jonasch & Platzer Wirtschaftsprüfungs- und Steuerberatungs-OHG	KPMG Austria GmbH Wirtschaftsprüfungs- und Steuerberatungsgesellschaft
/s/ Grant Thornton Jonasch & Platzer	/s/ KPMG Austria GmbH

Vienna

March 20, 2002

Table of Contents

Basaran Nas Serbest Muhasebeci

Mali Müsavirlik A.S.

a member of

PricewaterhouseCoopers

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of

Is-Tim Telekomünikasyon Hizmetleri A.S.

We have audited the accompanying balance sheet of Is-Tim Telekomünikasyon Hizmetleri A.S. (Is-Tim) at 31 December 2001 and the related statement of loss, changes in shareholders equity and cash flows for the year then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Is-Tim at 31 December 2001 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Basaran Nas Serbest Muhasebeci

Mali Müsavirlik Anonim Sirketi

a member of

PricewaterhouseCoopers

/s/ Murat Sancar

Murat Sancar, SMMM

(Partner)

Istanbul, 1 February 2002

F-120

Table of Contents

Telekom Austria

Consolidated Financial Statements

for the years ended December 31, 2003, 2002 and 2001

F-121

Table of Contents

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

Independent Auditor s Report

The Supervisory Board and Stockholders

Telekom Austria Aktiengesellschaft:

We have audited the accompanying consolidated balance sheets of Telekom Austria Aktiengesellschaft and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, stockholders equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of mobilkom austria AG & Co KG and mobilkom austria AG and subsidiaries (collectively mobilkom), wholly-owned consolidated subsidiaries (74.999% owned unconsolidated subsidiaries from January 1, 2002 to June 28, 2002) whose total assets as of December 31, 2003 and 2002 constitute 35.6 percent and 32.2 percent of total consolidated assets and whose revenues for the year ended December 31, 2003 and for the period June 28, 2002 to December 31, 2002, respectively, constitute 48.9 percent and 30.7 percent of total consolidated revenues. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for mobilkom, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Telekom Austria Aktiengesellschaft and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 143 Accounting for Asset Retirement Obligations effective January 1, 2003 and Statements of Financial Accounting Standards No. 141 Business Combinations and No. 142 Goodwill and Other Intangible Assets effective January 1, 2002.

KPMG Alpen-Treuhand GmbH

Wirtschaftsprüfungs-und Steuerberatungsgesellschaft

Vienna, Austria

March 10, 2004

Table of Contents

Independent Auditor s Report

The Supervisory Board and Stockholders

mobilkom austria AG & Co KG and

mobilkom austria AG:

We have audited the consolidated balance sheets of mobilkom austria AG & Co KG and mobilkom austria AG and subsidiaries (collectively mobilkom), wholly-owned consolidated subsidiaries of Telekom Austria Aktiengesellschaft (74.999% owned unconsolidated subsidiaries from January 1, 2002 to June 28, 2002), as of December 31, 2003 and 2002, and the related consolidated statements of income, stockholders equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of mobilkom as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 143 Accounting for Asset Retirement Obligations effective January 1, 2003 and Statements of Financial Accounting Standards No. 141 Business Combinations and No. 142 Goodwill and Other Intangible Assets effective January 1, 2002.

Grant Thornton

Wirtschaftsprüfungs-und Steuerberatungs-GmbH

Vienna, Austria

February 12, 2004

Table of Contents

Independent Auditors Report

The Supervisory Board and Stockholders

Telekom Austria Aktiengesellschaft:

We have audited the accompanying consolidated balance sheet of Telekom Austria Aktiengesellschaft and subsidiaries as of December 31, 2001, and the related consolidated statement of income, stockholders equity and comprehensive income, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Telekom Austria as of December 31, 2001, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton Jonasch & Platzer	KPMG Austria GmbH
Wirtschaftsprüfungs-und Steuerberatungs-OHG	Wirtschaftsprüfungs-und Steuerberatungsgesellchaft

Vienna, Austria

March 20, 2002

F-125

Table of Contents

TELEKOM AUSTRIA AG

CONSOLIDATED BALANCE SHEETS

(in EUR 000s, except share information)

	Notes No	December 31, 2003	December 31, 2002
ASSETS			
Current assets			
Cash and cash equivalents		201,926	27,337
Short-term investments		6,867	5,327
Accounts receivable trade, net of allowances of EUR 92,238 and EUR 74,945 as of December 31, 2003 and December 31, 2002	(5)	559,872	451,934
Receivables due from related parties	(6)	1,549	6,723
Inventories	(7)	83,535	91,261
Deferred tax assets	(18)	45,633	4,657
Prepaid expenses		91,177	81,935
Taxes receivable		9,739	22,829
Assets held for sale		5,560	30,512
Other current assets		118,963	142,743
TOTAL CURRENT ASSETS		1,124,821	865,258
Property, plant and equipment, net	(9)	4,457,666	5,000,659
Goodwill	(8)	597,577	590,727
Other intangible assets, net	(8)	711,988	725,893
Investments in affiliates	(3)	3,555	8,642
Other investments		143,630	162,682
Deferred tax assets	(18)	94,349	193,414
Other assets		762,679	987,063
TOTAL ASSETS		7,896,265	8,534,338
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities			
Short-term borrowings	(10)	631,321	1,309,905
Accounts payable trade		589,368	649,890
Accrued liabilities	(11)	231,778	256,790
Payables to related parties		23,657	37,198
Deferred income	(12)	150,378	129,963
Income taxes payable		7,650	6,077
Other current liabilities		155,563	141,210
TOTAL CURRENT LIABILITIES		1,789,715	2,531,033
Long-term debt, net of current portion	(14)	2,342,288	2,079,885
Lease obligations, net of current portion	(15)	861,300	1,076,354
Employee benefit obligations	(16)	155,960	232,529
Other liabilities and deferred income		107,629	104,997
Stockholders equity			

Common stock, issued and outstanding shares 500,000,000 with zero par value		1,090,500	1,090,500
Additional paid in capital		453,371	452,498
Retained earnings		1,103,867	969,626
Accumulated other comprehensive loss		(8,365)	(3,084)
TOTAL STOCKHOLDERS EQUITY	(20)	2,639,373	2,509,540
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY		7,896,265	8,534,338

see accompanying notes to consolidated financial statements

Table of Contents

TELEKOM AUSTRIA AG

CONSOLIDATED STATEMENTS OF OPERATIONS

(in EUR 000s, except share information)

	Notes No	twelve months ended December 31, 2003	2002	2001
Operating revenues (a)	(21)	3,969,750	3,118,064	2,659,660
Operating expenses (b)				
Materials		(297,084)	(196,434)	(71,908)
Employee costs, including benefits and taxes		(699,348)	(600,718)	(619,080)
Depreciation and amortization		(1,133,148)	(1,016,312)	(904,075)
Impairment charges	(9)	(6,825)	(41,871)	(145,126)
Other operating expenses	(22)	(1,463,521)	(1,205,354)	(1,153,930)
OPERATING INCOME		369,824	57,375	(234,459)
Other income (expense)				
Interest income (c)		75,167	88,191	82,683
Interest expense (d)		(230,979)	(244,628)	(240,986)
Equity in earnings of affiliates		19,112	140,543	195,450
Other, net	(23)	(567)	2,330	(2,756)
INCOME BEFORE INCOME TAXES, MINORITY INTERESTS AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE		232,557	43,811	(200,068)
Income tax (expense) benefit	(18)	(83,036)	(26,112)	94,913
Minority interests		(3,422)	(4,910)	530
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE		146,099	12,789	(104,625)
Cumulative effect of change in accounting principle, net of tax of EUR 6,071	(13)	(11,858)		
NET INCOME		134,241	12,789	(104,625)
Basic and fully diluted earnings per share		0.27	0.03	(0.21)
Basic and fully diluted earnings per share excluding cumulative effect of change in accounting principle		0.29	0.03	(0.21)
a) includes revenues from related parties of		89,506	147,990	293,459
b) includes operating expenses from related parties of		128,694	192,153	314,769
c) includes interest income from related parties of		1	4,992	17,619
d) includes interest expense from related parties of		30	938	749

see accompanying notes to consolidated financial statements

Table of Contents

TELEKOM AUSTRIA AG

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in EUR 000s, except share information)

	Notes No	twelve months ended December 31, 2003	2002	2001
Cash generated from operations				
Net income		134,241	12,789	(104,625)
Adjustments to reconcile net income to cash generated from operations				
Depreciation, amortization and impairment charges		1,139,973	1,058,183	1,049,201
Write-offs from investments		2,840		
Employee benefit obligation non cash		307	(49,840)	3,145
Allowance for doubtful accounts	(5)	30,629	39,184	14,818
Change in deferred taxes		59,241	33,498	(94,969)
Equity in earnings of affiliates less than (in excess of) dividends received		1,027	(45,801)	(80,731)
Asset retirement obligation accretion expense		1,336		
Cumulative effect of change in accounting principle, net of tax	(13)	11,858		
(Gain) Loss on sale of investments		(17,903)	195	
Loss on disposal / retirement of equipment		41,571	17,280	38,922
Other		(660)		
		1,270,219	*1,052,699*	*930,386*
Changes in assets and liabilities, net of effect of business acquired				
Accounts receivable trade		(140,331)	175,522	24,401
Due from related parties		5,813	3,759	69,050
Inventories		5,765	6,052	19,030
Prepaid expenses and other assets		71,506	(9,020)	(56,442)
Accounts payable trade		(58,944)	10,979	(85,734)
Employee benefit obligation		(76,649)	(102,565)	(73,592)
Accrued liabilities		(23,487)	3,881	(54,414)
Due to related parties		(13,358)	17,088	3,830
Other liabilities and deferred income		45,100	230	170,490
		(184,585)	*105,926*	*16,619*
Cash generated from operations		**1,219,875**	**1,171,414**	**842,380**
Cash from investing activities				
Capital expenditures, including interest capitalized		(599,684)	(560,742)	(459,039)
Acquisitions and investments, net of cash acquired		(85,989)	(665,128)	(4,759)
Sale of subsidiary, net of cash		205		
Proceeds from sale of equipment		17,300	49,819	12,106
Purchase of investments short-term		(79,750)	(1,629)	(2,790)
Purchase of investments long-term		(601)	(1,107)	
Sale of American call options		957	2,609	
Proceeds from sale of investments short-term		80,108	6	8
Proceeds from sale of investments long-term		23,599	225	1,285

Cash used in investing activities	**(643,855)**	**(1,175,947)**	**(453,189)**
Cash from financing activities			
Principal payments on bonds	(22,765)	(72,673)	(61,845)
Proceeds from issuance of long-term debt and bonds	775,948	127,857	
Principal payments on long-term debt	(385,330)	(406,294)	(335,159)
Changes in short-term bank borrowings	(774,644)	237,973	74,968
Changes from financing with mobilkom austria		114,921	(73,166)
Proceeds from sale of tax benefits			14,547
Cash (used in) generated from financing activities	**(406,791)**	**1,784**	**(380,655)**
Effect of exchange rate changes	**5,360**	3,693	142
Net increase in cash and cash equivalents	**174,589**	**944**	**8,678**
Cash and cash equivalents at beginning of period	27,337	26,393	17,715
Cash and cash equivalents at end of period	201,926	27,337	26,393

see accompanying notes to consolidated financial statements

F-128

Table of Contents

TELEKOM AUSTRIA AG

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(in EUR 000s, except share information)

	Common stock					
	Number of shares	Par value	Additional paid in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders equity
Balance January 1, 2001	500,000,000	1,090,500	451,677	1,061,462	(27)	2,603,612
Comprehensive income						
Net loss				(104,625)		(104,625)
Net unrealized loss on securities, net of EUR 83 deferred income tax					(162)	(162)
Foreign currency translation adjustment					14,630	14,630
Cumulative effect of accounting change, net of EUR 5,646 deferred income tax					(10,959)	(10,959)
Unrealized net loss of hedging activities, net of EUR 954 deferred income tax					(2,102)	(2,102)
Total comprehensive loss						(103,218)
Balance December 31, 2001	500,000,000	1,090,500	451,677	956,837	1,380	2,500,394
Comprehensive income						
Net income				12,789		12,789
Net unrealized loss on securities, net of EUR 362 deferred income tax					(687)	(687)
Foreign currency translation adjustment					(6,496)	(6,496)
Unrealized net gain of hedging activities, net of EUR (1,386) deferred income tax					2,719	2,719
Total comprehensive income						8,325
Sale of call options, net of EUR (424) income tax			821			821
Balance December 31, 2002	500,000,000	1,090,500	452,498	969,626	(3,084)	2,509,540
Comprehensive income						
Net income				134,241		134,241
					2,214	2,214

Net unrealized gains on securities, net of EUR (1,141) deferred income tax						
Foreign currency translation adjustment					(10,690)	(10,690)
Unrealized net gain on hedging activities, net of EUR (1,646) deferred income tax					3,195	3,195
Total comprehensive income						128,960
Sale of call options, net of EUR (451) income tax			873			873
Balance December 31, 2003	500,000,000	1,090,500	453,371	1,103,867	(8,365)	2,639,373

see accompanying notes to consolidated financial statements

F-129

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

(1) THE COMPANY AND SIGNIFICANT ACCOUNTING POLICIES

Description of business, organization and relationship with the Federal Republic of Austria

Telekom Austria AG and subsidiaries (the Company or Telekom Austria) is engaged as a full service telecommunications provider of long distance, local and wireless services, corporate data communications services as well as internet services. The Company also provides services through pay phones and supplies telephones and technical equipment for telephone communications. These activities are conducted and operated primarily in Austria.

On May 1, 1996, Post und Telekom Austria Aktiengesellschaft (PTA) was incorporated as the successor to Post und Telegraphenverwaltung. The Poststrukturgesetz (Austrian Post Restructuring Act) provided the basis for the separation of PTA from the Federal Republic of Austria. PTA s operations included postal services, telecommunications, coach line services and other activities.

As of December 31, 1997, the postal services, coach line services and other non-telecommunications-related operations of PTA were transferred to different legal entities. The operations remaining related to the telecommunications business and were named Telekom Austria AG.

Telecom Italia owned 29.78% of Telekom Austria until their sale of 75,000,000 shares on November 4, 2002 in a private placement, thereby reducing its level of ownership to 14.78% as of December 31, 2002 and 2003, respectively (see note (27)).

The Federal Republic of Austria, through Österreichische Industrie-Holding AG (ÖIAG), continues to be a significant shareholder with it s holding of approximately 47.17% of the voting common stock of the Company. In July 2003, ÖIAG issued convertible notes in the nominal amount of EUR 325,000 due in 2006 exchangeable into 25 million existing underlying common shares of Telekom Austria AG. The exchange price has been set at Euro 13 for each Telekom Austria AG share. In addition to the related party transactions described in note (6), the Federal Republic of Austria authorizes and supervises the Rundfunk und Telekom Regulierungs GmbH (RTR), which regulates certain activities of the Company. The government holds the taxing authority for the Austrian operations of Telekom Austria and imposes taxes such as income and value added taxes on the Company.

All of the Company s interests in mobile communications business are held through mobilkom austria AG & Co KG and mobilkom austria AG and its subsidiaries; collectively these companies are referred to as mobilkom austria.

Prior to June 28, 2002, the Company held a 74.999% interest in mobilkom austria. Due to certain substantive participating rights held by the minority shareholder, the Company s investment in mobilkom austria was accounted for under the equity method. These participation rights included significant blocking rights over operating decisions including operating budgets, capital spending, senior management positions, strategy and dividend distributions.

On June 28, 2002, the Company acquired the remaining 25.001% equity interest in mobilkom austria, thereby bringing its total interest in mobilkom austria to 100%. Consequently, the Company has consolidated mobilkom austria effective June 28, 2002. The consolidated statement of operations for the year ending December 31, 2002 reflects the Company s equity in earnings of mobilkom austria through June 28, 2002 and mobilkom austria s results of operations for the period June 28, 2002 until December 31, 2002.

Basis of presentation

The consolidated financial statements of Telekom Austria have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

The Company has reclassified certain amounts in prior year financial statements to conform to the current year presentation.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

In December 2001, the RTR enacted a regulation that revised the manner in which phone calls that are both i) initiated and terminated within Austria and ii) require interconnection between multiple networks, are controlled. Historically, the Company served as a central hub through which all such calls were interconnected based on agreements in place between the Company and Austrian alternative service providers or mobile phone operators. Accordingly, the Company would recognize revenue and a trade receivable on the interconnection fee charged to the provider on whose network the call was initiated and recognize expense and a trade payable to the provider on whose network the call was terminated. As a result of the new regulation, the Company is no longer a party to such transactions unless the call either originates or terminates on its network. Had the new regulation been in place during 2001, revenues and expenses in the accompanying consolidated statements of operations would have been lower by EUR 257,243, all of which relates to the wireline segment.

In September 2003, the Austrian Supreme Court ruled that no contractual relationship exists between value-added service providers (VASP) and the Company, with the contractual relationship being established directly between the VASP and the customers. The Company is no longer considered the primary obligor and ceased reporting revenues on a gross basis beginning on October 1, 2003. Had the ruling been in effect for all of 2003, 2002 and 2001, revenues and expenses in the accompanying consolidated statements of operations would have been lower by EUR 45,886, EUR 51,206 and EUR 41,386, respectively. Had the enacted regulation been in place during 2001 and the VASP ruling been in effect for all of 2003, 2002 and 2001 revenues and expenses would have been adjusted as follows:

	Year ended December 31,					
	2003	**2003**	**2002**	**2002**	**2001**	**2001**
	pro-forma	**as reported**	**pro-forma**	**as reported**	**pro-forma**	**as reported**
Revenues	3,923,864	3,969,750	3,066,858	3,118,064	2,361,031	2,659,660
Operating expenses	(3,554,040)	(3,599,926)	(3,009,483)	(3,060,689)	(2,595,490)	(2,894,119)
Operating income	369,824	369,824	57,375	57,375	(234,459)	(234,459)

Principles of consolidation

The consolidated financial statements include the accounts of Telekom Austria AG and all subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Investments in companies in which the Company has significant influence, but less than a controlling financial interest, are accounted for using the equity method. Under the equity method, only the Company s investments in and net amounts due to and due from the equity investee are included in the consolidated balance sheet. The Company s share of the investee s earnings is included in the consolidated operating results and only dividends, cash distributions, loans or other cash received from or paid to the investee are included in consolidated cash flows.

Cash and cash equivalents

The Company considers cash in banks and highly liquid investments with original maturities of three months or less to be cash and cash equivalents. Money market deposits with original maturities of more than three months are classified as short-term investments along with marketable securities.

Marketable securities

Marketable debt and equity securities, other than investments accounted for by the equity method, are classified as either available-for-sale or held-to-maturity. Securities classified as available-for-sale are reported at fair value at the balance sheet date and held-to-maturity securities are reported at amortized cost. Unrealized gains and losses on available-for-sale securities are included in accumulated other comprehensive income, net of applicable deferred tax.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Inventories

Inventories consist of merchandise sold in retail shops and material and spare parts used for the construction of networks, mainly for the Company s own use. Inventories are valued at the lower of cost or market, cost being determined on the basis of weighted average cost.

Property, plant and equipment

Property, plant and equipment are stated at cost, which includes certain costs that are capitalized during the installation and expansion of the telecommunications network including material, payroll, direct overhead and interest costs as well as the present value of estimated asset retirement obligations. Value added tax (VAT), which is charged by suppliers and refunded by the tax authorities, is not included in cost. Plant and equipment under capital leases are stated at the lower of present value of minimum lease payments or fair value.

Depreciation on plant and equipment is calculated using the straight-line method and the estimated useful lives of the assets. Plant and equipment under capital lease and leasehold improvements are amortized using the straight-line method over the lease term or the estimated useful life of the asset, whichever is shorter.

The useful lives are:

	Years
Transmission equipment	3 20
Cables and wires	10 20
Communications equipment	4 10
Software	3 8
Furniture, fixtures and other	3 8
Buildings and leasehold improvements	10 50

Maintenance and repairs are expensed as incurred while replacements and improvements are capitalized. The cost and accumulated depreciation of assets sold or retired are removed from the accounts, and any resulting gain or loss is reflected in other operating expenses.

Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are tested for impairment in accordance with SFAS No. 142 at least annually, but also on an interim basis if an event or circumstance indicates that an asset may be impaired. Other intangible assets with estimable useful lives are amortized over their respective useful lives to their estimated residual values and reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Asset .

The goodwill impairment test is a two-step evaluation. The first step requires the Company to compare the fair value and carrying value of any reporting unit to which goodwill has been allocated. If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists and the second step of the impairment test must be performed. In the second step, the implied fair value of goodwill, determined by allocating the aggregate fair value of the reporting unit to all identifiable tangible and intangible assets, is compared to its carrying amount. Any shortfall in fair value compared to carrying value is recognized as an impairment loss.

In each reporting period, the Company is required to reevaluate its decision that an Other intangible asset has an indefinite useful life. If a nonamortizable intangible asset is subsequently determined to have a finite useful life, the intangible asset is written down to the lower of its fair value or carrying amount and amortized prospectively based on its remaining useful life. The impairment test is a comparison of the fair value of the intangible asset with its carrying value. Any excess of carrying value over fair value is recognized as an impairment loss.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Amortizable intangible assets are stated at cost and are amortized using the straight-line method over their estimated useful lives, as shown below:

	Years
Wireless and wireline licenses	10 15
Patents and proprietary rights	4 20
Subscriber base	6
Other	10 30

Impairment of long-lived assets and long-lived assets to be disposed of

Long-lived assets and certain identifiable intangible assets are reviewed for impairment annually at each year-end and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets held for sale are reported at the lower of the carrying amount or estimated proceeds less cost to sell.

Internally developed software

Certain direct and indirect development costs associated with internally developed software, including direct costs of materials and services, and payroll costs for employees devoting time to the software projects, are capitalized once the project has reached the application development stage. The costs are amortized using the straight-line method over a period not exceeding four years, beginning when the asset is substantially ready for use. Costs incurred during the preliminary project stage, maintenance and training costs and research and development costs are expensed as incurred.

Advertising and promotional costs

Generally, advertising and promotional costs are expensed as incurred and totaled EUR 198,362, EUR 153,737 and EUR 75,368 for the years ended December 31, 2003, 2002 and 2001, respectively.

Research and development costs

Research and development costs are expensed as incurred and amounted to EUR 42,759, EUR 30,338 and EUR 21,817 for the years ended December 31, 2003, 2002 and 2001, respectively and are classified in the consolidated statement of operations according to the nature of the expense.

Income taxes

Income taxes are accounted for using the liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of an existing asset or liability and its respective tax basis and operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of changes in tax rates is recognized as income or expense in the period that includes the enactment date.

Investment tax credits are recognized as a reduction of income taxes in the period in which those credits are granted.

Deferred income taxes on investments in pass-through enterprises are provided on the excess of the financial statement carrying amount of the investment, including the goodwill within the pass-through enterprise, over the tax basis of the investment.

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Earnings per share

Basic and diluted earnings (loss) per share are computed by dividing consolidated net income (loss) by the weighted average number of common shares outstanding for the year. As the Company will not issue new shares for the stock option plan, but has purchased an American call option to satisfy the obligation, diluted earnings per share equals basic earnings per share, and there were no potentially dilutive securities for any of the periods presented.

Asset retirement obligation

The Company accounts for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs in accordance with SFAS No. 143, Accounting for Asset Retirement Obligations . The Company records the fair value of an asset retirement obligation as a liability in the period in which the legal obligation associated with the retirement of a tangible long-lived asset is incurred. An amount equal to the initial obligation is recorded as an increase to the carrying amount of the related long-lived asset and depreciated over the remaining useful life of the asset. The liability is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the initial fair value measurement.

Employee benefit obligations

The Company provides retirement benefits under defined contribution and defined benefit plans.

In the case of defined contribution plans the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory or contractual basis. Once the contributions have been paid, the Company has no further payment obligations. The regular contributions constitute net periodic costs for the year in which they are due.

All other retirement benefit plans are unfunded defined benefit plans for which the Company records accruals. The pension provisions are calculated using the projected unit credit method in accordance with SFAS No. 87. The future benefit obligations are valued using actuarial methods on the basis of an appropriate assessment of the discount rate, rate of compensation increase and rate of increase of pensions.

Concentration of risks

A portion of the Company s revenue is derived from services provided to other companies in the telecommunications industry, mainly to alternative telecommunications and cellular companies and internet online services. As a result, the Company has some concentration of credit risk in its customer base. The Company performs ongoing credit evaluations of its large customers financial condition to support its receivables. As of the balance sheet dates, the Company does not have any significant concentrations of business transacted with a particular supplier or lender that could, if suddenly eliminated, severely impact operations. The Company also does not have a concentration of available sources of labor, services, franchises, or licenses or other rights that could, if suddenly eliminated, severely impact operations. The Company invests its cash with several high-quality credit institutions.

Foreign currency translation

Until December 31, 2001, the Company prepared its consolidated financial statements in Austrian Schilling and then translated them into Euro using the official fixed exchange rate of 13.7603. Since January 1, 2002 the Company has adopted the Euro as its functional currency.

Foreign currency receivables and liabilities are recognized at the exchange rate applicable on the transaction date and retranslated periodically at the then ruling balance sheet rate. Unrealized foreign exchange losses and gains due to exchange rate fluctuations are recognized in the statement of operations.

The functional currency for the Company s foreign operations is the applicable local currency. Assets and liabilities are translated using the current exchange rate in effect at the balance sheet date. Revenues and expenses are translated using the weighted average exchange rate during the period. Resulting translation adjustments are recorded as other comprehensive income or loss.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Revenue recognition

Wireline

The Company generates revenues from fixed line services to individuals, commercial and non-commercial organizations and other national and foreign carriers. Fixed line services include access fees, domestic and long distance services, including internet, fixed to mobile calls, international traffic, voice value-added services, interconnection, call center services and public payphone services.

The Company recognizes long distance and local service revenue based upon minutes of traffic processed or contracted fee schedules when the services are rendered. Revenues due from other national and foreign carriers for incoming calls from outside the company s network are recognized in the period the call occurs.

Access fees, monthly base fees and lines leased to commercial customers are billed in advance resulting in deferred revenues. These fees are amortized over the period the service is provided. Cash discounts and incentives are accounted for as reductions in revenues when granted.

Product and other service revenues are recognized when the products are delivered and accepted by customers or when services are provided in accordance with contract terms.

The installation of customer lines in residences is a separate service and the Company provides this installation service in situations where it is not providing other services. Revenue on such installation work is recognized when the installation work is completed.

The Company has entered into a limited number of agreements with other telecommunication operators outside of Austria whereby the Company grants some pre-defined access to existing capacity on its physical network in return for similar access to the physical network of the counter party. The Company does not recognize revenue or an obligation to the counter party under such agreements apart from the trade revenue arising from subscriber transactions under normal tariff plans. The benefits and costs of such swap agreements will be reflected in the Company s results of operations in the periods in which they are realized through reduced interconnection obligations and revenues, respectively.

Wireless

The Company provides mobile communications services to individuals and commercial and non-commercial organizations through mobilkom austria. mobilkom austria generates revenue primarily by providing digital wireless services as well as value-added services, text and multimedia messaging, m-commerce and information services. To a lesser extent, mobilkom austria generates revenue from the sale of wireless handsets.

The Company recognizes mobile usage and roaming service revenue based upon minutes of traffic processed or contracted fee schedules when the services are rendered. Revenues due from foreign carriers for international roaming calls are included in revenues in the period in which the call occurs.

Certain prepaid usage services in the mobile communications segment are billed in advance resulting in deferred revenues. These fees are amortized over the period the service is provided. Cash discounts and incentives are accounted for as a reduction in revenues when granted. Customer acquisition costs are recognized ratably over the contract period as marketing expense when a service contract exists.

Revenue and related expenses associated with the sale of wireless handsets to distributors are recognized when the products are delivered and accepted, as such sales are separate and distinct from the sale of wireless services to customers.

Activation revenues and direct incremental expenses are generally recognized over the average expected contract term. When direct incremental expenses exceed revenues, the excess is expensed.

Other service revenues are recognized when delivered and accepted by customers and when services are provided in accordance with contract terms.

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Allowance for doubtful accounts

The Company estimates the portion of its outstanding receivables that are uncollectible based on aging schedules. Based on historical experience, uncollectibility is estimated as an increasing percentage of each aging category. Additionally, the Company records an allowance for specific customers if circumstances indicate non-collectibility.

The estimated allowance for doubtful accounts relating to receivables sold under the securitizations described in note (5) are recorded as accrued liabilities.

Stock compensation

The Company accounts for stock-based employee compensation in accordance with the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Further, the Company accounts for its combination stock option and stock appreciation right plan in accordance with the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*, which requires the plan be accounted for as a stock appreciation right.

The company will recognize a liability and pro rata compensation expense in the first period in which it is probable that the target stock price criteria outlined in the plan will be met. Based on historical trends of the stock and current market conditions, no compensation expense has been recognized under the plan for any of the years presented. Application of the fair-value approach prescribed by SFAS No. 123, *Accounting for Stock-Based Compensation*, would not effect the amount of compensation expense recognized under this combination plan (see note (27)).

Derivative financial instruments

Effective January 1, 2001, the Company adopted SFAS No. 133, as amended, which requires all derivative instruments, such as interest rate swap contracts and foreign-currency exchange contracts, be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. Changes in the fair value of derivative financial instruments are recognized periodically either in income or stockholders equity (as a component of accumulated other comprehensive income), depending on whether the derivative is being used to hedge changes in fair value or cash flows. For derivatives designated as fair value hedges, changes in fair value of the hedged item and the derivative are recognized in earnings. For derivatives designated as cash flow hedges, fair value changes of the effective portion of the hedging instruments are recognized in accumulated other comprehensive income in the balance sheet until the hedged item is recognized in earnings. The ineffective portion of the value changes are recognized in earnings immediately. SFAS No. 133 also requires that certain derivative instruments embedded in host contracts be accounted for separately as derivatives.

Upon the adoption of SFAS No. 133, the Company had cash flow hedges only and, therefore, recorded a transition loss of EUR 11,492, net of tax of EUR 5,920, related to the interest rate swap contracts and a transition gain of EUR 533, net of tax of EUR 275, related to the cross currency swap agreements, in other comprehensive income. Additionally, the adoption resulted in the recognition of a derivative instrument asset of EUR 48,359 and a derivative liability of EUR 17,412.

The Company has entered into various foreign currency forward contracts which are accounted for as free standing derivatives. These forward contracts serve as economic hedges of the Company s operating exposure to fluctuations in foreign currencies. Changes in the fair values of such forward contracts are recorded directly in income.

Fair value of financial instruments

The carrying amounts of cash, accounts receivable, accounts payable, receivables due from and payables due to related parties and accrued liabilities approximate their fair value. The fair values of securities held-to-maturity and securities available-for-sale is based on quoted market rates. The fair value of long-term debt and swap agreements is determined based on the cash flows from such financial instruments discounted at the Company s estimated current interest rate to enter into similar financial instruments.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The fair value of some investments is estimated based on quoted market prices. For other investments, mainly in unconsolidated subsidiaries and equity investments, for which there are no quoted market prices, the Company estimates the fair value to approximate the carrying value based on the audited financial statements, if available. Those investments are tested for impairment if losses are generated over an extended period or if the business environment changes materially.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires the use of estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Changes in accounting principles

See note (13) for discussion of the Company s adoption of SFAS No. 143 as of January 1, 2003.

As discussed in Goodwill and other intangible assets above, the adoption of SFAS No. 142 effective January 1, 2002, changed the manner in which the Company accounts for goodwill and intangible assets acquired in business combinations. Upon adoption of SFAS No. 142, the Company ceased amortization of goodwill and did not recognize amortization on the indefinite lived intangible assets. The following table reconciles reported net income (loss), basic earnings (loss) per share and diluted earnings (loss) per share to the corresponding adjusted amounts excluding the effects of amortization recognized for goodwill in prior years:

	2003	2002	2001
Year ended December 31,			
Reported net income (loss)	134,241	12,789	(104,625)
Add back amortization			
Goodwill			50,444
Goodwill included in equity in earnings from mobilkom austria			25,362
Goodwill included in equity in earnings, others			1,639
Adjusted net income	134,241	12,789	(27,180)
Basic and diluted earnings (loss) per share			

Reported net income (loss)	0.29	0.03	(0.21)
Add back amortization			
Goodwill			0.10
Goodwill included in equity in earnings from mobilkom austria			0.05
Goodwill included in equity in earnings, others			
Adjusted net income	0.29	0.03	(0.06)

New accounting pronouncements

In May 2003, the Emerging Issues Task Force reached consensus on EITF Issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables , which addresses (1) how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and (2) how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. EITF 00-21 does not change otherwise applicable revenue recognition criteria. EITF 00-21 is effective for Telekom Austria beginning January 1, 2004. The Company does not expect EITF 00-21 to have a material impact on the Company s consolidated financial statements.

The FASB issued FIN No. 46 in January 2003, Consolidation of Variable Interest Entities , which provides guidance regarding the consolidation of certain entities in which equity investors do not have the characteristics of controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 introduces the concept of variable interest entities, explains how to identify a variable interest entity, and requires that the primary

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

beneficiary of any variable interest entity consolidates that entity. In December 2003, the FASB deliberated a partial deferral of and certain proposed modifications to FIN No. 46 to address certain implementation issues. The Board decided that all of the proposed modifications will be incorporated directly into a revised FIN No. 46, rather than into a new interpretation that amends FIN No. 46 (FIN No. 46-R or the Revised Interpretation). The effective dates for the Company for both FIN No. 46 and FIN No. 46-R are at the end of the first annual reporting period ending after March 15, 2004. The Company does not expect to identify or consolidate any variable interest entities.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities , which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , to address (1) decisions reached by the Derivatives Implementation Group, (2) developments in other Board projects that address financial instruments, and (3) implementation issues related to the definition of a derivative. SFAS No. 149 has multiple effective date provisions depending on the nature of the amendment to SFAS No. 133. The adoption of SFAS No. 149 did not have a material impact on the Company s financial statements.

In May 2003, the FASB issued Statement of Financial Reporting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS No. 150 clarifies the accounting for certain financial instruments with characteristics of both liabilities and equity and requires that those instruments be classified as liabilities in statements of financial position. Previously, many of those financial instruments were classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. On November 7, 2003, FASB Staff Position 150-3 was issued, which indefinitely deferred the effective date of SFAS No. 150 for certain mandatory redeemable non-controlling interests. As the Company does not have any of these financial instruments, the adoption of SFAS 150 did not have any impact on the Company s consolidated financial statements.

(2) BUSINESS COMBINATIONS

All acquisitions have been accounted for under the purchase method, with the excess of the purchase price over the estimated fair value of the net assets acquired accounted for as goodwill. The results of operations of the acquired businesses are included in the consolidated financial statements from the dates of the acquisition.

The Company s interests in mobile communications are held through mobilkom austria AG & Co KG and mobilkom austria AG (mobilkom austria), which, together with its subsidiaries, operate mobile telecommunications networks and provide ancillary services in Austria, Croatia, Slovenia and Liechtenstein. The operations include wireless internet access.

On June 28, 2002, the Company acquired 100% of AUTEL Beteiligungs GmbH (Autel), which held a 25.001% interest in mobilkom austria, from Telecom Italia Mobile SpA (the successor of STET Mobile Holding N.V.), a publicly-traded subsidiary of Telecom Italia, bringing its total interest in mobilkom austria to 100%. Consequently, the Company consolidated the balance sheet of mobilkom austria for the first time as of

June 28, 2002. The aggregate purchase price was EUR 693,064 and the Company recognized goodwill in the amount of EUR 431,304, a brand name not subject to amortization of EUR 159,161 and amortizable intangible assets of EUR 229,004.

The consolidated statement of operations for the year ended December 31, 2002 reflects the Company s equity in earnings of mobilkom austria through June 28, 2002 and mobilkom austria s results of operations for the period June 28, 2002 until December 31, 2002. As a result of the acquisition, the Company gained strategic and operating control of mobile communications service providers in Austria, Croatia, Slovenia and Liechtenstein.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The following table shows pro forma consolidated results of operations for the year ended December 31, 2002, as if Autel had been acquired at the beginning of 2002.

	Pro forma December 31, 2002
Revenues	3,908,226
Net income	29,844
Basic and fully diluted earnings per share	0.06

The pro forma results include amortization of the intangible assets acquired, interest expense on debt assumed to finance the purchase and income taxes as well as other adjustments including amortization of fair value adjustments to long-term debt and pension benefit obligation and the reversal of deferred gain not representing a liability. The pro forma results of operations are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of the period presented, nor are they necessarily indicative of future consolidated results.

As of January 30, 2003, mobilkom austria acquired an additional 9% and as of June 23, 2003, a further 19% of VIPnet d.o.o., Zagreb, for a total purchase price of EUR 69,663 bringing its interest to 99%. mobilkom austria recognized intangible assets of EUR 34,035, including intangible assets with an indefinite life of EUR 15,728 and a goodwill totaling EUR 11,774 as a result of these two transactions.

On July 29, 2003, the Company acquired 74% of World-Direct eBusiness solutions GmbH bringing its total interest to 100%. The purchase price amounted to EUR 1,543, of which EUR 543 was already prepaid. The Company recognized goodwill totaling EUR 1,000 as a result of the transaction.

On September 23, 2003, mobilkom austria acquired 100% of paybox cee AG which held a 51.02% in paybox österreich AG for a total purchase price of EUR 795. Prior to this acquisition, mobilkom austria held the remaining 48.98% of paybox österreich AG and accounted for the investment using the equity method. Consequently, the Company consolidated the balance sheets of paybox cee AG and subsidiaries for the first time as of September 30, 2003. As the purchase price was less than the fair value of the net assets acquired and liabilities assumed, the Company reduced the purchase price allocated to intangible assets (licenses). Following the purchase, paybox österreich AG was merged into paybox cee as of December 17, 2003.

On December 23, 2003 mobilkom austria purchased 100% of 3G Mobile Telecommunications GmbH (3G Mobile). The net assets acquired consist of a UMTS license. The total purchase price was allocated to the license and therefore no goodwill was recognized. Tax assets on acquired tax loss carry forwards were not recognized as currently the use of these loss carry forwards is not considered more likely than not.

No pro forma disclosure has been presented for the effect of the acquisitions discussed in the prior four paragraphs because the Company believes that the impact on the financial statements is not material.

On November 28, 2003, the Company sold 90% of Telekom Building Systems GmbH in a management buy-out transaction for a total purchase price of EUR 537, reducing its interest to 10%.

(3) INVESTMENTS IN AFFILIATES

As of December 31, 2003, the investments in affiliates comprise a 26.00% interest in Omnimedia Werbegesellschaft mbH (Omnimedia) and a 25.10% interest in Output Service GmbH (OSG).

In October 2001, the Company purchased 26.00% of the common stock of Omnimedia, a marketing and advertising company for EUR 3,401. In accordance with SFAS Nos. 141 and 142, the goodwill totaling EUR 3,161 was not amortized in 2001 and 2002.

In January 2002 the Company sold a 74.90% interest in OSG, a formerly consolidated subsidiary, for EUR 26. The Company accounts for its remaining 25.10% interest in OSG using the equity method of accounting.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

In July 2003 the Company sold its 26.00% interest in Herold Business Data AG, the leading telephone directory provider in Austria, to PASR Vierte Beteiligungsverwaltung GmbH for a total purchase price of EUR 22,000 and realized a gain of EUR 18,367 which is recorded in equity in earnings of affiliates.

A summary of aggregated financial information as reported by equity investees is as follows:

Year ended December 31,	2003	2002	2001
Revenues	35,515	68,045	67,491
Operating income	4,653	7,833	10,922
Net income	2,908	8,285	6,867

At December 31,	2003	2002
Total current assets	31,003	81,914
Total assets	31,684	92,911
Current liabilities	28,808	70,129
Long-term debt	1,357	3,846
Total liabilities	30,165	73,975
Total stockholders equity	1,519	18,936

(4) MARKETABLE SECURITIES

Debt securities originating from cross border lease transactions entered into in 1998 and 1999 (see note (15)) are classified as held-to-maturity as the Company is contractually obligated to hold these securities until maturity. The securities are bonds of triple A rated issuers and held by a custodian. Through a further asset based swap the cash inflows from the securities are transformed into the cash flow stream required to match a specified portion of the lease payments. The securities are pledged to a counter-party in the swap agreement. No sales of securities held-to-maturity occurred in 2003, 2002 and 2001. The interest rates on the securities are fixed and range from 5.65% to 9.01%. Accrued interest is recorded as interest income. The securities will mature between 2006 and 2011.

	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value

At December 31, 2003				
Non-current assets				
Available-for-sale				
debt securities	4,702	168		4,870
equity securities	6,914	2,646	605	8,955
mutual funds	5,679	2	163	5,518
Held-to-maturity	124,951	16,596		141,547
At December 31, 2002				
Non-current assets				
Available-for-sale				
debt securities	5,908	298	1	6,205
equity securities	2,456		258	2,198
mutual funds	11,516	37	1,008	10,545
Held-to-maturity	138,454	21,015		159,469

The contractual maturities of debt securities classified as held-to-maturity at December 31, 2003 were as follows:

	Amortized cost	**Fair value**
Held-to-maturity		
Due within one year	5,159	5,195
Due after one year through five years	27,394	30,548
Due after five years through ten years	92,399	105,804
	124,951	141,547

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Proceeds from sales of available-for-sale securities amounted to EUR 80,108 and EUR 7,070 in 2003 and 2002, respectively. Gross realized gains from sales of available-for-sale securities were EUR 323 and EUR 46 in 2003 and 2002, respectively. The specific identification method was used to determine the cost in computing realized gains and losses.

For the following marketable securities the Company incurred holding losses but has not recognized an impairment, since the losses are not material:

	Less than 12 months		12 months or longer		Total	
	Fair value	Gross unrealized holding losses	Fair value	Gross unrealized holding losses	Fair value	Gross unrealized holding losses
At December 31, 2003						
Non-current assets						
Available-for-sale						
equity securities	988	48	4,550	557	5,538	605
mutual funds	125	8	4,231	155	4,355	163
Total temporarily impaired securities	1,113	56	8,781	712	9,893	768

(5) ACCOUNTS RECEIVABLE TRADE

The roll-forward of the allowance for accounts receivable-trade is as follows:

	2003	2002
Allowance beginning of the year	74,945	47,074
Foreign currency adjustment	(11)	2
Change in consolidated entities		32,838
Reclassification to accruals for sold receivables		(26,485)
Charged to expenses	30,629	39,184
Amounts written-off	(13,325)	(17,668)

Allowance at the end of the year	92,238	74,945

	December 31, 2003	December 31, 2002
Accounts receivable-trade, gross	652,110	526,879
Allowances	(92,238)	(74,945)
Accounts receivable-trade, net	559,872	451,934

Of these receivables EUR 226,807 are held for sale due to the securitization program described in the following paragraphs.

In January 2002, the Company entered into a revolving period securitization and sold trade receivables to a Qualifying Special Purpose Entity (QSPE) unrelated to the Company. The Company retains servicing responsibilities relating to the sold receivables. Solely for the purpose of credit enhancement from the perspective of the QSPE, the Company retains interests in the sold receivables (retained interests). These retained interests are initially measured at estimated fair values, which the Company believes approximate historical carrying values, and are subsequently measured based on a periodic evaluation of collections and delinquencies.

In December 2003 the asset-backed securitization program was extended regarding the trade receivables sold and the maximum amount transferred to the trust. Additionally, the discounts required were reduced. The maximum program limit was increased from EUR 290,000 to EUR 350,000.

At December 31, 2003, the Company recorded a receivable due from the QSPE of EUR 145,360. The Company routinely evaluates its portfolio of trade receivables for risk of non-collection and records an allowance for doubtful accounts to reflect the carrying value of its trade receivables at estimated net realizable value.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Pursuant to the provisions of the revolving-period securitizations, the Company effectively bears the risk of potential delinquency or default associated with trade receivables sold or interests retained. Accordingly, in the normal course of servicing the assets sold, the Company evaluates potential collection losses and delinquencies and updates the estimated fair value of the Company s retained interest.

The allowances recorded for sold receivables are classified as accrued liabilities. As of December 31, 2003 and 2002, respectively, the accruals totaled EUR 28,882 and EUR 62,481.

In accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* , the Company has not recorded a servicing asset as management believes it is not practicable to estimate this value given that verifiable data as to the fair value of the compensation and or cost related to servicing the types of the assets sold is not readily obtainable.

In the periods ended December 31, 2003 and 2002, respectively, the following cash flows were received from and paid to the QSPE:

	December 31,	
	2003	**2002**
Gross trade receivables sold to QSPE	2,789,761	2,044,513
Collections made on behalf of and paid to the QSPE	(2,578,860)	(1,732,372)
Deferred purchase price withheld	(168,846)	(104,616)
Unearned discount (withheld) reduced	(3,620)	(4,100)
Liquidity and program fees	(5,788)	(8,499)
Retained interests		(7,930)
Receivable from the QSPE	(145,360)	
Net cash (paid to) received from QSPE during the period.	(112,713)	186,996

Cash settlement with the QSPE takes place on a monthly basis. Gross trade receivables sold represent the fair value of billed and unbilled receivables to the QSPE during the periods ended December 31, 2003 and 2002, respectively. As the Company services these receivables, collection of the receivables previously sold is made on behalf of the QSPE. The Company recorded discounts, liquidity and program fees related to the securitization of trade receivables of EUR 5,690 and EUR 8,427 for the periods ended December 31, 2003 and 2002, respectively. These discounts and fees are included in interest expense in the statement of operations.

(6) RELATED PARTY TRANSACTIONS

The disclosures below present balances and transactions relating to the Company s majority shareholder ÖIAG and its subsidiary Österreichische Post AG as ÖIAG , with other government agencies and government-owned entities, for practical reasons, not being disclosed. None of the individual accounts associated with government agencies or government-owned entities is considered significant to the Company.

The majority of the related party transactions were carried out with mobilkom austria. The Company charged mobilkom austria for interconnection fees, voice telephony, rent, repair and other services. mobilkom austria charged the Company mainly for interconnection fees. Since June 28, 2002 such transactions are fully eliminated in consolidation.

Österreichische Post AG and its subsidiaries (Post), a subsidiary of ÖIAG which provides postal services, charged the Company for different services such as postal charges, rent, repair and administration. The Company charged Post for IT support, voice telephony, technical services, rent, repair and other services. On September 17, 2003, Postbus AG, a 100% subsidiary of Österreichische Post AG, was sold to Österreichische Bundesbahnen and is therefore no longer reported as related party.

The terms of services provided by Telekom Austria to government entities are generally based on standard pricing policies. However, the Company is obligated to provide voice telephone services for disadvantaged

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

individuals at reduced tariffs for which it is entitled to appropriate compensation from the government on a contractual basis. Beginning January 1, 2001, the contract with the government specifies the reimbursement of Euro 13.81 per customer per month, which is recorded as revenue in the service period. The total reimbursement was EUR 41,396, EUR 41,670 and EUR 43,032 in 2003, 2002 and 2001, respectively.

On June 28, 2001, a partner in a law firm which provides legal services to the Company was elected to the supervisory board. In 2003, 2002 and 2001 (since the day of appointment), respectively, the Company was charged EUR 560, EUR 993 and EUR 409 for legal services by that law firm.

Telecom Italia and the Company charged for interconnection services provided to each other at standard rates.

The Company has entered into agreements with Telecom Italia whereby the Company grants some pre-defined access to existing capacity on its physical network in return for similar access to the physical network of Telecom Italia. The Company does not recognize revenue or an obligation under such agreements apart from the trade revenue arising from subscriber transactions under normal tariff plans. The benefits and costs of such swap agreements will be reflected in the Company s results of operations in the periods realized through reduced interconnection obligations and revenues, respectively.

The following is the detail of the accounts receivable with related parties:

At December 31,	2003	2002
ÖIAG	945	4,296
Telecom Italia		435
Affiliated companies and other	604	1,992
Total	1,549	6,723

The following is the detail of the accounts payable to related parties:

At December 31,	2003	2002

ÖIAG	7,840	4,997
Omnimedia	13,192	25,032
Affiliated companies and other	2,625	7,169
Total	23,657	37,198

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The following is the detail of revenues from and expenses charged to related parties:

Year ended December 31,	2003	2002	2001
Revenues			
mobilkom austria		72,879	222,231
ÖIAG	62,635	56,660	55,344
Telecom Italia	24,014	14,361	13,448
Other	2,857	4,090	2,436
Total	89,506	147,990	293,459
Interest income			
mobilkom austria		4,988	17,619
Other	1	4	0
Total	1	4,992	17,619
Expenses			
mobilkom austria		43,590	207,172
ÖIAG	70,643	58,285	66,421
Telecom Italia	10,808	23,559	25,841
Other	47,243	66,719	15,335
Total	128,694	192,153	314,769
Interest expense			
mobilkom austria		837	731
ÖIAG and other	30	101	18
Total	30	938	749

For the years ended December 31, 2003 and 2002, respectively, EUR 36,146 and EUR 55,289 of other expenses mainly relate to advertising and marketing services provided by Omnimedia.

(7) INVENTORIES

Inventories consist of:

At December 31,	2003	2002
Spare parts, cables and supplies	44,510	36,830
Merchandise	39,025	54,431
Total	83,535	91,261

(8) GOODWILL AND OTHER INTANGIBLE ASSETS

Other intangible assets consist of:

At December 31,	2003	2002
Wireless and wireline licenses	559,273	544,893
Patents and proprietary rights	53,497	47,100
Brandnames	174,046	158,934
Subscriber base	138,622	120,999
Other	35,858	37,952
Total intangibles	961,296	909,878
Less accumulated amortization	(249,308)	(183,985)
Net intangibles	711,988	725,893

Amortization expense was EUR 68,340, EUR 27,410 and EUR 53,339 for the years 2003, 2002 and 2001, respectively.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Licenses are recorded at cost and amortized on a straight-line basis over the estimated useful life. In November 2000, mobilkom austria purchased a UMTS license for Austria with a term of 20 years for EUR 171,540. Interest in the amount of EUR 1,843 and EUR 6,495 was capitalized in 2003 and 2002, respectively, on the UMTS license. The amortization of the UMTS license over 14.2 years and depreciation of the related network equipment over 8 years began in May 2003 after the start of the UMTS services and the generation of revenues. The Company recorded amortization and depreciation expenses from the use of these assets of EUR 14,086 in 2003 and expects EUR 19,567 on an annual basis thereafter.

The Company holds licenses to operate as a mobile telecommunications service provider from the Austrian, Croatian and Slovenian communications commissions. The Croatian license, granted for 10 years, was acquired for EUR 13,672 in 1998. Licenses from the Slovenian Government granted in 2001 and 1999 for 15 years, were acquired for EUR 4,637 and EUR 11,121, respectively.

Upon adoption of SFAS No. 142 on January 1, 2002, the Company ceased amortizing goodwill. The following tables illustrate the changes in net book value of goodwill by segment for the periods ended December 31, 2003 and 2002, respectively:

	Wireline	Wireless	Total
Goodwill January 1, 2003	30,795	559,932	590,727
Acquisitions	1,000	11,774	12,774
Translation adjustment	(376)	(5,548)	(5,924)
Goodwill December 31, 2003	31,419	566,158	597,577
Goodwill January 1, 2002	60,244		60,244
Acquisitions	9,824	563,153	572,977
Impairment	(40,893)		(40,893)
Translation adjustment	1,620	(3,221)	(1,601)
Goodwill December 31, 2002	30,795	559,932	590,727

In 2002 and 2001 impairment charges in the amount of EUR 40,441 and EUR 119,950 were recorded for goodwill originally recorded from the acquisition of Czech On Line (COL). The acquisition was based on a business plan assuming the full liberalization of the Czech market. As this remained unsatisfactory with regard to interconnection and limited wholesale offers to alternative operators, the business of COL had not developed as originally expected. The valuation of the reporting unit in 2002 was based on forecasted cash flows and used the weighted average cost of capital employed of 13.2% as discount rate.

The gross carrying amounts and accumulated amortization of intangible assets subject to amortization, by major class, are as follows:

At December 31, 2003	Acquisition cost	Accumulated amortization	Carrying value
Wireless and wireline licenses	559,273	(172,301)	386,972
Subscriber base	138,622	(32,088)	106,534
Other	89,355	(44,919)	44,436
Total	787,250	(249,308)	537,942

At December 31, 2002	Acquisition cost	Accumulated amortization	Carrying value
Wireless and wireline licenses	544,893	(139,043)	405,850
Subscriber base	120,999	(10,083)	110,916
Other	85,052	(34,859)	50,193
Total	750,944	(183,985)	566,959

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The following table presents expected amortization expense related to amortizable intangible assets for each of the following periods:

2004	72,080
2005	70,384
2006	68,574
2007	65,374
2008	53,675
Thereafter	207,855

The total carrying amount of intangible assets, other than goodwill, not subject to amortization is EUR 174,046 as of December 31, 2003. This amount relates entirely to the value of brandnames. The value of brandnames increased by EUR 15,728 as a result of the acquisition of the 28% interest in VIPnet in 2003 (see note (2)).

(9) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment transferred to the Company by the government was recorded upon transfer at cost less accumulated depreciation as of that date. Acquisitions since then have been recorded at cost.

At December 31,	2003	2002
Land	60,281	62,462
Buildings and leasehold improvements	663,044	653,010
Communications network and other equipment	9,381,996	9,358,138
Capital leases	13,963	16,207
Software	376,567	325,387
Construction in progress, network	186,487	235,263
	10,682,338	10,650,467
Less accumulated depreciation (other than capital leases)	(6,214,641)	(5,640,965)
Less accumulated depreciation, capital leases	(10,031)	(8,843)
Property, plant and equipment, net	4,457,666	5,000,659

Total interest capitalized and amortization and depreciation expenses for the years ended December 31, 2003, 2002 and 2001 are as follows:

	2003	2002	2001
Interest capitalized	1,605	2,635	2,893
Depreciation and amortization expense	1,071,633	989,878	875,912
Thereof			
Amortization expense of software	79,059	42,623	24,276
Amortization expense of leased assets	3,663	2,341	1,025

In the period ended December 31, 2003, 2002 and 2001, respectively, impairment charges of EUR 6,825, EUR 977 and EUR 23,181 are included in depreciation. The impairment charges in 2003 primarily relate to long-lived assets as future estimated net cash flows were below the carrying value of related assets. The impairment charges of prior years related primarily to buildings which the Company no longer uses. The impairments recorded relating to these buildings equal the excess of carrying value over estimated fair value.

(10) SHORT-TERM BORROWINGS

The Company s short-term borrowings include:

At December 31,	2003	2002
Current portion of long-term debt	530,869	458,995
Short-term debt		737,144
Lines of credit	4,962	5,823
Current portion of lease obligations	95,490	107,943
Total	631,321	1,309,905

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The weighted-average interest rate on lines of credit was 3.20% and 4.02% in 2003 and 2002, respectively. As of December 31, 2003 the Company has unused committed lines of EUR 500,000 and recorded commitment and servicing fees for these unused lines of EUR 1,543, which represents 0.3% of the committed lines. The credit line commitments will expire between January 2004 and November 2006.

Short-term debts were repaid using part of the funds provided by the long-term bond issued by the Company in July 2003 (see note (14)).

(11) ACCRUED LIABILITIES

Accrued liabilities consist of the following:

At December 31,	2003	2002
Taxes, other than income	9,845	8,517
Employee benefits	69,935	67,384
Customer discounts	47,444	53,240
Customer retention programs	40,161	37,693
Exit costs	6,829	8,363
Bad debt reserve for sold receivables	28,882	62,481
Other	28,682	19,112
Total	231,778	256,790

Other accruals mainly relate to legal fees and lawsuits, audit fees, public fees and consulting services.

In establishing accruals, management assesses different scenarios of reasonably estimated outcomes in determining the amount that the Company is expected to pay upon the resolution of a contingency. The Company records the most likely of all scenarios contemplated or, if none of the scenarios is more likely to occur, the scenario with the lowest amount is considered in establishing the accrual.

During the year ended December 31, 2001, the Company formally terminated certain leases, which require the Company to refurbish the properties as they are vacated. Upon termination of the leases, the Company recorded an accrual totaling EUR 1,912. The Company utilized

EUR 1,456 and released EUR 456 of this accrual in 2002. As of December 31, 2002, the Company recorded an accrual totaling EUR 8,363 for certain non-cancellable lease contracts related to premises which the Company vacated in 2003. This accrual covers the minimum lease payments until the end of the lease contracts. The Company utilized EUR 3,297 and accrued an additional EUR 1,763 in 2003. As of December 31, 2003, the Company has an accrual of EUR 6,829 that it expects to be fully utilized.

(12) DEFERRED INCOME

At December 31,	2003	2002
Unearned income	143,266	122,850
Unamortized balance on sale of tax benefits	51,573	58,686
	194,839	181,536
Less non-current portion	(44,461)	(51,573)
Deferred income net of non-current portion	150,378	129,963

The deferred income mainly relates to prepaid access fees, monthly base fees, leased lines to commercial customers, prepaid mobile fees and rental income from site sharing. These fees are amortized over the period the service is provided.

Additional information concerning the sale of tax benefits is contained in note (15).

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

(13) ASSET RETIREMENT OBLIGATION

The Company adopted SFAS No. 143 as of January 1, 2003 and recorded the following additions to long-lived assets, asset retirement obligation and a cumulative change in accounting principles:

	January 1, 2003
Addition to long-lived assets	6,288
Addition to accumulated depreciation	(2,263)
Cumulative effect of change in accounting principle	17,929
Asset retirement obligations	21,954

The roll-forward of the asset retirement obligation starting January 1, 2003 is as follows:

Asset retirement obligations as of January 1, 2003	21,954
Foreign exchange difference	(3)
Liability incurred in the current period	451
Accretion expense	1,336
Settlement	(461)
Release	(15)
Asset retirement obligations as of December 31, 2003	23,262

The Company recorded asset retirement obligations for the retirement and decommissioning of base stations, buildings, booths for public payphones and wooden masts impregnated with tar or salt.

The Company has an obligation to operate a sufficient number of booths to assure that the Austrian population has sufficient access to telecommunications services. As long as the Company stays in business and technology does not materially change, the number of booths operated will be reduced but not eliminated completely for the foreseeable future. The Company estimated the number and timing of booths to be retired from service and estimated the asset retirement obligation based on probability-weighted cash flow estimates.

The Company has also recorded an asset retirement obligation for masts impregnated with tar or salt. Although the Company stopped setting up tar-masts in 1992, some will be in operation for approximately another 30 years. Masts impregnated with salt are currently in operation and set up for the foreseeable future. The average remaining useful life is 30 years. The Company has recorded an asset retirement obligation based on estimated settlement dates and expected cash flows.

Additionally, the Company recorded asset retirement obligations for buildings concerning obligations for the disposal of hazardous substances that were used in prior decades.

mobilkom austria rents land, rooftops and other premises for an unlimited period of time. As it becomes more difficult to obtain sites because of health concerns and as base stations are crucial to the business of a mobile communications operator, except as discussed below, mobilkom austria does not expect to, and will not give up the majority of its rented sites as long as it stays in business. As mobilkom austria has both the ability and the intent to renew its license indefinitely, the retirement obligation in relation to those base stations is indeterminate. mobilkom austria is therefore unable to estimate the fair value of an asset retirement obligation as potential settlement dates for the retirement obligation are not predictable. mobilkom austria will recognize the obligation as soon as sufficient information exists to estimate the range of potential settlement dates. However, mobilkom austria does estimate that approximately 5% of the base stations will be given up. Therefore, mobilkom austria recorded an asset retirement obligation based on expected cash flows and settlement dates.

Additionally, mobilkom austria recorded asset retirement obligations for buildings and shops under operating leases in accordance with the obligation to refurbish the sites at the expiration of the lease contracts.

Had the Company adopted SFAS No. 143 as of January 1, 2002 and measured the asset retirement obligation using the information, assumptions and interest rates in effect as of the date of the adoption of this Statement, the pro forma asset retirement obligation would have amounted to EUR 20,331.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

(14) LONG-TERM DEBT

The outstanding long-term debt, other than lease obligations are summarized as follows:

At December 31,	Maturity	2003	2002
Bonds under EMTN Programme	2004-2013	745,117	
Other bonds	2004-2013	159,741	175,537
Bank debt	2004-2011	1,967,509	2,347,652
Other	2008	790	15,691
		2,873,157	2,538,880
Less current portion of long-term debt		(530,869)	(458,995)
Long-term debt, net of current portion		2,342,288	2,079,885

On June 30, 2003, Telekom Austria AG and Telekom Finanzmanagement GmbH (the 100% financing subsidiary of Telekom Austria AG) initiated a Euro Medium Term Note (EMTN) Programme. The payments of all amounts due in respect of notes issued by Telekom Finanzmanagement GmbH under this framework agreement will be unconditionally and irrevocably guaranteed by Telekom Austria AG. The maximum aggregate nominal amount of all notes outstanding at any time under the programme will not exceed the equivalent of EUR 2,500,000.

Under this programme the Company successfully launched and placed a Eurobond offering which raised EUR 750,000 with a 10-year maturity and a coupon of 5.00% on July 10, 2003. The notes were issued at a discount including issue costs of EUR 9,053 (EUR 8,647 as of December 31, 2003) and were used to refinance existing debt.

Of the total bank debt, amounts of EUR 1,354,583 and EUR 1,751,264 at December 31, 2003 and 2002, respectively, are guaranteed by the Federal Republic of Austria. From the total long-term debt, as of December 31, 2003 and 2002, respectively, EUR 266,614 and EUR 286,947 are denominated in Japanese Yen and Swiss Francs. The loan of EUR 74,046 denominated in Japanese Yen is due in June 2004. The Company uses cross currency swaps to reduce the exposure to the risks of adverse changes in exchange rates as described in note (19).

The interest rates of the loans vary between 2.2% and 7.3%. The weighted average interest rate for the periods ended December 31, 2003 and 2002, respectively, were 4.6% and 3.7% for bonds and 5.2% for bank debt in both years.

The following bank debt is not guaranteed by the government as they were entered into after the privatization of the Company:

In March 2000, the Company entered into a loan agreement for EUR 145,000 with the European Investment Bank. As of December 31, 2003, EUR 116,000 of the loan is outstanding in accordance with the repayment terms. Under the terms of this agreement, the Company must observe covenants requiring the Company to meet certain financial ratios.

Further, in October 2000 the Company entered into a loan agreement for EUR 232,553. As of December 31, 2003 the loan is outstanding in full in accordance with the repayment terms. Under the terms of the contract the Company has to maintain certain investments, otherwise the loan becomes due. The interest rates vary depending on the rating of the Company.

As of December 31, 2003, EUR 295,160 of a syndicated loan granted to mobilkom austria was outstanding. The original loan totaled EUR 305,000 and was guaranteed by Telekom Austria AG.

In December 2002 VIPnet entered into a syndicated loan of EUR 150,000 of which EUR 96,200 were drawn. Outstanding debt is EUR 93,240 as of December 31, 2003. The loans become due between 2003 and 2008 and carry an interest rate of three month EURIBOR plus a margin that depends on operating performance and indebtedness and 0.375% commitment fees. The loan was used for the refinancing of the loans to VIPnet.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

In March 1999, Si.mobil entered into a loan agreement amounting to EUR 36,000 (original currency: Deutsche Mark 71,000) to finance the construction of the GSM network in Slovenia. The interest rate is three month LIBOR plus 1.075 %. The loan is secured by bills of exchange, property, receivables and shares of Si.mobil. The loan is repayable until March 2007.

As of December 31, 2003, the Company was in compliance with all covenants agreed to in the loan agreements mentioned above.

As of December 31, 2003, outstanding debt to VIPnet s minority shareholders is EUR 450.

The year-end average interest rates for the long-term debt excluding interest rate swap agreements for 2003 and 2002 are as follows:

	2003	2002
Bonds	4.57%	5.32%
Bank debt	4.96%	3.49%

Following is a table that shows the aggregate amounts of long-term debt maturing during the next five years and thereafter:

2004	530,869
2005	581,093
2006	492,099
2007	171,789
2008	290,990
Thereafter	806,317

(15) LEASING

The Company leases equipment used in its operations. The leases are classified as either operating or capital leases. The lease contracts expire on various dates through 2015.

Future minimum lease payments for noncancelable operating leases, capital leases and cross border leases as of December 31, 2003 are:

	Cross border leases	Capital leases	Operating leases
2004	93,725	1,898	71,430
2005	101,542	166	64,686
2006	114,603	25	61,680
2007	135,375	6	60,211
2008	119,214	8	59,431
after 2008	752,090		54,271
Total minimum lease payments	1,316,549	2,103	371,709
Less amount representing interest	(361,846)	(16)	
Present value of lease payments	954,703	2,087	
Less current portion	(93,725)	(1,765)	
Non-current lease obligations	860,978	322	

Total rent expense was EUR 74,358, EUR 67,666 and EUR 52,130 in 2003, 2002 and 2001, respectively.

Cross border leases

In 1999 and 1998, the Company entered into various cross border lease transactions whereby certain equipment items, mainly switches, were sold to a U.S.-based trust and leased back over certain terms. Concurrent

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

with the inception, the Company entered into Payment Undertaking Agreements (PUA) with several counter-parties whereby the counterparties agreed to make lease payments on behalf of the Company in exchange for a deposit. The counterparties in the PUAs received upfront payments totaling EUR 509,285 and EUR 113,763 for a portion of the debt assumed in 1999 and 1998, respectively. Interest accruing on the cash deposits matches interest on the debt portion financed through the deposit. In addition to the cash deposits, the Company purchased debt securities, deposited those securities with a custodian and pledged the securities to one of the counter-parties in the PUA; the balance is to cover the remaining portion of the present value of the lease obligation not yet covered by the cash deposit made by the Company. The Company then also entered into a swap agreement with that same counterparty swapping the entire cash flows from the securities for cash flows from the portion of the lease payments that the counterparty is obligated to pay under the PUA. As a result of the swap agreement, interest income on the securities matches interest expense on the lease.

In 1999, mobilkom austria entered into similar cross border lease transactions whereby certain equipment items (mainly transceiver stations, base station controllers and location registers) were sold to four U.S.-based trusts and leased back over certain terms.

In 2001, the Company entered into a cross border lease transaction whereby certain equipment items, mainly switches were leased to a U.S.-based trust and leased back over certain terms. Concurrent with the inception, the Company entered into PUAs with several counterparties whereby the counterparties agreed to make lease payments on behalf of the Company in exchange for the upfront lease payments received under the head lease. The counter-parties in the PUAs received upfront payments totaling EUR 200,526 for a portion of the debt assumed in 2001. In addition to the PUAs the Company provided a loan of EUR 66,554 to the U.S.-based trust. Interest accruing on the PUAs and the loan match interest on the debt portion.

The difference between the cash proceeds from the sale and the present value of the future minimum lease payments represents a gain on the sale of a tax benefit. The net cash effect resulting from these transactions relates to the total gain from the sale of the tax benefits which amounted to EUR 14,547, EUR 44,437 and EUR 7,337 in 2001, 1999 and 1998, respectively. The Company is amortizing these amounts over the term of the lease. The cash deposits, the securities purchased in connection with the PUAs and the upfront payments received for the head lease and the lease obligations are recorded separately on the balance sheets as the Company has not been released from their obligation under the lease and a legal right to offset does not exist. Accordingly, interest income and expenses in an equal amount totaling EUR 65,669, EUR 70,634 and EUR 58,598 have been recognized in 2003, 2002 and 2001, respectively.

Total assets and liabilities recorded in connection with the cross border leases are as follows:

At December 31,	2003	2002
Securities held-to-maturity, non-current	119,793	138,454
Other assets	834,910	1,038,580

Total assets in connection with cross border leases	954,703	1,177,034
Of which current	94,517	103,978
Lease obligations	954,703	1,177,034
Of which current	93,725	102,719

In 2001, two banks issued letters of credit to the trust for the liabilities of the Company. As of December 31, 2003, these letters of credit totaled EUR 108,497.

(16) EMPLOYEE BENEFIT OBLIGATIONS

Long-term liabilities for employee benefits consist of the following:

At December 31,	2003	2002
Contractual termination benefits	31,932	132,346
Service awards	46,870	57,862
Severance	67,606	32,612
Pensions	9,552	9,709
Total	155,960	232,529

F-151

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Contractual termination benefits

In June 2000, June 1999 and in November 1997, the Company offered voluntary retirement incentive programs (VRIPs) to civil servants who cannot be terminated involuntarily. An obligation for VRIPs was recognized when the eligible civil servant accepted the offer. The present value of the obligation is determined based on current compensation levels and the law. An annual increase of 2.5% for future years and a discount rate of 4.5% are used. VRIPs are not funded.

On January 1, 2002 a law was enacted that covers civil servants after the age of 55 by a governmental retirement plan with the effect of reducing the Company s obligation under the VRIPs. Following that law the Company reversed EUR 26,802 and EUR 57,366 of these accruals in 2003 and 2002, respectively. As of December 31, 2003, the accrual for the VRIPs relate to 120 employees. In connection with VRIPs the Company made payments of EUR 69,634, EUR 95,262 and EUR 68,456 during 2003, 2002 and 2001, respectively.

Expenses as well as the reversals of accruals are reflected as a reduction of employee costs in the accompanying consolidated statement of operations.

Actuarial assumptions

The assumptions used in the measurement of obligations for service awards, severance payments and pensions are shown in the following table:

At December 31,	2003	2002	2001
Actuarial assumptions:			
Discount rate	5.0%	5.0%	5.0%
Rate of compensation increase civil servants	4.0%	3.7%	3.6%
Rate of compensation increase other employees	2.5%	3.7%	3.6%
Rate of increase of pensions	1.8%	1.1%	1.1%

Service awards

Civil servants and certain employees (together employees) are eligible to receive service awards. Under these plans, eligible employees receive a cash bonus after a specified service period. The bonus is equal to two months salary after 25 years of service and four months salary after 40 years of service. Employees with at least 35 years of service when retiring are also eligible to receive a bonus equal to four months salary. The compensation is accrued as earned over the period of service taking into account estimates of employees whose employment will be terminated or who will retire prior to reaching the required service period. All actuarial gains and losses are recognized immediately in the period realized.

The following table provides the components and a reconciliation of the changes in service awards for the years ended December 31, 2003 and 2002, respectively:

	2003	**2002**
Accrual at the beginning of the year	57,862	59,186
Change in reporting entities		2,744
Service cost	2,301	2,348
Interest cost	2,814	3,024
Recognized actuarial gains	(12,125)	(6,930)
Benefits paid	(3,982)	(2,510)
Accrual at the end of the year	46,870	57,862

Severance

Severance benefit obligations for employees hired before January 1, 2003 are covered by defined benefit plans as described below. Following a legal change, obligations for employees starting to work for the Company after January 1, 2003 are covered by a defined contribution plan and the Company paid EUR 119 to this deferred contribution plan (BAWAG Allianz Mitarbeitervorsorgekasse AG) in 2003.

F-152

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Eligible employees receive severance payments equal to a multiple of their monthly compensation which comprises fixed compensation plus variable elements such as overtime and bonuses. Maximum severance is equal to a multiple of twelve times eligible monthly compensation. Up to three months of benefits are paid upon termination, with any benefit in excess of that amount being paid in monthly installments over a period not exceeding ten months. In case of death, the heirs of an eligible employee will receive 50% of the severance benefits.

The following tables provide the components of the net periodic benefit cost and a reconciliation of the changes in severance benefit obligations for the years ended December 31, 2003, 2002 and 2001, respectively:

	2003	2002	2001
Service cost	4,218	3,926	1,893
Interest cost	1,784	1,311	924
Amortization of unrecognized net obligation	308	221	29
Curtailment loss / settlement	1,090	683	1,876
Net periodic benefit cost	7,402	6,141	4,722

	2003	2002
Projected benefit obligation at the beginning of the year	36,849	22,415
Change in reporting units	(587)	4,249
Service cost	4,218	3,926
Interest cost	1,784	1,311
Actuarial (gains) losses	(11,004)	7,459
Curtailment loss / settlement	1,090	683
Benefits paid	(2,723)	(3,194)
Projected benefit obligation at the end of the year	29,627	36,849
Unrecognized net actuarial losses	(4,782)	(16,093)
Accrued liability at the end of the year	24,845	20,756
Voluntary severance obligation	42,761	11,856
Total accrued severance liabilities at the end of the year	67,606	32,612

The liability for voluntary severance payments relates to individuals who are generally not entitled to severance payments, but have accepted a special offer by the Company to receive severance payments for voluntary termination of employment.

Until November 28, 2003, the government offered to civil servants at a certain age an early retirement at reduced future pension payments. The Company offered these eligible employees additional severance payments to further encourage the acceptance of the government offer. The Company incurred a legal obligation to civil servants making use of this opportunity and accrued severance costs of EUR 39,630 and other costs of EUR 7,678 in 2003. Telekom Austria does not expect any future liabilities in addition to these accruals. Due to this one-time offer the Company s workforce was reduced by 650 civil servants in 2003.

Pensions

Defined contribution pension plans

Pension benefits are generally provided by social security for employees and by the government for civil servants in Austria. The Company is required to assist in funding the Austrian government s pension and health care obligations to the Company s current and former civil servants and their surviving dependents. The Company was legally obligated to make annual contributions to the Austrian government for active civil servants. These contributions gradually increased from 27.5% in 2000 to 30.1% in 2003. Beginning in October 2005 the contribution will be reduced to 28.3%. Contributions to the government, net of the share contributed by civil servants, were EUR 51,520, EUR 52,647 and EUR 56,380 in 2003, 2002 and 2001, respectively.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

In 2000 and 1999, the Company sponsored a defined contribution plan covering substantially all employees of one subsidiary. In 2001, this plan was also offered to the employees of Telekom Austria and all its other Austrian subsidiaries. The Company s contributions to this plan are based on a percentage of the compensation not exceeding 5% of the salaries. The annual cost of this plan amounted to approximately EUR 9,082, EUR 6,961 and EUR 4,669 in 2003, 2002 and 2001, respectively.

Defined benefit pension plan

The Company provides defined benefits for certain former employees. All of such employees are retired and were employed prior to January 1, 1975. This unfunded plan provides benefits based on a percentage of the salary and on the years employed, not exceeding 80% of the salary before retirement including the pension provided by social security.

The Company uses the projected unit credit method to determine pension cost for financial reporting purposes. In conjunction with this method the Company amortizes actuarial gains and losses using the corridor method.

The pension benefits for 2003, 2002 and 2001 are shown in the following table:

	2003	2002	2001
Interest cost	396	424	504
Amortization of actuarial gain	(64)	(50)	(59)
Amortization of unrecognized transition obligation	343	343	343
Net periodic pension benefit cost	675	717	788

The following table provides a reconciliation of the changes of benefit obligations for the years ended December 31, 2003 and 2002, respectively:

	2003	2002

Projected benefit obligation at the beginning of the year	8,327	8,926
Interest cost	396	424
Actuarial gains	(273)	(128)
Benefits paid	(832)	(895)
Projected benefit obligation at the end of the year	7,618	8,327
Unrecognized net gain	1,934	1,725
Unrecognized transition obligation		(343)
Accrued pension liability	9,552	9,709

(17) STOCK BASED COMPENSATION

Stock option plan

On October 4, 2000, the shareholders of Telekom Austria approved stock option plans for employees of the Company and mobilkom austria. Under this plan, the Company may grant a total of 4,686,881 options, each of which entitle eligible grantees upon exercise of the option to receive at their choice either cash equal to the difference between the average quoted price of Telekom Austria stock during the five trading days preceding the exercise and the IPO price of Euro 9 or shares at an exercise price of Euro 9. One option is convertible into one share. The options granted may be exercised on specific dates between May 31, 2002, and February 27, 2004, as long as the average share price during the five days prior to exercise exceeds the initial public offering price by 30% or more.

On November 21, 2000, the Company granted all 4,686,881 options. In 2003, 2002 and 2001, respectively, 164,077**,** 520,766 and 733,188 options were forfeited, therefore; 3,268,850, and 3,432,927 options are outstanding as of December 31, 2003 and 2002, respectively.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

As the stock option plans are accounted for in accordance with APB Opinion 25 and related interpretations, the amount of the liability is measured each period based on the current stock price. As the stock price as of December 31, 2003, 2002 and 2001 did not exceed the hurdle and was not deemed probable , no compensation expense was recorded in 2003, 2002 and 2001 (see note (27)).

(18) INCOME TAXES

Income (loss) before income taxes, minority interests and cumulative effect of a change in accounting principle is attributable to the following geographic locations:

	2003	2002	2001
Domestic	186,197	33,710	(199,049)
Foreign	46,360	10,101	(1,019)
Total	232,557	43,811	(200,068)

As described in note (2), on June 28, 2002 the Company acquired the remaining outstanding interest of mobilkom austria through the acquisition of Autel. mobilkom austria has been consolidated since that date. Prior to the acquisition of Autel on June 28, 2002, the Company held a 74.999% interest in mobilkom austria which was accounted for under the equity method. In the first quarter 2001, mobilkom austria recorded a tax expense of EUR 134,437 due to a change in tax status of mobilkom austria AG from a taxable entity to a nontaxable pass-through entity which occurred in the first quarter of 2001 and which was effective retroactive to July 1, 2000 for tax purposes. Correspondingly, the Company recorded its 74.999% proportional share of mobilkom austria s tax expense and recognized a deferred tax benefit during the three month period ended March 31, 2001. Thus, the direct income tax effects on the Company of the change in tax status of mobilkom austria and the proportional pickup from the income tax expense reported by mobilkom austria essentially offset each other in the income tax expense reported by the Company for the year ended December 31, 2001.

Income tax expense (benefit) attributable to income (loss) before income taxes, minority interests and extraordinary items for the years ended December 31, consisted of the following:

	2003	2002	2001
Current			

Domestic	8,899	1,097	(292)
Foreign	14,511	5,771	
	23,410	6,868	(292)
Deferred			
Domestic	52,506	15,627	(94,278)
Foreign	7,120	3,617	(343)
	59,626	19,244	(94,621)
Total	83,036	26,112	(94,913)

Benefits of operating loss carryforwards of EUR 1,818, EUR 8,641 and EUR 7,799 were included in the deferred tax expense (benefit) for the years ended December 31, 2003, 2002 and 2001, respectively.

Total income tax expense (benefit) was recorded as follows:

	2003	2002	2001
Continuing operations	83,036	26,112	(94,913)
Other comprehensive income	2,787	1,024	(6,683)
Additional paid in capital	451	424	
	86,274	27,560	(101,596)

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The Company is subject to income taxes in Austria at a rate of 34% of taxable income. The following table shows the principal components for the difference between the reported income tax expense (benefit) and the amount of income tax expense (benefit) that would result from applying the Austrian statutory income tax rate to income (loss) before income taxes, minority interests and changes in cumulative effect of a change in accounting principle:

	2003	2002	2001
Income tax expense (benefit) at statutory rate	79,069	14,896	(68,023)
Foreign tax rate differential	(7,053)	(2,125)	31
Non-deductible expenses	3,792	335	150
Tax incentives	(3,673)	(3,626)	(2,105)
Tax free income from investments	(563)	(1,163)	(1,603)
Tax rate differential on equity in earnings of affiliates		(1,389)	10,611
Nondeductible goodwill amortization and impairment charges		4,388	647
Tax benefit recognized for prior year goodwill amortization and impairment			(40,080)
Change in valuation allowance	7,724	11,008	5,456
Other	3,740	3,788	3
Income tax expense (benefit)	83,036	26,112	(94,913)
Effective income tax rate	35.7%	59.6%	47.4%

Non-deductible expenses mainly consist of interest expenses on shareholder loans. Tax incentives principally consist of research incentives.

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at December 31 are shown below.

	2003	2002
Deferred tax assets		
Goodwill	34,846	44,615
Deferred deduction for write downs of investments in subsidiaries	63,219	76,858
Operating loss carryforwards	227,956	207,232
Long-term debt	6,614	13,362
Other liabilities	10,484	5,542
Employee benefit obligations	3,745	
Other	8,276	12,354

Total deferred tax assets	**355,140**	**359,963**
Valuation allowance	(81,639)	(16,214)
Deferred tax assets, net of valuation allowance	**273,501**	**343,749**
Deferred tax liabilities		
Property, plant and equipment	(30,244)	(39,683)
Long-term investments	(8,690)	
Other intangible assets	(97,347)	(88,178)
Accrued liabilities	(350)	(4,892)
Other assets	(5,277)	(13,866)
Employee benefit obligation		(30)
Other	(8,093)	(12,351)
Total deferred tax liabilities	**(150,001)**	**(159,000)**
Net deferred tax	**123,500**	**184,749**

F-156

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

At December 31, 2003, the Company had approximately EUR 701,516 of operating loss carryforwards. Thereof, EUR 110,598 relate to foreign subsidiaries. Of these loss carryforwards relating to foreign subsidiaries, EUR 110,114 have expiration dates as follows:

Years	Amount
2004	8,111
2005	28,087
2006	40,214
2007	24,346
2008	8,465
2009	891
2010	
Total	110,114

The remaining amount of operating loss carryforwards are in Austria and do not expire. In Austria the annual usage is limited to 75% of the taxable income for that year.

In assessing the recoverability of deferred tax assets, management considers whether it is more likely than not that all the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. As of December 31, 2003 the Company has recognized a net deferred tax asset of EUR 124,138 related to the operations in Austria. In order to realize this deferred tax asset the Company will need to generate future taxable income exclusive of reversing taxable temporary differences of approximately EUR 486,815 over an indefinite period in Austria.

Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences and operating loss carry forwards, net of valuation allowances. The amount of deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

During the years ended December 31, 2003 and 2002 deferred tax expenses of EUR 6,560 and EUR 11,008, respectively, were recognized as adjustments to the valuation allowance because of a change in circumstances that caused a change in judgement about the realizability of the related deferred tax asset in future years. In 2003 and 2002 the valuation allowance increased by EUR 65,425 and EUR 10,758, respectively. Thereof EUR 57,701 and EUR 250 had no impact on the income statement in 2003 and 2002, respectively.

(19) FINANCIAL INSTRUMENTS

Derivative financial instruments are used by the Company to manage its exposure to adverse fluctuations in interest and foreign exchange rates. The Company has established a control environment which includes policies and procedures for risk assessment, approval, reporting and monitoring of derivative financial instrument activities. The Company is not a party to leveraged derivatives and the policies prohibit the holding or issuing of financial instruments for speculative purposes.

The Company uses into various types of financial instruments including derivative financial instruments in the normal course of business for purposes other than trading.

By their nature, all such instruments involve risk, including market risk and credit risk of nonperformance by counterparties, and the maximum potential loss may exceed the amount recognized in the balance sheets. However, at December 31, 2003 and 2002, in management s opinion the probability of nonperformance of the counterparties in these financial instruments was remote.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Credit risk

The Company monitors its exposure to credit risk. The Company does not have any significant exposure to any individual customer or counterparty, nor does it have any major concentration of credit risk related to any financial instrument other than noted under section concentration of credit risk in significant accounting policies.

The Company does not require collateral in respect of financial assets. In order to reduce the risk of nonperformance by the other parties to swap agreements, the contracts are subject to the International Swap Dealers Agreement.

Market risk

The market risk is monitored by using value-at-risk models for interest rate as well as currency risk for the long-term debt and derivative portfolios.

Information with respect to cash flow hedges

Changes in the fair value of interest rate swaps designated as hedging instruments of variability of cash flows associated with variable rate long-term debt are reported in accumulated other comprehensive income. These amounts are subsequently classified into financial income as a yield adjustment in the same period in which the related interest on the floating-rate debt obligations affect earnings. In 2003 and 2002, respectively, no hedge ineffectiveness occurred.

Interest rate swap agreements

In the years 1995 to 1997 the Company entered into interest rate swaps to reduce the aggregate exposure to changes in floating interest rates and fair market value fluctuations of the debt portfolio. Fixed interest rate payments as of December 31, 2003, ranged from 6.7% to 3.0%. Floating-rate payments are based on rates tied to different inter-bank offered rates.

In line with its risk policy the Company entered into fix to floating interest rate swaps in 2003. The floating rate is based on EURIBOR and enables the company to participate from current low short-term interest rates.

The following table indicates the types of swaps in use at December 31, 2003 and 2002, and their weighted-average interest rates and the weighted-average remaining terms of the interest rate swap contracts. Average variable rates are those in effect at the reporting date and may change significantly over the lives of the contracts:

	2003	2002
Variable to fixed swaps in EUR		
Notional amount in EUR	181,682	181,682
Average receive rate	2.25%	3.35%
Average pay rate	6.47%	6.47%
Average maturity in years	1.4	2.4
Fixed to variable swaps in EUR		
Notional amount in EUR	300,000	
Average receive rate	5.00%	
Average pay rate	2.96%	
Average maturity in years	9.5	
Variable to fixed swaps in Japanese Yen (JPY)		
Notional amount in JPY	10,000,000	10,000,000
Notional amount in EUR	74,047	80,392
Average receive rate	0.005%	0.01%
Average pay rate	3.15%	3.15%
Average maturity in years	0.5	1.5

Foreign exchange agreements

The Company entered into foreign currency denominated loans because of low interest rates connected to loans denominated in Japanese Yen and Swiss Francs (SFR). The use of cross currency swaps allows the

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Company to reduce the exposure to the risk of adverse changes in exchange rates. Fixed interest rates as of December 31, 2003, range from 6.4% to 7.7%.

The following table indicates the types of foreign exchange agreements in use at December 31, 2003 and 2002, and if applicable their weighted-average interest rates, the weighted-average remaining terms and the respective exchange rates of the contracts:

	2003	2002
Cross Currency Swaps EUR SFR		
Notional amount in EUR	176,635	176,635
Notional amount in SFR	300,000	300,000
Average receive rate SFR	5.47%	5.47%
Average pay rate EUR	7.65%	7.65%
Average maturity in years	1.4	2.4
Cross Currency Swaps EUR JPY		
Notional amount in EUR	73,554	73,554
Notional amount in JPY	10,000,000	10,000,000
Average receive rate JPY	3.15%	3.15%
Average pay rate EUR	6.41%	6.41%
Average maturity in years	0.5	1.5
Forward exchange contracts US $		
Notional amount in EUR	2,862	3,599
Notional amount in US $	3,350	3,600
Forward exchange rate (weighted)	1.17	1.00
Exchange rate as of the balance sheet date	1.26	1.05
Longest term of the contracts	February 2004	March 2003

The notional amounts of the derivative instruments above do not represent amounts exchanged by the parties and, therefore, are not a measure of our exposure. The Company s exposure is limited to the fair value of the contracts with a positive fair value plus interest receivable, if any, at the reporting date.

The following table summarizes the fair values of financial instruments:

	2003		2002	
		Fair		Fair

	Carrying amount	value	Carrying amount	value
Financial instruments				
Cash	201,926	201,926	27,337	27,337
Accounts receivable trade	559,872	559,872	451,934	451,934
Balances due from related parties	1,549	1,549	6,723	6,723
Accounts payable trade	(589,368)	(589,368)	(649,890)	(649,890)
Payables to related parties	(26,657)	(26,657)	(37,198)	(37,198)
Securities held-to-maturity	124,951	141,547	138,454	159,469
Securities available-for-sale	19,344	19,344	18,948	18,948
Long-term debt	(2,342,288)	(2,423,348)	(2,079,885)	(2,203,008)
Derivative financial instruments				
Interest rate swap agreements	(19,582)	(19,582)	(20,996)	(20,996)
Cross currency swap agreements	13,065	13,065	36,034	36,034
Foreign currency forward contract	(180)	(180)	(160)	(160)

(20) SHAREHOLDERS EQUITY

Accounting for derivative and hedging activities

Derivative financial instruments are used by the Company to manage its exposure to adverse fluctuations in interest and foreign exchange rates. The Company has established a control environment which includes policies

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

and procedures for risk assessment, approval, reporting and monitoring of derivative financial instrument activities. The Company is not a party to leveraged derivatives and the policies prohibit the holding or issuing of financial instruments for speculative purposes.

For derivatives designed either as fair value or cash flow hedges, changes in the time value of the derivatives are excluded from the assessment of hedge effectiveness and are recorded in earnings. Hedge ineffectiveness, determined in accordance with SFAS No. 133 had no impact on the Company s earnings for the years ended December 31, 2003 and 2002, respectively. No fair value hedges or cash flow hedges were derecognized or discontinued during the years ended December 31, 2003 and 2002, respectively.

The cumulative unrealized gains and losses for hedging activities recorded in other comprehensive income are as follows:

	December 31, 2003	December 31, 2002
Unrealized Losses		
Gross	(10,645)	(17,148)
Less income tax	3,498	5,559
Net of income tax	**(7,147)**	**(11,589)**
Unrealized Gains		
Gross		1,890
Less income tax		(643)
Net of income tax		**1,247**
Unrealized net loss	**(7,147)**	**(10,342)**

Other comprehensive income

Other comprehensive income consist of the following items:

	Unrealized gain (loss) on	Unrealized gain (loss) on hedging	Foreign currency translation	Accumulated other comprehensive

	securities	activities		income
Balance January 1, 2001	1		(28)	(27)
Cumulative effect of accounting change, net of income tax		(10,959)		(10,959)
Changes, net of income tax	(162)	(2,102)	14,630	12,366
Balance December 31, 2001	(161)	(13,061)	14,602	1,380
Changes, net of income tax	(687)	2,719	(6,496)	(4,464)
Balance December 31, 2002	(848)	(10,342)	8,106	(3,084)
Changes, net of income tax	2,214	3,195	(10,690)	(5,281)
Balance December 31, 2003	1,366	(7,147)	(2,584)	(8,365)

Sale of American call option

On November 21, 2000, Telekom Austria purchased 3,832,248 American call options for a premium of EUR 12,527. The expiration date is February 27, 2004. The underlying share of the American call option is the share of Telekom Austria AG. The strike and execution price of the call option is Euro 9 and settlement is either physical delivery of the shares or cash, at the request of Telekom Austria. The American call option will be used to satisfy any obligation resulting from the stock option plan. As of December 31, 2003, together with mobilkom austria, the Company holds 3,326,881 options.

In 2003, the Company sold 610,000 American call options for an aggregate price of EUR 957. In 2002, the Company sold 717,701 American call options for an aggregate price of EUR 1,245. As the original acquisition of the options was accounted for as permanent equity under the provisions of EITF 00-19, proceeds from the sale of the options have been credited net of tax directly to additional paid in capital in the accompanying statement of changes in shareholders equity.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

Treasury shares

At the Annual General Meeting on June 4, 2003, the Management Board was authorized to increase the share capital by up to EUR 21,810 in order to provide stock options to be granted to employees, directors and members of the Management Board of the Company or of an affiliated company for a period of five years, ending 2008.

In addition, the Management Board was authorized to acquire up to 50 million treasury shares at a minimum price of Euro 9 and a maximum price of Euro 15 per share during a period of 18 months, ending at the end of 2004, and is empowered to either retire these shares or use them to satisfy the obligation under the stock option program described in note (17).

Restricted earnings

Under the Austria Stock Corporation Act , retained earnings available for distribution to shareholders are based upon the unconsolidated retained earnings of Telekom Austria AG as reported in its balance sheet determined in accordance with the Austrian Commercial Code.

The net income of Telekom Austria AG including released untaxed reserves of EUR 63,096 amounts to EUR 396,710. According to the Stock Corporation Act, Article 126, the supervisory board and the management board have decided to transfer EUR 300,000 to retained earnings, resulting in unappropriated profits of EUR 69,710. The management board and supervisory board plan to propose to the shareholders at the annual general shareholders meeting a distribution from unappropriated earnings of Euro 0.13 per zero par value share.

(21) REVENUES

Year ended December 31,	2003	2002	2001
Revenues from services	3,726,955	2,931,892	2,555,596
Revenues from sales of merchandise	242,795	186,172	104,064
Total	3,969,750	3,118,064	2,659,660

(22) OTHER OPERATING EXPENSES

Year ended December 31,	2003	2002	2001
Interconnection	421,787	361,608	562,736
Repairs	178,256	167,496	137,345
Services received	201,050	99,395	39,626
Advertising and marketing	198,362	153,737	75,368
Other support services	107,079	87,121	59,027
Rental expenses	74,358	67,666	52,130
Commission expenses	41,078	25,347	4,531
Bad debt expenses	30,629	39,184	15,069
Legal and other consulting	44,451	54,368	55,304
Charges from related parties	15,013	32,980	35,062
Travel expenses	23,696	23,363	24,676
Other taxes	7,201	8,665	5,242
Energy	21,979	21,285	21,752
Training expenses	13,129	11,773	7,131
Other	85,453	51,366	58,931
Total	1,463,521	1,205,354	1,153,930

In accordance with SFAS No. 144, as amended, the net loss from retirement of long-lived assets in 2003, 2002 and 2001 respectively, of EUR 41,571, EUR 18,715 and EUR 39,020 is presented in other operating expenses, other.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

(23) OTHER, net

Year ended December 31,	2003	2002	2001
Foreign exchange losses	(246,883)	(216,261)	(63,632)
Foreign exchange gains	242,013	211,422	56,474
Dividend income	48	448	2,229
Other	4,255	6,721	2,173
Total	(567)	2,330	(2,756)

(24) COMMITMENTS AND CONTINGENCIES

In the normal course of business the Company is subject to proceedings, lawsuits and other claims, including proceedings under laws and regulations related to interconnection. Such matters are subject to many uncertainties, and outcomes are not predictable with certainty. Consequently, management is unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at December 31, 2003. These matters could affect the operating results or cash flows of any one quarter when resolved in future periods. However, management believes that after final disposition, any monetary liability or financial impact to the Company beyond that provided for at year-end would not be material to its consolidated financial statements.

(25) CASH FLOW STATEMENT

Following is a summary of supplemental cash flow information:

Years ended December 31,	2003	2002	2001
Cash paid for			
Interest	182,836	173,940	180,436
Income taxes	16,246	10,558	10,235
Cash received for			
Interest	3,128	11,122	18,176
Tax refunds		21	91,255

Non cash investing and financing		
Dividends	28,294	267,505
Cross border leasing		86,315

(26) SEGMENT REPORTING

As of January 1, 2003 management reorganized its operations into three segments: wireline, wireless and other activities. The segment reporting for the years 2002 and 2001 was reformatted to provide comparable data.

Wireline includes fixed line, data communications and internet services and focuses on wholesale and retail customers. Wholesale customers including telecommunications operators and service providers are offered network-based services, while retail customers, including business and residential end-users are offered voice telephony, data communications, internet and other services.

Wireless, operated by our mobile communications segment, offers a full range of digital mobile communications services to business and residential customers.

The segment other activities contains the financing activities of the Company.

Adjusted EBITDA is defined by the Company as operating income before depreciation, amortization and impairment charges. The Company uses adjusted EBITDA to measure the performance of segments because it is commonly used in the telecommunications industry as a comparative measure of financial performance. In addition, the Company believes it is a widely accepted indicator of its ability to incur and service debt.

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see note (1)).

For the period ended December 31, 2003, the segment totals reconcile to the consolidated financial statements as a result of eliminating transactions and balances between consolidated segments. For the periods ended December 31, 2002 and 2001, respectively, the reconciliation additionally includes the results of operations of mobilkom austria prior to June 28, 2002 (see note (2)).

	Wireline	Wireless	Other activities	Segment totals	Eliminations	Consolidated
Year ended December 31, 2003						
External revenues	2,029,893	1,939,857		3,969,750		3,969,750
Intersegmental revenues	167,758	90,344		258,102	(258,102)	
Total revenues	2,197,651	2,030,201		4,227,852	(258,102)	3,969,750
Adj. EBITDA (excl. Impairment charges)	780,508	727,057	(45)	1,507,520	2,277	1,509,797
Impairment charges	6,825			6,825		6,825
Adj. EBITDA (incl. Impairment charges)	773,683	727,057	(45)	1,500,695	2,277	1,502,972
Depreciation and amortization	807,935	325,620		1,133,555	(407)	1,133,148
Operating Income	(34,252)	401,437	(45)	367,140	2,684	369,824
Total assets	6,116,105	3,131,630	1,125,178	10,372,913	(2,476,648)	7,896,265
Additions to property, plant and equipment	300,991	294,629		595,620	(363)	595,257

	Wireline	Wireless	Other activities	Segment totals	Eliminations	Mobile communications	Consolidated
Year ended December 31, 2002							
External revenues	2,090,006	1,819,219		3,909,225		not provided	
Intersegmental revenues	170,005	90,132		260,137			
Total revenues	2,260,011	1,909,351		4,169,362	(144,348)	(906,950)	3,118,064
Adj. EBITDA (excl. Impairment charges)	807,562	649,487	(73)	1,456,976	7,691	(349,109)	1,115,558
Impairment charges	41,871			41,871			41,871
Adj. EBITDA (incl. Impairment charges)	765,691	649,487	(73)	1,415,105	7,691	(349,109)	1,073,687
Depreciation and amortization	880,971	268,757		1,149,728	(196)	(133,220)	1,016,312
Operating Income	(115,280)	380,730	(73)	265,377	7,887	(215,889)	57,375
Total assets	6,428,133	2,832,149	1,007,006	10,267,288	(1,732,950)		8,534,338
	340,710	321,656		662,366	(2,300)	(129,100)	530,966

Additions to property, plant and equipment							
Year ended December 31, 2001							
External revenues	2,437,429	1,506,026		3,943,455		not provided	
Intersegmental revenues	222,108	207,153	292	429,553			
Total revenues	2,659,537	1,713,179	292	4,373,008	(169)	(1,713,179)	2,659,660
Adj. EBITDA (excl. Impairment charges)	814,821	564,716	(72)	1,379,465	(7)	(564,716)	814,742
Impairment charges	145,126			145,126			145,126
Adj. EBITDA (incl. Impairment charges)	669,695	564,716	(72)	1,234,339	(7)	(564,716)	669,616
Depreciation and amortization	904,075	267,784		1,171,859		(267,784)	904,075
Operating Income	(234,380)	296,932	(72)	62,480	(7)	(296,932)	(234,459)
Total assets	7,352,012	2,214,101	520,046	10,086,159	(144,736)	(2,214,101)	7,727,322
Additions to property, plant and equipment	449,031	363,177		812,208		(363,177)	449,031

Table of Contents

TELEKOM AUSTRIA AG

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All amounts in EUR 000s)

EBITDA differs from consolidated net income as a result of the following differences:

	Year ended December 31,		
	2003	**2002**	**2001**
Adj. EBITDA segment totals	1,507,520	1,456,976	1,379,465
Impairment charges	(6,825)	(41,871)	(145,126)
Adj. EBITDA segment totals	1,500,695	1,415,105	1,234,339
Depreciation and amortization	(1,133,148)	(1,016,312)	(904,075)
Interest income	75,167	88,191	82,683
Interest expense	(230,979)	(244,628)	(240,986)
Adj. EBITDA mobilkom austria prior to acquisition		(349,109)	(564,715)
Equity in earnings of affiliates mobilkom austria prior to acquisition		142,906	197,941
Equity in earnings of affiliates other	19,112	(2,363)	(2,491)
Other	1,710	10,021	(2,764)
Income before taxes, minority interests and cumulative effect of change in accounting principle	232,557	43,811	(200,068)
Income tax expense	(83,036)	(26,112)	94,913
Minority interests	(3,422)	(4,910)	530
Cumulative effect of change in accounting principle, net of tax	(11,858)		
Net income	134,241	12,789	(104,625)

In 2003, 2002 and 2001, more than 89%, 90% and 94%, respectively, of the revenues generated by the reportable segments relate to operations in Austria. As of December 31, 2003 and 2002, respectively, 93% and 94% of the long-lived assets were located in Austria.

(27) SUBSEQUENT EVENTS

On January 21, 2004, Telecom Italia International N.V. sold its residual shareholding, corresponding to 73.9 million shares or 14.78% of Telekom Austria s share capital, in a private placement to institutional investors at a price of Euro 10.55 per share. Following completion of this transaction, the free float in Telekom Austria s share capital increased to 52.83%. The remaining stake is owned by ÖIAG, representing the Republic of Austria. ÖIAG and Telekom Austria have each entered into lock-up agreements that end on May 31, 2004.

On February 16, 2004, the Company acquired 33.33% of IVS Interactive Video Services GmbH, Vienna, bringing its total interest to 100%. The purchase price amounted to EUR 202.

As of February 27, 2004, the average share price had exceeded the Initial Public Offering price by 30% or more for five consecutive days. Therefore, the 3,268,850 stock options / stock appreciation rights discussed in note (17) became exercisable. Therefore, compensation expense estimated at EUR 8,832 will be recorded in the first quarter 2004.

On February 27, 2004, the Company exercised its 3,326,881 American call options on treasury shares which were acquired during the Initial Public Offering in November 2000 to limit the Company s exposure under the stock option plan that expired on February 27, 2004. The strike price of each call option was Euro 9. Following the exercise of the options, 3,326,881 Telekom Austria shares, i.e. 0.67% of its share capital, were credited to the accounts of Telekom Austria through an off-market transaction on March 3, 2004.