

TELECOM ITALIA S P A  
Form 20-F  
June 26, 2003  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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**FORM 20-F**

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

**OR**

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

**For the fiscal year ended: December 31, 2002**

**OR**

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

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

**Commission file number: 1-13882**

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# Telecom Italia S.p.A.

(Exact name of Registrant as specified in its charter)

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Italy

(Jurisdiction of incorporation or organization)

Corso d Italia 41, 00198 Rome, Italy

(Address of principal executive offices)

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

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

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

None

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(Title of Class)

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

**None**

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(Title of Class)

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

**Not applicable**

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

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

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

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**INTRODUCTION**

Telecom Italia S.p.A. (the Company) is incorporated as a joint stock company under the laws of Italy.

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in conformity with the Italian law governing consolidated financial statements interpreted and integrated by the accounting principles established or adopted by the Italian Accounting Profession ( Italian GAAP ), which, as described in Note 26 of Notes to the Consolidated Financial Statements, differ in certain material respects from generally accepted accounting principles in the United States ( U.S. GAAP ). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the Consolidated Financial Statements of the Telecom Italia Group (including the notes thereto) included herein.

**Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995.** The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Annual Report contains certain forward-looking statements, including, but not limited to, the discussion of the changing dynamics of the marketplace, including liberalization of the telecommunications industry, the opening to competition of public voice telephone services, the Company's outlook for growth in the telecommunications industry both within and outside of Italy, including sources of increasing revenues to offset the impact of increasing competition and the Company's outlook regarding the impact of tariff rebalancing on the telecommunications industry. Such statements include, but are not limited to, statements under the following headings: (i) Item 3. Key Information Risk Factors, (ii) Item 4. Information on the Telecom Italia Group Business Significant Developments during 2002 Updated Business Plan, (iii) Item 4. Information on the Telecom Italia Group Regulation, (iv) Item 5. Operating and Financial Review and Prospects, (v) Item 8. Financial Information Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risk, including statements regarding the likely effect of matters discussed therein. Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information involves risks and uncertainties, which are outside the Telecom Italia Group's control, that could significantly affect expected results and are based on certain key assumptions.

The following important factors could cause the Telecom Italia Group's 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 the core domestic fixed-line and wireless markets of the Telecom Italia Group;
- the ability of the Telecom Italia Group to introduce new services to stimulate increased usage of its fixed and wireless networks to offset declines in its fixed-line business due to the continuing impact of regulatory required price reductions, market share loss and pricing pressures generally;
- the ability of the Telecom Italia Group to achieve cost-reduction targets in the time frame established or to continue the process of rationalizing its non-core assets;
- the impact of regulatory decisions and changes in the regulatory environment;
- the impact and consequences of the Merger;

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- the impact of the slowdown in Latin American economies and the slow recovery of economies generally on the international business of the Telecom Italia Group focused on Latin America and on its foreign investments and capital expenditures;
- the continuing impact of rapid changes in technologies;
- the impact of political and economic developments in Italy and other countries in which the Telecom Italia Group operates;
- the impact of fluctuations in currency exchange and interest rates;
- Telecom Italia Group's ability to continue the implementation of its 2003-2005 Industrial Plan, including the rationalization of its corporate structure and the disposition of Telecom Italia Group's interests in various companies;
- the ability of the Telecom Italia Group to successfully achieve its debt reduction targets;
- Telecom Italia Group's ability to successfully roll out its UMTS networks and services and to realize the benefits of its investment in UMTS licenses and related capital expenditures;
- Telecom Italia Group's ability to successfully implement its internet strategy;

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- the ability of the Telecom Italia Group to achieve the expected return on the significant investments and capital expenditures it has made in Latin America;
- the amount and timing of any future impairment charges for Telecom Italia Group's 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. Telecom Italia Group undertakes no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events. See the related cautionary statement under Item 5. Operating and Financial Review and Prospects .

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**KEY DEFINITIONS**

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

<b>Company</b>	means Telecom Italia S.p.A.
<b>Draghi Law</b>	means Legislative Decree No. 58 of February 24, 1998 and the specific implementing regulations issued by CONSOB.
<b>EU</b>	means the European Union.
<b>Finsiel</b>	means Finsiel-Consulenza e Applicazioni Informatiche S.p.A., the Telecom Italia Group's principal subsidiary operating in Information Technology Market Business Unit.
<b>Finsiel group</b>	means Finsiel and its subsidiaries.
<b>Framework Law</b>	means Law No. 481 of November 14, 1995, which provides for, among other things, the definition of a transparent tariff system based on the "price cap" method.
<b>Maccanico Law</b>	means Law No. 249 of July 31, 1997, which established the formation of the National Regulatory Authority for regulating the communications industry and implemented the Framework Law.
<b>Merger</b>	means the merger of Telecom Italia into Olivetti, approved by the shareholders of Telecom Italia on May 24, 2003 and expected to be effective in the first half of August 2003.
<b>National Regulatory Authority</b>	means the independent body, responsible in Italy for the regulation of the telecommunications, radio and television broadcasting sector, established by the Maccanico Law.
<b>New Telecom Italia</b>	means the entity which will result from the Merger and "New Telecom Italia Group" means such entity together with its consolidated subsidiaries.
<b>Olivetti</b>	means Olivetti S.p.A., the holding company and controlling shareholder of Telecom Italia.
<b>Savings Shares</b>	means the savings shares, 0.55 par value each, of Telecom Italia.
<b>SEAT</b>	means Seat Pagine Gialle S.p.A.
<b>Shares</b>	means the ordinary shares, 0.55 par value each, of Telecom Italia.
<b>Telecom Italia</b>	means Telecom Italia S.p.A., the operating company for fixed telecommunications services and the holding company for various businesses, principally telecommunications.
<b>Telecom Italia Group</b>	means the Company and its consolidated subsidiaries.
<b>Telecommunications Regulations</b>	means the telecommunications regulations (approved by Presidential Decree No. 318 of September 19, 1997 which became effective on October 7, 1997, 15 days after its publication) adopted to implement a number of EU directives in the telecommunications sector.

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<b>TILab</b>	means Telecom Italia Lab S.p.A. (formerly CSELT).
<b>TIM</b>	means Telecom Italia Mobile S.p.A., the Telecom Italia Group's subsidiary operating in the mobile telecommunications business.
<b>TIM Demerger</b>	means the demerger which separated mobile telecommunications services from the Company's predecessor company effective July 14, 1995.
<b>Tin.it</b>	means Telecom Italia Net S.p.A., the Telecom Italia Group's subsidiary providing Internet access which was combined with SEAT in November 2000.

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**PART I**

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

**Not Applicable**

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

**Not Applicable**

**Item 3. KEY INFORMATION**

**RISK FACTORS**

**Risk Factors Relating to the Business of the Telecom Italia Group**

*Continuing competition in a fully liberalized market may further reduce Telecom Italia Group's market share of domestic and international traffic and may cause further reductions in prices and margins.*

Domestic competition exists in all of the principal telecommunications business areas in which the Telecom Italia Group operates, including, most significantly, fixed-line and mobile voice telecommunications services, which have been open to competition since 1998 for fixed-line services and since 1995 for mobile services. As a result, the Company and TIM face competition in Italy. This competition may increase due to the consolidation and globalization of the telecommunications industry in Europe and elsewhere. Consolidation is increasing rapidly and competition is expected to rise at all levels in the future. In addition, the use of the single European currency could further intensify competition by facilitating international operators' entry into the Italian market and direct competition with Telecom Italia and with TIM in fixed and mobile telephony and in the local and long-distance markets. As of December 31, 2002, there were a number of significant competitors offering fixed-line services and two other operators (as a result of the merger of Blu with TIM) offering mobile services in the Italian domestic market; a third mobile competitor (H3G) has entered the market in 2003, offering 3G commercial services. Although the decline in Telecom Italia's market share slowed during 2002, continuing pressures on prices due to competition and further erosion in market shares could adversely affect Telecom Italia Group's results of operations. Additional changes in the regulatory regime, including carrier preselection, number portability and local loop unbundling could further increase competition for the services Telecom Italia Group provides which could also adversely affect its business.

*Telecom Italia Group's business may be adversely affected if it is unable to continue the introduction of new services to stimulate increased usage of its fixed and wireless networks.*

In order to maintain a positive trend in revenues despite increased competition and lower prices, Telecom Italia Group's strategy has been to introduce new services in both its fixed-line and wireless services to increase traffic on its networks and find alternative revenue sources. These services include non-voice services such as Internet, data traffic and value added services such as interactive mobile services that allow users to receive news or engage in simple banking transactions. TIM has also introduced multimedia messaging services (MMS) allowing users to send and to receive images, photos and files. Alternative revenue sources also include increased interconnection traffic from other operators using the Company's fixed-line network. In addition to the steps taken in recent years, the Telecom Italia Group continues to develop new products and services, such as new data services for business customers, broadband services, enhanced communication services and new voice packages, in order to attract and retain customers, particularly business customers, and to stimulate usage of its fixed and wireless telecommunications network. The Telecom Italia Group is also investing in new infrastructure and technologies to enable it to introduce new products and services. The Telecom Italia Group expects that these strategic initiatives will require substantial expenditures and commitment of human resources. The Telecom Italia Group may not be able to introduce commercially these new products and services, and even if it introduces them, they may not be successful.

***The Telecom Italia Group's business will be adversely affected if it is unable to successfully implement its business plans, particularly in light of the Merger. Factors beyond the Telecom Italia Group's control may prevent the Telecom Italia Group from successfully implementing its strategy.***

Following the change in control of the Company in late 2001, the Telecom Italia Group adopted its 2002-2004 Industrial Plan and established priorities for 2002. The main objectives were:

- Strengthen competitive capabilities;

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

Significant portions of the 2002-2004 Industrial Plan were completed during 2002, particularly the sale of non-core assets and debt reduction. The Telecom Italia Group also took steps to strengthen its competitive position in its core domestic market through the introduction of new products and tariff packages and confirmed to focus on lowering costs through the reduction of operating expenses and capital expenditures.

In connection with the proposed Merger, the Company has confirmed the objectives of the 2002-2004 Plan and stated that it has established certain targets, which include strict limits on capital expenditures and cost controls, together with further assets sales, to reduce the significantly higher levels of debt the Telecom Italia Group will have as a result of the Merger. See *New Telecom Italia's total net financial debt will increase if the Merger of Telecom Italia and Olivetti is successful* below.

Factors beyond the Telecom Italia Group's control that could affect the further implementation and completion of the 2002-2004 Plan and the Telecom Italia Group reaching its targets for the period 2003-2005 include:

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

*Regulatory decisions and changes in the regulatory environment could adversely affect Telecom Italia Group's business.*

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Telecom Italia Group's fixed and mobile telecommunications operations, as well as its broadband services businesses, are subject to extensive regulatory requirements in Italy and its international operations and investments are subject to regulation in their host countries. In Italy, the Company is the only operator subject to universal service obligations, including the provision of fixed public voice telecommunications services in non-profitable areas, publication of telephone directories and provision of subscriber information services at affordable prices and provision of public payphones. In addition, the National Regulatory Authority has identified the Company as an operator having significant market power in all relevant markets. As a result, the Company is, or will be, subject to a number of regulatory constraints, including:

- a requirement to conduct its business in a transparent and non-discriminatory fashion;
- a requirement to have its prices for fixed-line telecommunications services approved by the National Regulatory Authority prior to implementation in accordance with a price cap mechanism which is currently being reviewed by the National Regulatory Authority; and
- a requirement to provide interconnection services, leased lines and access to the local loop to other operators at cost-oriented prices. These services include allowing other operators to interconnect to the Company's network and transport traffic through the network and offering certain services relating to its local access network, or local loop, on an unbundled basis to other operators to enable these operators to access directly end users by leasing the necessary components from the Telecom Italia Group.

As a member of the European Economic Area, or EEA, Italy is additionally required to adapt its regulatory framework to the legislative and regulatory framework established by the EU for the regulation of the European telecommunications market as far as the directives are made relevant to the EEA Agreement. The EU regulators

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approved revised telecommunications regulation in March 2002. Implementation of such regulation through Italian law is expected by July 2003. The implementation of the revised telecommunications regulation and possible future decisions relating thereto may change the regulatory accounting system currently used by the Telecom Italia Group in a manner adverse to the Telecom Italia Group. Please see Item 4. Information on the Telecom Italia Group Regulation in this report for more information on the regulatory requirements to which the Telecom Italia Group is subject.

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

*The Telecom Italia Group may not be able to achieve the expected return on the significant investments and capital expenditures it has made in Latin America due to the competitive environment in these markets. Returns from the sale of non-core international assets may be lower than expected.*

In recent years the Telecom Italia Group pursued a significant strategic acquisition program in Latin America and Europe aimed at achieving a stronger competitive position and balancing the loss of market share in its domestic market. During the past 18 months the Telecom Italia Group has reconsidered this strategy. The Telecom Italia Group's strategy is now focused on:

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

As a result of this change in strategy, in 2002 the Telecom Italia Group divested certain of its most significant European assets such as BDT (Bouygues Decaux Telecom), Autel (Mobilkom Austria), 9Telecom group and Auna and is still seeking to divest certain international non-strategic assets. In addition, certain investments which were made during the 1999-2001 period have declined significantly in value resulting in significant write-downs and asset impairments. Due to the current market situation, the general economic conditions and the high level of competition, the actual returns from the announced divestment of non-strategic assets may be lower than the ones originally expected and further impairment charges and goodwill writedowns may be required.

*Continuing rapid changes in technologies could increase competition or require the Telecom Italia Group to make substantial additional investments.*

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Many of the services the Telecom Italia Group offers are technology-intensive and the development of new technologies may render such services non-competitive. The Telecom Italia Group is already making and may have to make substantial additional investments in new technologies to remain competitive. The new technologies the Telecom Italia Group chooses may not prove to be commercially successful. In addition, the Telecom Italia Group may not receive the necessary licenses to provide services based on new technologies in Italy or abroad. As a result, the Telecom Italia Group could lose customers, fail to attract new customers or incur substantial costs in order to maintain its customer base.

*The value of the Telecom Italia Group's operations and investments may be adversely affected by political and economic developments in Italy or other countries.*

The Telecom Italia Group's business is dependent on general economic conditions in Italy, including levels of interest rates, inflation and taxes. A significant deterioration in these conditions could adversely affect the Telecom Italia Group's business and results of operations. The Telecom Italia Group may also be adversely

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affected by political and economic developments in other countries where it has made significant investments in telecommunications operators. Some of these countries have political, economic and legal systems that are unpredictable. Political or economic upheaval or changes in laws or their application in these countries may harm the operations of the companies in which the Telecom Italia Group has invested and impair the value of these investments. A significant risk of operating in emerging market countries is that foreign exchange restrictions could be established. This could effectively prevent the Telecom Italia Group from receiving profits from, or from selling its investments in, these countries.

### ***Fluctuations in currency exchange and interest rates may adversely affect the Telecom Italia Group's results.***

Because the Telecom Italia Group has made substantial international investments, primarily in U.S. dollars, and has significantly expanded its operations outside the euro zone, movements in the exchange rates of the euro against other currencies could have an adverse effect on the Telecom Italia Group's revenues and operating results. A rise in the value of the euro relative to other currencies in certain countries in which the Telecom Italia Group operates or has made investments would reduce the relative value of the revenues or assets of the Telecom Italia Group's operations in those countries and, therefore, may adversely affect the Telecom Italia Group's operating results or financial position. In addition, the Telecom Italia Group has raised, and may raise in an increasing proportion in the future, financing in currencies other than the euro, principally the U.S. dollar. Accordingly, the value of those liabilities will be affected by fluctuations of the currencies of the countries in which the TI Group operates against the currency in which the financing is denominated. The Telecom Italia Group generally enters into a number of forward currency transactions, swaps and options to manage foreign currency risk exposure with respect to its non-euro denominated liabilities. However, the Telecom Italia Group can give no assurances that it will be successful in managing foreign currency risk exposure, taking into consideration that appropriate foreign currency swaps and options may not be available as needed on the relevant financial markets.

In addition, total net financial debt at year end 2002 was 18,118 million. As a result of the Merger and on completion of the Merger, under Italian GAAP New Telecom Italia will have up to 43,576 million of pro forma net financial debt. The Telecom Italia Group generally enters into interest rate swaps and interest rate options to manage its exposure to floating interest rates. However, the Telecom Italia Group can give no assurance that fluctuations in interest rates will not adversely affect its results of operations.

### ***The Telecom Italia Group may not be able to realize the benefits of its investment in UMTS licenses and related capital expenditures.***

Through TIM and other subsidiaries, the Telecom Italia Group has acquired a third generation mobile telephone, or UMTS, license to commence operations of UMTS services in Italy and Greece. As of June 20, 2003, TIM has committed to pay 2,417 million (of which 2,300 million has already been paid) for its UMTS license in Italy and, through its international subsidiaries and affiliated companies, a further 145 million for UMTS licenses in Greece (of which approximately 101 million has already been paid). The size of the market for UMTS products and services is unknown and may fall short of the industry's expectations. The Telecom Italia Group cannot be certain that the demand for such services will justify the related costs. In some locations, the investments, although required under the licenses, may not be commercially desirable. In addition, the Telecom Italia Group has a number of significant competitors in each of its geographic markets.

The Telecom Italia Group will be rolling out the UMTS networks, together with its competitors, in compliance with the terms and conditions of their respective licenses. Given the substantial costs of upgrading Telecom Italia's existing networks to support UMTS and the uncertainty regarding the commercial adoption of UMTS, the Telecom Italia Group may not be able to recoup its investment according to its estimates, if at all. The Telecom Italia Group has entered into and intends to enter into arrangements with other operators to share the costs and infrastructure of its planned UMTS networks. However, the Telecom Italia Group cannot give any assurance that it will succeed in concluding the necessary agreements with other operators on satisfactory terms. Moreover, while network sharing is intended to reduce costs, the Telecom Italia Group cannot give any assurance that this will be the case or that it will be able to make such network sharing work commercially or technically.

*Devaluations of telecom assets and write-downs could adversely affect the Telecom Italia Group's financial condition and results of operations.*

Recent events in the market for telecom stocks and credit ratings of market participants, as well as the Telecom Italia Group's ongoing review and refinement of its business plan, has resulted and may result in substantial impairment write-downs of the Telecom Italia Group's assets at any time. Accounting standards

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relating to asset valuations and impairment may be refined to require the use of new criteria or methodology. Starting in fiscal year 2002, under U.S. GAAP, goodwill is tested for impairment pursuant to SFAS 142 Goodwill and Other Intangible Assets. In accordance with the provisions of SFAS 142, goodwill is no longer amortized, but is subject to annual impairment tests based on fair value. An interim assessment of goodwill may be necessary if an impairment indicator indicates that the fair value of a reporting unit may have decreased. Future changes in the fair value of the Telecom Italia Group's business units could adversely affect the Telecom Italia Group's U.S. GAAP results and financial conditions.

*Growth in the traditional mobile telecommunications industry has slowed significantly during the past few years and our revenues may not grow as rapidly as in the past.*

In recent years, the Telecom Italia Group's revenues have grown or remained stable in large part because of the rapid growth in the mobile communications business. This growth has been driven largely by the rapid expansion of the mobile telecommunications market in Italy. However, as a result of this growth, mobile phone use in the Italian market is approaching saturation levels.

Continued growth in the mobile telecommunications markets in which the Telecom Italia Group operates depends on a number of factors, many of which are outside the Telecom Italia Group's control. These factors include:

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

If the mobile telecommunications markets in which TIM operates do not continue to expand, or TIM is unable to retain its existing customers or is unable to stimulate increases in customer usage, the Telecom Italia Group's financial condition and results of operations may be harmed.

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

Various reports have alleged that certain radio frequency emissions from wireless handsets and transmission equipment may be linked to various health concerns and may interfere with various electronic devices. The Telecom Italia Group cannot rule out that exposure to electromagnetic fields or other emissions originating from wireless handsets will not be identified as a health risk in the future. The Telecom Italia Group's mobile communications business may be harmed as a result of these alleged health risks. For example, this could result in a lower number of customers, reduced usage per customer or potential consumer liability for the Telecom Italia Group. In addition, although Italian law already requires strict limits in relation to transmission equipment, these concerns may cause regulators to impose greater restrictions on the construction

of base station towers or other infrastructure, which may hinder the completion of network build-outs and the commercial availability of new services.

*The Telecom Italia Group may be adversely affected if it fails to successfully implement its Internet strategy.*

The Telecom Italia Group's ability to develop successfully its Internet dial-up and broadband operations and its strategy to provide contents and services to consumers and small and medium-sized companies may be adversely affected if:

- Internet usage in Italy grows more slowly than anticipated, for reasons such as changes in Internet users' preferences;
- competition increases, for reasons such as the entry of new competitors, consolidation in the industry or technological developments introducing new platforms for internet access and/or internet distribution; and
- Telecom Italia experiences any network interruptions or related problems with network infrastructure.

Any of the above factors may adversely affect the Telecom Italia Group's business and results of operations.

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***You may not be able to assert claims against Arthur Andersen***

The consolidated financial statements of the Telecom Italia Group for the year ended December 31, 2000, appearing in our annual report on Form 20-F have been audited by PricewaterhouseCoopers S.p.A., independent auditors for 2000, whose report is based in part on the report of Arthur Andersen S.p.A., now called Deloitte & Touche Italia S.p.A..

We have not been able to obtain, after reasonable efforts, the written consent of Arthur Andersen S.p.A., as required by section 7 of the Securities Act for incorporation by reference of its reports on our consolidated financial statements for the year ended December 31, 2000. Rule 437a of the Securities Act, as amended, permits us to include these reports on the financial statements which will be incorporated by reference into our Registration Statement (File No. 333 - 127666) without the consent of Arthur Andersen S.p.A.. Because Arthur Andersen S.p.A. has not consented to the incorporation by reference of its reports therein, your ability to recover for claims against Arthur Andersen S.p.A. may be limited. In particular, you will not be able to recover against Arthur Andersen S.p.A., under Section 11 (a) (4) of the Securities Act for any untrue material fact contained in the financial statements audited by Arthur Andersen S.p.A. or any omission to state a material fact required to be stated therein.

**Risk Factors Relating to the Merger**

***New Telecom Italia's total net financial debt will increase if the Merger of Telecom Italia and Olivetti is successful.***

On April 15, 2003, the Boards of Directors of Olivetti and the Company approved a plan of Merger between Olivetti and Telecom Italia. On May 24 and May 26 the Ordinary and Extraordinary Meetings of the Company's Ordinary Shareholders and the Ordinary and Extraordinary Meetings of Olivetti's Ordinary Shareholders voted in favor of the Merger, respectively. The merged company will be called Telecom Italia. The Merger is expected to become effective in the first half of August 2003, subject to the satisfaction of certain conditions.

From the date on which the Merger becomes effective and as a consequence thereof, New Telecom Italia will assume the rights and obligations of the Telecom Italia Group, continuing its activity. In particular, New Telecom Italia will succeed to Telecom Italia's concessions, licenses and administrative authorizations subject to regulatory approvals, where required. In addition, it will be responsible for the additional businesses currently operated by Olivetti.

See Item 4. Information on the Telecom Italia Group Business Significant Development during 2002 Merger of Telecom Italia into Olivetti .

The debt of New Telecom Italia could be greater than the present total debt of Olivetti and Telecom Italia as a consequence of the Merger although the total amount will depend on the level of acceptances of Telecom Italia's shareholders of the partial cash tender offer for Shares and Savings Shares by Olivetti. Under Italian GAAP, total net financial debt (see Item 3. Key Information Selected Financial and Statistical Information Note 10 ) is expected to be up to approximately 43.6 billion on a pro forma basis following the Merger, a maximum increase of approximately 25 billion from the net financial debt of 18.1 billion at December 31, 2002 of the Telecom Italia Group, of which about 15 billion is existing Olivetti net financial debt and a further 9 billion relates to the maximum amount of funding for the withdrawal rights exercised by certain Olivetti shareholders and the tender offers to be made by Olivetti for a portion of the Telecom Italia Shares and Savings Shares. At December 31, 2002 net financial debt of the Olivetti group was 33.4 billion (including the net financial debt of the Telecom Italia Group).

Net financial debt is projected to decrease and the 9 billion of additional debt which may be incurred is expected to be retired by the end of 2004, partly by using the proceeds of the sale of other non-strategic assets. There can be no assurance that factors beyond New Telecom Italia's control, including but not limited to deterioration in general economic conditions, will not significantly affect New Telecom Italia's ability to reduce such debt. The Telecom Italia Group's business will be adversely affected if it is unable to successfully implement its business plans, particularly in light of the Merger. Factors beyond the New Telecom Italia Group's control may prevent the New Telecom Italia Group from successfully implementing its strategy.

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

Beginning with the fiscal year 2001, the Telecom Italia group has published its consolidated financial statements in euros. References to     , euro and Euro are to the euro, the currency of 12 member states of the European Union, including Italy and references to     , lira and Lit. are to Italian lire, the former Italian non-decimal denomination of the euro, and references to U.S. dollars,     , dollars, U.S.\$ or \$ are to U.S. dollars, the currency of the United States.

For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate (the Euro/Dollar Exchange Rate) of 1.00 = U.S.\$1.1843, using the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the Noon Buying Rate) on June 16, 2003. These translations should not be construed as a representation that the euro amounts actually represent such dollar amounts or have been or could be converted into dollars at the rate indicated.

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

**Exchange Rates**

Effective January 1, 1999, the following 11 European Union member states adopted the euro as a common currency: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. They also established fixed conversion rates between their respective sovereign currencies and the euro. On January 1, 2001, Greece (together, with the 11 European Union member states referred to in the previous sentence, the Member States) joined the European Economic and Monetary Union. The exchange rate at which the lira was irrevocably fixed against the euro is Lit.1,936.27 = 1.00. On January 1, 2002, the Member States began issuing new euro-denominated bills and coins for use in cash transactions. As of March 1, 2002, the Member States withdrew the bills and coins denominated in their respective currencies from circulation, and they are no longer legal tender for any transactions.

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

At the extraordinary stockholders meeting held on May 3, 2001, Telecom Italia's share capital was converted from lire into euros by rounding up the par value of the shares, from Lit. 1,000 (approximately 0.52) to 0.55 partially through the cancellation of 112,998,070 Savings Shares held in treasury.

The following table sets forth, for the year 1998 certain information regarding the Noon Buying Rate for lira expressed in lira per U.S.\$1.

<u>Calendar Period</u>	<u>High</u>	<u>Low</u>	<u>Average(1)</u>	<u>At Period End</u>
1998	1,828	1,1592	1,737	1,654

- (1) Average of the rates for the last business day of each month in the relevant prices.

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The following table sets forth for the years 1999 to 2002 and for the beginning of 2003 certain information regarding the Noon Buying Rate for Dollars expressed in U.S.\$ per 1.00.

<u>Calendar Period</u>	<u>High</u>	<u>Low</u>	<u>Average(1)</u>	<u>At Period End</u>
1999	1.1812	1.0016	1.0588	1.0070
2000	1.0335	0.8270	0.9207	0.9388
2001	0.9535	0.8425	0.8909	0.8901
2002	1.0485	0.8594	0.9495	1.0485
2003 (through June 16, 2003)	1.1870	1.0361	1.1201	1.1843
<b>Monthly Amounts</b>				
December 2002	1.0485	0.9927	1.0194	1.0485
January 2003	1.0861	1.0361	1.0622	1.0739
February 2003	1.0875	1.0708	1.0785	1.0779
March 2003	1.1062	1.0545	1.0797	1.0900
April 2003	1.0621	1.1180	1.0862	1.1180
May 2003	1.1853	1.1200	1.1556	1.1766
June 2003 (through June 16, 2003)	1.1870	1.1686	1.1759	1.1843

- (1) Average of the rates for the last business day of each month in the relevant period except for 2003 for which the date used is June 16, 2003.

Beginning January 4, 1999, the Shares and Savings Shares commenced trading on *Mercato Telematico Azionario* ( Telematico ), managed by Borsa Italiana S.p.A. ( Borsa Italiana ) in euro. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the U.S. dollar equivalent of the euro price of the Shares and the Savings Shares and the price of the American Depositary Shares ( ADSs ) and the Savings Share American Depositary Shares ( Savings Share ADSs ), on the New York Stock Exchange ( NYSE ). Cash dividends were paid by Telecom Italia in lire until 2001 and in euro starting from 2002. Exchange rate fluctuations will affect the U.S. dollar amounts received by owners of ADSs and Savings Share ADSs upon conversion by the Depositary of cash dividends paid in euro on the underlying Telecom Italia Shares and Telecom Italia Savings Shares. See Item 10. Additional Information Description of American Depositary Receipts .

On completion of the Merger, New Telecom Italia will become a successor registrant to the Company under the Securities Exchange Act of 1934, as amended (the 1934 Act ) and, therefore, become subject to and continue to file periodic reports under the 1934 Act required for a foreign private issuer. New Telecom Italia intends to seek a listing of the New Telecom Italia ordinary shares and savings shares to be issued if the Merger is completed, on the NYSE where such ordinary shares and savings shares will trade in the form of ADSs.

**Table of Contents****SELECTED FINANCIAL AND STATISTICAL INFORMATION**

The selected financial data below should be read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere in this Annual Report. The selected financial data (other than the 2000 pro forma data) for each of the five years in the period ended December 31, 2002, are extracted or derived from the consolidated financial statements of the Telecom Italia group, which have been audited by the following independent auditors: Reconta Ernst & Young S.p.A. (only for the years ended December 31, 2001 and 2002), PricewaterhouseCoopers S.p.A. (only for the year ended December 31, 2000) and Arthur Andersen S.p.A. (now called Deloitte & Touche Italia S.p.A.) for all other periods. In accordance with Italian law, the financial statements of the parent company Telecom Italia have been approved by the shareholders of Telecom Italia at its Annual Meeting of Shareholders held on May 24, 2003. The Telecom Italia Group's Consolidated Financial Statements included herein have been approved by the Telecom Italia Board of Directors. Unless otherwise indicated, amounts presented are based on Italian GAAP.

	Year ended December 31,					
	2000					
	pro forma					
	1998(1)	1999(1)	2000(1)	(1)(2)	2001(1)	2002(1)
(millions of Euro, except per share and per ADS amounts)						
<b>Statement of Operations Data in accordance with Italian GAAP:</b>						
Operating revenues	25,052(3)	27,104	28,911	27,169	30,818	30,400
Other income	560	516	426	402	417	479
<b>Total revenues</b>	<b>25,612(3)</b>	<b>27,620</b>	<b>29,337</b>	<b>27,571</b>	<b>31,235</b>	<b>30,879</b>
Cost of materials	2,342	2,477	2,259	2,132	1,972	1,779
Salaries and social security contributions	4,992	4,977	5,025	4,745	4,666	4,540
Depreciation and amortization	5,412	5,339	5,647	5,209	6,275	5,877
Other external charges	9,065(3)	9,586	10,790	10,130	12,171	11,949
Changes in inventories	135	(130)	(277)	(255)	58	28
Capitalized internal construction costs	(1,078)	(1,062)	(912)	(831)	(581)	(675)
<b>Total operating expenses</b>	<b>20,868(3)</b>	<b>21,187</b>	<b>22,532</b>	<b>21,130</b>	<b>24,561</b>	<b>23,498</b>
<b>Operating income</b>	<b>4,744(3)</b>	<b>6,433</b>	<b>6,805</b>	<b>6,441</b>	<b>6,674</b>	<b>7,381</b>
Financial income	815	555	847	806	1,076	1,236
Financial expense	(868)	(1,466)	(2,470)	(2,261)	(5,031)	(3,399)
<i>Of which write-downs and equity in losses in unconsolidated subsidiaries, affiliated companies and other companies, net</i>	<i>(178)</i>	<i>(565)</i>	<i>(1,025)</i>	<i>(1,011)</i>	<i>(1,616)</i>	<i>(465)</i>
Other income and expense, net	69(3)	(507)	(214)	(184)	(3,452)	(5,637)
<b>Income (loss) before income taxes</b>	<b>4,760</b>	<b>5,015</b>	<b>4,968</b>	<b>4,802</b>	<b>(733)</b>	<b>(419)</b>
Income taxes	(2,048)	(2,606)	(2,020)	(1,910)	(925)	716
<b>Net income (loss) before minority interests</b>	<b>2,712</b>	<b>2,409</b>	<b>2,948</b>	<b>2,892</b>	<b>(1,658)</b>	<b>297</b>

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Minority interest	(734)	(672)	(920)	(864)	(410)	(619)
Net income (loss)	1,978	1,737	2,028	2,028	(2,068)	(322)
Net income (loss) per Share(4)	0.2634	0.2309	0.2741	0.2741	(0.2858)	(0.0474)
Net income (loss) per Share ADS(4)	2.6339	2.3086	2.7410	2.7410	(2.8581)	(0.4736)
Dividends per Share	0.1446	0.3114	0.3125	0.3125	0.3125	0.3125(5)
Dividends per Savings Share	0.1549	0.3218	0.3238	0.3238	0.3237	0.3235(5)
<b>Amounts in accordance with U.S. GAAP:</b>						
Total revenues	25,612(3)	27,620	27,938		31,017	30,830
Operating income (loss)	4,662(3)	6,153	(1,926)		2,272	4,850
Income (loss) before income taxes	4,419	4,774	7,058		(3,379)	1,357
Net income (loss)	1,526	1,505	3,522		(4,039)	828
Net income (loss) per Share Basic(6)	0.2026	0.1998	0.4731		(0.5553)	0.1103
Net income (loss) per Share Diluted(6)	0.2026	0.1997	0.4717		(0.5553)	0.1103
Net income (loss) per Share ADS Basic(6)	2.0255	1.9982	4.7307		(5.5531)	1.1031
Net income (loss) per Share ADS Diluted(6)	2.0255	1.9966	4.7173		(5.5531)	1.1031

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	Year ended December 31,					
	2000					
	pro forma					
	1998(1)	1999(1)	2000(1)	(1)(2)	2001(1)	2002(1)
(millions of Euro, except per share and per ADS amounts)						
<b>Balance Sheet Data in accordance with Italian GAAP:</b>						
Total current assets	12,186(7)	12,749	16,395	15,673	16,736	15,716
Total fixed assets, net	23,584	23,508	23,425	20,721	21,757	19,291
Intangible assets, net	1,884	2,737	16,037	15,571	16,197	13,052
Total assets	44,870(7)	46,058	65,515	61,985	62,670	52,786
Total short-term debt	4,824	4,969	15,136	14,745	9,114	5,089
Total current liabilities	16,865	17,448	27,482	26,510	21,945	17,616
Total long-term debt	5,598	5,166	8,268	6,733	16,083	15,018
Total liabilities	26,440(7)	26,270	39,986	37,293	43,361	39,959
Total stockholders equity before minority interest	16,346	17,045	18,821	18,821	13,522	9,049
Total stockholders equity	18,430	19,788	25,529	24,692	19,309	12,827
<b>Amounts in accordance with U.S. GAAP:</b>						
Total current assets	12,660	12,984	15,366		16,944	15,331
Total fixed assets, net	23,172	23,150	22,823		23,883	21,277
Intangible assets, net	5,292	5,894	24,084		22,506	18,384
Total assets	48,108	49,263	71,528		72,518	60,822
Total current liabilities	16,865	17,448	26,207		21,487	17,773
Total long-term debt	5,598	5,166	12,466		21,906	20,069
Total liabilities	26,908	26,908	44,848		52,332	46,129
Stockholders equity(8)	19,145	19,659	19,118		12,457	9,215
<b>Financial Ratios in accordance with Italian GAAP:</b>						
Gross operating margin (Gross operating profit/operating revenues)(%)(9)	47.2	45.1	45.4	45.0	44.2	45.9
Operating income/operating revenues (ROS) (%)	18.9	23.7	23.5	23.7	21.7	24.3
Return on equity (ROE) (%)	15.3	12.6	13.0	13.0	n.a.	n.a.
Return on investments (ROI) (%)	18.5	23.6	18.8	18.4	16.0	20.4
Net debt/Net invested capital (debt ratio) (%) (10)	30.7	29.1	42.7	41.1	53.2	58.6
<b>Statistical Data:</b>						
Subscriber fixed lines (thousands)(11)	25,986	26,502	27,153	27,153	27,353	27,142
ISDN equivalent lines (thousands)(12)	1,735	3,049	4,584	4,584	5,403	5,756
TIM lines in Italy (thousands)(13)	14,299	18,527	21,601	21,601	23,946	25,302
Subscriber fixed lines per full-time equivalent employee(14)	332	354	409	409	448	496
Page views Virgilio (millions)		505	2,218	2,218	3,945	5,267
Active Users (at year-end, thousands)		1,104	1,656	1,656	1,804	2,226

- (1) Beginning with the consolidated financial statements for the year ended December 31, 2001, under Italian GAAP, Nortel Inversora and the controlled Telecom Argentina group (Nortel Inversora group), which in 2000 were consolidated proportionally, have been accounted for using the equity method. Prior to 2000 the Nortel Inversora group was accounted for on the equity method. Under U.S. GAAP, the Nortel Inversora group is accounted for using the equity method. These differences in accounting treatment for 2000 did not affect net income and stockholders equity but had an impact on other line items, such as operating revenues and operating expenses, as well as a number of balance sheet line items.
- (2) The 2000 pro forma amounts give effect to the consolidation of the Nortel Inversora group using the equity method instead of the proportional consolidation method.
- (3) Beginning in 1999 the Telecom Italia Group changed the way in which it accounted for revenues from telecommunications services, calculating such revenues gross of interconnection and service charges payable to other operators and service providers and accounting for such interconnection and service charges as an operating expense (other external charges). In prior fiscal years, revenues from



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telecommunications services were accounted for net of interconnection and service charges. Due to this change, operating revenues from telecommunications services and other external charges increased by the same amount: 1,571 million in 1998. This accounting change had no impact on reported net income for 1998. In 1998, the item other external charges also takes into account additional expenses ( 10 million) included in other income and expense, net in the consolidated financial statements in Telecom Italia's 1998 Annual Report on Form 20-F.

- (4) Net income per Share in 1998 is calculated on the basis of 7,421,251,726 Shares and Savings Shares outstanding. Net income per Share in 1999 is calculated on the basis of 7,426,157,226 Shares and Savings Shares outstanding. Net income per share in 2000 is calculated on the basis of 7,321,179,156 Shares and Savings Shares outstanding; Savings Shares are net of 104,978,070 shares of treasury stock acquired during 2000. Net loss per Share in 2001 is calculated on the basis of 7,314,655,506 Shares and Savings Shares outstanding. Net loss per Share in 2002 is calculated on the basis of 7,265,103,156 Shares and Savings Shares outstanding; Shares are net of 5,280,500 shares of treasury stock and Savings Shares are net of 45,647,000 shares of treasury stock acquired during 2002.

The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares above dividends paid on the Shares. Prior to 2000 the par value of the Savings Shares was Lit. 1,000 per share, while for 2001 and 2002, following the resolution of the extraordinary shareholders' meeting held on May 3, 2001 regarding the re-denomination of Telecom Italia share capital into Euro, the calculations take into account the new par value per share of 0.55. Net income (loss) per Savings Share was 0.2737, 0.2412, 0.2844, (0.2748) and (0.0364) in each of 1998, 1999, 2000 (historical and pro forma), 2001 and 2002, respectively, and net income (loss) per Savings Share ADS was 2.7372, 2.4119, 2.8443, (2.7481) and (0.3636) in each of 1998, 1999, 2000 (historical and pro forma), 2001 and 2002, respectively.

As of December 31, 1998, 1999, 2000 (historical and pro forma), 2001 and 2002, the number of Shares and Savings Shares outstanding was 7,421,251,726, 7,426,157,226, 7,426,157,226, 7,314,655,506 and 7,316,030,656, respectively. The increase in Shares and Savings Shares outstanding in 1999 is due to the issuance of 4,905,500 new Shares in connection with the Stock Option Plan. The decrease in Shares and Savings Shares outstanding in 2001 is due to the cancellation of 112,998,070 Savings Shares of treasury stock following the re-denomination of the share capital into Euro and the issuance of 1,496,350 new Shares in connection with the Stock Option Plan. The increase in Shares and Savings Shares outstanding in 2002 is due to the issuance of 1,375,150 new Shares in connection with the Stock Option Plan.

- (5) In order to ensure shareholders dividends commensurate with those paid out for 2001, in December 2002, reserves were distributed corresponding to a dividend of 0.1357 per Share and a dividend of 0.1357 per Savings Share. Furthermore, the Shareholders' Meeting held on May 24, 2003 approved the pay out of an additional dividend of 0.1768 per Share and 0.1878 per Savings Share, by drawing from the income and capital reserves. Telecom Italia's dividend coupons for the year ended December 31, 2002 were clipped on June 23, 2003, and such dividends for the year ended December 31, 2002 are payable from June 26, 2003.
- (6) In accordance with U.S. GAAP, the Net income (loss) per Share has been calculated using the two class method, since the Company has both Shares and Savings Shares outstanding. Under this method, set forth in Statement of Financial Accounting Standards No. 128, Earnings per Share, Basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding, and diluted earnings per share is increased to include any potential common shares and is adjusted for any changes to income that would result from the assumed conversion of those potential common shares. For the purpose of these calculations, the weighted average number of Shares and Savings Shares was 7,421,251,726 for the year ended December 31, 1998, 7,421,660,518 for the year ended December 31, 1999, 7,398,247,829 for the year ended December 31, 2000, 7,314,353,578 for the year ended December 31, 2001 and 7,297,953,685 for the year ended December 31, 2002. The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares above dividends paid on the Shares. Prior to 2001 the par value of the Savings Shares was Lit. 1,000 per share, while for 2001 and 2002, following the resolution of the extraordinary shareholders' meeting held on May 3, 2001 regarding the re-denomination of Telecom Italia share capital into Euro, the calculations take into account the new par value per share of 0.55. In addition, in accordance with U.S. GAAP, net income (loss) per Savings Share Basic was 0.2129, 0.2101, 0.4834, (0.5443) and 0.1213 in 1998, 1999, 2000 (historical and pro forma), 2001 and 2002, respectively, and net income (loss) per Savings Share ADS Basic, was 2.1288, 2.1015, 4.8340, (5.4431) and 1.2131 in 1998, 1999, 2000 (historical and pro forma), 2001 and 2002, respectively.
- (7) As a consequence of the introduction of the new Italian Accounting Principle for Income Taxes, beginning in 1999, deferred tax assets and liabilities are offset. Due to this change as of December 31, 1998 the

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- amount of current assets was reduced by 114 million, while total assets and liabilities were reduced by the same amount of 379 million.
- (8) Stockholders' equity under U.S. GAAP is calculated after elimination of minority interest. See Note 26 of Notes to Consolidated Financial Statements included elsewhere herein.
- (9) Gross Operating Profit was 11,821 million, 12,226 million, 13,118 million, 12,217 million, 13,619 million and 13,964 million in each of 1998, 1999, 2000 (historical), 2000 (pro forma), 2001 and 2002, respectively. Because Gross Operating Profit includes certain financial statement items and excludes others it is considered a non-GAAP financial measure as defined in Regulation G 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 Telecom Italia 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,					
	1998	1999	2000	2000 pro forma	2001	2002
	(millions of Euro)					
Operating income	4,744	6,433	6,805	6,441	6,674	7,381
Depreciation and Amortization	5,412	5,339	5,647	5,209	6,275	5,877
Other external charges:						
• Provision for bad debts	364	363	477	394	439	542
• Write-downs of fixed assets and intangibles	950	73	48	48	16	57
• Provision for risk	178	80	119	108	189	109
• Other provisions and operating charges	654	380	382	353	382	436
Other income (excluding operating grants, reimbursements for personnel costs and costs of external services rendered)	(481)	(442)	(360)	(336)	(356)	(438)
<b>Gross Operating Profit</b>	<b>11,821</b>	<b>12,226</b>	<b>13,118</b>	<b>12,217</b>	<b>13,619</b>	<b>13,964</b>

- (10) For purposes of calculating the debt ratio, net financial debt is calculated as follows:

	As of December 31,					
	1998	1999	2000	2000 pro forma	2001	2002
	(millions of Euro)					
Short-term debt, including current portion of long-term debt	4,824	4,969	15,136	14,745	9,114	5,089
Long-term debt	5,598	5,165	8,268	6,733	16,083	15,018
Cash and cash equivalents:						
• Bank and postal accounts	(582)	(668)	(1,299)	(1,281)	(757)	(1,251)
• Cash and valuables on hand	(3)	(9)	(5)	(4)	(5)	(4)
• Receivables for sales of securities		(5)	(1)	(1)	(3)	(55)
Marketable debt securities	(1,252)	(1,265)	(2,020)	(1,869)	(1,935)	(278)
Financial accounts receivable (included under Receivables and Other current assets )	(523)	(144)	(1,110)	(1,110)	(805)	(683)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net	112	95	59	20	250	282

<b>Net Financial Debt</b>	<b>8,174</b>	<b>8,138</b>	<b>19,028</b>	<b>17,233</b>	<b>21,942</b>	<b>18,118</b>
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- (11) Data include multiple lines for ISDN and exclude internal lines.
- (12) Data exclude internal lines.
- (13) Data refer to TACS and GSM services lines, including holders of Prepaid Cards.
- (14) Ratio is based on employees of Telecom Italia only.

**Table of Contents****Dividends**

Telecom Italia has normally paid annual cash dividends on its outstanding Shares and Savings Shares, although the determination of Telecom Italia's future dividend policy, and the amounts thereof, will depend upon a number of factors, including but not limited to the Company's earnings, financial condition and cash requirements, prospects and such other factors as may be deemed relevant at the time.

Telecom Italia's management has publicly stated that in relation to the Merger between Olivetti and Telecom Italia, New Telecom Italia's dividend policy is not expected to change. New Telecom Italia is expected to be able to distribute to the Company's present shareholders an overall dividend corresponding to the dividends presently paid to them.

The dividends per share and per savings share declared by Telecom Italia with respect to each of the last five fiscal years and the aggregate dividend paid in such years are shown below. Actual dividends paid are rounded to the nearest whole cent.

Year ended December, 31	Dividends on Shares			Dividends on Savings Shares		
	Euros per Share	U.S. dollars per	(millions of	Euros per Share	U.S. dollars per	(millions of
		Share(2)	euros)		Share(2)	euros)
1998(1)	0.1446	0.15	759.94	0.1549	0.17	335.61
1999(1)	0.3099(3)	0.29	1,638.10	0.3218(3)	0.30	688.58
2000(1)	0.3125	0.27	1,643.93	0.3238	0.28	664.84
2001	0.3125(4)	0.28	1,644.19	0.3237(4)	0.29	662.33
2002	0.1357(5)	0.13	713.47	0.1357(5)	0.13	273.11

- (1) Dividends for 1998, 1999 and 2000 were paid in lire. The lire amounts were translated into euros at the irrevocably-fixed rate of exchange of Lit.1,936.27 = 1.
- (2) Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates. See Rates of Exchange.
- (3) The per share amount paid with respect to the fiscal year ended December 31, 1999 includes the distribution to all shareholders of the dividends payable on 26,046,820 Savings Shares held in treasury on the date the dividend was paid. A total of approximately 3.12 million was also distributed from the statutory reserve in order to round up such per share amounts.
- (4) Approved at the Annual Meeting of Shareholders held on May 7, 2002. Telecom Italia's dividend coupons for the year ended December 31, 2001 were clipped on May 20, 2002 and were payable from May 23, 2002. Dividends for the year ended December 31, 2001 were paid also utilizing reserves.
- (5) In order to ensure shareholders dividends commensurate with those paid out for 2001, in December 2002, reserves were distributed and paid corresponding to a dividend of 0.1357 per Share and a dividend of 0.1357 per Savings Share. Furthermore, the Shareholders' Meeting held on May 24, 2003 approved an additional dividend of 0.1768 per Share and 0.1878 per Savings Share, payable from income and capital reserves. Pursuant to Italian Stock Exchange rules, dividends on the Shares and the Savings Shares are payable from the fourth business day after the third Friday of each month, and in any case, at least four business days after the Annual Meeting of Shareholders approving the dividends. Telecom Italia's additional dividend coupons for the year ended December 31, 2002 were clipped on June 23, 2003, and are payable from June 26, 2003.

Payment of annual dividends is subject to approval by the holders of ordinary shares at the annual general shareholders' meeting, which must be convened within six months after the end of the financial year to which it relates. In addition, Article 21 of the Company's Bylaws gives the Board of Directors the power to approve the distribution of interim dividends. Pursuant to Italian law, the distribution may be approved after the final approval of the preceding year's financial statements, and the interim dividends may not exceed the lower of (i) the difference between

profits from the preceding fiscal year and amounts required to be attributed to legal and statutory reserves and (ii) available reserves. Once paid in compliance with applicable laws, shareholders cannot be required to repay interim dividends to the Company if the shareholders collected such dividends in good faith. Dividends are usually payable within 30 days of the general shareholders' meeting at which they are approved. Dividends not collected within five years from the date they become payable will be forfeited in favour of the Company.

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

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

Arrangements between Euroclear or Clearstream and Monte Titoli permit the shareholders to collect the dividends through Euroclear or Clearstream. Holders of American Depositary Receipts ( ADRs ) are entitled to receive payments in respect of dividends on the underlying Shares and Savings Shares, as the case may be, in accordance with the relevant Deposit Agreement. If profits are not fully distributed, additional reserves are created.

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

Pursuant to Italian law, in connection with the payment of dividends, participants of Monte Titoli are required to supply to the Italian tax authorities certain information concerning the identity of non-resident shareholders holding Shares or Savings Shares and resident shareholders holding Shares or Saving Shares in registered form provided that such resident shareholders have not exercised the option to receive dividends with the deduction of the withholding tax and to subsequently include such dividends in the annual income statement. Shareholders are required to provide their Italian tax identification number, if any, or alternatively, in the case of legal entities, their name, country of establishment and address, or in the case of individuals, their name, address and place and date of birth, or in the case of partnerships, the information required for legal entities and the information required for individuals with respect to one of their representatives.

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

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

### **BUSINESS**

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

The legal and commercial name of the Company is Telecom Italia S.p.A. The Company is incorporated as a joint stock company under the laws of Italy. The duration of the Company extends until December 31, 2050.

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On July 18, 1997, the Company's predecessor company was merged with and into STET Società Finanziaria Telefonica per Azioni ( STET ), its parent holding company, with STET as the surviving corporation. As of the effective date of the merger, STET changed its name to Telecom Italia S.p.A. In November 1997, the Ministry of the Treasury of the Republic of Italy (the Treasury ) completed the privatization of Telecom Italia selling substantially all of its stake in the Telecom Italia Group through a global offering, and a private sale to a stable group of shareholders. On May 21, 1999 Olivetti, through a tender offer, obtained control of the Telecom Italia Group when approximately 52.12% of Telecom Italia Shares were tendered to Olivetti. Through a series of transactions which started in July 2001, Olimpia acquired a 28.7% stake in Olivetti which resulted in the replacement of the then Board of Directors. On December 9, 2002 the Treasury sold all its remaining stake in the Company's ordinary and savings share capital. More recently Hopa, the merchant bank led by Emilio Gnutti which participated in the 1999 take-over of Olivetti, gained a 16% stake in Olimpia, leading to a proportional reduction of the other shareholders. Please see Significant Developments during 2002 The Pirelli-Olimpia Transaction .

The registered offices of Telecom Italia is at Piazza degli Affari 2, 20123 Milan, Italy. The corporate headquarters and the principal executive offices of Telecom Italia are located at Corso d Italia 41, 00198 Rome, Italy, the telephone number is +39 06 3688 -1.

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### **Introduction**

At the end of 2002, the Telecom Italia Group was one of the world's largest fixed telecommunications operators, with approximately 27.1 million subscriber fixed-lines installed (including ISDN equivalent lines). Through its subsidiary TIM, the Telecom Italia Group was also the largest mobile telecommunications operator in Italy and one of the largest in the world, with approximately 39.1 million mobile lines (which includes 31.5 million proportionate lines). The Telecom Italia Group also had 6.2 million mobile lines (2.2 million proportionate lines) through companies indirectly owned through Telecom Italia International. In Italy TIM is one of three operators with the right to provide GSM digital mobile telecommunications services and one of three operators with the right to provide DCS 1800 digital mobile telecommunications services (the fourth operator, Blu, was acquired in October 2002 and merged into TIM in December 2002). TIM is one of five entities which have acquired a UMTS license to provide third generation mobile services in Italy.

The Telecom Italia Group also provides leased lines and data communications services. Through SEAT, the Telecom Italia Group is a leading provider of Internet and directory publishing services, although Telecom Italia has recently agreed to sell the directory publishing business of SEAT. The sale is subject to the satisfaction of certain conditions. Please see "Recent Developments SEAT Spin-off and Proposed Sale". Other activities of the Telecom Italia Group include the provision of IT software and services.

The Telecom Italia Group's international portfolio of subsidiaries and investments includes fixed and mobile telecommunications companies which operate mainly in Latin America and certain countries in Europe.

### **Significant Developments during 2002**

#### ***The Pirelli-Olimpia Transaction.***

*The information contained herein on the Pirelli-Olimpia transaction 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.*

**Share Ownership.** On July 30, 2001, Pirelli S.p.A. (hereinafter "Pirelli") and Edizione Holding S.p.A. (hereinafter "Edizione") signed an agreement with Bell for the acquisition, through a company to be named, of Olivetti stock owned by Bell, representing about 23.3% of Olivetti's share capital. Edizione is the parent company of the Benetton group and is controlled by the Benetton family.

The agreement called for the acquisition of 1,552,662,120 ordinary shares and 68,409,125 warrants 2001-2002 on ordinary shares of Olivetti (hereinafter the "Olivetti Investment"), at a per unit price, respectively, equal to 4.175 and 1.0875, for a total price of 6,557 million, with a value date at August 31, 2001. The value date was to indicate that the price for the Olivetti Investment would be reduced if the payment was made before August 31, 2001 and increased if made after that date on the basis of the following formula: interest = total price x (1-month Euribor + 0.75%) x the number of days of early or delayed payment / 360.

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The purchase transaction was subject to receipt of the necessary authorizations and in particular from the EU Commission. This authorization was received on September 20, 2001.

On August 3, 2001, Pirelli (80 percent) and Edizione Finance International S.p.A. (20 percent a wholly-owned company of Edizione), set up Olimpia, the company designated for the acquisition of the aforementioned Olivetti Investment.

On August 9, 2001, Kallithea S.p.A. (a subsidiary of Pirelli S.p.A.) sold 147,337,880 Olivetti ordinary shares (equal to about 2.02% of Olivetti's share capital) to Olimpia for a price per share of 4.193, for a total of approximately 618 million. Pirelli Finance Luxembourg S.A. (a subsidiary of Pirelli S.p.A.) and Edizione sold a total of 265,302,250 Olivetti ordinary shares (equal to about 3.64% of Olivetti's share capital) to Olimpia at a total price of approximately 576 million.

On September 19, 2001, an agreement was signed among the majority shareholders of Bell, Pirelli, Edizione and Olimpia which called for a commitment by the majority shareholders of Bell to ensure that the latter, at the same time payment was made by Olimpia for the purchase of the Olivetti Investment, subscribed to bonds issued by Olimpia itself, with the following features: 6-year bonds for an amount of approximately 1,033 million, repayable at maturity, unless the bonds are redeemed in advance by the bondholder, convertible into 263,500,000 Olivetti shares in a ratio of one share for every bond with a face value of 3.92, bearing an annual fixed rate of interest of 1.5%, payable in cash at maturity or at the date of early redemption.

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The agreement also called for the transfer of the Olivetti Investment in two tranches, the first for 552,000,000 Olivetti shares to be carried out on September 27, 2001 and the second for the remaining shares and warrants by October 12, 2001.

In execution of the above agreement, on September 27, 2001, 552,000,000 Olivetti shares were transferred from Bell to Olimpia (for an equivalent amount of 2,315 million), while on October 5, 2001, the remaining 1,000,662,120 Olivetti shares and 68,409,125 warrants were transferred from Bell to Olimpia (for an equivalent amount of 4,199 million and 74 million, respectively). On the same date, October 5, 2001, Bell subscribed to the Olimpia Bonds.

Under the agreements on July 30, 2001, Pirelli and Edizione agreed to purchase a further 54 million Olivetti shares, held originally by Banca di Roma S.p.A., for a price of 225 million, corresponding to a price per share of 4.175. Based on these understandings, on October 31, 2001, with the value date and delivery of the stock on November 2, 2001, Olimpia purchased these shares. This resulted in a holding of approximately 27.7% of the share capital of Olivetti.

On November 20, 2001, in order to hedge the risk on the value of the Olivetti shares to be delivered to the holders of the Olimpia Bonds, Olimpia entered into a forward purchase agreement with UniCredit Banca Mobiliare S.p.A. and Caboto IntesaBci S.p.A. (ex-Caboto Holding Sim S.p.A.), for 263,500,000 Olivetti shares at a price equal to the average purchase price of approximately 1.37 per Olivetti share plus a premium equal to approximately 32% of the average purchase price. Settlement can be made through the physical delivery of the shares against payment of the agreed price or payment of the differentials compared to the market price.

On November 23, 2001, after a capital increase voted by the Board of Directors of Olivetti on October 13, 2001, Olimpia, by exercising its option rights subscribed to 504,825,563 Olivetti shares (for a price of approximately 505 million) and 504,825,562 Olivetti 1.5% 2001-2010 convertible bonds with a premium at redemption (for a price of approximately 505 million).

On December 19, 2002, Olimpia made a proposal to the holders of the Olimpia Bonds to retire them in exchange for either Olivetti shares (as provided under the existing terms of the Olimpia Bonds) or, alternatively, a combination of Olivetti shares and the aforementioned Olivetti 2001-2010 1.5% bonds convertible into Olivetti shares (Olivetti Bonds). On December 19, 2002, Hopa S.p.A. (Hopa) and two companies that Hopa has advised and that are controlled by it, Holinvest S.p.A. (Holinvest) and G.P.P. International S.A., accepted Olimpia's proposal for retirement of the total of 262,533,449 Olimpia Bonds held by them by delivery of a total of (i) 98,975,110 Olivetti shares (representing approximately 1.12% of the 8,845,313,805 Olivetti shares reported to be outstanding on December 31, 2002) effective in January 2003 and (ii) 163,558,339 Olivetti Bonds effective in June 2003.

Also on December 19, 2002, Pirelli, Edizione, UniCredito Italiano S.p.A. (Unicredito) and IntesaBci S.p.A. (IntesaBCI) (collectively, the Former Olimpia Shareholders), Olimpia and Hopa (collectively with the Former Shareholders and Olimpia, the Parties) executed a term sheet (the Hopa Term Sheet). Pursuant to the Hopa Term Sheet, the Parties agreed that, subject to certain terms and conditions, Holy S.r.l. (Holy), a wholly-owned subsidiary of Hopa, would be merged into Olimpia (the Holy Merger). As of the effective date of the Holy Merger, Holy shall own: (i) 163,558,339 million Olivetti Bonds and 99,941,661 Olivetti shares for a total book value of 476,935,000; (ii) a 19.999% equity stake in the capital stock of Holinvest, for a total book value of 385.4 million; (iii) net cash of 98.8 million, plus any dividends for the 98,975,110 Olivetti shares possibly distributed by Olivetti during the period between the date of the Hopa Term Sheet and the effective date of the Holy Merger.

Pursuant to the subsequent agreement signed by the Parties on February 21, 2003 (the Hopa Agreement), the Holy Merger took place on May 9, 2003. As a result of the Holy Merger and the net effect of the early redemption of Olimpia's 1.5% 2001-2007 bonds, Olimpia's holding in Olivetti

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increased to 2,252,094,364 shares, equal to a 28.55 stake in Olivetti's share capital of the same date. As of May 9, 2003, Olimpia also holds 504,825,562 Olivetti 1.5% 2001-2010 convertible bonds with a premium at redemption and 68,409,125 Olivetti 2001-2002 warrants on ordinary shares.

As of the date of this Annual Report, the share capital of Olimpia is fully paid and is equal to 1,562,596,150, consisting of 1,562,596,150 shares of par value 1 each.

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(1) Its current name is Banca Intesa S.p.A. .

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Following the Holy Merger, the share capital of Olimpia is held by Pirelli, Edizione, UCI, IntesaBci and Hopa in the following respective proportions: 50.4%, 16.8%, 8.4%, 8.4% and 16%.

As a result of the Merger, Olimpia's shareholding in New Telecom Italia will be diluted to between 9.94% and 13.27%, depending on certain assumptions, from its current holding in Olivetti of 28.55%. See Recent Developments.

### ***Shareholders' Agreements***

There are shareholders' agreements among Olimpia's shareholders.

In particular, shareholders' agreements were entered into between Pirelli and Edizione 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 and UniCredito on September 14, 2001, amended on September 26, 2001 and October 24, 2001 (hereinafter Agreements with the Banks).

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.

The Agreements and the Agreements with the Banks deal with the nomination of the Board of Directors of Olimpia, Olivetti, Telecom Italia, TIM and SEAT. They identify the key issues on which the board resolutions of Olimpia, Olivetti, Telecom Italia, TIM and SEAT 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, Telecom Italia, TIM and SEAT are set forth below. In connection with the composition of the Boards of Directors of Olivetti, Telecom Italia, TIM and SEAT, 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;

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- 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 .

CONSOB in its resolution dated October 30, 2001, which dealt with the matter of the authorization for the publication of the Olivetti prospectus for the offer of options on Olivetti ordinary shares and Olivetti 2001-2010 bonds, asked that the above prospectus indicate, based on CONSOB's evaluation, that de facto control of Olivetti is held by Olimpia and Olimpia is subject to the sole control of Pirelli. CONSOB explained the reasons why this supplementary information was requested in the communication published in the CONSOB Informa Newsletter dated November 5, 2001.

Pirelli did not agree with the reasons expressed by CONSOB and on December 6, 2001 filed a request to review the matter so that the questions surrounding the issue could be reexamined and the comments expressed about Olimpia's control over Olivetti could be revised. On January 8, 2002, under ruling No. RM/2001124, CONSOB gave its decision not agreeing with the request to review the matter of qualifying the holdings between Pirelli and Olimpia and between Olimpia and Olivetti.

Since the rulings were adverse, Olivetti, Pirelli and Olimpia filed an appeal with the TAR of Lazio to obtain their cancellation. The TAR of Lazio, in a ruling released on February 25, 2002, ruled favorably on the appeal, canceling the contested CONSOB rulings.

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The Hopa Agreement provides that, from the effective date of the Holy Merger, Hopa and the Former Olimpia Shareholders are bound by an agreement governing their relationship as shareholders of Olimpia (the Expanded Olimpia Shareholders Agreement).

Under the Expanded Olimpia Shareholders Agreement, 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, 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 shares at an Extraordinary Shareholders Meeting of Olivetti, (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 S.p.A. (Holinvest), a company jointly owned by Hopa (80.001%) and Olimpia (19.999%). 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 Hopa Agreement) and Olimpia will receive its proportional share of Holinvest's assets and liabilities (determined in accordance with the Hopa Agreement). Except under certain extraordinary circumstances (including the failure of Olimpia to hold at least 25% of Olivetti's share capital or to maintain a debt to equity ratio of 1:1 after a specified cure period), no such partial demerger transactions may not be implemented prior to the third anniversary of the Holy Merger.

Hopa is granted certain co-sale rights in the event Pirelli reduces its equity interest in Olimpia.

Hopa, Holy, 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 Hopa Term Sheet, (ii) in the case of Edizione, Unicredito and Intesa BCI, 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 Expanded Olimpia Shareholders Agreement.

The Expanded Olimpia Shareholders Agreement will have a three-year term as from the Holy Merger, subject to extension by mutual agreement of the parties thereto. If the Expanded Olimpia Shareholders Agreement is not renewed, the partial demerger transactions will occur and Hopa will receive a premium of at least 0.35 per Olivetti share (or financial instrument).

The Holinvest Shareholders Agreement will have a three-year term, subject to automatic extension if and to the extent the Expanded Olimpia Shareholders Agreement is extended.

The Parties have not sent any notification concerning the possible effects of the Merger on the Agreements, the Agreements with the Banks and the Hopa Agreement.

***Updated Business Plan.***

On February 14, 2002, Telecom Italia announced its 2002-2004 Industrial Plan (the Industrial Plan ) and established its priorities for 2002. The main objectives were to:

- Strengthen its competitive position;
- Improve cost efficiency; and
- Strengthen the Telecom Italia Group s financial structure.

The Telecom Italia Group has sought to strengthen its competitive position in its core domestic market through the introduction of new products and services in its main business areas:

- In *Domestic Wireline*, a new brand and a new range of services for broadband Internet (Alice) was launched, reaching, at the end of 2002, a customer base of 850,000 broadband accesses. New voice packages and innovative integrated solutions for business clients were also introduced;

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- In *Mobile*, a new offering of multimedia services (messaging and videostreaming) and voice portals was developed together with the launching of specialized packages for business; and
- In *Internet & Media*, the directories product range was renewed, a new broadband portal was launched and the programs list of La7 (the Internet and Media business unit television station) was redesigned.

At December 31, 2002, the Telecom Italia Group had achieved 80% of the 2002-2004 announced target of cost reductions of 2 billion through the reduction of both operating expenses and capital expenditures.

With respect to strengthening Telecom Italia Group's financial structure, consolidated net financial debt (see Note 10 to Selected Financial and Statistical Information ) of 18.1 billion as of December 31, 2002, meant that the Telecom Italia Group had fully achieved its target of 18.3 billion established under the Industrial Plan notwithstanding payment of 1.7 billion of dividends paid in advance in December 2002. This level of net financial debt was reached in large part with proceeds from the asset disposal program totaling 5.2 billion from September 2001 to December 2002, which included in 2002 assets such as Auna, Telekom Austria, Mobilkom Austria, Bouygues Decaux Telecom, real estate assets sold in the context of the Tiglio Project (see below Description of Property Tiglio Project ) and other smaller assets. As a result of the Merger, New Telecom Italia's level of indebtedness will increase significantly. See Item 3. Key Information Risk Factors Risk Factors Relating to the Merger New Telecom Italia's total net financial debt will increase if the Merger of Telecom Italia and Olivetti is successful and Item 8. Financial Information Condensed Consolidated Pro Forma Financial Data .

The Telecom Italia Group's Industrial Plan establishes certain financial targets which the Telecom Italia Group has confirmed also apply to the 2003-2005 period and take into account the Merger. These targets are focused on:

- Innovation;
- Leveraging its leadership in its core Italian domestic market;
- Launching new value added services; and
- Leveraging core capabilities to create new opportunities.

The financial targets (based on Italian GAAP) include:

	<b>Objectives of New Telecom Italia</b>	
	<b>on a consolidated basis CAGR(1)</b>	
	<b>2002-2005</b>	
Operating revenues	4	4.5%
Gross operating profit	5	5.5%
Operating income	8	8.5%
Net financial debt ( in billions)		34.3(2)

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- (1) Compound average growth rate.
  - (2) At December 31, 2004.

*Please see Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act 1995 at the beginning of this Annual Report for a discussion of factors which could cause New Telecom Italia's actual results to differ materially from the targets discussed above.*

***Reorganization.***

During 2002, the process of reorganizing the Telecom Italia Group's corporate structure continued.

The following new Functions were introduced and remain in place: Latin America Operations and Foreign Holdings, office of the General Counsel and Brand Enrichment.

Some institutionalized meetings such as a Purchasing Committee, which coordinates the purchasing process of the Telecom Italia Group, and the Network Development Committee, which is mandated to optimize the integration of wireline and mobile networks by controlling innovation and technological development, were added to the existing committees formed last year. They included the Business Reviews Committees, which monitor result, plans and projects of each Business Unit monthly, the Investments Committee which approves the

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major investments of the Telecom Italia Group, and the International Steering Committee, which defines the guidelines of the management of all the foreign holdings of the Telecom Italia Group.

As part of the reorganization, the Business Units underwent some further changes in 2002 and, in early 2003 the Telecom Italia Group further reorganized certain of its Business Units. See Item 5. Operating and Financial Review and Prospects Results of Operations General .

## **Disposition and Acquisition of Certain Equity Investments**

### ***Dispositions.***

***Sale of Real Estate Assets.*** On June 20, 2003, the Telecom Italia Group announced that it reached an agreement with Lastra Holding B.V. a company within the Five Mounts Properties group (FMP), for the sale of certain Telecom Italia Group real estate assets. FMP is the real estate arm of BSG (the Beny Steinmetz Group), which is owned and managed by the Geneva based Beny Steinmetz family trusts and foundation.

The value of the agreement, which is expected to be finalized by the end of July 2003, is equal to approximately 355 million.

***Disposal of TI logistics company arm.*** On 27 January, 2003, Telecom Italia announced a transaction with TNT Logistics Italia whereby TNT takes over the stocking and distribution of fixed-line telephony products for customers and Telecom Italia Network assistance and installation. Among other factors, the transaction includes the transfer to TNT Logistics of certain assets of Telecom Italia comprising 6 central warehouses, 100 outlying warehouses and over 4.5 million telephone sets and telephone installation articles annually. Devised to promote a company focus on core business, the agreement became operational on March 5, 2003, upon receipt of clearance from the Italian Competition Authority and completion of union consultation procedures.

***Disposal of GLB Servicios Interativos.*** On January 15, 2003, Telecom Italia Finance disposed of its 28.57% stake held in GLB Servicios Interativos to TIM Brasil for a consideration of U.S.\$ 15 million. At the end of January 2003, TIM Brasil sold such investment to the Globo broadcasting group. As a result of such transaction, the Telecom Italia Group realized a net gain of 4 million (see Note 25 of Telecom Italia s consolidated financial statements included elsewhere in this Annual Report).

***Disposal of Telekom Srbija.*** On December 28, 2002, the Telecom Italia Group announced that it had agreed to sell to PTT Srbija its 29% holding in Telekom Srbija. The deal was finalized on February 20, 2003 and is expected to be completed by the end of June. PTT Srbija is to pay 195 million, of which 120 million is to be paid by June 2003, and the remainder to be settled in six half-yearly installments from January 2006. The shares disposed of shall be placed in escrow with an international bank until payment of the consideration is complete.

***Sale of stake in IMMSI.*** On November 22, 2002, Telecom Italia disposed of its 45% stake in IMMSI to Omnipartecipazioni S.p.A. for consideration of 69 million.

**Sale of Telekom Austria.** In November 2002, Telecom Italia International N.V. sold 75 million Telekom Austria A.G. shares previously held by the Telecom Italia Group. The placement price was 7.45 per share generating gross proceeds of 559 million and a loss of 135 million. After this transaction, the Telecom Italia Group's stake in Telekom Austria decreased from 29.78% to 14.78%.

**Sale of Telespazio.** In November 2002, Telecom Italia finalized its agreement with Finmeccanica for the sale of Telespazio. The total impact on the Telecom Italia Group was to reduce net financial debt by 239 million and a net gain for the Telecom Italia Group of 36 million.

**Project Tiglio.** On October 29, 2002, the transaction envisaged by the framework agreement between the Pirelli, Olivetti-Telecom Italia Groups and The Morgan Stanley Real Estate Funds was finalized. The transaction provided for 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 Telecom Italia Group transferred assets to Tiglio I and Tiglio II in various corporate forms. The market value of these assets was 1,360 million, of which 50 million was related to Seat Pagine Gialle and approximately 1,310 million to real estate from Telecom Italia. The transaction had a net impact on the consolidated statement of operations of approximately 150 million for the Telecom Italia Group.

**Partial sale of Stream stake.** On October 1, 2002, Telecom Italia signed an agreement with the News Corporation group, partner of Telecom Italia in Stream, and Vivendi Universal, current shareholder of Tele+, in order to allow Stream to purchase Tele+ and to subsequently create a single Italian pay-TV company on one platform. On April 30, 2003, following the approval by the competent authorities, the agreement with News Corporation announced in October 2002 was concluded. The new company arising from the integration between Stream and Tele+ has been named SKY ITALIA and Telecom Italia paid approximately 30 million for its stake in the transaction. The company is held by Telecom Italia (19.9%) and News Corporation (80.1%).

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**Solpart Participações.** On August 27, 2002, the Telecom Italia Group reached agreement with the other shareholders in Solpart Participações (which has indirect control of Brasil Telecom) to reduce its own stake in Solpart (from 37.29% to 19% of ordinary share capital) through a sale of 18.29% of the ordinary share capital to Timepart Participações and to Techold Participações. This reduction was carried out to overcome regulatory constraints which had prevented TIM's local subsidiaries from commencing commercial operations of its GSM regulatory 1800 service. As soon as legally possible, the Telecom Italia Group intends to return to its previous investment position. To this extent option rights have been granted to all parties.

**Sale of 9Telecom.** On August 26, 2002, the Telecom Italia Group completed, with the Louis Dreyfus Communication Networks group (LDCom), the sale of the Telecom Italia Group's investment in 9Telecom and the concurrent purchase of approximately 7% of LDCom by the Telecom Italia Group. The net impact on the Telecom Italia Group's result was a loss of 267 million. LDCom is part of the Louis Dreyfus group, a leading French holding company with international operations in telecommunications, energy, oil, maritime and agricultural commodities trading.

**Sale of Auna.** On August 1, 2002, the Telecom Italia Group concluded the sale of Auna to Endesa, Union Fenosa and Banco Santander Central Hispano. The transfer of the entire interest held by the Telecom Italia Group (26.89%) resulted in proceeds of 1,998 million and contributed 1,033 million to the consolidated net result of the Telecom Italia Group.

**Sale of Telemaco Immobiliare.** On August 1, 2002, Telecom Italia sold its 40% interest 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 64 million.

**Sale of Sogei.** On July 31, 2002, Finsiel disposed of its 100% stake in Sogei to the Ministry of Economy and Finance, which reduced Telecom Italia Group's net financial debt by 176 million.

**Sale of stake in Mobilkom Austria.** On June 28, 2002, TIM International N.V. (TIM International), a subsidiary of TIM, disposed of its 25% stake in 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 and resulting in a gain, which contributed 64 million to the consolidated net result of the Telecom Italia Group.

**Sale of stake in Bouygues Decaux Telecom.** In March 2002, the Telecom Italia 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 266 million to the consolidated net result of the Telecom Italia Group.

**Sale of stake in Lottomatica S.p.A.** In February 2002, Finsiel S.p.A. accepted the tender offer from Tyche S.p.A. (De Agostini group), for its 18.3% investment in Lottomatica S.p.A. Proceeds for Finsiel were 212 million resulting in a gain which contributed 73 million to the consolidated net result of the Telecom Italia Group.

**Acquisitions.**

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**Agreement for the acquisition of Megabeam.** In March 2003, Telecom Italia signed an agreement to acquire 100% of the share capital of Megabeam Italia S.p.A., the first Italian wireless Internet service provider, for consideration of 11.5 million. Megabeam's acquisition falls under Telecom Italia's broadband strategy, in which wireless technology, such as Wi-Fi, occupies a fundamental role in solutions for families and businesses. Megabeam offers Wi-Fi networking services in private sites and is experimenting the same Wi-Fi service in public places, for example, in significant Italian airports and a hotel chain using Wireless-Lan which operates on the 2,400-2,483.5 frequency. The execution of the agreement is subject to the approval of the Italian Antitrust Authority.

**Purchase of Blu S.p.A.** On October 7, 2002, TIM concluded its agreement to purchase Blu S.p.A. (the fourth mobile operator) from its shareholders. Blu S.p.A. was merged with TIM S.p.A. becoming effective on December 23, 2002. The final purchase price was 84 million.

**Acquisition of the assets of the Pagine Gialle directories.** On September 11, 2002, the Telecom Italia Group reached an agreement with Pagine Italia S.p.A. for the acquisition of the assets of the Pagine Gialle directories, the business segment represented principally by the so-called pocket pages with about 60,000 advertisers. The transaction involves the payment of 214 million Seat Pagine Gialle ordinary shares held by the

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Telecom Italia Group, corresponding to 1.9% of the Seat Pagine Gialle ordinary share capital. The execution of this transaction is subject to the approval of the Italian Antitrust Authority. After the observations formulated by the Italian Antitrust Authority during the inquiry period, on January 16, 2003, Telecom Italia and Pagine Italia S.p.A. agreed to formally withdraw the announcement about the acquisition of the Pagine Utili business segment. The parties further agreed to extend the contract period in order to be able to renegotiate certain aspects of the transaction so that it can eventually be re-submitted to the Antitrust Authority.

**Purchase of stakes in EPIClink.** On August 2, 2002, Telecom Italia purchased 86% of EPIClink S.p.A. for a price of 60.2 million. The shares were sold by Edisontel S.p.A. (30.3%), Pirelli (25.3%), IntesaBci (20%), E\_voluzione (8%) and Camozzi Holding (2.4%). EPIClink specialized in outsourcing services in Information and Communication Technology (ITC) for small and medium-size businesses. After this transaction, EPIClink's shareholder base is as follows: Telecom Italia, 86%, Pirelli, 5%, IntesaBci, 5%, Camozzi, 2% and E\_voluzione, 2%. Telecom Italia is committed to acquire the residual 14% stake for a total consideration of 10 million.

**Purchase of stakes in Stet Hellas.** In August 2002, TIM International purchased, from the Verizon Europe Holding II group, a 17.45% stake in the share capital of Stet Hellas for a price of 108 million. Together with its existing stake of 63.95%, TIM International now holds 81.40% of Stet Hellas's share capital. The transaction, which in effect makes TIM International the only industrial partner and strategic shareholder in the company, falls within the framework of the Telecom Italia Group's strategy to rationalize its international portfolio and consolidate its position in the Mediterranean Basin.

**Investment in Webegg S.p.A.** In June 2002, IT Telecom S.p.A. purchased the 50% investment in Webegg S.p.A. held by Olivetti for consideration of 57.5 million. As of December 31, 2002, Webegg S.p.A. is held by IT Telecom S.p.A. (69.8%) and Finsiel S.p.A. (30.2%). The Webegg group is an Internet Consulting company offering its own solutions as well as those deriving from partnerships with the world's leading Internet solutions companies.

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

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

**Early purchase of leased assets.** On January 27, 2003, procedures were completed for the early purchase of 12 property units (approximately 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 financial leasing contracts. The deal involved a total financial payment of approximately 369 million for the entire Telecom Italia Group. Certain of these assets were recently agreed to be sold. See Dispositions above.

## **Other Developments**

**Nortel Inversora S.A.** As per the decision of the Shareholders meeting of April 25, 2002, the Preferred A shares of Nortel Inversora S.A. have the right to vote (one vote per share), as a consequence of the default by Nortel Inversora in repaying the amortization plan related to those shares. Moreover, following Nortel Inversora first quarter 2002 results, Telecom Argentina Total Liabilities/Net Equity ratio exceeded 1.75, giving a voting right also to Preferred B shares, that was officially established during the Shareholders meeting of September 13, 2002. As a result Telecom Italia International and Telecom Italia voting rights have been respectively diluted from 17.5% to 11.86% and from 32.5% to 22.03%, respectively.

**Table of Contents****Recent Developments*****Merger of Telecom Italia into Olivetti***

On March 11, 2003, the Boards of Directors of Telecom Italia and Olivetti met to discuss the proposed merger of Telecom Italia with Olivetti (the Merger), in which Olivetti would be the surviving company, changing its name to Telecom Italia S.p.A. upon the Merger becoming effective. At that time each of the Telecom Italia Board and Olivetti Board agreed that the proposed Merger transaction should be explored, and established a proposed exchange ratio of seven Olivetti Ordinary Shares for each Telecom Italia Ordinary Share and seven Olivetti Savings Shares for each Telecom Italia Savings Share. Telecom Italia was advised by Lazard & Co. S.r.l. and Goldman Sachs SIM S.p.A. and Olivetti by JPMorgan Chase Bank.

The Telecom Italia Board and the Olivetti Board reconvened on April 15, 2003 and in each case concluded to proceed with the Merger and fixed the exchange ratios as described above. As a result, the plan of merger was agreed upon and the shareholders' meetings of both companies were convened and such shareholders' meetings were held on May 26, 2003 and May 24, 2003, on second and first call, respectively. At such meetings each of the Olivetti Ordinary shareholders and the Telecom Italia Shareholders approved the Merger transaction. The effectiveness of the Merger is conditioned upon the savings shares of New Telecom Italia being accepted for listing on the automated screen-based trading system (Mercato Telematico Azionario) of Borsa Italiana.

In addition to the Merger, the following transactions are also contemplated:

- Olivetti shareholders who either voted against the Merger or did not attend the shareholders' meeting benefit from a withdrawal right of 0.9984 per share (which is the mean of the daily official prices of the Olivetti shares in the six months preceding the date the merger resolution was adopted on May 26, 2003). Olivetti shareholders were entitled to such a right by law due to the change in the corporate objectives of New Telecom Italia. As of June 12, 2003, the end of the withdrawal right period, Olivetti shareholders had exercised such right with respect to 10,958,057 Shares representing 0.12% of the outstanding Ordinary Shares. Olivetti shareholders will receive an aggregate payment of 10,940,525 when the Merger becomes effective.
- Voluntary cash tender offers by Olivetti for a portion of the outstanding Telecom Italia Shares and Savings Shares, to be made in connection with the Merger and before its completion (although the cash tender offer is not being made to Savings Shareholders in the United States). The tender offers for the Telecom Italia Shares and the Telecom Italia Savings Shares will commence on June 23, 2003, with Olivetti tendering for approximately 17.3% of the shares in the respective classes.

In connection with financing the withdrawal right and the cash tender offers, Olivetti has entered into a term loan facility pursuant to which it will borrow up to 9 billion (assuming that the tender offers are fully subscribed) with respect to the above transactions. Any such payments for withdrawal rights and for the cash tender offers will only be made at the time the Merger becomes effective. See Item 8. Financial Information Condensed Consolidated Pro Forma Financial Data. The total amount of the facilities is 15.5 billion, with the remaining 6.5 billion as a senior revolving credit facility available to refinance Telecom Italia's existing 7.5 billion facility providing for working capital and general corporate purposes for Telecom Italia and, following the Merger, New Telecom Italia.

*The tender offer for the Savings Share is not being made, directly or indirectly, in or into the United States and is not capable of being accepted, directly or indirectly, in or from the United States.*

The Merger is expected to become effective in the first half of August 2003, subject to certain conditions required under Italian law. As a result of Olivetti being the surviving company (and changing its name to Telecom Italia S.p.A. ), New Telecom Italia will, on completion of the Merger, succeed to the 1934 Act registration of Telecom Italia and become subject to the foreign private issuer reporting requirements of the 1934 Act. It is the intention of New Telecom Italia to apply for a listing, and complete such listing, on the New York Stock Exchange by the time of the effectiveness of the Merger.

*Reasons for the Merger.*

- *Principal Business Rationales*

The purpose of the Merger is to merge the operations, assets and liabilities of Olivetti and Telecom Italia into a single company, a substantial majority of whose share capital and voting rights will be held by

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shareholders unaffiliated with Pirelli or Olimpia. The Telecom Italia Board believes that the Merger will produce a simplified, more transparent corporate, capital and financial and ownership structure, which will benefit the shareholders of both Telecom Italia and Olivetti. The principal benefits include the following:

- *Improved ownership structure: Majority ownership by shareholders unaffiliated with Pirelli or Olimpia.*

As a result of, and immediately after, the Merger, shareholders unaffiliated with Olivetti, Pirelli or Olimpia will see their proportionate ownership of New Telecom Italia's share capital increase substantially. Currently, Olivetti S.p.A. owns approximately 54.94% of the Telecom Italia Shares. The exact percentage of New Telecom Italia's share capital that shareholders unaffiliated with Pirelli or Olimpia will hold immediately after the Merger depends on a number of factors, such as:

- the number of Olivetti shares which may be issued upon conversion of Olivetti's outstanding convertible bonds or exercise of Olivetti's outstanding warrants (a portion of which are held by Olimpia and its affiliated entities);
- the number of Olivetti shares issued pursuant to the exercise of outstanding stock options held by officers of Olivetti (Telecom Italia has suspended the exercise of outstanding stock options until after the Merger becomes effective); and
- the number of Telecom Italia Shares and Savings Shares tendered in response to Olivetti's cash tender offer for a portion of Telecom Italia's Shares and Savings Shares.

As a result of the Merger it is expected that Olimpia will be the largest shareholder in New Telecom Italia. The exact percentage of Olimpia's interest in New Telecom Italia's share capital immediately after the Merger can not currently be determined and depends on the factors discussed above but is expected to be in a range of 9.94% to 13.27%.

The Telecom Italia Board believes that the expected new ownership structure will facilitate the market's valuation of New Telecom Italia based on New Telecom Italia's business, financial condition and prospects and eliminates any negative effect that Telecom Italia's current ownership structure may have on valuation. The Telecom Italia Board also believes that the absence of a controlling shareholder will produce a corresponding increase in the liquidity of the New Telecom Italia shares compared to the current liquidity of Telecom Italia Shares and that this has the potential to enhance market valuations of New Telecom Italia shares.

- *Improved corporate structure.*

The Merger will simplify and make more transparent the Telecom Italia Group's corporate structure. Instead of having Olivetti, an intermediate holding company with few operations of its own, between Olimpia and Olivetti's other shareholders on the one hand and Telecom Italia on the other, all of Olivetti's and Telecom Italia's respective operations will be combined in a single entity with a single Board of Directors and a single Board of Statutory Auditors. In New Telecom Italia, Olimpia, Olivetti's other shareholders and Telecom Italia's minority shareholders will have direct ownership interests. This, and the integration of Olivetti's and Telecom Italia's respective corporate support functions, is expected to simplify and improve the corporate governance, management and decision-making process of New Telecom Italia compared to the current situation.

- *Rationalized capital and financial structure.*

The Merger is intended to optimize financial and income flows within the New Telecom Italia Group through a more efficient management of the New Telecom Italia Group debt and more effective use of financial leverage. The Merger as a whole will also make it possible to attain a more efficient financial structure, with an increase in debt capital, which currently has a lower net cost than equity capital. It is also likely that these effects will lead to an improvement in the creditworthiness of New Telecom Italia, which, in turn, could lead to a more favorable rating and a reduction in the cost of future debt.

The Telecom Italia Board also believes that the Merger will produce a more unified approach to debt management (for example, with respect to extending maturities and co-ordinating with the needs of the businesses) than is currently the case for Olivetti and Telecom Italia on a stand-alone basis.

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### *SEAT Spin-off*

On April 1, 2003, the Board of Directors of SEAT approved the proposed proportional spin-off of substantially all of the Directories, Directory Assistance and Business Information business segments of SEAT into a newly incorporated company which will assume the current name of SEAT ( *New SEAT* ). Effective as of the date of spin-off, the corporate name of SEAT will be *Telecom Italia Media S.p.A.* (hereinafter referred to as *Telecom Italia Media* ). The spin-off plan was approved by the SEAT extraordinary shareholders' meeting held on May 9, 2003.

The spin-off plan provides for a spin-off on a proportional basis. The allocation of the shares of, respectively, *New SEAT* and *Telecom Italia Media*, is based on the net assets of each company as of December 31, 2002. Consequently, for every 40 ordinary (or savings, as applicable) shares currently owned, the present shareholders of SEAT will receive:

- 11 new ordinary (or savings, as applicable) shares of *Telecom Italia Media*, and
- 29 new ordinary (or savings, as applicable) shares of *New SEAT*.

The shares of both companies will be listed on the automated screen-based trading system (*Mercato Telematico Azionario*) of *Borsa Italiana*: the effectiveness of the spin-off is conditioned upon the shares of *New SEAT* being accepted for listing.

The spin-off plan contemplates the creation of two independent companies, each focused on its core businesses. It is SEAT management's view that SEAT operates in two broad market sectors that have increasingly developed separate and distinct characteristics in terms of strategy, operations and competitive landscape. The first sector is that of targeted advertising and telephone services, in which SEAT operates through its Directories, Directory Assistance and Business Information segments, providing answers to queries via printed, online and telephone products and services.

The second sector is that of traditional advertising and the Internet, in which SEAT operates through its Internet, TV and other business segments, primarily providing access and content services. In SEAT management's view, both sectors present interesting development prospects (including broadband access and digital TV).

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

The spin-off plan provides for the transfer to *New SEAT* of the following companies within the Directories, Directory Assistance and Business Information business segments of SEAT:

Directories: Directories Italia Seat Pagine Gialle S.p.A. division, *Annuari Italiani S.p.A.*, *Euredit S.A.*, TDL group, Euro Directory S.A.

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Directories Assistance: Directories Assistance Seat Pagine Gialle division, Telegate group, Telegate Holding GmbH, IMR S.r.l.  
Business Information: Consodata S.A., Consodata group Ltd (including Netcreations Inc., Pan-Adress).

The other companies and business segments will remain in SEAT, which, as noted above, will be known as Telecom Italia Media.

For a further discussion of these businesses, please see [Internet and Media](#).

The spin-off, subject to certain conditions of Italian law, is expected to become effective at the end of July 2003.

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

On June 10, 2003 Telecom Italia and a consortium of investors formed by BC Partners, CVC Capital Partners, Investitori Associati and Permira entered into a sale and purchase agreement for the sale of approximately 61.5% of the share capital of New SEAT which will be received by the Telecom Italia Group after the spin-off transaction creating New SEAT (including the shares resulting from the expected exercise of the J.P.Morgan Chase put option). The parties agreed on a sale price of 0.598 per New SEAT ordinary share, representing an enterprise value of approximately 5.65 billion.

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The completion of the sale will be subject to the proportional spin-off becoming effective, the admission to listing of New SEAT, that is expected to occur by the beginning of August, and the approval of the relevant anti-trust authorities. Telecom Italia will receive approximately 3.03 billion for its stake. The buyers will also assume the estimated 708 million of debt of New SEAT at the closing.

The transaction will allow New Telecom Italia to reduce its net financial debt by approximately 3.74 billion.

See also Item 8. Financial Information Condensed Consolidated Pro Forma Financial Data .

### ***Telecom Italia Hewlett-Packard deal.***

On February 21, 2003, Telecom Italia and Hewlett-Packard agreed to a five-year management services and outsourcing agreement worth a total of 225 million. The agreement became effective on April 16, 2003 following receipt of clearance from the Italian Antitrust Authority and completion of labour union consultation procedures. Under the agreement, Hewlett-Packard will supply asset management, help desk, maintenance and workstation management services to the Telecom Italia Group, while IT Telecom will manage the Hewlett-Packard's Italian operational activities in the SAP environment and house the systems in its Data Centers. The agreement also contemplated the sale by IT Telecom of the Desktop Management Services business (100%-owned by Telecom Italia) to the new Hewlett-Packard's entity HP DCS (Hewlett-Packard Distributed Computing Services).

### ***Restructuring of the Telecom Argentina group's debt obligations.***

On February 12, 2003, Telecom Argentina STET-France Telecom S.A. (controlled by Nortel Inversora) (Telecom Argentina) and its subsidiaries, Telecom Personal S.A. and Publicom S.A. announced their intention to launch a cash tender offer for a portion of their financial debt obligations and to make partial interest payments on their financial debt obligations. Having obtained any necessary authorizations, the offer started on April 16, 2003 and represents the beginning of the process to restructure the Telecom Argentina group's debt obligations.

In June 2003, Telecom Argentina and its subsidiaries Telecom Personal S.A. and Publicom S.A., pursuant to a tender offer, repurchased U.S.\$ 292 million principal amount of their financial debt obligations at a price of U.S.\$ 160.6 million (55% of the face value).

### ***Telecom Italia share buyback.***

Under the buyback plan authorized by the Ordinary Telecom Italia Shareholders Meeting of November 7, 2001, the Company in March 2002 began to buy-back treasury shares on the market according to the terms and in the manner established by existing laws and the above shareholders' resolution. During the period between January 1 and May 7, 2003, 8,662,500 savings shares were acquired at an average price of 4.73 per share, corresponding to an investment of 41 million, plus 915,000 ordinary shares at an average price of 6.83 per share, corresponding to a 6 million investment. The above authorization expired on May 7, 2003 and at such date, 54,309,500 savings shares had been acquired at an average price of 5.24 per share, corresponding to an investment of 285 million, plus 6,195,500 ordinary shares at an average price of 8.00 per share, corresponding to a 50 million investment. As a result of the merger of Telecom Italia with and into Olivetti, the Telecom Italia Ordinary

and Savings Shares treasury stock will be cancelled.

***Telecom Italia Group Results for the First Quarter Ended March 31, 2003.***

For a discussion of first quarter results for 2003 see Item 5. Operating and Financial Review and Prospects Recent Developments Telecom Italia Group Results for the First Quarter Ended March 31, 2003 compared to March 31, 2002 .

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**Overview of the Telecom Italia Group s Major Business Areas**

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

- 
- (1) Mobile South America.
  - (2) Previously included in the International Operations Business Unit.

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

		Domestic Wireline		South America	Internet and Media	IT Market	IT Group	Sub Total	Other activities and eliminations	Consolidated Total
		(1)	Mobile	(1)(2)		(3)	(3)		(4)	
(millions of Euro, except number of employees)										
Gross operating revenues	2002								(3,016)	
	2001								(2,487)	
	2001	17,022	10,867	1,409	1,991	912	1,215	33,416		30,400
		17,168	10,250	1,534	1,957	1,198	1,198	33,305	(2,710)	30,818
	2000 (pro forma)(5)	17,419	9,418	312	263	1,135	1,332	29,879		27,169
	2000	17,419	9,418	2,100	263	1,135	1,332	31,667	(2,756)	28,911
Gross operating profit(6)	2002				593				(327)	
	2001				444				(216)	
	2000 (pro forma)(5)	7,965	5,039	450		104	140	14,291		13,964
		7,750	4,760	527	(35)	166	188	13,835	(109)	13,619
		7,403	4,447	172		136	203	12,326		12,217
	2000	7,403	4,447	1,073	(35)	136	203	13,227	(109)	13,118
Operating income	2002						(21)		(1,095)	
	2001				232					
					31		22		(1,186)	
	2000 (pro forma)(5)	4,700	3,358	146		61		8,476		7,381
		4,361	3,136	187	(73)	123	(15)	7,860	(567)	6,674
		3,904	2,988	99		105		7,008		6,441
	2000	3,904	2,988	473	(73)	105	(15)	7,382	(577)	6,805
Capital expenditures	2002					30				
	2001				81	30				
					175					
	2000 (pro forma)(5)	2,462	1,715	216			158	4,662	180	4,842
		2,801	3,151	406	34	37	162	6,725	265	6,990
		2,710	4,206	68			159	7,214	161	7,375
	2000	2,710	4,206	592	34	37	159	7,738	161	7,899
Number of employees at the year end	2002									
	2001									
	2000 (pro forma)(5)	53,682	18,702	5,461	7,715	4,493	7,327	97,380	4,333	101,713
		57,895	16,721	5,746	9,264	6,441	6,844	102,911	7,045	109,956
		62,366	15,257	1,087	7,515	7,400	6,385	100,010	7,161	107,171
	2000	62,366	15,257	8,585	7,515	7,400	6,385	107,508	7,161	114,669

(1) The data relating to 2001 and 2000 have been reclassified and presented consistent with the 2002 presentation.

(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.

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- (3) In early 2002, the IT Services Business Unit was split into two distinct units: Information Technology Market and Information Technology Group. Beginning January 1, 2002, Saritel S.p.A. was consolidated in the Information Technology Group Operating Activity instead of the Domestic Wireline Business Unit.
- (4) The data presented include the operations of the Foreign Holdings Corporate Function and the Business Unit Satellite Services (the Telespazio group) which was disposed of during the 4th quarter of 2002 and consolidated in the statement of operations only for the first nine months of 2002.
- (5) The 2000 pro forma amounts give effect to the consolidation of the Nortel Inversora group using the equity method instead of the proportional consolidation method.
- (6) See Item 3. Key Information Selected Financial and Statistical Information Note 9 .

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

	Year ended December 31,		
	2000	2001	2002
<b>Subscription and Customers:</b>			
Subscriber fixed-lines at period-end (thousands)(1)	27,153	27,353	27,142
Subscriber fixed-line growth(%)	2.5	0.7	(0.8)
Subscriber fixed-lines per full-time equivalent employee at period-end(2)	409	448	496
ISDN equivalent lines at period-end (thousands)(3)	4,584	5,403	5,756
TIM lines at period-end (thousands)	21,601	23,946	25,302
TIM lines growth per annum(%)	16.6	10.9	5.7
Average revenue per mobile line per month( ) (4)	30.5	29.1	28.8
Cellular penetration at period-end (TIM lines per 100 inhabitants)(%)	37.5	41.6	43.9
Cellular market penetration at period-end (lines for the entire market per 100 inhabitants)(%)	73.3	89.0	95.0
<b>Retail Traffic(5):</b>			
Average minutes of use per fixed-line subscriber during period(6)	4,722	4,739	4,292
Of which:			
Local traffic during period (in average minutes)(7)	3,621	3,575	3,198
Long-distance traffic during period (domestic and international) (in average minutes)	1,101	1,163	1,094
Growth in international incoming and outgoing traffic in minutes(%) (8)	5.4	12.1	5.7
Total mobile outgoing traffic per month (millions of minutes)	1,569	1,795	1,960
<b>Internet and Media:</b>			
Directories (units)	474	477	477
Of which SEAT Pagine Gialle	304	304	304
Of which Thomson (TDL Infomedia Ltd.)	170	173	173
Page Views Virgilio (millions)	2,218	3,945	5,267
Active Users (at year-end, thousands)	1,656	1,804	2,226

- (1) Data include multiple lines for ISDN and exclude internal lines.
- (2) Ratio is based on employees of Telecom Italia only.
- (3) Data exclude internal lines.
- (4) Including Prepaid Customers revenues and excluding equipment sales and including non TIM customer traffic.
- (5) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls (including calls to mobile phones).
- (6) Includes total fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).
- (7) Including district and internet dial-up traffic.
- (8) Data include incoming and outgoing wholesale traffic and retail outgoing traffic.

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**Strategy**

***General***

Telecom Italia Group's strategic priorities include:

- consolidating its leadership in the domestic wireline market by increasing customer loyalty through innovative offers and stimulating the market for value added and broadband services, with special reference to ADSL technology; in the mobile market, to increase traffic volumes and develop value added services in line with user expectations (MMS, community videotelephony), in part through the introduction of UMTS technology; and, in the Internet and Media sector, to continue the development of broadband services and portals;
- expanding the Telecom Italia Group's presence abroad in markets where it can capitalize on its marketing and technological know-how: in the mobile business, in Latin America and especially in Brazil and, in the wireline business, through the development of the pan-European broadband network;
- continuing to manage the Telecom Italia Group according to rigorous criteria of efficiency, relying on synergies deriving from the organizational model based on so-called "professional families" and service centers, cost control systems, and the careful selection of investment projects, aimed primarily at fostering innovation and growth.

Industrial investments will be directed towards reinforcing the following strategy:

- focus on innovation;
- continuing leadership in the domestic market; and
- development of value added services.

The industrial investments planned for the three years 2003-2005 will be between 14 billion and 16 billion, more or less in line with the forecast for the three years 2002-2004. The breakdown by sector of activity is shown in the table below.

	<b>Approximate % of Industrial Investments</b>
Domestic Wireline	45%
Mobile	40%

Internet and Media	2%
Other	13%

### *Domestic Wireline*

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

In particular, the Telecom Italia Group intends to:

- maintain its domestic leadership in its core business (voice services, internet access, data transmission services for businesses, national and international wholesale services);
- consolidate its operational capabilities with the objective of offering best in class service levels to its customers and leverage opportunities to retain its client base by enhancing customer loyalty (through billing, CRM and customer contact);
- concentrate on developing value added services, both for corporate and residential customers, to sustain revenue and margin levels, building, in particular, on the increasing penetration of internet and broadband services, but also on innovation in voice services and terminals, equipped with new facilities, similar to mobile phone functions;
- run efficient operations and continue its cost-cutting program (personnel, real estate, general and administrative, network); and
- maintain competitive services and focus investment on enhancing network evolution and innovation (optical transport, IP services, etc.).

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

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### ***Mobile***

TIM's strategy is focused on maintaining its leadership in the wireless market, in particular:

- defending its share of the voice and SMS market;
- developing a new GPRS and UMTS Mobile Data generation;
- developing GSM services in Brazil and acquire leadership in the GSM Latin American market; and
- completing the start-up phase of some subsidiaries.

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

- focus on the customer, to be achieved through caring, segmentation of the offer, focus on high spending clients and leadership on customer acquisition;
- premium positioning, guaranteed by the development of a consistent on-net community, by providing a high quality of service, by the maintenance of a price premium and by avoiding handsets subsidies;
- technological innovation and leadership, characteristics associated with the TIM brand, to be maintained through: GPRS/UMTS development, launching innovative value added services, maintenance of high standards of quality for the Network and IT services and the progressive migration from a TDMA network to a GSM network for some controlled companies;
- excellence in human resources, through recruitment, development and retention of key human resources, analysis and selection of methods for increasing flexibility of resources and the management of internal innovation process; and
- profitability and cash flow generation, through maintenance of high efficiency levels on its network, IT and back-office, investments and working capital control and a prudent capital allocation policy.

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

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### **The Organizational Structure**

The following diagram highlights the organizational structure of the Telecom Italia Group as of June 16, 2003.

- 
- (1) Consortium company which carries out Internal Auditing activities in the Telecom Italia Group and Olivetti.
  - (2) Beginning April 1, 2003, the company Telecom Italia Lab, which was the Research & Development function, was merged by incorporation into Telecom Italia S.p.A. At the same time, this function took the name of Telecom Italia Lab.
  - (3) Latin America Operations coordinates the activities of the Telecom Italia Group in Latin America. Beginning February 2003, Latin America Operations report directly to the CEO Carlo Buora for wireline TLC and to the head of the Mobile Business Unit Mobile for Mobile TLC.
  - (4) As of June 16, 2003, Domestic Wireline took the name Wireline. At the same time, Giuseppe Sala was appointed General Manager directly reporting to the Telecom Italia CEO and Head of Wireline Riccardo Ruggiero. Beginning July 1, 2003, Luca Luciani is appointed Assistant of the Chairman.
  - (5) As of June 18, 2003 the new central function, International Affairs, was established which reports directly to the CEO Carlo Buora. On the same date the central Function Foreign Holdings merged into International Affairs and the International Steering Committee was disbanded. Head of International Affairs is Giampaolo Zambelletti.

Telecom Italia Group's organizational structure includes:

- Central Functions, which are responsible for the Telecom Italia Group's operations;
- Operational Activities, which are responsible for the synergies of Intra-Group activities and for the supply of common services; and
- Business Units, which are responsible for business development and managing operations for the external markets.

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

The Domestic Wireline Business Unit accounted for gross operating revenues of 17,022 million in 2002, 17,168 million in 2001 and 17,419 million in 2000. The organizational structure of the Domestic Wireline Business Unit as of December 31, 2002 was as follows:

(1) On December 31, 2002 International Wholesale Services was moved to Telecom Italia Sparkle.

As a result of the 2002 Reorganization, Saritel (a company specializing in Internet operations and value added services for fixed and mobile telecommunications such as Internet hosting, e-business solutions, on-line services and vocal recognition software) was moved to the Information Technology Group Operating Activity and Intelcom San Marino S.p.A. is now included as part of the Domestic Wireline Business Unit.

Domestic Wireline operates on a national level as the consolidated market leader in wireline telephone and data service and call centers, for consumers and other operators. On an international level, Domestic Wireline develops fiber optic networks for wholesale customers, mainly in Europe and Latin America.

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

	As of December 31,				
	1998	1999	2000	2001	2002
Subscriber fixed-lines at period-end (thousands)(1)	25,986	26,502	27,153	27,353	27,142
Subscriber fixed-line growth %(2)	1.1	2.0	2.5	0.7	(0.8)
Subscriber fixed-lines per full time equivalent employee at period-end(3)	332	354	409	448	496
ISDN equivalent lines at period-end (thousands)(4)	1,735	3,049	4,584	5,403	5,756

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

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

(3) Ratios are based on employees of Telecom Italia.

(4) Excluding internal lines.

At December 31, 2002, Domestic Wireline had approximately 27.1 million fixed subscriber lines, including approximately 18.9 million residential lines (including multiple lines for ISDN), approximately 8.0 million business lines (including multiple lines for ISDN), and approximately 230,000 public telephones lines (including ISDN equivalent lines). Italy has 48 subscriber lines per 100 inhabitants.

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At December 31, 2002, Domestic Wireline had approximately 5.8 million ISDN equivalent lines. The number of subscribers is expected to continue increasing although marketing focus is on ADSL lines which

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provide greater speed on the Internet. This is evidenced by significant growth in broadband access: at December 31, 2002, Domestic Wireline had contracts for approximately 850,000 broadband points of access (390,000 at the end of 2001) with approximately 220,000 wholesale points of access (143,000 at the end of 2001) and 630,000 retail market points of access (247,000 at the end of 2001). The growth is attributable to the success of various tariff structures geared to the Mass Market, and to business customers. At the end of 2002 Domestic Wireline had contracts for 390,000 Mass Market and Soho broadband access and 240,000 business broadband access.

At December 31, 2002, 62% of the public telephones in service were equipped with phone card readers. The density of public telephones in Italy is among the highest in the world, with one public telephone per square kilometer and approximately 4.2 public telephones for every 1000 inhabitants. During 2002, ISDN technology was introduced to approximately 45% of public telephones in order to support the launch of innovative services (104,635 basic ISDN equivalent lines in public telephony architecture; unlike residential and business ISDN lines, each ISDN public telephone line is linked to only one phone).

**Domestic Traffic**

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

	Year ended December 31,				
	1998	1999	2000	2001	2002
Average minutes of use per fixed line subscriber during period(1)	4,259	4,298	4,722	4,739	4,292
of which:					
Local traffic during period (in average minutes)(2)	2,628	2,767	3,621	3,575	3,198
Long distance traffic during period (domestic and international) (in average minutes)	1,631	1,531	1,101	1,163	1,094

- (1) Includes total fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to mobile networks); excludes traffic for special services.
- (2) Data for the years 1998 and 1999 include internet dial-up traffic and exclude district traffic which is accounted for in long distance traffic; data for the years 2000, 2001 and 2002 include district and internet dial-up traffic.

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

Traffic packages mainly consist of Teleconomy offers for Mass Market and Small office/home office (Soho) customers. Further customized offers are provided to business customers.

Teleconomy was launched as a brand in June 2000. The Teleconomy offers include tariff packages with targeted discounts and customized programs for residential and business customers. Teleconomy offers were revised in 2002 to further support retention efforts and to win back

customers.

Penetration of Teleonomy offers and ADSL lines are key strategic priorities for Domestic Wireline.

New Teleonomy offers, which Domestic Wireline introduced in 2002, include:

- for Mass Market customers: Teleonomy Forfait (no payment for national calls, excluded calls to mobile, for an additional fee) and Teleonomy Zero (fixed price for any national calls, excluded calls to mobile, for an additional fee); and
- for Business customers: new offers as Teleonomy Professional (which provides a volume of no payment traffic minutes for an additional fee) and Teleonomy Zero Business (similar to Teleonomy Zero).

For Business customers Domestic Wireline has introduced specific offers for companies with high volumes of traffic, allowing companies to choose among a variety of price plans. In addition, Domestic Wireline has launched in two steps *Ricomincio date*, a standard offer for residential (February 2002) and business customers (second half 2002) which provide an amount of free national traffic minutes with no additional fees.

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**Domestic Tariff Rebalancing.** The Telecom Italia Group commenced rebalancing its tariffs in 1991 and made various adjustments until 1997. Since December 1998, the National Regulatory Authority has been responsible for tariff regulation. On July 28, 1999, the National Regulatory Authority introduced a price cap mechanism designed to promote productivity and efficiency for the Telecom Italia Group, as the incumbent operator in markets with a low level of competition. The price cap was applied until December 31, 2002 to a whole basket of public voice telephone services composed of activation fees, basic charges, long distance and international tariffs.

The table below sets forth, for the periods indicated, initial connection fees, bimonthly subscription fees and the average cost of a three-minute local call and a three-minute peak rate call for the four different domestic long distance regions (exclusive of value-added tax) and the percentage change since 1998.

	Year ended December 31,					Percentage
						change since
	1998(1)	1999(1)	2000(1)	2001(1)	2002	1998(2)
			( )			(%)
Connection fee	103.29	103.29	103.29	103.29	100.00	-3.2
Bimonthly subscription fee:(3)						
Residential subscribers	16.84	18.59	19.32	21.38	24.28	44.2
Business subscribers	26.24	27.27	27.27	29.23	30.40	15.9
Basic ISDN connection fee	103.29	103.29	103.29	103.29	100.00	-3.2
Basic ISDN bimonthly subscription fee:						
Residential subscribers	33.05	33.05	33.05	33.05	33.05	0.0
Business subscribers	51.65	51.65	51.65	51.65	54.74	6.0
Three minute local call:						
Standard	0.0930	0.0992	0.0992	0.0992	0.0992	6.7
Higher(4)	0.0930	0.0992	0.0992	0.0992	0.0992	6.7
Three minute call in the same District at higher rate(5)(6)		0.1312	0.1312	0.0992	0.0992	
Three minute domestic long distance call at higher rate(7)(8):						
Region 1	0.2231	0.2231	0.2231	0.2205	0.2205	-1.2
Region 2	0.3610	0.3610	0.3610	0.3522	0.3522	-2.4
Region 3	0.5903	0.4772	0.4065	0.3522	0.3522	-40.3
Region 4	0.5903	0.4772	0.4065	0.3522	0.3522	-40.3

- (1) The fees and costs for 1998, 1999, 2000 and 2001 were in Lire. The lire amounts have been converted to euros at the irrevocably fixed exchange rate of Lit. 1,936.27 = 1.
- (2) Data are not adjusted for inflation.
- (3) In February 2001, the residential and business subscription fees increased to 20.45 and 27.89, respectively.
- (4) For the year 1999, the introduction of per second billing resulted in an increase in the cost of a three minute call, while leaving unchanged the overall spending of the customers.
- (5) Long distance calls within the same area code. This tariff was introduced in November 1999.
- (6) In February 2001, district rates for three minute calls decreased by 24.4%.
- (7) In February 2001, the week-end flat tariff ( 0.1431 for three minutes call) was introduced.
- (8) Since July 2001, Region 3 charge (applied to calls over 30 Km) was combined with the former Region 2 charge (applied to calls between 15 and 30 km), with the result that current Region 2 tariffs apply to all long distance calls over 15 km.

**International Traffic**

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

	Year ended December 31,				
	1998	1999	2000	2001	2002
Total outgoing traffic (millions of minutes)	2,339	2,390	2,706	3,015	3,405
Growth in outgoing traffic (%) <sup>(1)</sup>	5.89	2.18	13.2	11.4	13.0
Total incoming traffic (millions of minutes)	2,950	3,419	3,415	3,845	3,842
Growth in incoming traffic (%) <sup>(1)</sup>	12.64	15.90	-0.1	12.6	-0.1

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

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Growth in the volume of international traffic from 1998 to 2002 has resulted mainly from macroeconomic factors such as growth in foreign demand and import/export activities, immigrants and new subscribers. The decline in gross operating revenues from 2001 to 2002 has resulted mainly from the impact of continuing tariff reductions and increasing competition. International traffic is mostly concentrated in communications with Germany, France, Romania, United Kingdom, Switzerland, United States, Spain and Albania, which together accounted for approximately 52% of toll minutes of outgoing international traffic in 2002.

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

In 2002, the traffic directed to the fixed network increased by 11%, growth that was offset by a decrease in the traffic directed to the mobile network. The traffic directed to the mobile network decreased because the component of the traffic deemed to be incoming registered a 61% decline due to the introduction of a surcharge for calls directed to the mobile network with a consequent increase in the price of the international calling cards.

**International Tariffs.** International calls utilize the same per second billing as domestic calls, with the price per minute depending upon the country called and, beginning July 2002, for certain countries also on the type of connection (the price will vary depending on whether the destination number called is fixed or mobile). See Domestic Traffic Domestic Fees and Tariffs .

The table below sets forth, for the periods indicated, the average cost of a three-minute international call to a fixed line at standard rates (exclusive of value-added tax) for selected countries for outgoing traffic with destination to fixed line and the percentage change since 1998.

	As of December 31,					Percentage
	1998(1)	1999(1)(2)	2000(1)	2001(1)	2002(3)	change since
						1998(4)
			( )			(%)
Germany, France	1.43	1.03	0.88	0.88	0.71	-50.3
United Kingdom	1.15	1.03	0.88	0.88	0.71	-38.3
Spain	1.43	1.03	0.88	0.88	0.71	-50.3
Russia	2.09	2.09	1.65	1.65	1.50	-28.2
Canada and United States	1.42	1.03	0.88	0.88	0.71	-50.0
Australia	3.29	2.64	2.43	2.43	2.38	-27.7
Japan	3.29	2.64	2.43	2.43	2.38	-27.7
Brazil	4.29	3.29	3.05	3.05	2.74	-36.1
Chile	5.45	5.45	4.91	4.91	2.74	-49.7

- (1) All amounts for 1998, 1999, 2000 and 2001 were converted to Euro at the fixed exchange rate of Lit. 1,936.27 = 1.
- (2) Rates became effective on November 1, 1999.
- (3) Since July 2002, price per minute of traffic into some countries is differentiated on the basis of the termination of the call (fixed network or mobile network).
- (4) Data are not adjusted for inflation.

**International Tariff Rebalancing.** During the last three years there has been a meaningful reduction in the total cost for international traffic with overall international traffic tariffs falling by an average of 23%. In particular, the reduction in the international traffic tariffs to Western Europe, the USA and Canada was an average of 25% (approximately 70% of the international traffic is represented by the volume with these countries).

**International Settlement Arrangements.** The Telecom Italia Group derives revenues from foreign telecommunications operators for incoming calls which use the Telecom Italia Group's network. The Telecom Italia Group has bilateral settlement arrangements with other international telecommunications operators under the general auspices of the ITU. Because incoming and outgoing international traffic are relatively equal, the

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Telecom Italia Group's net payments on international accounting rates are negligible. This has the effect of limiting the Telecom Italia Group's exposure to changes in currency exchange rates. The exposure to changes in currency exchange rates has also been reduced due to the adoption of the euro.

### ***Leased Lines***

At the end of 2002 gross operating revenues from leased lines, from retail and wholesale customers, including international leased lines, was 1,400 million (approximately equal to the level of gross operating revenues in 2001). With revenues from international services of approximately 75 million relatively stable, there has otherwise been a significant change in the revenue mix, with revenues from business customers falling, and revenues from other local operators growing significantly.

Leased lines services consist of offering to a customer-subscriber a permanent connection for telecommunication services between two geographically separate points. This kind of connection can be used to handle high volume voice, data or video transmission. During 2002 leased lines continued growing in connections between the Telecom Italia Group's network and other telecommunication operators network, resulting in an increase in revenues from approximately 800 million in 2001 to approximately 870 million in 2002.

Revenues from business customers continued to decline in 2002 as business customers migrated towards broadband connections. As of December 31, 2002, there were approximately 320,000 (in points of entry of data network) lines leased to business customers (approximately 342,000 in 2001) and approximately 132,000 digital leased lines (152,000 in 2001).

During 2002 migration from low speed lines to high speed lines continued as customers favor the convenience of this kind of connection. Retail revenues for leased lines decreased from approximately 500 million in 2001 to approximately 440 million in 2002.

### ***Interconnection with Other Operators***

On February 6, 2003, the National Regulatory Authority approved, subject to certain technical and economic amendments, the 2002 Reference Offer (RO) originally submitted by the Telecom Italia Group in April 2002. The Telecom Italia Group's Reference Offer includes the conditions for FRIACO (Flat-Rate Internet Access Call Origination) service, partial circuits provisions, shared access and sub-loop unbundling, thus enabling a competitive development of internet access and broadband services.

The offer presents, in comparison with the 2001 RO, a simplification of the interconnection planning process, includes a significant improvement of SLAs (Service Level Agreement) as well as further overall price reductions. Moreover, new elements are included such as double local exchange, transit at the level of local exchange, partial circuit offer, including new data speed and distances (more than 5 km).

Economic conditions have been defined according to the principle of non discrimination, transparency, objectivity and cost orientation. The RO will be retroactively applied to January 1, 2002. Pursuant to the recent decision of the National Regulatory Authority issued in March 2003 to adopt a network cap system, starting with the 2003 RO the market will have greater visibility over the arrangements relating to interconnection

services, allowing operators to rely on stable economic values in preparing their own business plans.

The Telecom Italia Group offers a comprehensive range of network access services which allow other telecommunications companies access to its fixed-telephony network, including:

- FRIACO: the Telecom Italia Group has been offering this service since 2001 but the 2002 RO provides for a 13% price reduction for local exchange, a 6.2% decrease at the metropolitan level and a 6.5% reduction for interconnection at the transit level.
- Partial circuits: represent partial circuits from customer premises to the Other Licensed Operators' Point Of Presence ( POP ), as a segment of an end-to-end leased line. The National Regulatory Authority determined that economic conditions are to be set according to the price ceiling methodology that was established by the European Commission Recommendation C(1999) 3863 of November 24, 1999, and introduced the price ceiling into national legislation with Order 10/00/CIR. For speeds and distances of partial circuit different from those included in the Recommendation, the prices are based, according to national as well as European accounting requirements, on Telecom Italia's own costs, evaluated according to the fully allocated current costs model.

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- Billing and bad debt service: the Telecom Italia Group also offers billing to Other Licensed Operators ( OLOs ) who decide not to bill the customers (*i.e.* customers that are connected to the network through indirect access service) accessing their non geographic services. The Telecom Italia Group, as required by the National Regulatory Agency, fixed the level of charge for the billing service at 2.9% calculated on the total revenues of each OLOs non geographic service. With respect to bad debt, the level of risk and insolvency is subject to negotiation between Telecom Italia and the other Licensed Operators.

The 2002 RO includes a detailed and complete Local Loop Unbundling ( LLU ) offer (physical LLU, sub loop unbundling and shared access) and the Telecom Italia Group has satisfied all National Regulatory Authority requests. To date, the Telecom Italia Group has equipped more than 90% of the sites requested by OLOs.

Economic conditions for LLU are lower than the one proposed in the 2001 RO (monthly rental of copper pair for POTS/ISDN decreased by 5.9%, for ADSL decreased by 11.5%, shared access decreased by 61.8% and sub loop unbundling decreased by 9.3%). With regard to implementation, on December 31, 2002 Italy had 131,000 fully unbundled lines compared with approximately 3,000 at the end of 2001.

Finally, law 59/02 of April 8, 2002 requires that Internet Service Providers have access to the RO of the notified operators with reference to internet traffic origination (both for metered and unmetered interconnection) and termination on 70x codes (dedicated in Italy to Internet access) and Partial Circuits. On June 26, 2002 the National Regulatory Authority issued an Order to define the criteria for ISPs to gain access to the RO economic conditions that the Telecom Italia Group has implemented on the 2003 RO issued on April 11, 2003.

## ***Data Services***

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.

Domestic Wireline provides a broad range of data transmission and web application services supported by a wide spectrum of technological platforms ranging from traditional to advanced platforms based on broadband access (SDH and xDSL).

Domestic Wireline's strategy consists of large penetration of the Mass Market and SOHO segments with ADSL connections, supported by Alice and Smart . Domestic Wireline focuses on switching from traditional to innovative technologies to enlarge IP services and the applications market. This strategy has had a significant success with 850,000 broadband points of access sold to the retail and the wholesale market (390,000 at the end of 2001); of which 630,000 access have been sold to retail customers.

During 2002 Domestic Wireline introduced several innovative offers for the data transmission networks and Internet access, including:

- new solutions with fiber optic technologies for SMEs, mainly for IP services;
- revised solutions for security and for full outsourcing services for SMEs;

- new web services offers for secured storage for Internet Data Center; and
- customized solutions for e-learning applications.

Revenues from Data Services amounted to 916 million in 2002 and increased by 14.2% over 2001 ( 802 million in 2001). Revenues from Data equipment were substantially in line with 2001 figures (approximately 220 million in 2002). Growth in services revenues has been driven mainly by innovative data services increasing by more than 50% ( 387 million in 2002; 253 million in 2001); web services continued to increase strongly (30%) and amounted to 130 million in 2002.

Revenues from traditional Data Services decreased from 450 million in 2001 to 400 million in 2002 due to customer migration to broadband services.

#### ***Fixed Network***

Since 1988, the Telecom Italia Group has installed high levels of fiberoptics, intelligent nodes, digital switching, satellite connections and high speed data transmission technology. The technologically advanced

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nature of its fixed network permits the Telecom Italia Group to offer a variety of advanced services such as toll free numbers, call waiting and call forwarding, VPNs, premium charges and charge splitting.

### *Domestic Network*

**Fixed Network.** The Telecom Italia Group's domestic fixed network includes 66 transit switches and 628 main local switches. The long distance fixed network includes 3.7 million circuits, while the distribution fixed network includes 104 million kilometers of pairs over copper cable.

In 2002, the Telecom Italia Group set up interconnections with the networks of 5 additional operators, making a total of 65 operators at December 31, 2002. In the same period 19 operators have disconnected.

During the year 2002, the following contracts were also signed or renewed:

- 7 new interconnection agreements (adding to the 77 interconnection agreements previously agreed);
- 8 additional reverse agreements, terminating calls on the network of another operator, for a total of 64, since 1998;
- 6 agreements to supply high-speed access services using ADSL technology for a total of 29 since 2000;
- 11 carrier preselection contracts, 1 district carrier selection agreements, 7 number portability agreements;
- 7 contracts for the local loop unbundling service on the local network; and
- 18 contracts to supply Digital Data Circuits for a total of 83 from 1998.

**Digitalization and ISDN.** At December 31, 2002, 100% of the Telecom Italia Group's domestic telecommunications lines were connected to digital telecommunications exchanges. The digitalization of the long distance fixed network was completed in 1994 and the level of digitalization of the local fixed network has been 100% since 2000. Since the end of 1999, ISDN services have been accessible to substantially all of Italy. The Telecom Italia Group has one of the largest ISDN networks in Europe. ISDN allows subscribers to use their existing access lines for a number of purposes, including high speed data transmission, video-conferencing, high speed fax and faster Internet access. The Telecom Italia Group expects to continue to make investments in its fixed network to permit the expansion of ISDN and IN services.

**SDH and ATM.** The Telecom Italia Group introduced SDH advanced transmission technology into operation in the long distance fixed network in 1996 and introduced such technology into operation for its local fixed network during 1997. These transmission systems are operating on fiber optics from 155 Mbit/s up to 2.5 Gbit/s. Moreover, in 2002 we started using transmission systems with speed up to 10 Gbit/s. Work on the development of the Arianna network which, by use of the latest generation of SDH technologies and the new optical DWDM technology (Dense Wavelength Division Multiplexing) constitutes the basis for a new transport network with a high transmission capacity

capable of covering the entire Italian territory, continued during 2002. The network will be used to transport flows with a high requirement for quality and availability, both in terms of incremental requirements and migration away from the current transit network. Arianna is based on a structure with SDH rings; since 2000, in order to reduce the number of fibers, DWDM systems have been used to multiply by a factor of 12 up to 40 the available optical fiber band and the current transmission capacity, thus increasing the transport capacity of the connections. The network will be operated by the same system that is currently used for regional networks. The DWDM systems provide the natural link between current transport networks and the future optical OTN (Optical Transport Networks), multiplexing and exchange entirely within the optical domain, without any need for optical-electric conversion. In November 2002 Domestic Wireline introduced a new generation Optical Digital Cross Connect on Domestic Wireline transmission backbone in order to progress with the transition towards a new generation meshed ASTN (Automatically Switched Transport Network) optical backbone which will start during 2003. By using the ASTN approach it is possible to build a multiservice platform with a high level of integration with the IP network. First applications of Metro DWDM systems were developed in Rome and Milan metropolitan areas.

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

ATM switching technology, introduced in 1996, allows the transfer of information combining data, video and other services over public and private networks both domestically and internationally. Telecom Italia ATM

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(Atmosfera) and Frame Relay (Business Frame) networks are overall networks that work together as a multiservice network, using SDH transmission systems as physical layer. The ATM Network allows for the provision of ATM native services with access rates ranking from 2Mbit/s up to 155 Mbit/s. It also acts as a backbone for both the Frame Relay Access network (with access rates ranking from 64 kbit/s up to 2 Mbit/s), and for the DSL network, used for the provisioning of xDSL services (ADSL, HDSL and SDSL). The ATM/Frame Relay networks allows for access to IP and MPLS customers with access rate ranking from 64 kbit/s to 155 Mbit/s.

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

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

Beginning in 1999 operating systems were, in turn, developed with the aim of ensuring the offering of new services, optimizing operational activities and pursuing objectives of total quality. Procedures were developed for systems dedicated to supervising traffic for verifying levels, the immediate management of measurements and constant monitoring of the quality of the service provided. In systems that operate the flexible network for data transmission, features were activated which reduce activation and connection time, permit the timely recognition of customers who have experienced malfunctions in services and augment the availability of the connections themselves. Moreover, operating systems have been equipped with new features for marketing new services.

**Broadband Network/ADSL.** The Telecom Italia Group's broadband network is capable of supporting advanced telecommunications services and multimedia applications and, to this end, the Telecom Italia Group has installed significant levels of fiber optic cables in its fixed network. In 1998, the Telecom Italia Group began introducing ADSL systems over copper pairs to deliver interactive services (e.g., fast-Internet). ADSL allows the Telecom Italia Group to fulfill in the short-term, market driven needs to provide services like fast-Internet, multimedia, video conferencing and teleworking either for business or residential customers. Furthermore, ADSL together with other existing infrastructure and satellite services allows the Telecom Italia Group to focus the commercialization of its broadband network services on a market basis and to tailor investments to the growth of the market. With reference to access services using ADSL technology, in 1999, the technical and commercial trials with fast Internet access for residential and Soho customers, begun in Rome and Milan at the end of 1998, were concluded. In 2002, commercial services with access to ADSL technology for business customers and Internet Service Providers had been extended to 1,300 cities (approximately 700 at the end of 2001). The commercial services for business customers include the use of ADSL technology in urban areas to supply access to IP and ATM services of the Telecom Italia Group's data networks. The services for ISPs supply ATM access based on ADSL technology to the public, leaving the commercial interface with the final customer to the Service Provider. At the end of 2002, the local exchange areas covered by ADSL technology numbered 2,120; in 2003, 3,000 local exchange areas are expected to be served.

**Fiberoptic Cables.** At December 31, 2002, the Telecom Italia Group had installed approximately 3.6 million kilometers of optical fiber for access and transfers, of which approximately 0.99 million kilometers were installed on long distance fixed-lines. Fiberoptic cables significantly increase the capacity of the network and permit the Telecom Italia Group to provide new advanced services based on the simultaneous transmission of several kinds of signals, such as voice, data and video. To enable the offer of such services, the Telecom Italia Group is planning to introduce fiberoptics in its local access network.

In 2002, a project which started in the second half of 2000, consisting of the creation of an optical fiber ring between Milan and Palermo (T-Bone), was completed with the installation of about 6,000 kilometers of cable with 96 optical fibers on two backbones and the laying of two

submarine links under the Strait of Messina.

**Flexible Data Network.** The Telecom Italia Group also operates a flexible network equipped with a centralized system that makes it possible to establish dedicated data links from a work station. At December 31, 2002, 600,000 direct digital line access points and 166,500 direct analog line access points had been installed.

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### *International Network*

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

The Telecom Italia Group owns capacity in a number of international cable links and its international network includes fiber optic cables to several countries. During 2002 major implementations in this traditional area were related to the upgrade of Catania (Italy) - Malta submarine cable, for supporting international voice traffic and IP connectivity, and to the completion of the Palma (Spain) - Algiers submarine link, for improving its capabilities to deliver traffic to Algeria.

On December 31, 2002, there were 9 exchanges utilized for voice services and digitalization of the international network exceeded 98%. In the aggregate, the Telecom Italia Group owns capacity on more than 360,000 kilometers of submarine cables.

In addition, the Telecom Italia Group has developed a new strategy building a number of proprietary networks in Europe, Latin America and in the Mediterranean area. These multiservice backbones are optical fiber rings with ring-topology protection that use the DWDM (Dense Wavelength Division Multiplexing) technology for transmission, while, for access and delivery, the POPs (Point of Presence) use multiservice platforms (voice, data and IP). These platforms complete the switching functions for voice and routing for data with packet/cell switching IP/ATM technology.

In 2002, three completely integrated multiservice backbones have been operating and supporting Telecom Italia's international services. In particular, the main activities included:

- *Pan European Backbone.* Fully activated cross-border services are available for wholesale customers: Managed Bandwidth, IP Connectivity, International Private Leased Circuit, Global Voice Services, .GRX (GPRS Roaming eXchange for Mobile Operator). The European fiber optic network (Pan European Backbone) 2 fiber pairs, 400 Gbit/s each is laid in the main industrialized European countries: Italy, France, U.K., Netherlands, Belgium, Germany, Switzerland and Austria with a total length of 9,100 km. (an extension of the Pan European Backbone to Madrid and Barcelona in Spain is planned for the second quarter of 2003).
- *Mediterranean Nautilus.* Mediterranean Nautilus Ltd., a company controlled by Telecom Italia, has built a new submarine optical ring, in a high-availability network configuration, with a total length of 7,000 km 6 fiber pairs, 64 lambda (10 Gbit/s each) per fiber pair. Such system will link the main markets of the Central-Eastern Mediterranean area: Italy, Greece, Turkey and Israel. Presently, the optical ring that links Catania, Athens, Chania-Crete, Haifa and Tel Aviv has been completed.
- *LAN (Latin American Nautilus).* The final network configuration of Latin America Nautilus has been activated. The Latin American Nautilus is a new high capacity backbone, previously utilized in Latin America and now integrated with the transatlantic and European networks. The backbone is an optical fiber ring network both on earth and under sea, 30,000 km long, including the Miami-New York City link. The ring, having optical automatic traffic protection and a bandwidth up to 320 Gbits, links the most important cities of South America to Central and North America.

Furthermore, Telecom Italia of North America (TINA), a wholly owned subsidiary of Telecom Italia, has implemented two POPs in Newark (NJ) and Miami to offer Voice and IP/Data services. In order to improve the capabilities between such POPs, the Pan European Backbone and Latin American Nautilus, Telecom Italia together with TINA signed contracts to purchase capacity on the Flag Atlantic-1 transatlantic cable and

TINA on the Middle Atlantic Crossing submarine cable.

***Mobile***

The Mobile Business Unit accounted for gross operating revenues of 10,867 million in 2002, 10,250 million in 2001 and 9,418 million in 2000.

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

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As of December 31, 2002, the business unit was organized as follows:

In May 2002, the International Operations (IOP) Operating Activity was disbanded. As a result of this reorganization, all the companies based in Latin America are now coordinated by Latin America Operations (LAO). Beginning February 2003, Latin America Operations reports directly to the CEO Carlo Buora for wireline telecommunication and to Marco De Benedetti, the CEO of the Mobile Business Unit, for mobile telecommunication.

Among the large mobile telecommunications operators in Europe at the end of 2002 TIM has the largest number of lines in its domestic market (source: Mobile Communication magazine) and has been the fastest growing area of the Telecom Italia Group's business for the past several years. Line growth was 17% in 2000, 11% in 2001 and 6% in 2002. Gross operating revenues from TIM totaled 7,929 million, 8,357 million and 9,022 million ( 8,915 million net of Blu merger effect) in 2000, 2001 and 2002, respectively.

### ***Holdings of International Operations***

As a result of a corporate reorganization completed at the end of 2000, TIM acquired 100% of STET Mobile Holding ( SMH ), the international holding company of the Telecom Italia Group holding substantially all of the Telecom Italia Group's wireless investments outside of Italy. On December 28, 2001, SMH merged with TIM International, the holder of stakes in Digitel and Is TIM. TIM International is managed by TIM and the international results have been fully consolidated with TIM's results since January 1, 2001. In January 2001, TIM Brasil, a wholly owned subsidiary of TIM International, was formed to act as a sub holding company for the subsidiaries which acquired PCS licenses in Brazil (TIM Celular Centro Sul, TIM Sao Paulo and TIM Rio Norte). In November 2001, TIM International's stake in Bitel (the majority shareholder of Tele Nordeste Celular and Tele Celular Sul) was contributed to TIM Brasil. TIM Brasil currently owns 100% of Bitel's share capital. In December 2002 within the framework of the corporate reorganization process, TIM Sao Paulo was merged with TIM Celular Centro Sul and TIM Rio Norte and, in January 2003, changed its name to TIM Celular.

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

At December 31, 2002, the overall number of TIM lines calculated on a proportionate basis, in Italy and internationally was approximately 31.5 million. There are approximately an additional 2.2 million equity mobile lines calculated on a proportionate basis that are part of the Telecom Italia Group.

The following tables list the countries in which TIM (through TIM International) currently has operations, the ownership interest in each operator and the number of lines for each operator. Beginning in May 2002, all the Latin America companies owned by TIM International are coordinated by Latin America Operations. The mobile operations in Austria, France and Spain were sold during 2002.

**Table of Contents****Controlled Operations**

<u>Country</u>	<u>Operator</u>	Percentage	Total Wireless lines
		interest of TIM	per operator at
		<u>International</u>	<u>December 31, 2002</u>
(millions)			
<b>Europe</b>			
Greece	STET Hellas	81.40(1)	2.5
<b>Latin America(2)</b>			
Brazil	Maxitel	100.00(3)	1.4
	Tele Nordeste Celular(*)	21.18	1.9
	Tele Celular Sul(*)	20.68	1.7
	TIM Celular (formerly TIM Sao Paulo)	100.00	0.3(4)
Perú	TIM Perú	100.00	0.4(5)
Venezuela	Digitel	66.56(6)	0.9

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

**Affiliated Companies**

<u>Country</u>	<u>Operator</u>	Percentage	Total Wireless lines
		interest of TIM	per operator at
		<u>International</u>	<u>December 31, 2002</u>
(millions)			
<b>Europe</b>			
Czech Republic	Radiomobil	4.35	3.5
Turkey	Is TIM	49.00	1.2(7)

- (1) In August 2002, TIM International acquired a 17.45% stake in STET Hellas from Verizon. As a consequence of this acquisition the stake owned by TIM International in STET Hellas increased from 63.95% to 81.40%.
- (2) Pursuant to the 2002 Reorganization the activities of the Latin American companies are now coordinated by Latin America Operations.
- (3) In February 2002, TIM Brasil acquired 10% of ordinary shares of Maxitel, corresponding to 3.33% of the total capital.
- (4) Operations started October 18, 2002.
- (5) Operations started January 25, 2001.
- (6) In December 2002, TIM International increased its interest in Digitel, through a share capital acquisition, by 10%.
- (7) Operations started March 21, 2001.

**Services Italy.** TIM offers both digital and analog mobile services. The GSM digital service, which commenced operations in April 1995, uses digital technology and is the standard throughout Europe. GSM generally provides higher quality transmission than analog service and may be used by customers to make and receive mobile calls throughout Europe and certain other countries. As of June 11, 2003, roaming agreements have been reached with 319 operators in over 180 countries, allowing customers to make and receive calls abroad. See **Mobile Tariffs** below.

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The analog service is based on the TACS 900 standard and began operation in 1990. See Cellular Network .

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

	Year ended December 31,			
	1999	2000	2001	2002
	(%)			
TIM Italian geographic coverage				
TACS	83	83	83	83
GSM	89	92	94	94
TIM Italian population coverage				
TACS	98	98	98	98
GSM	99	100	100	100

**Customers and Lines.** The penetration of mobile telecommunications service in Italy is above the Western European average at approximately 95 lines per 100 inhabitants and growth rates have been substantially higher than the European average. This compares to a penetration rate of 73 and 89 lines per 100

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inhabitants at the end of 2000 and 2001, respectively. The increase is due to innovative services and an increase in customers with multiple lines and operators. TIM's customer base consists of TACS subscribers, customers holding TACS prepaid services, ( TACS Prepaid Customers ), GSM subscribers and customers holding GSM TIM Cards ( GSM Prepaid Customers ), and together with TACS Prepaid Customers, Prepaid Customers ). In 2002, TIM added 48.5% of the net additional GSM lines, with 2.1 million net additions compared to 1.6 million for Vodafone Omnitel and the remaining 0.6 million attributable to Wind. At December 31, 2002, the number of lines for TIM's TACS and GSM mobile service was approximately 25.3 million (of which 24.3 million were GSM lines, consisting of 2.7 million GSM subscribers and 21.6 million GSM Prepaid Customers). As of March 31, 2003, TIM's customer base had increased to 25.7 million lines.

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

	Year ended December 31,				
	1998	1999	2000	2001	2002
	(number of customers in thousands)				
Lines at period end(1)	14,299	18,527	21,601	23,946	25,302
TACS subscribers	1,563	832	495	304	180
TACS prepaid lines	2,001	2,344	1,950	1,430	815
GSM subscribers(2)	2,453	2,442	2,485	2,538	2,685
GSM TIM Prepaid Lines	8,282	12,909	16,671	19,674	21,622
	(in %)				
Customer growth	54.1	29.6	16.6	10.9	5.7
Churn(3)	16.8	12.7	15.7	15.6	18.0
TIM penetration(4)	25.1	32.5	37.5	41.6	43.9
Cellular market penetration(5)	35.9	53.1	73.3	89.0	95.0
	( ) (6)				
Average revenue per line per month(7)	40.0	34.9	30.5	29.1	28.8

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

(2) Commenced GSM services in April 1995.

(3) In 1998 net of internal migration between TACS and GSM networks; since 1999 data refers to total lines. The churn rate for any given period represents the number of TIM customers whose service was discontinued during that period due to a payment default or who voluntarily gave up a mobile telephony service during that period, expressed as a percentage of the average number of customers during that period.

(4) TIM customers per 100 inhabitants.

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

(6) The data for the years ended December 31, 1998, 1999 and 2000 was in lire and was translated into euros at the irrevocably-fixed rate of exchange of Lit. 1,936.27 = 1.

(7) Including Prepaid Card revenues and excluding equipment sales and, since 1999, including non-TIM customer traffic revenues.

The significant growth in TIM's mobile lines since October 1996 has resulted almost entirely from the marketing success of the GSM TIM Card, a prepaid card which permits the customer to make outgoing calls up to the limit on the card for the 12 months following issuance of the card or the last recharge of the card and receive an unlimited number of calls for the 13 months following issuance of the card or the last recharge of the card. If a GSM TIM Card is not recharged within this 12-month period, the customer will not be able to make outgoing calls but for one additional month such customer will be able to receive incoming calls. The GSM TIM Card can be recharged at any time to permit additional outgoing calls. The GSM TIM Card offers several advantages, including elimination of bad debt charges and lower administration costs, as no statements are sent to customers. The TACS prepaid service, which was introduced in December 1997, functions the same way as the GSM TIM Card and has successfully reduced the decline in usage of the TACS network. Approximately 89% of TIM's lines at December 31, 2002 are prepaid.

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

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

	Year ended December 31,				
	1998	1999	2000	2001	2002
	(millions of minutes)				
Total outgoing traffic per month	839	1,219	1,569	1,795	1,960
Total incoming and outgoing traffic per month	1,473(1)	1,989(2)	2,479(3)	2,815(4)	3,036(5)
	(% of total)				
Of which:					
TACS(6)	33.3	19.5	10.3	5.4	3.0
GSM(6)	66.7	80.5	89.7	94.6	97.0

- (1) Includes domestic mobile incoming and outgoing traffic (96.2% of total mobile traffic in 1998 compared to 96.9% in 1997), international traffic (2.3% in 1998 compared to 2.1% in 1997) and roaming traffic (1.5% in 1998 compared to 1.0% in 1997). These data include fixed outgoing traffic to the mobile network.
- (2) Includes domestic mobile incoming and outgoing traffic (93.9% of total mobile traffic in 1999 compared to 96.2% in 1998), international traffic (3.2% in 1999 compared to 2.3% in 1998) and roaming traffic (2.9% in 1999 compared to 1.5% in 1998). These data include fixed outgoing traffic to the mobile network.
- (3) Includes domestic mobile incoming and outgoing traffic (90.4% of total mobile traffic in 2000 compared to 93.9% in 1999), international traffic (2.9% in 2000 compared to 3.2% in 1999) and roaming traffic (6.7% in 2000 compared to 2.9% in 1999). These data include fixed outgoing traffic to the mobile network.
- (4) Includes domestic mobile incoming and outgoing traffic (92.8% of total mobile traffic in 2001 compared to 90.4% in 2000), international traffic (2.7% in 2001 compared to 2.9% in 2000) and roaming traffic (4.5% in 2001 compared to 6.7% in 2000). These data include fixed outgoing traffic to the mobile network.
- (5) Includes domestic mobile incoming and outgoing traffic (94.5% of total mobile traffic in 2002 compared to 92.8% in 2001), international traffic (2.3% in 2002, compared to 2.7% in 2001) and roaming traffic (3.2% in 2002 compared to 4.5% in 2001). These data include fixed outgoing traffic to the mobile network.
- (6) Includes traffic from Prepaid Customers.

**Mobile Tariffs.** TIM's mobile customers (other than Prepaid Customers) are charged a one-time connection fee, a monthly basic charge and traffic fees for calls, as well as a monthly government tax. Prepaid Customers are charged an initial connection fee of 26 for the GSM TIM Card and TACS prepaid service and are required to pay a fee ranging from 5 to 1 to the dealer for each recharge, according to the cost of each recharge. No other connection or subscription fees or taxes are payable by Prepaid Customers. Mobile customers (including Prepaid Customers) must purchase their own mobile telephone handsets. TIM does not subsidize the cost of mobile telephone handsets to its customers and does not intend to do so in the foreseeable future. In 2002, approximately 76.8% of revenues from TIM mobile services (net of access charge) were derived from traffic charges, 5.7% from sales and rental of equipment, 8.4% from VAS and 9.1% were miscellaneous revenues (subscription and connection fees).

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

TIM also offers innovative services, such as an offering called AutoRicarica. The AutoRicarica formula has proven to be particularly successful: according to this formula, TIM gives a bonus of 3.7 (VAT included) for each 100 minutes of calls received.

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

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

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

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

**Value Added Services.** TIM has been building its brand as a platform for content providers by entering into partnerships and developing business synergies. TIM has offered WAP since May 2000 and has over 200 partnerships and commercial agreements with primary content and service providers, such as SEAT-Tin.it, Yahoo!Europe, Sonera Zed, Caltanet, Kataweb, Sit.com and Excite. TIM also has agreements with leading Italian banks and financial institutions to provide on-line trading and mobile banking. In August 2000, TIM launched GPRS services in the areas of Rome and Milan and GPRS national coverage was completed in December 2000. The GPRS service has been available to corporate customers since the first quarter of 2001 and was extended to consumer segments starting May 2001. GPRS services represent the transition between the evolution of second (GSM) to third (UMTS) generation mobiles.

The introduction of GPRS allowed TIM to launch other initiatives. All GSM lines are able to handle GPRS traffic, which has become a fundamental service for the professional market. TIM was the first provider to market GPRS in Italy, consolidating its technological leadership in the domestic market.

TIM also introduced M-Services, which represents a combination of multimedia services on its GSM and GPRS networks. M-Services allows customers to use their mobile phones to send photographs and images accompanied by written or musical messages and to access a WAP page simply by pressing a button (WAP Push). TIM has been the first in Europe to introduce the PhotoMessage service, a major step towards multimedia message services. In June 2002 these services became available with the new MMS (Mobile Multimedia Services) and will be available on UMTS in the future.

**Billing.** TIM's customers (other than Prepaid Customers) are billed in a staggered bimonthly billing cycle. TIM endeavors to minimize bad debts by implementing a credit check on each customer at the time of sign-up and by requiring certain customers to post a security deposit. In addition, if payment is not received, the customer is notified accordingly and his or her ability to place outgoing calls is interrupted. If no payment is received, all services are terminated. The average rate of innovative payments (credit cards, Banco Posta) made by customers (other than Prepaid Customers) rose, in 2002, to 66% of the total payments.

**Marketing and Distribution.** TIM believes that its active marketing programs, extensive customer service and distribution network (primarily a nationwide network of independent dealers) and responsiveness to customer needs provide it with a significant competitive advantage. At December 31, 2002, there were 1,509 distribution partners, with 4,650 sales points (including 69 Telecom Italia Group outlets marketing TIM products and 24 shops directly owned by TIM). As of December 31, 2002, 4,143 TIM employees (about 40.4% of its total workforce) were involved in customer service activities.

**Cellular Network.** TIM's TACS network consists of 2,730 radio base stations and 60,291 radio channels. TIM has reduced the level of investment in its TACS network as the number of TACS customers has decreased. TIM's GSM network consists of 11,750 radio base stations and 629,600 radio channels (an increase of 7.4% over 2001). The Telecom Italia Group believes that as a result of TIM's enhancement of the GSM service and increased coverage, TIM's network is in line with the best European GSM networks.

**Services International.** TIM continued to consolidate its role as a global player during 2002. TIM International's presence is now primarily concentrated in Latin America and in the Mediterranean Basin. In December 2002 TIM had 13.8 million lines attributable to customers abroad, 6.2 million represented proportionate lines. 52.0% of TIM's international lines are European mobile lines while 48.0% are Latin American

mobile lines. See Companies Controlled by TIM International .

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

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On April 7, 2003, TIM signed a cooperation agreement with Telefonica Moviles and T-Mobile International to set up an alliance to provide their customers with a unified and superior offering of products and services in the countries where the three operators are present, thereby strengthening their ability to compete in cross-border markets. Initially the partners plan to develop, through roaming agreements, joint offers in voice, data and mobile internet, in order to gain new customers, both private users as well as multinational companies and corporate users interested in maintaining their level and quality of services, regardless of the country or the operator. The benefits to customers will include simplified tariff schemes and the capacity to access the same service offering on a global scale, as easily as at home. Additional services will include recharging a prepaid account abroad, sending photos via MMS, accessing Customer Care in the client's home language or the use of the same short code for SMS services. Another aim of the alliance would be to join forces to obtain synergies, economies of scale and greater sales potential, as well as equipment and handsets development, in order to meet the demand for new products and services. All these elements will lead to an improved service offering to customers.

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

## **Companies Controlled by TIM International**

### **Europe**

#### ***Greece***

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

In July 2001, the company was awarded a UMTS license at the price of 145 million and a DCS 1800 license for 26 million. At December 31, 2002, STET Hellas had approximately 2.5 million lines. In 2002, operating revenues were 689 million against 523 million in 2001, gross operating profit was 255 million compared to 188 million in 2001 (a 35.6% increase) and operating income was 131 million against 89 million in 2001 (an increase of 47.2% compared to 2001).

STET Hellas was listed on NASDAQ and on the Amsterdam Stock Exchange in June 1998 through an initial public offering of American Depositary Shares on NASDAQ and of Dutch Depositary Receipts on the Amsterdam Stock Exchange. After completion of the initial public offering, the Telecom Italia Group's stake through TIM International was reduced from 74.8% to 58.14%. In February 2001, a stake of 1.14% was acquired by TIM International. In October 2001, TIM International subscribed to a capital increase to finance the acquisition of its new business, and its stake rose to 63.95%. In August 2002, TIM International acquired the 17.45% stake of Verizon, its original joint venture partner. Consequently, as of December 31, 2002, the TIM group's interest in STET Hellas was 81.40%.

### **Latin America**

***Brazil***

In 2001, TIM Brasil (a wholly owned subsidiary of TIM International) was incorporated to act as a sub holding company for TIM Celular Centro Sul, TIM Sao Paulo and TIM Rio Norte. In November 2001, TIM International's stake in Bitel (the majority shareholder of Tele Nordeste Celular and Tele Celular Sul) was contributed to TIM Brasil. Consequently, TIM Brasil is actually the holding company for all the Brazilian subsidiaries.

*Tele Nordeste Celular Participacoes group.* A controlling interest in Tele Nordeste Celular, a supplier of mobile telephone services in the regions of Alagoas, Cearà, Paraiba, Pernambuco, Piaui and Rio Grande do Norte, was acquired in 1998. At the end of 2002, in a market with a penetration level of 12%, Tele Nordeste had more than 1.9 million lines (an increase of 9.6% compared to 2001), corresponding to a market share of approximately 59%.

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In 2002, Tele Nordeste Celular reported operating revenues of Brazilian reais 984 million ( 355 million), an increase of 12.3% in local currency compared to 2001; gross operating profit of Brazilian reais 523 million ( 189 million), an increase of 25.7% in local currency compared to 2001; and operating income of Brazilian reais 271 million ( 98 million), an increase of 26.0% in local currency compared to 2001.

*Tele Celular Sul Participacoes group.* A controlling interest in Tele Celular Sul Participações, a mobile telephone operator in the states of Paraná, Santa Catarina and in the city of Pelotas, was acquired in 1998. In 2002, Tele Celular Sul had 1.7 million lines (an increase of 7.5% compared to 2001) representing an overall market share of 61%. In 2002, Tele Celular Sul reported operating revenues of Brazilian reais 1,010 million ( 364 million), an increase of 13.6% in local currency compared to 2001; gross operating profit of Brazilian reais 422 million ( 152 million), an increase of 12.2% in local currency compared to 2001; and operating income of Brazilian reais 192 million ( 69 million), an increase of 3.8% in local currency compared to 2001.

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

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

In 2002, Maxitel reported operating revenues of Brazilian reais 755 million ( 273 million), an increase of 29.7% in local currency compared to 2001, due to an increase in traffic; gross operating profit of Brazilian reais 293 million ( 106 million), an increase of 61.9% in local currency compared to 2001. Operating income was Brazilian reais 74 million ( 27 million).

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

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

At the end of 2002, TIM Celular had 293 thousand lines. In 2002, TIM Celular reported operating revenues of Brazilian reais 108 million ( 39 million); a loss in gross operating profit of Brazilian reais 472 million ( 170 million) compared to a loss of Brazilian reais 33 million in 2001; and an operating loss of Brazilian reais 521 million ( 188 million) compared to a loss of Brazilian reais 34 million in 2001.

## *Perú*

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

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

In 2002, TIM Perú reported operating revenues of 308 million Nuevo Soles ( 93 million), a loss in gross operating profit of 95 million Nuevo Soles ( 29 million) and an operating loss of 201 million Nuevo Soles ( 61 million) against an operating loss of 238 million Nuevo Soles ( 76 million) in 2001.

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***Venezuela***

In December 2000, TIM acquired a 56.6% stake in Corporacion Digitel S.A., a Venezuelan mobile operator. The amount paid for this acquisition was approximately US\$363 million (of which approximately US\$107 million was in the form of a capital increase and the balance was in the form of a share purchase). In December 2002, TIM International acquired a further 10% of Corporacion Digitel's share capital for 32 million. Consequently, TIM group's interest in Digitel increased to 66.56%. Corporacion Digitel was awarded a 900 MHZ 20-year renewable GSM license in January 1998 and is operating in the Venezuelan Central Region, which, including Caracas and other major cities, is the most important economic region of Venezuela, with 60% of the national GDP.

In 2002, Corporacion Digitel changed its network architecture with the choice of Nokia as a main supplier, updated its technologies for prepaid services and launched GPRS and MMS services. At the end of 2002 Corporacion Digitel's market share was 15%.

In 2002, Corporacion Digitel reported: operating revenues of 260 billion Bolivares ( 177 million), an increase of 50.2% in local currency against operating revenues of 173 billion Bolivares in 2001; gross operating profit of 51 billion Bolivares ( 35 million) compared to 10 billion Bolivares in 2001; and an operating loss of 30 billion Bolivares ( 20 million), an increase in loss of 40.1% compared to 2001.

As a consequence of the recent devaluation of the Venezuelan currency against the U.S.\$, Corporacion Digitel's 2002 operating loss was equal to approximately 120% of its share capital. According to Venezuelan law, this situation would cause the winding-up of the company unless the General Shareholders' Meeting, while approving the financial statements, provides for a replenishment of the losses. Under Venezuelan law losses can be offset through direct contributions by shareholders, without increasing the company's share capital. Any shareholder not contributing pro-rata to the replenishment of losses could lose its investment in Corporacion Digitel.

In order to avoid participating in the loss replenishment, as well as to avoid losing their investment, some minority shareholders have initiated legal actions against Corporacion Digitel and TIM International, including the request for issuance of cautionary injunctions aimed at preventing the approval and/or the implementation of the replenishment of losses.

Most of the aforesaid legal actions have been rejected by the competent courts, so that on June 6, 2003, Corporacion Digitel's annual Shareholders' Meeting finally approved with the contrary vote of the minority shareholders present at the Meeting the 2002 financial statements and a loss replenishment in an amount suitable to bring Corporacion Digitel out of the situation envisaged in the Venezuelan Civil Code as to losses and necessary remedies. TIM International contributed to such replenishment with a financial credit it had towards the same Corporacion Digitel, of U.S.\$45 million.

**Other investments held by TIM International**

***Czech Republic***

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The Telecom Italia Group holds a 7.16% interest in C-Mobil B.V., a company which owns a 60.76% interest in Radiomobil, a mobile telecommunications operator, which in March 1996 won a GSM license in the Czech Republic. As of December 31, 2002, the penetration rate in the Czech Republic had reached almost 85% and Radiomobil had approximately 3.5 million customers. Radiomobil had operating revenues of 705 million and net income of 88 million in 2002.

### *Turkey*

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

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

At the end of 2002, Is TIM had a customer base of approximately 1.2 million lines and it reported operating revenues of 141,276 billion Turkish lire ( 83 million) and an operating loss of 715,735 billion Turkish lire ( 420 million). These results are due to the consequence of the difficulties faced by Is TIM in developing its mobile business, because of the Turkish regulatory scenario. In fact beginning with the award of the license, some measures which should have fostered effective competition and permitted a new entrant to compete against incumbent operators (roaming arrangements in particular), did not effectively take place. These measures are essential in the light of international experience to foster competition and pursuant to applicable legislation in Turkey. Is TIM and its shareholders made repeated and formal efforts to have the situation rectified but was *de facto* prevented from entering the Turkish mobile telephony market, thereby infringing the terms and conditions of the tender.

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

On May 13, 2003 TIM International signed a Term Sheet with Turk Telekom (the fixed line operator) outlining a set of guidelines for the integration of Is TIM and Aycell (the 4<sup>th</sup> 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. Both the two telecoms operators, TIM and Turk Telekom will hold 40% of the shares of the new entity respectively; the remaining 20% will be held by Is Bank. The closing of the operation is expected by the end of June 2003.

## ***Other Countries***

During 2002 TIM disposed of its mobile investments in Austria, France and Spain. In Austria, TIM International sold its 25% stake in Mobilkom Austria to Telekom Austria. The sale was completed on June 28, 2002. In France, Telecom Italia sold its 19.61% stake in BDT, the company controlling 55% of French mobile company Bouygues Telecom, to Bouygues S.A. The sale was completed in March 2002. In Spain, TIM International sold its 3.81% stake in Auna. See *Significant Developments during 2002 Disposition and Acquisition of Certain Equity Investments*.

## **South America**

All the activities conducted by the Latin American subsidiaries (whether controlled by Telecom Italia International or by TIM International) are currently coordinated by Latin America Operations (LAO) and are developed in accordance with the Telecom Italia Group's overall strategic plan. LAO reports to the International Steering Committee, composed of the Chairman and CEO. Permanent invitations to the Steering Committee meetings are extended to those in charge of the Domestic Wireline and Mobile Business Units. Beginning February 2003, Latin America Operations reports directly to the CEO Carlo Buora for Wireline telecommunication, and to Marco De Benedetti for Mobile telecommunication.



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As of December 31, 2002, LAO was organized as follows:

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

### **International Strategy in Latin America**

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

- consolidate the Telecom Italia Group s presence in mobile and in the fixed-mobile integrated business;
- maximize return on investments and focus on sustainable growth;
- invest in high-growth market segments, such as wireless, data and broadband, through the creation of a common GSM platform and through the launch of VAS services based on state-of-the-art technologies that provide synergies to the Telecom Italia Group;
- enhance the value of shareholdings, maximizing efficiency and cash cost control particularly on legacy services;
- strengthen its role of strategic partner in the current operations by increasing the transfer of the Telecom Italia Group s technological expertise and marketing know-how; and
- divest investments in the existing Latin American portfolio where the Telecom Italia Group does not have control, in non-core businesses or divest minority participations in non-strategic geographical markets.

### *Significant Developments During 2002*

During 2002 the Telecom Italia Group, through its wholly owned subsidiary Telecom Italia International N.V. (the primary vehicle by which the Telecom Italia Group holds its international wireline and integrated mobile/fixed-line investments), continued pursuing its targets, supporting the growth of its majority owned subsidiaries and focusing on rationalization of other investments.

The following key transactions were finalized during 2002:

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- Telecom Italia Group sold part of its stake in Solpart Participacoes S.A. (indirect parent company of Brasil Telecom) to other shareholders reducing the Telecom Italia Group's stake in ordinary share capital from 37.29% to 19.0%. As a result, the regulatory restrictions preventing the TIM group from launching a mobile telephone service based on GSM technology throughout Brazil were removed. Within the framework of this transaction, both parties have an option which can be exercised in the event certain conditions are met that will restore the previous shareholder positions; and
- the Telecom Italia Group, as a result of the Nortel Inversora Shareholders' Meeting on April 25 and September 13, 2002 which gave voting rights in the shareholders' meeting to the preferred shareholders and the right to appoint their own representative on the Board of Directors, has reduced its voting percentage in the shareholders' meeting to 33.89%. The percentage holding of ordinary share capital has remained unchanged at 50%, as well as the economic rights thereto.

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Finally, as part of the plan to restructure debt, on February 12, 2003, Telecom Argentina and its subsidiaries Telecom Personal S.A. and Publicom S.A. announced the intention to launch an offer for a portion of its financial debt for cash and to effect a partial payment of the interest due. Having obtained any necessary authorizations, the offer started on April 16, 2003 and represents the beginning of the process for restructuring the Telecom Argentina group's debt obligations.

In June 2003, Telecom Argentina and its subsidiaries Telecom Personal S.A. and Publicom S.A., pursuant to a tender offer, repurchased U.S.\$292 million principal amount of their financial debt obligations at a price of U.S.\$160.6 million (55% of the face value).

## **Latin America Companies Controlled by Telecom Italia International**

### ***Chile***

Telecom Italia International has a 54.76% stake in Entel Chile. Entel Chile is the largest long distance international telecommunications operator in Chile and the second largest national telecommunications operator. Through its mobile and two PCS licenses, Entel Chile is the largest wireless telecommunications operator with nationwide coverage with almost 2.3 million subscribers at the end of 2002 (a 18% increase compared to 2001).

Despite weaker demand and the strong Chilean Peso's volatility, the Entel Chile group reported consolidated operating revenues of approximately 1,223 million in 2002 (an increase of 12.3% in local currency compared to 2001), gross operating profit of 381 million in 2002 (an increase of 17% in local currency compared to 2001) and an operating income of 151 million in 2002 (an increase of 37.5% in local currency compared to 2001, due to the increase of wireless operations). Entel Chile has been fully consolidated with Telecom Italia since the first quarter of 2001.

In 2002, the Company focused its efforts on reducing costs and capital expenditures levels, implying lowered funding requirements and increased its cash generation, and on growing to profitable mobile business (the wireless subsidiary has improved its Return on Sales (ROS) level from 18% in 2001 to 25% in 2002).

During 2002 Entel Chile launched a WLL (Wireless Local Loop) business in the Chilean broadband market and long distance operations in Peru and Venezuela. At the end of August, Entel Chile reduced staff levels (468 employees of both staff and outsourced workers were laid off) which has affected the 2002 results with a provision of approximately 10 million.

In September 2002, Entel Chile group restructured its debt through the refinancing of a US\$ 300 million syndicated loan at a rate of Libor + 0.875%, which is lower than the 1.25% implicit spread of the older loan. The loan has a 5 year term with a 3 year grace period.

### ***Bolivia***

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

Due to the increasing competition in the wireline segment (6 long-distance operators), together with the strong impact attributable to the volatility of the Bolivian currency, operating revenues were approximately 186 million in 2002, a decrease of 4.5% in local currency compared to 2001. Mobile growth partially compensated for a decline in wireline revenues. The competition resulted in lower profitability and gross operating profit was 72 million in 2002 (down 10.3% in local currency compared to 2001), while operating income was 2 million in 2002 (a decrease of 83.5% in local currency compared to 2001).

As of December 31, 2002, Entel Bolivia had 462,000 mobile customers, up 26% compared to the end of 2001, reaching a market share of 52% (45% in 2001). Subscriber fixed-lines were 50,000 at December 31, 2002, a 6% decrease compared to the end of 2001. Internet clients were approximately 15,000 as of December 31, 2002 (an increase of 23% compared to the end of 2001).

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### **Latin America Affiliated Companies**

#### ***Nortel Inversora***

The current interest of 50% the Telecom Italia Group holds in the Nortel ordinary share capital is the result of an initial share of 32.5% acquired in 1990 for approximately U.S.\$33 million and an additional share of 17.5% acquired in August 1999 for approximately U.S.\$265 million. Nortel currently owns 54.74% of Telecom Argentina, which until October 1999 operated the telecommunications network in the northern part of Argentina (including Buenos Aires) among others, fixed-line and mobile telecommunications operations, international services, data transmission services, value-added services and directories publishing. Since October 1999, the Argentinean market has been progressively liberalized, and as a consequence Telecom Argentina has expanded its operations to the entire national territory. In June 1999, Telecom Argentina also expanded its mobile telecommunications services, by acquiring new licenses in the PCS technology, for a total amount of U.S.\$327 million.

At the end of 2002, Telecom Argentina had accumulated 3.3 million fixed-line network subscribers corresponding to a 45% market share. Its subsidiary Telecom Personal (including Nucleo) which is a leading company in the wireless segment, accumulated more than 2.7 million mobile customers (80% with prepaid cards), with a market share of 33% in Argentina. In the Internet sector, there were approximately 177,000 subscribers (147,000 access clients and 30,000 Broad Band clients with a market share of 19%).

As a result of the financial crisis in Argentina, Telecom Argentina has seen a decline in the number of fixed lines and a migration from postpaid lines to prepaid lines in the mobile segment. There has also been a strong traffic fall in both mobile and fixed telephony. The situation can largely be attributed to the economic crisis the country is presently undergoing.

Argentina's economy is in its fourth straight year of recession. In January 2002, the Argentine government removed the peg of the Argentine peso to the U.S.\$, resulting in a significant devaluation of the peso against the U.S.\$ and against other major currencies. The Argentine government has also defaulted on the payment of its debt obligations. Whether companies doing business in Argentina will default on their obligations depends upon their own financial condition, and, in the case of U.S.\$ obligations, continued access to the foreign exchange markets. The default by the Argentine government and its decision to devalue the currency have resulted in considerable uncertainty about the government's political stability, its management of the economy and the current exchange rate regime. Economic activity declined 10.9% in 2002. The GDP per capita decreased from U.S.\$7,458 to U.S.\$ 2,700.

In February 2002, Telecom Argentina hired Morgan Stanley as financial advisor in order to explore the possibility of restructuring and consequently reducing its debt. The Company declared its financial default on April 2, 2002, and in 2002 has not made payments on its debt since then. In 2002, payment of interest was also frozen starting from June 24, 2002. Currently Telecom Argentina is working on the restructuring of the debt. In 2002, Telecom Argentina continued to implement a cost and investment optimization process in order to improve cash flow. The use of this strategy is expected to go on in future years.

In 2002, the Telecom Argentina group recorded consolidated operating revenues of Argentine Pesos 3,983 million ( 1,127 million). The gross operating profit was Argentine Pesos 2,417 million ( 684 million) and the operating income was Argentine Pesos 2 million ( 1 million).

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On April 22 and April 24, 2002 the Board of Telecom Internet and Telecom Argentina approved the merger of Telecom Internet with Telecom Argentina.

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### **Internet and Media**

The Internet and Media Business Unit consists of the SEAT group. As of December 31, 2002 the Business Unit was organized as follows:

The Telecom Italia Group operates in the Internet and publishing services sector through Seat Pagine Gialle S.p.A. Telecom Italia acquired control of Seat Pagine Gialle S.p.A. in 2000 pursuant to the SEAT/TIN.IT transaction. As of December 31, 2002 Telecom Italia holds, directly and indirectly, approximately 55% of Seat's ordinary share capital.

Through the combination of SEAT and Tin.it in 2000 and a number of key acquisitions in 2000 and 2001 (Telegate, Consodata, Netcreations, Holding Media e Comunicazione, the former Cecchi Gori Communications), SEAT has evolved into a leading multiplatform directory and business information provider, targeting small and medium-sized enterprises.

### ***SEAT Spin-off***

On April 11, 2003, the Board of Directors of SEAT approved the proposed proportional spin-off of substantially all of the Directories, Directory Assistance and Business Information business segments into a newly incorporated company ( *New SEAT* ). The spin-off plan was unanimously approved by SEAT's Board of Directors on April 11, 2003, and was approved by the SEAT extraordinary shareholders' meeting held on May 9, 2003.

The spin-off plan contemplates the creation of two independent companies, each focused on its core businesses. It is SEAT's management's view that SEAT operates in two broad market sectors that have increasingly developed separate and distinct characteristics in terms of strategy, operations and competitive landscape. The first sector is that of targeted advertising and telephone services, in which SEAT operates through its Directories, Directory Assistance and Business Information segments, providing answers to queries via printed, online and telephone products and services.

The second sector is that of traditional advertising and the Internet, in which SEAT operates through its Internet, TV and other business segments, primarily providing access and content services. Both sectors present interesting development prospects (including broadband access and digital TV).

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

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The spin-off plan provides for the transfer to New SEAT of the following companies within the Directories, Directory Assistance and Business Information business segments of SEAT:

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

SEAT's other companies and business segments will remain in SEAT, which, as noted above, will be known as Telecom Italia Media.

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Effective as of the date of the Spin-off, the beneficiary company will be called SEAT Pagine Gialle S.p.A. The spin-off, subject to certain conditions of Italian law, is expected to become effective at the end of July 2003.

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

On effectiveness of the spin-off, Telecom Italia will retain its current interest in the share capital of New SEAT and Telecom Italia Media.

On June 10, 2003 Telecom Italia and a consortium of investors formed by BC Partners, CVC Capital Partners, Investitori Associati and Permira entered into a sale and purchase agreement for the sale of approximately 61.5% of the share capital of New SEAT which will be received by the Telecom Italia Group after completion of the spin-off transaction creating New SEAT (including the shares resulting from the expected early exercise of the J.P.Morgan Chase put option). The parties agreed on a sale price of 0.598 per New SEAT ordinary share, representing an enterprise value of approximately 5.65 billion.

The completion of the sale will be subject to the proportional spin-off becoming effective, the admission to listing of New SEAT, that is expected to occur by the beginning of August, and the approval of the relevant anti-trust authorities. Telecom Italia will receive approximately 3.03 billion for its stake. The buyers will also assume the estimated 708 million of debt of New SEAT at the closing.

The transaction will allow New Telecom Italia to reduce its net financial debt by approximately 3.74 billion.

See also Item 8. Financial Information Condensed Consolidated Pro Forma Financial Data .

### ***Business***

The Internet and Media Business Unit is responsible for the whole chain of value in the media sector, satisfying the public's need for information and entertainment, and the communication requirements of the business sector, through the production of traditional products on paper, and innovative products through the media of Internet, the telephone and television.

The Telecom Italia Group is a leader in the field of telephone publishing and is the second largest telephone publishing group in the United Kingdom. Furthermore, in Italy, SEAT Pagine Gialle is the top company in the marketing of services and products for the office and is present in the television sector with La7 and MTV Italia.

SEAT's business activities are currently organized in six business segments:

- directories;
- directory assistance;
- Internet;
- office products & services;
- business information; and
- television and other.

In the Internet sector, SEAT Pagine Gialle promotes the development of all internet services for residential customers and for small and medium-size companies: access, portals and web services. In Directory Assistance, the group handles the 89.24.24 Pronto Pagine Gialle 24-hours service in Italy.

#### *Directories and Directory Assistance*

SEAT's principal revenue generating activity is the sale of advertising in the telephone directory products that it publishes. SEAT's principal publishing products are business-to-business Yellow Page directories (*PagineGialle<sup>®</sup> Lavoro*), business-to-consumer Yellow Page directories (*PagineGialle<sup>®</sup> Casa*) and the White Pages (*PagineBianche<sup>®</sup>*).

SEAT also publishes business-to-business Yellow Page directories with regional coverage (*Pagine Gialle Professional*) and national subscriber-only business-to-business directories, segmented by industry (*Annuario SEAT PG*), provides an operator-assisted talking Yellow Pages directory service accessible 24 hours a day, 365

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days a year (*Pronto Pagine Gialle*) and publishes city maps and information about local public services (*Tutto Città*) to be inserted into certain editions of the Yellow Pages.

SEAT also provides on-line directory Yellow Pages service (*PagineGialle.it*) and White Pages service (*PagineBianche.it*).

In October 2002, SEAT launched a new edition of *PagineBianche*<sup>®</sup> that replaces the traditional directories and contains the telephone numbers of the other operators' customers.

SEAT also participates in the European telephone directory advertising and services market through shareholdings in:

- TDL Infomedia, which is the second largest directories publisher in the United Kingdom, through Thomson Local Directories;
- EURÉDIT, a French company, which publishes and distributes Europages; and
- Telegate, the second largest operator of directory assistance services and vocal portal services in Germany, with operations in Italy, Spain and the United States became part of the directory assistance business unit.

## ***Internet***

SEAT offers a full range of Internet services, consisting of:

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

*Internet Access Services.* Through Tin.it, SEAT provides Internet access services to residential, SOHO and SME Internet users. The small office/home office, or SOHO, market consists of businesses that use telephone lines to connect to the Internet, as opposed to dedicated lines, and is made up of small businesses, generally with one or two employees, and businesses conducted out of the home. The small- and medium-sized enterprise, or SME, market consists of businesses having between 3 and 50 employees.

Tin.it offers two principal access subscription plans:

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

At December 31, 2002, Tin.it's subscriber base amounted to approximately 6.6 million registered users and 2.2 million active users (defined as users who connect to the Internet at least once every 45 days).

<u>Million users</u>	<u>2002</u>	<u>2001</u>
Registered users	6.6	5.0
Active users	2.2	1.8

During 2002, SEAT re-launched its Tin.it brand and completely reviewed the range of products, introducing, in particular, an ADSL connection based on usage. This innovation marked an increase in the customer base (Alice, ADSL of Telecom Italia, +Tin.it).

*Portal Services.* SEAT provides portal services through Matrix, which operates the Virgilio portal.

*Virgilio* is a leading Italian portal, with approximately 5.3 billion web page views in 2002 and approximately 3.9 billion web page views for 2001, that caters to the Italian speaking community on the Internet. Management believes that *Virgilio*, which has been on-line since July 1996, is one of the most complete Italian portals. It contains a search engine and a websites index, and it centralizes services in various interest areas such as stock quotes, weather forecasts, TV guides, games, chats advertisements and shopping. In order to simplify the use of information, *Virgilio* offers personalized, interactive services that correspond to the requirements of individual customers.

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In 2002, SEAT launched the pay version (Virgilio Più) on its Virgilio portal with services and exclusives contents for customers. The continued innovation of products is one of the most important basis for future evolution of Virgilio and it represented the primary focus for investment during 2002.

In particular, SEAT revised the range of text products proposed by the Virgilio portal. In detail, PG Net product, launched in July 2002, generated a more effective use of its search engine by offering outgoing priority and listing on the results of searches. In only a few months, almost 33 thousand on-line customers (22% of total clients) subscribed to this new product.

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

*Web Services.* SEAT provides web services through Tin.It and Matrix's division Matrix Communication.

Tin.It provides different packages, which enable SME and SOHO customers to establish a presence on the Internet or provide e-commerce services. In particular, Tin.It's Easy and Village packages provide SME and SOHO customers with solutions to build an Internet site, to advertise the site with a pre-assembled banner advertising campaign and to establish and manage e-commerce capabilities on the Internet.

Matrix Communication provides a wide range of web services, including communication consultancy, website construction and maintenance, housing and hosting services and technical assistance.

### ***Office Products & Services and Business Information.***

Through SEAT's control of Gruppo Buffetti S.p.A. (Buffetti), SEAT is a leading distributor of office products and business solutions in Italy. Through certain controlled companies (Consodata and Databank) it also offers direct marketing and database services.

During 2002, SEAT repositioned towards products with greater added value, with the introduction of print on demand and the digital signature and the development of software and the ADSL subscription plan.

### ***Television and other.***

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

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

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

In 2002, the main activities were:

- repositioning of the television broadcasting channel La7 with new programming and programs starting March 2002, and significant development of MTV Italia;
  - consolidation of geographical coverage and the percentage of the population served by the signal distribution network ;
  - agreement with Cairo Communication to collect advertising business with a guaranteed minimum on channel La7 with effect from 2003; and
  - collaboration with the Virgilio portal for news.
- 
- Through Giallo Professional Publishing, SEAT has interests in companies publishing specialized information in the hotel, restaurant and entertainment industry, in electronics, information technology and audiovisual communication and in ceramics, architecture and urban design sectors.

### **Information Technology Market**

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

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customer. The ITM Business Unit includes the Finsiel group and is responsible for the information technology activities of the Telecom Italia Group for local and central government entities, as well as for banks, insurance companies, manufacturers and service companies. This Business Unit is also the supplier of system integration and IT consulting to the Italian government and local government authorities. As of December 31, 2002, ITM was organized as follows:

In order to reflect the new strategic guidelines, the Business Unit's internal structure has been subdivided in accordance with the following functions and provides services in the field of IT and related activities, including the design, management and maintenance of software and information products and services for each-area:

### **Main Subsidiaries**

#### **Finsiel S.p.A.**

Finsiel is held 77.92% by the Company, 14.38% by the Bank of Italy and 7.70% by other shareholders.

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

During 2002, Finsiel increasingly focused new offerings of customized web-based solutions.

#### **Banksiel S.p.A.**

Banksiel, held 55.5% by Finsiel, is part of the Finsiel group's Finance sector operations. Italy's top banking industry IT player, in 2002, gained one of the first important customers in the insurance field, the Cattolica Assicurazioni group.

#### **Insiel S.p.A.**

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Insiel, held 52% by Finsiel S.p.A., provides services in the field of information technology and related activities for local government entities. During 2002, Insiel acquired new contracts in government and healthcare.

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### **Tele Sistemi Ferroviari S.p.A. (TSF)**

TSF, held 61% by Finsiel, is the ICT partner for the Ferrovie dello Stato group companies, for which it designs and develops both systems for passenger and freight transport, management and administration systems. TSF also offers e-ticketing and electronic fleet monitoring systems to local transport companies.

### **Information Technology Group**

The Information Technology Group ( ITG ) Operating Activity is responsible for the information technology activities of the Telecom Italia Group and covers the entire range of information services. It is oriented towards increasing efficiency and quality of service activities directed at all the Business Units of the Telecom Italia Group.

The Operating Activity was established in early 2002, completing a plan to integrate various companies.

As of December 31, 2002, IT Telecom S.p.A., the main company of the ITG Operating Activity, was organized as follows:

In June 2002, Telecom Italia contributed its shares in Netsiel S.p.A. (68.65%), Telesoft S.p.A. (60%), Sodalìa S.p.A. (100%) and Netikos S.p.A. (25%) to IT Telecom S.p.A. (a wholly owned subsidiary of the Company). IT Telecom also purchased the remaining stake of Netsiel S.p.A. (31.35%), Telesoft S.p.A. (40%) and Netikos S.p.A. (75%) from Finsiel S.p.A., through a capital contribution received from the Company.

On June 27, 2002, IT Telecom S.p.A. (100% owned by Telecom Italia) bought Olivetti's 50% stake in Webegg S.p.A. The price paid by IT Telecom was 57.5 million and was agreed on the basis of independent evaluations carried out by KPMG Corporate Finance for Telecom Italia and IT Telecom and by UBM for Olivetti. Following this operation, Webegg is owned by IT Telecom (69.8%) and Finsiel (30.2%).

In December 2002, Netsiel, Saritel, Sodalìa and Telesoft, 100% owned by IT Telecom S.p.A., were merged into IT Telecom. The merger was carried out to obtain more efficiency and effectiveness in the information technology services rendered to the Telecom Italia Group and to focus consistently on innovation, services and products.

As of December 31, 2002, the Information Technology Group Operating Activity also included the Netikos group, the Webegg group and the TILAB group (100% owned by the Company) and was organized as follows:

The Netikos group was created by the Company to meet the increasing needs of Internet and wireless services solutions, as one-stop-shop partner to different corporations and institutions.

The Webegg group is focused on spreading the use of internet by commercial entities. It is mainly a supplier of CRM systems and a software factory for several different customers, such as banks and insurance companies.

TILab was established in March 2001 to combine the Telecom Italia Group's venture capital and innovation activities, the *Centro Studi e Laboratori Telecomunicazioni S.p.A.* (or CSELT) research laboratories in Turin and the Future Centre in Venice and the Consumer Lab in Rome. The Technology Observatory in San Francisco collaborates, on an exclusive basis, with TILab. Telecom Italia Lab was formed to enhance the Telecom Italia Group's competitive position, promoting and managing innovation and by identifying and developing business opportunities. Telecom Italia Lab's strongest assets are its rich and consolidated R&D activities, its ability to

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promote corporate venture capital activities in emerging technology and to identify internal research areas through the development of new ideas.

Pursuant to the 2002 Reorganization, the venture capital activities of TILab became part of a separate venture capital central function and TILab became part of the Information Technology Group.

The Group spent 269 million, 138 million and 121 million on research and development in 2000, 2001 and 2002 respectively. The Group also receives grants from research and development national and international programs.

The purposes of the Group's research and development activities are mainly the development of innovative services and applications, to meet the increasing demand from the market. Some R&D activities are also devoted to support the manufacturing sector outside the Group.

Development of innovative services is pursued through both the introduction in the network infrastructure of new platforms and systems that enable the provision of a wide range of services, and the use of state-of-the-art information and communications technologies for the development of highly innovative applications, tested on selected customers' sites. Such activities are mainly carried out by TILab, the corporate research center of the Group. TILab performs both strategic research and research specifically requested by Group Companies.

The following main operations and developments that occurred in 2002 were:

- acquisition of the minority associates' share of Loquendo;
- the development of an Interactive TV service;
- the support of the evolution on the XDSL services; and
- restructuring of the partnership with SVP FUND, realized through the departure of the USA Ramius Capital group and reduction of the Capital Committed.

The management activity, focused in the field of research and development with collaborative projects together with Pirelli Lab, has involved:

- the study of enabling techniques in the mobile and fixed sectors;
- the definition of network design, planning and management tools;
- the definition and testing of local access techniques;

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- the development of solutions, products and architectures suitable for silicon integration;
- the development of modular products, obtained as software and capable of being turned into firmware for specific solutions or for hardware components; and
- the implementation of the interactive TV service.

In 2002, TILab's basic research involved different sectors within both fixed and mobile telecommunications, with reference to services, infrastructures and technology.

For Internet and mobile applications, it was oriented towards integrated application and technological solutions for the multimedia offering, to the definition of content access modes and management of broadband customers, to the implementation and assessment of advanced solutions for the user environment (terminals, home wiring, application platforms).

Activities in the field of switching and networking were aimed at developing IP networks, developing Content Delivery Network architectures for an efficient distribution of multimedia contents and defining IPv6 introduction strategies, also assessing their impact on networks and services. Particular attention was also devoted to Wireless LAN and to the corporate solutions for the PABXless Company. Within this context, new telephony solutions were also developed, using innovative solutions for packet network telephony.

Within the mobile network field, techniques for the efficient management of radio resources were developed, along with tools for assessing Quality of Service in different network and traffic situations. Research in the network intelligence field, which, though it does have implications on the fixed network as well, is currently more closely linked with the evolution of the mobile network, was oriented to the study and definition of the set of functionalities and architectures that constitute the enabling middleware for the new services.

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Research on network infrastructures involved the urban and transport network, experimenting with new optical network architectures with automatic switching, as well as the access network, proposing innovative solutions based on copper and fiber optics connections. New operational and strategic planning tools were also developed for fixed networks, to allow the operator to carry out technical/economic evaluations of the various network development options.

As a result of the new policy within the Telecom Italia Group to exploit intellectual property, the research activities described above led, in 2002, to the filing of 45 patent applications, up about 13% over the previous year.

## **Other Telecom Italia Group Activities**

### ***Real Estate and General Services***

The Real Estate and General Services Function provided an interface for the various corporate Functions/Business Units to satisfy the needs of the real estate and general services area. In particular, the activities performed by the Real Estate and General Services Function concerned planning of sites and locations of the Telecom Italia Group, the design and construction of civil works, the maintenance of the properties and technological plant, in addition to providing real estate and general services.

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

In February 2003, the Real Estate and General Services Operating Activity was disbanded; its activities and resources were reassigned to other corporate functions of the Telecom Italia Group.

### ***Foreign Holdings Corporate Function***

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

The corporate function Foreign Holdings, operating under the corporate control structure, is responsible for the companies Telecom Italia International, 9Telecom group, the BBNet group, the Telekom Austria group, Telekom Srbija, Etec S.A., Netco Redes and the residual segment of the former IOP.

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Foreign Holdings Corporate Function reports to the CEO, Mr. Carlo Buora, in order to strengthen the relationship with other Central Functions and, in particular, with Mergers & Acquisitions with whom Foreign Holdings Corporate Function will evaluate opportunities to reorganize or restructure participations held by Telecom Italia operating in the fixed and integrated fixed-mobile telecommunication business.

During the course of 2002 the Telecom Italia Group, through the wholly owned company Telecom Italia International N.V., continued to pursue its targets under the Business Plan, focusing on reorganizing and rationalizing its international presence. The principal corporate transactions which took place in 2002 were the following:

- on August 1, 2002, the Telecom Italia Group finalized the sale of the investment in Auna and Multimedia Cable to Endesa, Union Fenosa and Banco Santander Central Hispano;
- on August 26, 2002, the French group 9Telecom was sold to LDCOM with the simultaneous purchase on the part of Telecom Italia International of a 7.22% stake in LDCOM. At December 31, 2002, the stake was reduced to 6.99% after the company effected a reserved capital increase in November;
- Telecom Italia International, following the agreement reached in June with OIAG, in the month of November, sold 75,000,000 Telekom Austria shares at a price of euro 7.45 per share, reducing its investment from 29.78% to 14.78%. Under such agreement, the sale of the remaining part of the shares held by the Telecom Italia Group can be initiated as from January 1, 2004;
- on December 28, 2002, the Telecom Italia Group announced that it had reached an agreement for the sale of its 29% stake in Telekom Srbija to PTT Srbija (the local state owned partner). The agreement for the sale was finalized on February 20, 2003 and the closing is scheduled to take place by the end of

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June. PTT will pay 195 million, 120 million of which will be paid by June 2003. The remaining amount will be paid in six semi-annual installments beginning January 2006. The shares disposed of shall be placed in escrow with an international bank until payment of the consideration is complete.

### **The Netherlands**

BBNed, established in July 2000, is 97.56% owned by Telecom Italia International. BBNed is an alternative carrier in the Netherlands, providing broadband local access to ISPs and business clients. Its commercial operations are based on unbundled local loop and co-locations services acquired from the local incumbent operator. During 2002 the company finalized the roll out of a nationwide DSL network with 300 points of presence, and experienced a large growth in its portfolio and revenues. As of December 31, 2002 BBNed had 15,800 ADSL lines and 11.7 million of revenues, compared to 462 lines and 0.6 million revenues in 2001. In 2002 BBNed had a gross operating loss and an operating loss of 14.9 million and 21.7 million, respectively.

### **Cuba**

Telecom Italia International has a 29.29% interest in Empresa Nacional de Telecomunicaciones de Cuba S.A. ( ETEC S.A. ), the exclusive operator for national and international wire telecommunications services in Cuba. In order to fulfill the long term objectives related to its license, ETEC S.A. increased the number of lines from 555,000 in 2001 to 646,000 in 2002 (an increase of 16%), while the digitalization rate rose to 76% from 69% reached in 2001. Further development of telecommunication infrastructure includes the near completed fiber optic national backbone, and capacity doubling of the ATM/Frame Relay Network. In 2002, ETEC S.A. focused on Internet and data transmission commercial development, achieving a 35% growth compared to revenues of 2001 (from approximately U.S.\$10 million in 2001 to U.S.\$13.4 million in 2002). In 2002, total operating revenues were U.S.\$294 million compared with U.S.\$281 million in 2001, an increase of 4.6%. Gross Operating profit increased from U.S.\$185 million in 2001 to U.S.\$202 million in 2002 (an increase of 9.2%) and operating income was U.S.\$139 million compared with U.S.\$137 million in 2001 (an increase of 1.5%). Net income was U.S.\$132 million in 2002 compared to U.S.\$137 million in 2001 (a decrease of 3.6%).

### ***Telespazio***

The Satellite Services Business Unit (consisting of the Telespazio group, which was sold in November 2002, and Telecom Italia's Satellite Telecommunications business segment) was responsible for developing satellite communication systems for phone and data, radio and television broadcasting and earth-observation.

Telespazio (a wholly owned subsidiary of Telecom Italia) designed, developed and managed satellite telecommunications systems for a variety of commercial uses and managed such systems for the Telecom Italia Group, including the public network utilized by Telecom Italia.

### **Other Subsidiaries**

#### **Telecom Italia Finance S.A.**

Under the reorganization of the Telecom Italia Group companies in Luxembourg, in October 2002, Sogerim S.A. was absorbed by its sole shareholder Softe S.A., and Huit II was absorbed by its sole shareholder TI Media S.A. On December 16, 2002, Softe S.A. incorporated TI Media S.A. and the new company was merged with TI WEB S.A., which, on the same date, changed its name to Telecom Italia Finance. All the rights and obligations of the merged companies are vested in Telecom Italia Finance.

Following the merger, TI Finance, a subsidiary of Telecom Italia, took over responsibility of the international treasury function operating in support of the financial needs of the foreign companies of the Telecom Italia Group, a task previously carried out by Softe.

The company ended the year 2002 with a loss of 85 million, due principally to write-downs of 80 million. The write-downs specifically refer to a 24 million mark-to-market adjustment of third-party bonds in the portfolio, a 56 million mark-to-market adjustment of investments and the adjustment of the investment in GLB Serviços Interativos S.A. (Globo.com) to the sale price.

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### **Saiat S.p.A.**

The company, held 100% by Telecom Italia, carried out support services for the Telecom Italia Group, in the financial area and in investment management.

In 2002, in particular, the company continued to provide services under the program for the securitization of the Telecom Italia Group trade accounts receivable. Under the Tiglio Project, the company sold its interest (99.42%) in TELIMM to MSMC Immobiliare and, as part of the reorganization of the Luxembourg companies of the Telecom Italia Group, sold its stakes in Softe (0.01%) and Sogerim (0.05%).

### **T.I. Learning Services S.p.A.**

The company operates in the training sector with the aim of achieving a leadership position in the market of learning and knowledge management. Due to the technologies at its disposal and the experience gained in this field, the company is able to design complex and customized training systems that can be used by large numbers of people. Its product range includes more than 1,000 courses for continuous training, particularly on topics associated with ICT and Business Management.

At December 31, 2002, the conferral of the Training business segment of the Telecom Italia Group was completed, concluding the project to rationalize the companies of the Telecom Italia Group operating in the field of traditional and web-based training approved by the Board of Directors of Telecom Italia on December 18, 2001.

### **Other Investments**

#### ***Multimedia Services***

Stream, a wholly owned subsidiary of Telecom Italia, was formed in 1993 with the objective of establishing and promoting a wide range of multimedia services and applications for the Italian and other international markets.

On May 29, 1999, Telecom Italia, News Corporation, Cecchi Gori group and SDS (an Italian company that sells broadcast rights for the exploitation of Italian football games) signed an agreement to develop the second digital TV platform, pursuant to a memorandum of understanding signed by the parties on April 27, 1999. Following such agreement, on June 7, 1999 Telecom Italia sold 65% of Stream's shares to News Corporation, Cecchi Gori group and SDS for a total of 67 million. On May 16, 1999, SDS and Stream signed an agreement for the cable broadcast by Stream of sports events for the 1999-2000, 2000-2001 and 2001-2002 seasons. Stream has an option to renew the agreement for an additional three-year term. Stream will pay SDS an annual fee of 124 million.

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On April 18, 2000, Telecom Italia and News Corp agreed to acquire the stakes owned by Cecchi Gori and SDS in Stream. Through the above mentioned transaction Telecom Italia and News Corp increased their respective stakes in Stream to 50%. The total cost to Telecom Italia and News Corp was approximately 196 million.

In 2000, Stream acquired broadcasting rights, for new television channels and programs and for Italian and European soccer championships. Interactive and Internet applications were developed and in December 2000 an e-mail service via the television set was launched.

Stream's main activities in 2001 were:

- enhancing its offer packages by including the Calcio channel and three new theme-oriented channels (MT Channel, Stream Verde and Fox News);
- the acquisition of the broadcasting rights for all the football matches of the UEFA Champions League for seasons 2001-2002 and 2002-2003, and the rights of Bologna Calcio starting from the season 2001-2002; and
- creation of the single decoder a machine which allows the customer to purchase the subscription to both Stream and Stream's main competitor, Telepiu without installing two separate decoders.

On October 1, 2002, Telecom Italia signed an agreement with the News Corporation group ( News ), partner of Telecom Italia in Stream, and Vivendi Universal ( Vivendi ), current shareholder of Tele+, in order to allow Stream to purchase Tele+ and to subsequently create a single Italian pay-TV company on one platform.

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On April 30, 2003, following the approval by the competent authorities, the agreement with News Corporation announced in October 2002 was concluded. The new company arising from the integration between Stream and Tele+ has been named SKY ITALIA and Telecom Italia paid approximately 30 million for its share in the transaction. The company is held by Telecom Italia (19.9%) and News Corporation (80.1%).

## **Competition**

### ***Domestic Fixed-line and International Telecommunications Services***

Pursuant to the Telecommunications Regulations, fixed-line public voice telephony services and the operation of the fixed-line network for the provision of such services was liberalized effective January 1, 1998. Until January 1, 1998, the Telecom Italia Group was the sole provider of fixed-line public voice telephony services, which consist of local, long distance and international telecommunications services, in Italy. In addition to fixed-line public voice telephony services, over the last five years there has been increasing liberalization of all other business areas in which the Telecom Italia Group operates. The operation of telecommunications infrastructure for the provision of all telecommunications services other than fixed-line public voice telephony services was opened to competition by the Telecommunications Regulations and the Maccanico Law during 1997. As a result of the complete liberalization of the market for telecommunications services, the Telecom Italia Group has faced increasingly significant competition since 1998 in the Italian domestic market, including competition from foreign telecommunications operators, particularly with respect to medium-sized and large business customers.

On December 31, 2002, the number of licenses for the provision of both fixed voice telephony service and building public telecommunications networks granted by the Ministry of Communications and the National Regulatory Authority was approximately 163. See Regulation .

The Telecom Italia Group faces increasing competition in international and domestic telecommunications services from, among others Albacom and Wind, TISCALI and Tele2. International telecommunications services and long distance domestic services as well as mobile telecommunications services are the areas of its business which are attracting substantial competition, based mainly on pricing.

Since the beginning of 2001 there has been increased competitive pressure with respect to local calls.

Although increased competition (including the need to adjust tariffs in response to competition) has affected the Telecom Italia Group's operations, management believes that it will be able to increase traffic and revenue from domestic telecommunications services as a result of (i) the introduction and continued growth of new telecommunications services (in particular, non-voice services), capitalizing on the Telecom Italia Group's advanced fixed network, (ii) growth in traffic due to increased Internet and data usage, (iii) increased interconnect traffic as a result of the growth of other mobile telecommunications operators and alternative telecommunications operators in Italy, (iv) continued growth of the Telecom Italia Group's mobile telecommunications businesses, (v) continued focus on customer service quality and marketing initiatives, and (vi) growth of the Italian economy. The Telecom Italia Group expects its revenue mix to continue to change for domestic fixed telecommunications due to regulatory and competitive reasons, and the new business opportunities driven by data and Internet services and broadband access. On voice services, the Telecom Italia Group will seek to implement a strategy based on greater efficiency for its internal structure and competitive offerings in its services portfolio aimed at reducing market share losses.

The legal framework for regulation in the telecommunications sector in Italy was completely transformed, as a consequence of the adoption of the Maccanico Law (effective August 1, 1997), the Presidential Decree No 318/97 (the Telecommunications Act ) (effective September 22,

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1997) and a series of Orders issued by the National Regulatory Authority (see Regulation ) which have been important to the Telecom Italia Group as it has faced increasing competition. To date the regulatory environment has been characterized by an intensive implementation process in order to complete liberalization. The trend continued in 2002 as additional steps were taken regarding tariff rebalancing, interconnection charges and the further signing of contracts to permit the unbundling of the local loop. See Regulation .

Although management has taken steps over the last several years in response to increased competition, as management expected it has lost fixed-line telephony services market share, in particular, with respect to domestic fixed long distance traffic (including fixed to mobile traffic) and outgoing fixed-line international traffic. In 2001, revenues from fixed-line telecommunications services were primarily affected by increased competition due to the development of carrier selection operators. Any decline in market share is expected to be

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offset in part by increased interconnection revenues as new competitors utilize Telecom Italia's domestic fixed-line network. Telecom Italia maintained its subscriber lines volume in 2002, as the unbundling of the local loop did not have a significant impact in this year.

With respect to domestic fixed traffic, as a result of increasing competition and to limit market share losses, in particular for long distance traffic, Telecom Italia introduced a number of innovative tariff and loyalty packages, (such as Teleonomy and Ricomincio da te ). About 24% of Telecom Italia Group's customer base has subscribed to a loyalty package.

The Telecom Italia Group's overall strategy is to focus on pricing, customer service and loyalty, and new offers to achieve customer retention in order to stop or slow further losses in market share. For the year ended December 2002, Telecom Italia was able to maintain its market share on total traffic volumes compared to December 2001.

In the domestic wireline telecommunications services market, the Telecom Italia Group is also continuing to pursue the new opportunities offered by the Internet (about 850,000 broadband access lines at the end of 2002) and data services that have offset, in part, the continuing decline in voice revenues.

The Telecom Italia Group believes it is in the best position to capture the potential benefits to be derived from E-value. The Telecom Italia Group intends to develop broadband networks in order to offer customers more bandwidth and convergent services.

### ***Mobile Telecommunications Services***

**The Italian Mobile Market.** The mobile telephone market continued to grow in Italy in 2002, but at a slower pace (7% in 2002 compared to 21% in 2001 and 40% in 2000). By December 31, 2002, the number of cellular phone lines reached 54.8 million, corresponding to a penetration rate of around 95% of the population.

After several year of strong growth, the demand growth curve has reached its inflexion point and the remaining potential market will be smaller than the one already acquired. In addition, the increasing saturation means that new customers to be acquired are likely to result in lower revenues per customer as has been the case in recent years. Competition for mobile telecommunications services remained strong in 2002. Consequently TIM's strategy has been focused on strengthening its leadership through innovative offers, CRM actions, quality performance, reinforcement of the core voice business and marketing VAS.

By the end of 2002, TIM was the leading Italian operator with a market share of 46.1%. Vodafone Omnitel had 34.6%, while Wind obtained 15.7%. The remainder (3.6%) was held by Blu, the fourth operator that was acquired by TIM, with its customers transferred to Wind.

### ***The Regulatory Framework***

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

**TIM's role in the New Economy.** The opportunities offered by new technologies will accelerate the Information and Communication Technology (ICT) convergence process, linking the two currently fastest growing businesses: mobile communications and the Internet. TIM's strategic choice with respect to this convergence is the open model. TIM will not focus on Internet content but, rather, it will create alliances with the best content producers in order to provide its customers with the most innovative and the widest range of opportunities, while guaranteeing customers transaction security through TIM's authentication center. This is the context in which the strategic partnership with SEAT and agreement with YAHOO Europe in May 2000 operates.

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

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Technological development in data transmission (GPRS, UMTS) and platforms (MMS) will generate new business models based on the capability of offering information, entertainment and advertising through mobile phones and of executing an increasing number of complete commercial and banking transactions.

This means the mobile economy will play a fundamental role in the new economy as a whole, and it is one of the segments with the highest potential growth rates and profitability.

TIM will seek out commercial synergies with web-oriented companies in the market, which will increasingly demand mobile services (information and media, on-line banking and trading, geographic positioning information system). A further objective will be the consummation of partnerships with prime content and service providers to develop m-commerce.

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### REGULATION

#### Overview

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

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

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

The Telecommunications Regulations contain provisions concerning:

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

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

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

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

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

Since January 2001 Telecom Italia has been operating pursuant to a license (Order 820/00/Cons). See The Telecommunications Regulations and Implementing Regulations Authorizations and Licensing .

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

A new regulatory framework will be introduced in Italy by the incorporation of recently adopted EC Directives, the Framework directive together with three others on Access , Authorization and Universal Service (the Data Protection directive will be implemented separately). The new rules will be included in the national regulatory framework by July 24, 2003. In this connection, Law No. 166 of August 1, 2002 gave the Government a mandate to implement the new directives, and to adopt a code of legal and regulatory measures in the field of telecommunications. Furthermore, the European Commission published Recommendations on important product and services markets in electronic communications, as well as Guidelines for market analysis and the evaluation of significant market power.

### **The National Regulatory Authority and the Maccanico Law**

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

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

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

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

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The Framework Law provides that the National Regulatory Authority shall cooperate with the Italian Government and the Parliament, advising and assisting them in several areas:

- preparation of regulations in the telecommunications field;
- preparation of drafts for renewal of and amendments to concessions, authorizations, and program contracts (*contratti di programma*), which are usually multi-year agreements between the relevant Ministry and the concession holders concerning quality of service and tariffs;
- supervision of the procedures and requirements for adopting general authorizations and issuing individual licenses, with reference to matters such as network access and interconnection conditions;
- establishment of the criteria to be followed by operators in determining tariffs;
- monitoring operators to ensure their compliance with such tariff criteria;
- issuance of directives aimed at ensuring accounting separation between different activities carried out by the same operator;
- monitoring of the performance of services to ensure compliance with contracts and qualitative levels of service;
- issuance of directives regarding quality of services;

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

The National Regulatory Authority has been operational since June 1998.

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

## **The Telecommunications Regulations and Implementing Regulations**

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

- authorizations and licensing;
- universal service obligations;
- obligations imposed on operators having significant market power, in particular with respect to interconnection agreements and accounting policies;
- numbering (carrier selection, preselection, and number portability);
- rights of way;
- alignment of Public Concession to the new regulatory framework;
- assignment of UMTS licenses; and
- introduction of new broadband services (ADSL and XDSL).

*Authorizations and Licensing*

The Ministry of Communications has the power to grant individual authorizations and licenses.

The Telecommunications Regulations distinguish between a regime of general authorizations, under which operators meeting pre-established conditions determined by the Ministry of Communications may provide telecommunications services or operate telecommunications networks within the scope of such authorizations without individual licenses for the provision of telecommunications services and the operation of telecommunications networks. Operators are required to obtain individual licenses from the Ministry of Communications to provide telecommunications services or operate telecommunications networks not covered by a general authorization. An individual license is required for:

- provision of fixed public voice telephony services;
- mobile and personal communications services;
- creation and operation of public telecommunications networks;
- when specific obligations are to be imposed or limited resources such as frequency bandwidths have to be allocated.

The number of individual licenses can be restricted only to the extent required to ensure the efficient use of radio frequencies or until sufficient additional numbers are made available. The procedures for granting such licenses must be based on objective, non-discriminatory criteria. Mobile and personal communications licenses will be required to permit the provision of services using different technologies and cannot include unjustified technical restrictions.

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The Ministry of Communications Decree of November 25, 1997, concerning the issue of individual licenses and general authorizations in the telecommunications sector, pursuant to the Telecommunications Regulations ( License Decree ) imposes specific obligations on operators in accordance with the scope of their individual licenses. Moreover, on dominant operators, and thus on the companies of the Telecom Italia Group, additional obligations are imposed such as:

- non-discriminatory and cost-oriented interconnection offering;
- publication of a standard list of interconnection tariffs;
- offering of special accesses to the network (i.e., access at network termination points other than the standard ones);
- accounting separation between the interconnection offering and other activities carried out by the operator;
- carrier selection and number portability (see also Special Status of Operators Having Significant Market Power and Numbering ); and
- carrier selection should be considered both as easy access and equal access .

The Ministry of Communications issued, on February 5, 1998, a decree regarding fees to be paid by authorized and licensed operators, specifying the fees the latter will have to pay to refund the relevant administrative costs incurred by the National Regulatory Authority and the fees for the assignment of frequencies and numbering resources.

Telecom Italia (but not TIM) has been operating under a license regime since January 2001.

Presidential Decree No. 211 of August 1, 2002 changed the period of individual licenses in the TLC sector from 15 to 20 years (with an extension also for those already issued).

### ***Universal Service Obligations***

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

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In compliance with Ministry Communication Decree of March 10, 1998, Telecom Italia submits yearly (by March 31 of each year) to the National Regulatory Authority the evaluation of its net cost of the universal service. The National Regulatory Authority determines if the net cost represents an unfair burden on Telecom Italia and, in that case, appoints an independent Advisor to audit the cost evaluation. Before July 1 of each year, the National Regulatory Authority determines the final evaluation of the net cost, taking into account any indirect benefits, and informs the Ministry of Communications of the amounts due from each operator called to contribute.

By July 15 of each year, the Ministry of Communications publishes the amount due by the operators obliged to finance universal service, which has to be paid by August 15th . Telecom Italia, as the operator required to provide the universal service, receives payment from the Ministry of Communications on September 15 of the same year.

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

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

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

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

With respect to 1999, on January 27, 2002 the Administrative Court issued a decision in favor of the Other Local Operators, based only on procedural matters. Consequently, the procedure for the evaluation of the net cost for 1999 was re-opened by the National Regulatory Authority. With Order 5/03/CIR the National Regulatory Authority issued a final decision confirming its Order 8/00/CIR.

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

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

In 2002, Telecom Italia was confirmed as the operator with the obligation to supply the Universal Service under the conditions laid down in the regulations.

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

### ***Special Status of Operators Having Significant Market Power***

Under the Telecommunications Regulations, telecommunications operators operating fixed-line or mobile networks, or offering fixed public voice telephony services, leased lines or international circuits, are subject to special obligations with respect to interconnection and accounting policies if they have Significant Market Power (SMP). An operator is presumed to have Significant Market Power if its share of the relevant market is greater than 25%, although the National Regulatory Authority may determine that an operator having a market share greater than 25%

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does not have Significant Market Power, in view of the operator's ability to influence market conditions and its access to financial resources, or that an operator with a market share lower than 25% does have such power.

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

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

In April 1998, Telecom Italia was identified as an operator having Significant Market Power in the markets of fixed telecommunications networks, fixed-line public voice telephony services, leased lines and interconnection services. Telecom Italia is the sole operator identified as having Significant Market Power for the

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above-mentioned markets. In April 1998, TIM was identified as having Significant Market Power in the market of mobile telecommunications services. See EU Telecommunications Law The 1999 Review .

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

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

### ***Significant Market Power Internet***

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

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

### ***Significant Market Power 2000***

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

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

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

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

### *Significant Market Power 2001*

An inquiry was begun by the National Regulatory Authority on August 7, 2002. An official decision was taken on May 7, 2003, but the text has not been published yet. From a press release by the National Regulatory Authority, we understand that the decision will confirm Telecom Italia as having SMP in the market of fixed network services, as well as TIM and Vodafone Omnitel in the mobile market.

The National Regulatory Authority intends to carry out the market analyses, under the new European regulatory framework by December 2003. In order to do this, the National Regulatory Authority intends to

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separate the most important markets according to current laws (Presidential Decree No. 318/97 and Law No. 59/02) into the 18 markets identified by the recommendation of the European Commission, and to entrust a large part of the above-mentioned analyses to external consultants.

The National Regulatory Authority will adopt the resolutions designating the operators with Significant Market Power for years 2003 onwards, and establish suitable regulatory measures for 2004.

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

**Interconnection.** Telecommunications operators providing fixed-line public voice telephony services, mobile telecommunications services or leased line systems and having Significant Market Power are required to negotiate and enter into interconnection agreements at the request of other operators wishing to provide telecommunications services, to apply non-discriminatory terms and to communicate copies of their interconnection agreements to the National Regulatory Authority. Public fixed network operators and leased line service providers having Significant Market Power are required to publish a Reference Interconnection Offer (RIO). As required by EU Directive 96/19, Telecom Italia published its first RIO on July 1, 1997. Such list was subject to approval by the National Regulatory Authority. The Ministry of Communications Decree of April 23, 1998, published on June 10, 1998, pertaining to the interconnection agreements ( Interconnection Agreements Decree ) also provides specific implementing rules to be applied to interconnection agreements to be executed by telecommunications operators having a significant market power and providing fixed public voice telephony services, mobile telecommunications services or leased lines systems. Such rules deal with, among other things, nondiscriminatory and transparent practices, economic offering conditions (based on actual costs, including a reasonable return on investments), accounting separation and the content of the RIO to be published by the above mentioned operators, except those operating mobile networks. The economic conditions included in the RIO must range between the minimum and maximum thresholds fixed by the Recommendation of the European Commission C(98)50, with interconnection tariffs exceeding the maximum thresholds requiring justification by the concerned operators.

On July 15, 1999, Telecom Italia submitted a new cost based RIO. Prices proposed were consistent with the thresholds fixed by the Recommendation of European Commission 98/511/CE (Best Practice 1999). With Order 1/00/CIR of February 2000 the National Regulatory Authority established some modifications to be introduced in Telecom Italia's RIO 1999, including the retroactive effect from January 1, 1999 for interconnection prices. In the same Order the National Regulatory Authority fixed terms and a deadline for publication of the Reference Interconnection Offer 2000. As a result, on April 3, 2000, Telecom Italia published the RIO 2000, which was evaluated by National Regulatory Authority in Order 10/00/CIR published on November 2, 2000.

Consequently, on April 9, 2001, Telecom Italia published a revised RIO for the year 2000, consistent with the new order, which increased the number of interconnection services (i.e., access to non-geographical numbers for dial-up Internet) and defines service level agreements.

In Resolution 13/01/CIR Telecom Italia was authorized not to insert the economic conditions for the routing of international traffic of other operators towards the United States, Canada, Switzerland, Norway and the member states of the European Community.

On September 7, 2001 Telecom Italia published the RIO 2001 for interconnection and unbundling of the local loop services. In the RIO 2001 there was a change from historical to current cost accounting methodology for interconnection traffic services, whereas local loop unbundling

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services are to be evaluated at historical costs. The RIO was evaluated in the Order 4/02/CIR of March 1, 2002.

In compliance with the rules laid down in Resolution No. 4/02/CIR, Telecom Italia re-published on April 3, 2002 the Reference Offer for 2001 which contains technical and economic conditions for supplying the interconnection services for local loop unbundling. The new RIO include generalized reductions on the prices of services provided to interconnected operators.

With regard to direct calls to Internet, Order No. 25/01/CIR established that Telecom Italia should introduce the new flat-rate interconnection rate known as FRIACO (the licensed operators pay a fixed charge instead of

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an amount based on the minutes of interconnection). On March 12, 2002, the National Regulatory Authority issued Resolution No. 5/02/CIR, approving Telecom Italia's flat interconnection rate, but reducing the prices proposed by the Company.

According to Law 59 of April 8, 2002, Internet Service Providers also have the right to be granted the same economic conditions applicable to the other licensed operators according to the RIO. With Order 9/02/CIR of July, 18, 2002 the National Regulatory Authority defined the criteria of application to ISPs of the economic conditions of RIO, in compliance with the Law 59.

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

With Order 2/03/CIR of February 27, 2003, the National Regulatory Authority asked Telecom Italia to integrate the RIO with other services (e.g. interconnection links at 34 and 155 mbps rates) and to modify the economic conditions of traffic conveyance services (origination, termination and transit) and other services such as number portability and Partial Circuits. Consequently, TI published a new RIO 2002 on March 27, 2003.

On the same date of Order 2/03/CIR, the National Regulatory Authority published Order 3/03/CIR, which (on the basis of the previous Order 152/02/CONS) introduces a network cap, a mechanism for defining in advance the rules for pricing RIO services according to the RPI (Retail Price Index) and productivity factors; the network cap applies for the period 2003-2006. The Order 152/02/CONS established also non discrimination criteria in interconnection and wholesale market between Telecom Italia and the other licensed operators: a) same conditions to other licensed operators as applied to its retail units; b) further obligations of accounting separation; c) functional separation between network and retail units; and d) price squeeze tests for retail offers.

In compliance with Order 3/03/CIR, Telecom Italia submitted the RIO 2003 on April 11, 2003, which is currently under evaluation by the National Regulatory Authority.

**Local Loop Unbundling.** With Order 2/00/CIR issued on March 16, 2000 the National Regulatory Authority published the general guidelines regarding the services that must be offered by Telecom Italia on an unbundled basis: twisted copper pairs; fiber optics; access extension (lines between switches), and digital transmission channels (i.e., digital circuits between the local office of Telecom Italia and the operator's point of presence) and the related economic pricing criteria, based on fully distributed historical costs. The Order allows other operators to have direct access to end users by leasing the network components from Telecom Italia (full unbundling) as well as leasing only the high bandwidth (shared access).

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

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

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

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

On June 24, 2002, Telecom Italia presented the National Regulatory Authority with a Virtual Unbundling offer, which offers carrier preselection, inclusive of the payment for the unbundling charge wherever it is

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temporarily impossible to offer co-location. On September 16, 2002, following a number of meetings with the National Regulatory Authority, Telecom Italia further reduced the price of some unbundling services:

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

On February 27, 2003, with Order 2/03/CIR, the National Regulatory Authority approved Telecom Italia's Reference Offer for 2002 (OR 2002), after hearing the opinions expressed by the Antitrust Authority and the European Commission, and after Telecom Italia's submission to the National Regulatory Authority of its regulatory accounting for 2001, which took place on December 20, 2002.

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

As regards RO 2003, Order 3/03/CIR of February, 27 2003, asked Telecom Italia to set the monthly rental fee on the basis of the following criteria: a) the best European tariff, b) the anticipation of efficiency on operational costs, c) the non discrimination principle and d) on the basis of the cost structure of access network assets.

**Mobile termination rate.** According to the GSM Concessions of December 1994, mobile network operators were responsible for fixing tariffs for calls originated on the fixed network and terminated on mobile networks. Such regulatory framework has been modified by DPR 318/97 establishing, as a new principle, that the originating operator is responsible for fixing the retail tariff. This principle has been reaffirmed by the National Regulatory Authority with Order no. 85/98. Since issuing this order the Regulator has started an assessment of termination rates charged by mobile network operators and with Order 338/99 it set 19.0 eurocents/min, the maximum average termination price. The National Regulatory Authority has deemed it necessary to issue new regulations and on February 5, 2003 issued Order n. 47/03 setting new maximum values for the termination rates applied by mobile operators (TIM and Vodafone Omnitel) for calls originated on third networks. The ceilings for mobile termination charges will be 14.95 eurocents/min, as from June 1, 2003. For 2004 and 2005 the National Regulatory Authority has provided a mechanism (so called network cap) for the planned reduction of termination costs of fixed-mobile which will be introduced along with the improvements and fine-tuning of the regulatory accounting system based on incremental costs and the review of the obligations following the implementation of the new European regulatory framework. The National Regulatory Authority believes that, within this framework, a planned reduction of a maximum of 10% per year minus inflation in 2004/2005 would be reasonable.

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

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

Due to a delay in the appointment of the independent advisor, the results of the audit on 1999 and reports were published only on November 6, 2002 with Order 337/02/CONS. The results of audit on 2000 Reports were published in March 2003 with the Order 48/03/CONS. .

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On June 17, 2002, the National Regulatory Authority issued Order 152/02 CONS which requires Telecom Italia to provide more detailed accounting reports on a current cost basis (fully allocated costs); the cost basis previously adopted was the historical one. In compliance with Order 152/02 CONS on December 2002 Telecom submitted the regulatory accounting Reports of year 2001 the auditing of which is in progress. During 2001 the National Regulatory Authority issued an order which raised the allowed return on capital employed WACC (weighted average cost of capital) for regulatory purposes from 12.5% to 13.5% before taxes.

### ***TIM cost accounting policy***

According to Order 197/99 TIM and Vodafone Omnitel have been notified as a Significant Market Power operator in the national interconnection market and must provide a cost oriented fixed-mobile termination rate.

On the basis of Order 338/99 TIM was required to implement cost accounting report in order to calculate a fixed-mobile termination rate. In accordance with Order 340/00, in 2001 TIM produced a cost accounting system based on Fully Allocated Historical Cost Data for the year 1999 (positive certification was issued by the advisor of the National Regulatory Authority at the end 2002). It also introduced an accounting system based on a FAC-CC model (Fully Allocated Cost on a Current Cost basis), as an intermediate step towards the adoption of long-run incremental costs to determine the fixed mobile rates. In December 2001 the National Regulatory Authority adopted Order n. 485/01 requiring the SMP operators to prepare historical accounts for the year 2000.

With the recent Order no. 399/02, the National Regulatory Authority requested both historical cost data and Current Cost data for the year 2001. It also required a Long run incremental cost orientation for the year 2002 as the last step for cost orientation.

### ***Numbering***

In accordance with the Telecommunications Regulations and by the issuance of various Order 3 the National Regulatory Authority issued regulations related to Number Portability and Carrier Preselection as described below.

### ***Number Portability ( NP )***

Since February 2000, following the National Regulatory Authority Order 4/99/CIR and 7/00/CIR, which is consistent with EU Directive 98/61/CE, Service Provider Portability (SPP) in fixed networks was introduced, including non-geographic numbers (Premium Rates, Freephone Numbers, Splitting Charges).

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

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

On March 28, 2002, the National Regulatory Authority issued Order 7/02/CIR: by November 30, 2002 the National Regulatory Authority will determine the price of Mobile Number Portability ( per number costs ) which shall be equal to the one-off price that the operator receiving the customer/recipient must pay to the operator giving the customer/donor the price. Mobile Number Portability will apply starting January 1, 2003.

Per cost number will not be higher than the price applied to fixed-line services as established by Order 10/00/CIR at 10.02. In January 2003, The National Regulatory Authority issued a new Order (13/02/CIR) setting a cap price for the portability charge. This charge can not be higher than the price established for Number Portability between fixed operators.

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

Since February 2000, in accordance with Order 3/99/CIR and 4/00/CIR, which introduced new obligations for the provision of Carrier Preselection (i.e., timing, minimum daily number of user activations), customers can

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

### ***Rights of Way***

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

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

### **Public Concessions**

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

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

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

- An individual license for the installation and provision of public telecommunications networks, and for the provision to the public of voice telephone services (modification of the concessions and associated agreements formerly granted to SIP, Iritel and Italcable).
- An individual license for the installation and operation of a network of coastal stations with the aim of providing mobile maritime services via Inmarsat satellite (modification of the concession and associated agreement formerly granted to Iritel).

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- An individual license for the plant and operation of radio-electric boarder stations, and the supply of mobile maritime services and mobile services via satellite through Inmarsat terminals (modification of the concession and associated agreement formerly granted to Sirm).
- Authorization for the supply of satellite network and communications services (modification of the concession and associated agreement formerly belonging to Telespazio).

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

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

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

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

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

TIM is also a holder of an individual license for radio mobile analogical (TACS) public service, for radio mobile paging public service and for the installation of their relative networks. The term of validity for the license corresponds to that of the original concession (2012 with a further five year extension according to the Order n. 286 issued by the National Regulatory Authority on September 25, 2002).

## **Licensed Operators**

In December 2002, the number of licenses for the provision of both fixed voice telephony service and building public telecommunications networks and for mobile and satellite services granted by the Ministry of Communications and the National Regulatory Authority was about 209.

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

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

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

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

In accordance with Presidential Decree No. 211 of August 1, 2002, the duration of all individual licenses is now 20 years starting January 1, 2002 (before such decree the duration was 15 years). Transition towards the third generation will be gradual with an extensive launch of the service expected in 2004.

### *XDSL/ATM Broadband*

In December 1999, Telecom Italia received temporary authorization from the National Regulatory Authority for the wholesale offering of ADSL/ATM access service to Other Licensed Operators and Internet Service Providers. In February 2000, Telecom Italia started the always on retail offering for fast internet access. The ADSL 640 wholesale offer has been partially modified by the National Regulatory Authority with order 217/00/CONS issued in April 2000. In February 2001, the National Regulatory Authority approved the Permanent Virtual Circuit (ADSL up to 2 Mbit/s and HDSL up to 155 Mbit/s technologies) offer as presented by Telecom Italia and authorized Telecom Italia to offer XDSL retail services branded as RING and FULL BUSINESS COMPANY from April 2001. At the end of 2002, ADSL 640 and XDSL wholesale services were available for about 70% of total lines; this percentage is expected to be 80% at the end of 2003. At the end of April 2003, the service is available in 1,300 towns.

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### **Tariff and Pricing Policy**

#### *Overview*

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

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

With Order 171/99 the National Regulatory Authority described the rules to be applied by Telecom Italia in setting the tariffs for the services offered. The Agency distinguished two kinds of tariffs. The first required prior approval by the Agency and applied to:

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

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

**Mobile Network.** GSM prices are established autonomously by each of the GSM Operators, taking into account, among other factors, structure and levels of prices/tariffs for interchangeable services (analog mobile services and basic telephony services) and the policies of the main European operators, subject only to the obligation to give the Ministry of Communications or the National Regulatory Authority, as applicable, 30 days notice of changes in prices. Since June 1998, subscribers' TACS traffic fees were liberalized, so that TIM can modify all TACS prices according to its own strategy (but such fees may not be set lower than those for GSM).

#### ***Regulation of Tariffs and Pricing***

On July 28, 1999, the National Regulatory Authority introduced the price cap mechanism to promote productivity and efficiency for Telecom Italia through December 31, 2002. The price cap mechanism related to:

- rental and connection charges;
- local charges;
- trunk charges; and
- international charges.

The Order stated that, on a yearly basis for three years (until December 2002), the reduction of overall customer expenditure had to be less than or equal to RPI + 4.5%. In the same Order, the National Regulatory Authority introduced specific subcaps on rental fees (RPI + 1%), local calls (RPI + 0%) and overall expenditure of residential customer (RPI-2.5%).

Following the EU Commission infringement procedure against Italy concerning the rebalancing of voice telephony tariffs (subscription fees, and charges for local, inter-district and international calls), on December 11, 2000, the National Regulatory Authority issued Order 847/00/CONS revising the price cap formulas in effect for rental and installation fees, and charges for local, national and international calls. For the period from January 2001 through December 2002, the price caps in effect were as follows:

General price cap (installation fees; monthly rentals, local, national and international call charges)	RPI	-4.5%
Sub-price cap on overall expenditures of residential users	RPI	-2.5%
Sub-price cap on installation fees and monthly rentals	RPI	+6%
Sub-price cap on local call charges	RPI	+0%

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The change compared to the previous price cap formulas was an increase from RPI + 1% to RPI + 6% in the sub-price cap on installation fees and monthly rental charges.

The general effect of the new price cap formulas for 2001 provided for an increase of up to 8.5% in Telecom Italia's access service charges (i.e., subscription fee) and a reduction of 9.8% in Telecom Italia's traffic charges.

Tariffs set on the foregoing basis are proposed directly by the operator to the National Regulatory Authority and, to the extent the National Regulatory Authority does not object within 30 days (reduced from 90 days), the tariffs will be considered to have been approved.

Prices for all other services (other than universal services) provided by Telecom Italia may be established without the approval of the National Regulatory Authority. Management believes that the ability to price each service (other than universal services) selectively is important to Telecom Italia's competitive position.

The National Regulatory Authority on August 5, 2002, launched a public consultation on the possible renewal of the Price Cap Mechanism. From the results of this consultation, it is known that all interested parties are in favor of a reduced control of prices.

Telecom Italia believes the National Regulatory Authority agrees with the introduction of a Safeguard Cap: a mechanism more flexible than Price Cap, which should prevent Telecom Italia from raising its average price: this does not forbid a small raise of a single price, provided that reduction in other prices grant that the average increase is zero (or lower).

However, with Order 152/02/CONS, the National Regulatory Authority introduced another mechanism to control prices, based on price tests. Telecom Italia's offers must undergo two tests:

- Test 1 (costs): prices must be higher than the underlying costs of Telecom Italia. The purpose of Test 1 is to avoid dumping;
- Test 2 (replicability): offers must be higher than the underlying costs of an efficient alternative Operator, including a predefined mark-up. The purpose of Test 2 is to ensure that other operators are able to compete with Telecom Italia.

In some case, it may happen that a specific offer lies between the range of variation of the two tests: in this case, the National Regulatory Authority will perform a specific analysis taking into account also existing offers by alternative operators (which may sell services at a level lower than the one identified by test 2).

### ***Pricing Policy and Telecom Italia's Tariffs***

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**Tariff Rebalancing.** Telecom Italia commenced rebalancing in 1991 with further adjustments approved by the Ministry of Communications in 1993, 1994, 1996, 1997 and 1998, and by the National Regulatory Authority in 1999, 2000, 2001 and 2002. The adjustments have progressively rebalanced Telecom Italia's tariffs to align them more closely to underlying costs, taking into account demand for its services, particularly with respect to international calls, and inflation. As a consequence, subscription fees have been raised, while the relationship between tariffs for local and domestic long distance calls has gradually been narrowed to a current ratio of approximately 1:1.8 for reduced rate calls and 1:3.6 for standard rate calls.

These tariff adjustments caused subscribers' costs to remain unchanged in real terms in 1995, and decreased in real terms by 2.6%, 3.4%, 1.6% and 3.8% in 1996, 1997, 1998 and 1999, respectively; they decreased in real terms by 4.5% in 2000, 2001 and 2002, respectively.

These decreases should be compared to inflation rates as set forth in the table below

	Year ended December 31,							
	1995	1996	1997	1998	1999	2000	2001	2002
	(%)							
Inflation Rate	5.4	4.0	1.9	2.0	1.7	2.5	2.7	2.5

Rebalancing has been accompanied by a simplified tariff structure which has reduced the number of tariff schemes, and clarification of the price of the services being offered to customers. For example, in the case of

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domestic fixed public voice telephony services, during the year 2001 the local tariffs were extended to all trunk calls within the same area code, while for trunk calls between different area codes (long distance domestic calls) a weekend price was introduced, and the number of zones based on distance was reduced from three to two. During 2002, the following tariff changes were introduced:

From February 1, 2002:

monthly fee for residential customers: increase of +6.3%;

30 minutes per month of free local calls for residential customers (which brought an average overall reduction of local calls of about -8%);

reduction of the off-peak tariff for trunk calls