TELECOM ITALIA S P A
Form 20-F
May 19, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended: December 31, 2005

OR

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

OR

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

Commission file number: 1-13882

Telecom Italia S.p.A.

(Exact name of Registrant as specified in its charter)

Italy

(Jurisdiction of incorporation or organization)

Piazza degli Affari 2, 20123 Milan, Italy

(Address of principal executive offices)

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

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

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

None

(Title of Class)

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

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock

as of the close of the period covered by the annual report.

Ordinary Shares 13,244,665,769

Savings Shares 6,026,120,661

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

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

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨
Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 ¨ Item 18 x

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

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

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INTRODUCTION

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

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in conformity with International Financial Reporting Standards as adopted by the European Commission for use in the European Union (**IFRS**), which, as described in Note 43 Reconciliation of IFRS as adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements, differ in certain material respects from generally accepted accounting principles in the United States (**U.S. GAAP**). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the Consolidated Financial Statements of the Telecom Italia Group (including the notes thereto) included elsewhere herein.

Telecom Italia adopted IFRS for the first time in its annual Consolidated Financial Statements for the year ended December 31, 2005, which included comparative financial statements for the year ended December 31, 2004. IFRS 1, *First-time Adoption of International Financial Reporting Standards*, requires that an entity develop accounting policies based on the standards and related interpretations effective at the reporting date of its first annual IFRS financial statements (i.e., for Telecom Italia, December 31, 2005). IFRS 1 also requires that those policies be applied as of the date of transition to IFRS (i.e., for Telecom Italia, January 1, 2004) and throughout all periods presented in the first IFRS financial statements. See Item 5. Operating and Financial Review and Prospects 5.4 Adoption of International Financial Reporting Standards , and Note 42 Transition to International Financial Reporting Standards (IFRS) of the Notes to the Consolidated Financial Statements.

Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Annual Report contains certain forward-looking statements, including, but not limited to, the discussion of the changing dynamics of the marketplace, including the continuing developments in competition in all aspects of our businesses from new competitors and from new and enhanced technologies, our outlook for growth in the telecommunications industry both within and outside of Italy, including our outlook regarding developments in the telecommunications industry, including certain trends we have identified particularly in our core Italian market, continuing regulatory measures regarding pricing and access for other local operators. Such statements include, but are not limited to, statements under the following headings: (i) Item 3. Key Information 3.1 Risk Factors , (ii) Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.3 Significant Developments During 2005 and 4.1.8 Updated Strategy , (iii) Item 4. Information on the Telecom Italia Group 4.3 Regulation , (iv) Item 5. Operating and Financial Review and Prospects , (v) Item 8. Financial Information 8.3 Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risks , including statements regarding the likely effect of matters discussed therein. Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information involves risks and uncertainties, which are outside our control, that could significantly affect expected results and are based on certain key assumptions.

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

- the continuing impact of increased competition in a liberalized market, including competition from global and regional alliances formed by other telecommunications operators in our core Italian domestic fixed-line and wireless markets;

- our ability to introduce new services to stimulate increased usage of our fixed and wireless networks to offset declines in the traditional fixed-line voice business due to the continuing impact of regulatory required price reductions, market share loss, pricing pressures generally and shifts in usage patterns;

- the level of demand for telecommunications services, particularly wireless telecommunications services in the maturing Italian market and for new higher value added products and services such as broadband;

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- our ability to achieve the planned synergies expected to be generated by the merger of Telecom Italia and TIM, including in expenses, capital expenditures and capacity to launch new convergent services;
- the success of our customer loyalty and retention programs and the impact of such programs on our revenues;
- the impact of regulatory decisions and changes in the regulatory environment, including implementation of recently-adopted EU directives in Italy;
- our ability to successfully implement the new structure following the Telecom Italia and TIM merger;
- the impact of economic development generally on our international business and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;
- the impact of political and economic developments in Italy and other countries in which we operate;
- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our strategy over the 2006-2008 period;
- our ability to successfully achieve our debt reduction targets;
- our ability to successfully implement our Internet and broadband strategy both in Italy and abroad;
- our ability to achieve the expected return on the investments and capital expenditures we have made and continue to make in Brazil and in Europe on broadband;
- the amount and timing of any future impairment charges for our licenses, goodwill or other assets; and
- the impact of litigation or decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.

The foregoing factors should not be construed as exhaustive. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events. See Item 3. Key Information 3.1 Risk Factors and the related cautionary statement under "Item 5. Operating and Financial Review and Prospects".

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KEY DEFINITIONS

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

EU	means the European Union.
IFRS	means International Financial Reporting Standards, as adopted by the European Commission for use in the European Union.
Merger	means the merger of Old Telecom Italia into Olivetti, which became effective on August 4, 2003.
Mobile Italy	means the unit which operates our Italian mobile business.
Old Telecom Italia and Old Telecom Italia Group	means Telecom Italia and its consolidated subsidiaries as they existed immediately prior to the effective date of the Merger.
Olivetti	means Olivetti S.p.A., the holding company and controlling shareholder of Old Telecom Italia.
Olivetti Group	means Olivetti and its consolidated subsidiaries, including Old Telecom Italia.
Ordinary Shares	means the Ordinary Shares, 0.55 par value each, of Telecom Italia.
Savings Shares	means the Savings Shares, 0.55 par value each, of Telecom Italia.
Telecom Italia	means the entity which resulted from the Merger.
Telecom Italia Group	means the Company and its consolidated subsidiaries.
Telecom Italia Media	means the corporate name of the remaining part of Seat Pagine Gialle S.p.A., which resulted from the proportional spin-off of the directories and most of the directory assistance and business information business segments of SEAT into New SEAT. The spin-off became effective on August 1, 2003 and new SEAT was disposed of on August 8, 2003. Telecom Italia Media is the Telecom Italia Group s subsidiary operating in the Media business.

TIM	means Telecom Italia Mobile S.p.A., the Telecom Italia Group s subsidiary which operated in the mobile telecommunications business, and merged with and into Telecom Italia, with Telecom Italia as the surviving company, effective as from June 30, 2005.
Tim Italia	means the company deriving from the spin-off of TIM s domestic mobile assets, effective as from March 1, 2005. After the merger of TIM with and into Telecom Italia, Tim Italia became a wholly-owned subsidiary of Telecom Italia. Subsequently Tim Italia merged with and into Telecom Italia, with Telecom Italia as the surviving company, effective as from March 1, 2006. Tim Italia as used in this Annual Report refers to the unit (Mobile Italy) which operates our Italian mobile business.

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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

3.1 RISK FACTORS

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

Strong domestic competition exists in all of the principal telecommunications business areas in Italy in which we operate, including, most significantly, the fixed-line and mobile voice telecommunications businesses. The use of the single European currency and the liberalization of the Italian telecommunication market (since January 1998) have intensified competition by facilitating international operators entry into the Italian market and direct competition with our fixed line and mobile telephony businesses, particularly in the local and long-distance markets. As of December 31, 2005, there were a number of significant competitors offering fixed-line services and four other operators (in addition to Mobile Italy) offering mobile services in the Italian domestic market. This competition may increase further due to the consolidation and globalization of the telecommunications industry in Europe, including Italy, and elsewhere. We anticipate that in the short to medium term there may be a stronger entry of peer-level international competitors into markets with existing operators, including Italy, increasing the direct competition we face in our Italian domestic fixed line and mobile telephony businesses and in the local and long-distance markets.

Although we have taken a number of steps to realize additional efficiencies and introduce innovative and value added services over our networks, and although our plans take into account that we will face significant competition from a number of operators in all the markets in which we operate, continuing pressures on prices due to competition and further erosion in market shares could adversely affect our results of operations.

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

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

These strategic initiatives have required and will continue to require substantial expenditures and commitment of human resources. Although these initiatives are core to our strategy, we may be unable to introduce commercially these new products and services, and even if we introduce them, there can be no assurance they will be successful.

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

On March 1, 2006, we completed a significant reorganization. As part of the reorganization, our Italian mobile business was transferred to Telecom Italia by way of merger of Tim Italia into Telecom Italia. In addition, during 2005, all of our activities in the area of Internet, previously conducted by Telecom Italia Media, were also transferred to Telecom Italia.

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On March 8, 2006, we presented to the investor community our strategic targets for the period 2006-2008, which were updated in light of our new organizational structure known as the One Company model. The One Company model is based on the following five pillars:

- convergence synergies: reaping synergies from lower costs and improved offerings by consolidating the offering of our main services (fixed line, mobile and internet) in one company;
- productivity and skills: increasing the productivity and skill-base of employees;
- advanced network deployment: deploying an innovative network infrastructure making possible the rapid deployment of next-generation products and services while safeguarding the continued improvement of the quality of services;
- loyalty and retention: strengthening customer loyalty through an upgraded customer care model and improved offering; and
- marketing leadership and growth: continued leadership in marketing, sustaining continued growth.

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

- our ability to manage costs;
- our ability to attract and retain highly-skilled and qualified personnel;
- our ability to effectively integrate the Telecom Italia and TIM organization within the One Company model;
- our ability to achieve the synergies anticipated from the convergence of fixed communications, mobile communications and Internet;
- the effect of foreign exchange fluctuations on our results of operations;
- the entry of new competitors in the liberalized Italian telecommunications market and the other principal markets in which we operate, which may result in our losing market share in Italy and internationally;
- our ability to strengthen our competitive position through our focus on Brazil and Broadband in Europe based on our specialized skills and technical resources;

- our ability to successfully develop and introduce new technologies to meet market requirements, to manage innovation, to provide value-added services and to increase the usage of our fixed and mobile networks;
- the need to establish and maintain strategic relationships;
- declining prices for some of our services and increasing competition;
- the effect of adverse economic trends on our principal markets; and
- the success of new disruptive technologies that could cannibalize fixed and mobile revenues.

There can be no assurance that our objectives will be effectively implemented in the planned timeframes.

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

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

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

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Included within this new framework is the obligation on the part of the Italian regulator responsible in Italy for the regulation of the telecommunications, radio and television broadcasting sector (the National Regulatory Authority or NRA) to identify operators with significant market power based on a market analysis in eighteen separate retail and wholesale markets, in which it is considered necessary to intervene to protect free competition. The new framework establishes criteria and procedures for identifying remedies applicable to operators with significant market power . The NRA is expected to complete and publish the analyses by mid 2006 and the implementation of these revised telecommunications regulations and possible future decisions relating thereto, may change the regulatory environment in a manner adverse to us, particularly if such analysis relates to new services which are not currently part of the eighteen identified markets.

In Italy, we are subject to universal service obligations, which require us to provide fixed line public voice telecommunications services in non-profitable areas.

In addition, the NRA has identified us as an operator having significant market power in most relevant markets. As a result, we are, and, if we continue to be identified as having significant market power in most relevant markets, will be, subject to a number of regulatory constraints, including:

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

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

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

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

We have impermissible overlapping licenses in Brazil.

Currently, we hold licenses in Brazil through our indirectly owned subsidiary, TIM Celular, to provide Personal Communications Services (PCS) services in Regions I, II and III of the PCS general licensing plan and to provide national and international long distance services. The Brasil Telecom Group (Brasil Telecom) also holds licenses in Brazil to provide PCS services in Region II of the PCS general licensing plan and to provide national and international long distance services. The Brazilian regulatory authority, Anatel, prohibits the provision of the same services, by the same legal entity, whether directly or indirectly, in the same Region. Since we also indirectly hold certain equity participations and governance rights in connection with Brasil Telecom, under the broad definition of the expression directly or indirectly Brasil Telecom may be viewed as our affiliate for regulatory purposes in Brazil. As a consequence, according to Anatel s rulings there currently exists an impermissible overlap between certain of the licenses held by TIM Celular and certain of the licenses held by Brasil Telecom (the Overlap).

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Anatel has determined that the relevant entities of the Telecom Italia Group and Brasil Telecom should find a solution for such Overlap and has established that such solution should be reached within October 2006.

On April 28, 2005, TIM Brasil, Brasil Telecom, and certain other parties entered into an agreement intended to respond to the requests of Anatel to resolve the Overlap. The implementation of the agreement was prevented as a result of legal challenges initiated by some of the indirect co-shareholders of Brasil Telecom and by Brasil Telecom itself on various proceedings. It was terminated on April 29, 2006 in accordance with its terms. The relevant parties are continuing to seek a resolution to the Overlap to comply with Anatel s determinations. For more information, see Item 4. Information on the Telecom Italia Group 4.2.5 Other Telecom Italia Group Activities Brasil Telecom Group .

Absent a negotiated solution, upon expiration of the cure period set forth by Anatel (October 2006), Anatel itself will decide how to resolve the Overlap and the parties could be subject to penalties in accordance with the law. Such penalties could have a material adverse effect on the value of our investments in Brazil and our results of operations.

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

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

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

Pursuant to our 2006-2008 plan we will continue to target our international investments in Latin America, particularly mobile telecommunications in Brazil, European broadband and mobile telecommunications in selected markets. These investments will continue to require significant capital expenditures and there can be no assurance that we will be able to achieve a satisfactory return on such international investments.

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

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

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

Our business is dependent on general economic conditions in Italy, including levels of interest rates, inflation and taxes. A significant deterioration in these conditions could adversely affect our business and results of operations. We may also be adversely affected by political and economic developments in other countries where we have made significant investments in telecommunications operators. Some of these countries have political, economic and legal systems that are unpredictable. Political or economic upheaval or changes in laws or their application in these countries may harm the operations of the companies in which we have invested and impair the value of these investments. A significant additional risk of operating in emerging market countries is that foreign exchange restrictions could be established. This could effectively prevent us from receiving profits from, or from selling our investments in, these countries.

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

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

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

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

Mainly as a result of the need to finance Telecom Italia s Cash Tender Offer for ordinary and savings shares of TIM, completed in January 2005, the total gross debt of the Telecom Italia Group and corresponding interest payments increased. Our total gross financial debt as of December 31, 2005 was 52,101 million (43,313 million at year end 2004). At the end of 2005, approximately 34% of our gross financial debt carried a floating interest rate compared to approximately 30% at the end of 2004.

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