TELECOM ITALIA S P A
Form 20-F
June 21, 2007
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 20-F

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

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

**OR**

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

**OR**

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

**Commission file number: 1-13882**

# Telecom Italia S.p.A.

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

**Italy**

**(Jurisdiction of incorporation or organization)**

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

**(Address of principal executive offices)**

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

| 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 Ordinary Share ADSs ) | The New York Stock Exchange |
| Ordinary Shares of 0.55 par value each (the Ordinary Shares ) | The New York Stock Exchange* |
| American Depositary Shares, each representing 10 Savings Shares of 0.55 par value each (the Savings Share ADSs ) | The New York Stock Exchange |
| Savings Shares of 0.55 par value each (the Savings Shares ) | The New York Stock Exchange* |

**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 13,254,906,691

Savings Shares 6,026,120,661

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes 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 46 Reconciliation of IFRS as Adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements, differ in certain material respects from generally accepted accounting principles in the United States ( **U.S. GAAP** ). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the Consolidated Financial Statements of the Telecom Italia Group (including the notes thereto) included elsewhere herein.

Telecom Italia adopted IFRS for the first time in its annual Consolidated Financial Statements for the year ended December 31, 2005, which included comparative financial statements for the year ended December 31, 2004. See Item 5. Operating and Financial Review and Prospects 5.4 Adoption of International Financial Reporting Standards .

**Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995.** The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Annual Report contains certain forward-looking statements. Forward-looking statements are statements that are not historical facts and can be identified by the use of forward-looking terminology such as believes, may, is expected to, will, will continue, sh seeks or anticipates or similar expressions or the negative thereof or other comparable terminology, or by the forward-looking nature of discussions of strategy, plans or intentions.

The forward-looking statements in this Annual Report include, but are not limited to, the discussion of the changing dynamics of the telecommunications marketplace, including the continuing developments in competition in all aspects of our businesses from new competitors and from new and enhanced technologies, our outlook for growth in the telecommunications industry both within and outside of Italy, including our outlook regarding developments in the telecommunications industry, and certain trends we have identified particularly in our core Italian market, including regulatory measures regarding pricing and access for other local operators. Such statements include, but are not limited to, statements under the following headings: (i) Item 3. Key Information 3.1 Risk Factors , (ii) Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.7 Updated Strategy , (iii) Item 4. Information on the Telecom Italia Group 4.3 Regulation , (iv) Item 5. Operating and Financial Review and Prospects , (v) Item 8. Financial Information 8.2 Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risks , including statements regarding the likely effect of matters discussed therein.

Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information is based on certain key assumptions which we believe to be reasonable but forward-looking information by its nature involves risks and uncertainties, which are outside our control, that could significantly affect expected results.

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

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

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

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

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

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

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## KEY DEFINITIONS

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

| | |
|---|---|
| **Domestic Mobile** | means the unit which operates our Italian mobile business. |
| **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. |
| **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** | unless otherwise indicated, 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 and Group** | means the Company and its consolidated subsidiaries. |
| **Telecom Italia Media** | 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. |

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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

#### RISKS RELATED TO TELECOM ITALIA

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

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

- business functions dedicated to the development of specific market/segment targets (domestic and international fixed/broadband, domestic and international mobile, Top clients and ICT);
- 

across-the-board monitoring to improve cost efficiency, process effectiveness and service quality (Technology for the development and operation of infrastructures and service platforms, Field Services for the development and improvement of customer assistance); and

- rationalization of Group Functions providing guidance and control.

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

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

- defend the Group s leadership position in its Italian domestic fixed-line and mobile markets, leveraging the increasing penetration of broadband, fixed-line/mobile convergence, transparent and flexible customer offerings, ongoing innovation and development of value added services;

- expand into adjacent market sectors, mainly through the rollout of content offerings on innovative platforms (IPTV and Mobile TV), while broadening and strengthening ICT offerings to business customers;

- increase focus on the customer, through higher investment in Customer Care and quality of service;

- continue broadband network development and launch of the Next Generation Network 2 project, building an ultra-broadband network in line with market demand, and consistent with the evolution of the regulatory framework; and

- develop the Group s international footprint, maintaining its presence in South America (mobile telephony in Brazil, and the project aimed at acquiring control of Telecom Argentina in 2009) while consolidating European projects in Germany, France and The Netherlands.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Among other things, we could be required to:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Risks Related to the Telecommunications Industry and Financial Markets**

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

Our business is dependent to a large degree on general economic conditions in Italy, including levels of interest rates, inflation and taxes. A significant deterioration in these conditions could adversely affect our business and results of operations. We may also be adversely affected by political and economic developments in other countries where we have made significant investments. Certain of these countries have political, economic and legal systems that are unpredictable. Political or economic upheaval or changes in laws or their application in these countries may harm the operations of the companies in which we have invested and impair the value of these investments.

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

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

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

Included within this new framework is the obligation on the part of the Italian regulator responsible for the regulation of the telecommunications, radio and television broadcasting sector (the National Regulatory Authority or **NRA** ) to identify operators with significant market power based on a market analysis in eighteen separate retail and wholesale markets in which it is considered necessary to intervene to protect free competition. The framework established criteria and procedures for identifying remedies applicable to operators with significant market power . During 2006, the NRA concluded all of its preliminary inquiries regarding the analysis of the markets and introduced measures as a result of this analysis. For further details please see Item 4. Information on the Telecom Italia Group 4.3. Regulation .

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

- a requirement to conduct our business in a transparent and non-discriminatory fashion;

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

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

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

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

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

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

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

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

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

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

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

Competition in our principal lines of business could lead to:

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

- an increase in costs related to investments in new technologies that are necessary to retain customers and market share; and

- difficulties reducing debt and strategic and technological investments if we cannot generate sufficient profits and cash flow.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The effects of and any damage caused by exposure to an electromagnetic field were and are the subject of careful evaluations by the international scientific community, but until now there is no scientific evidence of harmful effects on health. We cannot rule out that exposure to electromagnetic fields or other emissions originating from wireless handsets will not be identified as a health risk in the future.

Our mobile communications business may be harmed as a result of these alleged health risks. For example, the perception of these health risks could result in a lower number of customers, reduced usage per customer or potential consumer liability. In addition, although Italian law already requires strict limits in relation to transmission equipment, these concerns may cause regulators to impose greater restrictions on the construction of base station towers or other infrastructure, which may hinder the completion of network build-outs and the commercial availability of new services and may require additional investments.

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

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

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

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

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

## 3.2 EXCHANGE RATES

We publish our consolidated financial statements in euros. References to , euro and Euro are to the euro, the single unified currency that was introduced in Italy and 10 other member states of the EU on January 1, 1999. References to U.S. dollars , dollars , U.S.$ or $ are to U.S. dollars, the currency of the United States of America.

For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate (the Euro/Dollar Exchange Rate ) of 1.00= U.S.$ 1.3197, using the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the Noon Buying Rate ) on December 29, 2006.

These translations should not be construed as a representation that the euro amounts actually represent such dollar amounts or have been or could be converted into dollars at the rate indicated.

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

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

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

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

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

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

## 3.3 SELECTED FINANCIAL AND STATISTICAL INFORMATION

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

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

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

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

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

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

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**Item 3. Key Information** **Selected Financial And Statistical Information**

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

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**Item 3. Key Information** **Selected Financial And Statistical Information**

| | As of December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2006 | 2005 | 2004 |
| | (millions of U.S. dollars, except percentages and employees)(1) | (millions of Euro, except percentages and employees) | | |
| **Balance Sheet Data in accordance with IFRS** | | | | |
| **Total Assets** | **118,056** | **89,457** | **96,010** | **81,834** |
| **Equity:** | | | | |
| Equity attributable to equity holders of the Parent | 34,336 | 26,018 | 25,662 | 16,248 |
| Equity attributable to Minority Interests | 1,425 | 1,080 | 1,323 | 4,550 |
| **Total Equity** | **35,761** | **27,098** | **26,985** | **20,798** |
| **Total liabilities** | **82,295** | **62,359** | **69,025** | **61,036** |
| **Total equity and liabilities** | **118,056** | **89,457** | **96,010** | **81,834** |
| **Share capital(6)** | **13,995** | **10,605** | **10,599** | **8,809** |
| **Financial Ratios in accordance with IFRS:** | | | | |
| • Net financial debt/Net invested capital (debt ratio)(%)(7) | 57.9 | 57.9 | 59.6 | 61.2 |
| • Employees (number in Group at year-end, excluding employees relating to the consolidated companies considered as discontinued operations/assets held for sale and including personnel with temp work contracts) | 83,209 | 83,209 | 85,484 | 82,620 |

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**Item 3. Key Information** **Selected Financial And Statistical Information**

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

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**Item 3. Key Information** **Selected Financial And Statistical Information**

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

| | As of and for the year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| **Statistical Data:** | | | | | |
| **Wireline:** | | | | | |
| Fixed network connections in Italy (thousands)(12) | 23,698 | 25,049 | 25,957 | 26,596 | 27,142 |
| Physical accesses (Consumer + Business) (thousands) | 20,540 | 21,725 | 22,395 | 22,962 | 23,661 |
| Voice pricing plans (thousands)(13) | 6,468 | 6,321 | 5,883 | 5,547 | 5,224 |
| Broadband Accesses (thousands)(14): | 8,660 | 7,020 | 4,430 | 2,200 | 850 |
| • Domestic (thousands) | 6,770 | 5,707 | 4,010 | 2,040 | 850 |
| • European, other than domestic (thousands) | 1,890 | 1,313 | 420 | 160 | |
| Alice page views ex-Virgilio (millions) | 13,283 | 9,842 | 7,902 | 6,612 | 5,267 |
| Alice (ex-Virgilio) average monthly single visitors (millions) | 19.1 | 15.7 | 13.9 | 12.0 | 9.5 |
| **Network infrastructure in Italy:** | | | | | |
| • Access network in copper (millions of km pair) | 105.7 | 105.2 | 105.2 | 105.2 | 104.3 |
| • Access network and transport in optical fibers (millions of km of optical fibers) | 3.7 | 3.7 | 3.7 | 3.6 | 3.6 |
| **Network infrastructure outside Italy:** | | | | | |
| • European backbone (km of optical fibers) | 51,000 | 51,000 | 39,500 | 39,500 | 36,600 |
| **Domestic Mobile:** | | | | | |
| Mobile telephone lines in Italy at year-end (thousands) | 32,450 | 28,576 | 26,259 | 26,076 | 25,302 |
| **Brazil Mobile:** | | | | | |
| Mobile telephone lines in Brazil at year-end (thousands) | 25,410 | 20,171 | 13,588 | 8,304 | 5,335 |
| **Media:** | | | | | |
| La7 average audience share Free to Air (analog mode) for the year (%) | 3.0 | 2.7 | 2.4 | 2.2 | 1.8 |
| La7 average audience share Free to Air (analog mode) for the month of December (%) | 3.1 | 3.1 | 2.6 | 2.2 | 2.1 |

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

(2) For the purposes of IFRS, Parent , as used in this annual report, means Telecom Italia S.p.A..

(3) The average number of employees in the Group (excluding employees relating to the consolidated companies considered as discontinued operations/assets held for sale and including personnel with temp work contracts) was 79,993, 79,869 and 79,602 in 2006, 2005 and 2004, respectively.

(4) In accordance with IAS 33 Earnings per share , basic earnings per Ordinary Share is calculated by dividing the Group s net income available to shareholders by the weighted average number of shares outstanding during the year, excluding treasury shares.

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

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

- Ordinary Shares was 13,254,860,233 for the year ended December 31, 2006, 12,283,195,845 for the year ended December 31, 2005 and 10,208,327,613 for the year ended December 31, 2004;

- Savings Shares was 6,026,120,661 for the year ended December 31, 2006, 5,930,204,164 for the year ended December 31, 2005 and 5,795,921,069 for the year ended December 31, 2004.

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

(5) Telecom Italia s dividend coupons for the year ended December 31, 2006, were clipped on April 23, 2007 and were payable from April 26, 2007.

(6) Share capital represents share capital issued net of the par value of treasury shares.

(7) Net Financial Debt is a Non-GAAP Financial Measure as defined in Item 10 of Regulation S-K under the 1934 Act. For further details please see Item 5. Operating and Financial Review and Prospects 5.5 Results of Operations for the Three Years Ended December 31, 2006 5.5.2 Non-GAAP Financial Measures .

(8) Refers only to Net income (loss) attributable to equity holders of the Parent.

(9) In accordance with U.S. GAAP, the Net income (loss) per Ordinary Share has been calculated using the two class method, since the Company has both Ordinary Shares and Savings Shares outstanding. Under this method, set forth in Statement of Financial Accounting Standards No. 128, *Earnings per Share* , basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding. For the purpose of these calculations, the weighted average number of Ordinary Shares and Savings Shares was 13,254,860,233 and 6,026,120,661 for the year ended December 31, 2006, 12,283,195,845 and 5,930,204,164 for the year ended December 31, 2005, 10,208,327,613 and 5,795,921,069 for the year ended December 31, 2004 and 6,620,513,494 and 2,414,967,112 for the year ended December 31, 2003. The weighted average number of Ordinary Shares was 4,054,375,543 for the year ended December 31, 2002. The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares in addition to dividends paid on the Ordinary Shares. The calculations also take into account that in 2002 (after the redenomination of the share capital into Euro following the resolution taken by the Extraordinary Shareholders Meeting held on July 4, 2000) the par value of Ordinary Shares was 1 per share, and that in 2003, after the Merger, the par value of Ordinary Shares and Savings Shares was reduced to 0.55 per share. For diluted earnings per share the weighted average number of shares outstanding is increased to include any potential common shares and is adjusted for any changes to income that would result from the assumed conversion of those potential common shares.

(10) Equity under U.S. GAAP refers only to Equity attributable to equity holders of the Parent.

(11) Includes Minority Interests.

(12) Data exclude internal lines.

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

(14) Number of contracts.

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### 3.4 DIVIDENDS

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

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

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

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

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

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

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

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

(2) Approved at the Annual Shareholders Meeting held on April 16, 2007. Pursuant to Italian Stock Exchange rules, dividends on the Ordinary Shares and the Savings Shares are payable from the fourth trading day after the third Friday of each month, and in any case, at least four business days after the Annual Meeting of Shareholders approving the dividends. Telecom Italia s dividend coupons for the year ended December 31, 2006 were clipped on April 23, 2007, and were payable from April 26, 2007.

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

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

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

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

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

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

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

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## Item 4. INFORMATION ON THE TELECOM ITALIA GROUP

### 4.1 BUSINESS

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

#### 4.1.1 BACKGROUND

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

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

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

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

On May 21, 1999, Olivetti, through a tender offer, obtained control of the Old Telecom Italia Group when approximately 52.12% of Old Telecom Italia Ordinary Shares were tendered to Olivetti. Through a series of transactions which started in July 2001, Olimpia acquired a 28.7% stake in Olivetti which resulted in the replacement of the then boards of directors of Olivetti and Old Telecom Italia. Please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders Agreements .

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

On August 4, 2003, Old Telecom Italia merged with and into Olivetti (the **Merger** ) with Olivetti as the surviving company changing its name to Telecom Italia S.p.A. . Following the Merger, the proportionate ownership of Telecom Italia s share capital by shareholders unaffiliated with Olimpia or Pirelli & C. S.p.A. ( Pirelli ), Olimpia s largest shareholder, increased substantially to approximately 88.43% of the outstanding Ordinary Shares. Following the Merger, Olimpia acquired additional shares through market purchases and, prior to the acquisition by Telecom Italia of the share capital in TIM it did non already own (the **TIM Acquisition** ), Olimpia held approximately 17% of Telecom Italia s Ordinary Shares, making it the largest shareholder of Telecom Italia. As a result of a series of transactions in December 2004 and March 2005, Olimpia acquired additional Ordinary Shares resulting in ownership of approximately 21.4% of the outstanding Ordinary Shares.

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

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

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

The following chart illustrates Telecom Italia s current ownership structure.

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

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

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

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

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

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

### 4.1.2 DEVELOPMENT

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

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

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

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

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

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

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

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

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

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

### 4.1.3 Business

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

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

### 4.1.4 Disposals and Acquisitions of Significant Equity Investments in 2006

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

### 4.1.5 Recent Developments During 2007

***Entel Bolivia***

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

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

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***Change in Ownership Structure***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) Data exclude internal lines.

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

(3) Number of contracts.

### 4.1.7 UPDATED STRATEGY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

***Wireline business***

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

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

In particular, we intend to:

- maintain the domestic leadership in our core business (voice services, Internet access, data transmission services for businesses, national and international wholesale services); on voice, the process of migrating an increasing portion of our customers to flat rate packages will be a key to ensure the success of our retention strategy;

- strengthen our leadership in service innovation and increase the penetration of broadband services, through dual play offers, triple play offers, and also quadruple play offers (fixed and mobile voice, broadband access and IPTV);

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

  Introduction of Fibre and VDSL2 technology in the access network;

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

  Implementation of a full IP network;

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

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

- consolidate our operational capabilities with the objective of offering top high quality service levels to our customers and leverage opportunities to retain our client base by enhancing customer loyalty (through customer relationship management and customer contact);

- run efficient operations and continue to be focused on cost-cutting and cost control (personnel, real estate, general and administrative, network).

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

***Italian mobile business***

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

- continuous innovation and improved segmentation of voice and Value Added Services (VAS) offers; we believe this should enable Telecom Italia to retain or improve its market share and to achieve leadership in the UMTS services market;

- strong customer care, able to respond and anticipate customer needs with a segmented approach; and

- full enhancement of the potential of the UMTS network and development of mobile broadband technologies (such as HSDPA High-Speed Downlink Packet Access: a UMTS evolution that allows broadband connections up to 3.6 Mbps) and of DVB-H (Digital Video Broadcasting-Handheld: a technology used to broadcast digital video to mobile devices) services. These are expected to enable the provision to mobile customers of value added services and content now available to fixed line customers, due to the development of convergent platforms.

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

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

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

***European Broadband Project***

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

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

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

  develop new VoIP and triple play offers;

  leverage on brand and sales efficiency;

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

  launch MVNO.

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

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

  maximum commercial focus on Local Loop Unbundled areas;

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

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

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

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

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

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

Tim Brasil will endeavor to reach these strategic objectives through:

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

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

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

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

#### 4.1.8 THE ORGANIZATIONAL STRUCTURE

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

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

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

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

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

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

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

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

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On January 22, 2007, the Telecom Italia Group implemented an organizational plan aimed at adapting its strategy to the evolution and advances in technology, the market, the competition and the regulatory developments as well as fostering the convergence of the business areas (fixed-mobile, fixed-media, communication and information technology), while maintaining autonomy and flexibility.

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

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

The following reported to the Executive Deputy Chairman:

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

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

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

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

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

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

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

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

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

*and also Business Development and Regulatory Affairs Functions;*

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

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

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

* * *

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