

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:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
American Depositary Shares, each representing 10 Ordinary Shares of 0.55 par value each (the 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 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

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 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 Accelerated filer Non-accelerated filer

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

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

* 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

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, 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.

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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;

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- 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

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);
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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;

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Item 3. Key Information

Risk Factors

- 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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Item 3. Key Information

Risk Factors

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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Item 3. Key Information

Risk Factors

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.

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Item 3. Key Information

Risk Factors

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;

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- 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

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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.

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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.

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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.

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Selected Financial And Statistical Information

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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	Year ended December 31,			
	2006	2006	2005	2004
	(millions of Euro, except			
	percentages and per share			
	amounts)			
	(millions of U.S. dollars, except percentages and per share amounts)(1)			
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
<i>of which:</i>				
• 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
<i>Of which:</i>				
<i>From continuing operations:</i>				
• Ordinary Share	0.20	0.15	0.14	0.12
• Savings Share	0.21	0.16	0.15	0.13
<i>From discontinued operations/assets held for sale:</i>				
• 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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	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	6,7