

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

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**FORM 20-F**

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

**OR**

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

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

**OR**

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

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

**Commission file number: 1-13882**

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# Telecom Italia S.p.A.

(Exact name of Registrant as specified in its charter)

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Italy

(Jurisdiction of incorporation or organization)

Corso d Italia 41, 00198 Rome, Italy

(Address of principal executive offices)

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

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

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

None

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(Title of Class)

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

**None**

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(Title of Class)

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

**Not applicable**

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

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

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

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**INTRODUCTION**

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

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

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

The following important factors could cause the Telecom Italia Group's actual results to differ materially from those projected or implied in any forward-looking statements:

- the continuing impact of increased competition in a liberalized market, including competition from global and regional alliances formed by other telecommunications operators in the core domestic fixed-line and wireless markets of the Telecom Italia Group;
- the ability of the Telecom Italia Group to introduce new services to stimulate increased usage of its fixed and wireless networks to offset declines in its fixed-line business due to the continuing impact of regulatory required price reductions, market share loss and pricing pressures generally;
- the ability of the Telecom Italia Group to achieve cost-reduction targets in the time frame established or to continue the process of rationalizing its non-core assets;
- the impact of regulatory decisions and changes in the regulatory environment;
- the impact and consequences of the Merger;

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

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- the ability of the Telecom Italia Group to achieve the expected return on the significant investments and capital expenditures it has made in Latin America;
- the amount and timing of any future impairment charges for Telecom Italia Group's licenses, goodwill or other assets; and
- the impact of litigation or decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.

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

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**KEY DEFINITIONS**

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

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

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

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**PART I**

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

**Not Applicable**

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

**Not Applicable**

**Item 3. KEY INFORMATION**

**RISK FACTORS**

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

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

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

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

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

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

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

- Strengthen competitive capabilities;

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### **Risk Factors Relating to the Merger**

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

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

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

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

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



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

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

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

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

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

**Exchange Rates**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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





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

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

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

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

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

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- amount of current assets was reduced by 114 million, while total assets and liabilities were reduced by the same amount of 379 million.
- (8) Stockholders' equity under U.S. GAAP is calculated after elimination of minority interest. See Note 26 of Notes to Consolidated Financial Statements included elsewhere herein.
- (9) Gross Operating Profit was 11,821 million, 12,226 million, 13,118 million, 12,217 million, 13,619 million and 13,964 million in each of 1998, 1999, 2000 (historical), 2000 (pro forma), 2001 and 2002, respectively. Because Gross Operating Profit includes certain financial statement items and excludes others it is considered a non-GAAP financial measure as defined in Regulation G of the 1934 Act. Telecom Italia believes that Gross Operating Profit provides the best indication of the Telecom Italia Group's operating performance and is meaningful information for investors. In addition the Telecom Italia Group also believes (although other telecommunication operators will calculate such information differently) that Gross Operating Profit permits an adequate comparison of the Telecom Italia Group's performance against its peer group. The following table reconciles operating income to the calculation of Gross Operating Profit by showing the Statement of Operation items included in calculating Gross Operating Profit.

	Year ended December 31,					
	1998	1999	2000	2000 pro forma	2001	2002
	(millions of Euro)					
Operating income	4,744	6,433	6,805	6,441	6,674	7,381
Depreciation and Amortization	5,412	5,339	5,647	5,209	6,275	5,877
Other external charges:						
• Provision for bad debts	364	363	477	394	439	542
• Write-downs of fixed assets and intangibles	950	73	48	48	16	57
• Provision for risk	178	80	119	108	189	109
• Other provisions and operating charges	654	380	382	353	382	436
Other income (excluding operating grants, reimbursements for personnel costs and costs of external services rendered)	(481)	(442)	(360)	(336)	(356)	(438)
<b>Gross Operating Profit</b>	<b>11,821</b>	<b>12,226</b>	<b>13,118</b>	<b>12,217</b>	<b>13,619</b>	<b>13,964</b>

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### **BUSINESS**

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

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

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

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

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### **Introduction**

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

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

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

### **Significant Developments during 2002**

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

*The information contained herein on the Pirelli-Olimpia transaction has been taken from publicly available information filed by the parties involved therein with regulatory authorities. So far as Telecom Italia is aware, no facts have been omitted herein which would render the information misleading. No further or other responsibility in respect of such information is accepted by Telecom Italia.*

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

There are shareholders' agreements among Olimpia's shareholders.

In particular, shareholders' agreements were entered into between Pirelli and Edizione on August 7, 2001, as amended on September 14, 2001 and February 13, 2002 (hereinafter the Agreements). Shareholders' agreements were entered into also between Pirelli, IntesaBci and UniCredito on September 14, 2001, amended on September 26, 2001 and October 24, 2001 (hereinafter Agreements with the Banks).

The Agreements and the Agreements with the Banks have a duration of three years and can be renewed at each expiration date. The renewal period is three years for the Agreements and two years for the Agreements with the Banks.

The Agreements and the Agreements with the Banks deal with the nomination of the Board of Directors of Olimpia, Olivetti, Telecom Italia, TIM and SEAT. They identify the key issues on which the board resolutions of Olimpia, Olivetti, Telecom Italia, TIM and SEAT have to decide in accordance with the Agreements and the Agreements with the Banks. The Agreements and the Agreements with the Banks also discuss the rules for the resolution of disagreements among the contracting parties on key issues (the so-called deadlock situations). In addition, the Agreements and the Agreements with the Banks govern the consequences among the parties of any change in the structure of control of Pirelli (in the Agreements with the Banks) and of Edizione or of Pirelli (in the Agreements); and grant the parties the right to purchase or sell (puts and calls) Olimpia shares in the event of withdrawal from the agreements themselves.

The provisions relating to the nomination of the members of the Boards of Directors of Olivetti, Telecom Italia, TIM and SEAT are set forth below. In connection with the composition of the Boards of Directors of Olivetti, Telecom Italia, TIM and SEAT, the parties to the Shareholders' Agreements have agreed to use their best efforts, within the limits established by law, in order to cause:

- the nomination by Edizione of one-fifth of the Boards of Directors, without taking into account the directors whose designation is reserved by law or applicable bylaws to the market or other parties;
- the nomination of one director by Intesa;
- the nomination of one director by Unicredito;

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- the nomination of the vice-president of the Boards of Directors from among the directors nominated by Edizione; and
- in the event of the establishment of an Executive Committee, the election of one member of the Executive Committee from among the directors nominated by Edizione. See Item 6. Directors, Senior Management and Employees Directors .

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

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

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

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

Under the Expanded Olimpia Shareholders Agreement, Hopa has the right to appoint one Olimpia director and the Former Olimpia Shareholders must use their best efforts in order to cause a director designated by Hopa nominated to the Board of Directors of Olivetti, Telecom Italia, TIM and SEAT (with a corresponding reduction in the number of Pirelli nominees). See Item 6. Directors, Senior Management and Employees Directors.

Hopa does not have the right to veto any decision taken by the board of directors or shareholders of Olimpia. In the event of a disagreement between the former Olimpia Shareholders and Hopa with respect to the passage of a resolution by either the Extraordinary Shareholders Meeting or the Board of Directors of Olimpia concerning certain matters (including (i) the determination as to how Olimpia will vote its Olivetti shares at an Extraordinary Shareholders Meeting of Olivetti, (ii) the purchase or sale of securities exceeding a certain amount and (iii) failure of Olimpia to maintain a debt to equity ratio of 1:1), Hopa may cause the partial demerger of Olimpia, in which event Olimpia may cause the partial demerger of Holinvest S.p.A. (Holinvest), a company jointly owned by Hopa (80.001%) and Olimpia (19.999%). In the event of any such partial demerger transactions, Hopa would receive its proportional share of Olimpia's assets and liabilities (determined in accordance with the Hopa Agreement) and Olimpia will receive its proportional share of Holinvest's assets and liabilities (determined in accordance with the Hopa Agreement). Except under certain extraordinary circumstances (including the failure of Olimpia to hold at least 25% of Olivetti's share capital or to maintain a debt to equity ratio of 1:1 after a specified cure period), no such partial demerger transactions may not be implemented prior to the third anniversary of the Holy Merger.

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

Hopa, Holy, Holinvest and Hopa controlling companies (the Hopa companies), the Former Olimpia Shareholders and their respective controlling and controlled companies agreed not to acquire any additional Olivetti Shares except (i) in the case of Pirelli, in connection with the exercise of certain existing call options and swap agreements referred to in the Hopa Term Sheet, (ii) in the case of Edizione, Unicredito and Intesa BCI, as currently permitted, respectively, under the Agreements and the Agreements with the Banks, and (iii) in the case of the Hopa companies, as permitted under the Expanded Olimpia Shareholders Agreement.

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

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

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

***Updated Business Plan.***

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

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

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

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

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

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

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

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

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

The financial targets (based on Italian GAAP) include:

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



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

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

***Reorganization.***

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

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

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

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

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

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

### ***Dispositions.***

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

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

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

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

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

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

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

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

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

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

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

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

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

**Sale of Telemaco Immobiliare.** On August 1, 2002, Telecom Italia sold its 40% interest in Telemaco Immobiliare to Mirtus, an indirect subsidiary of the American real estate fund Whitehall promoted by the Goldman Sachs group, for net proceeds of 192 million. The net gain realized by the Telecom Italia Group was 64 million.

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

**Sale of stake in Mobilkom Austria.** On June 28, 2002, TIM International N.V. (TIM International), a subsidiary of TIM, disposed of its 25% stake in Mobilkom Austria group to Telekom Austria (a company 14.78% owned by Telecom Italia International as of December 31, 2002), generating proceeds of 756 million and resulting in a gain, which contributed 64 million to the consolidated net result of the Telecom Italia Group.

**Sale of stake in Bouygues Decaux Telecom.** In March 2002, the Telecom Italia Group disposed of its 19.61% stake held by TIM International in BDT (Bouygues Decaux Telecom), parent company of the French operator Bouygues Telecom, generating proceeds of 750 million which contributed 266 million to the consolidated net result of the Telecom Italia Group.

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

**Acquisitions.**

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

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

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

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

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

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

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

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

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

***Early purchase of leased assets.*** On January 27, 2003, procedures were completed for the early purchase of 12 property units (approximately 300,000 square meters) from Teleleasing S.p.A. that are used by Telecom Italia S.p.A. and other Telecom Italia Group companies under financial leasing contracts. The deal involved a total financial payment of approximately 369 million for the entire Telecom Italia Group. Certain of these assets were recently agreed to be sold. See Dispositions above.

## **Other Developments**

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

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### Recent Developments

#### *Merger of Telecom Italia into Olivetti*

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

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

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

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

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

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



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

*Reasons for the Merger.*

- *Principal Business Rationales*

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

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

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

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

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

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

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

- *Improved corporate structure.*

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

- *Rationalized capital and financial structure.*

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

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

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### *SEAT Spin-off*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

and Savings Shares treasury stock will be cancelled.

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

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

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

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

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



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

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

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

(2) The data refer to Entel Chile Group, Entel Bolivia group, the company Telecom Italia America Latina and the business segment South America of Telecom Italia.

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

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

	Year ended December 31,		
	2000	2001	2002
<b>Subscription and Customers:</b>			
Subscriber fixed-lines at period-end (thousands)(1)	27,153	27,353	27,142
Subscriber fixed-line growth(%)	2.5	0.7	(0.8)
Subscriber fixed-lines per full-time equivalent employee at period-end(2)	409	448	496
ISDN equivalent lines at period-end (thousands)(3)	4,584	5,403	5,756
TIM lines at period-end (thousands)	21,601	23,946	25,302
TIM lines growth per annum(%)	16.6	10.9	5.7
Average revenue per mobile line per month( ) (4)	30.5	29.1	28.8
Cellular penetration at period-end (TIM lines per 100 inhabitants)(%)	37.5	41.6	43.9
Cellular market penetration at period-end (lines for the entire market per 100 inhabitants)(%)			