

Telecom Italia
1H'08 Group Financial Results – Conference Call
Milan – August 8, 2008
Q&A session

1. Mr. Nick Delfas from Morgan Stanley:

Thank you very much. I think fairly much has been (...) by the length of that presentation. Just quickly a question on guidance: why do you expect to reach the guidance given the trends have worsened in Q2 for domestic EBITDA? It fell 8.5% worse than Q1... I think the guidance is more like a 6% decline for the year as a whole. And also TIM is collapsing relative to Vodafone in terms of the revenue decline. So, you're obviously having a serious competitiveness issue there. How are you going to be able to turn that around? Thanks very much.

In the first half of 2008 the organic EBITDA margin in the domestic business has... as I said before, has been in the round of 44.9%; historically, the margin of the second half of the year is lower by a few percentage points than the one of the first half. So, I think that we will... we will reach the guidance essentially through two actions: the repricing and the turnaround in prices that Oscar Cicchetti has extensively illustrated and an acceleration in the action of costs that we are taking. When we started the cost cutting program, we didn't have the entire framework under control, because there were several things under observation; as soon as we got deeper and deeper into the processes and into the organization we had a better understanding of where to address costs and now I think we have a fairly good view of what is going on and how we can tackle it. So, I mean, that's the reason why we think we can confirm the guidance.

And can I just ask... on TIM specifically: I mean, in previous conference calls you indicated that TIM would see more or less flat growth in Q2, but I think that actually there doesn't seem to be any real benefits from the annualization of the Bersani decree. Could you let us... give us a clue as to what you think the trends for TIM revenue are going to be for the rest of the year?

Luca Luciani will answer to this question.

Yes, hi. I'll take this... this answer. You know, the clear disclosure of Vodafone in Italy is not so, let's say, white to do a deep comparison. According to our figure, there is no difference in market share trends; the key difference in advantage of TIM is in value-added services and especially in interactive VAS while they apparently are performing better on traditional core business, I mean the outgoing voice. What we did is exiting from Bersani elasticity... we had, let me say, lower volume, still positive, +16%, but not yet price up. This is the key reason why we're implementing the repricing. Now, overall, if you look at the gap between Vodafone and TIM it was more than 6 points in the first quarter, now we halved this gap and we think that we'll close further the gap in the second part of the year.

Thanks very much.

Please, the next one...

2. Mr. Giovanni Montalti from Cheuvreux :

Good evening to everybody, I would have a question on the regulatory side: in the last months there were, I mean, some expectations about potential (...) from the ongoing regulatory review process. I wanted to know your view about... I mean, what might be the outcome, especially with regard to the ULL tariff and the potential revision of the access tariff or traditional telephony. Thank you.

Thank you for your question. I think that what has... I mean, first of all I must say that for the first time I think that the problem that you were mentioning has been brought to the formal attention of the regulatory authority again. There is strong pressure and everyday there is a press... an interview by some of our competitors that claims that this is something that the regulatory body should not consider and should not... should not consider with respect to the requests that we have presented to them... what... what we have seen on the contrary is that the regulatory authority has seriously taken the problem into consideration. Of course it has not given an answer yet but for the first time in a long period the question is on the table, they are discussing it, and I'm fairly positive that they will come up with a solution. The size, the measure, the timing, everything is completely, of course, out of our control, because it is entirely a matter of the regulators, but I think that at least the problem has been posed, they are discussing it very seriously, I think that the arguments that we have presented to them are very solid and we are fairly confident that we will be able to sustain our reasons with respect to the entire process of changing the way of pricing the... unbundling of local loop from historic cost structure to an incremental long-term cost structure.

Sorry, may I follow up?

Sorry? Say it again?

May I follow up? I mean, just one more question if I may.

Yes, please.

About... I mean, do you expect this potential revision to come along with the revision of the tariffs for the access... traditional telephony, I mean, in order to keep the gap between the retail tariff and the wholesale tariff stable as, I mean, this gap is the lowest among European countries.

Well I think it's a fair question. Of course, I don't know what the answer is. I think that it depends on the side from which you look at something. Certainly, from our competitors' point of view this is a desirable outcome. I think it's entirely up to the regulator to take a decision, but the good news is that finally this thing is being discussed and is being discussed very seriously by everybody.

Okay. Thank you.

3. Mr. Stefano Lustig from Euromobiliare SIM:

Yes, good afternoon. Just a clarification on the tax benefit in first half. If I understood well, in first half we recorded the full P&L benefit but still we have to take into consideration the benefit from the cash point of view. So, the cash benefit is distributed in three years while the P&L benefit was recorded in first half 08. I was just willing to check if I understood well. And then the second question, always for Mr. Parazzini, is if you could give us an update on the current cost of debt for the group? Thanks very much.

Yes, but well... you have understood well, according to what I can interpret. Anyway, I'll repeat it. The benefit in the P&L is coming from the possibility to pay a lump sum, half a billion, and on the

other side to take advantage in future years of the lower taxes you pay of additional depreciation. The whole P&L effect in this quarter is coming from the cost of half billion and the benefit of the write-off of the (...) tax liabilities for 1 billion. The net is half billion. This is the P&L effect. We have assumed and we have included in our budget to pay half a billion in this year because it was not clear. It became clear in the following months that the payment should have been by installment in three years. So, you understood correctly. We have paid one third of that; we have to pay the other two thirds: one in 2009 and one in 2010. We will have a benefit from a cash standpoint in this year and a negative effect in 2009 and 2010, but without any changes on the level of the debt in our plan because it was taken into account the cash-out flow when I mentioned 1.4 cash-out flow for taxes in 2008 I included this amount. We have saved about two thirds, so the cash-out for taxes is now foreseen in 1.1 billion instead of 1.4. For what regards the cost of the debt, we are around 5.9% all included in six months; we expect to be around 6% by the end of the year. The cost of our debt. All included.

Thank you very much.

Thank you.

4. Ms. Carola Bardelli from Deutsche Bank:

Yes, good evening. I actually have a couple of questions, if I may. The first one is on targets: you are downgrading the 2008 target. I was wondering what we should apply in terms of KAGER 2009-2010. So, should we still apply the 1-2% growth for the sales over the revised 2008 number and the 39% margin going forward? And the other question I have is actually on dividends: given, again, your revising down, I was wondering what are your thoughts with regard to dividends. Do you still see it as a floor as you mentioned in the past or are you considering a potential cut? And this leads me also to the other question on the financial flexibility that you have. So, basically, the question would be: you're targeting three times that EBITDA by the year end what would be the level that could lead you to further downgrading your rating? And in case... let's say in a worse case scenario where you need to make some sacrifices, what would you be prepared to cut? Dividend? Go for a capital increase... as some papers were mentioning.. or the disposal of Germany potentially? Thank you.

I think that we need a new conference call to answer all your questions, but I'll try to be very synthetic. First of all, I think that the entire framework that we presented today indicates that we have taken extraordinary steps in the first half of 2008 that will not, of course, be repeated, except if we come up with deeper cuts in costs and so on and so forth. So, I think that we... what we can say is that except for what happened in Brazil and in Germany, which is now strictly under control, we confirm whatever we said and we will stick to this. I think that this answers all the rest of the questions. There will be an appropriate time for giving detailed answers, but I think that really what we will be doing now is confirming whatever we said.

So, basically, with regard to the dividends, it remains the idea that what you paid for last year is a floor for distribution... in your mind?

I said that we... I mean, whatever we said we confirm. I mean, there is no change. What happened so far is a... the consequence of few things that happened in Germany and in Brazil and we confirm what... I mean, the performance in the domestic market.

Okay. So, just one clarification with regard to the flexibility for a potential downgrading versus the 3 times what would be the level that would imply a downgrading of the rating? Maybe it's more a question for Mr. Parazzini.

Yes, yes, yes. Good evening. We... in our targets we confirm that the ratio of the debt will be (...) by the end of this year is anyway expected below 3. So, it's in line with the final target that we gave by 2010 of 2.5; we don't foresee any significant risk of downgrading because... because of that. I had phone calls with... unofficial, of course... with the rating agencies telling them, commenting with them our results and our forecasts and the reaction was flat. So, they don't... there is no reason to expect any revision in our rating because of the results we reached. They confirm their opinion in a recent study by SNP of the strength of our business and also commenting this for SNP there is no... no problem on that.

Okay. Thank you.

5. Mr. Justin Funnel from Credit Suisse:

Thank you. Two or three questions, please. On your pricing strategy and Italian mobile: that's quite an interesting approach to put your prices up; do you feel that your competitors will follow your lead here? We're all trying to see how and if they don't how can you avoid losing market share? Secondly, (...) a retail product you're launching can you give us a flavor to what discount that product is compared to your existing wireline retail products on a like-for-like basis? And thirdly, just following up on the Deutsche Bank question on the credit rating: would you be comfortable with a triple B minus credit rating or would you seek if your rating was put on negative watch, would you try avoid being downgraded to that level? I understand it's a hypothetical scenario...

Well, I would say the last question... I would not answer to a purely hypothetical question... I mean, I don't think that it's something that requires an answer, because there is no issue there. In... concerning the first question, I would like Luca Luciani to answer and the second question Pietro Labriola to answer.

Well, as a general trend I think yes. But some specification: last year, when the Bersani decree had been implemented our competitors priced up, mainly Wind and Voda; we didn't, because the conditions... the overall conditions of the group didn't leave us, let me say, a proof situation to price up. I think that there will be no change in market share because Wind is in any case convenient versus us up to now, so that the customer satisfaction of people who charge TIM is not because of convenience, because in any case we are price premium significantly versus Wind and in any case we are price premium versus Vodafone. I think that our main competitor Vodafone overall is following the same approach to create value, to defend the mobility price premium and if you look at the last eighteen months, in the Italian market the price of the core business dropped very much so that I think that is a, let me say, waterproof situation to have, let me say, intelligent, smart price up. I say smart because on one side we increase price, on the other side we give options to our customers to increase the usage so that net-net it could be a win-win solution.

Okay. On the fixed side, as we already mentioned during the presentation, the first item that has allowed us to reduce the cost was the rationalization of our portfolio services working more on services with high marginality. This allowed us to reduce commercial costs, but also to work on other hidden costs that are inside the company. Comparing our cost structure towards our competitors, we don't think that our competitors can approach.. can use our same approach and on the other side we can see in the future a higher cost of acquisition on the competitor side, due to the fact that the acquisition and the migration of customers from CPS and customer selection to unbundling local loop, (...) rental and naked is going to increase, owing to the fact that the number of customers that can be migrated is reducing month by month. Relating instead to some more details of our new offer, we can mention, for the fixed, two main items: the first one is the Alice naked offer, that will give us a good impact in terms of soft aspect of the offer on the marketing

side, due to the fact that for the first time we can cancel the word “canone”, the monthly fee of the line, from our customer bill. All market researches demonstrated that this is one of the most negative aspects in terms of capability to push our offer on the customer side. The other offer is Punto Land, the one mentioned before; for people that are more familiar also with the Spanish market is... what in Spain is called “resquest and presario” but is a more innovative version that works on IP. What we will supply to the customer will be only one access for VOIP, broadband and ICT services. It will be a real breakthrough because it will allow us to use, to exploit in a better way the sales opportunities with only one activity selling three items and it will be... this is the pact that we think... to follow in the next months also to continue to reduce our commercial cost.

Thank you. Just to be clear: the Alice naked offer, obviously you cancelled the monthly fee for PSTN... but just to compare that to a similar product including the voice fee, is there a discount or is it just, call it a (...), but effectively it's the same price but packaged in a different way.

No, we.... we... there were problems with the line, probably. We didn't get the question... yes. Yes, okay.

Okay. No, it's nothing really incredible. What happened is that today in the market not only in Italy but also throughout Europe the offer is a kind of bundle where we have access, broadband and flat rates for all voice traffic... national. The only exceptions are: international traffic and fixed-to-mobile. So, what will happen is that, starting from that date we will be able to supply this kind of offer with only one price x and the difference is that people will be able to read on the bill this amount without reading anymore the word “canone”. This is, to give you an idea, the same approach that was followed by many of our competitors that in the advertising campaign shout that there is no more canone in our offer and, at the end of the day, the price sometimes is also higher because it includes also the canone.

Okay, thank you very much.

6. Mr. James Ratzler from New Street Research:

Yes, thank you. I have two questions, please. The first one was: if I look at your presentation on the operational side... on page 24, it looks like there's been very strong growth in data cards specifically, what you call internet keys and laptops, in the first half of this year. And that seems to have corresponded with a slowdown in the fixed broadband market and what seems to be a much sharper decline in the overall number of fixed lines in Italy as a whole. If only you could just talk to us a little bit about what you're seeing for growth in the mobile data card market? And what substitution impact that's having on the fixed line business? And if it is having a substitution impact on the fixed business why that's not going to get worse going through this year and into 2009? And the second question I had was just regarding the ongoing tax investigation from authorities; I think on the Q1 call you said that the government asked for payments of 180 million euros out of the total 3.3 billion and this thing's investigated. Could you give us an update on where that stands, please? Thank you.

Luca Luciani will answer the first. Mr. Parazzini will answer the second.

Well, your question is very appropriate. Our strategy is not to promote the pure mobile market creation. Up to now this results from the fact that we do not introduce a very big bundle in terms of bytes... keeping a mobility price premium on data, looking forward and you have basically the concepts on page 26; what we are going to do is on the contrary to leverage the very wide existing customer base of wireline ADSL in the mobile data environment. That's the convergence of Alice. It means that we are going to offer an internet key, a mobile modem, with a small byte bundle to all

the existing ADSL customer base. And that's the key aspect in order not to switch from fixed to mobile in broadband.

And are you actually seeing people dropping fixed lines at the moment to take out mobile data cards, please?

That's actually not so. Most of the people that are taking the internet key now are, let me say, professionals or prosumer people and they need it to have an always-on connection, an outdoor connection to Internet to work.

For what regards your second question, about the investigation on taxes, there are no significant news. I'll take anyway the chance to repeat and explain that we, as a matter of fact, have... an access from the revenue agency but... regarding the Blue deal, and for what regards the other, I just have reports from the so-called Guardia di Finanza on which there are talks about that but no assessment has been made by the revenue agency. On Blue the good news is that we were requested, and we reported this in the first quarter, to pay 180 million of the total 1 billion requested by the revenue agency by April if I remember well... we appealed and we won and we had a relief so we will not pay this advance of 180 million. So, we are contesting, we are in contest with the revenue agency and we are going ahead. No significant news except the good news that we had a relief not to pay the 180 million in advance.

Next question?

7. Mr. James Britton from Lehman Brothers:

Thanks very much. I've got three questions. Firstly on the mobile price increases: what is the average increase in prices that you're planning? And are you going to risk increasing mobile prices for business customers as well? And secondly: the economic slowdown in Italy's pretty evident; what do you see as the economic impact on your business, especially in light of the prepaid nature of the mobile market? And then, thirdly, on the restructuring agreement with the Unions: when do you expect to finalize this? And will you have to compromise on wage settlements in order to achieve the headcount target? Thanks very much.

Luciani will answer the first two questions and I will answer the third one.

Yes, we did increase... we already did increase the price in the business market, overall ... if we look at the evidence that we do have up to now, considering both the business markets and the consumer with the Autoricarica Manovra and the TIM Tribù that have been already implemented, let me say that general behavior of the customer is under control, so that those customers that are more relaxed, especially on TIM Tribù, who have the way-out option to migrate to a very good tariff, and in any case TIM Tribù concept maintains a significant price advantage versus all other market concepts. B: of course, the price-up activity can be, let me say, tough in the market, especially in the low-end of the market. But if you consider that, let me say, most of our revenues come from high-end consumer market and business, let me say, these... these people are less price sensitive and more value-added sensitive; so that... that's the reason why we do not imagine a big turn among them.

So, what is the average increase in price that you expect?

It's, let me say, the equivalent is... 3 euro/cents on the average of the prepaid. It means that, overall, it means something like a 12% increase in the prepaid market.

And the business on the postpaid side?

Ah, the business has been already increased by 15%, with no major... on. On the... of course, I mean, this price increase is not impacting all the consumer market, but some specific ... that are planned. So that the blend effect is slightly lower.

An answer on the question on the redundancies just to tell you that the redundancy process in Italy is a very complex one and it has a number of steps that have to be formally taken before you go into the execution phase. With letter dated June 26, the day on which procedures started, according to the provisions of a law, which is law 223, which provides for an early phase of negotiations which lasts 45 days, that has to be carried out within the company. We held meetings with the Trade Unions, but no agreement has been reached; at the end of August the second phase will be started with the mediation of the (...) Ministry and another 30 days will be available to reach an agreement. I think that at the end of this period, that means, say, by the end of September - early October, we will close the negotiations and we will proceed.

Thank you.

Next question, please.

8. Ms. Micaela Ferruta from Intermonte SIM:

Good evening, I have... well, a lot of the questions have been answered, so three quick questions if I may...

One is: after the provision that has been released and so on and so forth, can you give us an updated guidance on the tax rate that we should assume for 2008 and, if possible, 09 and 2010? Second, you mentioned the fact that you're increasing prices in mobile and you're introducing new offers in wireline: is there any scope for price increases in wireline in 08 or going forth in 09 as well? And, finally, an update on the sale of Alice France. Thank you.

Mr. Parazzini.

Well, for what regards the taxes... well, of course, this year, taking into account the benefit we had in the P&L, it doesn't make any sense to talk about the rate, because we have an unusual benefit that should affect our rate. Anyway, normalizing our tax rate we confirm that we are in the range of 39-40% for this year and the same should be for the three-year plan. This year, taking into account this advantage, we will be lower than 30%, because of that; but normalization of tax rate is 40.... billion that as an advantage as compared to the previous year, due to the change in the rate for IRAS and IRAP provided by the finanziaria law of the government.

On prices... on the wireline: differently from what happened on the mobile side, in the fixed market we have several areas that are regulated, so the pricing cannot be incremented. For example, when we discuss about traffic we cannot increase prices and in the case of fixed-to-mobile our decreto ministeriale tariff is strictly correlated to the termination cost, so we usually decrease the price when the termination cost decreases; and we could increase prices when the termination cost should increase. On the services that are not regulated, our approach is more to try to increase our ARPU increasing or upselling the customer base. You will have better numbers also in the last two quarters of the year in terms of rebound of ADSL ARPU and this is an example of the way with which we want to work to increase our ARPU: migrating customers from free to flat and upselling them to new offers.

On France Cicchetti.

As far as Telecom Italia France sale, we are waiting for two important preliminary conditions: the first one is the antitrust approval and the second is a good answer from Unions, from local Unions. Our forecast: we feel confident that the deal will be closed in the first half of September. Of course we feel absolutely confident about the approval from the antitrust.

Thank you. Next question.

9. Mr. Terry Sinclair from Citigroup:

Thank you. Just a couple of numbers I'm striving to get straight. First one, can you give us a number for the total cost savings administered? You mentioned at the beginning of the call... cost savings were (...) in 2008. Is it possible to have some for the period to 2010? And secondly, I'm just interested to know whether you can give... on slide 19 you talk about the share of (...) customers... as now 32% of your customer base is from this market; what share of revenues does that represent? And is there currently an evidence that competitive pressure in US market is actually worsening in the high-end... in which you are increasing your presence? Thank you.

On the detailed cost savings, I think we already disclosed several times what our targets are for the present planning horizon. The next planning horizon will give a more detailed analysis of the cost cuts. I didn't get the second question that you...

Yes, just sticking with the cost cuts: are you able to confirm that those targets are maintained without any change? Not... the targets you gave on the last Investor's Day...

... wait a second... could you repeat? Because I think we have a terrible line and we really don't catch your... your questions.

Yes, I just asked a confirmation that the cost targets that you set up significantly at the last Investor's Day are the ones that you just (...) that there's been no change in them and that you don't refer to changes (...) within the year?

I... I mean, it's terrible... the line is terrible, but, I mean, if I understand correctly, you're asking me if I confirm the targets. Yes, I do. I mean, as we said, as we've already answered before, our answer is: yes, we will update the plan at... when we declared we will be updating the plan and at the time we will give more details.

Thank you very much.

Okay. I think that if there are no more questions, I wish to thank everybody and I excuse myself for keeping you so long during the... during the Olympics opening, but I think we provided you with all the information you needed, and our investor relations is available for any more questions that you have. Thank you very much and have a good weekend.

Ladies and gentlemen, the conference call is over. Thank you very much for your attention.