

Telecom Italia
FY'08 Group Financial Results – Conference Call
Milan – February 27, 2009
Q&A session

1. Mr. Nick Delfas from Morgan Stanley:

Yes, thanks very much. Two questions. First of all, on the public administration contracts: can you give some idea of the planning of any decisions by CNIPA and the other administration on... on returning some of those contracts to Telecom Italia potentially? And secondly on capital spending and VDSL: could you give us your perspective on what you think you are going to achieve for 2009? Thanks very much.

Thank you for your question. The answer will be given by Oscar Cicchetti, who's the Head of our Commercial Domestic Market Operations. And the second question will be answered by Stefano Pileri, who's the Chief of our Technology and IT Department.

Yes, as for the public administration contracts, the first is... regards wireline voice services. The new tender is expected in the coming months. We, of course... Telecom Italia lost the contract in the previous year, so now we are... we will fight against our competitors, perhaps there are two main... the entire contract will be split in two parts: one for the central public administration and the second for local. I think that the conclusion of the process will... will take place within the first half of 2009. The second is for mobile services: as you perhaps already know we won the contract and we are implementing the migration from Wind to Telecom Italia. The third regards the collectivity: and Telecom Italia lost the contract and... but as a consequence of this, we lost more or less 25% of the market share, because we have been able to maintain some important contracts in the local public administration. And the fourth is for the application... shared application. We won an important contract and we, as a matter of fact, are hosting all the portals of the public administration.

Thank you Mr. Cicchetti, Mr. Pileri.

Yes. As you have seen during the presentation, we have got the target in capex in 2008 going on with a very strong strategy in efficiency and focusing our capital expenditure in the main... important areas in terms of market development. We will follow the same strategy in 2009 and we are confirming our positioning in 2009 with approximately 4.8 billion capex for... in very high... decreasing in terms of comparing the capital expenditure in 2008 with the capital expenditure expected in 2009, in accordance with our target. In terms of the main... important capex allocations that we had in 2008 in the domestic... we had approximately 3 billion and 700 million euros of capex expenditure with 2.6 focusing in the technical infrastructure, mainly due to the mobile and fixed broadband evolution and our service platform and IT expenditure.

Thank you Stefano Pileri. Next question, please.

2. Mr. Jonathan Dann from JP Morgan:

(...)

Mr. Dann, please proceed with your question.

Sorry about that. I'm a telecom analyst with telephone problems. My question is a straightforward one. Can you talk us through on how recurring will... what will happen to working capital during 2009? And secondly, could you just make some comments on mobile trading in the first quarter? So, sort of prices, volume trends... what we can expect. Thank you.

Thank you very much. The first question will be answered by Mr. Patuano. The second question will be answered by Oscar Cicchetti.

Well, the dynamics of the working capital are strongly influenced by the capex and the opex evolution. As you know, any reduction in capex and opex directly affects the working capital... and of course on trade payables. What we expect on trade receivables... so, the effect coming from the reduction in the expenditure in the cash cost program directly affects working capital. Now, what is much more interesting is what's going on with trade receivables, since, you know the effects on the crisis in the (...) of the customers is something we are strictly monitoring. At the end of 2008 really nothing happened; to be honest, we have been positively surprised that the payments were absolutely more than in line with our expectations. The beginning of 2009 is still not critical but we see in some compartments around us that there are... they are showing some effects on the payments. Especially in small-medium enterprises. Let me say that the consumer market is not very much affected but small-medium enterprises can suffer more than families and the consumer market. So, I will expect some... some negative effect on this side and it won't be very surprising.

Thank you Mr. Patuano. Mr. Cicchetti.

For the mobile, first of all let me underline that our repricing maneuver in the second half of 2008 has been successful. As a matter of fact, we increased... we have been able to significantly increase the price per minute, now we close the quarter with 12.7 euro cents per minute; the usage per customer is more or less stable in comparison with the previous quarter but it continues to grow if compared year-on-year. The consequence is that the global volume of traffic is more or less stable; we are losing some traffic volume, but it's... the general trend is stable. And so let's say that the repricing strategy has been successful. At the basis of our repricing strategy, as already mentioned, we also have the objective to regain flexibility in order to restart with selective and creative promotions. Just to remind... to highlight something that Franco Bernabè was talking about, it's the important trend in broadband services. As Mr. Bernabè said, we have been able to enrich our customer base, we have now 2.6 million subs, and this is giving an important contribution to our brand ARPU and the single ARPU of those customers is more than 20 euros per month.

Next question, please.

3. Mr. Eric Sinclair from City:

Thank you. Good afternoon. Two questions for me. One is on domestic margins: correct me if I'm wrong, but the organic margin, which is just around 9% last year,(...) the target is 46% in 2011, and that goes with the cash cost of revenues changed from 71.5 last year down to 67-68 in three years' time. My first question is: would it be enough just to reduce costs to meet that margin target? Or do you believe that, on a structural basis, you'll have to continue raising prices from time to time? Would the cash cost change alone manage that margin target? The second question is a most simple one: I wondered if you're still as comfortable with the disposal target that you gave us in December of 2-3 billion? Thank you.

Okay. Thank you for your question. I think that the first question is quite important, because in these uncertain times with the macroeconomic environment which is... which is very complex, I

really don't want to rely on revenue targets, but I want to rely mostly on cost cutting. And what we have seen is that the cost cutting process that we have been... we have been able to start very successfully has gained momentum during the year and after the agreement with the trade unions on September 18, we were able to go ahead very quickly with the layoff program. As you may remember, many of you had questions on whether that program would have been backloaded or frontloaded and in fact I think that we're quite happy to see... to show you that the program was frontloaded. And this is the reason why we engaged in a second... in a second exercise that is still to be completed in terms of negotiations, but that will, I think, continue along the path that we have established here. So, my main objective is to go on with the rationalization of the cost structure; we will, of course, not only rely on layoffs, because, of course, they are, in the present environment, we think that we need to be very... very... also very careful of the human impact of this. But at the same time there are lots of costs that we can take out, in terms of organization, of structures, of redundant structures; we have dramatically simplified our organization. As a consequence of the reorganization, the consumer... the customer-centric organization that we have implemented last month, we have reduced the management positions by about 33%. This means not only, of course, layoffs, it means less costs, rationalization of real estate, rationalization of all the general and administrative expenditures. So, this is our core focus, and I confirm that the targets that we have set in terms of cash costs over the period are fully confirmed and we are very strongly committed to this. The second question on disposal: I think that what we have... what we are in the process of disposing are very good assets, I think that they create a lot of value for those who will buy them, because they have a strategic fit with a number of our competitors and of our peers in the industry, so I think that we will be able to fetch very decent prices from the sale of these assets. I think that this is mostly... this will be helped... the process will be helped by the opening of the market for corporate bonds; what we have seen in the last 45 days and that we keep seeing is a very healthy market for refinancing, that means that at least for the short term, I mean where we have visibility, there is financing available for those who want to engage in MNA and for the time being we are very confident. And, by the way, as I said in my presentation, we have specifically designed an organization to take care of the divestiture process, in order to... the head of the organization and the entire organization to be fully focused on the targets.

Thank you very much.

Next question, please.

4. Mr. James Britton from Nomura :

Thank you. I have a question on the economic impact you're seeing. Can you just give a bit more detail about the impact you mentioned on content that... which has emerged in the last few months? And also what impact do you expect on ICT spending in 2009? And the second question is just to clarify your expectations for cash tax for 2009? Thank you.

Okay. I'll answer the first question, then I'll turn it to Marco Patuano for the cash taxes. On the first question what we're seeing is a decline in the kind of expenditures that are related mostly to, say, downloads, ring tones, and so on and so forth. While we see a very healthy growth in terms of micro-browsing and of navigation, internet navigation, through mobile devices; so that what we have seen, substantially, is that the trend keeps growing, while traditional SMSs are flattening out and declining. But the pickup in data traffic on mobile is quite... I would say we have... we see a dramatically high figure, because year-on-year we have an increase in data traffic on mobile of 2000... 200... more than 200%. So, we keep seeing a healthy traffic in micro-browsing; people are getting used to micro-browsing in a country that has more 3G mobile phones than computers. We see the internet being developed by the usage of new handsets and by the new devices, including netbooks. Now let me turn to Mr. Marco Patuano for the second question.

Well, as we explained during the conference we had in December, we were expecting for 2009 cash payments something in the region of 2.5 billion euros. Now, this figure has to be revised in something lower, let me say something between... something in the round of 2.3, given the fact that we didn't receive the concession fee for 2000... for 1998, so since we haven't the concession fee in our results, of course we won't pay taxes on this figure; on the other hand, a part of the settlement of the tax litigations we had, or the tax complaint we had with the Tax Bureau in Italy has to be paid in 2009, approximately 100 million euros. So, net on net, it's in the region of 2.3 billion euros, keeping in mind that this year we will pay almost the double of normal... nearly double of the normal amount, in terms of cash.

Thank you Marco Patuano. Next question, please?

5. Mr. Justin Funnel from Credit Suisse:

Thank you. A couple of questions, if I can please. On slide 6 of Mr. Patuano's slides, there's a very helpful breakdown of savings. The last of the red rows is other... it talks about that decline of 221 million euros and that since redriving what is other than interconnect the biggest single saving in 08. I was just wondering what that has come from. Is that a south help program you've put in to control bad debts or is it just something that's naturally coming through in the business? Secondly, I was just wondering if you could give us a notion of where you are in terms of your discussions with rating agencies? I believe that they will be revealing the right thing after these results. I was just wondering if this is correct and where you stand? Then, finally, judging from the numbers you've given us, it looks like the yields you accepted on the private placements match 7%, should we see that as a sort of yields you have to accept when considering bond issues in the future? Thank you.

Well... Marco Patuano speaking. I will answer to all your questions.

Thank you.

First of all, on bad debt reduction. During 2000... at the end of 2007, we posted an amount in our balance sheet in order to clean all the trade receivables in 2008. This year... it was not only intended to clean the position with the consumer... customers, but also some of the problems we had with the alternative operators. So, during 2008, we have made almost all the cleaning up of the credits; we do not see for 2009 the need for another extraordinary action in this sense, and, once again, on the working capital in 2008 we have settled the large majority of the problems we had with other operators, so no major posting on our balance sheet is needed. So, this is the reason why we do not expect other further cleaning in 2009. The second question was... on the rating; the answer is yes, we had some preliminary discussions with the rating agencies, during the next week we will have a second session of discussions with them. The rating agencies are pretty satisfied with our figures, with our policy, with our financial discipline we are not only on track, we are very well... coherent with what we say and what we do and I think that this is really what the counterparties really appreciate in our management. Your third question was on private placement. Let me say that in January we did a private placement of 500 million euros; generally speaking, it's something we do not do ... generally we allocate our bonds on the market and... it was in any case important because we have been able to fix a point well below the theoretical curve of the CDS. So, it was very important to show the market that we were able to fund at a lower (...) cost versus the theoretical spread. Now, our major interest is for a market deal and we do expect better conditions versus the ones we have negotiated one and a half months ago.

Okay. Thank you.

Next question, please.

6. Ms. Zangua Doucean from AXA:

Yes, sorry, my question has been answered already. Thank you very much.

Thank you very much. Next question, please.

7. Ms. Micaela Ferruta from Intermonte SIM:

Thank you very much. I have three questions. One regards the negotiation with the unions regarding the further employee cuts you announced in December: you sounded a bit conservative before, when you mentioned further labor cuts, so I'd like to get an update on the issue. The second question regards the concession fee: what is happening there? Will you appeal the decision of the TAR del Lazio and what is the timing we should expect on this issue? And, finally, I don't know if it's possible to get a description of... or breakdown of your costs or cash costs, which is similar to what other competitors do and they distinguish between variables or dependent on traffic or dependent on market versus fixed costs? So, how much is it? Actually... just to give us... or for us... sorry, to get an impression or to be able to appreciate what the lever is, should be, as the economy deteriorates further, for you to accelerate on the cost cutting program, which you said appears to be frontloaded versus backhand loaded? Thanks very much.

Well, on the first question... thank you very much for the three questions, first of all. First, on the question on the negotiation with the unions, I want to say very clearly that we want to address the problem of layoffs in a very respectful way of the human problems that are involved, and therefore we will engage with the trade unions and we will negotiate the objectives with the trade unions. As I said before, our approach is not a wholesale approach, our approach is very specifically targeted, we want to cut out costs and curb out costs from our organization, which means not only making it slimmer but also making it more efficient and, therefore, if we can put that good use, people that are redundant in certain areas this will be done. So, the negotiation will take whatever time will be needed, but we are very confident that, given the fact that we approached the question very seriously and very respectfully for everybody who's involved, we will make good progress. On the concession fee we have already... we will repeal in a very short time and given the fact that the Court of Justice has already declared that... our right for the concession fee, I think that the appeal to the... to the final stage of the administrative justice, the Council of State, will be successful, but I think we will see the decision at the end of the year. And in terms of breakdown of costs, as you have noted, we have done a very careful representation of the areas where we want to cut costs. We have defined seven projects and these are structural cuts in costs that are being pursued very aggressively. By the way, just to give you an indication, we have done a success... after the presentation of our plan, we have done a... because it took a much longer period of time, we have done a very detailed benchmarking of our costs compared to our peers. And what comes out from that benchmarking is that the targets that we have given ourselves mean that we will become one of the most efficient operators among our peers. So, it's a very challenging target, we are very proud that the objectives... we have given ourselves are very... are very important, and the entire structure is committed to this. But I'd like Marco Patuano to add a few figures in order to clarify your question a little bit better.

Yes. I'll focus on the domestic market, because I think that the bulk of your question is on the domestic market. So, if we assume a total opex of around 13 billion, we can say that more or less

50% is variable costs, which does not mean that you cannot also compress the variable costs, and another 50% is fixed costs. Of course, the level of... the level of intervention is totally different. On the capex side, I'll give you a different split. So, we can say that almost 3 billion is technical capex and almost 700 million is commercial-related capex. So, the way we can squeeze down capex on the technical side and on the commercial side is, of course, different, but I think that you were interested in a rough representation and this is a good one.

Thank you very much. Next question, please.

8. Mr. Ottavio Adorisio from Société Générale:

Hi. Good afternoon, gentlemen. A couple of questions, if I may, all regarding your debt. The first one is on the estimate for the currency and dividend guidance. If I'm not wrong, you used 2.56 and currently the Brazilian reais trades around 3 to the euro. If I understand well, most of your debt, if not all your debt is in that currency. Could you just give a sort of sensitivity analysis of how you're giving ... would move if you would use 3 to the euro for the Brazilian reais. And if this also... entering your negotiations you discussed with the agencies. The second one is on the credit facilities: could you just tell us what is the cost you would have to access these credit facilities and how this cost compared with the service to put the cost of the service at (...)? Thanks.

Thank you very much. I'll ask Mr. Patuano to answer.

First of all, our hedging policy is to have the financing line hedged with the currency of the cash flows coming from the operations. So, we have all the financing in euros for the TI group that are hedged with the euro; by the way we can say that two thirds are euro, one third is currencies different from euros, mainly US dollar, which is two thirds of the FX part and the sterling, which is almost the other third. We have some yen, but really very few. For the funding we have in Brazil, the hedging is in Brazilian reais; so, we hedge the financing we get in currencies different from the Brazilian reais in Brazilian reais, so that at the end we have fully hedged also this exchange rate. So, today we have 1.6 billion which is in reais, reais-denominated, and we have approximately 500 million which is euro-denominated and which has been hedged in Brazilian reais. Of course, you know that the hedging market in Brazil is shorter term than in Europe, so we have a fair value hedging. The average cost of our facility is EURIBOR +30 basis points, three-zero, which is extraordinarily good; and the cost today for accessing to the bond market in euro terms we assume... around 500 basis points over the curve, depending on the time... we are assuming seven years. Of course, for a shorter period we assume a lower spread. The curve of... we are looking at the curve... the shorter part of the curve in euro and, let me say ten years for the dollar.

Thank you very much. Next question, please.

9. Mr. Stanley Martinez from Legal General:

(...)

Mr. Martinez is not available at the moment. The next question comes from:

10. Mr. Mitchell Collett from Cazenove:

Hi. So, Mitch Collett from Cazenove. Two questions, if I may. Firstly, I wondered what the process was that was set in the guidance for 2008 for Brazil and, looking at what we said in December, it didn't appear particularly achievable and I guess, given what they reported today, it now looks as though you need 10% revenue growth in 2009 to get your targets, which doesn't feel (...) targets, particularly given that they're going to go through such a basic cleanup in the first half of the year. And then, secondly, I wondered if you could talk us through where we're seeing the 1.3 billion of synergies, as Telephonica said that they're getting with you, of which, obviously this 55% is supposed to come through TI. So, I guess the progress on that one and also the curbing. Please. Thanks.

On the first I'll ask Marco Patuano to answer and the second I will answer.

Yes. We are aware that in terms of revenues the target for Brazil is tough. We do expect the year 2009 in Brazil to be made in a very different... with very different... two parts: the first part will be influenced by the relatively weak fourth quarter we had, so it will be necessary to prepare the ramp-up in the second part. We are aware that the plan is not easy on the revenue side. Let me say that if we look at the plan for 2009, it's much tougher on the revenue side than on the free cash-flow side. So, free cash-flow we expect can suffer less than revenues, even if we think that in order to have a better picture of Brazil we need to wait at least one quarter and to have a better figure. In terms of free cash-flow generated from Brazil, our business plan, our group business plan was expecting 200 million euros from Brazil in 2009. So, as I told you before, it's reasonable to think that on the free cash-flow side any impact can be not dramatically affecting the group synergies.

On the synergies with Telephonica, I can confirm that the program of 1 billion 300 million synergies over the period 2008-2010 is confirmed. We have achieved 200 million synergies that we declared for 2008 and 55% of these synergies belong to Telecom Italia group.

Thank you. Next question, please.

Thanks.

11. Mr. James Ratzer from New Street Research:

Yes. Thank you. I also have two questions, please. The first one's regarding the dividend you've set. I was wondering if you could talk a little bit about the decision-making process behind the 5 cent choice of dividend and to what extent... particularly interested... were your controlling shareholders Telco involved in this decision? It strikes me that at that kind of level it might struggle to service their interest payments at the Telco group. I mean, with that in mind, do you expect any change in the shareholding structure at Telco over the next twelve months? And the second question I had was just regarding your wireline broadband growth: it seems to have slowed quite sharply in the last fourth quarter. It looks like growth has currently been running around a 2.5%; is this a new run rate? And how do you see the retail broadband business developing? Thank you.

Thank you very much for your questions. As we have said, we have chosen and proposed a conservative payout for this year to allow us to progress in our deleveraging effort, and, considering what we have already declared during the Roadshow and during the presentation of the business plan back in December, that this year we have an exceptional tax payment and, of course, an unprecedented challenging economic backdrop in 2009. So, the only... the only considerations that the Board has used for making the decision on the level of the dividend were... was, how can I say, the well-being of the company, the deleveraging process that we have declared, the sustainability

of the dividend and, of course, it was reinforced by the positive trend in the results during the year. Our firm commitment is to offer a competitive and growing remuneration to our shareholders, focusing on profitability and deleveraging with the objective to be consistent with the main peers in the telecommunications industry. So, I think that it was a set of... of very specific reasons that were specific to Telecom Italia and, considering the environment, of course Telco's financial structure is something that is the responsibility of Telco. It's not the responsibility, of course, of Telecom Italia.

Thank you.

And now on the broadband... on the domestic broadband I'll ask Oscar Cicchetti to answer.

Yes. The growth slowdown in the fourth quarter in the broadband revenues is mainly due to two things: the first is that in the two previous quarters we had a growth that was really lower than the year average, and so this had a consequence on the revenue on the fourth quarter. And the second is that we sold less products; and this is part of our strategy to change the mix of revenues. But, on the other hand, we have two good news for the broadband trend, because the market totaled something more than 300,000; we have been able, in the fourth quarter, to have 40... around 42% of the market share. Of the net additional market share.

Thank you very much. Next question, please.

12. Mr. Nick Lyall from UBS:

Hi there, it's Nick Lyall from UBS. On the broadband point, on the extra market share of ads in the quarter, could you just explain... particularly on bundle operators? Do you think they're reaching saturation point? On unbundling, or is there... maybe their balance sheets are stopping them from reacting aggressively or is it just the launch of your naked ADSL you think that's fallen back in the quarter? Could you describe what's happening in the broadband market? And secondly, your total restructural separation of the start that the new story seemed to run a little on restructural separation; are you happy of this? And after finishing it would you go out and do it? Could you just confirm that, please? Thank you.

On... let me first answer on the structural separation, which I think is not an issue any longer, it's been completely... the whole discussion on transparency and equality of treatment has been completely taken care of through the process that we have engaged with... with the regulator and that has led us to the commitments we have signed with the regulator at the beginning of December and therefore I can clearly rule out any further discussion on network separation. On broadband, I'll ask Oscar Cicchetti again to elaborate on it.

Yes. The market share that we achieved in the fourth quarter is mainly due to our offer that Franco Bernabé already mentioned in his speech, which is Alice Casa, the no monthly fee offer that has been really successful for the new acquisition of further wingback. With regard to your question about the behavior of our competitors, they continue to focus, of course, and to be very aggressive on the market, mainly through promotion than through price decreases. You are right, they are getting less unbundling and more wholesale and rental and (...) for the simple reason that this is easier from a competitive... from a competitive point of view, because they can capitalize on their existing customer base on carrier preselection.

Thank you very much. We are taking the last question now.

13. Mr. Stanley Martinez from Legal General:

(...)

Mr. Martinez? You may proceed with your question.

(...)

Mr. Martinez is not available at the moment.

Is there any other question? We will take one more question if there is any. Otherwise we...

Yes, sir, I'm sorry, there is another question from:

14. Mr. Justin Funnel from Credit Suisse:

Thank you I'll be quick. Just an update on the dispute in Argentina. Any comments there on whether you can exercise the option and when any dispute might get resolved? And then... you're just one of the few people prepared to discuss what's going on at the market level in Italy on subsidies. It seems that you're benefiting too large really from Hutch reducing their investments in the market... range due subsidies in the market they're pulling back. I mean, do you expect further benefits from (...)? Please. Thank you.

On Argentina: we have done whatever was necessary to protect our rights in terms of exercising our options. The whole... the entire problem is now under consideration of the regulatory and antitrust authorities, and we will wait for the decisions they will make. It will be... it will be, I think, a long exercise, we will... we are in constant contact with the Argentinean authorities and we are confident that by the end... before the end of the year we will find a solution. On the subsidies: we... I'll ask perhaps Oscar Cicchetti to answer.

Yes. In general terms, we are reducing the subsidies on the customer acquisition. The main driver is... I would explain that the fourth mobile operator is getting really less aggressive than in the past and so, to that extent, we have been able to reduce the investment in acquisition... in customer acquisition. I can give you some figures: we capitalized SACS for, roughly, at group level, 300 million, that is split between Brazil and Italy. In Italy it's 160 and in Brazil it's 140 million.

Now, thank you very much to everybody. Thanks for your patience and your attention. I know that it's Friday afternoon, so everybody is ready to go for the weekend. Have a good weekend and thanks. We'll see you next time. Thank you.

Ladies and gentlemen, the conference call is over. Thank you for calling Telecom Italia Group.