

Telecom Italia
1Q'09 Group Financial Results – Conference Call
Milan – May 7, 2009
Q&A session

1. Mr. Terry Sinclair from City:

Good afternoon. I'd be interested to know... excuse me... a little bit more about how you see mobile domestically, particularly in terms of outgoing calls... excuse me... outgoing call prices. Mobile's obviously quite weak today in terms of numbers you've presented; a great deal of calls you've given us particularly on incoming regulator prices and so on, but are the outgoing call prices that probably will be the determinant of whether you'll be able to clawback in the loss in mobile. In that connection, I was also struck by looking at the fall of minutes of use recorded in the spreadsheet; I'd be interested to know whether the majority of minutes of use lost in the quarter are outgoing minutes or whether you've also had significant changes, for example, in international roaming and incoming minutes? Thanks very much.

Cicchetti, the Chief Marketing Officer will answer to this question.

Yes, as you know, the numbers that we... that we had in the mobile business and you... your question was mainly on the outgoing; of course, there are a couple of things that we have to take into account. The first is that the repricing in the consumer has shown some elasticity and this, of course, is mainly in the consumer areas. So, in the consumer areas we have, let's say, some consequences of the repricing: the first is an increase in the average price; the second is a small turn in the market segments that are more sensitive to the call, that are more cost-conscious; and the third is... and the third, of course, is, let's say, some reduction in the minutes of usage. But, of course, we have to consider the two different customer segments: the first is top clients; in the top clients there is an important point: we won, last year, a contract that is for the public administration, the so-called mobile CONSIP; thanks to this contract we are growing our customer base in the public administration; as a matter of fact, more or less 80% of the gross ads in the top areas comes from this contract. This contract, of course, was the consequence of a very competitive auction; we are getting a lot of customers, the... let's say, the target of this contract was to lock... to lock in the customers and to be able to provide public administration institutions with not only mobile but also wireline and ICT. As far as the business segment, small and medium enterprises, what happens is very clear: the customer base is more or less stable; we have and increase, an important increase, in the minutes of usage, thanks to the flat... mainly to the flat tariff, the so-called Tutto Compreso, thanks to the flat... so the overall numbers of the mobile business are the consequence of those three different trends in the three market segments.

Next question, please.

2. Mr. Giovanni Montalti from Chevreux:

Good afternoon. I would have a few questions, if I may. The first one on the revenue targets: if I'm not wrong, you were targeting, at the domestic units, a decrease between -1 and -2 for full year 2009. In Q1 you are delivering -4/-4.5; I was wondering if you expect an improvement, going forward, in the rest of 2009 or if you expect to make, let's say, so much cost savings to deliver the full-year target at the EBITDA level? Thank you.

Yes. As we announced at the introduction of the 2009-2011 industrial plan in London, as you may remember, the group is focused on protecting profitability, generating cash-flow, deleveraging... I mean, the main target that I said is that we want to squeeze out more cash for every unit of revenues that we generate. And Telecom Italia has demonstrated to be flexible enough to preserve these targets over and beyond the top line trend. This doesn't mean that we don't look at the top line trend, but, given the present circumstances, we really want to be on top of the.. of what we really can control in terms of... of costs. Of course, as Mr. Cicchetti just said, there is... there are customers that are showing in the present circumstances very great attention to the degree and to the level of telecommunications spending and, as in the past, we shall try to maximize our customer base spending, but it's difficult to see how much the customer base is sensitive to... in the present circumstances, not in general, what we've seen is that the psychology of customers is changing in certain segments, in the business segment they are, of course, more cost-conscious, where we... I mean, everybody's doing as we're doing, and they're cutting costs, so in order to lock in customers in the segment, we are providing more favorable contracts to them; with repricing, as Oscar Cicchetti said, we have had more turn in the EU segment, which is more price-sensitive, so all in all, I mean, as I said, we are focusing on... our priority... on profitability and generating cash. Top line we're looking at, but it's not... it's not something that we can totally control. In April we have seen some signs of recovery; I mean, the situation has not... is not turning around, of course, but we have seen a slowdown of the fall in the general economy, but there are signs that things are improving. So, together with the problems that we had in the reorganization, I think that over the next quarters we'll see improvements.

Sorry, can I ask a follow-up?

...

Hello? Can you hear me?

Yes, please.

Okay. Thanks. But looking at the synergies, in slide 16 of your presentation, of Mr. Bernabè's presentation, it seems to me that you are including in the cost cutting also, let's say, the overall decline of the cost base at the domestic unit, so not just the savings. My understanding of your savings, the ones that you announced at the plan in December, was that, I mean, there were some savings from some particular actions, in particular if I look at the presentation of December, for the network savings you were targeting some actions like side sharing, fiber back calling sharing, evaluation of further network sharing and so on... contract optimization and so on. It seems to me that in the savings from the... let's say 500 million savings targeted for the three-year period, these savings were not including the decline of the interconnection cost that, I mean, is something linked with the volumes going down and with the tariff that is going down. In the calculation that you are making now, I mean, to compare the results of Q1 with the full-year targets, it seems that you are including everything. So I just wanted to better understand how to match these two kinds of cost aggregates.

No, I'm sorry, it's not... I think that you're mistaken on this, because all our cost saving programs are exactly on track, as is shown on table 10 of Mr. Patuano's presentation, and of course we... there are interconnection cost declines, but simply because the revenues are declining. So...

Però... sorry to interrupt you. Sorry to interrupt you. I fully understand that. I mean, interconnection cost is going down and you're selling money. That's clear. But, I mean, to compare the results of Q1, the savings in terms of cost that you're delivering in Q1, with your full-year targets you're including everything? All...The entire decline of the cost base in Q1? And you're comparing this with your full-year target of savings? But it seems to me that the savings that you were targeting in full

year were not including also the decline in interconnection cost that was, let's say, an inertial trend, a natural trend compared to volumes...

No.

... and to price. So, we have to assume that the savings you announced are including also the interconnection cost decline that is, let's say, a physiological trend. We have to assume this now.

No, no, no. I'm sorry, I'm sorry, I think we should not be mistaken. I'll ask Marco Patuano to go through the table again and to explain exactly what has happened. Because it's not like you said.

Okay. Thank you.

Okay. If you move to page 10 of my presentation, you see that efficiency is 218 million euros. If you take growth, which has a negative -51, so this definition of growth can be misleading, we will find another one for the next presentation, but it's exactly the same one we used in London, so we left the same name. But, in any case, the sum of 218 and 51, which is 269, is exactly the total domestic cash cost reduction we have in first quarter. Now, what's efficiency and what's growth? The -51 of the growth is lower than 0 exactly because there are 70 million euros of interconnection costs... of interconnection cost savings that drive the total growth to a negative number. So, the costs devoted to the growth... so, there is an effort, as I told you, we are investing on quality, we are investing on customer care, we are investing in order to make our company more... more interesting for customers and those extra costs have been offset by the -70 of the interconnection costs. I'll give you another example. Personnel HR, personnel costs; if you look at page 11, you see that our total personnel costs increased by 17 million euros, which is: 21 million euros is the effect of the reduction in headcounts, which you will find in efficiency, and 38 million euros is the new costs, unitary costs of the workers, including some IAS effects. So, as you can see, we are comparing apples with apples and pears with pears. So, Mr. Bernabè is absolutely right when he says that efficiency's fully on track. I hope I answered you, if I didn't, I'm more than pleased to send you a detailed email.

No, no you definitely answered. Thank you.

Thank you very much. Next question, please.

3. Mr. Mitchell Collet from Cazenove:

Hi there. Two questions, please. I believe that at the time of the strategy update in December mobile value-added services were highlighted as a potential area of growth. This quarter's performance looks a touch disappointing, perhaps. Could you expand further on what's caused the decline in mobile value-added services? I mean, in particular, was it a specific offer that you haven't chosen or continued with or is there something else going on? And then secondly, looking at the cost savings again, part of that is clearly because you're selling less handsets, given that you've lost 600,000 mobile subs this quarter; how long do you continue to expect to lose that sort of order of magnitude of mobile subs? And, presumably, when that stabilizes again, I guess we'll see that some of those costs will be coming back in. So, I guess the question is: you long do you expect to continue to wind the mobile subs base down? Thank you.

Yes. On the first question, on mobile value-added services, what we observed is that people are moving... there's a dramatic increase in data traffic and a shift of customers away from... how can I say... stupid terminals into more sophisticated terminals that allow browsing on the net. And what is happening to customers is that they are, instead of downloading contents in a traditional way,

they are browsing more intensely the net. Now, on this and on the terminals, I'd like now Oscar Cicchetti to answer more in detail.

Yes, I think that the first point is what Mr. Bernabè already mentioned, so let's say that the traffic on the net is migrating from wap to web, and this is the first point that we have to take into account. The second is that the traditional messaging, the sms, is... we had a decline in this item because, also as a consequence of the repricing, we had some, let's say, as I told you before, we had some turn in the segments that are very, very sms-intensive. So, in the next... in the next quarter, as Mr. Bernabè said, we are planning to relaunch a new offer that is targeting this segment. The... another point that is related with the decline in these services is the content-related revenues. As we announced last year, we put in place a very, very disciplined attitude in this area. So, we want to give... we want to deliver quality to our customers, so we want to... we want to avoid shocking bills to our customers, so we want to deliver to our customers what they are asking for. Thanks to that, we applied this in our delivery platform and we are sure than when a customer asks for a content, he's really willing to pay for it now. So, the reality... the important good news in this area is the continuous growth of the mobile browsing. Mobile browsing continues to grow and this I think is the important... the most important print that we are on the right track, taking into account that our market share in the data traffic in the mobile data users is more than 50%.

Let me add just one point on this, because I think it's very important from a strategic point of view. Well, first let me give you a few figures, because on the unit subscriber acquisition costs we had a decline of almost 15%, which is quite sizeable, and on the handsets we had a decline which is in the order of 40%. And your question, the question you asked on the future of this I must say very clearly that, personally, I think... now I don't know whether the competition will allow me to pursue this strategy till the end, but personally what I'm thinking is that subsidizing handsets and subsidizing the new generation of handsets is a suicidal kind of attitude on the side of the industry, because we're simply subsidizing the over the top layers to enter into our market at our own costs. So, my personal opinion is that if the industry wants to survive long-term, it has to completely dismiss the handset subsidization policies that have created lots of problems in the last few years and that will create even more problems with the intelligent terminals in the future. So, personally, I would like to cancel completely the subsidy. Of course, we will evaluate this according to the competition and to the competitive environment, but I hope that everybody understands that... that this is the case.

So is it fair to say that you're continuing to lose subs until your competitors take a more rational approach to handset subsidies?

That's exactly the point. And thank you for asking me this.

And on the... the, sort of, the mobile backside of things, the wap-to-web migration you mentioned, presumably that will continue for a few quarters and then we'd expect it to annualize (...) out there?

Yes, I think you're right, it's exactly what will be happening.

Okay. Thank you.

Thank you very much. Next question, please.

4. Mr. Ottavio Adorisio from Société Générale :

Good afternoon, gentlemen. It looks like today the call's mostly on mobile. So, I'd like to add a new question on that and following on the data, it looks as the cycle has taken a big (...) on your VAS or data growth, but so far it's been in the outgoing. So, the question is this: for how long, considering that your customers are becoming very price-aware and they're looking for free downloads from the web, how long could it be that your customers would not use voice over IP and what would TIM do to stop them from doing it? Thank you.

Sorry, can you repeat? I did not understand what your question was.

Basically, considering that on the data side we've seen that there's been a significant change on parts where most of your customers are becoming much more price-aware and looking for free downloads from the web, so basically have been impacted by the economy. So, considering that most of your revenues and your cash is basically made on the voice side, and considering that voice over IP is freely available on the network but so far has been stopped by operators, so the question is this: for how long could this be the case going forward? And how could TIM, basically, react?

Well, I think that there is a general problem for the industry there. Because I think that the kind of model that the industry has pursued over the past years in a period where terminals were of a different kind, has to be completely rethought, because... and the pricing policy has to be completely rethought that has led to bundling the... bundling the prices... the offering for different categories of consumers and competing on the price bundle. I think that with the increase in the data traffic, we are experiencing a data traffic growth which is really dramatic. I mean, we are seeing an increase of over 200% a year. So, that means that the problem is not volume, because what we're seeing is a dramatic increase in volume of traffic and services provided over the net. What we're seeing is that the pricing policies of the past of the telecom operators are not sustainable any longer. And we have to change the attitude, unless everybody wants to... to be completely taken away by what is happening on the market. I mean, the market's healthy in terms of... of what the customers want and the desire to download. The market is unhealthy when competitors don't think sufficiently of the long-term consequences of what they're doing in terms of pricing and in terms of bundling. Thank you very much.

Next question, please.

5. Mr. Andreas Bolumburu from BBVA:

Hi, good afternoon. I have a couple of questions, if I may. The first one is: I was wondering if you could... if you could give us some more light on how your plan of a sale of non-core assets is going. Maybe you have some news or you could advance us something you got in handset? And secondly could you please give us some more visibility on your fixed broadband market, please? Thank you.

On the... on the disposal side, the process is in place; we are focusing our attention very much on this. I think that it's clear to say that we will give any news whenever this will be appropriate, given the kinds of procedures we have adopted in the different situations... situations. But, anyway, I think that we see... of course the market is complicated, but there's never the right timing to do things. And so, we are really handling the process with... with the best concentration that we have, and we are very careful and we will be giving details whenever it will be appropriate. Thank you very much. On the second question Mr. Cicchetti will answer.

Yes. About the broadband market, I think just a few items: the first is that the market continues to grow; if we look at the market growth in the first quarter, I think that our forecast for 2009 is absolutely... is absolutely in line. We forecasted more or less 1 million of net addition per year as

the Italian market. The second is that the price in the market for the time being appears to be stable. The second is that our market share continues to be significant; so, we had, let's say, an important market share in the gross addition, we totaled a market share in net addition that is lower than our expectations, that is 25%, our target is around 40%, the other good news is that the ARPU per customer is... the average revenue per customer is increasing, so we are continuing to migrate the free customer base to flat customer base and thanks to that our ARPU is increasing.

Okay. Thank you.

Next question, please.

6. Mr. James Britton from Nomura:

Thank you very much. Just a couple of specific, detailed questions. Firstly on business pricing; there's a slide in Mr. Bernabè's presentation, on page 13, which highlights that prices are falling in the business and enterprise segment, yet... yet I think we were told the prices had been increased in mid... in the middle of last year for this business segment. So, can you just clarify if prices have now come down sufficiently to fully offset last year's price increases? The price increase's actually falling year-on-year. Secondly, I see personnel costs have gone up in the domestic business; can you just clarify what the minimum salary increases that you're having to put through? And then, thirdly, just a general question on balance sheet health: the market seems to be supporting stocks who restore balance sheet health through right issues at the moment: would it be fair to say that management of TI would prefer to have a stronger balance sheet in order to better deal with the competitive... the competitive risk in both the Italian and Brazilian markets? Thanks.

Let me ... let me turn to give you details... I thought I had given an answer on this on what is happening in pricing in the business sector, but perhaps Oscar Cicchetti can elaborate a little bit on this, and then I'll come back to the other two questions.

No, first of all, we... the repricing that we put in place last year was only for the prepaid customers. So, all the business segment, both small and medium enterprises and top clients are post-paid. And so we didn't price up in 2008; so, the price-down that we are seeing in the first quarter is the consequence, as I told you, of mainly two things: the first is that we are... we won an important contract in a very competitive environment for the public administration in the top segment; and the second is that we tried to lock in the customers in the business segment with an offer, that is Impresa Semplice, that puts together wireline, wireless and a package of ICT offers. In this Impresa Semplice offer we have a Tutto Compreso, that is a flat tariff for mobile; so, as you can see, we have, let's say, less... lower prices but higher volumes. So, in the business we didn't... sorry, let's say, in summary: we didn't price up last year, it's a clear strategy to lock in the customers with a convergent offer in order to get more value from the same market segments.

On the second question I'll ask... I'll ask Marco Patuano to answer.

Yes. You're right. There is a component which is salary increase, as I answered to our previous colleague; the net effect is the sum of two different... of three different components: the first one is the headcount reduction; the headcount reduction drove us to a saving of about 20 million euros, which is the result of the number of headcounts we have been able to lay off. I would like to remember that the costs for the layoff were already posted in the 2008 balance sheet. Now, we had a salary increase of about 2.4%, which accounts, more or less, for 20 million euros. So, we... in terms of cash cost, the balance between the two is zero. And then we have another effect, accounting approximately for 16 million euros, which is specifically an accounting issue. As you know, the IAS accounting principle, with reference to the late retirement allowances, requires a fair

value actualization of the projected cash-out that are already booked. And this is the delta cost that you see. So, there is a zero cash cost impact and if you look at the figure, there is, let me say, an accounting impact of about 16 million euros.

On the last question you asked, which is a fairly.. a fairly complicated question, I would answer in this way: I have already excluded several times that we need a rights issue, or a capital increase, but perhaps I think that this time it's worth to elaborate a little bit on this because of your... of your comment on the fact that the market seems to be... seems to be favoring companies that raise their capital. Of course this happens, as far as I understand, mostly in the banking and financial sector and not in other sectors, unless they are sectors really in trouble. So, we, as I said several times, we don't feel that we have problems of needing any safety net and therefore we don't want to dilute our shareholders. But, of course, there is a more... a very specific point: I think that and this... I'll give it to you as a personal opinion... I think that, under present circumstances, a rights issue could be justified only in the framework of a big strategic deal, something that is really transforming, something that changes the nature of the company. Now, for the time being, I don't see anything of this kind in my radar screen, which, of course, does not exclude that something crosses my radar screen, and therefore I reiterate: we don't need capital and we don't feel insecure, given the present circumstances, we have shown that we have the flexibility, we have the reactivity to counteract the present situation and therefore we don't feel the need for any safety net. The... the environment will be... if the environment changes at some point, because of strategic opportunities, we will consider them, but they are not in the radar screen right now.

Thank you.

7. Mr. Jonathan Dann from JP Morgan:

Oh, hello. My first question is: can you just confirm the headcount reduction? I think I misheard what Mr. Patuano was saying on headcount. Are you... Can you ,sort of... do you think the Q1 pace of reduction will expect similar per quarter for the rest of the year? And, secondly, it's a question on the potential further line rental unbundled line rental increase perhaps in 2011. Can you sort of update us on any negotiations with the regulator? And then, finally, I don't believe you... I think you didn't reconfirm the revenue guidance, but you did confirm the 900 million of opex and capex and you reconfirmed the EBITDA. Could you just sort of give your thoughts on how, if revenue is weak and the cost cutting targets are not increased, how will you meet EBITDA? Thanks very much.

Okay. I'll turn it to Marco Patuano, because I think I've given answers on all your questions, but perhaps Marco Patuano can elaborate a little bit better, and perhaps be clearer than I have been.

Well, first question was... maybe I was unclear on personnel costs. As I... as we have already said, we had a reduction in the number of employees... we are now, let me say, roughly speaking, 3700 people less than when we began this process. Of course, this is a permanent saving we will have, it will continue in the year. Yes, we will continue on the plan, but let me say that we are not on track, we are much more than on track, we are well in advance versus the original... the original plan. This saving offsets the salary increases that have been recognized, you know that every year there is a salary renegotiation and, of course, the salary increase is also something permanent. So, we have been able to offset a permanent cost increase with a permanent cost decrease. Then, you asked... I'll try to answer to the revenue guidance, and then I'll leave... The group, as we said, the group is focused on... on profitability and cash-flow generation, deleveraging; so, we have demonstrated that we are flexible enough to preserve those targets over and beyond the top line trend; as you saw, we gave in London a guidance of domestic cash cost of revenues at the end of the three years of around 67% and today we are at around 68%; so, we are well on track. So, it's a matter of fact that in this moment there is a higher care for telecommunications spending; and this is evident at

the two opposite ends of the social pyramid: so, there are the business customers and there are the low spenders. So, what we are doing is to try to stimulate in a totally different way: consumers are totally different from business customers. So, we are adopting a very different strategy: with the consumers we are working in order not to decrease prices because once you decrease prices it's very hard to increase them and with the business customers we're working in order to lock in the customers and this is the most important effort we're doing. So, you see how the reorganization of our business, our sales approach is extremely well... is extremely important in this specific moment. So, with EBITDA we are absolutely confident we can achieve the high-profitability range in the domestic market, as we told you several times, we are well on track on the cost saving plan and so, we are... we said that protecting profitability, generating cash-flow and deleveraging are our priority and we strongly confirm that profitability, cash-flow and deleveraging will come.

Okay. On the monthly rental fee, the answer is that we're not envisaging any further increase in the monthly rental fee. Next question, please. I think that the next question will be the last question.

8. Ms. Micaela Ferruta from Intermonte SIM:

Good evening. Micaela Ferruta from Intermonte SIM. I have three questions, if I may. The first one is on fixed: do you think that a double-digit growth in ICT revenues is sustainable also in the second half of the year? When the comparison gets tougher and the current economic environment? The second is regarding the fact that press reports that AGCOM and the antitrust have opened an investigation on sms pricing, which, at least before promotions, in Italy's higher than the limit set by the European authority? So, any idea on the timing of this proceeding and the potential impact if such reduction were to be implemented? And, finally, if I can ask a very quick comment on what your thoughts are on the impact that (...) is having, if any, on both the mobile and fixed data markets? So, meaning broadband, the integrated broadband offer. Thank you.

On the regulatory front, I'll ask Mr. Talotta, the Chief Regulatory Officer, to answer.

Thank you very much. Good morning. In 2008 AGCOM and AGCM, the two Italian antitrust authorities, launched a joint investigation on the sms, mms and mobile data services, with the aim of verifying the competitiveness of the retail market and the transparency of the information provided to customers. Telecom Italia sent its contribution to the authorities, highlighting that the dynamic nature of the competition that characterizes these services were the effective prices suffered from the spreading of promotional offers, car services and consumer bundled. The process is still ongoing, and it's expected to be closed by May 2009, as you read in the newspapers today or yesterday, with a joint statement of AGCOM and AGCM. This investigation should not lead to the regulation of the sms termination rate. The market can be regulated only after a full market analysis process, but Telecom Italia doesn't expect AGCOM to start a market analysis on sms termination rate in 2009.

Thank you, Mr. Talotta; Oscar Cicchetti.

Yes. Two questions: the first is about our growth in IT. I think that when we think about the penetration from a telco operator in the IT market, the problem is that we are a newcomer. So, let's take into account that we have less than 15% of the market share in IT. So, to that extent, there is absolutely room for growth and this room comes essentially from the transformation of two things: first the networks, that are getting intelligent and broadband and the second is because IT is changing its paradigm, because the new information technology based on data center, based on software as a service, are becoming a reality, and to that extent we have room for growth in those new markets. So, I can confirm that we feel on track for the IT plan. The second is about the convergence; you know, Franco Bernabè in his presentation spent a few words on the most

important convergent offer that we put on the market that is giving us the first signals of success, that is Impresa Semplice for small-medium enterprises. Impresa Semplice is a full, convergent service for small and medium enterprises that includes wireline, that includes wireless and that includes ICT. So, let's say that the broadband seamless environment is encapsulated in this offer. As far as the consumer market, what we are experiencing with success is, let's say, let me call them "easy convergence". So, one of the most successful offers that we are experiencing in this quarter is a very, very simple offer: to offer a data key to our... that is in the wireline billing for customers. This is something that has an important success. We have more than... we have quite 17... 17 million of customers, we build them once every two months, so the possibility to get the key card and to have this card...to pay this card through the telecom bill is a very, very easy convergent offer that... where we are getting a lot of success.

I think we are done. Thank you very much for your attention and have a good evening. Thank you very much.

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