Telecom Italia
1H 2011 Results

Q&A session:

Operator: Ladies and gentlemen, the Q&A session is now open. I would like to remind you that if you want to register for your questions, please press star followed by 1, to cancel your reservation, press star followed by 2. Thank you.

1. Mr. Georgios Ierodiaconou from Citi:

Yes, hello. I would like to ask two questions, please. The first one is just to confirm that I understood correctly; you said earlier that you reiterate a net debt target but that the Spectrum auction was not included. Does that mean that Atimus is now included? And if you do reiterate it including this transaction, does that mean that you’ve had better cash-flow than expected or was there something that was budgeted at the start of the year? And my second question is around cost cutting: the fourth quarter of last year benefited from the labor agreement earlier in the year and you had a big decline in opex. Can you repeat that this year or will comparisons get tougher for the domestic market? Thank you.

A - Franco Bernabè – Chief Executive Officer: So, thank you very much. Yes, Atimus is included in the year-end 2011 debt target. Spectrum, as we said, is not included, and therefore that means that we are able to... because, as you remember, we never envisaged to make such an important acquisition in Brazil at the beginning of the period... that means that the cash-flow that we are generating, plus some minor divestitures that we are making, are compensating for our financial... for the financial needs to finance this acquisition. Of course, Spectrum is not included and it’s... by the way, we don’t know how much it will be at the end. So it could not be included at the beginning. On... on personnel, we'll turn it to Marco now.

A - Marco Patuano – Chief Operating Officer: Yes. The agreement we reached didn’t give us a one-off effect. The effect is... we get the effects quarter after quarter. So there is nothing in the previous... in the fourth quarter of last year that was changing the progression in a non-organic way. So, we have delivered a good cash cost control also in Q4 last year and I think that we’re doing a good job also this year. So we will post also in the second half a stringent cost control policy.

Q - Georgios Ierodiaconou: Perhaps if I may be more specific: if I remember, last year, apart from the headcount reduction, you agreed some reductions in working hours and overtime, so which contributed to more savings. Can you repeat a similar reduction in wages per employee this year or will a comparison, as we annualize, get a bit tougher from the fourth quarter? That was what I meant earlier.

A - Marco Patuano – Chief Operating Officer: Yes. Once again, the agreement... we are translating into effect the agreement this year, we have reduced the total number of employees of FTEs to be more precise, around 7%, and the real... almost half of the plan is done and we have... but we are completely in line with our expectations. So, if your question is if there are more reductions in terms of employees, yes, there is still a part that is ongoing.

Q - Georgios Ierodiaconou: Thank you.

2. Mr. Mathieu Robilliard from Exane BNP Paribas:

Good morning. The first question is on the competitive environment in mobile. As you showed in your results the (...) seems to have stabilized in Q2 have there been any new initiatives from your hand or from competitors that could strengthen that stability in price per minute? And second: going back, actually, to the cost question that was asked earlier, I think it’s fair to say that the rate of decline of EBITDA so far in the domestic business is a bit higher than what you’re targeting for the full year. So the question is: what are the specific elements you think that can enable you in the second part of the year to catch up with the rights you’re forecasting, I mean, I think you’re forecasting something like -4 and you’re doing -6... so if you could
maybe elaborate a bit in terms of what are the elements that in H2 could help you get that target back would be very helpful. Thank you.

A - Marco Patuano – Chief Operating Officer: Okay. Well, you're right when you say that you did not see any specific extra commercial activity or any specific extra commercial aggressiveness. This is exactly the reason why figures are stabilizing and prices are stabilizing. In reality, what we, at least, are doing, we are moving our... we are not changing the portfolio, but we are moving the customers from community offers to bundle offers. This is extremely interesting, because the profitability of those bundle offers is very good and, second, bundle offers prevent us in case of change of the mobile termination rate from a change in the commercial strategy of competitors, where the community concept loses part of its strength. Now, in July the acquisitions were still very good, prices are benefiting from seasonality, so all our metrics are confirming the trends and the comparison with the figures of one year ago in Q3 will explain part of the recovery of... we expect in mobile, especially in consumers in the last year. With reference to the... to the cost control program: of course, part of the actions we are... we have in the pipeline in terms of stabilization of revenues, turns into EBITDA. In any case, we have... we have identified further efficiencies that can be done, in industrial costs we are putting them in place, there are some other fixed opex that we are looking at with more care, just to mention some of them, real estate costs are quite important, and, last, keep in mind that our cash cost attention allows us to use... to protect, in any case, ultimately free cash-flow generation. So, we are keen to confirm the guidance also on EBITDA.

Q - Mathieu Robilliard: Thank you very much.

3. Mr. JP Davids from Barclays Capital:

Good morning, gentlemen. I had a question on international wholesale. You may have mentioned that this is one of the areas that you would see improving in the second half of the year. The breakout disclosure on the... in the appendix suggests that it's... it's... you know, in quite a lot of trouble at the moment, down 20% in terms of revenues and EBITDA. What are the prospects for this business? And is this a business you're looking to hang onto? Thank you.

A - Marco Patuano – Chief Operating Officer: Marco speaking. First of all, the... the improvement, in reality, has to be read as a minor decrease. So, what we did: to be very clear, the international wholesale business is made up of three parts: one is voice, international long-distance, the second is data and IP traffic on international wholesale, the third are transits. Transits is a quite common... a quite common business in international wholesale when an operator has no direct link with another operator and gives the traffic to a third party in order to have it delivered at the final destination. This very last component has very little margin and there is potential counterparty risk that has to be taken into consideration. During the last year we have been very cautious in keeping this under strict control. We renounced to some counterparty whose credit risk we considered too high and we benefited on two sides: the margin did not decrease... the total margin did not decrease, because we lost some margin on transits, but we improved on the bad debt. Now, we started this rationalization almost one year ago, it was September, it was a decision we made during the summer 2010, so starting from September and now we are almost... we have almost completed this clean-up. So, what remains is good voice, good data, which is growing very well, and good transits from reliable counterparties.


4. Mr. Tim Boddy from Goldman Sachs:

Yes, I'd like to ask a couple of questions, if I may. First of all, just to reconfirm you're expecting stabilization in mobile trends because of the stable pricing against easy comparisons by the end of the year, by the fourth quarter. Secondly, I wanted just to understand whether MTR effects or potential austerity measures could have an impact on consumer confidence and usage through the second half? And any early indications of that. And then thirdly, in terms of your comments on consolidation, just whether you'd be prepared to use your equity at these prices to follow a consolidation path? Thank you.
A - Marco Patuano – Chief Operating Officer: Okay. First, price stabilization in the rest of the year: yes, we do expect to keep prices stable also for the rest of the year, which means that the seasonality of the summer... at the end of the summer, comes back to the value we had at the beginning of it, so you have to expect prices in May... in September at the same level of May, and from May onwards you have to expect prices stable. On MTR we explained that the MTRs have no impact on the PTA, on our profitability, because we are able to offset the minor revenues with minor costs we pay both on the mobile and on the fixed... especially on the fixed, let me say. On the fixed side. The fact that MTR can affect volumes, the historical... if I look backwards, there is no major evidence of a significant impact, also because it’s not 100% true that the reduction is transferred to the final users. So... and it is especially true when the final users have a bundle offer. So, in any case, MTR light path is underway and we do not expect any impact on EBITDA. On the third question I’ll leave the floor to Mr. Bernabè.

A - Franco Bernabè – Chief Executive Officer: Yes. On consolidation we take, of course, that consolidation in the Italian market would help very much in stabilizing the mobile business and also, I would say, the fixed business, in the long term. The Italian market has always been a very healthy market, and I think that at some point it will be again a very healthy market, as, I mean, if you see from the current profitability... in terms of current profitability it is. But we are not currently engaging in any consolidation negotiation, and therefore we cannot say, of course, because there is nothing... nothing concrete at this point, whether we would be ready to use cash or stock for any consolidation process.

Q - Tim Boddy: And just on the austerity risk. Are you seeing any... any kind of incremental impacts on conceivers or business behavior following the recent austerity measures?

A - Franco Bernabè – Chief Executive Officer: Well, there are some austerity measures, I don’t think have any great impact for the time being, because, as you know, austerity measures, the greatest part of the austerity measures has effects starting from 2013. On the contrary, the government has announced a recovery plan the other day, but we will see what happens next, because now everybody is facing this very big turmoil that we have in the domestic and international markets and it’s not clear what the governments will do. Of course, there is a great deal of uncertainty on the side of the consumers, but the policies that we have been pursuing have proven very, very much welcomed by the consumers. Therefore, for the time being, I don’t see any impact.

Q - Tim Boddy: Great, thank you.

5. Ms. Micaela Ferruta from Intermonte:

Yes, good morning and congratulations on the results. I have three questions, if I may. One on consolidation: you just said that there is no negotiation underway, but maybe you could share with us whether you would be willing to be a consolidator and what would be the priorities? Whether mobile or fixed? And where do you see the highest possible synergies? So how we should think about the potential benefits for the overall market? The second question is for Mr. Patuano: you actually spoke of original cost cutting targets. So, I’m just checking whether you are actually increasing the cost cutting for the full year. And the third question: I’m sure we read everything on the semester report, but is it possible to have more comments on the current goodwill accounting and what kind of assumptions in terms of domestic goodwill... I’m basically, as you can imagine, worried about WAC assumptions and free risk, given the recent crisis. Thank you.

A - Franco Bernabè – Chief Executive Officer: Yes, on the first question, I don’t think there is much more to add to what I said before. I think that we like consolidation, we think consolidation is good for the market, we think also that there is a potential for consolidation in the Italian market, a concrete potential for consolidation in the Italian market. We are not currently in the process of negotiating anything. We think that we could be a consolidator but I think that for the time being there is nothing concrete, it’s too early to... to say anything about this. And I’ll turn it to Marco for the next question.

A - Marco Patuano – Chief Operating Officer: Hi, Micaela. Yes, when you are... when you do better than your plan you always try to do even better. So, we are looking for some more improvements we
can do or accelerations we can do. I'm very glad to say that our... our management team is confirming this very conscious... cost-conscious approach, so... we are doing better than our original plan and this means that we are looking around to find new opportunities.

Q - Micaela Ferruta: But you're not disclosing any targets. Sorry for…

A - Marco Patuano – Chief Operating Officer: No.

Q - Micaela Ferruta: Thank you.

A - Franco Bernabè – Chief Executive Officer: On the goodwill, I think that we... we are making available, and you know because we publish very extensively our goodwill calculations in our yearly report and we make available all the basic assumptions for the goodwill impairment that we have taken. We have taken this goodwill impairment on very conservative assumptions, and therefore I think that for the time being that's... that's what we can say and what is stated in our... our accounts.

Q - Micaela Ferruta: Thank you.

6. Mr. Ottavio Adorisio from Société Générale:

Hi, good morning. I have a couple of questions from my side. The first one is on free cash-flow and specifically on working capital: you touched on a number of points on cost cutting to boost free cash-flow, now last year you recorded a 600 million euro negative working capital, that actually depressed your free cash-flow by 25%. Now, looking at your two quarters, you're showing in both quarters year-on-year improvements in that line. So I was basically wondering if you are confident that dilution for the year end would reduce, and if this is affirmative, could you give us some sort of estimate by how much? And my second question is on the Brazilian margins: now I believe they have been negatively impacted by the change in the capitalization policy for the handset subsidies. Now, if this is the case, could you please give us some color on how much the change has impacted margins and what would have been the underlying growth you're delivering in Brazil EBITDA net of this change?  Thanks.

A - Franco Bernabè – Chief Executive Officer: Thank you. De Angelis will answer the first question.

A - Stefano De Angelis – Group Controller: On the working... on the working capital if I... if you refer to the domestic business, the improvement is mostly related to the reduction in the capex that we achieved at the end of 2010 when compared to the end of 2011. In terms of cash, as we always stated, we paid a capex with a 90-120 days' delay, so in the first part of 2011 we are benefiting from the reduced capex when comparing fourth quarter 2010 with fourth quarter 2011. On the other side, we have the benefit in terms of working capital of the reduction in the top line, and these are the basic impact when you compare year-on-year. If you compare the generation of cash in the six months, clearly the negative impact in terms of working capital is driven by the strong portion of capex that we always book in the fourth quarter of the year. So the negative cash absorption that we have in terms of working capital is related mostly to this impact in terms of capex booked in the fourth quarter of the year. For the... for the second part of the year, what will... what we will see: we have a budget in terms of capex that is basically in line for the second part of the year with 2010. So, the impact on working capital of the capex will be the same of 2010. On the other side, we expect to take the benefits from the recovery in the top line in terms of operating free cash flow, net we can confirm that for the full year, as for the group, we expect at domestic level an operating free cash-flow that is mostly in line with 2010 if you exclude the impact of the TI Sparkle issues that, just to remember, impacted for approximately 400 million in the operating free cash flow of 2010. So, as reported, we expect a benefit of approximately 400 million.

A - Franco Bernabè – Chief Executive Officer: The... the impact... yes, the impact of the handset subsidy in Brazil, if you compare... if you compare apples with apples, we had 28.4% EBITDA margin last year, which is going down 26.8%. Using the same criteria, we would have had 26% last year EBITDA margin and it would be up by 0.8%. And therefore, I mean, if you compare apples with apples, it had improved by 0.8%... the margin. Thank you.

Q - Ottavio Adorisio: Thank you.
7. Mr. Chris Alliott from RBS:

Yes, good morning, thanks. Just a quick question on the domestic broadband market. I mean, I wonder if you could comment, Mr. Patuano, on the current market environment you’re seeing. I mean, it looks to me as though perhaps the aggressive promotions that we saw in the fourth quarter… in the first quarter effectively have sort of sold the broadband net ads forward, and I wonder whether we might see quite a weak overall market for the remainder of this year. And then, just along with that, I wonder whether you think you might be able to see net ads in the second half of this year at tier on a retail basis? Thank you.

A - Marco Patuano – Chief Operating Officer: Yes. Just to give you some color on the difference between the price pressure that the OLOs put in the market versus Telecom Italia, we kept our price around 20 euro with a promotion on sales of three months and our competitors were at 3 euro with a promotion period of two years. So, it’s quite easy to understand that on the net… on the acquisition side, we were playing in a market situation that was quite tough. What we saw was really a huge OLO-to-OLO migration. This is something that we experienced for the very first time and also… I suppose that also the OLOs were a little bit unprepared to see this new market environment. The customers… some of the customers decided to stay with us just for quality reasons and even if it was clear that our solution was more expensive than our competitors’. Now, at the end of May, starting from June we started seeing a sort of change in the attitude of our competitors, which, as I said before, they pushed to some extent on the brake for these kinds of extra promotions. They’re still, of course, more aggressive than what we are doing, but, let me say, the difference is not 3 to 20, now the difference is much more balanced. So, what do I expect? First of all, I expect 2-3... you know, summer time is always a quarter in which net adds are lower than the other quarters, but we will probably benefit from some recovery of the backlog that we have in the pipeline and that the OLOs are not transferring to us. I assume that starting from September, when people come back from the locations, results can come back to what we once had... that we had in the first half of 2010.

Q - Chris Alliott: Okay. Thank you.

8. Mr. Torsten Achtmann from JP Morgan:

Yes, good morning. First of all, some of the trends we’ve seen in wholesale got worse this quarter, and I was wondering what was the main driver, given that you had an increase in the ULL fees, I was expecting that this got at least stable or could improve throughout the year. So, maybe if you could clarify what is in there. And secondly there seem to be MTR cuts in Brazil, they have been talked about, is this something you expect will happen next year or just what are your expectations there? Thank you.

A - Marco Patuano – Chief Operating Officer: Marco Patuano on the wholesale. Of course, some of the reductions we saw in the market were disconnections in the OLOs. So when you see the net commercial activity of the OLOs you can find in chart number 13 of my presentation, of course you have to keep in mind that this is the net effect of new connections and disconnections. So, when they cancelled the customers they not only cancelled the customers but they also cancelled the contract, the ULL or the (...) or the WLR contract they had with us. This is the... let me say that the fact that there was a revision in prices did not affect the commercial activity of the OLOs for the time being. If I look at the request of new connections or new equipments, we are +1% year-on-year.

A - Franco Bernabè – Chief Executive Officer: On... on MTR reduction in Brazil, although the amount of the MTR reduction is not known yet, and we are expecting an approximately 20% reduction in MTRs this year, but we don’t even know neither if it will be this year or next year, but the very important point is that TIM is consistently reducing its dependence on MTRs. Just to give you a few figures, incoming revenues over total revenues have come down from 30% in the second quarter of 2009 to 24% in the second quarter of 2011 and the EBITDA exposure to MTR has come down, again, from 33% in the second quarter of 2009 to 23% in the second quarter of 2011. I think that... I mean, as you know, it’s now under debate at Anatel how much it will impact... there are different positions from different operators. Oi is pushing more aggressively, I think that it is in the interest of Anatel to defend the position of those operators who have shown to be very much in favor of creating a more competitive environment in the Brazilian market, and therefore we expect that Anatel will also consider the different positions of the different operators. So, on the one hand, we are reducing our exposure, on the other hand we think that Brazil and the Brazilian authorities will clearly favor a situation where competition is preserved, as it happens in almost every market, I mean, you see, for
instance, in the Italian market, again, we expect a symmetry to take place, in the long term, but for the time being and for a long period of time, the Italian authority has maintained an asymmetric position in the market. Thank you.

9. Mr. Singh Mandeep from Occitan Capital:

Hi, thank you. Just a question on the domestic mobile business. If we rewind back a year, you had some confidence that you could exit 2010 with a positive domestic mobile performance in service revenues. Given now we’ve got stable prices and you’re growing your customer base, do you feel confident that after you can exit 2011 with positive service revenues? Thank you.

A - Marco Patuano – Chief Operating Officer: What happened... what happened a year ago was that some of the commercial activities we put in place during the summer hit... over-hit the price per minute and, looking backwards, I would say that it has been too aggressive. What we have in the pipeline today on the marketing side is nothing comparable to those initiatives and, to be honest, I don’t see... also looking at the competitors, I don’t see, let me say, any specific attitude of re-warming the competitive scenario. So, I think that the price cut that the market had in the last 12-18 months was more than enough. Now, we are all... all the players are willing to keep prices stable and to play with different... with different weapons. So, I’m confident that what caused the decrease a year ago will not be repeated this year. So, sorry for not putting a month, because I did it in the past and it was not a nice experience to come to you with a different date, but let me be general... the end of the year will be very close to breakeven.

Q - Singh Mandeep: Thank you very much.

10. Mr. Giovanni Montalti from Cheuvreux:

Good morning. Would you expect any pressure from the credit rating agencies to reduce your dividend policy? Thank you.

A - Franco Bernabè – Chief Executive Officer: Well, I think that we have indicated very clearly to the rating agencies that our objective is to deleverage and, in order to achieve this deleveraging, we are generating a very strong cash-flow, we are... we have completed, as I said before, the divestiture program but, at the same time, we are looking very deeply in our portfolio in order to find other minor things that we can divest, so we are fairly confident that we can maintain the deleveraging objective that we have indicated to the rating agencies, at the same time preserving our dividend policies. Thank you.

Q - Giovanni Montalti: Thank you.

11. Mr. James Ratzer from New Street Research:

Yes, thank you very much. I had two questions, please. The first one was just regarding your domestic broadband business. In relation to what we saw in your mobile business, about two years ago, when you started to lose mobile customers, you embarked in a more aggressive price cutting strategy. Why don’t you consider doing the same thing in your fixed line business? Now we’ve started to see you lose customers in this quarter you talk about aggressive promotions from your competitors, do you think you ultimately need to follow suit and cut prices there? The second question was just regarding overall number of fixed lines in Italy: it seems after a relatively stable performance during 2010 the number of total lines in Italy is beginning to gradually come down a bit. Is that something you see as a structural trend or do you think that is a more cyclical concern at the moment? Thank you.

A - Marco Patuano – Chief Operating Officer: Marco Patuano speaking. I think that the lesson we learned on the mobile has to be taken into consideration in the fixed. And, by the way, if you look at the average price we have in the broadband in Italy, it’s cheap. So, and nevertheless, even if the price is cheap, the mobile penetration on the total number of lines is low, compared with the rest of Europe. And I’m not referring to Scandinavian countries, I’m also referring to our more comparable neighbors in Europe. So, I don’t... personally I don’t think it’s a matter of price, and the demonstration has been done by the fact that our competitors tried to shock the market with very
aggressive prices. I’ve never seen anything as aggressive as what we’ve experienced last year. And the market, at the end, if I look at one year later, the market does not seem to have boomed. So I think that what we have to do is to work on new products, to innovate the way, the reason why you need to use it, you need broadband in your house, the quality of the broadband and the quality of the access that Telecom Italia can deliver. This is... this is, I think, by far more important than the price cut... than a generalized price cut. The second question was the shrink of the market or the dimension of the overall market. I think that Q2 2011, has shown that some of the figures of 2010 and beginning of 2011 were to some extent a little bit to be revised, because I do not believe that in this quarter the market has jumped down like the one that you see in the figures. So, it means that probably the number of lines... of market reduction in 2010 was underestimated and the number you see in Q2 is overestimated. So, I think that the trend is quite linear, I don’t see any structural reason to have an acceleration in the fixed mobile substitution. Thank you.

A - Franco Bernabè – Chief Executive Officer: That was the last question. I want to thank everybody... did you want to follow up on this?

Q - James Ratzer: No, thank you. That... that was great. Thank you.

A - Franco Bernabè: Okay. Thank you very much. Thank you. I think that was the last question. I want to thank all of you for your attention and for those of you who have not yet taken vacations, so I want to wish everybody to have a good... very excellent holidays in the next few days. Thank you very much.

Operator: Ladies and gentlemen, the conference is over. Thank you for calling Telecom Italia.