



Telephonica SpA  
**Financial Statements**  
For the year ended  
31 December 2003

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**TELEPHONICA S.p.A.**

**FINANCIAL STATEMENTS**

**For the year ended 31 December 2003**



## INCOME STATEMENT

*For the year ended 31 December 2003*

<i>in thousands of euro</i>	Note	2003	2002
Sales revenue	1	44,271	37,49
Cost of sales	2	-35,394	-30,792
<b>Gross profit</b>		<b>8,877</b>	<b>6,698</b>
Personnel expenses	3	-817	-546
Sales and marketing expenses	4	-1,688	-1,177
Other net operating expenses	5	-2,372	-1,265
<b>Profit from operations</b>		<b>4</b>	<b>3,71</b>
Net financing costs	6	-224	-470
<b>Profit (loss) before tax</b>		<b>3,776</b>	<b>3,24</b>
Income tax expense	7	-1,504	-957
<b>Net profit for the year</b>		<b>2,272</b>	<b>2,283</b>
Earnings per share (euro)	8	2.705	4.659
<u>EBITDA [1]</u>	9	4,976	4,187

[1] EBITDA is earnings before interest, taxation, depreciation and amortization.  
 It is included in the financial statements as it is a widely used measure of performance in the investment community.

*(The accompanying notes form part of these financial statements)*

## BALANCE SHEET

*For the year ended 31 December 2003*

<i>in thousands of euro</i>	Note	2003	2002
<b>Assets</b>			
Property, plant and equipment	10	5,387	3,28
Intangible assets	11	380	315
Investments in subsidiaries and associates	12	95	61
Other investments	13	75	75
Deferred tax assets	14	144	224
<b>Total non current assets</b>		<b>6,081</b>	<b>3,955</b>
Other receivables	15	4,476	12,417
Non trade receivables	16	2,525	815
Cash and cash equivalents	17	4,154	286
<b>Total current assets</b>		<b>11,155</b>	<b>13,518</b>
<b>Total assets</b>		<b>17,236</b>	<b>17,473</b>
<b>Equity</b>			
Issued capital		1,7	700
Reserves		70	5
Retained earnings		4,408	2,201
<b>Total equity</b>	18	<b>6,178</b>	<b>2,906</b>
<b>Liabilities</b>			
Interest – bearing loans and borrowings	19	1,778	1,046
Employee benefit obligations	20	58	36
Provisions	21	100	100
Deferred tax liabilities	14	224	733
<b>Total non current liabilities</b>		<b>2,16</b>	<b>1,915</b>
Interest – bearing loans and borrowings	19	791	401
Bank overdrafts	22	458	2,126
Other payables	23	5,716	9,808
Income tax payable	24	1,933	317
<b>Total current liabilities</b>		<b>8,898</b>	<b>12,652</b>
<b>Total equity and liabilities</b>		<b>17,236</b>	<b>17,473</b>

*(The accompanying notes form part of these financial statements)*

**STATEMENT OF CASH FLOWS**  
*For the year ended 31 December 2003*

<i>in thousands of euro</i>			
	Note	2003	2002
<b>Operating activities</b>			
<b>Net profit (loss) for the year</b>		<b>2,272</b>	<b>2,283</b>
<b>Adjustments for:</b>			
Depreciation and amortization		976	477
Employee benefit accruals	20	27	23
Deferred tax		-430	604
Accrual for provisions		-	100
		<b>2,845</b>	<b>3,487</b>
(Increase) decrease in other receivables		7,941	-10,78
(Increase) decrease in non trade receivables		-1,71	-214
Increase (decrease) in other payables and income tax		-1,39	8,432
Income tax paid		-1,08	-32
Other	20	-5	-4
<b>Cash flows from operating activities</b>		<b>6,597</b>	<b>893</b>
<b>Investing activities</b>			
Purchase of property, plant and equipment	10	-3,02	-2,664
Proceeds from sale of fixed assets	10	-	15
Purchase of intangible assets	11	-131	-124
Purchase of investments		-34	-48
<b>Cash flows from investing activities</b>		<b>-3,18</b>	<b>-2,821</b>
<b>Financing activities</b>			
Proceeds from loans and borrowings		1,121	901
Proceeds from the issue of share capital		1	117
<b>Cash flows from financing activities</b>		<b>2,121</b>	<b>1,018</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>5,536</b>	<b>-910</b>
<b>Cash and cash equivalents at 1 January</b>		<b>-1,84</b>	<b>-930</b>
<b>Cash and cash equivalents at 31 December</b>		<b>3,696</b>	<b>-1,84</b>

*(The accompanying notes form part of these financial statements)*

## NOTES TO THE FINANCIAL STATEMENTS

*(forming part of the financial statements)*

Telephonica S.p.A. (the “company”) is a company domiciled in Italy.

The financial statements were authorised for issue by the Sole Director on 18 March 2004.

### ***Significant accounting policies***

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial information.

#### **(a) *Statement of compliance***

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and with the interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

The financial statements derive from the books of account of the company, prepared in accordance with Italian GAAP to which appropriate adjustments have been applied.

#### **(b) *Basis of preparation***

The financial statements are presented in thousands of euro and have been prepared on the historical cost basis except for the following assets and liabilities, which are stated at their fair value: derivative financial instruments, employee benefit obligations.

The financial statements are composed of the income statement, balance sheet, statement of cash flows and notes to the financial statements. The notes provide further information regarding the income statement, balance sheet, cash flows statement and movement in capital and reserves.

Certain reclassifications of some accounting items concerning 2002 information disclosed for comparative purposes have been made respect to audited 2002 financial statements without any effect on net equity and result for the period.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

#### **(c) *Intangible assets***

Intangible assets include software and licenses and are stated at cost and amortized over their estimated useful lives. Software is amortized on a straight line basis over 5 years. Licenses are amortised on a straight line basis over 15 years to 20 years.

#### **(d) *Property, plant and equipment***

Property, plant and equipment are stated at cost. Assets acquired under finance leases, being those for which the company substantially assumes all the risks and rewards of ownership, are stated at

## NOTES TO THE FINANCIAL STATEMENTS

### TELEPHONICA S.p.A.

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an amount equal to the lower of their fair value and the present value of the minimum lease payments at the inception of the lease. Assets are written off on a straight-line basis over their estimated useful lives. As follows:

- Buildings: 33 years
- Plant and equipment:
  - Telephone plant: 8 years.
  - Dialers, private phones, Wll equipments: 5 years.
  - Telephone and Wll exchanges: 5.5 years.
  - Specific plants: 20 years.
- Other:
  - Movable property: 8 years.
  - Motorcars: 4 years.
  - Leasehold improvements, which are depreciated on a straight line basis over the duration of the rental contract.

#### **(e) Investments**

##### **(I) Investments in unconsolidated subsidiaries**

The company's investments in subsidiaries, alone and in aggregate, are immaterial to the financial position, performance and cash flows of the group and accordingly consolidated accounts have not been prepared. Unconsolidated subsidiaries are stated at cost.

##### **(II) Investments in associates**

Associates are those entities in which the company has significant influence, but not control, over the financial and operating policies. The investments in associates are stated at cost.

##### **(III) Other investments**

Other investments represent insurance policies. These are stated at amortised cost less impairment losses considering that the company has the positive intent and ability to hold the assets to maturity.

#### **(f) Derivative financial instruments**

The company uses derivative financial instruments, represented by an interest rate swap, to hedge exposure arising from financing activities. In accordance with its treasury policy, the company does not hold or issue derivative financial instruments for trading purposes. The interest rate swap is valued at the estimated amount that the company would pay to terminate the swap at the balance sheet date.

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**(g) Trade and other receivables**

Trade and other receivables are stated at their costs less impairment losses (see accounting policy n. i).

**(h) Cash and cash equivalents**

Cash and cash equivalents consist of cash balances and deposits with banks. For the purposes of the statement of cash flows, cash and cash equivalents are shown net of bank current account overdrafts recorded in "bank overdrafts".

**(i) Impairment**

The carrying amounts of the company's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For tangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

**(l) Provisions for liabilities and charges**

A provision is recognised in the balance sheet when the company has a legal or constructive obligation as a result of a past event, and it is probable that outflow of economic benefits will be required to settle the obligation.

**(m) Employee benefit obligations**

The company's net obligation in respect of employee retirement benefits is calculated separately for each employee, by estimating the amount of future benefit that employees have earned in return for their services in the current and prior periods; that benefit is discounted to determine the present value. The calculation is performed by a qualified actuary using the projected unit credit method.

**(n) Interest-bearing loans and borrowings**

Interest-bearing borrowings are recognised initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost.

**(o) Turnover**

Turnover represents revenues for services rendered at the balance sheet date. The services are fixed-line telephony (FLT), wireless local loop (WLL), value added services (VAS) and ethnic services. Revenue relating to FLT and WLL are determined on the basis of calls made by the clients through telephone exchanges owned by the company or owned by other telephone carriers, with whom we have code hosting contracts.

VAS revenues are based on connections made by clients of Telecom Italia who use premium rate telephone numbers owned by the company to connect with internet sites and other phone services.

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The revenue in relation to the ethnic services is invoiced and recognised monthly. Ethnic revenues, represented by prepaid telephone cards and telephone centre traffic, are invoiced and recognised on the basis of cash received.

**(p) Sponsorship and advertising costs**

Sponsorship expenses are charged against income on a straight line basis over the duration of the related contracts, which does not exceed one year. Advertising costs, which relate principally to poster and newspaper advertising, are expensed as incurred.

**(q) Income tax**

Income tax on the profit or loss for the year comprises current and deferred tax. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that is no longer probable that the related tax benefit will be realised.

**(r) Net financing costs**

Net financing costs comprise interest payable on borrowings, finance lease payments, gains or losses on derivatives that are recognised in the income statement and interest income as calculated using the effective interest rate method.

**(s) Segment reporting**

A segment is a distinguishable component of the company that is engaged in providing products or services (business segment), which is subject to risks and rewards that are different from those of other segments.

## Notes to the financial statements

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## 1 Segment reporting

Telephonica S.p.A. is a company active in supplying a wide range of telecommunications services. The company's core customers are small to medium businesses and residential customers.

In July 2002, the Italian Ministry of Telecommunications granted Telephonica one of the licences for the 24,5 – 26,5 Ghz frequency band for to the Umbria region.

Management has identified the following main business segments:

- Fixed line telephony (FLT)
- Wireless Local Loop (WLL)
- Value Added Services (VAS)
- Ethnic

In Fixed Line Telephony (FLT) the company purchases the telephone traffic from Telecom Italia and other carriers (Albacom, Plug-it) and sells it to its clients. In 2003 it completed the transition (started in 2001), from carrier selection mode (CS) to carrier pre selection mode (CPS), which means that the user is no longer obliged to dial the operator code before the number called. This contributed to the increase in FLT turnover over the last three years.

In Value Added Services (VAS), started in April 2002, the company becomes *access number provider* to other companies (service centres) which allow consumers to reconnect to the content provider's website via a premium call rate telephone line, thus incurring a premium call charge with their telephony provider (Telecom Italia).

WLL is a technology that allows a customer's "last mile" copper wire connection to be replaced with high-speed wireless access direct to the new operator. This business started in the last quarter of 2003.

Ethnic business consists of the distribution of voice traffic to phone centres and other distributors via prepaid cards. This business started in the last quarter of 2003.

The following table provides information regarding the main business segments:

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<i>in thousands of euro</i>	<b>2003</b>				<b>2002</b>		
	<b>Phone services (FLT/WLL)</b>	<b>VAS</b>	<b>Ethnic</b>	<b>Total</b>	<b>Phone Services (FLT)</b>	<b>VAS</b>	<b>Total</b>
Sales	7,931	35,376	964	44,271	7,106	30,384	37,490
Cost of sales excluding depreciation and amortisation	(4,123)	(29,515)	(855)	(34,493)	(4,090)	(26,225)	(30,315)
Other allocated expenses	(1,331)	(106)	-	(1,437)	(467)	-	(467)
Other allocated income	<u>281</u>	<u>-</u>	<u>-</u>	<u>281</u>	<u>-</u>	<u>-</u>	<u>-</u>
Profit before unallocated income/expenses	<u>2,758</u>	<u>5,755</u>	<u>109</u>	<u>8,622</u>	<u>2,549</u>	<u>4,159</u>	<u>6,708</u>
Unallocated income/expenses				(4,622)	-	-	(2,998)
Profit (loss) from operations				4,000			3,710
Segment assets- trade receivables	2,142	1,947	387	4,476	1,759	10,657	12,416
Unallocated assets				<u>12,760</u>			<u>5,057</u>
Total assets				<u>17,236</u>			<u>17,473</u>
Segment liabilities- trade payables	1,631	1,211	614	3,456	1,130	6,515	7,645
Unallocated liabilities				7,602			6,922
Total liabilities				11,058			14,567
Net Equity				<u>6,178</u>			<u>2,906</u>
Total				<u>17,236</u>			<u>17,473</u>

Other allocated expenses mainly refer to commissions on sales, government licenses, rent costs, recovery credit expenses.

Other allocated incomes refer to recovery of invoicing expenses from customers and the penalties for early rescission due by the customers.

Unallocated income/expenses mainly comprise sponsorship expenses amortization and depreciation, administrative expenses, rent of the interconnection cables and other operating income/expenses.

Unallocated assets mainly refer to Property, Plant and equipment, intangible assets, deferred tax assets and other financial assets.

Unallocated liabilities mainly refer to loans and borrowings, trade payables not assignable to a specific line of business, other payables and current taxes.

# NOTES TO THE FINANCIAL STATEMENTS

## TELEPHONICA S.p.A.

### 2 Cost of sales

*in thousands of euro*

	<b>2003</b>	<b>2002</b>
Purchase of telephone traffic	4,123	3,931
Purchase of Internet access	—	<u>159</u>
Total FLT	<u>4,123</u>	<u>4,090</u>
Cost of invoicing to final user and collection risk	5,147	4,469
Cost of services from ISP	<u>24,369</u>	<u>21,756</u>
Total VAS	<u>29,516</u>	<u>26,225</u>
Purchase of ethnic traffic	<u>855</u>	—
Amortisation and depreciation of property, plant and equipment and intangible assets	<u>900</u>	<u>477</u>
Total	<u>35,394</u>	<u>30,792</u>

The cost of invoicing the final user relates to the service supplied by Telecom Italia whereby internet services costs are detailed in the customer's telephone bill. Collection risks refer to a charge applied by Telecom Italia to the company as a provision for cases where the final user is insolvent.

The cost of services from the Internet Service Provider (ISP) refers to the charge applied by the ISP to the company for web content provided by the ISP and used by the customer.

### 3 Personnel expenses

*in thousands of euro*

	<b>2003</b>	<b>2002</b>
Salaries	644	426
Social security contributions	138	87
Employee benefits	31	27
Other	<u>4</u>	<u>6</u>
<b>Total</b>	<b><u>817</u></b>	<b><u>546</u></b>

The average number of employees is as follows:

	<b>2003</b>	<b>2002</b>
Staff	29	21
Managers	<u>1</u>	<u>1</u>
<b>Total</b>	<b><u>30</u></b>	<b><u>22</u></b>

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**4 Sales and marketing expenses**

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
Sponsorship expenses	956	336
Commission on sales to agents	649	467
Advertising costs	<u>83</u>	<u>374</u>
<b>Total</b>	<b><u>1,688</u></b>	<b><u>1,177</u></b>

**5 Other net operating expenses**

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
<b>Other income</b>		
- recovery of invoicing expenses	(181)	(167)
- recovery of legal fees	(125)	(108)
- other	<u>(379)</u>	<u>(80)</u>
<b>Total other income</b>	<b><u>(685)</u></b>	<b><u>(355)</u></b>
<b>Other expense</b>		
- general expenses	1,059	558
- system rent and other technical charges	785	370
- legal, tax, commercial and technical consultancy	286	224
- director's fees	180	150
- building rent	164	98
- exceptional items	203	97
- other	380	123
<b>Total other expense</b>	<b><u>3,057</u></b>	<b><u>1,620</u></b>
	<b><u>2,372</u></b>	<b><u>1,265</u></b>

**6 Net financing costs**

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
Interest income	(12)	(12)
Foreign exchange profit	(9)	-
Adjustment for IRS value	(2)	16
Interest expense	247	348
Commissions on factoring	<u>-</u>	<u>118</u>
	<b><u>224</u></b>	<b><u>470</u></b>

**7 Income tax expense**

Two taxes are applicable to the company:

- Corporate income tax (IRPEG) at the rate of 36% in 2001 and 2002 and 34% in 2003. From 1 January 2004 it changed its name in IRES and is at the rate of 33%.
- Regional tax (IRAP) at the rate of 4.25%.

## NOTES TO THE FINANCIAL STATEMENTS

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The difference in tax rates arises from the different basis for the two taxes.

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
Current tax expense:		
- IRPEG	1,669	229
- IRAP	<u>264</u>	<u>120</u>
Total current tax expense	<u>1,933</u>	<u>349</u>
Deferred tax (income) expense	<u>(429)</u>	<u>608</u>
	<u>1,504</u>	<u>957</u>

Income tax expense (income) may also be analysed as follows:

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
IRPEG	1,316	770
IRAP	<u>188</u>	<u>187</u>
Net (income) expense	<u>1,504</u>	<u>957</u>

### ***Reconciliation of the effective tax rate (IRPEG)***

<i>in thousands of euro</i>	<b>2003 %</b>	<b>2003</b>	<b>2002 %</b>	<b>2002</b>
Profit (loss) before tax		3,776		3,240
Income tax at standard rate	34%	1,284	36%	1,166
Non deductible expenses	6,9%	263	2,4%	80
Tax exempt revenues	1%	(50)	13%	(426)
Losses carried forward	-	-	0,6%	(22)
Effect on tax rules of decrease of tax rate (36% to 34%)	-	-	0,9%	<u>(28)</u>
Effect on tax rules of decrease of tax rate (34% to 20%)	4,7%	<u>(181)</u>		
	34,7%	<u>1,316</u>	23,7%	<u>770</u>

### ***Reconciliation of the effective tax rate (IRAP)***

<i>in thousands of euro</i>	<b>2003</b>	<b>2003</b>	<b>2002</b>	<b>2002</b>
Profit (loss) before tax		3,776		3,240
Income tax (net of deferred tax)	2.7%	103	4,25%	138
Non deductible expenses	2.2%	85	1,5%	50
Tax exempt revenues		-	-	<u>(1)</u>
	4.9%	<u>188</u>	5,7%	<u>187</u>

# NOTES TO THE FINANCIAL STATEMENTS

## TELEPHONICA S.p.A.

### 8 Earnings per share

The calculation of earnings per share for the year ended 31 December 2003 and 2002 have been determined as net profit attributable to ordinary shareholders divided by the weighted average number of ordinary shares by each year, as follows:

#### *Net profit attributable to ordinary shareholders*

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
Net profit (loss) attributable to ordinary shareholders	<u>2,272</u>	<u>2,283</u>

#### *Weighted average number of ordinary shares*

	<b>2003</b>	<b>2002</b>
Issued ordinary shares at 1 January (nominal value 0,52 euro)		800,000
Issued ordinary shares after euro conversion (1 euro per share)	700,000	416,000
Effect of shares issued on 10 November 2003	139,726	
Effect of shares issued on 25 September 2002	<u>-</u>	<u>73,917</u>
Weighted average number of ordinary shares	<u>839,726</u>	<u>489,917</u>
	<b>2003</b>	<b>2002</b>
Earnings per share at 31 December (euro)	2.705	4.659

### 9 EBITDA

EBITDA is earnings before interest, taxation, depreciation and amortization. It is included in the financial statements as it is a widely used measure of performance in the investment community.

<i>in thousands of euro</i>	<b>2003</b>				<b>2002</b>		
	<b>Phone Services (FLT/WLL)</b>	<b>VAS</b>	<b>Ethnic</b>	<b>Total</b>	<b>Phone Services (FLT)</b>	<b>VAS</b>	<b>Total</b>
Sales	7,931	35,376	964	44,271	7,106	30,384	37.490
Cost of sales excluding depreciation and amortization	<u>(4,123)</u>	<u>(29,515)</u>	<u>(855)</u>	<u>(34,493)</u>	<u>(4,090)</u>	<u>(26,225)</u>	<u>(30,315)</u>
<b>GROSS PROFIT</b>	<u>3,808</u>	<u>5,861</u>	<u>109</u>	<u>9,778</u>	<u>3,016</u>	<u>4,159</u>	<u>7,175</u>
Other allocated expenses	(1,331)	(106)		(1,437)	(467)		(467)
Other allocated income	281			281			
Unallocated income/expenses				<u>(3,491)</u>	=	=	<u>(2,521)</u>
EBITDA (before floatation expenses)				<u>5,131</u>	-	-	<u>4,187</u>
Floatation expenses				(155)			-
<b>EBITDA</b>				<u>4,976</u>			<u>4,187</u>
Amortisation and depreciation				<u>(976)</u>	-	-	<u>(477)</u>
Profit from operations				<u>4,000</u>			<u>3,710</u>

NOTES TO THE FINANCIAL STATEMENTS  
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**10 Property, plant and equipment**

*in thousands of euro*

<b>As at 31 December 2002</b>	<b>Land and buildings</b>	<b>Plant and equipment</b>	<b>Other</b>	<b>Total</b>
<i>Cost:</i>				
Balance at 1 January 2002	314	984	262	1,560
Additions	254	2,172	238	2,664
Disposals	<u>-</u>	<u>(13)</u>	<u>(2)</u>	<u>(15)</u>
Balance at 31 December 2002	<u>568</u>	<u>3,143</u>	<u>498</u>	<u>4,209</u>
<i>Depreciation:</i>				
Balance at 1 January 2002	-	(431)	(64)	(495)
Depreciation charge for the year	(9)	(348)	(81)	(438)
Disposals	<u>-</u>	<u>4</u>	<u>-</u>	<u>4</u>
Balance at 31 December 2002	<u>(9)</u>	<u>(775)</u>	<u>(145)</u>	<u>(929)</u>
Carrying amount at 31 December 2001	314	553	198	1,065
Carrying amount at 31 December 2002	559	2,368	353	3,280

*in thousands of euro*

<b>As at 31 December 2003</b>	<b>Land and buildings</b>	<b>Plant and equipment</b>	<b>Other</b>	<b>Total</b>
<i>Cost:</i>				
Balance at 1 January 2003	568	3,143	498	4,209
Additions	11	2,671	335	3,017
Disposals	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at 31 December 2003	<u>579</u>	<u>5,814</u>	<u>833</u>	<u>7,226</u>
<i>Depreciation:</i>				
Balance at 1 January 2003	(9)	(775)	(145)	(929)
Depreciation charge for the year	(17)	(743)	(150)	(910)
Disposals	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at 31 December 2003	<u>(26)</u>	<u>(1,518)</u>	<u>(295)</u>	<u>(1,839)</u>
Carrying amount at 31 December 2002	559	2,368	353	3,280
Carrying amount at 31 December 2003	553	4,296	538	5,387

The main additions to plant and equipment in 2003 relate to investments for the WLL business.

The company leases production equipment under a number of finance lease agreements. At the end of each lease, the company has the option to purchase the equipment at a favourable beneficial price. At 31 December 2003, the net carrying amount of leased plant and equipment was €1,471 thousand.

NOTES TO THE FINANCIAL STATEMENTS  
**TELEPHONICA S.p.A.**

**11 Intangible assets**

*As at 31 December 2002*

*in thousands of euro*

<i>Cost</i>	<b>Software</b>	<b>Licences, trademarks and similar rights</b>	<b>Other</b>	<b>Total</b>
Balance at 1 January 2002	91	164	44	299
Additions	29	91	4	124
Disposals	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at 31 December 2002	<u>120</u>	<u>255</u>	<u>48</u>	<u>423</u>

<i>Depreciation</i>	<b>Software</b>	<b>Licences, trademarks and similar rights</b>	<b>Other</b>	<b>Total</b>
Balance at 1 January 2002	(37)	(19)	(13)	(69)
Amortization charge for the year	<u>(22)</u>	<u>(12)</u>	<u>(5)</u>	<u>(39)</u>
Balance at 31 December 2002	<u>(59)</u>	<u>(31)</u>	<u>(18)</u>	<u>(108)</u>

<i>Carrying amount</i>	<b>Software</b>	<b>Licences, trademarks and similar rights</b>	<b>Other</b>	<b>Total</b>
Balance at 31 December 2001	54	145	31	230
Balance at 31 December 2002	61	224	30	315

NOTES TO THE FINANCIAL STATEMENTS  
**TELEPHONICA S.p.A.**

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*As at 31 December 2003*

*in thousands of euro*

<i>Cost</i>	<b>Software</b>	<b>Licences, trademarks and similar rights</b>	<b>Other</b>	<b>Total</b>
Balance at 1 January 2003	120	255	48	423
Additions	105	-	26	131
Disposals	<u>(1)</u>	<u>-</u>	<u>-</u>	<u>(1)</u>
Balance at 31 December 2003	<u>224</u>	<u>255</u>	<u>74</u>	<u>553</u>

<i>Depreciation</i>	<b>Software</b>	<b>Licences, trademarks and similar rights</b>	<b>Other</b>	<b>Total</b>
Balance at 1 January 2003	(59)	(31)	(18)	(108)
Amortization charge for the year	<u>(44)</u>	<u>(13)</u>	<u>(8)</u>	<u>(65)</u>
Balance at 31 December 2003	<u>(103)</u>	<u>(44)</u>	<u>(26)</u>	<u>(173)</u>

<i>Carrying amount</i>	<b>Software</b>	<b>Licences, trademarks and similar rights</b>	<b>Other</b>	<b>Total</b>
Balance at 31 December 2002	61	224	30	315
Balance at 31 December 2003	121	211	48	380

The main addition for 2003 refers to telephone exchange software.

## 12 Investments in subsidiaries and associates

*in thousands of euro*

	<b>2003</b>	<b>2002</b>
Telesolution S.p.A.	24	17
TLT Net S.r.l.	8	8
Moneyfast S.r.l.	-	-
Receivables due from subsidiaries	<u>63</u>	<u>36</u>
Total	<u>95</u>	<u>61</u>

## NOTES TO THE FINANCIAL STATEMENTS

# TELEPHONICA S.p.A.

The following chart summarises basic information regarding these subsidiaries and associates as at 31 December 2003<sup>1</sup>:

<i>in thousands of euro</i>	<b>Revenues</b>	<b>Net financial position</b>	<b>Share capital</b>	<b>Book value</b>	<b>% of particip. share</b>	<b>Net Equity</b>	<b>Share of equity</b>
	<b>31.12.2003</b>		<b>31.12.03</b>	<b>31.12.03</b>		<b>31.12.03</b>	<b>31.12.03</b>
Telesolution S.r.l. (associate)	353	(106)	100	24	24	229	55
TLT Net S.r.l.	52	26	11	8	71	12	8
Moneyfast S.r.l.	7	(23)	26	0	55	(206)	(113)

### ***Subsidiaries***

TLTNet Srl is an ISP (Internet Service Providers; ISPs provide the connection to the Internet). TLT Net was founded in 2000 and has always acted as an internal service department supplying internet services to Telephonica and its client base.

Moneyfast Srl was founded in early 2002 to develop a money transfer mechanism, in partnership with the banca Eurosystemi S.p.a. (previously ICCRI banca federale Europea SpA); the idea was to allow ethnic phone card users to transfer the monetary value stored on their prepaid card securely to a recipient in their country of origin.

Due to the start-up losses incurred by Moneyfast Srl. in its first year of activity and the impossibility to continue in the business because of a legal claim against its former banking partner, the company has fully written-off its investment in this subsidiary at 31 December 2003. A loan of €141 thousand granted to the subsidiary has also been written off.

### ***Associate***

Telesolution Srl is a small call centre based in Ivrea, near Torino. The company operates autonomously, although it does also undertake a small amount of work for Telephonica as a supplier (call centre services).

## **13 Other investments**

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>	<b>Expiry date</b>
Unit-linked policy insurance	52	52	May 2009
Index linked policy insurance	10	10	April 2007
Other insurance policies	10	10	July 2007
Other	<u>3</u>	<u>3</u>	
Total	<u>75</u>	<u>75</u>	

Other financial assets are stated at cost and they will be held to maturity.

<sup>1</sup> The above information have been prepared on the basis of draft statutory accounts subject to formal approval, and do not consider actual income tax calculation.

## NOTES TO THE FINANCIAL STATEMENTS

# TELEPHONICA S.p.A.

### 14 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable as follows:

	Assets		Liabilities	
	2003	2002	2003	2002
Property, plant and equipment	-	-	904	403
Intangible assets	(94)	(151)	-	-
Investments	(155)	(94)	-	-
Trade receivables	(226)	(226)		1,505
Employee benefit obligations	-	-	22	11
Other payables	(15)	(16)	-	-
Provisions	(100)	<u>(100)</u>	-	<u>-</u>
Tax (assets)/liabilities	<u>(590)</u>	<u>(587)</u>	<u>926</u>	<u>1,919</u>
Net tax (assets)/liabilities <sup>2</sup>	<u>(144)</u>	<u>224</u>	<u>224</u>	<u>733</u>

According to law 269/2003, for companies to be listed on European regulated stock markets during the period from 2 October 2003 to 31 December 2004, under some specific conditions, the IRPEG tax rate will amount to 20% for the fiscal year in which the quotation takes place and for the following two years; therefore an IRPEG tax rate of 20% has been applied for the calculation of deferred taxes.

The temporary differences in property, plant and equipment are due to the different accounting treatment (between Italian GAAP and IFRS GAAP) of assets acquired under financial leasing contracts and the accelerated depreciation recorded in the statutory financial statements as permitted by Italian tax rules.

The temporary differences for intangible assets refer to the write-off of advertising cost capitalized and amortised in the statutory financial statements.

### 15 Other receivables

<i>in thousands of euro</i>	2003	2002
- Trade receivables due from associates	30	24
- Other trade receivables	4,696	10,443
- Credit notes receivables	-	2,200
Bad debt provision	<u>(250)</u>	<u>(250)</u>
Total	<u>4,476</u>	<u>12,417</u>

The decrease of trade receivables in 2003 is partially due to the early collection from Telecom Italia of the monthly invoices relating to VAS; the telephone traffic relating to November 2003 and invoiced by Telephonica in December 2003 was collected in December 2003, but the invoices issued in December 2002 were collected in January 2003.

Credit notes to be received as at 31 December 2002 relate to the finalisation of an agreement with Telecom Italia S.p.A. in August 2003 in respect of services provided by that supplier in the year ended 31 December 2002.

<sup>2</sup> Considering IRPEG 20% and IRAP 4.25%

## NOTES TO THE FINANCIAL STATEMENTS

### TELEPHONICA S.p.A.

#### 16 Non trade receivables

<i>in thousands of euro</i>	2003	2002
Prepaid expenses and accrued income	786	446
Tax receivables	767	-
Cautionary deposits	503	-
Advance payments	465	-
Other	4	34
Receivables due from shareholders	-	199
Value added tax	<u>-</u>	<u>136</u>
Total	<u>2,525</u>	<u>815</u>

The detail of cautionary deposits is as follows:

- a preliminary agreement to acquire building land in Spello was signed on 13 October 2003 for a total cost €800 thousand. €400 thousand was accounted for as a payment in advance and €400 thousand has been paid and accounted for as cautionary deposit. The contract provides that the transfer of property will occur by the 31 March 2004 by a notary deed. Once the purchase is completed, the land will be sold.
- In order to support the ethnic traffic, the company signed 2 carrier agreements with “T-Systems Italia Spa” and “Colt Telecom Spa”, operators specializing in the carrying of international calls. The contracts provide the payment of caution deposits of €50 thousand each, to be returned as at the end of the contracts.

Tax receivables are payments in advance (June and November) for IRPEG (€648 thousand) and IRAP (€119 thousand) in accordance with Italian tax regulations.

#### 17 Cash and cash equivalents

Cash and cash equivalents consist of bank and postal account deposits.

#### 18 Equity

<i>in thousands of euro</i>	Share capital	Legal reserve	Retained earnings	Total
Balance at 1 January 2002	416	1	(78)	339
Net profit 2002	-	4	2,279	2,283
Shares issued	<u>284</u>	-	-	<u>284</u>
Balance at 31 December 2002	<u>700</u>	<u>5</u>	<u>2,201</u>	<u>2,906</u>
Balance at 1 January 2003	700	5	2,201	2,906
Net profit 2003	-	65	2,207	2,272
Shares issued	<u>1,000</u>	-	-	<u>1,000</u>
Balance at 31 December 2003	<u>1,700</u>	<u>70</u>	<u>4,408</u>	<u>6,178</u>

On 6 August 2003 the shareholders' extraordinary meeting resolved a capital increase up to 4.5 million euro to support its investment program.

## NOTES TO THE FINANCIAL STATEMENTS

### TELEPHONICA S.p.A.

In the shareholders' extraordinary meeting of the 10 November 2003 Mr Francesco Cimica, Ms Franca Bernardi and Mr Gianfranco Cimica (shareholders representing 98.7% of the share capital) subscribed for part of the increase for a total amount of €1,000,000, which has been fully paid in 2003.

The authorised share capital of the Company (fully subscribed) amounts to 1.700.000 euro and consists of number 1.700.000 Ordinary Share of 1.00 euro each.

#### **Legal Reserve**

The art. 2430 of the Italian civil code provides that share companies have to fund a legal reserve, when the statutory financial statements are approved by the shareholders, charging every year at least 5% of the yearly net profit. Such obligation lasts until the company has created in its net equity a legal reserve corresponding to 20% of the paid-up capital. This amount refers to statutory account figures.

Due to the recent changes in Italian tax rules (with the elimination of the tax credit on dividends), for any distribution of dividends to the shareholders of the company:

- if the shareholders are Italian corporates, they have to pay a tax rate of 33% only on 5% of the dividends received;
- if the shareholders are Italian individuals, the taxable amount is equal to the 40% or 12,% of the dividends received depending on the percentage of the shareholding;
- for dividends distributed outside Italy, the company has to withhold a taxable amount according to the double tax treaty.

The reconciliation between the statutory equity and the IFRS equity is as follows:

<i>in thousands of euro</i>	<b>Equity 2002</b>	<b>Profit (loss) 2003</b>	<b>Share capital increase</b>	<b>Equity 2003</b>
Statutory	2,084	2,476	1,000	5,560
Trade receivables	1,505	(1,505)		-
Tangible and intangible assets	252	558		810
Provision for risk and bad debts	(326)	326		-
Investments	(94)	94		-
Deferred tax assets/liabilities	(510)	310		(200)
Other	<u>(5)</u>	<u>13</u>	<u>-</u>	<u>8</u>
IFRS	<u>2,906</u>	<u>2,272</u>	<u>1,000</u>	<u>6,178</u>

# NOTES TO THE FINANCIAL STATEMENTS

## TELEPHONICA S.p.A.

### 19 Interest-bearing loans and borrowings

#### *Contractual terms*

<i>in thousands of euro</i>	<b>Interest rate</b>	<b>Initial Amount</b>	<b>Outstanding debt current</b>	<b>Outstanding debt non current</b>	<b>Outstanding total debt</b>	<b>Payment frequency</b>	<b>Expiry date</b>
<b>Financial institution</b>							
	Quart.						
Interbanca	Euribor + 2%	550	183	184	367	Half-yearly	September 2005
BNL	5.90%	150	29	78	107	Monthly	May 2007
Finconsumo	8.51%	19	6	7	13	Monthly	December 2005
Interbanca	5.73%	245	49	49	98	Half-yearly	December 2005
Interbanca	2.3%	746	149	448	597	Half-yearly	December 2007
Banca Popolare di Todi	4.50%	<u>364</u>	<u>32</u>	<u>285</u>	<u>317</u>	Monthly	May 2012
		<u>2,074</u>	<u>448</u>	<u>1,051</u>	<u>1,499</u>		
Lease creditors			<u>343</u>	<u>727</u>	<u>1,070</u>	Monthly	September 2007
Total			<u>791</u>	<u>1,778</u>	<u>2,569</u>		

#### *Terms and debt repayment schedule*

<i>in thousands of euro</i>	<b>Outstanding debt</b>	<b>1 year or less</b>	<b>1-2 years</b>	<b>2-5 years</b>	<b>More than 5 years</b>
<b>Bank loans:</b>					
- 550	367	184	183		
- 150	107	29	64	14	
- 19	13	6	7		
- 245	98	49	49		
- 746	597	149	299	149	
- 364 (secured)	<u>317</u>	<u>32</u>	<u>68</u>	<u>74</u>	<u>143</u>
Total	<u>1,499</u>	<u>449</u>	<u>670</u>	<u>237</u>	<u>143</u>

The above-secured loan is secured on the company's land and buildings.

### 20 Employee benefit obligations

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
Balance at 1 January	36	17
Charge for the year	27	23
Payments	<u>(5)</u>	<u>(4)</u>
Balance at 31 December	<u>58</u>	<u>36</u>

### 21 Provisions

Provisions relate principally to a reasonable estimate of the outcome of litigation and other contingent liabilities.

## NOTES TO THE FINANCIAL STATEMENTS

# TELEPHONICA S.p.A.

### 22 Bank overdrafts

Overdrafts and advance accounts as at 31 December 2003 amount to 458 thousand euro, 322 thousand euro of which refers to bills and invoices presented to banks for collection, with a maturity date immediately after the balance sheet date.

### 23 Other payables

<i>in thousands of euro</i>	<b>2003</b>	<b>2002</b>
Trade payables due to associates	60	30
Other trade payables	4,657	9,258
VAT payables	484	-
Sole director's fees	116	150
Other non trade payables	<u>399</u>	<u>370</u>
Total	<u>5,716</u>	<u>9,808</u>

The shareholders' meeting of 9 December 2002 resolved an annual fee for the sole director amounting to 180 thousand euro for 2003, (64 thousand euro of which has been paid by 30 November 2003) and 150 thousand euro for 2002.

The caption "other" for 2003 refers to the annual expenses paid for government licenses to operate in the FLT and WLL segments.

### 24 Income tax payable

This caption refers to taxes payable on the income for the year. It includes, for the year ended 31 December 2003, IRAP for 264 thousand euro (2002 euro 89 thousand) and IRPEG for 1,669 thousand euro (2002 euro 228 thousand).

### 25 Commitments and guarantees

#### *Interest rate swap contract*

<i>in thousands of euro</i>	<b>Notional value</b>
<b>Bank</b>	
BNL	516

The interest rate swap, the notional value of which is €516 thousand, hedges the interest rate risk on the fixed rate financial borrowing disclosed in note 19. However as it does not qualify for hedge accounting, it has been accounted for at fair value. Consequently a contingent loss of 16 thousand euro in 2002 and 15 thousand euro in 2003 has been charged against income and recorded in the balance sheet in "other payables".

**26 Credit risk and interest rate risk**

*Credit risk*

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Under this policy, investments are made only in liquid securities or financial assets.

At the balance sheet date of 31 December 2003 the only concentration of credit risk was with Telecom Italia; the company cashed a significant part of the balance with Telecom Italia after the balance sheet date.

*Interest rate risk*

The company adopts a policy of ensuring that its exposure to changes in interest rates on bank loans and borrowing is on a fixed rate basis. Interest rate swaps, denominated in euros, have been entered into to achieve this purpose.

***Effective interest rates and repricing analysis***

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice.

	<u>2003</u>							<u>2002</u>						
	Effective interest rate	Total	6 months or less	6-12 months	1-2 years	2-5 years	More than 5 years	Effective interest rate	Total	6 months or less	6-12 months	1-2 years	2-5 years	More than 5 years
<i>(Figures in thousands of euros)</i>														
Cash and cash equivalents (**)	0.010-1.155%	4,154	4,154	-	-	-	-	0.5-0.225%	286	286	-	-	-	-
Secured bank loans:														
- <i>euro floating rate loan</i>	4.5%	(317)	(317)	-	-	-	-	4.50%	(347)	(347)	-	-	-	-
Effect of interest rate swaps	2.035%	-	516	-	-	(516)	-	0.698	-	516	-	-	(516)	-
Finance lease liabilities	4.15-9.84%	(1,069)	-	(12)	(70)	(987)	-	7.09-11.02%	(249)	-	(10)	(74)	(165)	-
Unsecured bank loans:														
- <i>euro fixed rate loan</i> (**)	5.73-8.51%	(816)	-	-	-	(816)	-	5.73-8,51%	(301)	-	-	-	(301)	-
- <i>euro floating rate loan</i>	Quart Euribor +2%	(367)	(367)	-	-	-	-	Quart.Eur.+2%	(550)	(550)	-	-	-	-
Bank overdrafts	5.5-11%	(458)	(458)	-	-	-	-	5.5%-11%	(2,126)	(2,126)	-	-	-	-
<b>Total</b>		<b>1,127</b>	<b>3,528</b>	<b>(12)</b>	<b>(70)</b>	<b>(2,319)</b>	<b>-</b>		<b>(3,287)</b>	<b>(2,221)</b>	<b>(10)</b>	<b>(74)</b>	<b>(982)</b>	<b>-</b>

(\*) This interest rate is subject to repricing at 1 January, 1 April, 1 July, 1 October of each year on the basis of simple average calculated as half yearly Euribor's daily values for December, March, June, September of each year

(\*\*) These assets/liabilities bear interest at a fixed rate

## 27 Related party

### *Related party transactions*

The company has had the following transactions with subsidiaries, associate and with sole director and his immediate relatives.

### *Transactions with subsidiaries and associates*

<i>in thousands of euro</i>	<b>Telesolution S.p.A.</b>	<b>TLT Net S.r.l.</b>	<b>Moneyfast S.r.l.</b>
Trade receivables	30	-	-
Financial receivables	70	-	141
Trade payables	60	-	-
Revenues	123	22	1
Costs	60	8	4

Costs relating to Telesolution S.p.A. and TLT Net S.r.l. are for services rendered by these two companies for call centre services and for information technology services.

Revenues relating to Telesolution S.p.A. are mainly for software internally produced, sold to this company.

As mentioned in note 12, the above loan to Moneyfast Srl has fully written off.

### *Transactions with sole director and his immediate relatives*

The Sole Director of the company and his immediate relatives hold 98.75% of the voting rights. In addition to his emoluments, the company provides a car as a non-cash benefit.

The son of the Sole Director, who is also a shareholder of the company, is an employee of the company.

The company provides 1 car to the daughter of the sole director who is an employee of the company.

The company provides also an accommodation (apartment) to 2 staffs, who are Sole Director's nephews. The Sole Director, his wife (shareholder of the company), his daughter and his son (shareholder of the company) benefit from insurance policies paid by the company.

## 28 Subsequent events

The company entered into a preliminary agreement with Immobiliare Futura S.r.l. on the 23rd of January 2004. This agreement provides the sale of a new building for a total interior surface of 2,000 square meters and a court of 5,000 square meters to be built in Perugia, Via P. Soriano. The Building construction should be terminated and the notary deed signed within the 30 September 2004.

**29 Laws and regulations**

In the Telecom Italia public offer of 11 April 2003, approved by the AGCOM on September 2003, Telecom Italia decided to apply for the VAS services a cap on the total cost of each connection (€ 10,33 per call).

The Department of Communications (Ministero delle Comunicazioni) has published a proposal of new regulation on Value Added Services on 5 June 2003; such proposal has not been approved as law yet. The proposal could be considered important for many aspects, 2 of which are described as follows:

- Art. 16 (Invoicing): the proposal confirm the cap of each connection (10,33 €);
- Art. 19 (Responsibility of the parties): whoever gives information or renders services (Internet Service Provider), takes the responsibility for the Value Added Services's contents; whoever renders electronic communication services (telephone carrier), takes responsibility connected to the call's carrying and management.

**The Sole Director**

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18 March 2004



KPMG Assurance

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### Report of the Independent Auditors

To the Sole Director of Telefonica S.p.A

- 1 We have audited the accompanying balance sheet of Telefonica S.p.A. (the "Company") as of 31 December 2003, and the related statements of income and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2003, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Perugia, 18 March 2004

KPMG S.p.A.

Alberto Mazzeschi  
*Director of Audit*



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