



**Consolidated Interim Report as of June 30, 2005**

**Terna Group**

**RETE ELETTRICA NAZIONALE**

Board Meeting held on September 7, 2005

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## Report on Operations

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## **Board of Directors, Board of Statutory Auditors and Independent Auditors**

### Board of Directors

#### *Chairman*

Fulvio Conti

#### *Chief Executive Officer*

Sergio Mobili

#### *Directors*

Luca Arnaboldi

Paolo Cantarella

Davide Croff

Claudio Machetti

Salvatore Machì

Massimo Romano

Paolo Ruzzini

#### *Secretary to the Board*

Filomena Passeggio

### Board of Statutory Auditors

#### *Chairman of the Board of Statutory Auditors*

Giovanni Ferreri

#### *Acting Auditors*

Giancarlo Russo Corvace

Roberto Tasca

#### *Alternate Auditors*

Vito Di Battista

Bruno Franceschetti

### Independent Auditors

KPMG SpA

## **Introduction**

Pursuant to the provisions of Article 81 of the CONSOB Regulation No. 11971/1999, as amended by Resolution No. 14990 dated April 14, 2005, the Terna Group took steps to draw up the interim report as of June 30, 2005 in accordance with the international accounting standards (International Financial Reporting Standards - IFRS).

The attachment "Transition to the international accounting standards (IFRS)" contains the reconciliations, whose balances have been subject to audit, as anticipated by international accounting standard IFRS 1, accompanied by notes explaining the basis of presentation and the items included.

## **Terna Group results**

Revenues amounted to euro 499.6 million during the first half of the year, down by 1.8% when compared with the same period in 2004; the gross operating margin rose by 5.5% during the first six months to euro 348.1 million (+ euro 18.2 million).

Operating income came to euro 266.3 million during the period under review (+ 5.2%);

Net income pertaining to the Group totalled euro 140.3 million (euro 114.5 million during the same period in 2004).

Group employees at the end of June 2005 numbered 2,908, disclosing a decrease of 21 units when compared with 31 December 2004 (- 0.7%).

## TERNA and the financial markets

Financial ratios		June 30, 2005
Terna share weight <sup>(1)</sup>		
> on the MIB30 index (%)		0.976%
> on the S&P/MIB index (%)		0.586%
<b>Rating</b>		
Standard & Poor's	Outlook	stable
	M/L term	AA-
	Short term	A1+
Moody's	Outlook	stable
	M/L term	Aa3
	Short term	Prime1

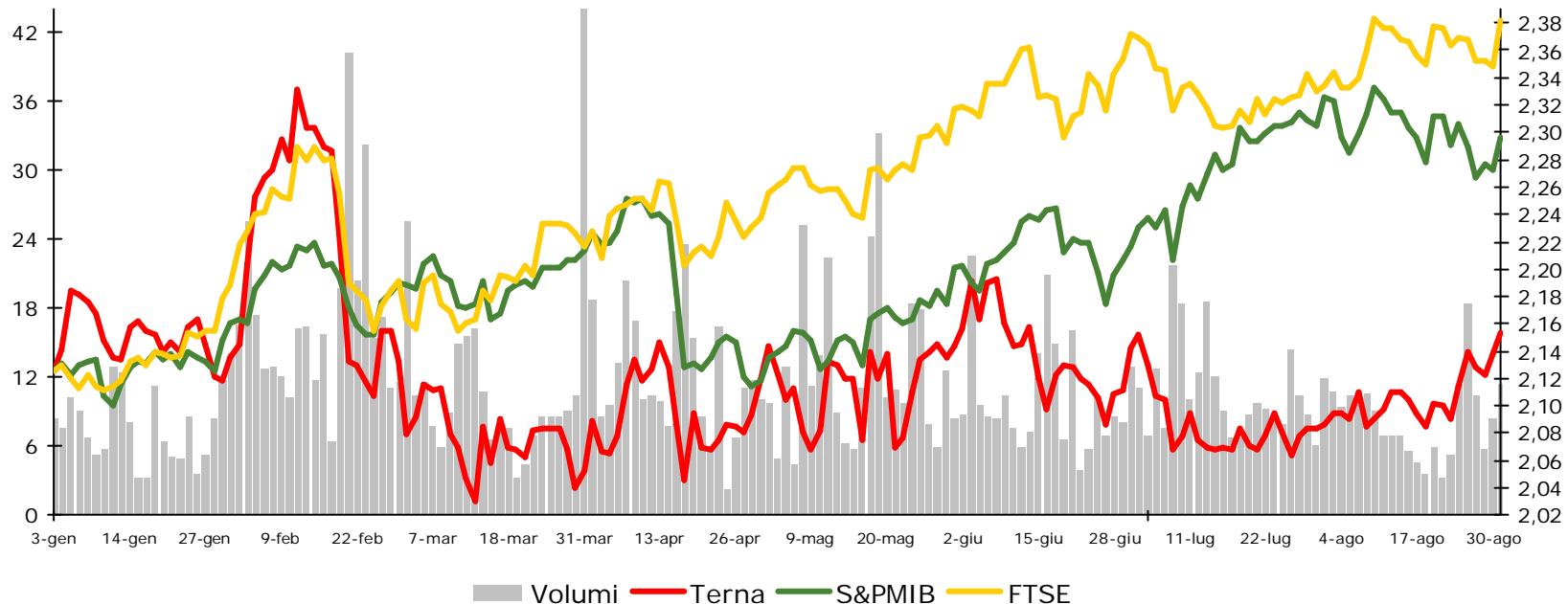
(1) Source: Borsa Italiana

During the first few weeks of 2005, Terna stock disclosed a substantial appreciation of its share price registering, as of February 11, an all-time high listed price at a value of euro 2.331 per share. In mid February, the recovery of the bond market caused a considerable streamlining of the listed prices of companies belonging to the utility sector which, due to their defensive nature, are often considered as alternative investments to bonds. This phenomenon also affected Terna stock which suffered a decrease with respect to the best and subsequently closed the interim period with a slight appreciation on the beginning of the year (around + 0.8%). During the same period, the S&P/MIB and FT-SE E300 Electricity indexes (the average of the other listed European electricity companies) disclosed a positive change equating to around four and twelve percentage points respectively.

On May 26, 2005 the shareholders were paid a dividend of euro 0.070 per share, being the balance of the dividend for the accounting period ended December 31, 2004. In this connection, shareholders are reminded that on October 21, 2004 the shareholders had already received an advance payment on the 2004 dividend amounting to euro 0.045 per share.

The average daily traded volumes during the six-month period came to around 11.8 million shares, or 0.59% of the share capital.

## Terna stock and S&PMib & FT-SE Electricity index performance



3-Jan 14-Jan 27-Jan 9-Feb 22-Feb 7-Mar 18-Mar 31-Mar 13-Apr 26-Apr 9-May 20-May 2-June 15-June 28-June 11-July 22-July 4-Aug  
17-Aug 30-Aug

Volumes

Source: Bloomberg

## **Significant events during the first half of 2005**

### **Agreement for the acquisition of the ISO business segment**

On February 28, 2005 Terna SpA and the ISO – Independent System Operator (GRTN SpA), in observance of the matters laid down by the DPCM (Prime Minister's Decree) dated May 11, 2004, signed the agreement for the transfer to Terna of the ISO business segment, comprising the activities, functions, assets and legal relationships as indicated by the same DPCM.

The purpose of the agreement is to integrate the ownership and management of the electricity NTN (National Transmission Network).

The business segment being transferred includes around 580 resources, and comprises:

- the dispatch activities, or rather the management of the flows introduced onto and withdrawn from the NTN in order to balance electricity supply and demand;
- the planning and development activities, or rather the definition of investment programs for upgrading the NTN.

The parties have agreed a price of euro 68.3 million for the transfer of the business segment, net of approximately euro 112 million in trade payables due to Terna. The overall valorization of the business segment transferred therefore amounts to euro 180 million.

The date of efficacy of the unification between the ownership and management of the NTN is deferred until the occurrence of the following abeyance conditions:

- the new concession by the Ministry of Production Activities for the performance of the electricity transmission and dispatching activities within the national territory belonging to Terna;
- the approval, by the Ministry of Production Activities and the Energy Authority, of the Network Code anticipated by the Prime Minister's Decree;
- the issue by the Antitrust Authority of a favourable opinion on the transaction.

The first two abeyance conditions have taken place.

With regards to the third condition, as of June 22, 2005 the Antitrust Authority launched a preliminary investigation into the acquisition by Cassa Depositi e Prestiti of 29.99% of Terna's share capital, as well as into the acquisition by the latter of the ISO business segment.

By means of Ruling No. 14542 dated August 4, 2005, communicated to the parties on August 5, 2005, the Antitrust Authority issued its authorization for the acquisition, by the company Cassa Depositi e Prestiti (CdP), of 29.99% of the share capital of Terna and of the ISO business segment, obliging CDP to observe the following measures:

- a) the transfer, as from July 1, 2007 and within the subsequent 24 months, by CDP of the equity investment held in ENEL S.p.A., as well as
- b) provisionally and until the satisfaction of the afore-mentioned condition, the undertaking of the following commitments:
  - i) approval by the new Terna Board of Directors of a resolution which lays down suitable procedures for enhancing the role of the Advisory Committee pursuant to Article 1 of the D.P.C.M. dated May 11, 2004 in relation to the adoption and implementation of the NTN development plans;

- ii) appointment of at least six of the seven Terna directors, due CDP in the event of a Board of Directors comprising ten members, who are independents.

### **EIB loan**

During March 2005, the Company obtained a line of credit from the European Investment Bank (EIB) for a total of euro 300 million. On March 15, the first portion of euro 100 million was disbursed. The loan anticipates a period of grace of 4 years and repayment period of 11 years, involving straight-line six-monthly instalments. The residual part can be disbursed up until December 31, 2006.

The annual loan cost will be equal to a margin of 12 basis points to be added to the rate from period to period determined by the Bank which in any event cannot exceed in total the Euribor rate plus 27 basis points for the entire duration of the loan.

### **Placement of Terna shares via the ABB procedure**

On March 31, Enel SpA transferred an equity investment of 13.86% in the subsidiary Terna by means of an accelerated bookbuilding transaction targeted at Italian and foreign institutional investors. The transaction closed at a final allocation price of euro 2.05 per share, essentially in line with the Terna share stockmarket prices during the same period, and was settled by means of consignment of the securities and payment of the price on April 5, 2005. As a result of this transaction, Enel's equity investment in Terna's share capital comes to 36.142%.

### **General Shareholders' Meeting**

As of April 1, 2005 Terna's General Shareholders' Meeting was held in first calling. During the ordinary session, it resolved on the approval of the 2004 statutory financial statements and the payment of the dividend balance of euro cents 7 per share, being the balance of the advance payment of the euro cents 4.5 per share dividend already paid out in October 2004. The balance of the dividend was made available for payment as from May 26, 2005, with the "detachment date" of coupon No. 2 coinciding with May 23, 2005. With regards to the additional resolutions adopted by the meeting for the period under review, reference should be made to the matters described in the section "Corporate Governance".

### **Development plan for the National Transmission Network**

On April 21, 2005 the Ministry of Production Activities approved the new development plan for the national electricity transmission network drawn up by the ISO.

In terms of network development measures, all the work scheduled over the short-term (by the end of 2009) and medium/long- term (by the end of 2014) is shown in the following table:

	<i>New stations</i>	<i>Increase in transformation power</i>	<i>Increase in power lines</i>
	<i>[No.]</i>	<i>[MVA]</i>	<i>[km]</i>
<i>Short/medium-term measures</i>	38	12,100	2,720
<i>Medium/long-term measures</i>	19	3,150	400
<b><i>Total</i></b>	<b>57</b>	<b>15,250</b>	<b>3,120</b>

In addition to the development measures, this Plan anticipates a change in the NTN perimeter during 2005 as a result of the acquisitions and disposals of network elements which almost exclusively concern Terna.

Specifically, as a result of the afore-mentioned change resolved by the ISO and approved by the MAP, Terna will have to

- acquire approximately 52 km of 150-132 kV lines and 11 stations including 2 220 kV and 9 132 kV;
- dispose of around 48 km of line and 3 150-132 kV stations.

**Reimbursement of TSN preference shares**

Further to the resolution adopted by TSN's Board of Directors and after having obtained the authorization of BNDES, 175,000,000 redeemable TSN preference shares were reimbursed during April for a total of R\$ 164.7 million. The reimbursement resulted in Terna S.p.A. collecting around euro 49 million.

## Subsidiary companies

### **ANEEL resolutions and authorizations**

On June 30, 2005 ANEEL established the new values of the Concession Fee (RAP) in force as from July 1, 2005 until June 30, 2006. The TSN and Novatrans fees were respectively set at R\$ 245 million and R\$ 269 million, reflecting the adjustment for inflation (IGPM rate) accumulated between June 2004 and May 2005, equating to 9.0752%. ANEEL also acknowledged an additional one-off increase, to be received in 12 monthly instalments as from July 2005 relating mainly to the adjustment for the additional PIS/COFINS rates paid by the companies up until May 30, 2005, amounting to around R\$ 13 million for TSN and R\$ 14 million for Novatrans.

### **Exchange rate performance during the period**

During the period December 2004 - June 2005, the Brazilian Real appreciated by 11% against the US Dollar and 21% against the Euro

#### **Exchange rate values at the end of each month in the period**

	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	May-05	June-05
<b>BRL/US\$</b>	2.65	2.63	2.60	2.68	2.54	2.38	2.36
<b>BRL/EUR</b>	3.61	3.43	3.45	3.47	3.30	2.93	2.85
<b>EUR/US\$</b>	1.36	1.30	1.33	1.30	1.30	1.23	1.21

### **Operations**

#### **TSN**

During the period, the Sudeste – Nordeste kV 500 transmission line, with an extension of 1,062 km, from Serra da Mesa (Goiás State) to Sapeaçu (Bahia State), including the intermediate sub-stations of Rio das Eguas, Bom Jesus da Lapa and Ibicoara, was fully operative.

**CONSTRUCTION ACTIVITIES.** Activities started for the supply and installation of the Capacitive Voltage Transformers (TVC) on the primaries of the transformers at the Sapeaçu and Bom Jesus da Lapa stations.

Work was concluded in August 2005.

**SERVICE QUALITY.** The ratios relating to availability and fault rate for the first half of 2005 are indicated in the table below. The 2004 figures are shown in brackets.

	Availability	(%)	Fault rate <sup>1</sup>
- Power lines (including reactors)	90.82	(99.90)	0.83 (0.85)
- Bar reactors	100	(99.99)	0.00 (0.00)
- ATR	99.98	(99.94)	0.25 (0.25)
- SVC	99.99	(99.83)	2.00 (5.01)

<sup>1</sup> Number of faults per line (100 Km)/component (unit)

The fault rate on the lines is conditioned by a series of faults affecting the lines reactors, deriving from an oil corrosion problem; the necessary corrective action is currently underway.

Shareholders are informed that the line function is considered unavailable in the event of the unavailability of the related reactors even if the line is operative.

### **Novatrans**

During the first half of 2005, the North-South II kV 500 transmission line, with an extension of 1,278 km, from Samambaia (Federal District) to Imperatriz (Maranhão State) including the intermediate substations of Serra da Mesa, Gurupí, Miracema and Colinas, was fully operative. Shareholders are reminded that in 2004, the line was fully operative only as from April.

**CONSTRUCTION ACTIVITIES.** The basic and tender design was accomplished for the acquisition of the equipment necessary for creating the new Ancillary Services with a power supply which is independent from Furnas and Eletronorte. Generators were started up and work was completed on the Samambaia station.

Installation of the reserve reactor at the Serra da Mesa station was completed, and the emergency satellite link at the Samambaia, Serra da Mesa and Sapeacú (TSN) stations was installed.

**SERVICE QUALITY.** The ratios relating to availability and the fault rate for the first six months of 2005 are indicated below. A comparison with the same period last year is not possible since : (i) some of the plants have become operative during 2004; (ii) since the period of grace for the purposes of the Parcela Variavel was applicable during 2004, extraordinary maintenance measures were carried out reducing the availability and increasing the fault rate.

	AVAILABILITY	FAULT RATE <sup>2</sup>
Power line (including reactors)	99.98%	1.09
Bar reactors	99.96%	2.00
FSC	96.76%	2.07
TCSC	94.64%	46.24

Shareholders are informed that the figures relating to the Capacitor Stand functions, both fixed (FSC) and variable (TCSC), are conditioned by a number of project errors made by the supplier which are being corrected by means of measures which have led to extraordinary out-of-service conditions.

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<sup>2</sup> Number of faults per line (100 Km)/component (unit)

## Operating and financial review

### Form and content of the consolidated accounting schedules and operating review

Terna's operational consolidated income statement for the first half and the second half of the years 2005 and 2004, is summarized in the following table, having been obtained by classifying the data presented in the income statement.

2nd quarter				In millions of euro				1st half			
2005	2004	Change	%	2005	2004	Change	%	2005	2004	Change	%
<b>Revenues:</b>											
225.2	215.5	9.7	4.5	NTN usage fees				448.5	469.4	-20.9	-4.5
12.0	15.1	-3.1	-20.5	Other sales and services				24.4	28.4	-4	-14.1
8.6	3.1	5.5	177.4	Other sundry revenues and income				26.7	11.0	15.7	142.7
<b>245.8</b>	<b>233.7</b>	<b>12.1</b>	<b>5.2</b>	<b>Total revenues</b>				<b>499.6</b>	<b>508.8</b>	<b>-9.2</b>	<b>-1.8</b>
<b>Operating costs:</b>											
42.5	43.7	-1.2	-2.7	- Payroll and related costs				84.5	82.3	2.2	2.7
29.8	37.2	-7.4	-19.9	- Services and use of third-party assets				54.5	62.2	-7.7	-12.4
4.3	3.9	0.4	10.3	- Materials				7.3	7.2	0.1	1.4
9.5	27.5	-18.0	-65.5	- Other costs				15.6	36.3	-20.7	-57.0
-6.6	-5.1	-1.5	29.4	- Capitalized costs				-10.4	-9.1	-1.3	14.3
<b>79.5</b>	<b>107.2</b>	<b>-27.7</b>	<b>-25.8</b>		<b>Total operating costs</b>			<b>151.5</b>	<b>178.9</b>	<b>-27.4</b>	<b>-15.3</b>
<b>166.3</b>	<b>126.5</b>	<b>39.8</b>	<b>31.5</b>	<b>GROSS OPERATING MARGIN</b>				<b>348.1</b>	<b>329.9</b>	<b>18.2</b>	<b>5.5</b>
<b>41.4</b>	<b>38.7</b>	<b>2.7</b>	<b>7.0</b>	<b>Amortization and depreciation</b>				<b>81.8</b>	<b>76.7</b>	<b>5.1</b>	<b>6.6</b>
<b>124.9</b>	<b>87.8</b>	<b>37.1</b>	<b>42.3</b>	<b>OPERATING INCOME</b>				<b>266.3</b>	<b>253.2</b>	<b>13.1</b>	<b>5.2</b>
-17.9	-20.1	2.2	-10.9	- Net financial income (expense)				-42.7	-51.3	8.6	-16.8
<b>107.0</b>	<b>67.7</b>	<b>39.3</b>	<b>58.1</b>	<b>RESULT PRIOR TO TAXATION</b>				<b>223.6</b>	<b>201.9</b>	<b>21.7</b>	<b>10.7</b>
36.9	30.3	6.6	21.8	- Income taxes for the period				83.3	87.4	-4.1	-4.7
<b>70.1</b>	<b>37.4</b>	<b>32.6</b>	<b>87.2</b>	<b>-NET INCOME FOR THE PERIOD</b>				<b>140.3</b>	<b>114.5</b>	<b>25.8</b>	<b>22.5</b>

During the first half of 2005, revenues fell by euro 9.2 million when compared with the same period in 2004 (- 1.8%) and can essentially be identified as follows:

- in the NTN usage fee (- euro 20.9 million) due to the following factors:

- minor revenues for the transport of energy on the Italian transmission network (euro 40.8 million) as the algebraic sum of minor revenues due to the effects of the new time bands introduced by means of the Electricity and Gas Board resolutions No. 05/04 and 235/04 and an increase due to the increased energy transported;
- greater revenues for the transport of energy on the Brazilian network (euro 19.9 million) both as the result of the full operating conditions of Novatrans' line as from 31 March 2004, and thanks to the appreciation of the Brazilian Real against the Euro;

Other sales and services decreased by around euro 4.0 million essentially as a result of lower revenues for the maintenance of the high voltage lines belonging to Enel Distribuzione (approximately euro 3.3 million).

By contrast, other revenues and income rose by around euro 15.7 million, essentially deriving from the out-of-period income for the adjustment made to the 2004 network rental fee (euro 15.3 million).

During the second quarter of 2005, Group revenues rose by euro 12.1 million when compared with the same period in 2004 and can essentially be identified as follows:

- in the network usage fees (euro 9.7 million) mainly as a result of the increased revenues for energy transportation on the Brazilian network (euro 6.8 million), in particular due to the rise in fees (euro 1.6 million) and the exchange delta (euro 5.2 million).
- in the increase of euro 5.5 million originated in particular by greater operating grants for plant benefiting the current quarter, greater insurance compensation for damages to plant and ordinary out-of-period income pertaining to the Parent Company.

Operating costs, which amounted to euro 151.5 million during the period, underwent a decrease with respect to last year of 15.3%, essentially as a result of:

- an increase in payroll and related costs of around euro 2.2 million reflected by the wage and salary trend as well as greater costs for redundancy incentives (euro 1.7 million).
- a decrease in costs for services of euro 7.7 million, essentially identifiable in the additional cost incurred in the previous year for stockmarket listing.
- a decrease in other costs of euro 20.7 million attributable to additional costs incurred in the accounting period for out-of-period expense due to the ISO for euro 16.7 million and to the 2002 tax amnesty for around euro 2.1 million.

When comparing the operating costs in the two quarters, purchases of raw materials and consumables, payroll and related costs and the depreciation of tangible fixed assets remain essentially aligned. By contrast, a considerable decrease has been recorded in the item "services" originated by the costs referring to Terna SpA's IPO which remained booked to the 2nd quarter of 2004. As far as other costs were concerned, a considerable decrease was seen due to that fact that during the 2nd quarter of 2004 out-of-period expense had been recorded pertaining to the adjustments to the charge of the Parent Company made to the network rental fee for previous years.

Costs for internal work remained stable in the comparison between the two periods.

Amortization and depreciation rose by euro 5.1 million, mainly as a result of the additional depreciation relating to new plant which became operative (approximately euro 3 million for the Parent Company and around euro 2 million for the Brazilian companies). The figure was also up (euro 2.7 million) in the comparison between the two quarters for the same reasons indicated above.

EBIT (operating income) during the interim period therefore came to euro 266.3 million, disclosing an increase of euro 13.1 million on the same period in 2004 (+ 5.2%), while in the second quarter of 2005 the figure came to euro 124.9 million, up by euro 37.1 million on the second quarter of 2004.

Net financial expense during the period, amounting to euro 42.7 million (of which euro 33.9 million relating to the Parent Company and euro 8.8 million to the Brazilian companies), underwent a decrease of euro 8.6 million which is mainly reflected as follows:

- in an increase of euro 11.8 million relating to the Parent Company and essentially attributable to higher interest on long-term loans;
- in a decrease of euro 20.4 million for the Brazilian companies, essentially attributable to the item "exchange gains and losses".

The comparison between the second half of 2005 and the same period in the previous year discloses a drop of around euro 2 million due to a rise in the net financial expense of the Parent Company for about euro 7 million, countered by a decrease of approximately euro 9 million pertaining to the subsidiaries.

Income taxes for the first half of 2005 amounted to euro 83.3 million, of which euro 72.5 million for the Parent Company (including euro 21.7 million for net deferred taxation) and euro 10.8 million relating to the subsidiaries.

The incidence of income taxes on pre-tax income came to 37.3%, compared with 43.3% in the same period in 2004.

The increase is the result, on the one hand, of greater non-deductible items pertaining to 2004 (Provisions for risks and charges, and charges for the tax amnesty) which represented increases in the income and, on the other hand, greater revenues due to dividends collected in 2005 from the subsidiaries, which are tax exempt in Italy in pursuance of Article 23 of the Italy/Brazil agreement.

Income for the period amounted to euro 140.3 million, disclosing an increase of euro 25.8 million (+ 22.5%) when compared with the same period last year.

The increase between the second quarter of 2005 and the second quarter of 2004 came to euro 32.6 million, corresponding to 87.2%, of which euro 20.7 million for the Parent Company and euro 12.0 million for the subsidiaries.

## Consolidated balance sheet

The operational consolidated balance sheet for the years 2005 and 2004 is summarized in the following table, obtained by reclassifying the data presented in the balance sheet.

In millions of euro

	as of June 30, 2005	as of Dec. 31, 2004	Change	%
<b>Net fixed assets</b>				
- Tangible and Intangible	4,595.4	4,440.3	155.1	3.5
- Financial	75.3	16.8	58.5	348.2
<b>Total</b>	<b>4,670.7</b>	<b>4,457.1</b>	<b>213.6</b>	<b>4.8</b>
<b>Net working capital</b>				
- Trade receivables	220.3	157.9	62.4	39.5
- Inventories	23.4	19.6	3.8	19.6
- Other assets	66.0	28.3	37.7	133.2
- Net tax payables	24.6	8.5	16.1	189.7
- Trade payables	129.5	183.6	-54.1	-29.5
-Other liabilities	273.9	215.5	58.4	27.1
<b>Total</b>	<b>-118.3</b>	<b>-201.8</b>	<b>83.5</b>	<b>-41.4</b>
<b>Gross capital employed</b>	<b>4,552.4</b>	<b>4,255.3</b>	<b>297.1</b>	<b>7.0</b>
Sundry provisions	618.5	596.2	22.3	3.7
<b>Net capital employed</b>	<b>3,933.9</b>	<b>3,659.1</b>	<b>274.8</b>	<b>7.5</b>
Shareholders' equity	1,826.5	1,759.1	67.4	3.8
Net financial debt	2,107.4	1,900.0	207.4	10.9
<b>Total</b>	<b>3,933.9</b>	<b>3,659.1</b>	<b>274.8</b>	<b>7.5</b>

The increase in net fixed assets, amounting to euro 213.6 million when compared with the balance as of December 31, 2004, comprises the following :

- an increase in tangible fixed assets of euro 123.6 million deriving from the algebraic sum of :
  - o a decrease of approximately euro 1.7 million relating to the net effect of investments, depreciation and disposals;
  - o an increase of around euro 125.3 million due to the appreciation of the \$R/Euro exchange rate which as from December 31, 2004 fell from \$R 3.61 to 2.85 per Euro.
- an increase in intangible fixed assets amounting to around euro 31.5 million (as a matching balance to shareholders' equity) due to the adjustment of the value of the goodwill at the period end exchange rates to the amount provided at the time of its recognition (December 31, 2003).
- an increase in long-term financial assets of euro 58.5 million entirely attributable to the fair value delta of the derivative financial instruments held in the portfolio.

Investments in tangible fixed assets during the first half of the year amounted to euro 83.7 million (of which euro 82.1 million relating to the Parent Company), down by 38.7% when compared with the same period last year mainly as a result of the completion of the Novatrans lines in 2004.

Net working capital presented a negative balance of euro 118.3 million (of which around euro 104.3 million relating to the Parent Company), disclosing a change with respect to the values as of December 31, 2004 equating to around euro 83.5 million attributable to:

- an increase in trade receivables amounting to around euro 62.3 million, including euro 48.8 million relating to the Parent Company and comprising additional amounts due from the ISO;
- an increase in other assets of around euro 37.7 million, essentially attributable to the Parent Company and including around euro 32.6 million of accrued income of which approximately euro 30 million on derivative contracts and euro 3.7 million of prepaid expenses for the 14th month salary payment;
- a decrease in trade payables of euro 54.1 million essentially attributable to the Parent Company, deriving from greater investment activities carried out in the latter part of 2004 and the payment of the related invoices;
- an increase in net tax payables for euro 16.1 million (euro 12.2 million relating to the Parent Company), essentially attributable to VAT payables;
- an increase in other liabilities of euro 58.4 million, entirely attributable to the Parent Company mainly for financial accrued liabilities and deferred income (around euro 35.8 million), accrued liabilities and advance payments for operating grants (around euro 14 million) and accrued liabilities and other amounts due to employees (approximately euro 7 million).

The change in the gross capital employed therefore came to euro 297.1 million.

The increase in provisions, amounting to euro 22.3 million, is essentially attributable to the item relating to net deferred taxation (euro 19.7 million).

Net capital employed, which amounted to euro 3,933.9 million, disclosing an increase of euro 274.8 million towards December 31, 2005, is covered by the shareholders' equity for euro 1,826.5 million (46.4% and 48.1% as of December 31, 2004) and by the net financial debt for euro 2,107.4 million (53.6% and 51.9% as of December 31, 2004).

Net financial debt is analyzed as follows:

<b>In millions of Euro</b>	<b>June 30, 2005</b>	<b>Dec. 31, 2004</b>	<b>Change</b>
<b>A. Medium/long-term debt</b>			
- Bond issue	1,508.1	1,434.7	73.4
- EIB loans	385.3	300.0	85.3
- Brazil loans	434.8	350.1	84.7
<b>Total</b>	<b>2,328.2</b>	<b>2,084.8</b>	<b>243.3</b>
<b>B. Short term debt (liquidity):</b>			
- Bond issue	0.0	0.0	0.0
- IEB loans	29.5	18.2	11.3
- Brazil loans	27.2	28.8	-1.6
- net position vis-à-vis banks and liquidity - Italy	-26.0	0.0	-26.0
- net position vis-à-vis banks and liquidity - Brazil	-61.6	-87.9	26.3
- net position of the intercompany cash management current account	-189.9	-143.9	-46.0
<b>Total</b>	<b>-220.8</b>	<b>-184.8</b>	<b>-36.0</b>
<b>Total A + B</b>	<b>2,107.4</b>	<b>1,900.0</b>	<b>207.4</b>

As can be seen in the table above, the rise in the Terna Group's net debt during the first half of 2005 came to euro 207.4 million.

The increase in the net financial position of the Parent Company came to euro 98 million and included euro 96.6 million due to the net increase in EIB loans and euro 73.4 million due to the increase in the fair value of the bond issues, while the increase in liquid funds amounted to euro 72 million.

The Brazilian companies reported an increase in the net financial position of around euro 109 million, due to the rise in the gross debt totalling approximately euro 83 million and a decrease in cash and cash equivalents of around euro 26 million. The increase in the Brazilian gross debt is due to the rise relating to the capitalization of interest (euro 6 million) and the exchange rate differential (euro 86 million), while the decrease is a result of the repayments anticipated by the repayment plans (euro 9 million).

## **Investments in tangible fixed assets**

The breakdown of investments made in the 1st half of 2005 by plant type, presented on a comparative basis with the same period last year, is illustrated as follows :

Total investments (in millions of euro)	2005	2004
- Power lines	32.9	57.0
- Transformer stations	44.5	49.7
- Other	4.7	2.2
- Brazil	1.6	27.7
<b>- Total</b>	<b>83.7</b>	<b>136.6</b>

During 2005, the following renovation and development work is anticipated:

### Development projects

- around 430 projects relating to lines;
- around 160 projects relating to stations;

### Renovation projects and other (adaptation, modification, rationalization)

- around 690 projects relating to lines;
- around 590 projects relating to stations.

The **development** investments of greatest importance included the following activities:

- Completion of the new 380 kV Laino-Rizziconi power line: the new 380 kV line from Rizziconi to Laino is essential for the purposes of increasing the reliability and safety of the transmission network in Calabria and significantly enhancing the interconnection between Sicily and the Continent. Bearing in mind that new production plants have also been authorized in the Calabria Region, the work emerged as particularly urgent in that it will make it possible to increase the available power in order to guarantee the coverage of the national demand.
- Change regarding the completion of the new 380 kV Matera-S.Sofia power line: the completion of the power line – of which around 95% of the 207 km plus overall length initially anticipated has already been built – is of fundamental importance for the safe transport of the energy produced by the generation plants (current and future) in Puglia and Calabria to the rest of the 380 kV Italian network. The work will be achieved by means of a variant of approximately 27 km whose route is the result of a Programme Agreement between the Ministry for Production Activities and local authorities. The work has been included amongst those of "leading national interest" contained in CIPE Resolution No. 121 dated December 21, 2001, for the purpose of the use of the instruments anticipated by the "Objective Law", and the related authorization is anticipated within the year.
- Start-up of activities for the new 380 kV mixed overhead-cable Turbigo-Bovisio power line. Turbigo-Rho section: This is the first example in Italy of a 380 kV power line using mixed technology (20 km of overhead power line, 8 km of underground cable). The work is of fundamental importance for the purposes of contributing towards increasing the transport capacity to the Milan load area and improving the running flexibility of the network.

- Creation of a new 150 kV underwater cable connection between Sardinia and Corsica (SARCO): the aim of the project is the construction of the new 150 kV interconnecting power line S.Teresa (Italy) - Bonifacio (Corsica) between the C.P. of Santa Teresa Gallura and the Italo-French territorial waters.
- New 380 kV Ferrara station: this involves the creation of a new 380 kV switching station to be connected incoming-outgoing to the "Ostiglia - Ferrara Focomorto" line, required for the connection of the 800 MW combined cycle generation plant under construction belonging to SEF.
- New 380 kV Sparanise station: : construction of a new 380 kV switching station to be connected incoming-outgoing to the "Garigliano - S. Maria C.V." line, required for the connection of the 800 MW combined cycle generation plant under construction belonging to CALENIA ENERGIA.
- Completion of the new 380 kV Feroleto section: Work continues for the realization, at the 150 kV Feroleto station (currently connected by means of antenna to the 220 kV network), of a 380 kV double bar section equipped with ATR 380/150 kV and connected incoming-outgoing to the 380 kV "Rizziconi – Laino" power line (currently under construction). On a parallel, extension continues (with two bays) of the current 150 kV section.

The **renovation** investments of greatest importance included the following activities:

- Reconstruction of the Verampio plant;
- Reconstruction of the 220 and 132 kV Pianezza sections;
- Reconstruction of the La Spezia plant;
- Reconstruction of the Verderio plant;
- Renovation and adaptation of the Soverzene plant;
- Adaptation of the Villavalle plant.

The investment work which during the first half of 2005 involved expenditure of more than euro 1,000,000 is indicated below.

## Lines

Plant	Description	Macro-category	Amount invested as of June 30 (in thousands of euro)
Laino - Feroleto - Rizziconi	Construction of new 380 kV power line stretching approx. 200 km for the closure of the 380 kV ring in Calabria	Development	10,603
S. Fiorano – Robbia	Completion of the new interconnection with Switzerland	Development	3,945
S. Maria C.V. – Teverola	Realization of the new connection to the NTN for the new SET generation plant at Teverola	Development	1,140

## Stations

Plant	Description	Macro-category	Amount invested as of June 30 (in thousands of euro)
Rumianca	Extension of the 380 and 150 kV sections and construction of new 220 kV section	Development	3,116
Santa Barbara	Construction of new 380 kV section	Development	2,551
Calenzano	Calenzano - CAL – Re-organization of Florence area network	Development	1,922
Pianezza	Reconstruction of 220 and 132 kV sections	Renovation	1,736
La Spezia	Plant reconstruction	Renovation	1,580
S. Maria C.V.	Construction of 220kV section	Development	1,442
Verderio	Plant reconstruction	Renovation	1,365
Ferrara	Construction of new 380 kV switching station for connecting SEF generation plant	Development	1,351
Bardi	New 132 kV switching station	Development	1,067
Verampio	Plant reconstruction	Renovation	1,021

### **Initiatives undertaken for reducing the environmental impact**

With particular emphasis on the construction of new power lines, Terna's initiatives to reduce the environmental impact involved an increased use of innovative design tools that ensure minimal impact on the landscape accompanied by ongoing research into new technological solutions.

The design of all new equipment takes place exclusively using maps of the terrain obtained by means of aerial photography, which, due to the high potential of the instrument, makes it possible to assess the impact of future work on the entire area involved with greater accuracy.

The same mapping systems represent an important means for presenting the plans for new work to the local authorities from the initial planning stage, enabling them to contribute proposals for the definition and the improvement of all the key environmental, landscape and visual impact problems involved.

During the first half of 2005, TERNA completed the final planning activities for the new 380 kV Tavarnuzze – Casellina power line, which anticipate the use, for the first time and for a section of approximately 2 km, of a number of Foster pylons (winner of the "Supports for the Environment" competition) for which the executive project was prepared in 2004 and the first prototypes created and tested.

In addition during the first six months, construction was started on the new Carpi station which uses particular plant engineering solutions for the improved environmental location of the plants (project for the re-qualification of the electricity stations: appointment entrusted to the MDL architects' firm for the Tavarnuzze, Carpi, Roma East stations).

### **Plant and equipment**

The Group's plants are illustrated in the table below:

	TERNA		TSN		NOVATRANS	
	N°	Km	N°	Km	N°	Km
<b>Stations</b>	300		5		-	
<b>Transformers</b>	567		14		-	
<b>Bays</b>	3,918		29		10	
<b>Lines</b>		34,979		1,077		1,278
<b>Double-circuit lines</b>	1,940	38,775	12	1,077	5	1,278

The number of stations has remained unchanged with respect to December 31, 2004.

With regards to the number of transformers, there was an overall reduction of 2 units due to the following changes:

- 1 380/220 kV 400 MVA transformer out of service due to a fault at the Pirossasco station as well as 1 380/132 kV 160 MVA transformer at the Venaus station;
- the installation of a new 220/132 kV 160 MVA transformer at the Biella East station;
- the replacement at the Este station of the 220/132 kV 100 MVA transformer with another 160 MVA one.

Overall, the total transformation capacity dropped from 108,749 MVA at the end of 2004 to 108,409 MVA for the first half of 2005.

As far as power lines were concerned, an increase was seen in the length of double-circuit lines with respect to December 31, 2004, by around 80 km. This increase was mainly due to the bringing onto stream of the following new connections:

- 380 kV double-circuit power line (around 42 km) for interconnection with Switzerland (S. Fiorano – Robbia);
- 150 kV Taloro 3 – Taloro 2 and Taloro 2 – Taloro 1 lines (for an approximate total of 14 km); which were countered by the shutdown of several sections of the former 220 kV Este – Colunga connection.

There were no changes at the plants in Brazil.

## **Research and development activities**

As far as research activities which require professional skills were concerned, TERNA avails of the collaboration of CESI S.p.A. in which it holds a 15% equity investment.

The related costs incurred during the period amounted to approximately euro 0.6 million.

### **Technological innovation**

#### **1. New plant engineering technologies**

##### **Installation of high temperature conductors with greater transport capacity**

The ever rising need for an increase in the energy to be transported and the growing difficulties in constructing new power lines, oblige the search for solutions capable of maximizing the exploitation of the existing lines. During the first half of the year, it was ascertained that a possible solution might be that of replacing the conductors with others of the same size but featuring an innovative technology capable of permitting the transit of greater energy (up to 150%); in fact, these new conductors can operate at extremely high temperatures without dilating too much and therefore without changing the distances of the conductors from the ground thereby permitting the use of existing structures. The type of conductors was identified and during the second half of the year steps will be taken to purchase the conductors and install them experimentally on the 150kV Spoleto-Villavalle line; furthermore, once again during the second half of the year, the performance of surveys is anticipated on the 380kV Benevento Foggia line in order to then proceed with the executive planning of the replacement of the conductors with other innovative models.

##### **Technical experimentation for helicopter-borne laser detection**

One of the main problems with regards to the management of the power lines is that of detecting the distances of the conductors from the ground and above all else from possible interference (plants, buildings, other structures) which may represent a danger.

The project consists in the experimentation of the detection of distances by means of a laser-gauging system; the system, helicopter-mounted, carries out high speed laser scanning, sending back the information with a degree of precision of just a few centimetres. The results can be used as the basis for mechanical assessments and modification planning, both in order to evaluate the need for cutting back plants and trees and for monitoring the occurrence of new structures. Lastly, the possibility of also detecting physical anomalies affecting the conductors and other components will also be assessed. During the first half of the year, a specific technique was set up for the performance of the surveys; practical application on two power lines is anticipated during the second half of 2005.

##### **Diffusion of on-line transformer monitoring systems**

The transformers are the most important equipment both as a result of the impact on the business and due to the elevated cost. The breakdown of a transformer always has serious consequences; therefore it is appropriate to aim at the installation of expedient sensors which make it possible to identify the

occurrence of anomalies thereby permitting action to be taken before the fault occurs. The project involves the installation of appropriate gas sensors dissolved in water, whose consistence is an indicator of the presence of anomalies, linked up to the expert support system for maintenance, "MBI". During the first six months, the design and planning was carried out and the necessary equipment was identified; installation is expected during the second half of the year.

### **New compact electricity station solutions**

The need to create stations within limited spaces together with that of speeding up the construction timescales, has led to the identification of compact technological solutions which nevertheless feature contained costs. The project involves the identification of new integrated equipment which, opportunely installed, makes it possible to construct electricity stations in smaller spaces, within shorter timescales and, in relation to the lesser number of elementary components and the high level of integration, with a lower expected fault rate. Overall, the solution would feature costs and realization timescales which are lower, combined with greater reliability. During the first half of the year, the equipment was sourced, the project created and work started; during the second half, installation is anticipated alongside the launch of experimentation in the field at Villanova.

### **2. MBI system**

The MBI (Monitoring & Business Intelligence) system is an expert information system supporting the decisions concerning the maintenance of the plants. It is divided up into two sections: the first supporting the short-term operations and therefore the scheduling and execution of the checks and maintenance, the second supporting the decisions and on-going improvement providing specific reports both on the efficacy and the efficiency of the measures and also the productivity of the activities. During the first half of the year, the system was completed for the stations and the operating section brought on stream for the lines. During the second half of the year, activation of the section supporting the decisions for the lines is anticipated.

### **3. Introduction of New Operating Procedures (Work on live equipment)**

Works carried out on live equipment are operating methods which make it possible to perform checks and maintenance on the lines and stations, while keeping them in service and therefore improving the availability of the electricity system.

#### **Set-up of new methods in stations**

The project involves the study and experimentation of methods for reviewing disconnecting switches and high voltage connections in stations, which represent the most recurrent activities and therefore those which have the greatest impact on out-of-service conditions. During the first half of the year, the methods were studied; experimentation within the field is anticipated during the second half of 2005.

#### **Industrialization of the replacement of guard cables**

Recently, a method has been tried and tested for the replacement of the guard cables of the power lines in service; the objective is to make the method simpler albeit in observance of the safety conditions which must be ensured.

#### **4. Computerization of flows and operating activities**

##### **SDSA (Automatic system supporting station design)**

The system permits the automatic design of the electricity stations starting off from the single-wire diagram using an extensive range of elementary modules - pre-defined for all the voltage levels - which make up the technical library. In addition to the design, the system permits the automatic estimation, the automatic issue of the purchase requests and the management of the entire design stage. The aim of the system is to standardize and speed up the station designs phases. During the first half of the year, the project was completed; the training of the staff and the bringing onto stream of the system is anticipated during the second part of the year.

##### **GIS Network (Geographic Information System)**

This is an information system which permits the graphic representation of the electricity network on a geographic system providing a wide range of information useful for the running and maintenance of the electricity network. In addition to the exact positioning of the power line throughout the territory, the system makes it possible to highlight all the possible interferences, all the technical information of the individual components as well as the data relating to faults or anomalies which have occurred, and measures underway. In conclusion, the system permits the handling of topics such as the ceraunic level, pollution, seismicity, hydrography, etc. The objective is to facilitate the operating activities making the salient information for the management of the network with reference to the territory available rapidly to the technicians. During the first half of the year, the system was completed; during the second half, the bringing onto stream and the development of a quick-to-use graphic interface is anticipated.

##### **CMS (Contract Management System)**

The CMS is a system supporting the general and detailed estimation operating activities for external services, the adequacy checks on the offers and the subsequent negotiation, and the drawing up of the final balance of the work on the power lines: The aim of the system is to increase the quality and the reliability of the purveying and to reduce the costs of the outside resources.

The application with the use of a sophisticated system of libraries and models of the activities, continually up-dated by the operating information gathered at the sites by means of the use of palm-top computers, permits an accurate analysis of the costs of the activities useful for design engineers and buyers.

The system also provides information useful for the subsequent reports supporting Vendor Rating, Supplier Qualification, market analysis, the accomplishment of tenders and purveying in general.

##### **SICAS Standard**

The SICAS STANDARD project sets itself the objective of the migration of the current systems for the protection, control and automation of the electricity stations, based on electro-mechanical technologies, to the new distributed intelligence digital technologies, in compliance with the new international standard IEC 61850, which ensures the inter-operativity between components of different manufacturers and the maximum economy of scale.

The project has entered into the final stage, with three manufacturers of primary importance in the automation industry: it is expected that trials for the certification of the related systems will be carried out as from November 2005.

SICAS STANDARD's impact on the management economy is of considerable interest, especially as a result of the tangible possibility of integrating within one system all the functions carried out today by separate devices, involving a consequent reduction in the overall investment costs. The benefits extend to the running costs, since the new technologies and the specific engineering of the Terna project will make it possible to carry out the majority of the checks and maintenance by means of remote management systems.

## Human resources

The following table shows a breakdown of the workforce by category.

Evolution of the workforce	Italy		Brazil		Total		
	as of: June 30, 2005	Dec. 31, 2004	June 30, 2005	Dec. 31, 2004	June 30, 2005	Dec. 31, 2004	Change
<b>TOTAL</b>	<b>2,858</b>	<b>2,871</b>	<b>50</b>	<b>58</b>	<b>2,908</b>	<b>2,929</b>	<b>-21</b>
Senior management	37	34			37	34	3
Middle management	214	221	3	3	217	224	-7
Office staff	1,466	1,467	47	55	1,513	1,522	-9
Workers	1,141	1,149			1,141	1,149	-8

The figures of the closing balances for the period are net of leavers, being effective as of the period end date (28 leavers as of June 30, 2005, 25 leavers as of Dec. 31, 2004).

The decrease in the closing balances for the period fall within the plans for the management of the turnover (to seek recoveries of efficiency, guaranteeing the maintenance and development of the Company's distinctive expertise).

As far as resource training and development was concerned, the commitment was focused in the first half of 2005 on the objective of consolidating and increasing the capital of distinctive expertise within the sphere of the core business, by means of intense and targeted specialist training activities aimed at the operations area.

On a parallel, on a consistent basis with 2004, specialist training activities were increased for the staff divisions and the commitment continued with regards to the training of new recruits, according to a plan which tends to develop (with focusing and specific methods for recent graduates and high-school leavers) both the technical-professional knowledge and the organizational abilities and the inclination towards the business.

As far as managerial training was concerned, a plan is currently being implemented which anticipates personalized initiatives addressing pinpointed targets.

Within the sphere of the initiatives supporting the Terna-ISO integration process, joint training activities on the subject of the Corporate Governance of listed companies were achieved and saw the participation of management and specialists from the two companies.

Again within the sphere of the activities supporting the Terna-ISO integration process, on the subject of internal communication a comparative survey was carried out at the start of 2005 into the organizational culture of the two companies, involving all the staff with the aim of furthering maximum participation in the changeover process.

The process for the re-definition of policies and action plans (on the subject of professional system, development, education and training, compensation, etc.), on a consistent basis with the changed context, was launched during the first half of 2005 starting off from the activities for the evaluation of the Intellectual Capital and Risk Management activities (included within an integrated system for the management and development of the human resources).

## **Long-term incentive systems**

On the basis of the proposals presented by the Remuneration Committee, during the meeting held on May 9, 2005, the Board of Directors voted for the adoption of the stock option Plan relating to the year 2005 and approved the related regulations.

The plan anticipates the offer of 9,950,000 options to be distributed, in total, to around 20 executives, belonging to Terna Spa and/or its subsidiaries pursuant to Article 2359 of the Italian Civil Code, who cover the most significant functions for the purposes of the achievement of the Company's strategic results. The overall number of the beneficiaries (20) also includes the ISO executives who will be identified among those who will join Terna; the Plan will be extended to the latter individuals at the time of the merger under the same terms and conditions, with the exception of the subscription price which will be established at the time of the offer itself to the executives, according to the formalities indicated below.

The approved regulations of the stock option plan:

1. anticipate that the strike price of each share is determined to the extent equating to the arithmetic average of the reference prices of ordinary TERNA S.p.A. stock struck by Borsa Italiana S.p.A.'s screen-based system in the period running from the date of the offer and the same day of the previous calendar month;

2. define the following as the conditions for the exercise of the options – having the nature of abeyance conditions – :

(a) the TERNA S.p.A. Group EBITDA relating to the year of allocation (2005) and indicated in the Group budget approved by the Board of Directors, is to have been exceeded;

(b) the percentage change between the reference price of the TERNA S.p.A. stock reported by Borsa Italiana S.p.A.'s screen-based system as of January 1, in the year in which the allocation of the Options took place and the same price as of December 31, of the same year, must be greater than the percentage change reported in the same period of time by the Reference Index (50% MIBTEL and 50% FTSE 300 Electricity). For the purposes of this calculation, both the percentage change of the reference price of the TERNA S.p.A. stock and the percentage change of the Reference Index will be adjusted in order to take into account the effect of the distribution of the respective gross dividends (ordinary and extraordinary including therein any bonus allocations of shares), within a logic of Total Shareholders' Return.

Both exercise conditions must be met for the exercise of the options themselves by the beneficiaries to be possible.

3. means that the subscription of the shares, at a price equating to the "strike price", is the entire responsibility of the beneficiaries, since the plan does not anticipate any concession in this connection.

4. lays down that the options, if the exercise conditions are achieved, can be exercised (i) in relation to a portion of 30% as from the year following that of allocation, (ii) in relation to a portion of 60% as from the second year following that of allocation and (iii) in relation to a portion of 100% as from the third year following that of allocation. All the options allocated and which have become exercisable must be exercised by March 31, 2010. The options can be effectively exercised only on open stockmarket days

including the last 10 days of each month, unless these fall within the 3 open stockmarket days prior to the so-called "coupon detachment" or in the two "blocking periods", lasting one month each, established in proximity of the approval of the draft statutory financial statements and the interim report by the Board of Directors.

During the first half of 2005, the application of the stock option plan led to the allocation of 3,899,000 options, characterized by a strike price of euro 2.098, to 9 executives of the Company. Verification of the achievement of the exercise conditions, as described above, will be made by the Board of Directors at the time of the approval of the draft financial statements for 2005.

The Board of Directors has also resolved to adopt - for the managers of the Company and the ISO who will join Terna not involved or who will not be involved in the stock option plan – a long-term incentive plan (LTI), linked to the achievement of challenging long-term performance objectives and the stock performance, postponing the definition of the objectives for the disbursement of the incentives established therein until the merger with the ISO.

### **Transactions with related parties**

Related parties were identified taking as reference the provisions of the CONSOB Communication No. 2064231 dated September 30, 2002.

With regard to the Terna Group's transactions during the first half of 2005, they are represented by transactions with subsidiary companies and companies belonging to the ENEL Group.

The transactions carried out by Terna with related parties mainly concern the exchange of goods, the provision of services the lending of financial resources, the coverage of insurance risks, as well as administrative, tax, legal and corporate assistance.

All the transactions form part of the ordinary operations and are regulated on an arms'-length basis, in other words at conditions which would be applied between two independent parties.

Lastly, shareholders are reminded that within the sphere of the corporate governance regulations which the Terna Group has adopted, the conditions have been anticipated for ensuring that the transactions with related parties are carried out in observance of the criteria of procedural and substantive correctness.

Transactions with related parties are indicated in the explanatory notes within the commentary to the individual balance sheet items.

## Corporate Governance

### Introduction

The corporate governance system in existence within the Company is consistent with the principles contained in the Code of Self-governance for listed companies, with the recommendations formulated by the CONSOB on the subject and, more generally, with the best practice established internationally.

This corporate governance system essentially has the aim of creating value for the shareholders, in awareness of the social importance of the activities which the Group is involved in and the consequent need to adequately consider, with regards to related performance, all the interests involved.

The changes during the first half of 2005 are illustrated below.

### Shareholding set up

The Company's share capital is entirely made up of ordinary shares, which are completely unrestricted and endowed with the right to vote both during ordinary general meetings of the shareholders and extraordinary sessions.

On the basis of the results of the shareholders' register and the information available, the only party – with the exception of Enel S.p.A., holder of 36.142% of the share capital, whose management and co-ordination activities Terna is subject to – who holds an interest in the share capital greater than 2%, is the shareholder Assicurazioni Generali SpA who directly and indirectly via its subsidiaries holds 5.296% of Terna's share capital. There is no evidence of shareholders' agreements covering the Company's shares.

### Board of Directors

#### *Resignation of Directors*

As from June 30, 2005 the Director Salvatore Sardo tendered his resignation from office, in relation to the conclusion of his activities within the Enel Group.

### Board of Statutory Auditors

In accordance with the provisions of the Company's By-laws, the Board of Statutory Auditors is made up of three acting Auditors and two alternate Auditors, appointed for a period of three years; they can be re-elected on expiry of their mandate.

All the members of the Board of Statutory Auditors must possess the requisites of respectability and professionalism requested by special legislation concerning the auditors of companies with listed shares, being supplemented by means of specific provisions of the By-laws; furthermore, on the basis of said By-laws, they cannot cover the office of acting auditor in more than four companies which issue securities issued on organized markets.

On a similar basis to the matters laid down for the Board of Directors, the By-laws anticipate that the appointment of the entire Board of Statutory Auditors should take place by means of the “list voting” mechanism, aimed at guaranteeing a presence within the supervisory body of an acting Auditor and an alternate Auditor appointed by the minority shareholders. This system was applied for the first time during the renewal of the Board of Statutory Auditors, appointed by the ordinary shareholders’ meeting held on April 1, 2005; this Board currently comprises the following acting Auditors: Giovanni Ferreri (Chairman), Giancarlo Russo Corvace and Roberto Tasca, the first of which confirmed in the office. The following individuals were also appointed as alternate Auditors: Bruno Franceschetti and Vito Di Battista. The Board of Statutory Auditors thus appointed will remain in office until approval of the statutory financial statements for 2007.

A brief professional resume of the acting Auditors is presented below.

➤ *Giovanni Ferreri, 70 years old, Chairman*

Graduate in law from the “La Sapienza” University in Rome, he passed his bar exams in 1961 and since 1975 has been a member of the counsel for the defence at the Supreme Court. He is also an auditor and joint-owner with Gianfranco Graziadei of the international law firm Graziadei – Ferreri, with head offices in Rome and branches in Milan, Munich and New York. He also covers the office of Deputy Chairman of A.S Roma SpA.

➤ *Giancarlo Russo Corvace, 52 years old, Acting Auditor*

Graduate in business studies from Rome’s LUISS University, he also gained a Masters in Business Administration at the *Scuola di Amministrazione Aziendale* at Turin University. Business consultant and chartered accountant, until 1985 he carried out his own activities at the Department of Financial Affairs of Banca Nazionale del Lavoro and until 1988 covered the offices of Chief Executive Officer with the company Ifigest Fiduciaria Sim S.p.A. (now Banca Ifigest). Since 1989 he has been a partner of the law firm Graziadei - Ferreri at the Rome head offices.

➤ *Roberto Tasca, 43 years old, Acting Auditor*

Graduate in Business Economics from the “Luigi Bocconi” commercial university. Since 2001 he has been an Extraordinary Professor of the Economics of Financial Brokers at the Faculty of Economics at Bologna University. Between 1992 and 2000 he covered various university lecturing positions at Bologna University and the Luigi Bocconi University in Milan. He is the author of numerous essays and monographs on various subjects dealing with the economics of financial brokerage, as well as a lecturer at SDA Bocconi and the University of Bologna for various Masters’ courses.

#### **General shareholders’ meetings**

During the first half of 2005, the general meeting of the shareholders’ held on January 31, 2005, resolved, in extraordinary session, to approve the amendments to the By-laws requested by the Decree of the Prime Minister dated May 11, 2004 (“DPCM”), containing “Criteria, methods and conditions for the unification of the ownership and the management of the National Transmission Network”, in view of the unification of the ownership and the

management of the national electricity transmission network. The aforementioned change to the By-laws will become applicable only as from the date of transfer to Terna of the activities of the Gestore della Rete di Trasmissione Nazionale SpA (ISO), in accordance with the matters anticipated by the aforementioned DPCM.

During the extraordinary session, the general shareholders' meeting held on April 1, 2005 also resolved the approval of the By-law amendments concerning the mandate granted to the Board of Directors to increase the share capital in view of future stock option plans reserved for Company management. During the same meeting, in ordinary session, the shareholder's meeting resolved the approval of the statutory financial statement for 2004 and the distribution of the dividend as well as the renewal of the Board of Statutory Auditors, whose mandate had expired, together with the related emoluments.

In relation to the matters anticipated by Consob resolution No. 14955 dated 23 March 2005 concerning the right to attend general shareholders' meetings, the Board meeting held on May 9, 2005 resolved the consequent adaptations to the By-laws.

### **Outlook for the rest of 2005**

During the remaining part of the accounting period, the revenue from the Terna SpA network rental will follow the seasonal trend established by the Electricity and Gas Board (AEEG) with the time bands introduced by resolution No. 05/04 and updated by resolution No. 235/04; this involves the concentration of the more remunerative bands in the summer period. It is believed that the revenues of the Terna Group for the remaining part of the year will remain at the levels seen last year. As far as costs are concerned, a slight increase is foreseeable due to the increased concentration of activities in the second half of the year and as a result of amortization/depreciation following the coming onto stream of new plants.

The acquisition of the ISO business segment (possible as from 1° November) will have a lightly negative overall impact on the results for the year, since the positive contribution of the business segment will be counterbalanced by one-off negative effects such as the registration tax, costs for outside resources linked to logistics and IT costs as well as additional charges relating to the long-term incentive systems.

The net financial debt is expected to rise with respect to the level seen at the end of June 2005, if one takes into account the effect of the 2005 advance dividend payment, the acquisition of the ISO business segment and the equity investment in Acea Trasmissione as well as additional investments in tangible fixed assets anticipated in the remaining part of the year, net of the cash flow generated by current operations.



## **Consolidated Accounting Schedules**

TERNA Group - Consolidated INCOME STATEMENT in millions of euro		1st Half 2005	1st Half 2004	Changes for the period
<b>A REVENUES</b>				
1 Revenues from sales and services		472,9	497,8	-24,9
2 Other revenues		26,7	11,0	15,7
<b>Total revenues</b>		<b>499,6</b>	<b>508,8</b>	<b>-9,2</b>
<b>B OPERATING COSTS</b>				
1 Raw materials and consumable		7,3	7,2	0,1
2 Services		54,5	62,2	-7,7
3 Personnel costs		84,5	82,3	2,2
4 Amortization, depreciation and write-downs		81,8	76,7	5,1
5 Other operating costs		15,6	36,3	-20,7
6 Capitalized costs		-10,4	-9,1	-1,3
<b>Total costs</b>		<b>233,3</b>	<b>255,6</b>	<b>-22,3</b>
<b>A-B Operating income</b>		<b>266,3</b>	<b>253,2</b>	<b>13,1</b>
<b>C Financial income and expense</b>				
1 Financial expense/(income)		42,7	51,3	-8,6
<b>D Income before taxes</b>		<b>223,6</b>	<b>201,9</b>	<b>21,7</b>
<b>E Income taxes</b>		<b>83,3</b>	<b>87,4</b>	<b>-4,1</b>
<b>F Net income (loss) for the period</b>		<b>140,3</b>	<b>114,5</b>	<b>25,8</b>
Earnings per share (euro)		0,070	0,057	0,0
Diluted earnings per share (euro)		0,070	0,057	0,0

TERNA Group - Consolidated BALANCE SHEET - ASSETS in millions of euro		as of June 30, 2005	as of Dec. 31, 2004	Changes for the period
<b>A- Non-current assets</b>				
1 Property, plant and machinery	4.446,9	4.323,3	123,6	
2 Goodwill	148,5	117,0	31,5	
3 Deferred tax assets	58,1	51,6	6,5	
4 Non-current financial assets	117,2	41,9	75,3	
5 Other non-current assets	6,5	6,4	0,1	
<b>Total non-current assets</b>	<b>4.777,2</b>	<b>4.540,2</b>	<b>237,0</b>	
<b>B- Current assets</b>				
1 Inventories	23,4	19,6	3,8	
2 Trade receivables	220,3	157,9	62,4	
3 Current financial assets	35,0	4,6	30,4	
4 Cash and cash equivalents	277,5	231,8	45,7	
5 Other current assets	71,0	34,8	36,2	
<b>Total current assets</b>	<b>627,2</b>	<b>448,7</b>	<b>178,5</b>	
<b>TOTAL ASSETS</b>	<b>5.404,4</b>	<b>4.988,9</b>	<b>415,5</b>	

TERNA Group - Consolidated BALANCE SHEET - LIABILITIES AND SHAREHOLDERS' EQUITY in millions of euro		as of June 30, 2005	as of Dec. 31, 2004	Changes for the period
<b>C- Group shareholders' equity</b>				
1 Share capital	440,0	440,0	0,0	
2 Other reserves	807,3	1.224,2	-416,9	
3 Retained earnings (losses) carried forward	438,9	-46,2	485,1	
4 Net income (loss) for the period	140,3	141,1	-0,8	
<b>Total Group shareholders' equity</b>	<b>1.826,5</b>	<b>1.759,1</b>	<b>67,4</b>	
<b>D- Minority interests</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	
<b>Total shareholders' equity</b>	<b>1.826,5</b>	<b>1.759,1</b>	<b>67,4</b>	
<b>E- Non-current liabilities</b>				
1 Long-term loans	2.327,9	2.084,9	243,0	
2 Termination indemnities and other employee benefits	138,9	138,3	0,6	
3 Provision for risks and charges	42,8	40,8	2,0	
4 Deferred tax liabilities	545,7	468,6	77,1	
5 Non-current financial liabilities	48,4	31,5	16,9	
6 Other non-current liabilities	164,5	158,2	6,3	
<b>Total non-current liabilities</b>	<b>3.268,2</b>	<b>2.922,3</b>	<b>345,9</b>	
<b>F- Current liabilities</b>				
1 Current portions of long-term loans	57,0	47,0	10,0	
2 Trade payables	129,5	183,6	-54,1	
3 Income tax payables	0,9	12,1	-11,2	
4 Current financial liabilities	46,5	12,9	33,6	
5 Other current liabilities	75,8	51,9	23,9	
<b>Total current liabilities</b>	<b>309,7</b>	<b>307,5</b>	<b>2,2</b>	
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>5.404,4</b>	<b>4.988,9</b>	<b>415,5</b>	

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

### FIRST HALF OF 2004

	Group share of capital and reserves						Group share- holders' equity	Minority interests	Total	
	Share capital	Legal reserve	Foreign currency conversion effects	Retaine d earnings	Other reserves	Net income for the period				
			Goodwill	Other						
<b>Balance as of Jan. 1, 2004</b>	<b>2,036.1</b>	<b>78.3</b>		<b>-40.8</b>	<b>631.3</b>	<b>220.4</b>	<b>2,925.3</b>	<b>0.2</b>	<b>2,925.5</b>	
Allocation of 2003 net income:										
to legal reserve	6.2					-6.2			0.0	
to other reserves (acc. depreciation)					36.9	-36.9			0.0	
to retained earnings				0.2		-0.2				
to dividends					-80.2		-80.2		-80.2	
Allocation to other reserves					85.8	-96.9	-11.1		-11.1	
Conversion of foreign company financial statements			-3.7	-8.3			-12.0		-12.0	
Share capital reduction	-1,596.1				396.1		-1,200.0		-1,200.0	
Other changes				2.4	-8.0		-5.6		-5.6	
Net income for the period					114.5		114.5		114.5	
<b>As of June 30, 2004</b>	<b>440.0</b>	<b>84.5</b>	<b>-3.7</b>	<b>-8.3</b>	<b>-38.2</b>	<b>1,142.1</b>	<b>114.5</b>	<b>1,730.9</b>	<b>0.2</b>	<b>1,731.1</b>

### FIRST HALF OF 2005

	Group share capital and reserves						Group share- holders' equity	
	Share capital	Legal reserve	Foreign currency conversion effects	Retained earnings	Other reserves	Net income for the period		
			Goodwill	Other				
<b>As of Dec. 31, 2004</b>	<b>440.0</b>	<b>84.5</b>	<b>1.5</b>	<b>-13.2</b>	<b>-34.5</b>	<b>1,139.7</b>	<b>141.1</b>	<b>1,759.1</b>
Conversion of foreign company financial statements			31.5	34.8				66.3
Reclassification for tax clean-up and other minor changes					421.2	-420.4		0.8
Allocation of net income		3.5			-2.4		-1.1	0.0
Dividend payment						-140.0		-140.0
Net income for the period						140.3		140.3
<b>As of June 30, 2005</b>	<b>440.0</b>	<b>88.0</b>	<b>33.0</b>	<b>21.6</b>	<b>384.3</b>	<b>719.3</b>	<b>140.3</b>	<b>1,826.5</b>

## Consolidated statement of cash flows

TERNA Group - Consolidated	June 30, 2005	June 30, 2004
STATEMENT OF CASH FLOWS		
<b>Group net income for the period</b>	<b>140.3</b>	<b>114.5</b>
Adjustments for:		
Depreciation of non-current tangible assets	82.0	76.6
Exchange rate gains and losses (including cash and cash equivalents)	-1.5	2.3
Operating grants credited to the income statement for the period	-3.2	-5.9
Provisions to reserves (including termination benefits)	7.2	17.4
Capital (gains) losses on disposals	0.7	0.3
Financial (income)/ expense	59.0	24.0
Income taxes	83.3	87.4
Other non-monetary items	0.0	2.1
<b>Cash flow from operations before changes in NWC</b>	<b>367.8</b>	<b>318.7</b>
Decrease in reserves (including termination benefits)	-9.4	-23.4
(Increase)/decrease in inventories	-3.8	19.7
(Increase)/decrease in trade receivables and other current assets	-151.4	-18.5
Increase/(decrease) in other non-current liabilities	6.3	25.2
Increase/(decrease) in other non-current assets	-0.1	20.3
Increase/(decrease) in trade payables and other liabilities	-34.9	-83.6
Interest income and other financial income collected	5.6	2.4
Interest expense and other financial expenses paid	-23.6	-14.6
Income tax paid	-22.0	-44.8
<b>Cash flow from operations [a]</b>	<b>134.5</b>	<b>201.4</b>
Increase in non-current tangible assets	-82.1	-136.7
Revenue from the sale of non-current tangible assets	0.0	0.6
Operating grants received	12.7	4.0
<b>Cash flow from investment activities [b]</b>	<b>-69.4</b>	<b>-132.1</b>
Increase/(decrease) in share capital	0.0	-1.596.1
Changes in reserves	4.9	397.5
Changes in medium/long-term financial payables	102.6	-479.5
Changes in short-term financial payables and term lines of credit	0.0	1.380.3
Dividends paid	-140.0	-80.2
<b>Cash flow from financing activities [c]</b>	<b>-32.5</b>	<b>-378.0</b>
<b>Impact of exchange rate fluctuations on cash and cash equivalents [d]</b>	<b>13.1</b>	<b>-0.1</b>
<b>Increase/(decrease) in cash and cash equivalents [a+b+c+d]</b>	<b>45.7</b>	<b>-308.8</b>
Cash and cash equivalents at the beginning of the period	231.8	340.0
Cash and cash equivalents at the end of the period	277.5	31.2

## **Explanatory notes to the statement of cash flows**

The liquidity generated by operations during the first half of the year came to approximately euro 134.5 million, attributable to operations before the changes in net working capital (self-financing for the period, income taxes, financial income and expense) amounting to around euro 367.8 million, and to the decrease in working capital of approximately euro 233.3 million.

During the first six months of the year, investment activities absorbed liquidity of around euro 69.4 million and concerned investments in tangible fixed assets amounting to approximately euro 82 million.

Flows of shareholders' equity disclose the balance of the 2004 dividend payment, while the change in net financial debt was negative during the period by around euro 102.6 million.

The change in cash originated by the afore-mentioned appreciation of the exchange rate came to euro 13.1 million; as a result of these changes, the liquidity generated during the period under review amounted to euro 45.7 million.



## **Notes to the interim financial statements**

## ACCOUNTING POLICIES AND STANDARDS

### Compliance with the IAS/IFRS

The consolidated interim report of the Terna Group as of June 30, 2005 has been drawn up in pursuance of international accounting standard No. 34 applicable for interim financial disclosure, in accordance with the matters laid down by Article 81 of the "Issuers' Regulations" No. 11971/1999 and subsequent amendments.

The Terna Group adopted the international accounting standards - International Financial Reporting Standards (IFRS) – as from the 2005 accounting period; while the transition date to the IFRS was January 1, 2004. The last set of consolidated financial statements drawn up in accordance with the Italian accounting principles refers to the accounting period ended December 31, 2004.

The consolidated accounting schedules and the related explanatory notes (hereinafter the consolidated interim financial statements) have been drawn up in compliance with the International Financial Reporting Standards in force as of the date of preparation of the same, inclusive of the IFRS recently adopted by the International Accounting Standards Board (IASB), the International Accounting Standards (IAS) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC). It is assumed that these standards are those which will be in force at the time of the preparation of the consolidated financial statements as of December 31, 2005; however, it may also be that they do not coincide with those in force at the end of 2005 as a result of both the new guidelines of the European Commission concerning their ratification and the issue of new standards or interpretations by the competent bodies.

In these consolidated interim financial statements, the comparative data pertaining to the corresponding periods in 2004 was reclassified in accordance with the international accounting standards; an attachment illustrates the effects of the adoption of the IFRS on the balances as of June 30, 2004 originally published and drawn up in accordance with the Italian accounting principles.

Reference should be made to the document "Transition to the international accounting standards (IFRS)" attached to this interim report for the effects of the adoption of the IFRS on the Terna Group balance sheet as of December 31, 2004 and as of the date of transition (January 1, 2004), on the 2004 income statement, as well as on the choices made at the time of initial application.

### Basis of presentation

The consolidated interim financial statements comprise the balance sheet, the income statement, the cash flows statement, the statement of changes in shareholders' equity and the explanatory notes.

The accounting policies and standards adopted are consistent with those used for the preparation of the statements for transition to the IFRS as of January 1, 2004 and as of December 31, 2004.

Shareholders are informed that the income statement has been reclassified on the basis of the nature of the costs, while the statement of cash flows is presented using the indirect method.

The consolidated interim financial statements are presented in euro and all the balances are expressed in millions of euro unless otherwise indicated.

By virtue of the options offered by Italian Legislative Decree No. 38/2005, the Parent Company Terna SpA has opted not to use the international accounting standards (IFRS) for the preparation of the statutory financial statements as of December 31, 2005. The accounting schedules as of June 30, 2005 of the Parent Company Terna SpA, attached to this interim report, have therefore been drawn up in accordance with the Italian accounting principles.

### **Use of estimates**

The drawing up of the consolidated interim financial statements, in accordance with the IFRS, requires us to make estimates and assumptions which have an effect on the values of the financial statement assets and liabilities and on the information relating to potential assets and liabilities as of the reference date. The results which will finally be recorded may differ from these estimates. The estimates are used in order to obtain the provisions for doubtful receivables, for inventory obsolescence, amortization and depreciation, asset write-downs, employee benefits, taxes and other provisions to reserves. The estimates and assumptions are periodically reviewed and the effects of each change are reflected in the income statement.

### **Subsidiary companies**

The scope of consolidation includes the Parent Company Terna SpA and the companies over which it directly exercises control by means of all the voting rights.

The financial statements of the subsidiary companies are consolidated as from the date on which control was acquired and until the date such control ceases.

The list of companies included within the scope of consolidation is presented as follows:

Company name	Registered offices	Activities	Share capital	Currency	% ownershi p
T.S.N. - Transmissora Sudeste Nordeste SA (Brazil)	Rio de Janeiro (Brazil)	Construction and maintenance of electricity transmission networks	R\$ 250,000,000	R\$	100%
Novatrans Energia SA	Rio de Janeiro (Brazil)	Construction and maintenance of electricity transmission networks	R\$ 373,135,465	R\$	100%

### **Method of consolidation**

All the interim financial statements used for the preparation of the consolidated interim financial statements have been drawn up as of June 30 and adjusted, where necessary, in order to render them uniform with the accounting standards adopted by the Parent Company.

All the infragroup balances and the transactions, including any unrealized gains deriving from transactions which have taken place between Group companies, are eliminated net of the theoretical tax effect, if significant. Unrealized losses are eliminated except in the case when they represent reductions in value.

#### **Translation of foreign currency balances**

The interim financial statements of each consolidated company are drawn up using the functional currency relating to the economic context in which each company operates.

In such financial statements, all the transactions in currency other than the functional currency are recorded using the exchange rate in force as of the date of the transaction. Monetary assets and liabilities denominated in currency other than the functional currency are subsequently adjusted to the exchange rate in force as of the period end date presented.

Non-monetary assets and liabilities denominated in foreign currency and recorded at historical cost are converted using the exchange rate in force as of the date of initial recognition of the transaction. Non-monetary assets and liabilities denominated in foreign currency and recorded at fair value are converted using the exchange rate in force as of the date of determination of this value.

#### **Translation of foreign currency financial statements**

For the purposes of the consolidated interim financial statements, the profit/loss, assets and liabilities are expressed in euro which represents the functional currency of the Parent Company Terna SpA.

For the purposes of the preparation of the consolidated interim financial statements, the interim financial statements in a functional currency other than the euro are converted into euro by applying the exchange rate in force as of the period end date to the assets and liabilities – inclusive of goodwill and the adjustments made at the time of consolidation – and the average exchange rates for the period to the income statement items; the latter rates approximate the exchange rates in force as of the date of the respective transactions. The related exchange differences are booked directly to the shareholders' equity and stated separately in a specific equity reserve.

Exchange differences are stated in the income statement at the time of the disposal of the subsidiary.

#### **Property, plant and equipment**

Tangible assets in use are stated at historical cost, inclusive of any directly chargeable related costs necessary for the bringing into stream of the asset for the use which it was purchased for. The cost is increased, in the presence of legal or constructive obligations, by the present value of the cost estimated for the dismantling or removal of the asset.

If significant parts of tangible assets in use have different useful lives, the components identified are recognised separately.

Some assets which had been subject to revaluation as of January 1, 2004 (the date of transition) or in previous periods, are recorded on the basis of the value revalued as of the date of revaluation, considered as substitute cost (deemed cost).

Tangible assets are stated net of the related accumulated depreciation and any impairment losses, determined in accordance with the methods described below. The depreciation is calculated on a straight-line basis with reference to the estimated useful life of the asset, which is reviewed annually and any changes are reflected in perspective. The depreciation of assets under construction starts when the asset is available for use.

The main rates calculated on the basis of the useful life are as follows:

#### **Depreciation rates**

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Industrial and non-industrial buildings	2.50% - 4.00%
Power lines	2.50% - 4.50%
Switching sub-stations:	
- Electrical equipment	2.00% - 3.00%
- Other electrical equipment	2.80 – 4.50%
- Automation and control systems	5.00 – 6.70%
Central systems for remote management and control:	
- Electrical equipment and ancillary plant	5.00%
- Computers	10.00%

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Land, both free from construction or attached to industrial and civil buildings, is not depreciated since it has an unlimited useful life.

Construction in progress is stated at historical cost, inclusive of any related charges, net of any impairment losses.

Tangible assets acquired under financial leases – whereby all risks and benefits linked to the ownership are essentially transferred to the Group – are recognized as Group assets at their present value or, if lower, at the present value of the minimum payments due for the leasing. The corresponding liability due to the lessor is classified among the financial payables. The assets are depreciated by applying the approaches and the rates indicated above.

Leases where the lessor essentially maintains all the risks and benefits associated with the ownership of the assets, are classified as operating leases. The costs referring to operative leases are recorded on a linear basis in the income statement over the duration of the lease agreement.

### **Goodwill**

All the acquisitions are recorded on the basis of the purchase method.

Goodwill, deriving from the acquisition of subsidiary companies, represents the excess of the purchase cost with respect to the fair value of the assets acquired net of the current and potential liabilities recorded and is allocated to each of the cash generating units identified. After the initial registration, the goodwill is not amortized and is reduced as a result of any impairment losses, determined in accordance with the methods described below.

Goodwill deriving from acquisitions carried out prior to January 1, 2004 is stated at the value recorded for this purpose in the last set of consolidated financial statements drawn up on the basis of the previous accounting principles (31 December 2003).

### **Impairment losses**

At each balance sheet date, tangible and intangible assets with a determinate life are tested for impairment. The recoverable value of the goodwill is by contrast estimated as of each balance sheet date. If an indication of impairment loss exists, steps are taken to estimate the estimated realizable value.

The estimated realizable value is represented either by the net sales price or the value in use, which ever is higher.

When determining the value in use, the expected future financial flows are discounted back using a pre-taxation discount rate which reflects the current market valuation of the cost of money stated in relation to the period of the investment and to the specific risks of the asset. For an asset which does not generate abundantly sufficient financial flows, the realizable value is determined in relation to the cash generating unit which this asset belongs to.

An impairment loss is recognized in the income statement if the book value of the assets, or of the related cash generating unit to which it is allocated, is higher than the estimated realizable value.

With the exception of goodwill, impairment losses are reversed if the reasons which generated them cease to exist.

### **Inventories**

Inventories are valued at cost or net estimated realizable value, whichever is the lower. The cost configuration adopted is weighted average cost which includes any related charges applicable.

## **Financial instruments**

### *Equity investments in other companies*

Equity investments in other companies, classified as “available for sale”, are valued at fair value and any gains or losses are charged directly against the shareholders’ equity. At the time of their disposal, such cumulative gains and losses are released to the income statement.

When the fair value cannot be reliably calculated, equity investments in other companies are valued at cost adjusted by impairment losses with any gains or losses recognised in the income statement.

These writedowns cannot be reinstated.

### *Financial assets*

Financial assets which the Company intends or is able to hold until maturity, are recorded at the amortized cost, using the interest rate method, net of any impairment loss.

### *Trade receivables*

Trade receivables, whose maturity falls within normal commercial timescales, are not discounted back and are recorded at cost (identified by their nominal amount) net of any impairment loss. The value reductions are determined on the basis of the present value of the expected future cash flows.

### *Cash and cash equivalents*

Cash and cash equivalents include the cash values, or rather those values which feature requisites of on-demand or extremely short-term availability, favourable outcome and the absence of costs for their collection.

For the purposes of the consolidated statement of cash flows, cash and cash equivalents are stated net of bank overdrafts as of the period end date.

### *Trade payables*

Trade payables, whose maturity falls within normal commercial timescales, are not discounted back and are recorded at cost (identified by their normal amount).

### *Financial liabilities*

Financial liabilities, with the exception of derivatives, are initially stated at fair value net of any directly attributable transaction costs.

Subsequently, financial liabilities are valued on an amortized cost basis, using the original effective interest rate method.

#### *Derivative financial instruments*

The Group holds derivative instruments for the purpose of hedging its exposure to interest rate fluctuation risks. On a consistent basis with the chosen strategy, the Group has not set up any transactions on derivatives for speculative purposes. However, in the event that these transactions cannot be qualified in the accounts as hedging transactions, they are recorded as speculative transactions.

The derivatives are classified as hedging instruments when the relationship between the derivative and the object of the hedge is formally documented and the effectiveness of the hedge, assessed periodically, is high. When the hedging derivatives cover the risk of a fluctuation in the fair value of the instruments subject to coverage (fair value hedge; e.g. coverage of the variability of the fair value of assets/liabilities at a fixed rate), they are stated at fair value and the effects are booked to the income statement; on a consistent basis, the instruments subject to hedging are adjusted in order to reflect the changes in the fair value associated with the risk hedged. When the derivatives cover the risk of fluctuation in the cash flows of the instruments subject to coverage (cash flow hedge; e.g. coverage of the variability of the cash flows of assets/liabilities at variable rates as a result of the fluctuations in interest rates), the fluctuations in the fair value are initially booked to shareholders' equity and subsequently charged to the income statement on a consistent basis with the economic effects produced by the transactions hedged.

The fluctuations in the fair value of the derivatives which do not satisfy the conditions for being qualified as hedges are stated in the income statement.

#### **Employee benefits**

The liability relating to the benefits acknowledged employees and paid out at the time of or subsequent to the termination of the employment relationship as well as relating to specific benefit programmes (termination indemnities, Ima<sup>1</sup>, Isp<sup>2</sup>, Energy Discount, Asem health care and other benefits) or other long-term benefits (Loyalty Bonus), is stated net of assets serving the plan and is determined, separately for each plan, on the basis of actuarial assumptions estimating the amount of the future benefits which the employees have accrued as of the reference date. The liability is recorded on an accruals basis over the vesting period of the related rights. The valuation of the liability is made by independent actuaries.

Gains and losses deriving from the amendment of the actuarial assumptions are stated in the income statement as a cost or revenue when their net cumulative value exceeds by more than 10% the higher value between the total of the liabilities referring to each specific benefit plan and the fair value of the assets serving the plan as of the balance sheet date (so-called "corridor approach").

#### **Provisions for risks and charges**

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<sup>1</sup> Additional months' payment allowance.

<sup>2</sup> Indemnity replacing notice period.

The provisions made for risks and charges are recorded when, as of the balance sheet, a legal or implicit obligation exists, which derives from a past event, and an outlay of resources is probable in order to satisfy the obligation and the sum total of this outlay can be estimated. If the effect is significant, the provisions are determined by discounting back the expected future financial flows to a pre-tax discount rate which reflects the current market valuation of the cost of money in relation to the timescale and, if applicable, the specific risk applicable to the obligation. When the amount is discounted back, the increase in the provision due to the passing of time is recorded as financial expense. If the liability refers to tangible assets (e.g. dismantling and recovery of sites), the provision is recorded as a matching balance to the asset to which it refers; the recording of the expense in the income statement takes place by means of the depreciation process of the tangible fixed assets to which the expense refers.

### **Grants**

Grants, both from Government and from private third parties, are stated at fair value when there is reasonable certainty that they will be received and the conditions anticipated for the attainment of the same will be satisfied.

Grants received for specific expenditure are recorded among other liabilities and credited to the income statement on a systematic basis over the same period during which the related costs accrue.

Grants received for specific assets whose value is recorded among fixed assets, are either directly charged against the value of said fixed assets or stated among other liabilities and credited to the income statement in relation to the depreciation period pertaining to the assets to which they refer.

Operating grants are recorded in full in the income statement at the time the conditions which allow their booking are satisfied.

### **Revenues**

Revenues are stated on the basis of the specific criteria illustrated below, in accordance with the type of transaction involved:

- revenues from the sale of goods are recorded when the significant risks and benefits pertaining to the ownership of the same are transferred to the purchaser;
- revenues for the performance of services are stated with reference to the stage of completion of the activities. In the event that it is impossible to reliably determine the value of the revenues, the latter are recorded up to the extent of the costs incurred which we believe will be recovered.

Specifically, revenues deriving from fees for the remuneration of the National Transmission Grid (NTG), are stated in accordance with the formalities established in the operating agreement with the ISO and valorized on the basis of the tariffs established by the Italian Regulatory Authority for Electricity and Gas.

### **Financial income and expense**

Financial income and expense is stated on an accruals basis with reference to the interest accrued on the net carrying amount of the related financial assets and liabilities, using the effective interest rate method.

### **Dividends**

These revenues are stated when the right of the shareholders to receive the dividends is established.

### **Income taxes**

Current taxes are determined on the basis of the estimate of the taxable profit (tax loss) and in pursuance of the tax legislation in force.

Deferred tax liabilities and assets are calculated on timing differences between the balance sheet values recorded in the consolidated interim financial statements and the corresponding values recognized for tax purposes, applying the tax rate in force or essentially in force as of the accounting reference date.

Their recording is made when the recovery is probable, in other words when it is foreseen that taxable amounts sufficient for recovering the assets may become available in the future.

The recoverability of deferred tax assets is re-examined at each period end.

### **Share-based transaction**

The cost of the services provided by the employees and remunerated by means of stock option plans is determined on the basis of the fair value of the options granted to employees at the grant date.

The calculation method for determining the fair value takes into account all the characteristics of the options (option, term, price and exercise conditions, etc.), as well as the Terna share price at the grant date, the share volatility and the interest rate curve at grant date consistent with the duration of the plan.

The cost is stated in the income statement over the vesting period considering the best estimate possible for the number of options which will become exercisable.

### **Risk Management**

Whilst carrying out its activities, Terna is exposed to the risk of interest rate fluctuations.

In order to minimize this risk, Terna stipulates derivative contracts hedging both specific transactions and its overall exposure, availing itself of the instruments offered by the market.

The transactions which, in observance of the risk management policies, satisfy the requisites established by the accounting standards for the treatment under hedge accounting are designated as "hedging", while those which, despite having been set up for hedging purposes, do not satisfy the requisites entailed by the standards are classified as "trading/non-IFRS hedges". Terna does not enter into derivative contracts for speculative purposes.

Financial assets and liabilities relating to derivative instruments are classified as follows:

- *Cash Flow Hedge Derivatives*, relating to the hedging of the risk of fluctuation in cash flows associated with a number of floating-rate medium/long-term loans.

- *Fair Value Hedge Derivatives*, relating to the hedging of the risk of fluctuation in the fair value of fixed rate liabilities.
- *Trading/Non- IFRS hedges Derivatives*, relating to the hedging of the interest rate risk which does not present the formal requisites required by IAS 39 in order to be booked as transactions hedging specific assets, liabilities, commitments or future transactions.

The fair value is determined by using the official prices for the instruments on regulated markets. The fair value of instruments which are not listed on organized markets is determined by discounting back the expected cash flows to the market interest rate curve as of the accounting reference date and converting the balances in currency other than euro using the period end exchange rates supplied by the European Central Bank.

With the aim of reducing the total financial debt subject to interest rate fluctuations and reducing the borrowing cost, various types of derivative contracts are used, in particular interest rate swaps and interest rate collars.

As a rule, these contracts are set up with a notional and maturity date less or equal to those of the underlying financial liabilities, so that each change in the fair value and/or in the expected cash flows of these contracts is balanced by a corresponding change in the fair value and/or in the expected cash flows of the underlying position.

The section “Explanatory notes” illustrates the notional value and the fair value of the derivatives outstanding as of June 30, 2005, grouped together as current and non-current financial assets and liabilities.

## INFORMATION ON THE CONSOLIDATED INCOME STATEMENT

### A - REVENUES

#### **1) Revenues from sales and services - euro 472.9 million**

An analysis of the revenues for the period is presented in the following table:

Millions of euro	1st Half 2005	1st Half 2004	Change
NTG usage fees	448.5	469.4	-20.9
Other sales and services	24.4	28.4	-4.0
<b>Total</b>	<b>472.9</b>	<b>497.8</b>	<b>-24.4</b>

They mainly refer (euro 376.8 million) to the fee falling under the responsibility of the Parent Company for use of the national transmission network; the decrease (euro -40.8 million) reported, derives from the effects of the new time bands introduced (AEEG resolution No. 05/04) as from April 2004, which led to greater benefits, in terms of revenues, during the first quarter of the previous year.

Revenues relating to the Brazilian companies, amounting to euro 71.7 million, refer to the fixed local fees established for the licence for the operation of power lines issued by the local energy authority (ANEEL); this item increased by euro 20.0 million due to the fact that the line run by the subsidiary Novatrans was fully operative.

“Revenues from other sales and services” amount to euro 24.4 million and chiefly relate to services and supplies benefiting Enel Group companies, including the revenues from Enel Distribuzione SpA (euro 10.4 million) mainly deriving from the contract for the maintenance of high-voltage lines owned by that company, and those from Enel.net SpA (euro 5.6 million) for the laying of fibre optics at Terna SpA plants, as well as the running, maintenance and development of the same.

#### **2) Other revenues - euro 26.7 million.**

This item mainly comprises rental income, reinsurance compensation for damages to plants and the relevant portion of contributions for connections to the National Transmission Grid; during the period, an adjustment payment from the ISO on the network usage fee referring to 2004 was also recorded, amounting to euro 15.3 million.

## **B – OPERATING COSTS**

### **1) Raw materials and consumable– euro 7.3 million**

This item consists of the costs incurred for the purchase of various materials and equipment used for the operation and maintenance of facilities chiefly attributable to the Parent Company (euro 7.2 million). The balance is in line with the same period in 2004.

### **2) Services – euro 54.5 million**

This item primarily consists of costs for maintenance and repair work relating to contracts and services for the ordinary maintenance of plant efficiency; the balance was down considerably (euro –7.7 million) on the same period in 2004, a period which felt the weight of the costs incurred for Terna's IPO. Costs for services provided, recorded by the Parent Company, amounted to euro 42.6 million.

### **3) Personnel costs – euro 84.5 million**

This item consists of the costs for wages and salaries, social security contributions and other personnel costs, including the liability of the Parent Company for staff redundancy incentives. The change with respect to the previous year is attributable specifically to the redundancy incentives (euro + 1.7 million). The afore-mentioned costs are broken down as follows:

Millions of euro	1st half 2005	1st half 2004	Change
Wages and salaries	59.9	56.2	3.7
Social security contributions	16.3	15.3	1.0
Employee termination indemnity	2.2	4.4	-2.2
Other costs	6.1	6.4	-0.3
<b>Total</b>	<b>84.5</b>	<b>82.3</b>	<b>2.2</b>

Employee numbers by category of employment as of June 30, 2005, are shown in the table below:

Average number for the period	Number as of June 30, 2005
Senior management	37
Middle management	218
Office staff	1,527
Workers	1,151
<b>Total</b>	<b>2,933</b>
	<b>2,908</b>

#### **4) Amortization, depreciation and writedowns – euro 81.8 million**

This item comes to euro 81.8 million and comprises the provisions made during the period calculated on the basis of the depreciation rates representative of the useful lives of the companies' plant; the balances are in line with the same period last year. Depreciation relating to just the Parent Company amounted to euro 73.6 million.

#### **5) Other operating costs – euro 15.6 million**

This item mainly comprises sundry indirect local taxes in addition to capital losses on the disposal of plant and other residual costs; the decrease with respect to 2004 originates from the out-of-period expense for adjustments payable on the NTG usage fee pertaining to 2002 and 2003 (euro 16.7 million) and from the effects of the tax amnesty (euro 2.1 million) recorded during the first six months of 2004.

#### **6) Capitalized costs- euro –10.4 million**

The amounts capitalized refer to labour costs (euro 5.2 million) and the consumption of inventory materials and equipment (euro 5.2 million) for plant currently under construction, and concern the Parent Company. The increase refers in particular to materials and equipment consumed.

## **C – FINANCIAL INCOME AND EXPENSE**

### **1) Net financial (income)/ expense - euro 42.7 million**

The item is analyzed as follows:

Millions of euro	1st Half 2005	1st Half 2004	Change
<b>Financial income</b>			
Interest income on intercompany current account	2.4	3.0	-0.6
Other financial income (TSN-NVT)	5.7	2.4	3.3
Adjustment of the Fair Value Hedge derivatives	75.3	0.0	75.3
Exchange gains	13.9	0.0	13.9
<b>Total income</b>	<b>97.3</b>	<b>5.4</b>	<b>91.9</b>
<b>Financial expense</b>			
Interest expense and other charges due to Enel SpA	0.0	14.3	-14.3
Interest expense on medium/long-term loans	52.8	18.2	34.6
Exchange losses	0.0	20.7	-20.7
Charges on trading derivatives	11.0	0.0	11.0
Debt (B.I.) adjustment – part hedged	73.3	0.0	73.3
Discounting of employee termination indemnities and other employee benefits	2.9	3.5	-0.6
<b>Total expense</b>	<b>140.0</b>	<b>56.7</b>	<b>83.3</b>
<b>Total</b>	<b>42.7</b>	<b>51.3</b>	<b>-8.6</b>

The decrease derives from the combined effect of various factors; in particular:

- an increase in financial expense inherent to the medium/long-term debt (around euro 20 million) attributable to loans granted to Novatrans (year end 2004) and to Terna (bond issue and more recently an additional tranche of the EIB loan);
- exchange gains referring to the current six-month period due to the strong appreciation of the Brazilian Real, against exchange losses reported in the 1st half of 2004;
- economic effects of financial derivatives present in the portfolio of the Parent Company (the same period in the previous year, in fact, revealed just interest rate hedging derivatives on EIB loans and on loans from Enel SpA).

## **E – INCOME TAXES**

Income taxes for the period amount to euro 83.3 million, representing 37.3% of the pre-tax income; in the same period during 2004, taxation came to euro 87.4 million representing 43.3% of the pre-tax income. The decrease in this percentage based incidence is mainly attributable to lower taxes for the period payable by the Parent Company as a result of the significant non-deductible items during 2004 (provisions to risk reserves and tax amnesty), not present during the current interim period, thereby involving a consequent rise in the 2004 taxable income.

Income taxes for the period is analyzed in the table below:

Millions of euro	1st Half 2005	1st Half 2004	Change
Current taxes:			
- IRES (company earnings' tax)	40.9	48.5	-7.6
- IRAP (regional business tax)	9.9	10.3	-0.4
- Brazilian companies	10.8	3.8	7.0
Prepaid taxes	-4.6	-4.5	-0.1
Deferred taxes	26.3	29.3	-3.0
<b>Total</b>	<b>83.3</b>	<b>87.4</b>	<b>-4.1</b>

The change with respect to the previous period refers to the decrease in taxes disclosed in Italy, more or less offset by the additional taxes payable by the Brazilian company and the effects of the deferred taxation relating lower excess depreciation for the period on the Parent Company's plant.

## DISCLOSURE BY GEOGRAPHIC AREA AS OF JUNE 30, 2005

The Group's revenues and results are presented below by geographic area.

TERNA Group - Consolidated 1st Half 2005 INCOME STATEMENT	Italy	Brazil	Consolidation effects	Total
<b>A REVENUES</b>				
1 Revenues from sales and services	401.1	72.2	-0.4	472.9
2 Other revenues	26	0.7	0	26.7
<b>Total revenues</b>	<b>427.1</b>	<b>72.9</b>	<b>-0.4</b>	<b>499.6</b>
<b>B OPERATING COSTS</b>				
1 Raw materials and consumable	7.2	0.1	0	7.3
2 Services	49	5.9	-0.4	54.5
3 Personnel costs	83.2	1.3	0	84.5
4 Amortization, depreciation and write-downs	73.5	8.3	0	81.8
5 Other operating costs	8.4	7.2	0	15.6
6 Capitalized costs	-10.4	0	0	-10.4
<b>Total costs</b>	<b>210.9</b>	<b>22.8</b>	<b>-0.4</b>	<b>233.3</b>
<b>A-B Operating income</b>	<b>216.2</b>	<b>50.1</b>	<b>0</b>	<b>266.3</b>
<b>C Financial income and expense</b>				
1 Financial expense/(income)	9.7	22.7	10.3	42.7
	<b>206.5</b>	<b>27.4</b>	<b>-10.3</b>	<b>223.6</b>
<b>D Income before taxes</b>	<b>72.5</b>	<b>10.8</b>	<b>0</b>	<b>83.3</b>
E Income taxes				
	<b>134</b>	<b>16.6</b>	<b>-10.3</b>	<b>140.3</b>

Reference should be made to the matters illustrated in the Report on operations for comments on the most significant items.

## INFORMATION ON THE CONSOLIDATED BALANCE SHEET

### ASSETS

#### A – NON-CURRENT ASSETS

##### 1) Property, plant and equipment – euro 4,446.9 million

Tangible fixed assets amounted to euro 4,446.9 million (euro 4,323.3 million as of December 31, 2004).

The following table shows the balance and the changes for each category of assets:

Millions of euro	as of Dec. 31, 2004	Expenditure	Transfers during the period	Depreciation	Disposals other changes exchange delta	
					as of June 30, 2005	
Land	20.3	0	0	0	-0.2	20.1
Buildings	373.6	0.1	0.7	-7.0	14.7	382.1
Plant and equipment	3,535.5	9.9	69.8	-73.5	107.0	3,648.7
Industrial and commercial equipment	12.0	0.6	0.0	-1.1	-0.1	11.4
Other assets	1.9	0.2	0.1	-0.2	0.1	2.1
Leasehold improvements	0	2.5	0	0	0	2.5
<b>Total operating assets</b>	<b>3,943.3</b>	<b>13.3</b>	<b>70.6</b>	<b>-81.8</b>	<b>121.5</b>	<b>4,066.9</b>
Work in progress and advances	380.0	70.4	-70.6	0.0	0.2	380.0
<b>TOTAL</b>	<b>4,323.3</b>	<b>83.7</b>	<b>0.0</b>	<b>-81.8</b>	<b>121.7</b>	<b>4,446.9</b>

The item “Plant and equipment” includes the electricity transport grid and the transformer stations in Italy and Brazil and the centralized systems for remote running.

The plants located in Brazil refer to the South-east – North-east transmission line, which has a nominal voltage of 500 kV and is about 1,062 km long, beginning at the Serra da Mesa sub-station, in the state of Goias, and ending at the Sapeaçu substation, in the state of Bahia (operative as from March 2003); and the North-South II transmission line, which has nominal voltage of 500 kV and is about 1,280 km long, beginning at the Imperatriz substation, in the state of Maranhão, and ending at the Samambaia substation, in the Federal District.

The item “Leasehold improvements” refers to the one-off contribution incurred for the upgrading and adaptation of the electricity supply systems of the Wind network technological infrastructure.

The following table, which shows the changes in the fixed assets divided up between the Parent Company and the subsidiary companies, discloses that the increase in the fixed assets (euro 123.6 million) is essentially attributable to the appreciation of the Real-euro exchange rate by 21%, leading to an effect of around euro 125.3 million.

Millions of euro	Expenditure	Depreciation	Disposals other changes exchange delta	as of June 30, 2005
	as of Dec. 31, 2004			
Parent Company	3,858.1	82.1	-73.4	-2.7 3,864.1
Subsidiaries	465.2	1.6	-8.4	124.4 582.8
<b>TOTAL</b>	<b>4,323.3</b>	<b>83.7</b>	<b>-81.8</b>	<b>121.7 4,446.9</b>

A summary of the changes in tangible fixed assets during the period is presented below:

Millions of euro
Capital expenditure:
- Power lines 32.9
- Switching substations 44.5
- Leasehold improvements and other 4.7
Brazil 1.6
<b>Total capital expenditure</b> <b>83.7</b>
Depreciation -81.8
Disposals and other changes 121.7
<b>TOTAL</b> <b>123.6</b>

The main investments made during the period by the Parent Company concerned the 380kV S. Fiorano - Robbia (euro 3.9 million) and Laino - Feroleto - Rizziconi (euro 10.6 million) power lines, and the Santa Barbara switching substation (euro 2.6 million).

As far as work in progress and advances were concerned, projects for the development and upgrading of the network with a value of more than euro 5 million are indicated below:

Millions of euro
<b>Power lines:</b>
- KV 380 MATERA - S.SOFIA 64.6
- KV 380 LAINO - FEROLETO - RIZZICONI 58.8
<b>380 Kv switching substations</b>
- CALENZANO 14.6
- FOGGIA 7.5
- SORGENTE 7.7
- FRATTA 5.9
- CARPI FOSSOLI 12.1

<b>220 Kv switching substations</b>	
- ORISTANO	8.2

## 2) Goodwill – euro 148.5 million

Goodwill recorded following the acquisition of the equity investments in TSN and Novatrans, which took place on December 31, 2003, refers to the additional price paid with respect to the shareholders' equity acquired.

The incremental difference between the balance as of June 30, 2005 and that as of December 31, 2004 (euro 117 million) amounts to euro 31.5 million and reflects the adjustment of the goodwill value using the exchange rate as of June 30, 2005.

## 3) Deferred tax assets – euro 58.1 million

Amounts receivable for deferred tax assets refer to the tax effects relating to the provisions for risks and charges subject to deferred tax deductibility (euro 15.4 million), to provisions for termination indemnities and other personnel costs (euro 26.5 million), to the recognition of cash flow hedge (euro 5.2 million) and trading derivative instruments (euro 8.2 million).

The change with respect to the previous period (euro 6.5 million) is mainly attributable to the change in the fair value of the Cash Flow Hedge and trading derivatives.

## 4) Non-current financial assets – euro 117.2 million

This account group comprises the following items:

Millions of euro	June 30, 2005	Dec. 31, 2004	Change
<b>Equity investments:</b>			
- in other companies	2.9	2.9	0.0
<b>Total equity investments</b>	<b>2.9</b>	<b>2.9</b>	<b>0.0</b>
Fair Value Hedge Derivatives	114.3	39.0	75.3
<b>Total</b>	<b>117.2</b>	<b>41.9</b>	<b>75.3</b>

Other minor share-based equity investments, amounting to euro 2.9 million, refer to Cesi SpA. The corresponding shareholding in the capital of this company has not changed since last year (equal to 15%). The change during the period refers solely to the fair value delta of the financial hedging instruments, contracts on the bond issue, determined by discounting back the expected cash flows to the market interest rate curve.

## 5) Other non-current assets – euro 6.5 million

Non-current receivables remained more or less in line with the balance as of December 31, 2004.

The change in other receivables (euro 0.1 million) is the result of the disbursement of additional loans to employees.

## **B – CURRENT ASSETS**

### **1) Inventories – euro 23.4 million**

Inventories classified among current assets comprise materials and equipment intended for activities for the running, maintenance and construction of plants totalling euro 23.4 million (euro 19.6 million as of December 31, 2004); the rise of euro 3.8 million is chiefly due to ordinary maintenance requirements of the plants, both in Italy and Brazil.

### **2) Trade receivables – euro 220.3 million**

Receivables are analyzed as follows:

Millions of euro	June 30, 2005	Dec. 12, 2004	Change
Receivables for contract work in progress	2.4	3.2	-0.8
Trade receivables from customers	204.1	137.9	66.2
Receivables from other Enel Group companies	13.8	16.8	-3.0
<b>Total</b>	<b>220.3</b>	<b>157.9</b>	<b>62.4</b>

#### Receivables for contract work in progress - euro 2.4 million

Receivables for contract work in progress underwent a decrease of euro 0.8 million when compared with December 31, 2004 and relate to long-term contracts which the Parent Company has outstanding with third party customers. These include the contracts underway with the ISO for adaptation work on the SCTI control system (euro 1.3 million), with Ferrovie dello Stato S.p.A. for work associated with the upgrading and enhancement of the transmission plants (euro 0.5 million), and with the Enel Produzione Group company (former EnelGreen Power) for the creation of the delivery points for wind farm connections in Sardinia (euro 0.5 million).

	Contract value	Advance s	<b>Balance as of June 30, 2005</b>	Contract value	Advance s	<b>Balance as of Dec. 31 2004</b>
Third parties	17.2	-15.3	<b>1.9</b>	17.1	-14.4	<b>2.7</b>
Enel Produzione	0.7	-0.2	<b>0.5</b>			
Enel GreenPower				0.5	-0.2	<b>0.3</b>
Enel Distribuzione				0.2		<b>0.2</b>

<b>Total</b>	<b>17.9</b>	<b>-15.5</b>	<b>2.4</b>	<b>17.8</b>	<b>-14.6</b>	<b>3.2</b>
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Guarantees given amount to euro 7.6 million and refer to the amount contractually agreed for the satisfactory execution of the work.

*Trade receivables from customers - euro 204.1 million.*

Most (euro 164.4 million) of the total concerns invoices to be issued by the Parent Company to the ISO (G.R.T.N. S.p.A.) for the National Transmission Grid (NTG) usage fee for the period.

The afore-mentioned receivable mainly refers to the fee for April/May 2005, falling due in July/August 2005 and also includes prior amounts due from the ISO amounting to euro 13.6 million. With reference to the afore-mentioned amounts, during July 2005 amounts were collected for an approximate total of euro 69.7 million.

They also include the portion of the fees for the operation of the Brazilian lines, both invoiced and to be invoiced (euro 18.3 million).

The receivables relating to the concession fee pertaining to the Brazilian companies (RAP), increased on last year (+ euro 12.3 million) mainly as a result of the appreciation of the R\$/€ exchange rate (euro 4.4 million) and due to additional Pis /Cofins receivables for the period January-June.

*Receivables from other Enel Group companies – euro 13.8 million*

Trade receivables from Enel Group companies are as follows:

<u>Millions of euro</u>	<u>Trade receivables as of June 30, 2005</u>	<u>Trade receivables as of Dec. 31, 2004</u>	<u>Change</u>
ENEL Distribuzione SpA	5.3	7.4	-2.1
Enel.Net Srl	6.1	6.7	-0.6
Enel Produzione SpA	1.2	0.7	0.5
Wind Telecommunicazioni SpA	0.7	0.6	0.1
Enel Green Power SpA		1.2	-1.2
Enel.it Srl		0.6	-0.6
Enelpower SpA		0.3	-0.3
Other	0.5	0.1	0.4
<b>Total</b>	<b>13.8</b>	<b>17.6</b>	<b>-3.8</b>

The net decrease in receivables totalling euro -3.8 million essentially relates to Enel Distribuzione (-2.1 million) further to the acquisition by the same, at the end of 2004, of a number of plants (Power lines, Stations and Switching Stations), involving a consequent reduction in the running and maintenance activities on the high-voltage lines belonging to the same company.

Shareholders are also informed that as from June 1, 2005, but effective for accounting purposes as of January 1, 2005, Enel Produzione S.p.A absorbed the company Enel Green Power while, as of January 1, 2005 Enel Ape S.p.A absorbed the companies Enel.it and Enel Facility Management.

The nature of the main transactions with other Enel Group companies and the related economic values are illustrated in the commentary to the income statement contained within these explanatory notes.

### **3) Current financial assets – euro 35.0 million**

The balance of this item is chiefly attributable to deferred assets relating to the interest on Fair value hedge derivatives (euro 32.6 million) and to the value of the accrued income on running current accounts relating to the Parent Company bearing interest (rate of 1.979% as of June 30, 2005), within the sphere of the centralized cash management contract (euro 2.4 million).

### **4) Cash and cash equivalents – euro 277.5 million**

The balance of this item is equal to euro 277.5 million (euro 231.8 million as of December 31, 2004) and largely comprises the credit balances of the current accounts held by the Brazilian companies (euro 61.6 million, of which euro 26.4 million held in fixed deposit accounts) and by the Parent Company (euro 25.9 million); it also includes the available credit balance on the intercompany account amounting to euro 189.9 million which is the main cause of the increase in the balance registered during the period.

### **5) Other current assets – euro 71.0 million**

This item discloses a balance of euro 71.0 million (euro 34.8 million as of December 31, 2004) mainly referable to the following amounts:

- tax receivables totalling euro 47.4 million relating mainly to Ires (euro 31.5 million) and Irap advance taxes (euro 7.5 million) paid by the Parent Company. The item also includes taxes paid abroad (Brazil and the Greek branch), which the Parent Company could deduct in the income tax returns, and whose total amounts comes to euro 8.4 million;
- deferred costs referring specifically to the employees' 14th month salary payment (euro 3.7 million) and the transfer of receivable contracts by Enel Distribuzione (euro 1.2 million);
- sundry receivables for a total of euro 18.7 million referring mainly (euro 10.1 million) to the credit due from the Greek revenue authorities for indirect taxes (VAT) relating to the activities carried out by the Terna branch in Greece, while the residual balance concerns items of minor significance mostly relating to various advances given to employees and suppliers.

## LIABILITIES AND SHAREHOLDERS' EQUITY

### C – SHAREHOLDERS' EQUITY – euro 1,826.5 million

Comments on the changes in the consolidated shareholders' equity during the first half of 2005 are presented below:

#### Share capital – euro 440.0 million

TERNA SpA's share capital is represented by 2,000,000,000 ordinary shares with a par value of euro 0.22 each, held by Enel S.p.A. for an interest holding of 36.142%; as far as the remaining 63.858% interest is concerned (1,277,160,000 shares), it was apportioned following the public sale offer intended for public and institutional investors and the subsequent accelerated bookbuilding transaction addressing Italian and foreign institutional investors.

#### Legal reserve – euro 88.0 million

The legal reserve represents 20% of the Parent Company's share capital.

#### Other reserves – euro 719.3 million

The other reserves underwent a net change of euro -420.4 million, essentially reflecting the following changes:

- reclassification of the reserve pursuant to the so-called Vietti Law among the retained earnings (- euro 421.3 million);
- adjustment to the fair value of the cash flow hedge derivative instruments net of the related tax effect (- euro 4.0 million);
- provision to the capital reserve of the portion referring to the first half of 2005 (euro 4.9 million), relating to the incentive obtained from the Brazilian Ministry of National Integration by the subsidiaries TSN and Novatrans.

#### Retained earnings (losses carried forward) – euro 438.9 million

Retained earnings mainly refer to the reserve pursuant to the so-called Vietti Law (euro 421.3 million) formed as of December 31, 2004 among the other reserves and reclassified during 2005 under retained earnings. Other changes during the period essentially refer to the following events:

allocation to the legal reserve of euro 2.4 million by way of integration of the allocation to this reserve of the surplus consolidated income for 2004, with respect to the dividend paid during the first half of 2005 (euro 140.0 million).

increase in the translation reserve (euro 66.3 million) as a result of the differences arising at the time of consolidation of the foreign subsidiaries and essentially a consequence of the reduction in the exchange rate of the Brazilian Real during the period. Within this sphere, the adjustment of the goodwill to the period end exchange rate led to an increase in the item under review of euro 31.5 million.

Guarantees given amounted to euro 255.0 million and refer to the shares of the subsidiary companies TSN and Novatrans, belonging to TERNA, given as security to the banks (BNDES – IDB) financing the investment in Brazil.

The reconciliation of the shareholders' equity and net income of the Parent Company as of June 30, 2005 with the corresponding consolidated amounts, is illustrated in the section "Statement of statutory and consolidated reconciliation".

## **E – NON-CURRENT LIABILITIES**

The composition of non-current liabilities as of June 30, 2005 was as follows:

Millions of euro	June 30, 2005	Dec. 31, 2004	Change
Long-term loans	2,327.9	2,084.9	243.0
Termination indemnities and other employee benefits	138.9	138.3	0.6
Provisions for future risks and charges	42.8	40.8	2.0
Deferred tax liabilities	545.7	468.6	77.1
Non-current financial liabilities	48.4	31.5	16.9
Other non-current liabilities	164.5	158.2	6.3
<b>Total</b>	<b>3,268.2</b>	<b>2,922.3</b>	<b>345.9</b>

### **1) Long-term loans – euro 2,327.9 million**

The item reflects the liability relating to the bond issues, medium/long-term bank loans and other medium/long-term loans in euro and other currencies.

The table below provides a breakdown of the medium/long-term debt and the repayment plan as of June 30, 2005 with indication of the type of loan and interest rate, inclusive of the instalments falling due within twelve months.

Millions of euro	Repayment period	Balance Dec. 31, 2004	Balance June 30, 2005	Current portion	Long-term portion	2nd half of 2006	Beyon d			
							2007	2008	2009	
Bond issue	2014-2024	1,435	1,508	0	1,508	0	0	0	0	1,508
EIB No. 20271	2014	68	65	7	58	3	7	7	7	34
EIB No. 21159	2016	250	250	23	227	11	23	23	23	147
EIB No. 22947	2020	0	100	0	100	0	0	0	5	95
BNDES	2016	332	411	22	389	12	26	30	34	287
IDB	2016	47	51	5	46	3	5	5	6	27
<b>Total</b>		<b>2,132</b>	<b>2,385</b>	<b>57</b>	<b>2,328</b>	<b>30</b>	<b>61</b>	<b>65</b>	<b>74</b>	<b>2,098</b>

The changes during the period included the following: as of March 15, 2005 a loan was granted to the Parent Company for a total of euro 100 million, relating to a contract signed for a total of euro 300 million with the European Investment Bank (EIB); the purpose of the loan is to cover part of the development investments anticipated by the Company's business plan. The remaining euro 200 million may be disbursed by the end of 2006 and, on a similar basis to the other EIB loans, will be repaid as from the fifth year over a plan period of 11 years. The loan features the following terms:

- Floating interest rate with a ceiling equal to Euribor + 0.27% (last fixing as of June 15, 2005 equating to 2.22% equivalent to a Euribor of 11 basis points);
- Interest payments: six-monthly deferred (March 15 – September 15);
- Repayment of principal: in 22 six-monthly equal instalments as from September 15, 2009 until December 15, 2019.

The loan is not hedged by derivative instruments and therefore the entire loan is exposed to interest rate fluctuations.

The table below illustrates the financial debt expressed by interest rate.

Repayment period	June 30, 2005	Balance			2007	2008	2009	Beyond
		Current portion	Long-term portion	1st half of 2006				
Fixed rate borrowing	2014-2024	1,508	0	1,508	0	0	0	0
Floating rate borrowing	2014-2016-2020	877	57	820	30	61	65	74
<b>Total</b>		<b>2,385</b>	<b>57</b>	<b>2,328</b>	<b>30</b>	<b>61</b>	<b>65</b>	<b>74</b>
								<b>2,098</b>

The following table analyzes the afore-mentioned debt by reference currency as of June 30, 2005:

Repayment period	Average interest		Balance as of June 30, 2005
	rate as of June 30, 2005		
Euro	2014-2024	4.07%	1,923
Other currencies	2016	12.90%	462

The table below shows the changes in debt during the period:

Type of debt	Notional debt as of Dec. 31, 2004	Book value as of Dec. 31, 2004	Repay- ments	New loans	Exchange differenc e	Value adjustment Dec. 31, 2004	Notional debt as of June 30, 2005	Book value as of June 30, 2005
Listed fixed rate bonds	1,400	1,435				73	1,400	1,508
Total bonds	1,400	1,435				73	1,400	1,508
Floating rate bank loans	379	379	9	6	86		462	462
Floating rate EIB loans	318	318	3	100			415	415
Total bank loans	697	697	12	106	86	0	877	877
<b>Total M/L-term financial debt</b>	<b>2,097</b>	<b>2,132</b>	<b>12</b>	<b>106</b>	<b>86</b>	<b>73</b>	<b>2,277</b>	<b>2,385</b>

When compared with December 31, 2004, overall medium/long-term debt presented an increase of euro 253 million, of which euro 106 million relating to new loans and euro 86 million due to exchange differences registered during the period, net of euro 12 million referring to repayments during the six months. An additional change of euro 73 million concerns the adjustment to fair value of the bond issues which took place during the accounting period under review.

## 2) Termination indemnities and other employee retirement benefits – euro 138.9 million

The Group provides its employees with benefits during their working relationship (e.g. loyalty bonus), at the time they leave the Group's employment (e.g. termination indemnity, additional monthly payment allowance, Indemnity replacing notice period and Substitute indemnity) and after the working relationship (e.g. Energy Discount, ASEM healthcare fund).

The benefits assigned during the working relationship (loyalty bonus) are due to the Group employees which the national collective labour agreement – CCNL is applied to (senior management included) on achievement of specific length of in-house service conditions (25th and 35th year of service).

The benefits due at the time of the termination of the employment relationship are due to all the employees (TFR –termination indemnity), to the senior management employed or appointed as of February 28, 1999 (Indemnity replacing notice period), and to the employees (workers, office staff and middle management) which the national collective labour agreement – CCNL for the electrical industry is applied to, employed as of July 24, 2001 (additional monthly payment allowance).

The benefits due subsequent to the working relationship comprise :

- a tariff reduction on energy consumed for family use, which is granted to all the Group workers which the national collective labour agreement – CCNL for the electrical industry is applied to, employed before June 30, 1996 (energy discount);
- a form of healthcare supplementary to the national health service as anticipated by the national collective agreement for industrial executives (Asem healthcare);

The balance and changes in the termination indemnity and other staff provisions as of June 30, 2005, is as follows:

Millions of euro	Dec. 31, 2004	Provisions	Uses and other changes	June 30, 2005
<b>Benefits due during the employment relationship:</b>				
<b>- Loyalty bonus</b>				
- Loyalty bonus	4.8	0.2	-0.1	4.9
<b>Total</b>	<b>4.8</b>	<b>0.2</b>	<b>-0.1</b>	<b>4.9</b>
<b>Benefits due on termination of the employment with the company:</b>				
<b>- Termination benefits</b>				
- Termination benefits	57.5	2.3	-2.0	57.8
<b>- Additional monthly payment allowance</b>				
- Additional monthly payment allowance	8.8	0.3	-0.1	9.0
<b>- Replacement indemnity, energy discount and indemnity replacing notice period</b>				
- Replacement indemnity, energy discount and indemnity replacing notice period	1.7	0.1	1.8	
<b>Total</b>	<b>68.0</b>	<b>2.7</b>	<b>-2.1</b>	<b>68.6</b>
<b>Post employment Benefits</b>				
<b>- Healthcare scheme ( ASEM)</b>				
- Healthcare scheme ( ASEM)	12.3	0.3	-0.3	12.3
<b>- Electricity discounts</b>				
- Electricity discounts	53.2	1.2	-1.3	53.1

<b>Total</b>	<b>65.5</b>	<b>1.5</b>	<b>-1.6</b>	<b>65.4</b>
<b>TOTAL</b>	<b>138.3</b>	<b>4.4</b>	<b>-3.8</b>	<b>138.9</b>

The items, equating to euro 138.9 million as of June 30, 2005 (euro 138.3 million as of December 31, 2004), underwent a net increase of euro 0.6 million when compared with the previous year. This change essentially reflects the increase due to the employee termination indemnity due in accordance with the law to the employees, net of any indemnities paid out or advances granted (euro 0.3 million) and net provisions made by the Parent Company for notice period (euro 0.1 million) and additional month indemnities (euro 0.2 million) in favour of staff in service.

The main assumptions used in the actuarial estimate of the liabilities for staff benefits are as follows:

	<b>2005</b>	<b>2004</b>
- discounting back rate	4.25%	5.00%
- labour costs increase rate	3.00%	3.50%
- health costs increase rate	3.50%	3.50%

### **Stock option plans**

During the first half of 2005, Terna resolved the adoption of the Stock option plan relating to the current year and approved the related regulations. The plan aims to endow the Terna Group – in line with international practice and the leading Italian companies listed on the stockmarket – with an instrument for retaining the loyalty and providing incentive for management, capable in turn of developing a sense of belonging to the Company for the key resources and ensuring on-going tension towards the creation of value for the latter, thereby determining a convergence between the interests of the shareholders and those of management.

As far as the features of the stock option plan adopted by Terna are concerned, reference should be made to the description contained in the report on operations as of June 30, 2005.

The pricing model used is the Cox-Rubinstein version, which takes into account the value of the Terna stock as of the grant date, the volatility of the stock and the interest rate curve as of the grant date consistent with the duration of the plan.

<i>Options allocated (as of June 30, 2005)</i>	<i>Expiry of option maturity period</i>	<i>Fair value as of grant date (euro)</i>	<i>Fair value option with allocation probability factor (50%)</i>
1,169,700	2006	0.183	0.092
1,169,700	2007	0.183	0.091

1,559,600	2008	0.181	0.091
3,899,000			

### 3) Provisions for risks and charges – euro 42.8 million

The net increase in the Provision for future risks and charges when compared with the balance as of December 31, 2004 amounts to euro 2.0 million and was essentially generated by the Parent Company (euro 1.2 million), being the balance between the new provision totalling euro 3.9 million (essentially referring to the ISO, euro 2.9 million, for adjustments payable on the network usage fee for the current year, inherent to the dispute underway with the independent energy producers Cip 6 and euro 0.8 million relating to the estimated charge payable by the Company for national insurance contribution obligations - INPS circular No. 63 dated May 6, 2005) and uses amounting to euro 2.7 million (mainly referring to prior charges reimbursed to independent producers for euro 0.4 million, to additional emoluments for senior management for euro 1.2 million and euro 1.0 million for redundancy incentives).

### 4) Current and deferred tax liabilities – euro 545.7 million

Changes in the provisions are detailed below:

<i>Millions of euro</i>	Dec. 31, 2004	Provisions	Uses	June 30, 2005
Deferred tax	468.6	50.5	-24.2	494.9
Current tax provided for	-	50.8	-	50.8
<b>Total</b>	<b>468.6</b>	<b>101.3</b>	<b>-24.2</b>	<b>545.7</b>

The item in question essentially refers to deferred taxes relating to prior accelerated depreciation (prior to 2004) provided by the Parent Company and reclassified in the equity reserves (amounting to euro 159.3 million, unchanged with respect to December 31, 2004) in addition to euro 329.7 million (euro 304.7 million as of December 31, 2004) for deferred taxes relating to additional depreciation provided by the Parent Company. The related increase amounting to euro 50.5 million is essentially attributable to the provision made for deferred taxes for the current period referring to additional depreciation, net of the related operating grants, for euro 25.1 million, and to the registration of deferred taxes on the adjustments to fair value at period end of the Fair value hedge financial instruments for 24.8 million. The use of euro 24.2 million entirely concerns the release of the deferred taxes on the fair value delta as of June 30, 2005 of the Parent Company's bond issue (determined as described within the comments on Long-term loans, to which reference should be made).

The item also includes the provision made by the Parent Company for IRES – company earnings' tax (40.9 million) and for IRAP –regional business tax (euro 9.9 million) on the period net income, determined on the basis of the average effective tax rate estimated annually.

## **5) Non-current financial liabilities**

The balance includes the following items:

Millions of euro	June 30, 2005	Dec. 31, 2004	Change
Cash flow hedge derivatives	24.9	18.9	6.0
Trading derivatives	23.5	12.6	10.9
<b>Total</b>	<b>48.4</b>	<b>31.5</b>	<b>16.9</b>

This item comprises the valorization of the fair value of the Cash flow hedge and trading derivatives (in other words those derivatives which do not meet the conditions for being qualified as for hedging purposes). During the first half of 2005, the decrease in the interest rate curve generated a negative change in the fair value of euro 6.0 million for the cash flow hedge derivatives and euro 10.9 million for trading derivatives.

## **6) Other non-current liabilities – euro 164.5 million**

The increase in this item (euro 6.3 million) is essentially due to the receipt of the last portion of the grant, by the Parent Company, for the connection to the Italy-Greece power line, partly off-set by the decrease due to the completion and consequent coming on stream of the plants which the grants refer to.

## **F – CURRENT LIABILITIES**

Current liabilities as of June 30, 2005 are analyzed as follows:

Millions of euro	June 30, 2005	Dec. 31, 2004	Change
Current portions of long-term loans	57.0	47.0	10.0
Trade payables	129.5	183.6	-54.1
Income taxes payable	0.9	12.1	-11.2
Current financial liabilities	46.5	12.9	33.6
Other current liabilities	75.8	51.9	23.9
<b>Total</b>	<b>309.7</b>	<b>307.5</b>	<b>2.2</b>

### **1) Current portions of long-term loans – euro 57.0 million**

Reference should be made to the section relating to long-term loans, illustrated within the sphere of non-current liabilities, for comments on the item under review.

### **2) Trade payables – euro 129.5 million**

Trade payables as of June 30, 2005 were made up as follows:

Millions of euro	June 30, 2005	Dec. 31, 2004	Change
Payables to suppliers	127.1	182.0	-54.9
Payables to the Parent Company	1.6	1.1	0.5
Payables for contract work in progress	0.8	0.5	0.3
<b>Total</b>	<b>129.5</b>	<b>183.6</b>	<b>-54.1</b>

#### Payables to suppliers

This item includes euro 93.8 million in payables due to third party suppliers and euro 33.3 million for payables due to other Enel Group companies.

Payables due to third party suppliers (euro 152.6 million as of December 31, 2004) underwent a decrease during the period of euro 58.8 million due to the payment of invoices referring to activities completed during the last quarter of the previous year.

The current exposure vis-à-vis suppliers refers to invoices received and to be received for contracts, services and purchases of materials and equipment.

Commitments undertaken with regards to suppliers came to euro 461.1 million and refer to the contractual purchase commitments outstanding at period end not forming part of the normal operating cycle and for the part not yet ordered.

Trade payables due to other Enel Group companies are broken down as follows:

Millions of euro	as of June 30,	
	2005	2004
Wind Telecomunicazioni	15.5	12.7
ENEL Distribuzione	2.6	3.2
Enelpower	4.3	3.4
ENEL Facility Management	0	5.7
Enel.it	0	2.8
Enel Ape	10.3	0.7
ENEL Produzione	0.3	0.4
Sfera	0.3	0.3
Other	0.0	0.2
<b>Total</b>	<b>33.3</b>	<b>29.4</b>

The payables due to Wind Telecomunicazioni regard costs for transmission and telephony services provided to the Parent Company; the increase in the debt exposure during the period, amounting to euro 2.8 million, essentially reflects the liability incurred for the upgrading and adaptation of the electricity supply systems of the Wind technological network infrastructure (euro 2.5 million).

The amount due to Enel Distribuzione refers to the energy discount granted to employees and to sundry technical services, while the amount due to Enelpower refers to amounts accrued on the Engineering Procurement and Construction contract stipulated with TSN and Novatrans.

Payables due to Enel Ape are essentially in line with those as of December 31, 2004, taking into account the merger transaction for the absorption of Enel Facility Management and Enel.it within Enel Ape during the first half of 2005.

#### Payables to the Parent Company

Trade payables due to the Parent Company ENEL S.p.A, amounting to euro 1.6 million as of June 30, 2005, mainly concern Management fee contracts, and services for Communication and E-Procurement activities.

Payables for contract work in progress

Payables for contract work in progress, amounting to euro 0.8 million as of June 30, 2005, underwent an increase of euro 0.3 million when compared with December 31, 2004 and comprised the following:

	Advances	Contract value	Balance as of June 30, 2005	Advances	Contract value	Balance as of Dec. 31, 2004
Third parties	-5.3	4.7	-0.6	-4.4	4.0	-0.4
Enel Produzione	-0.9	0.7	-0.2	-0.2	0.1	-0.1
<b>Total</b>	<b>-6.2</b>	<b>5.4</b>	<b>-0.8</b>	<b>-4.6</b>	<b>4.1</b>	<b>-0.5</b>

**3) Income tax payables – 0.9 million**

This item comprises the liability for income taxes, amounting to 0.9 million, referring exclusively to the subsidiary companies TSN and Novatrans.

**4) Current financial liabilities – 46.5 million**

The increase in the item under review when compared with December 31, 2004, totalling euro 33.6 million, essentially refers to interest accrued during the interim period on the two bonds issued by the Parent Company in the previous year. Deferred liabilities are analyzed below on the basis of the nature of the financial liabilities to which they refer:

<i>Millions of euro</i>	June 30, 2005	Dec. 31, 2004	Change
<b>Deferred liabilities on:</b>			
. Derivative contracts			
- <i>hedging</i>	-0.6	-	-0.6
- <i>trading</i>	0.9	-	0.9
	<u>0.3</u>	<u>-</u>	<u>0.3</u>
. Bond issue			
- 10-year	17.1	4.5	12.6
- 20-year	26.4	7.0	19.4
	<u>43.5</u>	<u>11.5</u>	<u>32.0</u>
. EIB loans			
	2.7	1.4	1.3
<b>Total</b>	<b>46.5</b>	<b>12.9</b>	<b>33.6</b>

## 5) Other current liabilities – 75.8 million

Other current liabilities are analyzed as follows:

<i>Millions of euro</i>	June 30, 2005	Dec. 31, 2004	Change
Advances	24.8	16.2	8.6
Other tax payables	20.5	13.0	7.5
Social security payables	9.4	8.1	1.3
Payables to employees	17.4	12.7	4.7
Other payables	3.7	1.9	1.8
<b>Total</b>	<b>75.8</b>	<b>51.9</b>	<b>23.9</b>

### Advances

This item comprises the operating grants collected by the Parent Company against construction and work in progress as of June 30, 2005. The value as of December 31, 2004 came to euro 16.2 million; the increase registered in the interim period (euro 8.6 million) essentially refers to contributions received from third parties for work concerning connection to the National Transmission Grid.

### Other tax payables

Other tax payables totalling euro 20.5 million, include euro 11.1 million in relation to the Parent Company and essentially concern the VAT settlement in June (euro 7.1 million) and the withholdings made by the same by way of substitute tax (euro 4.0 million). The remaining balance, euro 9.4 million, relates to taxes and withholdings provided for by the subsidiaries TSN and Novatrans.

### Social security payables

Social security payables amounting to euro 9.4 million (euro 8.1 million as of December 31, 2004) essentially concern the liabilities of the Parent Company payable to INPS (the national insurance institute) relating to June of this year.

### Payables to employees

Payables to employees amounting to euro 17.4 million (euro 12.7 million as of December 31, 2004) mainly relate to the amount due to employees for the portions of termination indemnities of the Parent Company to be paid out to leavers by June 30, 2005 (euro 4.3 million), payables to employees for the equivalent value of vacation and abolished public holidays accrued and not taken to be paid within the following month (euro 4.7 million), payables to employees for deferred liabilities relating to the thirteenth month salary (euro 3.2 million), in addition to amounts for employee incentives to be paid out (euro 4.3 million).

### Other payables

Other payables essentially refer to deferred liabilities (up by euro 1.8 million when compared with December 31, 2004), which include euro 1.7 million in Arca and Fisde contributions.

## **OFF-BALANCE SHEET COMMITMENTS AND RISKS**

### *Environmental litigation*

Environmental litigation relates to the installation and operation of electrical plant, and, especially, the effects of electrical and magnetic fields.

The Company is a defendant in a number of civil and administrative proceedings requesting the relocation of power lines or changes in operational conditions. The claims are based on the alleged health hazards posed by the power lines, even though they have been installed in full compliance with regulatory requirements. Only a very limited number of suits have been filed against the Company seeking damages for personal injury caused by electromagnetic fields .

In the connection, it should be noted that the issuance of the Prime Minister's Decree dated July 8, 2003, completing the provisions of framework Law No. 36 dated February 22, 2001 – which tangibly established the values of the three parameters (exposure limits, attention thresholds and quality targets), anticipated by the law and which electrical plant must meet – had a favourable impact on the pending dispute, since up to now the scope of the framework law was limited to general principles only.

With regards to sentences passed on this subject, only in a few sporadic cases have adverse rulings been issued against the Company, and these have all been appealed against (the cases are still pending). No claim for damages for personal injury has ever been upheld. An assessment of the suits, which included taking advice from external legal counsel, suggests that unfavourable rulings are remote, though for a limited number of cases this cannot be ruled out completely.

Finally, it should be noted that, in addition to Terna, the ISO has increasingly been called as a defendant in these proceedings, because the ISO is legally responsible for all the matters relating to energy flows transiting on the network owned by Terna.

### *Legislation concerning electrical and magnetic fields*

The relevant framework law, enacted on February 22, 2001, entrusts the State with the task of defining, through specific orders, the reference parameters (exposure limits, attention thresholds and quality targets) with which electrical plant must comply.

Attention is drawn in this regard to the framework law on reclamation which establishes a mechanism for recovery of related expenses according to criteria defined by the Electricity and Gas Authority, pursuant to Italian Law No. 481/95, given that costs are incurred for common benefit.

On August 29, 2003 the Prime Minister's Decree of July 8, 2003 for the "Definition of exposure limits, attention thresholds and quality targets for the protection of the population from exposure to electrical and magnetic fields at network frequency (50Hz) generated by power lines" which established the values for the

three parameters provided by the framework law, was published in the Official Gazette of the Italian Republic.

According to Company assessments, an estimated cost of over euro 400 million shall be incurred in implementing appropriate investments. The relevant interventions are expected to commence in 2007 and continue until at least 2014.

At regional legislative level, some regional authorities have formulated bills governing the matter, which establish more restrictive limits compared to those prescribed by the Prime Minister's Decree dated 1992, and by the more recent prime Minister's Decree of July 8, 2003.

However, it must be noted that on October 7, 2003 judgement No. 307 of the Constitutional Court was published and this declared some regional laws on the matter of electromagnetic fields to be constitutionally unlawful (amongst which the law of the Campania regional authority No. 13 dated November 24, 2001). It also established the principle that derogation from the State law is not permitted, even where this may involve higher standards being implemented by regional laws, as public health must be uniformly guaranteed throughout the Italian territory.

#### *Other pending litigation*

A number of legal disputes are pending in relation to urban planning and environmental issues associated with the construction and operation of a number of transmission lines. Adverse rulings could have repercussions, but since the impact cannot be quantified at present, they have not been included under the "Provision for disputes and sundry risks". An assessment of the suits, which included taking advice from external legal counsel, suggests that unfavourable rulings are remote, though for a limited number of cases this cannot be ruled out completely. The effects of an adverse ruling could include not only the payment of damages but also the costs involved in modifying power lines and the temporary unavailability of the lines.

In any case, an adverse outcome would not jeopardize the operation of the power lines.

## **EVENTS SUBSEQUENT TO JUNE 30, 2005**

### **Tariff review for 2006**

During March 2005, the Lombardy TAR (Regional Administrative Court) by means of rulings No. 956, No. 958, No. 959, No. 960, No. 961, No. 962 and No. 963 partially annulled the Electricity and Gas Authority (AEEG) resolution No. 05/04 and in particular the provisions which discipline the V1 tariff restriction, pursuant to Article 8 of Attachment A of the afore-mentioned resolution, and the provisions concerning connection contributions and fixed dues, pursuant to Article 9.1 of resolution No. 05/04.

The Authority decided to appeal to the Council of State against the afore-mentioned sentences, at the same time presenting a petition for precautionary suspension. Pending the ruling by the Council of State on the afore-mentioned suspension petition, by means of an announcement dated July 29, 2005, the AEEG considered it opportune to defer the 2006 review of the fees for the electricity transmission and distribution service, as well as the connection contributions and the fixed dues, anticipated by July 31, in accordance with the Integrated Text and the AEEG resolution No. 05/04.

### **Antitrust authority**

By means of ruling No. 14542 dated August 4, 2005, communicated to the parties on August 5, 2005, the Competition and Market Authority (Antitrust authority) issued its authorization for the acquisition, by the company Cassa Depositi e Prestiti (CdP), of 29.99% of Terna's share capital and the ISO business segment, obliging CDP to observe the following measures:

- a) the transfer, as from July 1, 2007 and within the subsequent 24 months, by CDP of the equity investment held in ENEL S.p.A., as well as
- b) provisionally and until the satisfaction of the afore-mentioned condition, the undertaking of the following commitments:
  - i) approval by the new Terna Board of Directors of a resolution which lays down suitable procedures for enhancing the role of the Advisory Committee pursuant to Article 1 of the D.P.C.M. dated May 11, 2004 in relation to the adoption and implementation of the NTG development plans;
  - ii) appointment of at least six of the seven Terna directors, due CDP in the event of a Board of Directors comprising ten members, who are independents.

## **Acea Trasmissione**

On August 8, Terna and Acea SpA (Acea) signed the contract for the purchase by Terna of the entire share capital of Acea Trasmissione SpA (Acea Trasmissione), a company wholly-owned by Acea.

Acea Trasmissione, which holds a portion of the National Transmission Grid (NTG), is owner of part of the high-voltage power lines in Lazio, Umbria and Abruzzo and ensures the maintenance and the development of the portion of NTG it owns.

By means of this acquisition, Terna launches the process for the unification of the National Transmission Grid anticipated by Italian Law No. 290/2003, which disciplines the re-organization of the electricity sector, and by the subsequent DPCM dated May 11, 2004.

The parties have agreed a price of euro 32.9 million for the transfer of the Acea Trasmissione equity investment. Finalization of the transaction is dependant on authorization issued by the Antitrust authority.

## **Consultation document on the incentives for network re-unification**

*“Incentive instruments for aggregation of the ownership of the national transmission network”*

Article 2 of the DPCM dated May 11, 2004 containing the criteria, methods and conditions for the unification and the management of the National Transmission Grid, establishes that, in order to improve the safety and the running efficiency of the NTG, the Authority assesses and, if necessary, arranges for the adoption of incentive instruments – also tariff-based – aimed at furthering the complete unification of the NTG ownership. In this connection, the Authority is provided with the faculty to differentiate the aforementioned instruments if the unification of the ownership involves investment in Terna's share capital by the other owners, thereby encouraging the pluralist composition of the shareholding structure.

The afore-mentioned DPCM has set April 30, 2006 as the final date for the applicability of the incentive instruments.

The AEEG has made an initial attempt at following up the DPCM by means of the publication on August 22, 2005 of a consultation document in which it illustrates the approaches which it intends to adopt in relation to the definition of the incentives pursuant to Article 2 of the afore-mentioned DPCM.

The following two instruments are proposed in the document:

- A. The application of an incentive/disincentive to be applied in the event that the merger transactions take place, respectively, by/after April 30, 2006.

The sum total of the incentive/disincentive will be estimated by the ISO on the basis of conditions established by the Authority so as to reflect the expected efficiency of the merger of the residual portions of the NTG falling under the responsibility of the Unified Transmission Operator.

While the incentive is paid to the sellers by the Independent Operator and is recovered by the latter via the tariff proceeds, the disincentive is imposed on the owners who are not re-unified thereby decreasing their tariff proceeds.

B. The hypothesis of a further incentive measure provided by the increase of the RAB yield by 1% - 2% for a period of 3 - 5 years extendable for an additional period of 2 – 3 years in the event that the seller opts for investment in Terna share capital.

## TRANSACTIONS WITH RELATED PARTIES

With regard to the Terna Group's transactions during the first half of 2005, related parties are represented by transactions with subsidiary companies and companies belonging to the ENEL Group.

The transactions carried out by Terna with related parties mainly concern the exchange of goods, the provision of services, the lending of financial resources, the coverage of insurance risks, as well as administrative, tax, legal and corporate assistance.

All the transactions form part of the ordinary operations and are regulated on an arms'-length basis, in other words at conditions which would be applied between two independent parties.

Lastly, shareholders are reminded that within the sphere of the corporate governance regulations which the Terna Group has adopted, the conditions have been anticipated for ensuring that the transactions with related parties are carried out in observance of the criteria of procedural and substantive correctness.

Main income statement items	In millions of euro	Company and nature of transaction
Revenues for other sales and services	11.6	<b>ENEL Distribuzione</b> - Services for running and maintenance of the HV lines belonging to Enel Distribuzione
	5.6	<b>ENEL.Net</b> – services relating to the support of the F.O. on plants belonging to Terna as well as the running, maintenance and development of the same
	0.5	<b>ENEL Produzione</b> - services relating to jobs for the construction of plants, as well as sundry services and maintenance on Enel Produzione SpA plants.
	1.1	<b>WIND Telecomunicazioni</b> - activities for teletransmission and telephone equipment housing
	0.1	<b>Enelpower</b> - sundry maintenance and services on Enelpower SpA plants
Costs for services	11.2	<b>WIND Telecomunicazioni</b> - Wind Telecomunicazioni services for telecommunications services and services for the development of special projects (SCTI)

2	<b>Enel Ape formerly ENEL.IT</b> (services up until March 31, 2005) - services for the realization and the maintenance of IT projects, for the operating of applications and connections to the Internet and to databases, electronic mail and the Intranet, hire and management of PCs
1,2	<b>Enel Ape formerly Enel Facility Management</b> - services carried out up until March 31, 2005 for: - catering service by means of the provision of meals in company restaurants (canteens) to Terna staff; - Property service (cleaning, ordinary maintenance and operating of installations, security, etc.) in the buildings occupied by Terna staff
5,8	<b>Enel Ape</b> – Services relating to: - the provision of meals replacing the canteen service (luncheon vouchers) - service for the management/administration of Terna staff; - from April 1, 2005, the creation and maintenance of IT projects, the running of applications and connections to the Internet and to databases, electronic mail and intranet, hire and management of PCs; - from April 1, 2005, catering service by means of the provision of meals in company restaurants (canteens) to Terna staff; - Property service (cleaning, ordinary maintenance and operating of installations, security, etc.) in the buildings occupied by Terna staff
2,8	<b>ENEL</b> - Management Fees (euro 2 million) and Communication Plan (euro 0.8 million)
Financial income and expense – other financial income - from parent companies	2,4
	<b>ENEL</b> - Interest income and Intercompany bank account



## Attachments

## IFRS RECONCILIATION TABLES AS OF JUNE 30, 2004

### IAS/IFRS Consolidated Balance Sheet as of June 30, 2004. IAS/IFRS Consolidated Income Statement for the 1st Half of 2004

The balance sheet and income statement schedules for the period ended June 30, 2004 are illustrated below and indicate:

- the balances according to the Italian accounting principles reclassified according to the IAS/IFRS formats;
- the adjustments for adaptation to the IAS/IFRS standards.

<b>Balance sheet as of June 30, 2004</b>	<b>Note</b>	<b>Italian accounting principles reclassified in accordance with IAS</b>	<b>IFRS_IAS conversion effects</b>	<b>IFRS_IAS</b>
<b>Non-current assets</b>				
Property, plant and equipment		4,234.5	9.6	4,244.1
Goodwill		113.3	-1.6	111.7
Deferred tax assets		25.9	27.9	53.8
Financial assets and other assets		11.1	2.2	13.3
<b>Total non-current assets</b>		<b>4,384.8</b>	<b>38.1</b>	<b>4,422.9</b>
<b>Current assets</b>				
Inventories		15.2		15.2
Trade receivables		185.9	1.0	186.9
Current financial assets		3.0	-0.2	2.8
Cash and cash equivalents		31.2		31.2
Other current assets		71.2		71.2
<b>Total current assets</b>		<b>306.5</b>	<b>0.8</b>	<b>307.3</b>
<b>TOTAL ASSETS</b>		<b>4,691.3</b>	<b>38.9</b>	<b>4,730.2</b>

<b>Non-current liabilities</b>				
Loans		1,892.5	-16.5	1,876.0
Termination indemnities and other employee benefits		64.5	73.6	138.1
Provision for risks and charges		69.0	-10.1	58.9
Deferred tax liabilities		498.8	4.4	503.2
Non-current financial liabilities		0.0	9.5	9.5
Non-current liabilities		161.4		161.4
<b>Total non-current liabilities</b>		<b>2,686.2</b>	<b>60.9</b>	<b>2,747.1</b>
<b>Current liabilities</b>				
Current portions of long-term loans		0.0	14.8	14.8
Trade payables		153.4	1.0	154.4
Income tax payable		2.1		2.1
Current financial liabilities		6.7		6.7
Other liabilities		74.0		74.0
<b>Total current liabilities</b>		<b>236.2</b>	<b>15.8</b>	<b>252.0</b>
<b>TOTAL LIABILITIES</b>		<b>2,922.4</b>	<b>76.7</b>	<b>2,999.1</b>
Share capital		440.0		440.0
Other reserves		1,246.9	-20.2	1,226.7
Retained earnings (losses) carried forward		-20.4	-29.9	-50.3
Net income for the period net of the advances distributed		102.2	12.3	114.5
Minority interests in capital and reserves		0.2		0.2
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>1,768.9</b>	<b>-37.8</b>	<b>1,731.1</b>
		<b>4,691.3</b>	<b>38.9</b>	<b>4,730.2</b>

<b>Income statement as of June 30, 2004</b>	<b>Note</b>	<b>Italian accounting principles reclassified in accordance with IAS</b>	<b>IFRS_IAS conversion effects</b>	<b>IFRS_IAS</b>
Ordinary revenues		508.7	-10.9	497.8
Other revenues		11.0		11.0
<b>Total revenues</b>		<b>519.7</b>	<b>-10.9</b>	<b>508.8</b>
Raw materials		7.2		7.2
Services		62.2		62.2
Personnel costs		81.4	0.9	82.3
Amortization, depreciation and write-downs		79.0	-2.3	76.7
Other operating costs		59.3	-23.0	36.3
Capitalized costs		-9.1		-9.1
<b>Total costs</b>		<b>280.0</b>	<b>-24.4</b>	<b>255.6</b>
<b>Operating income</b>		<b>239.7</b>	<b>13.5</b>	<b>253.2</b>
Financial expense		58.8	2.2	61.0
Financial income		9.7		9.7
<b>Income before taxes</b>		<b>190.6</b>	<b>11.3</b>	<b>201.9</b>
Income taxes for the period		88.4	-1.0	87.4
<b>Net income/loss for the period</b>		<b>102.2</b>	<b>12.3</b>	<b>114.5</b>

## 20) Statement of reconciliation of the shareholders' equity

By way of supplementing the reconciliation tables for the balance sheet and income statement illustrated above, the following table contains the statement of reconciliation of the shareholders' equity as of January 1, 2004 and December 31, 2004 and the 2004 net income, accompanied by comments relating to the adjustments made to the balances drawn up according to the Italian accounting principles.

Millions of euro	Note	Shareholders' equity as of June 30, 2004	Income statement for 1st Half of 2004
<b>ITA Gaap</b>		<b>1,769.0</b>	<b>102.2</b>
-tangible fixed assets and related depreciation	a	9.6	0.2
-goodwill	b	-1.6	2.1
-other personnel costs (termination benefits, Asem healthcare, etc.)	c	-73.6	-3.4
-financial derivative instruments	d	-5.9	1.2
-provisions for risks and charges	e	10.1	0.2
-other adjustments	f	0.0	11.0
-tax effects of adjustments	g	23.5	1.0
<i>Total</i>		-37.9	12.3
<b>IAS/IFRS</b>		<b>1,731.1</b>	<b>114.5</b>

### a) Tangible fixed assets and related depreciation.

The item indicates the separation and the elimination of the depreciation of "accessory" land, with an overall positive effect on shareholders' equity as of June 30, 2004 amounting to around euro 9.6 million.

### b) Goodwill.

This represents the adjustment to the period end exchange rate of the goodwill deriving from the purchase of equity investments not in euro; the overall effect on the shareholders' equity as of June 30, 2004 was negative for a total of euro 1.6 million.

### c) Employee benefits

These concern the adjustments to employee benefits on termination of the employment relationship (energy discount, loyalty bonus, termination indemnity, IMA - additional months' payment allowance fund and indemnity replacing notice period) which had a negative effect on shareholders' equity as of June 30, 2004 for around euro 73.6 million.

### d) Financial derivative instruments.

This concerns the negative effects on the shareholders' equity as of June 30, 2004

produced by the derivative instruments held in the portfolio, which amount to euro 5.9 million.

e) Provisions for risks and charges

The adjustment refers to the elimination of the provisions which are not recordable for IAS/IFRS purposes with a sum total (positive effect) of approximately euro 10.1 million on the shareholders' equity as of June 30, 2004.

f) Other adjustments.

This concerns the reversal of the charges attributable to corrections of errors noted during 2004, reclassified by direct deduction from shareholders' equity in accordance with the retrospective method.

g) Tax effect of the adjustments.

This originates from the tax effects of the adjustments to the income statement and balance sheet items generating a positive effect on shareholders' equity as of June 30, 2004 of euro 23.5 million.

## ACCOUNTING SCHEDULES OF TERNA SPA

T.E.R.NA. SpA BALANCE SHEET - ASSETS		Book values as of June 30, 2005	Book values as of Dec. 31, 2004	Changes for the period
	euro			
<b>A- SHARE CAPITAL NOT PAID-IN</b>		0	0	0
<b>B- FIXED ASSETS:</b>				
<b>I- Intangible assets</b>				
(1) incorporation costs		0	0	0
(2) research, development and advertising		0	0	0
(3) industrial patents and intellectual property rights		0	0	0
(4) concessions, licences and trademarks		0	0	0
(6) work in progress and advances		2.500.000	0	2.500.000
(7) other		0	0	0
<b>Total</b>	<b>2.500.000</b>	<b>0</b>	<b>2.500.000</b>	
<b>II- Tangible assets</b>				
(1) land and buildings		324.030.622	329.105.450	-5.074.828
(2) plant and machinery		3.134.507.001	3.125.465.914	9.041.087
(3) industrial and commercial equipment		11.455.502	12.022.499	-566.997
(4) other assets		1.804.460	1.768.198	36.262
(5) work in progress and advances		379.842.531	379.975.702	-133.171
<b>Total</b>	<b>3.851.640.116</b>	<b>3.848.337.763</b>	<b>3.302.353</b>	
<b>III- Financial assets</b>				
(1) equity investments in:				
(a) subsidiaries		255.043.446	300.007.357	-44.963.911
(b) affiliates		0	0	0
(c) Parent Company		0	0	0
(d) others		2.866.457	2.866.457	0
(2) receivables from:				
(a) subsidiaries		0	6.012.074	-6.012.074
(b) affiliates		0	0	0
(c) Parent Company		0	0	0
(d) others		5.769.042	5.868.084	-99.042
(3) other securities		0	0	0
<b>Total</b>	<b>263.678.945</b>	<b>314.753.972</b>	<b>-51.075.027</b>	
<b>TOTAL FIXED ASSETS (B)</b>		<b>4.117.819.061</b>	<b>4.163.091.735</b>	<b>-45.272.674</b>
<b>C- CURRENT ASSETS</b>				
<b>I- Inventories</b>				
(1) raw, ancillary and consumable materials		10.550.641	10.039.942	510.699
(3) contract work in progress		23.277.864	22.612.806	665.058
(5) advances		0	0	0
<b>Total</b>	<b>33.828.505</b>	<b>32.652.748</b>	<b>1.175.757</b>	
<b>II- Receivables</b>				
(1) trade:				
- third parties		175.388.085	121.568.464	53.819.621
- other Enel Group companies		14.189.899	17.545.098	-3.355.199
(2) subsidiaries		37.905.105	12.651.396	25.253.709
(3) affiliates		0	0	0
(4) Parent Company		189.933.445	143.916.271	46.017.174
(4-bis) tax receivables		46.320.785	12.702.492	33.618.293
(4-ter) deferred tax assets		15.387.898	14.837.169	550.729
(5) others		13.553.319	12.779.211	774.108
<b>Total</b>	<b>492.678.536</b>	<b>336.000.101</b>	<b>156.678.435</b>	
<b>III- Short-term investments</b>				
(4) other equity investments		0	0	0
(6) other securities		0	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	
<b>IV- Cash and cash equivalents</b>				
(1) bank and post office deposits		25.855.263	0	25.855.263
(3) cash on hand		122.730	92.025	30.705
<b>Total</b>	<b>25.977.993</b>	<b>92.025</b>	<b>25.885.968</b>	
<b>TOTAL CURRENT ASSETS (C)</b>		<b>552.485.034</b>	<b>368.744.874</b>	<b>183.740.160</b>
<b>D- ACCRUED INCOME AND PREPAID EXPENSES</b>				
(1) Accrued income		42.654.553	10.008.219	32.646.334
(2) Prepaid expenses:				
- issue discounts		3.085.771	3.169.817	-84.046
- other		10.827.435	8.043.301	2.784.134
<b>TOTAL ACCRUED INCOME AND PREPAID EXPENSES (D)</b>		<b>56.567.759</b>	<b>21.221.337</b>	<b>35.346.422</b>
<b>TOTAL ASSETS</b>		<b>4.726.871.854</b>	<b>4.553.057.946</b>	<b>173.813.908</b>

T.E.R.NA. SpA		Book values as of June 30, 2005	Book values as of Dec. 31, 2004	Changes for the period
BALANCE SHEET - LIABILITIES AND SHAREHOLDERS' EQUITY		euro		
<b>A- SHAREHOLDERS' EQUITY</b>				
I- Share capital		440.000.000	440.000.000	0
II- Share premium reserve		0	0	0
III- Revaluation reserves		0	0	0
IV- Legal reserve		88.000.000	84.491.220	3.508.780
V- Reserve for own shares		0	0	0
VI- Statutory reserves		0	0	0
VII- Other reserves :		0	0	0
- capital-related		396.066.445	396.066.445	0
- income-related		332.617.031	332.617.031	0
VIII- Retained earnings (losses carried forward)		441.278.092	522.937	440.755.155
IX- Interim dividend 2004		0	-90.000.000	90.000.000
<b>Net income (loss) for the period</b>		<b>138.614.357</b>	<b>674.263.935</b>	<b>-535.649.578</b>
	<b>Total</b>	<b>1.836.575.925</b>	<b>1.837.961.568</b>	<b>-1.385.643</b>
<b>B- PROVISIONS FOR RISKS AND CHARGES</b>				
(1) retirement benefits		997.915	717.399	280.516
(2) taxes:		0	0	0
- current		50.830.616	0	50.830.616
- deferred		489.026.491	463.968.279	25.058.212
(3) other		41.259.848	40.090.796	1.169.052
	<b>Total</b>	<b>582.114.870</b>	<b>504.776.474</b>	<b>77.338.396</b>
<b>C- EMPLOYEE TERMINATION INDEMNITY</b>				
		<b>62.136.162</b>	<b>60.424.427</b>	<b>1.711.735</b>
<b>D- PAYABLES</b>				
(1) bonds		1.400.000.000	1.400.000.000	0
(2) convertible bonds		0	0	0
(3) payables to shareholders for loans		0	0	0
(4) bank loans:		0	0	0
- medium and long-term loans		414.805.227	318.215.715	96.589.512
- short-term loans		0	0	0
(5) other loans		0	0	0
(6) advances		46.496.791	36.171.630	10.325.161
(7) trade payables:		0	0	0
- third parties		91.293.746	150.374.242	-59.080.496
- other Enel Group companies		28.987.658	25.882.440	3.105.218
(8) payables represented by credit instruments		0	0	0
(9) payables to subsidiaries		0	0	0
(10) payables to affiliates		0	0	0
(11) payables to Parent Company		1.649.249	1.702.059	-52.810
(12) tax payables		11.097.137	16.098.080	-5.000.943
(13) social security payables		8.324.929	7.917.083	407.846
(14) other payables		14.728.158	12.748.513	1.979.645
	<b>Total</b>	<b>2.017.382.895</b>	<b>1.969.109.762</b>	<b>48.273.133</b>
<b>E- ACCRUED LIABILITIES AND DEFERRED INCOME</b>				
(1) Accrued liabilities		60.730.433	19.025.199	41.705.234
(2) Deferred income:		0	0	0
- issue premiums		0	0	0
- other		167.931.569	161.760.516	6.171.053
	<b>Total</b>	<b>228.662.002</b>	<b>180.785.715</b>	<b>47.876.287</b>
<b>TOTAL LIABILITIES</b>		<b>2.890.295.929</b>	<b>2.715.096.378</b>	<b>175.199.551</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>4.726.871.854</b>	<b>4.553.057.946</b>	<b>173.813.908</b>
<b>MEMORANDUM ACCOUNTS</b>				
Guarantees granted		262.591.131	313.906.434	-51.315.303
Other memorandum accounts		2.593.414.404	2.519.259.113	74.155.291
	<b>Total</b>	<b>2.856.005.535</b>	<b>2.833.165.547</b>	<b>22.839.988</b>

T.E.R.NA. SpA INCOME STATEMENT euro		Book values as of June 30, 2005	Book values as of Dec. 31, 2004	Changes for the period
<b>(A) VALUE OF PRODUCTION</b>				
(1) revenues from sales and services:				
- network usage fees	376.790.031	428.462.998		-51.672.967
- other sales and services	23.662.878	29.959.904		-6.297.026
(3) change in contract work in progress	665.058	-1.023.777		1.688.835
(4) increases in internally constructed fixed assets	10.408.682	9.045.283		1.363.399
(5) other income and revenues :				
- operating grants	3.187.206	6.566.526		-3.379.320
- other	19.734.951	3.538.286		16.196.665
	<b>Total value of production</b>	<b>434.448.806</b>	<b>476.549.220</b>	<b>-42.100.414</b>
<b>(B) OPERATING COSTS</b>				
(6) raw, ancillary and consumable materials and goods for resale	7.691.393	6.562.859		1.128.534
(7) services	42.612.317	49.491.756		-6.879.439
(8) leases and rentals	6.970.852	7.225.207		-254.355
(9) personnel:				
- wages and salaries	58.473.934	55.682.917		2.791.017
- social security contributions	15.886.462	15.151.880		734.582
- employee termination indemnity	4.671.225	4.605.291		65.934
- retirement benefits	344.535	653.084		-308.549
- other costs	3.134.509	3.158.461		-23.952
(10) amortization, depreciation and write-downs				
- amortization of intangible fixed assets				
- depreciation of tangible fixed assets	73.644.930	70.597.836		3.047.094
- other amounts written off fixed assets	0	2.968		-2.968
- write-downs of current receivables and of cash and equivalents				
(11) change in inventories	-510.700	288.545		-799.245
(12) provisions for risks	3.869.329	15.280.000		-11.410.671
(13) other provisions				
(14) other operating costs	5.856.633	23.286.065		-17.429.432
	<b>Total operating costs</b>	<b>222.645.419</b>	<b>251.986.869</b>	<b>-29.341.450</b>
<b>OPERATING INCOME</b>		<b>211.803.387</b>	<b>224.562.351</b>	<b>-12.758.964</b>
<b>(C) FINANCIAL INCOME AND EXPENSE</b>				
(15) from equity investments in :				
- subsidiaries	10.316.279	4.882.457		5.433.822
- affiliates	0	0		0
- other companies	0	0		0
(16) other financial income:				
(a) from long-term receivables:				
- subsidiaries	0	0		0
- affiliates	0	0		0
- other companies	40.855	53.245		-12.390
(b) from long-term securities not representing equity investments	186	67		119
(c) from current securities not representing equity investments	0	0		0
(d) other income :				
- subsidiaries	13.928.819	8.464.570		5.464.249
- affiliates	0	0		0
- Parent Company	2.425.082	2.955.708		-530.626
- other companies	21.440	620		20.820
(17) interest and other financial expense :				
- subsidiaries	0	0		0
- affiliates	0	0		0
- Parent Company	26.254	14.270.105		-14.243.851
- other Enel Group companies	0	0		0
- other companies	27.995.608	7.360.438		20.635.170
(17-bis) exchange gains and losses	-3.453.031	-19.726		-3.433.305
	<b>Total financial income (expense)</b>	<b>2.163.830</b>	<b>-5.254.150</b>	<b>7.417.980</b>
<b>(D) ADJUSTMENTS TO FINANCIAL ASSETS</b>				
(18) revaluations:				
(a) of equity investments	0	0		0
(b) of long-term financial assets	0	0		0
(c) of current securities	0	0		0
(19) write-downs:				
(a) of equity investments	0	4.882.457		-4.882.457
(b) of long-term financial assets	0	0		0
(c) of current securities	0	0		0
	<b>Total adjustments to financial assets</b>	<b>0</b>	<b>4.882.457</b>	<b>-4.882.457</b>
<b>(E) EXTRAORDINARY ITEMS</b>				
(20) income:				
- gains on disposal of assets	0	0		0
- other	3.015.856	673.595.239		-670.579.383
(21) expense:				
- losses on disposal of assets	0	0		0
- prior year's taxes	0	2.148.473		-2.148.473
- other	3.030.617	252.673.954		-249.643.337
	<b>Total extraordinary items</b>	<b>-14.761</b>	<b>418.772.812</b>	<b>-418.787.573</b>
<b>INCOME BEFORE TAXES</b>		<b>213.952.456</b>	<b>633.198.556</b>	<b>-419.246.100</b>
(22) income taxes for the period, current, deferred and prepaid				
- income taxes for the year	75.338.099	84.599.345		-9.261.246
- prepaid taxes	50.830.616	58.810.619		-7.980.003
- deferred taxes	-550.729	-3.574.516		3.023.787
(23) NET INCOME (LOSS) FOR THE PERIOD	<b>138.614.357</b>	<b>548.599.211</b>		<b>-409.984.854</b>

## RECONCILIATION OF TERNA SPA'S SHAREHOLDERS' EQUITY AND NET RESULT FOR THE PERIOD AND THE CORRESPONDING CONSOLIDATED BALANCES

A reconciliation of the shareholders' equity and net income of the Parent Company, reconciled with the values according to Italian accounting principles<sup>1</sup>, with the corresponding consolidated balances is shown below:

Millions of euro	Net income June 30, 2005	Shareholders' equity as of June 30, 2005	Net income Dec. 12, 2004	Shareholders' equity as of Dec. 12, 2004
<b>Parent Company financial statements as per ITA_GAAP</b>	<b>138.6</b>	<b>1,836.6</b>	<b>584.3</b>	<b>1,838.0</b>
Termination indemnity and other staff-related provisions	1.4	-75.7	-7.0	-77.2
Separation of land from buildings	0.2	6.1	-3.4	6.0
Derivative instruments	-8.9	-47.4	-13.5	-32.5
Provision for risks and charges	-	3.8	-6.1	3.8
Tax effect	2.8	36.9	9.9	32.1
Tax clean-up	-	-	-421.3	-
<b>Total IAS conversion effects</b>	<b>-4.5</b>	<b>-76.3</b>	<b>-441.4</b>	<b>-67.8</b>
<b>Parent Company financial statements as per IFRS/IAS</b>	<b>134.1</b>	<b>1,760.3</b>	<b>142.9</b>	<b>1,770.2</b>
Net income and shareholders' equity contributed by consolidated companies	16.5	21.8	-1.8	0.4
Effect of converting financial statements of foreign subsidiaries	-	54.7	-	-11.5
Reversal of TSN dividends	-10.3	-10.3	-	-
<b>Consolidated financial statements as per IFRS/IAS</b>	<b>140.3</b>	<b>1,826.5</b>	<b>141.1</b>	<b>1,759.1</b>

<sup>1</sup> Reference accounting standards for the drawing up of the statutory financial statements of Terna SpA as of June 30, 2005.

## **GLOSSARY**

### ***Cash-generating unit***

A unit which generates financial flows: smallest group identifiable of activities which generate incoming financial flows widely independent of the incoming financial flows generated by other activities or groups of activities.

### ***Deemed cost***

Replaced cost value: amount used as the replaced cost value or amortized cost as of a set date. The subsequent amortization must be calculated on the basis of the assumption that the entity had initially stated the asset or the liability as of said set date and that the cost coincided, again as of that date, with the replaced cost value.

### ***Fair value***

Fair value: amount at which an asset can be traded, or a liability discharged, in an unrestricted transaction between informed and willing parties.

### ***Impairment loss***

Permanent loss in value: amounts by which the book value of an asset exceeds the value which can be recovered.

### ***Value in use***

Usage value: current value of the estimated future financial flows which are expected to derive from the on-going use of an asset and from the disposal at the end of its useful life.



## **Transition to the international accounting standards (IFRS)**

## **Introduction**

The TERNA Group has adopted the international accounting standards, *International Financial Reporting Standard*, as from 2005, while the date of transition to the IFRS was January 1, 2004. The last sets of financial statements (of the Parent Company and consolidated) drawn up in accordance with the Italian accounting principles are those relating to the accounting period ended December 31, 2004.

As required by IFRS 1 and by Article 81 of the Issuers' Regulations No. 11971/1999 adopted by the Consob by means of Resolution No. 14990 dated April 14, 2005, this attachment contains the tables illustrating the reconciliation between the values stated previously in accordance with the Italian accounting principles and those reclassified in accordance with the IFRS, accompanied by the related notes commenting on the adjustments.

These tables have been drawn up exclusively for the purposes of the transition project for the preparation of the first set of complete consolidated financial statements pursuant to the IFRS ratified by the European Commission and are lacking the comparative balances and the necessary explanatory notes which would be required for a complete representation of the equity-financial situation and the consolidated economic result of the Terna Group in compliance with the IFRS standards.

It should also be noted that they have been prepared in accordance with the International Financial Reporting Standards (IFRS) in force as of the date of preparation of the same, including the IFRS recently adopted by the International Accounting Standards Board (IASB), the International Accounting Standards (IAS) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC). These standards are those which it is assumed will be in force as of December 31, 2005. However, these standards may not coincide with those in force as of December 31, 2005 as a result of both the new guidelines of the European Commission concerning their ratification and the issue of new standards or interpretations by the competent bodies and, therefore, the balances presented could undergo changes for the purposes of use as comparative figures for the first complete consolidated financial statements drawn up in compliance with the IFRS.

The most significant accounting standards and policies used for the preparation of the reconciliation tables are illustrated below.

## **Consolidation method and procedures**

The scope of consolidation includes the Parent Company Terna SpA and the companies over which the latter directly exercises control by means of all the voting rights.

The financial statements of the subsidiary companies are consolidated as from the date on which control was acquired and until the date that said control ceases.

All the infragroup balances and the transactions, including any unrealized gains deriving from transactions which have taken place between Group companies, are eliminated net of the theoretical tax effect, if significant. Unrealized losses are eliminated except in the case when they represent reductions in value.

## **Accounting standards and policies**

### **Translation of foreign currency balances**

The financial statements of each consolidated company are drawn up using the reporting currency relating to the economic context in which each company operates.

In such financial statements, all the transactions in currency other than the functional currency are recorded using the exchange rate in force as of the date of the transaction. Monetary assets and liabilities denominated in currency other than the functional currency are subsequently adjusted to the exchange rate in force as of the period end date presented.

Non-monetary assets and liabilities denominated in foreign currency and recorded at historical cost are converted using the exchange rate in force as of the date of initial recognition of the transaction. Non-monetary assets and liabilities denominated in foreign currency and recorded at fair value are converted using the exchange rate in force as of the date of determination of this value.

### **Translation of foreign currency financial statements**

For the purposes of the consolidated financial statements, the profi/loss, assets and liabilities are expressed in euro which represents the functional currency of the Parent Company Terna SpA.

For the purposes of the preparation of the consolidated financial statements, the financial statements of the subsidiaries in a functional currency other than the euro are converted into euro by applying the exchange rate in force as of the period end date to the assets and liabilities – inclusive of goodwill and the adjustments made at the time of consolidation - and the average exchange rates for the period to the income statement items; the latter rates approximate the exchange rates in force as of the date of the

respective transactions. The related exchange differences are booked directly to the shareholders' equity and stated separately in a specific equity reserve.

Exchange differences are stated in the income statement at the time of the disposal of the subsidiary.

### **Property, plant and equipment**

Tangible assets in use are stated at historical cost, inclusive of any directly chargeable related costs necessary for the bringing into stream of the asset for the use for which it was purchased for; The cost is increased, in the presence of legal or constructive obligations, by the present value of the cost estimated for the dismantling or removal of the asset.

If significant parts of tangible assets in use have different useful lives, the components identified are recognised separately.

Some assets which had been subject to revaluation as of January 1, 2004 (the date of transition) or in previous periods, are recorded on the basis of the value revalued as of the date of revaluation, considered as substitute cost (*deemed cost*).

Tangible assets are stated net of the related accumulated depreciation and any impairment losses, determined in accordance with the methods described below. The depreciation is calculated on a straight-line basis with reference to the estimated useful life of the asset, which is reviewed annually and any changes are reflected in perspective. The depreciation of assets under construction starts when the asset is available for use.

The main depreciation rates used are as follows:

#### Depreciation rates

Industrial and non-industrial buildings	2.50% - 4.00%
Power lines	2.50% - 4.50%
Switching sub-stations:	
- Electrical equipment	2.00% - 3.00%
- Other electrical equipment	2.80 – 4.50%
- Automation and control systems	5.00 – 6.70%
Central systems for remote management and control:	
- Electrical equipment and ancillary plant	5.00%
- Computers	10.00%

Land, both free from construction or attached to industrial and civil buildings, is not depreciated since it has an unlimited useful life.

Construction in progress is stated at historical cost, inclusive of any related charges, net of any impairment losses.

Tangible assets acquired under financial leases – whereby all risks and benefits linked to the ownership are essentially transferred to the Group – are recognized as Group assets at their present value or, if lower, at the present value of the minimum payments due for the leasing. The corresponding liability due to the lessor is classified among the financial payables. The assets are depreciated by applying the approaches and the rates indicated above.

Leases where the lessor essentially maintains all the risks and benefits associated with the ownership of the assets, are classified as operating leases. The costs referring to operative leases are recorded on a linear basis in the income statement over the duration of the lease agreement.

#### Goodwill

All the acquisitions are recorded on the basis of the purchase method.

Goodwill, deriving from the acquisition of subsidiary companies, represents the excess of the purchase cost with respect to the fair value of the assets acquired net of the current and potential liabilities recorded and is allocated to each of the cash generating units identified. After the initial registration, the goodwill is not amortized and is reduced as a result of any impairment losses, determined in accordance with the methods described below.

Goodwill deriving from acquisitions carried out prior to January 1, 2004 is stated at the value recorded for this purpose in the last set of consolidated financial statements drawn up on the basis of the previous accounting principles (31 December 2003).

### **Impairment losses**

At each balance sheet, tangible and intangible assets with a determinate life are tested for impairment. The recoverable value of the goodwill is by contrast estimated as of each balance sheet date.

If an indication of value reductions exists, steps are taken to estimate the estimated realizable value.

The estimated realizable value is represented either by the net sales price or the value in use, which ever is higher.

When determining the value in use, the expected future financial flows are discounted back using a pre-taxation discount rate which reflects the current market valuation of the cost of money stated in relation to the period of the investment and to the specific risks of the asset. For an asset which does not generate abundantly sufficient financial flows, the realizable value is determined in relation of the cash generating unit which this asset belongs to.

An impairment loss is recognized in the income statement if the book value of the assets, or of the related cash generating unit to which it is allocated, is higher than the estimated realizable value.

With the exception of goodwill, impairment losses are reversed if the reasons which generated them cease to exist.

### **Inventories**

Inventories are valued at cost or net estimated realizable value, whichever is the lower.

The cost configuration adopted is weighted average cost which includes any related charges applicable.

## **Financial instruments**

### *Equity investments in other companies*

Equity investments in other companies, classified as “available for sale”, are valued at fair value and any gains or losses are charged directly against the shareholders’ equity. At the time of their disposal, such cumulative gains and losses are released to the income statement.

When the fair value cannot be reliably calculated, equity investments in other companies are valued at cost adjusted by impairment losses with any gain or losses recognised in the income statement.

These write-downs cannot be reinstated.

### *Financial assets*

Financial assets which the Company intends or is able to hold until maturity, are recorded at the amortized cost, using the interest rate method, net of any impairment losses.

### *Trade receivables*

Trade receivables, whose maturity falls within normal commercial timescales, are not discounted back and are recorded at cost (identified by their nominal amount) net of any impairment losses. The value reductions are determined on the basis of the present value of the expected future cash flows.

### *Cash and cash equivalents*

Cash and cash equivalents include the cash values, or rather those values which feature requisites of on-demand or extremely short-term availability, favourable outcome and the absence of costs for their collection.

For the purposes of the consolidated statement of cash flows, cash and cash equivalents are stated net of bank overdrafts as of the period end date.

### *Trade payables*

Trade payables, whose maturity falls within normal commercial timescales, are not discounted back and are recorded at cost (identified by their nominal amount).

### *Financial liabilities*

Financial liabilities, with the exception of derivatives, are initially stated at fair value net of any directly attributable transaction costs.

Subsequently, financial liabilities are valued on an amortized cost basis, using the

original effective interest rate method.

#### *Derivative financial instruments*

The Group holds derivative instruments for the purpose of hedging its exposure to interest rate fluctuation risks. On a consistent basis with the chosen strategy, the Group has not set up any transactions on derivatives for speculative purposes. However, in the event that these transactions cannot be qualified in the accounts as hedging transactions, they are recorded as speculative transactions.

The derivatives are classified as hedging instruments when the relationship between the derivative and the object of the hedge is formally documented and the effectiveness of the hedge, assessed periodically, is high. When the hedging derivatives cover the risk of a fluctuation in the fair value of the instruments subject to coverage (fair value hedge; e.g. coverage of the variability of the fair value of assets/liabilities at a fixed rate), they are stated at fair value and the effects are booked to the income statement; on a consistent basis, the instruments subject to hedging are adjusted in order to reflect the changes in the fair value associated with the risk hedged. When the derivatives cover the risk of fluctuation in the cash flows of the instruments subject to coverage (cash flow hedge; e.g. coverage of the variability of the cash flows of assets/liabilities at variable rates as a result of the fluctuations in interest rates), the fluctuations in the fair value are initially booked to shareholders' equity and subsequently charged to the income statement on a consistent basis with the economic effects produced by the transactions hedged.

The fluctuations in the fair value of the derivatives which do not satisfy the conditions for being qualified as hedges are stated in the income statement.

#### **Employee benefits**

The liability relating to the benefits acknowledged employees and paid out at the time of or subsequent to the termination of the employment relationship as well as relating to specific benefit programmes (termination indemnities, Ima<sup>1</sup>, Isp<sup>2</sup>, Energy Discount, Asem health care and other benefits) or other long-term benefits (Loyalty Bonus), is stated net of assets serving the plan and is determined, separately for each plan, on the basis of actuarial assumptions estimating the amount of the future benefits which the employees have accrued as of the reference date. The liability is recorded on an accruals basis over the vesting period of the related rights. The valuation of the liability is made by independent actuaries.

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<sup>1</sup> Additional months' payment allowance.

<sup>2</sup> Indemnity replacing notice period.

Gains and losses deriving from the amendment of the actuarial assumptions are stated in the income statement as a cost or revenue when their net cumulative value exceeds by more than 10% the higher value between the total of the liabilities referring to each specific benefit plan and the fair value of the assets serving the plan as of the balance sheet date (so-called “corridor approach”).

### **Provisions for risks and charges**

The provisions made for risks and charges are recorded when, as of the balance sheet date, a legal or implicit obligation exists, which derives from a past event, and an outlay of resources is probable in order to satisfy the obligation and the sum total of this outlay can be estimated. If the effect is significant, the provisions are determined by discounting back the expected future financial flows to a pre-tax discount rate which reflects the current market valuation of the cost of money in relation to the timescale and, if applicable, the specific risk applicable to the obligation. When the amount is discounted back, the increase in the provision due to the passing of time is recorded as financial expense. If the liability refers to tangible assets (e.g. dismantling and recovery of sites), the provision is recorded as a matching balance to the asset to which it refers; the recording of the expense in the income statement takes place by means of the depreciation process of the tangible fixed assets to which the expense refers.

### **Grants**

Grants, both from government and from private third parties, are stated at fair value when there is reasonable certainty that they will be received and the conditions anticipated for the attainment of the same will be satisfied.

Grants received for specific expenditure are recorded among other liabilities and credited to the income statement on a systematic basis over the same period during which the related costs accrue.

Grants received for specific assets whose value is recorded among fixed assets, are either directly charged against the value of said fixed assets or stated among other liabilities and credited to the income statement in relation to the depreciation period pertaining to the assets to which they refer.

Operating grants are recorded in full in the income statement at the time the conditions which allow their booking are satisfied.

### **Revenues**

Revenues are stated on the basis of the specific criteria illustrated below, in accordance with the type of transaction involved:

- revenues from the sale of goods are recorded when the significant risks and benefits pertaining to the ownership of the same are transferred to the purchaser;

- revenues for the performance of services are stated with reference to the stage of completion of the activities. In the event that it is impossible to reliably determine the value of the revenues, the latter are recorded up to the extent of the costs incurred which we believe will be recovered.

Specifically, revenues deriving from fees for the remuneration of the National Transmission Grid, are stated in accordance with the formalities established in the operating agreement with the ISO and valorized on the basis of the tariffs established by the Italian Regulatory Authority for Electricity and Gas.

### **Financial income and expense**

Financial income and expense is stated on an accruals basis with reference to the interest accrued on the net carrying amount of the related financial assets and liabilities, using the effective interest rate method.

### **Dividends**

These revenues are stated when the right of the shareholders to receive the dividends is established.

### **Income taxes**

Current taxes are determined on the basis of the estimate of the taxable profit (tax loss) and in pursuance of the tax legislation in force.

Deferred tax liabilities and assets are calculated on timing differences between the balance sheet values recorded in the consolidated balance sheet and the corresponding values recognized for tax purposes, applying the tax rate in force or essentially in force as of the accounting reference date.

The recording of prepaid tax assets is made when the recovery is probable, in other words when it is foreseen that taxable amounts sufficient for recovering the assets may become available in the future.

The recoverability of deferred tax assets is re-examined at each period end.

### **IFRS 1 adoption**

In relation to the adoption of the international accounting standards, the Group has applied the procedures laid down by the IFRS 1 – Initial adoption of the International Financial Reporting Standards, availing itself of a number of exceptions.

The exceptions anticipated by IFRS 1 applicable to the Group are illustrated below, with indication of those used for the drawing up of the opening balance sheet:

- company mergers: the Group has not applied IFRS 3 retrospectively to the company merger transactions which took place before the date of transition to

the IFRS;

- valuation of property, plant and equipment at fair value or, alternatively, at revalued cost as the replacement value of the cost: for some categories of assets, the Group has applied the revalued cost as substitute cost (deemed cost);
- employee benefits: the Group has decided to record all the cumulative actuarial gains and losses existing as of January 1, 2004, despite having chosen to use the corridor method for the subsequent actuarial gains and losses;
- reserve for net exchange differences deriving from the translation of the financial statements of consolidated companies operating in countries not included within the euro area: as permitted by IFRS 1, the Group has not availed of the exception and has maintained the cumulative net exchange differences deriving from previous translations of foreign company financial statements as determined previously;
- classification and valuation of the financial instruments: the Group has not availed of the faculty to defer the transition date of IAS 32 and 39 to January 1, 2005, taking into account the related effects in the preparation of the opening balance sheet as of January 1, 2004;
- designation of the financial instruments at fair value via the income statement or as available for sale: the Group has chosen to make this designation as of the transition date (January 1, 2004) rather than as of the date of initial registration as anticipated by IAS 39.

**IAS/IFRS Consolidated Balance Sheet as of January 1, 2004 and December 31, 2004**

**IAS/IFRS Consolidated Income Statement for the accounting period ended as of December 31, 2004**

The balance sheet as of January 1, 2004 and December 31, 2004 and the income statement for the 2004 accounting period are illustrated below and indicate:

- the balances according to the Italian accounting principles reclassified according to the IAS/IFRS formats;
- the adjustments for adaptation to the IAS/IFRS standards.

<b>Balance sheet as of January 1, 2004</b>  (Millions of euro)	<b>Notes</b>	<b>Italian accounting principles reclassified in accordance with IAS</b>	<b>IFRS_IAS conversion effects</b>	
				<b>IFRS_IAS</b>
<b>Non-current assets</b>				
Property, plant and equipment	1	4,195.8	9.4	4,205.2
Goodwill		115.5		115.5
Deferred tax assets	3	22.3	23.9	46.2
Financial assets and other assets	4	12.8	1.1	13.9
<b>Total non-current assets</b>		<b>4,346.4</b>	<b>34.4</b>	<b>4,380.8</b>
<b>Current assets</b>				
Inventories		15.6		15.6
Trade receivables	5	213.5	0.1	213.6
Cash and cash equivalents		340.0		340.0
Other current assets		35.4		35.4
<b>Total current assets</b>		<b>604.5</b>	<b>0.1</b>	<b>604.6</b>
<b>TOTAL ASSETS</b>		<b>4,950.9</b>	<b>34.5</b>	<b>4,985.4</b>
<b>Non-current liabilities</b>				
Loans	6	945.4	-6.8	938.6
Termination indemnities and other employee benefits	7	71.4	70.1	141.5
Provision for risks and charges	8	59.7	-9.9	49.8
Deferred tax liabilities	9	417.2	4.5	421.7
Non-current financial liabilities	10	0.0	10.6	10.6
Non-current liabilities		148.0		148.0
<b>Total non-current liabilities</b>		<b>1,641.7</b>	<b>68.5</b>	<b>1,710.2</b>
<b>Current liabilities</b>				
Current portions of long-term loans	11	0.0	6.8	6.8
Trade payables	12	232.5	0.1	232.6
Income tax payable		40.2		40.2
Other liabilities		70.1		70.1
<b>Total current liabilities</b>		<b>342.8</b>	<b>6.9</b>	<b>349.7</b>
<b>TOTAL LIABILITIES</b>		<b>1,984.5</b>	<b>75.4</b>	<b>2,059.9</b>
Share capital		2,036.1		2,036.1
Other reserves		709.7		709.7
Retained earnings (losses) carried forward	20	220.4	-40.9	179.5
Minority interests in capital and reserves		0.2		0.2
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>2,966.4</b>	<b>-40.9</b>	<b>2,925.5</b>

		<b>4,950.9</b>	<b>34.5</b>	<b>4,985.4</b>
		<b>Italian accounting principles reclassified in accordance with IAS</b>	<b>IFRS_IAS conversion effects</b>	
<b>(Millions of euro)</b>	<b>Note</b>			<b>IFRS_IAS</b>
<b>Non-current assets</b>				
Property, plant and equipment	1	4,313.6	9.7	4,323.3
Goodwill	2	111.2	5.8	117.0
Deferred tax assets	3	14.8	36.8	51.6
Financial assets and other assets	4	6.3	42.0	48.3
<b>Total non-current assets</b>		<b>4,445.9</b>	<b>94.3</b>	<b>4,540.2</b>
<b>Current assets</b>				
Inventories		19.6		19.6
Trade receivables	5	157.4	0.5	157.9
Current financial assets		4.6		4.6
Cash and cash equivalents		231.8		231.8
Other current assets		34.8		34.8
<b>Total current assets</b>		<b>448.2</b>	<b>0.5</b>	<b>448.7</b>
<b>TOTAL ASSETS</b>		<b>4,894.1</b>	<b>94.8</b>	<b>4,988.9</b>
<b>Non-current liabilities</b>				
Loans	6	2,090.1	-5.2	2,084.9
Termination indemnities and other employee benefits	7	61.1	77.2	138.3
Provision for risks and charges		40.8		40.8
Deferred tax liabilities	9	464.0	4.6	468.6
Non-current financial liabilities	10	0.0	31.5	31.5
Non-current liabilities		158.2		158.2
<b>Total non-current liabilities</b>		<b>2,814.2</b>	<b>108.1</b>	<b>2,922.3</b>
<b>Current liabilities</b>				
Current portions of long-term loans	11	0.0	47.0	47.0
Trade payables	12	183.1	0.5	183.6
Income tax payable		12.1		12.1
Current financial liabilities		12.9		12.9
Other liabilities		51.9		51.9
<b>Total current liabilities</b>		<b>260.0</b>	<b>47.5</b>	<b>307.5</b>
<b>TOTAL LIABILITIES</b>		<b>3,074.2</b>	<b>155.6</b>	<b>3,229.8</b>
Share capital		440.0		440.0
Other reserves	20	1,236.9	-12.7	1,224.2
Retained earnings (losses) carried forward	20	-3.0	-43.2	-46.2
Net income for the period net of the advances distributed	20	146.0	-4.9	141.1

<b>TOTAL SHAREHOLDERS' EQUITY</b>		1,819.9	-60.8	1,759.1
		4,894.1	94.8	4,988.9

<b>Income statement as of December 31, 2004</b> <b>(Millions of Euro)</b>	<b>Note</b>	<b>Italian accounting principles reclassified in accordance with IAS</b>	<b>IFRS_IAS conversion effects</b>	<b>IFRS_IAS</b>
Ordinary revenues		993.9		993.9
Other revenues		29.8	-3.7	26.1
<b>Total revenues</b>		<b>1,023.7</b>	<b>-3.7</b>	<b>1,020.0</b>
Raw materials and consumable		20.2		20.2
Services	<b>14</b>	127.4	2.4	129.8
Personnel costs	<b>15</b>	176.1	2.0	178.1
Amortization, depreciation and write-downs	<b>16</b>	161.7	-4.7	157.0
Other operating costs	<b>17</b>	72.0	-9.0	63.0
Capitalized costs		-22.5		-22.5
<b>Total costs</b>		<b>534.9</b>	<b>-9.3</b>	<b>525.6</b>
<b>Operating income</b>		<b>488.8</b>	<b>5.6</b>	<b>494.4</b>
Financial expense	<b>18</b>	139.1	62.4	201.5
Financial income	<b>18</b>	59.7	42.0	101.7
<b>Income before taxes</b>		<b>409.4</b>	<b>-14.8</b>	<b>394.6</b>
Income taxes	<b>19</b>	173.4	-9.9	163.5
<b>Net income/loss for the period</b>		<b>236.0</b>	<b>-4.9</b>	<b>231.1</b>

**Comments on the main IAS/IFRS adjustments made to the balance sheet items as of January 1, 2004 and December 31, 2004.**

Brief notes have been presented on the main adjustments made to the individual items of the balance sheets at the beginning and end of 2004.

**Balance sheet items - Assets**

1) Property, plant and equipment.

(euro 9.4 million as of January 1, 2004 and euro 9.7 million as of December 31, 2004); these adjustments refer to the reinstatement of the book value of land attached to electricity stations at their historical cost by means of the reversal of the related accumulated depreciation recorded in the financial statements. With regards to the 2004 accounting period, the adjustment is attributable to the reversal of the portion of depreciation for the period on land.

This approach is based on the assumption that the land has an unlimited useful life and, as a consequence, is not subject to depreciation.

2) Goodwill

(euro 0.0 million as of January 1, 2004 and euro 5.8 million as of December 31, 2004); this balance reflects the combined effect of the reversal of the portions of depreciation for the period on goodwill generated at the time of the consolidation of the foreign equity investments (consolidation difference equating to euro 4.3 million), since, for IFRS purposes, it is no longer subject to systematic amortization but rather periodic valuation (impairment test) and the incremental change registered for the adjustment to the exchange rate as of December 31, 2004 of the same for a total of euro 1.5 million.

3) Deferred tax assets.

(euro 23.9 million as of January 1, 2004 and euro 36.8 million as of December 31, 2004); these reflect the matching balance among balance sheet assets of the tax effects on adjustments made, mainly referring to benefits paid to employees subsequent to the employment relationship (euro 24.1 million as of January 1, 2004 and euro 26.5 million as of December 31, 2004) and to transactions on Cash Flow Hedge financial derivative instruments (euro 3.5 million as of January 1, 2004 and euro 6.2 million as of December 31, 2004).

4) Financial assets and other assets

(euro 1.1 million as of January 1, 2004 and euro 42.0 million as of December 31, 2004); these refer to the recording in the balance sheet of the fair value of the financial derivative instruments held in the portfolio as of January 1, 2004 (euro 1.1 million

Novatrans exchange fluctuation hedges) and as of December 31, 2004 (euro 42.0 million Fair Value Hedge hedges on Terna Public Offer).

5) Trade receivables

(euro 0.1 million as of January 1, 2004 and euro 0.5 million as of December 31, 2004); this item represents the re-determination of the net amount receivable referring to work in progress for third party contracts, relating to the periods in question, negotiated by the Parent Company. These values are matched by balances among trade payables.

**Balance sheet items - Liabilities**

6) Loans

(euro -6.8 million as of January 1, 2004 and euro -5.2 million as of December 31, 2004); this adjustment represents the reclassification of the current portions of long-term loans among current liabilities; as far as the change as of December 31, 2004 is concerned, it also comprises the adjustment to fair value of the bond issues (relating to the part hedged) negotiated by the Parent Company (euro 41.8 million adjustment for Public Offer; euro -47.0 million current portions of loans reclassified among current liabilities).

7) Termination indemnities and other employee benefits

(euro 70.1 million as of January 1, 2004 and euro 77.2 million as of December 31, 2004); these adjustments are summarized in the following table:

Millions of euro	Jan. 1, 2004	Dec. 31, 2004
Employee termination indemnity	-3.1	-2.9
"Energy discount" allowance	49.7	53.2
Other provisions	23.5	26.9
<b>Total</b>	<b>70.1</b>	<b>77.2</b>

These refer essentially to the application of the actuarial method to the Employee termination indemnity and to the booking of the current financial-actuarial value of the obligations relating to the benefits subsequent to the employment relationship for fixed-benefit programmes.

8) Provision for risks and charges.

(euro –9.9 million as of January 1, 2004 and euro 0.0 million as of December 31, 2004); the adjustment is entirely attributable to the reversal of that part of the provision for risks and charges which does not present the requisites for being recorded as anticipated by the IAS/IFRS.

9) Deferred tax liabilities.

(euro 4.5 million as of January 1, 2004 and euro 4.6 million as of December 31, 2004); these reflect the matching balance among the balance sheet liabilities of the tax effects on the adjustments made, mainly referring to the Employee termination indemnity and to the reversal of the accumulated depreciation on accessory land.

10) Non-current financial liabilities.

(euro 10.6 million as of January 1, 2004 and euro 31.5 million as of December 31, 2004); these refer to the recording in the balance sheet of the fair value derivative financial instruments held in the portfolio as of January 1, 2004 (CFH interest rate hedges for EIB loans) and as of December 31, 2004 (18.9 million CFH on EIB loans and 12.6 million trading derivatives).

11) Current portions of long-term loans.

(euro 6.8 million as of January 1, 2004 and euro 47.0 million as of December 31, 2004); this represents the reclassification of the current portions of long-term loans.

12) Trade payables

(euro 0.1 million as of January 1, 2004 and euro 0.5 million as of December 31, 2004); this represents the re-determination of the net liability referring to work in progress for third party contracts. These values are matched by balances among trade receivables.

**Adjustments to the 2004 consolidated income statement items**

13) Other revenues (euro –3.7 million) derive from the reinstatement of provisions for risks and charges no longer recordable on the basis of the IAS/IFRS standards and re-allocated among accumulated gains and losses; the specific amount refers to the reversal of the release to the income statement of the excess portion of the provision.

14) Services (euro 2.4 million); identical to previous point 13, it refers to the reversal of the use of the provision for risks and charges made during 2004 and, as already

indicated in point 8 above, re-allocated among accumulated gains and losses as of January 1, 2004.

15) Personnel costs (euro 2.0 million); this refers to the adjustment of the provisions to the current value (financial-actuarial) of the obligations relating to benefits subsequent to the employment relationship for fixed-benefit programmes. The period adjustment is attributable to greater costs recorded.

16) Amortization, depreciation and write-downs (euro -4.7 million); the adjustment is essentially attributable to the reversal of the portion of depreciation for the period on the goodwill generated at the time of the consolidation of the foreign equity investments (consolidation difference), since, for IAS/IFRS purposes, it is no longer subject to systematic amortization but rather periodic evaluation of any losses in value (impairment). It also comprises the reversal of the portion of depreciation referring to accessory land (euro -0.3 million).

17) Other operating costs (euro -9.0 million); this mainly concerns the reversal of the charges attributable to the correction of errors noted during the period, reclassified and directly deducted from shareholders' equity in accordance with the retrospective method (euro -11.0 million); they relate to charges for the tax clean-up pertaining to operating grants which are in excess of the economic-technical rates pertaining to years prior to 2003.

18) Net financial expense (euro 20.4 million); the adjustment essentially comprises:

- the financial component deriving from the discounting back of the benefits due to employees (euro 7.0 million);
- the net effect in the income statement of financial expense (euro 55.5 million) and income (euro 42.1 million) referring to derivative financial instruments (hedging and trading) held in the portfolio as of December 31, 2004.

19) Income taxes for the period (euro -9.9 million); this amounts reflects the tax effects of

the adjustments to income statement items, as analyzed below:

<b>Tax effect of the IAS adjustments</b>	<b>1st half 2004</b>
Termination indemnities and other employee benefits	-2.2
Separation of land from buildings	0.1
Derivative instruments	-4.1
Provisions	-3.7
<b>Total tax effects</b>	<b>-9.9</b>

## 20) Statement of reconciliation of the shareholders' equity

By way of supplementing the reconciliation tables for the balance sheet and income statement illustrated above, the following table contains the statement of reconciliation of the shareholders' equity as of January 1, 2004 and December 31, 2004 and the 2004 net income, accompanied by comments relating to the adjustments made to the balances drawn up according to the Italian accounting principles.

Millions of euro	note	Shareholders' equity as of Jan. 1, 2004	Shareholders' equity as of Dec. 31, 2004	Income statement 2004
<b>ITA Gaap</b>		<b>2.966,4</b>	<b>1.819,9</b>	<b>236,0</b>
-tangible fixed assets and related depreciation	a	9.4	6.0	-3.4
-goodwill	b	0.0	5.8	4.3
-employee benefits	c	-70.1	-77.2	-7.1
-financial derivative instruments	d	-9.5	-31.3	-13.5
-provisions for risks and charges	e	9.9	3.8	-6.1
-other adjustments	f	0.0	0.0	11.0
-tax effects of adjustments	g	19.4	32.1	9.9
<i>Total</i>		<i>-40.9</i>	<i>-60.8</i>	<i>-4.9</i>
<b>IAS/IFRS</b>		<b>2,925.5</b>	<b>1,759.1</b>	<b>231.1</b>

### a) Tangible fixed assets and related depreciation.

In relation to the item "land", the international accounting standards anticipate that it is recorded in a separate asset class and not subjected to depreciation. In relation to accessory land, previously depreciated together with the asset which stands on it, steps were taken to separate and eliminate the related depreciation, involving an overall positive effect on shareholders' equity as of January 1, 2004 and December 31, 2004, of around euro 9.4 million and euro 6.0 million, respectively.

### b) Goodwill.

As anticipated by IFRS 1, the net book value of the goodwill recorded in the financial statements drawn up in accordance with the Italian accounting principles as of the transition date, is periodically subject to impairment test and no longer subject to amortization. The goodwill relating to the purchase of equity investments not in euro, is adjusted for IFRS purposes to the period end exchange rates. The overall effect on the shareholders' equity as of December 31, 2004 was positive for a total of euro 5.8 million.

### c) Employee benefits

The IFRS identify the "Benefits subsequent to the employment relationship" among the various types of employee benefits. They represent the benefits due to employees on termination of the employment relationship. In the fixed-benefit programmes, the actuarial risk (that the benefits are lower than those expected) and the investment risk (that the assets invested are insufficient for meeting the expected benefits) fall on the company and not on the employee. Therefore, it is necessary to record the current financial-actuarial value of the liability anticipated and the related costs and revenues, including financial expense and actuarial gains and losses. For the fixed-benefit programmes which characterize the Terna Group, identified in the benefits associated with the termination indemnity, the Additional Months' Payment Allowance (IMA) and the Indemnity replacing notice period, the Loyalty Bonus and the Energy Discount (energy at a reduced tariff), steps were therefore taken to once again record and valorize:

- The liability for the energy discount;
- The liability for the Loyalty Bonus.

and assimilate the various valorization criteria for:

- The Employee Termination Indemnity;
- The IMA provision and the Indemnity replacing notice period.

The afore-mentioned adjustments have had a negative effect on the shareholders' equity as of January 1, 2004 and December 31, 2004 by around euro 70.1 million and euro 77.2 million, respectively, and a negative effect on the 2004 income statement by around euro 7.1 million.

d) Financial derivative instruments.

In order to deal with the risk of fluctuation in interest and exchange rates, derivative contracts are stipulated hedging both specific transactions and overall exposure. The IFRS establish specific rules for the accounting of these derivatives which differ from those anticipated by the Italian accounting principles.

Specifically, for derivatives hedging the risk of changes in future financial flows assigned to an asset, liability or future transaction (Cash Flow Hedge -CFH), the main effects can be seen:

- in the balance sheet registration of the fair value of the "derivative" asset/liability item;
- in the recording of the reserve for Cash Flow hedging, for the effective part of the hedge;
- in the booking to the income statement of the ineffective part of the hedge.

With reference to derivatives hedging the risk of changes in the fair value of the elements hedged comprising an asset or a liability recorded in the financial statements (Fair Value Hedge on interest rates), the main impacts can be seen:

- in the balance sheet registration of the "derivative" asset/liability item at its fair value;
- in the booking of the fair value delta attributable to the risk hedged adjusting the item hedged.

In conclusion, as far as "non-IAS hedging" derivatives are concerned, they are valued at fair value and the related effects are charged directly to the income statement.

This approach had a negative effect on the shareholders' equity as of January 1, 2004 and December 31, 2004, amounting euro 9.5 million and euro 31.3 million, respectively.

e) Provisions for risks and charges

The IFRS anticipate that the provisions for risks and charges must be stated only when a past obligatory event exists and the company has no realistic alternative other than to fulfil the obligation. The adjustment refers to the elimination of the provision for faults and the plant demolition provision which do not possess said characteristics, for a total of approximately euro 9.9 million on the shareholders' equity as of January 1, 2004 and around euro 3.8 million on the shareholders' equity as of December 31, 2004.

f) Other adjustments.

This concerns the reversal of the charges attributable to corrections of errors noted during 2004, reclassified by direct deduction from shareholders' equity in accordance with the retrospective method.

g) Tax effect of the adjustments.

This originates from the tax effects of the adjustments to the income statement and balance sheet items generating a positive effect on shareholders' equity as of January 1, 2004 and December 31, 2004, of euro 19.4 million and euro 32.1 million, respectively.

**Effects on the statement of cash flows as of December 31, 2004**

The reconciliation of the statement of consolidated cash flows is not presented since the effects deriving from the application of the IAS/IFRS accounting standards have not had any significant impacts.

The following table illustrates the reconciliation of the net financial debt as of December 31, 2004, involving the balances determined previously in accordance with the Italian accounting principles and those re-determined according to the IAS/IFRS.

Millions of Euro	Dec. 31, 2004
Net financial debt ITA Gaap	1,865.3

- Application of amortized cost on Terna Bond issues	-7.1
- Fair value delta calculated on the Bond issues hedged by fair value hedge transactions	41.8
<b>Net financial debt IAS/IFRS</b>	<b>1,900.0</b>

The net change reveals an increase in financial debt of euro 34.7 million, mainly attributable to the bonds issued by the Parent Company; the application of the amortized cost includes discounts and transaction costs directly attributable to the afore-mentioned loans no longer stated separately in the items anticipated by the Italian accounting principles.

#### **Audit on the reconciliations required by IFRS 1**

The reconciliation to the IFRS of the balance sheet balances as of January 1, 2004 and December 31, 2004, as well as that of the income statement balances for the 2004 accounting period, accompanied by the related notes, are subject to accounting audit. The independent auditing firm KPMG S.p.A. has completed its activities and the related report has been published together with this document.

**(Translation from the Italian original which remains the definitive version)**

## **Review report**

To the shareholders of  
Terna S.p.A.

- 1 We have reviewed the consolidated balance sheet, consolidated income statement and relative notes of Terna group as at and for the six months ended 30 June 2005, which are included in the half year report of Terna S.p.A.. This half year report is the responsibility of the management of Terna S.p.A.. Our responsibility is to prepare this report based on our review. We have also reviewed the part of the directors' report describing the activities of the group for the period with the sole objective of verifying consistency with the remainder of the half year report.
- 2 We conducted our review in accordance with Consob (the Italian Commission for Listed Companies and the Stock Exchange) guidelines set out in Consob resolution no. 10867 dated 31 July 1997. The review consisted primarily of the collection of information relating to the financial data and the consistency of application of the accounting policies through discussions with company management and analytical procedures applied to the financial data presented. The review excluded such audit procedures as tests of controls and verification or validation of assets and liabilities and is significantly less than an audit performed in accordance with generally accepted auditing standards. As a consequence, contrary to our reports on the consolidated financial statements, we do not express an opinion on the half year report.
- 3 With regard to the comparative figures relative to the annual consolidated financial statements of the previous year, included in the consolidated balance sheet and consolidated income statement and those shown in the appendix entitled "Transition to International Financial Reporting Standards", reference should be made to our report dated 13 September 2005.

Comparative figures relative to the half year report of the previous years have been restated in accordance with IFRS and the related IFRS reconciliation schedules have been derived from the half year figures prepared under previously-applicable accounting principles. We reviewed such half year figures, with respect to which reference should be made to our report dated 24 September 2004.

- 4 Based on our review, we are not aware of any material modifications or integrations that should be made to the consolidated balance sheet, consolidated income statement and relative notes described in paragraph 1 for them to be in conformity with the guidelines governing the preparation of the half year reports set out in article 81 of the Consob regulation approved with resolution no. 11971 dated 14 May 1999 and subsequent modifications and integrations.
- 5 We draw your attention to the disclosures provided by the directors in the half year report on the following matters:
  - the parent company Terna S.p.A. has pending disputes and other uncertain positions, mainly of an environmental and urban nature. An unfavourable outcome of such matters, considered remote, could lead to costs being incurred, whose amount cannot however be currently objectively quantified;
  - pursuant to Legislative decree no. 38/2005, the parent company Terna S.p.A. opted not to adopt the IFRS in the preparation of its separate annual financial statements as at and for the year ending 31 December 2005. Accordingly, the balance sheet and income statement of the parent company ENEL S.p.A. attached to the half year report have been drawn up under Italian GAAP;
  - the consolidated balance sheet and consolidated income statement have been prepared using the measurement and recognition criteria required by IFRS in force at the date of preparation of the half year report. Such criteria may differ from those provided for by IFRS and in force at 31 December 2005 due to further orientations of the European Commission adopting the IFRS or the issue of new standards or interpretations by the relevant bodies.

Rome, 13 September 2005

KPMG S.p.A.

(Signed on the original)

Bruno Mastrangelo  
Director of Audit

(Translation from the Italian original which remains the definitive version)

## Report of the auditors

To the board of directors of  
Terna S.p.A.

- 1 We have audited the attached IFRS reconciliation schedules of the Terna Group, comprising the consolidated balance sheets as at 1 January 2004 and 31 December 2004, consolidated income statement for the year ended 31 December 2004 and notes thereto, disclosed in the section entitled "Transition to International Financial Reporting Standards" of the half year report of Terna S.p.A. as at and for the six months ended 30 June 2005. The above IFRS reconciliation schedules are derived from the consolidated financial statements of Terna S.p.A. as at and for the year ended 31 December 2004, prepared in accordance with Italian legislation governing the preparation of financial statements. We audited such consolidated financial statements and issued our audit report thereon on 11 March 2005. The IFRS reconciliation schedules have been prepared as part of the transition to the International Financial Reporting Standards (IFRS) adopted by the European Commission. The IFRS reconciliation schedules are the responsibility of the parent company's management. Our responsibility is to express an opinion on these schedules based on our audit.
- 2 We conducted our audit in accordance with the auditing standards generally accepted in Italy. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the IFRS reconciliation schedules 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. We believe that our audit provides a reasonable basis for our opinion.
- 3 In our opinion, the IFRS reconciliation schedules referred to in paragraph 1 taken as a whole comply with the preparation criteria and principles set out in article 81 of Issuer Regulation no. 11971/1999, adopted by Consob, the Italian Commission for Listed Companies and the Stock Exchange, with resolution no. 14990 of 14 April 2005.

- 4 We draw your attention to the disclosures provided by the directors in the section "Foreword" of the "Transition to International Financial Reporting Standard" document about the following matters:
  - 4.1 The IFRS reconciliation schedules have been prepared using the measurement and recognition criteria required by IFRS in force at the date of preparation of the schedules. Such criteria may differ from those provided for by IFRS and in force at 31 December 2005 due to further orientations of the European Commission adopting the IFRS or the issue of new standards or interpretations by the relevant bodies.
  - 4.2 The IFRS reconciliation schedules have been prepared only for the purposes of the transition to IFRS for the preparation of the first complete set of consolidated financial statements in accordance with the IFRS adopted by the European Commission. Therefore, they do not include the comparative figures and notes which would be required to give a view of the financial position and results of the Terna Group in full compliance with IFRS.
- 5 Our audit report on the consolidated financial statements of the Terna Group as at and for the year ended 31 December 2004, issued on 11 March 2005, made reference to the disclosures provided by the directors in the notes to the consolidated financial statements about pending disputes and other uncertain positions, mainly of an environmental and urban nature, of the parent company Terna S.p.A.. An unfavourable outcome of such matters, considered remote, could lead to costs being incurred, whose amount cannot however be currently objectively quantified.

Rome, 13 September 2005

KPMG S.p.A.

(Signed on the original)

Bruno Mastrangelo  
Director

**Terna**  
Joint-stock Company  
Registered Offices in  
Via Arno 64, Rome