

VITAL SIGNS INC
Form S-3/A
January 31, 2006

As filed with the Securities and Exchange Commission on January 31, 2006

Registration No. 333-130691

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

**AMENDMENT NO. 3
TO**

**FORM S-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

VITAL SIGNS, INC.

(Exact name of registrant as specified in its charter)

New Jersey

(State or other jurisdiction
of incorporation or organization)

11-2279807

(I.R.S. Employer
Identification Number)

**20 Campus Road
Totowa, New Jersey 07512
(973) 790-1330**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Jay Sturm
Vital Signs, Inc.
20 Campus Road
Totowa, New Jersey 07512
(973) 790-1330**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this registration statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, check the following box: £

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If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box: £

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. £

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective statement for the same offering. £

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box: £

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box: £

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered (1)	Proposed maximum offering price per share (2)	Proposed maximum aggregate offering price (2)	Amount of registration fee (2)
Common Stock, no par value	2,070,000 sh.	\$46.23	\$95,696,100	\$10,240(3)

- (1) Includes 270,000 shares of common stock that may be purchased by the underwriters from the selling shareholders upon exercise of the underwriters' overallotment option.
- (2) Estimated solely for the purpose of computing the registration fee and based on the average of the high and low sale prices of the common stock of Vital Signs, Inc. as reported on the NASDAQ National Market on December 20, 2005 in accordance with Rule 457 under the Securities Act.
- (3) Previously paid.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this Prospectus is subject to completion and may be changed. We and the selling shareholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This Prospectus is not an offer to sell these securities, and we are not soliciting an offer to buy these securities in any state where such offer or sale is not permitted.

Subject to completion, dated January 31, 2006

Prospectus

1,800,000 shares

Common stock

Vital Signs, Inc. is selling 434,000 shares of common stock, and the selling shareholders are selling 1,366,000 shares of our common stock.

Our common stock is quoted on the NASDAQ National Market under the symbol "VITL." On January 17, 2006, the last sale price of our common stock reported on the NASDAQ National Market was \$45.85 per share.

	Per share	Total
Public offering price	\$	\$
Underwriting discounts and commissions	\$	\$
Proceeds to Vital Signs, Inc.	\$	\$
Proceeds to selling shareholders	\$	\$

The selling shareholders have granted the underwriters an option for a period of 30 days to purchase up to 270,000 additional shares of common stock. We will not receive any proceeds from the sale of shares by the selling shareholders.

Investing in our common stock involves a high degree of risk. See "Risk factors" beginning on page 6.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

JPMorgan

Thomas Weisel Partners LLC

Piper Jaffray

The date of this prospectus is _____, 2006.

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Except as otherwise indicated, market data and industry statistics used throughout this prospectus are based on independent industry publications and other publicly available information. Although we believe that these data and statistics are reasonable and sound, they have been prepared on the basis of underlying data to which we do not have access, and which we cannot independently verify.

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Prospectus summary

This summary highlights selected information contained elsewhere in this prospectus. This summary does not contain all the information that you should consider before investing in our common stock. You should read this entire prospectus carefully, including "Risk factors" on page 6 and our consolidated financial statements and notes, beginning on page F-1, before making an investment decision.

Vital Signs, Inc.

We are a leading designer, manufacturer and marketer of airway management products for the anesthesia, respiratory/critical care and sleep disorder markets. We sell our products in over 70 countries worldwide. We offer one of the broadest single-patient use anesthesia and respiratory/critical care product lines in the industry and have developed numerous innovative products which are now considered industry standards. In addition, we sell therapeutic products for patients suffering from sleep disorders and provide sleep disorder diagnoses at sleep laboratories and centers that we operate. We also deliver technology services to companies regulated by the Food and Drug Administration.

We categorize our product and service offerings within four business segments: anesthesia, respiratory/critical care, sleep disorder and pharmaceutical technology services.

Anesthesia. We have been supplying anesthesia products to the market for 33 years. Our single-patient use anesthesia products and systems are designed to deliver oxygen and anesthesia from a gas source, such as an anesthesia machine, to a patient's pulmonary system, remove anesthetic gases, oxygen and carbon dioxide from a patient and link a patient with various monitors. Based upon data furnished by IMS Health Incorporated, we believe that we have a number one U.S. market share position for anesthesia breathing circuits, face masks and infusors. Our principal anesthesia products consist of face masks, breathing circuits and general anesthesia products.

Respiratory/critical care. We have been supplying products to the respiratory/critical care market for over 25 years. Based upon data furnished by IMS Health Incorporated, we believe that we have a number two U.S. market share position for arterial blood gas syringes and resuscitators. Our primary respiratory products are arterial blood gas syringes and kits, manual resuscitators and blood pressure cuffs. Our critical care products include equipment kits and modules that are color coded to allow emergency room workers to rapidly and accurately determine the proper equipment size for use with pediatric patients.

Sleep disorder. Building upon our airway management expertise and our long-time experience with continuous positive airway pressure systems, we began providing sleep disorder products and services in the late 1990s. We believe that we are the only company that both operates sleep centers to diagnose obstructive sleep apnea and manufactures and sells products designed to treat that condition. As of September 30, 2005, we operated 52 sleep diagnosis laboratories and centers in seven states in the United States and in Washington D.C. At these sleep laboratories and centers, we conduct sleep studies to determine whether the patients referred to us suffer from sleep disorders. If a patient is determined to suffer from sleep apnea, we can offer the patient follow-up diagnostic and monitoring services and may, under certain circumstances, be in a position to sell our sleep disorder products to the patient. Our principal sleep disorder products, currently marketed primarily outside of the United States, are personal ventilation systems, which are used in the treatment of obstructive sleep apnea to prevent temporary airway closure during sleep.

Pharmaceutical technology services. In 1996, we began providing regulatory consulting services to clients, helping them to develop and validate systems and processes for their manufacturing, infrastructure, research and development, laboratory and quality assurance departments. In 2002, with our acquisition of our Stelex subsidiary, we expanded our services to include computer systems compliance. In addition, we have developed and currently market proprietary software products used in conjunction with our services to help clients comply with FDA regulations. We

deliver these technology services to FDA regulated companies primarily in the pharmaceutical sector, as well as to medical device, diagnostic and biotechnology companies. Our clients include some of the largest pharmaceutical companies in the world.

For our fiscal year ended September 30, 2005, the anesthesia, respiratory/critical care, sleep disorder, and pharmaceutical technology services segments accounted for 48.1%, 21.9%, 21.4%, and 8.6% of our net revenue, respectively.

Market overview

Our market opportunities are diverse:

Anesthesia and respiratory/critical care. Face masks and breathing circuits constitute our primary anesthesia product offerings. Manual resuscitators and arterial blood gas kits constitute our primary respiratory/critical care product offerings. According to a market forecast published by Medtech Insight, LLC, the size of the United States market for anesthesia and respiratory airway management products is currently estimated at approximately \$800 million and is expected to reach \$1.1 billion by calendar 2010.

Sleep disorder. Obstructive sleep apnea is considered to be one of the most common sleep disorders. According to the National Heart, Lung and Blood Institute of the National Institutes of Health, approximately 20 million people in the United States suffer from sleep apnea. We believe that a substantial portion of those remain undiagnosed.

Pharmaceutical technology services. For the highly regulated pharmaceutical and medical device markets, the tasks of developing FDA compliance programs and monitoring their performance are complex and time consuming. Many regulated companies require consultants to help them develop processes to comply with an ever-growing body of regulations. We assist pharmaceutical companies, as well as medical device, diagnostic and biotechnology companies, in their compliance efforts by providing consulting services and, to a lesser extent, software products.

Competitive strengths

- We are a developer and manufacturer of multiple products which have become industry-standards in both the anesthesia and respiratory/critical care markets.
- We have obtained worldwide brand recognition through years of supplying the anesthesia and respiratory/critical care markets.
- We have developed strong relationships with hospitals located throughout the United States.
- We have direct access to patients through our sleep laboratory affiliations, providing added product awareness in the development of sleep apnea treatments.
- We manufacture a majority of our products internally, providing numerous manufacturing efficiencies and the ability to react quickly to changes in market demand.

Growth strategy

- We seek to develop innovative anesthesia and respiratory/critical care products that respond to the needs of health care providers and that are complementary to our existing product lines.
- We expect our direct sales force to expand the number of hospitals that they cover and to penetrate deeper into the hospitals that we presently serve.

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- We intend to capitalize on the growing acceptance of single patient use products in international markets and to expand our distributor networks in those markets.
- We plan to continue to seek opportunities to grow externally through licensing agreements, strategic acquisitions and the purchase of technology.

- We intend to expand our sales of sleep disorder products in the United States through our sleep diagnostic services business.

We were incorporated in 1972 as a New York corporation and changed our state of incorporation to New Jersey in 1987. Our executive offices are located at 20 Campus Road, Totowa, New Jersey 07512, and our telephone number at that address is (973) 790-1330. We maintain a website on the Internet at www.vital-signs.com. Our website, and the information contained therein, is not a part of this prospectus.

In this prospectus, references to “Vital Signs,” “we,” “us” and “our” refer to Vital Signs, Inc. and its subsidiaries. Actar™, Actar D-Fib™, Aspirator™, Aspirator Plus™, BabyBlue II™, Babysafe™, Breas™, Breas HA50™, Breas PV10™, Breas PV PV101™, Breas PV102™, Breas PV403™, Breas PV501™, Breas SC20™, Broselow®, Broselow-Hinkle™, Broselow-Luten™, C-CO 2™, Cleencuff™, Code Blue II™, CUFF-ABLE™, Gas-Lyte™, Greenlight II™, iMask™, INFUSA™, iSleep™, Kurtis MSD™, Limb-Ø™, Micro ABG™, Misty OX®, Pedi Blue II™, Quick-ABG™, SURE-LOK™, TurboHeater™, T-Wall™, Vital Seal™, Vital View™, Vital View II™, Vivo 30™, and Vivo 40™ are our trademarks. We also have several registered and unregistered color scheme trademarks related to the Broselow product line. All other trademarks used in this prospectus are the property of their respective owners.

When we refer to our fiscal year in this prospectus, we are referring to the fiscal year ended on September 30 of that year. Unless the context expressly indicates a contrary intention, all references to years in this prospectus are to our fiscal years.

The offering

Common stock offered by Vital Signs: 434,000 shares

Common stock offered by the selling shareholders: 1,366,000 shares

Over-allotment option granted by the selling shareholders: 270,000 shares

Common stock to be outstanding after this offering: 13,052,044 shares

The share amounts listed here are based on shares outstanding as of December 1, 2005 plus 20,000 shares issuable upon exercise of certain stock options. These options will be exercised by one of the selling shareholders and the shares purchased through this exercise will be sold in this offering. The share amounts listed here exclude:

- 589,321 shares of common stock issuable upon the exercise of stock options outstanding as of December 1, 2005 at a weighted average exercise price of \$30.46 per share (which options are not expected to be exercised in connection with this offering); and
- 1,583,027 shares of common stock available for future grant or issuance under our various stock incentive and employee stock purchase plans.

Unless otherwise noted, the information in this prospectus assumes that the underwriters' over-allotment option will not be exercised.

Use of proceeds

We intend to use the proceeds that we receive from this offering to finance possible acquisitions of complementary products, technologies or businesses and for working capital and other general corporate purposes. We are not presently pursuing any acquisitions that have reached the stage where we consider it probable that they will be consummated. We will not receive any of the proceeds from the selling shareholders' sale of common stock in this offering. See "Use of proceeds" on page 19 for more information regarding our use of the proceeds from this offering.

NASDAQ National Market symbol: VITL

Risk factors

We are challenged by considerable risks, including the cost containment pressures imposed upon all participants in our industry, the time and expense required for us to comply with regulatory requirements, the competitive nature of the markets for our products and services, the impact that group purchasing organizations have upon us and other risks and uncertainties described under "Risk factors," beginning on page 6.

Summary consolidated financial information

The table below sets forth summary consolidated financial data for the periods indicated. The data has been derived from the audited consolidated financial statements of Vital Signs for the three years ended September 30, 2005, included elsewhere in this prospectus. It is important that you read this information together with "Management's discussion and analysis of financial condition and results of operations," beginning on page 25, and our consolidated financial statements and notes to those consolidated financial statements beginning on page F-1.

(in thousands, except per share amounts)	Year ended September 30,		
	2005	2004	2003
Consolidated income statement data:			
Net revenue	\$ 194,037	\$ 183,991	\$ 182,163
Gross profit	98,530	92,617	90,555
Income from continuing operations	26,300	22,168	19,190
Net income	26,389	22,053	14,222
Earnings from continuing operations per common share—basic	2.08	1.73	1.49
Earnings from continuing operations per common share—diluted	2.06	1.72	1.48
Basic weighted average number of shares	12,616	12,793	12,905
Diluted weighted average number of shares	12,789	12,907	12,985

The as-adjusted balance sheet data summarized below reflects the sale by Vital Signs of 434,000 shares of common stock in this offering at the assumed offering price of \$45.85 per share, after deducting underwriting discounts and commissions and estimated offering expenses, and the expected issuance of 20,000 shares of common stock resulting from the exercise of certain stock options by one of the selling shareholders in connection with this offering. Each \$1 increase (decrease) in the public offering price per share would increase (decrease) the as-adjusted figure shown below for total shareholders' equity by \$410,000, after deducting underwriting discounts and commissions and estimated offering expenses to be paid by us.

September 30, 2005 (in thousands)	Actual	As adjusted
Consolidated balance sheet data:		
Cash and cash equivalents	\$ 81,767	\$ 100,483
Working capital	119,555	138,271
Total assets	253,702	272,418
Short-term and long-term debt	—	—
Total shareholders' equity	232,706	251,422

Risk factors

You should carefully consider the risks described below and all other information contained in this prospectus before making an investment decision. If any of the following risks, as well as other risks and uncertainties that are not yet identified or that we currently think are immaterial, actually occur, our business, financial condition and results of operations could be materially and adversely affected. In that event, the trading price of our shares could decline, and you may lose part or all of your investment.

Risks related to our industry

Public and private sector health care organizations continue to exert substantial cost containment pressures that could adversely impact our prices and our profitability.

In recent years, widespread efforts have been made in both the public and private sectors to control health care costs, including the prices of products sold by us. Such efforts may have a material adverse effect on the pricing of, and demand for, our products. Health care organizations are evaluating approaches to reduce costs by decreasing the frequency with which a treatment, device or product is used. Cost containment has also caused the decision-making function with respect to purchasing to shift in many cases from the physician to the administrator at the health care institution, resulting in an increased emphasis on reduced price, as opposed to product features and clinical benefits. Efforts by U.S. governmental and private payors to contain costs will likely continue, and we expect that international health care markets will follow a similar trend toward cost containment.

The time and expense needed to obtain regulatory approval and respond to changes in regulatory requirements could adversely affect our ability to commercially distribute our products and services and generate revenue therefrom.

We are subject to extensive worldwide regulation with respect to product clearance and enforcement activities. This causes us to experience long approval cycles, uncertainty with respect to the timing of the introduction of new or modified products, risk with respect to approvals and substantial expenses. Our products are subject to extensive regulation by the United States Food and Drug Administration, commonly known as the FDA, and certain similar foreign regulatory agencies. Additionally, some of the services we provide in our sleep disorder segment are subject to additional regulation from various local regulatory agencies.

The FDA regulates the pre-clinical and clinical testing, manufacture, labeling, distribution and promotion of medical devices. It can take several years to receive the appropriate clearances from the FDA and we cannot assure you that we will always obtain such clearances. If we decide to develop any products that are categorized by the FDA as Class III medical devices, the time, effort and expense required to obtain the necessary clearances will increase significantly. In addition, the products that we manufacture or distribute pursuant to FDA clearances are subject to pervasive and continuing regulation by the FDA. Noncompliance with applicable requirements can result in, among other things, warning letters, fines, injunctions, civil penalties, recalls or seizures of products, total or partial suspension of production, failure of the government to grant pre-market clearance for devices, withdrawal of marketing clearances and criminal prosecution. The FDA also has the authority to require us to repair, replace or refund the cost of any device that we manufacture or distribute.

International sales of medical devices are subject to foreign government regulations, which vary substantially from country to country. The time required to obtain approval by a foreign country may be longer or shorter than that required for FDA clearance, and the requirements may differ significantly. Non-compliance with foreign regulations may carry the same or increased risks, liabilities and exposures as non-compliance with FDA requirements. Foreign regulatory authorities also have the authority to require us to repair, replace or refund the cost of any device that we manufacture or distribute.

Certain of our business activities require that we collect and/or use information about individuals and their medical conditions. As a result, we are subject to complex regulations by both United States and foreign authorities intended to protect the privacy of those individuals by requiring that we maintain the confidentiality of their information. Implementation and compliance with these regulations are costly.

Even after receiving FDA and foreign regulatory clearance or approval, our products may be subject to product recalls, which may harm us.

The FDA and similar governmental authorities in other countries have the authority to make a mandatory recall or order the removal from the market of our products in the event of material deficiencies or defects in design, manufacture, or labeling of devices. Any recall of our products may materially adversely affect our profitability, divert managerial resources and harm our reputation.

We may lose significant customers as a result of substantial consolidation within the health care industry.

Over the past several years, the health care industry, including many of our customers, has undergone significant consolidation, and we expect this trend to continue. We are subject to risks and uncertainties that result from mergers and acquisitions involving our customers. If, as a result of such mergers or combinations, our customers lose control of the purchasing function, decide to use one of our competitors or reduce their orders for our products, our revenues may be materially adversely affected.

Government and private insurance plans may not reimburse our customers for our products, which could result in reductions in sales or selling prices for our products.

The cost of medical care in the United States and many other countries is funded substantially by government and private insurance programs. If such funding becomes limited or unavailable to our customers, our business may be adversely affected. Although we do not generally receive payment for our products or services directly from these payors other than for our sleep diagnostic services, our continued success is dependent upon the ability of patients or our customers to obtain adequate reimbursement for our products and services. In most major markets, our products are purchased primarily by hospitals which in turn bill third-party payors or bill patients directly who then seek reimbursement from third-party payors.

In the United States, third-party payors include Medicare, Medicaid and private health insurance providers. These payors may deny reimbursement if they determine that a device has not received appropriate FDA clearance, is not used in accordance with approved indications, or is experimental, unnecessary or deemed to be inappropriate treatment for the patient. Third-party payors are also increasingly challenging prices charged for medical products and services. We cannot assure you that our products will be considered cost-effective by third-party payors, that reimbursement will be available, or that payors' reimbursement policies will not adversely affect our ability to sell our products on a profitable basis, if at all.

Health care reimbursement systems vary from country to country and, accordingly, we cannot assure you that third-party reimbursement available under one system will be available for procedures utilizing our products under any other reimbursement system. Lack of, or inadequate reimbursement by, government and other third-party payors for our products would have a material adverse effect on our business, financial condition and results of operations.

Health care reform proposals are gaining substantial support in the United States Congress and state legislatures and could impact the profitability of our business.

The United States health care industry is subject to several reform proposals, including more stringent regulations. It is uncertain whether and when such proposals would become legal

requirements affecting our business, but we cannot assure you that any such changes will not have a material adverse effect on our business. Changes in the law or new interpretations of existing laws may have a dramatic effect on the costs associated with doing business and the amount of reimbursement our customers receive from both government and third-party payors. Federal, state and local government representatives will, in all likelihood, continue to review and assess alternative regulations and payment methodologies.

We incur expenses to comply with environmental, health and safety laws and regulations.

We are subject to numerous environmental, health and safety laws and regulations, including those governing the use and disposal of hazardous materials. We incur expenses to comply with such laws and regulations and any violation of these laws and regulations could have a material adverse effect on our business, financial condition and results of operations.

Risks related to our business

The markets for our products and services are highly competitive and we compete against substantially larger companies.

Competition among medical device companies is intense. If we are unable to compete effectively with existing or future competitors, we may be prevented from retaining our existing customers or from attracting new customers, which could materially impair our business. There are a number of companies that currently offer, or are in the process of developing, products that compete with products that we offer. We cannot assure you that some of these competitors will not succeed in developing products that are more effective and/or less expensive than those currently used or produced by us or that would render some products offered by us obsolete or non-competitive. Many of our competitors have greater financial, research and development, manufacturing and marketing resources than we have and may be in a better position than we are to withstand the adverse effects on gross margins and profitability caused by price decreases prevalent in this competitive environment.

The presence of group purchasing organizations may affect our competitive position, our pricing and ultimately our profits.

Our ability to sell our products to hospitals depends on our relationships with group purchasing organizations. In fiscal 2005, sales of our anesthesia and respiratory/critical care products related to our group purchasing arrangements amounted to \$30.0 million, representing 33.9% of our net revenue from United States hospital sales. In 2006, our contracts with several of the group purchasing organizations with which we have relationships will terminate unless the parties mutually agree to renew them. In fiscal 2005, we had net revenues of \$17.0 million under the contracts subject to termination or renewal in 2006. We cannot assure you that we will be able to renew these contracts at the current or substantially similar terms. If we are unable to keep our relationships and develop new relationships with group purchasing organizations, our competitive position would likely suffer. In addition, some group purchasing organizations have tested the use of new internet bidding procedures in order to maximize their abilities to negotiate lower prices with suppliers. Movement to these bidding modalities has been implemented by some organizations and has resulted in lower pricing in some instances. We cannot assure you that continued movement to these bidding modalities will not increase. This may result in lower pricing or failure to secure contracts with these organizations.

We could lose customers and our business could be adversely affected if our competitors implement new technologies before we do.

The market for our products is characterized by frequent product improvements and evolving technology. Our revenue and profitability could be adversely affected by technological change. To compete effectively, we must anticipate and adapt to technological changes and offer, on a timely

basis, competitively priced products with new and improved features that meet evolving industry standards and customer preferences. We may choose to develop or invest in new technologies that prove to be ineffective, do not gain market acceptance or are incompatible with technologies of our customers. As new technologies develop, we may be forced to implement these new technologies at a substantial cost to us in order to remain competitive. In addition, competitors may implement new technologies which allow them to offer lower-priced and/or superior quality products which may render our products obsolete or uncompetitive.

We are dependent on a single supplier for one of our key products.

Since 1980, we have purchased our anesthesia face masks from a single source, Respironics, Inc., which maintains a site in the People's Republic of China at which it manufactures face masks for our anesthesia segment. If we are unable to obtain our anesthesia face masks from Respironics, or an alternate supplier, our business and revenue would be significantly and adversely affected. Sales of our anesthesia face masks, and products and systems which include our anesthesia face masks, such as our general anesthesia systems and breathing circuits, represented approximately 15.1% of our net revenue during our 2005 fiscal year. Our current exclusive supply agreement with Respironics extends through June 2012, unless either party provides notice of termination prior to January 1, 2007. We expect that we and/or Respironics may seek to negotiate modifications in our agreement prior to January 1, 2007, but do not expect that such negotiations will result in the termination of our exclusive supply agreement with Respironics or that any agreed-upon modifications will lead to a significant change in our overall relationship with Respironics. If the supply of our anesthesia face masks from Respironics is interrupted or ceases for any reason, we would experience significant disruption in our business. Although we believe that there may be one or more alternate suppliers that could supply us with face masks if our relationship with Respironics were interrupted or ceased for any reason, we have not as yet qualified any other supplier or made any determination as to whether any alternate supplier would have the capacity to manufacture anesthesia face masks in the quantities we require. Pursuant to our agreement with Respironics, we are precluded from purchasing anesthesia face masks from other sources unless Respironics is unable to supply face masks in accordance with the agreement. In the event of such an interruption or termination of our supply agreement, we may not be able to obtain anesthesia face masks in a sufficient quantity or at a cost-effective price, which would have a material adverse effect on our business, financial condition and results of operations.

We are dependent on a limited number of suppliers for key components of some of our products and delivery delays or the loss of vendors could adversely affect our business.

We rely on vendors to supply the key components of some of our products. During fiscal 2005, a component vendor advised our Breas subsidiary that it was unable to deliver a sufficient quantity of a key component at our required specifications. As a result, Breas was unable to bring a new sleep disorder and personal ventilation product line to market in a timely manner. Since we had pre-announced the availability of that product line, orders for pre-existing products were reduced substantially and the unavailability of the new products negatively affected Breas' 2005 revenues. We cannot assure you that we will not experience similar delays from this or other vendors of key components in the future. In the event we are unable to obtain components for any of our products, or are unable to obtain components on commercially reasonable terms, we may not be able to manufacture or distribute our products on a timely and competitive basis, or at all. If we experience any delays in component availability, the cost incurred in switching business to alternate suppliers could have a material adverse effect on our business, financial condition and results of operations.

If we lose key personnel, or are unable to attract and retain additional highly skilled personnel required to lead our company and to enable us to grow our activities, our business would likely suffer.

Our success is dependent on key personnel, including Terry D. Wall, our president and chief executive officer, Barry Wicker, our executive vice president and chief operating officer, and other members of our senior management. Mr. Wall is 64 years of age and has recommended to our Board of Directors that it plan on naming a successor chief executive officer by December 2008. Mr. Wall has no intention of discontinuing active involvement in our company either before or after his successor has been named, but believes that his specific role beyond 2008 will have to be assessed as that time period approaches. Once Mr. Wall's successor has assumed the position of chief executive officer, Mr. Wall's active involvement may consist of leading special projects that take advantage of Mr. Wall's substantial experience in identifying new products for future sale by our company. Mr. Wicker is 65 years of age and has indicated that he plans to remain as an executive officer of the Company at least through the end of the 2006 fiscal year, and to assess retirement possibilities at the end of such year. Even after retirement as an officer, Mr. Wicker's desire is to remain as a member of our Board of Directors and to provide ongoing counsel to us. We have no employment agreement with Mr. Wall, Mr. Wicker or any other executive officer. If Mr. Wall were to cease working for our company prior to the time that we transition to a new chief executive officer, or if we are unable to identify a viable successor to Mr. Wall, or if Mr. Wicker were unavailable to provide advice to us, our business would likely suffer.

To successfully expand our operations, we will need to attract and retain additional, highly skilled individuals, particularly in the areas of sales, marketing, manufacturing and finance. If we cannot attract sufficient skilled individuals, we may not be able to successfully grow our business and our business, financial condition and results of operations would be materially adversely affected.

Our success depends upon the development of new products and product enhancements, which entails considerable time and expense.

We place a high priority on the development of new products to add to our product portfolio and on the development of enhancements to our existing products. Product development involves substantial expense and we cannot be certain that a completed product will generate sufficient revenue for our business to justify the resources that we devote to research and development related to such product. The time and expense required to develop new products and product enhancements is difficult to predict and we cannot assure you that we will succeed in developing, introducing and marketing new products and product enhancements. Our inability to successfully develop and introduce new or enhanced products on a timely basis or at all, or to achieve market acceptance of such products, could materially impair our business.

Price changes in the raw materials we use could have a material adverse effect on our financial condition and results of operations.

The principal raw material used to produce our products is plastic resin, a petro-chemical compound. We have elected to purchase plastic resin under short term contracts rather than entering into long-term contracts or commodity futures or derivative instrument transactions. We are, therefore, subject to fluctuations in the price of plastic resin that may result from changes in the price of petroleum-based products generally, increases or decreases in demand during a given period, or for other reasons. As a result of price competition, we may be unable to pass on to customers the higher manufacturing costs we would incur if there were a significant increase in the price of plastic resin or other raw materials, which would negatively impact our profit margins and our results of operations.

If we are unable to identify, complete and integrate future acquisitions, our business may suffer.

We have supplemented internal growth with product, technology and business acquisitions in the past, and intend to do so in the future. Our acquisition strategy is subject to inherent risks, including the following:

- viable acquisition candidates may not be available to us on price and other terms that are satisfactory to us;

- we may be unable to integrate acquired companies effectively into our business;
- we may be unsuccessful in commercializing products that we manufacture pursuant to acquired or licensed patents;
- acquired companies may require more capital resources and/or management attention than we anticipate at the time of acquisition;
- we may have limited or no direct prior experience in new markets or countries that we enter;
- we may be unable to retain the key employees of the acquired business who are necessary to manage these businesses;
- we may suffer adverse customer reaction to the business combination;
- our due diligence may fail to identify liabilities and exposures which, once discovered, materially adversely affect our ability to operate the newly acquired business profitably; and
- management focus on our existing businesses may be diverted.

In addition, an acquisition could materially impair our operating results by causing us to incur debt or requiring us to amortize acquisition expenses and acquired assets.

We are subject to legal proceedings which, if determined adversely to us, could materially and adversely impact us.

We are engaged in certain substantial legal proceedings. In one instance, former shareholders of Vital Pharma, a subsidiary currently classified as a discontinued operation, are seeking damages of approximately \$14.0 million relating to the sale of that subsidiary to us in January 1996. The Vital Pharma shareholders' claims, which are contractual in nature and thus not subject to any insurance policy that we maintain, have been presented to an arbitrator for determination. While we believe that we have meritorious defenses, we are unable to predict the outcome of this arbitration.

We are also involved in a number of negligence and product liability lawsuits relating to an anti-adhesion product for gynecological surgery known as Intergel. Intergel was manufactured by Lifecore Biomedical, Inc. and distributed by Ethicon, Inc., a subsidiary of Johnson & Johnson. Vital Pharma packaged the Intergel product into plastic containers. Although we believe that we have meritorious defenses to this litigation, as well as indemnification protection from Lifecore and product liability insurance as described below, we cannot be certain that monetary damages will not be recoverable against Vital Pharma. For additional information regarding our involvement in legal proceedings, see the section entitled "Business—Legal proceedings" beginning on page 59.

The amount of damages claimed in the Vital Pharma and Intergel matters is substantial. If we are required to pay significant sums in these matters, our consolidated results of operations, cash flows and financial condition could be materially and adversely affected.

We cannot be certain that our product liability insurance will be sufficient to protect us against significant exposure to product liability risks.

We are exposed to potential product liability resulting from the use of our products. We presently maintain product liability insurance coverage of \$20.0 million in the aggregate. Our product liability policy generally protects us against claims of bodily injury or property damage arising out of any products manufactured, sold or distributed by us. If a judgment in a product liability suit were entered against us or we entered into a settlement agreement in excess of a policy limit or outside the scope of coverage, including for example, punitive damages, our profitability and financial

condition may be materially adversely affected. We cannot assure you that our current level of insurance will be sufficient to cover product liability claims or that such coverage will remain available to us on satisfactory terms, if at all. We have been advised by the carriers of our primary and umbrella liability insurance policies that in light of the number of lawsuits involving the Intergel product, we may be underinsured. To the extent that we are underinsured in the Intergel matter, it would be necessary for us to rely on indemnification protection given to us by

the manufacturer of the Intergel product and legal causes of action that we believe we have against the distributor of the Intergel product, which may or may not be successful.

We manufacture and sell a significant portion of our products in markets outside the United States, subjecting us to various risks relating to international activities.

International sales accounted for approximately 24.1% of our net revenue during fiscal 2005. Such sales are subject to several risks that are separate and distinct from those we face in our United States operations, including:

- difficulties in enforcing agreements and collecting receivables through certain foreign legal systems;
- foreign customers who may have longer payment cycles than customers in the United States;
- difficulties in enforcing intellectual property rights;
- currency losses that may arise as a result of the fact that not all of our sales are denominated in United States dollars;
- compliance with foreign medical device manufacturing and sales regulations in the countries in which we sell and/or manufacture our products;
- changes in trade policies and in domestic and foreign tax policies in the countries in which we sell and/or manufacture our products;
- possible changes in export or import restrictions in the countries in which we sell and/or manufacture our products;
- the modification or introduction of other governmental policies or regulations in the countries in which we sell and/or manufacture our products; and
- political uncertainties in countries in which we sell and/or manufacture our products, in particular in the People's Republic of China, where our supplier of anesthesia face masks is located.

Any such factor may affect our international operations and our potential for growth in markets outside of the United States and may have a significant adverse effect on the sales of our products and our profitability.

Our international sales may be adversely affected as a result of the termination of our strategic alliance and distribution contract with one of our primary international distributors.

In November 2005, our strategic alliance and distribution agreement with Rusch International was terminated by the parties following the acquisition by Rusch's parent of one of our competitors. Prior to the termination of this agreement, Rusch was our distributor of anesthesia and respiratory/critical care products in nine European countries where it has a direct sales force. For our 2005 fiscal year, sales through Rusch accounted for 0.9% of our net revenues. At least for a period of time, we expect to continue to sell through a number of Rusch's country-specific distribution channels. We are simultaneously evaluating alternative distribution methods, including partnering with third-party distributors in certain counties. Developing a distribution network is a difficult, expensive and time-consuming process and we may be unsuccessful in implementing a new network. Factors that may inhibit the implementation of a new international distribution network include difficulties in locating qualified personnel, difficulties in developing direct relationships with customers and/or effective local distributors and responding to competing needs for company resources and management attention. We cannot assure you that we will not lose customers or business or that we will be able to sustain the revenue levels that we achieved while we were represented by Rusch.

If we are unable to maintain relationships with distributors, our business may be adversely affected.

Certain hospitals require us to sell products to them through distributors. For fiscal 2005, approximately 22% of our net revenue was distributed through Cardinal Health Corporation, McKesson-General Medical Corp. and Owens & Minor, Inc. If our relationship with these distributors were damaged and we were unable to develop relationships with other distributors, our business, financial condition and results of operations could be materially adversely affected.

We may not be able to obtain new patents or protect our existing patents, which could enable third-parties to use our technology.

Our ability to compete effectively depends in part on our ability to maintain the proprietary nature of our technologies and manufacturing processes, which includes the ability to obtain, protect and enforce patents on our technology and products. If we are unable to obtain new patents and protect our existing patents, our competitive position may suffer. We own or have licensed patents that cover several aspects of our anesthesia, respiratory/critical care and sleep disorder segments. Others may challenge our patents and, as a result, our patents could be narrowed, invalidated or rendered unenforceable. Competitors may develop products similar to ours which our patents do not cover. In addition, our current and future patent applications may not result in the issuance of patents in the United States or foreign countries. Further, there is a substantial backlog of patent applications at the United States Patent and Trademark Office, and the approval or rejection of patent applications may take several years. Additionally, many of our products are not protected by patents, but rather are distinguished by product features that others may seek to copy.

Our competitive position is dependent in part upon unpatented trade secrets which we may not be able to protect.

Our competitive position is also dependent upon unpatented trade secrets. Trade secrets are difficult to protect and we cannot assure you that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets. If other companies are successful in copying our trade secrets and developing products similar to ours, we may lose our competitive position and our revenue may be significantly impacted.

We seek to protect our trade secrets, know-how and other unpatented proprietary technology, in part, with confidentiality agreements with select employees. We cannot assure you, however, that:

- these agreements will not be breached;
- we will have adequate remedies for any breach; or
- trade secrets, know-how and other unpatented proprietary technology will not otherwise become known to or independently developed by our competitors.

We hold licenses with third parties that are necessary to produce some of our products. The loss of such licenses would prevent us from manufacturing, marketing and selling these products, which could harm our business.

Our success is dependent in part on our ability to operate without infringing or misappropriating the proprietary rights of others.

We have been sued in the past, and may in the future be sued again, for infringing the intellectual property rights of others. In addition, we may find it necessary, if threatened, to initiate a lawsuit seeking a declaration from a court that we do not infringe the proprietary rights of others or that others' rights are invalid or unenforceable. Even if we prevail in such litigation, infringement proceedings can be very expensive and time-consuming. If we do not prevail in an infringement litigation, we may be required to pay damages and expenses, and we would be required to stop the infringing activity or obtain a license. Any required license may not be available to us on

acceptable terms, or at all. In addition, some licenses may be nonexclusive, and, therefore, our competitors may have access to the same technology licensed to us. If we fail to obtain a required license or are unable to design around a patent, we may be unable to sell some of our products, which could have a material adverse effect on our business. We may decide not to introduce a product in the United States or a foreign country based on potential risk of patent infringement litigation.

Government regulation restricts the manner in which we may sell our obstructive sleep apnea products to customers of our sleep centers and the manner in which we relate to referring physicians.

We operate sleep centers and laboratories in the United States that diagnose obstructive sleep apnea and other sleep disorders. Our ability to sell our Breas products in our sleep centers and laboratories is restricted by strict regulations which prohibit us from diverging from a physician's prescription. If a physician prescribes a continuous positive airway pressure, or CPAP, product other than a Breas product for a patient at one of our sleep centers or laboratories, we are generally prohibited by federal regulations from substituting a Breas product. Federal anti-kickback and anti-referral regulations strictly limit the extent to which we may provide anything of value to physicians who refer Medicare or Medicaid patients to our sleep centers or laboratories. Any failure by us to comply with these regulations may result in significant regulatory actions, including criminal prosecution and large fines, which could have a material adverse effect upon our business, financial condition and results of operations.

If we are unable to support our continued growth, our business may suffer.

As we grow, the complexity of our operations increases, placing greater demands on our management. Our ability to manage our growth effectively depends in part upon our ability to implement and improve our financial and management information systems on a timely basis and to effect other changes in our business. If we fail to manage our growth effectively, our business could suffer. Unexpected difficulties during expansion, the failure to attract and retain qualified employees, the failure to successfully replace or upgrade our management information systems, the failure to manage costs or our inability to respond effectively to growth opportunity or plan for future expansion could cause our growth to slow down or could require us to reduce our size.

A significant shift in technologies or methods used in the treatment of sleep apnea could make our sleep centers and products obsolete or less attractive.

The development of new technologies or methods could reduce demand for our sleep centers and laboratories and our sleep disorder products. For example, pharmaceutical advances could result in different methods of treating sleep apnea and a reduced need for our CPAP therapy products. The emergence of a low-invasive cost-effective surgery to treat sleep apnea could also diminish demand for our sleep products and our sleep centers and laboratories.

If a natural or man-made disaster strikes one or more of our manufacturing facilities, we may be unable to manufacture certain products for a substantial amount of time and our revenue could decline.

We have four manufacturing facilities located in the United States and one manufacturing facility located in Sweden. These facilities and the manufacturing equipment and personnel know-how that we use to produce our products would be difficult to replace and could require substantial lead-time to repair or replace. Our facilities may be affected by natural or man-made disasters. In the event that one of our facilities was affected by a disaster, we would be forced to attempt to shift production to our other manufacturing facilities or rely on third-party manufacturers, and our other facilities or a third-party manufacturer may not have the capability to effectively supply the affected products. Although we have insurance for damage to our property and the interruption of

our business, this insurance may not be sufficient in scope or amount to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all.

Requirements associated with the evaluation of internal controls required by Section 404 of the Sarbanes-Oxley Act of 2002 have required and will require significant company resources and management attention.

Although we believe that we are currently in compliance with Section 404 of the Sarbanes-Oxley Act, we may in the future identify material deficiencies that we may not be able to remediate on a timely basis. If we are not able to comply with the requirements of Section 404 in a timely manner, we could be subject to scrutiny by regulatory authorities, such as the Securities and Exchange Commission or SEC, or the NASDAQ National Market, and the trading price of our stock could decline. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important in helping us to prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

Risks related to purchasing our common stock in this offering

Our quarterly operating results are subject to fluctuation which may impact the price of our stock.

Our operating results have, from time to time, fluctuated on a quarterly basis and may be subject to similar fluctuations in the future. These fluctuations may result from a number of factors, including:

- the introduction of new products by us or our competitors;
- actions taken by group purchasing organizations;
- timing of orders by our customers;
- the mix of our product sales;
- competitive pricing in different regions in which we sell our products;
- timing and cost of regulatory clearances and approvals of our products;
- the cost, effect and success of our promotional and marketing programs;
- the effect of the flu season on our respiratory/critical care business;
- loss of any of our key management or technical personnel;
- product liability lawsuits against us;
- changes in health care policy in the United States and internationally;
- conditions in the financial markets in general or changes in general economic conditions;
- changes in stock market analyst recommendations regarding our common stock, other comparable companies or the medical device industry generally, or lack of analyst coverage of our common stock;
- changes in accounting principles;

- expenditures incurred by us for research and development; and
 - expenditures incurred by us to comply with enhanced regulatory obligations and internal control requirements.
- Any of these factors may cause the price for our common stock to fluctuate and therefore decrease the value of your investment in our company.

A substantial portion of our assets includes goodwill and an impairment in the value of our goodwill would have the effect of decreasing our earnings or increasing our losses.

As of September 30, 2005, goodwill represented 30.4% of our total assets. If we are required to record an impairment charge to earnings relating to goodwill, it will have the effect of decreasing our earnings or increasing our losses. Goodwill represents the excess of the total purchase price of our acquisitions over the fair value of the net assets acquired. The accounting standards on goodwill and other intangible assets, which we adopted as of October 1, 2001, require goodwill to be reviewed at least annually for impairment, and do not permit amortization. In the event that impairment is identified, a charge to earnings will be recorded and our stock price may decline as a result.

A large percentage of our outstanding common stock is held by insiders, and, as a result, the trading market for our common stock is less liquid and our stock price can be volatile.

After the completion of this offering and assuming no exercise of stock options after December 1, 2005, other than the exercise of options covering 20,000 shares of our common stock by one of the selling shareholders in connection with this offering, we will have 13,052,044 shares of common stock outstanding. If the underwriters' overallotment option is not exercised, approximately 17.3% of our outstanding shares will continue to be beneficially owned by Terry D. Wall, our chief executive officer, and his wife, an additional 12.7% of our outstanding shares will continue to be beneficially owned by trusts established for the benefit of the Walls' children and an additional 11.2% of our outstanding shares will continue to be beneficially owned by an estate planning trust established by Terry D. Wall. Such trusts are administered by trustees who have no current or prior relationship with Vital Signs. Companies like ours, with a relatively small percentage of shares held by the public, can be subject to a more volatile stock price. Our stock price, and therefore your investment in our company, may be volatile.

Our major shareholders will continue to exercise significant influence on us after this offering and they may pursue policies with which you disagree.

As of December 22, 2005, Terry D. Wall, our chief executive officer, and his wife beneficially owned 17.9% of our outstanding common stock. In addition, trusts established for the benefit of the Walls' children beneficially owned 19.2% of our outstanding common stock and an estate planning trust established by Terry D. Wall beneficially owned 15.9% of our outstanding common stock. Pursuant to the terms of the estate planning trust, any one of four members of a committee, comprised of Mr. Wall's adult children, brother and sister, may cause the assets of that trust, including the net proceeds from the sale of shares offered hereby, to be transferred to Terry D. Wall. Upon consummation of this offering, it is expected that Mr. Wall and his wife will continue to have a significant influence in electing our directors, appointing new management and approving any action requiring the approval of our shareholders, including any amendment to our certificate of incorporation and approval of mergers or sales of substantially all of our assets. This influence may also have the effect of delaying or preventing a change in control of our company or discouraging others from making tender offers for our shares, which could prevent stockholders from receiving a premium for their shares.

There are a substantial number of shares of common stock which will be available for sale in the market upon consummation of this offering which could adversely affect our stock price.

Upon completion of this offering, we will have 13,052,044 shares of common stock outstanding, assuming no exercise of outstanding options subsequent to December 1, 2005, other than the exercise of options covering 20,000 shares of our common stock by one of the selling shareholders in connection with this offering. The common stock sold in this offering will be freely tradable without further restriction or further registration under the Securities Act of 1933, except for shares purchased by affiliates of ours, which will be subject to the limitations of Rule 144 under the Securities Act. The remaining outstanding shares may be resold in the market, subject to time

and volume limitations imposed pursuant to Rule 144 with respect to shares held by affiliates and subject to a 90-day lock-up which will apply to 5,563,171 shares of common stock held by our directors, executive officers and the selling shareholders. Sales of a substantial number of such shares may have a disruptive effect on the market price of our common stock.

Our certificate of incorporation, our by-laws and New Jersey law contain provisions that could discourage another company from acquiring us and may prevent attempts by our stockholders to replace or remove our current management.

Anti-takeover provisions in our certificate of incorporation make it more difficult for a third-party to acquire us, even if doing so would be beneficial to our shareholders. These provisions include:

- the authorization of the issuance of up to 4,000,000 shares of our preferred stock without further approval of our shareholders;
- the election of directors on a staggered term basis; and
- the elimination of shareholder action by written consent.

Similarly, our by-laws establish procedures, including advance notification procedures, with regard to the nomination, other than by or at the direction of our board of directors, of candidates for election as directors or for shareholder proposals to be submitted at shareholder meetings.

We are also subject to the New Jersey Shareholders Protection Act, an anti-takeover provision. In general, that Act prevents a shareholder owning 10% or more of a New Jersey public corporation's outstanding voting stock from engaging in business combinations with that corporation for five years following the date the shareholder acquired 10% or more of the corporation's outstanding voting stock, unless board approval is obtained prior to the time that the shareholder reaches the 10% threshold.

These provisions are expected to discourage different types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of our company to first negotiate with our board of directors. At the same time, however, these provisions make it more difficult for a third-party to successfully acquire us, even if the acquisition were beneficial to our shareholders, and thus could prevent shareholders from receiving a premium for their shares.

Forward-looking statements

This prospectus contains forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934) that are based on our management's beliefs and assumptions and on information currently available to us. These statements may be found throughout this prospectus, particularly under the headings "Prospectus summary," "Risk factors," "Business" and "Management's discussion and analysis of financial condition and results of operations". These sections contain discussions of some of the factors that could cause actual results to differ materially from the results projected in our forward-looking statements. When used in this prospectus, the words or phrases "will likely result," "expects," "intends," "will continue," "is anticipated," "estimates," "projects," "management believes," "we believe" and similar expressions are intended to identify "forward-looking statements" within the meaning of the Exchange Act and the Securities Act. Forward-looking statements include plans and objectives of management for future operations. These forward-looking statements involve risks and uncertainties and are based on assumptions that may not be realized. Actual results and outcomes may differ materially from those discussed or anticipated.

All forward-looking statements are subject to known and unknown risks and uncertainties, including those discussed in the section entitled "Risk factors," that could cause actual results to differ materially from historical results and those presently anticipated or projected. No forward-looking statement is a guarantee of future performance. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. You should read our cautionary statements as being applicable to all related forward-looking statements whenever they appear in:

- this prospectus and materials referred to in this prospectus;
- the materials incorporated by reference into this prospectus; and
- our press releases.

Use of proceeds

We expect to receive net proceeds of approximately \$18.3 million from the sale of 434,000 shares of common stock by us, based on an assumed public offering price of \$45.85 per share and after deducting underwriting discounts and commissions and estimated offering expenses. Each \$1 increase (decrease) in the public offering price per share would increase (decrease) our net proceeds, after deducting underwriting discounts and commissions and estimated offering expenses to be paid by us, by \$410,000. We will receive no proceeds from shares sold by the selling shareholders.

We will retain broad discretion in the allocation of the net proceeds in this offering. We currently intend to use the proceeds received by us from this offering:

- to finance possible acquisitions of complementary products, technologies or businesses; and
- for working capital and other general corporate purposes.

Pending such uses, we intend to invest the net proceeds of this offering in interest bearing, investment grade securities. We are not presently pursuing any acquisitions that have reached the stage where we consider it probable that they will be consummated.

Price range of our common stock and dividend history

Our common stock trades on the NASDAQ National Market under the symbol "VITL." The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported on the NASDAQ National Market and the per share dividends declared on our common stock:

	High	Low	Dividend
Fiscal 2004—quarter ended			
December 31, 2003	\$ 34.08	\$ 29.01	\$ 0.06
March 31, 2004	35.75	30.00	0.06
June 30, 2004	34.00	26.70	0.06
September 30, 2004	33.72	27.65	0.06
Fiscal 2005—quarter ended			
December 31, 2004	\$ 39.84	\$ 31.84	\$ 0.06
March 31, 2005	42.93	35.22	0.07
June 30, 2005	45.72	38.33	0.07
September 30, 2005	48.80	41.81	0.07
Fiscal 2006—quarter ended			
December 31, 2005	\$ 48.50	\$ 42.52	\$ 0.07
March 31, 2006 (through January 17, 2006)	\$ 47.23	\$ 43.64	—

On January 17, 2006, the last reported sale price for our common stock on the NASDAQ National Market was \$45.85 per share. As of November 30, 2005, there were 310 holders of record of our common stock. This number of record holders does not represent the actual number of beneficial owners of shares of our common stock because shares are frequently held in "street name" by securities dealers and others for the benefit of individual owners who have the right to vote their shares.

We expect to continue to pay dividends on our common stock. However, the declaration of dividends is subject to the discretion of our board of directors and will depend upon various factors, including our financial condition, capital requirements, loan agreement restrictions and earnings, as well as such other factors as our board may deem relevant.

Capitalization

The following table shows our cash and total capitalization as of September 30, 2005 on:

- an actual basis; and
- an as adjusted basis to give effect to the sale by us of 434,000 shares of common stock in this offering, at an assumed offering price of \$45.85 per share, net of underwriting discounts and commissions and estimated offering expenses to be paid by us and the expected issuance of 20,000 shares of our common stock resulting from the exercise of certain stock options held by one of the selling shareholders in connection with this offering. Each \$1 increase (decrease) in the public offering price per share would increase (decrease) the as-adjusted figure shown below for common stock by \$410,000, after deducting underwriting discounts and commissions and estimated offering expenses to be paid by us.

This table should be read in conjunction with the consolidated financial statements and notes to those consolidated financial statements included elsewhere in this prospectus.

September 30, 2005 (in thousands)	Actual	As adjusted
Cash and cash equivalents	\$ 81,767	\$ 100,483
Debt	—	—
Common stock, no par value; 40,000,000 shares authorized; 12,593,579 shares issued and outstanding, actual; 13,047,579 shares issued and outstanding, as adjusted	18,832	37,548
Accumulated other comprehensive income	2,012	2,012
Retained earnings	211,862	211,862
Total shareholders' equity	232,706	251,422
Total capitalization	232,706	251,422

The number of shares of common stock shown as issued and outstanding in the table above excludes the following as of September 30, 2005:

- 577,211 shares subject to outstanding options at a weighted average exercise price of \$29.83 per share (after the assumed issuance of 20,000 shares upon the exercise of certain stock options by one of the selling shareholders in connection with this offering); and
- 1,604,602 additional shares available for future grants under our existing stock option plans.

Selected consolidated financial data

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and notes to those consolidated financial statements, beginning on page F-1, and “Management's discussion and analysis of financial condition and results of operations,” beginning on page 25. The consolidated statement of income data for the years ended September 30, 2005, 2004 and 2003, and the consolidated balance sheet data as of September 30, 2005 and 2004, are derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The consolidated statement of income data for the years ended September 30, 2002 and 2001, and the consolidated balance sheet data as of September 30, 2003, 2002 and 2001, are derived from our audited consolidated financial statements, which are not included in this prospectus.

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Year ended September 30,
(in thousands, except per share data)

	2005	2004	2003	2002	2001
Consolidated statement of income data:					
Net revenue	\$ 194,037	\$ 183,991	\$ 182,163	\$ 174,018	\$ 163,142
Cost of goods sold and services performed	95,507	91,374	91,608	86,803	78,080
Gross profit	98,530	92,617	90,555	87,215	85,062
Operating expenses:					
Selling, general and administrative	51,025	50,115	51,338	44,216	41,063
Research and development	7,011	7,036	5,871	6,615	6,937
Restructuring charge	213	539	—	—	—
Impairment and other charges (benefits) (1)	—	—	133	(3,428)	2,107
Goodwill amortization (2)	—	—	—	—	1,120
Other (income) expense—net	(78)	612	717	305	(390)
Total operating expenses	58,171	58,302	58,059	47,708	50,837
Operating income	40,359	34,315	32,496	39,507	34,225
Interest income	(1,672)	(824)	(654)	(638)	(976)
Interest expense	36	26	910	179	1,028
Total other (income) expense	(1,636)	(798)	256	(459)	52
Income from continuing operations before provision for income taxes and minority interest	41,995	35,113	32,240	39,966	34,173
Provision for income taxes	15,093	12,498	12,802	13,225	9,794
Income from continuing operations before minority interest	26,902	22,615	19,438	26,741	24,379
Minority interest in net income of subsidiary	602	447	248	241	9
Income from continuing operations (3)	\$ 26,300	\$ 22,168	\$ 19,190	\$ 26,500	\$ 24,370
Earnings from continuing operations per common share:					
Basic	\$ 2.08	\$ 1.73	\$ 1.49	\$ 2.05	\$ 1.93
Diluted	\$ 2.06	\$ 1.72	\$ 1.48	\$ 2.03	\$ 1.90
Basic weighted average number of shares outstanding	12,616	12,793	12,905	12,896	12,633
Diluted weighted average number of shares outstanding	12,789	12,907	12,985	13,036	12,850
Dividends declared and paid per common share	\$ 0.27	\$ 0.24	\$ 0.19	\$ 0.16	\$ 0.16

(1) For fiscal 2001, excludes special charges associated with operations currently classified as discontinued operations; the impairment charges for that year relate primarily to the writedown of certain investments. During

fiscal 2002, we reversed \$5.0 million in litigation accruals as a result of the successful conclusion of a patent infringement suit. This benefit was offset in part by an impairment charge of \$1.6 million related principally to our Chinese distributor, based on an evaluation of its business. The charge in fiscal 2003 relates to the write-off of certain amounts due from our Chinese distributor.

- (2) In October 2001, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." Assuming no amortization of goodwill for the year ended September 30, 2001, income from continuing operations would have been \$25.2 million for that year.
- (3) In fiscal 2003, we classified our Vital Pharma business as a discontinued operation. Accordingly, the results of Vital Pharma are not included in continuing operations.

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The as-adjusted balance sheet data summarized below reflects the sale by Vital Signs of 434,000 shares of common stock in this offering at an assumed offering price of \$45.85 per share after deducting underwriting discounts and commissions and estimated offering expenses, and the expected issuance of 20,000 shares of common stock resulting from the exercise of certain stock options by one of the selling shareholders in connection with this offering. Each \$1 increase (decrease) in the public offering price per share would increase (decrease) the as-adjusted figure shown below for total shareholders' equity by \$410,000, after deducting underwriting discounts and commissions and estimated offering expenses to be paid by us.

At September 30, (in thousands)	2005 (as adjusted)	2005	2004	2003	2002	2001
Consolidated balance sheet data:						
Cash and cash equivalents	\$ 100,483	\$ 81,767	\$ 76,468	\$ 55,660	\$ 29,303	\$ 31,029
Working capital	138,271	119,555	112,853	98,469	86,600	70,493
Total assets	272,418	253,702	236,064	223,078	205,077	191,560
Total long term debt including current portion	—	—	—	1,690	1,955	2,199
Total shareholders' equity	251,422	232,706	216,223	202,222	187,815	160,626

For information regarding acquisitions effected during the past five years, see "Management's discussion and analysis of financial condition and results of operations—Overview—Acquisitions".

**Management's discussion and analysis of
financial condition and results of operations**

The following discussion should be read in conjunction with our consolidated financial statements and notes to those consolidated financial statements, included elsewhere in this prospectus.

Overview

We are a leading designer, manufacturer and marketer of airway management products for the anesthesia, respiratory/critical care and sleep disorder markets. We sell our products in over 70 countries worldwide. We offer one of the broadest single-patient use anesthesia and respiratory/critical care product lines in the industry and have developed numerous innovative products which are now considered industry standards. In addition, we sell therapeutic products for patients suffering from sleep disorders and provide sleep disorder diagnoses at sleep centers and laboratories that we operate. We also deliver technology services to companies regulated by the FDA.

Anesthesia

Our single-patient use anesthesia products and systems are designed to deliver oxygen and anesthesia from a gas source, such as an anesthesia machine, to a patient's pulmonary system, remove anesthetic gases, oxygen and carbon dioxide from a patient and link a patient with various monitors. Our principal anesthesia products consist of face masks, breathing circuits and general anesthesia products. See the section entitled "Business—Principal products and services—Anesthesia." We also include within this segment the products sold by our Thomas Medical Products subsidiary. Thomas Medical is an original equipment manufacturer that primarily manufactures vascular access products for sale to other health care product providers to be used in their products or kits or as a finished product.

Revenues in our anesthesia segment are driven primarily by the extent to which our hospital customers perform general surgeries and by the aging of the populations in the geographical markets that we serve. In addition, because most of our anesthesia products are single use products, we benefit when hospitals undertake programs to reduce the frequency of infections, known as nosocomial infections, which originate or occur within their settings. Revenues in this segment are negatively impacted by the trend among hospitals to allow group purchasing organizations to negotiate long-term contracts with medical device manufacturers on their behalf. See the section entitled "Business—Sales, marketing and distribution—United States sales." Expenses in our anesthesia segment are driven primarily by the cost of raw materials, labor costs and freight expenses. During recent periods, our petrochemical based raw materials, such as resins, and freight expenses have been impacted by high gas prices, gas shortages and plant shutdowns resulting from Hurricane Katrina.

In March 2005, we acquired the disposable airway management device business from a subsidiary of Baxter International Inc. for approximately \$10.1 million, including related transaction costs. This acquisition was structured as an asset purchase pursuant to which we acquired certain manufacturing assets related to the disposable airway management device business valued at approximately \$1.3 million, and inventory, including anesthesia circuits, face masks, heat and moisture exchanger filters and other associated anesthesia components valued at approximately \$1.2 million. The excess of the purchase price over the fair value of the net assets acquired, which has been allocated to goodwill, was approximately \$7.7 million. The results of operations of this business, including revenues of approximately \$4.5 million, are included in our results of operations for our anesthesia segment from March 2, 2005.

Respiratory/critical care

Our primary respiratory/critical care products are arterial blood gas, or ABG, syringes and kits, manual resuscitators and blood pressure cuffs. Our respiratory/critical care segment responds to the growing needs of hospitals to provide respiratory relief and emergency care. We believe that in

recent years there has been an increasing incidence of respiratory illnesses, such as asthma and emphysema, due in part to an increasingly susceptible aging population, environmental pollution, smoking-related illnesses and communicable diseases with significant respiratory impact, such as tuberculosis, HIV and influenza. These trends, together with concerns regarding the spread of nosocomial infections, drive our sales of respiratory products. As in our anesthesia segment, revenues in this segment have been negatively impacted by the emergence of group purchasing organizations and expenses in this segment are driven principally by raw material costs, labor costs and freight expenses.

Sleep Disorders

We serve the sleep disorder market as both a provider of diagnostic services and a manufacturer of therapeutic products focused on sleep disorders. Through our Sleep Services of America, or SSA, subsidiary, we provide sleep diagnostic testing services in the United States in free standing laboratories and centers and, through contracts with hospitals, in hospital facilities, for patients suspected of suffering from obstructive sleep apnea. As of September 30, 2005, we managed 52 sleep laboratories and centers. We have focused our efforts on laboratories and centers affiliated with hospitals, such as Johns Hopkins and the University of Maryland. Our diagnostic services business is driven by the growing awareness of the existence and significant consequences of obstructive sleep apnea. Our principal expense in our sleep diagnostic services business is the cost of employing the technicians who operate our sleep laboratories and centers.

Our Breas Medical AB, or Breas, subsidiary is a European manufacturer of personal ventilators for obstructive sleep apnea and long term ventilation. Our sleep disorder products deliver airflow to patients undergoing therapy for the treatment of obstructive sleep apnea with the objective of increasing patient comfort and acceptance of the treatment. Our sleep disorder products employ CPAP, which is a common method for treating obstructive sleep apnea. We have manufactured and distributed CPAP systems for more than a decade. Our sales of sleep disorder and other personal ventilation products have been made principally in international markets. These sales depend principally on the prevalence of sleep disorders and the acceptance by patients and care-givers in developed markets of treatment modalities for obstructive sleep apnea. Like our anesthesia and respiratory/critical care businesses, our Breas subsidiary faces the challenge of controlling raw material, labor and freight costs. To date, we have had only limited sales of our sleep disorder products in the United States due in part to the need to obtain regulatory clearance and in part to the dominance by our competitors in selling to home supply dealers. Our United States strategy is to sell these products primarily through our sleep centers.

Pharmaceutical technology services

We deliver technology services to FDA regulated companies primarily in the pharmaceutical sector. In addition, we also provide services to medical device, diagnostic and biotechnology companies. We advise clients by helping them establish and monitor processes designed to satisfy their regulatory requirements set forth by the FDA and have begun to sell dedicated compliance software to our clients. We entered the pharmaceutical regulatory services market in 1996 and expanded into computer system compliance through our acquisition in 2002 of Stelex Inc. This segment benefits from regulatory efforts to systemize compliance by the regulated community and by our clients' efforts to control costs through the outsourcing of compliance functions. Our principal costs in this segment are our labor costs. We also incur technology-related expenses as part of our development of compliance software.

Net revenues

Net revenues consist of sales of our anesthesia, respiratory/critical care and sleep disorder and personal ventilation products and revenues from our sleep disorder diagnostic services and pharmaceutical technology services. The amount and percentage of our net revenue derived from each of our business segments was as follows during the periods indicated:

Fiscal year ended September 30, (dollars in thousands)	2005		2004		2003	
	Net revenue	Percent of total revenue	Net revenue	Percent of total revenue	Net revenue	Percent of total revenue
Anesthesia	\$ 93,337	48.1%	\$ 82,791	45.0%	\$ 75,949	41.7%
Respiratory/critical care	42,423	21.9%	42,079	22.9%	45,829	25.2%
Sleep disorder and personal ventilation	41,517	21.4%	44,053	23.9%	45,580	25.0%
Pharmaceutical technology services	16,760	8.6%	15,068	8.2%	18,105	9.9%
Rebate allowance adjustment (1)	—	—	—	—	(3,300)	(1.8)%
Total	\$ 194,037	100.0%	\$ 183,991	100.0%	\$ 182,163	100.0%

(1) This rebate allowance adjustment relates to our anesthesia and respiratory/critical care segments. For information regarding the approach we have taken in calculating this adjustment, see “—Critical accounting policies—Revenue recognition” below.

For all product sales, revenue is recognized when title to the product passes to the customer. For product sales to all customers except for certain domestic distributors, title passes upon shipment of the product by us. For sales through certain domestic distributors, title passes when the product is received by the distributor.

Gross revenues associated with our anesthesia and respiratory/critical care products are reduced by the amount of rebates due on sales to distributors. See “—Critical accounting policies—Revenue recognition” for a description of how we calculate those rebates. Sales to distributors represented 26.1%, 25.4% and 24.7% of our net sales during the years ended September 30, 2005, 2004 and 2003, respectively.

We have provided a reconciliation of gross to net product sales, as well as a comparison with service revenues, below:

Fiscal year ended September 30, (in thousands)	2005	2004	2003
Gross sales	\$ 220,504	\$ 203,314	\$ 194,295
Rebates (1)	(55,917)	(47,809)	(44,439)
Other deductions (2)	(4,006)	(3,711)	(3,977)
Net sales	160,581	151,794	145,879
Service revenues	33,456	32,197	36,284
Total net revenues	\$ 194,037	\$ 183,991	\$ 182,163

(1) See “—Critical accounting policies—Revenue recognition” for information regarding approaches we have taken in calculating rebates.

(2) Other deductions consist of discounts, returns and allowances for credits.

For service revenue in the sleep disorder and pharmaceutical technology services segments, revenue is recognized when the service is performed.

Research and development

The focus of our research and development efforts, and the amount of such expenses that we incur, vary from year to year and quarter to quarter based on the specific needs of our business. Thus, for example, when changes were required in our sleep disorder and personal ventilation product line during the past two years, 41% of our research and development investment was focused upon our sleep disorder segment in fiscal 2005 and 44% of our research and development

investment was focused upon that segment in fiscal 2004. For fiscal 2005, 2004 and 2003, we incurred research and development expenses of \$7.0 million, \$7.0 million and \$5.9 million, respectively.

International sales

Our products are sold in over 70 countries worldwide. The table below sets forth our international sales, by segment, for the periods presented:

Fiscal year ended September 30, (dollars in thousands)	2005		2004		2003	
	Net revenue	Percent of total revenue	Net revenue	Percent of total revenue	Net revenue	Percent of total revenue
Anesthesia	\$ 8,357	4.3%	\$ 6,907	3.8%	\$ 6,146	3.4%
Respiratory/critical care	13,617	7.0%	12,755	6.9%	12,653	6.9%
Sleep disorder.	24,820	12.8%	26,924	14.6%	26,521	14.6%
Pharmaceutical technology services	—	—	—	—	—	—
Total	\$ 46,794	24.1%	\$ 46,586	25.3%	\$ 45,320	24.9%

For international sales other than in the United Kingdom, where we operate our own sales and distribution office, we rely primarily on third-party distributors. Commencing in 2002, we sold our anesthesia and respiratory/critical care products in nine European and certain other related international markets primarily through a strategic alliance with Rusch GmbH, a manufacturer of medical devices. However, during our 2004 fiscal year, Rusch's parent company announced its purchase of Hudson-RCI, a competitor of ours in a number of respiratory and anesthesia products. In light of this acquisition, the parties terminated the distributor agreement, effective as of November 30, 2005. For a period of time we expect to continue to sell through a number of Rusch's country specific organizations. We are simultaneously evaluating alternative distribution methods, including partnering with third-party distributors in certain countries. If we are unable to establish new channels promptly and effectively, our international sales of anesthesia and respiratory products may be adversely impacted in fiscal 2006 by the termination of our distribution agreement with Rusch.

Foreign exchange risks

Our international business exposes us to foreign exchange risks, particularly with respect to our sleep disorder segment and, more particularly, with respect to international sales of our sleep disorder and personal ventilation products by our Breas subsidiary. Sales of such products by our Breas subsidiary are translated from Swedish kroner to United States dollars. The relative strength of the Swedish kroner as compared to the United States dollar, in fiscal 2005 and 2004, has resulted in increases in reporting Breas' revenue and operating losses. See “—Quantitative and qualitative disclosures about market risk” below.

Acquisitions

As part of our growth strategy, we pursue licensing agreements, strategic acquisitions and the purchase of technology. During the five year period ended September 30, 2005, we made or completed the following acquisitions:

- We acquired a 100% equity interest in Breas over a period from June 1997 through April 2002. Breas is engaged in the manufacture and sale of sleep disorder and personal ventilation products.

- We acquired a controlling interest in National Sleep Technologies, Inc. over a period from June 1998 through June 2000. In 2002, National Sleep Technologies merged with a subsidiary of The Johns Hopkins Health System Corporation, to form SSA. We own a 70% equity interest in SSA, which operates our sleep diagnostic services business. The portion of SSA that we do not own is principally owned by Johns Hopkins and is recorded as a minority interest in our consolidated financial statements.

- We acquired a 100% equity interest in Stelex in 2002. We provide pharmaceutical technology services through this subsidiary.
- In March 2005, we acquired a disposable airway management device business from a subsidiary of Baxter International, Inc. to improve our market share in the anesthesia segment.

These acquisitions have been accounted for as purchases and, accordingly, are included in our consolidated financial statements from the respective dates of acquisition.

Results of operations

The following table sets forth, for the periods indicated, certain statement of income data as a percentage of our net revenue.

For the year ended September 30,	2005	2004	2003
Consolidated statement of income data:			
Net revenue	100.0%	100.0%	100.0%
Cost of goods sold	49.2	49.7	50.3
Gross profit:			
Anesthesia	53.7	54.4	53.8
Respiratory/critical care	52.7	51.8	54.3
Sleep disorder	47.3	45.3	43.7
Pharmaceutical technology services	38.6	38.6	45.2
Total	50.8	50.3	49.7
Operating expenses:			
Selling, general and administrative	26.3	27.2	28.2
Research and development	3.6	3.8	3.2
Restructuring and impairment	0.1	0.3	0.1
Other (income) expense, net	0.0	0.3	0.4
Total operating expenses	30.0	31.7	31.9
Interest income, net	(0.8)	(0.4)	0.1
Provision for income taxes	7.8	6.8	7.0
Income from continuing operations	13.6	12.0	10.5
Net income	13.6	12.0	7.8

Comparison of results for the year ended September 30, 2005 to the year ended September 30, 2004

Net revenues

Total net revenue increased by 5.5%, from \$184.0 million for fiscal 2004 to \$194.0 million for fiscal 2005. The percentage increase would have been 4.9% but for the impact of favorable foreign exchange rates. Of our total net revenue, \$147.2 million, or 75.9%, were derived from domestic sales and \$46.8 million, or 24.1%, were derived from international sales. Domestic revenues increased by 7.2%, from \$137.4 million for fiscal 2004 to \$147.2 million for fiscal 2005. International sales increased by \$0.2 million. The international sales increase would have been a 1.8% decrease were it not for favorable foreign exchange rates.

We have set forth below the net revenues by business segment for fiscal 2005 compared to fiscal 2004.

Net revenue by business segment

For the year ended September 30, (dollars in thousands)	2005	2004	Percent change
Consolidated statement of income data:			
Anesthesia	\$ 93,337	\$ 82,791	12.7%
Respiratory/critical care	42,423	42,079	0.8%
Sleep disorder	41,517	44,053	(5.8)%
Pharmaceutical technology services	16,760	15,068	11.2%
Total	\$ 194,037	\$ 183,991	5.5%

Anesthesia. Sales of anesthesia products increased by 12.7% from \$82.8 million for fiscal 2004 to \$93.3 million for fiscal 2005. This increase was due to volume growth in anesthesia circuits, including a 43.9% increase in sales of our patented anesthesia circuit, Limb-Ø™, to \$11.8 million, a 22.0% increase in sales of traditional anesthesia breathing systems to \$36.3 million resulting from the acquisition of the Baxter disposable airway management product line and volume increases in sales of products by our Thomas Medical Products subsidiary. Domestic sales of anesthesia products increased 12.0%, from \$75.9 million to \$85.0 million. International sales of anesthesia products increased 21.0%, from \$6.9 million to \$8.4 million.

Respiratory/critical care. Sales of respiratory/critical care products increased 0.8%, from \$42.1 million for fiscal 2004 to \$42.4 million for fiscal 2005, resulting from volume growth in our Broselow-Luten System, CPAP and ABG product lines, offset by a decline in the domestic sales of our blood pressure cuffs. We attribute the \$1.3 million increase in sales of our Broselow-Luten System to growing awareness by hospitals of the special needs and risks associated with treating pediatric patients in the emergency room. Domestic sales of respiratory/critical care products declined by 1.8%, from \$29.3 million to \$28.8 million. International sales of respiratory/critical care products increased by 6.8% from \$12.8 million for fiscal 2004 to \$13.6 million for fiscal 2005, reflecting higher sales volumes in our ABG and CPAP product lines.

Sleep disorder. Our sleep disorder segment revenues decreased by 5.8% from \$44.1 million for fiscal 2004 to \$41.5 million for fiscal 2005. The percentage decrease would have been 8.0% but for the impact of favorable foreign exchange rates.

Revenues from our diagnostic services decreased by 2.5% from \$17.1 million for fiscal 2004 to \$16.7 million for fiscal 2005. In fiscal 2004, our SSA subsidiary closed 14 sleep laboratories and centers and opened nine new sleep laboratories and centers. In the continuing sleep laboratories and centers, revenue increased 22.3% from fiscal 2004 to fiscal 2005.

Revenues from the sale of sleep disorder and personal ventilation products at our Breas subsidiary decreased 7.8% from \$26.9 million for fiscal 2004 to \$24.8 million for fiscal 2005. The percentage decrease would have been 11.4% but for the impact of favorable foreign exchange rates. During fiscal 2005, a component vendor advised Breas that it was unable to deliver a sufficient quantity of a key component at our required specifications. As a result, Breas was unable to bring a new sleep disorder and personal ventilation product line to market in a timely manner. Since we had pre-announced the availability of that product line, orders for pre-existing products were reduced substantially and the unavailability of the new products negatively affected Breas' 2005 revenues. Limited shipments of the new product line began during the fourth quarter of fiscal 2005. We believe that this supply issue has now been adequately

resolved.

Pharmaceutical technology services. Service revenues in our pharmaceutical technology services segment increased by 11.2%, from \$15.1 million for fiscal 2004 to \$16.8 million for fiscal 2005, resulting in part from increased sales of our ComplianceBuilder software product and in part from

increased project work. The increased project work reflects improved demand from certain new and existing pharmaceutical and medical device clients.

Gross profit

We have set forth below the dollar amount of our gross profits and our gross profit margins for each of our four segments:

For the year ended September 30, (dollars in thousands)	2005		2004	
	Gross profit	Gross profit margin	Gross profit	Gross profit margin
Anesthesia	\$ 50,082	53.7%	\$ 45,026	54.4%
Respiratory/critical care	22,357	52.7%	21,801	51.8%
Sleep disorder	19,627	47.3%	19,974	45.3%
Pharmaceutical technology services	6,464	38.6%	5,816	38.6%
Total	\$ 98,530	50.8%	\$ 92,617	50.3%

Gross profit dollar improvements in our anesthesia and respiratory/critical care segments correspond to the sales volume increases in those segments. The decline in gross profit margin in the anesthesia segment resulted from the inclusion of the Baxter disposable airways product into the sales mix at a lower margin. The increase in gross profit margin in the respiratory/critical care segment was due to the effect of a one-time inventory writedown of \$1.0 million in fiscal 2004.

The gross profit dollar decline in our sleep disorder segment resulted from the sales volume declines in diagnostic services and sleep disorder/personal ventilation products, which was offset in part by a cost savings resulting from the closing of 14 poorly performing sleep laboratories and centers. The gross profit margin in sleep disorder diagnostic services increased from 49.4% in fiscal 2004 to 53.1% in fiscal 2005, reflecting our efforts to close these facilities. The gross profit at Breas increased from 42.8% in fiscal 2004 to 43.4% in fiscal 2005 as the sales mix changed to include an increased percentage of higher margin new personal ventilation products.

Gross profit dollar improvements of approximately \$0.6 million in our pharmaceutical technology services segment corresponded to the sales volume increase. Gross profit margin for fiscal 2004 and 2005 remained constant at 38.6%.

Operating expenses

Selling, general and administrative expenses. Selling, general and administrative expenses increased by 1.8%, from \$50.1 million for fiscal 2004 to \$51.0 million for fiscal 2005. The increase resulted primarily from increased freight costs resulting from increased sales volumes, the impact of foreign exchange translation at Breas, increased compensation cost, increased accounting fees primarily related to Sarbanes-Oxley compliance and increased group purchasing organization fees. These increases were partially offset by reductions in legal expense and reduced health care costs.

Research and development. Research and development expenses were approximately \$7.0 million for both fiscal 2004 and fiscal 2005. We continue to invest in the development of the new Breas family of sleep CPAP and personal ventilation equipment, and single use products for anesthesia and respiratory/critical care.

Restructuring and impairment. During fiscal 2005, we completed the closure of our California plant and charged \$0.2 million to restructuring expense. During fiscal 2004, we recognized a \$0.5 million restructuring charge associated with the closing of our California plant, a reduction in force at our Totowa, New Jersey headquarters and the closing of the Breas sales office in Belgium.

Other (income) expense, net. For fiscal 2005, other income, net of \$0.1 million resulted from a litigation settlement, gains on sales of assets and realized foreign exchange gains, offset in part by charitable contributions consisting of product donations. For fiscal 2004, other expense, net of \$0.6

million resulted from costs associated with an acquisition that we did not pursue to completion, severance costs and charitable product donations.

Other items

Interest income, net. Interest income, net doubled from \$0.8 million for fiscal 2004 to \$1.6 million for fiscal 2005, resulting from an increase in the level of cash and cash equivalents being invested and an increase in interest rates.

Income tax. The provision for income tax expense for fiscal 2005 and 2004 was \$15.1 million and \$12.5 million, respectively, reflecting effective tax rates of 35.9% and 35.6% for these periods, respectively. The tax rate increase to 35.9% resulted from the expiration of certain net operating loss carryforwards. See Note 15 of the notes to consolidated financial statements.

Discontinued operations. The net gain from our Vital Pharma discontinued operations was \$0.1 million for fiscal 2005, as compared to a \$0.1 million loss for fiscal 2004. See Note 2 of the notes to consolidated financial statements.

Comparison of results for the year ended September 30, 2004 to the year ended September 30, 2003

Net revenues

Total net revenue increased by 1.0%, from \$182.2 million for fiscal 2003 to \$184.0 million for fiscal 2004. The 1.0% increase would have been a 0.9% decrease were it not for favorable foreign exchange rates. Of our total net revenue, \$137.4 million, or 74.7%, were derived from domestic sales and \$46.6 million, or 25.3%, were derived from international sales. Domestic revenues increased by 0.4%, from \$136.8 million for fiscal 2003 to \$137.4 million for fiscal 2004. The 0.4% increase resulted from a 9.0% increase in our anesthesia segment which offset declines in our respiratory/critical care, sleep disorder and pharmaceutical technology services segments. International revenues increased by 2.8%, from \$45.3 million for fiscal 2003 to \$46.6 million for fiscal 2004. The 2.8% increase would have been a 4.6% decrease were it not for favorable foreign exchange rates.

We have set forth below the net revenues by business segment for fiscal 2004 compared to fiscal 2003:

For the year ended September 30, (dollars in thousands)	2004	2003	Percent change
Consolidated statement of income data:			
Anesthesia	\$ 82,791	\$ 75,949	9.0%
Respiratory/critical care	42,079	45,829	(8.2)%
Sleep disorder	44,053	45,580	(3.4)%
Pharmaceutical technology services	15,068	18,105	(16.8)%
Rebate allowance adjustment (1)	—	(3,300)	N/A
Total	\$ 183,991	\$ 182,163	1.0%

(1) This rebate allowance adjustment relates to our anesthesia and respiratory/critical care segments. For information regarding the approach we have taken in calculating this adjustment, see “—Critical accounting policies—Revenue recognition” below.

Anesthesia. Sales of anesthesia products increased by 9.0% from \$75.9 million for fiscal 2003 to \$82.8 million for fiscal 2004. This increase was due to volume growth in anesthesia circuits, including Limb-Ø™, our patented anesthesia circuit, sales of which increased 70.5% to \$8.2 million, a 12.0% increase in sales of traditional anesthesia circuits to

\$25.0 million and volume increases in our Thomas Medical Products subsidiary. Domestic sales of anesthesia products increased by 8.7%,

from \$69.8 million to \$75.9 million. International sales of anesthesia products increased by 12.4%, from \$6.1 million to \$6.9 million, principally from the European distribution agreement with Rusch.

Respiratory/critical care. Sales of respiratory/critical care products decreased by 8.2%, from \$45.8 million for fiscal 2003 to \$42.1 million for fiscal 2004. Domestic sales declined 11.6%, from \$33.2 million to \$29.3 million, resulting from increased competition within the segment. International sales increased by 0.8% from \$12.7 million for fiscal 2003 to \$12.8 million for fiscal 2004, reflecting higher sales volumes through our distributor arrangement in Europe with Rusch.

Sleep disorder. Our sleep disorder revenues decreased by 3.4% from \$45.6 million for fiscal 2003 to \$44.1 million for fiscal 2004. The 3.4% decrease would have been a 10.2% decrease were it not for favorable foreign exchange rates.

Revenues from our diagnostic services decreased by 5.8% from \$18.2 million for fiscal 2003 to \$17.1 million for fiscal 2004. We closed 14 sleep laboratories and centers and opened nine new sleep laboratories and centers in fiscal 2004. In the continuing sleep laboratories and centers, revenue increased 16.1%.

Revenues from sales of sleep disorder and personal ventilation products at our Breas subsidiary decreased by 1.7% from \$27.4 million for fiscal 2003 to \$26.9 million for fiscal 2004, resulting from increased competition in our ventilator product line and from discontinuing certain original equipment manufacturer, or OEM, products as a result of an increased focus on our own manufactured products. The 1.7% decrease would have been a 12.8% decrease were it not for favorable foreign exchange rates.

Pharmaceutical technology services. Service revenues in our pharmaceutical technology services segment decreased by 16.8%, from \$18.1 million for fiscal 2003 to \$15.1 million for fiscal 2004. During fiscal 2004, our larger pharmaceutical customers reduced their external resource usage with respect to FDA regulatory compliance needs.

Gross profit

We have set forth below the dollar amount of our gross profits and our gross profit margins for each of our four segments:

For the year ended September 30, (dollars in thousands)	2004		2003	
	Gross profit	Gross profit margin	Gross profit	Gross profit margin
Anesthesia	\$ 45,026	54.4%	\$ 40,880	53.8%
Respiratory/critical care	21,801	51.8%	24,866	54.3%
Sleep disorder	19,974	45.3%	19,921	43.7%
Pharmaceutical technology services	5,816	38.6%	8,188	45.2%
Rebate adjustment	—	—	(3,300)	N/A
Total	\$ 92,617	50.3%	\$ 90,555	49.7%

Gross profit dollar and margin improvements in our anesthesia segment resulted from sales volume increases at our Thomas Medical Products subsidiary and cost improvement projects at our New Jersey plant. The declines in gross profit dollars and margin in our respiratory/critical care segment resulted primarily from sales volume declines and inventory writedowns of \$1.0 million. In both the anesthesia and respiratory/critical care segments, we were impacted

by pricing pressures resulting from the membership of our customers in group purchasing organizations.

We experienced a gross profit dollar decline of \$2.1 million in our sleep disorder segment as a result of volume and price reductions at our Breas subsidiary. These declines were more than offset by the cost saving effect of closing poorly performing sleep laboratories and centers. The gross profit percentage in our sleep diagnostic services business increased from 45.0% in fiscal 2003

to 49.4% in fiscal 2004, while the gross profit percentage in our Breas subsidiary decreased from 43.6% in fiscal 2003 to 42.8% in fiscal 2004.

The declines in gross profit dollars and margin in our pharmaceutical technology services reflect the decline in service revenues resulting from reduced FDA regulatory compliance needs.

Operating expenses

Selling, general and administrative expenses. Selling, general and administrative expenses decreased by 2.4%, from \$51.3 million for fiscal 2003 to \$50.1 million for fiscal 2004. The decrease consists primarily of cost reductions, primarily at our Breas sales offices and in our pharmaceutical technology services subsidiary, and a reduction in bad debt expense, offset in part by an increase resulting from foreign exchange rate changes.

Research and development. Research and development expenses increased by approximately \$1.1 million, or 19.8%, from \$5.9 million for fiscal 2003 to \$7.0 million for fiscal 2004, as we invested in the development of new products for our Breas subsidiary.

Restructuring and impairment. During the third quarter of fiscal 2002, we recognized an impairment charge of \$1.6 million relating principally to a Chinese distributor based on an evaluation of its business in China. At that time, we believed that we would be able to renegotiate our agreement with our Chinese distributor to preserve some of our business in that country. In May of 2003, we retained counsel in China to commence certain legal actions against our distributor to collect our accounts receivable, and in the third quarter of fiscal 2003 we wrote-off all amounts due from this distributor, amounting to \$0.5 million. In September 2003, we received \$0.4 million in cash from this distributor and we recovered certain inventory. Accordingly, in the fourth quarter of fiscal 2003, we recorded that payment as income. See Note 11 of the notes to consolidated financial statements.

During our 2004 fiscal year, we recognized a \$0.5 million restructuring charge resulting from the closing of our California plant, a reduction in force at our Totowa, New Jersey headquarters and the closing of the Breas sales office in Belgium.

Other (income) expense, net. For fiscal 2004, other expense, net of \$0.6 million resulted from charitable product donations, costs associated with an acquisition that we did not pursue to completion and severance costs. For fiscal 2003, other expense, net of \$0.7 million consisted primarily of costs of a public offering that we did not pursue to completion, charitable product donations and costs relating to the closing of several redundant sales offices operated by our Breas and pharmaceutical technology services subsidiaries.

Other items

Interest income, net. Interest income increased by 26.0%, from \$0.7 million for fiscal 2003 to \$0.8 million for fiscal 2004, resulting from an increase in the level of cash and cash equivalents being invested. Interest expense decreased from \$0.9 million for fiscal 2003 to less than \$0.1 million for fiscal 2004. Interest expense for fiscal 2003 included \$0.8 million of interest relating to past taxes due resulting from an Internal Revenue Service examination, and interest of \$0.1 million on a loan that was paid off in December 2003.

Income tax. The provision for income tax expense for fiscal 2004 and fiscal 2003 was \$12.5 million and \$12.8 million, respectively, reflecting effective tax rates of 35.6% and 39.7% for these periods, respectively. We included in the provision for fiscal 2003 an additional provision of \$1.1 million resulting from a routine examination by the Internal Revenue Service of our 1997, 1998 and 1999 Federal income tax returns. Also, in fiscal 2003, in order to reflect the results of the IRS examination, we re-filed certain state tax returns for prior periods, resulting in additional tax expense of \$0.3 million and interest expense of \$0.1 million.

Discontinued operations. On October 30, 2003, we sold the assets of our Vital Pharma subsidiary to ProClinical, Inc. We received \$0.5 million in cash and a three-year note receivable from ProClinical for \$2.0 million. The note is secured by a first lien against all of the assets sold. No

gain or further loss was recorded on the sale. On December 29, 2003, we sold certain related real estate. We have accounted for these sales on a cost recovery basis. The net loss, after applying the tax benefit, from discontinued operation was approximately \$0.1 million for fiscal 2004 and approximately \$5.0 million for fiscal 2003.

Liquidity and capital resources

We believe that the funds generated from operations, along with our current working capital position and the net proceeds to be received by Vital Signs in this offering, will be sufficient to satisfy our capital requirements for at least the next twelve months.

Cash flows

Historically, our primary liquidity requirements have been to finance business acquisitions and to support operations. We have funded these requirements primarily through internally generated cash flow.

During fiscal 2005, operating activities provided \$31.0 million of net cash. Investing activities used \$15.5 million of net cash, including \$9.9 million for the acquisition of the Baxter disposable airway management product line and capital additions of \$5.6 million. Financing activities used \$9.4 million, consisting of \$9.1 million for the repurchase of common stock and \$3.4 million paid for dividends, which were offset in part by \$3.1 million of cash received from the exercise of stock options.

During fiscal 2004, operating activities provided \$35.1 million of net cash. Investing activities used \$3.7 million of net cash, including capital additions of \$5.3 million. Financing activities used \$11.2 million, consisting of \$8.1 million for the repurchase of common stock, \$3.1 million paid for dividends and \$1.7 of principal payments on long-term debt, which were offset in part by \$1.7 million of cash received from the exercise of stock options.

During fiscal 2003, operating activities provided \$33.4 million of net cash. Investing activities used \$4.5 million of net cash, including capital additions of \$4.7 million, offset in part by \$0.2 million of net proceeds from the sale of certain investment securities. Financing activities used \$4.6 million, consisting of \$2.6 million for the repurchase of common stock, \$2.5 million paid for dividends and \$0.3 million of principal payments on long-term debt, which were offset by \$0.7 million of cash received from the exercise of stock options.

Cash and working capital

Cash and cash equivalents were \$81.8 million at September 30, 2005 as compared to \$76.5 million at September 30, 2004. At September 30, 2005, our working capital was \$119.6 million compared to \$112.9 million at September 30, 2004. At September 30, 2005, the current ratio was 7.9 to 1.0 and at September 30, 2004 the current ratio was 7.8 to 1.0.

Debt

We have no committed lines of financing.

Working capital policy and capital expenditures

Our current policy is to retain working capital and earnings for use in our business, subject to the payment of certain cash dividends. Such funds may be used for the buyback of our common stock, business acquisitions, product acquisitions and product development, among other things. We regularly evaluate and negotiate with domestic and foreign medical device companies regarding potential business or product line acquisitions, licensing arrangements and strategic alliances.

Capital expenditures for our 2005 fiscal year were approximately \$5.6 million, and included expenditures for the capitalized costs of software development (\$1.9 million); computer hardware and software to upgrade our management information systems (\$0.6 million); tools and molding for

use at our Breas facility (\$1.2 million); molds and equipment at both our Thomas Medical Products facility (\$0.4 million) and our Colorado manufacturing plant (\$0.3 million); equipment and building improvements at our New Jersey facility (\$0.4 million) and Thomas Medical Products facility (\$0.4 million); new laboratory equipment (\$0.1 million) for our sleep laboratories and centers; and patents (\$0.2 million). For information regarding capital expenditures by segment, see Note 18 of the notes to the consolidated financial statements.

Dividend and stock buybacks

Our board of directors had authorized a total expenditure of up to \$35.0 million for the repurchase of our common stock, including the expenditure of \$15.0 million authorized by our board of directors on February 8, 2005. During the past three fiscal years, we repurchased 613,300 shares for \$19.8 million, at an average price of \$32.30 per share. On November 22, 2005, our board of directors suspended this repurchase authorization while this offering is pending.

Contractual obligations

The following table sets forth, at September 30, 2005, the amounts of payments due under our operating leases and other long-term obligations for the time periods described below:

Payments Due by Period

Contractual obligations (in thousands)	Total	Less than one year	One year to three years	Three years to five years	More than five years
Operating leases	\$4,040	\$1,312	\$2,354	\$374	—
Long-term debt	—	—	—	—	—
Capital leases	—	—	—	—	—
Purchase obligations	—	—	—	—	—

Other

At September 30, 2003, 2004 and 2005, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have material relationships or transactions with persons or entities that derive benefits from their non-independent relationship with us or our related parties other than what is disclosed in Note 19 of the notes to the consolidated financial statements.

Critical accounting policies

We have identified the following critical accounting principles that affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to asset impairment, revenue recognition, allowance for doubtful accounts, and contingencies and litigation. We state these

accounting policies in the notes to our consolidated financial statements and at relevant places in this discussion and analysis. These estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable

under the circumstances. Actual results could vary from these estimates under different assumptions or conditions.

We believe that the following critical accounting principles affect the more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue recognition

Net revenues consist of sales of our anesthesia, respiratory/critical care and sleep disorder and personal ventilation products and revenues from our sleep disorder diagnostic services and pharmaceutical technology services. For all product sales, revenue is recognized when title to the product passes to the customer. For product sales to all customers except for certain domestic distributors, title passes upon shipment of the product by us. For sales through certain domestic distributors, title passes when the product is received by the distributor. For service revenue, revenue is recorded when the service is performed.

Our sales to United States distributors are made at our distributor list price. Because the end-user (i.e., a hospital) is typically entitled, on a case by case basis, to a price lower than our distributor list price, the distributor is then due a rebate, equal to the difference between the distributor list price and the final lower contract price, when shipment is made to the end user. In order to properly reflect our sales to distributors, we record the gross sale at our distributor list price, less the amount of the expected rebate, to arrive at the net sale. This net sale is the amount we expect to receive in cash from the distributor on the sale.

On a monthly basis, each distributor provides us with documentation of shipments to particular end-users and computes a rebate claim on such shipments. Once the distributor has provided us with this claim, the distributor will deduct the computed rebate from its net remittance.

The amount of the estimated rebate that has not yet been taken by the distributor through the reduction of a payment is included in the allowance for rebates, which reduces the accounts receivable on our balance sheet. This allowance is calculated by adding the amount of rebates claimed by the distributors through documentation but not yet reimbursed plus an estimate by us of the amount of future rebates due on any inventory that the distributors are holding at the end of each period.

Prior to fiscal 2003, we utilized an historical moving average to estimate the allowance for rebates. Based upon a review that we conducted in fiscal 2003 in connection with the preparation of our second quarter financial report, we concluded that the moving average estimate did not necessarily result in the appropriate liability due to the distributor. Accordingly, we changed our method of estimating rebate claims to record the allowance for rebates based upon the documentation provided by the distributor for shipments and inventory not yet shipped. We also recorded a \$3.3 million expense to increase the amount of our allowance for rebates. Over the years, our information systems have improved. During the second quarter of fiscal 2005, we concluded that rebates due could be better measured by utilizing current period rebate data to determine an estimated rebate percentage, by distributor and product, and applying that percentage to the current period gross sales by distributor and product. We believe that there was no material financial statement impact between our current approach and the approach we adopted in fiscal 2003.

The allowance for rebates was \$7.3 million and \$8.2 million at September 30, 2005 and September 30, 2004, respectively. Rebate expense was \$55.9 million and \$47.9 million for the years ended September 30, 2005 and 2004, respectively.

Amortization of goodwill

Through September 30, 2001, we amortized goodwill and intangibles on a straight-line basis over their estimated lives. Upon our adoption of SFAS No. 142 on October 1, 2001, we ceased amortizing goodwill and we perform an annual impairment analysis based upon discounted cash flows to assess the recoverability of the goodwill, in

accordance with the provisions of SFAS No.

142. We last completed this impairment test during the three month period ended March 31, 2005 and found no impairment. We also review the carrying value of other long-lived assets on a periodic basis, or whenever events or changes in circumstances indicate that the amounts may not be recoverable. If we determine that the carrying amount of an asset may not be recoverable, we then estimate the future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. We will recognize an impairment loss if the carrying value of the assets exceeds the estimated future undiscounted cash flows of those assets. See Note 1 of the notes to our consolidated financial statements presented elsewhere herein. We have not incurred material impairment charges since fiscal 2001. If we are required to record impairment charges in the future, it would have an adverse impact on our results of operations and financial condition. Goodwill amounted to \$77.2 million at September 30, 2005 and \$69.5 million at September 30, 2004.

Allowance for doubtful accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, which results in bad debt expense. Our allowance for doubtful accounts was \$0.5 million at September 30, 2005 and \$0.6 million at September 30, 2004. We determine the adequacy of this allowance by evaluating individual customer receivables, considering the customer's financial condition and credit history and analyzing current economic conditions. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Claims and proceedings

We are subject to various claims and legal actions in the ordinary course of our business. These matters frequently arise in disputes regarding the rights to intellectual property, where it is difficult to assess the likelihood of success and even more difficult to assess the probable ranges of recovery. Although we currently are not aware of any legal proceeding that is reasonably likely to have a material adverse effect on our financial position and results of operations other than legal proceedings for which accruals have been provided, if we become aware of any such claims against us, we will evaluate the probability of an adverse outcome and provide accruals for such contingencies to the extent that such contingencies are measurable.

Inventory obsolescence

We establish an allowance for inventory obsolescence. The allowance is determined by performing an aging analysis of the inventory; based upon this allowance, inventory is stated at the lower of cost, using the first in, first out method, or its net realizable value. During fiscal 2004, we wrote-off certain inventory amounting to \$1.0 million. Our inventory allowance for obsolescence was \$0.7 million at September 30, 2005 and \$1.2 million at September 30, 2004.

Recent accounting pronouncements

For information regarding new accounting pronouncements, see Note 1 of the notes to consolidated financial statements.

Quantitative and qualitative disclosures about market risk

We are exposed to market risks, including the impact of material price changes and changes in the market value of our investments and, to a lesser extent, interest rate changes and foreign currency fluctuations. In the normal course of business, we seek to limit the impact of market risks on earnings and cash flows.

The impact of interest rate changes is not material to our financial condition. We do not enter into interest rate transactions for speculative purposes.

For fiscal 2005, our international net revenue represented approximately 24.1% of our total net revenues. Our Breas subsidiary, located in Sweden, represented 53% of our total international net revenues during fiscal 2005. We do not enter into any derivative transactions, including foreign currency transactions, for speculative purposes. We have not entered into any derivative instrument transactions, such as foreign exchange forward or option contracts, as of September 30, 2005.

Our primary risk involving price changes relates to raw materials used in our operations. We are exposed to changes in the prices of resins and latex for the manufacture of our products. We do not enter into commodity futures or derivative instrument transactions. Except with respect to our single source of supply for facemasks, we seek to maintain commercial relations with multiple suppliers and when prices for raw materials rise to attempt to source alternative supplies.

Business

Our company

We are a leading designer, manufacturer and marketer of airway management products for the anesthesia, respiratory/critical care and sleep disorder markets. We sell our products in over 70 countries worldwide. We offer one of the broadest single-patient use anesthesia and respiratory/critical care product lines in the industry and have developed numerous innovative products which are now considered industry standards. In addition, we sell therapeutic products for patients suffering from sleep disorders and provide sleep disorder diagnoses at sleep laboratories and centers that we operate. We also deliver technology services to companies regulated by the FDA.

We categorize our product and service offerings within our four business segments: anesthesia, respiratory/critical care, sleep disorder and pharmaceutical technology services, which we describe in more detail below:

Anesthesia

We have been supplying products to the anesthesia market for 33 years. Our single-patient use anesthesia products and systems are designed to deliver oxygen and anesthesia from a gas source, such as an anesthesia machine, to a patient's pulmonary system. They also remove anesthetic gases, carbon dioxide and expiratory oxygen from a patient and link a patient to various monitors. Based upon data furnished by IMS Health Incorporated, we believe that we have a number one U.S. market share position for anesthesia breathing circuits, face masks and infusors. Our principal anesthesia products consist of face masks, breathing circuits and general anesthesia products. We believe that the breadth of our product offerings gives us the advantage of being able to sell customized circuits composed of multiple products. Historically, we have included the products sold by our Thomas Medical Products subsidiary within this segment. Thomas Medical is an original equipment manufacturer that produces vascular access products for sale to other health care product providers. These providers use Thomas Medical's offerings as components of their products or kits or as finished products. For fiscal 2004 and 2005, our anesthesia segment contributed 45.0% and 48.1%, respectively, of our net revenue.

Respiratory/critical care

We have been supplying products to the respiratory/critical care market for over 25 years. Based upon data furnished by IMS Health Incorporated, we believe that we have a number two U.S. market share position for ABG syringes and resuscitators. Our primary respiratory products are ABG syringes and kits, manual resuscitators and blood pressure cuffs. We also distribute critical care equipment kits and modules, which are color coded to allow emergency room workers to quickly and accurately determine the proper equipment size to use with pediatric patients. For fiscal 2004 and 2005, our respiratory/critical care segment contributed 22.9% and 21.9%, respectively, of our net revenue.

Sleep disorder

Building upon our airway management expertise and our long-time experience with CPAP systems, we began providing sleep disorder products and services in the late 1990s. We believe that we are the only company that both operates sleep laboratories and centers to diagnose obstructive sleep apnea and manufactures and sells products designed to treat that condition. As of September 30, 2005, we operated 52 sleep diagnosis laboratories and centers in seven states in the United States and in Washington D.C. At these laboratories and centers, we conduct sleep studies to determine whether the patients referred to us suffer from sleep disorders. If a patient is determined to suffer from sleep apnea, we can offer the patient follow-up diagnostic and monitoring services and may, under certain circumstances, be in a position to sell our sleep disorder products to the patient. Our principal sleep disorder products, currently marketed primarily outside of the United States,

are personal ventilation systems, which are used in the treatment of obstructive sleep apnea to prevent temporary airway closure during sleep. For fiscal 2004 and fiscal 2005, sleep disorder and personal ventilation products and services accounted for 23.9% and 21.4%, respectively, of our net revenue.

Pharmaceutical technology services

In 1996, we began providing regulatory consulting services to clients, helping them to develop and validate systems and processes for their manufacturing, infrastructure, research and development, laboratory and quality assurance departments. In 2002, with our acquisition of our Stelex subsidiary, we expanded our services to include computer systems compliance. In addition, we have developed and currently market proprietary software products used in conjunction with our services to help clients comply with FDA regulations. We deliver these technology services to FDA regulated companies primarily in the pharmaceutical sector, as well as to medical device, diagnostic and biotechnology companies. Our clients include some of the largest pharmaceutical companies in the world. For fiscal 2004 and fiscal 2005, pharmaceutical technology services accounted for 8.2% and 8.6%, respectively, of our net revenue.

Market overview

Anesthesia and respiratory/critical care

Demand for single-patient use anesthesia and respiratory/critical care products depends in part on trends in the total number of surgical procedures performed. According to a market forecast published by Medtech Insight, LLC, the size of the United States market for anesthesia and respiratory airway management products is currently estimated at approximately \$800 million and is expected to reach \$1.1 billion by calendar 2010.

In response to rising health care costs, managed care companies and other third-party payors have placed pressure on health care providers to reduce costs, which could hamper our revenue growth. Yet, we believe that efforts to contain rising health care costs have increased the preference for single-patient use medical products, which we believe improve the productivity of health care professionals, reduce overall provider costs and improve patient care.

We believe that single-patient use medical products provide the United States health care industry with the following benefits:

- *cost effectiveness*, by lowering the labor costs associated with sterilizing, reassembling and re-testing reusable products, lowering inventory costs, reducing the initial capital outlays for stocking new reusable products and improving the ability to allocate costs directly to individual patients;
- *improved patient care*, by reducing the risk of contracting infections from reusable products that have been inadequately sterilized, thereby reducing the risk of additional post-operative patient care; and
- *reduced set up time*, resulting from the fact that many single-patient use products can be packaged in disposable kits, allowing medical practitioners to reduce set up time and thereby perform more procedures.

As a result of these factors, we believe that single-patient use medical products have become the products of choice in the United States anesthesia and respiratory/critical care markets.

We view the international markets as a significant growth opportunity for our company as single-patient use products have not fully penetrated those markets. We believe that in developed countries, heightened concern regarding cross-contamination and sterilization costs are resulting in single-patient use medical products replacing traditional reusable products. We believe that the trend towards utilizing single-patient use products is accelerating in developing countries as health care standards improve. In addition, many developing markets have high incidences of

communicable respiratory diseases and are becoming increasingly aware of the value of single-patient use respiratory products.

Single-patient use anesthesia products and systems are designed to deliver oxygen and anesthesia from a gas source, such as an anesthesia machine, to a patient's pulmonary system. They also remove anesthetic gases, carbon dioxide and expiratory oxygen from a patient and link the patient to various monitors. Face masks and breathing circuits constitute our primary anesthesia product offerings.

Single-patient use respiratory/critical care products are designed to assist hospitals with their infection control programs by helping to reduce infections caused by cross-contamination when products are used by more than one patient. These products also offer patient benefits as they are generally lighter than reusable products resulting in better patient care, for example, by causing less torque on the endotracheal tube. We believe that in recent years there has been an increasing incidence of respiratory illnesses, such as asthma and emphysema, due in part to an increasingly susceptible aging population, environmental pollution, smoking-related illnesses and communicable diseases with significant respiratory impact, such as tuberculosis, HIV and influenza. People with these conditions have a need for our products, such as manual resuscitators and ABG kits, in emergency care situations.

Sleep disorder

Obstructive sleep apnea is considered to be one of the most common sleep problems. Obstructive sleep apnea, or OSA, is a condition that causes the soft tissue in the rear of the throat to narrow and repeatedly close during sleep. Oxygen deficiency, elevated blood pressure and increased heart rate associated with OSA are related to increased risk of cardiovascular morbidity, stroke and heart attack. Additionally, OSA may result in excessive daytime sleepiness, reduced cognitive functions, including memory loss, lack of concentration, depression and irritability. According to the National Heart, Lung and Blood Institute of the National Institutes of Health, approximately 20 million in the United States alone suffer from sleep apnea. We believe that a substantial portion of those remain undiagnosed. Increased awareness of OSA among doctors and patients in recent years is expected to continue fueling growth of the OSA diagnostic and treatment industry.

The diagnosis of obstructive sleep apnea typically requires monitoring a patient during sleep. During overnight testing, which usually takes place in a clinical setting, respiratory parameters and sleep patterns are monitored along with other vital signs, providing information about the quality of an individual's sleep. A report by Frost & Sullivan indicates that in 2003, there were approximately 2,800 sleep laboratories and centers in the United States. We believe that this represents a significant expansion over the number of such laboratories and centers that existed in the United States two decades earlier.

CPAP therapy has evolved as the primary method for the treatment of obstructive sleep apnea, in part because it is less invasive and more cost-effective than surgery. Unlike surgery, which may only result in reduced snoring, we believe that CPAP therapy actually reduces the occurrence of obstructive sleep apnea. During this therapy, a patient sleeps with a nasal or facial mask connected by a tube to a small portable airflow generator that delivers room air at a predetermined continuous positive pressure. The continuous air pressure acts as a pneumatic splint to keep the patient's upper airway open and unobstructed. As a result, the cycle of airway closures, which leads to the disruption of sleep and other symptoms that characterize obstructive sleep apnea, is prevented.

CPAP is generally not a cure but a therapy for managing obstructive sleep apnea, and therefore, must be used on a daily basis as long as treatment is required. Patient compliance has been a major factor in the efficacy of CPAP treatment. Early generations of CPAP units provided limited patient comfort and convenience. More recently, product innovations to improve patient comfort and compliance have been developed.

Pharmaceutical technology services

Pharmaceutical, diagnostic, biotechnology and medical device companies are strictly regulated by the FDA. The FDA's regulatory framework covers virtually every aspect of these companies' operations. FDA regulations mandate that these companies maintain highly detailed records to enable them to demonstrate compliance with complex requirements. Companies that fail to comply with FDA regulations may be delayed or prevented from commercializing new products and product enhancements and may have existing products removed from the market.

The tasks of developing FDA compliance programs and monitoring their performance are complex and time-consuming. Enforcement of FDA requirements has increased significantly in recent years, and the FDA has publicly stated that compliance will be more strictly scrutinized. If the FDA believes that its regulations have not been fulfilled, it may invoke extensive enforcement powers against the violating company. We believe that many FDA regulated companies do not maintain the internal staff necessary to meet the increased requirements and FDA scrutiny and therefore require consultants to help them become and remain compliant. We also believe that regulated companies are under continuing scrutiny with regard to the quality and compliance of critical computer systems and will continue to require external help to develop and implement these systems.

Competitive strengths

We believe that we have demonstrated competitive strengths in each of our segments which help to differentiate us from other medical device manufacturers that compete with us in particular markets. Those strengths include the following:

Anesthesia and respiratory/critical care

Industry leading developer and manufacturer. We are a developer and manufacturer of multiple products which have become industry-standards in both the anesthesia and respiratory/critical care markets. We strive to identify problems that confront hospitals and their patients and then develop safe, effective and innovative solutions to those problems.

Brand recognition. We have obtained worldwide brand recognition through years of supplying the anesthesia and respiratory/critical care markets. In the United States, we sell our products to our hospital customers both directly and through national medical supply distributors. Internationally, we distribute our products both through our own direct sales force and through distributors. In fiscal 2005, 24.1% of our net revenue was sold internationally.

Relationships with hospitals. We have developed strong relationships with hospitals located throughout the United States. As of September 30, 2005, we employed 57 salespersons who sell directly to United States based hospitals.

Most manufacturing is done internally. Several of our facilities have been designed to allow us to perform various manufacturing functions. See the section entitled "Business—Properties." We manufacture a majority of our products internally, providing numerous manufacturing efficiencies and the ability to react quickly to changes in market demand. We believe that these capabilities allow us to contain costs, control quality and maintain security of proprietary processes.

Broad range of product offerings. We believe that our broad range of product offerings represents a competitive advantage over suppliers with more limited product lines and helps us to grow our business. We continue to supplement our existing products and services with new offerings designed to meet the needs of health care professionals. For example, in response to reports of allergic reactions to medical devices containing latex, we manufacture a number of latex free products.

Sleep disorders

Direct access to patients. As of September 30, 2005, we operated 52 sleep laboratories and centers in the United States. These sleep laboratories and centers provide us with direct access to patients.

Through our sleep laboratory affiliations, we are able to educate health care providers and patients with respect to the development of sleep apnea treatments and, in certain cases, introduce our sleep disorder and personal ventilation products directly to the patient.

Pharmaceutical technology services

Ability to leverage our own expertise. We are strictly regulated by the FDA. As a result, we are mindful of the complexity of FDA regulations and the strict environment in which such regulations are enforced. We believe that we have a thorough understanding of the questions that must be asked and the processes that must be undertaken, because we have been focused on regulatory compliance for decades.

Growth strategy

Our goal is to strengthen our position as a leading provider of single-patient use medical devices for the anesthesia and respiratory/critical care markets, while also enhancing our position as a provider of sleep disorder and personal ventilation products and services, and as a provider of regulatory consulting services. In order to achieve these objectives, we intend to continue to pursue the following growth strategies:

Anesthesia and respiratory/critical care

Develop complementary and innovative products. We intend to continue to develop new products to respond to the needs of health care providers and that are complimentary to our existing product lines. We have introduced a variety of innovative products, including our air cushion face masks, our clear non-conductive circuits, our dry heparin ABG kits and our single patient resuscitators and blood pressure cuffs.

Extend our penetration into hospitals. As of September 30, 2005, we had a 57 person domestic direct sales force. We utilize our direct sales force to increase the number of hospitals that we cover and to penetrate deeper into the hospitals that we presently serve.

Capitalize on the popularity of single patient use products. We intend to capitalize on the growing acceptance of single patient use products in international markets. We believe that once single patient use products gain visibility in particular markets, there is significant opportunity for us to expand both our products offerings and our distributor networks in those markets.

Pursue licensing arrangements and strategic acquisitions. We intend to pursue licensing arrangements and strategic acquisitions, both domestically and internationally, to expand our product line, to develop our technology and to improve our market share positions. From fiscal 1997 through fiscal 2005, we have completed and successfully integrated five acquisitions. We typically target product areas in which licensing arrangements or business, technology or product acquisitions will allow us to reach the market more quickly and less expensively than if we had developed the products internally. We believe that our direct sales and distribution network, well-recognized brand name and experienced management team, provide a strong platform on which to execute our expansion strategy.

Expand our relationship with group purchasing organizations. Our strategy is to sell more products to our customers that are group purchasing organization members, negotiate favorable terms with group purchasing organizations with which we now deal and secure additional group purchasing organization contracts.

Sleep disorder

Leverage airway management experience. We seek to leverage our airway management expertise by providing products and services for the high growth sleep disorder and personal ventilation markets. We offer products for the treatment of obstructive sleep apnea and operate sleep diagnosis laboratories and centers in the United States which

test the need for sleep apnea products.

Expand significantly in the obstructive sleep apnea diagnosis field. We intend to expand our presence in the obstructive sleep apnea diagnosis field significantly by increasing the number of hospital-based sleep laboratories and centers that we operate. As of September 30, 2005, we operated 52 sleep diagnosis laboratories and centers in seven states in the United States and in Washington D.C. The operation of these laboratories and centers provides us with direct access to patients at the point of diagnosis. This is a highly fragmented industry comprised of numerous unaffiliated sleep facilities that, in many cases, offer fewer services than we offer. We seek to align ourselves, and more particularly our new sleep laboratories and centers, with hospitals and clinics that can be expected to offer a steady source of patient referrals. We believe that the information derived from our laboratories and centers enables us to improve our sleep diagnosis services, develop complementary sleep disorder and personal ventilation products and educate physicians about sleep disorders and the benefits that may be derived from CPAP devices.

Introduce our sleep products in the United States and leverage our sleep laboratories and centers to develop markets for those products. We intend to develop in the United States the same reputation that our Breas subsidiary enjoys in Europe as a leading provider of sleep disorder and personal ventilation products. We have received clearance from the FDA to market several Breas products that presently are sold in international markets but not in the United States. We plan to submit additional sleep disorder and personal ventilation products for FDA clearance in the next 12 months.

Pharmaceutical technology services

Leverage expertise in navigating FDA regulations. We have developed expertise navigating complex FDA regulations that directly affect the time required to bring a product to market. We seek to leverage this expertise by providing consulting services on issues of regulatory compliance and satisfaction of internal protocols both to large pharmaceutical companies and to smaller diagnostic, biotechnology and medical device companies.

Expand our pharmaceutical technology services. We seek to provide additional consulting services to existing clients and will seek to obtain new consulting clients. We believe that there are a significant number of FDA regulated companies, subject to increasing regulation and scrutiny, that do not maintain the internal staff necessary for identifying, interpreting and assuring compliance with FDA and other regulatory requirements. We also believe that the complexity of implementing and validating critical computer systems to meet regulatory requirements continues to increase. As a result, we have developed and currently market proprietary software products that we use in conjunction with our services to help clients comply with FDA regulations. We plan to continue to partner with leading software providers and to develop internal expertise to provide additional services to clients and to differentiate our service offerings from those offered by our competitors.

Principal products and services

Our principal products and services fall into four segments: anesthesia, respiratory/critical care, sleep disorder, and pharmaceutical technology services, which are described below.

Anesthesia

Anesthesia products were our first line of business and continue to be our leading source of revenue. Our single-patient use products and systems are designed to deliver oxygen and anesthesia from a gas source, such as an anesthesia machine, to a patient's pulmonary system. They also remove anesthetic gases, carbon dioxide and expiratory oxygen from a patient and link a patient to various monitors. Based upon data furnished by IMS Health Incorporated, we believe that we have a number one U.S. market share position for anesthesia breathing circuits, face masks and infusors, and a leading market position in the other anesthesia subcategories in which we sell products. We offer a wide variety of products which are designed to be compatible with the anesthesia equipment manufactured by most companies. Our anesthesia segment accounted for 45.0% of our net revenue in fiscal 2004 and 48.1% of our net revenue in fiscal 2005.

Our primary anesthesia products and systems include:

- *Anesthesia breathing circuits* are single-patient use devices used to ventilate and carry oxygen and anesthesia to a patient while under general anesthesia during surgery as well as to connect the patient to an anesthesia machine and to monitors. The traditional system is referred to as a “circuit” because it is comprised of two tubes, one carrying inspiratory gases to a patient and the other carrying expiratory gases away from a patient. Each traditional breathing circuit consists of flexible hoses, a breathing bag, and a “Y” and elbow attachment. Because the breathing circuit needs of hospitals vary significantly, we offer a large variety of circuits designed to be compatible with anesthesia equipment manufactured by other companies. Technological advances in the areas of gas sampling, temperature monitoring, humidification and bacterial/viral filtration have provided us with opportunities to expand our breathing circuit offerings. In late 2000, we introduced the patented product Limb-Ø™, a single limb breathing circuit used for general anesthesia, transport and/or critical care ventilations. The single limb incorporates a patented technology with a septum to separate inspiratory and expiratory gases. The expiratory portion of the tube contains warmed exhalation gas which helps to warm the inspiratory gas. The Limb-Ø™ competes with the traditional two limb system on the basis of the added benefit of heat and moisture provided to the patient and the reduction of bulk and weight associated with traditional two limb circuits and is an alternative to the tube within a tube circuit.
- *Face masks* are single-patient use devices which cover the nose and mouth of a patient while general anesthesia is being administered. In 1981 we became the first company to sell the now-standard air-filled clear cushion face mask for single-patient anesthesia and respiratory use. We believe that the soft air-filled cushion facemask provides a better seal on most patients than other facemasks, thereby improving the delivery of anesthetic gases and oxygen to the patient. A clear facemask also permits the clinician to better observe certain patient problems, such as life-threatening aspiration, while the patient is anesthetized. We offer various sizes and types of facemasks. We anticipate that the usage of single-patient use face masks in surgical procedures internationally will continue to increase as single-patient use products become more accepted in international hospitals.
- *General anesthesia systems* are customized single-patient use anesthesia kits that we assemble which can include more than 20 of our single-patient use products, such as air filled cushion face masks, breathing circuits, blood pressure cuffs and temperature monitoring probes. We market these kits under the name GAS™. Our sales representatives use detailed questionnaires to assist each customer in determining the particular products that an institution desires in its anesthesia kits. We then assemble our GAS™ kits to meet an institution's specific needs.
- *Pressure infusors* are single patient use devices utilized hospital wide to apply pressure to a sealed bag of fluid, such as intravenous solutions or blood products. Our INFUSABLE® pressure infusor is a patented system consisting of a pressure gauge, an inflatable bladder and a bulb to pump air into the bladder. Our INFUSABLE® has a mesh netting into which a package of sterile fluid or “solution bag” is placed. The fluid is connected to the patient monitoring system and the pressure on the solution bag is set at a level designed to maintain the pressure required by the monitoring system. Our INFUSABLE® is also designed to deliver blood or fluids to a patient at a rapid rate, usually under trauma conditions.
- *Fiberoptic laryngoscope systems* are single-patient use devices used by anesthesiologists to assist in correctly placing an endotracheal tube within the trachea of a patient. Our Vital View™ system has single-patient use blades which we believe offers several advantages over traditional reusable metal blade laryngoscope systems, including lowering the risk to both patient and physician of infection associated with reusable metal blades and handles. In early fiscal 2006, we introduced a new laryngoscope handle system utilizing an LED light source. We believe that hospital capital outlays for stocking emergency crash carts can be reduced by purchasing our single use system rather than a reusable fiberoptic system.

- *Laryngeal airway devices* are single use airway devices used for airway management during general anesthesia procedures. We expect to introduce *Vital Seal™*, a single use laryngeal mask device, in early calendar 2006. *Vital Seal™* has several patented features intended to address known complications, including a reinforced tongue within the tip of the sealing cuff to resist over-folding and ribbed slots to minimize the possibility of occlusion by a patient's epiglottis.

We also manufacture a wide range of accessories and components for use with our anesthesia products, including heat/moisture exchangers, bacterial/viral filters, anesthesia breathing bags (including latex-free bags), airways, temperature monitoring devices and other components.

In addition to the products and systems described above, through our wholly-owned Thomas Medical Products, Inc. subsidiary, we act as an original equipment manufacturer. We manufacture devices which provide access primarily to the vascular system, including introducers, sheaths, dilators, hemostasis valves and catheters. These products are sold primarily to other health care product providers to be used in their products or kits or as a finished product.

Respiratory/critical care

Based upon data furnished by IMS Health Incorporated, we believe that we have a number two U.S. market share position for ABG syringes and resuscitators. Our respiratory/critical care segment accounted for 22.9% of our net revenue in fiscal 2004 and 21.9% of our net revenue in fiscal 2005.

Our primary respiratory/critical care products and systems include:

- *ABG syringes and collection kits* are used to collect arterial blood for blood gas analyses routinely performed in hospitals on patients suspected of having metabolic, respiratory or other cardiopulmonary difficulties. We offer a broad line of disposable ABG syringes and collection systems in both standard configurations and in kits that are customized to meet a specific hospital's needs and to function with the hospital's blood gas analyzers. We offer syringes containing our *SURE-LOK™* needle protection device to protect the health care worker from the risk of being punctured by a contaminated needle.
- *Manual resuscitators* are single-patient use devices which are squeezed by hand to force oxygen into a patient's lungs. Manual resuscitators are used throughout the hospital in a variety of settings. For example, patients on a ventilator require the use of a resuscitator prior to tracheal suctioning procedures. Another use is in providing oxygen while transporting the patient between the operating room and other critical care units. In addition, resuscitators are typically placed strategically throughout the hospital to provide assistance to patients who have stopped breathing and require resuscitation. Our *Code Blue II™* resuscitators are sold in different sizes for infants, children and adults. These resuscitators alleviate certain problems involved in mouth-to-mouth emergency resuscitation, including the risk to both the rescuer and the individual of transmitting infections. We believe that reusable manual resuscitators are costly to sterilize and require re-assembly, which may result in errors that compromise proper function. In contrast, our *Code Blue II™* resuscitators are relatively inexpensive and are delivered fully assembled.
- *Blood pressure cuffs* are single-patient use devices which are wrapped around the arm or thigh of a patient to obtain a blood pressure reading. Our *CUFF-ABLE®* single-patient use blood pressure cuffs provide hospitals with an alternative to traditional reusable blood pressure cuffs that can become contaminated by touch, with blood and other body fluids. While all patients admitted to hospitals are candidates for their own dedicated blood pressure cuff, we believe that to date the primary market for disposable cuffs has been for cases where infection control is a high priority. Our *CUFF-ABLE®* blood pressure cuffs are sold in a variety of sizes (including neonatal) and are adaptable to all manual and electronic blood pressure monitors that utilize blood pressure cuffs.

-

Hyperinflation systems are devices used for patient resuscitation. We offer both our *Babysafe*TM and traditional hyperinflation systems for infant resuscitation in transport and prior to tracheal suctioning. These products are used in labor and delivery rooms and in neonatal intensive care units, where controlling the spread of infection is particularly critical. *BabySafe*TM offers the ability to adjust and limit the level of pressure that can be delivered during resuscitation. Oxygen can be delivered with limited risk of barotrauma. These systems are available in a variety of configurations and sizes to meet the needs of infants.

- *CPAP systems* consist of a compact flow generator connected to a dual-port, air-filled cushion face mask and are used as therapy for various respiratory diseases. The face mask is attached to a single-patient use positive end expiratory pressure valve designed to maintain positive airway pressure in the lungs, allowing for more oxygen to diffuse into a patient's blood system. Our facemask CPAP systems provide a less invasive and more comfortable way of providing oxygen to certain patients than conventional ventilator-based systems. Our facemask CPAP systems eliminate the need to insert an endotracheal tube into the patient's trachea and then attach the patient to a ventilator. Our facemask CPAP systems are now being used successfully in the hospital and pre-hospital setting to treat patients with cardiogenic pulmonary edema and other respiratory deficiencies.
- *Heated humidification systems* provide a flow of warm moist air to a patient at risk from loss of body temperature and drying of the lung linings. Our *MistyOx*® line consists of two respiratory products that deliver hydration to a patient, a nebulizer which delivers medium to high flow and high concentrations of oxygen to patients, combined with a regulated heater. These products may be used by infants, children and adults in many areas of the hospital, including emergency, recovery and critical care.
- *CPR training mannequins* are training aids for teaching cardiopulmonary resuscitation, commonly known as CPR. Our *Actar*® training mannequin provides a low cost alternative to many of the other training mannequins on the market. Its low cost allows each trainee to practice on his or her own mannequin rather than waiting to take turns on a single mannequin used by an entire class. Our newest model, *Actar D-FIB*®, incorporates additional functionality to meet the updated requirements of the American Heart Association and the Red Cross. New features include jaw thrust, abdominal thrust and anatomical landmarks for proper defibrillation training.
- *Broselow® pediatric emergency products*. The Broselow/Hinkle™ Pediatric Emergency System and the Broselow-Luten System are a part of our “Color Coding Kids” product line. These are the results of extensive clinical efforts by James Broselow, M.D., Robert Luten, M.D. and Alan Hinkle, M.D. to enable emergency care providers to determine the appropriate equipment size for infants in emergency situations. The Broselow® system takes advantage of the direct correlation between a pediatric patient's body length and the proper size of emergency supplies. This patented system, licensed to Vital Signs, consists of a tape measure having nine color zones, a corresponding series of color-coded single-patient use emergency kits or modules and a nylon organizer bag custom-designed to hold all the supplies needed in either a trauma, cardiac or respiratory pediatric emergency.

In addition to the products and systems described above, we also manufacture a wide range of accessories and components for use with our respiratory/criticism"> 311 276 35

EBIT

EBIT of the Domestic Business Unit for the first half of 2017 came to 1,685 million euros (1,581 million euros in the same period of 2016), up 104 million euros (+6.6%), with an EBIT margin of 22.5% (21.8% in the first half of 2016). The EBIT performance mainly reflected the improvement in EBITDA reported above, partially offset by the increase in depreciation and amortization, of +78 million euros. In organic terms the increase was 6.5%.

EBIT for the first half of 2017 was pulled down by a total of 95 million euros in non-recurring expenses (83 million euros for the same period of the previous year), without which the organic change in EBIT would have been 6.9%, with an EBIT margin of 23.8%.

Organic EBIT is calculated as follows:

(millions of euros)	1st Half 2017	1st Half 2016	Change	
			amount	%
REPORTED EBIT	1,685	1,581	104	6.6
Foreign currency financial statements translation effect		1	(1)	
Changes in the scope of consolidation				
ORGANIC EBIT	1,685	1,582	103	6.5
of which non-recurring income/(expenses)	(95)	(83)	(12)	
ORGANIC EBIT excluding non-recurring component	1,780	1,665	115	6.9

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Domestic Business Unit

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Financial highlights of the Domestic Cash Generating Units

The main financial and operating highlights of the Domestic Business Unit are reported according to two Cash Generating units (CGU):

Core Domestic: includes all telecommunications activities pertaining to the Italian market. Revenues are broken down in the following tables according to the net contribution of each market segment to the CGU's results, excluding intrasegment transactions. The sales market segments established on the basis of the customer centric organizational model are as follows:

Consumer: the segment consists of all Fixed and Mobile voice and Internet services and products managed and developed for individuals and families and of public telephony; customer care, operating credit support, loyalty and retention activities, sales within its remit, and administrative management of customers; the segment includes the companies 4G, Persidera and Noverca.

Business: the segment consists of voice, data, and Internet services and products, and ICT solutions managed and developed for small and medium-size enterprises (SMEs), Small Offices/Home Offices (SOHOs), Top customers, the Public Sector, Large Accounts, and Enterprises in the Fixed and Mobile telecommunications markets; it also includes the company Olivetti.

Wholesale: the segment consists of the management and development of the portfolio of regulated and unregulated wholesale services for Fixed and Mobile telecommunications operators in the domestic market and Open Access operations connected with delivery and assurance processes for customer services.

Other (INWIT S.p.A. and support structures): includes:

INWIT S.p.A.: from April 2015, the company has been operating within the Operations area in the electronic communications infrastructure sector, specifically relating to infrastructure for housing radio transmission equipment for mobile telephone networks, both for TIM and other operators;

Other Operations units: covering technological innovation and the processes of development, engineering, building and operating network infrastructures, IT, real estate properties and plant engineering;

Staff & Other: services carried out by Staff functions and other support activities performed by minor companies of the Group, also offered to the market and other Business Units.

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International Wholesale Telecom Italia Sparkle group: includes the activities of the Telecom Italia Sparkle group, which operates in the market for international voice, data and Internet services for fixed and mobile telecommunications operators, ISPs/ASPs (Wholesale market) and multinational companies through its own networks in the European, Mediterranean and South American markets.

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Key results for the first half of 2017 for the Domestic Business Unit are presented in the following tables, broken down by market/business segment and compared to the first half of 2016.

Core Domestic

(millions of euros)	1st Half 2017	1st Half 2016	Change	
			amount	%
Revenues	6,965	6,736	229	3.4
<i>Consumer</i>	3,767	3,572	195	5.5
<i>Business</i>	2,280	2,200	80	3.6
<i>Wholesale</i>	834	863	(29)	(3.4)
<i>Other</i>	84	101	(17)	(16.8)
EBITDA	3,278	3,093	185	6.0
<i>EBITDA Margin</i>	47.1	45.9		1.2 pp
EBIT	1,657	1,540	117	7.6
<i>EBIT Margin</i>	23.8	22.9		0.9 pp
Headcount at period end (number) ^(*)	50,307	⁽¹⁾ 50,527	(220)	(0.4)

(1) Headcount at December 31, 2016

(*) Includes employees with temp work contracts: 0 employees at 6/30/2017 (1 employee at 12/31/2016).

In detail:

Consumer: revenues for the Consumer segment for the first half of 2017 amounted to a total of 3,767 million euros, an increase of 195 million euros compared to the same period of 2016 (+5.5%). This performance continued the trend of recovery already underway in the previous year.

In particular:

revenues from the Mobile business amounted to 1,847 million euros and showed growth compared to the first half of 2016 (+70 million euros, +4.0%), with revenues from services in particular up 51 million euros

(+3.3% on the first half of 2016). This continued the trend of improvement already seen in the previous quarters (+4.1% in the second quarter 2017; +3.9% in the first quarter 2017; +4.8% in the fourth quarter 2016) due to the progressive stabilization and improvement of market share and the steady growth in Internet mobile and digital services, which sustained the ARPU levels;

revenues for the Fixed-line segment amounted to 1,903 million euros, up 130 million euros compared to the first half of 2016 (+7.3%), representing a continued improvement on the previous quarters (+11.2% in the second quarter 2017; +3.5% in the first quarter 2017; +2.0% in the fourth quarter 2016), thanks to the reduction in line losses, the growth in the Broadband and Ultra broadband customer base (which offset the loss of voice only accesses), the increase in ARPU levels and the strong performance of sales of connected devices.

Business: revenues for the Business segment amounted to 2,280 million euros, up 80 million euros on the first half of 2016 (+3.6%).

In detail:

revenues from the Mobile business posted performance in line with the first half of 2016 (+0.1%); specifically, the continuing decline in traditional mobile services (-9.0% in the voice and messaging component compared to the first half of 2016), driven by the shift of customers (both private individuals and government agencies) towards formulas with lower ARPU, was fully offset by the positive performance of new digital services (+9.6% on the first half of 2016);

revenues for the Fixed-line segment increased by 77 million euros (+4.6% on the first half of 2016) thanks to the steady increase in revenues from ICT services (+9.8%), which more than offset the reduction in prices and revenues from traditional services and the effects of the technological shift towards VoIP systems.

Wholesale: revenues for the Wholesale segment in the first half of 2017 came to 834 million euros, down on the same period of 2016 (-29 million euros, -3.4%). The impact on revenues was entirely due to the reduction in regulated prices, which produced a shortfall of -44 million euros, partially offset by the growth in numbers in the NGN, SULL and Co-location segments.

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BRAZIL

	(millions of euros)		(millions of reais)		Change	
	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	amount	%
	(a)	(b)	(c)	(d)	(c-d)	(c-d)/d
Revenues	2,293	1,858	7,894	7,674	220	2.9
EBITDA	762	556	2,624	2,296	328	14.3
<i>EBITDA Margin</i>	33.2	29.9	33.2	29.9		3.3 pp
EBIT	194	121	669	498	171	34.3
<i>EBIT Margin</i>	8.5	6.5	8.5	6.5		2.0 pp
Headcount at period end (number)			9,471	⁽¹⁾ 9,849	(378)	(3.8)

(1) Headcount at December 31, 2016

	1st Half 2017	1st Half 2016
Lines at period end (thousands)	60,831	⁽¹⁾ 63,418
MOU (minutes/month) (*)	106.7	118.4
ARPU (reais)	19.2	17.2

(1) Number at December 31, 2016, including corporate lines

(*) Net of visitors

Revenues

Revenues for the first half of 2017 amounted to 7,894 million reais and were up 220 million reais (+2.9%) year-on-year. Service revenues totaled 7,494 million reais, an increase of 305 million reais compared to 7,189 million reais for the first half of 2016 (+4.2%). These results confirm the continued improvement in the trend, with positive growth in the second quarter of 2017 both in total revenues (+3.2% compared to +2.5% for the first quarter of 2017 and -1.7% for the fourth quarter of 2016) and in revenues from services (+5.0% compared to +3.5% for the first quarter 2017 and -0.7% for the fourth quarter of 2016).

Mobile Average Revenue Per User (ARPU) for the first half of 2017 was 19.2 reais, up on the figure of 17.2 reais for the first half of 2016 (+11.6%), due to the general repositioning towards the postpaid segment and new commercial initiatives aimed at increasing data usage and the average spend per customer.

The total number of lines at June 30, 2017 was 60,831 thousand, representing a decrease of 2,587 thousand on December 31, 2016 (63,418 thousand), with a market share of 25.1% in June 2017 (26.0% at December 31, 2016). This reduction was entirely attributable to the prepaid segment (-3,540 thousand) and was only partially offset by the growth in the postpaid segment (+953 thousand), also as a result of the consolidation underway in the market for second SIM cards. Postpaid customers represented 26.0% of the customer base at June 30, 2017, up 2.5 percentage points on December 2016 (23.5%).

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Revenues from product sales came to 400 million reais (485 million reais in the first half of 2016 (-17.5%). The reduction reflects the change in the commercial policy, which is now more focused on value rather than sales volume growth. The main goals of this strategy are to increase the purchasing of new handsets giving TIM customers access to broadband services on 3G/4G networks and to support the new loyalty offerings for higher-value postpaid customers. This new strategy is reflected in an increase in the average handset price of +7.7% compared with the first half of 2016 and an increase in smartphone penetration within the Company's total customer base, which reached 77% in May 2017 (70% in June 2016).

EBITDA

EBITDA amounted to 2,624 million reais, up 328 million reais on the first half of 2016 (+14.3%). The growth in EBITDA was attributable to both the positive performance of revenues and the benefits from the projects to enhance the efficiency of the operating expenses structure, launched in the second half of 2016, with an improvement in the second quarter (+15.8% compared to +12.6% in the first quarter of 2017 and +5.8% in the fourth quarter of 2016).

The EBITDA margin stood at 33.2%, 3.3 percentage points higher than in the first half of 2016.

You are also reminded that the employee benefits expenses for the first half of 2016 included non-recurring expenses for termination benefits of 34 million reais.

Even without the impact of these non-recurring expenses, EBITDA for the first half of 2017 showed an increase (+12.6%) compared to the first half of 2016, continuing the trend of steady improvement in the second quarter (+15.7% compared to +9.4% for the first quarter of 2017 and +2.1% for the fourth quarter of 2016).

The changes in the main cost items are shown below:

	(millions of euros)		(millions of reais)		Change (c-d)
	1st Half 2017 (a)	1st Half 2016 (b)	1st Half 2017 (c)	1st Half 2016 (d)	
Acquisition of goods and services	1,169	978	4,025	4,041	(16)
Employee benefits expenses	178	161	613	663	(50)
Other operating expenses	262	224	901	925	(24)
Change in inventories	(5)	(8)	(18)	(31)	13

EBIT

EBIT amounted to 669 million reais, up 171 million reais (+34.3%) on the first half of 2016 (498 million reais). This result benefited from the greater contribution from the EBITDA (+328 million reais), which was offset by higher depreciation (+119 million reais) related to the development of industrial infrastructure, and a lower impact of net

gains on disposals of assets (-38 million reais), mainly attributable to the telecommunication towers. In this regard, we note that the last partial sale of telecommunication towers to American Tower do Brasil took place in the second quarter of 2017. This transaction resulted in proceeds and an income effect of an immaterial amount.

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CONSOLIDATED FINANCIAL POSITION AND CASH FLOWS PERFORMANCE

NON-CURRENT ASSETS

Goodwill: this decreased by 101 million euros, from 29,612 million euros at the end of 2016 to 29,511 million euros at June 30, 2017 due to the negative variation in exchange rates for the Brazilian companies ⁽¹⁾. Further details are provided in the Note Goodwill in the Half-year Condensed Consolidated Financial Statements at June 30, 2017 of the TIM Group.

Other intangible assets: were down 357 million euros, from 6,951 million euros at the end of 2016 to 6,594 million euros at June 30, 2017, representing the balance of the following items:

capex (+673 million euros);

amortization charge for the period (-907 million euros);

disposals, exchange differences, reclassifications and other changes (for a net negative balance of 123 million euros).

Tangible assets: were down 318 million euros, from 16,360 million euros at the end of 2016 to 16,042 million euros at June 30, 2017, representing the balance of the following items:

capex (+1,383 million euros);

changes in financial leasing contracts (+30 million euros);

depreciation charge for the period (-1,342 million euros);

disposals, exchange differences, reclassifications and other changes (for a net negative balance of 389 million euros).

CONSOLIDATED EQUITY

Consolidated equity amounted to 23,619 million euros (23,553 million euros at December 31, 2016), of which 21,404 million euros attributable to Owners of the Parent (21,207 million euros at December 31, 2016) and 2,215 million euros attributable to non-controlling interests (2,346 million euros at December 31, 2016). In greater detail, the changes in equity were the following:

(millions of euros)	6/30/2017	12/31/2016
At the beginning of the period	23,553	21,333
Correction due to errors		(84)
At the beginning of the period revised	23,553	21,249
Total comprehensive income (loss) for the period	269	2,801
Dividends approved by:	(205)	(204)
<i>TIM S.p.A.</i>	(166)	(166)
<i>Other Group companies</i>	(39)	(38)
Issue of equity instruments	4	1
Conversion of the Guaranteed Subordinated Mandatory Convertible Bonds due 2016		1,300
Disposal of the Sofora Telecom Argentina group		(1,582)
Other changes	(2)	(12)
At the end of the period	23,619	23,553

(1) The spot exchange rate used for the translation into euro of the Brazilian real (expressed in terms of units of local currency per 1 euro) was 3.77532 at June 30, 2017 and 3.43542 at December 31, 2016.

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CASH FLOWS

Adjusted net financial debt stood at 25,104 million euros, down 15 million euros compared to December 31, 2016 (25,119 million euros).

The table below summarizes the main transactions that had an impact on the change in adjusted net financial debt during the first half of 2017:

Change in adjusted net financial debt

(millions of euros)	1st Half 2017	1st Half 2016	Change
EBITDA	4,114	3,726	388
Capital expenditures on an accrual basis	(2,056)	(1,983)	(73)
Change in net operating working capital:	(1,130)	(1,078)	(52)
<i>Change in inventories</i>	(44)	(40)	(4)
<i>Change in trade receivables and net amounts due from customers on construction contracts</i>	(52)	(130)	78
<i>Change in trade payables (*)</i>	(692)	(635)	(57)
<i>Other changes in operating receivables/payables</i>	(342)	(273)	(69)
Change in employee benefits	(7)	40	(47)
Change in operating provisions and Other changes	37	(34)	71
Net operating free cash flow	958	671	287
% of Revenues	9.8	7.4	2.4 pp
Sale of investments and other disposals flow	9	732	(723)
Share capital increases/reimbursements, including incidental costs	6		6
Financial investments flow	(1)	(9)	8

Dividends payment	(218)	(227)	9
Change in financial leasing contracts	(30)	(123)	93
Finance expenses, income taxes and other net non-operating requirements flow	(709)	(1,242)	533
Reduction/(Increase) in adjusted net financial debt from continuing operations	15	(198)	213
Reduction/(Increase) in net financial debt from Discontinued operations/Non-current assets held for sale		(38)	38
Reduction/(Increase) in adjusted net financial debt	15	(236)	251

(*) Includes the change in trade payables for amounts due to fixed asset suppliers.

In addition to what has already been described with reference to EBITDA, net financial debt during the first half of 2017 has been particularly impacted by the following items:

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Capital expenditures on an accrual basis

The breakdown of capital expenditures by operating segment is as follows:

(millions of euros)	1st Half 2017		1st Half 2016		Change
		% of total		% of total	
Domestic	1,626	79.1	1,575	79.4	51
Brazil	430	20.9	408	20.6	22
Other Operations					
<i>Adjustments and eliminations</i>					
Consolidated Total	2,056	100.0	1,983	100.0	73
<i>% of Revenues</i>	21.0		21.8		(0.8)pp

Capital expenditures in the first half of 2017 totaled 2,056 million euros, up 73 million euros on the first half of 2016. In particular:

the Domestic Business Unit posted capital expenditures of 1,626 million euros, an increase of 51 million euros compared to the first half of 2016. This increase was mainly attributable to the innovative component (+266 million euros on the first half of 2016) and, in particular, it reflected the increase in capital expenditure for the development of next-generation networks and services and the reduction in other types of expenditure. It also confirms the selectivity and attention given to the capital allocation choices based on strategic priorities and profit optimization.

The Brazil Business Unit recorded an increase in capital expenditure of 22 million euros for the first half of 2017 (including a positive currency effect of 82 million euros) compared to the first half of 2016; capital expenditures for the half-year were mainly aimed at the development of industrial infrastructure.

Change in net operating working capital

The change in net operating working capital for the first half of 2017 was a decrease of 1,130 million euros (decrease of 1,078 million euros in the first half of 2016). In particular:

the change in inventories and the management of trade receivables generated negative impacts of 44 million euros and 52 million euros, respectively;

the change in trade payables (-692 million euros) included the payment of around 257 million euros made by the Brazil Business Unit to the consortium that is carrying out the clean-up of the 700 MHz spectrum, which the Business Unit purchased the user rights to in 2014. The level of trade payables was also influenced by the seasonal peak in payments for bills payable;

the other changes in operating receivables/payables (-342 million euros) include a negative amount of 134 million euros, for levies on telecommunications operations paid by the Brazil Business Unit the taxes are normally paid every year by the end of March. There was also an increase in the VAT payable, which was settled in July.

Sale of investments and other disposals flow

This item showed a positive figure of 9 million euros for the first half of 2017 and related to disposals of assets within the normal operating cycle.

In the first half of 2016 it was a positive figure of 732 million euros and essentially related to the sale of the Sofora Telecom Argentina group that took place on March 8, 2016.

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Financial investments flow

In the first half of 2017 this item amounted to 1 million euros.

In the first half of 2016 this item amounted to 9 million euros and included around 6 million euros for the payment made by INWIT S.p.A., net of the cash acquired, for the acquisition of the investments in Revi Immobili S.r.l., Gestione Immobili S.r.l. and Gestione Due S.r.l., and around 3 million euros for the subscription of the capital increase in the company Northgate held as a non-controlling interest.

Change in leasing contracts

In the first half of 2017, this item amounted to 30 million euros.

In the first half of 2016 the change was 123 million and related to TIM S.p.A..

Further details are provided in the Note Tangible assets (owned and under finance leases) of the Half-year Condensed Consolidated Financial Statements at June 30, 2017 of the TIM Group.

Finance expenses, income taxes and other net non-operating requirements flow

The item amounted to 709 million euros and mainly included the payment, during the first half of 2017, of net finance expenses and income taxes, as well as the change in non-operating receivables and payables.

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Net financial debt

Net financial debt is composed as follows:

(millions of euros)	6/30/2017 (a)	12/31/2016 (b)	Change (a-b)
Non-current financial liabilities			
Bonds	19,587	20,369	(782)
Amounts due to banks, other financial payables and liabilities	6,944	7,656	(712)
Finance lease liabilities	2,356	2,444	(88)
	28,887	30,469	(1,582)
Current financial liabilities (*)			
Bonds	3,022	2,595	427
Amounts due to banks, other financial payables and liabilities	1,625	1,269	356
Finance lease liabilities	197	192	5
	4,844	4,056	788
Financial liabilities directly associated with Discontinued operations/Non-current assets held for sale			
Total Gross financial debt	33,731	34,525	(794)
Non-current financial assets			
Securities other than investments		(1)	1
Financial receivables and other non-current financial assets	(2,185)	(2,697)	512
	(2,185)	(2,698)	513
Current financial assets			
Securities other than investments	(1,102)	(1,519)	417
Financial receivables and other current financial assets	(630)	(389)	(241)
Cash and cash equivalents	(4,086)	(3,964)	(122)
	(5,818)	(5,872)	54

Financial assets relating to Discontinued operations/Non-current assets held for sale

Total financial assets	(8,003)	(8,570)	567
Net financial debt carrying amount	25,728	25,955	(227)
<i>Reversal of fair value measurement of derivatives and related financial assets/liabilities</i>	<i>(624)</i>	<i>(836)</i>	<i>212</i>
Adjusted net financial debt	25,104	25,119	(15)
<i>Breakdown as follows:</i>			
Total adjusted gross financial debt	32,002	32,574	(572)
Total adjusted financial assets	(6,898)	(7,455)	557

(*) of which current portion of medium/long-term debt:

<i>Bonds</i>	<i>3,022</i>	<i>2,595</i>	<i>427</i>
<i>Amounts due to banks, other financial payables and liabilities</i>	<i>853</i>	<i>670</i>	<i>183</i>
<i>Finance lease liabilities</i>	<i>197</i>	<i>192</i>	<i>5</i>

The financial risk management policies of the TIM Group are aimed at minimizing market risks, fully hedging exchange rate risk, and optimizing interest rate exposure through appropriate diversification of the portfolio, which is also achieved by using carefully selected derivative financial instruments. Such instruments, it should be stressed, are not used for speculative purposes and all have an underlying, which is hedged.

In addition, to determine its exposure to interest rates, the Group sets an optimum composition for the fixed-rate and variable-rate debt structure and uses derivative financial instruments to achieve that composition. Taking into account the Group's operating activities, the optimum mix of medium/long-term non-current financial liabilities has been established, on the basis of the nominal amount, at a range of 65% - 75% for the fixed-rate component and 25% - 35% for the variable-rate component.

In managing market risks, the Group has adopted Guidelines for the Management and control of financial risk and mainly uses IRS and CCIRS derivative financial instruments.

To provide a better representation of the true performance of Net Financial Debt, from 2009, in addition to the usual indicator (renamed Net financial debt carrying amount), a measure called Adjusted net

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financial debt has also been shown, which neutralizes the effects caused by the volatility of financial markets. Given that some components of the fair value measurement of derivatives (contracts for setting the exchange and interest rate for contractual flows) and derivatives embedded in other financial instruments do not result in actual monetary settlement, the Adjusted net financial debt excludes these purely accounting and non-monetary effects (including the effects resulting from the introduction of IFRS 13 Fair Value Measurement from January 1, 2013) from the measurement of derivatives and related financial assets/liabilities.

Sales of receivables to factoring companies

Sales of trade receivables to factoring companies completed during the first half of 2017 resulted in a positive effect on net financial debt at June 30, 2017 of 969 million euros (1,091 million euros at December 31, 2016).

Gross financial debt*Bonds*

Bonds at June 30, 2017 were recorded for a total of 22,609 million euros (22,964 million euros at December 31, 2016). Their nominal repayment amount was 22,310 million euros, down 107 million euros compared to December 31, 2016 (22,417 million euros).

Changes in bonds over the first half of 2017 are shown below:

<i>(millions of original currency)</i>	Currency	Amount	Issue date
New issues			
Telecom Italia S.p.A. 1,000 million euros 2.500% maturing 7/19/2023	Euro	1,000	1/19/2017
<i>(millions of original currency)</i>	Currency	Amount	Repayment date
Repayments			
Telecom Italia S.p.A. 545 million euros 7.000% ⁽¹⁾	Euro	545	1/20/2017

(1) Net of buybacks by the Company of 455 million euros during 2015.

With reference to the Telecom Italia S.p.A. 2002-2022 bonds, reserved for subscription by employees of the Group, the nominal amount at June 30, 2017 was 200 million euros, down 1 million euros compared to December 31, 2016 (201 million euros).

Revolving Credit Facility and Term Loan

The following table shows the composition and the drawdown of the committed credit lines available at June 30, 2017:

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(billions of euros)		6/30/2017		12/31/2016	
		Agreed	Drawn down	Agreed	Drawn down
Revolving Credit Facility	expiring May 2019	4.0		4.0	
Revolving Credit Facility	expiring March 2020	3.0		3.0	
Total		7.0		7.0	

TIM has two syndicated Revolving Credit Facilities for amounts of 4 billion euros and 3 billion euros expiring May 24, 2019 and March 25, 2020 respectively, both not yet drawn down.

TIM also has:

a bilateral Term Loan from Banca Regionale Europea expiring July 2019 for 200 million euros, drawn down for the full amount;

two bilateral Term Loans from Mediobanca respectively for 200 million euros expiring in November 2019 and 150 million euros expiring in July 2020, drawn down for the full amount;

a bilateral Term Loan from ICBC expiring July 2020 for 120 million euros, drawn down for the full amount;

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a bilateral Term Loan from Intesa Sanpaolo expiring August 2021 for 200 million euros, drawn down for the full amount;

an Hot Money loan with Banca Popolare dell Emilia Romagna expiring July 2017 for 200 million euros, drawn down for the full amount.

On March 6, 2017, TIM S.p.A. signed a supplementary agreement with Mediobanca under which an early repayment was made on July 3, 2017 for 75 million euros for the bilateral term loan of an original amount of 150 million euros maturing in July 2020, which has been fully drawn down.

Maturities of financial liabilities and average cost of debt

The average maturity of non-current financial liabilities (including the current portion of medium/long-term financial liabilities due within 12 months) is 7.71 years.

The average cost of the Group's debt, considered as the cost for the year calculated on an annual basis and resulting from the ratio of debt-related expenses to average exposure, is about 5.0%.

For details on the maturities of financial liabilities in terms of expected nominal repayment amounts, as contractually agreed, see the Notes Financial liabilities (non-current and current) in the Half-year Condensed Consolidated Financial Statements at June 30, 2017 of the TIM Group.

Current financial assets and liquidity margin

The TIM Group's available liquidity margin amounted to 12,188 million euros at June 30, 2017, corresponding to the sum of Cash and cash equivalents and Current securities other than investments, totaling 5,188 million euros (5,483 million euros at December 31, 2016), and the committed credit lines, mentioned above, of which a total of 7,000 million euros has not been drawn down. This margin is sufficient to cover Group financial liabilities due at least for the next 24 months.

In particular:

Cash and cash equivalents amounted to 4,086 million euros (3,964 million euros at December 31, 2016). The different technical forms used for the investment of liquidity as of June 30, 2017 can be analyzed as follows:

Maturities: investments have a maximum maturity of three months;

Counterparty risk: investments by the European companies are made with leading banking, financial and industrial institutions with high credit quality. Investments by the companies in South America are made with leading local counterparties;

Country risk: deposits have been made mainly in major European financial markets.

Current securities other than investments amounted to 1,102 million euros (1,519 million euros at December 31, 2016); these forms of investment represent alternatives to the investment of liquidity with the aim of improving

returns. They include 613 million euros of Italian treasury bonds purchased respectively by TIM S.p.A. (256 million euros) and Telecom Italia Finance S.A. (357 million euros) and 488 million euros of bonds purchased by Telecom Italia Finance S.A. with different maturities, all with an active market and consequently readily convertible into cash. The purchases of the above government bonds, which, pursuant to Consob Communication no. DEM/11070007 of August 5, 2011, represent investments in Sovereign debt securities, have been made in accordance with the Guidelines for the Management and control of financial risk adopted by the TIM Group since August 2012.

In the second quarter of 2017, the adjusted net financial debt fell by 131 million euros compared to March 31, 2017 (25,235 million euros) due to the positive business and operational performance which, in particular, provided coverage for the requirements resulting in particular from the already mentioned payment of dividends of 218 million euros.

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(millions of euros)	6/30/2017 (a)	3/31/2017 (b)	Change (a-b)
Net financial debt carrying amount	25,728	25,923	(195)
<i>Reversal of fair value measurement of derivatives and related financial assets/liabilities</i>	(624)	(688)	64
Adjusted net financial debt	25,104	25,235	(131)
<i>Breakdown as follows:</i>			
Total adjusted gross financial debt	32,002	32,796	(794)
Total adjusted financial assets	(6,898)	(7,561)	663

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CONSOLIDATED FINANCIAL STATEMENTS – TIM GROUP

The Half-Year Financial Report at June 30, 2017 of the TIM Group has been prepared in compliance with Article 154-ter (Financial Reports) of Italian Legislative Decree no. 58/1998 (Consolidated Law on Finance - TUF) and subsequent amendments and supplements and presented in accordance with the international accounting standards issued by the International Accounting Standards Board and endorsed by the European Union (designated as IFRS) as well as with the regulations issued to implement Article 9 of Italian Legislative Decree no. 38/2005.

The Half-year Financial Report includes:

the Interim Management Report;

the Half-Year Condensed Consolidated Financial Statements;

the certification of the Half-Year Condensed Consolidated Financial Statements pursuant to Article 81-ter of the Consob Regulation 11971 dated May 14, 1999, with Amendments and Additions.

The accounting policies and consolidation principles adopted in the preparation of the half-year condensed consolidated financial statements at June 30, 2017 are the same as those adopted in the annual consolidated financial statements at December 31, 2016, to which reference can be made. No new standards and interpretations were endorsed by the EU and in force from January 1, 2017.

The TIM Group, in addition to the conventional financial performance measures established by IFRS, uses certain alternative performance measures in order to present a better understanding of the trend of operations and financial condition. Specifically, these alternative performance measures refer to: EBITDA; EBIT; the organic change in revenues, EBITDA and EBIT; EBITDA margin and EBIT margin; and net financial debt carrying amount and adjusted net financial debt.

Moreover, the part entitled Business Outlook for 2017 contains forward-looking statements in relation to the Group's intentions, beliefs or current expectations regarding financial performance and other aspects of the Group's operations and strategies. Readers of the Half-year financial Report are reminded not to place undue reliance on forward-looking statements; actual results may differ significantly from forecasts owing to numerous factors, the majority of which are beyond the scope of the Group's control.

MAIN CHANGES IN THE SCOPE OF CONSOLIDATION

There were no significant changes in the scope of consolidation during the first half of 2017.

The following changes in the scope of consolidation occurred during 2016:

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TIMVISION S.r.l. (Domestic Business Unit): established on December 28, 2016;

Noverca S.r.l. (Domestic Business Unit): on October 28, 2016 TIM S.p.A. acquired 100% of the company;

Flash Fiber S.r.l. (Domestic Business Unit): established on July 28, 2016;

Sofora - Telecom Argentina group: classified as Discontinued Operations (Discontinued operations/Non-current assets held for sale) was sold on March 8, 2016;

Revi Immobili S.r.l., Gestione Due S.r.l. and Gestione Immobili S.r.l. (Domestic Business Unit): on January 11, 2016, INWIT S.p.A. purchased 100% of these companies, which were subsequently merged by absorption.

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Separate Consolidated Income Statements

(millions of euros)	1st Half 2017 (a)	1st Half 2016 (b)	Change (a-b) amount	%
Revenues	9,772	9,096	676	7.4
Other income	217	107	110	
Total operating revenues and other income	9,989	9,203	786	8.5
Acquisition of goods and services	(4,136)	(3,783)	(353)	(9.3)
Employee benefits expenses	(1,530)	(1,551)	21	1.4
Other operating expenses	(576)	(501)	(75)	(15.0)
Change in inventories	50	33	17	51.5
Internally generated assets	317	325	(8)	(2.5)
Operating profit before depreciation and amortization, capital gains (losses) and impairment reversals (losses) on non-current assets (EBITDA)	4,114	3,726	388	10.4
Depreciation and amortization	(2,249)	(2,047)	(202)	(9.9)
Gains/(losses) on disposals of non-current assets	6	13	(7)	(53.8)
Impairment reversals (losses) on non-current assets		(5)	5	
Operating profit (loss) (EBIT)	1,871	1,687	184	10.9
Share of profits (losses) of associates and joint ventures accounted for using the equity method	(1)	(2)	1	50.0
Other income (expenses) from investments	(19)	7	(26)	
Finance income	1,110	2,012	(902)	(44.8)
Finance expenses	(1,850)	(2,157)	307	14.2
Profit (loss) before tax from continuing operations	1,111	1,547	(436)	(28.2)

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Income tax expense	(457)	(489)	32	6.5
Profit (loss) from continuing operations	654	1,058	(404)	(38.2)
Profit (loss) from Discontinued operations/Non-current assets held for sale		47	(47)	
Profit (loss) for the period	654	1,105	(451)	(40.8)
Attributable to:				
Owners of the Parent	596	1,018	(422)	(41.5)
Non-controlling interests	58	87	(29)	(33.3)

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Consolidated Statements of Comprehensive Income

In accordance with IAS 1 (*Presentation of Financial Statements*), the following consolidated statements of comprehensive income include the Profit (loss) for the period as shown in the Separate Consolidated Income Statements and all non-owner changes in equity.

(millions of euros)		1st Half 2017	1st Half 2016
Profit (loss) for the period	(a)	654	1,105
Other components of the Consolidated Statements of Comprehensive Income			
Other components that subsequently will not be reclassified in the Separate Consolidated Income Statements			
Remeasurements of employee defined benefit plans (IAS 19):			
Actuarial gains (losses)		33	(118)
Income tax effect		(8)	32
	(b)	25	(86)
Share of other profits (losses) of associates and joint ventures accounted for using the equity method:			
Profit (loss)			
Income tax effect			
	(c)		
Total other components that subsequently will not be reclassified in the Separate Consolidated Income Statements	(d=b+c)	25	(86)
Other components that subsequently will be reclassified in the Separate Consolidated Income Statements			
Available-for-sale financial assets:			
Profit (loss) from fair value adjustments		34	76
Loss (profit) transferred to the Separate Consolidated Income Statements		(37)	(69)
Income tax effect		2	(4)
	(e)	(1)	3
Hedging instruments:			
Profit (loss) from fair value adjustments		(331)	(327)

Loss (profit) transferred to the Separate Consolidated Income Statements		497	245
Income tax effect		(43)	(2)
	(f)	123	(84)
Exchange differences on translating foreign operations:			
Profit (loss) on translating foreign operations		(551)	618
Loss (profit) on translating foreign operations transferred to the Separate Consolidated Income Statements		19	304
Income tax effect			
	(g)	(532)	922
Share of other profits (losses) of associates and joint ventures accounted for using the equity method:			
Profit (loss)			
Loss (profit) transferred to the Separate Consolidated Income Statements			
Income tax effect			
	(h)		
Total other components that subsequently will be reclassified to the Separate Consolidated Income Statements	(i=e+f+g+h)	(410)	841
Total other components of the Consolidated Statements of Comprehensive Income	(k=d+i)	(385)	755
Total comprehensive income (loss) for the period	(a+k)	269	1,860
Attributable to:			
Owners of the Parent		367	1,726
Non-controlling interests		(98)	134

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Consolidated Statements of Financial Position

(millions of euros)	6/30/2017	12/31/2016	Change
	(a)	(b)	(a-b)
Assets			
Non-current assets			
Intangible assets			
Goodwill	29,511	29,612	(101)
Intangible assets with a finite useful life	6,594	6,951	(357)
	36,105	36,563	(458)
Tangible assets			
Property, plant and equipment owned	13,671	13,947	(276)
Assets held under finance leases	2,371	2,413	(42)
	16,042	16,360	(318)
Other non-current assets			
Investments in associates and joint ventures accounted for using the equity method	17	18	(1)
Other investments	48	46	2
Non-current financial assets	2,185	2,698	(513)
Miscellaneous receivables and other non-current assets	2,324	2,222	102
Deferred tax assets	525	877	(352)
	5,099	5,861	(762)
Total Non-current assets	(a) 57,246	58,784	(1,538)
Current assets			
Inventories	314	270	44
Trade and miscellaneous receivables and other current assets	5,617	5,426	191
Current income tax receivables	45	94	(49)
Current financial assets			

<i>Securities other than investments, financial receivables and other current financial assets</i>		1,732	1,908	(176)
<i>Cash and cash equivalents</i>		4,086	3,964	122
		5,818	5,872	(54)
Current assets sub-total		11,794	11,662	132
Discontinued operations/Non-current assets held for sale				
Total Current assets	(b)	11,794	11,662	132
Total Assets	(a+b)	69,040	70,446	(1,406)

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(millions of euros)	6/30/2017 (a)	12/31/2016 (b)	Change (a-b)
Equity and Liabilities			
Equity			
Equity attributable to Owners of the Parent	21,404	21,207	197
Non-controlling interests	2,215	2,346	(131)
Total Equity	(c) 23,619	23,553	66
Non-current liabilities			
Non-current financial liabilities	28,887	30,469	(1,582)
Employee benefits	1,336	1,355	(19)
Deferred tax liabilities	323	293	30
Provisions	813	830	(17)
Miscellaneous payables and other non-current liabilities	1,594	1,607	(13)
Total Non-current liabilities	(d) 32,953	34,554	(1,601)
Current liabilities			
Current financial liabilities	4,844	4,056	788
Trade and miscellaneous payables and other current liabilities	7,056	7,646	(590)
Current income tax payables	568	637	(69)
Current liabilities sub-total	12,468	12,339	129
Liabilities directly associated with Discontinued operations/Non-current assets held for sale			
Total Current Liabilities	(e) 12,468	12,339	129
Total Liabilities	(f=d+e) 45,421	46,893	(1,472)
Total Equity and Liabilities	(c+f) 69,040	70,446	(1,406)

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Consolidated Statements of Cash Flows

(millions of euros)	1st Half 2017	1st Half 2016
Cash flows from operating activities:		
Profit (loss) from continuing operations	654	1,058
Adjustments for:		
Depreciation and amortization	2,249	2,047
Impairment losses (reversals) on non-current assets (including investments)	10	5
Net change in deferred tax assets and liabilities	336	257
Losses (gains) realized on disposals of non-current assets (including investments)	(6)	(13)
Share of profits (losses) of associates and joint ventures accounted for using the equity method	1	2
Change in employee benefits	(7)	40
Change in inventories	(44)	(40)
Change in trade receivables and net amounts due from customers on construction contracts	(52)	(130)
Change in trade payables	44	(141)
Net change in current income tax receivables/payables	72	95
Net change in miscellaneous receivables/payables and other assets/liabilities	(119)	(687)
Cash flows from (used in) operating activities	(a) 3,138	2,493
Cash flows from investing activities:		
<i>Purchase of intangible assets</i>	(673)	(709)
<i>Purchase of tangible assets</i>	(1,413)	(1,397)
Total purchase of intangible and tangible assets on an accrual basis	(2,086)	(2,106)
<i>Change in amounts due for purchases of intangible and tangible assets</i>	(707)	(371)

Total purchase of intangible and tangible assets on a cash basis		(2,793)	(2,477)
Acquisition of control in subsidiaries or other businesses, net of cash acquired			(6)
Acquisitions/disposals of other investments		(1)	(3)
Change in financial receivables and other financial assets		695	364
Proceeds from sale that result in a loss of control of subsidiaries or other businesses, net of cash disposed of			492
Proceeds from sale/repayment of intangible, tangible and other non-current assets		9	29
Cash flows from (used in) investing activities	(b)	(2,090)	(1,601)
Cash flows from financing activities:			
Change in current financial liabilities and other		(663)	(262)
Proceeds from non-current financial liabilities (including current portion)		1,256	2,061
Repayments of non-current financial liabilities (including current portion)		(1,200)	(3,094)
Share capital proceeds/reimbursements (including subsidiaries)		6	
Dividends paid		(218)	(227)
Cash flows from (used in) financing activities	(c)	(819)	(1,522)
Cash flows from (used in) Discontinued operations/Non-current assets held for sale	(d)		(45)
Aggregate cash flows	(e=a+b+c+d)	229	(675)
Net cash and cash equivalents at beginning of the period	(f)	3,952	3,216
Net foreign exchange differences on net cash and cash equivalents	(g)	(95)	159
Net cash and cash equivalents at end of the period	(h=e+f+g)	4,086	2,700

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Additional Cash Flow Information

(millions of euros)	1st Half 2017	1st Half 2016
Income taxes (paid) received	(27)	(104)
Interest expense paid	(1,198)	(1,327)
Interest income received	432	516
Dividends received		7

Analysis of Net Cash and Cash Equivalents

(millions of euros)	1st Half 2017	1st Half 2016
Net cash and cash equivalents at beginning of the period		
Cash and cash equivalents - from continuing operations	3,964	3,559
Bank overdrafts repayable on demand - from continuing operations	(12)	(441)
Cash and cash equivalents - from Discontinued operations/Non-current assets held for sale		98
Bank overdrafts repayable on demand - from Discontinued operations/Non-current assets held for sale		
	3,952	3,216
Net cash and cash equivalents at end of the period		
Cash and cash equivalents - from continuing operations	4,086	2,707
Bank overdrafts repayable on demand - from continuing operations		(7)
Cash and cash equivalents - from Discontinued operations/Non-current assets held for sale		
Bank overdrafts repayable on demand - from Discontinued operations/Non-current assets held for sale		
	4,086	2,700

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OTHER INFORMATION

Average salaried workforce

(equivalent number)		1st Half 2017	1st Half 2016	Change
Average salaried workforce	Italy	45,907	47,448	(1,541)
Average salaried workforce	Outside Italy	9,392	11,688	(2,296)
Total average salaried workforce ⁽¹⁾		55,299	59,136	(3,837)
Discontinued operations/Non-current assets held for sale - Sofora - Telecom Argentina group			5,161	(5,161)
Total average salaried workforce - including Discontinued operations/Non-current assets held for sale		55,299	64,297	(8,998)

1) Includes employees with temp work contracts: the average headcount was 3 in the first half of 2017 (2 in Italy and 1 outside Italy). In the first half of 2016, the average headcount was 4 (2 in Italy and 2 outside Italy).

Headcount at period end

(number)		6/30/2017	12/31/2016	Change
Headcount	Italy	50,926	51,125	(199)
Headcount	Outside Italy	9,726	10,104	(378)
Total headcount at period end ⁽¹⁾		60,652	61,229	(577)

1) Includes employees with temp work contracts: 1 at 6/30/2017 and 4 at 12/31/2016.

Headcount at period end Breakdown by Business Unit

(number)	6/30/2017	12/31/2016	Change
Domestic	51,095	51,280	(185)
Brazil	9,471	9,849	(378)
Other Operations	86	100	(14)
Total	60,652	61,229	(577)

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For details of subsequent events see the Note Events Subsequent to June 30, 2017 in the TIM Group half-year condensed consolidated financial statements.

BUSINESS OUTLOOK FOR THE YEAR 2017

As envisaged in the 2017-2019 Plan, TIM will continue the process of profound transformation of the Company. This process consists of firm financial discipline in support of development, aimed at creating more room for investments for new networks and platforms (Fiber and mobile UltraBroadband and Cloud-based services) and eliminating less strategic cash costs, in addition to maximizing return on investment. The objective is to ensure structural growth in revenue and EBITDA and consolidate TIM's position as the market leader in terms of technology, network quality and service excellence in the Fixed-line and Mobile segments. The key elements of this approach are innovation, convergence, exclusive content and closeness to the Customer.

In the Domestic Fixed segment, TIM expects to reduce the decrease in the number of clients and that all loss lines will be brought to zero by 2018 through the faster spread and subsequent adoption of fiber optic networks. A crucial role will also be played by our commercial strategy that aims to retain and increase the number of customers by offering, inter alia, devices and appliances for the Smart Home connected to the home network and directly charged in the phone bill.

Within the Domestic Mobile segment, in an increasingly polarized and segmented competitive scenario, TIM particularly in the high-end market with ever-increasing data usage will leverage the reach of its 4G network (expected population coverage of over 99% in 2019) and the diffusion of convergent services and quality content. Kena, the second no-frills brand (launched in April), will allow the company to compete in the more price-sensitive segments.

Operations will be characterized by greater selectivity and priority in investment choices and efficiency recovery actions through structural cost optimization programs. At the same time, the transformation and simplification of organization and processes combined with the commercial development and the expected growth in revenue will provide the Group with EBITDA growth (low single digit) and the cash generation needed to reduce the Adjusted net financial debt to reported EBITDA ratio, which is expected to be below 2.7x in 2018.

In Brazil, the Plan provides for the continued turnaround of Tim Brasil through its re-positioning based on network and product quality, thereby enabling the company to maintain its leadership in the prepaid segment and successfully compete in the postpaid segment. The Cost Containment Plan launched in 2016 has also been continued and strengthened and will enable the achievement of solid profit and cash flow generation. More specifically, further impetus will be given to the construction of the UBB Mobile infrastructure at completion of the Plan, the 4G network will reach 95% of the population with coverage of about 3,600 cities and the development of convergent offers, also thanks to agreements with major premium content providers.

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Business outlook 39

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MAIN RISKS AND UNCERTAINTIES

Risk governance is a strategic tool for value creation. The TIM Group has adopted an Enterprise Risk Management Model based on the methodology of the Committee of Sponsoring Organizations of the Treadway Commission (ERM CoSO Report), which enables the identification and management of risk in a uniform manner across the Group companies, highlighting potential synergies among the actors involved in the assessment of the Internal Control and Risk Management System. The ERM process is designed to identify potential events that may affect the business, to manage risk within acceptable limits and to provide reasonable assurance regarding the achievement of corporate objectives.

The business outlook for 2017 could be affected in the second half of the year by risks and uncertainties caused by a multitude of factors, the majority of which are beyond the Group's control.

In particular, several major alterations need to be noted, such as the changes in several senior executive positions and the modification of the market environment, with the initiation of proceedings by the Anti-Trust Authority on the projects for development of the ultrabroadband and fiber optic networks, in addition to a possible revision of the business strategies for the content component. These risk factors may have repercussions which are currently unforeseeable in terms of the strategic choices adopted by the company and could have an impact, for example, on the ultrabroadband development plans and on the evolution model adopted in the multimedia market.

In view of the above risks, in addition to the expected performance of the domestic market and the impacts from the new tariff model for roaming services, as well as several non-recurring business trends in the third quarter of 2016 (resulting in a not fully like-for-like comparison in the second half of the year), management has confirmed the guidance announced for the full year 2017 and for the period of the Plan (e.g. low-single digit growth in Domestic EBITDA), despite the strong performance in the second quarter of 2017.

The main risks affecting the business activities of the TIM Group, which may impact, even significantly, the ability to achieve the objectives of the Group are detailed below.

STRATEGIC RISKS

Risks related to macro economic factors

The TIM Group's economic and financial situation is subject to the influence of numerous macroeconomic factors such as economic growth, political stability, consumer confidence, and changes in interest rates and exchange rates in the markets in which it operates. The expected results may be affected, in the domestic market, by the strengthening of the economic recovery: the year 2016 ended with growth of around 1% (a low figure when compared to the average of the EMU countries) and the forecast for 2017 is for higher growth, albeit only slightly. Consumption is starting to pick up again, after a slowdown in the second half of 2016, despite the erosion of purchasing power due to rising inflation. Confidence has also improved among consumers and businesses. Unemployment is still high, despite the significant fall from the second quarter of 2016, with consequent possible effects on income available for consumption.

On the Brazilian market, the expected results may be significantly affected by the macroeconomic and political situation. After 8 quarters of GDP decline, marking the deepest and most profound crisis in its history, Brazil returned to growth in the first quarter of 2017 (+1%). 2017 should close with a growth rate just above zero. Apart from this positive result, there is an ongoing situation of high political instability, as well as a very problematic employment situation (with a total of more than 14 million unemployed and an unemployment rate of 14% in the first quarter of 2017) which are significantly slowing down the recovery in domestic demand.

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Risks related to competition

The telecommunications market is characterized by strong competition that may reduce market share in the geographical areas where the TIM Group is engaged as well as erode prices and margins. Competition is focused, on one hand, on innovative products and services and, on the other hand, on the price of traditional services. In addition, in the area of infrastructure competition, the growth of alternative operators could represent a threat for TIM, particularly in the years of the Plan after 2017 and also beyond the Plan period.

In the mobile market, Iliad S.A. is about to launch a new mobile operator in Italy with the aim of acquiring 10-15% of the market, as per its own announcements, by adopting the strategies it has already used for the French market. For its part, TIM has launched a new operator with its own independent systems and features.

In addition, Open Fiber and Infratel have announced their plans for the development of an ultrabroadband telecommunications network as an alternative to the TIM network, respectively in the major Italian cities and the market failure areas.

In Brazil, the deterioration of the macroeconomic environment continues to negatively impact on the telecommunications market. Competitive risk is given both by a deterioration of the business model tied to traditional services, which have not been replaced by innovative services, and by the rationalization of consumption by customers as a result of a contraction of their purchasing power. In this scenario, the Tim Brasil group may be further impacted in the short term to a greater extent than its main competitors, due to the higher proportion of customers with prepaid services, which are more affected by the current macroeconomic situation, and by a slowdown in their replacement with postpaid customers.

OPERATIONAL RISKS

Operational risks inherent in our business relate to possible inadequacies in internal processes, external factors, frauds, employee errors, errors in properly documenting transactions, loss of critical or commercially sensitive data and failures in systems and/or network platforms.

Risks related to business continuity

The TIM Group's success depends heavily on the ability to ensure continuous and uninterrupted delivery of the products and services we provide through the availability of processes and the relating supporting assets. In particular, the Network Infrastructure and the Information Systems are sensitive to various internal and external threats: power outage, floods, storms, human errors, system failures, hardware and software failures, software bugs, cyber attacks, earthquakes, facility failures, strikes, fraud, vandalism, terrorism, etc.. Each of these events could lead to an interruption in the supply of services/products and potentially affect our business both directly and indirectly: reduction in revenues and/or increased costs for recovery and for penalties and fines, decrease in customer satisfaction, and negative impact on reputation.

Risks related to the development of fixed and mobile networks

To maintain and expand our customer portfolio in each of the markets in which we operate, it is necessary to maintain, update and improve existing networks in a timely manner. A reliable and high quality network is necessary to maintain the customer base and minimize the terminations to protect the Company's revenues from erosion. The maintenance and improvement of existing installations depend on our ability to:

upgrade the capabilities of the networks to provide customers with services that are closer to their needs; in this regard, the TIM Group may participate in tenders for broadcasting frequencies;

increase the geographical coverage of innovative services;

upgrade the structure of the systems and the networks to adapt it to new technologies;

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sustaining the necessary level of capital expenditure in the long term.
Risks of internal/external fraud

The TIM Group has adopted an organizational model to prevent fraud. However, the implementation of this model cannot ensure the total mitigation of the risk. Dishonest activities and illegal acts committed by people inside and outside the organization could adversely affect the Company's operating results, financial position and image.

Risks related to disputes and litigation

The TIM Group has to deal with disputes and litigation with tax authorities, regulators, competition authorities, other telecommunications operators and other entities. The possible impacts of such proceedings are generally uncertain. In the event of settlement unfavorable to the Group, these issues may, individually or as whole, have an adverse effect, which may even be significant, on its operating results, financial position and cash flows.

FINANCIAL RISKS

The TIM Group may be exposed to financial risks, such as risks arising from fluctuations in interest rates and exchange rates, credit risk, liquidity risk and risks related to the performance of the equity markets in general, and more specifically risks related to the performance of the share price of the TIM Group companies. These risks may adversely impact the earnings and the financial structure of the Group. Accordingly, to manage those risks, the TIM Group has established guidelines, at central level, which must be followed for operational management, identification of the most suitable financial instruments to meet set goals, and monitoring the results achieved. In particular, in order to mitigate the liquidity risk, the TIM Group aims to maintain an adequate level of financial flexibility, in terms of cash and syndicated committed credit lines, enabling it to cover refinancing requirements at least for the next 12 -18 months.

On June 23, 2016, a referendum was held in the United Kingdom, commonly referred to as Brexit, in which voters approved the UK's exit from the European Union. The potential impact of Brexit will depend, in part, on the outcome of the negotiations on tariffs, trade, regulations and other matters, which started in the second half of June 2017. The result of the referendum had an adverse effect on the global markets and also produced a sharp decline in the pound against the dollar and the euro. Brexit and the possible changes during the exit negotiations could create further instability in the global financial markets and uncertainty about the laws and regulations of the European Union that the United Kingdom may decide to replace with national laws and regulations. The potential effects of Brexit could adversely affect our financial conditions, our business and the related earnings and cash flows.

REGULATORY AND COMPLIANCE RISKS

Regulatory risks

The telecommunications industry is highly regulated. In this context, new decisions by the Communications Authority (AGCom) may lead to changes in the regulatory framework that may affect the expected results of the Group. More specifically, the main elements that introduce uncertainty are:

lack of predictability in start-up timing and consequent new process decisions;

decisions with retroactive effect (for example, price revisions for previous years as a result of judgments issued by the Administrative Courts);

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decisions that can influence the technological choices made and to be made, with potential impact on the timing of return on infrastructure investment.

Implementation has been completed of the New Equivalence Model (NEM), launched by TIM in 2015, aimed at further improving the effectiveness of guarantees for equal treatment between own business divisions and competitors that buy wholesale services. The NEM and the related implementation roadmap were approved by the Board of Directors of TIM on November 5, 2015. The Italian Antitrust Authority (AGCM) and the AGCom positively evaluated the effectiveness of the NEM and decided, respectively, to close the non-compliance proceedings A428C, acknowledging that TIM has complied with the earlier A428 decision, and to discontinue the ongoing penalty proceedings.

Compliance risks

The TIM Group may be exposed to risks of non-compliance due to non-observance/breach of internal (self-regulation, such as, for example, bylaws, code of ethics) and external rules (laws and regulations), with consequent judicial or administrative penalties, financial losses or reputational damage.

The TIM Group aims to ensure that processes, and, therefore, the procedures and systems governing them, and corporate conduct comply with legal requirements. The risk is associated with potential time lags in making the processes compliant with regulatory changes or whenever non-conformities are identified.

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MAIN CHANGES IN THE REGULATORY FRAMEWORK

DOMESTIC

Wholesale fixed-line markets

Wholesale access services

Following the Resolution 623/15/CONS, in which AGCom requested TIM to submit a proposal for improving the effectiveness of its equivalence model in the processes for the supply of wholesale services to competitors and to its own commercial divisions, TIM completed the implementation of the New Equivalent Model (NEM) on April 30, 2017.

Within the above-mentioned Resolution, AGCom also requested TIM to submit a proposal containing the operating procedures for the introduction of a model for the unbundling of incidental services associated to the delivery and assurance of wholesale access lines for local loop unbundling and sub-loop unbundling services. The proposal submitted by TIM is based on the extension of the Unique System (i.e., use of outside companies at the request of the competitors) to the above-mentioned delivery and assurance activities. The procedure is still ongoing and AGCom final decision, after notification of the draft measure to the European Commission, is expected by the third quarter of 2017.

Infratel Tenders for the subsidizing of the Ultra Broadband networks

On March 7, 2017, Infratel Italia awarded the company Open Fiber (OF) all five lots of the tender for the construction and operation of networks enabling the offering of Ultra Broadband services (from 30 to 100 Mbit/s) in the so-called White Areas (in which the private operators had not envisaged the independent construction of Ultra Broadband infrastructure in the next three years) of the municipalities of six Italian regions (Abruzzo, Molise, Emilia Romagna, Lombardy, Tuscany and Veneto).

On March 20, 2017, a ruling with an unfavorable outcome for TIM was issued in the main proceedings for the appeal filed by TIM concerning the tender and on June 20, 2017 TIM lodged an appeal with the *Consiglio di Stato*.

Retail fixed-line markets

Universal Service

Through Resolution 46/17/CONS of January 26, 2017, AGCom introduced new measures regarding the subsidized financial conditions for access to fixed and mobile services for particular categories of disabled customers. The provisions of the measure, which apply to the deaf and the totally and partially blind, broaden the current subsidies, both in terms of discounted services (e.g. flat voice and data offers) and categories of disabled people covered (e.g. the

partially blind).

In February 2017, TIM submitted an appeal to the Lazio Regional Administrative Court against Resolution 456/16/CONS of October 2016, through which AGCom rejected TIM's proposal for a price adjustment on the Voice offering (the basic voice telephony offering), and introduced a strict procedure for future changes of Universal Service prices, by providing, for example, a minimum time interval of a year between two successive tariff changes and the possibility to only change prices with reference to: (i) increase in *wholesale* costs; (ii) offsetting inflation; (iii) socio-economic conditions. The first hearing has been set for November 22, 2017.

Through resolution 163/17/CONS of April 18, 2017, AGCom imposed a fine of 232,000 euros on TIM for the failure to achieve 4 quality objectives of 2015.

For information on the pending disputes relating to the remuneration of the net costs of the Universal Service incurred by TIM in the years 1999-2003, excluding 2002, see the Note Contingent liabilities, other information, commitments and guarantees of the Consolidated financial statements of the TIM Group at December 31, 2016.

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Wholesale mobile network markets

International roaming

On June 15, 2017, the provision of European Regulation 2015/2120 of November 25, 2015 (Telecom Single Market - TSM Regulation) entered into force, which requires for the application of the national tariff for intra-EU voice, SMS and roaming data traffic.

On April 25, 2017, the European Parliament and the Council adopted a regulation establishing new wholesale caps for roaming traffic valid from June 15, 2017 to June 30, 2022 (Voice: 3.2 euro cents per minute; SMS 1 euro cents per SMS, data: 7.7 euro/GByte in 2017; 6 euro/GByte in 2018; 4.5 euro/GByte in 2019; 3.5 euro/GByte in 2020; 3 euro/GByte in 2021; and 2.5 euro/GByte in 2022).

AGCom contribution fee

On March 31, 2017, TIM paid an amount of 19.3 million euros, with reservation, for the 2017 AGCom contribution fee. The value was calculated by applying the rate of 0.0014 to the revenues recorded in the Company's 2015 Financial Statements. The guidelines for the calculation of the contribution fee, set out in the AGCom Resolutions 463/16/CONS and 62/17/CONS, have not changed with respect to those established for the calculation of the 2016 contribution fee.

Antitrust

For information on the pending legal disputes, relating to proceedings already completed by the AGCM A428 and I761 see the Note Contingent liabilities, other information, commitments and guarantees of the Half-year condensed consolidated financial statements of the TIM Group at June 30, 2017.

Case A500B

In April 2017, the AGCM extended to Telecom Italia Sparkle the case A500B, opened against TIM and regarding the possible improper conduct in the market consisting in bulk SMS messaging services.

Case I799

In February 2017, AGCM initiated investigation proceedings for possible violation of Article 101 TFEU (ban on competition-restricting agreements) against TIM S.p.A. and Fastweb S.p.A., following the signing of an agreement aimed at establishing a joint cooperative enterprise Flash Fiber S.r.l.. The end of the proceedings has been set at December 31, 2017.

Case A514

On June 28, 2017, AGCM initiated proceedings against TIM for possible breaches of Article 102 TFEU following complaints made by Infratel, Enel, Open Fiber, Vodafone and Wind-Tre. For more details see the description provided in the Note Contingent liabilities, other information, commitments and guarantees of the Half-year condensed

consolidated financial statements of the TIM Group at June 30, 2017.

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BRAZIL

700 MHz and Analog TV switch off

In September 2014, TIM won the tender for the award of the 700MHz (4G/LTE) band frequencies, for a price of 1.7 billion reais, and with additional commitments of 1.2 billion reais (in four annual installments, adjusted for inflation) as a contribution to the consortium established by the tender (EAD) for all the operators (TIM, Algar, Claro and Vivo) awarded the contract for managing the freeing up of the 700MHz band through the switch off of analog TV, the redistribution of channels and the reduction of interference. To that end, the first payment (370 million reais) was made in April 2015 and the subsequent two payments (for a total of 860 million reais) were both made in January 2017.

In April 2017, the first towns to complete the implementation of the 4G/LTE network were Brasilia, Campo Grande and Teresina. Subsequently, seven other towns have installed the new network and start-up is scheduled in another nine towns within the year in the country.

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CORPORATE BOARDS AT JUNE 30, 2017

BOARD OF DIRECTORS

The ordinary shareholders meeting of the Company, held on May 4, 2017, appointed the new Board of Directors, setting its number of members at 15 and its term of office at three years (up to the approval of the financial statements at December 31, 2019). The Board of Directors meeting, held on May 5, 2017, appointed Giuseppe Recchi as Chairman of the Board, Arnaud Roy de Puyfontaine as Deputy Chairman and Flavio Cattaneo as Chief Executive Officer of the Company.

On June 1, 2017 the Board of Directors approved a change in the company officers, with the appointment of Arnaud Roy de Puyfontaine as Chairman of the Board of Directors and Giuseppe Recchi as Deputy Chairman.

The Board of Directors of the Company at June 30, 2017 was composed as follows:

Chairman	Arnaud Roy de Puyfontaine
Deputy Chairman	Giuseppe Recchi
Chief Executive Officer	Flavio Cattaneo
Directors	Camilla Antonini (independent)
	Franco Bernabè (independent)
	Ferruccio Borsani (independent)
	Lucia Calvosa (independent)
	Francesca Cornelli (independent)
	Frédéric Crépin
	Dario Frigerio (independent)
	Félicité Herzog (independent)
	Anna Jones (independent)
	Marella Moretti (independent)
	Hervé Philippe

Danilo Vivarelli (independent)

Secretary to the Board Agostino Nuzzolo

All the board members are domiciled for the positions they hold in TIM at the registered offices of the Company in Milan, Via G. Negri 1.

The following board committees were in place at June 30, 2017:

Control and Risk Committee: composed of the Directors: Lucia Calvosa (Chair appointed in the meeting of June 22, 2017), Francesca Cornelli, Frederic Crépin, Félicité Herzog and Marella Moretti;

Nomination and Remuneration Committee: composed of the Directors: Anna Jones (Chair appointed in the meeting of June 15, 2017), Ferruccio Borsani, Frederic Crépin, Hervé Philippe and Danilo Vivarelli;

Strategy Committee: made up of the Chairman of the Board of Directors, Arnaud Roy de Puyfontaine, the Chief Executive Officer, Flavio Cattaneo, the Deputy Chairman, Giuseppe Recchi, and the Directors Franco Bernabé and Dario Frigerio.

BOARD OF STATUTORY AUDITORS

The ordinary shareholders' meeting of May 20, 2015 appointed the Company's Board of Statutory Auditors with a term up to the approval of the 2017 financial statements.

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The Board of Statutory Auditors of the Company is now composed as follows:

Chairman	Roberto Capone
Acting Auditors	Vincenzo Cariello Paola Maiorana Gianluca Ponzellini Ugo Rock
Alternate Auditors	Francesco Di Carlo Gabriella Chersicla Piera Vitali Riccardo Schioppo

INDEPENDENT AUDITORS

The shareholders' meeting held on April 29, 2010 appointed the audit firm PricewaterhouseCoopers S.p.A. to audit TIM financial statements for the nine-year period 2010-2018.

MANAGER RESPONSIBLE FOR PREPARING THE CORPORATE FINANCIAL REPORTS

At the meeting of May 5, 2017, the Board of Directors confirmed Piergiorgio Peluso (Head of the Group Administration, Finance and Control Function) as the manager responsible for preparing TIM's financial reports.

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MACRO-ORGANIZATION CHART AT JUNE 30, 2017

On July 24, 2017, the Board of Directors of TIM S.p.A. approved a settlement agreement for the termination, with effect from July 28, of Mr. Flavio Cattaneo's term of office as Chief Executive Officer and as the General Manager (with effect from July 31).

On July 27, 2017, the Board of Directors, in line with the Company's succession plan, temporarily assigned the Chief Executive Officer's responsibilities to the Executive Chairman Mr. de Puyfontaine. The responsibilities related to the Security Function and the company Telecom Italia Sparkle were assigned on an interim basis to the Deputy Chairman, Giuseppe Recchi.

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Macro-Organization Chart at June 30, 2017 49

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INFORMATION FOR INVESTORS

TIM S.P.A. SHARE CAPITAL AT JUNE 30, 2017

Share capital	11,677,002,855.10 euros
Number of ordinary shares (without nominal value)	15,203,122,583
Number of savings shares (without nominal value)	6,027,791,699
Number of TIM S.p.A. ordinary treasury shares	37,672,014
Number of TIM S.p.A. ordinary shares held by Telecom Italia Finance S.A.	126,082,374
Percentage of ordinary treasury shares held by the Group to total share capital	0.77%
Market capitalization (based on June 2017 average prices)	16,577 million euros

Regarding the trading of shares issued by Group companies on regulated markets, the ordinary and savings shares of TIM S.p.A. are listed in Italy (FTSE index), as well as the ordinary shares of INWIT S.p.A., whereas the ordinary shares of Tim Participações S.A. are listed in Brazil (BOVESPA index). The ordinary and savings shares of TIM S.p.A., and the ordinary shares of Tim Participações S.A. are also listed on the NYSE (New York Stock Exchange); trading occurs through ADS (American Depositary Shares) that respectively represent 10 ordinary shares and 10 savings shares of TIM S.p.A. and 5 ordinary shares of Tim Participações S.A..

SHAREHOLDERS

Composition of Telecom Italia S.p.A. shareholders at June 30, 2017 according to the Shareholders Book, supplemented by communications received and other available sources of information (ordinary shares):

There are no significant shareholders agreements for TIM pursuant to Article 122 of Italian Legislative Decree 58/1998.

MAJOR HOLDINGS IN SHARE CAPITAL

At June 30, 2017, taking into account the entries in the Shareholders Book, communications sent to Consob and to the Company pursuant to Italian Legislative Decree 58 of February 24, 1998, Article 120, and other available sources of information, the relevant holdings of TIM S.p.A. s ordinary share capital are as follows:

Holder	Type of ownership	Percentage of ownership
Vivendi S.A.	Direct	23.94% (*)

(*) Equity interest obtained following receipt of a notification by Vivendi S.A. pursuant to Article 152 *octies*, paragraph 7, of the Consob Issuer Regulations.

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Blackrock Inc. also notified Consob that, on November 15, 2016, as an asset management company, it indirectly held a quantity of ordinary shares equal to 3.10% of the total ordinary shares of TIM S.p.A. at June 30, 2017.

COMMON REPRESENTATIVES

The special meeting of the savings shareholders held on June 16, 2016 renewed the appointment of Dario Trevisan as the common representative for three financial years, up to the approval of the financial statements for the year ended December 31, 2018.

By decree of June 9, 2017, the Milan Court confirmed the appointment of Enrico Cotta Ramusino (already appointed by the decrees of April 11, 2014 and March 7, 2011) as the common representative of the bondholders for the Telecom Italia S.p.A. 2002-2022 bonds at variable rates, open special series, reserved for subscription by employees of the TIM Group, in service or retired , with a mandate for the three-year period 2017-2019.

By decree of June 12, 2015, the Milan Court appointed Monica Iacoviello as the common representative of the bondholders for the Telecom Italia S.p.A. 1,250,000,000 euros 5.375 percent. Notes due 2019 up to the approval of the 2017 Annual Report.

RATING AT JUNE 30, 2017

At June 30, 2017, the three rating agencies Standard & Poor's, Moody's and Fitch Ratings rated TIM as follows:

	Rating	Outlook
STANDARD & POOR'S	BB+	Stable
MOODY'S	Ba1	Stable
FITCH RATINGS	BBB-	Stable

On July 12, 2017, the rating agency Standard & Poor's upgraded TIM S.p.A.'s outlook from Stable to Positive .

WAIVER OF THE OBLIGATION TO PUBLISH DISCLOSURE DOCUMENTS FOR EXTRAORDINARY OPERATIONS

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On January 17, 2013, the board of directors of TIM S.p.A. resolved to exercise the option, as per article 70 paragraph 8 and article 71 paragraph 1-bis of the Consob Regulation 11971/99, to waive the obligations to publish disclosure documents in the event of significant operations such as mergers, demergers, capital increases by means of the transfer of assets in kind, acquisitions and disposals.

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RELATED PARTY TRANSACTIONS

In accordance with Article 5, paragraph 8 of Consob Regulation 17221 of March 12, 2010 concerning related party transactions and the subsequent Consob Resolution 17389 of June 23, 2010, no significant transactions were entered into in the first half of 2017 as defined by Article 4, paragraph 1, letter a) of the aforementioned regulation which had a major impact on the financial position or on the results of the TIM Group for the first half of 2017.

Furthermore, there were no changes or developments regarding the related party transactions described in the 2016 Report on operations which had a significant effect on the financial position or on the results of the TIM Group in the first half of 2017.

Related party transactions, when not dictated by specific laws, were conducted at arm's length. In addition, the transactions were carried out in accordance with an internal procedure that establishes the terms and timing for verification and monitoring.

Up to May 4, 2017, the companies of the Generali group, Intesa Sanpaolo group, Mediobanca group and Telefonica group (shareholders of the company Telco) were also considered related parties, based on the provision of TIM's procedure for the management of related party transactions according to which it applies also to the participants in significant shareholder agreements according to Article 122 of the Consolidated Law on Finance that govern the candidacy to the position of Director of the Company, where the majority of the Directors nominated have been drawn from the list submitted. The members of the Board of Directors of TIM in office up to May 4, 2017 had in fact been drawn from the list originally submitted by the shareholder Telco. With the reappointment of the Board of Directors this circumstance no longer applied and the scope of related parties through Directors was therefore amended.

On May 3 and June 1, 2017, the Board of Directors of TIM approved several changes to the Procedure for the management of related party transactions, deciding, on a voluntary basis and therefore without any obligation, to treat Vivendi as if it was the parent, in accordance with the Consob Regulation. The process of identifying new entities that entered the scope of related parties essentially led to the identification of all the entities with which the Group has significant relationships. The full list is currently being completed.

The new Procedure for the management of related party transactions is available for consultation at the website www.telecomitalia.com, About Us section Governance System channel.

The information on related parties required by Consob Communication DEM/6064293 of July 28, 2006 is presented in the financial statements and in the Note Related party transactions in the Half-year condensed consolidated financial statements at June 30, 2017 of the TIM Group.

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Related Party Transactions 52

Table of Contents**ALTERNATIVE PERFORMANCE MEASURES**

In this Half-year Financial Report at June 30, 2017 of the TIM Group, in addition to the conventional financial performance measures established by IFRS, certain *alternative performance measures* are presented for purposes of a better understanding of the trend of operations and financial condition. Such measures, which are also presented in other periodical financial reports (annual and interim) should, however, not be construed as a substitute for those required by IFRS.

The alternative performance measures used are described below:

EBITDA: this financial measure is used by TIM as the financial target in internal presentations (business plans) and in external presentations (to analysts and investors). It represents a useful unit of measurement for the evaluation of the operating performance of the Group (as a whole and at the Business Unit level), in addition to EBIT. These measures are calculated as follows:

Profit (loss) before tax from continuing operations

- + Finance expenses
- Finance income
- +/- Other expenses (income) from investments
- +/- Share of profits (losses) of associates and joint ventures accounted for using the equity method
- EBIT - Operating profit (loss)
- +/- Impairment losses (reversals) on non-current assets
- +/- Losses (gains) on disposals of non-current assets
- + Depreciation and amortization

EBITDA - Operating profit (loss) before depreciation and amortization, Capital gains (losses) and Impairment reversals (losses) on non-current assets

Organic change in Revenues, EBITDA and EBIT: these measures express changes (amount and/or percentage) in revenues, EBITDA and EBIT, excluding, where applicable, the effects of the change in the scope of consolidation and exchange differences.

TIM believes that the presentation of the organic change in revenues, EBITDA and EBIT allows for a more complete and effective understanding of the operating performance of the Group (as a whole and at the Business Unit level). This method of presenting information is also used in presentations to analysts and investors. This Half-Year Financial Report provides a reconciliation between the reported figure and the organic figure .

EBITDA margin and EBIT margin: TIM believes that these margins represent useful indicators of the Group's ability, as a whole and at Business Unit level, to generate profits from its revenues. In fact, EBITDA margin and EBIT margin measure the operating performance of an entity by analyzing the percentage of revenues that are

converted, respectively, into EBITDA and EBIT. Such indicators are used by TIM in internal presentations (business plans) and in external presentations (to analysts and investors) in order to illustrate the results from operations also through the comparison of the operating results of the reporting period with those of the previous periods.

Net Financial Debt: TIM believes that Net Financial Debt represents an accurate indicator of the Group's ability to meet its financial obligations. It is represented by Gross Financial Debt less Cash and Cash Equivalents and other Financial Assets. This Half-Year Financial Report includes tables showing the amounts taken from the statement of financial position and used to calculate the Net Financial Debt of the Group.

To better represent the real performance of Net Financial Debt, in addition to the usual indicator (called Net financial debt carrying amount), Adjusted net financial debt is also shown, which excludes effects that are purely accounting and non-monetary in nature deriving from the fair value measurement of derivatives and related financial assets and liabilities.

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Net financial debt is calculated as follows:

- + Non-current financial liabilities
- + Current financial liabilities
- + Financial liabilities directly associated with Discontinued operations/Non-current assets held for sale
- A) Gross financial debt
- + Non-current financial assets
- + Current financial assets
- + Financial assets relating to Discontinued operations/Non-current assets held for sale
- B) Financial assets
- C=(A - B) Net financial debt carrying amount
- D) Reversal of fair value measurement of derivatives and related financial assets/liabilities
- E=(C + D) Adjusted net financial debt

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Alternative Performance Measures 54

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SUSTAINABILITY

In the past, environmental, social and governance issues were of interest to a limited community of stakeholders; now, increasingly, they are an essential condition for the prosperity of companies in the long term. Introducing and integrating social responsibility in business activities, in order to promote it as an opportunity to create value, is a strategic lever to strengthen the competitiveness of the company.

To demonstrate the growing importance of sustainability issues, in January 2017 Legislative Decree n° 254 of December 30, 2016 came into force, which transposed Directive 2014/95/EU of the European Parliament¹. The Decree takes the disclosure of diversity and non-financial information by businesses and large groups from being voluntary to mandatory as of the 2017 financial year.

The Decree lists the topics companies are required to provide information about, in particular:

environmental aspects, including the use of energy resources, water usage, CO₂ emissions;

social aspects;

issues related to personnel management, including the actions taken to ensure gender equality and dialogue with social partners;

respect for Human Rights and the actions taken to prevent violations and discriminatory conduct;

the fight against active and passive corruption.

The content of the Decree recognizes what is increasingly felt by the financial and non-financial community, the need for the thorough representation of company activities; in fact it provides further tools that allow stakeholders, including shareholders, to perceive the contribution that sustainability can make to both the financial results of the company and to the community in terms of social value.

The TIM Group operates with the conviction that business activities must be conducted in a way that considers the expectations of stakeholders, in keeping with the principles established by internationally recognized standards. In defining and implementing its sustainability strategy and program, TIM is inspired by the guidelines issued by the main global guidance and standardization organizations in the field of Corporate Responsibility. TIM's sustainability report, prepared using the triple bottom line approach², has been prepared for almost 20 years and integrated into the consolidated financial statements from 2003 onwards. The adherence of the sustainability report to the GRI G4³ standard, comprehensive version, enables TIM to be already compliant with Legislative Decree 254.

¹ Directive 2014/95/EU of the European Parliament and of the Council of October 22, 2014, containing an amendment to Directive 2013/34/EU. The Directive concerns the disclosure of non-financial information and information on diversity by certain enterprises and certain large groups.

- ² This approach, defined for the first time by John Elkington in 1994, provides for the economic-financial data to be represented together with the environmental and social results.
- ³ GRI: Global Reporting Initiative, the standard setter for sustainability issues. The comprehensive version is the most complete reporting option in terms of the indicators used.

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RESEARCH & DEVELOPMENT AND INNOVATIVE SERVICES

As a result of the growing presence and importance of digitization in the lives of citizens, consumers and companies, technological and business innovation have become strategic for the market positioning and competitiveness of companies, particularly in the telecommunications sector.

The Group, in consideration of this, has adopted a strategy that aims to:

promote the internal innovation lines, focusing research on key aspects of the development of the fixed and mobile network moving towards the future 5G standards and ultrabroadband, and issues concerning service platforms and the new operations systems¹.

create initiatives such as Idea Sharing², to promote innovation and creativity among employees;

continue with Open Innovation projects and activities which permit osmosis between innovation within the Company and external sources of innovative ideas.

This context also encompasses the development of laboratories specifically open to industrial collaboration, in particular in the context of the Internet of Things (IoT), and the Joint Open Labs (JOL), set up through collaborations with Universities of excellence, and TIM #WCAP, TIM's Corporate Accelerator covering around 5 thousand square meters in Rome, Milan, Bologna and Catania, entirely dedicated to entrepreneurial open innovation.

In terms of patents, 9 new ones were filed in the first half of 2017. In particular, 2 of these were created in close collaboration with the University of Pisa and the University of Genoa on specific Digital Home topics. Another initiative aimed at enhancing the world of inventions was held in Turin in March 2017: Techshare Day 2017, a day entirely dedicated to sharing technological knowledge with companies that want to introduce patent-protected forms of innovation resulting from research in their specific activities.

For the JOL 2017 activities, focused on infrastructural issues and application solutions, specific research contracts are being finalized (16 with the Polytechnic University of Turin and 6 with the Polytechnic University of Milan) which commit around 660,000 euros, in addition to 30 of TIM's technical experts and 50 researchers from the Universities. With respect to the joint participation in projects funded as part of the European Programme Horizon 2020³ a benefit of around one million euros is estimated in 2017 in the form of proceeds deriving from the activities of the JOL.

Moreover, thanks to collaboration and exchange between TIM and the Polytechnic University of Turin, the latter has become one of the first 5G campuses in Europe, a technology campus but also a Living Lab open to students, researchers and possible partners and vendors, thereby involving energies from all over Italy.

Finally, in 2017 TIM #WCap strengthened its role as an innovation tool, in line with TIM's business strategy, completing the evolution route which led to the launch of the Call for Partners in May 2017 for the selection of ready-to-market start-ups focused on specific areas of particular interest to the Company: IOT Consumer; Payment & Digital Identity, Industry 4.0, Cyber Security for Business customers. The start-ups selected will gain access to the Co-Creation Programme aimed at the design and implementation of Proof of Concept (POC) of the digital solutions

proposed, with the involvement of the Business Units. The aim, therefore, is primarily to speed up the integration of innovative digital solutions in TIM's offer or technology.

With reference to technological innovation, the following are the projects most worthy of note:

support for the launch of numerous LTE Advanced services at 225 Mbps and 300 Mbps and the first in-the-field testing of LTE Advanced services with speeds of up to 700 Mbps in download and up to 75 Mbps in upload, a new milestone following on from the European record achieved for the commercial launch of 4.5G technology of up to 500 Mbps. The service with speeds of up to 700 Mbps will be made available to TIM customers in the coming months, with the arrival of enabled smartphones and the upgrading of the 4.5G network currently underway in the principal cities;

- ¹ Operations are defined as the set of processes that help to create and deliver value to customers, in general through a mixture of products and services.
- ² Idea Sharing is an internal crowdsourcing project aimed at discovering the talent and creativity of TIM's employees to stimulate and promote innovation.
- ³ Horizon 2020 (H2020) is the Framework Programme of the European Union (EU) for research and innovation relating to the period 2014-2020.

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support for the launch of 200M/20M offers on enhanced VDSL and the 1G/100M offer on FTTH;

Smart Farm: this is Olivetti's solution which enables agricultural enterprises to improve the quality of their harvest and encourage increased profits by exploiting the most innovative IoT technologies. Smart Farm is based on an in-cloud platform that offers companies a complete system of tools and information to accurately monitor the factors that help to determine the health of plants, irrigation requirements and climatic conditions. Through a network of in-the-field sensors, data is collected and transmitted to an application, which is easy to use and accessible through a web interface which enables all the parameters of interest to be kept under control. This makes it possible to manage the activities as effectively as possible and to intervene in a prompt and targeted way where necessary;

Smart Energy: is an added value service for customers who consume high amounts of electricity and are connected to low voltage which allows them to know their electricity consumption in real time, receive suggestions to optimize their consumption, reduce their electricity bill and choose the best offer available. Moreover, if there is a photovoltaic plant, the service helps the customer to optimize the use and return, and to control its effectiveness over time. The main characteristics of the service are simple DIY (do it yourself) installation and the ability to carry out an automatic energy audit through consumption behavior indicators and social comparisons with similar users.

Energy Aggregation: enables management of an aggregate of the energy resources of industrial customers and their monetization by providing electricity services remunerated on the Dispatching Services Market¹. It is based on an ICT platform equipped with the appropriate interfaces to receive dispatching orders from Terna and to execute them on an aggregate of energy resources, as well as to monitor the progress of the orders and measure the electrical flexibility capacity at any given time;

Smart Retail: in early 2017 TIM set up the first 50 Smart Retail solutions distributed throughout Italy, equipping retail outlets with BLE (Bluetooth Low Energy) beacon technology, small devices installed in theme-based corners (e.g. TIM Vision area, Apple corner, etc.) which are detected by today's smartphones. Customers who have the MyTIM Mobile App are then guided during their visit to the shop, receiving welcome/goodbye messages (push notifications) and information on their position within the retail outlet. The solution goes beyond the physical confines of the shop, extending the customer's engagement to the geographic area in the immediate vicinity of the shop (geofence area) achieved by using proximity marketing cases: customers with the MyTIM Mobile App, when they are in the vicinity of Smart Retail or a shop that has activated a geofencing campaign, receive a message on their smartphone inviting them to visit the nearest TIM center to activate a promotional offer with particularly advantageous conditions. This idea is part of the company's New Concept Store project to renew retail outlets in terms of both their physical layout and technological equipment.

INDUSTRY 4.0

The innovations brought by Industry 4.0 are often represented as the fourth industrial revolution. The four key technological principles of Industry 4.0 for the Smart Factory, as defined by the promoters of this initiative (a working

group of the German government set up during the Hannover Fair), are:

Interoperability, seen as the capacity to communicate between smart devices, sensors and people in a transparent and standard way through the Internet of Things and of People (also known as the Internet of Everything);

Information transparency, seen as the capacity to create a cybernetic image of the Factory, virtual and updated in real time, also enriched with information obtained from smart devices, sensors, legacy databases and the people who work in the factory;

Technical Assistance, seen as the aggregation of information even using augmented reality techniques to support technicians who must resolve problems and make urgent interventions inside the Factory;

Remote control and the decentralization of decisions which can also be taken automatically by the CPS at the premises, but with supervision from a control room not necessarily located in the same building or in the same geographic area.

- ¹ The quantity of energy required by the set of consumers (families and companies) must be produced in real time, and must be transmitted so that supply and demand are always balanced, thereby ensuring the continuity and reliability of the supply of service. Management of these energy flows on the network is called dispatching.

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Case studies linked to Industry 4.0 under development are represented by the introduction of Internet technologies and IoT within the production processes of the manufacturing industry. They are essentially based on CPS (Cyber-Physical Systems), that is smart devices used in production processes seen as the evolution of present-day and widely used PLC (Programmable Logic Controllers)¹. The aim is to create a smart factory, modular and with islands, which can be remotely controlled and represented through a virtual image. Through the IoT the CPS (evolution of the PLC) communicate and cooperate with each other and with human beings in real time and, again through the Internet (the Future Internet as defined for example in the FI-PPP Program² of the European Commission), they present services both to departments within the manufacturing industry and to external organizations.

Immersive Technologies

Immersive technologies, based on environments created around the user in which the latter is literally immersed, linked to virtual, augmented and mixed reality, are becoming increasingly pervasive and in the near future may represent a new revolutionary computing platform, just as PCs and smartphones were in the past.

The panorama of immersive technologies is broken down into different areas. Virtual Reality (VR), the aim of which is to substitute some sense perceptions (first and foremost sight and hearing) with digital content and simulations that are so realistic they convince the user at a subconscious level of the credibility of the virtual world in which they are immersed. Using appropriate VR headsets (HMD – Head Mounted Display) the user's visual field is entirely replaced with digitally processed images which accurately follow the movements of the user's head. The user has the sensation of truly finding themselves in a different place, from a simulation of a space station cabin to a fantastic cartoon or a documentary on far-flung locations.

Instead, we are talking about Augmented and Mixed Reality (AR and MR) when the reality perceived by the user, instead of being completely replaced by a virtual world, is integrated with information and digital content. Already available for some time through applications for smartphones and tablets, these technologies now allow the direct overlapping of content in the user's visual field through the use of particular eyeglasses.

Thanks to the widespread availability of processing power offered by present-day devices and the lower costs of some components, such as LCD displays, for example, these technologies, until now reserved for niche markets and industrial scopes, are now accessible to the consumer market and will soon be part of our daily lives.

TIM is active in the research and development of solutions that use Virtual and Augmented Reality in many areas:

Social VR, Interpersonal Communication, Collaboration: from an initial analysis VR might seem to be a technology that isolates people, but in fact it has the potential to be the most social platform ever tested. Thanks to integration with the network, the virtual worlds are not solitary experiences but places in which to meet real people with whom to interact and chat in the same natural way (or almost) one would in real life. Any application, game or content, can become an experience to share with friends. Applications relating to social networking, interpersonal communication, and company collaboration abound and they are all there to be explored.

Digital entertainment: many of the main VR and AR applications will be linked, above all in the initial phase, to the entertainment area. Immersive technologies completely revolutionize present-day storytelling tools and will give rise to new and unexpected forms of artistic expression. The streaming of 360° immersive videos in 3D and high quality is a challenging matter from a technological viewpoint, and the potential offered by TIM's 4G LTE networks and the future innovations of the mobile wireless network will play a key role in making this content available everywhere.

- ¹ The Programmable Logic Controller (PLC) is a controller for industry originally specialized in managing or controlling industrial processes.
- ² Future Internet Public-Private Partnership Programme.

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Culture and eTourism: the potential of these technologies linked to the world of education, culture and tourism is vast. Think for example of the possibility of bringing an entire class of students to see the pyramids in Egypt, the surface of Mars and the barrier reef, in just one day. The bHERE framework, which arose from the development of this application, will allow the creation of virtual museum experiences and narration of this type which, in the future, will also be available in VR.

VR eCommerce: immersive technologies will make it possible to offer the entire commodity of present-day electronic commerce solutions combined with the advantages of visiting a real shop: the possibility of being able to view and touch the products (1:1 scale replicas) and interact with a real shop assistant in a virtual environment, even eliminating annoying queues.

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ENVIRONMENTAL PROTECTION

Energy efficiency

Actions aimed at improving the efficiency of technological systems and reducing electricity consumption, consequently reducing greenhouse gas emissions, are always an integral part of TIM's environmental strategy.

2017 is marked by significant growth in technological developments in the Network context, leading to a substantial increase in energy consumption in both fixed and mobile, estimated for this year at around 200 GWh. Therefore, over the course of the first half year, further new adaptation and efficiency-improvement measures for the structures of fixed network exchanges were assessed and prepared, to be carried out in the second half of the year with the aim of offsetting the aforementioned demand and at the same time reducing the increase in consumption. All the sites not affected by the efficiency-improvement plans already launched (disposal and decommissioning of industrial buildings) were taken into consideration. Actions to reduce consumption in other areas (data centre rooms and offices) were also analysed.

The main projects already underway or planned for the months ahead are described below.

Fixed network

Reengineering of Exchanges: planned adaptation work on both the power supply and air conditioning of the infrastructure of the exchanges is in the deployment phase, aimed at increasing energy efficiency, reducing the active electrical power and minimizing the reactive electrical power¹. Plans have been conceived to carry out work, in the second half of 2017, on the 100 exchanges (SGUs² and POPs³) which consume the most energy (out of a total of 10,500 exchanges) which indicatively represent 11% of the total consumption of the exchanges, amounting to around 159 GWh per year (105 GWh telecommunications equipment and 54 GWh infrastructure) with a savings target, when fully operational, of around 21 GWh.

Revamping Equipment: a set of streamlining, compactness and optimization measures are in the deployment phase, aimed at reducing energy consumption in the SGU exchanges in Metropolitan areas with initial estimated savings, when fully operational, of around 4 GWh.

Summer Efficiency Trial: in order to handle situations of abnormal consumption, the launch of summer monitoring has been planned for 80 fixed network exchanges.

Data Centre

Room cooling optimization: reducing consumption linked to the cooling of rooms is planned through the selective switching off of machines by installing a particular solution for the dynamic optimization of cooling mechanisms already tested in previous years. In the initial phase work will be carried out at a data center with significant consumption in the Rome area, obtaining an estimated annual saving of over 1 GWh.

Eco4Cloud solution: the plan is to expand the number of machines set up with real-time controlled and dynamic switching off of servers in farms in the cloud based on VMware virtualization, with optimization of the use of physical resources (CPU and RAM) and the consequent energy savings. The solution, the efficiency of which has already been tested, leads

- ¹ The active or real power is that actually consumed by a load, while the reactive power provides no consumption values as it is an exchange energy between the power line and the inductive load (motor, fluorescent lamps, etc.). Reducing the reactive power signifies, in practical terms, increasing the system's capacity to use energy to perform useful work by reducing the heating of the load and the cables, which cause energy losses due to the Joule effect.
- ² SGUs, or Urban Group Stages, are Area Exchanges that represent level 2 of TIM's switching hierarchy and are positioned between the Group Transit Stage (SGT, intercity network) and the Main Exchanges (MEs, which include the users through the distribution network).
- ³ In telecommunications the POP, or Point of Presence, is a network access point (router) along the access network, provided by an Internet Service Provider (ISP), capable of routing traffic to the end-users connected to it.
- ⁴ A farm in the cloud is a farm or a series of servers positioned in a single area in order to centralize the management, maintenance and security thereof. The various farms are distributed in the cloud.
- ⁵ This involves a series of software packages developed by VMware Inc. which allow several operating systems to run in a virtual environment. This makes it possible to implement, on a platform with a Windows or Linux operating system and the relevant hardware, a number of other virtual machines with different operating systems.

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to the better operation of IT farms in terms of performance and capacity planning, enabling optimization of the physical development of IT platforms following increases to the processing load required.

Offices

Energy efficiency at sites used as offices through the Building Energy Management System (BEMS), namely a building management system, with a dynamic approach, which aims to achieve lower energy consumption during operation and for the entire life cycle of the building-plant system¹; implementation is planned for 20 more energy-intensive offices which are not subject to divestment in the next 3 years.

As anticipated, decommissioning initiatives for obsolete technological platforms already launched in previous years also continued in the first half of 2017, mainly with regard to the following projects:

PSTN²: the project involves the migration of traditional accesses (except for ISDN accesses) to VoIP platforms. This results in reduced energy consumption, occupation of space and maintenance, and in general in the overcoming of the obsolescence of the traditional plants. The 2017 plan includes switching off 3.6 million ports with anticipated progress of over 50% by June with respect to the plan.

SuperSGU: the initiative plans to make the fixed network equipment more compact, concentrating the functions of some SGUs on a reduced number of SuperSGUs with direct benefits in terms of reducing energy consumption. The 2017 plan includes work on 25 SGUs with anticipated progress of over 50% by June with respect to the plan.

ATM³: the project involves optimizing data accesses with the gradual disposal of ATM devices and a shift to IP technology devices. This results in reduced energy consumption and in general the overcoming of the obsolescence of the traditional plants. The 2017 plan includes switching off 1.3 million ports with anticipated progress of over 30% by June with respect to the plan.

- ¹ See also standard UNI EN 15232 - Energy Performance of Buildings - Impact of building automation, control and technical building management which defines the methods for assessing the energy savings that can be achieved in buildings that use technologies for the management and automatic control of the technological systems and the electricity system.
- ² PSTN is the acronym for Public Switched Telephone Network; it is also known as RTG (General Telephone Network) or switched public telephone network.
- ³ ATM, or Asynchronous Transfer Mode, identifies a series of network protocols developed from the 90s onwards capable of offering an integrated single telecommunications service which is able to combine voice services with various types of data services.

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TIM PEOPLE

The evolution of the TLC industry towards Digital Telco models, the technological evolution of infrastructure and market challenges linked to the development of new digital and innovative services are all parts of the framework of an employment market undergoing profound transformation. The Digital Transformation, which TIM is working on, is pervasive and forces us to rethink processes and services and to develop new skills and professionals who are able to make the best use of the new opportunities.

At TIM in particular, the move towards a business model centered around Digital Innovation, the consequent need for a reshuffling of skills in line with the expanding range of offers and market positioning, and the extension of working life are the challenges that have the most impact on the definition of the new HR strategy, launched last year and currently on course for full application with particular emphasis on the following priority intervention areas:

Efficiency: in the first half of 2017 there was a continuation of actions aimed at rationalizing costs, simplifying the organizational structure and processes and improving productivity indexes.

Welfare: the reference model has been redesigned with a renewed proposal of services with particular attention to the work longevity phenomenon. The various actions planned include those to support the enhancement of professional characteristics functional for the increase of Company's value irrespective of age and following a logic of equality, inclusion and sustainability.

Skills: a significant number of professional re-training programs are in progress (job center), with particular attention to the digitization of professions; individual professional and managerial development plans to ensure the alignment of skills profiles with the new strategic direction.

Development Model

Compared to last year's, TIM's development model has been further refined in terms of individual components in order to support people in the various phases of their professional path within the company.

In particular, the first half saw the continuation of activities related to onboarding programs which involved new graduates and junior professionals already working at the Company, in order, amongst other things, to further support them in their professional career in keeping with the evolution of the business.

With respect to the other evaluation processes - Performance, Motivation and Knowledge Review - which constitute the primary source for the construction of development plans open to all directed at the entire Company population, the following activities were carried out:

Performance: in February the choice of evaluators phase was carried out by the persons responsible for the evaluation according to multirater logic; in March there was an evaluation phase involving everyone in the Group; the feedback phase was then initiated in April (starting with the MBO20 beneficiaries) which concluded for the entire Company population in the month of June.

Motivation Review: a new evaluation process aimed at detecting the energy people express in their work activities. In February the testing phase was initiated for the scientific validation of the tool; four companies in the Group are involved (TCC, Sparkle, HRS, INWIT).

Knowledge Review: in May the planning of the critical knowledge assessment process was completed, the results of which will constitute the basis for defining development plans for Professional Leadership aimed at recognizing Knowledge Holders as possessors of strategic know-how for the current and future business of the Company.

Finally, in the first half of the year, an overall review of the instrumentation for the Assessment of potential processes was carried out and the relative evaluation activities were started, aiming to define the development plans for Managerial Leadership.

²⁰ Management by Objectives

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Training

Continuing on the path of the enhancement and development of in-house expertise, which started in July 2016, the skills development strategy is outlined through the following main pillars:

Professional re-training and enhancement

Development of the managerial profile

Evolution and digitization of skills

Individual development plans

In keeping with these drivers, the consolidation of the TIM Academy and Development Model continues, in order to ensure tools and methodologies that can support employees at this delicate time of transformation.

The training activities are divided into four macro-categories, each of which entails several main activities carried out in the first half.

Management Education: training aimed at managers is essential to accelerate company turnaround and ensure the implementation of the 2017-2019 strategic plan. A Management Education course for 2017/2018 has been established, which will involve a total of 700 managers, offering targeted programs differentiated on the basis of the complexity of the roles managed by the participants. In June the planning was completed and the first programs are in the launch phase. The plan, developed in blended mode, includes: webinar sessions, online coaching sessions, bite-size training and video-talks, experimental laboratories, workshops and seminars on strategic topics with key speakers.

Development of role-based and specialized skills and new capabilities: training to develop role-based and specialized skills, as well as new capabilities, occupies a central role in TIM's training investments plan. The main projects launched in the first half are:

Open Access on-the-field technicians skills improvement : blended training for around 9,000 in-the-field technicians aimed at bridging the gaps in the technical skills that emerged from the skill assessment.

Maintenance and Development of Corporate Certifications : measures to enable participation in tenders and contracts in the private sector and in Central and Local Public Administration.

Big Data Transformation : development path for Big Data skills to support the transformation underway at TIM.

Field Management Training : management training for 52 Coordinator Managers for Integrated Access Network Assurance & Delivery (Field Force) in the Open Access area.

Development and empowerment

The organizational changes and the evolution of business-linked skills require new tools to support the change and the awareness of TIM 's people.

The Skills Model e-learning course has been created, which aims to increase awareness and promote the culture needed to guide the behavior of the Group 's personnel.

Institutional and corporate culture

Institutional and mandatory training, involving the entire population of the Company, aims to raise awareness and disseminate knowledge of the content required by the legal formalities and support the transformation of the organizational culture. The main projects of the first half year are:

New Equivalence Model (NEM): dedicated to staff in the commercial departments to facilitate the transition towards the New Model.

Safety: in relation to the obligations deriving from current regulations, around 100 senior managers are involved in the Sicuri Adesso (Safe Now) training project.

Anti-corruption and whistleblowing: a digital learning module has been created, which involves the entire population of the company and the Group in order to encourage the adoption of transparency, correctness and behaviors in good faith by the whole Company.

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Job Centre and the development of in-house expertise

In relation to the re-training paths in progress, professional re-skilling activities continued as part of the Job Centre Project, which pursues the following main objectives:

re-allocating the people currently assigned to support activities with a direct impact on the business and on customers;

provide a professional qualification for people to be re-employed in activities previously outsourced and now brought back in-house;

represent a professional opportunity which allows the company to open up to the market more effectively and efficiently, with energy, skills and professionalism, while also allowing people to maintain an updated professional profile.

At the end of June more than 2,700 people have been involved in the Job Center.

HR Partnerships

In 2017 we implemented the new model of relations with the educational ecosystem (academic world, schools, business schools, institutional and social entities) pro-actively collaborating on the definition of training projects, the teaching of the topics specific to our business and the implementation of specific School-Work Alternation courses with technical institutions and schools from across the country.

The aim of the new partnership model is to generate value in the short-medium term for the organization, on the one hand, through the blending of different knowledge; and for young people, on the other, making our know-how available to them.

People Caring

TIM believes that being an inclusive company, one that is able to take care of its people and to create solutions that put everyone in a position to give the best of themselves, is the basis for economic and social sustainability. In this context, 2017 also saw numerous initiatives launched in various and diverse areas, all connected by the common thread of placing people at the center, which are encompassed in the following four macro areas:

Work-life balance and Family Care (including daycare centers, summer camps for employees' children, commute management, free tickets and the testing of agile working);

Volunteering initiatives by employees (including blood donation days organized at Company offices, stands hosted at Company offices to sell charity products and participate in charitable activities);

Equity & Inclusion Management (which include disability management and longevity management initiatives);

Promotion and support for people and their well-being (for example the provision of financial assistance to support employees in particular financial difficulties; the provision of scholarships, for visits abroad and the reimbursement of university taxes; and for enrolment in the first year of single-cycle university programs and selected master s degrees for worthy children of employees).

Health and Safety

During the first half, the main areas of action in the field of health and safety at work, related to the re-modelling of the process of identifying and assessing risks in keeping with TIM s shift to a multi-employer model, which resulted in the reviewing of the organizational and procedural framework linked to the management of prevention aspects.

Campaigns to monitor physical agents continued by means of tools specific to the measurement of vibrations, noise and electromagnetic fields. Training activities for all company employees were planned and launched, in particular for operational technical staff increasingly affected by the application of new technologies and involved in new operating scenarios.

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As part of the information and awareness-raising initiatives to strengthen the safety culture, planning started for a video on how to handle emergencies in the event of earthquakes.

With reference to the monitoring of accidents, in the first half the careful analysis of events and the potential identification of corrective actions continued; for greater synergy, there was stronger direct involvement of the staff affected.

A number of digital projects are also being developed in collaboration with technical personnel; these are also aimed at the application of new technologies in the Safety area.

Industrial relations

In the first half, in keeping with the Industrial Relations model shaped by seeking dialogue and a constructive comparison of ideas, and in compliance with contractual structures, information and discussion sessions with trade unions continued at both national and regional level.

At national level, on several occasions TIM outlined the strategic positioning of the Company in relation to the main economic and production indicators and the consequent need to identify measures aimed at supporting the recovery of competitiveness and profitability as well as improving the quality of services, in order to safeguard employment levels and the company scope.

In this context, in February the Company issued a Company Regulation which innovates and modernizes some fundamental aspects of the employment relationship, including, inter alia, with respect to remuneration, specific individual incentive measures for technical staff. This Regulation was then subsequently refined and improved, accepting the proposals and suggestions of the trade union organizations.

In June, the Company and the Trade Union reached an understanding that defines the structure of the 2017/2019 Performance Bonus for companies of the TIM Group.

The Bonus takes a new approach: it provides for equal incentive systems for all, from managers to technical personnel, and they are based on the results achieved with respect to the goals set.

The agreement, which positively concludes the negotiations started last month with the trade union, provides for the performance bonus to be comprised of:

- a basic bonus, which uses the Group EBITDA as an indicator;
- a production bonus, which uses the revenues from group services net of product revenues as an indicator;
- an improvement bonus which uses the Customer Satisfaction Index as an indicator;

a department bonus linked to the departmental targets.

The objectives, changed by managerial incentive systems, recognize the contribution of all workers to the achievement of the forecast economic and production results.

The average value of the Bonus for TIM was also defined (1,300 euros per year), correlated and commensurate to the achievement of the goals set.

The payout will concern all employees, including those with apprenticeship and fixed-term contracts, but the bonus will be awarded upon achievement, first of all, of the measure set for the Group EBITDA indicator.

The parties have also provided for the Welfare option, according to which people may choose whether to receive all or a part of the bonus in welfare services, benefiting from full tax relief. The list of services includes, inter alia, daycare centers, taxes and schools books, elderly care, healthcare costs, pension funds, loans, shopping vouchers, sports and free time which are only a part of the welfare capital, in which TIM invests a total of over 100 million euros each year.

A consultancy body has been set up to manage the agreement, which will be notified of the goals each year, derived from the budget process, in keeping with the Business Plan.

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With respect to the trend reversal of the Company's main economic and profit indicators, recorded in the second half of 2016, TIM paid its employees a contribution made on the basis of overall efficiency recovery and improvement of the Company's economic performance. In this sense TIM's people were paid a One-off Bonus, diversified according to their grade. Appreciation was also shown to personnel of the Group's other companies - to whom the Telecommunications Collective Employment Agreement applies - with the agreement on the Performance Bonus which expired in 2016.

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Assets

(millions of euros)	<i>note</i>	6/30/2017	<i>of which related parties</i>	12/31/2016	<i>of which related parties</i>
Non-current assets					
Intangible assets					
Goodwill	4)	29,511		29,612	
Intangible assets with a finite useful life	5)	6,594		6,951	
		36,105		36,563	
Tangible assets					
Property, plant and equipment owned	6)	13,671		13,947	
Assets held under finance leases		2,371		2,413	
		16,042		16,360	
Other non-current assets					
Investments in associates and joint ventures accounted for using the equity method	7)	17		18	
Other investments	7)	48		46	
Non-current financial assets	8)	2,185		2,698	532
Miscellaneous receivables and other non-current assets		2,324		2,222	
Deferred tax assets		525		877	
		5,099		5,861	
Total Non-current assets	(a)	57,246		58,784	
Current assets					
Inventories		314		270	
Trade and miscellaneous receivables and other current assets	9)	5,617	<i>15</i>	5,426	<i>136</i>

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Current income tax receivables		45		94
Current financial assets	8)			
Securities other than investments, financial receivables and other current financial assets		1,732	5	1,908
				132
Cash and cash equivalents		4,086		3,964
				621
		5,818	5	5,872
				753
Current assets sub-total		11,794		11,662
Discontinued operations/Non-current assets held for sale				
Total Current assets	(b)	11,794		11,662
Total Assets	(a+b)	69,040		70,446

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Equity and Liabilities

(millions of euros)	<i>note</i>	6/30/2017	<i>of which related parties</i>	12/31/2016	<i>of which related parties</i>
Equity	10)				
Share capital issued		11,677		11,677	
less: Treasury shares		(90)		(90)	
Share capital		11,587		11,587	
Additional paid-in capital		2,094		2,094	
Other reserves and retained earnings (accumulated losses), including profit (loss) for the period		7,723		7,526	
Equity attributable to Owners of the Parent		21,404		21,207	
Non-controlling interests		2,215		2,346	
Total Equity	(c)	23,619		23,553	
Non-current liabilities					
Non-current financial liabilities	11)	28,887		30,469	912
Employee benefits	15)	1,336		1,355	
Deferred tax liabilities		323		293	
Provisions	16)	813		830	
Miscellaneous payables and other non-current liabilities		1,594		1,607	2
Total Non-current liabilities	(d)	32,953		34,554	
Current liabilities					
Current financial liabilities	11)	4,844		4,056	133

Trade and miscellaneous payables and other current liabilities	17)	7,056	76	7,646	263
Current income tax payables		568		637	
Current liabilities sub-total		12,468		12,339	
Liabilities directly associated with Discontinued operations/Non-current assets held for sale					
Total Current Liabilities	(e)	12,468		12,339	
Total Liabilities	(f=d+e)	45,421		46,893	
Total Equity and Liabilities	(c+f)	69,040		70,446	

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SEPARATE CONSOLIDATED INCOME STATEMENTS

(millions of euros)	<i>note</i>	1st Half 2017	<i>of which related parties</i>	1st Half 2016	<i>of which related parties</i>
Revenues		9,772	118	9,096	164
Other income		217	7	107	2
Total operating revenues and other income		9,989		9,203	
Acquisition of goods and services		(4,136)	(99)	(3,783)	(110)
Employee benefits expenses		(1,530)	(54)	(1,551)	(66)
Other operating expenses		(576)		(501)	
Change in inventories		50		33	
Internally generated assets		317		325	
Operating profit before depreciation and amortization, capital gains (losses) and impairment reversals (losses) on non-current assets (EBITDA)		4,114		3,726	
<i>of which: impact of non-recurring items</i>	25)	(95)		(91)	
Depreciation and amortization		(2,249)		(2,047)	
Gains/(losses) on disposals of non-current assets		6		13	
Impairment reversals (losses) on non-current assets				(5)	
Operating profit (loss) (EBIT)		1,871		1,687	
<i>of which: impact of non-recurring items</i>	25)	(96)		(82)	
Share of profits (losses) of associates and joint ventures accounted for using the equity method		(1)		(2)	
Other income (expenses) from investments		(19)		7	
Finance income	19)	1,110	37	2,012	60
Finance expenses	19)	(1,850)	(40)	(2,157)	(67)

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Profit (loss) before tax from continuing operations		1,111	1,547
<i>of which: impact of non-recurring items</i>	25)	(110)	(93)
Income tax expense		(457)	(489)
Profit (loss) from continuing operations		654	1,058
Profit (loss) from Discontinued operations/Non-current assets held for sale			47
			9
Profit (loss) for the period	20)	654	1,105
<i>of which: impact of non-recurring items</i>	25)	(173)	(78)
Attributable to:			
Owners of the Parent		596	1,018
Non-controlling interests		58	87

		1st Half 2017	1st Half 2016
(euros)			
Earnings per share:		21)	
Earnings per share (Basic)			
Ordinary Share		0.03	0.05
Savings Share		0.04	0.06
<i>of which:</i>			
from Continuing operations attributable to Owners of the Parent			
Ordinary Share		0.03	0.05
Savings Share		0.04	0.06
Earnings per share (Diluted)			
Ordinary Share		0.03	0.03
Savings Share		0.04	0.04
<i>of which:</i>			
from Continuing operations attributable to Owners of the Parent			
Ordinary Share		0.03	0.03
Savings Share		0.04	0.04

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Note 10

(millions of euros)		1st Half 2017	1st Half 2016
Profit (loss) for the period	(a)	654	1,105
Other components of the Consolidated Statements of Comprehensive Income			
Other components that subsequently will not be reclassified in the Separate Consolidated Income Statements			
Remeasurements of employee defined benefit plans (IAS 19):			
Actuarial gains (losses)		33	(118)
Income tax effect		(8)	32
	(b)	25	(86)
Share of other profits (losses) of associates and joint ventures accounted for using the equity method:			
Profit (loss)			
Income tax effect			
	(c)		
Total other components that subsequently will not be reclassified in the Separate Consolidated Income Statements	(d=b+c)	25	(86)
Other components that subsequently will be reclassified in the Separate Consolidated Income Statements			
Available-for-sale financial assets:			
Profit (loss) from fair value adjustments		34	76
Loss (profit) transferred to the Separate Consolidated Income Statements		(37)	(69)
Income tax effect		2	(4)
	(e)	(1)	3
Hedging instruments:			
Profit (loss) from fair value adjustments		(331)	(327)
Loss (profit) transferred to the Separate Consolidated Income Statements		497	245

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Income tax effect		(43)	(2)
	(f)	123	(84)
Exchange differences on translating foreign operations:			
Profit (loss) on translating foreign operations		(551)	618
Loss (profit) on translating foreign operations transferred to the Separate Consolidated Income Statements		19	304
Income tax effect			
	(g)	(532)	922
Share of other profits (losses) of associates and joint ventures accounted for using the equity method:			
Profit (loss)			
Loss (profit) transferred to the Separate Consolidated Income Statements			
Income tax effect			
	(h)		
Total other components that subsequently will be reclassified to the Separate Consolidated Income Statements	(i=e+f+g+h)	(410)	841
Total other components of the Consolidated Statements of Comprehensive Income	(k=d+i)	(385)	755
Total comprehensive income (loss) for the period	(a+k)	269	1,860
Attributable to:			
Owners of the Parent		367	1,726
Non-controlling interests		(98)	134

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CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Changes from January 1, 2016 to June 30, 2016

(millions of euros)	Equity attributable to Owners of the Parent								Non-controlling interests	Total equity
	Share capital	Additional paid-up capital	Reserve for financial assets	Reserve for cash flow hedges	Reserve for translating foreign operations	Reserve for employee benefit plans (IAS 19)	Share of other profits (losses) of associates and joint ventures	Other reserves and retained earnings		
							including net profit (loss) for the period	Total		
Balance at December 31, 2015	10,650	1,731	32	(249)	(1,459)	(87)	6,992	17,610	3,723	21,333
Correction due to errors					46		(102)	(56)	(28)	(84)
Adjusted Balance at December 31, 2015	10,650	1,731	32	(249)	(1,413)	(87)	6,890	17,554	3,695	21,249
Changes in equity during the period:										
Dividends approved							(166)	(166)	(26)	(192)
Total comprehensive income (loss) for the period			3	(84)	875	(86)	1,018	1,726	134	1,860
Disposal of the Sofora - Telecom Argentina group									(1,582)	(1,582)
Issue of equity instruments							3	3		3
Other changes							(11)	(11)		(11)

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Balance at June 30, 2016	10,650	1,731	35	(333)	(538)	(173)	7,734	19,106	2,221	21,327
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Changes from January 1, 2017 to June 30, 2017 Note 10

(millions of euros)	Equity attributable to Owners of the Parent								Non-controlling interests	Total equity
	Share capital	Additional paid-in capital	Reserve for financial assets	Reserve for cash flow hedges	Reserve for foreign operations	Reserve for exchange differences	Reserve for defined benefit plans (IAS 19) method	Share of other profits (losses) of associates, reserves and joint ventures (including accumulated earnings (losses),		
Balance at December 31, 2016	11,587	2,094	39	(551)	(366)	(113)	8,517	21,207	2,346	23,553
Changes in equity during the period:										
Dividends approved							(166)	(166)	(39)	(205)
Total comprehensive income (loss) for the period			(1)	123	(376)	25	596	367	(98)	269
Issue of equity instruments							4	4		4
Other changes							(8)	(8)	6	(2)
Balance at June 30, 2017	11,587	2,094	38	(428)	(742)	(88)	8,943	21,404	2,215	23,619

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(millions of euros)	note	1st Half 2017	1st Half 2016
Cash flows from operating activities:			
Profit (loss) from continuing operations		654	1,058
Adjustments for:			
Depreciation and amortization		2,249	2,047
Impairment losses (reversals) on non-current assets (including investments)		10	5
Net change in deferred tax assets and liabilities		336	257
Losses (gains) realized on disposals of non-current assets (including investments)		(6)	(13)
Share of profits (losses) of associates and joint ventures accounted for using the equity method		1	2
Change in employee benefits		(7)	40
Change in inventories		(44)	(40)
Change in trade receivables and net amounts due from customers on construction contracts		(52)	(130)
Change in trade payables		44	(141)
Net change in current income tax receivables/payables		72	95
Net change in miscellaneous receivables/payables and other assets/liabilities		(119)	(687)
Cash flows from (used in) operating activities	(a)	3,138	2,493
Cash flows from investing activities:			
<i>Purchase of intangible assets</i>	5)	(673)	(709)
<i>Purchase of tangible assets</i>	6)	(1,413)	(1,397)
Total purchase of intangible and tangible assets on an accrual basis (*)		(2,086)	(2,106)
<i>Change in amounts due for purchases of intangible and tangible assets</i>		(707)	(371)

Total purchase of intangible and tangible assets on a cash basis		(2,793)	(2,477)
Acquisition of control in subsidiaries or other businesses, net of cash acquired			(6)
Acquisitions/disposals of other investments		(1)	(3)
Change in financial receivables and other financial assets		695	364
Proceeds from sale that result in a loss of control of subsidiaries or other businesses, net of cash disposed of			492
Proceeds from sale/repayment of intangible, tangible and other non-current assets		9	29
Cash flows from (used in) investing activities	(b)	(2,090)	(1,601)
Cash flows from financing activities:			
Change in current financial liabilities and other		(663)	(262)
Proceeds from non-current financial liabilities (including current portion)		1,256	2,061
Repayments of non-current financial liabilities (including current portion)		(1,200)	(3,094)
Share capital proceeds/reimbursements (including subsidiaries)		6	
Dividends paid (*)		(218)	(227)
Cash flows from (used in) financing activities	(c)	(819)	(1,522)
Cash flows from (used in) Discontinued operations/Non-current assets held for sale	(d)		(45)
Aggregate cash flows	(e=a+b+c+d)	229	(675)
Net cash and cash equivalents at beginning of the period	(f)	3,952	3,216
Net foreign exchange differences on net cash and cash equivalents	(g)	(95)	159
Net cash and cash equivalents at end of the period	(h=e+f+g)	4,086	2,700
(*) of which related parties:			
Total purchase of intangible and tangible assets on an accrual basis		75	63

Dividends paid

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Additional Cash Flow Information

(millions of euros)	1st Half 2017	1st Half 2016
Income taxes (paid) received	(27)	(104)
Interest expense paid	(1,198)	(1,327)
Interest income received	432	516
Dividends received		7

Analysis of Net Cash and Cash Equivalents

(millions of euros)	1st Half 2017	1st Half 2016
Net cash and cash equivalents at beginning of the period		
Cash and cash equivalents - from continuing operations	3,964	3,559
Bank overdrafts repayable on demand from continuing operations	(12)	(441)
Cash and cash equivalents - from Discontinued operations/Non-current assets held for sale		98
Bank overdrafts repayable on demand from Discontinued operations/Non-current assets held for sale		
	3,952	3,216
Net cash and cash equivalents at end of the period		
Cash and cash equivalents - from continuing operations	4,086	2,707
Bank overdrafts repayable on demand from continuing operations		(7)
Cash and cash equivalents - from Discontinued operations/Non-current assets held for sale		
Bank overdrafts repayable on demand from Discontinued operations/Non-current assets held for sale		
	4,086	2,700

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NOTE 1

FORM, CONTENT AND OTHER GENERAL INFORMATION

FORM AND CONTENT

Telecom Italia S.p.A. (the Parent), also known in short as TIM S.p.A. , and its subsidiaries form the TIM Group or the Group .

TIM is a joint-stock company (S.p.A.) organized under the laws of the Republic of Italy.

The registered offices of the Parent, TIM, are located in Milan, Italy at Via Gaetano Negri 1.

The duration of TIM S.p.A., as stated in the company s bylaws, extends until December 31, 2100.

The TIM Group operates mainly in Europe, the Mediterranean Basin and South America.

The Group is engaged principally in the communications sector and, particularly, the fixed and mobile national and international telecommunications sector.

The TIM Group half-year condensed consolidated financial statements at June 30, 2017 have been prepared on a going concern basis (further details are provided in the Note Accounting policies) and in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and endorsed by the European Union (designated as IFRS), as well as the laws and regulations in force in Italy.

The TIM Group half-year condensed consolidated financial statements at June 30, 2017 have been prepared in compliance with IAS 34 (*Interim Reports*) and, as permitted by this standard, do not include all the information required in the annual consolidated financial statements; accordingly, these financial statements should be read together with the 2016 TIM Group consolidated financial statements.

For purposes of comparison, the consolidated statements of financial position at December 31, 2016 and the separate consolidated income statements, the consolidated statements of comprehensive income, the consolidated statements of cash flows, as well as the consolidated statements of changes in equity for the first half of 2016 are presented.

The TIM Group half-year condensed consolidated financial statements at June 30, 2017 are expressed in euro (rounded to the nearest million unless otherwise indicated).

Publication of the TIM Group half-year condensed consolidated financial statements at June 30, 2017 was approved by resolution of the Board of Directors meeting held on July 27, 2017.

FINANCIAL STATEMENT FORMATS

The financial statement formats adopted are consistent with those indicated in IAS 1. In particular:

the consolidated statements of financial position have been prepared by classifying assets and liabilities according to the current and non-current criterion;

the separate consolidated income statements have been prepared by classifying operating expenses by nature of expense as this form of presentation is considered more appropriate and representative of the specific business of the Group, conforms to internal reporting and is in line with the TIM Group's industrial sector.

In addition to EBIT or Operating profit (loss), the separate consolidated income statements include the alternative performance measure of EBITDA or Operating profit (loss) before depreciation and amortization, Capital gains (losses) and Impairment reversals (losses) on non-current assets.

In particular, besides EBIT, EBITDA is used by TIM as the financial target in internal presentations (business plans) and in external presentations (to analysts and investors). It represents a useful unit of measurement for the evaluation of the operating performance of the Group (as a whole and at the Business Unit level). EBIT and EBITDA are calculated as follows:

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Profit (loss) before tax from continuing operations

+ Finance expenses

- Finance income

+/- Other expenses (income) from investments

+/- Share of profits (losses) of associates and joint ventures accounted for using the equity method

EBIT - Operating profit (loss)

+/- Impairment losses (reversals) on non-current assets

+/- Losses (gains) on disposals of non-current assets

+ Depreciation and amortization

EBITDA - Operating profit (loss) before depreciation and amortization, Capital gains (losses) and Impairment reversals (losses) on non-current assets

the consolidated statements of comprehensive income include the profit or loss for the period as shown in the separate consolidated income statements and all other non-owner changes in equity;

the Consolidated statements of cash flows have been prepared by presenting cash flows from operating activities according to the indirect method, as permitted by IAS 7 (Statement of Cash Flows).

Furthermore, as required by Consob Resolution 15519 of July 27, 2006, in the separate consolidated income statements, income and expenses relating to transactions which by nature do not occur during normal operation (non-recurring transactions) have been specifically identified and their impacts on the main intermediate levels have been shown separately, when they are significant. Specifically, non-recurring income/(expenses) include, for instance: income/expenses arising from the sale of properties, plant and equipment, business segments and investments; expenses stemming from company reorganization and streamlining processes and projects, also in connection with corporate transactions (mergers, spin-offs, etc.); expenses resulting from litigation and regulatory fines and related liabilities; other provisions and related reversals; costs for the settlement of disputes; and impairment losses on goodwill and/or other intangible and tangible assets).

Also in reference to the above Consob resolution, the amounts of the balances or transactions with related parties have been shown separately in the consolidated financial statements.

SEGMENT REPORTING

An operating segment is a component of an entity:

that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity);

whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources (for TIM, the Board of Directors) to be allocated to the segment and assess its performance; and

for which discrete financial information is available.

In particular, the operating segments of the TIM Group are organized according to geographic location (Domestic and Brazil) for the telecommunications business.

The Sofora - Telecom Argentina group, which was sold on March 8, 2016, has been recognized under Discontinued operations.

The term "operating segment" is considered synonymous with "Business Unit".

The operating segments of the TIM Group are as follows:

Domestic: includes operations in Italy for voice and data services on fixed and mobile networks for end customers (retail) and other operators (wholesale), the operations of the Telecom Italia Sparkle group (International wholesale), which, at international level (Europe, the Mediterranean and South America), develops fiber optic networks for wholesale customers, the operations of Olivetti (products

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and services for Information Technology), as well as INWIT S.p.A. (a company operating in the electronic communications infrastructure sector, and in particular the infrastructure for hosting radio transmission equipment for mobile telephone networks, both for TIM and other operators) and the units supporting the Domestic sector.

See the section Financial and Operating Highlights of the Business Units of the TIM Group Domestic Business Unit of the Interim Management Report for more details;

Brazil: includes mobile (TIM Celular) and fixed (TIM Celular and Intelig) telecommunications operations in Brazil;

Other Operations: include finance companies and other minor companies not strictly related to the core business of the TIM Group.

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NOTE 2

ACCOUNTING POLICIES

GOING CONCERN

The half-year condensed consolidated financial statements at June 30, 2017 have been prepared on a going concern basis as there is the reasonable expectation that TIM will continue its operational activities in the foreseeable future (and in any event with a time horizon of at least twelve months).

In particular, the following factors have been taken into consideration:

the main risks and uncertainties (that are for the most part of an external nature) to which the Group and the various activities of the TIM Group are exposed:

- (2) changes in the general macroeconomic situation in the Italian, European and Brazilian markets, as well as the volatility of financial markets in the Eurozone also as a result of the Brexit referendum in the United Kingdom;
- (3) variations in business conditions, also related to competition;
- (4) changes to laws and regulations (price and rate variations or decisions that may affect technological choices);
- (5) outcomes of legal disputes and proceedings with regulatory authorities, competitors and other parties;
- (6) financial risks (interest rate and/or exchange rate trends, changes in the Group's credit rating by rating agencies);

the mix between equity and debt capital considered optimal as well as the policy for the remuneration of equity, described in the 2016 consolidated financial statements in the paragraph devoted to the Share capital information under the Note Equity ;

the policy for financial risk management (market risk, credit risk and liquidity risk) as described in the Note Financial risk management in the annual consolidated financial statements at December 31, 2016.

Based on these factors, the Management believes that, at the present time, there are no elements of uncertainty regarding the Group's ability to continue as a going concern.

ACCOUNTING POLICIES AND PRINCIPLES OF CONSOLIDATION

The accounting policies and consolidation principles adopted in the preparation of the half-year condensed consolidated financial statements at June 30, 2017 are the same as those adopted in the annual consolidated financial statements at December 31, 2016, to which reference can be made, except for the changes required because of the nature of interim financial reporting.

Furthermore, in the half-year condensed consolidated financial statements at June 30, 2017, income taxes for the period of the individual consolidated companies are calculated according to the best possible estimate based on available information and on a reasonable forecast of performance up to the end of the tax period. Conventionally, the income tax liabilities (current and deferred) on the profit for the interim period of the individual consolidated companies are recorded net of advances and tax receivables (excluding receivables for which refunds have been requested) as well as deferred tax assets, under "Deferred tax liabilities"; if the balance between deferred tax assets and deferred tax liabilities is an asset it is conventionally recognized in "Deferred tax assets".

USE OF ESTIMATES

The preparation of the half-year condensed consolidated financial statements at June 30, 2017 and related disclosure requires management to make estimates and assumptions based also on subjective judgments, past experience and hypotheses considered reasonable and realistic in relation to the information known at the time of the estimate. Such estimates have an effect on the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial

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Accounting policies 79

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statements, as well as the amount of revenues and costs during the period. Actual results could differ, even significantly, from those estimates owing to possible changes in the factors considered in the determination of such estimates. Estimates are reviewed periodically.

With regard to the most important accounting estimates, please refer to those illustrated in the annual consolidated financial statements at December 31, 2016.

NEW STANDARDS AND INTERPRETATIONS ENDORSED BY THE EU AND IN FORCE FROM JANUARY 1, 2017

There were no new Standards and Interpretations that had been endorsed by the EU and were in force from January 1, 2017.

NEW STANDARDS AND INTERPRETATIONS ISSUED BY IASB BUT NOT YET APPLICABLE

At the date of preparation of these half-year condensed consolidated financial statements, the following new standards and interpretations, which have not yet entered into force, had been issued by the IASB:

	Mandatory application starting from
New Standards and Interpretations endorsed by the EU	
IFRS 15 (Revenues from contracts with customers)	1/1/2018
IFRS 9 (Financial Instruments)	1/1/2018
New Standards and Interpretations not yet endorsed by the EU	
IFRS 16 (Leases)	1/1/2019
Amendments to IFRS 10 (Consolidated Financial Statements) and to IAS 28 (Investments in Associates and Joint Ventures): Sale or contribution of assets between an investor and its associate/joint venture	Application deferred indefinitely
Amendments to IAS 12 (Income taxes) - Recognition of Deferred Tax Assets for Unrealized Losses	1/1/2017
Amendments to IAS 7 (Cash flow statement - Disclosure)	1/1/2017

initiative)

Clarifications to IFRS 15 (Revenue from contracts with customers)	1/1/2018
Amendments to IFRS 2 (Classification and measurement of share-based payments)	1/1/2018
Improvements to the IFRS (2014-2016 cycle) Amendments to IFRS 12 and IAS 28	1/1/2017
	for IFRS 12 1/1/2018
	for IAS 28
IFRIC 22 (Foreign currency transactions and advance consideration)	1/1/2018
Amendments to IAS 40 (Investment property)	1/1/2018
IFRIC 23 Uncertainty over income tax treatments	1/1/2019

The potential impacts on the consolidated financial statements from application of these standards and interpretations are currently being assessed. With regard to the adoption of IFRS 15, IFRS 16 and IFRS 9, specific projects have been initiated at Group level and therefore a reliable estimate of their quantitative effects will only be possible when each project has been completed.

For more details of the specific projects see the information provided in the Note Accounting policies of the annual consolidated financial statements at December 31, 2016.

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NOTE 3

SCOPE OF CONSOLIDATION

The changes in the scope of consolidation at June 30, 2017 compared to December 31, 2016 are listed below.

Subsidiaries exiting the scope of consolidation:

Company		Business Unit	Month
Exit:			
TIERRA ARGENTEA S.A.	Liquidated	Other Operations	May 2017

In addition to that noted above, the changes in the scope of consolidation at June 30, 2017 compared to June 30, 2016 are listed below:

Subsidiaries entering/exiting/merged into the scope of consolidation

Company		Business Unit	Month
Entry:			
FLASH FIBER S.r.l.	New company	Domestic	July 2016
TI SPARKLE RUSSIA LLC	New acquisition	Domestic	July 2016
NOVERCA S.r.l.	New acquisition	Domestic	October 2016
TIMVISION S.r.l.	New company	Domestic	December 2016
Exit:			
PURPLE TULIP B.V.	Liquidated	Other Operations	July 2016
Merger:			
TELECOM ITALIA INTERNATIONAL N.V.	Merged into Telecom Italia Finance S.A.	Other Operations	August 2016
TELECOM ITALIA DEUTSCHLAND HOLDING GmbH	Merged into TIM S.p.A.	Other Operations	August 2016
GESTIONE DUE S.r.l.	Merged into INWIT S.p.A.	Domestic	September 2016
GESTIONE IMMOBILI S.r.l.	Merged into INWIT S.p.A.	Domestic	September 2016
REVI IMMOBILI S.r.l.	Merged into INWIT S.p.A.	Domestic	September 2016
TELECOM ITALIA INFORMATION TECHNOLOGY S.p.A.	Merged into TIM S.p.A.	Domestic	December 2016

The breakdown by number of subsidiaries and associates of the TIM Group is as follows:

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Companies:	6/30/2017		Total
	Italy	Outside Italy	
subsidiaries consolidated line-by-line	25	47	72
joint ventures accounted for using the equity method	1		1
associates accounted for using the equity method	20		20
Total companies	46	47	93

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		12/31/2016		
			Outside	
Companies:	Italy	Italy		Total
subsidiaries consolidated line-by-line	25	48		73
joint ventures accounted for using the equity method	1			1
associates accounted for using the equity method	19			19
Total companies	45	48		93
		6/30/2016		
			Outside Italy	
Companies:	Italy	Italy		Total
subsidiaries consolidated line-by-line	26	50		76
joint ventures accounted for using the equity method	1			1
associates accounted for using the equity method	18			18
Total companies	45	50		95

Further details are provided in the Note List of companies of the TIM Group .

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Scope of consolidation 82

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NOTE 4

GOODWILL

The breakdown and the changes in Goodwill during the first six months of 2017 were as follows:

(millions of euros)	12/31/2016	Reclassification	Increase	Decrease	Impairment	Exchange differences	6/30/2017
Domestic	28,489						28,489
Core Domestic	28,077						28,077
International Wholesale	412						412
Brazil	1,123					(101)	1,022
Other Operations							
Total	29,612					(101)	29,511

In accordance with IAS 36, goodwill is not subject to amortization, but is tested for impairment annually or more frequently, whenever specific events or circumstances occur that may indicate an impairment.

At June 30, 2017, TIM's market capitalization was less than the value of its equity; however, in view of the positive performance of the first six months of the year, in line with the plan forecasts, the absence of new and additional external indicators and the results in terms of recoverable amount of the impairment testing conducted for the 2016 Financial Statements, it was not considered necessary to redetermine the recoverable amount and consequently the goodwill allocated to the individual cash generating units in the 2016 Consolidated Financial Statements was confirmed.

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Goodwill 83

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NOTE 5

INTANGIBLE ASSETS WITH A FINITE USEFUL LIFE

Intangible assets with a finite useful life decreased by 357 million euros compared to December 31, 2016. The breakdown and movements are as follows:

(millions of euros)	12/31/2016	Additions	Amortization	Impairment (losses) / reversal	Disposals	Exchange differences	Capitalized borrowing costs	Other changes	6/30/2017
Industrial patents and intellectual property rights	2,458	255	(645)			(101)		318	2,285
Concessions, licenses, trademarks and similar rights	2,854	7	(198)			(53)		30	2,640
Other intangible assets	109	76	(64)			(3)		1	119
Work in progress and advance payments	1,530	335				(106)	45	(254)	1,550
Total	6,951	673	(907)			(263)	45	95	6,594

Additions in the first six months of 2017 included 133 million euros of internally generated assets (147 million euros in the first six months of 2016).

Industrial patents and intellectual property rights at June 30, 2017 essentially consisted of software applications purchased outright and user license rights of unlimited duration, relating to TIM S.p.A. (1,240 million euros) and the Brazil Business Unit (1,021 million euros).

Concessions, licenses, trademarks and similar rights at June 30, 2017 mainly refer to:

- (1) the remaining cost of telephone licenses and similar rights (1,823 million euros for TIM S.p.A., 383 million euros for the Brazil Business Unit);
- (2) Indefeasible Rights of Use - IRU (319 million euros) mainly relating to companies of the Telecom Italia Sparkle group - International Wholesale (215 million euros) and the Parent (104 million euros);
- (3) TV frequencies of the company Persidera in the Core Domestic segment (115 million euros).

Other intangible assets at June 30, 2017 essentially consist of capitalized subscriber acquisition costs (SAC) of 103 million euros (70 million euros for the Parent and 33 million euros for the Brazil Business Unit), mainly related to

commissions for the sales network, for a number of commercial deals that lock in customers for a set period.

Work in progress and advance payments increased by 20 million euros. You are reminded that this item includes the user rights for the 700 MHz frequencies, acquired in 2014 by the Tim Brasil group for a total of 2.9 billion reais (equal to around 1 billion euros). Since the assets require a period of more than 12 months to be ready for use, again in the first half of 2017, borrowing costs of 45 million euros were capitalized, as they were directly attributable to the acquisition. The yearly rate used for the capitalization of borrowing costs in reais is 10.28%. Capitalized borrowing costs have been recorded as a direct reduction of the income statement item Finance expenses - Interest expenses to banks . In the second quarter of 2017, the implementation was completed of the 4G/LTE network in the city of Brasilia and nine other cities; accordingly, the first part of the amount was reclassified to the item Concessions, licenses, trademarks and similar rights.

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Intangible assets with a finite useful life 84

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NOTE 6

TANGIBLE ASSETS (OWNED AND UNDER FINANCE LEASES)

PROPERTY, PLANT AND EQUIPMENT OWNED

Property, plant and equipment owned decreased by 276 million euros compared to December 31, 2016. The breakdown and movements are as follows:

(millions of euros)	12/31/2016	Additions	Depreciation	Impairment (losses) / reversals	Disposals	Exchange differences	Other changes	6/30/2017
Land	203	1				(1)	3	206
Buildings (civil and industrial)	509	1	(23)			(2)	3	488
Plant and equipment	11,709	824	(1,140)		(3)	(217)	249	11,422
Manufacturing and distribution equipment	38	4	(8)				1	35
Other	391	21	(82)		(3)	(12)	64	379
Construction in progress and advance payments	1,097	479				(19)	(416)	1,141
Total	13,947	1,330	(1,253)		(6)	(251)	(96)	13,671

Additions in the first six months of 2017 included 184 million euros of internally generated assets (178 million euros in the first six months of 2016).

Land comprises both built-up land and available land and is not subject to depreciation. The figure at June 30, 2017 mainly related to TIM S.p.A. (119 million euros) and TIM Real Estate S.r.l. (55 million euros).

Buildings (civil and industrial) almost exclusively includes buildings for industrial use hosting telephone exchanges or for office use, and light constructions. The figure at June 30, 2017 mainly related to TIM S.p.A. (228 million euros) and TIM Real Estate S.r.l. (212 million euros).

Plant and equipment includes the aggregate of all the structures used for the functioning of voice and data telephone services. The figure at June 30, 2017 was mainly attributable to TIM S.p.A. (8,671 million euros) and to companies of the Brazil Business Unit (2,101 million euros).

Manufacturing and distribution equipment consists of instruments and equipment used for the operations and maintenance of plants and equipment; the amount was essentially in line with the end of the prior year and primarily related to TIM S.p.A..

The item Other mainly consists of hardware for the functioning of the Data Center and for work stations, furniture and fixtures and, to a minimal extent, transport vehicles and office machines.

Construction in progress and advance payments refer to the internal and external costs incurred for the acquisition or internal production of tangible assets, which are not yet in use.

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Tangible assets (owned and under finance leases) 85

Table of Contents**ASSETS HELD UNDER FINANCE LEASES**

Assets held under finance leases decreased by 42 million euros compared to December 31, 2016. The breakdown and movements are as follows:

(millions of euros)	12/31/2016	Change in financial leasing Additions	contracts	Depreciation	Exchange differences	Other changes	6/30/2017
Land under lease	16						16
Buildings (civil and industrial)	1,835	6	2	(64)		10	1,789
Plant and equipment	365	40	8	(10)	(32)	14	385
Other	125		20	(15)	(1)	(1)	128
Construction in progress and advance payments	72	7				(26)	53
Total	2,413	53	30	(89)	(33)	(3)	2,371

The additions consisted of the acquisition of IRU transmission capacity, due to the full financial settlement at the beginning of the contract, and improvements and incremental expenses incurred for movable and immovable third-party assets used on the basis of finance lease agreements.

The item Buildings (civil and industrial) includes buildings under long rent contracts and related building adaptations, almost exclusively attributable to TIM S.p.A..

The item Plant and equipment mainly includes the recognition of the value of the telecommunications towers sold by the Tim Brasil group to American Tower do Brasil and subsequently repurchased in the form of finance lease. The additions consisted of the acquisition of IRU transmission capacity by the Parent.

The item Other mainly comprises the finance leases on autovehicles.

Other changes included disposals for a total of 3 million euros, in addition to reclassifications between the items.

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Note 6
Tangible assets (owned and under finance leases) 86

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NOTE 7

INVESTMENTS

Investments in associates and joint ventures accounted for using the equity method include:

(millions of euros)	6/30/2017	12/31/2016
Tiglio I	7	8
NordCom	5	5
W.A.Y.	3	3
Other	2	2
Total Associates	17	18
Alfiere		
Total Joint Ventures		
Total investments accounted for using the equity method	17	18

The list of investments accounted for using the equity method is presented in the Note List of companies of the TIM Group .

Other investments refer to the following:

(millions of euros)	6/30/2017	12/31/2016
Assicurazioni Generali	3	2
Fin.Priv.	18	17
Northgate Telecom Innovations Partners L.P.	14	14
Other	13	13
Total	48	46

The TIM Group does not hold investments in structured entities.

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Investments 87

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NOTE 8

FINANCIAL ASSETS (NON-CURRENT AND CURRENT)

Financial assets (non-current and current) were broken down as follows:

(millions of euros)	6/30/2017	12/31/2016
Non-current financial assets		
Securities, financial receivables and other non-current financial assets		
Securities other than investments		1
Financial receivables for lease contracts	90	101
Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature	1,886	2,497
Receivables from employees	46	48
Non-hedging derivatives	13	39
Other financial receivables	150	12
Total non-current financial assets (a)	2,185	2,698
Current financial assets		
Securities other than investments		
Held for trading	1	140
Held-to-maturity		
Available-for-sale	1,101	1,379
	1,102	1,519
Financial receivables and other current financial assets		
Liquid assets with banks, financial institutions and post offices (with maturity over 3 months)	250	100
Receivables from employees	15	15
Financial receivables for lease contracts	57	59
	287	185

Hedging derivatives relating to hedged items
classified as current assets/liabilities of a
financial nature

Non-hedging derivatives		18	28
Other short-term financial receivables		3	2
		630	389
Cash and cash equivalents		4,086	3,964
Total current financial assets	(b)	5,818	5,872
Financial assets relating to Discontinued operations/Non-current assets held for sale	(c)		
Total non-current and current financial assets	(a+b+c)	8,003	8,570

Financial receivables for lease contracts refer to:

Teleleasing lease contracts entered into directly with customers in previous years and for which TIM is the guarantor;

the portion of rental contracts, with the rendering of accessory services;

finance leases on user rights and equipment.

Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature mainly refer to the mark-to-market spot valuation component of the hedging derivatives, whereas Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature mainly consist of accrued income on derivative contracts.

The Non-hedging derivatives consist of the *spot* mark-to-market component of the non-hedging derivatives of the Brazil Business Unit.

Further details are provided in the Note Derivatives .

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Securities other than investments included in current assets relate to:

listed securities (1,101 million euros), classified as available-for-sale due beyond three months. They consist of 613 million euros of treasury bonds purchased respectively by TIM S.p.A. (256 million euros) and Telecom Italia Finance S.A. (357 million euros) and 488 million euros of bonds purchased by Telecom Italia Finance S.A. with different maturities, all with an active market and consequently readily convertible into cash. The purchases of the above government bonds, which, pursuant to Consob Communication no. DEM/11070007 of August 5, 2011, represent investments in Sovereign debt securities, have been made in accordance with the Guidelines for the Management and control of financial risk adopted by the TIM Group since August 2012, in replacement of the previous policies in force;

securities (1 million euros), classified as held-for-trading, relating to the investment made by the Brazil Business Unit in a monetary fund that invests almost entirely in instruments in US dollars.

Cash and cash equivalents increased by 122 million euros compared to December 31, 2016 and were broken down as follows:

(millions of euros)	6/30/2017	12/31/2016
Liquid assets with banks, financial institutions and post offices	3,123	2,491
Checks, cash and other receivables and deposits for cash flexibility	1	1
Securities other than investments (due within 3 months)	962	1,472
Total	4,086	3,964

The different technical forms of investing available cash at June 30, 2017 had the following characteristics:

- (2) maturities: all deposits have a maximum maturity date of three months;
 - (3) counterparty risk: deposits have been made with leading high-credit-quality banks and financial institutions with a rating of at least BBB- according to Standard & Poor's with regard to Europe, and with leading local counterparts with regard to investments in South America;
 - (4) Country risk: deposits have been made mainly in major European financial markets.
- Securities other than investments (due within 3 months) consisted of 893 million euros (1,471 million euros at December 31, 2016) of Brazilian bank certificates of deposit (Certificado de Depósito Bancário) held by companies of the Brazil Business Unit with premier local banking and financial institutions, and 68 million euros of Euro

Commercial Papers held by Telecom Italia Finance S.A. (with an issuer rating of BBB- from S&P s).

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NOTE 9

TRADE AND MISCELLANEOUS RECEIVABLES AND OTHER CURRENT ASSETS

Trade and miscellaneous receivables and other current assets increased by 191 million euros compared to December 31, 2016 and were broken down as follows:

(millions of euros)	6/30/2017	12/31/2016
Amounts due on construction contracts	29	33
Trade receivables:		
Receivables from customers	3,083	3,110
Receivables from other telecommunications operators	888	815
	3,971	3,925
Miscellaneous receivables and other current assets:		
Other receivables	703	784
Trade and miscellaneous prepaid expenses	914	684
	1,617	1,468
Total	5,617	5,426

Trade receivables amounted to 3,971 million euros (3,925 million euros at December 31, 2016) and were net of the provision for bad debts of 592 million euros (648 million euros at December 31, 2016).

Trade receivables mainly related to TIM S.p.A. (2,817 million euros) and the Brazil Business Unit (712 million euros). They also included 64 million euros (82 million euros at December 31, 2016) of medium/long-term receivables, principally in respect of agreements for the sale of Indefeasible Rights of Use (IRU).

Other receivables amounted to 703 million euros (784 million euros at December 31, 2016) and were net of a provision for bad debts of 73 million euros (72 million euros at December 31, 2016). Details are as follows:

(millions of euros)	6/30/2017	12/31/2016
Advances to suppliers	64	41
Receivables from employees	32	26
Tax receivables	189	228
	202	242

Receivables for grants from the government and public entities

Sundry receivables	216	247
Total	703	784

Tax receivables included, among others, 156 million euros relating to the Brazil Business Unit, largely with reference to local indirect taxes, and 34 million euros relating to the Domestic Business Unit, partly represented by credits resulting from tax returns, other taxes and also the VAT receivable on the purchase of cars and related accessories for which refunds were requested under Italian Decree Law 258/2006, converted with amendments by Italian Law 278/2006.

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 Trade and miscellaneous receivables and other current assets 90

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Receivables for grants from the government and public entities (202 million euros) mainly relate to Ultra-Broadband-UBB and Broadband-BB projects. The grants are recognized to the income statement when the related plants become ready for use upon satisfaction of specific requirements for each tender notice.

Sundry receivables mainly included:

(4) receivables from factoring companies, totaling 50 million euros;

(5) receivables from social security and assistance agencies due to TIM S.p.A. of 27 million euros;

(6) miscellaneous receivables due to TIM S.p.A. from other licensed TLC operators of 43 million euros.

Trade and miscellaneous prepaid expenses mainly relate to the deferrals of costs referring to the activation of new contracts with customers (467 million euros), building leases (34 million euros), rent and maintenance (78 million euros) and insurance premiums (16 million euros).

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NOTE 10

EQUITY

Equity consisted of:

(millions of euros)	6/30/2017	12/31/2016
Equity attributable to owners of the Parent	21,404	21,207
Non-controlling interests	2,215	2,346
Total	23,619	23,553

The breakdown of Equity attributable to Owners of the Parent is provided below:

(millions of euros)	6/30/2017	12/31/2016
Share capital	11,587	11,587
Additional paid-in capital	2,094	2,094
Other reserves and retained earnings (accumulated losses), including profit (loss) for the period	7,723	7,526
Reserve for available-for-sale financial assets	38	39
Reserve for cash flow hedges	(428)	(551)
Reserve for exchange differences on translating foreign operations	(742)	(366)
Reserve for remeasurements of employee defined benefit plans (IAS 19)	(88)	(113)
Share of other profits (losses) of associates and joint ventures accounted for using the equity method		
Sundry reserves and retained earnings (accumulated losses), including profit (loss) for the period	8,943	8,517
Total	21,404	21,207

On the basis of the resolution passed by the Shareholders Meeting held on May 4, 2017, the profit for the year 2016 reported in the financial statements of the Parent TIM S.p.A. has been allocated as follows:

- (5) 166 million euros, for the distribution of a preferred dividend to Savings Shareholders of 0.0275 euros for each savings share, gross of withholdings required by law;
- (6) 95 million euros to the legal reserve;
- (7) 1,636 million euros to retained earnings.

Movements in Share Capital during the first half of 2017, amounting to 11,587 million euros, and already net of treasury shares of 90 million euros, are shown in the tables below:

Reconciliation between the number of shares outstanding at December 31, 2016 and June 30, 2017

(number of shares)		at 12/31/2016	Share issues	at 6/30/2017	% of share capital
Ordinary shares issued	(a)	15,203,122,583		15,203,122,583	71.61%
less: treasury shares	(b)	(163,754,388)		(163,754,388)	
Ordinary shares outstanding	(c)	15,039,368,195		15,039,368,195	
Savings shares issued and outstanding	(d)	6,027,791,699		6,027,791,699	28.39%
Total TIM S.p.A. shares issued	(a+d)	21,230,914,282		21,230,914,282	100.00%
Total TIM S.p.A. shares outstanding	(c+d)	21,067,159,894		21,067,159,894	

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Reconciliation between the value of shares outstanding at December 31, 2016 and June 30, 2017

(millions of euros)		Share capital at 12/31/2016	Change in share capital	Share capital at 6/30/2017
Ordinary shares issued	(a)	8,362		8,362
less: treasury shares	(b)	(90)		(90)
Ordinary shares outstanding	(c)	8,272		8,272
Savings shares issued and outstanding	(d)	3,315		3,315
Total TIM S.p.A. share capital issued	(a+d)	11,677		11,677
Total TIM S.p.A. share capital outstanding	(c+d)	11,587		11,587

POTENTIAL FUTURE CHANGES IN SHARE CAPITAL

Details of Future potential changes in share capital are presented in the Note Earnings per share .

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Equity 93

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NOTE 11

FINANCIAL LIABILITIES (NON-CURRENT AND CURRENT)

Non-current and current financial liabilities (gross financial debt) were broken down as follows:

(millions of euros)	6/30/2017	12/31/2016
Financial payables (medium/long-term):		
Bonds	17,740	18,537
Convertible bonds	1,847	1,832
Amounts due to banks	4,916	5,461
Other financial payables	173	306
	24,676	26,136
Finance lease liabilities (medium/long-term)	2,356	2,444
Other financial liabilities (medium/long-term):		
Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature	1,849	1,876
Non-hedging derivatives	6	13
Other liabilities		
	1,855	1,889
Total non-current financial liabilities (a)	28,887	30,469
Financial payables (short-term):		
Bonds	3,016	2,589
Convertible bonds	6	6
Amounts due to banks	1,438	1,072
Other financial payables	107	117
	4,567	3,784
Finance lease liabilities (short-term)	197	192
Other financial liabilities (short-term):		

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Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature		77	69
Non-hedging derivatives		3	11
Other liabilities			
		80	80
Total current financial liabilities	(b)	4,844	4,056
Financial liabilities directly associated with Discontinued operations/Non-current assets held for sale	(c)		
Total Financial liabilities (Gross financial debt)	(a+b+c)	33,731	34,525

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Gross financial debt according to the original currency of the transaction is as follows:

	6/30/2017		12/31/2016	
	(millions of foreign currency)	(millions of euros)	(millions of foreign currency)	(millions of euros)
USD	7,209	6,317	7,504	7,119
GBP	2,007	2,282	2,017	2,356
BRL	7,449	1,973	7,128	2,075
JPY	20,031	157	20,032	162
EURO		23,002		22,813
Total		33,731		34,525

The breakdown of gross financial debt by effective interest rate bracket, excluding the effect of any hedging instruments, is provided below:

(millions of euros)	6/30/2017	12/31/2016
Up to 2.5%	4,846	5,041
From 2.5% to 5%	10,313	9,368
From 5% to 7.5%	11,555	12,629
From 7.5% to 10%	3,772	3,918
Over 10%	641	673
Accruals/deferrals, MTM and derivatives	2,604	2,896
Total	33,731	34,525

Following the use of derivative hedging instruments, on the other hand, the gross financial debt by nominal interest rate bracket is:

(millions of euros)	6/30/2017	12/31/2016
Up to 2.5%	11,767	9,410
From 2.5% to 5%	6,181	7,775

From 5% to 7.5%	9,652	10,586
From 7.5% to 10%	2,018	1,430
Over 10%	1,509	2,428
Accruals/deferrals, MTM and derivatives	2,604	2,896
Total	33,731	34,525

The maturities of financial liabilities according to the expected nominal repayment amount, as defined by contract, are the following:

Details of the maturities of financial liabilities at nominal repayment amount:

(millions of euros)	maturing by 6/30 of the year:						Total
	2018	2019	2020	2021	2022	After 2022	
Convertible bonds	2,667	3,047	720	1,111	3,084	11,681	22,310
Loans and other financial liabilities	721	1,837	1,267	622	590	474	5,511
Finance lease liabilities	144	115	110	110	93	1,919	2,491
Total	3,532	4,999	2,097	1,843	3,767	14,074	30,312
Current financial liabilities	769						769
Total	4,301	4,999	2,097	1,843	3,767	14,074	31,081

The main components of financial liabilities are commented below.

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Bonds are broken down as follows:

(millions of euros)	6/30/2017	12/31/2016
Non-current portion	17,740	18,537
Current portion	3,016	2,589
Total carrying amount	20,756	21,126
Fair value adjustment and measurements at amortized cost	(446)	(709)
Total nominal repayment amount	20,310	20,417

The convertible bonds consist of the unsecured equity-linked bond for 2,000 million euros, with a coupon of 1.125%, issued by TIM S.p.A., convertible into newly-issued ordinary shares, maturing in 2022.

This item was broken down as follows:

(millions of euros)	6/30/2017	12/31/2016
Non-current portion	1,847	1,832
Current portion	6	6
Total carrying amount	1,853	1,838
Fair value adjustment and measurements at amortized cost	147	162
Total nominal repayment amount	2,000	2,000

The nominal repayment amount of the bonds and convertible bonds totaled 22,310 million euros and was down 107 million euros compared to December 31, 2016 (22,417 million euros), as a result of the new issues and repayments in the first half of 2017.

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The following table lists the bonds issued by companies of the TIM Group, by issuing company, expressed at the nominal repayment amount, net of bond repurchases, and also at market value:

Currency	Amount (millions)	Nominal repayment amount (millions of euros)	Coupon	Issue date	Maturity date	Issue price (%)	Market price at 6/30/17 (%)	Market value at 6/30/17 (millions of euros)
Bonds issued by TIM S.p.A.								
Euro	628.2	628.2	4.500%	9/20/12	9/20/17	99.693	100.969	634
GBP	750	852.9	7.375%	5/26/09	12/15/17	99.608	102.862	877
Euro	592.9	592.9	4.750%	5/25/11	5/25/18	99.889	104.243	618
Euro	581.9	581.9	6.125%	6/15/12	12/14/18	99.737	108.894	634
Euro	832.4	832.4	5.375%	1/29/04	1/29/19	99.070	108.361	902
GBP	850	966.6	6.375%	6/24/04	6/24/19	98.850	109.320	1,057
Euro	719.5	719.5	4.000%	12/21/12	1/21/20	99.184	109.243	786
Euro	547.5	547.5	4.875%	9/25/13	9/25/20	98.966	114.211	625
Euro	563.6	563.6	4.500%	1/23/14	1/25/21	99.447	114.230	644
Euro	^(b) 200.5	200.5	6 month Euribor (base 365)	1/1/02	1/1/22	100	100	200
Euro	883.9	883.9	5.250%	2/10/10	2/10/22	99.295	119.865	1,059
Euro	^(c) 2,000	2,000	1.125%	3/26/15	3/26/22	100	99.237	1,985
Euro	1,000	1,000	3.250%	1/16/15	1/16/23	99.446	110.480	1,105
GBP	375	426.5	5.875%	5/19/06	5/19/23	99.622	115.482	492
Euro	1,000	1,000	2.500%	1/19/17	7/19/23	99.288	105.373	1,054
Euro	750	750	3.625%	1/20/16	1/19/24	99.632	111.427	836
USD	1,500	1,314.4	5.303%	5/30/14	5/30/24	100	107.716	1,416
Euro	1,000	1,000	3.000%	9/30/16	9/30/25	99.806	106.289	1,063

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Euro	1,000	1,000	3.625%	5/25/16	5/25/26	100	111.489	1,115
Euro	670	670	5.250%	3/17/05	3/17/55	99.667	108.387	726
Subtotal		16,530.8						17,828
Bonds issued by Telecom Italia Finance S.A. and guaranteed by TIM S.p.A.								
Euro	1,015	1,015	7.750%	1/24/03	1/24/33	^(a) 109.646	138.906	1,410
Subtotal		1,015						1,410
Bonds issued by Telecom Italia Capital S.A. and guaranteed by TIM S.p.A.								
USD	^(d) 676.6	592.9	6.999%	6/4/08	6/4/18	100	104.560	620
USD	^(d) 759.7	665.6	7.175%	6/18/09	6/18/19	100	109.292	728
USD	1,000	876.3	6.375%	10/29/03	11/15/33	99.558	107.946	946
USD	1,000	876.3	6.000%	10/6/04	9/30/34	99.081	105.714	926
USD	1,000	876.3	7.200%	7/18/06	7/18/36	99.440	116.327	1,019
USD	1,000	876.3	7.721%	6/4/08	6/4/38	100	121.229	1,062
Subtotal		4,763.7						5,301
Total		22,309.5						24,539

(a) Weighted average issue price for bonds issued with more than one tranche.

(b) Reserved for employees.

(c) Bond convertible into newly-issued TIM S.p.A. ordinary treasury shares.

(d) Net of the securities bought back by TIM S.p.A. on July 20, 2015.

The regulations and the Offering Circulars relating to the bonds of the TIM Group are available on the corporate website www.telecomitalia.com.

The following table lists the changes in bonds during the first half of 2017:

New issues

(millions of original currency)	Currency	Amount	Issue date
Telecom Italia S.p.A. 1,000 million euros 2.500% maturing 7/19/2023	Euro	1,000	1/19/2017

Repayments

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(millions of original currency)	Currency	Amount	Repayment date
Telecom Italia S.p.A. 545 million euros 7.000% ⁽¹⁾	Euro	545	1/20/2017

(1) Net of buybacks by the Company of 455 million euros during 2015.

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Medium/long-term amounts due to banks of 4,916 million euros (5,461 million euros at December 31, 2016) decreased by 545 million euros. Short-term amounts due to banks totaled 1,438 million euros (1,072 million euros at December 31, 2016) and included 758 million euros of the current portion of medium/long-term amounts due to banks. In addition, Telecom Italia Finance S.A. had investments in repurchase agreements (Repos) on government bonds for a total value of 250 million euros maturing in July 2017.

Medium/long-term other financial payables, amounting to 173 million euros (306 million euros at December 31, 2016), decreased by 133 million euros (following the early repayment on April 10, 2017 of the bilateral term loan with Cassa Depositi e Prestiti of the amount of 100 million euros maturing April 2019) and included 152 million euros of the Telecom Italia Finance S.A. loan for 20,000 million Japanese yen maturing in 2029. Short-term other financial payables amounting 107 million euros (117 million euros at December 31, 2016) decreased by 10 million euros and included 15 million euros of the current portion of the medium/long-term other financial payables.

Medium/long-term finance lease liabilities totaled 2,356 million euros (2,444 million euros at December 31, 2016) and mainly related to property leases accounted for using the financial method established by IAS 17. Short-term finance lease liabilities amounted to 197 million euros (192 million euros at December 31, 2016).

Hedging derivatives relating to items classified as non-current liabilities of a financial nature amounted to 1,849 million euros (1,876 million euros at December 31, 2016). Hedging derivatives relating to items classified as current liabilities of a financial nature totaled 77 million euros (69 million euros at December 31, 2016).

Non-hedging derivatives classified as non-current financial liabilities totaled 6 million euros (13 million euros at December 31, 2016). Non-hedging derivatives classified as non-current financial liabilities totaled 3 million euros (11 million euros at December 31, 2016). These also include the measurement of derivatives which, although put into place for hedging purposes, do not possess the formal requisites to be considered as such under IFRS.

COVENANTS AND NEGATIVE PLEDGES EXISTING AT JUNE 30, 2017

The bonds issued by the TIM Group do not contain financial covenants (e.g. ratios such as Debt/EBITDA, EBITDA/Interest, etc.) or clauses that would force the early redemption of the bonds in relation to events other than the insolvency of the TIM Group. Furthermore, the repayment of the bonds and the payment of interest are not covered by specific guarantees nor are there commitments provided relative to the assumption of future guarantees, except for the full and unconditional guarantees provided by TIM S.p.A. for the bonds issued by Telecom Italia Finance S.A. and Telecom Italia Capital S.A..

Since these bonds have been placed principally with institutional investors in major world capital markets (Euromarket and the U.S.A.), the terms which regulate the bonds are in line with market practice for similar transactions effected on these same markets. Consequently, for example, there are commitments not to use the company's assets as collateral for loans (negative pledges).

With regard to the loans taken out by TIM S.p.A. with the European Investment Bank (EIB), at June 30, 2017, the nominal amount of outstanding loans amounted to 1,950 million euros, of which 800 million euros at direct risk and 1,150 million euros secured.

EIB loans not secured by bank guarantees for a nominal amount equal to 800 million euros need to apply the following covenants:

in the event the company becomes the target of a merger, demerger or contribution of a business segment outside the Group, or sells, disposes or transfers assets or business segments (except in certain cases, expressly provided for), it shall immediately inform the EIB which shall have the right to ask for guarantees to be provided or changes to be made to the loan contract, or, only for certain loan contracts, the EIB shall have the option to demand the immediate repayment of the loan (should the merger, demerger or contribution of a business segment outside the Group compromise the Project execution or cause a prejudice to EIB in its capacity as creditor);

with the 500 million euros loan, signed on December 14, 2015, TIM undertook to ensure that, for the entire duration of the loan, the total financial debt of the Group companies other than TIM S.p.A. except for the cases when that debt is fully and irrevocably secured by TIM S.p.A. is lower than 35% (thirty-five percent) of the Group's total financial debt.

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EIB loans secured by banks or entities approved by the EIB for a total nominal amount of 1,150 million euros, and direct risk loans, respectively for 300 million euros, signed on July 30, 2014 and 500 million euros, signed on December 14, 2015, must apply the following covenants:

Inclusion clause , covering a total of 1,650 million euros of loans, under which, in the event TIM commits to uphold financial covenants in other loan contracts (and even more restrictive clauses for 2014 and 2015 direct risk loans, including, for instance, cross default clauses and commitments restricting the sale of goods) that are not present in or are stricter than those granted to the EIB, the EIB will have the right if, in its reasonable opinion, it considers that such changes may have a negative impact on TIM's financial capacity to request the provision of guarantees or the modification of the loan contract in order to establish an equivalent provision in favor of the EIB;

Network Event , covering a total of 1,350 million euros of loans, under which, in the event of the disposal of the entire fixed network or of a substantial part of it (in any case more than half in quantitative terms) to third parties or in the event of disposal of the controlling interest in the company in which the network or a substantial part of it has previously been transferred, TIM must immediately inform the EIB, which shall have the option of requiring the establishment of guarantees or amendment of the loan contract or an alternative solution.

The loan agreements of TIM S.p.A. do not contain financial covenants (e.g. ratios such as Debt/EBITDA, EBITDA/Interests, etc.) which would oblige the Company to repay the outstanding loan if the covenants are not observed.

The loan agreements contain the usual other types of covenants, including the commitment not to use the Company's assets as collateral for loans (negative pledges), the commitment not to change the business purpose or sell the assets of the Company unless specific conditions exist (e.g. the sale takes place at fair market value). Covenants with basically the same content are also found in the export credit loan agreement.

In the Loan Agreements and the Bonds, TIM is required to provide notification of change of control. Identification of the occurrence of a change of control and the applicable consequences including the establishment of guarantees or the early repayment of the amount paid and the cancellation of the commitment in the absence of agreements to the contrary are specifically covered in the individual agreements.

In addition, the outstanding loans generally contain a commitment by TIM, whose breach is an Event of Default, not to implement mergers, demergers or transfer of business, involving entities outside the Group. Such Event of Default may entail, upon request of the Lender, the early redemption of the drawn amounts and/or the annulment of the undrawn commitment amounts.

In the documentation of the loans granted to certain companies of the Tim Brasil group, the companies must generally respect certain financial ratios (e.g. capitalization ratios, ratios for servicing debt and debt ratios) as well as the usual other covenants, under pain of a request for the early repayment of the loan.

Finally, as of June 30, 2017, no covenant, negative pledge clause or other clause relating to the above-described debt position, has in any way been breached or violated.

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REVOLVING CREDIT FACILITY

The following table shows the composition and the drawdown of the committed credit lines available at June 30, 2017:

(billions of euros)		6/30/2017		12/31/2016	
		Agreed	Agreed	Agreed	Drawn down
Revolving Credit Facility	expiring May 2019	4.0		4.0	
Revolving Credit Facility	expiring March 2020	3.0		3.0	
Total		7.0		7.0	

TIM has two syndicated Revolving Credit Facilities for amounts of 4 billion euros and 3 billion euros expiring May 24, 2019 and March 25, 2020 respectively, both not yet drawn down.

TIM also has:

a bilateral Term Loan from Banca Regionale Europea expiring July 2019 for 200 million euros, drawn down for the full amount;

two bilateral Term Loans from Mediobanca respectively for 200 million euros expiring in November 2019 and 150 million euros expiring in July 2020, drawn down for the full amount;

a bilateral Term Loan from ICBC expiring July 2020 for 120 million euros, drawn down for the full amount;

a bilateral Term Loan from Intesa Sanpaolo expiring August 2021 for 200 million euros, drawn down for the full amount;

an Hot Money loan with Banca Popolare dell Emilia Romagna expiring July 2017 for 200 million euros, drawn down for the full amount.

On March 6, 2017, TIM S.p.A. signed a supplementary agreement with Mediobanca under which an early repayment was made on July 3, 2017 for 75 million euros for the bilateral term loan of an original amount of 150 million euros expiring in July 2020, which had been fully drawn down.

TIM S RATING AT JUNE 30, 2017

At June 30, 2017, the three rating agencies Standard & Poor s, Moody s and Fitch Ratings rated TIM as follows:

	Rating	Outlook
STANDARD & POOR S	BB+	Stable
MOODY S	Ba1	Stable
FITCH RATINGS	BBB-	Stable

On July 12, 2017, the rating agency Standard & Poor s upgraded TIM S.p.A. s outlook from Stable to Positive .

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NET FINANCIAL DEBT

The following table shows the net financial debt at June 30, 2017 and December 31, 2016, calculated in accordance with the criteria indicated in the Recommendations for the Consistent Implementation of the European Commission Regulation on Prospectuses, issued on February 10, 2005 by the European Securities & Markets Authority (ESMA), and adopted by Consob.

For the purpose of determining such figure, the amount of financial liabilities has been adjusted by the effect of the relative hedging derivatives recorded in assets and the receivables arising from financial subleasing.

This table also shows the reconciliation of the net financial debt determined according to the criteria indicated by the ESMA and net financial debt calculated according to the criteria of the TIM Group.

(millions of euros)		6/30/2017	12/31/2016
Non-current financial liabilities		28,887	30,469
Current financial liabilities		4,844	4,056
Financial liabilities directly associated with Discontinued operations/Non-current assets held for sale			
Total Gross financial debt	(a)	33,731	34,525
Non-current financial assets (°)			
Non-current financial receivables for lease contract		(90)	(101)
Non-current hedging derivatives		(1,886)	(2,497)
	(b)	(1,976)	(2,598)
Current financial assets			
Securities other than investments		(1,102)	(1,519)
Financial receivables and other current financial assets		(630)	(389)
Cash and cash equivalents		(4,086)	(3,964)
Financial assets relating to Discontinued operations/Non-current assets held for sale			
	(c)	(5,818)	(5,872)
Net financial debt as per Consob communication DEM/6064293/2006 (ESMA)	(d=a+b+c)	25,937	26,055

Non-current financial assets (°)			
Securities other than investments			(1)
Other financial receivables and other non-current financial assets		(209)	(99)
	(e)	(209)	(100)
Net financial debt(*)	(f=d+e)	25,728	25,955
Reversal of fair value measurement of derivatives and related financial assets/liabilities	(g)	(624)	(836)
Adjusted net financial debt	(f+g)	25,104	25,119

(°) At June 30, 2017 and at December 31, 2016, Non-current financial assets (b+e) amounted to 2,185 million euros and 2,698 million euros, respectively.

(*) For details of the effects of related party transactions on net financial debt, see the specific table in the Note Related party transactions .

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DERIVATIVES

Derivative financial instruments are used by the TIM Group to hedge its exposure to foreign exchange rate risk, to manage interest rate risk and to diversify the parameters of debt so that costs and volatility can be reduced to within predetermined operational limits.

Derivative financial instruments in place at June 30, 2017 are principally used to manage debt positions. They include interest rate swaps (IRSs) to reduce interest rate exposure on fixed-rate and variable-rate bank loans and bonds, as well as cross currency and interest rate swaps (CCIRSs), currency forwards and foreign exchange options to convert the loans/receivables secured in currencies different from the functional currencies of the various Group companies.

IRS transactions, provide for or may entail, at specified maturity dates, the exchange of flows of interest, calculated on the notional amount, at the agreed fixed or variable rates.

The same also applies to CCIRS transactions which, in addition to the settlement of periodic interest flows, may provide for the exchange of principal, in the respective currencies of denomination, at maturity and possibly spot.

The following table shows the derivative financial instruments of the TIM Group at June 30, 2017 and at December 31, 2016, by type (for cross currency and interest rate swaps the notional amount refers to the synthetic coverage):

Type (millions of euros)	Hedged risk	Notional amount at 6/30/2017	Notional amount at 12/31/2016	Spot (*) Mark-to- Market (Clean Price) at 6/30/2017	Spot* Mark-to- Market (Clean Price) at 12/31/2016
Interest rate swaps	Interest rate risk	3,734	3,334	(7)	42
Cross Currency and Interest Rate Swaps	Interest rate risk and currency exchange rate risk	851	851	12	46
Total Fair Value Hedge Derivatives **		4,585	4,185	5	88
Interest rate swaps	Interest rate risk				
Cross Currency and Interest Rate Swaps	Interest rate risk and currency exchange rate risk	7,952	7,952	170	551
Total Cash Flow Hedge Derivatives **		7,952	7,952	170	551
Total Non-Hedge Accounting Derivatives		184	484	23	51

Total TIM Group derivatives	12,721	12,621	198	690
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* *Spot Mark-to-market above represents the market measurement of the derivative net of the accrued portion of the flow in progress.*

** *On the 2009 issue in GBP there are two hedges, in FVH and CFH; accordingly, although it is a single issue, the notional amount of the hedge is included in both the FVH and CFH groupings.*

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SUPPLEMENTARY DISCLOSURES ON FINANCIAL INSTRUMENTS

MEASUREMENT AT FAIR VALUE

The fair value measurement of the financial instruments of the Group is classified according to the three levels set out in IFRS 7. In particular, the fair value hierarchy introduces three levels of input:

Level 1: quoted prices in active market;

Level 2: prices calculated using observable market inputs;

Level 3: prices calculated using inputs that are not based on observable market data.

The tables below provide additional information on the financial instruments, including the table relating to the hierarchy level for each class of financial asset/liability measured at fair value at June 30, 2017.

Key for IAS 39 categories

		Acronym
Loans and Receivables	Loans and Receivables	LaR
Financial assets Held-to-Maturity	Financial assets Held-to-Maturity	HtM
Available-for-Sale financial assets	Financial assets Available-for-Sale	AFS
Financial Assets/Liabilities Held for Trading	Financial Assets/Liabilities Held for Trading	FAHfT/FLHfT
Financial Liabilities at Amortized Cost	Financial Liabilities at Amortized Cost	FLAC
Hedging Derivatives	Hedge Derivatives	HD
Not applicable	Not applicable	n.a.

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Fair value hierarchy level for each class of financial asset/liability at 6/30/2017

(millions of euros)	IAS 39 Categories	Note	Carrying amount in financial statements at 6/30/2017	Hierarchy Levels		
				Level 1 (*)	Level 2 (*)	Level 3 (*)
ASSETS						
Non-current assets						
Other investments	AfS	7)	48	3	18	
Securities, financial receivables and other non-current financial assets						
<i>of which securities</i>	AfS	8)				
<i>of which hedging derivatives</i>	HD	8)	1,886		1,886	
<i>of which non-hedging derivatives</i>	FAHfT	8)	13		13	
	(a)		1,947	3	1,917	
Current assets						
Securities						
<i>of which available-for-sale financial assets</i>	AfS	8)	1,101	1,101		
<i>of which held-for-trading financial assets</i>	FAHfT	8)	1	1		
Financial receivables and other current financial assets						
<i>of which hedging derivatives</i>	HD	8)	287		287	
<i>of which non-hedging derivatives</i>	FAHfT	8)	18		18	
	(b)		1,407	1,102	305	
Total	(a+b)		3,354	1,105	2,222	
LIABILITIES						
Non-current liabilities						
<i>of which hedging derivatives</i>	HD	11)	1,849		1,849	

<i>of which non-hedging derivatives</i>	FLHfT	11)	6	6
	(c)		1,855	1,855
Current liabilities				
<i>of which hedging derivatives</i>	HD	11)	77	77
<i>of which non-hedging derivatives</i>	FLHfT	11)	3	3
	(d)		80	80
Total	(c+d)		1,935	1,935

(*) Level 1: quoted prices in active markets.

Level 2: prices calculated using observable market inputs.

Level 3: prices calculated using inputs that are not based on observable market data.

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NOTE 15

EMPLOYEE BENEFITS

Employee benefits decreased by 26 million euros compared to December 31, 2016 and were broken down as follows:

(millions of euros)		12/31/2016	Increases/ Present value	Decrease	Exchange differences and other changes	6/30/2017
Provision for employee severance indemnities	(a)	1,009	(26)	(8)		975
Provision for pension and other plans		28	7	(1)		34
Provision for termination benefit incentives		348	10	(8)		350
Total other provisions for employee benefits	(b)	376	17	(9)		384
Total	(a+b)	1,385				1,359
<i>of which:</i>						
non-current portion		1,355				1,336
current portion (*)		30				23

(*) The current portion refers only to Other provisions for employee benefits.

The Provision for employee severance indemnities only refers to Italian companies and decreased overall by 34 million euros. The Decreases of 8 million euros refer to indemnities paid during the period to employees who terminated employment or for advances. The decrease of 26 million euros in the column Increases/Present value consists of the following:

(millions of euros)	1st half 2017	1st half 2016
Current service cost (*)		
Finance expenses	7	10
Net actuarial (gains) losses for the period	(33)	118
Total	(26)	128

Effective return on plan assets there are no assets servicing the plan

(*) Following the social security reform in 2007, the portions intended for the INPS Treasury Fund or for the supplementary pension funds have been recorded under Employee benefits expenses , in Social security expenses , and not as Employee severance indemnities expenses . The latter account will continue to be used only for the severance indemnity expenses of companies with less than 50 employees.

The net actuarial gains recognized at June 30, 2017, totaling 33 million euros (net actuarial losses of 118 million euros for the first half of 2016), essentially related to the change in the discount rate to 1.67% from the 1.31% used at December 31, 2016, while the inflation rate was considered to be 1.5% for the entire time (curve at December 2016: 1.1% for 2017; 1.3% for 2018; and 1.5% from 2019 onwards).

The Provision for pension and other plans amounted to 34 million euros at June 30, 2017 (28 million euros at December 31, 2016) and mainly represented pension plans in place at foreign companies of the Group.

The Provision for termination benefit incentives increased by a total of 2 million euros and included the recognition of the net impacts resulting from the various agreements with the trade unions signed during 2015 and 2016 by TIM S.p.A. and TI Information Technology (later merged into TIM S.p.A.) and by other companies of the Domestic Business Unit. These agreements are part of the process of dialog between the parties, aimed at managing redundancies resulting from the streamlining processes affecting all the companies operating in the TLC sector.

The figure consists of 326 million euros for the Parent, 10 million euros for Telecom Italia Sparkle S.p.A., 9 million euros for Olivetti S.p.A and a total of 5 million euros for the other companies of the Domestic Business Unit.

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PROVISIONS

Provisions increased by 160 million euros compared to December 31, 2016 and were broken down as follows:

(millions of euros)	12/31/2016	Increase	Taken to income	Used directly	Exchange differences and other changes	6/30/2017
Provision for taxation and tax risks	119	104		(11)	(4)	208
Provision for restoration costs	326	4		(2)	(2)	326
Provision for legal disputes	457	127	(1)	(62)	4	525
Provision for commercial risks	46	1		(1)	(6)	40
Provision for risks and charges on investments and corporate-related transactions	28				6	34
Other provisions	8	4		(1)		11
Total	984	240	(1)	(77)	(2)	1,144
of which:						
non-current portion	830					813
current portion	154					331

The provision for taxation and tax risks increased by 89 million euros compared to December 31, 2016. The increase was mainly due to the provision of 93 million euros by Telecom Italia Sparkle S.p.A. as described in the Note Contingent Liabilities. The figure at June 30, 2017 was mainly attributable to the Domestic Business Unit (144 million euros) and the Brazil Business Unit (61 million euros).

The provision for restoration costs related to the provision for the estimated cost of dismantling tangible assets (in particular: batteries, wooden poles and equipment) and for the restoration of the sites used for mobile telephony by the companies, with 322 million euros attributable to the Domestic Business Unit.

The provision for legal disputes included the provision for litigation with employees, social security entities, customers, regulatory authorities and other counterparties.

The figure at June 30, 2017 includes 443 million euros for the Domestic Business Unit and 82 million euros for the Brazil Business Unit.

The provision for commercial risks is attributable to the Domestic Business Unit.

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NOTE 17

TRADE AND MISCELLANEOUS PAYABLES AND OTHER CURRENT LIABILITIES

Trade and miscellaneous payables and other current liabilities decreased by 590 million euros compared to December 31, 2016 and were broken down as follows:

(millions of euros)		6/30/2017	12/31/2016
Payables on construction work	(a)	26	25
Trade payables			
Payables to suppliers		3,820	4,532
Payables to other telecommunication operators		349	323
	(b)	4,169	4,855
Tax payables	(c)	503	292
Miscellaneous payables and other current liabilities			
Payables for employee compensation		377	319
Payables to social security agencies		146	215
Trade and miscellaneous deferred income		537	488
Advances received		25	53
Customer-related items		713	847
Payables for TLC operating fee		16	15
Dividends approved, but not yet paid to shareholders		17	33
Other current liabilities		173	320
Employee benefits (except for employee severance indemnities) for the current portion expected to be settled within 1 year		23	30
Provisions for risks and charges for the current portion expected to be settled within 1 year		331	154
	(d)	2,358	2,474
Total	(a+b+c+d)	7,056	7,646

Trade payables amounting to 4,169 million euros (4,855 million euros at December 31, 2016), mainly refer to TIM S.p.A. (3,007 million euros) and to the companies of the Brazil Business Unit (797 million euros).

Tax payables refer in particular to TIM S.p.A. and relate to the VAT payable (311 million euros), the payable for the government concession tax (25 million euros) and the withholding tax payables to the tax authorities as withholding agent (39 million euros). They also included other tax payables of the Brazil Business Unit of 113 million euros.

Within miscellaneous payables and other current liabilities it is noted in particular that:

trade and miscellaneous deferred income mainly consists of 268 million euros for interconnection charges, 175 million euros for the deferral of revenues from the activation of telephone service, 17 million euros for traffic and charges, and 78 million euros for rent and maintenance payments;

(2) customer-related items largely consisted of the advance payments received by the Parent TIM S.p.A. from its fixed-line telephony customers for deposits made for telephone calls and subscription charges debited in advance;

other current liabilities mainly relate to debt positions of the Parent TIM S.p.A..

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CONTINGENT LIABILITIES, OTHER INFORMATION, COMMITMENTS AND GUARANTEES

A description is provided below of the most significant judicial, arbitration and tax disputes in which TIM Group companies are involved as of June 30, 2017, as well as those that came to an end during the period.

The TIM Group has posted liabilities totalling 520 million euros for those disputes described below where the risk of losing the case has been considered probable.

A) SIGNIFICANT DISPUTES AND PENDING LEGAL ACTIONS

For the following disputes and pending legal actions no significant facts have emerged with respect to what was published in the 2016 Annual Report:

- (5) international tax and regulatory disputes;
- (6) administrative offence charge pursuant to Legislative Decree 231/2011 for the so-called TIM Security Affair;
- (7) irregularities concerning transactions for the leasing/rental of assets.

Telecom Italia Sparkle Relations with I-Globe, Planetarium, Acumen, Accrue Telemedia and Diadem: investigation by the Public Prosecutor's Office of Rome

The Rome Public Prosecutor's Office has challenged the judgement of the Court of Rome of October 2013 with which the three former managers of Telecom Italia Sparkle were fully acquitted of the charges of transnational conspiracy for the purpose of tax evasion and false declarations through the use of invoices or other documents for non-existent transactions (carousel fraud), also in relation to the position of the Telecom Italia Sparkle employees; currently, judgement is pending in the Court of Appeal in Rome. Telecom Italia Sparkle is still being investigated for the administrative offence pursuant to Legislative Decree 231/2001, with the predicate offence of conspiracy and translational money laundering.

Following the outcome of the immediate trial, the Company fully released the provisions for risk in the profit and loss account during 2014 and obtained from the Judicial Authority the release and return of all the sums issued to guarantee any obligations deriving from the application of Legislative Decree 231/2001; the sum of 1,549,000 euros, which corresponds to the maximum fine applicable for the administrative offence, still remains under seizure.

As for risks of a fiscal nature, it should be noted that in February 2014 the Revenues Agency (Lazio Regional Office) served three formal notifications of fines for the years 2005, 2006 and 2007, based on the assumption that the

telephone traffic in the carousel fraud did not exist. The amount of the fines 25% of the crime related costs unduly deducted total 280 million euros. In this respect the Company has filed an appeal to the Provincial Tax Commission in April 2014. The Commission rejected the appeal with a decision filed in May 2016.

The Company lodged an appeal with the Regional Tax Commission in October 2016, opposing the judgement in the first instance, requesting a suspension of the enforcement of this first instance judgement subject to presentation of an appropriate guarantee. In December 2016, the Regional Tax Commission granted this suspension, fixing the date for a hearing on the merits in April 2017.

On 5 April 2017 the appeal was discussed before the Regional Tax Commission of Lazio. On 26 April 2017 the second tier ruling was filed (2310/2017 sec. 11) which rejected the Company's appeal.

During the same month of April an application was filed for the scrapping of the case opened by Equitalia following the unfavourable judgement of the Rome Provincial Tax Commission concerning the

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application for payment of 2/3rds of the sanction imposed earlier by the Revenues Agency; the probable risk is therefore confirmed as totalling 93 million euros, provision for which was made in the first quarter of 2017.

It should be noted that for some of the disputes described below, it was not possible to make a reliable estimate of the size and/or times of possible payments, if any, on the basis of the information available at the closing date of the present document, particularly in light of the complexity of the proceedings, the progress made, and the elements of uncertainty of a technical-trial nature. Moreover, in those cases in which disclosure of information on a dispute could seriously jeopardise the position of TIM or its subsidiaries, only the general nature of the dispute is described.

Of the disputes with the aforementioned characteristics, no significant facts have emerged for those listed below with respect to the information published in the 2016 Annual Report:

(7) Italian Competition Authority Case I-761;

(8) WIND (I-761);

(9) VODAFONE (A428);

(10) VODAFONE;

(11) COLT TECHNOLOGY SERVICES;

(12) KPNQ West Italia S.p.A.;

(13) EUTELIA and VOICEPLUS;

(14) Vodafone Dispute - Universal Service;

(15) Olivetti Asbestos exposure;

(16) POSTE;

(17) Elinet S.p.A. Bankruptcy;

(18) Dispute relative to Adjustments on license fees for the years 1994-1998;

(19) Brazil - Docas/JVCO Arbitration;

(20) Brazil CAM JVCO Arbitration.
Antitrust Case A428

At the conclusion of case A428, in May 2013, Italian Competition Authority AGCM imposed two administrative sanctions of 88,182,000 euros and 15,612,000 euros on TIM for abuse of its dominant position. The Company allegedly (i) hindered or delayed activation of access services requested by OLOs through unjustified and spurious refusals; (ii) offered its access services to final customers at economic and technical conditions that allegedly could not be matched by competitors purchasing wholesale access services from TIM itself, only in those geographic areas of the Country where disaggregated access services to the local network are available, and hence where other operators can compete more effectively with the Company.

TIM appealed against the decision before the Regional Administrative Court (TAR) for Lazio, applying for payment of the fine to be suspended. In particular, it alleged: infringement of its rights to defend itself in the proceedings, the circumstance that the organisational choices challenged by AGCM and allegedly at the base of the abuse of the OLO provisioning processes had been the subject of specific rulings made by the industry regulator (AGCom), the circumstance that the comparative examination of the internal/external provisioning processes had in fact shown better results for the OLOs than for the TIM retail department (hence the lack of any form of inequality of treatment and/or opportunistic behaviour by TIM), and (regarding the second abuse) the fact that the conduct was structurally unsuitable to reduce the margins of the OLOs.

In May 2014, the judgement of the Lazio TAR was published, rejecting TIM's appeal and confirming the fines imposed in the original order challenged. In September 2014 the Company appealed against this decision.

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In May 2015, with the judgement no. 2497/15, the Council of State found the decision of the court of first instance did not present the deficiencies alleged by TIM and confirmed the AGCM ruling. The company had already proceeded to pay the fines and the accrued interest.

In a decision notified in July 2015, AGCM started proceedings for non-compliance against TIM, to ascertain if the Company had respected the notice to comply requiring it to refrain from undertaking behaviours analogous to those that were the object of the breach ascertained with the concluding decision in case A428 dated May 2013.

On 13 January 2017 TIM was notified of the conclusive assessment of the Italian Competition Authority (AGCM), acknowledging that TIM has fully complied with the judgement in proceedings A428 and that therefore the conditions do not exist for the imposition of any sanctions for non-compliance.

AGCM recognises, furthermore, that TIM's behaviour subsequently to the 2013 proceedings has been directed towards continuous improvement of its performance in the supply of wholesale access services concerning not only the services which were the subject of the investigation, but also the new super-fast broadband access services. In assessing compliance, AGCM recognised the positive impact of the implementation, albeit not yet completed, of TIM's New Equivalence Model (NME). AGCM's decision forces TIM to: (i) proceed with the implementation of the NME until its completion which is expected to be by 30 April 2017; (ii) to inform the Authority about the performance levels of the systems for providing wholesale access services and about the completion of the corresponding internal reorganisation plan by the end of May 2017. Both impositions were promptly fulfilled.

Vodafone lodged an appeal with the Lazio Regional Administrative Court against the final decision in the proceedings for non-compliance taken by AGCM. TIM filed an appearance, as it did in the further proceedings brought in the month of March 2017 by the operators CloudItalia, Kpnqwest and Digitel.

VODAFONE (I-761)

With a writ of summons before the Milan Court, Vodafone has sued TIM and some network companies, bringing claims for compensation from the Company for around 193 million euros for damages arising from alleged anti-competitive conduct censured in the known ICA case I-761 (on corrective maintenance) referring to the period from 2011 to 2017.

Like Wind before it, with which a similar judgement is pending, Vodafone contests the abuse of a dominant market position allegedly carried out by TIM in the wholesale markets giving access to its fixed network (LLU lines; Bitstream; WLR), through an unlawful agreement with the maintenance companies to maintain the monopoly on the offer of corrective maintenance services on its network. In particular this restrictive agreement would have concerned the coordination, by the Company, of the financial conditions contained in the offers formulated by the aforementioned companies with respect to the OLOs, for the maintenance service, at artificially high prices with respect to the cost of the maintenance included in the regulated access subscription charge, in order to make it seem as if the unbundling of the service itself were not convenient. The Company will file an appearance, contesting all of the other party's requests.

TELEUNIT

With a writ of summons before the Rome Court, Teleunit has claimed 35.4 million euros in compensation from TIM, based on the known decision of the Italian Competition Authority that settled the A428 case. Specifically, the other party complained that in the period 2009/2010 it had suffered abusive conduct on TIM's part in the form of technical boycotting (refusals to activate network access services - KOs), and anticompetitive practices in the form of margin squeezing (excessive squeezing of discount margins, considered abusive inasmuch as it cannot be replicated by competitors). Telecom Italia filed an appearance, contesting all of the plaintiff's allegations.

With a writ of summons issued in October 2009 before the Milan Appeal Court, Teleunit asked that TIM alleged acts of abuse of its dominant position in the premium services market be ascertained. The plaintiff quantified its damages at a total of approximately 362 million euros. TIM filed an appearance, contesting the claims of the other party.

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After the ruling of January 2014 with which the Court of Appeal declared that it was not competent in this matter and referred the case to the Court, Teleunit reinstated the case before the Milan Court the following April. TIM filed an appearance in the reinstated proceedings challenging the plaintiff's claims.

In its judgement of May 2017, the Milan Court rejected Teleunit's claim in its entirety, and ordered the company to pay the legal costs of the case. This judgement was appealed by Teleunit, in June 2017, before the Milan Court of Appeal. The Company will file an appeal challenging the arguments presented by the other party and asking that the judgement in the first instance be fully confirmed.

Competition Authority case A514

In June 2017 the Italian Competition Authority (AGCM) started proceedings A514 against TIM, to ascertain a possible abuse of its dominant market position in breach of article 102 of the Treaty on the Functioning of the European Union. The proceedings were started based on some complaints filed in May and June 2017, by Infratel, Enel, Open Fiber, Vodafone and Wind Tre, and concerns a presumed abuse of TIM's dominant position in the market for wholesale access services and for retail services using the broadband and ultrabroadband fixed network. In particular, the ICA hypothesised that TIM had adopted conduct aimed at: i) slowing and hindering the course of the Infratel tender processes so as to delay, or render less remunerative the entry of another operator in the wholesale market; ii) pre-emptively securing customers on the retail market for ultrabroadband services by means of commercial policies designed to restrict the space of customer contendibility remaining for the competitor operators.

After the start of the proceedings, the Authority's officials carried out an inspection at some of TIM's offices in the month of July 2017. The proceedings, within which the company will be upholding all its arguments to support the correctness of its work, must be concluded by 31 October 2018.

SKY

TIM has started civil proceedings against SKY Italia in the Milan Court, asking the court to void the partnership contract signed by the two companies in April 2014 for the delivery and marketing, between 2015 and 2019, of the SKY IPTV (Internet Protocol Television) offer on the TIM IPTV platform, due to abuse of dominant position by the other party.

As an alternative, the Company also asked the court to reduce to a fair level the amounts demanded by SKY by way of the so-called Guaranteed Minimums (penalties) established to SKY's advantage and related to predetermined customer sign-up and churn-rate thresholds in the five years of the partnership.

Sky filed an appearance in February 2017, challenging TIM's claim and demanding payment of the Guaranteed Minimums it claimed to have accrued, a request which was opposed by the Company. The proceedings are ongoing: the next hearing is scheduled for the month of May 2018.

Investigation by the Monza Public Prosecutor's Office

Criminal charges have recently been brought before the Monza Court regarding a number of transactions for the leasing and/or sale of assets. At the end of the preliminary hearing, the judge ordered a former employee of the Company to be committed for trial on charges of aggravated fraud and tax crimes, and, at the same time, declared that the statute of limitations applied to other charges; at the start of the trial, the Court declared that all the remaining offences were statute-barred. As part of these proceedings TIM, which had filed a formal complaint against persons unknown in 2011, joined the proceedings as a civil party as the person injured and damaged by the offence.

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Brazil - Opportunity Arbitration

In May 2012, TIM and Telecom Italia International N.V (now merged in Telecom Italia Finance) were served with a notice of arbitration proceedings brought by the Opportunity group, claiming compensation for damages allegedly suffered for presumed breach of a settlement agreement signed in 2005. Based on the claimant's allegations, the damages relate to circumstances that emerged in the criminal proceedings pending before the Milan Court regarding, *inter alia*, unlawful activities engaged in by former employees of TIM.

The investigatory phase having been completed, the hearing for oral discussion took place in November 2014, after which the parties filed their concluding arguments in preparation for the decision on the case.

In September 2015, the Board of Arbitration declared the proceedings closed, as the award was going to be filed.

Subsequently, the Board of Arbitration allowed the parties to exchange short arguments and the ICC Court extended the term for the filing of the award.

In September 2016 the ICC Court notified the parties of its judgement, based on which the Board of Arbitration rejected all the claims made by the Opportunity group and decided that the legal costs, administrative costs and costs for expert witnesses should be split between the parties.

In April 2017 the Opportunity group filed an appeal against the arbitration award before the Court of Appeal of Paris.

Formal Notice of Assessments against TIM S.p.A.

On 29 October 2015 the Guardia di Finanza concluded a tax investigation into TIM S.p.A., started in 2013, regarding the years 2007 to 2014. The formal notice of assessment (Processo Verbale di Costatazione, or PVC) contained two substantial findings. The first relates to the presumed non-debiting of royalties to the company's indirect subsidiary Tim Brasil, for the use of the TIM brand. The second regards the alleged non-application of withholding tax on interest paid to subsidiary Telecom Italia Capital S.A.

In this regard, on the basis of the aforementioned formal notice of assessment, the Milan Revenues Agency in December 2015 served assessment notices on the company for the 2010 tax year, and in December 2016 it served assessment notices for the tax years 2007 and 2011.

While believing, on the basis of opinions issued by established professionals, that it has acted correctly in fulfilling all its tax obligations, the Company has attempted to come to an agreement with the Revenues Agency. Having failed to reach an agreement, as already occurred for the 2010 tax year, the Company has lodged an appeal with the Provincial Tax Commission against the verification notices relating to the 2007 and 2011 tax years too, in any event without excluding the possibility of coming to a judicial settlement with the Revenues Agency, with the object of closing the disputes in pre-litigation proceedings, for these and the other tax years.

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B) OTHER INFORMATION

With reference to the cases listed below no significant facts have emerged with respect to that published in the 2016 Annual Report:

(8) Dispute concerning the license fees for 1998,

(9) Vodafone (previously TELETU),
Mobile telephony - criminal proceedings

In March 2012 TIM was served notice of the conclusion of the preliminary enquiries, which showed that the Company was being investigated by the Public Prosecutor of Milan pursuant to the Legislative Decree n. 231/2001, for the offences of handling stolen goods and counterfeiting committed, according to the alleged allegations, by fourteen employees of the so-called ethnic channel, with the participation of a number of dealers, for the purpose of obtaining undeserved commissions from TIM.

The Company, as the injured party damaged by such conduct, had brought two legal actions in 2008 and 2009 and had proceeded to suspend the employees involved in the criminal proceedings (suspension later followed by dismissal). It has also filed an initial statement of defence, together with a technical report by its own expert, requesting that the proceedings against it be suspended, and that charges of aggravated fraud against the Company be brought against the other defendants. In December 2012, the Public Prosecutor's Office filed a request for 89 defendants and the Company itself to be committed for trial.

During the preliminary hearing, the Company was admitted as civil party to the trial and, in November 2013, the conclusions in the interest of the civil party were filed, reaffirming TIM's total lack of involvement in the offences claimed.

At the end of the preliminary hearing, which took place in March 2014, the Judge for the Preliminary Hearing committed for trial all the defendants (including TIM) who had not asked for their situation to be settled with alternative procedures, on the grounds that examination in a trial was needed. In April 2016, at the end of the first part of the trial, the Public Prosecutor asked for TIM to be sentenced to pay an administrative fine of 900 thousand euros, but decided not to ask for confiscation of any of the presumed profits of the offences (quantified in the committal proceedings as totalling several million euros), based on the assumption that TIM had in any event remedied the presumed organisational inadequacies. While acknowledging the considerable redimensioning of the accusations, the Company has reiterated its total non-involvement in the facts at issue. In November 2016 the Court gave a verdict acquitting the Company on the grounds that there was no case to answer. All the individuals charged were also acquitted on various grounds. The acquittal judgement is not final, as it was challenged in April 2017 by the Public Prosecutor who sought appeal before the Court of Cassation.

C) COMMITMENTS AND GUARANTEES

Guarantees, net of back-to-back guarantees received, amounted to 21 million euros.

The guarantees provided by third parties to Group companies, amounting to 5,356 million euros, consisted of guarantees for loans received (1,688 million euros) and of performance under outstanding contracts (3,668 million euros).

The guarantees provided by third parties for TIM S.p.A. obligations include the surety issued in favor of the Ministry of Economic Development for 38 million euros, for the commitment made by the Company to build equipment networks with eco-sustainable characteristics. In particular, the Company has made a commitment to achieve energy savings in the new LTE technologies of approximately 10% on infrastructure and 20% on transmission devices over a period of 5 years (compared to energy consumed by current technology).

A surety was also issued in October 2016 on behalf of Telecom Italia Sparkle, in favor of the Italian Revenue Agency - Lazio Regional Department, for 198 million euros, upon the outcome of the summary

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suspension order for the provisional execution of the ruling issued by the Provincial Tax Commission of Rome, which had rejected the Company's appeal against the fines issued by the Italian Revenue Agency - Lazio Regional Department for a total amount of 280 million euros (see paragraph a) Significant disputes and pending legal actions). The guarantee has been issued in accordance with Article 68 of Italian Legislative Decree 546/1992 and gives the Italian Revenue Agency - Lazio Regional Department the right, with respect to the appeal lodged by the Company, to collect an amount equal to 2/3 of the original claim.

Main guarantees for loans at June 30, 2017

Issuer

	Amount (millions of euros)
BBVA - Banco Bilbao Vizcaya Argentaria	368
SACE	368
Intesa Sanpaolo	220
Cassa Depositi e Prestiti	158
Barclays Bank	105
Ing	105
Unicredit	105
Commerzbank	57
Banco Santander	52
Sumitomo Mitsui Banking	52
Bank of Tokyo - Mitsubishi UFJ	52

The amounts shown in the table relate to loans issued by the EIB for the TIM Broadband Digital Divide, TIM Ricerca & Sviluppo Banda Larga, TIM Rete Mobile a Banda Larga, and TIM RDI for Broadband Services projects.

It is noted that the following guarantees from:

(3) Bank of Tokyo Mitsubishi UFJ of 52 million euros,

(4) BBVA Banco Bilbao Vizcaya Argentaria of 157 million euros, and

(5) Intesa Sanpaolo of 105 million euros,

relating to the loan granted by the EIB for the TIM Broadband Digital Divide/B project, and repaid in advance in the amount of 300 million euros on December 27, 2016, will remain valid for 13 months after the repayment as provided in the agreement to protect against clawback risk.

It is also noted that the Barclays Bank guarantee of 105 million euros, for the loan granted by the EIB for the Digital Divide/C project, expired on April 17, 2017 and was replaced, as per the option granted to TIM, with another guarantor bank. The guarantee will remain valid for 3 months after its expiry as provided in the agreement to protect against clawback risk.

There are also surety bonds on the telecommunication services in Brazil for 571 million euros.

D) ASSETS PLEDGED TO GUARANTEE FINANCIAL LIABILITIES

The contracts for low-rate loans granted by the Brazilian development bank BNDES (Banco Nacional de Desenvolvimento Econômico e Social) to Tim Celular for a total equivalent amount of 1,487 million euros are covered by specific covenants. In the event of non-compliance with the covenant obligations, BNDES will have a right to the receipts which transit on the bank accounts of the company.

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FINANCE INCOME AND FINANCE EXPENSES

FINANCE INCOME

This item decreased by 902 million euros compared to first half of 2016, and was broken down as follows:

(millions of euros)	1st Half 2017	1st Half 2016
Interest income and other finance income:		
Income from financial receivables, recorded in Non-current assets		
Income from securities other than investments, recorded in Non-current assets		
Income from securities other than investments, recorded in Current assets	6	8
Income other than the above:		
Interest income	75	62
Exchange gains	518	613
Income from fair value hedge derivatives	32	31
Reversal of the Reserve for cash flow hedge derivatives to the income statement (interest rate component)	290	344
Income from non-hedging derivatives	8	6
Miscellaneous finance income	12	25
	(a)	941
		1,089
Positive fair value adjustments to:		
Fair value hedge derivatives		77
Underlying financial assets and liabilities of fair value hedge derivatives	88	124

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Non-hedging derivatives		81	722
	(b)	169	923
Reversal of impairment loss on financial assets other than investments	(c)		
Total	(a+b+c)	1,110	2,012

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FINANCE EXPENSES

This item decreased by 307 million euros compared to first half of 2016, and was broken down as follows:

(millions of euros)	1st Half 2017	1st Half 2016
Interest expenses and other finance expenses:		
Interest expenses and other costs relating to bonds	552	566
Interest expenses to banks	57	57
Interest expenses to others	133	122
	742	745
Commissions	44	49
Exchange losses	498	382
Charges from fair value hedge derivatives		
Reversal of the Reserve for cash flow hedge derivatives to the income statement (interest rate component)	244	304
Charges from non-hedging derivatives	17	34
Miscellaneous finance expenses	118	113
	(a) 1,663	1,627
Negative fair value adjustments to:		
Fair value hedge derivatives	82	124
Underlying financial assets and liabilities of fair value hedge derivatives		75
Non-hedging derivatives	105	331
	(b) 187	530
Impairment losses on financial assets other than investments	(c)	
Total	(a+b+c) 1,850	2,157

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For greater clarity of presentation, the net effects relating to derivative financial instruments are summarized in the following table:

(millions of euros)		1st Half 2017	1st Half 2016
Exchange gains		518	613
Exchange losses		(498)	(382)
Net exchange gains and losses		20	231
Income from fair value hedge derivatives		32	31
Charges from fair value hedge derivatives			
Net result from fair value hedge derivatives	(a)	32	31
Positive effect of the reversal of the Reserve of cash flow hedge derivatives to the income statement (interest rate component)		290	344
Negative effect of the reversal of the Reserve of cash flow hedge derivatives to the income statement (interest rate component)		(244)	(304)
Net effect of the Reversal of the Reserve of cash flow hedge derivatives to the income statement (interest rate component)	(b)	46	40
Income from non-hedging derivatives		8	6
Charges from non-hedging derivatives		(17)	(34)
Net result from non-hedging derivatives	(c)	(9)	(28)
Net result from derivatives	(a+b+c)	69	43
Positive fair value adjustments to fair value hedge derivatives			77
Negative fair value adjustments to Underlying financial assets and liabilities of fair value hedge derivatives			(75)
Net fair value adjustments	(d)		2
Positive fair value adjustments to Underlying financial assets and liabilities of fair value hedge derivatives		88	124

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Negative fair value adjustments to fair value hedge derivatives		(82)	(124)
Net fair value adjustments	(e)	6	
Net fair value adjustments to fair value hedge derivatives and underlyings	(d+e)	6	2
Positive fair value to non-hedging derivatives	(f)	81	722
Negative fair value adjustments to non-hedging derivatives	(g)	(105)	(331)
Net fair value adjustments to non-hedging derivatives	(f+g)	(24)	391

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NOTE 20

PROFIT (LOSS) FOR THE PERIOD

Profit for the period decreased by 451 million euros compared to first half of 2016 and may be broken down as follows:

(millions of euros)	1st Half 2017	1st Half 2016
Profit (loss) for the period	654	1,105
Attributable to:		
Owners of the Parent:		
Profit (loss) from continuing operations	596	1,021
Profit (loss) from Discontinued operations/Non-current assets held for sale		(3)
Profit (loss) for the period attributable to owners of the Parent	596	1,018
Non-controlling interests:		
Profit (loss) from continuing operations	58	37
Profit (loss) from Discontinued operations/Non-current assets held for sale		50
Profit (loss) for the period attributable to non-controlling interests	58	87

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NOTE 21

EARNINGS PER SHARE

		1st Half 2017	1st Half 2016
Basic earnings per share			
Profit (loss) for the period attributable to owners of the Parent		596	1,018
Less: additional dividends for the savings shares (0.011 euros per share and up to capacity)		(66)	(66)
	(millions of euros)	530	952
Average number of ordinary and savings shares			
	(millions)	21,067	21,126
Basic earnings per share	Ordinary shares (euros)	0.03	0.05
Plus: additional dividends per savings share		0.01	0.01
Basic earnings per share	Savings shares (euros)	0.04	0.06
Basic earnings per share from continuing operations			
Profit (loss) from continuing operations attributable to Owners of the Parent		596	1,021
Less: additional dividends for the savings shares		(66)	(66)
	(millions of euros)	530	955
Average number of ordinary and savings shares			
	(millions)	21,067	21,126
Basic earnings per share from continuing operations	Ordinary shares (euros)	0.03	0.05
Plus: additional dividends per savings share		0.01	0.01
Basic earnings per share from continuing operations	Savings shares (euros)	0.04	0.06

Basic earnings per share from Discontinued operations/Non-current assets held for sale			
Profit (loss) from Discontinued operations/Non-current assets held for sale	(millions of euros)		47
Average number of ordinary and savings shares			
	(millions)	21,067	21,126
Basic earnings per share from Discontinued operations/Non-current assets held for sale Ordinary shares			
	(euros)		
Basic earnings per share from Discontinued operations/Non-current assets held for sale Savings shares			
	(euros)		
		1st Half 2017	1st Half 2016
Average number of ordinary shares		15,039,368,195	15,098,152,504
Average number of savings shares		6,027,791,699	6,027,791,699
Total		21,067,159,894	21,125,944,203

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		1st Half 2017	1st Half 2016	
Diluted earnings per share				
Profit (loss) for the period attributable to owners of the Parent		596	1,018	
Dilution effect of stock option plans and convertible bonds (*)		29	(437)	
Less: additional dividends for the savings shares (0.011 euros per share and up to capacity)		(66)	(66)	
	(millions of euros)	559	515	
Average number of ordinary and savings shares	(millions)	22,219	19,364	
Diluted earnings per share	Ordinary shares	(euros)	0.03	0.03
Plus: additional dividends per savings share		0.01	0.01	
Diluted earnings per share	Savings shares	(euros)	0.04	0.04
Diluted earnings per share from continuing operations				
Profit (loss) from continuing operations attributable to Owners of the Parent		596	1,021	
Dilution effect of stock option plans and convertible bonds (*)		29	(437)	
Less: additional dividends for the savings shares		(66)	(66)	
	(millions of euros)	559	518	
Average number of ordinary and savings shares	(millions)	22,219	19,364	
Diluted earnings per share from continuing operations	Ordinary shares	(euros)	0.03	0.03
Plus: additional dividends per savings share		0.01	0.01	
Diluted earnings per share from continuing operations	Savings shares	(euros)	0.04	0.04

Diluted earnings per share from Discontinued operations/Non-current assets held for sale			
Profit (loss) from Discontinued operations/Non-current assets held for sale	(millions of euros)		47
Dilution effect of stock option plans and convertible bonds			
Average number of ordinary and savings shares	(millions)	22,219	19,364
Diluted earnings per share from Discontinued operations/Non-current assets held for sale			
Ordinary shares	(euros)		
Diluted earnings per share from Discontinued operations/Non-current assets held for sale			
Savings shares	(euros)		
		1st Half 2017	1st Half 2016
Average number of ordinary shares (*)		16,191,454,392	13,336,157,383
Average number of savings shares		6,027,791,699	6,027,791,699
Total		22,219,246,091	19,363,949,082

(*) The average number of ordinary shares also includes the potential ordinary shares relating to the equity compensation plans of employees for which the (market and non-market) performance conditions have been met, in addition to the theoretical number of shares that are issuable as a result of the conversion of the unsecured equity-linked convertible bond. Consequently, the Net profit (loss) for the period attributable to Owners of the Parent and the Profit (loss) from continuing operations attributable to Owners of the Parent have also been adjusted to exclude the effects, net of tax, related to the above-mentioned plans and to the convertible bond (+29 million euros in the 1st Half 2017).

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The table below shows future potential changes in share capital, based on: the issuance of the convertible bond by TIM S.p.A. in March 2015; the authorizations to increase the share capital in place at June 30, 2017; and the options and rights granted under equity compensation plans, still outstanding at June 30, 2017:

	Number of maximum shares issuable	Share capital (thousands of euros)	Additional Paid-in capital (thousands of euros)	Subscription price per share (euros)
Additional capital increases not yet approved (ordinary shares)				
2014-2016 Stock Option Plan	133,042	73	80	1.15
	343,069	189	158	1.01
	893,617	492	393	0.99
	13,555,651	7,455	5,287	0.94
Total additional capital increases not yet approved (ordinary shares)	14,925,379	8,209	5,918	
Capital increases already approved (ordinary shares)				
2015 Convertible Bond (ordinary shares) (*)	1,082,485,386	2,000,000	n.a.	n.a.
Convertible bonds		2,000,000		
Total		2,008,209		

(*) The number of shares potentially issuable shown may be subject to adjustments. Further information is provided in the Notes Financial liabilities (non-current and current) and Equity compensation plans .

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SEGMENT REPORTING

A) SEGMENT REPORTING

Segment reporting is based on the following operating segments:

- (1) Domestic
- (2) Brazil
- (3) Other Operations

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Separate Consolidated Income Statements by Operating Segment

(millions of euros)	Domestic		Brazil		Other Operations		Adjustments and eliminations		Consolidated Total	
	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016
Third-party revenues	7,480	7,231	2,292	1,857			8		9,772	9,096
Intragroup revenues	14	16	1	1			1	(15)	(18)	
Revenues by operating segment	7,494	7,247	2,293	1,858			9	(15)	(18)	9,772
Other income	199	98	18	10			1		(2)	217
Total operating revenues and other income	7,693	7,345	2,311	1,868			10	(15)	(20)	9,989
Acquisition of goods and services	(2,976)	(2,812)	(1,169)	(978)	(2)	(5)	11	12	(4,136)	(3,783)
Employee benefits expenses	(1,348)	(1,384)	(178)	(161)	(4)	(7)		1	(1,530)	(1,551)
of which: accruals to employee severance indemnities	(1)	(1)							(1)	(1)
Other operating expenses	(311)	(276)	(262)	(224)	(3)	(2)		1	(576)	(501)
of which: write-downs and expenses in connection with credit management and provision charges	(200)	(162)	(86)	(69)					(286)	(231)
Change in inventories	45	32	5	8		(7)			50	33
Internally generated assets	258	279	55	43			4	3	317	325
EBITDA	3,361	3,184	762	556	(9)	(11)		(3)	4,114	3,726
Depreciation and amortization	(1,675)	(1,596)	(575)	(450)			1	(1)	(2,249)	(2,047)

Gains/(losses) on disposals of non-current assets	(1)	(2)	7	15					6	13
Impairment reversals (losses) on non-current assets		(5)								(5)
EBIT	1,685	1,581	194	121	(9)	(11)	1	(4)	1,871	1,687
Share of profits (losses) of associates and joint ventures accounted for using the equity method	(1)	(2)							(1)	(2)
Other income (expenses) from investments									(19)	7
Finance income									1,110	2,012
Finance expenses									(1,850)	(2,157)
Profit (loss) before tax from continuing operations									1,111	1,547
Income tax expense									(457)	(489)
Profit (loss) from continuing operations									654	1,058
Profit (loss) from Discontinued operations/Non-current assets held for sale										47
Profit (loss) for the period									654	1,105
Attributable to:										
Owners of the Parent									596	1,018
Non-controlling interests									58	87
Revenues by operating segment										

(millions of euros)	Domestic		Brazil		Other Operations		Adjustments and eliminations		Consolidated Total	
	1st Half	1st Half	1st Half	1st Half	1st Half	1st Half	1st Half	1st Half	1st Half	1st Half
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Revenues from equipment sales - third party	655	430	116	118			8		771	556
Revenues from equipment sales - intragroup							1		(1)	

Total revenues from equipment sales	655	430	116	118	9	(1)	771	556
Revenues from services - third party	6,827	6,804	2,176	1,739			9,003	8,543
Revenues from services - intragroup	14	16	1	1		(15)	(17)	
Total revenues from services	6,841	6,820	2,177	1,740		(15)	(17)	9,003
Revenues on construction contracts - third party	(2)	(3)					(2)	(3)
Revenues on construction contracts-intragroup								
Total revenues on construction contracts	(2)	(3)					(2)	(3)
Total third-party revenues	7,480	7,231	2,292	1,857	8		9,772	9,096
Total intragroup revenues	14	16	1	1	1	(15)	(18)	
Total revenues by operating segment	7,494	7,247	2,293	1,858	9	(15)	(18)	9,772

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Purchase of intangible and tangible assets by operating segment

(millions of euros)	Domestic		Brazil		Other Operations		Adjustments and eliminations		Consolidated Total	
	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016
	Purchase of intangible assets	436	465	237	244					673
Purchase of tangible assets	1,212	1,208	201	189					1,413	1,397
Total purchase of intangible and tangible assets	1,648	1,673	438	433					2,086	2,106
<i>of which: capital expenditures</i>	1,626	1,575	430	408					2,056	1,983
<i>of which: change in financial leasing contracts</i>	22	98	8	25					30	123

Headcount by Operating Segment

(number)	Domestic		Brazil		Other Operations		Consolidated Total	
	6/30/2017	12/31/2016	6/30/2017	12/31/2016	6/30/2017	12/31/2016	6/30/2017	12/31/2016
Headcount	51,095	51,280	9,471	9,849	86	100	60,652	61,229

Assets and liabilities by Operating Segment

(millions of euros)	Domestic		Brazil		Other Operations		Adjustments and eliminations		Consolidated Total	
	6/30/2017	12/31/2016	6/30/2017	12/31/2016	6/30/2017	12/31/2016	6/30/2017	12/31/2016	6/30/2017	12/31/2016
	Non-current operating assets	47,508	47,428	6,958	7,711	4	5	1	1	54,471
Current operating assets	4,780	4,472	1,129	1,209	14	16	8	(1)	5,931	5,696

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Total operating assets	52,288	51,900	8,087	8,920	18	21	9		60,402	60,841
Investments accounted for using the equity method	17	18							17	18
Discontinued operations/Non-current assets held for sale										
Unallocated assets									8,621	9,587
Total Assets									69,040	70,446
Total operating liabilities	8,970	8,968	1,646	2,397	51	57	(5)	(16)	10,662	11,406
Liabilities directly associated with Discontinued operations/Non-current assets held for sale										
Unallocated liabilities									34,759	35,487
Equity									23,619	23,553
Total Equity and Liabilities									69,040	70,446

B) REPORTING BY GEOGRAPHICAL AREA

(millions of euros)		Revenues				Non-current operating assets	
		Breakdown by location of operations		Breakdown by location of currencies		Breakdown by location of operations	
		1st Half 2017	1st Half 2016	1st Half 2017	1st Half 2016	06/30/2017	12/31/2016
Italy	(a)	7,312	7,079	6,878	6,620	47,080	46,948
Outside Italy	(b)	2,460	2,017	2,894	2,476	7,391	8,197
Total	(a+b)	9,772	9,096	9,772	9,096	54,471	55,145

C) INFORMATION ABOUT MAJOR CUSTOMERS

None of the TIM Group's customers exceeds 10% of consolidated revenues.

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RELATED PARTY TRANSACTIONS

The following tables show the figures relating to related party transactions and the impact of those amounts on the separate consolidated income statements, consolidated statements of financial position and consolidated statements of cash flows.

Related party transactions, when not dictated by specific laws, were conducted at arm's length. The transactions were carried out in accordance with the internal procedure that contains the rules aimed at ensuring the transparency and fairness of related party transactions, in accordance with Consob Regulation 17221/2010.

Up to May 4, 2017, the companies of the Generali group, Intesa Sanpaolo group, Mediobanca group and Telefonica group (shareholders of the company Telco) were also considered related parties, based on the provision of TIM's procedure for the management of transactions with related parties according to which it applies also to the participants in significant shareholder agreements according to Article 122 of the Consolidated Law on Finance, which govern the candidacy to the position of Director of the Company, where the slate presented is the slate where the majority of the Directors nominated have been drawn from. The members of the Board of Directors of TIM in office up to May 4, 2017 had in fact been drawn from the list originally submitted by the shareholder Telco. With the reappointment of the Board of Directors this circumstance no longer applied and the scope of related parties through Directors was therefore amended.

On May 3 and June 1, 2017, the Board of Directors of TIM approved several changes to the Procedure for the management of related party transactions, deciding, on a voluntary basis and therefore without any obligations, to treat Vivendi as if it was the parent, in accordance with the Consob Regulation. The process of identifying new entities that entered the scope of related parties essentially led to the identification of all the entities with which the Group has significant relationships. The full list is currently being completed.

The new Procedure for the management of related party transactions is available for consultation at the website www.telecomitalia.com, About Us section Governance System channel.

Lastly, you are reminded that the investment held in the Sofora Telecom Argentina group, classified under Discontinued operations/Non-current assets held for sale starting from the consolidated financial statements at December 31, 2013, was sold on March 8, 2016.

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The effects on the individual line items of the separate consolidated income statements for the first half of 2017 and 2016 are as follows:

SEPARATE CONSOLIDATED INCOME STATEMENT LINE ITEMS FIRST HALF 2017

(millions of euros)	Total (a)	Associates, subsidiaries of associates and joint ventures	Other related parties (*)	Pension funds	Key managers	Total related parties (b)	% of financial statement item (b/a)
Revenues	9,772	2	116			118	1.2
Other income	217	3	4			7	3.2
Acquisition of goods and services	4,136	11	88			99	2.4
Employee benefits expenses	1,530		1	40	13	54	3.5
Finance income	1,110		37			37	3.3
Finance expenses	1,850	9	31			40	2.2

(*) Vivendi Group and Companies belonging to the group that it belongs to; other related parties through directors, statutory auditors and key managers and as participants in shareholder agreements pursuant to Article 122 of the Consolidated Law on Finance.

SEPARATE CONSOLIDATED INCOME STATEMENT LINE ITEMS FIRST HALF 2016

(millions of euros)	Total (a)	Associates, subsidiaries of associates and joint ventures	Other related parties (*)	Pension funds	Key managers	Total related parties (b)	Transactions Discontinued Operations (c)	Total related parties net of discontinued operations (d)	% of financial statement item (b/a)
Revenues	9,096	2	185			187	(23)	164	1.8

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Other income	107		2			2		2	1.9
Acquisition of goods and services	3,783	11	113			124	(14)	110	2.9
Employee benefits expenses	1,551		1	41	24	66		66	4.3
Finance income	2,012		60			60		60	3.0
Finance expenses	2,157		67			67		67	3.1
Profit (loss) from Discontinued operations/Non-current assets held for sale	47	(1)	10			9			

(*) Other related parties both through directors, statutory auditors and key managers and as participants in shareholder agreements pursuant to Article 122 of the Consolidated Law on Finance.

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The effects on the individual line items of the consolidated statements of financial position of the Group at June 30, 2017 and at December 31, 2016 are as follows:

CONSOLIDATED STATEMENT OF FINANCIAL POSITION LINE ITEMS AT 6/30/2017

(millions of euros)	Total (a)	Associates, subsidiaries of associates and joint ventures	Other related parties ^(*)	Pension funds	Total related parties (b)	% of financial statement item (b/a)
Net financial debt						
Non-current financial assets	(2,185)					
Securities other than investments (current assets)	(1,102)		(5)		(5)	0.5
Financial receivables and other current financial assets	(630)					
Cash and cash equivalents	(4,086)					
Current financial assets	(5,818)		(5)		(5)	0.1
Non-current financial liabilities	28,887					
Current financial liabilities	4,844					
Total net financial debt	25,728		(5)		(5)	
Other statement of financial position line items						
Trade and miscellaneous receivables and other current assets	5,617	15			15	0.3
Trade and miscellaneous payables and other current liabilities	7,056	24	25	27	76	1.1

(*) Vivendi Group and Companies belonging to the group that it belongs to; other related parties through directors, statutory auditors and key managers.

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CONSOLIDATED STATEMENT OF FINANCIAL POSITION LINE ITEMS AT 12/31/2016

(millions of euros)	Total (a)	Related Parties			Total related parties net of Discontinued Operations (b)	% of financial statement item (b/a)
		Associates, subsidiaries of associates and joint ventures	Other related parties (*)	Pension funds		
Net financial debt						
Non-current financial assets	(2,698)	(12)	(520)	(532)	(532)	19.7
Securities other than investments (current assets)	(1,519)		(110)	(110)	(110)	7.2
Financial receivables and other current financial assets	(389)		(22)	(22)	(22)	5.7
Cash and cash equivalents	(3,964)		(621)	(621)	(621)	15.7
Current financial assets	(5,872)		(753)	(753)	(753)	12.8
Non-current financial liabilities	30,469		912	912	912	3.0
Current financial liabilities	4,056		133	133	133	3.3
Total net financial debt	25,955	(12)	(228)	(240)	(240)	(0.9)
Other statement of financial position line items						
Trade and miscellaneous receivables and other current assets	5,426	9	127	136	136	2.5
Miscellaneous payables and other non-current liabilities	1,607		2	2	2	0.1
Trade and miscellaneous payables and other current liabilities	7,646	37	200	26	263	3.4

(*)

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Other related parties both through directors, statutory auditors and key managers and as participants in shareholder agreements pursuant to Article 122 of the Consolidated Law on Finance.

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The effects on the significant line items of the consolidated statements of cash flows for the first half of 2017 and 2016 are as follows:

CONSOLIDATED STATEMENT OF CASH FLOWS LINE ITEMS FIRST HALF 2017

(millions of euros)	Total (a)	Associates, subsidiaries of associates and joint ventures	Other related parties (*)	Pension funds	Total related parties (b)	% of financial statement item (b/a)
Purchase of intangible and tangible assets on an accrual basis	2,086	75			75	3.6

(*) Vivendi Group and Companies belonging to the group that it belongs to; other related parties through directors, statutory auditors and key managers and as participants in shareholder agreements pursuant to Article 122 of the Consolidated Law on Finance.

CONSOLIDATED STATEMENT OF CASH FLOWS LINE ITEMS FIRST HALF 2016

(millions of euros)	Total (a)	Associates, subsidiaries of associates and joint ventures	Other related parties (*)	Pension funds	Total related parties (b)	% of financial statement item (b/a)
Purchase of intangible and tangible assets on an accrual basis	2,106	63			63	3.0

(*) Other related parties both through directors, statutory auditors and key managers and as participants in shareholder agreements pursuant to Article 122 of the Consolidated Law on Finance.

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TRANSACTIONS WITH ASSOCIATES, SUBSIDIARIES OF ASSOCIATES AND JOINT VENTURES

The most significant amounts are summarized as follows:

SEPARATE CONSOLIDATED INCOME STATEMENT LINE ITEMS

(millions of euros)	1st Half 2017	1st Half 2016	TYPE OF CONTRACT
Revenues			
Italtel group	1	1	Provision of equipment rental, fixed and mobile telephone and outsourced communication services.
NordCom S.p.A.		1	Fixed and mobile voice services, data network connections and outsourced ICT products and services.
Other minor companies	1		
Total revenues	2	2	
Other income	3		Contributions governed by partnership agreements and penalties with respect to the Italtel group.
Acquisition of goods and services			
Italtel group	9	9	Supply and maintenance of switching equipment, software development and platforms upgrading, and customized products and services, as part of TIM offerings to the Italtel group customers, and extension of professional services for the new Multimedia Video Data Center for the provision of the TIM Vision service.
W.A.Y. S.r.l.	2	1	Supply and installation of geolocation equipment and provision of related technical support services within the TIM customer offering.
Other minor companies		1	
Total acquisition of goods and services	11	11	
Finance expenses	9		Write-down of the financial receivable due from Alfiere.

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CONSOLIDATED STATEMENT OF FINANCIAL POSITION LINE ITEMS

(millions of euros)	6/30/2017	12/31/2016	TYPE OF CONTRACT
Net financial debt			
Non-current financial assets		12	Shareholder loans to Alfiere S.p.A.
Other statement of financial position line items			
Trade and miscellaneous receivables and other current assets			
Alfiere S.p.A.	1		Contracts for project management, administration, corporate and compliance services, and sundry chargebacks.
Italtel group	12	6	Provision of equipment rental, fixed and mobile telephone and outsourced communication services.
W.A.Y. S.r.l.	1	1	Supply of fixed-line telephony, ICT and mobile services.
Other minor companies	1	2	
Total trade and miscellaneous receivables and other current assets	15	9	
Trade and miscellaneous payables and other current liabilities			
Italtel group	21	33	Supply transactions connected with investment and operations activities.
Dono per... S.c.a.r.l.	1		Payable for fixed and mobile calls made by TIM customers for charity initiatives.
Movenda S.p.A.		1	SIM-card supply and certification and functional development of IT platforms.
NordCom S.p.A.		1	Supply and development of IT solutions, provision of customized services as part of TIM offerings to end customers, and rental expense for base transceiver station housing.
W.A.Y. S.r.l.	1	2	Supply and installation of geolocation equipment and provision of related technical support services within the TIM customer offering.
Other minor companies	1		
Total trade and miscellaneous payables and other current liabilities	24	37	

CONSOLIDATED STATEMENT OF CASH FLOWS LINE ITEMS

(millions of euros)	1st Half		TYPE OF CONTRACT
	2017	2016	
Purchase of intangible and tangible assets on an accrual basis			
Italtel group	74	63	Purchases of telecommunications equipment.
Other minor companies	1		
Total purchase of intangible and tangible assets on an accrual basis	75	63	

The shareholder loan with Alfiere S.p.A. in place at December 31, 2016 was increased by 3 million euros in the first half of 2017 and subsequently converted into an equity interest amounting to 6 million euros. The remaining amount, of 9 million euros, was fully written down.

At June 30, 2017, TIM S.p.A. had issued guarantees in favor of the joint venture Alfiere S.p.A. for 1 million euros.

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TRANSACTIONS WITH OTHER RELATED PARTIES (BOTH THROUGH DIRECTORS, STATUTORY AUDITORS AND KEY MANAGERS AND AS PARTICIPANTS IN SHAREHOLDER AGREEMENTS PURSUANT TO ARTICLE 122 OF THE CONSOLIDATED LAW ON FINANCE)

Details are provided below of the transactions with:

Companies (and related groups) formerly shareholders of Telco S.p.A. (in short Former Telco Companies) namely: the Mediobanca group, the Generali group, the Intesa Sanpaolo group and the Telefonica group. Up to May 4, 2017;

Related companies through Directors whose term of office ended on May 4, 2017;

Vivendi Group and the companies of the group it belongs to (as a result of the resolutions of the Board of Directors of TIM S.p.A. of May 3 and June 1, 2017);

Related companies through Directors appointed on May 4, 2017.
The most significant amounts are summarized as follows:

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SEPARATE CONSOLIDATED INCOME STATEMENT LINE ITEMS

(millions of euros)	1st Half 2017	1st Half 2016	TYPE OF CONTRACT
Revenues			
Generali group	12	25	Supply of telephone and data transmission services, peripheral data networks, connections, storage, and telecommunications products and services.
Intesa Sanpaolo group	31	34	Telephone services, MPLS data and international network, ICT services and Microsoft licenses, Internet connectivity and high-speed connections.
Mediobanca group	3	3	Telephone and MPLS data network services and marketing of data devices and sale of equipment for fixed and mobile networks.
RCS Media Group		2	Fixed-line telephony service.
Telefónica group	70	121	Interconnection services, roaming, broadband access fees, supply of IRU transmission capacity and software.
Total revenues	116	185	
Other income	4	2	Generali group damage compensation.
Acquisition of goods and services			
Bollorè-Havas group	12		Conception, planning and implementation of advertising campaigns for products and services for the TIM Group.
Generali group	7	11	Insurance premiums and property leases.
Intesa Sanpaolo group	5	6	Factoring fees, fees for smart card top-ups/activation and commissions for payment of telephone bills by direct debit and collections via credit cards.
Mediobanca group	1	1	Credit recovery activities.
RCS Media Group		1	Provision of content and digital publishing services and fees for telephone top-up services.

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Telefónica group	59	91	Interconnection and roaming services, site sharing, co-billing agreements, broadband linesharing and unbundling.
Vivendi group	4	3	Purchase of musical and television digital content (TIMmusic and TIMvision) and supply of D&P cloud-based games (TIMgames).
Total acquisition of goods and services	88	113	
Employee benefits expenses	1	1	Generali group insurance related to the work of personnel.
Finance income			
Intesa Sanpaolo group	27	47	Bank accounts, deposits and hedging derivatives.
Mediobanca group	8	10	Bank accounts, deposits and hedging derivatives.
Telefónica group	2	3	Finance lease.
Total finance income	37	60	
Finance expenses			
Intesa Sanpaolo group	23	54	Term Loan Facility, Revolving Credit Facility, hedging derivatives, loans and bank accounts.
Mediobanca group	8	13	Term Loan Facility and Revolving Credit Facility and hedging derivatives.
Total finance expenses	31	67	

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CONSOLIDATED STATEMENT OF FINANCIAL POSITION LINE ITEMS

(millions of euros)	6/30/2017	12/31/2016	TYPE OF CONTRACT
Net financial debt			
Non-current financial assets		520	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Securities other than investments (current assets)			
Former Telco Companies		105	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Vivendi group	5	5	Bonds.
Total Securities other than investments (current assets)	5	110	
Financial receivables and other current financial assets			
Former Telco Companies		22	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Total financial receivables and other current financial assets		22	
Cash and cash equivalents			
Former Telco Companies		621	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Total cash and cash equivalents		621	
Non-current financial liabilities			
Former Telco Companies		912	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Total non-current financial liabilities		912	
Current financial liabilities			
Former Telco Companies		133	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Total current financial liabilities		133	

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(millions of euros)	6/30/2017	12/31/2016	TYPE OF CONTRACT
Other statement of financial position line items			
Trade and miscellaneous receivables and other current assets			
Former Telco Companies		127	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Total trade and miscellaneous receivables and other current assets		127	
Miscellaneous payables and other non-current liabilities			
Former Telco Companies		2	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Total miscellaneous payables and other non-current liabilities		2	
Trade and miscellaneous payables and other current liabilities			
Bollorè-Havas group	22		Conception, planning and implementation of advertising campaigns for products and services for the TIM Group.
Former Telco Companies		196	See Note 40 of the 2016 Consolidated financial statements of the TIM Group.
Vivendi group	3	4	Purchase of musical and television digital content (TIMmusic and TIMvision).
Total trade and miscellaneous payables and other current liabilities	25	200	

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TRANSACTIONS WITH PENSION FUNDS

The most significant amounts are summarized as follows:

SEPARATE CONSOLIDATED INCOME STATEMENT LINE ITEMS

(millions of euros)	1st Half 2017	1st Half 2016	TYPE OF CONTRACT
Employee benefits expenses			Contributions to pension funds.
Fontedir	5	6	
Telemaco	33	34	
Other pension funds	2	1	
Total employee benefits expenses	40	41	

CONSOLIDATED STATEMENT OF FINANCIAL POSITION LINE ITEMS

(millions of euros)	6/30/2017	12/31/2016	TYPE OF CONTRACT
Trade and miscellaneous payables and other current liabilities			Payables for contributions to pension funds.
Fontedir	3	4	
Telemaco	22	21	
Other pension funds	2	1	
Trade and miscellaneous payables and other current liabilities	27	26	

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In the first half of 2017, the total remuneration recorded on an accrual basis by TIM or by companies controlled by the Group in respect of key managers amounted to 12.7 million euros (23.6 million euros in the first half of 2016), broken down as follows:

(millions of euros)	1st Half 2017	1st Half 2016
Short-term remuneration	5.5	7.6
Long-term remuneration	2.7	0.5
Employment termination benefit incentives		12.5
Share-based payments (*)	4.5	3.0
	12.7	23.6

(*) These refer to the fair value of the rights, accrued to June 30, under the share-based incentive plans of TIM S.p.A. and its subsidiaries (2014/2016 Stock Option Plan, Special Awards and Stock Option Plans of the South American subsidiaries).

Short-term remuneration is paid during the period it pertains to, and, at the latest, within the six months following the end of that period.

The amounts shown in the table do not include:

in the first half of 2017, the effects of the allocation of a total amount of 4.9 million euros as the 2016/2019 Special Award for the discretionary amount allocated to the managers and/or directors of TIM or its subsidiaries and consequently to several Key Managers;

in the first half of 2016, the effects of the reversal of the accruals related to the costs for the 2014/2016 Stock Option Plan of 1.6 million euros.

In addition, in the first half of 2017, the beneficiaries of the Special Award were identified for the 1.5% of the 2016 over-performance, already allocated in 2016.

The Key Managers, recipients of that bonus, were assigned a total amount of 1,850,000 euros (of which 1,480,000 euros consisted of 1,897,434 TIM ordinary shares). The payment is scheduled for after the approval of the Financial Statements for the year 2019.

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In the first half of 2017, the contributions paid in to defined contribution plans (Assida and Fontedir) by TIM S.p.A. or by subsidiaries of the Group on behalf of key managers amounted to 47,000 euros (46,000 euros in the first half of 2016).

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In the first half of 2017, the Key Managers, i.e. those who have the power and responsibility, directly or indirectly, for the planning, management and control of the operations of the TIM Group, including directors, had been identified as follows:

Directors:

Arnaud Roy de Puyfontaine	(1) Executive Chairman of TIM S.p.A.
Giuseppe Recchi	(2) Executive Chairman of TIM S.p.A.
Flavio Cattaneo	Managing Director and Chief Executive Officer of TIM S.p.A. General Manager of TIM S.p.A.

Managers:

Stefano De Angelis	Diretor Presidente Tim Participações S.A.
Stefano Azzi	Head of Consumer & Small Enterprise
Stefano Ciurli	Head of Wholesale
Giovanni Ferigo	Head of Technology
Lorenzo Forina	Head of Business & Top Clients
Francesco Micheli	(3) Head of Human Resources & Organizational Development
Cristoforo Morandini	Head of Regulatory Affairs and Equivalence
Agostino Nuzzolo	(4) Head of Legal
Piergiorgio Peluso	(5) Head of Administration, Finance and Control

(1) from June 1, 2017;

(2) to May 31, 2017;

(3) responsibility for the Human Resources & Organizational Development function has been assigned on an interim basis to the Head of Group Special Projects, Francesco Micheli;

(4) from January 10, 2017;

(5) the Chief Financial Officer of the Company Piergiorgio Peluso has been assigned responsibility on an interim basis for the Business Support Office function.

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EQUITY COMPENSATION PLANS

Equity compensation plans in effect at June 30, 2017 are used for retention purposes and as a long-term incentive for the managers and employees of the Group.

However, it should be noted that these plans do not have any significant effect on the economic result or on the financial position or on cash flows at June 30, 2017.

DESCRIPTION OF STOCK OPTION PLANS

For a description of the:

TIM S.p.A. 2014-2016 Stock Option Plan, and the

Tim Participações S.A. 2011-2013 Stock Option Plan, already in place at December 31, 2016, see the consolidated financial statements of the TIM Group at that date.

Other Tim Participações S.A. Stock Option Plans.

2014-2016 Plan

On April 10, 2014, the General Meeting of Shareholders of Tim Participações S.A. approved the long-term incentive plan for managers in key positions in the company and its subsidiaries.

Exercise of the options is not subject to the achievement of specific performance targets, but the exercise price is adjusted upwards or downwards according to the performance of the Tim Participações S.A. shares in a ranking of Total Shareholder Return, in which companies in the Telecommunications, Information Technology and Media industry are compared during each year of validity of the plan. If the performance of the Tim Participações S.A. shares, in the 30 days prior to September 29 of each year, is in last place in that ranking, the participant loses the right to 25% of the options vesting at that time.

The vesting period is 3 years (a third per year), the options are valid for 6 years, and the company does not have the legal obligation to repurchase or liquidate the options in cash, or in any other form.

Year 2014

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On September 29, 2014, the grantees of the options were granted the right to purchase a total of 1,687,686 shares.

At December 31, 2016, a total of 623,027 options were considered lapsed due to failure to achieve the minimum exercise conditions set in the Plan, whereas 502,097 of the remaining 1,064,659 options were considered vested. No option has been exercised. At June 30, 2017, a further 285,487 options had lapsed.

Year 2015

On October 16, 2015, the grantees of the options were granted the right to purchase a total of 3,355,229 shares.

At December 31, 2016, a total of 780,144 options were considered lapsed and 338,266 options were considered vested.

At June 30, 2017, a total of 157,663 options had been exercised at a price of 8.7341 reais (initial price of 8.4526 reais adjusted by 3.33%, in line with the positioning in the benchmarking). A further 387,197 options also lapsed.

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On November 8, 2016, the grantees of the options were granted the right to purchase a total of 3,922,204 shares. At June 30, 2017, there were no options that could be considered as vested and 381,444 options had lapsed.

DESCRIPTION OF OTHER TIM S.p.A. EQUITY COMPENSATION PLANS

For the description of the Special Award 2016-2019, launched in 2016, see the 2016 Consolidated financial statements of the TIM Group.

In the first half of 2017, the beneficiaries of the Special Award were identified for the 1.5% of the 2016 over-performance.

The Key Managers, recipients of that bonus, were assigned a total amount of 1,850,000 euros (of which 1,480,000 euros consisted of 1,897,434 TIM S.p.A. ordinary shares). The payment is scheduled for after the approval of the Financial Statements for the year 2019.

On July 24, 2017, following the resignation of Mr. Cattaneo, an agreement was reached between the parties that provides for the payment of a gross amount of 22.9 million euros as a settlement arrangement. This amount takes particular, but not exclusive, account of the Special Award.

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SIGNIFICANT NON-RECURRING EVENTS AND TRANSACTIONS

The effect of non-recurring events and transactions of the first half of 2017 on equity, profit, net financial debt and cash flows of the TIM Group is set out below in accordance with Consob Communication DEM/6064293 of July 28, 2006. The non-recurring effects on Equity and Profit (loss) for the period are shown net of tax effects.

(millions of euros)			Equity	Profit (loss)	Net financial debt	Cash flows
Amount	financial statements	(a)	for the period	carrying amount	(*)	
			23,619	654	25,728	229
	Acquisition of goods and services - Expenses related to agreements and the development of non-recurring projects		(1)	(1)	8	(8)
	Employee benefits expenses - Expenses related to restructuring and rationalization		(7)	(7)	65	(65)
	Other operating expenses - Expenses related to disputes and regulatory penalties and liabilities related to those expenses, and expenses related to disputes with former employees and liabilities with customers and/or suppliers		(61)	(61)	103	(103)
	Gains on disposals of non-current assets		(1)	(1)		
	Finance expenses - Other finance expenses related to litigations		(10)	(10)		
	Provision charges for Sparkle tax dispute		(93)	(93)		
	Total non-recurring effects	(b)	(173)	(173)	176	(176)
	Figurative amount - financial statements	(a-b)	23,792	827	25,552	405

(*) Cash flows refer to the increase (decrease) in Cash and Cash equivalents during the period.

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Significant non-recurring events and transactions

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The impact of non-recurring items on the separate consolidated income statement line items is as follows:

(millions of euros)	1st Half 2017	1st Half 2016
Acquisition of goods and services:		
Sundry expenses	(2)	
Employee benefits expenses:		
Expenses related to restructuring and rationalization	(10)	(75)
Other operating expenses:		
Sundry expenses and provisions	(83)	(16)
Impact on Operating profit (loss) before depreciation and amortization, capital gains (losses) and impairment reversals (losses) on non-current assets (EBITDA)	(95)	(91)
Gains (losses) on non-current assets:		
Gains on disposals of non-current assets		9
Losses on disposals of non-current assets	(1)	
Impact on EBIT Operating profit (loss)	(96)	(82)
Finance expenses:		
Interest expenses and miscellaneous finance expenses	(14)	(11)
Impact on profit (loss) before tax from continuing operations	(110)	(93)
Effect on income taxes on non-recurring items	30	27
Provision charges for Sparkle tax dispute	(93)	
Discontinued operations Effect of the disposal of the Sofora Telecom Argentina group		(12)
Impact on profit (loss) for the period	(173)	(78)

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POSITIONS OR TRANSACTIONS RESULTING FROM ATYPICAL AND/OR UNUSUAL OPERATIONS

In accordance with Consob Communication DEM/6064293 of July 28, 2006, a statement is made to the effect that in the first half of 2017 no atypical and/or unusual transactions, as defined by that Communication, were carried out.

NOTE 27

OTHER INFORMATION**A) EXCHANGE RATES USED TO TRANSLATE THE FINANCIAL STATEMENTS OF FOREIGN OPERATIONS(*)**

(local currency against 1 euro)		Period-end exchange rates (statements of financial position)		Average exchange rates for the period (income statements and statements of cash flows)	
		6/30/2017	12/31/2016	1st Half 2017	1st Half 2016
Europe					
BGN	Bulgarian Lev	1.95580	1.95580	1.95580	1.95580
CZK	Czech koruna	26.19700	27.02100	26.78393	27.03985
CHF	Swiss franc	1.09300	1.07390	1.07656	1.09582
TRY	Turkish lira	4.01340	3.70720	3.93800	3.25790
GBP	Pound sterling	0.87933	0.85618	0.86027	0.77859
RON	Romanian leu	4.55230	4.53900	4.53675	4.49533
RUB	Russian Ruble	67.54500	64.30000	62.75611	78.30656
North America					
USD	U.S. dollar	1.14120	1.05410	1.08279	1.11572
Latin America					
VEF	Venezuelan bolivar	15.40620	14.23035	14.57744	15.02350
BOB	Bolivian Bolíviano	7.88569	7.28383	7.48209	7.70963
PEN	Peruvian nuevo sol	3.70976	3.54020	3.54696	3.77419

ARS	Argentine peso	18.88510	16.74880	17.00284	15.98614
CLP	Chilean peso	758.21400	704.94500	714.60792	769.03591
COP	Colombian peso	3,478.65000	3,169.49000	3,164.52430	3,481.92257
BRL	Brazilian real	3.77532	3.43542	3.44195	4.13001
Other countries					
ILS	Israeli shekel	3.98880	4.04770	3.96243	4.30633

(*) Source: data processed by the European Central Bank, Reuters and major Central Banks.

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Table of Contents**B) RESEARCH AND DEVELOPMENT**

Expenditures for research and development activities are represented by external costs, labor costs of dedicated staff and depreciation and amortization. Details are as follows:

(millions of euros)	1st Half 2017	1st Half 2016
Research and development costs expensed during the period	24	25
Capitalized development costs	846	722
Total research and development costs (expensed and capitalized)	870	747

Moreover, in the separate consolidated income statements for the first half of 2017, amortization charges are recorded for development costs, capitalized during the period and in prior years, for an amount of 401 million euros.

Research and development activities conducted by the TIM Group are detailed in the Report on Operations (Research and Development Section).

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NOTE 28

EVENTS SUBSEQUENT TO JUNE 30, 2017

**TERMINATION OF THE EMPLOYMENT RELATIONSHIP WITH THE CHIEF EXECUTIVE OFFICER AND
CONSEQUENT SETTLEMENT AGREEMENT**

On July 24, 2017, the Board of Directors of TIM S.p.A. approved a settlement agreement by majority vote (upon favorable recommendation by majority of the Appointment and Remuneration Committee, also pursuant to the procedure for the approval of minor related-party transactions, due to the Chief Executive Officer's status as a related party) for the termination, with effect from July 28, 2017, of Mr. Flavio Cattaneo's term of office as Chief Executive Officer (and as such also as a member of the Strategic Committee) and as the General Manager (with effect from July 31, 2017). The Board of Statutory Auditors expressed a non-favorable, non-binding opinion in this regard.

The agreement provides for the payment to Mr. Cattaneo, upon termination of the relationship, of the gross amount of 22.9 million euros as a settlement for the compensation due to Mr. Cattaneo under his contract with the Company, considering in particular the Special Award and the MBO, in relation to the work already carried out as Director and the value identified as having been created based on available data. The agreement also provides for the payment to Mr. Cattaneo of the gross amount of 2.1 million euros consideration for non-competition, non-solicitation and non-poaching covenants, for one year, towards the main competitors of TIM in Italy and Brazil, subject to claw-back in case of breach of the covenants (as well as the transfer of certain company goods).

GOVERNANCE RESOLUTIONS

On July 27, 2017, the Board of Directors of TIM S.p.A. acknowledged the start of the direction and coordination by Vivendi S.A..

In relation to Mr Cattaneo's termination from the offices of Chief Executive Officer and Director, the Board, in line with the Company's succession plan, has temporarily assigned his responsibilities to the Executive Chairman Mr. de Puyfontaine, who will lead the Group, with the aid of the Company's management, in accordance with the guidelines of the strategic plan. The responsibilities related to the Security Function and the company Telecom Italia Sparkle have been assigned on an interim basis to the Deputy Chairman, Giuseppe Recchi.

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LIST OF COMPANIES OF THE TIM GROUP

In accordance with Consob Communication DEM/6064293 dated July 28, 2006, the list of companies is provided herein.

The list is divided by type of investment, consolidation method and operating segment.

The following is indicated for each company: name, head office, country and share capital in the original currency. In addition to the percentage ownership of share capital, the percentage of voting rights in the ordinary shareholders meeting, if different than the percentage holding of share capital, and which companies hold the investment.

Company name	Head office	Currency	Share capital	% Ownership	% of voting rights	Held by
PARENT COMPANY						
TIM S.p.A.	MILAN (ITALY)	EUR	11,677,002,855			
SUBSIDIARIES CONSOLIDATED LINE-BY-LINE DOMESTIC BU						
4G RETAIL S.r.l. (sale of fixed and mobile telecommunications products and services and all analog and digital broadcasting equipment)	MILAN (ITALY)	EUR	2,402,241	100.0000		TIM S.p.A
ADVANCED CARING CENTER S.r.l. (telemarketing, market research and surveys activities and development)	ROME (ITALY)	EUR	600,000	100.0000		TELECONTACT CENTER S.p.A.
ALFABOOK S.r.l. (on-line sale of digital texts)	TURIN (ITALY)	EUR	100,000	100.0000		OLIVETTI S.p.A.
BEIGUA S.r.l.	ROME (ITALY)	EUR	51,480	100.0000		PERSIDERA S.p.A.

(purchase, sale and maintenance of systems for repair work and radio and television broadcasting)

CD FIBER S.r.l. (design, construction, maintenance and management of network infrastructure services and high-speed electronic communication systems)	ROME (ITALY)	EUR	50,000	100.0000	TIM S.p.A
FLASH FIBER S.r.l. (development, implementation, maintenance and supply of the fiber network in Italy)	MILAN (ITALY)	EUR	30,000	80.0000	TIM S.p.A
H.R. SERVICES S.r.l. (personnel training and services)	L AQUILA (ITALY)	EUR	500,000	100.0000	TIM S.p.A
INFRASTRUTTURE WIRELESS ITALIANE S.p.A. (installation and operation of installations and infrastructure for the management and the sale of telecommunications services)	MILAN (ITALY)	EUR	600,000,000	60.0333	TIM S.p.A
MED 1 SUBMARINE CABLES Ltd (construction and management of the submarine cable lev1)	RAMAT GAN (ISRAEL)	ILS	55,886,866	100.0000	TELECOM ITALIA SPARKLE S.p.A.
NOVERCA S.r.l. (development and provision of services in the TLC and multimedia sector in Italy and abroad)	ROME (ITALY)	EUR	10,000	100.0000	TIM S.p.A
OLIVETTI MULTISERVICIS S.p.A.	MILAN (ITALY)	EUR	20,337,161	100.0000	TIM S.p.A

(real estate management)					
OLIVETTI S.p.A.	IVREA (TURIN) (ITALY)	EUR	10,000,000	100.0000	TIM S.p.A
(production and sale of office equipment and information technology services)					
PERSIDERA S.p.A.	ROME (ITALY)	EUR	21,428,572	70.0000	TIM S.p.A
(purchase, sale and maintenance of systems for repair work and radio and television broadcasting)					
TELECOM ITALIA SAN MARINO S.p.A.	BORGO MAGGIORE (SAN MARINO)	EUR	1,808,000	100.0000	TIM S.p.A
(San Marino telecommunications management)					
TELECOM ITALIA SPARKLE S.p.A.	ROME (ITALY)	EUR	200,000,000	100.0000	TIM S.p.A
(completion and management of telecommunications services for public and private use)					
TELECOM ITALIA TRUST TECHNOLOGIES S.r.l.	POMEZIA ROME (ITALY)	EUR	7,000,000	100.0000	TIM S.p.A
(other operations related to non-classified IT services)					
TELECOM ITALIA VENTURES S.r.l.	MILAN (ITALY)	EUR	10,000	100.0000	TIM S.p.A
(investment holding company)					
TELECONTACT CENTER S.p.A.	NAPLES (ITALY)	EUR	3,000,000	100.0000	TIM S.p.A
(telemarketing services)					
TELEFONIA MOBILE SAMMARINESE S.p.A.	BORGO MAGGIORE (SAN MARINO)	EUR	78,000	51.0000	TELECOM ITALIA SAN MARINO S.p.A.
(development and management of mobile					

telecommunications plants and services)

TELENERGIA S.r.l.	ROME (ITALY)	EUR	50,000	100.0000	TIM S.p.A
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(import, export, purchase, sale and trade of electricity)

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Company name	Head office	Currency	Share capital	% of ownership	% of voting rights	Held by
TELSY ELETTRONICA E TELECOMUNICAZIONI S.p.A. (production and sale of equipment and systems for crypto telecommunications)	TURIN (ITALY)	EUR	390,000	100.0000		TIM S.p.A
TI SPARKLE NETHERLANDS B.V. (telecommunications services)	AMSTERDAM (NETHERLANDS)	EUR	18,200	100.0000		TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE AMERICAS Inc. (managed bandwidth services)	MIAMI (UNITED STATES)	USD	10,000	100.0000		TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE ARGENTINA S.A. (managed bandwidth services)	BUENOS AIRES (ARGENTINA)	ARS	9,998,000	95.0000	5.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE AUSTRIA Gmbh (telecommunications services)	VIENNA (AUSTRIA)	EUR	2,735,000	100.0000		TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE BELGIUM S.P.R.L. - B.V.B.A (telecommunications services)	BRUSSELS (BELGIUM)	EUR	2,200,000	99.9999	0.0001	TELECOM ITALIA SPARKLE S.p.A. TI SPARKLE UK Ltd
TI SPARKLE BOLIVIA S.r.l. (managed bandwidth services)	LA PAZ (BOLIVIA)	BOB	1,747,600	99.9999	0.0001	TELECOM ITALIA SPARKLE S.p.A. TI SPARKLE AMERICAS Inc.

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TI SPARKLE BRASIL PARTIÇIPACOES Ltda (investment holding company)	RIO DE JANEIRO (BRAZIL)	BRL	71,563,866	99.9999 0.0001	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd TI SPARKLE AMERICAS Inc.
TI SPARKLE BRASIL TELECOMUNICAOES Ltda (managed bandwidth services)	RIO DE JANEIRO (BRAZIL)	BRL	69,337,363	99.9999 0.0001	TI SPARKLE BRASIL PARTIÇIPACOES Ltda TI SPARKLE AMERICAS Inc.
TI SPARKLE BULGARIA EODD (telecommunications)	SOFIA (BULGARIA)	BGN	100,000	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE CHILE SPA (managed bandwidth services)	SANTIAGO (CHILE)	CLP	5,852,430,960	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE COLOMBIA Ltda (managed bandwidth services)	BOGOTA (COLOMBIA)	COP	5,246,906,000	99.9999 0.0001	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd TI SPARKLE AMERICAS Inc.
TI SPARKLE CZECH S.R.O. (telecommunications services)	PRAGUE (CZECH REPUBLIC)	CZK	6,720,000	100.0000	TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE FRANCE S.A.S. (installation and management of telecommunications services for fixed network and related activities)	PARIS (FRANCE)	EUR	18,295,000	100.0000	TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE GERMANY GmbH (telecommunications services)	FRANKFURT (GERMANY)	EUR	25,000	100.0000	TELECOM ITALIA SPARKLE S.p.A.

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TI SPARKLE GREECE S.A. (telecommunications)	ATHENS (GREECE)	EUR	368,760	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd (telecommunications services, installation and maintenance of submarine cable systems for managed bandwidth services)	DUBLIN (IRELAND)	USD	1,000,000	100.0000	TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE ISRAEL Ltd (international wholesale telecommunication services)	RAMAT GAN (ISRAEL)	ILS	1,000	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE MED S.p.A. (installation and management of submarine cable systems)	ROME (ITALY)	EUR	3,100,000	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE NORTH AMERICA, Inc (telecommunications and promotional services)	NEW YORK (UNITED STATES)	USD	15,550,000	100.0000	TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE PANAMA S.A. (managed bandwidth services)	PANAMA	USD	10,000	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE PERU S.A. (managed bandwidth services)	LIMA (PERU)	PEN	57,101,788	99.9999 0.0001	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd TI SPARKLE AMERICAS Inc.
TI SPARKLE PUERTO RICO LLC (managed bandwidth services)	SAN JUAN (PUERTO RICO)	USD	50,000	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
		RON	3,021,560	100.0000	

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TI SPARKLE ROMANIA S.r.l.	BUCHAREST (ROMANIA)					TELECOM ITALIA SPARKLE S.p.A.
(telecommunications services)						
TI SPARKLE RUSSIA LLC	MOSCOW (RUSSIA)	RUB	8,520,000	99.0000 1.0000		TELECOM ITALIA SPARKLE S.p.A.
(telecommunications services)						
TI SPARKLE SINGAPORE Pte.Ltd	SINGAPORE	USD	5,121,120	99.9999 0.0001		TELECOM ITALIA SPARKLE S.p.A.
(telecommunications services)						
TI SPARKLE SLOVAKIA S.R.O.	BRATISLAVA (SLOVAKIA)	EUR	300,000	100.0000		TELECOM ITALIA SPARKLE S.p.A.
(telecommunications services)						
TI SPARKLE SPAIN Telecommunications S.L.	MADRID (SPAIN)	EUR	1,687,124	100.0000		TELECOM ITALIA SPARKLE S.p.A.
(telecommunications services)						
TI SPARKLE St. Croix LLC	VIRGIN ISLANDS (UNITED STATES)	USD	10,000	100.0000		TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
(managed bandwidth services)						

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Company name	Head office	Currency	Share capital	% of voting rights	Held by
TI SPARKLE SWITZERLAND Gmbh (telecommunications services)	ZURICH (SWITZERLAND)	CHF	2,000,000	100.0000	TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE TURKEY TELEKOMÜNİKASYON ANONİM SİRKETİ (telecommunications services)	YENİSBONA İSTANBUL (TURKEY)	TRY	40,600,000	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TI SPARKLE UK Ltd (value-added and networking services)	LONDON (UNITED KINGDOM)	EUR	3,983,254	100.0000	TELECOM ITALIA SPARKLE S.p.A.
TI SPARKLE VENEZUELA CA. (managed bandwidth services)	CARACAS (VENEZUELA)	VEF	981,457	100.0000	TI SPARKLE IRELAND TELECOMMUNICATIONS Ltd
TIM REAL ESTATE S.r.l. (real estate)	MILAN (ITALY)	EUR	50,000	100.0000	TIM S.p.A
TIMB2 S.r.l. (management of television frequency user rights)	ROME (ITALY)	EUR	10,000	99.0000 1.0000	PERSIDERA S.p.A. TIM S.p.A
TIMVISION S.r.l. (production, co-production, conception and creation of programs, films and audiovisual content, including multimedia and interactive content)	ROME (ITALY)	EUR	50,000	100.0000	TIM S.p.A
TMI TELEMEDIA INTERNATIONAL DO	SÃO PAULO (BRAZIL)	BRL	8,909,639	100.0000	TI SPARKLE BRASIL PARTICIPAÇÕES Ltda

BRASIL Ltda

(telecommunications
services and promotional
services)

TN FIBER S.r.l.

(design, construction,
maintenance and supply of
optical network access to
users in the province of
Trento)

TRENTO (ITALY)	EUR	55,918,000	100.0000	TIM S.p.A
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BRAZIL BU

INTELIG TELECOMUNICAÇÕES Ltda	RIO DE JANEIRO (BRAZIL)	BRL	4,041,956,045	99.9999	TIM PARTICIPAÇÕES S.A.
				0.0001	TIM CELULAR S.A.

(telecommunications
services)

TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A.	RIO DE JANEIRO (BRAZIL)	BRL	7,169,029,859	99.9999 0.0001	TELECOM ITALIA FINANCE S.A.
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(investment holding
company)

TIM S.p.A

TIM CELULAR S.A.	SÃO PAULO (BRAZIL)	BRL	9,434,215,720	100.0000	TIM PARTICIPAÇÕES S.A.
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(telecommunications
services)

TIM PARTICIPAÇÕES S.A.	RIO DE JANEIRO (BRAZIL)	BRL	9,913,414,422	66.5819 0.0264	TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A.
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(investment holding
company)

TIM PARTICIPAÇÕES S.A.

OTHER OPERATIONS

OLIVETTI DEUTSCHLAND GmbH	NURENBERG (GERMANY)	EUR	25,600,000	100.0000	OLIVETTI S.p.A.
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(sale of office equipment
and supplies)

OLIVETTI ESPAÑA S.A. (in Liquidation)	BARCELONA (SPAIN)	EUR	1,229,309	100.0000	OLIVETTI S.p.A.
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(sale and maintenance of
office supplies,

consultancy and network management)					
OLIVETTI UK Ltd. (sale of office equipment and supplies)	NORTHAMPTON (UNITED KINGDOM)	GBP	6,295,712	100.0000	OLIVETTI S.p.A.
TELECOM ITALIA CAPITAL S.A. (financial company)					
TELECOM ITALIA FINANCE IRELAND Ltd (in liquidation) (financial company)	DUBLIN (IRELAND)	EUR	1,360,000,000	100.0000	TELECOM ITALIA FINANCE S.A.
TELECOM ITALIA FINANCE S.A. (financial company)					
TELECOM ITALIA LATAM PARTICIPAÇÕES E GESTÃO ADMINISTRATIVA Ltda (telecommunications and promotional services)					
	SÃO PAULO (BRAZIL)	BRL	118,925,803	100.0000	TIM S.p.A
TIAUDIT COMPLIANCE LATAM S.A. (in liquidation) (internal audit services)					
	RIO DE JANEIRO (BRAZIL)	BRL	1,500,000	69.9996 30.0004	TIM S.p.A TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A.
TIESSE S.c.p.A. (installation and assistance for electronic, IT, telematics and telecommunications equipment)					
	IVREA (TURIN) (ITALY)	EUR	103,292	61.0000	OLIVETTI S.p.A.
TIM TANK S.r.l.					
	MILAN (ITALY)	EUR	16,600,000	100.0000	TIM S.p.A

(fund and securities
investments)

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Company name	Head office	Currency	Share capital	% Ownership	% of voting rights	Held by
ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD						
ALFIERE S.p.A. (*) (real estate)	ROME (ITALY)	EUR	9,250,000	50.0000		TIM S.p.A
AREE URBANE S.r.l. (in liquidation) (real estate management)	MILAN (ITALY)	EUR	100,000	32.6200		TIM S.p.A
ASSCOM INSURANCE BROKERS S.r.l. (insurance brokerage)	MILAN (ITALY)	EUR	100,000	20.0000		TIM S.p.A
BALTEA S.r.l. (in bankruptcy) (production and sale of office products and telecommunications IT services)	IVREA (TURIN) (ITALY)	EUR	100,000	49.0000		OLIVETTI S.p.A.
CLOUDESIRE.COM S.r.l. (design, implementation and marketing of a marketplace platform for the sale of software-as-a-service applications)	PISA (ITALY)	EUR	11,671		(**)	TELECOM ITALIA VENTURES S.r.l.
CONSORZIO ANTENNA COLBUCCARO Società Consortile a RL (installation, management and maintenance of metal pylons complete with workstations for device recovery)	ASCOLI PICENO (ITALY)	EUR	121,000	20.0000		PERSIDERA S.p.A.
CONSORZIO ANTENNA MONTECONERO Società Consortile a RL (multimedia services)	SIROLO (ANCONA) (ITALY)	EUR	51,100	22.2211		PERSIDERA S.p.A.

CONSORZIO E O (in liquidation) (training services)	ROME (ITALY)	EUR	30,987	50.0000		TIM S.p.A
DONO PER...S.C.A.R.L. (in liquidation) (collection and distribution of funds for charitable purposes or for financing of political parties or political or social movements)	ROME (ITALY)	EUR	30,000	33.3333		TIM S.p.A
ECO4CLOUD S.r.l. (development, production and sale of innovative products or services with high technological value)	RENDE (COSENZA) (ITALY)	EUR	19,532	(**)		TELECOM ITALIA VENTURES S.r.l.
ITALTEL GROUP S.p.A. (investment holding company)	SETTIMO MILANESE (MILAN) (ITALY)	EUR	825,695	34.6845	19.3733	TELECOM ITALIA FINANCE S.A.
ITALTEL S.p.A. (telecommunications systems)	SETTIMO MILANESE (MILAN) (ITALY)	EUR	2,000,000	(**)		TIM S.p.A
KOPJRA S.r.l. (development, production and sale of innovative products or services with high technological value)	SCHIO (VICENZA) (ITALY)	EUR	16,207	22.8491		TELECOM ITALIA VENTURES S.r.l.
MOVENDA S.p.A. (design, construction and diffusion of Internet sites, products and computer media)	ROME (ITALY)	EUR	133,333	24.9998		TELECOM ITALIA FINANCE S.A.
NORDCOM S.p.A. (application service provider)	MILAN (ITALY)	EUR	5,000,000	42.0000		TIM S.p.A
OILPROJECT S.r.l.	MILAN (ITALY)	EUR	13,556	(**)		TELECOM ITALIA

(research, development, marketing and patenting of all intellectual property related to technology, information technology and TLC)						VENTURES S.r.l.
PEDIUS S.r.l. (implementation of specialized telecommunications applications, telecommunications services over telephone connections, VOIP services)	ROME (ITALY)	EUR	159	(**)		TELECOM ITALIA VENTURES S.r.l.
TIGLIO I S.r.l. (real estate management)	MILAN (ITALY)	EUR	5,255,704	47.8019		TIM S.p.A
TIGLIO II S.r.l. (in liquidation) (real estate management)	MILAN (ITALY)	EUR	10,000	49.4700		TIM S.p.A
W.A.Y. S.r.l. (development and sale of geolocation products and systems for security and logistics)	TURIN (ITALY)	EUR	136,383	39.9999		OLIVETTI S.p.A.
WIMAN S.r.l. (development, management and implementation of platforms for social-based Wi-Fi authentication)	MATTINATA (FOGGIA) (ITALY)	EUR	21,568	(**)		TELECOM ITALIA VENTURES S.r.l.

(*) Joint Venture.

(**) Associate over which TIM S.p.A., directly or indirectly, exercises significant influence pursuant to IAS 28 (Investments in Associates and Joint Ventures).

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**CERTIFICATION OF THE HALF-YEAR CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
PURSUANT TO ARTICLE 81-TER OF THE CONSOB REGULATION 11971 DATED MAY 14, 1999, WITH
AMENDMENTS AND ADDITIONS.**

We, the undersigned, Arnaud Roy de Puyfontaine, as Chairman, Flavio Cattaneo, as Chief Executive Officer, and Piergiorgio Peluso, as Manager responsible for preparing TIM S.p.A. financial reports, certify, having also considered the provisions of Article 154-bis, paragraphs 3 and 4, of Italian Legislative Decree 58 of February 24, 1998:

the adequacy in relation to the characteristics of the company and

the effective application

of the administrative and accounting procedures used in the preparation of the half-year condensed consolidated financial statements for the period January 1 – June 30, 2017.

TIM has adopted the Internal Control – Integrated Framework Model (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission, as its framework for the establishment and assessment of its internal control system, with particular reference to the internal controls for the preparation of the financial statements.

The undersigned also certify that:

the Half-year Condensed Consolidated Financial Statements at June 30, 2017:

- a. are prepared in conformity with international accounting standards adopted by the European Union pursuant to EC regulation 1606/2002 of the European Parliament and Council of July 19, 2002 (International Financial Reporting Standards – IFRS) as well as the legislative and prescribed provisions in force in Italy also with reference to the measures enacted for the implementation of Article 9 of Italian Legislative Decree 38 of February 28, 2005;
- b) agree with the results of the accounting records and entries;
- 2) provide a true and fair view of the financial condition, the results of operations and the cash flows of the Company and its consolidated subsidiaries;

the interim management report contains a reliable analysis of important events which took place during the first six months of 2017 and their impact on the half-year condensed consolidated financial statements at June 30, 2017, together with a description of the main risks and uncertainties for the remaining six months of 2017. The interim management report also contains a reliable analysis of information concerning significant related party transactions.

27 July 2017

**Manager responsible for
preparing corporate financial
reports**

Chairman

Chief Executive Officer

reports

_____[signature]_____
Arnaud Roy de Puyfontaine

_____[signature]_____
Flavio Cattaneo

_____[signature]_____
Piergiorgio Peluso

TIM Group
Half-year Condensed Consolidated Financial Statements
at June 30, 2017

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statements

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REVIEW REPORT ON CONSOLIDATED CONDENSED INTERIM FINANCIAL STATEMENTS

To the shareholders of

TIM SpA

Foreword

We have reviewed the accompanying consolidated condensed interim financial statements of TIM SpA and its subsidiaries (TIM Group) as of and for the six-month period ended 30 June 2017, comprising the statement of financial position, the separate income statement, the statement of comprehensive income, the statement of changes in shareholders' equity, the statement of cash flows and related explanatory notes. The directors of TIM SpA are responsible for the preparation of the consolidated condensed interim financial statements in accordance with International Accounting Standard 34 applicable to interim financial reporting (IAS 34) as adopted by the European Union. Our responsibility is to express a conclusion on these consolidated condensed interim financial statements based on our review.

Scope of review

We conducted our work in accordance with the criteria for a review recommended by the National Commission for Companies and Stock Exchange (CONSOB) in Resolution No. 10867 of 31 July 1997. A review of consolidated condensed interim financial statements consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than a full-scope audit conducted in accordance with International Standards on Auditing (ISA Italia) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion on the consolidated condensed interim financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying consolidated condensed interim financial statements of TIM Group as of and for the six-month period ended 30 June 2017 are not prepared, in all material respects, in accordance with International Accounting Standard 34 applicable to interim financial reporting (IAS 34) as adopted by the European Union.

Milan, 9 August 2017

PricewaterhouseCoopers SpA

Signed by

Francesco Ferrara

(Partner)

This report has been translated into English from the Italian original solely for the convenience of international readers

PricewaterhouseCoopers SpA

Sede legale e amministrativa: Milano 20149 Via Monte Rosa 91 Tel. 0277851 Fax 027785240 Cap. Soc. Euro 6.890.000,00 i.v., C .F. e P.IVA e Reg. Imp. Milano 12979880155 Iscritta al n° 119644 del Registro dei Revisori Legali - Altri Uffici: **Ancona** 60131 Via Sandro Totti 1 Tel. 0712132311 - **Bari** 70122 Via Abate Gimma 72 Tel. 0805640211 - **Bologna** 40126 Via Angelo Finelli 8 Tel. 0516186211 - **Brescia** 25123 Via Borgo Pietro Wuhrer 23 Tel. 0303697501 - **Catania** 95129 Corso Italia 302 Tel. 0957532311 - **Firenze** 50121 Viale Gramsci 15 Tel. 0552482811 - **Genova** 16121 Piazza Piccapietra 9 Tel. 01029041 - **Napoli** 80121 Via dei Mille 16 Tel. 08136181 - **Padova** 35138 Via Vicenza 4 Tel. 049873481 - **Palermo** 90141 Via Marchese Ugo 60 Tel. 091349737 - **Parma** 43121 Viale Tanara 20/A Tel. 0521275911 - **Pescara** 65127 Piazza Ettore Troilo 8 Tel. 0854545711 - **Roma** 00154 Largo Fochetti 29 Tel. 06570251 - **Torino** 10122 Corso Palestro 10 Tel. 011556771 - **Trento** 38122 Viale della Costituzione 33 Tel. 0461237004 - **Treviso** 31100 Viale Felissent 90 Tel. 0422696911 - **Trieste** 34125 Via Cesare Battisti 18 Tel. 0403480781 - **Udine** 33100 Via Poscolle 43 Tel. 043225789 - **Verona** 21100 Via Albuzzi 43 Tel. 0332285039 - **Verona** 37135 Via Francia 21/C Tel. 0458263001- **Vicenza** 36100 Piazza Pontelandolfo 9 Tel. 0444393311

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USEFUL INFORMATION

Free copies of this report, can be obtained by:

Calling	Free Number 800.020.220 (for calls inside Italy) or +39 011 2293603 (for calls outside Italy) providing information and assistance to shareholders
E-mail	ufficio.soci@telecomitalia.it
Internet	Users can view the Half-Year financial Report at June 2017, by visiting the website telecomitalia.com/Bilanci-Relazioni

They can also obtain information about TIM at the following URL:
www.telecomitalia.com and information about its products and services at the following URL: www.tim.it

Investor Relations	+39 02 85954131 (switchboard) +39 02 85954132 (fax)
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investor_relations@telecomitalia.it

TIM S.p.A.

A company directed and coordinated by Vivendi S.A.

Registered Office Via G. Negri n. 1 - Milan

Headquarters and Secondary Office in Corso d Italia 41 - Rome

PEC (Certified Electronic Mail) box: telecomitalia@pec.telecomitalia.it

Share Capital 11,677,002,855.10 euros, fully paid up

Tax Code/VAT no. and Milan Companies Register file no. 00488410010

Interim Management Report
at June 30, 2017

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Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995.

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. The Group's interim report as of and for the six months ended June 30, 2017 included in this Form 6-K contains certain forward-looking statements. Forward-looking statements are statements that are not historical facts and can be identified by the use of forward-looking terminology such as believes, may, is expected to, will, will continue, seeks or anticipates or similar expressions or the negative thereof or other comparable terminology, or by the forward-looking nature of discussions of strategy, plans or intentions.

Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information is based on certain key assumptions which we believe to be reasonable but forward-looking information by its nature involves risks and uncertainties, which are outside our control, that could significantly affect expected results.

The following important factors could cause our actual results to differ materially from those projected or implied in any forward-looking statements:

1. our ability to successfully implement our strategy over the 2017-2019 period;
2. the continuing effects of the global economic crisis in the principal markets in which we operate, including, in particular, our core Italian market;
3. the impact of regulatory decisions and changes in the regulatory environment in Italy and other countries in which we operate;
4. the impact of political developments in Italy and other countries in which we operate;
5. our ability to successfully meet competition on both price and innovation capabilities of new products and services;
6. our ability to develop and introduce new technologies which are attractive in our principal markets, to manage innovation, to supply value added services and to increase the use of our fixed and mobile networks;
7. our ability to successfully implement our internet and broadband strategy;
8. our ability to successfully achieve our debt reduction and other targets;

9. the impact of fluctuations in currency exchange and interest rates and the performance of the equity markets in general;
10. the outcome of litigation, disputes and investigations in which we are involved or may become involved;
11. our ability to build up our business in adjacent markets and in international markets (particularly in Brazil), due to our specialist and technical resources;
12. our ability to achieve the expected return on the investments and capital expenditures we have made and continue to make in Brazil;
13. the amount and timing of any future impairment charges for our authorizations, goodwill or other assets;
14. our ability to manage and reduce costs;
15. any difficulties which we may encounter in our supply and procurement processes, including as a result of the insolvency or financial weaknesses of our suppliers; and
16. the costs we may incur due to unexpected events, in particular where our insurance is not sufficient to cover such costs.

The foregoing factors should not be construed as exhaustive. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: September 7, 2017

TELECOM ITALIA S.p.A.

BY: /s/ Umberto Pandolfi
Umberto Pandolfi
Company Manager