Pirelli & C. S.p.A. Milan

Annual Report 2006

Call to the Annual General Meeting of the Shareholders

The ordinary shareholders of Pirelli & C. Società per Azioni are called to the ordinary session of the shareholders' meeting to be held in Milan, Viale Sarca 214,

- on Friday April 20, 2007 at 16:00 p.m. in first call;

- on Monday April 23, 2007 at 10:30 a.m. in second call,

to pass resolutions on the following

AGENDA

Ordinary Session

1. The financial statements at December 31, 2006; inherent and consequent resolutions.
2. Appointment of two Directors and/or reduction of Board of Directors members. Inherent and consequent resolutions
3. Proposals of modifications of the Regulations for Shareholders' Meetings adopted by the shareholder meeting held on May 11, 2004.

Extraordinary session

- Modifications to articles 5 (share capital), 6 (shareholders), 7 (shareholders meetings), 8 (resolutory and final quorum), 9 (procedures for shareholders meetings), 10 (Company administration), 11 (functions of the Board of Directors), 12 (Board of Directors meetings), 13 (representation of the company), 15 (expiry of the term of office of the Board of Directors) and 16 (Board of Statutory Auditors) of the Company Bylaws.

Inherent and consequent resolutions. Conferring of powers.

Call to the AGM
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Pirelli & C. S.p.A.

Board of Directors [1]

Chairman [2]	Marco Tronchetti Provera
Deputy Chairman [2]	Alberto Pirelli
Deputy Chairman [2]	Carlo Alessandro Puri Negri
Directors	Carlo Acutis *
	Carlo Angelici * °
	Gilberto Benetton
	Alberto Bombassei *
	Franco Bruni * °
	Gabriele Galateri di Genola
	Mario Garraffo *
	Dino Piero Giarda *
	Berardino Libonati * □
	Giulia Maria Ligresti
	Massimo Moratti
	Giovanni Perissinotto
	Giampiero Pesenti * □
	Aldo Roveri * □
	Carlo Secchi * °
	Paolo Vagnone

* Independent director
° Member of the Internal Control and Corporate Governance Committee
□ Member of the Remuneration Committee

Secretary to the Board	Anna Chiara Svelto

Board of Statutory Auditors [3]

Chairman	Luigi Guatri
Standing members	Enrico Laghi
	Paolo Francesco Lazzati
Alternate members	Franco Ghiringhelli
	Luigi Guerra

General Managers [4]

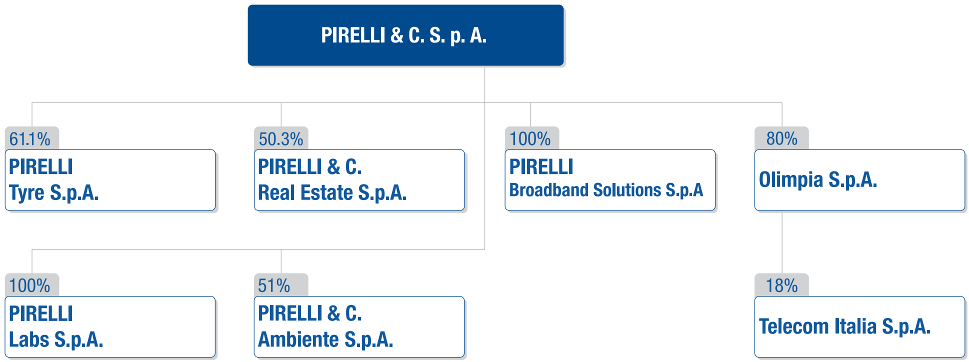
Operations	Claudio De Conto
Finance and Strategic Planning	Luciano Gobbi

Independent Auditors [5]

PricewaterhouseCoopers S.p.A.

[1] Appointment: April 28, 2005. Expiry: shareholders' meeting called to approve the financial statements at December 31, 2007. Alberto Bombassei was co-opted by the board of directors' meeting held on September 12, 2006. On November 6, 2006, Carlo Buora tendered his resignation from the posts held in the company
[2] Office conferred by the board of directors' meeting held on April 28, 2005.
[3] Appointment: April 21, 2006. Expiry: shareholders' meeting called to approve the financial statements at December 31, 2008.
[4] Francesco Gori was General Manager of Tyres Sector until June 30, 2006. Starting July 1, 2006 he is Managing Director and General Manager of Pirelli Tyre S.p.A..
[5] Appointment conferred by the shareholders' meeting held on April 28, 2005.

Structure of Pirelli Group at December 31, 2006



Pirelli & C. S.p.A. on the Stock Market

Pirelli & C. S.p.A. share capital movements since December 31, 2002

Date	**Capital** (thousands)	Transactions
December 2002	Euros 339,423	bond conversion
May 2003	Euros 272,083	exercise of the right of share withdrawal following the change in the company type and the corporate business purpose
June 2003	Euros 1,084,247	issue of shares cum warrants (1 warrant : 1 share) with rights offering (3 ordinary shares : 1 share of any class) at € 0.52
August 2003	Euros 1,799,400	share capital increase as a result of the merger by exchange
December 2004	Euros 1,800,383	warrant conversion
February 2005	Euros 1,974,633	warrant conversion
March 2005	Euros 2,763,953	issue of shares with rights offering (2 ordinary shares: 5 shares of any class) at € 0.70
December 2005	Euros 2,764,057	warrant conversion
April 2006	Euros 2,764,716	warrant conversion
June 2006	Euros 2,791,311	warrant conversion

Number of shares outstanding

	at December 31, 2006	at April 20, 2007
Pirelli & C. S.p.A. - Ordinary shares	5,233,142,003	5,233,142,003
Pirelli & C. S.p.A. - Savings shares	134,764,429	134,764,429

Market Trading on the Milan Stock Exchange

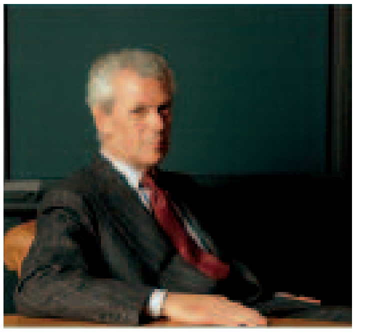
	Shares traded Volume	Amount (in millions of euros)
Pirelli & C. - Ordinary shares	8,861,567,702	6,576
Pirelli & C. - Savings shares	115,895,385	82

Five-Year Summary of Selected Consolidated Financial Data

	(IAS/IFRS)			(Italian GAAP)	
in millions of euros	**2006**	**2005**	**2004**	**2003**	**2002**
Net sales	**4,841**	**4,546**	**3,967**	**6,671**	**6,718**
Gross operating profit	614	568	470	628	523
Operating profit	**401**	**355**	**269**	**268**	**118**
Operating profit (loss) incl. earnings (losses) from investments	(748)	622	425	217	(57)
Total income (loss)	**(1,049)**	**399**	**304**	**4**	**(405)**
Income (loss) attribut. to the equity holders of Pirelli & C. S.p.A.	**(1,167)**	**327**	**251**	**(39)**	**(58)**
Earnings (losses) per share (in euros)	(0.22)	0.07	0.07	(0.01)	(0.09)
Fixed assets	6,924	7,629	6,097	5,902	6,596
Net working capital	463	(53)	466	566	991
Net invested capital	**7,387**	**7,576**	**6,563**	**6,468**	**7,587**
Equity	4,687	5,614	3,841	3,678	4,626
Provisions	720	785	1,121	1,045	911
Net financial (liquidity)/debt position	**1,980**	**1,177**	**1,601**	**1,745**	**2,050**
Equity attributable to the equity holders of Pirelli & C. S.p.A.	**3,880**	**5,205**	**3,502**	**3,429**	**1,933**
Equity per share (in euros)	0.72	0.98	1.01	0.99	2.96
Free cash flow	**317**	**343**	**287**	**564**	**476**
R&D expenditures	**171**	**174**	**171**	**204**	**219**
Depreciation	201	197	182	278	315
Capital expenditures	255	234	211	273	337
Gross operating profit / net sales	12.68%	12.49%	11.85%	9.41%	7.79%
Operating profit / net sales - ros	8.28%	7.81%	6.78%	4.02%	1.76%
Income / equity * - roe	(20.37%)	7.38%	5.77%	0.10%	(8.75%)
Operating profit / net invested capital* - roi	5.36%	5.02%	4.13%	3.81%	1.56%
Operating profit (post investments) / net invested capital *	(10.00%)	8.80%	6.52%	3.09%	(0.71%)
Net financial position / equity	0.42	0.21	0.42	0.47	0.44
Capital expenditures / depreciation	1.27	1.19	1.16	0.98	1.07
R&D expenditures / net sales (industrial aggregate)	3.53%	3.83%	4.31%	3.38%	3.45%
Net sales per employee (in thousands of euros)	172	173	162	182	174
Pirelli & C. S.p.A. ordinary shares (no. in millions)	5,233.1	5,180.7	3,327.5	3,325.6	618.2
Pirelli & C. S.p.A. savings shares (no. in millions)	134.8	134.8	134.8	134.8	34.4
Total Pirelli & C. S.p.A. shares (no. in millions)	5,367.9	5,315.5	3,462.3	3,460.4	652.6
Treasury shares (no. in millions)	2.6	2.6	2.6	2.6	2.6
Factories	24	24	74	77	79
of which discontinued operations			*52*		
Employees (at 12/31)	28,617	26,827	24,790	36,337	37,350
of which temporary employees	*3,479*	*3,102*	*2,721*	*2,417*	*2,257*

*Average amounts

Chairman's letter



To the shareholders,
2006 was a particularly demanding year for the Pirelli & C. Group which dealt not only with the complexity of normal business operations but had to confront important challenges on the financial front.
From the standpoint of operations, the Group continued on the path of growth begun in the last few years thanks to the good performance of all its activities, especially the Tyres and Real Estate sectors. In fact, the consolidated figures show that revenues grew by 6.5 percent to nearly Euros 5 billion, with a gross operating margin of 8.2 percent, and operating income exceeded the threshold of Euros 400 million, recording double-digit growth (+13.1 percent). These results confirm the excellent state of the health of the Group's activities and the validity of our strategy of focusing on sectors with greater value-added and with a higher technological content.
During the course of 2006, besides, the Group further expanded its presence worldwide in the wake of a tradition that spans a century in which Pirelli is a protagonist of the competition in the major international markets. As regards industrial activities, in particular, Pirelli Tyre commenced the production of high-performance tyres in Romania, inaugurated a new truck tyre production facility in Brazil and consolidated its presence in China, where in the next few months the current truck tyre factory will be joined by a new car tyre plant. But 2006 was also the year of the internationalization of Pirelli Real Estate, a protagonist in important deals in Poland and especially in Germany where it concluded the agreement for the acquisition of DGAG, one of the foremost real estate companies in the country with its main offices in Hamburg and Kiel.
On the financial front, the first part of the year was the focus of the project for the listing of Pirelli Tyre on the stock market. The objective of this operation was the further development of the company, which its launch on the market would have been an optimal way for its intrinsic value to emerge. However, the difficult market conditions and, above all, the sharp drop in the market prices of the major operators of the sector during the final stages of the process led us to choose to withdraw the offering last June 30. But the idea of listing Pirelli Tyre on the stock market was not abandoned. At the beginning of August, in fact, we signed an agreement with a syndicate of leading financial institutions for a private placement of 38.9 percent of the company, finalized with a view to a successive Initial Public Offering.
Again on the financial side, we began a plan to dispose of non-strategic investments with the aim of focusing still further on the core businesses of the Group. With regard to Olimpia, Pirelli increased its investment in 2006, raising it from 57.66 percent to 80 percent following the purchase of the stakes held by Hopa, Banca Intesa and UniCredit at the end of pre-existing shareholders' agreements. Nevertheless, the market performance of Telecom Italia shares, below the expectations of Pirelli's management, and the reduction in the target price by analysts led to a decline in the market value of that investment. As a consequence, at the board of directors' meeting, we decided to adjust the carrying amount.
The amount of the adjustment in the consolidated financial statements was equal to Euros 2,110 million and corresponds to the value assigned to Olimpia's asset (the Telecom Italia shares) of Euros 3 per share versus the previous value of about Euros 4 per

share. This transaction had an impact on the net result of Pirelli which, despite its good operating performance reported a loss of Euros 1,048.8 million on consolidation and will not allow the company to pay out dividends for the year 2006. The adjustment of the value of the Telecom Italia investment in Olimpia, however, had no repercussions on the soundness of the equity and financial position of our company which, at the end of 2006, reported consolidated equity of Euros 4,686.6 million and net financial debt of Euros 1,979.6 million, a figure in line with the forecasts announced to the market.

As for Olimpia, finally, the Pirelli board of directors' meeting last March 12 vested me with the power to explore all possible options, not excluding that of its total disposal, to achieve the best strategic valuation of the asset in the interests of all the stakeholders.

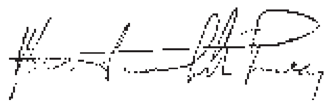
Moving on to the individual businesses, in tyres, Pirelli Tyre recorded an increase in sales of nearly 9 percent and a growth in operating income compared to 2005, despite higher raw material costs which hurt the tyre industry throughout the world. In an economic scenario that was not favorable, the company managed to grow more than the average of the market thanks to efficiencies and, above all, to the product mix, the outgrowth of its positioning in the high range of the segments.

The performance of the Consumer market (cars and motorcycle), in particular, was excellent: strong gains were recorded in both sales and operating income. Demand was particularly positive in Europe and in North America (even though the market in that area was negative), confirming Pirelli's leadership in the high-performance, ultra-high-performance and Winter segments. In the Industrial market, in spite of a general rise in demand which had a positive effect on sales, operating income is lower than in 2005 owing to the peak reached in the price of natural rubber, the main raw material cost item of the sector. As for Pirelli's international presence, the start of the new truck plant at Gravatai (Brazil) allowed the company to complete its investment program in the Industrial segment with additional production capacity and a better competitive position. In the second half of the year, moreover, the new car tyre production facility came on line at Slatina (Romania) and once fully operational will be able to manufacture each year 4.5 million high-performance tyres slated for the European market and employ about 1,000 people. The overall investment totals Euros 170 million and makes it possible to bring into being, together with the steelcord factory inaugurated in 2005, one of the most important industrial hubs of the company in the world.

In real estate, Pirelli Real Estate recorded double-digit growth in the main economic indicators, in particular, in operating income including the earnings of investment holdings (+15 percent) which reached the top range in the three year 2006-2008 business plan (CAGR 10-15 percent). During 2006, the company consolidated its leadership position in Italy and, with Pirelli Pekao Real Estate in Poland and DGAG in Germany, accelerated the expansion process in Central-East Europe. Asset management reached Euros 14.5 billion (14 percent of which is outside Italy), with a growth of 12 percent compared to 2005. In March 2007, moreover, Pirelli Real Estate was awarded the management of the first private fund seeded by state-owned properties managed by the Sicily Region. The acquisition of Ingest Facility from the Fiat Group followed in the same month; this company has become the leader in the facility management sector in Italy and is now branching out to create a European pole.

As for the start-ups, Pirelli Broadband Solutions reported a 15.3 percent gain in sales, linked in part to a significant contribution by second-generation photonics, and achieved breakeven at the

operating level for the time since it was set up. After having consolidated the top position on the market in Italy, the company has commenced the internationalization process, marketing its solutions in Europe for broadband access (specifically residential gateway accesses and dual-mode telephones) and higher-margin photonics products (components and optical modules for improving the performance and the flexibility of telecommunications networks).
Pirelli Ambiente, too, active in the sectors of the environment and sustainable development, reached an operating breakeven and confirmed the growth trend in sales (+12.2 percent). In 2006, moreover, the company signed the lease contract for land in the Romanian county of Gorj on which a production facility will be built for anti-particulate filters for diesel vehicles destined for the original equipment market in Europe.
The growth of the results of the start-ups is also the outcome of synergies with Pirelli Labs, the center of technological excellence of the Group. In 2006, Pirelli Labs continued its research activities on innovative materials and on optical technologies for telecommunications, sectors in which it has also sealed two new partnerships with the ENEA and the CNR Istituto sull'Inquinamento Atmosferico research centers. Besides collaborating with all the businesses of the Group, Pirelli Labs has also gone forward on the joint research projects with important national and international centers such as Politecnico di Milano University, Georgia Tech and the Alberta Research Council.
Pirelli's commitment on the front of innovation is also confirmed by the latest figures of the World Organization of Intellectual Property Organization (Wipo), according to which in 2006 our company is in the top three in Italy for international patent filings.
For 2007, the strategy of focusing on segments with higher value-added and the good performance of the core businesses allow us to forecast a further improvement in results. This path on the road to growth will thus continue thanks to the quality and the values which have always been the trademark of the Pirelli Group and its persons; orientation towards results, ability to innovate and compete on international markets, allegiance, correctness and transparency.
Loyalty to values, in fact, has always been the inspiration behind all of the Group's actions and this leads us to dedicate a section to the Sustainability Report. Now in its second edition, the report aims to be the full expression of the company culture founded on the integration of economic choices with environmental and social ones, representing an indication of priorities and, at the same time, an encouragement to work for the satisfaction of all the stakeholders.
It is to them that we wish to offer a description that is the most exact possible of the activities of the Group, also from this particular point of view. The promotion of a sustainable industrial growth is increasingly appreciated by the financial markets and the rating agencies and the whole of public opinion as an important element in the evaluation of corporations, as a premise for healthy and long-lasting growth.
On January 23, 2007, Leopoldo Pirelli, Honorary Chairmen of the company passed away. The memory full of respect and affection is not only mine and that of family and friends alike but of all those who have, as Pirellians, lived the entrepreneurial adventure of the company from the postwar period until today.



Directors' report on operations

To the Shareholders,

The Pirelli & C. S.p.A. Group closed the year 2006 with a further growth in its operating results compared to 2005.

The consolidated income statement shows a significant increase in revenues (+6.5 percent over the prior year) near the threshold of Euros 5 billion and a double-digit increase in operating profit (+13.1 percent) which exceeds Euros 400 million, thanks to the good performance of the core businesses in the tyres and real estate sectors in addition to an improvement in the broadband and environment businesses in the start-up stages.

The loss for the year of Euros 1,048.8 million was significantly impacted by the impairment adjustment made to the carrying amount of the investment held by Pirelli & C. S.p.A. in Olimpia S.p.A.. This adjustment, on consolidation, is equal to Euros 2,110 million and corresponds to a transparent valuation of Olimpia's assets (that is, the Telecom Italia S.p.A. shares held by Olimpia) at Euros 3 per share as compared to the previous valuation at approximately Euros 4 per share.

The reduction in the recoverable amount of the investment which occurred during the course of 2006 can be ascribed to the stock market performance of Telecom Italia S.p.A. shares – lower than both the European sector indexes and the expectations of Pirelli management – and the decline in the target prices by analysts.

Having established the effective existence of an impairment of the investment, in order to determine the amount of the impairment loss, the recoverable amount of the Telecom Italia S.p.A. shares was established by reference to the value in use, taking into account the observations formulated by Consob.

For purposes of estimating the value in use since there is neither a preference nor a consolidated practice relative to the two measurement techniques set forth in IAS 28.33, it was decided to use both estimation criteria in order to ensure a consistent result under a plurality of calculation methods and measurement techniques. This refers to:
a) the so-called asset side criterion which considers the operating flows of the investee and the consideration deriving from the final disposal of the investment;
b) the so-called equity side criterion which considers the flows from expected dividends and from the disposal of the investment.

In order to estimate the value in use, all the factors that market participants would consider were taken into account and, in particular:
a) flows from operating results and dividends, as well as the discount and capitalization rate used by the analysts (aligned with the consensus) who follow Telecom Italia S.p.A. stock;
b) multiples of comparable transactions for the estimate of the final amount under the asset side criterion;
c) premiums paid in transactions involving listed companies operating in the telecommunications sector both in Europe and in the United States (the country where the concentration process of the sector first began) to arrive at the estimate of the consideration deriving from the disposal of the stock under the equity side criterion.

The two criteria for the estimate of the value in use gave a recoverable amount of between Euros 3 and Euros 3.2. The company deemed it appropriate to adjust the carrying amount of the investment to an equivalent amount of Euros 3 per Telecom Italia S.p.A. ordinary share.

After this adjustment, the consolidated equity of Pirelli & C. S.p.A. at December 31, 2006 is equal to Euros 4,686.6 million, compared to a net financial debt position of Euros 1,979.6 million. The equity of the parent, Pirelli & C. S.p.A., after the impairment loss on the investment, is equal to Euros 2,882.3 million (inclusive of share capital amounting to Euros 2,790 million).
The adjustment of the investment in Olimpia S.p.A., therefore, has no repercussions on the equity and financial soundness of the company and the group.

Assets managed by Pirelli RE in 2006 total more than Euros 14 billion

In the **industrial businesses**, Pirelli Tyre closed 2006 with an increase in revenues of just under 9 percent and growing operating results despite the increase in raw material costs that penalized the tyre sector all over the world.

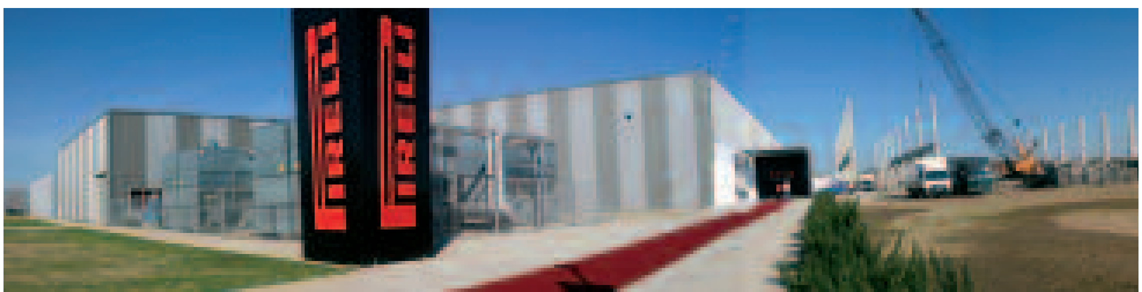
In the **real estate business**, Pirelli Real Estate recorded double-digit growth in operating profit including earnings from investments (+15 percent), reaching the top of the range indicated in the 2006-2008 three-year plan (CAGR 10-15 percent) and a significant increase in assets under management at market value, which amount to approximately Euros 14.5 billion.

As for the start-ups, **Pirelli Broadband Solutions** in 2006 reported an increase in net sales of over 15 percent, closing the year with at breakeven at the operating level.

Pirelli Ambiente also reached an operating breakeven and confirmed the trend of sales growth.

Furthermore, in 2006, the Pirelli Group continued to **expand its international presence** in all sectors of activity. Pirelli Tyre opened a new truck-tyre facility in Brazil and production of car tyres came on line at the new plant in Romania. Pirelli Real Estate began to expand its foreign business with important transactions in Poland and, more particularly, in Germany, where an agreement was signed to acquire DGAG, one of the most important German real estate companies. Pirelli Broadband Solutions commenced expansion of its international activities by marketing its products throughout Europe. Pirelli Ambiente took its first steps by building the first plant for manufacturing anti-particulate filters in Romania for the original equipment market.

As for **Olimpia S.p.A.**, during 2006, Pirelli raised its investment from 57.7 percent to 80 percent following the purchase of the stakes of Hopa S.p.A., Banca Intesa S.p.A. and UniCredito Italiano S.p.A.. It should be recalled that on November 7, 2006, the board of directors of Pirelli & C. S.p.A. decided to adjust the carrying amount of the investment held in Olimpia S.p.A., as previously mentioned.



In October 2006, Pirelli Tyre inaugurated a car tyre factory in Romania

The Group

2006 operating and financial

Consolidated net sales of the group in 2006 amount to Euros 4,841.2 million. This is an increase of 6.5 percent compared to Euros 4,545.7 million in 2005, with gains recorded in all business activities. Excluding the exchange effect, net sales grew by 5.1 percent.

Consolidated gross operating profit is Euros 614.1 million (12.7 percent of net sales) up 8.2 percent compared to Euros 567.6 million (12.5 percent of net sales) in 2005. Excluding nonrecurring expenses incurred for the project to list Pirelli Tyre S.p.A. (Euros 13.2 million), consolidated gross operating profit is Euros 627.3 million (13 percent of net sales) with an increase of 10.5 percent compared to 2005.

Consolidated operating profit amounts to Euros 401.4 million, an increase of 13.1 percent compared to Euros 354.9 million in 2005 with growth across all business segments. The profit margin (ROS - Return on Sales) at the consolidated level is equal to 8.3 percent, a further increase over 7.8 percent in 2005. Excluding nonrecurring expenses incurred for the project to list Pirelli Tyre S.p.A. (Euros 13.2 million), consolidated operating profit is Euros 414.6 million (+16.8 percent over 2005) with a ROS of 8.6 percent (7.8 percent in 2005).

Earnings (losses) from investments show a loss of Euros 1,149.3 million, compared to earnings of Euros 267.1 million in 2005. The caption includes the impairment loss on the investment in Olimpia S.p.A. (Euros 2,110 million) and is countered by the gain realized on the private placement of the 38.9 percent stake in Pirelli Tyre S.p.A. (Euros 416.4 million) and the sale of the investment in Capitalia S.p.A. (Euros 215.2 million). It also comprises the result of the companies accounted for using the equity method and dividends from other unconsolidated holdings.
Olimpia S.p.A., in particular, contributed earnings of Euros 170.0 million compared to Euros 152.5 million in 2005. It should be recalled that the financial statements of Olimpia S.p.A., included in the consolidated financial statements of the group, have been drawn up in accordance with IFRS and comprise the valuation of the investment in Telecom Italia S.p.A. by the equity method. The caption also includes the results of the companies in the real estate sector accounted for by the equity method, which show earnings of Euros 110.7 million (Euros 102.3 million in 2005).

The **consolidated net result** in 2006, which was influenced by the aforementioned impairment loss on the investment in Olimpia S.p.A. for an amount of Euros 2,110 million, is a loss of Euros 1,048.8 million, compared to income of Euros 398.9 million in 2005. Excluding nonrecurring items (the impairment loss on the investment in Olimpia S.p.A., the gains on the sales of the 38.9 percent stake in Pirelli Tyre S.p.A. and the investment in Capitalia S.p.A. and the costs of the Pirelli Tyre S.p.A. IPO project), and on a comparable consolidation basis (net of the loss from discontinued operations), the net result would be income of Euros 472.8 million, with an increase compared to Euros 349.1 million in 2005.

As regards **discontinued operations** (the Cables and Systems activities), which in 2005 recorded income of Euros 49.8 million, a loss of Euros 30 million was reported in 2006 due to the adjustment of accruals as a result of reaching an agreement on the price adjustment provided by the contract and the guarantees given.

The **loss attributable to the equity holders of Pirelli & C. S.p.A.** in 2006 is Euros 1,167.4 million (-Euros 0.217 per share) compared to income of Euros 327.4 million in 2005 (Euros 0.066 per share). Excluding nonrecurring items (impairment of Olimpia, gain on the sale of the stake in Pirelli Tyre, gain on the sale of the investment in Capitalia and IPO project costs) and considering a comparable consolidation basis (net of the loss from discontinued operations), the income attributable to the equity holders of Pirelli & C. S.p.A. is Euros 354.2 million, an increase compared to Euros 277.6 million in 2005.

Consolidated net sales by the Pirelli Group grew by 6.5% over 2005

The **loss of the parent, Pirelli & C. S.p.A.**, is Euros 1,642.3 million in 2006 (income of Euros 139.8 million in 2005). In view of this result, the Company will not pay dividends for the year 2006. The loss will be absorbed from existing reserves.

Total consolidated equity at December 31, 2006 is Euros 4,686.6 million compared to Euros 5,613.8 million at December 31, 2005. The change from the end of 2005 is mainly due to the impairment loss on the investment in Olimpia S.p.A..

Equity attributable to the equity holders of Pirelli & C. S.p.A. at December 31, 2006 is Euros 3,879.6 million (Euros 0.723 per share) compared to Euros 5,204.9 million at December 31, 2005 (Euros 0.979 per share).

The **equity of the parent, Pirelli & C. S.p.A.**, is equal to Euros 2,882.3 million which includes Euros 2,790.0 million of share capital.

The **net financial position** of the group at December 31, 2006 is a net financial debt position of Euros 1,979.6 million, reflecting the forecast announced to the market. The change from the net financial debt position of Euros 1,430.8 million at September 30, 2006 is primarily due to the difference between the outlay for the purchase of the 9.54 percent stake in Olimpia S.p.A. from Banca Intesa S.p.A and UniCredito Italiano S.p.A. (Euros 1,040 million), the proceeds on the sale of the 1.92 percent stake in Capitalia S.p.A. (Euros 333.0 million) and the cash generated by operating activities during the period. The net financial debt position was Euros 1,177.4 million at December 31, 2005. The change on an annual basis is primarily due to the factors mentioned previously and the disbursements made during the first nine months of the year (purchase of Olimpia S.p.A. from Hopa S.p.A. for Euros 497.7 million, purchase of Telecom Italia S.p.A. shares for Euros 201.0 million and dividends paid for Euros 162.7 million) against the net proceeds collected on the sale of the 38.9 percent stake in Pirelli Tyre S.p.A. (Euros 715.8 million).

Major events in 2006

The major events which occurred in 2006 are described below:

Corporate

- On February 6, 2006, Olimpia S.p.A. and the shareholders Pirelli & C. S.p.A., Edizione Finance International S.A., Edizione Holding S.p.A., Banca Intesa S.p.A. and UniCredito Italiano S.p.A. sent Hopa S.p.A. the statement withdrawing from the agreement signed among the parties in 2003. Therefore, at the expiration date (May 8, 2006), this agreement was not renewed. Subsequently, on July 4, 2006, Pirelli & C. S.p.A., Edizione Finance International S.A. and Edizione Holding S.p.A. together with Hopa S.p.A. communicated that they had reached full agreement over all the aspects relating to the cash settlement of the investments held in Olimpia S.p.A. and in Holinvest S.p.A. following the dissolution of the shareholders' agreements that were already in existence among the above companies.

This agreement provided for:
- the purchase on the part of Pirelli & C. S.p.A., Edizione Finance International S.A. and Edizione Holding S.p.A. of all the shares held by Hopa S.p.A. in Olimpia S.p.A. (equal to 16 percent of capital) for a cash settlement of Euros 622 million (of which Euros 208 million relates to the premium to which Hopa had the right on the basis of previous agreements);
- the purchase on the part of Hopa S.p.A. of all the shares held by Olimpia S.p.A. in Holinvest S.p.A. (equal to 19.999 percent of capital) for a cash settlement of Euros 86 million.

Holinvest S.p.A., at that date, was the owner of 492,697,862 Telecom Italia S.p.A. shares, equal to about 3.68 percent of ordinary share capital.
On the basis of the terms of the agreement, 320,253,610 Telecom Italia S.p.A. shares held by Holinvest S.p.A. (equal to 65 percent of the total shares in its possession) are covered by a pre-emptive two-year agreement in favor of Olimpia S.p.A. which also establishes that Holinvest S.p.A. may not effect new purchases of Telecom Italia S.p.A. shares without the prior agreement of Olimpia S.p.A. during the same period. The purchases of the investments and the signing of the pre-emptive agreement were finalized on July 12, 2006.
Specifically, Pirelli & C. S.p.A. purchased 12.8 percent of Olimpia S.p.A. for an outlay of Euros 331 million. At the same time, it paid its share of the premium due to Hopa S.p.A. of Euros 166 million, which had already been set aside in the 2005 financial statements.

- On February 14, 2006, the Pirelli & C. S.p.A. board of directors voted to undertake a course of action that would lead to the best way of appreciating the value of the tyres division ("Pirelli Tyres"), including its listing on the Electronic Trading Market of Borsa Italiana, with the understanding that Pirelli & C. S.p.A. would still hold the majority of the shares of Pirelli Tyres.
In addition to the project to appreciate the value of Pirelli Tyre, the board of directors also approved a plan for the further concentration of resources in the strategic businesses of the group through the disposal of financial investments for an equivalent amount of approximately Euros 400 million at current values, equal to about a half of that portfolio.

- On April 10, 2006, Pirelli Pneumatici S.p.A. (which later took the name of Pirelli Tyre S.p.A.), the company which heads all the tyre design, development, manufacturing and marketing activities of the Pirelli & C. S.p.A. Group, filed a request to list its ordinary shares with Borsa Italiana, with the shares to be put up for a public offering of sale by the 100-percent parent, Pirelli Tyre Holding N.V., a company which, in turn, is a wholly-owned subsidiary of Pirelli & C. S.p.A..
Subsequently, on June 30, 2006, the board of directors of Pirelli & C. S.p.A., – after the same resolution was passed by Pirelli Tyre Holding N.V. – decided not to go through with the IPO at the end of the offering period of the Pirelli Tyre S.p.A. shares. Pirelli & C. S.p.A. deemed that the financial market conditions and, in particular, the stock market performance of the principal world tyre operators, would not make it possible to accurately and adequately value Pirelli Tyre S.p.A. so that it would reflect the intrinsic value of the company which is recognized as one of the most important tyre companies in the world in terms of profitability, positioning and capacity for innovation.

- During the first half of 2006, Pirelli Finance (Luxembourg) S.A., a wholly-owned subsidiary of Pirelli & C. S.p.A., exercised two call options on Telecom Italia S.p.A. shares for a total of 75,000,000 ordinary shares (equal to 0.56 percent of ordinary share capital) at the average price of Euros 2.35 per share for a total investment of Euros 176 million.
Furthermore, during the same period, 10,400,000 Telecom Italia S.p.A. ordinary shares were purchased on the market (equal to 0.08 percent of ordinary share capital) at an average price per share of Euros 2.40 for a total investment of Euros 25 million.

A forward share transaction signed on April 20, 2006 was put into place with Banca Caboto on the shares held by Pirelli Finance (Luxembourg) S.A. (134,957,885). The shares were sold at the spot price per share of Euros 2.42 for a total of Euros 326.3 million and were subsequently repurchased on August 14, 2006 at a per share price of Euros 2.31 for a total of Euros 312 million.
At December 31, 2006 Pirelli & C. S.p.A. holds, directly and indirectly, through Pirelli Finance (Luxembourg) S.A., 182,113,185 Telecom Italia S.p.A. ordinary shares (equal to 1.36 percent of ordinary share capital).

- On March 27 and 28, 2006, Banca Intesa S.p.A. and UniCredito Italiano S.p.A. communicated their intention to withdraw from the shareholders' agreement, regarding the investment in Olimpia S.p.A. concluded in September 2001 with Pirelli & C. S.p.A., and consequently to exercise the right to sell their investments (equal to about 4.77 percent for each bank) to Pirelli & C. S.p.A..
The execution of the purchase of the investment took place at the expiration of the pact on October 4, 2006. Pirelli & C. S.p.A. purchased the investments in Olimpia S.p.A. held by Banca Intesa S.p.A. (4.77 percent) and UniCredito Italiano S.p.A. (4.77 percent) against payment of approximately Euros 585 million to each bank. The transaction was funded by cash and by the utilization of available credit lines. The impact of the purchase on the net debt of Pirelli & C. S.p.A. was about Euros 1,040 million, since part of the payment (approximately Euros 130 million) had already been considered, in accordance with IFRS, in the debt of the company as at December 31, 2005.

- On April 27, 2006, Pirelli Labs S.p.A., the Pirelli Group's center of technological excellence, and ENEA, Ente per le Nuove Tecnologie, l'Energia e l'Ambiente, launched three hi-tech research projects in the field of renewable energy sources and sustainable development within the sphere of a special five-year framework agreement. The first research projects launched involve concentrated photovoltaic cell technology, a new generation of sensors for monitoring the environment and, finally, groundwork studies in the field of cold fusion. The agreement between ENEA and Pirelli Labs also calls for the definition of other research projects in sectors of mutual interest. The beginning of this partnership is further proof of Pirelli's commitment to the field of technologies for sustainable development.

One of Pirelli Labs most recent accomplishments, the development of new-generation environmental sensors

- On June 16, 2006, Pirelli & C. S.p.A. sold a 15.26 percent stake in F.C. Internazionale Milano S.p.A. to the current majority stockholder of that company for Euros 13.5 million. This transaction falls under the program approved by the meeting held by board of directors of Pirelli & C. S.p.A. on February 14, 2006 to further concentrate on its core business partly by disposing of non-strategic financial investments.
Pirelli & C. S.p.A., however, remains a shareholder of F.C. Internazionale Milano S.p.A. with a 4.2 percent stake. It is the company's intention to continue its current sponsorship relationship with F.C. Internazionale Milano S.p.A. and evaluate any new future possibilities of collaboration, especially in light of the considerable benefits this partnership has brought to the Pirelli brand over the years.

- On July 27, 2006, the board of directors of Pirelli & C. S.p.A. examined a transaction with some leading Italian and international financial institutions (Banca Intesa, Banca Leonardo Group, Capitalia, One Equity Partners – JP Morgan, Lehman Brothers and Mediobanca) for the sale of a minority interest in the capital of Pirelli Tyre S.p.A., for the purpose of a later IPO. Subsequently, on July 29, 2006, the relevant agreements were reached for the sale of 38.9 percent of the capital of Pirelli Tyre S.p.A. for consideration equal to Euros 740 million, with an equity value for the entire company of about Euros 1.9 billion, with realization of a gain on the transaction of approximately Euros 416 million. The purchase of the minority interest in Pirelli Tyre S.p.A., finalized on August 2, 2006, was carried out by Speed S.p.A., an Italian company in which about a 19 percent stake each is held by Banca Intesa, Capitalia, One Equity Partners – JP Morgan Group, Lehman Brothers and Mediobanca and about a 4 percent stake by the Banca Leonardo Group. The agreements provide that the purchasing company may start and conduct, within a period of four years and six months from the closing date, an Initial Public Offering of the shares acquired.


On August 2, 2006, a 38.9% stake in Pirelli Tyre S.p.A. was acquired by Speed S.p.A.

Pirelli has the right to repurchase the shares that were sold in the event in which, after four years and six months, the shares have not been placed in an IPO.
The relationships between the seller and the buyer are regulated by shareholder agreements which provide, among other things, that the acquiring company may designate five out of the thirteen directors on the board of directors of Pirelli Tyre S.p.A. and appoint a member of the board of statutory auditors.
After a lock-up period of six months, and after receiving Pirelli's approval, the acquiring company or its shareholders will have the right to sell up to 49 percent of the shares originally purchased to qualified parties (leading financial institutions or mutual funds).
A commission of 3 percent of the equivalent amount of the transaction was paid to the financial institutions and an additional 1 percent will be paid on an annual basis until the IPO.

- On September 28, 2006, in implementing the plan for the disposal of financial investments communicated to the market on February 14, 2006, Pirelli & C. S.p.A. announced that it had informed the participants of the Capitalia Shareholders' Agreement of its intention to sell its investment in the company (about 1.92 percent of share capital), entirely contributed to the Agreement.
  The offer was finalized on October 26, 2006 with the sale of 49,689,476 shares for a total of approximately Euros 333 million, realizing a gain, on consolidation, of about Euros 214 million. The shares offered with the right of first refusal to the parties in the Capitalia Shareholders' Agreement for consideration of approximately Euros 6.6993 euro per share, were purchased by: ABN Amro Group (24,606,761 shares), Fondazione Mondadori (6,612,508 shares), Fondiaria SAI Group (10,041,915 shares), Cinecittà Centro Commerciale S.p.A. (4,535,779 shares), Fininvest S.p.A. (3,204,468 shares) and Fineldo S.p.A. (688,045 shares).

- On October 18, 2006, Olimpia, Pirelli, Edizione Holding, Edizione Finance International, Mediobanca and Generali signed a shareholders' agreement in which Olimpia, Mediobanca and Generali contributed a total of 23.2 percent of Telecom Italia S.p.A. ordinary capital. With the signing of this agreement, the intention of the Parties is to ensure the continuity and stability of the shareholder base and the governance of the Telecom Italia group with the aim of sustaining its industrial development in a context of economic and financial equilibrium for the creation of value for all the shareholders.
  The three-year agreement is managed by a body, the Board, in which all the Parties are members and the Chairman is designated by Olimpia S.p.A. The agreement establishes, in particular:
  1. the obligation of the Parties to consult with each other before each Telecom Italia S.p.A. shareholders' meeting on how to exercise their voting rights, with the understanding that each Party may freely exercise the right to vote in Telecom Italia shareholders' meeting where the Board of the pact does not unanimously agree;
  2. the possibility of admitting to the agreement new Parties having at least a 0.5 percent stake;

3. lock-up on the Telecom Italia S.p.A. shares in the agreement, except for limited operational thresholds;
4. the possibility that Olimpia sells its entire holding, subject to the right of first refusal of Mediobanca and Generali; such right of first refusal shall not apply in the case of an offer to buy the shares held by Olimpia, Mediobanca and Generali. The same mechanism is applicable in the event of a sale by Pirelli, alone or together with Edizione, to third parties, of an interest in Olimpia S.p.A. exceeding 50 percent; sales by Pirelli, alone or together with Edizione, up to that ceiling are not restricted;
5. the possibility that Mediobanca and Generali purchase additional shares up to a maximum of 25 percent of the Telecom Italia shares contributed in the pact by each of them;
6. the possibility that Olimpia increases its share capital by way of a contribution in kind of Telecom Italia S.p.A. shares by new shareholders.

- On December 5, 2006, Pirelli Labs, the center for advanced research of the Pirelli Group, and the Istituto sull'Inquinamento Atmosferico (Institute of Atmospheric Pollution) of the CNR (National Research Center) (CNR-IIA), presented a project for monitoring the quality of air and the levels of electromagnetic and acoustic pollution in real time which will take place in the city of Parma until May 2007. Such activity will be conducted by means of innovative experimental technologies and will cover the city environs and the decentralized area near the A1 toll road junction.

Pirelli Labs teams up with CNR-IIA on innovative atmospheric monitoring projects

- On December 21, 2006, Pirelli & C. S.p.A. announced that the period of the revolving committed credit line of Euros 1 billion, arranged in 2003 with a pool of international banks and renegotiated in 2005, was further extended from 2010 to 2011. The mandated lead arrangers of the loan are Barclays Capital, BNP Paribas, HSBC Bank plc, J.P. Morgan plc and The Royal Bank of Scotland plc. The extension of the period of the credit line, at the same costs, allows Pirelli & C. S.p.A. to improve its financial structure.

Tyres Sector

- On March 22, 2006, Pirelli Pneus S.A. opened a new plant for manufacturing radial tyres for trucks and buses at Gravataì, in the Brazilian state of Rio Grande do Sul. The production unit is located in an area which already constitutes the group's main center for the development and production of conventional Motorcycle tyres. With a surface area of 573,000 m2, the new plant adds about 500

In March 2006, a new radial truck tyre factory was inaugurated at Gravataì (Brazil)

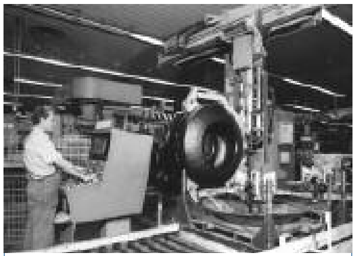
employees (direct and allied) to the current approximate 1,500 work force, and, when fully operational, will have a production capacity of 12,000 tons a year in addition to the current 64,000-ton production capacity.
80 percent of the Gravataì production is destined for the domestic market and 20 percent for export, mainly to countries in Latin America. The new plant calls for an overall investment of approximately Brazilian reais 116 million (more than US$ 50 million) and, when fully operational, will contribute 8 percent to the sales of Pirelli Tyre in Brazil.
The opening of the new Gravataì plant has given another boost to Pirelli's presence in the radial Truck tyre segment after the launch, in the second half of 2005, of production activities in China. These factories complete Pirelli Tyre's investment program in the Industrial market, which can now count on new and more competitive production capacity to meet the growth in demand over the three-years 2006-2008.
The investment in Gravataì is part of Pirelli Tyre's growth strategy on a global scale, which involves expanding into emerging markets in the Industrial market and focusing on the Car and Motorcycle Premium segments. The new plant joins other Pirelli plants in the radial Truck segment which are already operating in Italy, Turkey, Egypt, China and the Brazilian plant of Santo André.

- On May 8, 2006, Pirelli and Schrader Electronics signed an agreement with the aim of developing and marketing an innovative system, located, for the first time, directly inside the tyre and capable of detecting all kinds of identifying data in addition to temperature and pressure. The heart of the system consists of a miniature sensor which can function without batteries thanks to its capacity to generate its own energy.
Thanks to the new sensor, the tyre is able to interact with the vehicle, optimizing the on-board electronic systems, whose parameters adapt according to the information received from the device, leading to improved safety and performance.
The system, which was specially developed for original equipment, is particularly suitable for Run Flat tyres, since it allows for optimum management of the parameters when traveling with a flat tyre caused by a puncture.

- On May 11, 2006, Francesco Gori, managing director of Pirelli Tyre, was elected president of the European Tyre and Rubber Manufacturers Association – ETRMA. The new non-profit organization replaces the previous representative body of rubber industries founded in 1959 and has the aim of representing the tyre and rubber product industry within European Union institutions and other international organizations.

- On October 26, 2006, Pirelli Tyre officially started up tyre production in Romania in the new factory at Slatina. With an investment of about Euros 170 million, the new production facility will manufacture top-of-the-range tyres for cars and SUVs and is located near the steelcord factory inaugurated last year.
The industrial complex, steelcord included, extends over an area of 500 thousand m2 and, at the end of the year will employee about 770 employees, 450 of whom will work in tyres. The year 2006 will close with a production of 300 thousand tyres which will rise to 2 million in 2007.
When fully operational, the new factory will be able to manufacture 4.5 million high-performance tyres a year, with about a 1,000-person work force. The group is thus building up its presence in Eastern Europe with an annual growth target set at more than 10 percent per year. Pirelli intends to take advantage of the Slatina area by adding a platform of logistics, computer and commercial services to the industrial activities to support its

When fully operational, the Romanian production facility at Slatina will be able to produce 4.5 million tyres a year expansion in those countries. Moreover, Pirelli also has plans for a series of initiatives to promote the training and the wellbeing of its employees and their families and the local area in general.



An agreement with the city of Settimo Torinese will lead to the relaunching of the two historic Pirelli plant facilities for car and truck tyres

- On November 24, 2006, the city of Settimo Torinese and Pirelli Tyre signed a protocol agreement for the industrial relaunching of the area where the Pirelli Group company has two separate production facilities making tyres for cars and industrial vehicles. Under the agreement, the production activities currently located in the car-tyre facility will be transferred to the facility which makes tyres for industrial vehicles.
  The unification of production activities will make it possible to expand and modernize the plants. By creating a single industrial complex of a size and with technology which are better suited to Pirelli Tyre's requirements, the company will be able to become even more firmly established in this important area of Piedmont. The aim of unifying the two production facilities is to develop a modern industrial hub which will use cutting-edge innovative technologies.

Pirelli Broadband Solutions

- On September 27, 2006, Pirelli Broadband Solutions reached an agreement with Arasor International Limited, a Chinese company specializing in integrated solutions in the field of optics and wireless communications, to develop new optical components for telecommunications networks. Under the agreement, a new line of ITLA (Integrable Tunable Laser Assembly) opto-electronic components will be jointly developed and subsequently marketed. The components, which will be based on Pirelli's tunable laser, an innovative optical device using nanotechnology, through software, can rapidly change the wavelength of signals, achieving the same amount of work as more than 100 fixed conventional lasers, while guaranteeing very high spectral purity and frequency stability. These components will be used with the aim of augmenting flexibility and reducing the running costs of metropolitan telecommunications networks.
  The devices will be produced in the Arasor facility at Guangzhou, whereas the tunable lasers on which the system is based will be produced by Pirelli in Italy. To begin with, the new components will be destined for the Chinese market, in particular to the Huawei Technologies group, one of the world's key players in the field of optical solutions for telecommunications operators.

- On October 11, 2006, Pirelli Broadband Solutions and Arcor (Vodafone Group), the second largest land-line operator on the German market, reached an agreement for the supply of Pirelli's new dual-mode telephones. These phones will be used by the German operator as part of the launch of a new offer for telephone services via Internet (Voice Over IP).
  The Pirelli dual-mode telephone is an innovative phone which supports the integration of land-line and mobile telephone services, combining the technology of cell phones with the advantages of telephony via Internet.
  Based on SIP protocol (Session Initiation Protocol), the new Pirelli telephone can act alternatively as a land-line telephone in Wi-Fi mode and as a cell phone. With the dual-mode telephone, the user can make calls from a cell phone using a normal SIM card or call via Internet with a DSL connection. The solution makes it possible to use mobile telephone services such as SMS, MMS, e-mail and Internet also through a broadband connection on a land-line network, with important benefits in economic terms and from the standpoint of bandwidth capacity.

Pirelli Broadband Solutions' dual mode telephone is an apparatus integrating fixed and mobile telephones using internet standards

Pirelli Ambiente

- On August 25, 2006, Pirelli & C. Ambiente Eco Technology S.p.A., a company in the group working in the sector of sustainable development technologies, received a Special Award for its innovative solutions promoted in the area of sustainable transportation, specifically for the emulsion diesel fuel Gecam™, at the 2006 edition of the World Renewable Energy Congress (WREC). This international congress was held in Florence and sponsored by the Florence Università degli Studi and the Architettura Bioecologia e Innovazione Tecnologica per l'Ambiente Center (ABITA).

- On November 29, 2006, Pirelli Ambiente, a company in the Pirelli & C. Group also active in the sector of sustainable development technologies, signed in Romania, in the presence of local authorities, the lease contract for the land on which a production facility will be built for the manufacturing of anti-particulate filters for vehicles, destined for the original equipment market.
  The plant, spread over 10 hectares in the Gorj County Industrial Park in the southwest of Romania, will start manufacturing in the second half of 2008 on two production lines. The new factory, on which work will commence in January 2007 and operations will start in the second half of 2008, will produce more than 1,300 tons of silicon carbide filters per year.

Special award received in 2006 from the World Renewable Energy Congress for the emulsion diesel fuel "Gecam™", produced by Pirelli Ambiente

Real estate activities

- On January 12, 2006, after winning the bid concluded on October 14, 2005 for the purchase of a residential property portfolio in Berlin at the price of Euros 72.5 million, ownership was formally transferred to Tizian Wohnen 1 and Tizian Wohnen 2, in which investments are held by the subsidiary P&K Real Estate. The properties purchased were part of the Corpus Immobiliengruppe property portfolio.

- On February 16, 2006, Pirelli Real Estate and the Corporate Credit group of Morgan Stanley finalized the acquisition of the former BNL non-performing loan portfolio that was awarded at the end of last year for approximately Euros 345 million. At the same time, a portion of the portfolio was sold to Deutsche Bank for approximately Euros 102 million. The transaction was concluded through the purchase of 35 percent of the securities from the securitization of the above portfolio by Esphela – Serviços de Consultadoria (in which Pirelli Real Estate has a 49 percent stake).

- On February 20, 2006, Pirelli Real Estate and Merrill Lynch signed a binding agreement to set up a joint venture (with a 35 percent stake by Pirelli Real Estate and a 65 percent stake by Merrill Lynch) for the investment of Euros 1.5 billion in the hotel tourism sector in Italy over the next five years.
  On June 22, 2006, Pirelli & C. Real Estate Opportunities SGR S.p.A. received approval to start the activities of Fondo Hospitality&Leisure, specialized in the tourism-hotel sector. The shares of this fund have been subscribed to by the Pirelli Real Estate-Merrill Lynch joint venture. The first investment was concluded with four tourist resorts seeded by Valtur located in Pila, Nicotera, Marileva and Ostuni worth approximately Euros 103 million. Over the next two years, the structures are scheduled to be appreciated through an investment of approximately Euros 12 million.

- On March 29, 2006, the second investment of the Raissa Fondo Uffici was finalized when 201 properties worth approximately Euros 158.1 million were contributed by Olivetti Multiservices (Telecom Italia Group). The contribution of the properties is in addition to the properties conferred on December 28, 2005 worth about Euros 486 million.

- On May 31, 2006, Resident Berlin 1 P&K GmbH undertook a commitment for the purchase of 16 buildings located in Berlin mainly for residential use at a price of Euros 61.1 million.

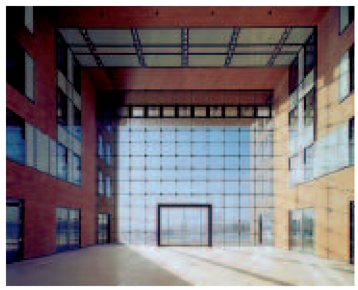
- On June 28, 2006, Pirelli Real Estate, together with Conwert Immobilien and Eco Business-Immobilien, won the bid for the purchase from Allianz of a property portfolio in Austria worth approximately Euros 207 million (net of closing costs and a building on which there is a right of first refusal). This property portfolio is principally located in the cities of Vienna, Innsbruck and Salzburg and is composed (again net of the building on which there is a right of first refusal) of 30 mainly residential buildings and 47 buildings for office and commercial use. Pirelli Real Estate later monetized the investment in the second half of the year by selling its shares.

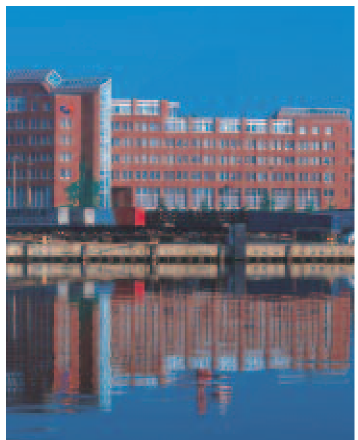
- On September 1, 2006, the Polish Investment Real Estate Holding B.V. joint venture was set up between Pirelli Real Estate (40 percent) and Cypress Grove International (60 percent) for investing in the residential sector in Poland. The aim of the joint venture is to develop residential projects over the next three years for approximately Euros 1.5 billion. The first transaction of the joint venture was the purchase from Pirelli Pekao Real Estate Sp.zo.o, on September 26, 2006, of Nowe Ogrody Sp.zo.o, a company owning land and building complexes located in Warsaw. Thus the first stage of the investment project commenced which consists of realizing approximately 3,300 apartments worth approximately Euros 420 million once the work is completed.

- On October 9, 2006, Pirelli Real Estate signed a binding agreement for the purchase of about 97 percent of Deutsche Grundvermögen (DGAG), one of the most important real estate companies in Germany with offices in Hamburg and Kiel. On December 19, 2006, the pertinent antitrust authority approved the purchase which was finalized on January 10, 2007. Greater details are provided under subsequent events.

- On October 13, 2006, the placement of Spazio Investment N.V. was successfully concluded on the Alternative Investment Market of the London Stock Exchange (AIM). Spazio Investment N.V. is registered under Dutch law and at the placement date was 65 percent-owned by Cypress Grove International and 35 percent-owned by Pirelli Real Estate. The total offer of Euros 300 million, composed of a capital increase (85 percent) for approximately Euros 256 million and the sale of existing shares by Cypress Grove International (15 percent) for approximately

In 2006 the Polish Investment RE Holding activities began in Poland. A joint venture between Pirelli RE and Cypress Grove Int.





The Hamburg and Kiel offices of the German real estate company DGAG, purchased by Pirelli RE in the early months of 2007

Euros 44 million, was subscribed to with a 10 percent NAV discount. Demand was considerably higher than the offer, 95 percent of which was subscribed to by leading international institutional investors, mainly American and British. The placement price was fixed at Euros 12.5 per share. At December 31, 2006 (the placement was closed on December 29, 2006), the shares of the company were listed at Euros 14.95 per share (+20 percent). After the offering was closed, Spazio Investment NV was 12 percent-owned by Pirelli Real Estate and approximately 88 percent-owned by leading international investors, ten of which had stakes of more than 3 percent (the ceiling for purposes of disclosure obligations for AIM). Among the major investors are Bank Julius Baer & Co., TIAA-CREF, Fidelity International, Lansdowne Partners, KDA Capital, New Star, Viking and Theorema, in addition to Cypress Grove.

- On November 2, 2006, after approval was received from the antitrust authority and the trustees of the securitizations, a joint venture was formed between Pirelli Real Estate (33 percent) and Calyon (67 percent). The newly established joint venture became operational in December 2006, purchasing 100 percent of five non-performing mortgage portfolios (with a residual gross book amount at December 2005 of Euros 2.6 billion) held since 2004 by the Pirelli Real Estate and MSREF joint adventure. In December, the loan portfolio purchased from Banco Popolare di Verona e Novara on June 7, 2006 was also added to the non-performing loans of the joint venture.

- On December 29, 2006, Pirelli Real Estate and General Electric, through GE Real Estate and GE Commercial Finance Services Italia won the bid for the purchase of the non-performing loans of Banca Antonveneta and the subsidiary Interbanca (ABN AMRO Group) for a price of approximately Euros 299 million. The gross book amount of the portfolio is approximately Euros 1 billion. The purchase transaction, which was concluded by the company Vesta Finance in which Pirelli Real Estate has a 35 percent investment, refers to a portfolio of loans receivable guaranteed by properties for residential, hotel and industrial use.

Group consolidation

In this report on operations, in addition to the financial performance measures established by IFRS, certain non-IFRS measures originated from the latter are presented although they are not required by IFRS ("Non-GAAP Measures").

These performance measures are presented for purposes of a better understanding of the trend of operations of the group and should not be construed as a substitute for the information required by IFRS.

Specifically, the "Non-GAAP Measures" used are described as follows:

- **Gross operating profit**: this financial measure is used by the group as the financial target in internal 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 for each single segment, in addition to the Operating Profit. The Gross Operating Profit is an intermediate performance measure represented by the Operating Profit from which depreciation and amortization are subtracted.
- **Earnings (losses) from investments**: earnings (losses) from investments consist of all the effects recorded in the income statement referring to investments that are not consolidated line-by-line. These include dividends, the share of the earnings (losses) of companies accounted for using the equity method, impairment losses of available-for-sale financial assets and gains (losses) on the disposal of available-for-sale financial assets.
  Movements in the fair value of assets available-for-sale that are recognized directly in equity are excluded.
- **Net financial (liquidity)/debt position**: this performance measure is represented by the gross financial debt less cash and cash equivalents as well as other interest-earning financial receivables. The notes present a table that shows the balance sheet amounts used to calculate the net financial (liquidity)/debt position.

The highlights of the consolidated financial statements for the year ending December 31, 2006 can be summarized as follows:

(in millions of euros)

	12/31/2006	12/31/2005
Net sales	4,841.2	4,545.7
Gross operating profit	614.1	567.6
% of net sales	12.7%	12.5%
Operating profit	401.4	354.9
% of net sales	8.3%	7.8%
Earnings (losses) from investments	(1,149.3)	267.1
Operating profit (loss) incl. earnings (losses) from investments	(747.9)	622.0
Financial income (expenses)	(143.1)	(144.4)
Income taxes	(127.8)	(128.5)
Income (loss) from continuing operations	**(1,018.8)**	**349.1**
% of net sales	n.s.	7.7%
Income (loss) from discontinued operations	**(30.0)**	**49.8**
Total income (loss)	**(1,048.8)**	**398.9**
Income (loss) attributable to the equity holders of Pirelli & C. S.p.A.	(1,167.4)	327.4
Earnings per share (in euros)	(0.217)	0.066
Total equity	4,686.6	5,613.8
Equity attributable to the equity holders of Pirelli & C. S.p.A.	3,879.6	5,204.9
Equity per share (in euros)	0.723	0.979
Net financial (liquidity)/debt position	1,979.6	1,177.4
Capital expenditures	255	234
R&D expenditures	171	174
Employees (number at year-end)	28,617	26,827
Factories	24	24
Pirelli & C. shares outstanding		
• ordinary shares (number in millions)	5,233.1	5,180.7
• savings shares (number in millions)	134.8	134.8
• Total shares outstanding	5,367.9	5,315.5

For a more meaningful understanding of the performance of the group in its various segments of business, the following economic data and the net financial position are provided divided by business segment.

(in millions of euros)			2006			
	Tyre	Broadband	Environment	Real Estate	Other	**Total**
Net sales	3,949.5	129.4	69.0	702.0	(8.7)	**4,841.2**
Gross operating profit (loss)	533.7	1.1	0.5	113.1	(34.3)	**614.1**
Operating profit (loss)	342.3	(0.3)	(0.2)	103.7	(44.1)	**401.4**
Earnings (losses) from investments	(2.4)	(1.0)	-	110.7	(1,256.6) (1)	**(1,149.3)**
Operating profit (loss) incl. earnings (losses) from inv.	339.9	(1.3)	(0.2)	214.4	(1,300.7)	**(747.9)**
Financial income (expenses)	(54.1)	(1.6)	(0.1)	(3.1)	(84.2)	**(143.1)**
Income taxes	(86.5)	(0.4)	(0.5)	(49.3)	8.9	**(127.8)**
Income (loss) from continuing operations	199.3	(3.3)	(0.8)	162.0	(1,376.0)	**(1,018.8)**
Net financial (liquidity)/debt position	601.5	13.1	-	96.4	1,268.6	**1,979.6**

(in millions of euros)			2005			
	Tyre	Broadband	Environment	Real Estate	Other	**Total**
Net sales	3,632.9	112.2	61.5	700.2	38.9	**4,545.7**
Gross operating profit (loss)	518.1	(6.3)	(2.0)	92.8	(35.0)	**567.6**
Operating profit (loss)	328.8	(7.0)	(3.6)	83.9	(47.2)	**354.9**
Earnings (losses) from investments	(1.3)	-	-	102.3	166.1 (1)	**267.1**
Operating profit (loss) incl. earnings (losses) from inv.	327.5	(7.0)	(3.6)	186.2	118.9	**622.0**
Financial income (expenses)	(32.1)	(0.7)	-	1.2	(112.8)	**(144.4)**
Income taxes	(97.0)	(0.4)	0.2	(40.5)	9.2	**(128.5)**
Income (loss) from continuing operations	198.4	(8.1)	(3.4)	146.9	15.3	**349.1**
Net financial (liquidity)/debt position	237.4	7.2	0.8	30.5	901.5	**1,177.4**

(1) This includes the valuation of Olimpia S.p.A. by the equity method showing earnings of Euros 170 million (Euros 153 million in 2005), the writedown of Olimpia S.p.A. for Euros 2,110 million, the gain on the private placement of Pirelli Tyres for Euros 416 million and the gain on the sale of the investment in Capitalia S.p.A. for Euros 215 million.

Net sales

Net sales amount to Euros 4,841.2 million and record an increase of 6.5 percent compared to the prior year (Euros 4,545.7 million).
Excluding the foreign exchange effect (+1.4 percent), the effective change is equal to +5.1 percent.
The distribution of net sales by geographical area is as follows:

	2006	2005
Tyres Sector	81.5%	79.9%
Pirelli Broadband Solutions	2.7%	2.5%
Environment Sector	1.4%	1.4%
Pirelli Real Estate	14.4%	15.4%
Other	-	0.8%

A percentage breakdown of net sales on a comparable basis by business segment is as follows:

Tyres Sector	+ 7.0%	
Pirelli Broadband Solutions	+ 15.3%	
Environment Sector	+ 12.2%	
Pirelli Real Estate	+ 0.3%	
Total group		**+ 5.1%**
Foreign exchange effect		**+ 1.4%**
Total change		**+ 6.5%**

Operating profit

Operating profit in 2006 amounts to Euros 401.4 million, representing 8.3 percent of net sales compared to Euros 354.9 million in the prior year (7.8 percent of net sales). Excluding nonrecurring expenses incurred for the project to list Pirelli Tyre S.p.A. (Euros 13.2 million), the consolidated

operating profit from ordinary operations is Euros 414.6 million (+ 16.8 percent) with a ROS of 8.6 percent compared to 2005.
The change in operating profit can mainly be attributed to (in millions of euros):

Operating profit 2005		**354.9**
Tyres Sector	13.5	
Pirelli Broadband Solutions	6.7	
Environment Sector	3.4	
Pirelli Real Estate	19.8	
Other	3.1	
		46.5
Operating profit 2006		**401.4**

Earnings (losses) from investments

Earnings (losses) from investments in 2006 amounts to losses of Euros 1,149.3 million compared to earnings of Euros 267.1 million in the prior year. The result for this year includes the impairment loss on the investment in Olimpia S.p.A. (Euros 2,110 million) offset by the gain realized on the sale of a 38.9 percent stake in Pirelli Tyre (Euros 416.4 million), the sale of the investment in Capitalia S.p.A (Euros 215 million) and the valuation of the investment in Olimpia S.p.A. using the equity method for a positive Euros 170.0 million (Euros 152.5 million in 2005).
The item also includes the results of the companies in the real estate sector valued by the equity method (Euros 105.6 million) and dividends collected (Euros 67.1 million).

Income (loss)

On a comparable consolidation basis, the consolidated net result from continuing operations in 2006 is a loss of Euros 1,018.8 million compared to income of Euros 349.1 million in the prior year.
The total result in 2006 is a loss of Euros 1,048.8 million, including a loss of Euros 30 million from discontinued operations compared to total income in 2005 of Euros 398.9 million including income from discontinued operations of Euros 49.8 million.
The loss attributable to the equity holders of Pirelli & C. S.p.A. is Euros 1,167.4 million compared to income of Euros 327.4 million in 2005.

Equity

Consolidated equity went from Euros 5,613.8 million at December 31, 2005 to Euros 4,686.6 million at December 31, 2006. The change in equity can be summarized as follows:

		(in millions of euros)
Translation differences		(96.9)
Income/(Loss) for the year		(1,048.8)
Dividends to third parties paid by:		(162.7)
- Pirelli & C. S.p.A.	(113.7)	
- Pirelli & C. Real Estate S.p.A.	(36.6)	
- Other Group companies	(12.4)	
Exercise of Pirelli & C. Real Estate S.p.A. stock options		30.8
Pirelli & C. Real Estate S.p.A. treasury share purchases/sales		48.5
Fair value adjustment of available-for-sale financial assets		24.0
Net actuarial gains (losses) on employee benefits		44.0
Exercise of warrants 2003/2006		26.8
Change in Olimpia valuation		41.0
Pirelli Tyre stake purchased by third parties with a private placement		295.0
(Income)/expenses from fair value adjustment of financial assets recognized in income		(127.5)
Acquisition of Pirelli Tyre stake from third parties		(7.1)
Capital increase by minority interest		7.0
Other changes		(1.3)
		(927.2)

The equity attributable to the equity holders of Pirelli & C. S.p.A. at December 31, 2006 is equal to Euros 3,879.6 million (Euros 0.723 per share) compared to Euros 5,204.9 million at December 31, 2005 (Euros 0.979 per share).

Net financial position

The net financial position of the Group went from a debt position of Euros 1,177.4 million at December 31, 2005 to a debt position of Euros 1,979.6 million at December 31, 2006.
In detail, the change can be explained by the following analysis of cash flows:

	(in millions of euros)
Cash flows used in ordinary activities	103.5
Exercise of warrants 2003/2006	27.3
Purchase of Telecom Italia shares	(201.0)
Purchase of Capitalia shares	(38.2)
Partial sale of F.C. Internazionale Milano shares	13.5
Outlay to Hopa	(497.7)
Net proceeds from sale of 38.9% stake in Pirelli Tyre	715.8
Proceeds from sale of Capitalia shares	332.9
Outlay for banks put	(1,040.0)
Pirelli Real Estate transaction in Germany	(140.0)
Sale of Pirelli Real Estate treasury shares	84.4
Dividends paid	(162.7)
Change in net financial position	**(802.2)**

Employees

At December 31, 2006, there are 28,617 employees compared to 26,827 at December 31, 2005, with an increase of 1,790 (including 377 with temporary contracts) due primarily to the expansion of activities in the tyres and real estate sectors.

Capital expenditures

Capital expenditures total Euros 255 million. The ratio of capital expenditures to depreciation is 1.3.
Capital expenditures are principally concentrated in the Tyres Sector and directed to the development of innovative processes, the increase in production capacity for the premium tyre range and the launch of new products.

Capital expenditures by the Group in 2006 were mainly concentrated in the tyre sector to increase production capacity

R&D expenditures

R&D expenditures borne by the group and completely expensed to income went from Euros 174 million in 2005 to Euros 171 million in 2006. R&D as a percentage of net sales is 3.5 percent.

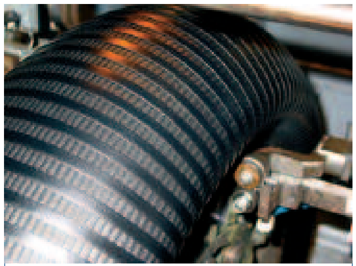
Pirelli Labs

Pirelli Labs and ENEA teamed up in 2006 to start three advanced research projects in the field of renewable energy and sustainable development

During 2006, Pirelli Labs, the group's pool of technological excellence, continued its activities in the sphere of research on innovative materials and optical technologies for telecommunications. As part of the development of its activities, it signed partnership agreements with two Italian research centers: ENEA and the Istituto sull'Inquinamento Atmosferico of the CNR (CNR-IIA).
Pirelli Labs has initiated three advanced research projects with ENEA, Ente per le Nuove Tecnologie l'Energia e l'Ambiente, in the field of renewable energy sources and sustainable development as part of a framework agreement over a five-year period.
The projects involve research on the concentrator photovoltaic power system, a new generation of sensors for monitoring the environment, and groundwork research in the field of cold fusion.
With regard to photovoltaic systems, one of the most interesting areas is the development of an innovative photovoltaic system. Taking the Phocus technology previously developed by ENEA as a basis, they will develop a prototype of a high- concentration photovoltaic system using a Fresnel lens and a solar tracker, rated at a total of 1 kW. This system, created within the context of an activity of interest to Telecom Italia, together with two conventional silicon crystal systems, each rated at 1 kW and only one of which has a solar tracker, will be installed at the Telecom Italia exchange at Naples Barre. A monitoring system will make it possible to detect remotely and continuously the electrical energy produced according to the prevailing weather conditions and will allow an objective comparison to be made between the different systems being used.
Within the sphere of sustainable development, the aim of the partnership is to study a new generation of smart, remote-controlled sensors with low consumption to monitor air pollution. When spread over a wide area, these sensors should be able to provide data in real time through a wireless connection with low running costs.
With regard to research in the field of cold fusion, the partners intend to clarify controversial aspects of this technology with a view to developing solutions for producing energy in the future.
Along with the Istituto sull'Inquinamento Atmosferico of the CNR (CNR-IIA), Pirelli Labs has presented a project which involves monitoring air quality and levels of electromagnetic and noise pollution in real time, to be conducted in Parma until May 2007.
This new philosophy of monitoring air and environmental pollution hopes to offer solutions which are complementary to the conventional ones, extremely flexible and simple to use, as well as being cheap and producing high-quality results. In this way, it will be possible to increase the number of monitoring points and obtain a more representative picture by supplying those responsible with effective tools for monitoring environmental pollution in towns and cities.
Cooperation continued with partners in Italy and abroad, such as Georgia Tech University (in Georgia, U.S.A.) and the Milan Politecnico University, on joint projects.

Monitoring of air quality by Pirelli Labs and CNR is an ongoing project at Parma

Pirelli Labs Materials Innovation


Research into nanocomposite elastomer-based compounds is one of the activities of Pirelli Labs-Materials Innovation

In 2006, the main activities focused, on the one hand, on supporting the businesses of the group, and, on the other, on developing special projects, such as Sensor Networks and Fuel Cells.
Cooperation continued with Telecom Italia on the development of joint projects.
Research work for Pirelli Tyre focused on using nanocomposite-based compounds with a polymeric matrix with the aim of exploiting their excellent physical and mechanical properties and consolidating their use in special types of compounds.
A systematic study has begun to examine their use in different types of polymer compounds made to function with polar molecules.
Cooperation with the Pirelli Real Estate Group has been expanded, concentrating on projects associated with the concept of "sustainable building", with particular emphasis on building materials and saving energy.


Cooperation between Pirelli Labs and Pirelli RE is basically centered on the development of innovative materials for "sustainable building"

As far as products/systems for monitoring traffic flows are concerned, work on sensors and management control systems, both developed in-house, have reached the engineering stage.
In addition, in collaboration with Pirelli Broadband Solutions, testing has begun in the laboratory and in the field, and moves have been made towards production on an industrial scale, which should result in commercial products/systems being available in 2007. Through the consolidated relationship with Telecom Italia, contacts have also begun preliminary to the development of the market and the exploitation of these systems commercially.
With regard to the products/systems for monitoring the environment, various joint testing projects have successfully been concluded with public authorities. In addition, an important field testing phase, financed by the Ministry for the Environment, with the collaboration of CNR, has begun in the city of Parma. Furthermore, the testing of the instrumentation required by the national state body responsible for homologation was successfully completed. In parallel, the development and engineering of products continued, while an assessment was made of potential partners to produce the sensors developed on a large scale. The partnership continued with Telecom Italia and Sartec, a well-established player in the sector of environmental monitoring, with regard to defining and developing the market.
In the sector of Distributed Sensor Networks (DSN), in 2006 work continued on the optimization and development of the product, on the level of general purpose platform and specific applications for monitoring the environment and traffic flow. Furthermore, protection of the product was consolidated at the level of intellectual property, with the registration of three new patent applications.
In Fuel Cells research, activities focused on the development of materials for highly-efficient components for polymeric cells fed with direct methanol (DMFC) and for Solid Oxide Fuel Cells (SOFC).
In the sector of DMFC cells, collaboration has begun with DuPont, the world's leading player in the field of materials for fuel cell components. The work focuses on the development and optimization of the polymer electrolyte membranes (PEM) patented by Pirelli according to different specific applications. They will mainly be used in batteries for charging portable electronic systems. During these first six months of collaboration with DuPont, considerable progress has been made in the performance of the membranes, which is also viewed positively by our partner in the project.
In the field of SOFC cells, collaboration continued with the prestigious Canadian research body, the Alberta Research Council (ARC). The aim is to combine the technology for miniaturizing the tubular

fuel cells developed by ARC with innovative materials for direct fuel oxidation developed by Pirelli Labs. Various powder compositions have been developed which can withstand direct oxidation of fuels such as methane, methanol and methane-and-hydrogen compounds without incurring any damage.
Various quantities of the above-mentioned powder were supplied to the ARC for optimization with their own microcells.
Collaboration with Telecom Italia continued, generating results which are sure to be of interest in spheres of activity relating to the study of innovative materials used in mobile devices for applications in telecommunications.
In particular, a new category of dielectric antenna has been developed for Wi-Fi applications. The core of the antenna consists of dielectric polymeric composites filled with dielectric ceramic powder. Compared to the normal outdoor antennas of devices currently on the market, this new type of antenna performs as well, and, in some cases, better, their production costs are comparable and more importantly, they are integrated with the apparatus of which they are part, thus providing the option of designing devices with innovative esthetic effects. This consideration becomes even more important with the growing number of antennas required by the new Wi-Fi devices. The first application of this antenna, presented at the Broadband World Forum held in Paris in October 2006, is an ADSL Wi-Fi modem which has aroused the interest of several operators in the sector.

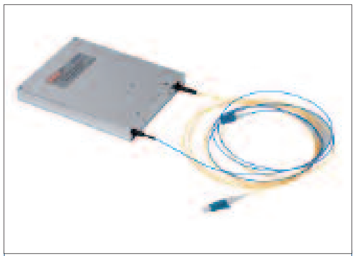
In the field of Materials Innovations, Pirelli Labs has developed dielectric antenna integrated in Wi-Fi equipment

Other devices currently being researched include innovative devices, based on ceramic material, that extend the capacity and coverage of radio base stations in mobile networks. Various prototypes of devices that are able to change the field phase are currently available and can operate at different power levels matching a wide application field. Pirelli Labs has produced iron-electronics samples in which it is possible to alter some physical properties making the devices applicable to various sectors of the electronics industry.
In the sector of more long-term research, work began successfully in the sphere of the two European projects QAP and SINPHONIA. In the laboratory, the feasibility of innovative single photon counting systems, necessary for implementing quantum optical networks was demonstrated. In addition, work continued in the project to develop a new type of solar neutrino detector. In collaboration with ENEA, joint development work began, with promising preliminary results, in the sector of phenomena of energy generation in palladium hydride (cold fusion).
Finally, the Telemedicina Project was presented at Telbios with the aim of identifying a business model. This will be based mainly on marketing the prototype of the recently developed, very high-resolution remote electrocardiograph.

Pirelli Labs Optical Innovation

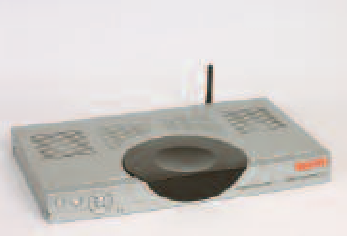
The activities of the laboratories focused on telecommunications applications in three main spheres: photonics nanotechnologies, optical systems and network access devices.
In the field of photonics nanotechnologies, the tunable laser was qualified according to the Telcordia standard for application in optical transport networks, both in cities and long-distance networks. A new version of the laser is being developed which will be cheaper to produce and more competitive in terms of power consumption. This laser will be available for marketing through Pirelli Broadband Solutions by the second quarter of 2007.
Work began on the development of a new integrated, optical tunable laser that can be directly modulated and will feature higher performance, a smaller footprint, less power consumption, and lower cost than tunable lasers currently available in the marketplace today.
Work continues on the development of the integrated optical router (OADM) for which the first batch of samples is expected to be ready in the second quarter of 2007.

With the aim of exploiting integrated devices, development work has begun on opto-electronic modules which perform the same functions as optical systems.
In particular, a MSA standard transceiver module is being developed that can be mounted on an electronic plate. It uses the tunable laser and a dispersion compensator based on nanotechnologies. This transceiver will allow installers of apparatus to make 10 Gbit/s optical links without having to distribute dispersion compensators approximately every 350 km, thus significantly reducing the cost of transport infrastructures in metropolitan areas. The product will become available in 2007.



In the field of Optical Innovation, development began on opto-electronic modules – such as the MSA transceiver – able to perform the main functions of optical systems

A 10 Gbit/s transceiver module is being developed with connection according to the XFP standard which, thanks to a special optical filter, makes it possible to achieve performance which is significantly better than current products in terms of tolerance of chromatic dispersion.
In the sphere of optical systems, work continued to develop Coarse Wavelength Division Multiplexing (CWDM) systems, which have found broad application in the transport of voice, data and video on regional networks in Europe and the U.S.A.. New work has started based on the same platform for a new generation of products called Light WDM which integrates the functions of Coarse WDM and Dense WDM systems and exploits innovative modules based on nanotechnologies in an optimum way.
In the sphere of devices for network access, the qualification of the ADSL2+ gateway was completed at Telecom Italia with access speeds of up to 20 Mbit/s and also integrates high-speed Wi-Fi functions.
Work began to develop the new generation of gateway based on VDSL2 technology.
The new gateway will allow access speeds of up to 100 Mbit/s and will constitute the user termination of the new broadband network being developed by Europe's leading operators.
In the area of home networking, the qualification process was completed at Telecom Italia for a new generation product for residential diffusion on power lines of telecommunications signals with a transmission capacity of up to approximately 100 Mbit/s.
Development work was completed on a highly sensitive transceiver for Wi-Fi transmissions using MIMO technology, with the aim of achieving reliable wireless broadcasting of video signals using real-time streaming from the access terminal to the set-top-box.
Research continued to develop a high capacity (2.5 Gbit/s) wireless solution with radio broadcasts using millimetric wave frequencies (60 GHz) in collaboration with Georgia Tech University (Georgia, U.S.A.).
The development of a new generation of set-top-box has been completed with highly integrated electronics. The new device will be pre-set to cope with the most advanced video codes and to broadcast high-definition television. The integration of software to manage the content distribution system which will be adopted by the largest world operators is in the process of completion. This product will be distributed by Telecom Italia in 2007.



Development of a new-generation set-top-box with highly integrated electronics for high-definition TV was completed in 2006

Significant events subsequent to the end of the year

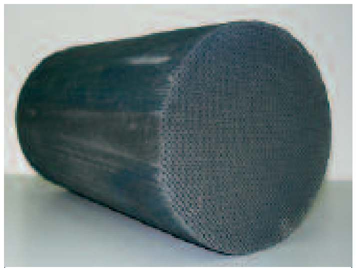
- On January 9, 2007, Pirelli & C. S.p.A. and Quattroduedue Holding B.V. (the controlling shareholder of Intek S.p.A.), with a view to the project for the merger of Gim S.p.A. in Intek S.p.A. and in execution of the provisions established by the new codicil No. 1 among the members of the Gim Shareholders' Agreement, signed a put&call agreement relating to 14,923,526 Gim S.p.A. ordinary shares held by Pirelli & C. S.p.A., equal to approximately 7.04 percent of Gim S.p.A. ordinary share capital.
The understanding provides that, starting from the date the indicated merger comes into effect, Pirelli and Quattroduedue will have, respectively, the right to sell – up to the limits of the tender offer – and purchase the entire investment acquired by Pirelli as a result of the merger for consideration of Euros 13.1 million.
The agreement is subject to the merger becoming effective and can be carried out by Quattroduedue Holding B.V. in more than one tranche by and not after May 31, 2008. Subsequent to that date, should Quattroduedue Holding B.V. not yet have exercised the option on the entire investment, Pirelli & C. S.p.A. will have the right to sell such shares to third parties, with the possible payment of compensation by Quattroduedue Holding B.V. if there is a negative difference compared to the agreed price.

- On January 10, 2007, Pirelli Real Estate, in execution of the binding agreement signed on October 9, 2006, purchased approximately 97 percent of Deutsche Grundvermögen AG (DGAG), one of the most important real estate companies in Germany with offices in Hamburg and Kiel. The purchase price, subject to a price adjustment on the basis of the 2006 financial statements, was set at approximately Euros 465 million for 100 percent of DGAG. As a result of additional purchases on January 12, 2007, Pirelli Real Estate increased its percentage ownership to more than 99 percent. In keeping with the Pirelli Real Estate business model, DGAG will be transformed into a platform of real estate investments, asset management and services. By the end of 2007, DGAG's residential portfolio worth approximately Euros 1,040 million will be transferred to the joint venture between Pirelli Real Estate (35 percent) and the real estate investment funds of RREEF (65 percent), the division of Deutsche Bank which deals with real estate investments, while the retail and office portfolio worth approximately Euros 275 million will be transferred to the joint venture between Pirelli Real Estate (30 percent) and the real estate investment funds of Morgan Stanley (MSREF) (70 percent). Other assets and the assets under management and services will remain with Pirelli & C. Real Estate Deutschland Gmbh.

- On January 17, 2007, Pirelli & C. S.p.A. announced that none of the parties in the Pirelli & C. S.p.A. shareholders' agreement indicated the desire to withdraw from the pact within the contractually established expiration date of January 15, 2007. The pact will thus remain in effect, with the same composition, until the new expiration date of April 15, 2010.

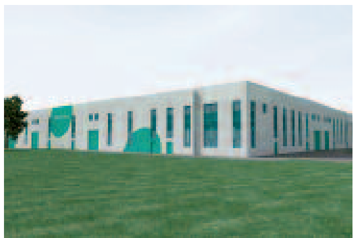
The Deutsche Grundvermorgen AG office in Hamburg, an important real estate company acquired by Pirelli RE in 2007

- On January 22, 2007, Pirelli & C. Ambiente Eco Technology S.p.A., which also operates in the sector of technologies for sustainable development, and LiqTech A/S, a Danish company which has operated for years in the sector of silicon carbide filters for the retrofit market, signed an agreement to conduct joint research into silicon carbide filters.
The results generated by the research will be jointly owned by the two companies but Pirelli will have the exclusive rights to exploit them in Europe, Russia and the former Soviet Socialist Republics, Brazil and China. Similarly, LiqTech will have the exclusive rights to exploit the results of the research in the U.S.A., Mexico, South Korea, India and Japan. Furthermore, under the agreement, LiqTech will support Pirelli & C. Ambiente Eco Technology S.p.A in the development of the production technology for mass-producing silicon carbide anti-particulate filters which will first be used on diesel engines.
The results generated by this development work will be the exclusive property of Pirelli & C. Ambiente Eco Technology S.p.A. and will be implemented in the factory which the company will start to build in Romania in January 2007 to produce anti-particulate filters for the original equipment market. As already mentioned, the factory will become operational in the second half of 2008 and will have a production capacity of more than 1,300 tons of silicon carbide filters a year.



Pirelli Ambiente is building a plant in Romania for the manufacture of anti-particulate silicon carbide filters slated for the original equipment of diesel engines

- On January 30, 2007, the board of directors of Pirelli & C. Real Estate SGR S.p.A. approved the management accounts of Tecla Fondo Uffici, Berenice Fondo Uffici and Olinda Fondo Shops at December 31, 2006, confirming returns that were higher than the targets indicated in the placement also for the year 2006.
- On February 12, 2007, Pirelli Tyre S.p.A. made it known that it had successfully concluded the syndication of a five-year multicurrency revolving credit line announced to the market on January 8, 2007. The contract was signed by the company with the mandated lead arrangers BNP Paribas and Banca Monte dei Paschi di Siena, and a pool of leading Italian and international banks (Akbank, Bank of America, Banca Carige, Banco do Brasil, Banca Popolare dell'Emilia Romagna, Banco Santander Central Hispano, ItauEuropa, Mizuho, Natixis and Royal Bank of Canada). In view of the high number of commitments, the initial amount of Euros 500 million was increased to Euros 675 million. The loan bears interest at an initial rate equal to the Euribor + 40 basis points. The purpose of the transaction is to allow Pirelli Tyre to improve its financial structure while at the same time increasing its flexibility.

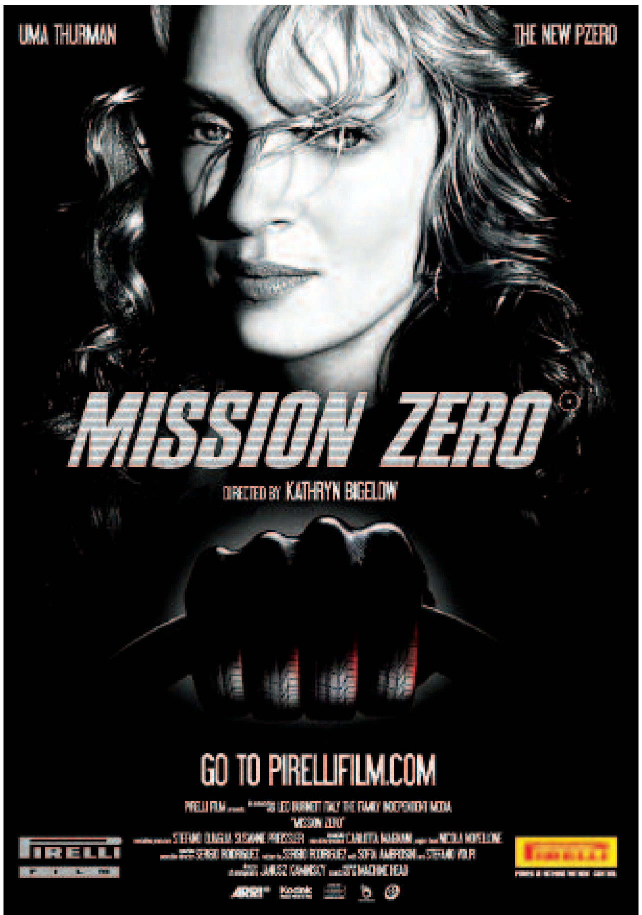


Pirelli RE: the Eastgate Park project, the largest industrial park in the east part of the northeast of the country is located in the city of Portogruaro

- On February 12, 2007, a land area was purchased in the city of Portogruaro for approximately Euros 8 million for the Eastgate Park project. This is the largest integrated industrial park in the east part of the northeast of the country on which construction began in the early months of 2006. On February 13, 2007, following the preliminary agreement signed on December 29, 2006, Fondo Spazio Industrial also purchased two additional buildings for industrial use situated in Pordenone and Belluno for a price of Euros 22 million.

- On February 27, 2007, the world council of the FIA accepted Pirelli's offer to supply tyres for the World Rally Championship (WRC) over the three-year period 2008-2010, appreciating not only the product and Pirelli's capacity for technological innovation, but also its aim to seek out and encourage young talent and to promote national championships. In particular, one of the reasons why the FIA chose Pirelli, is its century-long commitment to motor racing, and car rallies in particular. Pirelli's winning of the bid to supply the WRC was the second victory in the space of a few weeks. At the end of January, the Grand Am series, the most exciting championship for prototypes in the United States and one of the most popular in America, decided to adopt the Pirelli PZero for the three-year period 2008-2010.

For the three years 2008-2010, Pirelli will be the sole supplier of tyres for the World Rally Championship



"Mission Zero", starring Uma Thurman, is the second PirelliFilm released on the website *www.pirellifilm.com* since February 2007

Outlook for the current year

The strategy of focusing on the segments with high added value and the positive trend of the core business allow the Pirelli & C. S.p.A. Group to forecast a further improvement in results for 2007, unless external extraordinary events occur which cannot be foreseen at this time.

In particular, in industrial activities, **Pirelli Tyre** again expects to report higher sales than the market average, partly as a result of focusing on the premium segments in the Consumer area and in rapidly developing markets in the Industrial area. The improvement in the price/mix ratio should compensate the factors of cost and allow a higher operating result than 2006, unless events intervene of a nonrecurring nature.

As for the prospects of **Pirelli Real Estate** in 2007, a further growth is expected in the operating result inclusive of the share of earnings (losses) of equity investments, in line with the 2006-2008 three-year business plan.

With regard to the start-ups, **Pirelli Broadband Solutions** forecasts a further increase in sales in 2007, concentrated especially in the second half of the year, thanks to the completion of the portfolio of access solutions and an ever-greater contribution from the photonics business. In 2007, there will again be significant investments in research and production to develop new products in this area.

Pirelli Ambiente expects to consolidate the growth trend in sales.

With regard to the investment in Olimpia S.p.A., the board of directors has given the Chairman a mandate to explore all the possible options, not excluding the divestiture of the investment, with the aim of achieving the best strategic appreciation of the asset in the interest of all the shareholders.

Reconciliation of consolidated equity

The reconciliation between the equity of the parent, Pirelli & C. S.p.A., and the consolidated equity attributable to the equity holders of the parent is as follows:

(in millions of euros)

	Share capital	Reserves	Income (loss)	Total
Equity - Pirelli & C. S.p.A. at December 31, 2006	**2,790**	**1,735**	**(1,642)**	**2,882**
Results for the year of consolidated companies (pre-consolidation adjustments)			846	846
Capital and reserves of consolidated companies (pre-consolidation adjustments)		1,978		1,978
Consolidation adjustments:				
- carrying amount of investments in consolidated companies		(1,356)		(1,356)
- infragroup dividends		186	(186)	-
- other		(285)	(185)	(471)
Consolidated equity - group at December 31, 2006	**2,790**	**2,257**	**(1,167)**	**3,880**

Programmatic security documents

In compliance with the Legislative Decree of June 30, 2003 no. 196, attachement B, paragraph 26, the Pirelli Group has already provided to update the Programmatic Security Documents for the year 2006.

Pirelli Tyre

The highlights of the consolidated financial statements for the year ending December 31, 2006 can be summarized as follows:

		(in millions of euros)
	2006	**2005**
Net sales	**3,949.5**	3,632.9
Gross operating profit	**533.7**	518.1
% of net sales	**13.5%**	14.3%
Operating profit	**342.3**	328.8
% of net sales	**8.7%** (1)	9.1%
Earnings (losses) from investments	**(2.4)**	(1.3)
Operating profit (loss) incl. earnings (losses) from investments	**339.9**	327.5
Financial income (expenses)	**(54.1)**	(32.1)
Income taxes	**(86.5)**	(97.0)
Income	**199.3**	198.4
% of net sales	**5.0%**	5.5%
Net financial (liquidity)/debt position	**601.5**	237.4
Capital expenditures	**224**	208
R&D expenditures	**147**	146
Employees (number at year-end)	**25,169**	23,673
Factories (number)	**24**	24

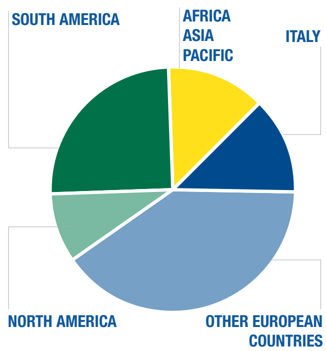
(1) 8.9% excluding IPO costs.

Net sales

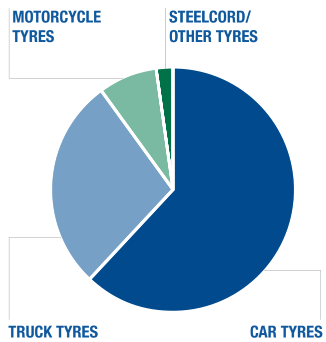
Net sales in 2006 amount to Euros 3,949.5 million, with an increase of 8.7 percent compared to the prior year. The trend is positive in terms of volumes and prices/mix which record increases of 3.9 percent and 3.1 percent, respectively. The foreign exchange difference also produced a positive effect on net sales (+1.7 percent).
The distribution of net sales is as follows:

Geographical Area	2006	2005
Italy	11%	13%
Other European countries	40%	41%
North America	8%	8%
South America	26%	25%
Africa/Asia/Pacific	15%	13%

Product Category	2006	2005
Car tyres	62%	62%
Truck tyres	28%	28%
Motorcycle tyres	8%	8%
Steelcord/Other tyres	2%	2%



Tyres: 2006 sales by geographical area and product category.



Gross operating profit

Gross operating profit is Euros 533.7 million (+3 percent compared to 2005 and equal to 13.5 percent of net sales) including nonrecurring costs of Euros 7.4 million incurred for the IPO project. The gross operating profit from ordinary operations is Euros 541.1 million, with an increase of 4.4 percent compared to Euros 518.1 million in 2005.

Operating profit

Operating profit, although influenced by nonrecurring costs incurred for the project to list Pirelli Tyre S.p.A. (Euros 7.4 million), amounts to Euros 342.3 million (8.7 percent of net sales).

This is a growth of 4.1 percent compared to 2005 in which the operating profit amounted to Euros 328.8 million with a margin on net sales of 9.1 percent.
The positive impact associated with the growth of sales, mix and efficiencies, in addition to the positive contribution by exchange rates, more than compensated the increase in production factors and, in particular, the increase in raw material costs (Euros 111 million) which is the main cause of the decline in the profit margin, besides the effect of the start-up of the truck tyre factory in China.

Details of the positive change of Euros 13.5 million in the operating profit compared to 2005 can be summarized as follows (in millions of euros):

Operating profit 2005		**328.8**
Foreign exchange effect	11.8	
Prices/mix	24.5	
Volumes	60.8	
Production factors per unit cost	(136.3)	
Efficiencies	26.3	
Depreciation and other *	26.4	
		13.5
Operating profit 2006		**342.3**

(*) Includes the reduction of costs for sports activities, marketing expenses, depreciation, amortization and other.

Income

Income in 2006 is Euros 199.3 million (after financial expenses and the earnings (losses) from investments equal to Euros 56.5 million and income tax expenses of Euros 86.5 million) compared to income of Euros 198.4 million in 2005 (after financial expenses and the earnings (losses) from investments equal to Euros 33.4 million and income tax expenses of Euros 97 million). With regard to financial expenses, it should stressed that as a result of the corporate reorganization carried out during the first quarter, the net debt of Pirelli Tyre increased by Euros 406 million.

Net financial position

The net financial position at December 31, 2006 is a net debt position of Euros 601.5 million compared to Euros 237.4 million at December 31, 2005. The increase is connected with the aforementioned reorganization which was partially compensated by the cash generated by ordinary activities.

Employees

There are 25,169 employees at December 31, 2006 including 2,532 employees with temporary contracts and 733 temp employees.
Compared to December 31, 2005, there was an increase of 181 management and permanent staff due mostly to the hiring of people for the new investment areas in China and Romania, and an increase of 87 people with temporary contracts.
As regards the blue-collar work force, the number increased by 1,228 (of whom 1,008 are in permanent positions and 220 with temporary contracts and temp work) due basically to the hiring of people in Brazil mostly in the factories in Gravataì for the manufacture of All Steel Truck tyres (+94), in Feira de Santana due to higher Car volumes (+200), in Campinas as a result of the change in the work plan (+169), in Romania (+396), in China (+252).
At December 31, 2006, the work force (excluding employees with temporary contracts) may be analyzed as follows:

	2006	2005
Senior executives	0.9%	0.9%
Staff	21.1%	21.5%
Blue-collar	78.0%	77.6%

The organizational development activities during 2006 involved both the entrenched areas of international presence by Pirelli Tyre, and the new operations in China and Romania.

In 2006, a worldwide project was launched to map the skills and competencies of the key resources in the industrial function and in the quality function. The aim is to create a common base from which to start planning and implementing special training courses as well as recompense and development actions according to a common rationale. With reference to the sales project called "Running the Market" launched in the prior year, 2006 was a year devoted to designing and distributing training packages, with the aim of developing expertise and role skills through technical, professional and managerial training courses.

As for the investment in China, within the framework of the China Intercultural Management project, a series of seminars was held with the aim of acquiring greater knowledge of the Chinese macro-economic situation and learning about cultural differences between Europe and China.
A Development Center was created for the purpose of assessing the expertise of local management and defining training and development plans.

With reference to the new area of investment, Romania, training involved both factory workers, who attended theoretical courses and on-the-job training in European factories, and staff, who attended courses on corporate values, the Code of Ethics and cultural differences.
Within the sphere of research, selection and employer branding, in 2006, Pirelli Tyre held a talent attraction initiative called Project Recruiting Day on the test-track at Vizzola. On this occasion, 70 undergraduates from the most prestigious universities had the opportunity to follow a special driving lesson on safety during the first part of the day, and later participated in a first part of a selection phase which was organized on the basis of an innovative team game.

With regard to Industrial Relations, the economic part of the collective bargaining labor contracts was renewed in Italy, the U.K., Turkey, Brazil and Argentina with the aim of keeping labor costs in line with local inflation.
In Brazil in particular, agreements were stipulated among the parties, in order to optimize the work schedules used in factories.

A picture of Pirelli employees in 1905 in front of the first factory at Ponte Seveso. Today, more than 25,000 people make up the Group's work force

Capital expenditures

Productivity of the MIRS manufacturing process was increased at the Breuberg (Germany) tyre factory

During 2006, capital expenditures in fixed assets amounted to Euros 224 million, equal to 1.17 percent of depreciation and 5.7 percent of net sales (compared to 1.10 percent of depreciation and 5.7 percent of net sales in 2005).
Capital expenditures in factories represent 93 percent of the total. This is in line with the group's strategy and market demand.
The capital investments were employed in the development of innovative processes, expansion of production capacity, especially in low-cost areas, increasing high-performance production and launching new products.

Car: In the sphere of innovative processes, the production capacity of the MIRS (Modular Integrated Robotized System) process was increased in Germany, the U.S.A. and the U.K., by optimizing existing lines. With regard to traditional processes, conversion of the production capacity of "high-performance" products and the revamping of existing machinery continued.
With the aim of meeting increased market demand by reducing production costs, a greater boost was given to increasing production in geographical areas with low costs. In particular, a new factory was opened at Slatina in Romania and building work began on a new factory at Yanzhou in China. Work is continuing to augment the capacity of the factory at Bahia (Brazil) where semi-automatic processes are being installed.

Industrial vehicles: The new All Steel plant has been completed at Gravataì in Brazil and the new plant at Yanzhou in China is now fully operational.
In the field of innovative processes, production continued to increase at the factory at Settimo Torinese for the new Amaranto product line using the innovative SATT (Spiral Advanced Technology for Truck) technology derived from MIRS technology. The extension of this production process began in the plants at Izmit in Turkey and at S. Andrè in Brazil.
Furthermore, the group continues to follow the strategy of renewing the product line-up and extending programs for improving efficiency and quality in all the factories.

Steelcord: the expansion plan continued to move forward, especially at the new plant at Slatina in Romania and in Brazil, whereas, in Italy, efforts were concentrated on researching and developing prototypes for new products and materials.

Research & Development expenditures

2006 Pirelli Tyre capital expenditures traditionally focused on the most advanced high-range products

In 2006, R&D expenditures amount to Euros 147 million, equal to 3.7 percent of net sales, and are completely expensed to income. Traditionally this activity has focused on the development of new high-performance products (e.g. Run-Flat, SUV and motorcycle tyres) by exploiting technological components and very advanced know-how which are the result of intensive research in the areas of materials, design, profiles, tread patterns and processes.

To sustain improvement and innovation of the product portfolio, research is under way to find innovative solutions through the study and application of new types of polymers and nanotechnologies. Applying these new technologies have made it possible to increase the level of product performance and, on the other hand, it opened up the possibility of using new types of materials.

In 2006, Pirelli's leading role as a supplier of Original Equipment on a global scale was confirmed, judging by the ever-greater consensus in the high technological standard of Pirelli products.
At the Detroit Motor Show, 23 leading car manufacturers exhibited models fitted with Pirelli tyres of the PZero, Run Flat Eufori@ and Scorpion range. At the Geneva International Motor Show, very-high-performance Pirelli tyres equipped various prototypes (the Isotta-Fraschini, the Aston Martin Rapide and the Lamborghini Miura, and the off-road Fiat "Oltre", exhibited with Pirelli Truck PS22 tyres). What's more, at its own stand, Pirelli presented the innovative K-Pressure Optic system for the active control of tyre pressure.

Pirelli Scorpion ATR is the new product line for SUVs, pick-ups and 4x4 off-road vehicles

In terms of day-by-day development, close collaboration continues with carmakers. This resulted in products of the PZero range being fitted on the latest models of many leading car manufacturers, both Italian companies like Ferrari, Lamborghini, Maserati and Alfa Romeo (at the Paris Motor Show with the new Alfa Romeo 8C Competizione), and foreign companies (like Porsche, Bentley, Audi, Aston Martin, Volvo and Jaguar). It should be emphasized that, with the very low profile PZero Corsa System tyres, which are derived from racing models and guarantee excellent performance in terms of road-holding on curves, with a good acceleration and braking capacity, whether on dry or wet surfaces or on the race track, Pirelli's position in the top car segment was strengthened with important homologations on Lamborghini models (the Gallardo Spyder and the new Murciélago LP640) and as a "sport tyre option" on the Aston Martin V8 Vantage. The PZero range was also the center of attention at the 2006 SEMA Show, the most important tyre show in the United States. The star of the show was the Scorpion Zero Asimmetrico in the 405/25R24 size (the widest tyre on the market in the SUV segment and scheduled for production at the Pirelli Tyre North American MIRS plant), presented at SEMA on a Dodge RAM 1500.
The collaboration agreement was renewed with Maserati and Ferrari, both in the racing sphere (GT1 and GT2), and to research new products destined for their cars.

The cooperation agreement with Ferrari and Maserati for Granturismo racing activities was renewed

Pirelli, always the protagonist at American automobile shows thanks to the Scorpion Zero Asimmetrico, offered in sizes up to 24-inchs

In 2006, Pirelli won the international FIA GT1 and GT2 championships with the Ferrari team and drivers, and the European Le Mans Series GT2 category with Porsche. In addition, Stèphane Sarrazin, driving an Aston Martin with Pirelli tyres won the title of Best Driver of the Year.
In the tests conducted by the European specialized press, in 2006, Pirelli again achieved excellent results in terms of performance, both in the Summer segment with the PZero Nero, P6, P7 and the Scorpion Zero, and in the Winter segment with all the tyres of the range (Snowsport, Snowcontrol, Sottozero and the Scorpion Ice & Snow). These were also praised for their comfort and their contribution to safe driving.

As for the SUV segment, in Tunisia in May, Pirelli presented its latest product for 4x4 vehicles (SUVs and pick-ups), the new Scorpion ATR product line. This special product is the result of development conducted in cooperation with the most prestigious automotive

companies, combined with Pirelli's long experience in the segment. It can be used in many different applications because of its special characteristics, and performs safely at a very high level, both off-road and on asphalt. The tyre will be distributed on worldwide markets (North and South America, Europe, Africa and Asia): a truly global product.
In September, an important acknowledgement arrived from the United States with the publication of the JD Power and Associates 2006 OE Tyre Satisfaction Study. This survey was conducted by consulting 23,000 American consumers about tyres in the Mass Market/Non-Luxury segment. Especially with the P6 Four Seasons, Pirelli was voted better than the average of the segment in all of the five factors considered (duration, road-holding, design, driver satisfaction and handling), obtaining the highest marks for road-holding and design, and the final result of absolute best in the segment.

Tyre System and Vehicle Dynamics

Marketing commenced for the K-Pressure Optic device for controlling tyre pressure

Research and development work continues on systems for controlling correct tyre pressure. In fact marketing has begun of the K-Pressure Optic, an extremely simple device to install (it is merely screwed onto the valve instead of using a cap) and just as simple to use. If the tyre pressure is below the optimum, the end of the device changes color.
The collaboration between Pirelli and Schrader Electronics, one of the leading electronics companies producing tyre-pressure detection systems for original equipment, has been made official and is now operational. Together, they intend to develop the Cyber Tyre Lean system, an innovative device for detecting tyre pressure that is applied directly onto the inside of the tyre and gives real-time information about pressure, but also other useful information, such as the type of tyre and when it reaches the maximum load.
Pirelli's research group has also begun strategic collaboration with the University of California at Berkeley to develop sensors with wireless technology to be applied on tyres, with the aim of improving vehicle performance and safety.
Finally Pirelli acquired the patents of Leonardo Fioravanti with a view to developing the Cyber Tyre.

The Aston Martin DBR9 equipped by Pirelli was one of the revelations of the Fia Gt 2006 Championship

Consumer market

The Consumer market includes the Car Business Unit, the Motorcycle Business Unit and some minor activities associated with them (distribution etc.).

In the Consumer market, which accounts for 69 percent of total sales, 2006 recorded an increase in both revenues (+8 percent) and operating profit (+22 percent) compared to the prior year. Specifically, revenues amount to Euros 2,735 million and the operating profit from ordinary operations is Euros 245.7 million. The improvement in the result can be attributed to the positive contribution of sales variables and efficiencies, which more than compensated the higher cost of raw materials.

Sales of **Original Equipment for Cars** remained fairly steady in terms of volumes and reported an increase in value in Europe and the United States. This result was achieved thanks to the consolidation of the positions acquired with the leading European car manufacturers, the growth of supply contracts to the largest American car manufacturers (Ford, GM and Daimler Chrysler) and an improvement in the mix obtained through consolidated collaboration with the main manufacturers in the high-performance car segments (Alfa Romeo, Audi, Bentley, BMW, Ferrari, Maserati, Mercedes, Jaguar, Land Rover, Peugeot, Porsche, Saab, Volvo and VW).
In the South American area, an increase in both volumes and sales was reported on all the Mercosur manufacturers (Fiat, Ford, GM, Honda, Peugeot, Toyota, VW), compared to the prior year.
The homologation portfolio is growing: in addition to the well-established products of the Pzero range (Rosso, Nero and Corsa) for the top cars, the P6 and P7 for Europe and South America and the P6 Four Seasons for the NAFTA, there was a positive start to the homologation process for the new Pzero, the Hero tyre, the new ultra high-performance tyre developed for supercars and directly derived from Pirelli's experience in racing.

At present, the PZero has obtained more than 15 homologations as original equipment for the latest, most prestigious supercars and is already being supplied for the Ferrari 599 GTB Fiorano, the Lamborghini Murciélago and Gallardo, the Audi R8 and S8, the Aston Martin DB9, the Maserati Quattroporte, the Jaguar XK and the Mercedes AMG. It will shortly be supplied for the Alfa Romeo 8C Competizione and the sportier models made by Porsche and BMW.
During 2006, the positive trend of the SUV lines continued. Pirelli

The new line of ultra-high performance P Zero the Hero tyres was launched in spring 2007

The Lamborghini Gallardo is among the first and most prestigious homologations for P Zero the Hero

The Scorpion ATR is supplied as original equipment on the Ford F-150, the pick-up most sold in the United States is proud to have many homologations on high-performance vehicles. In particular, during the year, the range of the Scorpion line was further enhanced: the Scorpion STR, Scorpion Ice & Snow and Scorpion Zero were joined by the new Scorpion ATR, which is supplied as original equipment on the Ford F-150, the most successful pick-up vehicle in the United States.

Sales of **Replacements** for Cars ended 2006 with an increase compared to the prior year in all the main areas of the market. In Europe, the market grew in terms of sales while volumes remained fairly steady. This situation can be attributed to the different dynamics of the various segments of the market: positive in the high-performance range (Winter, SUV, HP/UHP and Run Flat), and negative in the other segments.
In South America, there was growth both in volumes and sales, in line with the market trend, while in North America, Pirelli reported growth despite the negative performance of the U.S. market.
The technological leadership and excellent performance of Pirelli products continues to be confirmed by the positive results in all segments in the comparative tests conducted by the specialized press.
In the Ultra High Performance segment, PZero Corsa, PZero Nero and PZero Rosso dominated the tests of specialized European journals, while in the High Performance segment, the P6 and P7 tyres continue to have extremely positive assessments.
In the Winter segment, the product tests were completely dominated by the products Sottozero, Snowsport and Scorpion Ice & Snow. In 2006, the Citynet Winter Plus winter tyre for light industrial vehicles was added to the list of successes.

Another victory for Pirelli in the World Motocross Championship, a tradition spanning more than 20 years

In the **Motorcycle** segment, sales of the Pirelli and Metzeler brands increased in 2006, reporting growth that was higher than the average of the market, which reported a slight recovery compared to the prior year.

In the **Replacements** channel for motorcycle tyres, the most significant growth was reported in North and South America, in Oceania and Japan, while growth in Europe was in line with the market, where there was an improvement of the mix.
There was a positive trend in the sales of the **Original Equipment** channel, especially in Brazil and Japan, with important homologations of the Pirelli Diablo Corsa on the Yamaha YZF-R1 and the Ducati Hypermotard, and of the Dragon Supercorsa PRO on the Ducati 1098 and the Triumph Daytona 675 Triple naked; the Metzler Roadtec Z6 was homologated on the BMW R1200 R and the Yamaha MT 01.
There were excellent results deriving from the success of new

Positive trend of motorcycle original equipment in 2006 thanks partly to the success of the Metzeler Roadtec Z6

products such as the Diablo Superbike, the Diablo Supercorsa and the Diablo Corsa III under the Pirelli brand, and from the Sportec M3, the 6 Days Extreme and the scooter Feel Free under the Metzeler brand.
The Pirelli brand was again highly successful in international racing, with its 46th victory in the MX1 category of the World Motocross Championship, the World Sidecar title, first place in the three main categories of the Italian Speed-racing Championships, victory in the British Supersport Championship and confirmation of the role of top partner as the Official Tyre Supplier for the World Superbike Championship, the Canadian Superbike Championship and the English and Australian Superstock Championships.
For the second consecutive year, the Metzeler brand won a resounding victory in all three of the E1, E2 and E3 categories of the World Enduro Championship, confirming the superiority of the product and the professional level of the support service provided for drivers in the competitions.

Industrial market

The Industrial market includes the Truck and Agro Business Unit, the Steelcord Business Unit and some minor activities associated with them (distribution, reconstruction, etc.).

In the Industrial market, revenues amount to Euros 1,214 million, an increase of 9 percent compared to the prior year. Overall, the demand was positive in all areas of the market concerning the Truck business (Europe, the Mediterranean and the Middle East, South America and China). In the case of the Steelcord business, too, the demand grew everywhere except in North America. The operating result from ordinary operations is Euros 104 million, a decrease compared to 2005, owing to the high-point reached in the prices of natural rubber, the main cost item on the business's raw materials bill, and the fact that it was impossible to transfer the extra cost to the market in such a short time. Because of this, ROS (8.6 percent) was 2.8 points lower than in 2005.
In terms of market dynamics, the overall demand was positive in Europe, Turkey and Egypt, while an overall contraction was reported in South America.

The performance of the Diablo sports tyre reconfirms Pirelli in the role as the sole supplier of the World Superbike Championship

In the segment of tyres for **Trucks**, Pirelli consolidated its share of the market in all its reference markets (Europe, the Mediterranean area and South America), whereas, in China, where operations were conducted for the first whole year, attention focused on creating a sales network, geographical coverage and the development of the Pirelli product. The mix of new products was enhanced with new sizes using SATT® technology (derived from MIRS technology) and by extending this technological platform to Brazil.
Racing activities continued, resulting in a number of places on the podium for the PS22, in races of national and international championships.

Gigantic Pirelli ST22 tyres at the base of the good result achieved by the Tatra team in the Lisbon-Dakar 2007

In 2006, the economic performance of Steelcord operations improved compared to the prior year despite strong competition on the market. The growth in volumes was concentrated particularly on third-party customers and on products with very complex applications. Growth in world demand is estimated at 7 percent on an annual basis (tons), driven by the continuous growth of the Chinese market where consumption is rising by almost 30 percent. Growth is also high in South America and Eastern Europe as a result of the phenomenon of relocation and greater production capacity. The absorption level of the mature markets of North America and Western Europe is down. Consumption in Japan and South Korea remained constant.
Technological evolution means that new, high-resistance cords made with special steel and special treatments are continuing to become more widespread. The ever-growing investment of the business in cord with high added value is consistent with the maximum commitment that is being placed on know-how. In the industrial area, growth continues in low-cost areas, where, at the end of 2006, these accounted for more than 66 percent of finished product capacity. During 2006, work continued on the large-scale expansion of the production capacity of the plants at Sumarè in Brazil and the plant opened in 2005 at Slatina in Romania.
Cord Romania, in collaboration with Continental, not only constitutes an opportunity to develop European production capacity at a competitive cost, but also consolidates an industrial and commercial partnership which began in 1972 with Drathcord Saar in Germany.

Strong expansion of steelcord production capacity in 2006 after the Romanian plant at Slatina came on line

Outlook for the current year

For the current year, Pirelli Tyre again forecasts a growth in sales above the market average, thanks to the focus on the premium segments in the Consumer area and in the rapidly growing markets of the Industrial area. In a scenario where the cost of raw materials stabilizes at current levels, it forecasts a further improvement of the operating result in all areas of business.

Pirelli Broadband Solutions

The highlights for the year ending December 31, 2006 can be summarized as follows:

		(in millions of euros)
	2006	**2005**
Net sales	**129.4**	112.2
Gross operating profit (loss)	**1.1**	(6.3)
% of net sales	**n.s.**	n.s.
Operating loss	**(0.3)**	(7.0)
% of net sales	**n.s.**	n.s.
Earnings (losses) from investments	**(1.0)**	-
Operating profit (loss) incl. earnings (losses) from investments	**(1.3)**	(7.0)
Financial income (expenses)	**(1.6)**	(0.7)
Income taxes	**(0.4)**	(0.4)
Loss	**(3.3)**	(8.1)
% of net sales	**n.s.**	n.s.
Net financial (liquidity)/debt position	**13.1**	7.2
Employees (number at year-end)	**166**	122

Net sales

Net sales in 2006 amount to Euros 129.4 million, with an increase of 15.3 percent compared to Euros 112.2 million in 2005. The increase is partly due to the start of activities connected with second-generation photonics products with higher-margins (optical components and modules to improve the performance and flexibility of the telecommunications network) for Euros 14.6 million.

Operating result

The operating result in 2006 is basically a breakeven, compared to an operating loss of Euros 7 million in 2005. A positive contribution was made by access activities while photonics was affected by the investments in research and development typical of the start-up stage and completely expensed to income.

Loss

The loss for 2006 is Euros 3.3 million (after financial expenses of Euros 1.6 million). This is an improvement over the prior year and includes the write off of the investment in Alloptic Inc (Euros 1 million).

Net financial position

The net financial position is a net debt position of Euros 13.1 million compared to Euros 7.2 million at December 31, 2005.

Employees

At December 31, 2006, there are 166 employees, an increase of 44 people compared to December 2005, concentrated in the Engineering and Sales functions.

Broadband Access

The broadband market continues to grow, thanks to the release of ADSL2+ technology, which makes it possible to supply users with a band around 20Mb/s.

This has made it possible to supply ever-more dynamic surfing profiles and, furthermore, to provide new service opportunities for operators, such as television via the Internet (IP-TV) and voice over the Internet (VOIP).

These applications are seen by operators as fundamental steps for winning the loyalty of their customers and for reaching people who do not own a computer, who would otherwise not be able to subscribe to broadband services. In order to confront the market situation, a portfolio has been developed consisting of five product lines: access gateways, Set-top Boxes, Extenders, Terminals and the PMP (Pirelli Management Platform).

Access gateways, set-top-boxes, extenders, terminals and PMPs constitute the range of Pirelli Broadband Solutions' Broadband Access products

The product range of access gateways extends from simple USB modems to routers that are capable of supporting triple and quadruple play applications, and even small business and enterprise machines (thanks to an agreement of strategic cooperation signed with the French company OneAccess).

To augment the competitiveness of the SW solutions used in the access gateways line, technology was licensed from Jungo, a market leader in the sector, which, in addition to supplying PBS with a complete stack which is also suitable for small business applications, makes it possible to transfer all the applications developments implemented by PBS to various xDSL chipsets. This will guarantee a level of continuity to the services being offered on several platforms, thus augmenting the competitiveness of PBS's proposals to the market.

The set-top box line will begin to be supplied early in 2007 with a product that is capable of supporting IP-TV and DVB-T on Linux and Microsoft operating systems. Work has begun to develop a product that will support an internal hard disk for use where local registration services are to be provided.

Again with the aim of strengthening its offering of SW, as well as Alcatel OMP and Microsoft middleware, it was decided to begin integration of the Confocus stack, which is a fundamental element for simplifying various possible commercial middleware solutions or proprietary middleware solutions required by the market.

With the aim of providing connectivity solutions among the products of the portfolio, the extenders line has been enhanced by a new generation of power line (200Mb/s) and wireless (MIMO) solutions, which make it possible to supply high definition (HD) video streaming between access gateways and set-top boxes, thus helping to solve the problem of installing an IP-TV service.

The terminals line has been very successful as a result of dual-mode telephones. In just a few months these have enabled them to acquire new international customers (Arcor, Free and many ISPs) who appreciate the toughness of the product and the various configuration possibilities supplied by Pirelli Broadband Solutions, as well as the correct price positioning.

It was therefore decided to expand the range being offered in 2007, by introducing a product rather like a smart-phone based on Windows Mobile technology, and a "clam-shell" phone which, thanks to the fact that it has a wider screen, will have better browsing capacity and can support various multimedia features.

The PMP has been reorganized to meet developments in the market, supplying a modular system which has proved to be a winning solution with the acquisition of two new customers (Slovak Telecom and On Telecoms in Greece) towards the end of 2006.

PBS expanded its 2007 dual-mode telephone product line with new smart-phone type products using Windows Mobile technology

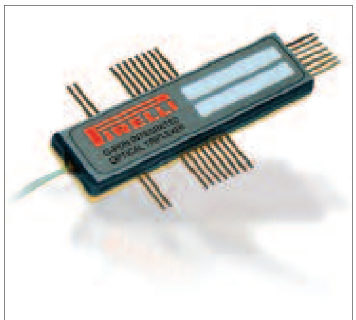
In 2007, new functions demanded by the market will be introduced, together with the capacity to manage the dual-mode telephone.
In parallel to telecom-oriented applications, the first "vertical" applications will be launched with the aim of being able to provide services thanks to "bundled" offers between products and operating systems.

New Photonics Products

PBS – Photonic Products: the City8 metropolitan optical transport platform reached sales of 1800 devices in 2006 in Europe

In 2006, thanks to the continuous penetration of the broadband services offering, the phase of strong growth in the communications market continued, especially in the "metro" area. In this context, Pirelli Broadband Solutions successfully continued to introduce the metropolitan optical transport platform known as City8, selling a total of more than 1,800 in Italy, France, Germany, Sweden and Spain in less than 18 months after the launch of the product. With regard to this product, a partnership agreement was signed with Ericsson which involves marketing City8 and future versions of the product on Ericsson's worldwide market.
In the field of optical components, the qualification of the Tunable Laser for application in transmission systems for metropolitan optical and transport networks was successfully completed and the first supplies of the product began to be shipped in small volumes, destined for customers in North America and the Far East. Samples of the product are also in the process of being tested at the premises of many customers in Europe, Japan and North America.
Finally, work continues on development of the line of innovative opto-electronic modules (in the MSA-tunable and XFP-pluggable format), begun in December 2005, based on optical devices and nanotechnology (such as the Tunable Laser and the Optical Dispersion Compensator) which were developed in-house. While Europe's top optical communications event (ECOC 2006) was being staged, the new product lines were officially announced, and were enthusiastically received by potential customers. Main customers continue to test samples of the product.

Outlook for the current year



The development of the Triplexer optical chip for Fiber-to-the-Home applications continued successfully during 2006

During the current year, every product line in the access market will be completed and strengthened to consolidate the market positioning of Pirelli Broadband Solutions.
This will be achieved both by introducing new technologies such as VDSL2, Wi-Fi 802,11n and AV Power Line, and by enhancing the SW functions which will make it possible to supply ever-more integrated end-to-end solutions that can be managed remotely through the PMP.
As far as the photonics market is concerned, development work is continuing of the City8 platform with the aim of also supporting 10 Gbit/s signals and DWDM. The introduction of these functions, which are innovative for such a compact optical product, will result in a new platform known as LyteWDM which will be able to combine the versatility and low costs typical of the CWDM systems with the typical services of a DWDM system of a higher level. In the sphere of components and modules, as has been described above, the main objective is to complete the product portfolio by introducing tunable and pluggable modules to the market.
In 2007, as a result, there is expected to be a further increase in sales, concentrated in the second half of the year, thanks to the completion of the portfolio of solutions for access and the ever-more significant contribution of photonics products. Again, in 2007, significant investments will be made in research and production to develop new products.

Pirelli & C. Real Estate

Pirelli Real Estate is a management company that manages real estate investment funds and companies that own real estate and non-performing loans in which it invests by acquiring minority stakes (Investment & Asset Management). It also provides these and other clients with every kind of specialist real estate service (service provider) both directly and through the franchising network.
In 16 years of constant growth, Pirelli Real Estate has established a reputation as the leading operator in the Italian real estate market, introducing a new business model and professional standards from the most highly evolved markets.
Today, the Pirelli Real Estate brand is recognized for its tradition, reliability and innovation: the main factors behind its success lie in the experience and focusing skills of management and the experience gained in large-scale operations.

Pirelli Real Estate's mission can be summarized as follows:
- to create value for the shareholders through a system of dealings with the outside community geared to satisfying all the company's stakeholders;
- to affirm itself as the benchmark of the Italian real estate market;
- to export its successful model to Central and Eastern European countries;
- to innovate real estate products through a quality response that meets the needs of final users and investors alike;
- to base its corporate governance system on national and international best practices;
- to create and disseminate a state-of-the-art culture in the real estate sector;
- to orient corporate behavior so that it focuses on the aspects of "corporate social responsibility".

Pirelli Real Estate is active on the domestic real estate market with offices in Milan, Rome and Naples and, thanks to a qualified network of franchising agencies, the group is able to operate efficiently throughout Italy.

Rendering of Pirelli RE's Headquarter 2 project at Milano Bicocca

With regard to the European market, besides Warsaw, the group today has operating offices in Hamburg, Berlin and Kiel.
The ability to offer itself as the one source for the entire real estate cycle (valuation, purchase, management, appreciation and sale of assets) and the high degree of know-how in various areas of real estate operations, have, at the beginning, led the group to attract the most important investment funds seeking investment opportunities and, later, also investors interested in core products.
The group's activities are conducted through specific Investment & Asset Management business units which make it possible to effectively and efficiently supervise the various product lines, coordinating the work of the service companies and the franchising network for each stage of the process.

Major events in 2006

Rendering of the former Manifattura Tabacchi at Milan, a development project under a joint venture between Pirelli RE and Fintecna

The Pirelli Real Estate Group conducted a series of important transactions in 2006. In particular:

- important purchases of luxury real estate portfolios for approximately Euros 1,202 million in addition to the purchase of the real estate portfolio held by DGAG, Deutsche Grundvermögen A.G., one of the most important real estate companies in Germany for approximately Euros 1,400 million. That purchase, concluded in the early days of 2007, together with the one in Poland for the real estate portfolio of Pekao (UniCredit Group) in 2006, represents a significant step forward in the announced strategy of expansion into the countries of Central and Eastern Europe (European markets which hold more interesting growth prospects) where the company has intention of extending the business model that has already been successfully adopted for some time in Italy;
- investments in non-performing loans by purchasing new portfolios for approximately Euros 977 million, thanks also to new joint ventures with some of the most important operators of the sector;
- appreciation of the assets under management which made it possible to generate sales to third parties of almost Euros 2,806 million with an increase of 14 percent over 2005;
- affirmation of its leadership position in Italy in real estate investment fund management with the launch and management of six new products. The operating funds rose from 10 in 2005 to 16 in 2006 in addition to another seven funds that have already been authorized. During the period, in fact, the following funds started up: Hospitality&Leisure, Armilla, Portafogli Misti, Patrimonio Uffici, Progetto Uffici and Progetti Residenza. Specifically, the assets managed by the investment funds grew by 25 percent, from Euros 6.1 billion last year to Euros 7.6 billion at December 31, 2006;
- finalization of the listing of Spazio Investment N.V. on the Alternative Investment Market of the London Stock Exchange (AIM). This company holds all the shares of the investment in Spazio Industriale, a real estate investment fund specialized in the light industrial/logistics sector launched at the end of the prior year;
- signing, in the services sector, of an agreement to take over Ingest Facility from the Fiat Group. Ingest Facility operates the facility management activities of Fiat in Italy and Europe;
- strengthening of Pirelli Real Estate Franchising's operations in the distribution of real estate services to the retail market particularly with regard to financial products.

Pirelli Pekao Real Estate's Szafarnia project, at Danzig. Growth prospects for the real estate sector in Poland are strong

Economic review

In reading the highlights of the income statement presented below, it should be noted that the aggregate revenues and the operating profit including earnings from investments, because of the type of business conducted by the group, are the most important indicators and express, respectively, the share of aggregate revenues and the trend in results.

(in millions of euros)

	2006	2005
Total aggregate revenues (*)	4,017.8	3,507.2
Share of aggregate revenues (**)	**1,560.0**	**1,386.8**
Consolidated revenues	702.0	700.2
Operating profit including earnings from investments (***)	**214.4**	**186.1**
Income attributable to the equity holders of the company	**159.5**	**145.4**

(*) Aggregate revenues express total business volumes and include consolidated revenues and revenues of the associates, joint ventures and Funds in which Pirelli RE has holdings.
(**) The share of aggregate revenues expresses the share of business volumes and includes consolidated revenues and the share of the revenues of associates, joint ventures and Funds in which Pirelli Re has holdings.
(***) Operating profiit including earnings from investments comprises the operating profiit (Euros 103.7 million in 2006) in addition to the share of earnings of companies accounted for by the equity method (Euros 101.6 million in 2006), dividends from holdings (Euros 4 million in 2006) and income from real estate investment funds (Euros 5.1 million in 2006).

Aggregate revenues amount to Euros 4,017.8 million, an increase of 15 percent compared to Euros 3,507.2 million in 2005.

The share of aggregate revenues amounts to Euros 1,560.0 million, an increase of 12 percent compared to Euros 1,386.8 million in 2005.

Consolidated revenues amount to Euros 702.0 million compared to Euros 700.2 million in 2005.

Operating profit including earnings from investments is Euros 214.4 million, with an increase of 15 percent compared to Euros 186.1 million in 2005. This result recorded a strong growth especially in Tertiary Assets, which increased from Euros 100.7 million to Euros 126.0 million, a jump of 25 percent, and in the more recent sector of asset management of non-performing loans, which rose from Euros 3 million to Euros 11.6 million.

Income attributable to the equity holders of the company is Euros 159.5 million, with an increase of approximately 10 percent compared to Euros 145.4 million in 2005.

Balance sheet and financial review

(in millions of euros)

	12/31/2006	12/31/2005
Fixed assets	**581.7**	**410.7**
- including investments in funds and investment companies (*)	426.1	303.3
Net working capital	**283.3**	**210.6**
Net invested capital	**865.0**	**621.3**
Equity	**708.7**	**552.1**
- of which attributable to the equity holders of the company	700.3	535.4
Provisions	**59.9**	**38.7**
Net financial (liquidity)/debt position	**96.4**	**30.5**
- of which shareholder loans	(334.1)	(262.0)
Total net invested capital financed	**865.0**	**621.3**
Net financial (liquidity)/debt position before shareholder loans	**430.5**	**292.5**
Gearing ratio (**)	**0.61**	**0.53**

(*) This item includes investments in associates and joint ventures, investments in real estate investment funds and junior notes.
(**) The gearing ratio corresponds to the ratio of the net fiinancial (liquidity)/debt position before shareholder loans to equity.

Equity attributable to the equity holders of the company at December 31, 2006 is Euros 700.3 million compared to Euros 535.4 million at December 31, 2005, with an increase of Euros 164.9 million. The change is due to a higher result net of dividends paid during the year (+Euros 82.2 million) and other equity movements (+Euros 82.7 million), largely connected with the decrease in treasury shares.

The net financial position shows a net debt position of Euros 96.4 million compared to Euros 30.5 million at December 31, 2005. It includes an advance of Euros 140 million for the DGAG deal.

The adjusted net financial position (expressed before shareholder loans made to minority-owned companies) is a net debt position of Euros 430.5 million, compared to Euros 292.5 million at December 31, 2005. The gearing ratio, in line the 2006-2008 three-year plan, is 0.61 compared to 0.53 at December 31, 2005.

Fixed assets total Euros 581.7 million compared to Euros 410.7 million at the end of December 2005, with an increase of Euros 171.0 million. The change is due to an increase in the value of the investments in associates and joint ventures and investment funds for an amount of Euros 122.8 million, in addition to the change in securities mainly from the securitization of the non-performing loans of the former Banco di Sicilia. The remaining amount is largely related to investments for a 75 percent stake in Pirelli Pekao Real Estate, for the remaining 12.7 percent interest in Pirelli & C. Real Estate SGR and for the 53.6 percent stake in Credit Servicing.

Net working capital at December 31, 2006 is equal to Euros 283.3 million compared to Euros 210.6 million at the end of 2005. The increase of Euros 72.7 million is mainly due to the combined effect of an increase due to the advance on the purchase of the investment in DGAG (+Euros 140.0 million) and the increase in trade receivables as a result of transactions carried out during the last few days of 2006 (+Euros 40.6 million), as well as the decrease in net receivables of non-performing loans (-Euros 90.4 million) and inventories (-Euros 8.2 million).

Outlook for the current year

Starting from June and for the entire year 2007, the growth in operating profit including earnings (losses) from investments is expected to exceed the targets set in the 2006-2008 three-year plan (CAGR 10-15 percent).

Pirelli & C. Ambiente

The highlights for the year ending December 31, 2006 can be summarized as follows:

(in millions of euros)

	12/31/2006	12/31/2005
Net sales	69.0	61.5
Gross operating profit (loss)	0.5	(2.0)
% of net sales	n.s.	n.s.
Operating loss	(0.2)	(3.6)
% of net sales	n.s.	n.s.
Financial income (expenses)	(0.1)	-
Income taxes	(0.5)	(0.2)
Loss	(0.8)	(3.4)
% of net sales	n.s.	n.s.
Net financial (liquidity)/debt position	-	0.8
Employees (number at year-end)	52	43

Pirelli & C. Ambiente S.p.A.

The result of the company for the year 2006 is a loss of Euros 0.8 million with an improvement over the loss of Euros 3.4 million reported in 2005.

Net sales amount to Euros 69 million and grew 12.2 percent compared to Euros 61.5 million in 2005.

During the course of 2006, the companies of the Ambiente Group changed names. Pirelli & C. Ambiente Holding S.p.A. took the name of Pirelli & C. Ambiente S.p.A..

Likewise, the three operating companies in the Ambiente Group also changed names:
Pirelli & C. Ambiente S.p.A. was changed to Pirelli & C. Ambiente Renewable Energy S.p.A., Pirelli & C. Ambiente Tecnologie Pirelli S.p.A. to Pirelli & C. Ambiente Eco Technology S.p.A. and Pirelli & C. Ambiente Bonifiche S.p.A. to Pirelli & C. Ambiente Site Remediation S.p.A..

The following is a summary of the results of the three operating companies which are wholly-owned subsidiaries of the company.

Pirelli & C. Ambiente Renewable Energy S.p.A. (PARE)
During the course of the year, the company continued to promote negotiations aimed at starting new projects in the field of renewable energy using RDF-P (Refuse Derived Fuel-Pirelli) derived from solid urban waste for the subsequent development of renewable energy through the replacement of primary fossil fuels in existing plants.
The result for the year benefited considerably from the agreement which provides for the granting of licenses, patents, know-how and assistance to the UK and North Ireland start-up by Pirelli & C. Ambiente Renewable Energy S.p.A. to ReEnergy Group Plc.
Last January, the company collected the amount agreed for granting the licenses, patents and know-how of Pounds sterling 1.8 million, equal to Euros 2.7 million (Euros 2.9 million net of the 8 percent withholding tax equal to Euros 0.2 million). This transaction has made it possible to export the business model of the company abroad and to evaluate whether to propose it at an international level.
During the year, the activities for producing the quality fuel (RDF-P) were profitably conducted through the associate I.D.E.A. Granda S.Cons.R.l. which developed renewable energy of 19,673 tons of fuel compared to 17,002 tons in 2005.

Pirelli & C. Ambiente Eco Technology S.p.A. (PAET)
In 2006, the margin generated by the emulsions business largely made it possible to absorb the start-up costs incurred for the diesel post-treatment particulate filtering systems and for the OEM filters project.
With regard to emulsions, there was a decrease of approximately 17 percent in volumes of Gecam sold in Italy, compared to the same period of 2005. This was offset by the good performance of per unit margins and controls over costs and the considerable increase in volumes sold in France, which are in line with the strong growth reported also in 2005.
With regard to the diesel post-treatment filtering systems, during 2006, despite the slowness with which the regulatory framework is evolving at both a regional and national level, work on the development, fine-tuning and marketing of the systems have been further stepped up.
The company has also decided to embark on an investment project in Romania aimed at building a plant for the manufacture of silicon carbide filters for the original equipment market. The new factory could produce more than 1,300 tons/year of silicon carbide filters with approximately 400 employees.


Pirelli Ambiente Eco Technology: activities in the field of post-treatment diesel filtering systems continued in 2006

Pirelli & C. Ambiente Site Remediation S.p.A. (PASR)
During the year, the company continued its work on the full-scale management of environmental problems principally for the companies of the group and related companies, with particular reference to Environmental Due Diligence, evaluation, planning and management of activities such as demolition and land reclamation conducted by specialist companies which are authorized to conduct such work.


In 2006, Pirelli Ambiente Renewable Energy went forward on the development of new projects in the field of RDF-P fuel production

Information systems

The Information Systems of the Pirelli Group are operated and coordinated through Share Service Center S.c.r.l., a company owned 50 - 50 by Pirelli and Telecom Italia S.p.A..

• Architectures & Infrastructures

With regard to SAP environments, the Brazilian SAP systems are being moved to the Data Center at Cesano Maderno.
The Spanish SAP HR systems are being brought into the normal running of all the SAP environments within the Data Center.
During the first quarter of 2007, the L20 SAP One Client Latam system will be moved to the Data Center.
The overall SAP environment, currently operated by the Systems Competence Center, now has a production Data Base, with approximately 45 Terabytes (approximately 90 Terabytes if the duplication required for the architecture "in mirroring" is considered) of which 9.7 are linked to Prysmian environments, with an average number of 12,000 daily users.
In the sphere of the Pirelli Group, work continued to coordinate and integrate the data transmission network for which work is continuing to increase throughput for the Units included in the international backbone. In addition to allowing further consolidation in Milan of services that were formerly managed locally (Electronic Mail in Spain, Germany and Turkey), this has also made it possible to extend VoIP services to countries such as Spain, Germany and Turkey.
The Latam line is being upgraded to make it more secure for when the One SAP Latam system is moved to Milan.

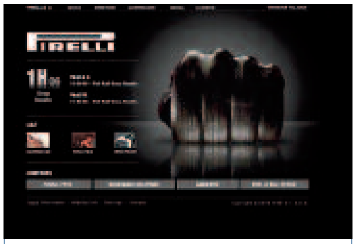
With regard to the distributed architecture (APISxp), the migration to the new operating system Windows R2 for all the WW infrastructure servers was completed, together with the migration of WW electronic mail systems to Exchange 2003. As services are continuously being centralized, this move, in addition to the network adaptations, has made it possible to bring the electronic mail systems of Germany, Spain and Turkey to Milan.
The architecture is now so widespread that there are more than 16,000 XP customers in more than 30 countries. As far as the electronic mail service is concerned, action continued to consolidate the infrastructure which now comprises only 4 "Exchange sites" WW. The hand-held and smartphone service (MIS-PDA-Qtek) now has almost 600 users worldwide.

• Applications Architectures

In 2006, activities focused on reviewing the SAP Roadmap, the support of corporate portals through the Intranet and Internet architectures, the issue and distribution of guidelines and development standards, testing and benchmarking new software products and project support.

• Portal and e-business Development

Pirelli's websites continue to show an increase in user traffic, reaching 1,450,000 visitors a month (in December 2005, 1,200,000 users visited the website). During the year, the corporate and tyre sites were completely restyled, reorganized and innovated, resulting in a complete overhaul of the infrastructure, which had become obsolete. In September, the new websites of Pirelli S.p.A., Tyre and Broadband Solutions went online. The website *www.pirelli.com* was classified 5th in the prestigious table drawn up every year by Hallvarsson & Halvarsson, which assesses the websites of the 83 companies with the highest capitalization listed on the Milan stock exchange and decides which company is the "best improver" of the year.



The *www.pirelli.com* internet portal was completely restyled and reorganized during the last part of 2006

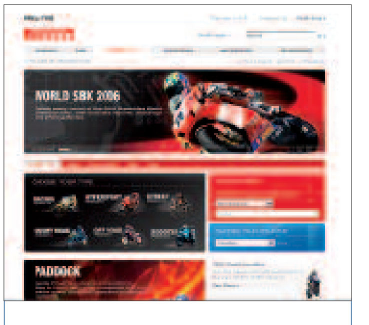
This result was achieved thanks to key services and action in the field of communication, including the innovative Pirelli Film project, the broadcasting in high-quality webcasting of financial conference calls, the offer of alert services via e-mail and SMS about group events, and the RSS service which automatically informs users about the presence of new available content. The release of the Pirelli.com website will be followed throughout 2007 by the development of new local websites. During the year, on-going updates continued on the Pirelli Intranet. In this connection, in December, the new Investments Procedure was released for the marketing area, and will be implemented as from 2007.

• Pirelli Tyre

Activities focused on aspects of the geographical extension of the One-Client platform, the enhancement and extension of Sell-Side and Supply Chain Value Targeting solutions for the Supply Chain function and PVT (Purchasing Value Targeting) in Purchasing. In addition, work continued on the functional and geographical extension of the solutions relating to the One-supplier initiative. Particular attention was given to the Product Lifecycle Management project in the sphere of R&D, the up-grade to the new version of the Datawarehouse platform and the review of the rationale and indicators for the Industrial Tableau de Board. There was also a massive update of the product line-up based on the new business rationales for product descriptions and tread codes: with the consequent modification of SAP and other related applications.

In particular:

- During the year, the One-business/One-client initiative was extended to South Africa, Egypt and Japan and was completed in Romania and China. With regard to the functional extension of the platform, the following achievements were particularly important: the global review of the processes and systems for the management of orders, shipping documents, intercompany invoices and repeat-invoicing tools taking parameters into consideration; the SAP automation (from order entry to shipment tracking) of the Singapore branch for the management of the purchase of natural rubber and the release in Germany and Brazil of MRP (Material Resource Planning) for managing long-term and execution of materials requirements. The rationalization and consolidation of the SAP One-client Europe and LATAM systems continued with the release, in 2006, of the Cockpit "Virtual One-Client" system for viewing data on a global scale.
- With regard to Sell-Side, and CRM, new contact centers were activated in Austria and Poland, and the Genesys platform was updated. The Work Flow Management Tool system was released in France and Germany while, in Spain, the roll-out of the Mobile Sales Automation system was completed. In the area of B2B, integration of the dealer portal with the group's Datawarehouse was completed. The B2Fleet system was released in the U.K. for the Truck Business Unit and in Austria for the Car Business Unit. Also, new functions were created to dematerialize proof of delivery documents and invoices, giving dealers the option of creating and downloading invoices and shipment documents electronically.
- Based on the concept of "extended enterprise", the SCVT and PVT initiatives focused on achieving better integration between customers and suppliers. In particular, in the case of SCVT, integration involves: PE customers in Germany, the U.K., the U.S., Spain and Sweden. With regard to suppliers, integration with the HUB RNC (Rubber Network) led to the integration of suppliers of raw materials in Germany the U.K., Italy and Spain. One particularly important aspect of the One Supplier initiative is Go-live, the new procedure for managing pre-invoicing of international road transport in Italy, Germany, the U.K., Spain and European branches.



In 2006, new services were added to the Motorcycle Business Unit internet portal

- Important achievements in the sphere of industrial systems include the completion of the PCS (Production Control System) infrastructure in Romania and activation of Phase 1 (Kanban, WMS, Scheduling and Datacollection) at the new plant at Slatina. Other achievements with regard to PCS, this time in Italy, at the Bollate plant, include the activation of Datacollection for the Vulcanization area, and, for the Turin Truck and Car plants, the activation of Datacollection for building phase for the former and the installation of the CQS (Compound Quality System) module for the latter. In Germany, PCS was extended for the Motorcycle BU, while, in Spain, the WMS module was activated. SMS (Specification Management System) was implemented at the Steelcord BU in Turkey.

The home page of the Investor Relations section of *www.pirelli.com.* The portal was ranked fifth in the table drawn up each year by Hallvarsson & Halvarsson

- In the area of R&D, special efforts were made to improve the protection of corporate know-how, by raising the level of security of critical applications (adoption of SSL/https protection) and reviewing policies authorizing access to users. Within the sphere of extending the PLM (Product LifeCycle Management) solution, two new elements were added: tools to manage the parameters of information on the sides and the relative CAD designs (Lettering), and tools to manage the mould specifications, Sector’s Mould Database (MDB). Finally, the roll-out of the RMQ (Raw Material Quality) system was completed in China.

- **Pirelli & C. Real Estate**

The information systems of Pirelli Real Estate (PRE) were implemented to increase the functional coverage and the efficiency of the business systems of the Services Companies, to support the development of Franchising and SGR, to integrate Credit Servicing in the group and to begin to expand PRE abroad. There follows a description of the main projects completed in 2006.

- Agency: the new Leasing Valuation application was produced which manages valuations according to ASSILEA standards. The first phase of the development of the new system (Magister) was completed for exploiting business opportunities introduced by the Basel 2 Accord.
- Credit Servicing: the core functions of the new Phoenix management system were released for production. The system is being used for newly acquired portfolios, and data about portfolios previously managed by another system is gradually being transferred to the new one. New functions were implemented on the Real Estate Valuation system for acquisitions of new customers.
- Facility: the maintenance system based on SAP-PM has been enhanced by introducing functions to close maintenance orders via an IVR mobile phone and to calculate and manage SLA on extraordinary maintenance. Customer reporting was developed on a business intelligence platform which makes it possible to have dynamic reports. The aim is to standardize and automate the periodical reports required for operations.
- Franchising: work continues to develop the management systems supporting business lines which use the affiliates network as a distribution channel. Financial Products: the integration of UBCasa (UniCredito) and the integration of the system for budget management and commissioning with SAP R/3 were completed. Release 2 of the back office of the Financial Services Center was released. The CRM was integrated with the main commercial partners and the activation processes of affiliated agencies were updated. A system was developed to support the marketing of PRE property through the network of affiliated agencies (Gessica).

- Property: Telematic IRE was released, namely, the possibility of paying the Registration Tax on lease contracts by sending files directly to the website of the Tax Office (Entratel). The "Land Register" environment for managing ICI and the relative fiscal, legal and asset requirements was completely redesigned and released. All the regulations introduced by the Bersani Decree regarding fiscal matters for the management of lease contracts were implemented.
- Foreign business: activities to integrate the Warsaw office in the standards of the Pirelli network were completed. The first SAP implementation phase for Poland was concluded (modules FI, CO and SD) and implementation was completed of the new model of the "Foreign Development" Business Plan being used by Polish asset managers. The Due Diligence on the information systems of DGAG, the company acquired in October, was completed.
- PRE Management Control: the new Tableau de Board of the Purchasing function was released and the Tableaux de Board of Project and Franchising were revised to bring them into line with the new business models. Development of the new Tableau for PRE's Integrated Income Statement was completed and the new Tale for the new Agency, Franchising and Property management plan were released. The new MIS model for group consolidation was redesigned.
- SGR: the new Armilla fund was opened and management of it began.
- SGR Opportunities: the Information System was implemented and the first five funds were created.
- For all the companies of the PRE Group: the new corporate website (*www.pirellire.com*) was released and the new method of sending invoices to customers through the Postel platform was implemented.

• Pirelli Broadband Solutions

In the Systems business, development activities concentrated on the area of purchasing and logistics. In particular, the following functions were released:

- Activation of a SAP workflow of the approval process of an ECR (Engineering Change Request);
- Additional functions in the process of Vendor rating and reporting for assessing suppliers;
- Management flow of the new type of MAS products;
- Electronic saving of purchasing documents in PDF;
- Additional functions in the corporate Intranet including a dedicated area for top management and workflow in the document approval cycle;
- Activation of SAP Profitability Analysis (COPA);
- Activation of interfaces between SAP and the CAD system (Mentor);
- Opening of the new company Pirelli Broadband Solutions North America.

Furthermore, in June, the new webpage www.pirellibroadband.com was released.

Proforma data

Proforma consolidated economic and financial data assuming the line-by-line consolidation of Olimpia S.p.A.

Proforma consolidated data at December 31, 2006 of Pirelli & C. S.p.A. is presented below, assuming the consolidation line-by-line of Olimpia S.p.A..

		Proforma adjustments				
(in millions of euros) IAS/IFRS	Consolidated financial statements 12/31/2006 Pirelli & C. S.p.A. (1)	Elimination of Olimpia S.p.A. result attributable to Pirelli & C. S.p.A.	Olimpia S.p.A. line-by-line consolid.	Olimpia consolid. entries	Total proforma adjustments	Proforma consolidated financial statements 12/31/2006 Pirelli & C. S.p.A. (2)
Condensed income statement						
Net sales	**4,841**	-	-	-	-	**4,841**
Operating profit	**401**	-	(1)	-	(1)	**400**
Financial income (expenses)/valuation adjustments to financial assets	**(1,292)**	1,940	(2,715)	-	(775)	**(2,067)**
Income taxes	**(128)**	-	-	-	-	**(128)**
Income (loss) from continuing operations	**(1,019)**	1,940	(2,716)	-	(776)	**(1,795)**
Income (loss) from discontinued operations	**(30)**	-	-	-	-	**(30)**
Total Income (loss)	**(1,049)**	1,940	(2,716)	-	(776)	**(1,825)**
Income (loss) attributable to the equity holders of Pirelli & C. S.p.A.	**(1,167)**	1,940	(1,940)	-	-	**(1,167)**
Reclassified balance sheet						
Equity	**4,687**	1,940	4,360	(5,428)	872	**5,559**
- of which equity attributable to the equity holders of Pirelli & C. S.p.A.	**3,880**	1,940	3,488	(5,428)	-	**3,880**
Net financial (liquidity)/debt position	**1,980**	-	3,216	-	3,216	**5,196**

(1) Pirelli & C. S.p.A. consolidated financial statements (investment in Olimpia S.p.A. accounted for by the equity method with Olimpia accounting for Telecom Italia by the equity method).
(2) Proforma Olimpia financial statements used for line-by-line consolidation of Olimpia S.p.A..

The proforma consolidated economic and financial data has been prepared using:

- the financial statements of Olimpia S.p.A. at December 31, 2006, adjusted to conform with IFRS, wherein the investment in Telecom Italia S.p.A. is accounted for by the equity method (using financial statements prepared in accordance with IFRS);
- the consolidated financial statements of Pirelli & C. S.p.A. at December 31, 2006 (prepared in accordance with IFRS) wherein Olimpia S.p.A. is accounted for, in turn, by the equity method.

The principal proforma adjustments included in the above table are as follows:

- in the column "Elimination of Olimpia S.p.A. result attributable to Pirelli & C. S.p.A.": elimination of the income statement and balance sheet effects of valuing Olimpia S.p.A. by the equity method in the Pirelli & C. S.p.A. consolidated financial statements at December 31, 2006;
- in the column "Olimpia S.p.A. line-by-line consolidation": inclusion of the assets, liabilities, costs and revenues resulting from the financial statements at December 31, 2006 of Olimpia S.p.A., prepared in accordance with IFRS consistent with the Pirelli Group, attributing the share of net equity and the results of operations to the minority interest. It should be pointed out that the forward purchase of 124,129,937 Telecom Italia S.p.A. ordinary shares, concluded by Olimpia S.p.A. in 2001, was accounted for at original cost as an increase in the investment in Telecom Italia S.p.A. with a contra-entry to the relative payable account;

- in the column "Olimpia S.p.A. consolidation entries", the carrying amount of the Olimpia investment in the Pirelli financial statements was eliminated against the underlying share of the accounting net equity.

A comparison of equity and net debt between the consolidated financial statements of Pirelli & C. S.p.A. and the proforma consolidated financial data of Pirelli & C. S.p.A. at December 31, 2005 and at December 31, 2006 is presented below, assuming:

- the line-by-line consolidation of Olimpia S.p.A.;
- the line-by-line consolidation of both Olimpia S.p.A. and the Telecom Group.

(in millions of euros) IAS/IFRS	**Equity**		**Net debt**		**Net debt/ Equity**		**Equity attributable to the equity holders of Pirelli & C. S.p.A.**	
	12/31/2006	**12/31/2005**	**12/31/2006**	**12/31/2005**	**12/31/2006**	**12/31/2005**	**12/31/2006**	**12/31/2005**
Pirelli & C. S.p.A. Group: consolidated data	4,687	5,614	1,980	1,177	0.42	0.21	3,880	5,205
Pirelli & C. S.p.A. Group: proforma consolidated data with Olimpia S.p.A. consolidated line-by-line	5,559	8,393	5,196	4,667	0.93	0.56	3,880	5,205
Pirelli & C. S.p.A. Group: proforma consolidated data with Olimpia S.p.A. and the Telecom Italia group consolidated line-by-line	29,263	32,029	42,497	44,525	1.45	1.39	3,880	5,205

Equity Investments held by Directors, Statutory Auditors and General Managers

Pursuant to article 79 of Consob Regulation approved by resolution No. 11971 dated May 14, 1999, the following information is provided as regards the equity investments held in the company Pirelli & C. S.p.A., and its subsidiaries, by the Directors, Statutory Auditors and General Managers, as well as spouses, not legally separated, and minor children, either directly or through subsidiaries, trustee companies or individual persons, resulting from the shareholders' register at December 31, 2005, from notices received or other information acquired from the same Directors, Statutory Auditors and General Managers.

Name	Company in which investment held	No. of shares held at prior year-end	No. of shares purchased / subscribed	No. of shares sold	No. of shares held at current year-end
Tronchetti Provera Marco	Pirelli & C. S.p.A.	13,764			13,764
	Pirelli & C. S.p.A. (indirect ownership)	1,323,599,275 (1)			1,323,599,275 (1)
	Pirelli & C. S.p.A. (indirect ownership)	1,217,398 (2)			1,217,398 (2)
	Pirelli & C. Ambiente S.p.A. (indirect ownership)	10,478,000 (1)			10,478,000 (1)
Pirelli Alberto	Pirelli & C. S.p.A.	29,925			29,925
Puri Negri Carlo Alessandro	Pirelli & C. S.p.A.	66,500			66,500
	Pirelli & C. Real Estate S.p.A.	449,500	555,000		1,004,500
Buora Carlo (4)	Pirelli & C. S.p.A.	68,688			68,688
Ligresti Giulia Maria (3)	Pirelli & C. Real Estate S.p.A.	10			10
Moratti Massimo	Pirelli & C. S.p.A.	11,551,427			11,551,427
	Pirelli & C. S.p.A. (indirect ownership)	37,427,732 (5)			37,427,732 (5)
	Pirelli & C. S.p.A. (indirect ownership)	11,328,318 (6)			11,328,318 (6)
De Conto Claudio	Pirelli & C. S.p.A.	55,258			55,258
Gobbi Luciano	Pirelli & C. S.p.A.	150,000			150,000
Guatri Luigi	Pirelli & C. S.p.A.	186,654 (3)			186,654

(1) Shares held through Camfin S.p.A.
(2) Shares held through Cam Partecipazioni S.r.l.
(3) Shares held through spouse
(4) In office until November 6, 2006
(5) Shares held through CMC
(6) Shares in the name of Istifid as a trustee

Stock option plans

The information on stock option plans previously provided in accordance with Consob communication No. 11508 dated February 15, 2000 has now been included in the notes to the consolidated financial statements.

Corporate Governance

Introduction

The Company is aware of the importance of its Corporate Governance system in fulfilling its objective of creating value for all shareholders and making progress in sustainable development, and thus induces the Company to keep its own corporate governance system constantly in line with national and international best practices, as well as making sure that it is up to date with legislative changes.

During 2006, the Company – after having implemented changes according to the national legislation and regulations regarding market abuses – launched an overall survey and updating of its corporate governance instruments, in order to align them with provisions under the law no. 262/2005 and the legislative decree No. 303/2006 (henceforth, respectively, the "**Savings Law**" and the "**Corrective Decree**"), as well as recommendations in the new edition of the Self-Regulatory Code for listed companies published in March 2006 (henceforth the "**new Code of Conduct**").

With reference to updates made according to the new Code of Conduct, we note that the Company – having formalized its adherence to this code at the Board of Directors meeting on March 12th, 2007 – avails itself of the faculty, conceded by the Borsa Italiana, to make reference in this Report to the Self-Regulatory Code published in July 2002 (henceforth the "**Code**"), indicating the completed or planned activities made in order to adhere to the recommendations indicated in the new Code of Conduct.

As a preview to the points elaborated in detail in this report, we note that the complete review of the governance framework – which was carried out by a specific working team coordinated by the Secretary to the Board of Directors and subject to constant attention (in three consecutive meetings during which the Board of Statutory Auditors participated as well) by the Committee for Internal Control and Corporate Governance, which formulated the proposals to the Board of Directors – brought about the defining of a series of changes that did not significantly modify the company governance, which proved to be largely in line, if not to the letter at least in substance, with the new relevant regulatory framework.

The governance system adopted by the Company, before and after the revision mentioned above, is and remains founded on the central position of the Board of Directors, on the presence of correct disclosure practices regarding the choices and the procedures for the decisions of the Company, on an effective system of internal controls, on an effective monitoring for potential clash of interests and on a rigorous code of conduct regarding the implementation of transactions with related parties.

These benchmarks are specified in the Code of Ethics, in the Company bylaws, in the Regulations regarding shareholders' meetings, and in a series of principles, rules and procedures that are available on the website of the Company at *www.pirelli.com* under the section dedicated to the Governance.

In compliance with the regulation of markets instructions organized and managed by Borsa Italiana and taking also into account information included in the "Guidelines for the drawing up of the annual report on corporate governance" published by Borsa Italiana and in the "Corporate governance reports handbook" published by Assonime, this report describes the main characteristics of the corporate governance system of the Company and the functioning of its various components during the 2006 financial year, as well as it accounts for its already existing activities and those planned for the future in order to ensure compliance with the new Code of Conduct, in accordance with Borsa Italiana indications made on November 16th, 2006.

GOVERNANCE STRUCTURE

1. Company Organisation

The Board of Directors

In line with Italian regulations, the management of the Company is entrusted to a Board of Directors that plays an active role regarding its strategic directions, as well as its management control, while directing administration as a whole and having a direct hand in a series of decisions that are necessary or useful in the pursuit of the corporate aims.
In order to fulfil its tasks, the Board avails itself of the assistance of Committees established within it (i.e. the Remuneration Committee and the Committee for Internal Control and Corporate Governance), entirely composed of independent directors.

The Board of Statutory Auditors

According to the law and the Company bylaws, the Board of Statutory Auditors is entrusted with the following:
- the observance of the law and the bylaws;
- the respecting of proper administration principles;
- the adequacy of the organisational structure of the Company for the aspects within its competence, of the internal control and administration-accounting systems, as well as the latter's reliability in correctly representing management results;
- the methods of application of the corporate governance rules contained in the codes of conduct prepared by companies that manage regulated markets or associations of category, which the company declares to follow;
- the adequacy of the regulations imposed by the Company on its subsidiaries regarding the reporting of price sensitive information[1].

The Board of Statutory Auditors fulfils its tasks by exercising all of the powers conferred upon it by law and being able to count on a constant and analytical information flow from the Company, during and beyond the regular meetings of the Board of Directors and its Committees.
In fulfilling its functions, the Board of Statutory Auditors, besides participating in all the Board of Directors and Shareholders' Meetings, also takes part in the tasks of the Remuneration Committee and the Committee for Internal Control and Corporate Governance. Moreover, Paolo Francesco Lazzati, a Statutory Auditor, is a member of the Monitoring Board in accordance with the legislative decree No. 231/2001.

The Shareholders' Meeting

The Shareholders' meeting – that may be ordinary or extraordinary – has the competence, according to the law, for resolving upon a series of specified matters such as the approval of the financial statements, the election and the revocation of directors and statutory auditors, their fees and responsibilities, the purchase or sale of own shares, the modification of the Company bylaws, the issuance of convertible bonds, and, except for restricted cases, merger and division transactions.
The Shareholders' meeting, which may be held in Italy also out of the registered office of the Company, must be called within 120 days, or in special circumstances within 180 days, as from the end of the financial year; if the meeting is called within 180 days, the directors must indicate the reason for the delay in the Directors' Report included in the year-end financial statements.
In addition to the law and the bylaws, shareholders' meetings are governed by the Rules of Proceeding, which were approved by the shareholders' meeting held on May 11th, 2004 (available on the website of the Company www.pirelli.com in the section entitled "Governance"). In order to pay attention to the possible integration of the agenda on shareholders' request, as introduced by

[1] Now known as "sensitive information" (art. 114 of the Legislative Decree No. 58/1998).

the Savings Law, the Board of Directors, in the meeting held on March 12th, 2007, resolved to propose to the shareholders – at the meeting called to examine the 2006 financial statements – some modifications to the Rules. For full details of these proposals, please see the report that was drafted by the Directors regarding this matter.
The Shareholders' Meeting is chaired, in the following order, by the Chairman of the Board of Directors, by a Deputy Chairman or a Managing Director; if there are two or more Deputy Chairmen or Managing Directors, they are chaired by the senior in age. In the absence of the aforementioned individuals, the Shareholders' Meeting is chaired by another person elected by the shareholders with the favourable vote of the majority of the capital represented at the meeting.
The Chairman of the shareholders' meeting – among other things – verifies that the meeting has been validly constituted, ascertains the identity of those present and their right to attend, including by way of proxies, ascertains the legal quorum and governs the proceedings, with the faculty to establish a different order for the discussion of the topics listed in the agenda indicated in the notice convening the meeting. The Chairman also takes appropriate action to ensure orderly discussion and voting, establishing the procedures and verifying the results. The decisions of the meeting are recorded in minutes signed by the Chairman of the meeting and the Secretary or by the Notary public.
The minutes of extraordinary Shareholders' Meetings must be prepared by a Notary public appointed by the Chairman of the meeting.

Audit of accounts
The audit of accounts activity is carried out by an auditing firm appointed during a Shareholders' Meeting and chosen among those listed in a specific register held by Consob.
The task – conferred in reference to the 2005-2007 financial years at the Shareholders' Meeting held on April 28th, 2005 – is currently entrusted to PricewaterhouseCoopers S.p.A., which was also appointed by other major Group companies to audit their accounts.

2. Composition of share capital

On March 12th, 2007 the share capital of Pirelli & C. S.p.A. was 2,791,311,344.64, divided into no. 5,367,906,432 shares with a par value of 0.52 each, of which no. 5,233,142,003 were ordinary shares and no. 134,764,429 were non-convertible savings shares.
The share capital may further increase up to a nominal maximum of 2,819,508,786.64 by means of the issue of a maximum of no. 54,225,850 ordinary shares 0.52 each, at a price of 1.15 each, of which 0.63 as a share premium, against the possible exercising of options granted to managers and cadres employed by the Company, by its subsidiaries and by the subsidiaries of the latter as part of the "Pirelli to People" and "Group Senior Executives" stock-option plans set up by Pirelli S.p.A. in 2001.
To the best of the Company's knowledge, no legal or natural person can exercise control according to the Article 93 of the Legislative Decree 58/1998 (henceforth the "Financial Services Act").
Participants in the Pirelli & C. S.p.A. Block Share Syndicate, the purpose of which is to ensure Pirelli & C. share structure stability, and an excerpt of the relevant agreement are listed at the bottom of this chapter and are available on the website of the Company at www.pirelli.com.

Implementation of provisions in the self-regulatory code

1. Board of Directors

1.1 Role and functions

As mentioned, the Board of Directors plays a central role in the Company's corporate governance system; it has the power (and the duty) to direct Company business, pursuing and fulfilling its primary and ultimate objective of creating shareholder value.

Pursuant to Article 11 of the Company bylaws, the Board is responsible for the management of the Company and, to this end, it is vested with the broadest powers, except for those matters remitted by law or the bylaws to the authority of the shareholders' meeting.

In line with the provisions in the Self-Regulatory Code for listed companies (new edition published March 2006), the Board of Directors has the exclusive right to:

- examine and approve the strategic, business and financial plans of the Company and the Group;
- draw up and adopt the corporate governance regulations of the Company and define the governance guidelines of the Group;
- evaluate the adequacy of the general organisational, administrative and accounting structure of the Company as well as of those subsidiaries of strategic importance as set up by the Managing Directors, with special reference to internal auditing and the management of clashes of interests;
- grant powers to the Managing Directors and the Executive Committee (if established) and revoke them; fix the limits, the manner in which they have to be exercised and the frequency, at least on a quarterly basis, with which such bodies must report to the Board on the activity performed in the exercise of the powers granted;
- determine, after having examined the Remuneration Committee proposals and consulted the Board of Statutory Auditors, the remuneration of the Managing Directors and of those directors who are vested with special offices and, if the shareholder meeting has not already resolved upon it, allocate the total amount to which the members of the Board of Directors are entitled;
- evaluate the general performance of the Company, taking particularly into consideration the information received from the entrusted corporate bodies and compare periodically the results achieved with those planned;
- examine and approve all transactions involving the Company and its subsidiaries which have a significant impact on the strategy, the profitability, the assets or the financial position of the Company, paying particular attention to situations in which one or more directors act in their own interest or in the interest of third parties, and more generally to transactions with related parties. During the revision of the corporate governance instruments, it was expressly stated that the Board of Directors establish general criteria for the detection of these kinds of transactions;
- at least once a year, evaluate the size, composition and functioning of the Board itself and its Committees, expressing in case an opinion on the professional figures whose presence in the Board could be deemed advisable;
- establish the Self-Regulatory Body, pursuant to Legislative Decree 231 of June 8th, 2001;
- appoint and dismiss the position of the responsible for internal control, determine relevant duties and fees, taking into consideration the advices of the Committee for Internal Control, the Corporate Governance Committee and the Board of Statutory Auditors;
- assess and approve periodic reports prepared according to applicable legislation;
- exercise other powers and fulfil duties as required by the law and the Company bylaws.

1.2 Appointment of Directors

Since 2004, the Company bylaws have stated (in article 10) that the appointment of the Board of Directors shall take place through a slate vote and therefore they are already in line with the regu-

lations introduced by the Savings Law in the Financial Services Act. This system ensures that – if more than one slate is presented – minority shareholders can elect one fifth of the Directors.
The slates presented by shareholders, undersigned by the parties submitting them, must be deposited at the registered office of the Company at least ten days prior to the date set for the shareholders' meeting to be held on first call and made available to anyone on request.
Each shareholder may present or participate in the presentation of only one slate and each candidate may appear on only one slate, on pain of ineligibility.
Only shareholders who, alone or together with other shareholders, hold at least 2 per cent of the share capital entitled to vote at the ordinary shareholders' meeting, may present slates, subject to their proving ownership of the necessary number of shares not later than two days prior to the date set for the shareholders' meeting to be held on first call.
Declarations in which the candidates individually accept their candidacy and attest, on their own responsibility, that there are no grounds for ineligibility or incompatibility, and that they meet the requirements prescribed by law and the bylaws, must be deposited together with the slates within the time limit specified above. The declarations must be accompanied by a *curriculum vitae* for each candidate regarding his personal and professional characteristics, with the possible indication that the candidate qualifies as independent.
As per international best practices, the renewal of the administrative body of the Company allows shareholders to vote individually on: (i) the number of people on the Board of Directors; (ii) the election of Directors through a vote on the presented slates; (iii) the duration of the mandate of the Board of Directors; and (iv) the pay packages of the Directors.
In reference to the election methods, it seems pertinent to note that the Board of Directors that convened on March 12th, 2007 – in order to align the above-mentioned elections system with the new provisions introduced by the Savings Law and the Corrective Decree, as well as recommendations in the new Code of Conduct – proposed some changes at the following Shareholders' Meeting aiming at (i) allowing for the percentage of share capital required to present slates to be less than 2% if so deemed by Consob (ii) increasing the time within which slates must be presented to 15 days, and (iii) together with the depositing of the curriculum vitae of each candidate, requiring a list of all the administrative and control positions that the candidate has held in other companies, and requiring that the candidate be suitable to be qualified as an independent Director according to legal and Company criteria.
During the same meeting, following a specific recommendation in the new Code of Conduct (criterion no. 1.C.3.), which requires the Board to express an opinion regarding the limit of the number of director's or auditor's positions held in other companies that can be considered compatible with administrative positions in Pirelli & C., the Board mandated the Committee for Internal Control and Corporate Governance to draw up a proposal regarding this point.

1.3 The composition of the Board of Directors

The Board of Directors of the Company, as established by the bylaws, consists of no less than seven and no more than twenty-three members.
The Board of Directors in office on April 28th, 2005 was renewed for three financial years (and will therefore be the Board that will convene for the approval of the financial statements at December 31st, 2007), and set the number of its members at twenty.
Through a vote, the minority list therefore nominated four Directors, i.e. one fifth of the total number. Two lists were presented, one by the participants in the Pirelli & C. S.p.A. Share Block Syndicate and the other by various savings management companies. Those proposing the slates made the candidates' profiles available so that the candidates' personal and professional characteristics, as well as some candidates' qualifications as independents, were made known prior to vot-

ing. The *curricula vitae* presented when the slates were filed were promptly published on the Company web site at www.pirelli.com, where they remain available in an updated version.
During 2006, some changes were made in the system of directors. Specifically, following the resignation of the Director Carlo De Benedetti – which took place in May – the Board of Directors convened on September 12th, 2006 nominated Alberto Bombassei who, in accordance with legislation, will remain in office until the next Shareholder Meeting. Subsequently, on November 6th, 2006 Carlo Buora resigned from his post of Managing Director and Board Member (as well as General Manager) of the Company.
Not having added any more members, the Board of Directors is therefore currently comprised of the following 19 members:

Marco Tronchetti Provera	Chairman
Alberto Pirelli	Deputy Chairman
Carlo Alessandro Puri Negri	Deputy Chairman
Carlo Acutis	
Carlo Angelici	Member of the Committee for Internal Control and Corporate Governance
Gilberto Benetton	
Alberto Bombassei	
Franco Bruni	Member of the Committee for Internal Control and Corporate Governance
Gabriele Galateri di Genola	
Mario Garraffo	
Dino Piero Giarda	
Berardino Libonati	Chairman of the Remuneration Committee
Giulia Maria Ligresti	
Massimo Moratti	
Giovanni Perissinotto	
Giampiero Pesenti	Member of the Remuneration Committee
Aldo Roveri	Member of the Remuneration Committee
Carlo Secchi	Chairman of the Committee for Internal Control and Corporate Governance and Lead Independent Director
Paolo Vagnone	

Carlo Angelici, Franco Bruni, Mario Garraffo and Aldo Roveri were minority candidates.
Three of the members of the Board of Directors are *executive directors* as defined in Article 2.C.1 of the new Code of Conduct: The Chairman Marco Tronchetti Provera, and (due to the executive duties bestowed upon them regarding the companies Pirelli Tyre S.p.A. and Pirelli & C. Real Estate S.p.A.) Deputy Chairmen Alberto Pirelli and Carlo Alessandro Puri Negri.
The Board of Directors evaluated the role of *independent directors* based on the most rigorous requirements in the new Code of Conduct (criterion 3.C.1.) which states that an independent director may not be – by law – considered independent:
a) if they, directly or indirectly or on behalf of subsidiaries, trust companies or through third parties, control the issuer or are able to exercise considerable influence, or are a participant in a shareholder agreement through which one or more individuals can exercise control or significant influence on the issuer;

b) if they have or have been in the past three financial years a member of prominence[2] of the issuer, or one of its strategic subsidiaries or a company under joint control with the issuer, or a company or a body that, alone or together with others in accordance with shareholders agreements, control the issuer or are able to exercise considerable influence;
c) if directly or indirectly (e.g. through subsidiaries or bodies that have a significant position, such as a partner of a law firm or a consultancy company) they have, or had in the previous financial year, a close business, financial or professional relationship with the following:
   – the issuer, one of its subsidiaries, or any related prominent exponent thereof;
   – an individual who, alone or together with others within a shareholder agreement, controls the issuer, or – if a company or body – with related prominent exponents thereof;

   or if, in the previous three financial years, they were an employee of one of the above-mentioned individuals or bodies;
d) if they receive, or in the past three financial years received, from the issuer or one of its subsidiaries or parent companies, a substantial bonus compared to their "fixed" salary as non-executive director of the issuer, including performance-based incentive plans, such as stock bonuses or other;
e) if they have been a director for more than nine years of the past twelve;
f) if they are an executive director in another company in which the executive director of the issuer holds the role of director;
g) if they are a board member or director of a company or body belonging to the company mandated to audit the accounts of the issuer;
h) if they are a close family member of a person that finds themselves in one of the situations described above.

Following a lengthy evaluation of the information supplied by the Directors and available to the Company, the Board of Directors – also based on declarations made by the same – judged 10 of the remaining 16 directors (Carlo Acutis, Carlo Angelici, Alberto Bombassei, Franco Bruni, Mario Garraffo, Dino Piero Giarda, Berardino Libonati, Giampiero Pesenti, Aldo Roveri and Carlo Secchi) may be qualified as independent directors, while the other six (Gilberto Benetton, Gabriele Galateri di Genola, Giulia Maria Ligresti, Massimo Moratti, Giovanni Perissinotto and Paolo Vagnone) may be qualified as non-executive directors.

Moreover, we note that the Board of Directors has checked that all directors qualified as independent may also be so deemed in accordance with the requirements for members of the board of statutory auditors in the Financial Services Act, as amended by the Savings Law.
A table at the end of this chapter shows the positions which the directors of the Company hold as director or member of the board of statutory auditors in other listed companies in Italy and abroad, in financial, banking and insurance companies, and in other large companies.

1.4 The role of Lead Independent Director

As of November 2005, in order to increase further the role of the ten Independent Directors, the Board of Directors decided to introduce a Lead Independent Director. The Lead Independent Director (Carlo Secchi, the Chairman of the Committee for Internal Control and Corporate Governance, was chosen) coordinates and acts as a point of reference for the requirements and contributions of the independent Directors.
The Lead Independent Director may also convene – on his own initiative or upon the request of other Directors – specific meetings solely for independent Directors (i.e. Independent Directors' executive sessions) in order to discuss subjects occasionally felt to be of interest to the functioning of the Board of Directors or management of the firm.

[2] The following are considered "members of prominence" of a company or body: the chairman of the body, the legal representative, the chairman of the board of directors, the executive directors and managers with strategic responsibilities within the company or body concerned.

Please note that the Lead Independent Director may collaborate with the Chairman of the Board of Directors for the better functioning of the Board of Directors.
During 2006, two Independent Directors' executive sessions were held that involved the discussion of intrinsic subjects to the corporate governance of the Company, the role and function of the independent Directors and the accounting measurement of the shareholding held in Olimpia S.p.A..
During 2007, one Independent Directors' executive session has already been held.

1.5 **Board performance evaluation**

During 2006, for the first time, the Board of Directors made a self-evaluation of its performance (officially called a "Board performance evaluation"), thus adhering to international best practices and the provisions in the new Code of Conduct (criterion 1.C.1., letter g); this evaluation studied the size, the composition and the functioning of the Board and its Committees, and was carried out with the assistance of a specialised external consultancy company that worked side by side with the Committee for Internal Control and Corporate Governance in order to set self-evaluation methods and analyse the results.
A generally positive evaluation of the Board and its work emerged from an analysis of the results, together with useful suggestions to improve its functioning further.

1.6 **Board of Directors Meetings**

During 2006, 10 Board of Directors meetings were held. The overall participation level of Directors was about 77%; the independent Directors ensured that their average overall attendance level was higher than 80%.
The bylaws do not provide for a minimum frequency of Board of Directors meetings. It is, however, the practice for the Board to convene on June 30th to examine the preliminary data, the budget project and the quarterly and biannual reports. As a rule, at the end of the last Board meeting of each financial period, the market is informed of the timing of the major company events (that is, Board and Shareholders' Meetings) planned for the following financial period. Any changes are promptly communicated to the market.
In November 2006, the Company distributed a schedule for five meetings in 2007. The schedule confirms the advance publication, also in 2007, of the budget documentation and the biannual report (making it possible, among other things, to take advantage of the exemption from the drawing up of the fourth 2006 quarterly report and of the second 2007 quarterly report).
The Board meetings may take place by means of telecommunication enabling participation of all parties concerned, with equal information, in the debate.
The Board of Directors meetings are convened by means of letter, telegram, fax or e-mail sent at least five days prior (or, in the event of emergencies, at least six hours prior) to the meetings. Each Director and Acting Auditor is called to the meetings.
Barring exceptional cases, the Directors and the Auditors have always received early enough the necessary documentation and data in order to express an informed opinion on the materials subject to their examination.

1.7 **Directors' remuneration**

In addition to reimbursement for expenses incurred in performing their duties, Directors receive annual fees determined by the shareholders' meeting (Article 14 of the bylaws).
The meeting of April 28th, 2005 decided "to establish a maximum of 1,200,000 as the total annual compensation to the Board of Directors pursuant to Art. 2389, paragraph 1, of the Civil Code, an amount to be distributed among its members in conformity with decisions taken in this regard by the Board."
At the same meeting, on April 28th, 2005, the Board of Directors established the distribution of the compensation as follows:
- € 50,000 annually for each of the 20 members of the Board of Directors;

- € 25,000 annually for each of the members of the Committee for Internal Control and Corporate Governance;
- € 20,000 annually for each member of the Remuneration Committee, with the right being reserved to use the residual amount (65,000) in the future to give the Board a margin of organizational flexibility, including for the adoption of any new governance solutions.

A payment of 10,000 annually is also made to the Board member taking part in the Self-Regulatory Body as per legislative decree no. 231/2001 (Carlo Secchi).

The Board of Directors upon consultation with the Board of Statutory Auditors establishes remuneration for directors given particular tasks, as proposed by the Remuneration Committee. The current remuneration system provides for payments to comprise a fixed amount and an additional bonus linked to the performance of the Group, and to be related to the attainment of specific objectives set by the Board.

Information on the remuneration of the directors entrusted with special powers can be found in a chart in the notes to the financial statements for 2006.

Lastly, it should be noted that there are no stock-option plans for either the executive or the non-executive directors[3].

1.8 Delegated powers

Taking into consideration and according to the new corporate regulations established in legislative decree no. 6/2003, the Chairman Marco Tronchetti Provera and the Managing Director Carlo Buora (the latter of which ended his mandate on November 6th, 2006) were identically recognized as legal proxies of the Company, each given legal powers to perform any pertinent act to corporate activity in its various manifestations.

Limits to the powers conferred have also been established and qualified as internal limits to the relationship between the delegating body of the Board and the parties with delegated powers: the Chairman Marco Tronchetti Provera has the power to guarantee Company and subsidiary bonds having individual values of more than 25 million, or for third parties regarding bonds with individual values of more than 10 million (in the latter cases another Director' s signature must be included with the Chairman's signature); the General Manager Carlo Buora – as stated, as long as he fills this role – has quantitative limits to the powers to make transactions of greater significance (50 million regarding the undertaking or alienation of interests or shareholdings in companies or bodies, the subscription of capital increases and bonds, the signing of exchange and purchase/sale contracts involving real estate assets or financial instruments).

Furthermore, the Chairman, Marco Tronchetti Provera, was confirmed as having the following organizational functions:
- relations with shareholders and the information provided to them;
- coordination of the Managing Directors' activities;
- formulation, in agreement with the Managing Directors, of the general strategies and development policy for the Company and the Group, to be submitted to the Board of Directors together with extraordinary corporate actions;
- proposals, to be submitted to the Board of Directors in agreement with the Managing Directors, for the appointment of members of the General Managers' Departments and, after consulting the Remuneration Committee, for their compensation;
- chairmanship of the managing committees with strategic functions;
- all forms of communication to the market, with the right to delegate to the managing directors, in accordance with what is covered by the procedure for the management and communication to the market of privileged information, as approved by the Board on March 13th, 2006;

[3] With the exception of Deputy Chairman Carlo Alessandro Puri Negri, in that, as Chief Executive Officer of Pirelli & C. Real Estate S.p.A., he holds stock options in that company.

- the right to acquire from the Managing Directors and the management of the Group all the data and information considered necessary to carry out the above-mentioned functions.

Powers pertaining to their specific functions, subject to certain quantitative limits, have been granted to Claudio De Conto[4], Chief Operating Officer, and to Luciano Gobbi[5], Chief Finance and Strategic Planning Officer[6].

Less broad powers have been granted to other managers of the Company to be used in their individual spheres of competence.

As in the past, in 2006 the Chairman, the Managing Director (during his mandate), the General Managers and the Managers used their delegated powers only for the ordinary management of the activities of the Company (in regard to which the directors were periodically informed) and submitted the transactions which were more important from an operational or financial perspective to the Board of Directors.

In fact, delegation does not mean the assignment of exclusive powers but is rather the solution adopted by the Company to ensure, in terms of the organization of the Board, the best degree of operational flexibility, both within the Company and in relation to third parties.

1.9 Provision of information to the Board of Directors

Pursuant to Article 11 of the bylaws (which incorporate the prescriptions of Article 150, paragraph 1 of the Financial Services Act), the Board of Directors and the Board of Statutory Auditors are kept informed, inter alia by the persons with delegated powers, about the performance of the Company, its general management, its prospects and the transactions of greatest significance for its profitability, financial position or assets and liabilities carried out by the Company or its subsidiaries; in particular, such persons report any transactions in which they have an interest, for their own account or on behalf of third parties, or that are influenced by the person, if any, who performs management and coordination activities. Such reports are made promptly and at least once every three months, on occasion of the Board of Directors meetings (and the Executive Committee, if established) or by means of a written communication.

In order to favour the orderly organization of the flow of information, in July 2002, the Company adopted a procedure with the rules to be followed to ensure compliance with the above-mentioned Article 150 with regard to the activities of the executive directors, both in exercising their delegated powers and in carrying out the transactions approved by the Board of Directors.

This procedure has also recently been subject to a review that involved Company governance frameworks. The Board of Directors meeting on March 12th, 2007 actually decided to adopt a general procedure on information flows to the Directors and Auditors, which incorporates more widely the procedure adopted to fulfil the obligations of art. 150 of the Financial Services Act. The new procedure aims at regulating and coordinating the various types of data flowing to Directors and Auditors, so that they all have the common aim of continuously making available to the members of these Boards the data needed to properly fulfil their directional, policy and control responsibilities.

The text of this new policy, shown at the end of this chapter, is also available on the website of the Company at _www.pirelli.com_, under the sectioned entitled "Governance".

1.10 Rules of conduct for transactions with related parties

The Company has also established since 2002 the rules of conduct for transactions with related parties, including intra-group business. The aim of the rules is to guarantee substantial and procedural

[4] Up until November 7th, 2007, General Manager of Administration and Control.
[5] Up until November 7th, 2007, General Manager of Finance.
[6] Similar powers were given to General Manager of the Tires Sector, Francesco Gori, until June 30th, 2006, the date on which he began his role with the subsidiary Pirelli Tyre S.p.A., where he is Chief Executive Officer.

fairness and transparency of transactions made by Pirelli & C. with parties related to Pirelli & C., either directly or through subsidiaries.
In fact, under the rules, the Board of Directors is required to give advance approval of transactions with related parties, including intra-group transactions, apart from those of a customary nature and those to be concluded at standard conditions. To this end, a provision is made for the Board to be adequately informed of all the relevant aspects: the nature of the relationship, the manner of carrying out the transaction, the economic and other conditions, the evaluation procedures used, the rationale for the transaction and the interest of the Company in its implementation and the associated risks. If the related party is a Director or a party related via a Director, the Director in question – unless the board decides otherwise – may only provide clarifications and must leave the meeting when the motion is examined and put to a vote. Depending on the nature, value and other aspects of related-party transactions, the Board of Directors may be assisted by one or more outside experts in order to prevent contracts from being concluded at inappropriate conditions. According to the circumstances, such experts express an opinion on the economic and/or legal and/or technical aspects of the transaction.
Finally, please note that in order to identify what constitutes a related party, the Company – as also indicated by Consob – defines the concept of "related party" according to the IAS/IFRS principles (specifically IAS 24).
The text of the main principles of conduct is shown at the bottom of this report, and is available on the website of the Company at *www.pirelli.com* under the section entitled "Governance".

2. Committees

2.1 The Remuneration Committee

The Board has established, since 2000, the Remuneration Committee from among its members, charged with fact-finding and advisory functions.
In line with the provisions in the new Code of Conduct, this Committee:
- prepares proposals to the Board regarding the remuneration to the Board of Directors and those who hold certain roles, to ensure that they align with the objective of shareholder value creation in the medium-long term;
- periodically evaluates the remuneration criteria for the upper management of the Company and, upon request of the Board of Directors, prepares related proposals and recommendations, with specific reference to the adoption of possible stock option plans or stock bonuses;
- monitors the application of the decisions made by the relevant bodies and company policy regarding top management compensation.

The Committee – which may also request the assistance of external consultants in fulfilling its mandate – meets whenever its Chairman deems it appropriate or a meeting has been requested by another member of the committee or by a Managing Director. The Board of Statutory Auditors and, when considered appropriate, other Company representatives participate in the Committee meetings.
In full compliance with provisions in the new Code of Conduct, the Remuneration Committee consists exclusively of independent Directors: Berardino Libonati (Chairman), Giampiero Pesenti and Aldo Roveri.
During 2006, the Remuneration Committee met four times during which it examined – and presented to the Board – pay packages to the Chairman, the Managing Director (also in reference to the end of the mandate regarding the roles covered by the same) and the General Managers, also disclosing the criteria underlying its decisions.
All members of the Remuneration Committee participated in the meetings, except for one absence during one meeting.

2.2 The Committee for Internal Control and Corporate Governance

The Board has established the Committee for Internal Control and Corporate Governance, which is charged with fact-finding and advisory functions, from amongst its members since 2000. In particular, this committee:

a) assists the Board of Directors in establishing the guidelines for the internal control system and periodically verifying its adequacy and effective working, so as to ensure that the risks facing the Company are managed appropriately;
b) evaluates the work plan prepared by the persons responsible for internal control, from whom it receives periodic reports;
c) assesses, together with the financial officers and the independent auditors of the Company, the appropriateness of the accounting standards applied and their homogeneousness for the purpose of preparing the consolidated financial statements;
d) evaluates the proposals made by independent auditors in order to be awarded the appointment, as well as the audit plan and the results set out in the auditors' report and in the letter of suggestions;
e) reports to the Board of Directors at least once every half year, on the occasion of the approval of the draft of annual financial statements and the half-yearly report on the activity performed and the adequacy of the internal control system;
f) performs the additional tasks that may be assigned to it by the Board of Directors, particularly with regards to relations with the independent auditors; and
g) monitors compliance with the rules of corporate governance and their periodic updating and compliance with the rules of conduct adopted by the Company and its subsidiaries.

Similarly to the Remunerations Committee, the Board of Directors that convened on March 12th, 2007 provided for the adjustment of duties mentioned above to those required in the new Code of Conduct for committees and internal control (art. 8), as well as deciding that the Committee should continue to maintain the corporate governance prerogatives (see letter g above) that have characterised it since its establishment, as well as additionally providing for the following:

- that it expresses an opinion on those proposed for election, revocation or assigning of duties to the internal control provost and the manager proposed as the manager responsible for the preparation of company accounting reports;
- in case of the substitution of an independent Director, it shall propose a candidate to the Board of Directors for co-optation;
- that it defines the methods and effective times of the Board of Directors annual evaluation.

The Committee – which, as it has in the past, may also request the assistance of external consultants to fulfil its role – normally meets before the Board of Directors meetings are called for approval of the draft annual financial statements, the half-yearly report and the quarterly reports; it also meets whenever its chairman deems it appropriate or a meeting has been requested by another member of the committee or by a Managing Director.

The members of the Board of Statutory Auditors, the head of the Internal Control Committee and if deemed necessary other company representatives may participate in the meetings of the committee.

In line with best practices and in full compliance with the recommendations in the new Code of Conduct for listed companies, the Committee is exclusively composed of the following independent Directors: Carlo Secchi (Chairman), Carlo Angelici and Franco Bruni, two of which[7], as ascertained by the Board of Directors convened on March 12th, 2007, possess adequate accounting and financial experience.

During 2006, the Committee for Internal Control and Corporate Governance met seven times and all members participated in these meetings.

The Committee actively contributed to the implementation process and the updating of Company corporate governance instruments. Specifically, following the addition of market abuse regulations in national law (EU Law 2004), the issuing of the Savings Law, the Corrective Decree and the new

[7] Mr Bruni and Mr Secchi.

Code of Conduct, the Committee for Internal Control and Corporate Governance in 2006 – availing itself of support from various Company departments – contributed to the defining of a procedure for the management and the market communication of sensitive information. Moreover, in 2007 it had already approved the interventions necessary regarding alignment with the new Code of Conduct (as cited throughout this Report), as well as drafting a procedure regarding information flows to Directors and Auditors, besides formulating proposals for modifications to the Company bylaws and shareholders' meeting regulations, which will be put forth at the Meeting called to examine the 2006 financial statements.
Also during 2006, the internal control provost of the Company (who is the head of the Internal Auditing Department) was able to refer his actions to the Committee for Internal Control and Corporate Governance through the submission of four reports. The Committee also monitored the activities carried out by the Internal Auditing Department of the Company, specifically examining the result of activities regarding the 2006 Audit Plan and approving the Audit Plan for the financial year 2007.
The Committee was also constantly informed on the auditing activities of the "231 organisational model" and the implementation of the "262 Project" (described below in paragraph 4) and, with the representatives of PricewaterhouseCoopers, verified the auditing activities plan.
Lastly, it was felt opportune to give an account of the development of the actions, legal and otherwise, that involved two ex-heads of Company Security that were subject to an investigation by the Committee for Internal Control and Corporate Governance, along with the Board of Statutory Auditors.
Specifically, during the meeting held on July 20th, 2006, the Committee analysed the affair that involved an ex-Manager of the Company, Giuliano Tavaroli – who up until a few years earlier had been the head of the Security Department – in a criminal proceedings case for conspiring to violate professional discretion. At this meeting, the Committee was informed of the verification activities carried out by the Company with the assistance of legal consultants, as well as the conduct taken in order to ensure a maximum level of collaboration and transparency of the Company regarding the court of jurisdiction, which – in June 2006 – had deposited a memorandum at the public prosecutor's office in Milan (an additional memorandum was thereafter deposited with the national prosecutor's office on December 6th, 2006).
During a meeting on September 8th, 2006, the Committee received notice of the outcome of the intrinsic verifications to the passive cycle of the security activities made during the April-May 2006 period by the Internal Auditing Department of the Company. This intervention allowed to the identification of some areas of improvement for which corrective actions were held necessary (i.e. the complete involvement of the Purchasing Division in security services procurement; the creation of a suppliers' registry listing only those who satisfy certain requirements regarding quality, financial reliability and trustworthiness; the establishment of adequate authorisation levels regarding security service purchase flows; the adoption of additional control measures that guarantee complete traceability for each phase of the purchasing process and the monitoring of the costs of the Security Department).
Subsequently, in October 2006, the Committee – with the assistance of legal consultants that aided the Company on this theme – investigated further developments that took place regarding the legal process following the injunction issued on September 20th, 2006 by the Preliminary Investigations at the Court of Milan (which became public domain following the full publication of this provision on the web site *www.ilvelino.it*) which remanded in custody Giuliano Tavaroli, as well as Pierguido Iezzi (along with others) who at that moment held the role of head of Pirelli & C.'s Security Division. The individuals mentioned above were charged with (i) conspiracy to commit crimes aimed at corrupting public officials, using data retrieved from unlawful use of their access to IT systems and embezzlement of Pirelli Group and Telecom Italian funds, (ii) several counts of embezzlement, (iii) corruption of a public official, and (iv) unlawful divulgation of sensitive and reserved information.
The Committee specifically examined the position of Pierguido Iezzi since, up until the date of the injunction, no reasons existed that would lead one to believe or even presume that this individual

could have been implicated in the affair and, following the application of precautionary measures, he was suspended from his position as head of Security.
Regarding the injunction, the legal consultants of the Company noted that (considering the significant level of transparency and collaboration shown by the Company, among other reasons) the order qualified Pirelli as an offended party and therefore subject to damages that occurred due to the felonies and – as of now – excludes the same from the application of the provisions in legislative decree no. 231/2001 on the administrative responsibility of companies, on the premises (i) that Company Top Management was unaware of the felonies, and (ii) according to the fact that the felonies were committed against, and not in favour, and not even in the interests of the Company.
Lastly, the Committee inquired as to the need for corrective actions regarding the internal control system, and acknowledged that the improvements made based on suggestions from an internal audit on Security functions (which, as mentioned, had already taken place during April and May 2006 based on an independent decision of the Company) constituted an adequate solution, despite having examined and promoted possible refinements to the system at subsequent meetings.
Lastly, during a meeting held on November 6th, the Committee – again discussing the matter – mandated the Internal Audit Department of the Company to launch the collection of data on the security service performance required by various company functions during the past few years through the initiation of a specific data requirements memo sent to all "front line" Company members. In tandem, the Internal Audit Department was also given the task of requiring employees in the Security division of companies in the Pirelli Group to declare if they had or had not kept copies of files or documents regarding duties assigned to this Department during the January 2000 – June 2006 period. From initial reports of the verifications made until now – which were still being made during the preparation of this report – no particular critical findings had come to light.
Finally, it should be noted that the Company has launched a civil lawsuit against the security service suppliers involved in the investigations, in order to be compensated for services that were not contractually fulfilled or were even illegal.
The Committee for Internal Control and Corporate Governance and the Board of Directors, taking into account the comments of the Board of Statutory Auditors, judged the internal control system of the Company and of its underlying Group to be adequate.

2.3 Elections Committee

The Board of Directors has decided not to establish an election committee charged with putting forward proposals for the position of Director, since at present the conditions envisaged by the Code for its establishment do not exist, because of the current ownership structure and, above all, the By-laws provision for the slate system, in view of the transparency this mechanism ensures in the selection of candidates.
The Board has made the same conclusions also in accordance of provisions in the new Code of Conduct.
In fact, since the Board considers the reasons mentioned above still valid, it has not felt that the constitution of a specific elections committee is necessary. Moreover, it has given the Committee for Internal Control and Corporate Governance the power to identify candidates to propose to the Board in the event that an independent Director is to be co-opted.

3. Disclosure of sensitive information and insider dealing

3.1 Internal management and disclosure of documents and information

Market transparency, clarity, correctness and integrity of information are the values that are upheld by the conduct of the corporate bodies, the management and all the employees of the Pirelli Group.
In March 2006, the Board of Directors of the Company adopted a specific procedure for the management and market communication of sensitive information that, keeping account of the regulations regarding market abuse, governs the management of sensitive information connected to Pirelli & C., its unlisted subsidiaries and the listed financial instruments of the Group, and as such all the members of corporate bodies such as the employees and collaborators of companies external to the Group that may have access to information that could evolve into sensitive information. This procedure also applies as instructions to all subsidiaries in order to obtain from them, without hesitation, the necessary information for the timely and proper fulfilment of financial reporting obligations.
This procedure also governs the registration (operative as of April 1st, 2006) of persons having access to privileged information.
The adoption of the new procedure is the most evident result of the work done by the working group set up by the Company to assess the consequences of the national regulation (EU Law 2004) implementing the Community Directive on Market Abuse
Both the Committee for Internal Control and Corporate Governance and the Board of Statutory Auditors were regularly updated on the activity of the working group and agreed with its results.
The text of the procedure may be consulted at *www.pirelli.com*, under the section entitled "Governance".

3.2 Insider dealing

Matters regarding the transparency of transactions on Company shares or financial instruments underlying or linked to shares made directly or by third parties for relevant persons or by persons closely related or linked to them (i.e. insider dealing) are currently fully governed by law and by regulations established by Consob (art. 114 of the Financial Services Act and art. 152-sexies and following amendments of the Issuer's Regulation), as of April 1st, 2006 over-riding the Code of Conduct of the Company regarding insider dealing, adopted as from December 2002.
Pursuant to the law, irectors and statutory auditors of the Company, as well as "persons who carry out administrative [...] functions in a listed company and managers that have regular access to sensitive information [...] and have the power to make management decisions that could affect the performance and the future prospects of a listed company…" and others are obliged to disclose to the market any insider dealing transactions made on Company shares or financial instruments linked to these shares having a value of more than Euros 5,000 annually. The Company opted to identify these managers as its General Managers, and – as an example of self-regulation – as the Managing Director and General Manager of Pirelli Tyre S.p.A. (who, until June 30th, 2006, was the Managing Director of the Company). Similarly, disclosure obligations also involve Pirelli & C. Real Estate S.p.A., a company that is also listed on a regulated market.
Within the more general auditing process for the corporate governance instruments, despite being not obliged by law, the Board of Directors decided to institute a black out period for the persons mentioned above who must adhere to insider dealing regulations; they shall therefore abstain from making transactions on Company shares or on financial instruments linked to these shares. These periods may moreover be extended or suspended by the Board of Directors in exceptional cases.

4. Internal Control

The internal control system of Pirelli & C. and the Group it heads is designed to ensure the provision of correct information and adequate cover of all the activities of the Group, with special reference to those areas that are considered to be potentially at risk
It has developed as a process intended to achieve substantial and procedural fairness, transparency and accountability by ensuring that transactions and, more generally, business related activities are efficient and can be known and verified, that financial information and accounting and operational data are accurate, that applicable laws and regulations are complied with, and that the assets of the business are safeguarded, not least with a view to prevent the perpetration of fraud against the Company and financial markets.
The cardinal rules of the internal control system of the Company are:
i. separation of roles in the performance of the principal activities involved in each operating process;
ii. traceability and constant visibility of decisions;
iii. management of decision-making processes according to objective criteria.
Responsibility for the internal control system lies with the Board of Directors, which lays down the guidelines for the system and periodically verifies that it is adequate and working effectively. To this end, the Board refers to the Committee for Internal Control and Corporate Governance, as well as to a Provost, who is given an adequate level of independence and appropriate means in order to carry out this mandate, and who carries out typical audit functions to verify the adequacy and efficiency of this system; and, if anomalies are detected, who proposes the necessary corrective solutions.
A specifically nominated Director (currently the Chairman of the Board of Directors) has the mandate of identifying the main company risks that must periodically be examined by the Board and the execution of the policy lines defined by said Board, seeing to the planning, realisation and management of the internal control system, constantly verifying its overall adequacy, efficiency and adaptation to the changes in business conditions and legislation and regulation frameworks.
The internal control Provost – that the Board of Directors, with the approval of the Committee for Internal Control and Corporate Governance and in accordance with best practice, has identified as the head of the Internal Audit Department, also deciding his/her remuneration – is functionally responsible to the Committee for Internal Control and Corporate Governance and the Board of Statutory Auditors and hierarchically responsible to the Chairman of Pirelli & C. S.p.A..
The Internal Audit Department has a significantly important role in the internal control system and, also for activities performed regarding subsidiaries, it has the principal task of assessing the adequacy and functionality of control, risk management and corporate-governance processes throughout the entire Group by means of autonomous assurance and consultancy. The work of the Internal Audit Department is carried out in accordance with its mandate and is shared with the Committee for Internal Control and Corporate Governance, regarding the following aspects:
- mission;
- objectives and responsibilities (independence, complete access to information, activity framework, communication of results);
- improvement in the quality of internal audits;
- principles of professional ethics;
- professional reference standards.

The Company also has in place a planning and control system that focuses on individual sectors and operating units and produces a detailed monthly report for the General Managers, so that they have a useful tool with which to monitor specific activities.
In order to favour compliance with the strategies and guidelines adopted by the parent company, the relevant General Managers and senior executives sit on the Boards of Directors of the largest subsidiaries.

Also regarding internal control, please note that – in order to comply with provisions in art. 154-bis of the Financial Services Act (as amended by the Savings Law, and more recently, by the Corrective Decree), which does not apply regarding financial statements for 2006 – the Company initiated a project (named "Project 262"), guided by a specific steering committee, with the objective of making a system of controls for administrative and accounting procedures available to the administrative boards and the managers involved in the preparation of corporate accounts for the preparation and the validation of periodic accounting reports, which allow these individuals to make the declarations regarding them as required by law. Please also note that the role of "manager responsible for the preparation of company accounting reports" will be introduced into the bylaws by the shareholders at the meeting called to approve the 2006 financial statements. Regarding the detailed report that will be published for this meeting, please note that the professional requirements of this new role will be set in the bylaws (i.e. administrative, financial and control experience); the person occupying this position will be nominated (and revoked) by the Board of Directors, subject to approval of the Board of Statutory Auditors, and the Board of Directors will also set the powers and duties for this role.

The internal control system described above has been further strengthened by the introduction of an organizational model that the Board of Directors approved on July 31st, 2003 and which was revised and modified according to updated regulations by a resolution of the Board of Directors on March 12th, 2007. Intended to ensure the creation of a system responding to the specific requirements deriving from the entry into force of Legislative Decree 231/2001, on the administrative liability of companies for criminal offences committed by their employees, the model consists of a set of principles and procedures arranged in a pyramid that, starting from the base, can be summarized as follows:

- **Group Code of Ethics**, which formulates the general principles (transparency, correctness and fairness) inspiring the conduct of business. It indicates the objectives and the values informing business activity in relation to the main stakeholders with which Pirelli & C. S.p.A. interacts on a daily basis: the shareholders, the financial market, customers, staff and the community.
- **General principles of internal control**, which qualify the Internal Control System and the field of application, and which extend uniformly across the various organizational levels;
- **Lines of conduct**, which set out specific rules aiming to avoid the creation of environmental situations that favour criminal activity in general, and in particular, crimes covered under legislative decree no. 231/2001, and translate the principles established by the Group Code of Ethics into operational terms.
- **Internal control checklists**, which set out the main phases of each high and medium risk process and of the instrumental processes, the specific checks to be performed with a view to reasonably anticipating the risks of any criminal offence, and specify the reports to be transmitted to the Self-Regulatory Body to draw the attention to situations of possible non-compliance with the procedures established in the organizational model.

A specific Self-Regulatory Body monitors the functioning of and the adherence to the organisational model. It is composed of Carlo Secchi, the Lead Independent Director and Chairman of the Committee for Internal Control and Corporate Governance, Paolo Francesco Lazzati, a member of the Board of Statutory Auditors, and Maurizio Bonzi, head of the Internal Audit Department and Provost of internal control. It is also ensured full independence from this Body, as well as having many expert professionals that contribute to corporate management control.

The Self-Regulatory Body is in charged of making recommendations to the Board of Directors for it to adapt the organizational model to changes in the legal framework, the nature of the business activities of the Company and the ways they are conducted. It reports to the Board of Directors, the Committee for Internal Control and Corporate Governance and the Board of Statutory Auditors on the checks performed and their results.

The shareholders' meeting of April 28th, 2005 fixed the annual gross fee payable to each member of the Self-Regulatory Body at Euros 10,000.

With reference to unlisted Italian Group companies, the Self-Regulatory Body has been adapted by adopting the technical and operational solution that, while respecting the mandate and the powers reserved to the body by law, is appropriate to the size and organizational context of each company.
A disciplinary system has been introduced to sanction non-compliance with the measures indicated in the organizational, operational and control systems.
Finally, it should be pointed out that the Internal Audit Department of Pirelli & C. provides, when requested by the self-regulatory bodies of Group companies, operative assistance in the management and analysis of information flows established pursuant to Art. 6, paragraph 2, letter d), of Legislative Decree 231/2001, as well as in implementation of specific audits on the basis of data received through the aforementioned information flows.
During the second half of the year, the Self-Regulatory Body became involved in the court case that implicated two ex-heads of the Security Department of the Company, as detailed more extensively in paragraph 2.2 above. The Self-Regulatory Body acknowledged that the injunction issued on September 20th, 2006 for the Preliminary Investigations of the Court of Milan (which, as stated, became public domain following the full publication of this provision on the web site *www.ilvelino.it*) which remanded in custody Giuliano Tavaroli, as well as Pierguido Iezzi who at that moment held the role of head of Pirelli's Security Division, qualified Pirelli as an offended party and therefore subject to damages that occurred due to the felonies committed and – in the current state – excludes it from the application of the provisions in legislative decree no. 231/2001 on the administrative responsibility of companies, on the premises (i) that Company Upper Management was unaware of the felonies, and (ii) according to the fact that the felonies were committed against, and not in favour, and not even in the interests of the Company.
As mentioned, the Board of Directors and the Committee for Internal Control and Corporate Governance believe that the internal control system of the Company and of the Group is adequate, following evaluations made based on indications received from the Board of Statutory Auditors and other information.

5. Relations with institutional investors and other shareholders

In line with its tradition of transparency and fairness, the Company actively promotes relations with shareholders, institutional and private investors and with financial analysts, with other market operators and with the financial community in general within the proper limits of their respective roles, and periodically organizes meetings with representatives from the Italian and international financial communities.
In March 1999, the Company established an Investor Relations Department to foster continuous dialogue with the financial market. The Investor Relations Department, which reports directly to Finance and Strategic Planning Managing Director Carlo Buora, is headed by Alberto Borgia and has its own section in the website of the Company at *www.pirelli.com.*
In this section of the website, investors can find every document of interest published by the Company, in English as well as in Italian, related to financial reporting (e.g., the annual financial statements and the half-yearly and quarterly reports) and the corporate governance system of the Company (e.g., the bylaws, the regulations for Shareholder meetings, the Rules of conduct for transactions with related parties, the procedure for information flows to Directors and Auditors, the procedure for the management and communication to the public of privileged information and the minutes of Shareholders' Meetings). The section also gives access to press releases distributed by the Company and the documentation that the Company makes available to the financial community in presentations and/or meetings and information on the share capital of the Company and shareholders (including the publication of shareholders' agreements).
Pirelli & C. was one of the first companies in Italy and Europe to publish specific inserts giving

economic and financial data in the mass media, as well as one of the first to set up a kit on its website for small investors.
Investor queries may be sent to: e-mail: *ir@pirelli.com*; tel.: +39 02 64422949; fax: +39 02 64424686.

6. Shareholders' Meetings

It is the constant policy of the Company to use Shareholders' Meetings to communicate information on the Company and its prospects to the shareholders. Obviously, it does this in accordance with the rules governing confidential information and, where necessary, simultaneously communicates the same information to the market.
The Company carefully considers the choice of the place, date and time for convening Shareholders' Meetings, to facilitate the participation of the shareholders. All the Directors and all the members of the Board of Statutory Auditors make every possible effort to attend the meetings, especially those Directors whose positions permit them to make an important contribution to the discussion.
Moreover, in coherence with the bylaws that facilitates corporate involvement by minimising costs and charges, during 2005 article 7 (Shareholders' Meetings) in the Company Bylaws was modified to allow intervention in Shareholders' Meetings through the notice of intention, without the party concerned needing to produce any certification.
At the Meeting held on April 21st, 2006, in addition to approving the 2005 financial statements, shareholders deliberated to renew the mandate of the Board of Statutory Auditors (as detailed below) and authorised the purchase and alienation of ordinary and/or savings Company shares, within legal limits, for a period of 18 months.

7. Auditors

The Company bylaws provide that the Board of Statutory Auditors consists in three Standing Auditors and two Alternate Auditors. In order to allow minority shareholders to elect one Standing Auditor and one Alternate, Article 16 of the bylaws provides for use of the slate system, with one Standing Auditor and one Alternate elected from the slate that obtains the second largest number of votes (the minority slate). The other two Standing Auditors and the other Alternate are elected from the slate that obtains the largest number of votes (the majority slate).
Shareholders who, alone or together with others, hold at least 2 per cent of the share capital entitled to vote at the ordinary shareholders' meeting, may present slates, subject to their proving ownership of the necessary number of shares not later than two days before the date set for the shareholders' meeting at the first call. Each shareholder may present or participate in the presentation of only one slate.
The slates, signed by the persons who present them, shall be deposited at the registered office of the Company at least ten days before the date set for the shareholders' meeting at the first call and made available to anyone who requests a copy. The slates must be accompanied by a professional curriculum vitae for each candidate and declarations in which the candidates individually accept their candidacy and attest, on their own responsibility, that there are no grounds for ineligibility or incompatibility, and that they meet the requirements prescribed by law and the bylaws.
Slates presented in violation of the above rule are considered null.
Subject to ineligibility, each candidate may only appear on one slate.
Slates must be divided into two sections: one for candidates for the position of Standing Auditors and the other for candidates for the position of Alternate. The first candidate in each section must be selected from among persons entered in the register of statutory auditors who have worked on statutory audits for a period of not less than three years.

Each person entitled to vote may vote for only one slate.
Additionally, according to the Company bylaws, the chairmanship of the Board of Statutory Auditors is to be given to the statutory auditor at the top of the slate which obtains the largest number of votes.
This clause – as detailed below – was not applied at the renewal of the mandate of the Board of Statutory Auditors resolved by the Shareholders' Meeting on April 21st, 2006, in that it went against the provision in art. 148 of the Financial Services Act as amended by the Savings Law, which stipulates the election of the Chairman from amongst the minority members.
In the event of death, resignation or disqualification of a Standing auditor, he (or she) is replaced by the alternate director elected on the same slate. If the Chairman of the Board of Statutory Auditors is replaced, the other Standing Auditor elected on the same slate takes the Chair (see the note at the end of this paragraph); if it is not possible to proceed in the manner described above, a shareholders' meeting is called to fill the vacancy or vacancies by means of a resolution approved by a relative majority of the votes cast.
When the shareholders' meeting has to appoint Standing Auditors and/or Alternates to bring the board up to full complement as provided for above or in conformity with the applicable law, it proceeds as follows: if statutory auditors elected from the majority slate are to be replaced, the appointment is made with the favourable votes of a relative majority without being tied to a slate; if, instead, statutory auditors elected from the minority slate are to be replaced, the shareholders' meeting replaces them with the favourable votes of a relative majority, choosing where possible from among the candidates on the slate from which the statutory auditor to be replaced was elected
In appointing statutory auditors who, for any reason, are not appointed following the procedure specified above, the shareholders' meeting votes according to the majorities required by law.
Statutory auditors whose term of office has expired may be re-elected.
Participation in meetings of the Board of Statutory Auditors may be – if the Chairman or his substitute verifies the necessity – by means of telecommunication techniques that permit participation in the discussion and equality of information for all those taking part.
The Board of Statutory Auditors instated until April 21st, 2006 was composed of Standing Auditors Luigi Guatri (Chairman), Roberto Bracchetti and Paolo Francesco Lazzati.
Franco Ghiringhelli and Sebastiano Guido were both Alternate Auditors
The Shareholders' Meeting held on April 21st, 2006 resolved to renew this Board for the 2006-2008 period, nominating Luigi Guatri, Enrico Laghi and Paolo Francesco Lazzati as Standing Auditors.
Luigi Guerra and Franco Ghiringhelli were appointed Alternate Auditors.
The election took place through a slate vote. The members of the Pirelli & C. block shares syndicate presented the sole slate. The level of authority and the reputation of the candidates proposed on this list are believed by the Company to be a possible reason why no other alternative slate was presented by the minority shareholders.
Lacking any Auditors on the Statutory Board chosen from the minority slate, the Shareholders resolved to confirm Luigi Guatri as Chairman of this Board.
The Shareholders also resolved that Euros 41,500 be the gross annual remuneration for each of the Standing Auditors, and Euros62,000 be the gross annual remuneration for the Chairman of the Board of Statutory Auditors, also resolving that to the Auditor that is appointed to the Self-Regulatory Body as per legislative decree no. 231/2001 (Paolo Francesco Lazzati) is granted an additional gross annual remuneration of Euros10,000.
During 2006, the Board of Statutory Auditors held 4 meetings prior to April 21st, 2006 and another 4 following that date. All members of this Board took part in these meetings except for one absence in two meetings; please also note that the members of this Board also attended the Shareholders' Meetings and the meetings of the Board of Directors of the Company and all seven of the meetings that were held during the year for the Committee for Internal Control and Corporate Governance, and all four of the Remuneration Committee meetings, as required by the corporate governance rules adopted by the Company, which offer the Board of Statutory Auditors

the full possibility of directly following the activities of the Committees and performing the control functions of their role with greater efficiency.
In line with provisions in the new Code of Conduct (art. 10) and as expressly ascertained by the Board of Statutory Auditors, all Auditors may be defined as independent based on criteria contained in the new Code of Conduct regarding directors.
In order to conform the Company Bylaws' provisions relevant to the appointment of the Board of Statutory Auditors to the new regulations introduced in the Financial Services Act by the Savings Law and the Corrective Decree, as well as to the provisions of the new Code of Conduct, the Board of Directors held on March 12th, 2007 resolved to propose at the Shareholders' Meeting some amendments to the Bylaws, i.e.: (i) to eliminate the clause which limits the total number of offices a Board member may hold (ii) to amend the clause relevant to the election system of the Chairman of the Board of Statutory Auditors, (iii) to increase the period within which slates may be presented to 15 days, (iv) to align the percentage of corporate shareholdings required to present slates to the percentage required in the nomination of the Board of Directors, and (v) to require in any case that each candidate declare all offices held in management and supervisory bodies held in the past, filing such a list at the registered office together with their curriculum vitae.

The following tables summarise all the methods by which the main recommendations of the new Code of Conduct were adopted by the Company:

- Structure of the Board of Directors, the Remuneration Committee and the Committee for Internal Control and Corporate Governance
- Structure of the Board of Statutory Auditors
- Other provisions in the Code
- Offices held in management and supervisory bodies by members of the Board of Directors and the Board of Statutory Auditors in other listed companies, in financial companies, banks, insurance companies, or in other companies of significant size.

Table 1

STRUCTURE OF THE BOARD OF DIRECTORS AND THE BOARD COMMITTEES

Board of Directors (1)							**Committee for Internal Control**		**Remuneration Committee**	
Position	**Name**	**executive**	**non-executive**	**independent**(2)	********	**Number of other positions ****	*******	********	*******	********
Chairman	Marco Tronchetti Provera	X			100%	6				
Deputy Chairman	Alberto Pirelli	X			100%	6				
Deputy Chairman	Carlo Alessandro Puri Negri	X			90%	11				
Director	Carlo Acutis		X	X	60%	10				
Director	Carlo Angelici (*)		X	X	90%	1	X	100%		
Director	Gilberto Benetton		X		60%	11				
Director	Alberto Bombassei		X	X	-	3				
Director	Franco Bruni (*)		X	X	90%	3	X	100%		
Director	Gabriele Galateri di Genola		X		90%	11				
Director	Mario Garraffo (*)		X	X	90%	2				
Director	Dino Piero Giarda		X	X	50%	2				
Director	Berardino Libonati		X	X	100%	6			X	100%
Director	Giulia Maria Ligresti		X		80%	11				
Director	Massimo Moratti		X		30%	6				
Director	Giovanni Perissinotto		X		40%	13				
Director	Giampiero Pesenti		X	X	70%	12			X	75%
Director	Aldo Roveri (*)		X	X	100%	-			X	100%
Director	Carlo Secchi		X	X	100%	4	X	100%		
Director	Paolo Vagnone		X		60%	3				
Managing Director	Carlo Buora (1)	X			89%	-				
Director	Carlo De Benedetti (1)		X	X	67%	-				
Number of meetings held during the year (the data refer to the entire financial period):			Board of Directors: 10			Committee for Internal Control: 7			Remuneration Committee: 4	

LEGEND

* Indicates that the director was elected from a slate presented by a minority shareholders (quorum required: 2% of voting stock).

** The positions held on the Board of Directors or Statutory Auditors of other companies listed on Italian and foreign regulated markets, of financial banking and insurance companies, and of other large companies are shown in detail in the Report on *Corporate Governance.*

*** The "X" in one of these columns indicates membership in the relevant Board Committees.

**** Indicates the attendance of directors at the meetings of the Board of Directors and the Board Committees.

(1) Changes occurred during the 2006 fiscal year: (i) Mr. Carlo De Benedetti has held the position of director until May 5th, 2006, (ii) Mr. Alberto Bombassei has held the position of director as from September 12th, 2006, and (iii) Mr. Carlo Buora has held the position of director until November 6th, 2006.

(2) All the directors eligible for the independent requirement provided by the new Self-Regulatory Code have further declared to be eligible for the independence requirement requested by the article 147-ter, comma 4 of d. Lgs. 58/1998.

Table 2

BOARD OF STATUTORY AUDITORS

Position	**Name**	**Attendance at Board meetings**	**Number of other appointments****
Chairman	Luigi Guatri	87,50%	16
Auditor	Enrico Laghi	75%	19
Auditor	Paolo Francesco Lazzati	100%	23
Number of meetings held during the relevant fiscal year: 8 (of which 4 before April 21, 2006)			
Quorum required for the presentation of slate by minority shareholders for the election of one or more auditors: 2%			

LEGEND

* Indicates that the director was elected from a slate presented by minority shareholders (quorum required: 2% of voting stock).

** Indicates the number of the main appointments of statutory auditors or director of other companies, including those held in the Pirelli Group. In the Report on Corporate Governance, these appointments are shown in detailed.

(1) lThe information of the chart refer to the Board of Statutory Auditors appointed on April 21st, 2006. The prior Board of Statutory Auditors was composed as follows: Luigi Guatri (Chairman), Roberto Bracchetti and Paolo Francesco Lazzati (Acting Auditors), Franco Ghiringhelli and Sebastiano Guido (Alternate Auditors). Prior to April 21st, 2006, 4 meetings of the Board of Statutory Auditors were held with an aggregate attendance rate of approximately 92%. The information of the chart relating to the attendance of the Professor Luigi Guatri and Mr. Paolo Francesco Lazzati also take into account the meetings held prior to April 21st, 2006.

Table 3

OTHER PROVISIONS OF THE SELF-REGULATORY CODE	YES	NO	Summary reasons for divergence from the recommendations of the Code
Delegated powers and transactions with related parties			
The Board of Directors has delegated powers and established:			
a) the limits to such powers?	X		
b) the manner of exercising them?	X		
c) the frequency of reports?	X		
Has the Board reserved the right to examine and approve transactions having a significant impact on the profitability, the assets and the liabilities or financialposition of the Company (including transactions with related parties)?	X		
Has the Board established guidelines for identifying "significant" transactions?	X		
Are the above guidelines described in the report?	X		
Has the Board established special procedures for examining and approving transaction with related parties?	X		
Are the procedures for approving transaction with related parties described in the report?	X		
Procedures used for the most recent appointments of the Board of Directors and the Board of Auditors			
Were the nominations to the board of directors filed at least ten days in advance?	X		
Were the nominations to the board of directors accompanied by detailed information?	X		
Were the nominations to the board of directors accompanied by an indication as to whether they qualified as independent?	X		
Were the nominations to the board of statutory auditors filed at least ten days in advance?	X		
Were the nominations to the board of statutory auditors accompanied by detailed information?	X		
Shareholders' meetings			
Has the Company approved rules of proceeding for shareholders' meetings?	X		
Are these rules included in the report (or does the report indicate where they can be obtained/downloaded)?	X		
Internal control			
Has the Company appointed the persons responsible for internal control?	X		
Are such persons hierarchically independent from the heads of the operating units?	X		
Unit responsible for internal control (ex Art. 9.3 of the Code)	X		
Investor relations			
Has the Company appointed a person to be responsible for investor relations?	X		
Unit and contact details of the person responsible for investor relations.	X[1]		

[1] Investor Relations Department (directly under General Manager Finance and Strategic Planning), headed by Alberto Borgia; Contact details: e-mail ir@pirelli.com; tel.: +39.02.64422949; fax: +39.02.64424686.

Posts of Director or Statutory Auditor held by members of the Board of Directors or members of the Board of Statutory Auditors in other listed companies, in financial companies, banks, insurance companies or companies of significant size

Marco Tronchetti Provera	Camfin S.p.A.	Chairman
	Gruppo Partecipazioni Industriali S.p.A.	Chairman
	Olimpia S.p.A.	Chairman
	Pirelli & C. Real Estate S.p.A.	Chairman
	Pirelli Tyre S.p.A.	Chairman
	Marco Tronchetti Provera & C. S.a.p.a.	Member of the Board of Managing Partners
Alberto Pirelli	FIN.AP di Alberto Pirelli & C. A.p.A.	Chairman
	Gruppo Partecipazioni Industriali S.p.A.	Deputy Chairman
	Camfin S.p.A.	Director
	GIM S.p.A	Director
	KME S.p.A.	Director
	Pirelli Tyre S.p.A.	Director
Carlo Alessandro Puri Negri	Pirelli & C. Real Estate Franchising Holding S.r.l.	Chairman
	Pirelli & C. Real Estate Opportunities Società di Gestione del Risparmio S.p.A.	Chairman
	Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A.	Chairman
	Camfin S.p.A.	Deputy Chairman
	Pirelli & C. Real Estate S.p.A.	Deputy Chairman and Managing Director
	Gruppo Partecipazioni Industriali S.p.A.	Managing Director
	Aon Italia S.p.A.	Director
	Eurostazioni S.p.A.	Director
	Olimpia S.p.A.	Director
	Pirelli Tyre S.p.A.	Director
	Telecom Italia S.p.A.	Director
Carlo Acutis	BPC Investimenti SGR S.p.A.	Chairman
	Vittoria Capital N.V.	Chairman
	Banca Passadore & C. S.p.A.	Deputy Chairman
	Vittoria Assicurazioni S.p.A.	Deputy Chairman
	Camfin S.p.A.	Director
	Ergo Assicurazioni S.p.A.	Director
	Ergo Italia S.p.A.	Director
	Ergo Previdenza S.p.A.	Director
	IFI S.p.A.	Director
	Yura International B.V.	Director
Carlo Angelici	Stretto di Messina S.p.A.	Director
Gilberto Benetton	Autogrill S.p.A.	Chairman
	Edizione Holding S.p.A.	Chairman
	Ragione Sapa di G. Benetton e C.	Chairman
	Olimpia S.p.A.	Deputy Chairman
	Telecom Italia S.p.A.	Deputy Chairman
	Aldeasa S.A.	Director
	Autostrade S.p.A.	Director
	Benetton Group	Director
	Loyd Adriatico S.p.A.	Director
	Mediobanca S.p.A.	Director
	Schemaventotto S.p.A.	Director
Alberto Bombassei	Brembo S.p.A.	Chairman
	Autostrade S.p.A	Director
	Italcementi S.p.A.	Director

Franco Bruni	Pioneer Global Asset Management S.p.A.	Director
	Unicredito Banca Mobiliare S.p.A.	Director
	Unicredit Audit S.p.A.	Director
Gabriele Galateri di Genola	Mediobanca S.p.A.	Chairman
	Istituto Europeo di Oncologia S.r.l.	Chairman
	Assicurazioni Generali S.p.A.	Deputy Chairman
	RCS MediaGroup S.p.A.	Deputy Chairman
	Accor SA	Director
	Banca CRS S.p.A.	Director
	Banca Esperia S.p.A.	Director
	Fiera di Genova S.p.A.	Director
	Italmobiliare S.p.A.	Director
	San Faustin NV	Director
	Commerzbank AG	Member of the Central Advisory Board
Mario Garraffo	Recordati S.p.A.	Director
	Terna S.p.A.	Director
Dino Piero Giarda	Banca Popolare Italiana S.p.A.	Chairman
	ACEA S.p.A.	Director
Berardino Libonati	Alitalia S.p.A.	Chairman
	Banca di Roma S.p.A.	Chairman
	Unidroit	Chairman
	Mediobanca S.p.A	Director
	Nomisma S.p.A.	Director
	RCS Mediagroup S.p.A.	Director
Giulia Maria Ligresti	Fonsai MB&A S.p.A.	Chairman
	Premafin Finanziaria Holding di Partecipazioni S.p.A.	Chairman and Managing Director
	Fondiaria Sai S.p.A.	Deputy Chairman
	Sai Holding Italia S.p.A	Managing Director
	Saifin S.p.A	Managing Director
	Finadin S.p.A.	Director
	Milano Assicurazioni S.p.A.	Director
	Sailux S.A.	Director
	Sainternational S.A.	Director
	Telecom Italia Media S.p.A.	Director
	Helm Finance SGR S.p.A.	Director
Massimo Moratti	F.C. Internazionale Milano S.p.A.	Chairman
	Sarint S.A.	Chairman
	Angelo Moratti di Gian Marco e Massimo Moratti & C. S.a.p.a.	Member of the Board of Managing Partners
	Interbanca S.p.A.	Director
	Saras S.p.A. Raffinerie Sarde	Managing Director
	Telecom Italia S.p.A.	Director
Giovanni Perissinotto	Banca Generali S.p.A.	Chairman
	Generali Finances S.A.	Chairman
	Generali Investments S.p.A. SGR	Chairman
	Generali Property S.p.A.	Chairman
	Banca della Svizzera Italiana S.A.	Deputy Chairman
	Alleanza Assicurazioni S.p.A.	Director
	Generale Espana Holding de Entidades de Seguros	Director
	Generali France Holding	Director
	Generali Property Investments Sgr S.p.A.	Director
	Ina Assitalia S.p.A.	Director
	Toro Assicurazioni S.p.A.	Director
	Partecipatie Maatschappij Graafschap Holland N.V.	Director
	Intesa San Paolo S.p.A.	Member of the Management Board

Giampiero Pesenti	Italcementi S..A.	Chairman
	Franco Tosi S.r.l.	Chairman
	Italmobiliare S.p.A.	Chairman and Managing Director
	Ciments Francais	Deputy Chairman
	Fincomind AG	Deputy Chairman
	Ciments de Maroc	Director
	Compagnie Monegasque de Banque	Director
	Credit Mobilier de Monaco	Director
	Finter Bank Zurich	Director
	Soparfinter S.A. Luxembourg	Director
	Mittel S.p.A.	Director
	R.A.S. S.p.A.	Director
Aldo Roveri	-	-
Carlo Secchi	Lloyd Adriatico S.p.A.	Director
	Mediaset S.p.A.	Director
	Parmalat S.p.A.	Director
	R.A.S. S.p.A.	Director
Paolo Vagnone	R.A.S. S.p.A.	Managing Director and General Managing
	Mol Holding S.p.A.	Director
	UniCredito Italiano	Director
Luigi Guatri	Banche Popolari Unite S.c.p.A.	Chairman Board of Statutory Auditors
	Centrobanca S.p.A.	Chairman Board of Statutory Auditors
	Italmobiliare S.p.A.	Chairman Board of Statutory Auditors
	Movi Lemar S.p.A.	Chairman Board of Statutory Auditors
	Movi S.p.A.	Chairman Board of Statutory Auditors
	Permasteelisa S.p.A.	Chairman Board of Statutory Auditors
	Rhifim S.p.A.	Chairman Board of Statutory Auditors
	Wimed S.p.A.	Chairman Board of Statutory Auditors
	Granitifiandre S.p.A.	Chairman Board of Statutory Auditors
	Finanziaria 2000 S.p.A.	Chairman Board of Director
	Vittoria Assicurazioni S.p.A.	Chairman Board of Director
	Maffei S.p.A.	Director
	Negri Bossi S.p.A.	Director
	Banco di Desio e della Brianza S.p.A.	Director
	Medinvest Int. ScA	Member of Supervisory Board
	Acbgroup S.p.A.	Chairman of the Supervisory Board
Enrico Laghi	Alitalia Servizi S.p.A.	Chairman Board of Statutory Auditors
	Raffineria di Gela S.p.A.	Chairman Board of Statutory Auditors
	Sarda Bitumi – Sarbit S.p.A.	Chairman Board of Statutory Auditors
	Alitalia – Linee Aeree Italiane S.p.A.	Statutory Auditors
	01 Distribution S.r.l	Statutory Auditors
	Gruppo Editoriale Espresso S.p.A.	Statutory Auditors
	Iridium S.p.A. – in liquidazione	Statutory Auditors
	Loquendo S.p.A.	Statutory Auditors
	Servizi Aerei S.p.A.	Statutory Auditors
	Rainet S.p.A.	Statutory Auditors
	TM News S.p.A.	Statutory Auditors
	IT Telecom S.r.l.	Statutory Auditors
	Manzano Sviluppo S.r.l.	Statutory Auditors
	Beni Stabili Investimenti SGR S.p.A.	Chairman Board of Director
	FdP Consulting S.r.l.	Sole Director
	Europrom 2000 S.r.l.	Sole Director
	Banca Finnat Euroamerica S.p.A.	Director
	Beni Stabili S.p.A.	Director
	Nomura SIM Italia S.p.A.	Director

Paolo Francesco Lazzati	Amiata Energia S.p.A.	Chairman Board of Statutory Auditors
	Baleri Italia S.p.A.	Chairman Board of Statutory Auditors
	Capitolotre S.p.A.	Chairman Board of Statutory Auditors
	Giangiacomo Feltrinelli Editore S.r.l.	Chairman Board of Statutory Auditors
	IVRI Direzione S.p.A. - Milano	Chairman Board of Statutory Auditors
	Pirelli Tyre S.p.A.	Chairman Board of Statutory Auditors
	Pre Agency S.p.A.	Chairman Board of Statutory Auditors
	Antonio Cerruti & C. S.a.p.a.	Statutory Auditors
	Cam Partecipazioni S.r.l.	Statutory Auditors
	Credito Artigiano S.p.A.	Statutory Auditors
	Dear S.p.A.	Statutory Auditors
	Effe 2005 Finanziaria Feltrinelli S.p.A.	Statutory Auditors
	Elesa S.p.A.	Statutory Auditors
	Erogasmet Holding S.p.A	Statutory Auditors
	ICBPI S.p.A.	Statutory Auditors
	Ilma Plastica S.p.A.	Statutory Auditors
	Kedrios S.p.A.	Statutory Auditors
	Lanificio F.lli Cerruti S.p.A.	Statutory Auditors
	Librerie Feltrinelli S.r.l.	Statutory Auditors
	Pirelli & C. Real Estate Opportunities SGR S.p.A.	Statutory Auditors
	Pirelli & C. Real Estate SGR S.p.A.	Statutory Auditors
	Prysmian S.r.l.	Statutory Auditors
	Fnaval S.r.l.	Director

Procedure for information flows to directors and auditors

1. Introduction

1.1 – The completeness of the available information to directors is essential for the proper fulfilment of their duties and responsibilities regarding the management, the direction and the monitoring of the business activities of Pirelli & C. S.p.A. (henceforth "Pirelli" or "the Company") and of the Group.
1.2 – Similar appropriate information is due to the Board of Statutory Auditors.
1.3 – In compliance with the legal and the bylaws' provisions, non-executive Directors and Auditors are therefore the receivers of a permanent information flows from the Executive Directors, who are coordinated by the Chairman of the Board of Directors who, if necessary, can refer to the Secretary to the Board of Directors of the Company.
1.4 – The purpose of the current procedure is to regulate the above-mentioned information flows in order to:
- guarantee the transparency of the management of the Company;
- ensure good conditions for efficacious and effective actions of direction and monitoring of the Company activities and management by the Board of Directors;
- supply the Board of Statutory Auditors with the requisite tools for an efficient fulfilment of its role.

2. Terms and procedures

2.1 – The information flows to Directors and Auditors is preferably provided with written documents, specifically:
- notes, memoranda, presentations and reports drawn up by Company offices or consultants, including those prepared for Board of Directors meetings;
- other documents, published and un-published, available to the Company;
- documents of accounting period of the Company that are intended for publication;
- quarterly financial reports including external information, drawn up according to specific guidelines.

2.2 – The above-mentioned documentation is timeless transmitted to non-executive Directors and Auditors and, in any case:
- with a sufficient frequency in order to ensure that legal and bylaws data provisions are respected,
- according to coherent deadlines with the scheduling of the single Board of Directors meeting.

2.3 – The information reproduced according to the procedures above are integrated (or, if necessary, omitted for reasons of privacy) with the comments made orally by the Chairman, the Executive Directors or by members of the management of the Group during Board of Directors meetings or specific informal meetings, open to Directors' or Auditors' participation, and organized in order to go into topics about the management of the Company.
2.4 – The transmission of documents and any other material to Directors and Auditors is coordinated by the Secretary to the Board of Directors of the Company, in agreement with the manager in charge of the preparation of the accounting documents of the Company, as per his competence.
2.5 – In any case, Directors and Auditors are the receivers of the information published by Pirelli as provided by legal provisions regarding Company reports (such as press releases and reports) and investment solicitation (reports that are denominated, anyhow).

3. Contents

3.1 – The information flow to Directors and Auditors – besides matters intended for the examination and/or the approval of the Board of Directors of the Company according to the law and the bylaws of the Company – includes:
- the general results of operations and their foreseeable development;

- the completed activity, with specific reference to transactions involving significant economic, financial and equity income, to transactions with related parties and to atypical or unusual transactions;
- the instructions given during the execution of direction and coordination activities;
- any further activities, transactions or events that are deemed appropriate to bring to the attention of Directors and Auditors.

4. General results and development of operations

4.1 – The corporate activities of the Group are the focus of background information about management.
4.2 – Information are considered in a strategic perspective of planning and direction, as well as in terms of the attainment of results and in comparison with industrial and budget forecasts.
4.3 – General results and development of operations are regularly examined by the Board of Directors of the Company when they approve the accounting period reports. The attained results are compared:
- with historic figures (opportunely reconstructed using pro forma figures in order to obtain homogeneous comparisons with previous periods);
- with budget objectives, indicating the causes of possible variances, also in order to evaluate the effects of these variances on strategic or anticipatory objectives and/or on forecasts regarding following periods;
- with the general trend of the sector and peers, in order to benchmark.

5. Business activity

5.1 – General information about the completed business activity concern executive businesses and developments of operations already decided by the Board of Directors, as well as activities performed by Executive Directors – also through units and subsidiaries of the Company – in the exercise of their duties.
5.2 – General information about the business activities are completed with a specific report of details regarding:
- transactions involving significant economic, financial and equity income;
- operations with related parties;
- atypical or unusual transactions.

6. Significant transactions

6.1 – The following – besides operations reserved to the Board of Directors according to the art. 2381 of the Italian Civil Code and the bylaws of the Company – are considered transactions involving significant economic, financial and equity income when Pirelli or subsidiaries carry out:
- the issues of financial tools for a total value higher than Euros 100 million;
- the granting of personal and collateral securities in the interest of subsidiary companies (and in the interest of Pirelli regarding collateral securities) against bonds having a unit value higher than Euros 25 million;
- the granting of loans or securities in favour or in the interest of third parties for amounts higher than Euros 10 million;
- the granting of loans in favour of subsidiary companies and the investment or disinvestment transactions, also real estate transactions, transactions for the purchase and the assignment of share, of company and company branches, of assets and other activity, for amounts higher than Euros 100 million;
- merger and division transactions, when at least one of the parties is a listed company or when subsidiary companies are involved if at least one of the parameters indicated below, in case of application, come out equal or higher than 15% of:

– the total assets of the merged company or of the activities submitted to division/the total assets of the Company (figures taken from the consolidated balance sheet, if reported);
– the pre-tax results and the extraordinary parts of the merged company, or of the activities to be divided/the pre-tax results and extraordinary parts of the Company (figures taken from consolidated balance sheet, if reported);
– the total equity capital of the merged company, or of the company branch submitted to division/the total equity capital of the Company (figures taken from consolidated balance sheet, if reported).

6.2 – Informative report on transactions involving significant economic, financial and equity income shall highlight the strategic aims, the budget and the industrial plan coherence, the executive procedures (including economic terms and conditions for their fulfilment), the business developments as well as the possible changes and implications for the activities of the Pirelli Group.

6.3 – Informative reports shall also be made for transactions that, even if they are individually smaller than the above-mentioned threshold value, are associated within the same strategic plan or executive programme and therefore, considered altogether, exceed the threshold value.

7. Operations with related parties

7.1 – The following definitions must be made regarding the current procedure relating to "related parties"; these are defined according to international accounting standards concerning financial statements for transactions with related parties, adopted in accordance with art. 6 of EC Regulation n. 1606/2002.

7.2 – The Company adopted this apposite procedure in order to ensure that the principle of fairness was respected in substance and form for all transactions made, directly or through subsidiaries, with related parties with Pirelli

7.3 – Besides the transactions with related parties subject to the board approval according to the above-mentioned procedure (atypical, unusual or non-standard transactions), transactions with related infra-Group parties (i.e. companies owned by Pirelli or by the company that owns Pirelli) must be similarly reported to Directors and Auditors if they involve amounts higher than Euros 50 million, and those with associated non infra-Group parties if they involve amounts higher than Euros 500.000. For each of these transactions, the following points must be indicated:

• object and amount;
• the date of targeting of the contract(s) below or those linked anyway with the transactions;
• the identities of the counterparties (specifying the nature of their relationship with Pirelli).

7.4 – As to every quarter of statement, an overall figure of the transactions concluded with the individual parties related to Pirelli must be supplied, separating the transactions directly carried out with Pirelli and the transactions achieved by subsidiary companies.

8. Atypical or unusual transactions

8.1 – Transactions that form part of the ordinary business of the Company are considered typical, i.e. essential to the production and the dealing cycle of the Company. On the contrary, transactions are considered usual when intended for the fulfilment of ordinary requirements, i.e. requirements that normally belong to the business of the Company.

8.2 – In any case, transactions may be called neither typical nor usual when they actually present particular elements of criticality due to their specific characteristics and/or to their intrinsic risks, to the nature of the counterparty or to the time of their fulfilment.

8.3 – Information about atypical or unusual transactions highlight the interest below and illustrate the executive procedures (including the economic terms and conditions of their fulfilment), with specific reference to the estimative procedures followed.

9. Direction and coordination activities

9.1 – Information about the execution of direction and coordination activities illustrate:
- the strategic aims, with specific reference to the entrepreneurial interest justifying them and the results that are followed;
- the executive procedures (including the economic terms and conditions of their fulfilment), with specific reference to the estimative procedures followed;
- the possible changes and implications on the execution of the company, also with reference to the budget and the industrial plan.

9.2 – Further updating on the affected transactions shall be supplied in order to estimate overall results of the direction and the coordination activities.

Data collection procedure

In order to allow an adequate information flow to non-executive Directors and to the Board of Statutory Auditors, information must be obtained by the Chairman and CEOs according to the procedure listed below.

1. Information about business activities, about transactions involving significant economic, financial and equity income, about infra-group transactions and atypical or unusual transactions.

Pirelli General Managers and the Heads of Business units/Central Functions/Business Operations that report directly to the Chairman and the CEOs (the so-called "Front Line") through the General Manager and Chief Operating Officer transmit, on a quarterly basis, to the Chairman and the CEOs, with an apposite note, the activities that the competent structure carried out in the period, highlighting specifically the transactions involving significant economic, financial and equity income; the infra-Group transactions higher than Euros 50 million; non-standard, atypical or unusual transactions; the executive businesses and developments of operations already decided by the Board of Directors; as well as the main business activities carried out within the duties attributed to Managing Directors, including the most important launched projects and the most significant undertaken initiatives.
Informative reports shall also be made for transactions that, even if they are individually smaller than the above-mentioned threshold value, are associated within the same strategic plan or executive programme and therefore, considered altogether, exceed the threshold value.

2. Information about operations with related parties different than intra-group transactions

The purpose of the current procedure are the transactions with related parties carried out by Pirelli or by companies owned by Pirelli, with parties directly or indirectly related to Pirelli.
a) the persons who, directly or indirectly, control Pirelli, also in virtue of shareholder agreement, individually or jointly with other persons included in these agreements;
b) the persons who, directly or indirectly, exercise a significant influence over Pirelli. This influence is presumed in case of shareholdings equal to or higher than 10% of the authorized capital in the form of ordinary Pirelli shares;
c) the members of the Board of Directors and Acting Auditors of Pirelli;
d) the managers with strategic responsibilities in the Company, identified by the Board of Directors of Pirelli, or in its possible subsidiaries (i.e. "key managers");
e) the immediate family members of the persons indicated in letters c) and d), i.e. spouses and dependents, as indicated in civic records;

f) the companies upon which the persons indicated above in letters a) to e) exert control, directly or indirectly, also in virtue of shareholders agreement, individually or jointly with other persons included in these agreements;
g) the companies on which the persons indicated above in letters a) to e) exert significant influence, if they are physical persons. This influence is presumed in case of shareholdings equal to or higher than 10% (in the case of listed companies) or 20% (in the case of unlisted companies) of the authorized capital in the form of voting shares at the general meetings;
h) the companies in which the persons indicated above in letters a) to e) hold strategic management roles and the companies controlled by these companies;
i) the joint ventures in which Pirelli participates;
j) the pension funds for the employees of Pirelli or of related parties;
k) the companies that share a majority of their Directors with Pirelli.

With the same regularity as mentioned under point 1 above, General Operations Management collects and transmits to the Chairman and to the CEOs declarations from the persons mentioned under letters a) to d) above pointing out the transactions involving amounts higher than Euros 500.000, or those with lower amounts but non-standard, achieved directly by or through one of the persons indicated in letters f) to k) above, also through third parties, with Pirelli or its subsidiaries, by themselves or, in the case of physical persons, by spouses or dependents, as indicated in civic records.

Amongst these information, must be pointed out transactions that, even if they are individually smaller than the above-mentioned threshold value, are associated within the same relation and therefore, considered altogether, exceed the threshold value.

General Operations Management also collects the declarations whereby the persons in letters a) to d) above: (i) list the companies for which they perform the cases in letters f) to j) above, as well as companies in which they hold the role of directors; (ii) update this list.

General Operations Management transmits the list to the parties related to Pirelli as specified above to the General Managers and to the Front Line.

The Front Line communicates on a quarterly basis to the Chairman and the CEOs the transactions completed with Pirelli – or companies controlled by Pirelli – also through third parties or indirectly related parties as specified in the list given by the General Operations Management, involving amounts higher than Euros 500,000 and, also if involving lower amounts, made under non-standard conditions.

Rules of conduct for effecting transactions with related parties

1. Transactions with related parties, including intra-group transactions, except for typical or usual transactions concluded at arm's length conditions, must be approved in advance by the Board of Directors.

2. Typical or usual transactions shall be taken to mean those which, by their object or nature, are not extraneous to the normal course of business of the Company and those which do not involve particular critical factors due to their characteristics or to the risks related to the nature of the counterpart or to the time at which they are concluded. Transactions concluded at arm's length conditions means transactions concluded at the same conditions as those applied by the Company to whatsoever party.

3. The Board of Directors shall receive adequate information on the nature of the relationship, the manner of execution of the transaction, the economic and other terms and conditions governing it, the valuation procedure adopted, the underlying interest and motivations, and the possible risks for the Company. Where the relationship is with a Director or with a party related by means of a Director, the Director concerned shall limit himself to providing clarifications and shall leave the meeting of the Board when the decision is to be taken; the Board of Directors may also resolve in a different way.

4. Depending on the nature, value and other characteristics of the transaction, to guard against the transaction's being carried out at unsuitable conditions the Board of Directors shall be assisted by one or more experts, who shall express an opinion, according to the case, on the economic conditions and/or the legitimacy and/or the technical aspects of the transaction.

5. For transactions with related parties, including intra-group transactions, which are not submitted to the Board of Directors inasmuch as they are typical or usual concluded at arm's length, the Directors having delegated powers or the managers responsible for carrying out the transaction, without detriment to compliance with the specific procedure pursuant to Article 150.1 of the Consolidated Law on Financial Intermediation, shall collect and preserve, inter alia by type or group of transaction, adequate information on the nature of the relationship, the manner of execution of the transaction, the economic and other terms and conditions governing it, the valuation procedure adopted, the underlying interest and motivations, and the possible risks for the Company. For such transactions also, one or more experts may be appointed as provided above.

6. The experts are to be chosen from among persons of recognized professional experience and competence in the matters concerned. Their independence and absence of conflicts of interest will be carefully evaluated.

Abridged form of Pirelli & C. Società per Azioni Shareholders Agreement

1. Type and objective of the agreement

The purpose of the Pirelli & C. shareholders agreement is to ensure a stable shareholder base and a uniform strategy in the management of the company.

2. Parties to the shareholders agreement and Pirelli & C. shares transferred to the agreement:

	Number of Shares granted	% of all shares granted	% of the total n. of ordinary shares issued
CAMFIN S.p.A.	1,027,455,727	42.48	19.63
MEDIOBANCA S.p.A.	233,001,859	9.63	4.45
EDIZIONE HOLDING S.p.A.	232,992,911	9.63	4.45
FONDIARIA - SAI S.p.A.	223,543,498	9.24	4.27
RAS S.p.A.	222,958,537	9.22	4.26
ASSICURAZIONI GENERALI S.p.A. (*)	222,958,531	9.22	4.26
CAPITALIA PARTECIPAZIONI S.p.A.	81,665,400	3.38	1.56
INTESA SANPAOLO S.p.A.	81,665,400	3.38	1.56
Massimo MORATTI (**)	60,300,084	2.49	1.15
SINPAR HOLDING S.A. - SINPAR S.p.A. (***)	32,048,563	1.33	0.61
Total	**2,418,590,510**	**100.00**	**46.20**

(*) n. 57,400,000 shares through La Fédération Continentale Compagnie d'Assurances Sur La Vie S.A., n. 82,779,265 shares through Ina Vita S.p.A. and n. 82.779.266 shares through Generali Vita S.p.A.
(**) Including 37,420,339 shares through CMC S.p.A. and n. 11,328,318 shares fiduciary owned by Istifid S.p.A.
(***) n. 19,797,563 shares of Sinpar Holding S.A. and n. 12,251,000 shares of Sinpar S.p.A.

3. The party, if any, which, through the agreement, can exercise control over the company

There is no party which, through the agreement, can exercise control over Pirelli & C..

4. Restrictions on the sale of the shares transferred and on the subscription and the purchase of new shares

The sale of the shares to third parties (and option rights in the event of a capital increase against payment) is prohibited. Shares can be sold freely and pre-emptively to subsidiaries, according to article 2359, paragraph 1, point 1 of the Italian Civil Code, and to the parent companies as well as other participants to the shareholders agreement.
Each participant may buy or sell additional shares for an amount not in excess of the higher of 20% of the shares already transferred by the participant itself and 2% of the ordinary share capital issued; purchases of greater amounts are permitted only with the intent of reaching a holding equal to 5% of the ordinary share capital issued, on condition that the amount in excess of the above limits came under the shareholders agreement.
CAMFIN S.p.A. is authorized to freely purchase additional Pirelli & C. shares; it can transfer shares to the shareholders agreement, but to the extent that, at any one time, the shares do not exceed 49.99% of total shares transferred by all the participants in the shareholders agreement. This has been decided so that a stable predominate position is not assumed in the shareholders agreement or a stable veto power is not exercised over common decisions.
Except where the Pirelli & C. ordinary shares in the shareholders agreement correspond to the majority of the voting rights in the ordinary shareholders' meetings, each participant (also through parent companies and/or subsidiaries) intending to purchase shares of that category shall inform the President in writing beforehand and the President shall inform the participant if, taking into account the laws in force concerning tender offers, the participant can proceed, in whole or in part, with the proposed purchase. Buy or sell the shares.

5. Availability of the shares
The shares transferred shall remain at disposal of the participants in the shareholders agreement.

6. Bodies governing the agreement, composition, meetings and powers
The Body governing the agreement is the Shareholders Agreement Executive Committee.
The Shareholders Agreement Executive Committee shall consist of a president and vice-president, in the form of the president and the longest serving vice-president of Pirelli & C., and by a member representing each participant unless a participant has deposited more than 10% of ordinary share capital, in which case another member may be designated: for this purpose, in the event the shareholders agreement is composed of several companies related by a controlling relationship or belonging to the same parent company, their aggregate shall be considered for this purpose as one sole participant in the shareholders agreement.
The Shareholders Agreement Executive Committee shall be convened to evaluate the proposals to be submitted to the shareholders' meetings, for the possible earlier termination of the agreement and for the admission of new participants. The Shareholders Agreement Executive Committee shall also meet at least twice a year to examine the semiannual performance, the annual results, the general guidelines for the company's development, the investment policy and proposed significant divestitures and more in general, all the relevant matters of discussion by both the ordinary and extraordinary sessions of the shareholders' meetings.

7. Matters covered by the agreement
Those contemplated in points 4 and 6 above.

8. Majorities needed to reach decisions regarding the issues governed by the agreement
The Shareholders agreement Executive Committee approves its resolutions with the favourable vote of the majority of the shares transferred; the Shareholders agreement Executive Committee can designate a trusted person to represent the shares in the shareholders agreement at the shareholders' meetings in order to vote according to its instructions. Whenever the decisions of the Shareholders Agreement Executive Committee are not voted unanimously, the dissenting participant shall have the right to freely vote at the shareholders' meeting.

9. Term, renewal and cancellation of the agreement
The agreement shall be valid until April 15, 2010 and shall be tacitly renewed for a period of three years except for withdrawal, which can be exercised between December 15 and January 15 prior to the expiration date. In case of withdrawal, the shares transferred by the withdrawing party shall be automatically offered pro quota to the other participants. The agreement shall remain in force, whenever it is possible, at every expiration date, to renew the agreement for a percentage of Pirelli & C.'s subscribed ordinary share capital of not less than 33%.

10. Penalties for breach of the commitments contained in the agreement
They are not envisaged by the agreement.

11. Registration of the agreement at the Company Registry
The agreement is registered at the office of the Milan Companies Registry.

Milan, 19 January 2007

Pirelli & C. S.p.A. - Summary Data

Balance sheet and financial position

(in millions of euros)

	12/31/2006	12/31/2005
Property, plant and equipment	103.4	51.7
Intangible assets	1.7	2.5
Financial assets	5,353.2	6,433.8
Net working capital	(186.1)	(391.3)
	5,272.2	**6,096.7**
Equity	2,882.3	4,661.1
Provisions	221.4	193.4
Net financial (liquidity)/debt position	2,168.5	1,242.2
	5,272.2	**6,096.7**

The above statement presents the balance sheet and financial position of the company. The most significant changes during 2006 refer to the following:

- **property, plant and equipment** increased by Euros 51.7 million basically as a result of a finance lease contract taken on by Pirelli Tyres S.p.A. (Euros 55 million);

- **financial assets** decreased by Euros 1,080.6 million. An analysis of movements is presented in the following table:

(in millions of euros)

Investments:	
Olimpia S.p.A.	1,139
Pirelli Tyres S.p.A.	152
Capitalia S.p.A.	38
Mediobanca S.p.A.	14
Assicurazioni Generali S.p.A.	5
Subscriptions:	
Banca Leonardo S.p.A.	4
Reimbursements of capital and reserves:	
Pirelli Tyre Holding N.V.	(310)
Consortium S.r.l.	(15)
Divestitures:	
Capitalia S.p.A.	(178)
F.C. Internazionale Milano S.p.A.	(11)
Assicurazioni Generali S.p.A.	(5)
Writedowns:	
Olimpia S.p.A.	(1,827)
Pirelli S.A.	(12)
Pirelli Finance (Luxembourg) S.A.	(16)
Pirelli Cultura S.p.A.	(1)
KME Group S.p.A.	(5)
Euroqube	(2)
Measurement at fair value and income (expenses) recognized in income at the time of sale or in the presence of impairment losses previously recognized in income	(50)
Total	**(1,080)**

- the change in "**net working capital**" is mainly due to the decrease in liabilities relating to the put options granted by shareholder banks of Olimpia (Banca Intesa S.p.A. and UniCredit Italiano S.p.A.) under the shareholders' agreements (Euros 233 million). Such liabilities in 2006 show a nil balance following the right of withdrawal exercised and communicated by the banks in March 2006 and which was executed on October 4, 2006 upon the purchase of the investments in Olimpia S.p.A. on the part of Pirelli & C. S.p.A..

- **equity** decreased by Euros 1,778.8 million compared to December 31, 2005. The changes in equity are presented in the following table:

		(in millions of euros)
Equity at December 31, 2005		**4,661.1**
Dividends paid		(113.7)
Capital increase due to exercise of warrants		26.8
Income (expenses) recognized directly in equity:		
- Fair value adjustment of available-for-sale financial assets	21.0	
- Income /expenses recognized in income at the time of sale of available-for-sale financial assets or in the presence of impairment losses	(70.6)	
Total income (expenses) recognized directly in equity		(49.6)
Loss for the year		(1,642.3)
Equity at December 31, 2006		**2,882.3**

- the **net debt position** went from a net financial debt position of Euros 1,242.2 million at December 31, 2005 to Euros 2,168.5 million at December 31, 2006. A summary of the changes is detailed in the following table:

	(in millions of euros)
Net financial debt position at December 31, 2005	**1,242.2**
Financial investments	1,353.0
Capital expenditures in property, plant and equipment	55.7
Financial divestitures	(677.0)
Dividends collected	(192.8)
Dividends paid	113.7
Change in net working capital	205.2
Other	68.5
Net financial debt position at December 31, 2006	**2,168.5**

Income statement

		(in millions of euros)
	2006	**2005**
Financial income (expenses)	58.7	(39.9)
Investment income	192.8	325.4
Valuation adjustments to financial assets	(1,864.9)	(132.8)
Other operating income (expenses)	(47.1)	(31.5)
Income (loss) before income taxes	**(1,660.5)**	**121.2**
Income taxes	18.2	18.6
Income (loss) for the year	**(1,642.3)**	**139.8**

The loss for the year 2006 amounts to Euros 1,642.3 million compared to income of Euros 139.8 million in 2005.

- **Financial income (expenses)** compared to December 31, 2005 show an improvement of Euros 98.6 million. Compared to the prior year, this improvement is due principally to higher gains from the sale of investments during 2006 (+Euros 136 million) and higher interest income earned on loans made to Pirelli Tyres S.p.A. (+Euros 13 million) and was offset in part mostly by higher financial expenses for the interest on loans made by Pirelli Finance (Luxembourg) SA (+Euros 18 million) and the price adjustment on the sale of the energy and telecommunications cables and systems activities on July 28, 2005 to Goldman Sachs Capital Partner (+Euros 30 million).

Details of "investment income" are as follows:

(in millions of euros)

	2006	2005
Subsidiaries:		
Pirelli Tyre Holding N.V.	100.0	120.0
Pirelli & C. Real Estate S.p.A.	40.7	36.4
Sipir Finance N.V.	7.0	147.0
Pirelli S.A.	1.9	2.8
Other minor companies	-	0.6
Associates:		
Eurostazioni S.p.A.	1.6	1.3
Other companies:		
Consortium S.p.A.	11.2	-
Mediobanca S.p.A.	8.7	6.8
Capitalia S.p.A.	9.9	3.4
Telecom Italia S.p.A.	6.6	5.2
RCS Mediagroup S.p.A.	3.9	0.9
Other minor companies	1.3	1.0
Total	**192.8**	**325.4**

The item **"valuation adjustments to financial assets"** increased significantly due to the impairment loss on the investment in Olimpia S.p.A. (Euros 1,827 million).

The net expense balance of **"other operating income (expenses)"** increased as a result of the IPO costs and the change/reduction in the services rendered following the sale of the cables activities on July 28, 2005.

Compensation paid to Directors, Statutory Auditors and General Managers (in thousands of euros)

Individual	Description of post		Compensation received in 2006				Compensation for the year 2006 to be paid in 2007	
Name	Post held	Term of office	Compensation for the post	Non-monetary benefits	Bonuses and other incentives	Other compens.	Compens. for the post	Bonuses and other incentives
Tronchetti Provera Marco	Chairman	2008	2,802			45 (2)	50	1,200
Pirelli Alberto	Deputy Chairman	2008	555			353 (3)	50	50 (3)
Puri Negri Carlo Alessandro	Deputy Chairman	2008	315			2,085 (4)	50	3,668 (4)
Buora Carlo	Managing Director	up to 11/6/06	196			37 (5)		
	General Manager	up to 11/6/06		6		14,811 (6)		
Acutis Carlo	Director	2008					50	
Angelici Carlo	Director	2008				25 (7)	50	
Benetton Gilberto	Director	2008					50	
Bombassei Alberto	Director	from 9/12/06					15	
Bruni Franco	Director	2008				25 (7)	50	
De Benedetti Carlo (1)	Director	up to 5/5/06	17					
Galateri di Genola Gabriele (1)	Director	2008					50	
Garraffo Mario	Director	2008					50	
Giarda Dino Piero	Director	2008					50	
Libonati Berardino	Director	2008				20 (8)	50	
Ligresti Giulia Maria	Director	2008					50	
Moratti Massimo	Director	2008					50	
Perissinotto Giovanni	Director	2008					50	
Pesenti Giampiero	Director	2008				20 (8)	50	
Roveri Aldo	Director	2008				20 (8)	50	
Secchi Carlo	Director	2008				35 (9)	50	
Vagnone Paolo	Director	2008					50	
De Conto Claudio	General Manager	-		4	586	653		350
Gobbi Luciano	General Manager	-		3	544	607		350
Gori Francesco	General Manager	up to 6/30/06		2	200	874 (10)		480
Guatri Luigi	Chairman of the Board of Statutory Auditors	2009					62	
Bracchetti Roberto	Standing members	up to 4/20/06	12			117 (11)		
Laghi Enrico	Standing members	from 4/21/07					29	
Lazzati Paolo	Standing members	2009				107 (12)	41	

1) Remuneration paid over to his company
2) As Chairman of Pirelli & C. Real Estate S.p.A.
3) From Pirelli Tyre S.p.A.
4) From Pirelli & C. Real Estate S.p.A. and its subsidiaries
5) As a Director of Pirelli & C. Real Estate S.p.A.
6) Of which Euros 13,423 thousand paid in addition to employees' leaving indemnity due by law, at the same time as resigning from the posts of CEO and General Manager on November 6, 2006
7) As a member of the Internal Control and Corporate Governance Committee
8) As a member of the Remuneration Committee
9) As a member of the Internal Control and Corporate Governance Committee (Euros 25 thousand) and the Supervisory Board (Euros 10 thousand)
10) Of which Euros 403 thousand from Pirelli & C. S.p.A. and Euros 471 thousand from Pirelli Tyre S.p.A.
11) For the post of Chairman of the Board of Statutory Auditors of Pirelli & C. Real Estate S.p.A. (Euros 56 thousand) and of Pirelli & C. Ambiente S.p.A. (Euro 5 thousand), and the post of statutory Auditory in subsidiaries of Pirelli & C. Real Estate S.p.A. (Euros 56 thousand)
12) For the post of Chairman of the Board of Statutory Auditors of Pirelli Tyre S.p.A. (Euros 22 thousand), for the post of Statutory Auditor in subsidiaries of Pirelli & C. Real Estate S.p.A. (Euros 75 thousand) and as a member of the Supervisory Board of Pirelli & C. S.p.A. (Euros 10 thousand)

Shareholders' resolutions

Appropriation of result

The year ended December 31, 2006 shows a loss of Euros 1,642,304,515.
The board proposes to absorb the loss by using the available reserves.

If in agreement with our proposal, we ask you to pass the following

RESOLUTION

The shareholders' meeting:

- having taken note of the Directors' Report on Operations;
- having taken note of the reports of the board of statutory auditors' and the independent auditors;
- having examined the financial statements at December 31, 2006 which show a loss of Euros 1,642,304,515

RESOLVES

a) to approve:
- the Directors' Report on Operations;
- the balance sheet, the income statement, the notes to the financial statements for the year ended December 31, 2006 which show a loss of Euros 1,642,304,515 as presented by the board of directors in their entirety and in the individual entries, with the proposed accruals;

b) to completely absorb the loss for the year 2006 of Euros 1,642,304,515 as follows:

• by completely using the merger reserve	Euros	583,707,610
• by completely using the contribution reserve	Euros	22,391,115
• by completely using the monetary revaluation reserve Law 413/91	Euros	707,349
• by completely using the monetary revaluation reserve Law 72/83	Euros	972,216
• by completely using retained earnings	Euros	286,057,304
• by partially using the share premium reserve	Euros	748,468,921

taking note that the same share premium reserve, after the above utilization, is equal to Euros 10,466,928.

Nomination of two directors and/or reduction in the number of the members of the board of directors. Inherent and consequent resolutions.

Dear Shareholders,

The board of directors in its meeting held on September 12, 2006 passed a resolution appointing Alberto Bombassei as a director to replace Carlo De Benedetti who resigned at the beginning of May 2006.

On the date of today's shareholders' meeting, the mandate conferred by the board of directors to Mr. Bombassei's will expire.

Subsequently, on November 6, 2006, Carlo Buora tendered his resignation from all posts held in Pirelli & C. S.p.A..

In this last case, also in view of the imminence of the shareholders' meeting that was to be held for the approval of the financial statements for the year ended December 31, 2006, the board did not make a replacement so that the shareholders could indicate the candidates and/or propose a possible reduction in the number of directors.

Having said this, the board of directors invites the shareholders' meeting to take the necessary decisions as a result of the two directors no longer being in office.

Amendment to the Regulations for Shareholders' Meetings approved by resolution of the ordinary shareholders' meeting held on May 11, 2004

Dear Shareholders,

In connection with the proposed amendments to the bylaws, which will be examined by you in the special session, you are called to review the updates to the Regulations for Shareholders' Meetings adopted by the shareholders' meeting held on May 11, 2004.
The most important changes refer to the effects on the organization of the work of the shareholders' meetings deriving from the introduction of the institution of the addition of matters to the agenda at the request of shareholders in accordance with Law 262 dated December 28, 2005.
In particular, the chairman of the meeting shall have the right to grant those shareholders who have requested, under the law and the bylaws, the addition of matters to be discussed in the shareholders' meeting, a time of not more than 15 minutes to illustrate the corresponding motions on which to pass resolutions and to explain the reasons thereto (new article 8).
In giving the shareholders the possibility of proposing additions to the agenda, account is also taken of interventions proposed in the renumbered article 12, aimed at ensuring the proposing shareholders the same rights held by the board of directors to amend or add to their motions.
On this occasion, it was also decided to propose some additional changes of a formal nature aimed at offering better clarity.
Having said this, if you are in agreement with us, we ask you to approve the following

RESOLUTION

"The shareholders' meeting:
– having examined the report of the Board of Directors;
– having considered the provision of article 2364, first paragraph, number 6) of the Italian Civil Code and that of article 8 of the bylaws

RESOLVES

to change articles 3, 4, 5, 6, 7, 12, 13, 14 and 15 of the Regulations for Shareholders' Meetings, approved by resolution of May 11, 2004 cited at the beginning and to introduce a new article 8, with the following update of the numbering of the articles, in the terms resulting from the text reported below with an indication of the amendments introduced:

Existing Text

PIRELLI & C. SOCIETA' PER AZIONI

Regulations for shareholders' Meetings

Article 1

- These Regulations shall apply to the company's ordinary and extraordinary shareholders' meetings.

Article 2

- To ensure the regular conduct of shareholders' meetings, for matters not expressly governed by these Regulations, the Chairman of the meeting (hereinafter the "Chairman") shall adopt the measures and solutions deemed most appropriate, in compliance with the law and the bylaws.

Article 3

- Meetings may be attended, with the right to take part in the discussion and to vote, by persons entitled to do so pursuant to the applicable provisions (hereinafter the "Participants").
- Unless stated otherwise in the notice convening the meeting, personal identification and verification of the right to attend the meeting shall begin at the place where it is to be held at least one hour before the time fixed for it to start. When the Participants have been identified and their right to attend verified, under the supervision of the Chairman, the auxiliary staff provided by the Company shall issue badges that serve for control purposes and to exercise the right to vote.
- The Participants shall be able to follow the discussion, take the floor during the discussion and exercise their right to vote, in the technical manner specified on each occasion by the Chairman.
- Participants who, after being admitted to the meeting, intend for any reason to leave the premises where it is being held, must inform the auxiliary staff.

Article 4

- Directors, senior executive and employees of the Company and of Group companies may attend the meetings, as may other persons whose presence is deemed useful in relation to the matters to be discussed.

Proposed Text

PIRELLI & C. SOCIETA' PER AZIONI

Regulations for shareholders' Meetings

Articolo 1

- These Regulations shall apply to the Company's ordinary and extraordinary shareholders' meetings.

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- The Participants shall be able to follow the discussion, take the floor during the discussion and exercise their right to vote, in the technical manner specified on each occasion by the Chairman.
- Participants who, after being admitted to the meeting, intend for any reason to leave the premises where it is being held, must inform the auxiliary staff.

Article 4

- Directors, senior executive and employees of the Company and of Group companies may attend the meetings, **following also the course of actions decide by the Chairman,** as may other persons whose presence is

- With the agreement of the Chairman, the proceedings may be followed by professionals, consultants, experts, financial analysts and suitably qualified journalists, accredited for a single meeting, in areas which could specifically be set aside for that purpose.

- Persons accredited to follow the proceedings must report for identification by the Company's appointees at the entrance of the premises where the meeting is to be held and collect a special badge to be exhibited upon request.

Article 5
- In accordance with the law and the bylaws, it is up to the Chairman to direct the meeting and ensure the best conditions for its orderly and effective conduct.
- The Chairman may authorize the use of audio-visual recording and transmission equipment.

Article 6
- The Chairman shall be assisted in the conduct of the meeting and in the preparation of the minutes by a Secretary, where a Notary public is not present. The Secretary or the Notary public may in turn arrange to be assisted by persons of their trust.
- The Chairman, for the purposes of conducting the voting procedures, shall be assisted by scrutineers; he may use auxiliary staff to provide the necessary technical support and to maintain order.

Article 7
- When the quorum for duly constituting the shareholders' meeting is not reached, after an appropriate period of time the Participants shall be informed of the fact and the discussion of the matters on the agenda shall be understood to be deferred until the next call of the meeting, if any.
- During a meeting the Chairman may, if he deems it desirable and the majority of the capital represented at the meeting does not object, suspend the proceedings for up to three hours.

deemed useful in relation to the matters to be discussed.
- With the agreement of the Chairman **and following the course of action decided by him,** the proceedings may be followed by professionals, consultants, experts, financial analysts and suitably qualified journalists, accredited for a single meeting, in areas which could specifically be set aside for that purpose.

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- When the quorum for duly constituting the shareholders' meeting is not reached, after an appropriate period of time the Participants shall be informed of the fact and the discussion of the matters on the agenda shall be understood to be deferred until the next call of the meeting, if any.
- During a meeting the Chairman may, if he deems it desirable and the majority of the capital represented at the meeting does not object, suspend the proceedings for up to three hours.

Article 8
- The Chairman shall establish the order in which the items on the agenda are to be discussed, which may differ from that indicated in the notice convening the meeting.
- He may provide for several items to be discussed together or for the discussion to proceed item by item.
- The Chairman and, at his invitation, persons attending the meeting pursuant to the Article 4, paragraph 1, shall explain the items on the agenda.

Article 9
- It is up to the Chairman to conduct and moderate the discussion, ensure its correctness and prevent disturbances of the regular course of the meeting.
- The Chairman, taking account of the subject matter and importance of the individual items on the agenda, may establish at the start of the meeting the time - not less than 15 minutes - available to each speaker.
- The Chairman shall call on Participants to comply with the time limits for speaking established in advance and to keep to the matters stated in the agenda. In the event of an overrun and/or an abuse, the Chairman shall interrupt the speaker.

Article 10
- Persons who intend to speak must apply to the Chairman or the Secretary, indicating the subject they will address. Such requests may be submitted until the Chairman closes the discussion on the subject to which they refer.
- Participants may ask to take the floor a second time during the same discussion, for not more than five minutes, exclusively in response to

Article 8
– Opening the proceeding of the meetings, the Chairman shall summarize all the items of the agenda.
– The Chairman can grant to shareholders' who have required to add items to the agenda, according to the By-Laws and to the provisions of law, up to 15 minutes for describing the proposed resolutions to be taken and for explaining the reasons why they are proposed.

Article 9
- The Chairman shall establish the order in which the items on the agenda are to be discussed, which may differ from that indicated in the notice convening the meeting.
- He may provide for several items to be discussed together or for the discussion to proceed item by item.
- The Chairman and, at his invitation, persons attending the meeting pursuant to the Article 4, paragraph 1, shall explain the items on the agenda.

Article 10
- It is up to the Chairman to conduct and moderate the discussion, ensure its correctness and prevent disturbances of the regular course of the meeting.
- The Chairman, taking account of the subject matter and importance of the individual items on the agenda, may establish at the start of the meeting the time - not less than 15 minutes - available to each speaker.
- The Chairman shall call on Participants to comply with the time limits for speaking established in advance and to keep to the matters stated in the agenda. In the event of an overrun and/or an abuse, the Chairman shall interrupt the speaker.

Article 11
- Persons who intend to speak must apply to the Chairman or the Secretary, indicating the subject they will address. Such requests may be submitted until the Chairman closes the discussion on the subject to which they refer.
- Participants may ask to take the floor a second time during the same discussion, for not more than five minutes, exclusively in response to

other speakers or to declare how they intend to vote.	other speakers or to declare how they intend to vote.
Article 11	**Article 12**
- The Board of Directors and the Participants may put forward, giving reasons, proposals for alternative or amended resolutions with respect to those originally put forward by the Board of Directors.	- The Board of Directors and the Participants may put forward, giving reasons, proposals for alternative or amended resolutions with respect to those originally put forward by the Board of Directors **or by the Shareholders who have requested to add items to the agenda in accordance with the By-Laws and with the provisions of law.**
- The Chairman shall evaluate the compatibility of such proposals in relation to the agenda of the meeting.	- The Chairman shall evaluate the compatibility of such proposals in relation to the agenda of the meeting **and to the applicable provisions.**
Article 12	**Article 13**
- The members of the Board of Directors and the Board of Statutory Auditors may intervene in the discussion; at the invitation of the Chairman, persons attending the meeting pursuant to the Article 4, paragraph 1, may also take the floor, inter alia to respond to requests for clarification.	- The members of the Board of Directors and the Board of Statutory Auditors may intervene in the discussion; at the invitation of the Chairman, persons attending the meeting pursuant to the Article 4, paragraph 1, may also take the floor, inter alia to respond to requests for clarification.
Article 13	**Article 14**
- The Chairman shall take appropriate measures to ensure the orderly conduct of voting and provide for the voting on an item to be held immediately after the close of the discussion thereof or at the end of the discussion of all the items on the agenda.	- The Chairman shall take appropriate measures to ensure the orderly conduct of voting and provide for the voting on an item to be held immediately after the close of the discussion thereof or at the end of the discussion of all the items on the agenda.
- The Chairman shall establish how each voting procedure is to be conducted and the procedures for identifying and counting the votes cast and shall be responsible for ascertaining the results.	- The Chairman shall establish how each voting procedure is to be conducted and the procedures for identifying and counting the votes cast and shall be responsible for ascertaining the results.
Article 14	**Article 15**
- Upon completion of the voting and the necessary counting of the votes with the help of the scrutineers and the Secretary, the results of the voting shall be announced.	- Upon completion of the counting of the votes with the help of the scrutineers and the Secretary, the results of the voting shall be announced.

The Board of Directors
Milan, March 12, 2007

THE GROUP

Consolidated Financial Statements at December 31, 2006

CONTENTS Page

(in thousands of euros)

CONSOLIDATED BALANCE SHEET		12/31/2006	of which related parties	12/31/2005	of which related parties
	ASSETS				
7	Property, plant and equipment	1,574,589		1,571,972	
8	Intangible assets	516,374		476,801	
10	Investments in associates and joint ventures	3,825,928		4,542,902	
11	Available-for-sale financial assets	1,006,898		1,032,317	
12	Deferred tax assets	64,230		82,300	
14	Other receivables	705,828	334,211	538,798	262,250
15	Tax receivables	10,917		9,214	
9	Investment properties	-		5,140	
	NON-CURRENT ASSETS	**7,704,764**		**8,259,444**	
16	Inventories	715,533		681,056	
13	Trade receivables	999,669	168,125	943,434	190,089
14	Other receivables	356,205	11,888	325,018	1,007
17	Securities held for trading	119,174		179,636	
18	Cash and cash equivalents	269,574		300,331	
15	Tax receivables	33,432		58,195	
27	Financial instruments	29,147		67,061	
	CURRENT ASSETS	**2,522,734**		**2,554,731**	
	TOTAL ASSETS	**10,227,498**		**10,814,175**	
	EQUITY				
19.1	Attributable to the equity holders of the company:	**3,879,591**		**5,204,859**	
	Share capital	2,789,950		2,762,696	
	Other reserves	1,971,026		2,010,712	
	Retained earnings	286,057		104,035	
	Income (loss) for the year	(1,167,442)		327,416	
19.2	Attributable to the minority interest:	**806,966**		**408,947**	
	Reserves	688,351		337,413	
	Income for the year	118,615		71,534	
	TOTAL EQUITY	**4,686,557**		**5,613,806**	
	LIABILITIES				
24	Borrowings from banks and other financial institutions	1,377,426		1,550,512	
26	Other payables	156,886		61,768	
22	Provisions for other liabilities and charges	145,119		170,561	
12	Deferred tax liabilities	42,931		54,606	
23	Employee benefit obligations	415,850		510,802	
21	Tax payables	9,708		2,650	
27	Financial instruments	4,751		2,048	
	NON-CURRENT LIABILITIES	**2,152,671**		**2,352,947**	
24	Borrowings from banks and other financial institutions	1,562,262	242	600,362	
25	Trade payables	1,102,456	25,085	1,018,264	26,549
26	Other payables	512,896	3,440	838,315	271
22	Provisions for other liabilities and charges	116,525		53,999	
21	Tax payables	48,769	688	42,208	
27	Financial instruments	45,362		294,274	
	CURRENT LIABILITIES	**3,388,270**		**2,847,422**	
	TOTAL EQUITY AND LIABILITIES	**10,227,498**		**10,814,175**	

The captions relating to transactions with related parties are disclosed in Note 44.

(in thousands of euros)

CONSOLIDATED INCOME STATEMENT	2006	of which related parties	2005	of which related parties
29 Revenues from sales and services	4,841,224	371,439	4,545,669	405,229
30 Other income	292,763	104,138	283,612	117,902
of which, nonrecurring events			21,116	
Change in inventories of work in process, semifinished and finished products	6,840		13,404	
Raw materials and consumables used	(1,773,194)		(1,640,352)	
31 Personnel costs	(1,075,771)	(5,471)	(1,029,880)	(8,149)
32 Amortization, depreciation and impairments	(215,328)		(215,704)	
33 Other expenses	(1,683,944)	(111,081)	(1,612,591)	(106,333)
of which, non-recurring events	(13,200)		(20,998)	
Increase in property, plant and equipment from internal work	8,796		10,761	
OPERATING PROFIT	**401,386**		**354,919**	
34 Financial income	897,377	17,258	248,310	13,156
of which, nonrecurring events	631,600			
35 Financial expenses	(365,123)	(32)	(313,682)	(81)
36 Dividends	65,857	26,344	26,694	10,050
37 Valuation of financial assets	(54,394)		(90,069)	
38 Share of earnings (losses) of associates and joint ventures	(1,836,081)		251,366	
of which, nonrecurring events	(2,110,000)			
INCOME (LOSS) BEFORE INCOME TAXES	**(890,978)**		**477,538**	
39 Income taxes	(127,848)		(128,484)	
INCOME (LOSS) FROM CONTINUING OPERATIONS	**(1,018,826)**		**349,054**	
40 Income (loss) from discontinued operations	(30,000)		49,896	
INCOME (LOSS) FOR THE YEAR	**(1,048,826)**		**398,950**	
Attributable to:				
equity holders of the company	(1,167,441)		327,416	
minority interest	118,615		71,534	
41 **EARNINGS (LOSS) PER SHARE (euros per thousand of shares)**				
basic earnings (loss) per share				
continuing operations	(212.87)		55.53	
discontinued operations	(5.57)		10.08	
	(218.44)		**65.61**	
diluted earnings (loss) per share				
continuing operations	(212.87)		55.32	
discontinued operations	(5.57)		10.04	
	(218.44)		**65.36**	

The captions relating to transactions with related parties are disclosed in Note 44.

CONSOLIDATED STATEMENT OF RECOGNIZED INCOME AND EXPENSE

(in thousands of euros)

	2006	2005
Differences on translation of foreign currency financial statements	(94,843)	248,956
Fair value adjustment of available-for-sale financial assets	23,870	106,028
Net actuarial gains (losses) on employee benefits	51,081	(69,123)
Fair value adjustment of derivatives designated as cash flow hedges	38,189	9,414
(Gains (losses) taken to income upon disposal of available-for-sale financial assets, or impairments	(126,796)	-
Tax effect	(6,935)	9,759
Income (expenses) recognized directly in equity	**(115,434)**	**305,034**
Income (loss) for the year	(1,048,826)	398,950
Total income (expenses) recognized directly in equity	**(1,164,260)**	**703,984**
Attributable to:		
- equity holders of the company	(1,267,166)	626,682
- minority interest	102,906	77,302

(in thousands of euros)

CONSOLIDATED STATEMENT OF CASH FLOWS	2006	of which related parties	2005	of which related parties
Income (loss) from continuing operations	(1,018,826)		349,054	
Amortization, depreciation / impairment losses/reversals of intangible assets and property, plant and equipment	212,691		212,678	
Financial expenses	365,123		313,682	
Financial income	(897,377)		(248,310)	
Dividends	(65,857)		(26,694)	
Valuation of financial assets	54,394		90,069	
Share of earnings (losses) of associates and joint ventures	1,921,699		(251,366)	
Change in inventories	(34,477)		(53,900)	
Change in trade receivables/payables	27,957		63,927	
Change in other receivables/payables	(194,324)		31,415	
Change in employee benefit obligations/other provisions	(29,608)		(9,265)	
Other changes	(8,131)		(3,993)	
A Net cash flows provided by (used for) operating activities	**333,264**		**467,297**	
Investments in property, plant and equipment	(255,456)		(233,624)	
Disposals of property, plant and equipment including gain/loss	11,906		8,750	
Investments in intangible assets	(54,884)		(8,835)	
Disposals of intangible assets including gain/loss	192		852	
Acquisitions of investments in associates and joint ventures	(1,566,479)		(1,405,257)	(1,345,523)
Disposals of investments in associates and joint ventures	1,315		2,599	
Acquisitions of available-for-sale financial assets	(251,386)		(247,822)	(15,320)
Disposals of available-for-sale financial assets	374,516	13,500	16,629	
Pirelli Tyre private placement	715,800		-	
Dividends received	65,857		26,694	
B Net cash flows provided by (used for) investing activities	**(958,619)**		**(1,840,014)**	
Change in share capital and share premium reserve	27,254		1,065,634	
Other changes in equity	(12,727)		(16,820)	
Sale of Pirelli Real Estate shares	84,400		-	
Change in financial payables	926,396		212,441	
Change in financial receivables	(18,768)		(265,396)	
Financial income/expenses (net of gains on fin. assets avail.-for-sale)	(99,346)		(65,372)	
Effect of sale of Cables and Systems	-		490,000	
Dividends paid	(162,672)	(29,089)	(149,542)	(29,762)
C Net cash flows provided by (used for) financing activities	**744,537**		**1,270,945**	
D Total cash flows from discontinued operations	**-**		**(258,629)**	
E Total cash flows provided by (used) during the year (A+B+C+D)	**119,182**		**(360,401)**	
F Cash and cash equivalents, at beginning of the year	**146,310**		**490,005**	
G Exchange differences on translation of cash and cash equivalents	**(6,103)**		**16,706**	
H Cash and cash equivalents, at end of the year (E+F+G) (°)	**259,389**		**146,310**	
(°) of which:				
cash	269,574		300,331	
bank overdrafts	(10,185)		(154,021)	

The consolidated statement of cash flows shows transactions with related parties that cannot be directly deduced from the other statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL INFORMATION

Pirelli & C. S.p.A. is a corporation organized under the laws of the Republic of Italy.

Founded in 1872 and listed on the Milan Stock Exchange, Pirelli & C. S.p.A. is a holding company which manages, coordinates and finances the operations of its subsidiaries.

At the balance sheet date, the company's businesses are mainly represented by investments in:

- Pirelli & C. Real Estate S.p.A. - a listed company operating in the real estate sector – 50.3 percent of share capital;
- Pirelli Tyre S.p.A. - a company operating in the tyres sector – 61.1 percent of share capital;
- Pirelli Broadband Solutions S.p.A. - a company operating in the field of components, equipment and systems for telecommunications – 100 percent of share capital;
- Olimpia S.p.A. – a company which holds 18 percent of the share capital of Telecom Italia S.p.A. represented by ordinary shares (18.92 percent of voting rights under IFRS as described in note 10) – 80 percent of share capital;
- Pirelli & C. Ambiente S.p.A. – a company operating in the environmental services sector – 51 percent of share capital.

The registered office of the company is in Milan, Italy.

The consolidated financial statements are audited by PricewaterhouseCoopers S.p.A. pursuant to art. 159 of Legislative Decree 58 dated February 24, 1998 and taking into account the Consob recommendation dated February 20, 1997, in execution of the resolution passed by the shareholders on April 28, 2005 which engaged the audit firm for the three years 2005-2007. The fees agreed for the audit of the consolidated financial statements for the year 2006 amount to Euros 2,889 thousand, inclusive of the fees relating to the limited review of the interim consolidated financial statements at June 30, 2006.

2. BASIS OF PRESENTATION

Accounting policies adopted

In accordance with Regulation 1606 issued by the European Parliament and by the Council of the European Union in July 2002, the consolidated financial statements of the Pirelli & C. Group have been prepared in accordance with the International Financial Reporting Standard (IAS/IFRS) effective at December 31, 2006.
The accounting policies adopted for the preparation of the consolidated financial statements at December 31, 2006 have not changed since December 31, 2005 except for the comments below in respect of the measurement of investment properties.
For purposes of a better accounting representation and a more appropriate presentation of the transactions for a more meaningful understanding of the financial statements and comparability with major domestic and international operators, starting from these financial statements for the year ended December 31, 2006, as permitted by IAS 40, the Group has decided to measure investment property at fair value instead of cost, net of the relative depreciation and impairment losses. This treatment has not resulted in any change to retained earnings since the value of investment property in the financial statements at December 31, 2005 approximated fair value. The effect on the result for the year 2006 in respect of the investment property held through associates has resulted in income of Euros 11 million.

Moreover, the company has applied Consob resolution 15519 dated July 27, 2006 with regard to financial statement formats and Consob communication 6064293 dated July 28, 2006 with regard to disclosures.

Reclassifications made to the prior year's figures presented for comparison purposes with the figures at December 31, 2006 are reported in the following table:

(in thousands of euros)

	Published 12/31/2005	2005 comparatives in financial statements 12/31/2006	Reclassifications
Deferred tax assets	77,046	82,300	5,254
Other non-current receivables	529,393	538,798	9,405
Non-current tax receivables	18,619	9,214	(9,405)
Other current receivables	272,252	325,018	52,766
Current tax receivables	110,961	58,195	(52,766)
TOTAL RECLASSIFICATIONS ASSETS	**1,008,271**	**1,013,525**	**5,254**
Deferred tax liabilities	(49,352)	(54,606)	(5,254)
Non-current provisions for other liabilities and charges	(144,734)	(170,561)	(25,827)
Current provisions for other liabilities and charges	(79,826)	(53,999)	25,827
Other non-current payables	(53,196)	(61,768)	(8,572)
Non-current tax payables	(8,706)	(2,650)	6,056
Other current payables	(771,538)	(838,315)	(66,777)
Current tax payables	(111,501)	(42,208)	69,293
TOTAL RECLASSIFICATIONS LIABILITIES	**(1,218,853)**	**(1,224,107)**	**(5,254)**

In addition, the lines "Investments in associates" and Investments in joint ventures" have been combined into one line "Investments in associates and joint ventures".

Accounting standards or interpretations not yet effective or not yet endorsed by the European Union

As required by IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", new Standards and new Interpretations not yet effective or not yet endorsed by the European Union are summarized and briefly described below.
None of these Standards or Interpretations has been early applied by the Group.

<u>New standards or interpretations which are effective but are not yet endorsed by the European Union</u>

- IFRIC 10 – Interim Financial Reporting and Impairment
  This interpretation deals with the interaction between the requirements of IAS 34 (Interim Financial Reporting) and the impairment of goodwill (IAS 36 – Impairment of Assets) and certain financial assets (IAS 39 – Financial instruments: Recognition and Measurement). IFRIC 10 states that were an entity has recognized an impairment loss in an interim period on goodwill or on investment in an equity instrument, that impairment cannot be reversed in subsequent interim financial statements nor in the annual financial statements.
  The interpretation is effective from January 1st, 2007 but has not yet been approved by the European Union.

<u>New standards or interpretations not yet effective but already endorsed by the European Union</u>

- IFRS 7 – Financial Instruments: Disclosures
  This standard, endorsed by the European Union in January 2006 (EC Regulation 108-2006),

supersedes IAS 30 (Disclosures in the Financial Statements of Banks and Similar Financial Institutions) and includes the section on disclosures contained in IAS 32 (Financial Instruments: Presentation and disclosure) with amendments and additions the title of IAS 32 has been changed to "Financial Instruments: Presentation".
IFRS 7 is effective starting from January 1st, 2007.

- Amendments to IAS 1 – Presentation of Financial Statements – Capital Disclosures
  These amendments, endorsed by the European Union in January 2006 (Regulation EC 108-2006), provide that an entity presents disclosures that allow users of the financial statements to evaluate its objectives, policies and procedures for managing capital.
  These amendments are effective from January 1st, 2007.

- IFRIC 7 – Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies
  This interpretation, endorsed by the European Union in May 2006 (EC Regulation 708/2006), provides guidance on how to apply the requirements of IAS 29 in a reporting period in which an entity for the first time identifies the existence of hyperinflation in the economy of its functional currency. Under IFRIC 7, the entity should restate the amounts in its financial statements in accordance with IAS 29, as if the economy had always been hyperinflationary.
  IFRIC 7 is effective starting from January 1st, 2007.

- IFRIC 8 – Scope of IFRS 2
  IFRIC 8, endorsed by the European Union in September 2006 (EC Regulation 1329/2006), clarifies that IFRS 2 also applies to arrangements where an entity makes share-based payments for services for apparently nil or inadeguate consideration.
  In particular, IFRIC 8 states that where the identifiable consideration given appears to be lower than the fair value of the equity instrument granted (or liability incurred), this typically indicates that additional consideration has been or will be received.
  IFRIC 8 is effective starting from January 1st, 2007.

- IFRIC 9 – Reassessment of Embedded Derivatives
  This interpretation, endorsed by the European Union in September 2006 (EC Regulation 1329/2006), requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract, that is, at the time of initial recognition. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the original cash flows.
  IFRIC 9 is effective starting from January 1st, 2007.

<u>New standards or interpretations not yet effective and not yet endorsed by the European Union</u>

- IFRIC 11 – IFRS 2 – Group and Treasury Share Transactions
  IFRIC 11 provides guidance on applying IFRS 2 (Share-based Payment) to certain types of plans involving different units of the Group.
  IFRIC 11 applies starting from January 1st, 2008.

- IFRIC 12 – Service Concession Arrangements
  IFRIC 12 deals with service concession arrangements with private operators for the supply of public services such as roads, airports, energy and water distribution. Under these arrangements, the assets are not necessarily controlled by the private operators which, however, are responsible for constructing, operating or maintaining the public sector asset.
  The assets, under the arrangements, could possibly not be recorded as property, plant and

equipment in the financial statements of the private operators but rather as financial assets and/or intangible assets depending on the type of service concession arrangement.
IFRIC 12 applies starting from January 1st, 2008.

- IFRS 8 – Operating Segments
  This standard supersedes IAS 14 (Segment Reporting) and aligns segment disclosures with the requirements of US GAAP (SFAS 131 Disclosures about Segments of an Enterprise and Related Information), introducing the approach whereby the segments are identified in the same way they are identified in internal reports for management.
  IFRS 8 will be effective starting from January 1st, 2009.

At the present time, the future application of the above standards and interpretations is not expected to have a significant quantitative impact on the consolidated financial statements of Pirelli & C. Group.

Financial statement formats

The format adopted for the balance sheet distinguishes the assets and liabilities between current and non-current.
The income statement is prepared under the costs by nature format.
The format for the changes in equity is entitled "Statement of recognized income and expense" and includes the result for the year and, by homogeneous categories, the income and expenses which, under IFRS, are recognized directly in equity. The amounts of transactions with shareholders and movements during the year in reserves are presented in the explanatory notes.
In the statement of cash flows, cash flows from operating activities are presented using the indirect method where the income or loss for the year is adjusted by the effect of non-monetary transactions, by any deferral or accrual of previous or future operating collections or payments and by revenues or costs connected with cash flows from investing or financing activities.

Scope of consolidation

The scope of consolidation includes the subsidiaries, the associates and the investments in joint ventures.
Subsidiaries are considered all those companies and entities in which the Group has the power to determine the financial and operating policies. This circumstance is generally considered to occur when more than half of the voting rights are held.
Joint ventures are considered those companies in which, under a contractual agreement or in accordance with the bylaws, two or more parties undertake an economic activity subject to joint control as defined in IAS 31.
Associates are considered all those companies in which the Group exercises a significant influence. This influence is presumed to exist when the Group holds a percentage of voting rights between 20 and 50 percent.

Consolidation

For consolidation purposes, the financial statements used are those of the companies included in the scope of consolidation, prepared at the closing date and adjusted, where necessary, to conform to IAS/IFRS as applied by the Group.
The financial statements expressed in foreign currencies are translated into euros at rates prevailing at the year-end for the balance sheet and at the average exchange rates for the income statement.

The differences arising from the translation of opening net equity at year-end exchange rates have been recognized in the reserve for translation differences, together with the difference between the result in the income statement, translated at average rates, and result included in the balance sheet, translated at year-end rates. The reserve for translation differences is recognized in the income statement when the company that generated the reserve is either sold or put into a wind-up.
The consolidation principles can be summarized as follows:

- Subsidiaries are consolidated on a line-by-line basis according to which:
  – the assets and liabilities and revenues and costs of the financial statements of the subsidiaries are assumed in full, regardless of the percentage of ownership;
  – the carrying amount of the investments is eliminated against the corresponding share of net equity;
  – the balance sheet and income statement transactions between companies consolidated line-by-line, including dividends distributed within the Group, are eliminated;
  – the equity or income (loss) attributable to the minority interest is presented separately in equity and in the income statement;
- investments in associates and joint ventures are accounted for by the equity method and the carrying amount of the investments is adjusted by:
  – the share of the post-acquisition results of the associate or joint venture;
  – the adjustments from movements in equity that were not recognized in the income statement in accordance with benchmark principles;
  – dividends paid by the investment holding;
- gains on transactions for sales made by subsidiaries to joint ventures and associates are eliminated to the extent of the Group's interest in the joint ventures and associates;
- gains arising on transactions for sales of properties made by one joint venture to other joint ventures or associates are recognized to the extent of the lower of the Group's interest in the buyer company compared to that of the seller company, that is, only to the extent of the gain realized with third parties;
- gains arising on sales transactions of properties from associates to other associates are recognized to the extent of the gain realized with third parties;
- at the time of acquisition of the subsidiary, associate or joint venture, the price paid is allocated according to the purchase method by:
  – determining the cost of acquisition in accordance with IFRS 3;
  – determining the fair value of the assets and liabilities acquired (both actual and contingent);
  – by allocating the price paid to the fair value of the assets acquired and liabilities assumed;
  – by recognizing any residual amount in goodwill, consisting of the excess of the cost of acquisition over the net fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities;
  – by immediately recognizing the negative goodwill, if any, directly in the income statement if the fair value of the net assets acquired exceeds the cost of acquisition.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Intangible assets

Intangible assets with a definite useful life are measured at cost less accumulated amortization and accumulated impairment losses.

Amortization starts when the asset is available for use.

Goodwill
Goodwill is subjected to impairment testing at least on annual bases.
Goodwill is allocated to cash-generating units for purposes of impairment testing.

Trademarks and licenses
Trademarks and licenses are stated at cost less accumulated amortization and accumulated impairment losses. Cost is amortized over the duration of the contract or the asset's estimated useful life, wichever is shorter.

Software
Software license costs, including direct incidental costs, are capitalized and recorded in the balance sheet less accumulated amortization and accumulated impairment losses.

Research and development
Research expenditures for new products and/or processes are expensed when incurred.
There are no development costs which meet the conditions for capitalization.

The useful lives of intangible assets are the following:

Trademarks and licenses	5 years
Software	not more than 3 years

Property, plant and equipment

Property, plant and equipment are measured at the cost of acquisition or production and include directly attributable incidental expenses.
Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, except for land, which is not depreciated and is stated at cost less accumulated impairment losses.
Depreciation is accounted starting from the month in which the asset is available for use, or is potentially able to provide the economic benefits associated with it.
Depreciation is calculated monthly using the straight-line method at rates designed to write-off the assets to the end of their residual useful lives or, for disposals, until the last month of use.
Depreciation rates are as follows:

Buildings	3% - 10%
Plant	7% - 10%
Machinery	5% - 10%
Equipment	10% - 33%
Furniture	10% - 33%
Motor vehicles	10% - 25%

Government grants relating to property, plant and equipment are recognized as deferred income and credited to the income statement over the period of depreciation of the relative assets.
Borrowing costs incurred for the purchase of an asset are expensed unless they are directly attributable to the purchase, construction or production of a qualifying asset, in which case they are capitalized.
Leasehold improvements are classified as property, plant and equipment, consistently with the nature of the costs incurred. The depreciation period corresponds to the remaining useful life of the asset or the residual period of the lease contract, whichever is sooner.
Major spare parts are capitalized and depreciated over the estimated useful life of the assets to which they refer.
Assets acquired under finance lease contracts are accounted for as property, plant and equipment with a contra-entry to the related financial liability. The lease payment is split between interest expense, recorded in the income statement, and the repayment of principal, recorded as a reduction of the financial liability.

Investment property

Investment property is defined as property held to earn rent and or for capital appreciation.

Investment property is initially recognized at cost, including transaction costs, and subsequently measured at fair value. The changes in the fair value of investment property are recorded in the income statement.

The fair value of an investment property reflects the market value at the balance sheet date and represents the amount at which the investment property could be exchanged between knowledgeable and willing parties in an arm's length transaction and after the outcome of adequate sales negotiations based on the principle of reciprocal independence.

Each single property is measured and takes into consideration the future rental income and, where significant, the relative costs, discounted by applying a discount rate that reflects the risks specific to the cash flows generated by the asset.

The income or expense representing changes in the fair value of the investment property is recorded in the income statement in the year in which the change occurs.

The gain or loss on the disposal of investment property is calculated as the difference between the net proceeds and the accounting amount of the asset and is recorded in the income statement in the year of disposal.

When there is a change in use of an investment property from inventories to investment property to be recognized at fair value, the difference between the fair value at the balance sheet date and the previous carrying amount is recorded in the income statement.

When there is a change in use from investment property recognized at fair value to owner-occupied property, the fair value at the date of the change of use is considered the cost of the property under its new classification.

Impairment of assets

Property, plant and equipment and intangible assets
Whenever specific indicators point to an impairment loss, the property, plant and equipment and the intangible assets are tested for impairment.
The test consists of an estimate of the recoverable amount of the asset and a comparison with its carrying amount.
The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use, where value in use is the present value of estimated future cash flows originating from the use of the asset and those deriving from its disposal at the end of its useful life.
If the recoverable amount is lower than the asset's carrying amount, the carrying amount is reduced to the recoverable amount. This reduction constitutes an impairment loss which is recognized in the income statement.
For intangible assets with an indefinite life, including goodwill, the impairment test is performed annually, regardless of the presence of specific indicators.

Investments in associates and joint ventures
For impairment test purpose, the value of investments in associates and joint ventures accounted for by the equity method must be compared with the recoverable amount. The recoverable amount

corresponds to the higher of the fair value, less costs to sell, and the value in use. It is not necessary to estimate both amounts since it is sufficient to verify that one of the two amounts is higher than the accounting amount in order to establish the absence of an impairment.
In keeping with recent interpretations, for purposes of impairment testing, the fair value of an investment in an associate or joint venture with shares listed on an active market is always equal to its market value regardless of the percentage of ownership.
In order to determine the value in use of an associate or joint venture accounted for by the equity method, the following estimates should be made:

a) the share of the present value of estimated future cash flows that will be generated by the associate or joint venture, including cash flows generated by the operating activities of the associate or joint venture and the consideration that will be received on the final disposal of the investment (known as the Discounted Cash Flow – asset side)
b) the present value of estimated future cash flows that will be generated by dividends to be received and the final disposal of the investment (known as the Dividend Discount model – equity side).

Available-for-sale financial assets

Available-for-sale financial assets include investments in other companies and other securities not held for trading. They are included in non-current assets since there is no intention to dispose of them within 12 months of the balance sheet date.
For measurement purposes, they are classified as available-for-sale financial assets and measured at fair value. Fair value gains and losses are recognized in a specific reserve in equity.

In case of impairment losses or in the event of disposal, the gains and losses recognized up to that time in equity are reversed to the income statement.
Any impairment losses recognized on available-for-sale financial assets in the income statement cannot be reversed through the income statement.
Purchases and sales of available-for sale financial assets are recognized on the settlement date.

Inventories

Inventories are stated at the lower of cost, using the FIFO method, and the estimated realizable value.

Construction contracts

A construction contract is a contract specifically negotiated for the construction of an asset based on the instructions of a principal that, as a preliminary step, designs the plans and the technical characteristics.
Contract revenues include the consideration initially agreed, in addition to changes in the construction work and price variations envisaged by the contract that can be determined reliably.
When the outcome of a construction contract can be estimated reliably, they are measured using the percentage of completion method. The stage of completion is measured by reference to the costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract.
Contract revenues are compared to contract costs incurred to reach the stage of completion.
Costs incurred during the year in connection with future contract activity are excluded from contract costs in determining the stage of completion and recorded as inventories.
When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized as an expense immediately.

The gross amount due from customers for contract work for all the contracts in progress and for which the costs incurred plus recognized profit (less recognized losses) exceed progress billings is included in trade receivables.
The gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognized profit (less recognized losses) is included in trade payables.

Receivables and payables

Receivables and payables are initially recorded at their fair value, generally represented by the present value of the amount that will be collected or paid.
Subsequently, they are measured at amortized cost, and in the case of receivables, less bad debt provision.
Junior notes generated by transactions for the securitization of non-performing loans (NPL) as well as non-performing deep discount receivables included in non-current assets and current assets, are classified as loans and receivables and measured at amortized cost, less bad debt provision.
The amortized cost is calculated using the effective interest rate method. The effective interest rate is equivalent to the rate used to discount future cash flows to arrive at exactly the net carrying amount at the initial recognition date.
Any impairment of junior securities is represented by the difference between the projections of the estimated future net cash flows on the underlying non-performing loan portfolios at the date of acquisition of the notes, and the projections of the estimated future net cash flows of these same portfolios, updated to the date of the preparation of the financial statements, both discounted at the effective interest rate determined at the date of the acquisition of the junior securities. When the conditions that gave rise to the impairment of the junior notes no longer exist, the impairment losses recorded in previous periods are cancelled by a credit to the income statement up to the amortized cost which would have been recorded had no impairment loss been recognized.
The accounting amount of non-performing loans is adjusted whenever there is a change in the present value of the estimated future cash flows. Any differences are recognized in the income statement.
Receivables and payables in currencies other than the functional currency of the individual companies are adjusted to the year-end exchange rates with a contra-entry to the income statement.
Receivables are derecognized when the right to receive cash flows from the receivables have expired or the Group has transferred substantially all the risks and rewards of ownership or the receivable is considered definitively irrecoverable after all the necessary recovery procedures have been completed
Payables are derecognized when the specific contractual obligation is extinguished.

Securities held for trading

Securities held for trading include securities principally purchased for resale in the short term. Such securities are classified as current assets.
Securities held for trading are measured at fair value through the income statement. Transaction costs are expensed in the income statement.
Purchases and sales of financial assets held for trading are recognized on the settlement date.

Cash and cash equivalents

Cash and cash equivalents include bank and postal deposits and cash on hand. Cash and cash equivalents are stated at nominal value.

Provisions for other liabilities and charges

Provisions for other liabilities and charges include accruals for current obligations (legal or constructive) deriving from a past event, for the fulfillment of which an outflow of resources will probably be necessary, the amount of which can be estimated in a reliable manner.

Employee benefits

Employee benefits paid subsequent to the termination of the employment relationship classified as post-retirement benefits under defined benefit plans and other long-term benefits are subject to actuarial calculations. The liability recorded in the financial statements is the present value of the Group's obligation, net of plan assets, if any.
With regard to employee benefits, the Pirelli & C. Group elected the option allowed by IAS 19 under which actuarial gains and losses are recognized in the statement of recognized income and expense in the year in which they arise.
For other long-term benefits, the actuarial gains and losses are recognized directly in the income statement.
The interest cost and the expected return on plan assets are classified in personnel costs.

Stock option

Stock options are divided into two types which require different accounting treatments according to the features of the plan:
- *equity-settled:* are plans in which the grantee has the right to purchase shares of the company at a fixed price whenever specific conditions are met. In such cases, the fair value of the option, determined at the grant date, is recognized as an expense over the period of the plan with a contra-entry to increase the reserves in equity;
- *cash-settled*: are plans which provide for put options on behalf of the grantee, combined with call options on behalf of the issuer, or plans in which the grantee directly receives the monetary equivalent amount of the benefit originating from the exercise of the stock option. The fair value of the liability, re-measured at the end of every reporting period, is recognized in the income statement over the vesting period. The changes in the fair value of the liability subsequent to the vesting period are recognized in the income statement.

Financial instruments

Derivatives are recognized initially at fair value with a contra-entry to the income statement. They are subsequently re-measured at fair value; fair value gains or losses are recognized in the income statement except for interest rate swaps designated as cash flow hedges.

Derivatives that qualify as cash flow hedges
In all cases in which derivatives are designated as hedging instruments for purposes of IAS 39, the Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions.
The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the cash flows of hedged items.
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized directly in equity. The gain or loss relating to the ineffective portion is recognized immediately in the income statement.
Amounts recognized directly in equity are reversed to the income statement in the periods when the hedged item produces an effect in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the hedged item ultimately produces an effect in the income statement.
When the hedged item is no longer expected to produce an effect in the income statement, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting
Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognized immediately in the income statement.

Fair value estimation
The fair value of financial instruments traded in active markets is based on listed market prices at the balance sheet date. The listed market price used for financial assets is the current bid price; the appropriate listed market price for financial liabilities is the current ask price. The fair value of financial instruments that are not traded on an active market is determined by using valuation techniques with a variety of methods and assumptions that are based on market conditions existing at each balance sheet date.
The fair value of interest-rate swaps is calculated as the present value of estimated future cash flows. The fair value of forward foreign exchange contracts is determined using the forward rate at the balance sheet date.

Income taxes

Current income taxes are determined on the basis of a realistic estimate of the tax expense payable under the current tax laws of the country.
Deferred taxes are calculated on temporary differences arising between the asset and liability amounts in the balance sheet and their tax bases (full liability method). They are classified in non-current assets and liabilities.
Deferred tax assets are only recognized when there is a probability of future recovery.

Equity

Treasury shares
Treasury shares are classified as a deduction from equity.
In the event of sale, re-issue or cancellation, the gains and losses as a result thereof are classified in equity.

Costs of equity transactions
Costs directly attributable to equity transactions of the parent are recognized as a deduction from equity.

Recognition of revenues

Revenues are measured at the fair value of the consideration received for the sale of the products or services.

Sales of products
Revenues from sales of products are recognized when all the following conditions are met:
- the significant risks and the rewards of ownership of the goods are transferred to the buyer;
- the effective control over the goods has ceased;
- the amount of revenues is determined in a reliable manner;
- it is probable that the economic benefits deriving from the sale will flow to the group;
- the costs incurred or to be incurred are determined in a reliable manner.

With specific reference to sales of properties, revenues are generally recognized at the time when ownership has been transferred to the buyer which corresponds to the date of the deed of sale. If the nature and measure of the involvement of the seller are such as to cause that the risks and rewards of ownership are not in fact transferred, then the recognition date of the revenues is deferred until such time as the transfer can be considered to have taken place.

Rendering of services
Revenues from rendering of services are recognized by reference to their completion at the balance sheet date.
With regard specifically to the revenues from the rendering of services of Telecom Italia S.p.A. (an associate of the joint venture Olimpia S.p.A whose share of the results is included in the consolidated financial statements by the equity method), the revenues for activating telephone services (as well as the relative costs) are deferred over the estimated duration of the relationship with the customer. Revenues from prepaid traffic are recorded on the basis of the minutes used at the contract price per minute. The revenues from the income of recharging prepaid cards and the relative costs with the latter not exceeding the amount of the income from recharging cards, are deferred over the period between two subsequent recharges (about one month). Starting from the year 2006, following the introduction of new types of contracts which bind the customer to Telecom Italia for periods of 24 months, otherwise a penalty is applied, the Company capitalizes directly attributable subscriber acquisition costs to intangible assets and recognizes them in the income statement over the period of the underlying contract. In all other cases, subscriber acquisition costs are expensed when incurred.

Dividend income
Dividend income is recognized when the right to receive payment is established, which normally corresponds to the resolution passed by the shareholders' meeting for the distribution of dividends. Dividends received from associates and joint ventures are recognized as a deduction from the carrying amount of the investment.

Segment information

The business segment (primary reporting segment) is a distinctly identifiable part of the Group which supplies a single product or service or an aggregate of related products and services and is subject to risks and rewards different from those of the other business segments of the Group.
The geographical segment (secondary reporting segment) is a distinctly identifiable part of the Group which supplies a single product or service or an aggregate of related products and services and is subject to risks and rewards different from those relating to the components which operate in other economic environments.

Accounting principles for hyperinflationary countries

The Group companies that operate in high-inflation countries have to restate the amounts in their original respective financial statements in order to eliminate distorting effects due to the loss of the purchasing power of the currency. The inflation rate used to adopt inflation accounting corresponds to the consumer price index.
The companies adopt inflation accounting in countries where cumulative inflation rate over a three-year period approximates or exceeds 100 percent and discontinue it in the event when cumulative inflation rate over a three-year period falls below 100 percent.
Gains and losses on monetary positions are recognized in the income statement.

Classification of property portfolio: inventories (IAS 2) – Investment property (IAS 40)

In accordance with the business model prevalent within the Group, the majority of property assets are classified in inventories insofar as they are held for the purpose of trading and are in any case intended for sale during the course of the normal operating cycle of the companies included in the scope of consolidation.

4. FINANCIAL RISK MANAGEMENT POLICY

Financial risk management is an integral part of the management of the Group's operations. Risk management is carried out centrally using policies defined by the General Finance and Strategic Planning Department and approved by the chief executive officer. Such policies define the categories of risk and specify the procedures and operating limits for each type of transaction and/or instrument. In accordance with these policies, the Group uses derivative contracts in relation to underlying financial assets or liabilities or future transactions. Financial risk management is centralized at the Sector Treasury Units which have the task of evaluating the risks and putting into place the relative hedges under the coordination of Group Treasury. The Sector Treasury Units act directly in the market on behalf of the Operating Units and, where they cannot operate directly because of external restrictions, they coordinate the activities with the Local Treasury Unit.

Type of risk covered

Foreign exchange risk
The Group operates internationally and is exposed to foreign exchange risk, managed by the Sector Treasury Units and coordinated by Group Treasury.
The Operating Units are responsible for gathering all the information inherent to the positions subject to foreign exchange risk which are managed by forward contracts negotiated with the Sector Treasury Units.
The Sector Treasury Units are responsible for evaluating and managing the net position for every currency, consistent with policies and restrictions, by negotiating derivative contracts on the market, generally forward contracts.
Forward contracts between the Operating Units and the Sector Treasury Units as well as those among the Sector Treasury Units and the market are not designated as hedging instruments as defined by IAS 39 although they are in place for the purposes of managing risks.

Credit risk
The Group has no significant concentrations of credit risk. The policies in place ensure a proper evaluation of the financial soundness of the customers.

Liquidity risk
Prudent liquidity risk management implies maintaining sufficient cash and/or short-term securities that can be readily converted into cash, the availability of funding through an adequate amount of committed credit facilities and/or the ability to close out market positions. Due to the dynamic nature of the businesses in which it operates, the Group aims to maintain flexibility in funding by keeping committed credit lines available.

Interest rate risk
The Group's interest-rate risk arises from long-term borrowings. Borrowings issued at floating rates expose the Group to cash flow risk. Borrowings issued at fixed rates expose the Group to fair value. Group policy is to maintain approximately 70 percent of its long-term borrowings in fixed rate instruments.
The Group manages its cash flow interest-rate risk also by using derivative contracts, generally floating-to-fixed interest-rate swaps.
The designation of such derivatives as hedging instruments under IAS 39 is decided case by case and authorized centrally by the General Finance and Strategic Planning Department and the General Operations Department.

5. ESTIMATES AND ASSUMPTIONS

The preparation of the consolidated financial statements requires management to make estimates and assumptions which, in some circumstances, are based on difficult and subjective judgments and estimates derived from historical experience and assumptions which are believed to be reasonable and realistic under the circumstances. Such estimates affect the reported amounts of some assets and liabilities, costs and revenues, as well as the disclosure of contingent assets and liabilities at the balance sheet date.
The estimates and assumptions will generally refer to the measurement of the recoverable amounts of intangible assets, the definition of the useful lives of property, plant and equipment, the recoverability of receivables and the recognition and measurement of provisions. The estimates and assumptions are based upon data which reflects the current state of available knowledge.

Accounting policies of particular importance requiring a higher degree of judgment
The accounting policies involving a higher degree of judgment by management in making estimates and for which a change in the conditions underlying the assumptions could have a significant impact on the consolidated financial statements are the following:

a. Investment in the Olimpia joint venture
- Although the interest held in Olimpia S.p.A. (80 percent) is higher than 50 percent, the investment qualifies as a joint venture by virtue of the bylaws and the shareholders' agreements. In particular, Pirelli, even though it has the absolute majority of voting rights (80 percent), may not appoint more than three out of the six directors (art. 13 of the bylaws). Furthermore, art. 17 of the same bylaws state that the resolutions of the Board shall only be valid if the majority of the directors in office are present and the resolutions are passed by majority vote.
  Finally, art. 12 of the bylaws establishes that the special shareholders' meeting is duly constituted and the resolutions are passed by a favorable vote cast by as many shareholders as those representing at least 81 percent of the share capital. This quorum also applies to the validity of the resolutions that change or eliminate the clause for the slate to nominate directors as well as the variation in the number of the members of the board of directors.
- In the impairment test of Olimpia S.p.A., the estimates and assumptions made by management mainly refer to the estimate of the value in use of the investment in Telecom Italia S.p.A., for which the following factors were incorporated:
  a) flows of results (operating) and dividends as well as the discount and capitalization rates used by the analysts (aligned with the consensus) who follow Telecom Italia stock;
  b) multiples of comparable transactions, for the estimate of the final amount under the asset side criterion;
  c) premiums paid in transactions involving listed companies operating in the telecommunications sector in both Europe and the United States (the country where the sector concentration process first began) to estimate the consideration on the disposal of the shares under the equity side criterion.

  In the impairment test on the investment in Olimpia, valuation techniques commonly applied by experts in company valuations were used, taking into accound the information available at the date of the preparation of the financial statements. Given the complexity of the valuation and the significance of the amount of the investment, the estimates resulting could vary as a result of changes in the assumptions and the hypotheses used for the impairment test.

b. Goodwill
In accordance with the accounting policies applied in the preparation of the financial statements, goodwill is tested annually in order to assess whether there is an impairment that should be recorded in the income statement. In particular, the test involves the allocation of goodwill to cash-generating units and the determination of the relative recoverable amount, understood as being the higher of fair value and the value in use.
If the value in use is lower than the accounting amount of the cash-generating units, an impairment

on the goodwill allocated to them should be recognized. The allocation of goodwill to cash-generating units and the determination of their value in use involves estimates which depend on subjective valuations as well as on factors which could change over time with consequent and possibly significant effects on the assessment made by management.

c. Impairment of property, plant and equipment and intangible assets
In accordance with the accounting policies applied, property, plant and equipment and intangible assets are tested to ascertain if there is an impairment, which should be recognized, when there are indications that would imply difficulties in recovering the net carrying amount through the use of the asset. The verification of the existence of these indications requires management to make judgments based on available internal or external information and historical experience. Moreover, when it has been determined that there could be a potential impairment, that impairment must be determined by reference to suitable valuation techniques. The proper identification of elements indicating the existence of a potential impairment and the estimates used to determine it depend on subjective judgments and factors which can vary over time and influence the assessments and estimates made by management.

d. Deferred income taxes
The recognition of deferred tax assets is made on the basis of expectations of future income. The measurement of future income for purposes of recognizing deferred income taxes depends on factors which can vary over time and determine significant effects on the measurement of deferred tax assets.

e. Provisions for other liabilities and charges
Accruals are made for legal and fiscal liabilities and charges that will probably require an outflow of resources. The amount of the provisions recorded in the financial statements relating to such liabilities and charges represents the best estimate at that time made by management. This estimate involves assumption which depend on factors which can change over time and which could therefore have significant effects on the current estimates made by management in the preparation of the consolidated financial statements.

6. SEGMENT INFORMATION

For the Pirelli & C. Group, the business segment constitutes the primary segment whereas the geographical segment represents the secondary segment.

a) primary reporting format – business segments

At December 31, 2006, continuing operations of the Group are divided into five main business segments:
- Tyres (Pirelli Tyre)
- Broadband
- Environment
- Real Estate (Pirelli & C. Real Estate)
- Olimpia investment

The remaining part comprises financial companies (including the parent) and other service companies. None of these constitutes a reportable segment.

Segment results of continuing operations for the year ended December 31, 2006 are as follows:

CONTINUING OPERATIONS							(in thousands of euros)
	Tyre	Broadband	Environment	Real Estate	Olimpia	Other	TOTAL 2006
					-		
Sales to third parties	3,947,159	129,434	66,261	691,161	-	7,209	4,841,224
Sales to the Group	2,343	-	2,706	10,803	-	(15,852)	-
TOTAL SALES	**3,949,502**	**129,434**	**68,967**	**701,964**	**-**	**(8,643)**	**4,841,224**
GROSS OPERATING PROFIT	**533,653**	**1,056**	**480**	**113,089**	**-**	**(34,201)**	**614,077**
Depreciation of property, plant and equipment	(185,852)	(1,299)	(531)	(5,773)	-	(7,973)	(201,428)
Amortization of intangible assets	(5,457)	(24)	(173)	(3,598)	-	(2,011)	(11,263)
OPERATING PROFIT (LOSS)	**342,344**	**(267)**	**(224)**	**103,718**	**-**	**(44,185)**	**401,386**
Share of earnings (losses) of companies accounted for by the equity method	179			101,570	(1,940,039)	2,209	(1,836,081)
Financial income (expenses)							532,254
Dividends							65,857
Valuation of financial assets							(54,394)
LOSS BEFORE INCOME TAXES							**(890,978)**
Income taxes							(127,848)
LOSS FOR THE YEAR							**(1,018,826)**

Segment results of continuing operations for the year ended December 31, 2005 are as follows:

CONTINUING OPERATIONS							(in thousands of euros)
	Tyre	Broadband	Environment	Real Estate	Olimpia	Other	TOTAL 2005
Sales to third parties	3,632,667	112,155	59,907	690,330	-	50,610	4,545,669
Sales to the Group	256	19	1,562	9,850	-	(11,687)	-
TOTAL SALES	**3,632,923**	**112,174**	**61,469**	**700,180**	**-**	**38,923**	**4,545,669**
GROSS OPERATING PROFIT	**518,060**	**(6,330)**	**(2,034)**	**92,844**	**-**	**(34,943)**	**567,597**
Depreciation of property, plant and equipment	(181,816)	(644)	(582)	(5,224)	-	(8,772)	(197,038)
Amortization of intangible assets	(7,462)	(51)	(1,007)	(3,743)	-	(3,377)	(15,640)
OPERATING PROFIT (LOSS)	**328,782**	**(7,025)**	**(3,623)**	**83,877**	**-**	**(47,092)**	**354,919**
Share of earnings (losses) of companies accounted for by the equity method	14			98,787	152,486	79	251,366
Financial income (expenses)							(65,372)
Dividends							26,694
Valuation of financial assets							(90,069)
INCOME BEFORE INCOME TAXES							**477,538**
Income taxes							(128,484)
INCOME FOR THE YEAR							**349,054**

The method of measuring sales among sectors is the same as that applied for sales to third parties.

Segment assets, liabilities and capital expenditures at December 31, 2006 are as follows:

							(in thousands of euros)
	Tyre	Broadband	Environment	Real Estate	Olimpia	Other	TOTAL 2006
Segment assets	3,066,993	44,985	32,477	891,516	-	56,279	4,092,250
Investments in associates and joint ventures	1,010	-	660	285,798	3,487,855	53,528	3,828,851
Unallocated assets							2,306,397
TOTAL ASSETS	**3,068,003**	**44,985**	**33,137**	**1,177,314**	**3,487,855**	**109,807**	**10,227,498**
Segment liabilities	1,484,001	55,459	17,029	453,060	-	345,032	2,354,581
Unallocated liabilities							3,186,360
TOTAL LIABILITIES	**1,484,001**	**55,459**	**17,029**	**453,060**	**-**	**345,032**	**5,540,941**
Capital expenditures- property, plant and equipment	224,200	6,942	1,015	12,458	-	10,841	255,456
Capital expenditures - intangible assets	4,133	95	400	47,045	-	3,211	54,884

Segment assets, liabilities and capital expenditures at December 31, 2005 are as follows:

(in thousands of euros)

	Tyre	Broadband	Environment	Real Estate	Olimpia	Other	TOTAL 2005
Segment assets	3,064,576	39,172	32,395	723,544		110,161	3,969,848
Investments in associates and joint ventures	3,992	-	642	239,200	4,247,944	51,124	4,542,902
Unallocated assets							2,301,425
TOTAL ASSETS	**3,068,568**	**39,172**	**33,037**	**962,744**	**4,247,944**	**161,285**	**10,814,175**
Segment liabilities	1,538,913	56,947	16,304	452,598		745,697	2,810,459
Unallocated liabilities							2,389,910
TOTAL LIABILITIES	**1,538,913**	**56,947**	**16,304**	**452,598**	**-**	**745,697**	**5,200,369**
Capital expenditures- property, plant and equipment	208,326	3,377	510	7,932		13,479	233,624
Capital expenditures - intangible assets	4,004	242	531	3,108		950	8,835

Segment assets mainly consist of property, plant and equipment, intangible assets, assets under finance leases, inventories, trade receivables and other receivables and exclude financial receivables, available-for-sale financial assets, securities held for trading and current and deferred tax assets.

Segment liabilities mainly include trade payables and other payables, advances from customers, provisions for other liabilities and charges and employee benefit obligations and exclude financial payables and current and deferred tax liabilities.

Capital expenditures mainly refer to the purchase of plant and machinery.

b) secondary reporting format – geographical segments

Sales by geographical area, allocated on the basis of the country in which the customer resides, are as follows.

(in thousands of euros)

Geographical areas	2006		2005	
Europe:				
- Italy	1,331,865	27.51%	1,382,769	30.42%
- Other European countries	1,586,865	32.78%	1,494,600	32.89%
North America	318,846	6.59%	286,600	6.30%
Central and South America	1,029,302	21.26%	921,600	20.27%
Oceania, Africa and Asia	574,346	11.86%	460,100	10.12%
	4,841,224	**100.00%**	**4,545,669**	**100.00%**

Assets by geographical area, allocated on the basis of the country in which the assets are located, are as follows.

(in thousands of euros)

	12/31/2006	12/31/2005
Assets		
Europe		
- Italy	6,941,147	8,124,512
- Other European countries	1,700,580	1,533,719
North America	136,721	142,698
Central and South America	950,625	621,373
Oceania, Africa and Asia	498,425	391,873
	10,227,498	**10,814,175**

Capital expenditures by geographical area, allocated on the basis of the country in which the assets are located, are as follows:

(in thousands of euros)

	2006	2005
Capital expenditures		
Europe		
- Italy	45,599	60,508
- Other European countries	149,344	76,682
North America	2,228	5,158
Central and South America	81,636	87,315
Oceania, Africa and Asia	31,533	12,796
	310,340	**242,459**

7. PROPERTY, PLANT AND EQUIPMENT

At December 31, 2006, the composition and movements in property, plant and equipment are as follows:

(in thousands of euros)

	12/31/2006			12/31/2005		
	Gross carrying amount	Accumul. Depreciat.	Net carrying amount	Gross car. amount	Accumul. Deprec.	Net car. amount
Land and improvements	83,186	-	83,186	67,272	-	67,272
Buildings	636,276	(279,337	356,939	616,589	(274,890)	341,699
Plant and machinery	2,453,970	(1,502,184)	951,786	2,421,571	(1,449,690)	971,881
Industrial and comm. equipment	530,971	(405,094)	125,877	509,673	(387,135)	122,538
Other property, plant and equipment	238,999	(182,198)	56,801	249,667	(181,085)	68,582
	3,943,402	**(2,368,813)**	**1,574,589**	**3,864,772**	**(2,292,800)**	**1,571,972**

(in thousands of euros)

	Movements in gross carrying amount						
	12/31/2005	Exchange diff.	Increase	Decrease	Reclass.	Other	12/31/2006
Land and improvements	67,272	(2,236)	3,613	(1,397)	5,748	10,186	83,186
Buildings	616,589	(12,567)	34,044	(17,124)	10,849	4,485	636,276
Plant and machinery	2,421,571	(79,890)	160,988	(22,156)	(28,707)	2,164	2,453,970
Industrial and comm. equipment	509,673	(16,549)	37,879	(16,823)	13,827	2,964	530,971
Other property, plant and equipment	249,667	(4,556)	18,932	(22,420)	(1,717)	(907)	238,999
	3,864,772	**(115,798)**	**255,456**	**(79,920)**	**-**	**18,892**	**3,943,402**

(in thousands of euros)

	Movements in accumulated depreciation						
	12/31/2005	Exchange difference	Reclass.	Decrease	Deprec./ impairments	Other	12/31/2006
Buildings	(274,890)	5,553	831	14,572	(23,551)	(1,852)	(279,337)
Plant and machinery	(1,449,690)	49,617	844	18,219	(120,361)	(813)	(1,502,184)
Industrial and comm. equipment	(387,135)	13,238	(441)	13,576	(42,234)	(2,098)	(405,094)
Other property, plant and equipment	(181,085)	3,405	(1,234)	11,646	(16,427)	1,497	(182,198)
	(2,292,800)	**71,813**	**-**	**58,013**	**(202,573)**	**(3,266)**	**(2,368,813)**

(in thousands of euros)

	Movements in net carrying amount							
	12/31/2005	Exchange differences	Incr.	Decr.	Reclass.	Deprec./ impairments	Other	12/31/2006
Land and improvements	67,272	(2,236)	3,613	(1,397)	5,748	-	10,186	83,186
Buildings	341,699	(7,014)	34,044	(2,552)	11,680	(23,551)	2,633	356,939
Plant and machinery	971,881	(30,273)	160,988	(3,937)	(27,863)	(120,361)	1,351	951,786
Industrial and comm. equipment	122,538	(3,311)	37,879	(3,247)	13,386	(42,234)	866	125,877
Other property, plant and equipment	68,582	(1,151)	18,932	(10,774)	(2,951)	(16,427)	590	56,801
	1,571,972	**(43,985)**	**255,456**	**(21,907)**	**-**	**(202,573)**	**15,626**	**1,574,589**

At December 31, 2005, movements were as follows:

(in thousands of euros)

	Movements in gross carrying amount								
	12/31/2004	Discont. operations	Change in scope of consolid.	Exchan. differen.	Increase	Decr.	Reclass.	Other	12/31/2005
Land and improvements	127,834	(64,014)		2,178	2,118	(3,410)	964	1,602	67,272
Buildings	983,891	(445,107)		30,813	49,800	(15,335)	1,553	10,974	616,589
Plant and machinery	3,550,203	(1,538,035)	72,333	178,380	120,706	(29,836)	11,631	56,189	2,421,571
Industrial and comm. equipment	524,285	(96,449)		27,134	34,460	(9,392)	14,976	14,659	509,673
Other property, plant and equipment	490,477	(221,919)		13,870	26,540	(14,696)	(29,124)	(15,481)	249,667
Total	**5,676,690**	**(2,365,524)**	**72,333**	**252,375**	**233,624**	**(72,669)**	**-**	**67,943**	**3,864,772**

(in thousands of euros)

	Movements in accumulated depreciation								
	12/31/2004	Discont. operations	Change in scope of consolid.	Exchan. differen.	Reclass.	Decr.	Deprec./ impair.	Other	12/31/2005
Buildings	(452,466)	214,915		(15,547)	138	5,828	(21,490)	(6,268)	(274,890)
Plant and machinery	(2,441,975)	1,202,630		(75,253)	1,192	20,173	(119,617)	(36,841)	(1,449,691)
Industrial and comm. equipment	(404,222)	83,559		(19,709)	(3)	5,022	(40,891)	(10,890)	(387,134)
Other property, plant and equipment	(297,180)	129,342		(7,018)	(1,327)	12,076	(18,066)	1,088	(181,085)
	(3,595,843)	**1,630,446**	**-**	**(117,528)**	**-**	**43,099**	**(200,064)**	**(52,911)**	**(2,292,800)**

(in thousands of euros)

	Movements in net carrying amount									
	12/31/2004	Discont. operations	Change in scope of consolid.	Exchan. differen.	Increase	Decr.	Reclass.	Deprec./ impair.	Other	12/31/2005
Land and improvements	127,834	(64,014)		2,178	2,118	(3,410)	964	-	1,602	67,272
Buildings	531,425	(230,192)		15,266	49,800	(9,507)	1,691	(21,490)	4,706	341,699
Plant and machinery	1,108,228	(335,405)	72,333	103,127	120,706	(9,663)	12,823	(119,617)	19,348	971,880
Industrial and comm. equip.	120,063	(12,890)		7,425	34,460	(4,370)	14,973	(40,891)	3,769	122,539
Other property, plant and equip.	193,297	(92,577)		6,852	26,540	(2,620)	(30,451)	(18,066)	(14,393)	68,582
	2,080,847	**(735,078)**	**72,333**	**134,848**	**233,624**	**(29,570)**	**-**	**(200,064)**	**15,032**	**1,571,972**

Increases in the year 2006 mainly refer to the new operating units of the Tyres Sector in Romania (at Slatina), in China (at Yanzhou) and the build-up of the production facilities in Brazil with a view towards increasing production capacity, especially at Bahia and Gravatai.
The ratio of additions during the year to depreciation is 1.27.
Assets under construction at December 31, 2006 amount to Euros 69,512 thousand (Euros 58,892 thousand at December 31, 2005).
Impairments in 2006, included in the column "Depreciation and impairments" in the above table, amount to Euros 2,638 thousand (Euros 3,026 thousand at December 31, 2005) and are recorded in the income statement under "Amortization, depreciation and impairments" (Note 32).
Restrictions on the ownership of assets are as follow:

– machinery and plant for Euros 14,076 thousand are used as collateral to secure a loan from the National Bank of Egypt obtained by the subsidiary Alexandria Tyre Company S.A.E. (Euros 16,985 thousand at December 31, 2005);
– machinery and land for Euros 77,645 thousand are used as collateral by the subsidiary Pirelli Pneus S.A. (Euros 76,411 thousand at December 31, 2005).

Borrowing costs have not been capitalized to property, plant and equipment.

7.1. LEASING

Buildings, plant, machinery and other assets purchased by the Group under finance leases are included in the respective categories of property, plant and equipment.

Details are as follows:

(in thousands of euros)

	12/31/2006			12/31/2005		
	Capitalized cost	Accumulated depreciation	Net carry. amount	Capitalized cost	Accumulated depreciation	Net carry. amount
Land leased	11,187	-	11,187	11,187	-	11,187
Buildings leased	64,415	(10,992)	53,423	64,591	(18,711)	45,880
Other property, plant and equipment leased	1,036	(631)	405	10,796	(341)	10,455
Plant and machinery leased	1,828	(631)	1,197	146	(146)	-
	78,466	**(12,254)**	**66,212**	**86,720**	**(19,198)**	**67,522**

Details of the most important contracts regarding buildings leased are as follows:

Italy:

- Pirelli & C. S.p.A. has a leasing contract with a syndicate of banks (DEUTSCHE BANK LEASING S.p.A. - now SG LEASING S.p.A. - Franfinance Leasing Italia; SOGELEASE ITALIA S.p.A. – now SG LEASING S.p.A. - Franfinance Leasing Italia; LOCAT S.p.A.) on the building which houses the structures and the R&D activities of the Tyres Sector.
  The contract, signed in May 2000, has a term of 13 years and a purchase option at expiration.
  This contract was sold during 2006 by the subsidiary Pirelli Tyre S.p.A. (ex-Pirelli Pneumatici S.p.A.) to Pirelli & C. S.p.A..
  The net book amount of the building is equal to Euros 43,563 thousand (Euros 45,221 thousand at December 31, 2005).

Germany:

- the subsidiary Pirelli Deutschland GmbH has a leasing contract with the company DAL-Florenta on the distribution warehouse located in Breuberg. The term of the contract is divided into two periods: the first period has a term of 15 years from January 1, 1995 to December 31, 2009; the second period has a term of another 7.5 years. The contract has a purchase option;
- the subsidiary Pneumobil GmbH has five leasing contracts with the company DAL on the buildings of five points of sale in Germany. The terms of the contracts are between 20 and 25 years. All the contracts expire between 2008 and 2010. The contracts have purchase options.
  The net carrying amount of the buildings total Euros 7,715 thousand (Euros 9,183 thousand at December 31, 2005).

Finance lease payables associated with the above significant contracts are included in financial payables (Note 24).

Minimum lease payments due (that is, the payments requested by the lessor over the remaining lease period) are detailed as follows:

(in thousands of euros)			
			12/31/2006
	Germany	Italy	Total
due within 1 year	1,091	4,151	5,242
due between 1 and 5 years	7,923	16,603	24,526
due beyond 5 years	-	16,643	16,643
Total	9,014	37,397	46,411
Future financial expenses	(1,024)	(7,529)	(8,553)
Leases payable	**7,990**	**29,868**	**37,858**
Altri contratti			1,365
Total in financial statements (Note 24)			**39,223**

The minimum lease payments due at December 31, 2005 were as follows:

(in thousands of euros)			
			12/31/2005
	Germany	Italy	Total
due within 1 year	1,181	5,189	6,370
due between 1 and 5 years	9,642	16,603	26,245
due beyond 5 years	-	20,794	20,794
Total	10,823	42,586	53,409
Future financial expenses	(2,099)	(9,717)	(11,816)
Leases payable	**8,724**	**32,869**	**41,593**
Other contracts			60
Total in financial statements (Note 24)			**41,653**

The following table shows finance lease payables associated with the above significant contracts divided by expiration date:

(in thousands of euros)			
			12/31/2006
	Germany	Italy	Total
due within 1 year	721	2,554	3,275
due between 1 and 5 years	7,269	11,737	19,006
due beyond 5 years	-	15,577	15,577
Total	**7,990**	**29,868**	**37,858**
Other contracts			1,365
Total in financial statements (Note 24)			**39,223**

At December 31 2005, the breakdown by expiration date was as follows:

(in thousands of euros)			
			12/31/2005
	Germany	Italy	Total
due within 1 year	607	3,001	3,608
due between 1 and 5 years	8,117	11,111	19,228
due beyond 5 years	-	18,757	18,757
Total	**8,724**	**32,869**	**41,593**
Other contracts			60
Total in financial statements (Note 24)			**41,653**

8. INTANGIBLE ASSETS

The composition and movements in intangible assets are as follows:

(in thousands of euros)

	12/31/2005	Exch. differen.	Increase	Decr.	Amortiz./ impairm.	Other	12/31/2006
Patents and intellectual property rights	992	-	21	-	(263)	27	777
Concessions, licenses and trademarks	21,330	-	5,145	(65)	(2,215)	(7)	24,188
Goodwill	440,568	(111)	42,201	-	-	(2,924)	479,734
Software	12,437	(17)	4,888	(18)	(8,480)	1,307	10,117
Other intangible assets	1,474	(35)	2,629	(110)	(1,798)	(602)	1,558
	476,801	**(163)**	**54,884**	**(193)**	**(12,756)**	**(2,199)**	**516,374**

(in thousands of euros)

	12/31/2004	Discont. operations	Exch. differen.	Increase	Decr.	Amortiz./ impairm.	Other	12/31/2005
Patents and intellectual property rights	2,294	(42)	-	113	(96)	(1,274)	(3)	992
Concessions, licenses and trademarks	21,819	(104)	-	1,653	(104)	(2,010)	76	21,330
Goodwill	460,028	(15,262)	118	-	-	-	(4,316)	440,568
Software	24,742	(5,526)	151	5,569	-	(12,057)	(442)	12,437
Other intangible assets	3,995	(3,137)	42	1,500	(618)	(299)	(9)	1,474
	512,878	**(24,071)**	**311**	**8,835**	**(818)**	**(15,640)**	**(4,694)**	**476,801**

The increase in 2006 in "Goodwill" includes Euros 40,561 thousand relating to the following transactions in the real estate segment (Pirelli & C. Real Estate Group):

- for Euros 1,606 thousand, the purchase of the entire investment in Aponeo S.r.l. on July 27, 2006, a company later merged by Pirelli & C. Real Estate Facility Management S.p.A.;
- for Euros 5,161 thousand, the purchase of the remaining 52.63 percent stake of Pirelli RE Credit Servicing S.p.A. (ex-Credit Servicing S.p.A.) on November 30, 2006; this company evaluates mortgage loan portfolios and manages the credit recovery process both in court and in out-of-court settlements;
- for Euros 26,771 thousand, the purchase of shares from the minority shareholder of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. held as a result of the sale option exercised by the latter on June 27, 2006. The price was established on the basis of a global valuation of the company, equal to approximately Euros 315 million, made by Credit Suisse;
- for Euros 3,062 thousand, the purchase of the shares of P&K Real Estate GmbH from the shareholder Kronberg Partecipazioni Immobiliari S.r.l.;
- for Euros 3,257 thousand, the purchase on April 3, 2006 from Bank Pekao S.A. of 75 percent of Pekao Development Sp.zo.o., now Pirelli Pekao Real Estate Sp.zo.o., one of the major real estate operators on the Polish market employing about 40 staff and managing several residential development projects mainly in the city of Warsaw.

Goodwill under IAS 36 is not amortized but it is subject to impairment test at least annually. For purposes of assessing impairment, goodwill is allocated to the cash-generating units or groups of cash-generating units, considering the highest level of aggregation that may not exceed the business segment identified in accordance with IAS 14.

At December 31, 2006, the breakdown of goodwill according to the business segments and the cash-generating units to which it was allocated for purposes of assessing impairment are shown in the following table:

(in thousands of euros)

Business segment	Cash-generating unit	Amount
Tyres	Consumer	208,522
Tyres	Industrial	172,956
Environment	Eco Technologies	4,860
Real Estate	Services	57,220
Real Estate	Franchising network	425
Real Estate	Investment & Asset Management	35,751
		479,734

The test consists of estimating the recoverable amount of the cash-generating unit and comparing it with the net carrying amount of the relative assets including goodwill.
The recoverable amount of the cash-generating unit has been determined on the basis of the value in use, that is, the present value of future cash flows which is estimated to be associated with the cash-generating unit.
Cash flows used to determine the value in use are based on projections covering a five-year period and are based on:
- for the Real Estate Sector, for the first three years, on projections approved by management; the cash flows for the fourth and fifth year correspond to the cash flows for the last year of the plan while the cash flows generated by the disposal of the cash-generating units at the end of the explicit period correspond to the perpetual return again based on the last year of the plan;
- for the Tyres Sector, for the first year, on plans approved by management; the cash flows relating to the second to the fifth year and the cash flows generated by the disposal of the cash-generating units at the end of the explicit period (assumed as being equal to the present value of the perpetual return of cash flows generated in the last year of projection) have been extrapolated using a growth factor of about 2 percent to the cash flows of the first year.

At December 31, 2006, the discount rates, net of taxes, applied to the cash flow projections are as follows:

Business segment	Cash-generating unit	Discount rate
Tyres	Consumer	7.20%
Tyres	Industrial	7.20%
Environment	Eco Technologies	7.80%
Real Estate	Services	7.31%
Real Estate	Franchising network	7.31%
Real Estate	Investment & Asset Management	7.31%

On the basis of the results of the tests performed, no impairment arose.

9. INVESTMENTS PROPERTIES

Investments properties at December 31, 2005 referred to a former industrial structure denominated "Hangar Bicocca" then held by Lambda S.r.l..
After the building was sold to Pirelli & C. Real Estate S.p.A. and its use changed, the building was reclassified to property, plant and equipment under land and buildings.

10. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Investments in associates and joint ventures total Euros 3,825,928 thousand compared to Euros 4,542,902 thousand at December 31, 2005.

Movements during the year are as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Beginning amount	4,542,902	2,984,387
Discontinued operations	-	(18,492)
Adoption of IAS	-	(964)
Acquisition/change in share capital and reserves	1,228,115	1,411,869
Distribution of dividends	(87,188)	(130,729)
Disposals and wind-ups	(50,972)	(1,317)
Share of earnings	(1,836,411)	251,272
Reclassifications	(1,206)	-
Other	30,688	46,876
	3,825,928	**4,542,902**

The following table details the movements in investments in associates:

(in thousands of euros)

	12/31/2005	Acquisitions/ change in share capital and reserves/other	Distribut. of dividends/ reserves	Disposals and wind-ups	Share of earnings (losses)	Reclas.	Other	12/31/2006
Dixia S.r.l.	5,822	16	-	-	(249)	-	-	5,589
Orione Immobiliare Prima S.p.A.	12,946	-	(11,435)	-	201	-	-	1,712
Sci Roev Texas Partners L.P.	2,125	-	(308)	-	407	-	-	2,224
Spazio Investment N.V.	-	25,200	-	-	624	(250)	21,990	47,564
Turismo e Immobiliare S.p.A.	4,061	912	-	-	(826)	-	-	4,147
Stip Tunisi	1,206	-	-	-	-	(1,206)	-	-
SMP Melfi S.r.l.	1,807	-	-	(1,807)	-	-		-
Eurostazioni S.p.A.	53,861	-	(1,570)	-	2,249	-	(924)	53,616
Other	1,107	359	(1,656)	-	(176)	-	23	(343)
Total investments in associates	**82,935**	**26,487**	**(14,969)**	**(1,807)**	**2,230**	**(1,456)**	**21,089**	**114,509**

Note that the fair value at December 31, 2006 of the company Spazio Investment N.V., listed on the Alternative Investment Market of the London Stock Exchange, is equal to Euros 52.3 million, which was calculated using the market price at December 29, 2006 of Euros 14.95.

The following table details the movements in investments in joint ventures:

(in thousands of euros)

	12/31/2005	Acquisitions/ change in share capital and reserves/other	Distribut. of dividends/ reserves	Disposals and wind-ups	Share of earnings (losses)	Reclas.	Other	12/31/2006
Afrodite S.à r.l.	923	(60)	-	-	2,980	-	-	3,843
Alceo B.V.	621	495	-	-	(1,420)	-	304	-
Alimede Luxembourg S.à.r.l.	-	129	-	-	(75)	-	-	54
Alnitak S.à r.l,	-	1,844	-	-	262	-	-	2,106
Altair Zander Italia S.r.l.	61	-	-	-	9	-	-	70
Aree Urbane S.r.l.	8,167	18	-	-	(265)	-	-	7,920
Artemide S.à r.l.	714	(78)	-	-	1,781	-	-	2,417

(in thousands of euros)

	12/31/2005	Acquisitions/ change in share capital and reserves/other	Distribut. of dividends/ reserves	Disposals and wind-ups	Share of earnings (losses)	Reclas.	Other	12/31/2006
Austin S.à.r.l.	-	1,445	-	-	5,051	(2,706)	-	3,790
Bernini Immobiliare S.r.l.	1,323	(570)	(472)	-	(281)	-	-	-
Capitol Immobiliare S.r.l.	3	165	-	-	(129)	-	-	39
Castello S.r.l.	44	-	-	-	100	-	-	144
Colombo S.a.r.l.	1,346	1,113	-	-	3,071	-	-	5,530
Consorzio ARP	-	53	-	-		-	-	53
Consorzio G6 Advisor	22	-	-	-	-	-	-	22
Continuum S.r.l.	6,226	-	(2,702)	-	1,164	-	-	4,688
Dallas S.à.r.l.	-	1,445	-	-	5,051	(2,706)	-	3,790
Dolcetto Otto S.r.l.	-	18	-	-	(7)	-	-	11
Domogest S.r.l.	908	-	-	-	117	-	-	1,025
Doria S.a.r.l.	1,357	1,002	-	-	3,063	-	-	5,422
Elle Dieci S.c.a.r.l.	40	-	-	-	-	-	-	40
Elle Tre S.c.a.r.l.	40	-	-	-	-	-	-	40
Erice S.r.l.	1,053	-	-	-	198	-	-	1,251
Espelha - Serviços de Consultadoria Lda.	-	35,177	-	-	4,045	-	-	39,222
European NPL S.A.	-	9,166	-	-	30	-	-	9,196
Fattoria Medicea S.r.l.	-	549	-	-	(24)	-	-	525
Galatea S.r.l.	-	348	-	-	(384)	-	36	-
Geolidro S.r.l.	10,497	(10,330)	-	-	(167)	-	-	-
Gestioni Immobiliari 2003 S.r.l.	-	105	-	-	(7)	-	-	98
Golfo Aranci S.p.A. - Società di trasformazione urbana	-	1,378	-	-		-	-	1,378
Immobiliare Prizia S.r.l.	4,178	(19)	-	-	2,192	-	-	6,351
IN Holdings I S.a.r.l.	2,184	-	(1,640)	-	(137)	-	-	407
Induxia S.r.l.	2,307	-	-	-	(501)	-	-	1,806
Inimm Due S.a.r.l.	2,192	-	-	-	1,767	-	-	3,959
Iniziative Immobiliari S.r.l.	14,188	-	(8,409)	-	1,606	-	-	7,385
Localto S.p.A.	615	536	-	(1,300)	149	-	-	-
Localto ReoCo S.r.l.	-	4	-	-	-	-	-	4
LSF Italian Finance Company S.r.l.	5	-	-	(5)	-	-	-	-
Maro S.r.l. (già M.S.M.C. Immobiliare Tre S.r.l.)	-	53	-	-	(11)	-	-	42
Masaccio S.r.l.	-	196	-	-	(1)	-	-	195
Masseto I B.V.	23,163	-	(23,107)	-	17,433	979	-	18,468
Max B.V.	692	(2)	-	-	4,444	-	-	5,134
M.S.M.C. Italy Holding B.V.	17,533	88	(11,239)	-	6,145	-	-	12,527
Mirandia – Trading e Consultoria LdA	41,607	-	-	(44,244)	2,637	-	-	-
MP Facility S.r.l.	2,062	210	(890)	-	(145)	-	-	1,237
MSPRE Luxembourg NPL S.à r.l. (in liquidation)	898	(979)	-	-	81	-	-	-
Nashville S.à.r.l.	-	1,445	-	-	5,051	(2,705)	-	3,791
Pirelli RE Credit Servicing S.p.A. (ex-Credit Servicing S.p.A.)	9,001	(5,023)	(1,895)	-	(2,083)	-	-	-
Polish Investemts Real Estate Holding B.V.	-	2,475	-	(11)	(48)	-	-	2,416
Progetto Bicocca La Piazza S.r.l.	557	-	-	-	(185)	-	-	372
Progetto Nuovo Sant'Anna S.r.l.	-	1,479	-	-	(21)	-	-	1,458
Popoy Holding B.V.	15,489	-	(12,223)	-	5,604	7,138	-	16,008
Progetto Gioberti S.r.l.	42	-	-	-	316	-	-	358
Quadrifoglio Milano S.p.A.	5,509	81	-	-	(216)	-	-	5,374
Resi S.r.l. (ex-Dolcetto Cinque S.r.l.)	-	5	-	-	3	-	-	8
Resident Berlin P&K 1 GmbH	-	7,665	(3,932)	-	122	-	-	3,855

(in thousands of euros)

	12/31/2005	Acquisitions/ change in share capital and reserves/other	Distribut. of dividends/ reserves	Disposals and wind-ups	Share of earnings (losses)	Reclas.	Other	12/31/2006
Rinascente/Upim S.r.l.	9,819	(427)	-	-	(4,747)	-	-	4,645
Riva dei Ronchi S.r.l.	766	26	-	-	(73)	-	-	719
Roca S.r.l. (ex- M.S.M.C. Immobiliare Sei S.r.l.)	-	368	-	-	(27)	-	-	341
S.AN.CO S.c.a.r.l.	-	2	-	-		-	-	2
Sicily Investments S.à.r.l.	-	5	-	-		-	-	5
Solaris S.r.l.	9,463	-	(5,391)	-	236	-	-	4,308
Spazio Industriale B.V.	1,936	-	(113)	-	2,429	250	-	4,502
Spazio Industriale II B.V.	3,674	6,060	(206)	-	22,269	-	(31,797)	-
Tamerice Immobiliare S.r.l.	3,475	(77)	-	-	11,385	-	-	14,783
Tizian Wohnen 1 GmbH	12	2,766	-	-	(14)	-	-	2,764
Tizian Wohnen 2 GmbH	12	1,072	-	-	64	-	-	1,148
Trinacria Capital S.à.r.l.	-	5	-	-		-	-	5
Trinoro S.à r.l.	-	11	-	-	(8)	-	-	3
Trixia S.r.l.	2,359	-	-	-	(1,561)	-	-	798
Tronador - Consultoria Economica LdA	3,593	-	-	(3,605)	12	-	-	-
Vespucci S.a.r.l.	1,348	1,112	-	-	3,069	-	-	5,529
Vesta Finance S.r.l.	-	12	-	-		-	-	12
Waterfront Flegreo S.p.A.	-	173	-	-	(1)	-	-	172
Olimpia S.p.A.	4,247,944	1,138,894	-	-	(1,940,039)		41,056	3,487,855
Total investments in joint ventures	**4,459,967**	**1,201,628**	**(72,219)**	**(49,165)**	**(1,838,641)**	**250**	**9,599**	**3,711,419**
TOTAL INVESTMENTS IN ASSOCIATES AND JOINT VENTURES	**4,542,902**	**1,228,115**	**(87,188)**	**(50,972)**	**(1,836,411)**	**(1,206)**	**30,688**	**3,825,928**

Key data of the main associates and joint ventures of the real estate sector are as follows:

(in thousands of euros)

	Associates	Joint venture
Non-current assets	701,319	1,747,663
Current assets	940,116	6,112,156
Non-current liabilities	747,976	3,930,602
Current liabilities	311,332	2,454,390
Revenues from sales and services	371,703	3,387,096
Costs	(356,074)	(3,743,147)
Net income	3,818	415,997

The following amounts refers to the financial statements of the company Olimpia S.p.A., adjusted in accordance with IFRS:

(in thousands of euros)

Olimpia	
Non-current assets	7,491,064
Current assets	85,504
	7,576,568
Non-current liabilities	3,216,126
Current liabilities	570
	3,216,696
Revenues	429,144
Costs	(3,145,839)
Loss	**(2,716,695)**

The investments in joint ventures amount to Euros 3,711,419 thousand compared to Euros 4,459,968 thousand at December 31, 2005. The amount mainly refers to the investment in Olimpia S.p.A. (80 percent).
In the above table of movements in joint ventures, the amount presented on the corresponding line in the column "Other" (Euros 41,056 thousand) includes the fair value adjustment of the interest rate swaps designated as cash flows hedges (Euros 38,189 thousand) and other movements recognized directly in equity relating to the investment in Telecom Italia S.p.A.; such amounts are recorded in the statement of recognized income and expense in equity.

Although the interest held in Olimpia S.p.A. is higher than 50 percent, the investment qualifies as a joint venture by virtue of the shareholders' agreements and the bylaws, as described in the previous paragraph 5 "Estimates and assumptions".

The investment held by Olimpia S.p.A. in Telecom Italia S.p.A., although below 20 percent, qualifies as an associate in that, considering Telecom Italia's broad shareholder base, Olimpia's investment allows it to exercise a significant influence. Therefore the investment is consolidated by the equity method.
Olimpia S.p.A., under IFRS, holds 2,531,475,296 Telecom Italia S.p.A. ordinary shares (including 124,129,937 shares relating to the equity swap on Telecom Italia S.p.A. shares), equal to a 13.04 percent investment (18.92 percent of voting rights).

The impairment test of the Olimpia joint venture

The impairment test on the investment in Telecom Italia S.p.A. held by Olimpia S.p.A. was carried out as described in the "Summary of significant accounting policies – impairment of assets".
IAS 36 Impairment of assets states that when there are indications of an impairment of an asset, the recoverable amount shall be estimated and compared with the carrying amount. Since there were indications of an impairment in certain market parameters during the course of 2006, the company estimated the recoverable amount of the investment in Telecom Italia S.p.A. held through Olimpia S.p.A..

The main indicators of an impairment in the recoverable amount which arose in 2006 can be ascribed to:
a) the market price of Telecom Italia S.p.A. shares which recorded a relative negative performance compared to the sector indexes in Europe and (most particularly) compared to the expectations of Pirelli's management;
b) the target prices of the analysts who follow Telecom Italia S.p.A. shares, which recorded a higher reduction than that recorded in the market price.

Having ascertained the effective existence of an impairment of the investment, in order to determine the amount of the impairment, the recoverable amount of the investment in Telecom Italia S.p.A. was determined by making reference to its value in use. In this specific case, moreover, the carrying amount used to compare the recoverable amount is represented by the carrying amount of the Telecom Italia S.p.A. ordinary shares implicit in the valuation of the investment by the equity method used by Olimpia S.p.A..
In estimating the value in use, since there is neither a preference nor a consolidated practice relating to the two valuation techniques provided by IAS 28.33, the company decided to use both estimation criteria in order to ensure a result consistent with a variety of calculation methods and measurement techniques.
These refer to:
a) a criterion (the so-called asset side) which considers the operating flows of the associate and the consideration received on the final disposal of the investment;
b) a criterion (the so-called equity side) which considers the estimated flows from dividends and from the disposal of the investment.

In order to estimate the value in use all of the factors which market participants would have considered have been taken into account. They refer, in particular, to:

a) flows of results (operating) and dividends as well as the discount and capitalization rates used by the analysts (aligned with the consensus) who follow Telecom Italia S.p.A. stock;
b) multiples of comparable transactions, for the estimate of the final amount under the asset side criterion;
c) premiums paid in transactions involving listed companies operating in the telecommunications sector in both Europe and the United States (the country where the sector concentration process first began) to estimate the consideration on the disposal of the shares under the equity side criterion.

The two criteria for estimating the value in use resulted in recoverable amounts of between Euros 3 and 3.2 per Telecom Italia S.p.A. share. The company decided to adjust the carrying amount of the investment to an amount equivalent to Euros 3 per Telecom Italia S.p.A. ordinary share, which is an impairment loss of Euros 2,110,000 thousand.

Performance of the company Telecom Italia S.p.A. (an associate of Olimpia S.p.A.) during 2006
The consolidated income of the Telecom Italia group in 2006 is Euros 3,014 million (Euros 3,003 million before minority interests). In 2005, the consolidated income was Euros 3,216 million (Euros 3,690 million before minority interests).
The change in consolidated income (-Euros 202 million) is due to the following factors:
– *operating loss* (-Euros 62 million);
– *share of the earnings (losses) of investments in associates valued by the equity method* (+Euros 28 million);
– lower *net financial expenses* (+Euros 14 million);
– higher *income taxes* (-Euros 124 million);
– lower *net income from discontinued operations/assets held for sale* (-Euros 543 million);
– lower *income attributable to the minority interest* (+Euros 485 million), mainly as a result of the TIM integration operation (cash tender offer and merger), which led to full control over Mobile operations.

The net financial debt position amounts to Euros 37,301 million, with a decrease of Euros 2,557 million compared to Euros 39,858 million at the end of 2005.
The board of directors of Telecom Italia S.p.A. put forward a motion to the shareholders' meeting to pay out dividends equal to Euros 0.14 for each ordinary share.

11. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets amount to Euros 1,006,898 thousand compared to Euros 1,032,317 thousand at December 31, 2005.

Movements during the year are as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Beginning amount	1,032,317	518,612
Discontinued operations	-	(10,787)
Adoption of IAS 32/39	-	225,667
Increase	251,139	231,153
Decrease	(161,889)	(12,567)
Impairments	(13,376)	(22,391)
(Gains) losses taken to income upon disposal of available-for-sale financial assets, or impairments, previously recognized in equity	(126,797)	-
Fair value adjustment gains (losses) recognized in equity	23,842	106,028
Reclassifications	1,206	-
Other	456	(3,398)
	1,006,898	**1,032,317**

At December 31, 2006, available-for-sale financial assets include:

- Euros 836,052 thousand of shares listed on the stock market and held in the portfolio of Pirelli & C. S.p.A. and Pirelli Finance (Luxembourg) S.A.. Such shares refer to Telecom Italia S.p.A., Mediobanca S.p.A., RCS Mediagroup S.p.A., Generale Industrie Metallurgiche S.p.A. and KME Group S.p.A;
- Euros 124,772 thousand of unlisted shares;
- Euros 46,074 thousand of shares of closed-end property investment funds held by Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A.

The increase is mainly due to the purchase of Telecom Italia S.p.A ordinary shares (Euros 186,209 thousand), Assicurazioni Generali S.p.A. shares (Euros 4,567 million), Capitalia S.p.A. shares (Euros 38,219 million), Mediobanca S.p.A. shares (Euros 13,545 million) and Banca Leonardo S.p.A. shares (Euros 4,598 million).

In addition to the increases, there were decreases for the sale of Capitalia S.p.A ordinary shares (Euros 117,669 million), F.C. Internazionale Milano S.p.A. shares (Euros 10,997 million), Consortium S.r.l. shares (Euros 14,699 million), Equinox shares (Euros 7,944 million) and Assicurazioni Generali shares (Euros 4,567 thousand).

Impairments mainly refer to the investments in Euroqube S.A. (Euros 2,181 thousand) and Consortium S.r.l. (Euros 4,532 thousand).

Net gains taken to income (Euros 126,797 thousand) mainly refer to the fair value adjustments of Capitalia S.p.A shares previously recognized in equity (Euros 131,339 thousand) and reversed to the income statement during the year at the time of sale.

For listed securities and closed-end property investment funds, the fair value corresponds to the market prices at December 31, 2006.

For unlisted securities and closed-end property investment funds, the fair value has been estimated using appropriate estimation techniques.

12. DEFERRED TAX ASSETS AND LIABILITIES

These are composed as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Deferred tax assets	64,230	82,300
Deferred tax liabilities	(42,931)	(54,606)
	21,299	**27,694**

Since deferred tax assets and liabilities are offset in the financial statements when the income taxes are levied by the same tax authority and where there is a legally enforceable right of offset, the composition of the gross amounts is presented below:

(in thousands of euros)

	12/31/2006
Deferred tax assets	157,851
- of which, recoverable within 12 months	66,561
- of which, recoverable beyond 12 months	91,290
Deferred tax liabilities	(136,552)
- of which, recoverable within 12 months	(3,514)
- of which, recoverable beyond 12 months	(133,038)
	21,299

Temporary differences which generate this caption at December 31, 2006 are as follows:

	(in thousands of euros)
	12/31/2006
Deferred tax assets:	
- Provision for other liabilities and charges	34,973
- Employee benefit obligations	36,763
- Inventories	16,108
- Tax loss carryforwards	13,806
- Depreciation and amortization	4,243
- Trade and other receivables	8,101
- Trade and other payables	18,079
- Intragroup transactions	9,027
- Other	16,752
Total	**157,851**
Deferred tax liabilities:	
- Depreciation and amortization	(118,658)
- Other	(17,895)
Total	**(136,552)**

At December 31, 2006, deferred tax assets relating to temporary differences have not been calculated for an amount of Euros 358,160 thousand since they refer to situations in which recoverability is not considered probable.

Unused tax loss carryforwards, by expiration date, are as follows:

	(in thousands of euros)
Year of expiration	
2007	23,134
2008	147,350
2009	294,516
2010	156,798
2011	91,114
2012	50,298
2021	30,140
2022	68,887
2023	4,187
2024	10,162
without expiration	423,760
	1,300,348

These losses, in most cases, refer to situations in which recoverability is not considered probable. Accordingly, deferred tax assets have been recognized in the financial statements for Euros 13,806 thousand and the unrecognized portion is equal to Euros 415,624 thousand.

The tax effect of gains and losses recognized directly in equity is a negative Euros 6,935 thousand and is shown in the statement of recognized income and expenses in equity. These movements are mainly due to the tax effect of actuarial gains/losses on employee benefits and the fair value adjustment of available-for-sale financial assets.

13. TRADE RECEIVABLES

Trade receivables are analyzed as follows:

(in thousands of euros)

	12/31/2006			12/31/2005		
	Total	Non-current	Current	Total	Non-current	Current
Associates and joint ventures	115,450	-	115,450	133,608	-	133,608
Third parties	879,824	-	879,824	804,492	-	804,492
Receivables on construction contracts	4,395	-	4,395	5,334	-	5,334
	999,669	**-**	**999,669**	**943,434**	**-**	**943,434**

The costs incurred and the profit recognized on open contracts at December 31, 2006 amount to Euros 66,632 thousand (Euros 66,079 thousand at December 31, 2005), while billings in excess of costs of contracts in progress amount to Euros 62,237 thousand (Euros 60,745 thousand at December 31, 2005).

The writedown of receivables, equal to Euros 13,620 thousand (Euros 9,808 thousand at December 31, 2005), is recognized in the income statement under "Other expenses" (Note 33).

14. OTHER RECEIVABLES

Other receivables can be analyzed as follows:

(in thousands of euros)

	12/31/2006			12/31/2005		
	Total	Non-current	Current	Total	Non-current	Current
Associates and joint ventures						
- financial receivables	333,804	333,561	243	262,497	262,187	310
- other receivables	11,108	169	10,939	1,015	-	1,015
Financial receivables from third parties	246,896	219,935	26,961	232,860	206,254	26,606
Trade and other accrued income and prepaid expenses/third parties	18,949	249	18,700	17,069	250	16,819
Financial accrued income and prepaid expenses	13,542	7,999	5,543	14,845	6,176	8,669
Receivables from employees	6,882	3,373	3,509	5,241	2,308	2,933
Receivables from social security agencies	2,856	-	2,856	2,554	-	2,554
Receivables from tax authorities	74,592	10,348	64,244	62,171	9,405	52,766
Receivables for junior notes	94,177	94,177	-	16,669	16,669	-
Other receivables	259,227	36,017	223,210	248,895	35,549	213,346
	1,062,033	**705,828**	**356,205**	**863,816**	**538,798**	**325,018**

Non-current financial receivables from associates and joint ventures, equal to Euros 333,561 thousand, refer to the real estate sector and are classified as non-current since the collection times, connected to the plans for the disposal of properties held directly and indirectly by the companies, will be concluded over a period of between two and five years. Such loans are made at rates in line with those applied by the major market operators except for non-interest earning loans made to certain non-operating companies or companies in a stage of transition for a total amount of Euros 20,276 thousand at December 31, 2006 (Euros 35,181 thousand at December 31, 2005).

Non-current financial receivables from third parties mainly include a fixed-rate vendor loan maturing on January 28, 2016 granted to Prysmian (Lux) S.à.r.l. under the agreement reached on July 28, 2005 between Pirelli and Goldman Sachs Capital Partners. This agreement regards the sale of the Pirelli Energy and Telecom Cables and Systems businesses (Euros 145,742 thousand). The increase from the end of last year (Euros 10,742 thousand) refers to the capitalization of interest earned between July 28, 2005 and June 30, 2006. The reported amount approximates the fair value.

Pirelli was also assigned a warrant, expiring on January 28, 2016, entitling it to obtain economic benefits equivalent to 5 percent of the capital of the vehicle company used by Goldman Sachs Capital Partners for the purchase operation; this will allow Pirelli to take advantage of any opportunities arising from the future growth of the business.

Consequently, the warrant is treated as a contingent asset, the realization and the amount of which depends on the occurrence of future events, which by their very nature are uncertain.
The recognition of a contingent asset in the financial statements assumes the existence of a receivable that is virtually certain in amount at the balance sheet date. Therefore, in the financial statements at December 31, 2006, the warrant has not been measured.

Receivables for junior notes relate to the real estate sector. The increase of the amount compared to the end of 2005, is due to the purchase of Class E and DPP junior notes by Pirelli & C. Real Estate S.p.A. on June 30, 2006 for Euros 80,000 thousand. The junior notes come from the securitization of a non-performing loan portfolio of the former Banco di Sicilia which is mainly composed of receivables for loans guaranteed by properties and by unsecured receivables for the remaining part.

As a result of the merger of Partecipazioni Real Estate S.p.A., Pirelli & C. Real Estate S.p.A. acquired Class C junior notes worth Euros 10,701 thousand, relating to the securitization of a non-performing loan portfolio held by the company Cairoli Finance S.r.l., and Class D2 junior notes for Euros 6,707 thousand, relating to the securitization of a non-performing loan portfolio of the company LSF Italian Finance Company S.r.l.; the latter was sold to third parties on December 29, 2006.

Other current receivables principally refer to the real estate sector and include advances made for the acquisition of Deutsche Grunvermogen AG - DGAG (one of the most important real estate companies in Germany with offices in Hamburg and Kiel) for Euros 140,000 thousand, non-performing loan receivables (Euros 16,011 thousand), dividends to be collected (Euros 3,029 thousand) and regional grants which will be paid by the Campania region to aid buyers of property units owned by the company Geolidro S.p.A. (Euros 10,259 thousand).

15. TAX RECEIVABLES

Tax receivables amount to Euros 44,349 thousand (of which Euros 10,917 thousand is non-current) compared to Euros 67,409 thousand at December 31, 2005 (of which Euros 9,214 thousand is non-current).

16. INVENTORIES

Inventories may be analyzed as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Tyres Sector	590,925	546,287
Real Estate Sector	120,642	128,768
Other	3,966	6,001
	715,533	**681,056**

	12/31/2006	12/31/2005
Raw materials, auxiliaries and consumables	190,101	161,812
Sundry materials	1,774	4,086
Work in process and semifinished products	66,629	94,686
Finished products	195,073	172,581
Merchandise purchased for resale	216,811	201,420
Land to be developed	37,795	22,102
Advances	7,350	24,369
	715,533	**681,056**

Inventories include capitalized borrowing costs of Euros 4,110 thousand at December 31, 2006 (Euros 4,270 thousand at December 31, 2005).
The writedown of inventories made in 2006 amounts to Euros 2,530 thousand.

17. SECURITIES HELD FOR TRADING

Securities held for trading amount to Euros 119,174 thousand and include the following:
– Euros 94,995 thousand of variable rate bonds issued and guaranteed by banking institutions;
– Euros 4,417 thousand of fixed rate bonds;
– Euros 19,762 of equity securities intended for sale.

The positions are held at leading banks.

For listed securities, the fair value corresponds to the market price at December 31, 2006.
For unlisted securities, the fair value was estimated using appropriate estimation techniques.

The fair value adjustments are recognized in the income statement under "valuation of financial assets" (Note 37).

18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are concentrated in the financial companies, the holding companies and the subholding companies of the Group. They are mainly invested in short-term deposits held by leading banking counterparts at interest rates reflecting market rates.
For the purpose of the statement of cash flows, the balance of cash and cash equivalents is shown net of bank overdrafts, equal to Euros 10,185 thousand at December 31, 2006 and Euros 154,021 thousand at December 31, 2005.

19. EQUITY

19.1 ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE COMPANY

"**Share capital**" amounts to Euros 2,789,950 thousand at December 31, 2006 and consists of 5,233,142,003 ordinary shares and 134,764,429 savings shares, all with a par value of Euros 0.52 per share and normal dividend rights.
The changes in share capital are detailed below:

	Number of ordinary shares (thousands)(*)	Number of savings shares (thousands)	Ordinary shares (€ thousands)	Savings shares (€ thousands)	Total (€ thousands)
Balance at December 31, 2005	**5,178,112**	**134,764**	**2,692,619**	**70,077**	**2,762,696**
Exercise of warrants	52,412	-	27,254	-	27,254
Balance at December 31, 2006	**5,230,524**	**134,764**	**2,719,873**	**70,077**	**2,789,950**

(*) Net of 2,617,500 treasury shares in portfolio.

Changes in equity are as follows:

(in millions of euros)

	attributable to the equity holders of the company								
	Share capital	Share premium reserve	Legal reserve	Reserve for translation differences	Reserve for fair value adjustment of AFS assets	Other reserves/ Retained earnings	Total attributable to equity holders of company	Minority interest	Total
Balance at 1/1/2005	**1,799**	**500**	**75**	**24**	**-**	**1,241**	**3,639**	**339**	**3,978**
Total recognized income and expenses in equity	-	-	-	174	106	19	299	6	305
Income for the year						327	327	72	399
Appropriation of income as per resolution of 4/28/2005:									
- legal reserve			7			(7)	-	-	-
- dividend payment						(113)	(113)	-	(113)
Other dividends paid to third parties							-	(36)	(36)
Exercise of warrants 2003-2006	175					(174)	1	-	1
Pirelli & C. share capital increase	789	259					1,048	-	1,048
PRE stock options exercised in the year							-	8	8
Yanzhou Evolution Tyre CO Ltd Consolidation							-	21	21
Other						4	4	(1)	3
Balance at 12/31/2005	**2,763**	**759**	**82**	**198**	**106**	**1,297**	**5,205**	**409**	**5,614**
Total recognized income and expenses in equity	-	-	-	(79)	(110)	90	(99)	(16)	(115)
Loss for the year						(1,167)	(1,167)	118	(1,049)
Appropriation of income as per resolution of 4/21/2006:									
- legal reserve			7			(7)	-	-	-
- dividend payment						(114)	(114)	-	(114)
Other dividends paid to third parties							-	(49)	(49)
Exercise of warrants 2003-2006	27						27	-	27
Movements in Pirelli & C. Real Estate S.p.A. treasury shares						25	25	23	48
P.Tyre minority interest stake sold by private placement							-	295	295
PRE stock options exercised in the period						2	2	29	31
Acquisition of interests from minority interest							-	(7)	(7)
Minority interest share capital increase							-	7	7
Other						1	1	(2)	(1)
Balance at 12/31/2006	**2,790**	**759**	**89**	**119**	**(4)**	**127**	**3,880**	**807**	**4,687**

19.2 ATTRIBUTABLE TO THE MINORITY INTEREST

The minority interest in equity went from Euros 408,947 thousand at December 31, 2005 to Euros 806,966 thousand at December 31, 2006. The change is mainly due to the interest in Pirelli Tyre S.p.A. sold with a private placement in addition to the net balance between the result for 2006, the payment of dividends referring to the prior year and the impact of the translation of foreign currency financial statements to euros.

The major percentages of investments held by minority interests are as follows:

	12/31/2006	12/31/2005
Shared Service Center s.c.a r.l. (Italy)	50.00%	50.00%
Drahtcord Saar Gmbh & Co. K.G. (Germany)	50.00%	50.00%
Celikord A.S. (Turkey)	49.00%	49.00%
Pirelli & C. Ambiente S.p.A. (già Pirelli & C. Ambiente Holding S.p.A.) (Italy)	49.00%	49.00%
Pirelli & C. Real Estate S.p.A. (Italy)	49.42%	46.74%
Pirelli Tyre Co. Ltd (già Yanzhou Evolution Tyre CO. Ltd) (China)	40.00%	40.00%
Pirelli Tyre S.p.A. (Italy)	38.94%	-
Turk Pirelli Lastikleri A.S. (Turkey)	34.41%	36.94%
S.C. Cord Romania S.R.L (Romania)	20.00%	20.00%
Alexandria Tire Co. S.A.E. (Egypt)	10.90%	13.19%
Pirelli de Venezuela C.A. (Venezuela)	3.78%	3.78%

20. STOCK OPTION PLANS

During the year ended December 31, 2006, the company did not introduce any stock option plans. Pirelli & C. S.p.A. has two existing stock option plans for the senior executives and staff of Pirelli & C. S.p.A. and other companies of the Group which were granted option rights, not transferable to third parties, for the subscription/purchase of Pirelli & C. S.p.A. ordinary shares.

The following disclosure is provided on the above plans called Pirelli to People and Group Senior Executives.

	Pirelli to People	Group Senior Executives
Features of the plan	Option rights granted, non-transferable to third parties, for the subscription of future new issues of Pirelli & C. ordinary shares or, as decided by the latter, for the purchase of treasury shares of Pirelli & C.	Option rights granted, non-transferable to third parties, for the subscription of future new issues of Pirelli & C. ordinary shares or, as decided by the latter, for the purchase of treasury shares of Pirelli & C.
Recipients at December 31, 2006	288 employees (senior executives, cadres, key employees) of the companies of the Group. Originally 725 persons at the date of approval of the plan.	28 senior executives of the companies of the Group. Originally 51 persons at the date of approval of the plan.
Conditions for exercising options	Continuance of employment.	(a) continuance of employment, and (b) the reaching, in the two-year period 2001-2002, of specific targets, assigned to each recipient.
Subscription/purchase price per share	Each option right granted gives the right to subscribe/purchase one Pirelli & C. ordinary share at the price of Euros 1.150 [1].	Each option right granted gives the right to subscribe/purchase one Pirelli & C. ordinary share at the price of Euros 1.150 [1].

	Pirelli to People	Group Senior Executives
Vesting period of options	Up to nine years from the date the options are granted (which took place on November 5, 2001), but not before one year has passed from that date for 50 percent of the options granted, two years for another 25 percent and three years for the remaining 25 percent.	As regards the options granted on November 5, 2001, up to nine years from the date the options are granted, but not before one year has passed from that date for 50 percent of the options, two years for another 25 percent and three years for the remaining 25 percent. For the options granted definitively on May 10, 2002, up to May 31, 2009 but not before June 1, 2002 for 50 percent of the options and not before January 1, 2003 for the remaining 50 percent.
Maximum number of options for which the offer was open at December 31, 2005	21,693,205 options equal to about 0.4 percent of outstanding ordinary shares destined for 309 recipients.	13,986,882 options equal to about 0.27 percent of outstanding ordinary shares destined for 31 recipients.
Maximum number of options for which the offer was open at December 31, 2006	20,389,204 options equal to about 0.39 percent of outstanding ordinary shares destined for 288 recipients.	12,397,548 options equal to about 0.24 percent of outstanding ordinary shares destined for 28 recipients.
Options forfeit during 2006 as a result of persons leaving the Group	1,304,001	1,589,334
Shares issued during the period	None	None

(1) This amount was changed (from Euros 1.284) on the basis of the adjustment factor established by AIAF on February 7, 2005 following the capital increase approved by the special shareholders' meeting held on January 21, 2005, in accordance with the Regulations of those Stock Option Plans in the event of transactions involving share capital.

The following table shows the changes in the above plans, the number of option rights and the exercise price.

Pirelli to People						
Table 1	Year 2006			Year 2005		
	Number of shares	Average exercise price in €	Market price in €	Number of shares	Average exercise price in €	Market price in €
Rights existing at 1/1/2006	21,693,205	1,15 (1)	0,77	36,826,541	1,284	0.99
Rights granted during year	-	-	-	-	-	-
(rights exercised during year)	-	-	-	-	-	-
(Rights forfeit during the year 2006 as a result of persons leaving the Group)	1,304,001	-	-	15,133,336	-	-
Rights existing at 12/31/2006	20,389,204	1.15 (1)	0.75	21,693,205	1.15 (1)	0.77

Table 2	Rights granted – existing at December 31, 2006		
Exercise price	**Remaining contractual life**		**Of which exercisable**
	>2 years *	Total	From 11/5/2004
€ 1.15 (1)	20,389,204	20,389,204	20,389,204

* until 11/5/2010

(1) This amount was changed to Euros 1.150 on the basis of the adjustment factor established by AIAF on February 7, 2005 following the capital increase approved by the special shareholders' meeting held on January 21, 2005, in accordance with the Regulations of those Stock Option Plans in the event of transactions involving share capital.

Table 1	Group Senior Executives Year 2006			Year 2005		
	Number of shares	Average exercise price in €	Market price in €	Number of shares	Average exercise price in €	Market price in €
Rights existing at 1/1/2006	13,986,882	1.15 (1)	0.77	17,399,309	1.284	0.99
Rights granted during year	-	-	-	-	-	-
(rights exercised during year)	-	-	-	-	-	-
(Rights forfeit during the year 2006 as a result of persons leaving the Group)	1,589,334	-	-	3,412,427	-	-
Rights existing at 12/31/2006	12,397,548	1.15 (1)	0.75	13,986,882	1,15 (1)	0.77

Table 2	Rights granted – existing at December 31, 2006		
Exercise price	Remaining contractual life		Of which exercisable
	>2 years *	Total	From 11/5/2004
€ 1.15 (1)	12,397,548	12,397,548	12,397,548

* until 5/31/2009

(1) This amount was changed to Euros 1.150 on the basis of the adjustment factor established by AIAF on February 7, 2005 following the capital increase approved by the special shareholders' meeting held on January 21, 2005, in accordance with the Regulations of those Stock Option Plans in the event of transactions involving share capital.

The following tables indicates the number of rights granted under the above-described incentive plans, held at December 31, 2006, directly and indirectly, by the members of the board of directors, the board of statutory auditors, general managers and key managers of the Company and its subsidiaries.

Name	Rights held at 1/1/2006		Rights granted during year 2006		Rights exercised during year 2006		Rights held at 12/31/2006	
	No. of rights	Average exercise price	No. of rights	Average exercise price	No. of rights	Average exercise price	No. of rights	Average exercise price
Claudio De Conto	778,774 (1)	1.15 (3)	-	-	-	-	778,774 (1)	1.15 (3)
	410,667 (2)	1.15 (3)	-	-	-	-	410,667 (2)	1.15 (3)
Luciano Gobbi	778,774 (1)	1.15 (3)	-	-	-	-	778,774 (1)	1.15 (3)
	360,000 (2)	1.15 (3)	-	-	-	-	360,000 (2)	1.15 (3)
Francesco Gori (4)	533,334 (1)	1.15 (3)	-	-	-	-	533,334 (1)	1.15 (3)
	666,667 (2)	1.15 (3)	-	-	-	-	666,667 (2)	1.15 (3)

(1) *Group Senior Executives* incentive plan.
(2) *Pirelli to People* incentive plan.
(3) This amount was changed to Euros 1.150 on the basis of the adjustment factor established by AIAF on February 7, 2005 following the capital increase approved by the special shareholders' meeting held on January 21, 2005, in accordance with the Regulations of those Stock Option Plans in the event of transactions involving share capital.
(4) Francesco Gori, starting from July 1, 2006, took over the post of chief executive officer and general manager of the subsidiary Pirelli Tyre S.p.A..
The Deputy Chairman Carlo Alessandro Puri Negri is the grantee of stock options as the chief executive officer of Pirelli & C. Real Estate S.p.A..
Carlo Buora, starting November 6, 2006 – after relinquishing all the posts held in the Company – is no longer a grantee of any option rights.

Giovanni Ferrario (chief executive officer and general manager of the Company since December 2004) holds 1,333,334 option rights granting the right to subscribe/purchase to the same number of Pirelli & C. S.p.A. ordinary shares at the price of Euros 1.15 each.

Valerio Battista (general manager of the Company since June 2005) holds 1,650,134 option rights granting the right to subscribe/purchase to the same number of Pirelli & C. S.p.A. ordinary shares at the price of Euros 1.15 each.

Plans put in place by the subsidiary Pirelli & C. Real Estate S.p.A. and by its subsidiaries

The company, in order to permanently involve its staff and management in increasing the value of Pirelli & C. Real Estate S.p.A., approved a stock option plan on May 9, 2002 (hereinafter "Plan 2002"), which ended on December 15, 2006.
On February 24, 2004, the company – partly in consideration of the expiration date of the exercise periods for Plan 2002 – approved a new stock option plan (hereinafter "Plan 2004") on behalf of the directors and employees of the Pirelli RE group (hereinafter "Group"), as an added incentive and to increase a sense of loyalty, partly with view towards the development of new business areas – among which, the placement of mutual funds and non-performing loan activities – that the Group is pursuing.
Lastly, on December 16, 2005, a new stock option plan was approved (hereinafter "Plan 2006") for directors and employees of the Group. The plan is an added incentive to increase their loyalty while bearing in mind the important targets fixed in that three-year 2006-2008 Plan which provide – besides a renewed dynamics in the development and in the consolidation of the traditional residential and commercial sectors, specialist services, the promotion and management of property investment funds – also: (i) an appreciable growth in the non-performing loan sectors; (ii) a clear and significant slant towards foreign markets; (iii) the innovative promotion and management of speculative funds; (iv) the growth of the franchising network's contribution to the Group's overall results and, in general (v) an overall annual increase in the long-term component of the business as compared to the traditional short-term component, with an annual growth in results of 10 – 15 percent. The new Plan 2006 was also designed by considering the expiration dates of the exercise periods of Plan 2004.
The most important information about the stock option plans of the Group is provided as follows:

PLAN 2002

Plan features: granting of option rights, non-transferable to third parties, for the subscription of new Pirelli & C. Real Estate S.p.A. ordinary shares following the capital increase approved to service this plan.
Grantees: 88 persons (directors, executives and cadres) of Pirelli & C. Real Estate S.p.A. and its subsidiaries.
Conditions for exercising the options rights: (a) continuance of the employment relationship with one of the above companies, (b) continued status of the company, in which the person is an employee or a director, as a company of the Group headed by Pirelli & C. S.p.A. (c) achievement of the specific targets assigned to each grantee during the three-year period 2002-2004.
Per share subscription price: Euros 26; this price may vary as a result of share capital increases unconnected with the Plan or in the case of mergers, spin-offs or amendments to the bylaws affecting the rights of the grantees.
Option exercise period: 50 percent of the options can be exercised from July 1, 2004 to December 15, 2006 and the remaining 50 percent from July 1, 2005 to December 15, 2006; all options must be exercised by December 15, 2006.
Maximum number of shares covered by the plan: 2,150,000, of which 2,053,000 have been assigned.
There were 530,250 rights remaining at January 1, 2006; during 2006, 522,250 rights were exercised.
There were 8,000 rights remaining at December 15, 2006, which are now forfeit since – in conformity with regulations – the plan ended on December 15, 2006.
At the time of transition to IFRS, IFRS 2 was not adopted for this plan since it was approved before November 7, 2002.

PLAN 2004

Plan features: granting of option rights, non-transferable to third parties, for the purchase of Pirelli & C. Real Estate S.p.A. ordinary shares held by the company (treasury shares).
Grantees: 50 persons (directors, executives and cadres) of Pirelli & C. Real Estate S.p.A. and its subsidiaries.
Conditions for exercising the options rights: (a) continuance of the employment relationship or status as a director with Pirelli & C. Real Estate S.p.A. or another company controlled, directly or indirectly, by the same company (b) share performance by Pirelli & C. Real Estate S.p.A. shares better than the European Public Real Estate Association (EPRA), Europe Return Index.
Per share purchase price: Euros 26.75, which corresponds to the fair value of the share on the grant date. This price may vary as a result of share capital increases or other extraordinary transactions, but in every case ensuring the equivalent rights held by the grantees before those transactions.
Option exercise period: 50 percent of the options can be exercised from July 1, 2006 to December 15, 2007 (first tranche) and the remaining 50 percent from July 1, 2007 to December 15, 2007 (second tranche); all options must be definetely exercised by December 15, 2007.
Maximum number of shares covered by the plan: 1,000,000.
There were 947,000 rights remaining at January 1, 2006; during 2006, 14,000 rights were forfeit as a result of the termination of employment and 469,000 rights were exercised. Consequently, there were 464,000 options granted remaining at December 31, 2006.
The fair value of the options on the grant date, equal to Euros 2.50 for the first tranche and Euros 2.69 for the second tranche, was determined using the Monte-Carlo model.
The assumptions which were considered in the valuation model can be summarized as follows:
- weighted average price of the shares at the grant date equal to Euros 26.75, equal to their per share exercise price;
- estimated volatility of 22 percent determined on the basis of the historical volatility of the price of the shares from the time Pirelli & C. Real Estate S.p.A. was listed up to the grant date of this plan;
- estimated period of the rights equal to 3 years for the first tranche and 3 and a half years for the second;
- estimated dividends equal to 6 percent;
- risk-free interest rate equal to 3 percent.

PLAN 2006

Plan features: granting of option rights, non-transferable to third parties, for the purchase of Pirelli & C. Real Estate S.p.A. ordinary shares held by the company (treasury shares).
Grantees: 70 persons (directors, executives and other key resources) of Pirelli & C. Real Estate S.p.A. and its subsidiaries.
Conditions for exercising the options rights: (a) continuance of the employment relationship or status as a director in the companies of the Pirelli Group (b) the reaching/exceeding, when the rights are exercised, of a minimum market price of the Pirelli & C. Real Estate S.p.A. share, which must not be lower than Euros 55.00 [market restriction], (c) average annual growth of the Operating Result Parameter (PBIT) + Income from investment holdings (IEP) not less than 10 percent [operating restriction].
Per share purchase price: Euros 46.50, which corresponds to the fair value of the share on the grant date; this price may vary as a result of share capital increases or other extraordinary transactions, but in every case ensuring the equivalent rights held by the grantees before those transactions.
Option exercise period: 40 percent of the options can be exercised from July 1, 2008 to December 15, 2009 (first tranche) and the remaining 60 percent from July 1, 2009 to December 15, 2009 (second tranche); all options must be exercised by December 15, 2009. The options may be exercised in advance, in the event of a "change of control" and, as a result of which, Pirelli & C. S.p.A. would no

longer be the majority shareholder of the company. However, the market and operating restrictions remain in place, with predetermined criteria to be applied in relation to the exercise of the options if the event should occur.
On March 9, 2007, the board of directors approved the extension of the vesting period for the first tranche of this plan from July 1, 2008 to December 18, 2008 and keeping the closing date unchanged at December 15, 2009.
The change was necessary in order to allow the grantees of the plan to exercise the their stock options in conformity with the new tax regime on the subject, introduced by Decree Law 262 dated October 2, 2006, which calls for a minimum vesting period of three years.
Since this change had no effect on the basic elements of the plan, the fair value of the plan was not increased and therefore the accounting amount remained the same.
Maximum number of shares covered by the plan: 1,800,000.
The fair value of the options on the grant date, equal to Euros 5.90 for the first tranche and Euros 5.27 for the second tranche, was determined using the Black-Scholes model.
The assumptions which were considered in the valuation model can be summarized as follows:
- weighted average price of shares at the grant date equal to Euros 46.50, equal to their per share exercise price;
- estimated volatility of 23 percent determined on the basis of the historical volatility of the price of the shares from the time Pirelli & C. Real Estate S.p.A. was listed up to the grant date of this plan;
- estimated period of the rights equal to 3 years and 3 months for the first tranche and 3 years and 9 months for the second;
- estimated dividends equal to 5 percent;
- risk-free interest rate equal to 3.07 percent.

The assumptions that were considered in the valuation model take into account the fair amount of the shares at the grant date (Euros 46.50) equal to the per share exercise price of the shares and the estimated volatility of 23 percent determined on the basis of the historical volatility of the price of the shares from the time Pirelli & C. Real Estate S.p.A. was listed up to the grant date of this plan.
The table below – in conformity with Scheme 2 of Attachment 3C of Consob Regulation 11971/1999 – shows the movements in the stock options held by the directors and general managers Pirelli & C. Real Estate S.p.A. during 2006.

		Rights held at 1/1/2006			Rights granted in 2006			Rights exercised in 2006			Rights expired/forfeit in 2006	Rights held at 12/31/2006	
(A)	(B)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)=(1)+(4)-(7)-(10)	(12) (b)
Name	Position	Number of options	Average exercise price	Expiration	Number of options	Average exercise price	Due date	Number of options	Average exercise price	Average exercise market price	Number of options	Number of options	Average exercise price
Carlo Alessandro Puri Negri	Chief Exective Officer	982,500	32.45	12/15/09	-	-	-	555,000	26.17	52.53	-	427,500	40.61
Carlo Bianco	Deputy Chairman	257,000	37.42	12/15/09	-	-	-	74,000	26.44	54.77	-	183,000	41.86
Emilio Biffi	Managing Director Chief Technical Officer	226,000	38.98	12/15/09	-	-	-	43,000	26.75	52.60	40,000 (a)	143,000	41,86
Olivier de Poulpiquet	Director	400,000	36.63	12/15/09	-	-	-	100,000	26.75	52.60	-	300,000	39.92

(a) Options forfeit after relinquishing post.
(b) The average exercise price takes into account the average values referring to plans 2004 and 2006.

Stock option plans by subsidiaries of Pirelli & C. Real Estate S.p.A.

On July 31, 2003, Giulio Malfatto, a director of Pirelli & C. Real Estate S.p.A., upon his appointment as the chief executive officer of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A., was offered an option for the purchase of ordinary shares representing 3 percent of the share capital of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A., to be executed by a share capital increase to service this option. The option is an integral part of Giulio Malfatto's compensation as the chief executive officer of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A..

The option was exercisable:

a) at the expiry of the first three-year term of his appointment as the chief executive officer of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. and for the following six months, or
b) from an earlier date in the case of revocation without a just cause, or dismissal with a just cause from the post of chief executive officer of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A., until the expiry date mentioned in point a), or
c) within three months from December 31, 2005, if at that date the value of the assets managed by Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. is lower than Euros 3 billion.

The exercise of the option, in the event indicated in the previous letter a), was subject to the verification of having reached certain targets (in terms of profitability, assets managed, etc.) established by the same board of directors of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A..
The exercise price of the option was equal to the fair value of 3 percent of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. shares at the date of July 31, 2003, resulting from a specific appraisal. This price could have varied in relation to subsequent increases in share capital, if any, approved and subscribed to, in order for the chief executive officer to have an option right equal to 3 percent of the resulting capital at the date of the exercise of the option.
In June 2006, in conformity with the contract clauses, the option was exercised. The exercise price was equal to the fair value of 3 percent of the Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. shares determined on the basis of a specific appraisal by Credit Suisse.
The board of directors of Pirelli & C. Real Estate S.p.A., on November 7, 2003, also approved stock option plans for 33 executive and directors of some wholly-owned service companies of Pirelli & C. Real Estate S.p.A.. These plans do not include the directors and general managers of the parent. For all the plans approved, the exercise prices were determined on the basis of specific appraisals to determine the fair value of the companies. The option rights can be exercised in the months of April 2005 and April 2006, but are contingent on several factors, including the reaching of performance targets that are higher than those established in the plan 2003-2005. Furthermore, there is a put and call mechanism in place for the repurchase of the shares connected with the exercise, if any, of the options.

There were 41,160 option rights granted on January 1, 2006 relating to the various service companies; during 2006, 20,474 option rights were exercised and 20,686 rights expired. Consequently at December 31, 2006, there are no remaining options.
The board of directors of Pirelli & C. Real Estate Franchising Holding S.r.l. approved a stock option plan for 10 directors and employees of its wholly-owned subsidiary Pirelli & C. Real Estate Franchising S.p.A. on June 29, 2004. This plan does not include the directors and general managers of the parent. The plan provides for granting 12,167 option rights for the purchase of Pirelli & C. Real Estate Franchising S.p.A. shares (equal to 2.43 percent of the share capital) at the exercise price per share of Euros 119.90.
The exercise price was determined on the basis of a specific appraisal to determine the fair value of the company. The option rights can be exercised in the months of April 2006 (first tranche) and April 2007 (second tranche) but are contingent on several factors, including the reaching of performance

targets. Furthermore, there is a put and call mechanism in place for the repurchase of the shares connected with the exercise, if any, of the options.
There were 9,420 option rights granted on January 1, 2006, during 2006, 3,354 option rights were exercised and 414 option rights were forfeit. Consequently, there were 5,652 option rights granted remaining at December 31, 2006.
Lastly, the board of directors of Pirelli & C. Real Estate S.p.A. approved a stock option plan for executives and other employees of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A., a subsidiary of Pirelli & C. Real Estate S.p.A. on July 28, 2004. This plan does not include the directors and general managers of Pirelli & C. Real Estate S.p.A.. The plan was adopted at a later date, compared to the other service subsidiaries, in order to include the executives and other employees of Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. in incentive mechanisms that had not been included in the previous plans introduced by the parent, since these companies had been in the start-up phase, and thus bring their compensation packages into line with a consistent policy within the Group.
The stock option plan for the subsidiary Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. is for 11 executives and other employees and provides for a maximum of 170,523 options to be granted for the purchase of the Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. shares (equal to 2.07 percent of the share capital) at the exercise price per share of Euros 17.47. Also in this case, the exercise price was determined on the basis of a specific appraisal to determine the fair value of the company. The options can be exercised during the period April 1, to April 30, 2007, but are contingent on several factors, including the reaching of performance targets. Furthermore, there is a put and call mechanism in place for the repurchase of the shares connected with the exercise, if any, of the options.
The options rights granted and remaining at January 1, 2006 total 73,284 and there were no changes during 2006.
At December 31, 2006, the fair value of the existing cash-settled stock option plans relating to subsidiaries amount to Euros 1,384 thousand (Euros 11,743 thousand at December 31, 2005), calculated by assuming an implicit volatility determined on the basis of the projection of the economic capital of the company involved in the stock option plans.

Plans relating to the subsidiary Pirelli & C. Ambiente S.p.A. and its subsidiaries

During 2006, there were changes to the stock option plan approved by the boards of directors of Pirelli & C. Ambiente Renewable Energy S.p.A. (ex-Pirelli & C. Ambiente S.p.A.) and its parent Pirelli & C. Ambiente S.p.A. (ex-Pirelli & C. Ambiente Holding S.p.A.), effective January 2006. The plan calls for granting purchase options for a total of 306,000 Pirelli & C. Ambiente S.p.A. shares to nine grantees, equal to 10 percent of the share capital of the latter company, at the per share price of Euros 1.85, on the basis of an appraisal carried out for this purpose.

All the above options can be exercised in April 2009, subject to reaching specific corporate targets by the date of December 31, 2008, or, in September 2009, in the case those targets are reached by June 30, 2009. The shares from exercising the option can be sold by the grantees to Pirelli & C. Ambiente S.p.A. within one month of exercising the options at a price that will take into account the revaluation of the net asset value of the company during the period.
At December 31, 2006, the fair value of the existing cash-settled stock option plan amounts to Euros 225 thousand. This has been calculated on the basis of the projection of the economic capital of the company to which the stock option plan refers.

21. TAX PAYABLES

Tax payables amount to Euros 58,477 thousand (of which Euros 9,708 thousand is non-current) compared to Euros 44,858 thousand at December 31, 2005 (of which 2,650 thousand is non-current).

22. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

The movements during the year in provisions for other liabilities and charges are presented in the following table:

(in thousands of euros)

Provisions for other liabilities and charges - non-current	
Beginning balance at 1/1/2006	**170.561**
Exchange differences	(1.560)
Increase	21.734
Utilization/Release	(14.440)
Reclassification	(36.000)
Other	4.824
Ending balance at 12/31/2006	**145.119**

(in thousands of euros)

Provisions for other liabilities and charges - current	
Beginning balance at 1/1/2006	**53.999**
Exchange differences	(2.185)
Increase	44.496
Utilization/Release	(26.794)
Reclassification	36.000
Other	11.009
Ending balance at 12/31/2006	**116.525**

At December 31, 2006, the non-current portion mainly includes Euros 76,616 thousand relating to the accruals for the legal and tax disputes of the subsidiary Pirelli Pneus S.A. with headquarters in Brazil, Euros 32,689 thousand for the risks of a fiscal nature of the parent Pirelli & C. S.p.A. and Euros 11,916 thousand for contractual commitments undertaken for the performance of extraordinary maintenance work on buildings sold.

The current portion primarily refers to:
- accruals for the price adjustments covered by the contract for the sale of Pirelli's operations in the Energy and Telecom Cables and Systems sector to Goldman Sachs Capital Partners in July 2005 and guarantees provided (Euros 66,000 thousand);
- accruals for contractual guarantees and product claims (Euros 12,940 thousand).

23. EMPLOYEE BENEFIT OBLIGATIONS

These include:

(in thousands of euros)

	12/31/2006	12/31/2005
Pension funds:		
- funded	156,271	236,536
- unfunded	99,887	104,889
Employees' leaving indemnity	96,824	100,099
Medical care plans	28,362	33,386
Other benefits	34,506	35,892
	415,850	**510,802**

- Pension funds

The composition of pension funds, at December 31, 2006, is as follows:

(in thousands of euros)

					12/31/2006
	Germany	**Total unfunded pension funds**	USA	UK	**Total unfunded pension funds**
Funded					
Present value of funded obligations			146,708	947,160	1,093,868
Fair value of plan assets			(113,136)	(824,461)	(937,597)
Unfunded					
Present value of unfunded obligations	99,887	99,887			
Net liability in the balance sheet	99,887	**99,887**	33,572	122,699	**156,271**
of which:					
- Tyres	99,887	**99,887**	33,572	62,071	**95,643**
- Other				60,628	**60,628**

The composition of pension funds, at December 31, 2005, was as follows:

(in thousands of euros)

					12/31/2005
	Germany	**Total unfunded pension funds**	USA	UK	**Total unfunded pension funds**
Funded					
Present value of funded obligations			169,606	924,787	1,094,393
Fair value of plan assets			(117,610)	(740,247)	(857,857)
Unfunded					
Present value of unfunded obligations	104,889	104,889			
Net liability in the balance sheet	104,889	**104,889**	51,996	184,540	**236,536**
of which:					
- Tyres	104,889	**104,889**	51,966	74,504	**126,500**
- Other				110,036	**110,036**

The main features of the pension plans existing at December 31, 2006 are as follows:

- Germany: this is an unfunded defined benefit plan based on the most recent remuneration. It guarantees another pension besides the government pension. The plan was closed in October 1982; consequently, the participants in the plan are employees who were hired prior to that date.
- USA: this is a funded defined benefit plan based on the most recent remuneration. It guarantees another pension besides the government pension. The plan is under the administration of a trust. The plan was closed in 2001 and frozen in 2003 for those employees who passed over to a defined contribution scheme. None of the current participants in the plan are in service.
- UK: these are funded defined benefit plans based on the most recent remuneration. They guarantee another pension besides the government pension. The plans are under the administration of a trust. The plans were closed in 2001; consequently, the participants in the plan are employees who were hired prior to that date.

The changes during the year in the present value of the liabilities for pension funds (funded and unfunded) are as follows:

(in thousands of euros)

	12/31/2006	**12/31/2005**
Beginning balance	1,199,282	1,079,679
Discontinued operations	-	(80,475)
Exchange differences	1,645	45,378
Movements through the income statement	60,963	62,281
Actuarial (gains)/losses recognized in equity	(13,413)	148,562
Employee contribution	1,774	2,854
Benefits paid	(56,451)	(58,997)
Other	(45)	-
Closing balance	**1,193,755**	**1,199,282**

The changes during the year in the fair value of the pension plan assets are as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Beginning balance	(857,857)	(735,645)
Discontinued operations	-	26,271
Exchange differences	(3,371)	(33,627)
Movements through the income statement	(58,374)	(55,026)
Actuarial (gains)/losses recognized in equity	(33,029)	(75,420)
Employee contribution	(32,906)	(33,484)
Employee contribution	(1,774)	(2,854)
Benefits paid	49,679	51,928
Other	35	-
Closing balance	**(937,597)**	**(857,857)**

The composition of the funded pension plan assets is presented in the following table:

	12/31/2006		12/31/2005	
	UK	USA	UK	USA
Shares	82%	68%	80%	68%
Bonds	15%	29%	17%	30%
Deposits	1%	3%	1%	2%
Other	2%	-	2%	-
	100%	**100%**	**100%**	**100%**

The effective return of pension plan assets is as follows:

(in thousands of euros)

	USA	UK	Total
Effective return 2006	10,931	80,175	91,106
Effective return 2005	5,843	125,006	130,849

The amounts recognized in the income statement for pension funds are as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Current service costs	4,713	7,006
Interest cost	56,250	55,342
Expected return on plan assets	(58,374)	(55,093)
	2,589	**7,255**

The amounts recognized in the income statement are included in the item "Personnel costs" (Note 31).

The contributions which are expected to be paid for pension funds during 2007 amount to Euros 37,678 thousand.

- Employees' leaving indemnity (TFR)

The changes during the year in employees' leaving indemnity are as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Beginning balance	**100,099**	**136,014**
Discontinued operations	-	(32,089)
Change in the scope of consolidation	2,497	(348)
Movements through the income statement	14,979	16,576
Actuarial (gains)/losses recognized in equity	(4,122)	(6,090)
Payments/advances	(17,040)	(14,093)
Transfers	329	196
Other	82	(67)
Closing balance	**96,824**	**100,099**

Beginning January 1, 2007, the Italian Finance Bill and the relative decrees implementing it introduced changes regarding employees' leaving indemnity which include allowing the employee to choose the destination of his/her indemnity that is accruing. In particular, the employee can choose to direct the new flows of the indemnity to pre-chosen pension schemes or to keep them with the company (in which case, the company will pay the TFR contributions to a treasury account set up at INPS). At the present time, the uncertainty surrounding the interpretation of the recently enacted law, the various possible interpretations of the qualification under IAS 19 of the TFR accruing and the resulting changes in the actuarial calculations of the indemnity already accrued, as well as the impossibility of estimating what destinations will be chosen by the employee (the individual employees have until June 30 to make their decisions) would render it premature to offer any assumptions on the actuarial change in the calculation of the indemnity accrued at December 31, 2006.

- Medical care plans

The composition of medical care plans is as follows:

(in thousands of euros)

	USA
Liability in the balance sheet at December 31, 2006	28,362
Liability in the balance sheet at December 31, 2005	33,386

The medical care plan existing in the United States covers white-collars and blue-collars, in service and retired.
The plan is structured according to "pre-medicare" and "post-medicare", with the latter referring to participants over the age of 65.
Contributions are paid in both by the employer and the employee.

The changes during the year in the liabilities recognized in the financial statements for medical care plans are the following:

(in thousands of euros)

	12/31/2006	12/31/2005
Beginning balance	**33,386**	**46,528**
Discontinued operations	-	(18,216)
Exchange differences	(3,552)	4,478
Movements through the income statement	1,535	1,725
Actuarial (gains)/losses recognized in equity	(995)	2,071
Benefits paid	(1,906)	(3,200)
Other	(106)	-
Closing balance	**28,362**	**33,386**

The effect of a one percentage point increase or decrease in the estimated rates for the costs of medical care is as follows:

(in thousands of euros)

	1% increase		1% decrease	
	12/31/2006	12/31/2005	12/31/2006	12/31/2005
- Effect on current service cost and interest cost	65	50	(63)	(45)
- Effect on liabilities recognized in the balance sheet	1,126	835	(1,068)	(763)

The amounts recognized in the income statement relating to medical care plans are as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
Current service costs	8	60
Interest cost	1,527	1,665
	1,535	**1,725**

The amounts recognized in the income statement are included in the item "Personnel costs" (Note 31).

- Other information

Actuarial gains referring to 2006 recognized directly in equity amount to Euros 51,081 thousand (actuarial losses of Euros 69,123 thousand at December 31, 2005). The cumulative amount at December 31, 2006, equal to a net loss of Euros 65,286 thousand, is made up as follows:

	(in thousands of euros)
Cumulative amount at 12/31/2005	**(116,468)**
Exchange differences	101
year 2006	51,081
Cumulative amount at 12/31/2006	**(65,286)**

The cumulative amount at December 31, 2005 was composed as follows:

	(in thousands of euros)
Cumulative amount at 12/31/2004	**(52,978)**
Exchange differences	(2,468)
Discontinued operations	8,101
Year 2005	(69,123)
Cumulative amount at 12/31/2005	**(116,468)**

The breakdown of the cumulative amount at December 31, 2006 by country is as follows:

	cumulative amount at December 31, 2006				(in thousands of euros)
	Italy	**Germany**	**USA**	**UK**	**Total**
Pension funds	-	(4,845)	(11,749)	(56,706)	**(73,300)**
Medical care plans	-	-	(1,912)	-	**(1,912)**
Employees' leaving indemnity	9,926	-	-	-	**9,926**
Total actuarial gains/(losses) recognized in equity	**9,926**	**(4,845)**	**(13,661)**	**(56,706)**	**(65,286)**

The breakdown of the cumulative amount at December 31, 2005 by country is as follows:

	cumulative amount at December 31, 2005				(in thousands of euros)
	Italy	**Germany**	**USA**	**UK**	**Total**
Pension funds	-	(7,999)	(16,505)	(94,811)	**(119,314)**
Medical care plans	-	-	(3,244)	-	**(3,244)**
Employees' leaving indemnity	6,090	-	-	-	**6,090**
Total actuarial gains/(losses) recognized in equity	**6,090**	**(7,999)**	**(19,749)**	**(94,811)**	**(116,468)**

The main actuarial assumptions used at December 31, 2006 and also to determine the estimated cost for the year 2007 are as follows:

	Italy	**Germany**	**UK**	**USA**
Discount rate	4.50%	4.50%	5.10%	5.75%
Inflation rate	2.0%	2.0%	2.80%	-
Expected return on plan assets	-	-	7.31%	7.5%
Expected remuneration increase rate	2% - 4.3%	2.50%	2.80%	-
Medical care cost trend rate - initial	-	--	-	9.0%
Medical care cost trend rate - final	-	-	-	4.5%

The main actuarial assumptions used at December 31, 2005 and also to determine the estimated cost for the year 2006 were as follows:

	Italy	Germany	UK	USA
Discount rate	4.0%	4.25%	4.75%	5.50%
Inflation rate	2.0%	2.0%	2.50%	-
Expected return on plan assets	-	-	6.85%	7.0%
Expected remuneration increase rate	3.2%	2.50%	2.50%	-
Medical care cost trend rate - initial	-	-	-	9.5%
Medical care cost trend rate - final	-	-	-	4.5%

The adjustments based on past experience made to defined benefit plans are the following:

(in thousands of euros)

	12/31/2006	12/31/2005
Adjustments to plan liabilities	(7,527)	46,038
Adjustments to plan assets	(32,733)	(75,756)

The adjustments to liabilities represent the change in the actuarial liability that is not generated by changes in the actuarial assumptions. These typically include changes in the demographic and remuneration structure. Experience does not include the changes in the plan regulations ("past service cost").
The adjustments to assets represent the difference between the effective return of the assets and the expected return at the start of the year.

24. BORROWINGS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

The analysis of borrowings from banks and other financial institutions is as follows:

(in thousands of euros)

	December 31, 2006			December 31, 2005		
	Total	Non-current	Current	Total	Non-current	Current
Bonds	1,150,000	650,000	500,000	1,150,000	1,150,000	-
Borrowings from banks	1,668,780	658,881	1,009,899	836,109	311,999	524,110
Borrowing from other financial institutions	31,757	31,116	641	53,947	50,117	3,830
Finance lease payables	39,223	35,949	3,274	41,653	38,045	3,608
Financial accrued liabilities and deferred income	40,669	-	40,669	44,559	-	44,559
Other financial payables	9,260	1,481	7,779	24,606	351	24,255
	2,939,689	**1,377,427**	**1,562,262**	**2,150,874**	**1,550,512**	**600,362**

These liabilities are secured by real guarantees (liens and mortgages) for Euros 73,262 thousand.

For the current payables and the other non-current payables (excluding bonds), the carrying amount approximates fair value.
The amount due within one year, totaling Euros 1,562,262 thousand, includes the current portion of long-term financial payables of Euros 623,300 thousand (Euros 382,046 thousand at December 31, 2005).

At December 31, 2006, the breakdown of payables by interest rate is as follows:

(in thousands of euros)

	Fixed rate		Floating rate		TOTAL
Current	771,979		790,283		1,562,262
Non-current	915,563		461,864		1,377,427
Total	**1,687,542**	**57%**	**1,252,147**	**43%**	**2,939,689**

At December 31, 2005, the situation was as follows:

(in thousands of euros)

	Fixed rate		Floating rate		TOTAL
Current	109,618		490,744		600,362
Non-current	1,360,047		190,465		1,550,512
Total	**1,469,665**	**68%**	**681,209**	**32%**	**2,150,874**

The maturities of non-current payables can be summarized as follows:

(in thousands of euros)

	12/31/2006	12/31/2005
between 1 and 2 years	543,902	612,950
between 2 and 5 years	601,150	889,525
beyond 5 years	232,375	48,037
	1,377,427	**1,550,512**

The maturities of non-current payables can be summarized as follows:

(in millions of euros)

	Current	Non-current	TOTAL
EUR	1,487	1,313	2,800
USD	37	35	72
BRL (Brazil Real)	7	29	36
CNY (Chinese Renminbi)	29	-	29
Other currencies	2	-	2
	1,562	**1,377**	**2,939**

At December 31, 2005, the composition was as follows:

(in millions of euros)

	Current	Non-current	TOTAL
EUR	522	1,464	1,986
USD	3	54	57
BRL (Brazil Real)	38	33	71
CNY (Chinese Renminbi)	37	-	37
	600	**1,551**	**2,151**

With regard to financial covenants on the credit lines agreed and used, the following should be noted:

- on the Syndicated Line (granted to Pirelli & C. Real Estate S.p.A.), in which 18 banks participate for a total of Euros 450 million, Pirelli & C. Real Estate S.p.A. is obliged not to exceed a certain value in the ratio of the adjusted financial position (expressed gross of the loans made by shareholders to the companies in which minority interests are held) to the operating result including earnings (losses) and financial income from investment holdings;
- on the credit line granted by Banca Monte dei Paschi di Siena to the Pirelli Real Estate Group, Pirelli & C. Real Estate S.p.A. is obliged not to exceed a certain value in the ratio of the adjusted financial position (expressed gross of the loans made by shareholders to the companies in which minority interests are held) to equity.

At December 31, 2006, both of these covenants were within the limits.
On the Syndicated Line, there is also a negative pledge clause on the shares and the receivables of the services companies.
The other financial payables in existence are not covered by financial covenants or clauses which could cause the early repayment of the loans due to events other than insolvency.

There are no significant negative pledge clauses.
The bonds – current portion (Euros 500,000 thousand) refer to bonds issued in 2002 by the subsidiary Pirelli Finance (Luxembourg) S.A., maturing April 4, 2007, paying interest at 6.5 percent.
The non-current portion refers to:

- 1998-2008 bonds of Euros 500,000 thousand, issued by Pirelli & C. S.p.A. on October 21, 1998, paying interest at 4.875 percent and repayable in a one-off payment on October 21, 2008;
- bonds of Euros 150,000 thousand issued by Pirelli & C. S.p.A. in 1999, paying interest at 5.125 percent, maturing on April 7, 2009.

These bonds do not contain either financial covenants or clauses which could cause the early repayment of the bonds due to events other than insolvency.

With regard to negative pledge clauses, there is a commitment on these bonds requiring that real guarantees are not to be provided on relevant debt (bonds and similar securities destined for listing) with the exception for real guarantees on existing debt and, in the first case, for relevant debt, below the floor of Euros 100 million.

The fair value of the bonds compared to the carrying amount is as follows:

(in thousands of euros)

	Carrying amount		Fair value	
	12/31/2006	12/31/2005	12/31/2006	12/31/2005
Pirelli & C. S.p.A. 1998-2008	500,000	500,000	501,010	512,300
Pirelli & C. S.p.A. 1999-2009	150,000	150,000	150,351	153,503
Pirelli Finance (Luxembourg) S.A. 2002-2007	500,000	500,000	502,685	511,825
	1,150,000	**1,150,000**	**1,154,046**	**1,177,628**

Fair value corresponds to market prices, respectively, at December 31, 2006 and at December 31, 2005.

Financial accruals mainly include the amount of interest accrued but not yet paid on bonds (Euros 34,604 thousand).

As for financial lease payables, reference should be made to Note 7.1 "Leasing".

25. TRADE PAYABLES

The analysis of trade payables is as follows:

(in thousands of euros)

	December 31, 2006			December 31, 2005		
	Total	Non-current	Current	Total	Non-current	Current
Associates and joint ventures	8,366	-	8,366	11,390	-	11,390
Others	991,137	-	991,137	902,476	-	902,476
Notes payable	102,953	-	102,953	104,398	-	104,398
	1,102,456	**-**	**1,102,456**	**1,018,264**	**-**	**1,018,264**

26. OTHER PAYABLES

The analysis of other payables is as follows:

(in thousands of euros)

	December 31, 2006			December 31, 2005		
	Total	Non-current	Current	Total	Non-current	Current
Associates and joint ventures	3,263	-	3,263	315	-	315
Trade and other accrued liabilities and deferred income	150,002	38,932	111,070	143,177	10,955	132,222
Tax payables	92,955	3,409	89,546	75,349	8,572	66,777
Payables to employees	123,059	73	122,986	120,258	50	120,208
Payables to social security agencies	48,148	2,064	46,084	43,364	1,481	41,883
Payables for stock options	1,609	-	1,609	11,743	-	11,743
Dividends payable	2,196	-	2,196	905	-	905
Advances from customers	3,796	7	3,789	4,410	29	4,381
Other payables	244,754	112,401	132,353	500,562	40,681	459,881
	669,782	**156,886**	**512,896**	**900,083**	**61,768**	**838,315**

Current accrued liabilities and deferred income include:
- revenues (Euros 10,000 thousand) relating to the following year in respect of the use of the Pirelli brand by the Prysmian group. This conforms to the terms of the agreement, executed on July 28, 2005, between Pirelli & C. S.p.A. and Goldman Sachs Capital Partner for the sale to the latter of Pirelli's Energy and Telecom Cables and Systems businesses;
- Euros 19,112 thousand referring to deferred gains relating to transactions mainly in respect of the sale of properties for the portion that has not yet been realized with third parties.

Non-current accrued liabilities primarily include Euros 33,300 thousand related to commissions which will be paid to the financial institutions which took part in the private placement of the 38.9 percent interest of Pirelli Tyre S.p.A., up to the IPO.

The other current payables include Euros 64,581 thousand relating to the real estate sector mainly for down-payments made by property buyers on contracts that have not yet been executed (Euros 16,358 thousand), payables for the acquisition of investments (Euros 10,888 thousand) and payables for non-performing loans (Euros 8,570 thousand).

The other non-current payables include Euros 79,013 thousand mainly related to the real estate sector mainly for the purchase of Class E and DPP junior notes on a non-performing loan portfolio of the former Banco di Sicilia by Pirelli & C. Real Estate S.p.A. (Euros 78,489 thousand).

27. FINANCIAL INSTRUMENTS

"Financial instruments", included in current assets and current and non-current liabilities, comprise the measurement at fair value of forward currency purchases and sales in place at December 31, 2006. These are derivative transactions which, although used for hedging purposes, are not designated as such under IFRS. The fair value is determined by using the forward exchange rate at the balance sheet date.

At December 31, 2005, "Financial instruments – current liabilities" comprised the measurement at fair value of the put options granted to the shareholders banks of Olimpia (Banca Intesa S.p.A. and UniCredit Italiano S.p.A.) under the shareholders' agreements for Euros 233,000 thousand. This item was written off after the right of withdrawal communicated by the banks in March 2006 was exercised and that was perfected on October 4, 2006 with the purchase of the Olimpia S.p.A. shares by Pirelli & C. S.p.A. previously held by the banks.

At December 31, 2005, "Financial instruments – current assets" included Euros 31,843 thousand related to the measurement at fair value of the derivatives on Telecom Italia S.p.A. shares held by the subsidiary Pirelli Finance (Luxembourg) S.A , which ended during the course of 2006.

28. COMMITMENTS AND CONTINGENCIES

Personal guarantees

Sureties were provided to guarantee loans made by credit institutions to associates and joint ventures for a total of Euros 38,929 thousand consisting of the shares of the associates and joint ventures pledged for an amount of Euros 44,853 thousand.
Various sureties were provided by banking institutions and insurance companies to third parties and in the interests of Pirelli & C. Real Estate S.p.A. to fulfill contractual obligations of the Pirelli & C. Real Estate S.p.A. Group for a total of Euros 221,314 thousand.

Commitments for purchases of properties

Commitments for the purchase of properties refer to:
- the commitment undertaken by Pirelli & C. Real Estate S.p.A. to purchase certain buildings that remained unsold by Imser 60 S.r.l., for a maximum amount of Euros 320,000 thousand.
  The purchase price of these buildings is established by contract at about 20 percent of their market value. This option may be exercised by the counterpart up to May 31, 2022;
- the commitment undertaken by Pirelli & C. Real Estate Agency S.p.A. with Pirelli & C. Real Estate Opportunities Società di Gestione del Risparmio S.p.A. to purchase a building located in Segrate at the price of Euros 9,100 thousand if the building is not sold by December 22, 2007;
- the commitment undertaken by Resident Baltic GmbH for the purchase of buildings located in Rostock (Germany) for an amount of Euros 13,200 thousand and by Resident Sachsen GmbH for the purchase of a building located in Germany for an amount of Euros 500 thousand.

Commitments for purchases of property, plant and equipment

Commitments for the purchase of property, plant and equipment refer to the Tyres Sector and total Euros 91.5 million mainly related to the companies in Brazil, Romania, China and Germany.

Commitments for purchases of investments / shares of funds

These refer to:
- the put option granted to Edizione Finance International S.A./Edizione Holding S.p.A. ("Edizione"), under the shareholders' agreement signed on August 7, 2001, and subsequently amended.
  This put option can be exercised in the case of a (I) deadlock situation among the shareholders, (II) withdrawal on the part of Pirelli & C. S.p.A. from the shareholders' agreements and (III) the occurrence of a substantial change in the controlling structure of Pirelli & C. S.p.A., by which is meant the exercise by parties other than those currently holding the determining power to nominate the majority of the members of the management board, with a consequent potential modification of the strategic guidelines.
  The exercise price of the put option is equal, respectively, under assumption (I) to the price equal to the value of the economic capital of Olimpia increased by a premium (the "Price"), in the case of (II) to the Price increased by an amount equal to 50 percent of the Price and in the case of (III) to the Price increased by an amount equal to 200 percent of the Price. In this case, however, there is no provision for a Floor or Cap.;

- the irrevocable put option in favor of Marzotto S.p.A. for the transfer to Pirelli & C. Real Estate S.p.A. of the entire residual receivable for principal and interest due, at the date of December 31, 2006, by the same Marzotto S.p.A. from the joint venture Aree Urbane S.r.l. for amounts shown as shareholder loans. Subject to the exercise of that option, a call option in favor of Pirelli & C. Real Estate S.p.A. can be exercised for the purchase of the investment held by Marzotto S.p.A. in Aree Urbane S.r.l. (32.5 percent).
- the commitment undertaken by Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. to subscribe shares of the closed-end real estate Fund "Fondo Abitare Sociale 1 – Fondo Comune Chiuso di Investimento Immobiliare Etico Riservato ad Investitori Qualificati", for a total amount of Euros 2,422 thousand.

Other guarantees

Other guarantees refer to:

- income guarantees provided to third parties on the sale of buildings for commercial use for Euros 2,107 thousand;
- guarantees provided under securitization transactions conducted by vehicle companies for the correct and precise fulfillment of payment obligations for a total of Euros 61,435 thousand;
- guarantees provided under property purchase transactions effected by joint ventures for the fulfillment of their payment obligations of Euros 5,250 thousand.

In addition, Pirelli & C. Real Estate S.p.A. has a commitment to cover its proportionate share of any negative difference between the flows from rental income and interest expense due to the lender banks by Tiglio I S.r.l. on their credit lines expiring in 2009. At the moment, on the basis of available information, the projected revenue flows are higher than the estimated interest expense.

29. REVENUES FROM SALES AND SERVICES

Revenues from sales and services can be analyzed as follows:

(in thousands of euros)

	2006	2005
Revenues from sales of products	4,244,589	3,967,530
Revenues from services	590,657	566,429
Revenues on construction contracts	5,978	11,710
	4,841,224	**4,545,669**

30. OTHER INCOME

"Other income" amounts to Euros 292,763 thousand compared to Euros 283,612 thousand in 2005 and includes rent income, commissions, royalties, compensation, insurance refunds and other minor items.
In 2006 royalties paid by other companies for the use of the Pirelli brand (Euros 25,891 thousand).
In 2005, this item included royalties of Euros 21,116 thousand for the use of Pirelli intellectual properties by the Energy and Telecom Cables and Systems companies sold on July 28, 2005 (7.4 percent of the total), which qualify as nonrecurring events.

31. PERSONNEL COSTS

Personnel costs consist of the following:

(in thousands of euros)

	2006	2005
Salaries and wages	809,982	767,302
Stock option costs	6,069	7,247
Social security costs	185,600	183,605
Leaving indemnity and similar costs (*)	38,185	33,379
Defined contribution pension fund costs	8,296	7,918
Defined benefit pension fund costs	2,589	7,255
Defined benefit medical care plan costs	1,535	1,725
Long-service bonus costs	560	2,478
Defined contribution medical care plan costs	17,534	13,110
Other costs	5,421	5,861
	1,075,771	**1,029,880**

* Including italian and foreign company

With regard to the amounts relating to employees' leaving indemnity, pension funds and medical care defined benefit plans, reference should be made to "Employee benefit obligations" (Note 23).

32. AMORTIZATION, DEPRECIATION AND IMPAIRMENTS

Amortization, depreciation and impairments are as follows:

(in thousands of euros)

	2006	2005
Amortization of intangible assets	11,263	15,640
Depreciation of property, plant and equipment	201,428	197,038
Impairment of property, plant and equipment/intangible assets	2,637	3,026
	215,328	**215,704**

33. OTHER EXPENSES

"Other expenses" include the following:

(in thousands of euros)

	2006	2005
Receivables writedown	13,620	9,808
Other accruals	32,137	36,744
Operating lease payments	7,494	6,403
Rent and hires	61,568	56,095
Software and information services expenses	37,036	41,114
Consulting fees	116,422	146,900
Insurance	28,912	28,918
Maintenance	94,032	90,352
Selling expenses	270,367	255,858
Cleaning expenses	42,905	34,806
Contractual work expenses	39,858	32,138
Traveling expenses	42,654	38,322
Advertising expenses	144,780	145,270
Utilities and power	157,153	131,586
Other	595,006	558,277
	1,683,944	**1,612,591**

The balance in 2006 includes Euros 13,200 thousand (0.8 percent of the total) relating to the costs incurred for the Pirelli Tyre S.p.A. IPO, which qualifies as a nonrecurring event, included under consulting fees, advertising expenses and other.
The balance in 2005 included Euros 20,998 thousand (1.3 percent of the total) relating to expenses incurred for the sale of the Energy and Telecom Cables and Systems operations, which qualify as nonrecurring events, included in consulting fees.

Research expenses went from Euros 174 million in 2005 (3.8 percent of sales) to Euros 171 million in 2006 (3.5 percent of sales). They are entirely expensed to income statement. There are no development expenditures which meet the conditions for capitalization under IFRS.

34. FINANCIAL INCOME

Financial income includes the following:

(in thousands of euros)

	2006	2005
Interest	76,460	68,736
Other financial income	32,389	15,465
Gains on exchange	145,576	142,961
Gains on disposal of available-for-sale financial assets	218,563	9,443
Gains on disposal of investments in subsidiaries	416,400	-
Gains on disposal of securities held for trading	7,989	11,705
	897,377	**248,310**

Other financial income includes Euros 13,000 thousand relating to derivatives on Telecom Italia S.p.A. shares following the change of the underlying hedged item from bonds to shares.

Gains on exchange include the adjustment of open items at the balance sheet date expressed in currencies other than the functional currency and the gains realized on closed positions.

Gains on the disposal of available-for-sale financial assets mainly include Euros 215,200 for the sale of the investment in Capitalia S.p.A..

The gains on the disposal of investments in subsidiaries, equal to Euros 416,400 thousand, relate to the sale of a 38.9 percent interest in the capital of Pirelli Tyre S.p.A. for consideration of Euros 740 million, equal to an equity value for the entire company of approximately Euros 1.9 billion.

The above gains (for a total of Euros 631,600 thousand equal to 70.4 percent of “financial income”) qualify as nonrecurring events.

35. FINANCIAL EXPENSES

Financial expenses include the following:

(in thousands of euros)

	2006	2005
Bank interest	151,288	126,466
Other financial expenses	78,403	39,248
Losses on exchange	129,700	146,416
Losses on disposal of available-for-sale financial assets	5,732	1,552
	365,123	**313,682**

Other financial expenses mainly include Euros 27,351 thousand relating to the equity swap transactions on Telecom Italia S.p.A. shares (held by the subsidiary Pirelli Finance Luxembourg S.A.) which ended during the course of the year with a payment of Euros 10,072 thousand, Euros 7,465 thousand relating to losses on other derivatives on Telecom Italia S.p.A. shares and also bank commissions, listing rights and other financial expenses.

Losses on exchange include the adjustment of open items at the balance sheet date expressed in currencies other than the functional currency and losses realized on closed positions.

36. DIVIDENDS

Dividends primarily refer to those received from Telecom Italia S.p.A. (Euros 26,344 thousand), from Capitalia S.p.A. (Euros 9,938 thousand), from RCS MediaGroup S.p.A. (Euros 3,875 thousand), from Mediobanca S.p.A. (Euros 8,702 thousand), from Consortium S.r.l. (Euros 11,162 thousand) and from Fin.Priv. S.r.l. (Euros 1,132 thousand).

37. VALUATION OF FINANCIAL ASSETS

The valuation of financial assets includes:

(in thousands of euros)

	2006	2005
Impairment loss of available-for-sale financial assets	(13,378)	(22,391)
Measurement of securities held for trading at fair value	2,814	15,923
Measurement of currency derivatives at fair value	(35,201)	(19,640)
Measurement of other derivatives at fair value	(8,629)	(63,961)
	(54,394)	**(90,069)**

The "impairment loss of available-for-sale financial assets" mainly includes the writedown of the investments in G.I.M. – Generale Industrie Metallurgiche S.p.A. (Euros 1,244 thousand), Consortium S.r.l. (Euros 4,532 thousand), Euroqube S.A. (Euros 2,181 thousand), Allopitc Inc. (Euros 1,000 thousand), Stip Tunisi (Euros 1,206 thousand) and KG Deutsche Gasrubwerke GmbH (Euros 1,710 thousand).

The "measurement of securities held for trading at fair value" refers to the fair value adjustment at year-end of listed securities classified in the financial statements as "securities held for trading" (Note 17).

The "measurement of currency derivatives at fair value" includes transactions for forward currency purchases and sales. For open positions at year, the fair value is determined using the exchange rate at the balance sheet date.

The "measurement of other derivative instruments at fair value" includes Euros 7,899 thousand relating to the negative fair value change in the call options on Telecom Italia shares, held by the subsidiary Pirelli Finance (Luxembourg) S.A., and exercised in March 2006.

38. SHARE OF EARNINGS (LOSSES) OF ASSOCIATES AND JOINT VENTURES

The share of earnings (losses) of associates and joint ventures accounted for using the equity method is a loss of Euros 1,836,242 thousand (earnings of Euros 251,366 thousand in 2005). The item particularly includes:

- the share of the loss of Olimpia S.p.A. for Euros 1,940,039 thousand (earnings of Euros 152,486 thousand in 2005), mainly generated as a result of the writedown of the investment held in Telecom Italia S.p.A. for Euros 2,110,000 thousand (please refer to the specific paragraph relating to investments in associates and joint ventures – Note 10), which qualifies as a nonrecurring event;
- the earnings of the investments in the real estate sector accounted for using the equity method (Pirelli Real Estate Group) for Euros 101,570 thousand (Euros 98,787 thousand in 2005).

39. INCOME TAXES

Income taxes for the period are composed as follows:

(in thousands of euros)

	2006	2005
current income taxes	125,460	122,745
deferred income taxes	2,388	5,739
	127,848	**128,484**

The reconciliation between theoretical and effective taxes is as follows:

(in thousands of euros)

	2006	2005
Income before taxes	**(890,978)**	**477,538**
Share of earnings of associates and joint ventures	1,836,242	(251,366)
Total taxable income	945,264	226,172
Theoretical income taxes	**(310,044)**	**(103,392)**
Main reasons for differences between theoretical and effective income taxes:		
Non-taxable income	288,359	139,653
Non-deductible costs	(88,735)	(156,213)
Utilization of tax loss carryforwards	27,483	16,860
Unrecognized deferred taxes	(18,763)	(36,525)
Other	(26,149)	11,133
Effective income taxes	**(127,848)**	**(128,484)**

The percentage of the effective tax charge of the Group for 2006 is lower than the 32.8 percent theoretical tax charge of the Group given the presence of income components not subject to taxation mainly in reference to gains on the disposal of investments to third parties and the use of tax losses carryforwards which had not been recognized as deferred tax assets. The figure also includes the recognition by Pirelli & C. S.p.A. of the tax effects generated by the option for national tax consolidation.

The theoretical tax charge of the Group is calculated by taking into account the nominal tax rates in the countries in which the major companies of the Group operate, as indicated in the following table:

Europe:	**2006**	**2005**	**North America:**	**2006**	**2005**
Italy	37.25%	37.25%	USA	40%	40%
Spain	35%	35%	**South America:**		
Germany	38.34%	41.4%	Argentina	35%	35%
United Kingdom	30%	30%	Brazil	34%	34%
Turkey	20%	30%	Venezuela	34%	34%

Source : KPMG Corporate Tax Rate Survey 2006

40. INCOME (LOSS) FROM DISCONTINUED OPERATIONS

On July 28, 2005, the agreement was executed between Pirelli & C. S.p.A. and Goldman Sachs Capital Partners for the purchase of Pirelli's Energy and Telecom Cables and Systems activities by Goldman Sachs Capital Partners.
The "income from discontinued operations" for 2005 included the income from discontinued operations for the six months ending June 30, 2005 (Euros 32,773 thousand) and the impact from the disposal (Euros 17,123 thousand), for a total of Euros 49,896 thousand.

The "loss from discontinued operations" for the year 2006 of Euros 30,000 thousand refers to the adjustment of the accruals relating to the price adjustment envisaged by the contract and the guarantees provided.

41. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is calculated by dividing the income (loss) attributable to the equity holders of the company (adjusted for the minimum dividends due to savings shares) by the weighted average number of outstanding ordinary shares during the year, excluding ordinary treasury shares.

	2006	2005
Income/(loss) from **continuing operations** for the year attributable to the equity holders of the company	(1,137)	278
Income/(loss) attributable to savings shares considering the extra 2% (except for 2006 in that the net result is a loss) *	29	(8)
Income/(loss) from adjusted **continuing operations** for the year attributable to the equity holders of the company	(1,108)	270
Weighted average number of outstanding ordinary shares (in thousands)	5,205,142	4,861,900
Basic earnings (loss) per ordinary share from continuing operations (in euros per thousand of shares)	**(212,87)**	**55,53**

	2006	2005
Income/(loss) from **discontinued operations** for the year attributable to the equity holders of the company	(30)	49
Income/(loss) attributable to savings shares considering the extra 2% (except for 2006 in that the net result is a loss) *	1	(1)
Income/(loss) from **discontinued operations** for the year attributable to the equity holders of the company	(29)	48
Weighted average number of outstanding ordinary shares (in thousands)	5,205,142	4,861,900
Basic earnings (loss) per ordinary share from **discontinued operations** (in euros per thousand of shares)	**(5.57)**	**10.08**

* This right will be cumulative with that matured in the first year in which the company reports a profit.

Diluted earnings (loss) per share is calculated by adjusting the weighted average number of outstanding ordinary shares to assume conversion of all dilutive potential ordinary shares.
The company has only one category of dilutive potential ordinary shares: stock options.
Since the price to exercise the stock options is higher than market value, the stock options are assumed not to have been exercised.
At December 31, 2005, the dilutive potential shares deriving from the exercise of outstanding warrants had been considered.
At December 31, 2006, there are no longer any warrants outstanding.

	2006	2005
Income/(loss) from **continuing operations** for the year attributable to the equity holders of the company	(1.137)	278
Income/(loss) attributable to savings shares considering the extra 2% (except for 2006 in that the net result is a loss) *	29	(8)
Income/(loss) from adjusted **continuing operations** for the year attributable to the equity holders of the company	(1.108)	270
Weighted average number of outstanding ordinary shares (in thousands)	5.205.142	4.861.900
Adjustment for the issue of warrants		18.963
Adjusted weighted average number of outstanding ordinary shares (in thousands)	5.205.142	4.880.863
Diluted earnings (loss) per ordinary share from continuing operations (in euros per thousand of shares)	**(212,87)**	**55,32**

	2006	2005
Income/(loss) from **discontinued operations** for the year attributable to the equity holders of the company	(30)	49
Income/(loss) attributable to savings shares considering the extra 2% (except for 2006 in that the net result is a loss)	1	(1)
Income/(loss) from **discontinued operations** for the year attributable to the equity holders of the company	(29)	48
Weighted average number of outstanding ordinary shares (in thousands)	5.205.142	4.861.900
Adjustment for the issue of warrants		18.963
Adjusted weighted average number of outstanding ordinary shares (in thousands)	5.205.142	4.880.863
Diluted earnings (loss) per ordinary share from **discontinued operations** (in euros per thousand of shares)	**(5,57)**	**10,04**

* This right will be cumulative with that matured in the first year in which the company reports a profit.

42. DIVIDENDS PER SHARE

The company paid dividends of Euros 108,767 thousand on the ordinary shares (Euros 0.0210 per share) and Euros 4,905 thousand on the savings shares (Euros 0.0364 per share).

43. HYPERINFLATION

The subsidiary with headquarters in Venezuela used inflation accounting to prepare its consolidated financial statements at December 31, 2006. In accordance with Group accounting principles with regard to the criteria for starting and discontinuing use of inflation accounting, this company will cease to use inflation accounting starting from January 1, 2007.

The gains and losses on the net monetary position are recognized in the income statement under "Other expenses" (Note 33) for Euros 766 thousand (Euros 125 thousand in 2005) for the part relating to the monetary adjustment relative to non-financial factors and under "Financial expenses" (Note 35) for Euros 1,936 thousand (Euros 2,899 thousand in 2005) for the part relative to the monetary adjustment relative to financial factors.

44. RELATED PARTY DISCLOSURES

Related party transactions, including intragroup transactions, are neither unusual nor exceptional but fall under the ordinary course of business of the companies of the Group. Such transactions, when not concluded at standard conditions or dictated by specific laws, are in any case conducted at arm's length.

The following table summarizes the balance sheet and income statement captions which include related party transactions and the relative percentage of the total:

(in millions of euros)

	Total in financial statements 2006	of which related parties	% of total	Total in financial statements 2005	of which related parties	% of total
Balance sheet						
Non-current assets						
Other receivables	705.8	334.2	47.4%	538.8	262.3	48.7%
Current assets						
Trade receivables	999.7	168.1	16.8%	943.4	190.1	20.1%
Other receivables	356.2	11.9	3.3%	325.0	1.0	0.3%
Current liabilities						
Borrowings from banks and other financial institutions	1,562.3	0.2	0.0%	-	-	-
Trade payables	1,102.5	25.1	2.3%	1,018.3	26.5	2.6%
Other payables	512.9	3.4	0.7%	838.3	0.3	-
Taxes payables	48.8	0.7	1.4%	42.2	-	-
Income statement						
Revenues from sales and services	4,841.2	371.4	7.7%	4,545.7	405.2	8.9%
Other income	292.8	104.1	35.6%	283.6	117.9	41.6%
Personnel costs	(1,075.8)	(5.4)	0.5%	(1,029.9)	(8.1)	0.8%
Other expenses	(1,683.9)	(111.1)	6.6%	(1,612.6)	(106.3)	6.6%
Financial income	897.4	17.3	1.9%	248.3	13.2	5.3%
Financial expenses	(365.1)	-	-	(313.7)	(0.1)	-
Dividends	65.9	26.3	40.0%	26.7	10.1	37.8%

The income statement and balance sheet effect of transactions with related parties on the consolidated financial statements of the Pirelli Group at December 31, 2006 are as follows,

Transactions with associates and joint ventures:

(in millions of euros)

Revenues for goods and services	218	These mainly refer to the supply of services to associates and joint ventures of Pirelli & C. Real Estate S.p.A..
Other expenses	10	
Financial income	17	
Trade receivables	115	These mainly refer to receivables from associates and joint ventures of Pirelli & C. Real Estate S.p.A..
Non-current other receivables	1	
Non-current financial receivables	333	These mainly refer to receivables from associates and joint ventures of Pirelli & C. Real EstateS.p.A..
Other current receivables	12	These mainly refer to receivables from associates and joint ventures of Pirelli & C. Real Estate S.p.A..
Current trade payables	8	These mainly refer to payables to associates and joint ventures of Pirelli & C. Real Estate S.p.A..
Other current payables	3	These mainly refer to payables to associates and joint ventures of Pirelli & C. Real Estate S.p.A..

Transactions with parties related to Pirelli & C. S.p.A. through directors (Telecom Italia group, Camfin group and F.C. Internazionale Milano S.p.A.):

(in millions of euros)

Revenues for goods and services	153	These refer to services rendered by Pirelli & C. S.p.A., Shared Service Center s.c.r.l. and Pirelli & C. Real Estate S.p.A. to the Telecom Italia group (Euros 147 million); services rendered by Pirelli Ambiente Tecnologie S.p.A. to the Camfin group (Euros 2 million) and services rendered to F.C. Internazionale Milano S.p.A. (Euros 4 million).
Other income	104	These refer to services rendered by Shared Service Center s.c.r.l. to the Telecom Italia group (Euros 104 million).
Other costs	89	These refer to telephone, computer and power services by the Telecom Italia group (Euros 32 million); the supply of natural gas by the Camfin Group (Euros 49 million) and costs for the sponsorship of F.C. Internazionale Milano S.p.A. (Euros 8 million).
Current trade receivables	54	These refer to receivables for the supply of the above services (to the Telecom Italia group for Euros 51 million, to the Camfin group Euros 1 million and F.C. Internazionale Milano S.p.A. Euros 2 million).
Current trade payables	16	These refer to payables for the supply of the above services (to the Telecom Italia group for Euros 3 million, the Camfin group Euros 11 million and F.C. Internazionale Milano S.p.A. Euros 2 million).

Benefits to key executives

In 2006, the compensation to key executives, that is, those who have the power and the responsibility, directly or indirectly, for the planning, direction and control of the activities of Pirelli & C. S.p.A., including executive and non-executive directors, amounts to Euros 17,201 thousand (Euros 18,648 thousand in 2005). The part relating to the payment of employee benefits was charged to the income statement in "Personnel costs" (Note 31) for Euros 5,417 thousand, of which the part relating to employees' leaving indemnity totals Euros 361 thousand (Euros 8,149 thousand in 2005, of which the part relating to employees' leaving indemnity amounts to Euros 446 thousand). The part relating to the compensation to directors was charged to the income statement in "Other expenses" (Note 33) for Euros 11,784 thousand (Euros 10,499 thousand in 2005).

45. SUBSEQUENT EVENTS

- On January 9, 2007, Pirelli & C. S.p.A. and Quattroduedue Holding B.V. (the controlling shareholder of Intek S.p.A.), in view of the project for the merger of Gim S.p.A. in Intek S.p.A. and in execution of the provisions established by the new codicil No. 1 among the members of the Gim S.p.A. Shareholders' Agreement, signed a put&call agreement relating to 14,923,526 Gim S.p.A. ordinary shares held by Pirelli & C. S.p.A., equal to approximately 7.04 percent of Gim S.p.A. ordinary share capital.
  The understanding provides that, starting from the date the indicated merger comes into effect, Pirelli & C. S.p.A. and Quattroduedue Holding B.V. will have, respectively, the right to sell – up to the limits of the tender offer – and purchase the entire investment acquired by Pirelli & C. S.p.A. as a result of the merger for consideration of Euros 13.1 million.
  The agreement is subject to the merger becoming effective and can be carried out by Quattroduedue Holding B.V. in more than one tranche by and not after May 31, 2008. Subsequent to that date, should Quattroduedue Holding B.V. not yet have exercised the option on the entire investment, Pirelli & C. S.p.A. will have the right to sell such shares to third parties, with the possible payment of compensation by Quattroduedue Holding B.V. if there is a negative difference compared to the agreed price.
- On January 17, 2007, Pirelli & C. S.p.A. announced that none of the parties in the Pirelli & C. S.p.A. shareholders' agreement indicated the desire to withdraw from the pact within the contractually established expiration date of January 15, 2007. The pact will thus remain in effect, with the same

composition, until the new expiration date of April 15, 2010.

- On January 22, 2007, Pirelli & C. Ambiente Eco Technology S.p.A., also active in the sector of technologies for sustainable development, and LiqTech A/S, a Danish company which has operated for years in the sector of silicon carbide filters for the retrofit market, signed an agreement to conduct joint research into silicon carbide filters. The joint research project has the objective of improving the performance of silicon carbide filters. The results generated by the research will be jointly owned by the two companies but Pirelli will have the exclusive rights to exploit them in Europe, Russia and the former Soviet Republics, Brazil and China. Similarly, LiqTech will have the exclusive rights to exploit the results of the research in the U.S.A., Mexico, South Korea, India and Japan. Furthermore, under the agreement, LiqTech will support Pirelli & C. Ambiente Eco Technology S.p.A. in the development of the production technology for mass-producing silicon carbide anti-particulate filters which will first be used on diesel engines.
  The results generated by this development work will be the exclusive property of Pirelli & C. Ambiente Eco Technology S.p.A.and will be implemented in the factory which the company will start to build in Romania in January 2007 to produce anti-particulate filters for the original equipment market. As already mentioned, the factory will become operational in the second half of 2008 and will have a production capacity of more than 1,300 tons of silicon carbide filters a year.

- On February 12, 2007, Pirelli Tyre S.p.A. announced that it had successfully concluded the syndication of a five-year multicurrency revolving credit line announced to the market on January 8, 2007. The contract was signed by the company with the mandated lead arrangers BNP Paribas and Banca Monte dei Paschi di Siena, and a pool of leading Italian and international banks (Akbank, Bank of America, Banca Carige, Banco do Brasil, Banca Popolare dell'Emilia Romagna, Banco Santander Central Hispano, ItauEuropa, Mizuho, Natixis and Royal Bank of Canada).
  In view of the high number of commitments, the initial amount of Euros 500 million was increased to Euros 675 million.
  The loan bears interest at an initial rate equal to the Euribor + 40 basis points. The purpose of the transaction is to allow Pirelli Tyre to improve its financial structure while at the same time increasing its flexibility.

- On February 27, 2007, the world council of the FIA accepted Pirelli's offer to supply tyres for the World Rally Championship (WRC) over the three-year period 2008-2010, appreciating not only the product and Pirelli's capacity for technological innovation, but also its aim to seek out and encourage young talent and to promote national championships. In particular, one of the reasons why the FIA chose Pirelli, is its century-long commitment to motor racing, and car rallies in particular. Pirelli's winning of the bid to supply the WRC was the second victory in the space of a few weeks. At the end of January, the Grand Am series, the most exciting championship for prototypes in the United States and one of the most popular in America, decided to adopt the Pirelli PZero for the three-year period 2008-2010.

- On January 10, 2007, Pirelli RE, in execution of the binding agreement signed on October 9, 2006, purchased approximately 97 percent of Deutsche Grundvermogen AG (DGAG), one of the most important real estate companies in Germany with offices in Hamburg and Kiel. The purchase price, subject to a price adjustment on the basis of the 2006 financial statements, was set at approximately Euros 465 million for 100 percent of DGAG. As a result of additional purchases on January 12, 2007, Pirelli RE increased its percentage ownership to more than 99 percent. In keeping with the Pirelli RE business model, DGAG will be transformed into a platform of real estate investments, asset management and services.
  By the end of 2007, DGAG's residential portfolio worth approximately Euros 1,040 million will be transferred to the joint venture between Pirelli RE (35 percent) and the real estate investment funds of RREEF (65 percent), the division of Deutsche Bank which deals with real estate investments, while the retail and office portfolio worth approximately Euros 275 million will be transferred to the joint venture between Pirelli RE (30 percent) and the real estate investment funds of Morgan Stanley (MSREF) (70 percent). Other assets and the assets under management

and services will remain with Pirelli RE Deutschland.

- On January 30, 2007, the board of directors of Pirelli Real Estate Società di Gestione del Risparmio S.p.A. approved the management accounts of Tecla Fondo Uffici, Berenice Fondo Uffici and Olinda Fondo Shops at December 31, 2006, confirming returns that were higher than the targets indicated in the placement also for the year 2006.
- On February 12, 2007, land was purchased in the city of Portogruaro for approximately Euros 8 million for the Eastgate Park project. This is the largest integrated industrial park in the east part of the northeast of the country on which construction began in the early months of 2006. On February 13, 2007, following the preliminary agreement signed on December 29, 2006, Fondo Spazio Industriale also purchased two additional buildings for industrial use situated in Pordenone and Belluno for a price of Euros 22 million.

46. OTHER INFORMATION

Compensation to directors and statutory auditors

Compensation to directors and statutory auditors of Pirelli & C. S.p.A. to carry out these functions also in other companies included in the scope of consolidation is as follows:

(in thousands of euros)

	2006	2005
Directors	11,784	10,499
Statutory auditors	368	372
	12,152	**10,871**

Employees

The average number of employees of the companies included in consolidation, by category, is the following:

	2006	2005
Executives and staff	7,579	7,328
Blue-collar	16,871	15,562
Temporary workers	3,713	3,313
	28,163	**26,203**

Exchange rates

The main exchange rates used for consolidation purposes are as follows:

(valuta locale contro Euro)

	Year-end		Change in	Average		Change in
	12/31/2006	12/31/2005	%	2006	2005	%
British pound	0.6715	0.6853	(2.01%)	0.6818	0.6838	(0.29%)
Swiss franc	1.6069	1.5551	3.33%	1.5729	1.5482	1.60%
Slovakian koruna	34.4350	37.8800	(9.09%)	37.2336	38.6031	(3.55%)
American dollar	1.3170	1.1797	11.64%	1.2555	1.2444	0.90%
Canadian dollar	1.5281	1.3725	11.34%	1.4236	1.5092	(5.67%)
Brazilian real	2.8158	2.7613	1.97%	2.7334	3.0289	(9.76%)
Venezuela bolivar	2,831.5500	2,536.3550	11.64%	2,699.3680	2,628.8349	2.68%
Argentinean peso	4.0327	3.5769	12.74%	3.8601	3.6377	6.11%
Australian dollar	1.6691	1.6109	3.61%	1.6670	1.6320	2.15%
Chinese renminbi	10.2812	9.5181	8.02%	10.0089	10.1915	(1.79%)
Singapore dollar	2.0202	1.9628	2.92%	1.9939	2.0707	(3.71%)
Egyptian pound	7.5135	6.7567	11.20%	7.1991	7.1891	0.14%

Net financial position (non-GAAP measure)

The composition of the net financial position is as follows:

(in millions of euros)

	12/31/2006	of which related parties	12/31/2005	of which related parties
. Borrowings from banks and other financial institutions - current	1,522		556	
. Financial accrued liabilities and deferred income - current	60		62	
. Cash and cash equivalents	(270)		(300)	
. Financial assets held for trading	(119)		(180)	
. Financial receivables - current	(27)		(27)	
. Financial accrued income and prepaid expenses - current	(7)		(12)	
. Borrowings from banks and other financial institutions - non-current	1,382		1,551	
Net financial debt	**2,541**		**1,650**	
. Financial receivables - non-current	(553)	(333)	(468)	(262)
. Financial accrued income and prepaid expenses - non-current	(8)		(5)	
Total net financial (liquidity)/debt position	**1,980**		**1,177**	

The main nonrecurring events which had an impact on the net financial position are the following:
- the purchase by Pirelli & C. S.p.A. of Olimpia S.p.A. shares from Hopa S.p.A., UniCredito Italiano S.p.A. and Banca Intesa S.p.A. (Euros 1,534.8 million);
- the sale of the entire investment in Capitalia S.p.A. (Euros 332.9 million);
- the operation for the private placement of Pirelli Tyre S.p.A. (Euros 715.8 million).

Net financial position (non-GAAP measure)

The composition of the net financial position is as follows:

(in millions of euros)

	12/31/2006	of which related parties	12/31/2005	of which related parties
. Borrowings from banks and other financial institutions - current	1,522		556	
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List of investments

Companies consolidated line-by-line

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Europe							
Austria							
ECOI-Immobilien Gmbh	Real Estate	Vienna	Euro	35,000	100.00%		P&K Real Estate Gmbh
Pirelli Gesellschaft mbH	Tyre	Vienna	Euro	726,728	100.00%		Pirelli Tyre (Europe) S.A.
Belgium							
Pirelli Tyres Belux S.A.	Tyre	Brussels	Euro	700,000	100.00%		Pirelli Tyre (Europe) S.A.
France							
Gecam France S.a.S	Enviroment	Paris	Euro	750,000	70.00%		Pirelli & C. Ambiente Eco Tecnology S.p.A. (ex- Pirelli & C. Ambiente Tecnologie S.p.A.)
Pirelli Broadband Solutions France S.a.r.l.	Enviroment	Paris	Euro	10,000	99.00%		Pirelli Broadband Solutions S.p.A.
					1.00%		Maristel S.p.A.
Pneus Pirelli S.a.S	Tyre	Roissy en France	Euro	1,515,858	100.00%		Pirelli Tyre (Europe) S.A.
Germany							
Auster Real Estate (ex- aptus 226.Gmbh)	Real Estate	Hamburg	Euro	25,000	100.00%		Mistral Real Estate B.V.
Deutsche Pirelli Reifen Holding Gmbh	Financial	Breuberg/Odenwald	Euro	7,694,943	100.00%		Pirelli Tyre Holland N.V.
Drahtcord Saar Geschaeftsfuehrungs Gmbh	Tyre	Merzig	Deut. Mark	60,000	50.00%		Pirelli Deutschland Gmbh
Drahtcord Saar GmbH & Co. K.G.	Tyre	Merzig	Deut. Mark	30,000,000	50.00%		Pirelli Deutschland Gmbh
Driver Fleet Solution Gmbh	Tyre	Breuberg/Odenwald	Euro	26,000	100.00%		Deutsche Pirelli Reifen Holding Gmbh
Etesian Real Estate (ex- aptus 227.Gmbh)	Real Estate	Hamburg	Euro	25,000	100.00%		Mistral Real Estate B.V.
Leste Real Estate (ex- aptus 228.Gmbh)	Real Estate	Hamburg	Euro	25,000	100.00%		Mistral Real Estate B.V.
P&K Real Estate Gmbh	Real Estate	Berlin	Euro	570,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli Deutschland Gmbh	Tyre	Breuberg/Odenwald	Euro	26,334,100	100.00%		Deutsche Pirelli Reifen Holding Gmbh
Pirelli & C. Real Estate Deutschland Gmbh (ex- Pirelli & C. Real Estate Germany Gmbh)	Real Estate	Berlin	Euro	25,000	100.00%		Jamesmail B.V.
Pirelli & C. Real Estate Deutschland II Gmbh	Real Estate	Amburg	Euro	25,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli Personal Service Gmbh	Tyre	Breuberg/Odenwald	Euro	25,000	100.00%		Deutsche Pirelli Reifen Holding Gmbh
PK Grundstueckverwaltung Gmbh	Tyre	Hoechst/Odenwald	Euro	26,000	100.00%		Deutsche Pirelli Reifen Holding Gmbh
Pneumobil Gmbh	Tyre	Breuberg/Odenwald	Euro	259,225	100.00%		Deutsche Pirelli Reifen Holding Gmbh
Projekt Northwind Gmbh & Co. K.G.	Real Estate	Hamburg	Euro	1,000	94.90%		Pirelli & C. Real Estate Deutschland Gmbh
Resident Baltic Gmbh (ex- gatus 251.Gmbh)	Real Estate	Berlin	Euro	25,000	90.00%		P&K Real Estate Gmbh
Resident Berlin Zwei P&K Gmbh	Real Estate	Berlin	Euro	100,000	94.90%		P&K Real Estate Gmbh
Resident Sachsen P&K Gmbh	Real Estate	Berlin	Euro	25,000	85.00%		P&K Real Estate Gmbh
Tigotan Vermogenverwaltungsgesellschaft mbh	Real Estate	Amburg	Euro	25,000	100.00%		Pirelli & C. Real Estate Deutschland Gmbh
Tortuga Vermogenverwaltungsgesellschaft mbh	Real Estate	Amburg	Euro	25,000	100.00%		Pirelli & C. Real Estate Deutschland Gmbh
Greece							
Elastika Pirelli S.A.	Tyre	Athens	Euro	785,370	99.90%		Pirelli Tyre (Europe) S.A.
					0.10%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Pirelli Hellas S.A. (in liquidation)	Commercial	Athens	US $	22,050,000	79.86%		Pirelli Tyre Holding N.V.
Hungary							
Pirelli Hungary Tyre Trading and Services Ltd	Tyre	Budapest	Hun. Forint	3,000,000	100.00%		Pirelli Tyre (Europe) S.A.

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Ireland							
Pirelli Reinsurance Company Ltd	Reinsurance	Dublin	US $	7,150,000	100.00%		Pirelli Finance (Luxembourg) S.A.
Italy							
Acquario S.r.l. (in liquidation)	Real Estate	Genoa	Euro	255,000	100.00%		Pirelli & C. Real Estate S.p.A.
Alfa S.r.l.	Real Estate	Milan	Euro	2,600,000	100.00%		Pirelli & C. Real Estate S.p.A.
Asset Management NPL S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Pirelli & C. Real Estate S.p.A.
Bernini Immobiliare S.r.l.	Real Estate	Milan	Euro	500,000	100.00%		Pirelli & C. Real Estate S.p.A.
Beta S.r.l.	Real Estate	Milan	Euro	26,000	100.00%		Pirelli & C. Real Estate S.p.A.
Botticino S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Pirelli & C. Real Estate S.p.A.
Casaclick S.p.A.	Real Estate	Milan	Euro	299,000	100.00%		Pirelli & C. Real Estate Agency S.p.A.
Centrale Immobiliare S.p.A.	Real Estate	Milan	Euro	5,200,000	100.00%		Pirelli & C. Real Estate S.p.A.
Centro Servizi Amministrativi Pirelli S.r.l.	Services	Milan	Euro	51,000	34.00%		Pirelli & C. S.p.A.
					33.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
					33.00%		Pirelli & C. Real Estate S.p.A.
CFT Finanziaria S.p.A.	Real Estate	Florence	Euro	10,010,000	100.00%		Pirelli & C. Real Estate S.p.A.
Consorzio Stabile Pirelli RE Servizi	Real Estate	Milan	Euro	200,000	100.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Dolcetto Sei S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Pirelli & C. Real Estate S.p.A.
Driver Italia S.p.A.	Commercial	Milan	Euro	350,000	73.07%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Edilnord Gestioni S.p.A.	Real Estate	Milan	Euro	517,000	100.00%		Pirelli & C. Real Estate S.p.A.
Elle Uno Società Consortile a r.l.	Real Estate	Milan	Euro	100,000	60.00%		Edilnord Gestioni S.p.A.
Erato Finance S.r.l.	Real Estate	Milan	Euro	600,000	53.85%		Pirelli & C. Real Estate S.p.A.
Esedra S.r.l.	Real Estate	Milan	Euro	2,376,234	100.00%		Pirelli & C. Real Estate S.p.A.
Geolidro S.p.A.	Real Estate	Naples	Euro	3,099,096	100.00%		Centrale Immobiliare S.p.A.
Iniziative Immobiliari 3 S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Iniziative Immobiliari 3 B.V.
Lambda S.r.l.	Real Estate	Milan	Euro	578,760	100.00%		Pirelli & C. Real Estate S.p.A.
Maristel S.p.A.	Telecommunicat.	Milan	Euro	1,020,000	100.00%		Pirelli Broadband Solutions S.p.A.
NewCo RE 1 S.r.l.	Real Estate	Milan	Euro	30,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 2 S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 4 S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 5 S.r.l.	Real Estate	Milan	Euro	40,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 6 S.r.l.	Real Estate	Milan	Euro	40,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 7 S.r.l.	Real Estate	Milan	Euro	40,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 8 S.r.l.	Real Estate	Milan	Euro	40,000	100.00%		Pirelli & C. Real Estate S.p.A.
NewCo RE 9 S.r.l.	Real Estate	Milan	Euro	40,000	100.00%		Pirelli & C. Real Estate S.p.A.
P.I.T. - Promozione Imprese e Territorio S.c.r.l.	Real Estate	Pozzuoli (Na)	Euro	25,823	100.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Parcheggi Bicocca S.r.l.	Real Estate	Milan	Euro	1,500,000	75.00%		Pirelli & C. Real Estate S.p.A.
PBS S.C.a.r.l.	Real Estate	Milan	Euro	100,000	60.00%		Edilnord Gestioni S.p.A.
Pirelli & C. Ambiente Eco Tecnology S.p.A. (ex- Pirelli & C. Ambiente Tecnologie S.p.A.)	Enviroment	Milan	Euro	2,080,000	100.00%		Pirelli & C. Ambiente S.p.A. (ex- Pirelli & C. Ambiente Holding S.p.A.)
Pirelli & C. Ambiente Renewable Energy S.p.A. (ex- Pirelli & C. Ambiente S.p.A.)	Enviroment	Milan	Euro	3,060,000	100.00%		Pirelli & C. Ambiente S.p.A. (ex- Pirelli & C. Ambiente Holding S.p.A.)
Pirelli & C. Ambiente S.p.A. (ex- Pirelli & C. Ambiente Holding S.p.A.)	Enviroment	Milan	Euro	23,120,000	51.00%		Pirelli & C. S.p.A.
Pirelli & C. Ambiente Site Remediation S.p.A. (ex- Pirelli & C. Ambiente Bonifiche S.r.l.)	Enviroment	Milan	Euro	155,700	100.00%		Pirelli & C. Ambiente S.p.A. (ex- Pirelli & C. Ambiente Holding S.p.A.)
Pirelli & C. Opere Generali S.p.A.	Real Estate	Milan	Euro	104,000	100.00%		Pirelli & C. Real Estate S.p.A.

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Pirelli & C. Real Estate Agency S.p.A.	Real Estate	Milan	Euro	832,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli & C. Real Estate Energy S.p.A.	Real Estate	Milan	Euro	120,000	100.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Pirelli & C. Real Estate Facility Management S.p.A.	Real Estate	Milan	Euro	5,561,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli & C. Real Estate Franchising Holding S.r.l.	Real Estate	Milan	Euro	120,000	70.00%		Pirelli & C. Real Estate S.p.A.
Pirelli & C. Real Estate Franchising S.p.A	Real Estate	Milan	Euro	500,000	100.00%		Pirelli & C. Real Estate Franchising Holding S.r.l.
Pirelli & C. Real Estate Franchising Servizi Finanziari S.r.l.	Real Estate	Milan	Euro	10,000	100.00%		Pirelli & C. Real Estate Franchising Holding S.r.l.
Pirelli & C. Real Estate Opportunities Società di Gestione del Risparmio S.p.A.	Real Estate	Milan	Euro	1,000,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli & C. Real Estate S.p.A.	Real Estate	Milan	Euro	21,274,678	50.30%		Pirelli & C. S.p.A.
					0.56%	0.00%	Pirelli & C. Real Estate S.p.A.
Pirelli & C. Real Estate Property Management S.p.A.	Real Estate	Milan	Euro	114,400	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A.	Real Estate	Milan	Euro	24,458,763	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli Broadband Solutions S.p.A.	Telecommunicat.	Milan	Euro	10,120,000	100.00%		Pirelli & C. S.p.A.
Pirelli Cultura S.p.A.	Sundry	Milan	Euro	1,000,000	100.00%		Pirelli & C. S.p.A.
Pirelli Labs S.p.A.	Research and Development	Milan	Euro	10,000,000	100.00%		Pirelli & C. S.p.A.
Pirelli Nastri Tecnici S.p.A. (in liquidation)	Sundry	Milan	Euro	384,642	100.00%		Pirelli & C. S.p.A.
Pirelli RE Credit Servicing S.p.A. (ex- Credit Servicing S.p.A.)	Real Estate	Milan	Euro	1,809,500	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli Servizi Finanziari S.p.A.	Financial	Milan	Euro	1,976,000	100.00%		Pirelli & C. S.p.A.
Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)	Tyre	Milan	Euro	256,820,000	61.06%		Pirelli & C. S.p.A.
Polo Viaggi S.r.l.	Travel Agency	Milan	Euro	46,800	100.00%		Pirelli & C. S.p.A.
Progetto Bicocca Università S.r.l.	Real Estate	Milan	Euro	50,360	50.50%		Pirelli & C. Real Estate S.p.A.
Progetto Perugia S.r.l. (ex- Progetto Salute Bollate S.r.l.)	Real Estate	Milan	Euro	100,000	100.00%		Pirelli & C. Real Estate S.p.A.
Progetto Vallata S.r.l.	Real Estate	Milan	Euro	1,500,000	80.00%		Pirelli & C. Real Estate S.p.A.
					9.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Servizi Amministrativi Real Estate S.p.A.	Real Estate	Milan	Euro	520,000	100.00%		Pirelli & C. Real Estate S.p.A.
Servizi Aziendali Pirelli S.C.p.A.	Services	Milan	Euro	104,000	95.00%		Pirelli & C. S.p.A.
					2.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
					1.00%		Polo Viaggi S.r.l.
					2.00%		Pirelli & C. Real Estate S.p.A.
Servizi Immobiliari Banche S.r.l.	Immobiliare	Milano	Euro	10,100	100.00%		Pirelli RE Credit Servicing S.p.A. (ex- Credit Servicing S.p.A.)
Shared Service Center S.c.r.l.	Information Systems	Milan	Euro	1,756,612	50.00%		Pirelli & C. S.p.A.
Vindex S.r.l.	Real Estate	Brescia	Euro	12,000	68.00%		CFT Finanziaria S.p.A.
					32.00%		Pirelli & C. Real Estate S.p.A.
Luxembourg							
Pirelli Finance (Luxembourg) S.A.	Financial	Luxembourg	Euro	270,228,168	100.00%		Pirelli & C. S.p.A.
Poland							
Driver Polska Sp.ZO.O.	Tyre	Warsaw	Pol. Zloty	100,000	72.50%		Pirelli Polska Sp.ZO.O.
Pirelli Pekao Real Estate Sp.ZO.O.	Real Estate	Warsaw	Pol. Zloty	35,430	75.00%		Pirelli & C. Real Estate S.p.A.
Pirelli Polska Sp.ZO.O.	Tyre	Warsaw	Pol. Zloty	625,771	100.00%		Pirelli Tyre (Europe) S.A.

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Romania							
S.C. Cord Romania S.R.L.	Tyre	Slatina	Rom. Leu	24,990,100	80.00%		Pirelli Tyre Holland N.V.
S.C. Pirelli Tyres Romania S.R.L.	Tyre	Slatina	Rom. Leu	77,169,800	95.00%		Pirelli Tyre Holland N.V.
					5.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Russia							
OOO Pirelli Tyre Russia	Commercial	Moscow	Russian Rouble	950,000	95.00%		Pirelli Tyre (Europe) S.A.
					5.00%		Pirelli Tyre Holland N.V.
Slovakia							
Pirelli Slovakia S.R.O.	Tyre	Bratislava	Slov. Koruna	200,000	100.00%		Pirelli Tyre (Europe) S.A.
Spain							
Euro Driver Car S.L.	Tyre	Barcelona	Euro	690,000	25.00%		Pirelli Neumaticos S.A.
					26.00%		Proneus S.L.
Omnia Motor S.A.	Tyre	Barcelona	Euro	1,502,530	100.00%		Pirelli Neumaticos S.A.
Pirelli Neumaticos S.A.	Tyre	Barcelona	Euro	45,075,908	100.00%		Pirelli Tyre Holland N.V.
Proneus S.L.	Tyre	Barcelona	Euro	3,005	51.00%		Pirelli Neumaticos S.A.
Tyre & Fleet S.L.	Tyre	Barcelona	Euro	20,000	100.00%		Pirelli Neumaticos S.A.
Sweden							
Pirelli Tyre Nordic A.B.	Tyre	Bromma	Swed. Krona	950,000	100.00%		Pirelli Tyre (Europe) S.A.
Switzerland							
Agom S.A.	Tyre	Conthey	Swiss Franc	50,000	80.00%		Pirelli Tyre (Europe) S.A.
Agom S.A. Bioggio	Tyre	Bioggio	Swiss Franc	590,000	100.00%		Pirelli Tyre (Europe) S.A.
Pirelli Société de Services S.à r.l.	Financial	Basel	Swiss Franc	50,000	100.00%		Pirelli Tyre (Europe) S.A.
Pirelli Société Générale S.A.	Financial	Basel	Swiss Franc	28,000,000	100.00%		Pirelli & C. S.p.A.
Pirelli Tyre (Europe) S.A.	Tyre	Basel	Swiss Franc	1,000,000	100.00%		Pirelli Tyre Holland N.V.
The Netherlands							
Iniziative immobiliari 3 B.V.	Real Estate	Amsterdam	Euro	4,500,000	100.00%		Pirelli & C. Real Estate S.p.A.
Jamesmail B.V.	Real Estate	Amsterdam	Euro	18,000	100.00%		Pirelli & C. Real Estate S.p.A.
Mistral Real Estate B.V.	Real Estate	Amsterdam	Euro	18,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli China Tyre N.V.	Tyre	Heinenoord	Euro	8,045,000	100.00%		Pirelli Tyre Holland N.V.
Pirelli RE Netherlands B.V.	Real Estate	Amsterdam	Euro	21,000	100.00%		Pirelli & C. Real Estate S.p.A.
Pirelli Tyre Holding N.V.	Holding Company	Heinenoord	Euro	250,000,000	100.00%		Pirelli & C. S.p.A.
Pirelli Tyre Holland N.V.	Tyre	Heinenoord	Euro	3,045,000	100.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Pirelli Tyres Nederland B.V.	Tyre	Heinenoord	Euro	18,152	100.00%		Pirelli Tyre (Europe) S.A.
Sipir Finance N.V.	Financial	Heinenoord	Euro	13,021,222	100.00%		Pirelli & C. S.p.A.
Solaia Real Estate B.V.	Real Estate	Amsterdam	Euro	18,000	100.00%		Pirelli & C. Real Estate S.p.A.
Turkey							
Celikord A.S.	Tyre	Istanbul	Turk. Lira/mil.	29,000,000	50.733%		Pirelli Tyre Holland N.V.
					0.27%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Turk-Pirelli Lastikleri A.S.	Tyre	Istanbul	Turk. Lira/mil.	140,000,000	65.44%		Pirelli Tyre Holland N.V.
					0.15%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
United Kingdom							
Central Tyre Ltd	Tyre	London	British Pound	100,000	100.00%		Pirelli UK Tyres Ltd
CPK Auto Products Ltd	Tyre	London	British Pound	10,000	100.00%		Pirelli UK Tyres Ltd
CTC 1994 Ltd	Tyre	London	British Pound	984	100.00%		Central Tyre Ltd
Pirelli International Ltd	Financial	London	Euro	250,000,000	75.00%		Pirelli UK Tyre Holding Ltd
					25.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Pirelli Tyres Ltd	Tyre	London	British Pound	16,000,000	100.00%		Pirelli UK Tyres Ltd
Pirelli UK Finance Ltd	Financial	London	British Pound	6,969,280	100.00%		Pirelli UK Ltd "C"

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Pirelli UK Ltd "A"	Tyre	London	British Pound	85,535,300	100.00%		Pirelli Tyre Holding N.V.
Pirelli UK Ltd "C"	Finance Holding Company	London	British Pound	11,625,978	100.00%		Pirelli & C. S.p.A.
Pirelli UK Tyre Holding Ltd	Holding Company	London	British Pound	96,331,000	100.00%		Pirelli Tyre Holland N.V.
Pirelli UK Tyres Ltd	Tyre	London	British Pound	85,000,000	75.00%		Pirelli UK Tyre Holding Ltd
					25.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
North America							
Canada							
Pirelli Tire Inc.	Tyre	Frederic Town (New Brunswick)	Can. $	6,000,000	100.00%		Pirelli Tyre (Europe) S.A.
U.S.A.							
Pirelli Broadband Solutions North America Inc.	Telecommunicat.	Wilmington (Delaware)	US $	1	100.00%		Pireli Broadband Solutions S.p.A.
Pirelli North America Inc.	Tyre	Wilmington (Delaware)	US $	10	100.00%		Pirelli Tyre Holland N.V.
Pirelli Tire LLC	Tyre	Wilmington (Delaware)	US $	1	100.00%		Pirelli North America Inc. "A"
Central/South America							
Argentina							
Pirelli Argentina de Mandatos S.A.	Services	Buenos Aires	Arg. Peso	3,030,009	59.41%		Pirelli & C. S.p.A.
					40.59%		Pirelli Société Générale S.A.
Pirelli Neumaticos S.A.I.C.	Tyre	Buenos Aires	Arg. Peso	101,325,176	95.00%		Pirelli Tyre Holland N.V.
					5.00%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Brazil							
Muriaé Ltda	Financial	Santo Andrè	Bra. Real	80,000,000	100.00%		Pirelli Pneus S.A.
Novacorp Consultora e Serviços Corporativos Ltda	Holding Company	Santo Andrè	Bra. Real	6,000	99.98%		Pirelli S.A.
Pirelli & C. Real Estate Ltda	Real Estate	Santo Andrè	Bra. Real	2,000,000	100.00%		Pirelli S.A.
Pirelli Pneus Nordeste Ltda	Tyre	Feira de Santana	Bra. Real	29,991,402	100.00%		Pirelli Pneus S.A.
Pirelli Pneus S.A.	Tyre	Feira de Santana	Bra. Real	342,085,095	99.73%	99.57%	Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Pirelli S.A.	Financial	Sao Paulo	Bra. Real	49,189,271	100.00%		Pirelli & C. S.p.A.
Pneuac Comercial e Importadora Ltda	Tyre	Sao Paulo	Bra. Real	12,913,526	100.00%		Pirelli Pneus S.A.
Chile							
Pirelli Neumaticos Chile Limitada	Tyre	Santiago	US $	1,918,451	99.98%		Pirelli Pneus S.A.
					0.02%		Pneuac Comercial e Importadora Ltda
Colombia							
Pirelli de Colombia S.A.	Tyre	Santa Fe De Bogota	Col. Peso/000	3,315,069	92.91%		Pirelli Pneus S.A.
					2.28%		Pirelli de Venezuela C.A.
					1.60%		Muriaè Ltda
					1.60%		Pirelli Pneus Nordeste Ltda
					1.60%		Pneuac Comercial e Importadora Ltda
Mexico							
Pirelli Neumaticos de Mexico S.A. de C.V.	Tyre	Mexico City	Mex. Peso	35,098,400	99.98%		Pirelli Pneus S.A.
					0.02%		Pneuac Comercial e Importadora Ltda
Servicios Pirelli Mexico S.A. de C.V.	Tyre	Mexico City	Mex. Peso	50,000	99.00%		Pirelli Pneus S.A.
					1.00%		Pneuac Comercial e Importadora Ltda
Venezuela							
Pirelli de Venezuela C.A.	Tyre	Valencia	Ven. Bolivar/000	20,062,679	96.22%		Pirelli Tyre Holland N.V.

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Africa							
Egypt							
Alexandria Tire Company S.A.E. (*)	Tyre	Alexandria	Egy. Pound	393,000,000	86.79%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
					0.03%		Pirelli Tyre (Europe) S.A.
International Tire Company Ltd	Tyre	Alexandria	Egy. Pound	50,000	99.80%		Alexandria Tire Company S.A.E.
South Africa							
Pirelli Tyre (Pty) Ltd	Tyre	Sandton	S.A. Rand	1	100.00%		Pirelli Tyre (Europe) S.A.
Oceania							
Australia							
Pirelli Tyres Australia Pty Ltd	Tyre	Pymble - N.S.W.	Aus. $	150,000	100.00%		Pirelli Tyre (Europe) S.A.
New Zealand							
Pirelli Tyres (NZ) Ltd	Tyre	Wellington	N.Z. $	100	100.00%		Pirelli Tyres Australia Pty Ltd
Asia							
China							
Pirelli Tyre Co. Ltd (ex- Yanzhou Evolution Tyre CO. Ltd)	Tyre	Yanzhou	China Renmimbi	800,000,000	60.00%		Pirelli China Tyre N.V.
Japan							
Pirelli Japan Kabushiki Kaisha	Tyre	Tokyo	Jap. Yen	2,700,000,000	100.00%		Pirelli Tyre Holland N.V.
Singapore							
Pirelli Asia Pte Ltd	Tyre	Singapore	Sing. $	2	100.00%		Pirelli Tyre (Europe) S.A.

(*) For IAS purposes, the percentage ownership is 89.1%

Investments accounted for by the equity method

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Europe							
Germany							
Industriekraftwerk Breuberg Gmbh	Cogeneration	Hoechst/Odenwald	Euro	1,533,876	26.00%		Pirelli Deutschland Gmbh
Resident Berlin 1 P&K Gmbh	Real Estate	Berlin	Euro	125,000	40.00%		P&K Real Estate Gmbh
Tizian Wohnen 1 Gmbh	Real Estate	Berlin	Euro	1,114,400	45.00%		P&K Real Estate Gmbh
Tizian Wohnen 2 Gmbh	Real Estate	Berlin	Euro	347,450	45.00%		P&K Real Estate Gmbh
Italy							
Agorà S.r.l. (in liquidation)	Real Estate	Milan	Euro	10,000	40.00%		Pirelli & C. Real Estate S.p.A.
Altair Zander Italia S.r.l.	Real Estate	Milan	Euro	100,000	50.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Aree Urbane S.r.l.	Real Estate	Milan	Euro	307,717	34.60%		Pirelli & C. Real Estate S.p.A.
					0.28%		Pirelli & C. S.p.A.
Cairoli Finance S.r.l.	Real Estate	Milan	Euro	10,000	35.00%		Pirelli & C. Real Estate S.p.A.
Capitol Immobiliare S.r.l.	Real Estate	Milan	Euro	10,000	33.00%		Pirelli & C. Real Estate S.p.A.
Castello S.r.l.	Real Estate	Milan	Euro	1,170,000	49.10%		Pirelli & C. Real Estate S.p.A.
Consorzio ARP	Real Estate	Rome	Euro	130,000	41.30%		Pirelli & C. Real Estate Property Management S.p.A.
Continuum S.r.l.	Real Estate	Milan	Euro	500,000	40.00%		Pirelli & C. Real Estate S.p.A.
Dixia S.r.l.	Real Estate	Milan	Euro	2,500,000	30.00%		Pirelli & C. Real Estate S.p.A.
Dolcetto 8 S.r.l.	Real Estate	Milan	Euro	10,000	50.00%		Pirelli & C. Real Estate S.p.A.
Domogest S.r.l.	Real Estate	Florence	Euro	1,050,000	50.00%		Centrale Immobiliare S.p.A.
Elle Dieci Società Consortile a.r.l.	Real Estate	Milan	Euro	100,000	40.00%		Pirelli & C. Real Estate Property Management S.p.A.
Elle Nove Società Consortile a.r.l.	Real Estate	Milan	Euro	100,000	34.90%		Edilnord Gestioni S.p.A.
Elle Tre Società Consortile a.r.l.	Real Estate	Milan	Euro	100,000	40.00%		Pirelli & C. Real Estate Property Management S.p.A.
Erice S.r.l.	Real Estate	Milan	Euro	10,000	40.00%		Pirelli & C. Real Estate S.p.A.
Eurostazioni S.p.A.	Holding	Rome	Euro	160,000,000	32.71%		Pirelli & C. S.p.A.
Fattoria Medicea S.r.l.	Real Estate	Prato (Florence)	Euro	100,000	40.00%		Pirelli & C. Real Estate S.p.A.
G6 Advisor	Real Estate	Milan	Euro	50,000	42.30%		Pirelli & C. Real Estate Agency S.p.A.
Galatea S.r.l.	Real Estate	Milan	Euro	10,000	30.00%		Pirelli & C. Real Estate S.p.A.
Gestioni Immobiliari 2003 S.r.l.	Real Estate	Milan	Euro	20,000	50.00%		Pirelli & C. Real Estate S.p.A.
Golfo Aranci S.p.A. - Società di Trasformazione Urbana	Real Estate	Milan	Euro	1,000,000	43.80%		Pirelli & C. Real Estate S.p.A.
					1.20%		Pirelli & C. Real Estate Facility Management S.p.A.
					5.00%		Centrale Immobiliare S.p.A.
Idea Granda Società Consortile r.l.	Enviroment	Cuneo	Euro	1,292,500	49.00%		Pirelli & C. Ambiente Renewable Energy S.p.A. (ex- Pirelli & C. Ambiente S.p.A.)
Immobiliare Prizia S.r.l.	Real Estate	Milan	Euro	469,000	36.00%		Pirelli & C. Real Estate S.p.A.
Induxia S.r.l.	Real Estate	Milan	Euro	836,300	18.00%		Pirelli & C. Real Estate S.p.A.
Iniziative Immobiliari S.r.l.	Real Estate	Gavirate (Va)	Euro	5,000,000	49.46%		Pirelli & C. Real Estate S.p.A.
Le Case di Capalbio S.r.l.	Real Estate	Milan	Euro	10,000	20.00%		Pirelli & C. Real Estate S.p.A.
Localto ReoCo S.r.l.	Real Estate	Milan	Euro	10,000	35.00%		Pirelli & C. Real Estate S.p.A.
Malaspina Energy S.c.a.r.l.	Real Estate	Milan	Euro	100,000	50.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Maro S.r.l. (ex- M.S.M.C. Immobiare 3 S.r.l.)	Real Estate	Milan	Euro	20,000	25.00%		Pirelli & C. Real Estate S.p.A.

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Masaccio S.r.l.	Real Estate	Milan	Euro	100,000	40.00%		Pirelli & C. Real Estate S.p.A.
MP Facility S.p.A.	Real Estate	Milan	Euro	1,000,000	50.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Olimpia S.p.A.	Holding Company	Milan	Euro	4,630,233,510	80.00%		Pirelli & C. S.p.A.
Orione Immobiliare Prima S.p.A.	Real Estate	Milan	Euro	104,000	40.10%		Pirelli & C. Real Estate S.p.A.
Perseo S.r.l.	Services	Milan	Euro	20,000	50.00%		Pirelli & C. S.p.A.
Progetto Bicocca la Piazza S.r.l.	Real Estate	Milan	Euro	3,151,800	26.00%		Pirelli & C. Real Estate S.p.A.
Progetto Corsico S.r.l.	Real Estate	Milan	Euro	100,000	49.00%		Pirelli & C. Real Estate S.p.A.
Progetto Fontana S.r.l.	Real Estate	Milan	Euro	10,000	23.00%		Pirelli & C. Real Estate S.p.A.
Progetto Gioberti S.r.l.	Real Estate	Milan	Euro	100,000	50.00%		Pirelli & C. Real Estate S.p.A.
Progetto Lainate S.r.l.	Real Estate	Milan	Euro	25,500	25.00%		Pirelli & C. Real Estate S.p.A.
Progetto Nuovo Sant'Anna S.r.l.	Real Estate	Milan	Euro	3,000,000	49.50%		Consorzio Stabile Pirelli RE Servizi
Quadrifoglio Milano S.p.A.	Real Estate	Rome	Euro	11,230,000	50.00%		Pirelli & C. Real Estate S.p.A.
Resi S.r.l. (ex- Dolcetto 5 S.r.l.)	Real Estate	Milan	Euro	10,000	25.00%		Pirelli & C. Real Estate S.p.A.
Rinascente/Upim S.r.l.	Real Estate	Rozzano (Milan)	Euro	10,000	20.00%		Pirelli & C. Real Estate S.p.A.
Riva dei Ronchi S.r.l.	Real Estate	Carrara	Euro	100,000	35.00%		Pirelli & C. Real Estate S.p.A.
Roca S.r.l. (ex-M.S.M.C. Immobiare 6 S.r.l.)	Real Estate	Milan	Euro	20,000	25.00%		Pirelli & C. Real Estate S.p.A.
S.AN.CO S.c.a.r.l.	Real Estate	Milan	Euro	10,000	37.50%		Pirelli & C. Real Estate Facility Management S.p.A.
Serenergy S.r.l.	Enviroment	Milan	Euro	25,500	50.00%		Pirelli & C. Ambiente Renewable Energy S.p.A. (ex- Pirelli & C. Ambiente S.p.A.)
Solaris S.r.l.	Real Estate	Milan	Euro	20,000	40.00%		Pirelli & C. Real Estate S.p.A.
Tamerice Immobiliare S.r.l.	Real Estate	Milan	Euro	500,000	20.00%		Pirelli & C. Real Estate S.p.A.
Telepost S.p.A.	Real Estate	Milan	Euro	120,000	20.00%		Pirelli & C. Real Estate Facility Management S.p.A.
Trixia S.r.l.	Real Estate	Milan	Euro	1,209,700	36.00%		Pirelli & C. Real Estate S.p.A.
Turismo e Immobiliare S.p.A.	Real Estate	Milan	Euro	120,000	25.00%		Pirelli & C. Real Estate S.p.A.
Verdi S.r.l. (in liquidation)	Real Estate	Milan	Euro	20,000	43.74%		Pirelli & C. Real Estate S.p.A.
Vesta Finance S.r.l.	Real Estate	Conegliano (TV)	Euro	10,000	35.00%		Pirelli & C. Real Estate S.p.A.
Waterfront Flegreo S.p.A.	Real Estate	Milan	Euro	500,000	35.00%		Pirelli & C. Real Estate S.p.A.
Luxembourg							
Afrodite S.à r.l.	Real Estate	Luxembourg	Euro	4,129,475	40.00%		Pirelli & C. Real Estate S.p.A.
Alimede Luxembourg S.à.r.l.	Real Estate	Luxembourg	Euro	12,500	36.25%		Pirelli & C. Real Estate S.p.A.
Alnitak S.à r.l.	Real Estate	Luxembourg	Euro	4,452,500	35.00%		Pirelli & C. Real Estate S.p.A.
Artemide S.à r.l.	Real Estate	Luxembourg	Euro	2,857,050	35.00%		Pirelli & C. Real Estate S.p.A.
Austin S.à.r.l.	Real Estate	Luxembourg	Euro	125,000	28.46%		Pirelli & C. Real Estate S.p.A.
Colombo S.à r.l.	Real Estate	Luxembourg	Euro	960,150	35.00%		Pirelli & C. Real Estate S.p.A.
Dallas S.à.r.l.	Real Estate	Luxembourg	Euro	125,000	28.46%		Pirelli & C. Real Estate S.p.A.
Doria S.à r.l.	Real Estate	Luxembourg	Euro	992,850	35.00%		Pirelli & C. Real Estate S.p.A.
European NPL S.A.	Real Estate	Luxembourg	Euro	1,851,126	33.00%		Pirelli & C. Real Estate S.p.A.
IN Holdings I S.à r.l.	Real Estate	Luxembourg	Euro	4,595,725	20.50%		Pirelli & C. Real Estate S.p.A.
Inimm Due S.à r.l.	Real Estate	Luxembourg	Euro	240,950	25.00%		Pirelli & C. Real Estate S.p.A.
Nashville S.à.r.l.	Real Estate	Luxembourg	Euro	125,000	28.46%		Pirelli & C. Real Estate S.p.A.
Sicily Investments S.à.r.l. (ex- Marsala S.à.r.l.)	Real Estate	Luxembourg	Euro	12,500	40.00%		Pirelli & C. Real Estate S.p.A.
Trinacria Capital S.à.r.l. (ex- Zibibbo S.à.r.l.)	Real Estate	Luxembourg	Euro	12,500	40.00%		Pirelli & C. Real Estate S.p.A.
Trinoro S.à r.l.	Real Estate	Luxembourg	Euro	30,000	35.00%		Pirelli & C. Real Estate S.p.A.
Vespucci S.à r.l.	Real Estate	Luxembourg	Euro	960,150	35.00%		Pirelli & C. Real Estate S.p.A.
Portugal							
Espelha - Serviços de Consultadoria Lda	Real Estate	Madeira	Euro	5,000	49.00%		Pirelli & C. Real Estate S.p.A.

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Spain							
Signus Ecovalor S.L.	Tyre	Madrid	Euro	200,000	20.00%		Pireli Neumaticos S.A.
The Netherlands							
Alceo B.V.	Real Estate	Amsterdam	Euro	18,000	33.00%		Pirelli & C. Real Estate S.p.A.
M.S.M.C. Italy Holding B.V.	Real Estate	Amsterdam	Euro	20,000	25.00%		Pirelli & C. Real Estate S.p.A.
Masseto 1 B.V.	Real Estate	Amsterdam	Euro	19,000	33.00%		Pirelli & C. Real Estate S.p.A.
Max B.V.	Real Estate	Amsterdam	Euro	18,000	45.00%		Pirelli & C. Real Estate S.p.A.
Polish Investments Real Estate Holding B.V.	Real Estate	Amsterdam	Euro	20,000	40.00%		Pirelli & C. Real Estate S.p.A.
Popoy Holding B.V.	Financial	Amsterdam	Euro	26,550	25.05%		Pirelli & C. Real Estate S.p.A.
Spazio Industriale B.V.	Real Estate	Amsterdam	Euro	763,077	25.00%		Pirelli & C. Real Estate S.p.A.
North America							
U.S.A.							
Sci Roev Texas Partners L.P.	Real Estate	Dallas	US $	12,000,000	10.00%		Pirelli & C. Real Estate S.p.A.
Central/South America							
Argentina							
Lineas de Transmision de Buenos Aires S.A. (in liquidation)	Services	Buenos Aires	Arg. Peso	12,000	20.00%		Pirelli Argentina de Mandatos S.A.

Other investments considered significant as per Consob resolution 11971 of May 14, 1999

Company	Business	Headquarters	Share Capital		Percentage ownership	Perc. of voting rights	Held by
Belgium							
Euroqube S.A.	Services	Brussels	Euro	84,861,116	17.79%		Pirelli & C. S.p.A.
France							
Aliapur S.A.	Tyre	Lyons	Euro	262,500	14.29%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
Hungary							
HUREC Tyre Recycling Non-Profit Company	Tyre	Budapest	Hun. Forint	50,000,000	17.00%		Pirelli Hungary Tyre Trading and Services Ltd
Italy							
Fin. Priv. S.r.l.	Financial	Milan	Euro	20,000	14.29%		Pirelli & C. S.p.A.
Servizio Titoli S.p.A.	Services	Turin	Euro	126,000	12.38%		Pirelli & C. S.p.A.
Tecnocittà S.r.l. (in liquidation)	Real Estate	Milan	Euro	547,612	12.00%		Pirelli & C. Real Estate S.p.A.
Poland							
Centrum Utylizacji Opon Otganizacja Odzyseu S.A.	Tyre	Warsaw	Pol. Zloty	1,008,000	14.28%		Pirelli Polska Sp. ZO.O.
The Netherlands							
MB Venture Capital Fund I Participating Company G N.V.	Financial	Amsterdam	Euro	50,000	14.00%		Pirelli Finance (Luxembourg) S.A.
Spazio Investment N.V. (ex- Spazio Industriale Investments I B.V.)	Financial	Amsterdam	Euro	6,096,020	11.48%		Pirelli RE Netherlands B.V.
Tunisia							
Société Tunisienne des Industries de Pnéumatiques S.A.	Tyre	Tunis	Tun. Dinar	42,078,240	15.83%		Pirelli Tyre S.p.A (ex- Pirelli Pneumatici S.p.A.)
United Kingdom							
Tlcom I Ltd Partnership	Financial	London	Euro	1,204	10.39%		Pirelli Finance (Luxembourg) S.A.

Independent Auditors' report

PricewaterhouseCoopers SpA

INDEPENDENT AUDITORS' REPORT IN ACCORDANCE WITH ARTICLE 156 OF LAW DECREE N° 58 DATED 24 FEBRUARY 1998

To the Shareholders of
Pirelli & C. SpA

1 We have audited the consolidated financial statements of Pirelli & C. SpA and its subsidiaries ("Pirelli & C. Group"), which comprise the balance sheet, income statement, statement of recognised income and expense, cash flow statement and the related notes as of and for the year ended 31 December 2006. These consolidated financial statements are the responsibility of Pirelli & C. SpA management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

2 We conducted our audit in accordance with the auditing standards and criteria recommended by CONSOB. Those standards and criteria require that we plan and perform the audit to obtain the reasonable assurance about whether the financial statements are free of material misstatement and, taken as a whole, are presented fairly. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management. We believe that our audit provides a reasonable basis for our opinion.

For the opinion on the consolidated financial statements of the prior period, which are presented for comparative purposes, reference is made to our report dated 4 April 2006.

3 In our opinion, the consolidated financial statements of Pirelli & C. Group comply with International Financial Reporting Standards as adopted by the European Union and with Italian regulation implementing the provisions of article 9 of Law Decree n. 38/2005; accordingly, they give a true and fair view of the financial position as of 31 December 2006, and of the results of operations, income and expenses recognised in equity and cash flows of Pirelli & C. Group for the year then ended.

Sede legale e amministrativa: Milano 20149 Via Monte Rosa 91 Tel. 0277851 Fax 027785240 Cap. Soc. 3.754.400,00 Euro i.v., C.F. e P. IVA e Reg. Imp. Milano 12979880155 Iscritta al n. 43 dell'Albo Consob – Altri Uffici: **Bari** 70125 Viale della Repubblica 110 Tel. 0805429863 – **Bologna** 40122 Via delle Lame 111 Tel. 051526611 – **Brescia** 25124 Via Cefalonia 70 Tel. 0302219811 – **Firenze** 50129 Viale Milton 65 Tel. 0554627100 – **Genova** 16121 Piazza Dante 7 Tel. 01029041 – **Napoli** 80121 Piazza dei Martiri 30 Tel. 0817644441 – **Padova** 35137 Largo Europa 16 Tel. 0498762677 – **Palermo** 90141 Via Marchese Ugo 60 Tel. 091349737 – **Parma** 43100 Viale Tanara 20/A Tel. 0521242848 – **Roma** 00154 Largo Fochetti 29 Tel. 06570251 – **Torino** 10129 Corso Montevecchio 37 Tel. 011556771 – **Trento** 38100 Via Manzoni 16 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** 37122 Corso Porta Nuova 125 Tel. 0458002561

PRICEWATERHOUSECOOPERS

4 On 1 April 2007 the Board of Directors of Pirelli & C. SpA acknowledged the receipt of two offers from two leading international telecom operators for the acquisition of the majority stake of Olimpia SpA. The two operators also expressed their availability to grant to Pirelli & C. SpA a put option on the remaining investment in Olimpia and on the Telecom Italia shares directly held by Pirelli & C. Group. The Board of Directors favourably assessed the two offers giving mandate to the Chairman to proceed with the negotiations. The financial implications of the two offers, although not final, are not materially different from the estimates made by Pirelli & C. Group in the preparation of the consolidated financial statements as of and for the year ended 31 December 2006.

Milan, 5 April 2007

PricewaterhouseCoopers SpA

Signed by

Paolo Caccini
(Partner)

(This report has been translated from the original which was issued in accordance with Italian legislation. References in this report to the Financial Statements refer to the Financial Statements in original Italian and not to their translation)

(2)

Extraordinary session

This report was prepared by the Directors in accordance with art. 72, paragraph one of Consob Regulation n. 11971 dated May 14, 1999 and subsequent amendments.

Amendment to articles 5 (Share capital), 6 (Shares), 7 (Shareholders meetings), 8 (constitutive and voting *quorum*), 9 (shareholders meetings proceeding), 10 (Company administration), 11 (duties of the Board of Directors), 12 (Board of Directors meetings), 13 (Company legal representation), 15 (dissolution of the Board of Directors) and 16 (Board of Statutory Auditors) of the Company By-laws.

Dear Shareholders,

We have convened this extraordinary general meeting to submit to you the proposal to resolve upon some amendments to the Company By-laws mainly relating to the need to conform them – by June 30, 2007 – to the provision of law n. 262 of December 28, 2005 (so-called savings protection law), and modified by legislative decree n. 303 of December 29, 2006, (so-called the corrective decree) that requires an adjustment, by June 30, 2007, of the By-Laws.

We have taken this opportunity to make further updatings and - as deemed a by the Board of Directors - improvements to the text, with the goal of making the By-laws clearer, more systematic and complete.

Furthermore are hereby proposed amendments which consider the recommendations and suggestions contained in the new edition of the self-regulatory code for listed companies of March 2006 (the "New Self-Regulatory Code").

Moreover please take note that in drawing up such proposals, it was not possible to take into account Consob regulations issued in accordance with the savings protection law, as they were not available when this meeting was convened.

In this respect, following the regulations issued by Consob, the Board of Directors reserves the right to proceed with all necessary adjustments within the time-frame and modalities deemed more appropriatein the times and modesaccording to appropriate time frames and means that are appropriate.

The following paragraphs illustrate in detail the above mentioned amendments in respect to each article of the By-laws.

Article 5 (Share capital)
The proposed amendments will (i) update the amount of the share capital and its structure at the date of this report, and (ii) delete the fourth paragraph relating to share capital increase resolution pertaining to the exercising of warrants on ordinary Pirelli & C. shares for 2003-2006, since June 30, 2006 was the expiry term for share capital increases.

Article 6 (Shares)
Besides making clear the fact that the savings shareholders' organisation is regulated by law and these By-laws, the amendment aims at formally regulating what has until now been the general practice adopted by the Company, by formalising in these By-laws that all costs pertaining to the organisation of the savings shareholders meetings as well as the fee due to the representative of such category of shares, shall be borne by the Company.

Articles 7, 8 and 9 (Shareholders Meetings)
The proposed amendments concern changes deriving from new Law implementation (new paragraph five, article 7) as well as changes aimed at completing the internal regulatory framework (the introduction of a new last paragraph in article 7 and amendments to articles 8 and 9).
The first amendment, implementing the provisions of Law regarding savings protection, regulates the possibility for shareholders to request additional items to the shareholders meetings agenda.
Similarly to current legislative provisions for proposals made by the Board of Directors – though within shorter time periods (10 days instead of 15 days) – this amendment provides that the requests for additional items to the agenda made by shareholders be detailed in a report, to be made available, for completeness of information purposes, to the other shareholders before the shareholders meeting convened to discuss the agenda,
The second amendment to article 7, made to align the by-laws with the legislation in force, regulates the procedures for the convocation of savings shareholders meetings.
Article 8 proposed amendment in order to avoid interpretation doubts regarding the application of the Rules of Proceeding, specifies that such Rules apply only to ordinary shareholders meetings.
Eventually, in consistance with the other above mentioned amendments aimed at regulating in detail some aspects relating to the organisation of the savings shareholders category, article 9 specifies the procedures regarding the appointment of the Chairman of the shareholders meetings for such category.

Articles 10, 11, 12, 13 and 15 (Board of Directors)
Besides all amendments that are merely formal (such as those relating to articles 13 and 15) or that simplify operational procedures, we have proposed amendments to the regulations for the Board of Directors aimed at aligning the By-laws with the new regulatory framework.

- Article 10. The terms for the presentation of the slates for the position of director have been made more strict (i.e. at least 15 days before the date set for the first call of the shareholders meeting, instead of at least 10 days before). The alignment with the term recommended by the New Self-Regulatory Code if, on one hand, it involves fewer days for the shareholders to collect the documents necessary for the presentation of the slates, on the other it allows the market and other shareholders to obtain the information relating to the candidates for the directorship more quickly. Similarly, further proposals for modifications to article 10 regard aspects relating to the publication of the slates and the characteristics of the documents to be presented along with the candidatures proposed in the slates themselves.
  Lastly, regarding the necessary treshold for the presentation of the slates by shareholders for the appintment of the directors, which is currently set at two percent of ordinary share capital, we plan to change it, if currently lower, so that it is equal to the level set by Consob regulations.
- Article 11. We propose the following three main modifications: (i) availing ourselves of the possibilities provided by law, we propose to extend the duties currently attributed to the Board of Directors for the merger of companies owned in 90% or more, also in the case of so-called simplified de-mergers; (ii) we propose a simplification of the obligatory notifications to the Board of Directors and the Board of Statutory Auditors by providing for the possibility that reports may be also given to them in written form and at meetings other than board or executive committee meetings; (iii) finally we provide – in alignment with provisions introduced through the savings protection law – that the Board of Directors appoint, subject to approval of the Board of Statutory Auditors, a manager responsible for the preparation of company accounting documents who must be an expert in administration, financial and auditing affairs, and who possesses the same requirements of good standing set for directors. Moreover we provide that this position has the same expiry term of the Board of Directors that appointed him/her (thus keeping account of the relationship of trust between them), and that the loss of the requirements for such position constitutes forfeiture.
- Article 12. The proposed modification aligns the text of the by-laws with the new provisions in article 151 of legislative decree n. 58/1998 (Italian Financial Services Act), giving each Statutory Auditor the faculty of convening meetings of the Board of Directors.

Article 16 (Board of Statutory Auditors)
Regarding the changes of the regulations for the Board of Statutory Auditors, while awaiting the issue of Consob regulations, we propose to align the procedures for the appointment of members of this Board with those adopted for the Board of Directors.
In order to conform the clause relating to the appointment of the Board of Statutory Auditors to the provisions introduced in the Italian Financial Services Act on savings protection, we propose moreover to eliminate the provision of statutory limits in respect to the total number of offices held (a subject that is also specifically regulated by Consob), modifying the regulations relating to the appointment system for the Chairman of the Board in order to provide – in the case of more than one slate – that the name be taken from the so-called minority slate (also in case of their possible replacement).
Together with the deposit of the curriculum vitae of each candidate, it is also required a list of all the offices held in management and supervisory bodies (to be updated up to the day of the shareholders meeting in order to ensure that the provision in art. 2400 of the Italian Civil Code is respected), as well as a declaration that the candidate possesses all of the requirements for the position, without prejudice to any additional documentation required by current legislation and regulations. Lastly, we propose to define in the By-laws the regulations that shall be applied if only one slate is presented for the appointment of the Chairman of the Board of Statutory Auditors.

* * *

If you agree to the above, we invite you to approve the following

Proposal

"The extraordinary Pirelli & C. S.p.A. shareholders meeting
- in consideration of law n. 262 of December 28, 2005, (deemed the "savings protection law "), and modified by legislative decree n. 303 of December 29, 2006;
- having examined the Report of the Directors detailing the proposals for modifications to articles 5 (share capital), 6 (shares), 7 (shareholders meetings), 8 (constitutive and voting quorum), 9 (procedures for shareholders meetings), 10 (Company administration), 11 (functions of the Board of Directors), 12 (Board of Directors meetings), 13 (Company legal representation), 15 (dissolution of the Board of Directors) and 16 (Board of Statutory Auditors) of these By-laws;

RESOLVES

a) to modify articles 5, 6, 7, 8, 9, 10, 11, 12, 13, 15 and 16 of the by-laws of Pirelli & C. S.p.A. in the text below with highlights showing the amendments introduced:

EXISTING TEXT	PROPOSED TEXT
NAME – PURPOSE – REGISTERED OFFICE – TERM	**NAME – PURPOSE – REGISTERED OFFICE – TERM**
Article 1 A joint-stock company has been incorporated under the name *Pirelli & C. Società per Azioni* or, in abbreviated form, *Pirelli & C. S.p.A.*.	**Article 1** A joint-stock company has been incorporated under the name *Pirelli & C. Società per Azioni* or, in abbreviated form, *Pirelli & C. S.p.A.*.
Article 2 The Company's purpose shall be: a) the acquisition of equity interests in other companies or corporations, both in Italy and abroad; b) the financing and the technical and financial coordination of the companies or corporations in which it holds interests; c) the sale and purchase, ownership, management and/or placement of both government and private securities. The company may carry out all operations of any type whatsoever - excluding any activities reserved by law - connected to its corporate purpose.	**Article 2** The Company's purpose shall be: a) the acquisition of equity interests in other companies or corporations, both in Italy and abroad; b) the financing and the technical and financial coordination of the companies or corporations in which it holds interests; c) the sale and purchase, ownership, management and/or placement of both government and private securities. The company may carry out all operations of any type whatsoever – excluding any activities reserved by law – connected to its corporate purpose.
Article 3 The registered office of the Company shall be in Milan.	**Article 3** The registered office of the Company shall be in Milan.
Article 4 The duration of the company shall be until December 31, 2100. The extension of the term of duration does not award the right of withdrawal to shareholders who do not take part in the approval of the relating resolution.	**Article 4** The duration of the company shall be until December 31, 2100. The extension of the term of duration does not award the right of withdrawal to shareholders who do not take part in the approval of the relating resolution.
SHARE CAPITAL	**SHARE CAPITAL**
Article 5 The Company shall have a subscribed and paid-in share capital of Euros 2,764,029,317.92 (two billion, seven hundred and sixty-four million, twenty-nine thousand, three hundred and seventeen point nine two) divided into no. 5,315,440,996 (five billion, three hundred and fifteen million, four hundred and forty thousand, nine hundred and ninety-six) shares with a par value of Euros 0.52 (fifty-two cents) each, consisting of n. 5,180,676,567 (five billion, one hundred and eighty million, six hundred and seventy-six thousand, five hundred and sixty-seven) ordinary shares and n. 134,764,429 (one hundred and thirty-four million, seven hundred and sixty-four thousand, four hundred and	**Article 5** The Company shall have a subscribed and paid-in share capital of EUR **2,791,311,344.64 (twobillionssevenhundredandninetyonemillionsthreehundredandeleventhousands-threehundred-andfourtyfourpointsixtyfour)** divided into no. **5,367,906,432 (fivebillions-threehundredsixtysevenmillionsninehundred andsixthousandsfour-hundredandthirtytwo)** shares with a par value of EUR 0.52 (fiftytwo cents) each, consisting of **5,233,142,003 (fivebillionstwohundredandthirtythreemilliosonehundredandfourtytwothousandsand-three)** ordinary shares and 134,764,429 (onehundredandthirtyfourmillionssevenhundreda ndsixtyfourthousandsfourhundredandtwenty-

twenty-nine) savings shares.
In resolutions to increase the share capital by issuing shares against payment, pre-emption rights may be excluded for up to a maximum of ten percent of the previously existing capital, provided that the issue price corresponds to the market value of the shares and that this is confirmed in a specific report prepared by the firm appointed to audit the accounts.
If so resolved by the shareholders meeting, the share capital may also be increased by means of contributions in kind or of receivables.
The extraordinary shareholders meeting held on May 7, 2003 resolved to increase the share capital against payment, in divisible form, by and no later than June 30, 2006, in a maximum nominal amount of Euros 203,041,192.12 (at November 11, 2005 Euros 27,600,805.96), by issuing, even in more than one batch, up to a maximum of 390,463,831 (at November 11, 2005 no. 53,078,473) ordinary shares against payment, with a par value of Euros 0.52 (fifty-two cents) each and regular dividend rights, to be reserved exclusively and irrevocably for the exercise of 1,561,855,326 warrants (at November 11, 2005 no. 212,313,894) issued in implementation of the resolution adopted by the same shareholders meeting on May 7, 2003.
By resolution of the extraordinary shareholders meeting held on May 7, 2003, the directors were authorised to issue, on one or more occasions before April 30, 2008, up to a maximum of 100,000,000 (one hundred million) ordinary shares, to be allocated to executive managers and cadres employed by the Company, by its subsidiaries and by the subsidiaries of the latter, in Italy and abroad, in compliance with article 2441, paragraph 8, of the Italian Civil Code and article 134 of Legislative Decree no. 58/1998. On February 25, 2005 the Board of Directors resolved, in partial implementation of the authorisation granted to it by the extraordinary shareholders meeting held on May 7, 2003, to increase the share capital by a maximum nominal amount of Euros 28,197,442 by issuing up to 54,225,850 ordinary shares with a par value of Euros 0.52 each, at a price of Euros 1.15 per share, inclusive of a Euros 0.63 share premium, to be reserved for subscription by executive managers and cadres employed by the Company, by its subsidiaries and by the latter's subsidiaries, in Italy and abroad.
By resolution of the extraordinary shareholders meeting held on May 11, 2004, the directors were authorised to increase the share capital against

nine) savings shares.
In resolutions to increase the share capital by issuing shares against payment, pre-emption rights may be excluded for up to a maximum of ten percent of the previously existing capital, provided that the issue price corresponds to the market value of the shares and that this is confirmed in a specific report prepared by the firm appointed to audit the accounts.
If so resolved by the shareholders' meeting, the share capital may also be increased by means of contributions in kind or of receivables.

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By resolution of the extraordinary shareholders meeting held on May 11, 2004, the directors were authorised to increase the share capital against

payment, on one or more occasions and within May 10, 2009, by a total maximum nominal amount of Euros 600 million, with or without a share premium, by issuing up to a maximum of 1,153,846,153 ordinary shares against payment, to be offered on option to shareholders and convertible bondholders, with the possibility of excluding pre-emption rights, in compliance with the combined provisions of article 2441, last paragraph, of the Italian Civil Code and article 134, paragraph 2, of Legislative Decree no. 58/1998, if the shares are offered for subscription by the employees of Pirelli & C. S.p.A. and/or its subsidiaries.
By resolution of the extraordinary shareholders meeting held on May 11, 2004, the directors were authorised to issue, on one or more occasions within May 10, 2009, bonds that are convertible into ordinary and/or savings shares, or that carry warrants valid for the subscription of said shares, to be offered on option to shareholders and convertible bondholders, corresponding to a total maximum nominal amount of Euros 1,000 million within the limits permitted each time under the laws in force, with the ensuing eventual increase of the share capital to back the conversion of the bonds and/or exercise of the warrants.
The resolutions passed by the Board of Directors to increase the share capital during the exercise of the rights allocated as described above shall set the share subscription price (inclusive of any share premium) as well as the specific term for the subscription of the shares: they may also provide that, if the capital increase resolved is not fully subscribed by the date set for this purpose, the capital shall be increased by an amount corresponding to the subscriptions received up to such date.

Article 6

The shares are divided into ordinary shares and savings shares.
Ordinary shares award the right to one vote per share; they may be either registered or bearer shares insofar as the law permits, and in this case may be converted from one type to the other, especially at the shareholder's request and expense.
Savings shares do not carry voting rights and, unless the law provides otherwise, are bearer shares.
They may be converted into registered shares on request and expense of the shareholder.

payment, on one or more occasions and within May 10, 2009, by a total maximum nominal amount of Euros 600 million, with or without a share premium, by issuing up to a maximum of 1,153,846,153 ordinary shares against payment, to be offered on option to shareholders and convertible bondholders, with the possibility of excluding pre-emption rights, in compliance with the combined provisions of article 2441, last paragraph, of the Italian Civil Code and article 134, paragraph 2, of Legislative Decree no. 58/1998, if the shares are offered for subscription by the employees of Pirelli & C. S.p.A. and/or its subsidiaries.
By resolution of the extraordinary shareholders meeting held on May 11, 2004, the directors were authorised to issue, on one or more occasions within May 10, 2009, bonds that are convertible into ordinary and/or savings shares, or that carry warrants valid for the subscription of said shares, to be offered on option to shareholders and convertible bondholders, corresponding to a total maximum nominal amount of Euros 1,000 million within the limits permitted each time under the laws in force, with the ensuing eventual increase of the share capital to back the conversion of the bonds and/or exercise of the warrants.
The resolutions passed by the Board of Directors to increase the share capital during the exercise of the rights allocated as described above shall set the share subscription price (inclusive of any share premium) as well as the specific term for the subscription of the shares: they may also provide that, if the capital increase resolved is not fully subscribed by the date set for this purpose, the capital shall be increased by an amount corresponding to the subscriptions received up to such date.

Article 6

The shares are divided into ordinary shares and savings shares.
Ordinary shares award the right to one vote per share; they may be either registered or bearer shares insofar as the law permits, and in this case may be converted from one type to the other, especially at the shareholder's request and expense.
Savings shares do not carry voting rights and, unless the law provides otherwise, are bearer shares.
They may be converted into registered shares on request and expense of the shareholder.

As well as any rights and privileges provided for by law and in other parts of these By-laws, savings shares shall have priority in the repayment of the capital up to their entire par value; in the event of a reduction of the share capital due to losses, the par value of saving shares will be reduced only by the amount of the loss that exceeds the total par value of the other shares.
Savings shares shall retain the rights and privileges contemplated by law and by these By-laws also in the event that the Company's ordinary and/or savings shares are de-listed.
In the event of a share capital increase being carried out by issuing shares of only one class, such shares must be offered on option to the holders of all classes of shares.
In the event of both ordinary and savings shares being issued:
a) the holders of ordinary shares shall be entitled to receive an option on ordinary shares, and on savings shares to make up any difference;
b) the holders of savings shares shall be entitled to receive an option on savings shares, and on ordinary shares to make up any difference.
Any introduction or removal of restrictions on the circulation of shares does not award the right of withdrawal to shareholders who do not take part in the approval of the related resolution.

SHAREHOLDERS MEETINGS

Article 7
The calling of shareholders meetings, which may be held anywhere in Italy, including in a place other than the Company's registered office, the right to attend meetings and representation at the same are all regulated by law and by these By-laws.
The notice of the call of an extraordinary shareholders meeting may provide for it being held on third call.
Shareholders for which the Company has received the documentation pursuant to art. 2370, paragraph 2, of the Italian Civil Code, at least two days prior to the date set for each meeting shall be entitled to attend shareholders meetings.
The ordinary shareholders meeting must be

As well as any rights and privileges provided for by law and in other parts of these By-laws, savings shares shall have priority in the repayment of the capital up to their entire par value; in the event of a reduction of the share capital due to losses, the par value of saving shares will be reduced only by the amount of the loss that exceeds the total par value of the other shares.
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a) the holders of ordinary shares shall be entitled to receive an option on ordinary shares, and on savings shares to make up any difference;
b) the holders of savings shares shall be entitled to receive an option on savings shares, and on ordinary shares to make up any difference.
Any introduction or removal of restrictions on the circulation of shares does not award the right of withdrawal to shareholders who do not take part in the approval of the related resolution.
The savings shareholders' organisation is governed by law and by these By-laws. The expenses related to the organisation of the special savings shareholders meetings and the remuneration of the common representatives of savings shareholders shall be borned by the Company.

SHAREHOLDERS MEETINGS

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The notice of the call of an extraordinary shareholders meeting may provide for it being held on third call.
Shareholders for which the Company has received the documentation pursuant to art. 2370, paragraph 2, of the Italian Civil Code, at least two days prior to the date set for each meeting shall be entitled to attend shareholders meetings.
The ordinary shareholders meeting must be

called within 120 days or, where special circumstances make this necessary, within 180 days of the end of the Company's financial year; if the meeting is called within 180 days, the directors shall give the reasons for the delay in the directors' report included in the year-end financial statements.	called within 120 days or, where special circumstances make this necessary, within 180 days of the end of the Company's financial year; if the meeting is called within 180 days, the directors shall give the reasons for the delay in the directors' report included in the year-end financial statements. **Requests to add items to the agenda of the general meetings presented by shareholders in accordance with the law must be detailed by a report to be filed in the Company's registered office in time to be made available to the other shareholders and at least 10 days prior to the date set for the meeting on first call.** **Special meetings of savings shareholders shall be convened by the common representative of savings shareholders or by the Board of Directors of the Company whenever they deem necessary or in accordance with law.**
Article 8 The due constitution of shareholders meetings and the validity of the resolutions adopted by the same are governed by law. The proceedings of shareholders meetings, besides being regulated by law and by these By-laws, are also governed by the Rules of Proceeding approved by resolution of the Company's ordinary shareholders meeting.	**Article 8** The due constitution of shareholders meetings and the validity of the resolutions adopted by the same are governed by law. The proceedings of shareholders meetings **are governed** by law, by **these** By-laws, and – **solely for the ordinary and extraordinary general meetings** – by the Rules of Proceeding approved by resolution of the Company's ordinary shareholders meeting.
Article 9 The Shareholders meetings shall be chaired over by the Chairman of the Board of Directors, by a Deputy Chairman or by a Managing Director, in that order; whenever there are two or more Deputy Chairmen or Managing Directors, the meetings will be chaired by the elder of them. In the absence of all of the aforementioned individuals, the meeting shall be chaired by another person elected with the favourable vote of the majority of the capital represented at the meeting.	**Article 9** **Ordinary and extraordinary** shareholders meetings shall be chaired over by the Chairman of the Board of Directors, by a Deputy Chairman or by a Managing Director, in that order; whenever there are two or more Deputy Chairmen or Managing Directors, the meetings will be chaired by the elder of them. In the absence of all of the aforementioned individuals, the meeting shall be chaired by another person elected with the favourable vote of the majority of the capital represented at the meeting. **The special meeting for savings shareholders shall be chaired by the common representative for savings shareholders or, in his absence, by the person appointed with the favourable vote of the majority of the capital represented at the meeting.**
The Chairman shall be assisted by a Secretary who is to be appointed with the favourable vote	The Chairman shall be assisted by a Secretary who is to be appointed with the favourable vote

of the majority of the capital represented at the meeting and need not be a shareholder; there is no need to appoint a Secretary when a notary public is designated to draw up the minutes of the meeting.
The Chairman of the shareholders meeting shall chair over the meeting and govern its proceedings in compliance with the law and these By-laws. To this end, the Chairman shall, amongst other things: verify that the meeting is duly constituted; ascertain the identity of those present and their right to attend, including by proxy; ascertain the legal quorum for passing resolutions; direct the business, including by establishing a different order for the discussion of the items listed on the agenda in the notice convening the meeting. The Chairman shall also take appropriate measures to ensure the orderly conduct of discussions and votes and shall establish the procedures and ascertain the results thereof.
The resolutions of shareholders meetings shall be recorded in the minutes that must be signed by the Chairman of the meeting and by the Secretary or the notary public.
The minutes of extraordinary shareholders meetings must be drawn up by a notary public appointed by the Chairman of the meeting.
Any copies of and extracts from minutes that have not been drawn up by a notary public shall be certified as true copies by the Chairman of the Board of Directors.

ADMINISTRATION OF THE COMPANY

Article 10

The Company shall be managed by a Board of Directors composed of no less than seven and no more than twenty three members who shall remain in office for three financial years (unless the shareholders meeting establishes a shorter term at the time of their appointment) and may be re-elected. The shareholders meeting shall establish the number of members of the Board of Directors, which shall remain unchanged until said meeting resolves otherwise.
The Board of Directors shall be appointed on the basis of slates presented by the shareholders pursuant to the following paragraphs hereof, in which the candidates are listed by consecutive number.
The slates presented by the shareholders, which must be undersigned by the parties submitting them, shall be filed at the Company's registered office, and be available to anyone on request, at

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The Board of Directors shall be appointed on the basis of slates presented by the shareholders pursuant to the following paragraphs hereof, in which the candidates are listed by consecutive number.
The slates presented by the shareholders, which must be undersigned by the parties submitting them, shall be filed at the Company's registered office, and be available to anyone on request, at

least ten days before the date set for the shareholders meeting to be held on first call.
Each shareholder may present or take part in the presentation of only one slate and each candidate may appear on only one slate on pain of ineligibility.
Only shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 2 percent of the share capital entitled to vote at the ordinary shareholders meeting are entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates at least two days prior to the date set for the shareholders meeting to be held on first call.

Together with each slate, and within the respective terms specified above, statements must be filed in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet any requisites prescribed for the positions. Together with such statements, a *curriculum vitae* must be filed for each candidate, setting out their relevant personal and professional data and specifying, where appropriate, the grounds on which they qualify as an independent candidate.

Any slates submitted without complying with the foregoing provisions shall be disregarded.
Each person entitled to vote may vote for only one slate.
The Board of Directors shall be elected as specified below:

a) four-fifths of the directors to be elected shall be chosen from the slate which obtains the highest number of votes cast by the shareholders, in the order in which they are listed on the slate; in the event of a fractional number, it shall be rounded-down to the nearest whole number;
b) the remaining directors shall be chosen from the other slates; to this end, the votes obtained by the various slates shall be divided first by one, then by two, then by three, then

least fifteen days before the date set for the shareholders meeting to be held on first call.
Each shareholder may present or take part in the presentation of only one slate and each candidate may appear on only one slate on pain of ineligibility.
Only shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 2 percent of the share capital entitled to vote at the ordinary shareholders meeting **or the minor percentage, according to the regulations issued by Commissione Nazionale per le società e la borsa,** are entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates at least two days prior to the date set for the shareholders' meeting to be held on first call.
Together with each slate, and within the respective terms specified above, statements must be filed in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet any requisites prescribed for the positions. Together with such statements, a curriculum vitae must be filed for each candidate, setting out their relevant personal and professional data and **mentioning the offices held in management and supervisory bodies** of other companies and specifying, where appropriate, the grounds on which they qualify as an independent candidate **in accordance with the criteria established by law and the Company. Any changes that occur up to the date the Shareholders' meeting must be promptly notified to the Company.**
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b) the remaining directors shall be chosen from the other slates; to this end, the votes obtained by the various slates shall be divided by **whole progressive numbers from one**

by four – and so on – according to the number of directors to be elected. The quotients thus obtained shall be assigned to the candidates on each slate in the order they are respectively listed thereon. On the basis of the quotients assigned, the candidates on the various slates shall be ranked in a single list in decreasing order. Those who have obtained the highest quotients shall be elected.
If more than one candidate obtains the same quotient, the candidate from the slate that has not yet elected a director or that has elected the lowest number of directors shall be elected.
If none of such slates has as yet elected a director or they have all elected the same number of directors, the candidate from the slate which obtained the highest number of votes shall be elected. If the different slates obtain the same number of votes and their candidates are assigned the same quotients, a new vote shall be held by the entire shareholders meeting and the candidate who obtains the simple majority of the votes shall be elected.

When appointing directors who, for whatsoever reason, were not appointed under the procedure established herein, the shareholders meeting shall vote on the basis of the majorities required by law.
If one or more vacancies occur on the Board of directors during the course of the financial year, the procedure established in article 2386 of the Italian Civil Code shall be followed.
The Board of Directors shall elect its own Chairman, if the shareholders meeting has not already done so, and may also appoint one or more Deputy Chairmen.
In the absence of the Chairman, a Deputy Chairman or a Managing Director, in that order, shall act in his/her stead; should there be two or more Deputy Chairmen or Managing Directors, the Board shall be presided over by the elder of them.
The Board shall appoint a Secretary, who need not be a director.
Until the shareholders meeting resolves otherwise, the directors shall not be subject to the prohibition contemplated in article 2390 of the Italian Civil Code.

Article 11

The Board of Directors shall conduct the management of the company and is accordingly

up to the number of directors to be elected. The quotients thus obtained shall be assigned to the candidates on each slate in the order they are respectively listed thereon. On the basis of the quotients assigned, the candidates on the various slates shall be ranked in a single list in decreasing order. Those who have obtained the highest quotients shall be elected.
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In the absence of the Chairman, a Deputy Chairman or a Managing Director, in that order, shall act in his/her stead; should there be two or more Deputy Chairmen or Managing Directors, the Board shall be presided over by the elder of them.
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Until the shareholders meeting resolves otherwise, the directors shall not be subject to the prohibition contemplated in article 2390 of the Italian Civil Code.

Article 11

The Board of Directors shall conduct the management of the company and is accordingly

vested with the broadest powers of administration, except for those remitted by law or by these By-laws to the authority of the shareholders meeting.
Within the limits established by law, the Board of Directors shall be authorised to decide on the merger of companies in which Pirelli & C. S.p.A. owns at least 90 percent of the shares or quotas, the reduction of the share capital in the event of the withdrawal of shareholders, the revision of the By-laws to conform with statutory provisions, the relocation of the registered office within Italy, and the opening and closing of branch offices

The Board of Directors and the Board of Statutory Auditors shall be kept informed, also by corporate bodies with delegated powers, on the activities carried out, the general performance of operations and their foreseeable development, and the transactions of greatest economic, financial and equity-related significance concluded by the Company or its subsidiaries; in particular, said corporate bodies with delegated powers shall report on transactions in which they have an interest, directly or on behalf of third parties, or that are influenced by the party that performs management and coordination activities, if any. Such reports shall be made promptly, on a quarterly basis at the least, on the occasion of the meetings of the Board of Directors and the Executive Committee - if established - or in a written memorandum.
In accordance with the established times and procedures for disclosing information to the market, the representative of the holders of savings shares must be informed by the Board of Directors or by the persons delegated for such purpose about any corporate events that might affect the price of the shares in that class.
In the context of the management of the Company, the Board of Directors shall be authorised to delegate those powers which it deems appropriate to one or more of its members, possibly with the title of Managing Director, and grant them the single or joint signature powers it decides appropriate to establish.
It may also delegate its powers to an Executive Committee composed of some of its own members, whose remuneration shall be established by the shareholders meeting.
It may also establish one or more committees

vested with the broadest powers of administration, except for those remitted by law or by these By-laws to the authority of the shareholders meeting.
Within the limits established by law, the Board of Directors shall be authorised to decide on the merger of companies in **Pirelli & C. S.p.A. or de-merger in favour of Pirelli & C. S.p.A.** of companies in which Pirelli & C. S.p.A. owns at least 90 percent of the shares or quotas, the reduction of the share capital in the event of the withdrawal of shareholders, the revision of the By-laws to conform with statutory provisions, the relocation of the Company's registered office within Italy, and the opening and closing of branch offices.
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with consulting and propositional functions, also for purposes of adjusting the corporate governance structure in line with the recommendations issued from time to time by the pertinent authorities.	with consulting and propositional functions, also for purposes of adjusting the corporate governance structure in line with the recommendations issued from time to time by the pertinent authorities.
	The Board of Directors shall appoint - with the consent of the Board of Statutory Auditors - the manager responsible for preparing the Company's financial reports. His office shall expire at the same time as that of the Board of Directors that appointed him/her, unless annulment for good cause, with the consent of the Board of Statutory Auditors.
	The manager responsible for preparing the Company's financial reports must be an expert on administration, finances and auditing of companies and satisfy the integrity qualifications required to be a directors. Failing of such qualifications shall determine the termination of the office to be resolved by the Board of Directors within thirty days since the acknowledgement of the defect.
Lastly, the Board of Directors may appoint general managers, deputy general managers, managers and deputy managers and attorneys-in-fact to carry out certain operations or categories of operations, establishing their powers and functions. The appointment of managers, deputy managers and attorneys-in-fact to carry out certain operations or categories of operations may also be remitted by the Board to the Managing Directors and the General Managers.	Lastly, the Board of Directors may appoint general managers, deputy general managers, managers and deputy managers and attorneys-in-fact to carry out certain operations or categories of operations, establishing their powers and functions. The appointment of managers, deputy managers and attorneys-in-fact to carry out certain operations or categories of operations may also be remitted by the Board of Directors to the Managing Directors and the General Managers.
Article 12	**Article 12**
The Board of Directors shall meet, at the invitation of the Chairman or whoever acts in his/her stead, at the Company's registered office or at any other venue stated in the letter of convocation, whenever he/she deems it appropriate in the best interests of the Company or receives a written request to do so from one of the Managing Directors or one-fifth of the directors in office or at least two standing members of the Board of Statutory Auditors.	The Board of Directors shall meet, at the invitation of the Chairman or whoever acts in his/her stead, at the Company's registered office or at any other venue stated in the letter of convocation, whenever he/she deems it appropriate in the best interests of the Company or receives a written request to do so from one of the Managing Directors or one-fifth of the Directors in office.
	The meeting of the Board of Directors can also be convened by the Board of Statutory Auditors, or by a single Statutory auditor, subject to prior notice given to the Chairman of the Board of Directors.
The Chairman shall give advance notice of the matters to be discussed at Board meetings and arrange for adequate information on the	The Chairman shall give advance notice of the matters to be discussed at Board meetings and arrange for adequate information on the

questions to be examined to be provided to all the directors, taking account of the circumstances of each case.
Board meetings shall be called by letter, telegram, fax or e-mail, to be sent to each director and standing member of the Board of Statutory Auditors at least five days prior (or in urgent cases, with at least six hours' notice) to the date scheduled for the meeting.
Even when a Board meeting is not formally called, resolutions of the Board of Directors shall nevertheless be valid if adopted in the presence of all the Board members in office and all the standing members of the Board of Statutory Auditors.
Board meetings - and meetings of the Executive Committee, if established - may, if the Chairman or whoever acts in his/her stead verifies the necessity, be attended by means of telecommunications systems that permit all attendees to participate in the discussion and obtain information on an equal basis.
Meetings of the Board of Directors, and of the Executive Committee, if established, shall be considered held at the place in which the Chairman and the Secretary must be simultaneously located.
Resolutions of the Board shall only be valid if adopted in the presence of the majority of Board members and by majority vote. In the event of a tied vote, the Chairman shall hold the casting vote.
Resolutions of the Board of Directors, including those adopted at meetings held via telecommunications, must be recorded in a specific minutes book and signed by the Chairman and the Secretary of the meeting. Any copies of and extracts from minutes that have not been drawn up by a notary public shall be certified as true copies by the Chairman.

Article 13

The legal representation of the Company vis-à-vis third parties and in court proceedings shall pertain separately to the Chairman of the Board of Directors and, within the limits of the powers granted to them by the Board of Directors, to the Deputy Chairmen and the Managing Directors, if appointed.
Each of the aforementioned shall in any event be vested with all powers to bring legal actions and file petitions before any judicial authority and at all levels of jurisdiction, including in appeal and Supreme Court proceedings, to file statements

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and charges in criminal cases, to sue on behalf of the Company in criminal proceedings, to bring legal proceedings and file petitions before all administrative jurisdictions, to intervene and protect the Company's interests in any proceedings and claims concerning the Company and to grant the mandates and powers of attorney *ad litem* required for such purpose.
The Board of Directors and, within the limits of the powers granted to them by said Board, the Chairman of the Board of Directors and, if appointed, the Deputy Chairmen and the Managing Directors, shall be authorised to grant the power to represent the Company vis-à-vis third parties and in court proceedings to managers and staff in general and, when necessary, to third parties.

Article 14
In addition to the reimbursement of all expenses sustained by reason of their office, members of the Board of Directors shall be entitled to an annual emolument established by the shareholders meeting.
The remuneration of directors vested with special office shall be established by the Board of Directors after obtaining the opinion of the Board of Statutory Auditors.

Article 15
If, due to resignations or for any other reason, more than half of the seats on the Board become vacant, the entire Board of Directors shall be deemed to have resigned and cease to hold office with effect as of the time of its reconstitution.

BOARD OF STATUTORY AUDITORS

Article 16
The Board of Statutory Auditors shall be composed of three standing and two alternate auditors, who must be in possession of the requisites established under applicable laws and regulations; to this end, it shall be borne in mind that the fields and sectors of business closely connected with those of the Company are those stated in the Company's purpose, with particular reference to companies or corporations operating in the financial, industrial, banking, insurance and real estate sectors and in the services field in general.
The ordinary shareholders meeting shall elect the Board of Statutory Auditors and determine

and charges in criminal cases, to sue on behalf of the Company in criminal proceedings, to bring legal proceedings and file petitions before all administrative jurisdictions, to intervene and protect the Company's interests in any proceedings and claims concerning the Company and to grant the mandates and powers of attorney *ad litem* required for such purpose.
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The ordinary shareholders meeting shall elect the Board of Statutory Auditors and determine

its remuneration. The minority shareholders shall be entitled to appoint one standing auditor and one alternate auditor. With the exception of the provisions of the third-to-last paragraph of this article 16, the Board of Statutory Auditors shall be appointed on the basis of slates presented by the shareholders in which candidates are listed by consecutive number. Each slate shall contain a number of candidates which does not exceed the number of members to be appointed. Shareholders who, alone or together with other shareholders, represent at least 2 percent of the shares with voting rights in the ordinary shareholders meeting, shall be entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates at least two days prior to the date set for the shareholders meeting to be held on first call. Each shareholder may present or take part in the presentation of only one slate.	its remuneration. The minority shareholders shall be entitled to appoint one standing auditor and one alternate auditor. With the exception of the provisions of the third-to-last paragraph of this article 16, the Board of Statutory Auditors shall be appointed on the basis of slates presented by the shareholders in which candidates are listed by consecutive number. Each slate shall contain a number of candidates which does not exceed the number of members to be appointed. Shareholders who, alone or together with other shareholders, represent at least 2 percent of the shares with voting rights in the ordinary shareholders' meeting **or the minor percentage, according to the regulations issued by Commissione Nazionale per le società e la borsa,** shall be entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates at least two days prior to the date set for the shareholders' meeting to be held on first call. Each shareholder may present or take part in the presentation of only one slate.
The slates of candidates, which must be undersigned by the parties submitting them, shall be filed in the Company's registered office and be available to anyone on request, at least ten days prior to the date set for the shareholders meeting to be held on first call. A professional curriculum of the individuals standing for election must be enclosed with the slates together with statements in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet the requisites prescribed by law or by these By-laws for the position.	The slates of candidates, which must be undersigned by the parties submitting them, shall be filed in the Company's registered office and be available to anyone on request, at least **fifteen** days prior to the date set for the shareholders' meeting to be held on first call. A **personal and professional** curriculum, mentioning **also the offices held in management and supervisory bodies of other companies,** of the individuals standing for election must be enclosed with the slates together with statements in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet the requisites prescribed by law, by these By-laws and **by regulation** for the position. **Any changes that occur up to the date the Shareholders' meeting must be promptly notified to the Company.**
Any slates submitted without complying with the foregoing provisions shall be disregarded. Each candidate may appear on only one slate, on pain of ineligibility. Furthermore, those individuals who are not in possession of the requisites established by the applicable rules and regulations, or who already hold the position of standing auditor in more	Any slates submitted without complying with the foregoing provisions shall be disregarded. Each candidate may appear on only one slate, on pain of ineligibility.

than five companies whose securities are listed on regulated Italian markets, with the exception of the subsidiaries of Pirelli & C., cannot be elected to the Board of Statutory Auditors.

The slates shall be divided into two sections: one for candidates for the position of standing auditor and one for candidates for the position of alternate auditor. The first candidate listed in each section must be selected from among the persons enrolled in the Register of Auditors who have worked on statutory audits for a period of no less than three years.

Each person entitled to vote may vote for only one slate.

The Board of Statutory Auditors shall be elected as specified below:

a) two standing members and one alternate member shall be chosen from the slate which obtains the highest number of votes (known as the majority slate), in the consecutive order in which they are listed thereon;

b) the remaining standing member and the other alternate member shall be chosen from the slate which obtains the highest number of votes cast by the shareholders after the first slate (known as the minority slate), in the consecutive order in which they are listed thereon; if several slates obtain the same number of votes, a new vote between said slates will be cast by all the shareholders attending the meeting, and the candidates on the slate which obtains the simple majority of the votes will be elected.

The chair of the Board of Statutory Auditors shall be given to the standing member listed as the first candidate on the slate which obtains the highest number of votes.

The position of a standing auditor which falls vacant due to his/her death, forfeiture or resignation shall be filled by the alternate auditor chosen from the same slate as the former. In the event of the replacement of the Chairman of the Board of Statutory Auditors, the chair shall be given to the other standing member chosen from the same slate as the former Chairman; if it proves impossible to effect substitutions and replacements under the foregoing procedures, a shareholders meeting shall be called to complete the Board of Statutory Auditors which shall adopt resolutions by relative majority vote.

When the shareholders meeting is required, pursuant to the provisions of the foregoing paragraph or to the law, to appoint the standing

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The chair of the Board of Statutory Auditors shall pertain to the standing member listed as the first candidate on the slate **mentioned in point b) of the paragraph above.**

The position of a standing auditor which falls vacant due to his/her death, forfeiture or resignation shall be filled by the alternate auditor chosen from the same slate as the former. In the event of the replacement of the Chairman of the Board of Statutory Auditors, the chair shall pertain **to the candidate listed in the same slate of the former Chairman, following the order contained in the list;** if it proves impossible to effect substitutions and replacements under the foregoing procedures, a shareholders' meeting shall be called to complete the Board of Statutory Auditors which shall adopt resolutions by relative majority vote.

When the shareholders meeting is required, pursuant to the provisions of the foregoing paragraph or to the law, to appoint the standing and/or alternate members needed to complete the Board of Statutory Auditors, it shall proceed as follows: if auditors elected from the majority slate have to be replaced, the appointment shall be made by relative majority vote without slate constraints; if, however, auditors elected from the minority slate have to be replaced, the shareholders meeting shall replace them by relative majority vote, selecting them where possible from amongst the candidates listed on the slate on which the auditor to be replaced appeared.

When appointing auditors who, for whatsoever reason, were not appointed under the procedures established herein, the shareholders meeting shall vote on the basis of the majorities required by law.
Outgoing members of the Board of Statutory Auditors may be re-elected to office.
Meetings of the Board of Statutory Auditors may, if the Chairman or whoever acts in his/her stead verifies the necessity, be attended by means of telecommunications systems that permit all attendees to participate in the discussion and obtain information on an equal basis.

FINANCIAL STATEMENTS - ALLOCATION OF PROFITS

Article 17
The company's financial year shall close on December 31 of each year.

Article 18
Following the mandatory allocations to statutory reserves, the Company's net year-end profits shall be distributed as follows:
a) savings shares shall be awarded a dividend corresponding to a maximum of seven percent of their par value; if a dividend of less than seven percent of par value is awarded to savings shares in a given financial year, the difference shall be computed as an increase to be added to the preference dividend over the subsequent two financial years; any profits remaining following the award of the aforementioned dividend to

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In case only one slate has been presented, the shareholders's meeting shall vote on it; if the slate obtains the relative majority, the candidates listed in the respective section shall be appointed to the office of standing auditors and alternate auditors; the candidate listed at the first place in the slate shall be appointed as Chairman of the Board of Statutory Auditors.
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savings shares shall be distributed amongst all the shares in such a way that savings shares shall receive an aggregate dividend which is higher, compared to the dividend awarded to ordinary shares, by an amount corresponding to two percent of their par value;
b) without prejudice to the foregoing provisions regarding the aggregate higher dividends awarded to savings shares, ordinary shares shall be awarded a dividend corresponding to a maximum of five percent of their par value.
The remaining profits shall be distributed amongst all the shares, in addition to the allocations contemplated in the foregoing points a) and b), unless the shareholders meeting, on the proposal of the Board of Directors, resolves to make special allocations to extraordinary reserves or for other uses, or decides to carry some of such profits forward to the next year.
Should reserves be distributed, savings shares shall be awarded the same rights as other shares.
Interim dividends may be distributed in compliance with the law.

GENERAL PROVISIONS

Article 19
Insofar as their relations with the Company are concerned, the domicile of the shareholders is understood, for all legal purposes, to be that reported in the Shareholders' Register.

Article 20
All matters not specifically regulated in these By-laws shall be governed by the applicable provisions of the law.

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b) To grant to the Board of Directors – and therefore to the Chairman and Deputy Chairman severally – all the powers necessary to fill the resolution taken in the Company's Register, accepting and introducing all the amendments which might be necessary or required by law.

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SUSTAINABILITY

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Terms marked with the symbol * are explained in the glossary

1. PIRELLI AND SUSTAINABLE DEVELOPMENT

"A well-run multinational corporation does not just export investments, production, technologies and expertise. It also exports progressive personnel policies, state-of- the-art environmental protection systems and standards of behaviour that are at least on a par with those adopted in the other regions of the world in which it operates.

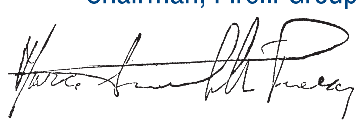
By its very nature, the multinational corporation exports respect for the different cultures with which it has to operate and interact, drawing new life-force from them in terms of ideas and how situations are addressed.

It exports social responsibility.

It does not, therefore, just grow available wealth, it also contributes to raising the ethical level of the economic environment."

Marco Tronchetti Provera

Chairman, Pirelli Group



A note on methodology

This, the second edition of the Pirelli Group Sustainability* Report, is intended to be a full and complete expression of the Pirelli corporate culture. It does this by reporting the group's economic choices together with its environmental and social choices, in line with the 'triple bottom line' approach. For this reason, the details of our sustainable performance are included in the Annual Report, instead of being published separately. This is a clear sign of the importance that sustainable development holds for Pirelli, and at the same time it encourages us to operate to the satisfaction of all stakeholders*. It is, in short, a move towards growth that is both sound and long-lasting.

The report has been drawn up according to the Sustainability Reporting Guidelines* issued by the Global Reporting Initiative (GRI*). Analysis of sustainable performance is based on a set of Key Performance Indicators *(KPI), developed in conformance with GRI indicators (updated to the G3 standard) and according to the principles of the Global Compact, and also taking account of data periodically monitored by the major rating agencies.

The sections on economic and social relations have also drawn on the 'Principles of Sustainability Report Accounting' issued by the Sustainability Report Study Group of the Italian Ministry of Labour and Social Policy.

In this section we have concentrated on what we believe will be of most interest to the reader, bearing in mind the wide variety of stakeholders. We have shown Pirelli's corporate social responsibility in its essence, without undue enphasis on the goals that have been achieved, while transparently illustrating critical issues that have emerged, and highlighting and explaining the progress in 2006 of what was reported in 2005.

1.1. IDENTIFICATION OF STAKEHOLDERS AND APPROACH ADOPTED

The term 'stakeholder' means 'holder of legitimate interests' in the company, i.e. parties (individuals or groups) who have an interest in the company's decisions, influence its success and/or are influenced by the organisation's activities.

Pirelli Group encompasses several different business areas, each of which is responsible for sustainability as it affects that business area. Consequently, relations with stakeholders are to a certain degree heterogeneous, which may be regarded as a beneficial diversity in Pirelli's ways of listening to and involving stakeholders.

Pirelli Group adopts a multi-stakeholder approach, which means that it pursues lasting and sustainable growth based as far as possible on the equable reconciliation of the interests and expectations of all who interact with the company, in particular:

» Environment

» Shareholders

» Human Resources

» Customers

» Suppliers

» Institutions

» External Community

There are many and varied initiatives, activities, tools for dialogue and projects of specific interest to the categories of stakeholders listed above. These are explained in detail in chapters 2, 3 and 4 of this report, to which the reader is referred for further information.

1.2. GOVERNANCE OF CORPORATE SOCIAL RESPONSIBILITY*

As regards corporate identity and Group organization, please see Preliminary Information and Directors' Report that precede this section.

For Pirelli, governance of CSR means integrating sustainability with the various different aspects and precincts of company management. Among other things, this translates to the mapping, control and sustainable management of all risks associated with the company's activities.

Clear evidence of this approach is found in the Group's advanced Principles of Corporate Governance and in its Sustainability Documents, which together support Pirelli's Vision and Mission on the subject of sustainable development*.

The sustainability model adopted by the Group is in its turn based on the principles of the United Nations Global Compact, to which Pirelli has formally adhered since 2004.

Operational management of CSR benefits from an effective organisational structure that extends throughout the company and which was set up in order to better govern the Group's sustainability. To this must be added the recently-issued operative procedure for Corporate Social Responsibility, which sets out and regulates the methods for internal management of activities associated with Corporate Social Responsibility, with particular attention to the roles and responsibilities of the departments involved. These regulations also govern the planning and control processes and the process of drawing up this Sustainability Report.

The following sections contain a more detailed discussion of the topics mentioned above.

CORPORATE GOVERNANCE

As part of its tradition of transparency and integrity, Pirelli actively participates in reciprocal relations with the financial community (and in particular with shareholders, both institutional and private), by organising periodical meetings in Italy and abroad and by ensuring that all stakeholders receive the same level of information, as specified by current legislation in force.

In recent years Pirelli Group has set up a Corporate Governance system in line with best practices in Italy and beyond.

Of particular note in this regard is the recent effort to nominate independent and minority representatives in the company's board of directors. As of 12 March 2007, independent directors represent over fifty per cent of the total (ten out of nineteen, four of which are nominated by the 'minorities').

In order to take full advantage of the role played by independent directors, the Group's Board of Directors starting from November 2005 decided to introduce the role of Lead Independent Director, who acts as a point of reference and coordination for all independent directors.

For more details and discussion please see the Corporate Governance Report. In addition, the homepage of the corporate website (www.pirelli.com) gives access to the webpage for the Group's Corporate Governance system.

VISION

Right from its origins, Pirelli has always been aware that its performance as a company could not be considered exclusively from an economic point of view, but that it would also have to account for its contribution to the quality of the environment and the social system, in view of the complex connections and interactions that exist between the economic, social and environmental dimensions.

Pirelli considers that the principal challenge that a company must confront in order to be sustainable and to remain in business over time is that of creating value. The company must reconcile the expectations of the various stakeholders, even where these are not in agreement with those of the company.

Based on this principle, Pirelli prefaces its 'Policy for Health, Safety, Environment and Social Responsibility' as follows:

"Pirelli supports and respects the protection of internationally-proclaimed human rights, is committed to implementing the ethical code approved by the Board and is engaged in continuous improvement of social, ethical, health and safety and environmental aspects. Pirelli considers the protection of the integrity, health and welfare of its employees and of the environment as one of the primary needs that is to be respected in organizing its activities. Pirelli abides the principle of 'Sustainable Development' and undertakes to put it into practice."

THE MISSION IN THE GROUP'S SUSTAINABILITY DOCUMENTS

THE VALUES AND ETHICAL CODE OF THE PIRELLI GROUP

In order to provide all the Group's affiliates with convincing and uniform guidelines on the professional practices to be followed by those working in the company, in July 2003 the Board of Directors of Pirelli & C. S.p.A. approved the 'The Values and Ethical Code of the Pirelli Group'.

The document has been translated into the languages spoken within the Group and issued to all Pirelli employees. The document is publicly available in the 'Sustainability' area of the Pirelli website (www.pirelli.com).

The Group's ethical code outlines the general principles (transparency, correctness and loyalty) that inspire the way it does business. It summarises the objectives and values of the company's activities with regard to the main stakeholders that Pirelli & C. S.p.A. regularly interacts with: shareholders, the financial market, associates, customers, and the community.

Observance of the ethical code is required by a specific clause inserted by Pirelli in its General Conditions for Purchase of Goods and Services. Please see the 'Suppliers' section for more details.

The nine articles of the ethical code are not given in the present paragraph, but are reported as opening statements to the relevant pargraphs.

PIRELLI POLICY ON HEALTH, SAFETY, ENVIRONMENT AND SOCIAL RESPONSIBILITY

Within an international context in which the economic, environmental and social expectations are ever more demanding, the policy adopted by Pirelli in June 2004 has further enhanced the correct balance between sustainability and industrial development. As well as introducing the principle of sustainable development, Pirelli's policy for Health, Safety, Environment and Social Responsibility brings together in a single document the previous policies on the environment (first drawn up in July 1995 and updated in September 2000) and on safety at work (September 1995).

Pirelli Group has always considered the protection of the integrity, health and welfare of its employees and of the environment as one of the primary needs that is to be respected in organizing its activities, by adhering to the principle of sustainable development and by striving to commit, among others, to the following principles:

» to manage its activities by adopting health, safety, environmental and social accountability Management Systems in compliance with international standards;

» to communicate and spread health, safety, environmental and social accountability information to internal and external stakeholders, actively co-operating with national and international academic and legislative bodies;

» to promote the use of the most advanced technologies in order to achieve the excellence in safety, workers' health and environment protection;

» to assess and reduce the environmental impact of its processes/products by adopting the LCA (Life Cycle Assessment) approach;

» to use material resources responsibly, with a view to achieving sustainable growth that respects the environment and the rights of future generations;

» to appraise the risks of work injury or occupational ill health in order to eliminate or reduce them, by complying with the legislation in the various different countries as a minimum requirement;

» not to engage in or support the use of child labour and forced labour;

» to ensure equal opportunity, freedom of association, and to promote the development of each individual;

» to establish and maintain appropriate procedures to evaluate and select suppliers and subcontractors based on their commitments to social and environmental accountability;

» to involve all levels of the organization and all Group employees by assuring that responsibilities and operating procedures are precisely defined, appropriately communicated and clearly understood.

Pirelli is committed to continuously improve its policy and programmes, as it is committed to implement procedures, rules and instructions serving to ensure that the values embodied in the policy are reflected in the conduct of each company and in the conduct of its employees and collaborators.

The HSE & CSR policy has been translated into the various different languages spoken within the Group and issued to all Pirelli employees, in the same way as for the ethical code.

Observance of the HSE & CSR policy is required by a specific clause inserted by Pirelli in its General Conditions for Purchase of Goods and Services. Please see the 'Suppliers' section for more details.

The text of the policy is publicly available in the 'Sustainability' area of the Pirelli website (www.pirelli.com).

PIRELLI GROUP EQUAL OPPORTUNITIES STATEMENT

Pirelli's commitment to equal opportunities in the workplace is clearly set out in its 'Equal Opportunities Statement', signed by the Group's Chairman.

This document is the fulcrum of the Group's equal opportunities programme. For more information on this programme, please see the 'Social Dimension' section.

The declaration:

- confirms Pirelli's strong commitment, as firm today as in has been in the past, to comply with the principles of equal opportunities in the workplace, without any form of discrimination on the basis of gender, marital status, sexual orientation, religious or political beliefs, union membership, colour, ethnic origins, nationality, age or disability;
- declares Pirelli's opposition to any and all forms of discrimination, direct and indirect, and/or harassment of individuals or groups by others;
- sanctions Pirelli's commitment to preventing discrimination in all areas of working life, including selection and all decisions related to remuneration, professional status, the assignment of responsibilities, training and career development, and specifies that all such decisions are made solely and exclusively on the basis of the competence, experience and professional potential that individuals possess and the results that they achieve.

The declaration also indicates the objectives that Pirelli has set itself:

- acknowledge and promote the importance of individual differences in all company processes;
- identify and eliminate any form of discrimination that may hinder equal access to employment opportunities;
- guarantee genuine equality of treatment of all company employees in every sector, role and level of seniority and in all positions of responsibility, thereby acknowledging the results and potential of all individuals;
- foster diversification in individual professional choices.

The declaration has been translated into the various different languages spoken within the Group and issued to all Pirelli employees at the end of 2006. The document is publicly available in the 'Sustainability' area of the Pirelli website (www.pirelli.com).

THE GROUP'S SUSTAINABILITY MODEL: THE UN GLOBAL COMPACT

The concept of the Global Compact was first proposed on 31 January 1999 in Davos by the then Secretary General of the UN, Kofi Annan, in an appeal to the World Economic Forum. The Secretary General invited the leaders of the world economy to adhere to the Global Compact, an international initiative to support specific, universal principles that would bring together companies, UN agencies, unions and civil society.

The Global Compact is a voluntary initiative intended to promote responsible company policies, and is based on a network centred around the Global Compact Office and several UN agencies.

More specifically, the Global Compact requires companies to implement and support ten basic principles in their spheres of influence. The principles cover human rights, working standards, the environment and the fight against corruption. They are universally shared, and are directly based on the Universal Declaration of Human Rights, the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention against Corruption.

In October 2004 in a letter to the then Secretary General of the UN, Kofi Annan, Pirelli Group formally declared its adherence to the Global Compact and its commitment to observe and support the ten principles.

In particular, this letter included the following passage:

"With this communication, we express our intent to support and advance those principles within our sphere of influence. We commit to making the Global Compact and its principles part of the strategy, culture and day-to-day operations of our company and undertake to make a clear statement of this commitment - both to our employees, partners, clients and to the public. We support public accountability and transparency and will report on progress made in a public manner."

Pirelli has always been attentive to the environment and human rights, and the Group's commitment in this regard has been formalised in recent years with the publication of 'The Values and Ethical Code of the Pirelli Group' in 2003 and the 'Pirelli Group Policy for Health, Safety, Environment and Social Responsibility' in 2004 (both of which are discussed above). The application of these policies completely fulfils the principles of the Global Compact.

Within the required deadline, Pirelli provided the Global Compact Office with evidence of the development and progress reached in its sustainable activities.

MANAGEMENT OF CORPORATE SOCIAL RESPONSIBILITY

ORGANISATIONAL STRUCTURE OF CORPORATE SOCIAL RESPONSIBILITY

Governance of Corporate Social Responsibility is centred around the Corporate Social Responsibility Steering Committee, a high-level organ that was formed at the beginning of 2004 by the Chairman to guide and supervise the advancement of CSR throughout the Group. The CSR organisational structure is made up of a Group HSE&CSR Director, a Group CSR Manager, Sector CSR Managers (one for each sector of the Group) and Company CSR Managers (one for each affiliated company in the Group).

In conformance with the above-cited principle "…*ensure equal opportunity… promote the development of each individual*" declared in the Policy for Health, Safety, Environment and Social Responsibility (see above) and to implement article 6 of the Group's ethical code, which says "*Working relationships are managed with a view to guaranteeing equal opportunities and pro-*

moting the personal development of each employee", in 2005 the Chairman nominated an Equal Opportunities Steering Committee*, a high-level organ to guide and supervise programmes for equal opportunities in the company. At the same time, in order to steer the implementation of the Equal Opportunities Programme (see above) within the Group, and also to achieve better organisational balance and to monitor the advancement of equal opportunities at all affiliated companies, an Equal Opportunities Manager was nominated for the Group as a whole. Finally there are Equal Opportunities Managers for each country, who are responsible for guiding and supervising the advancement of equal opportunities at a local level.

2006 OPERATIVE PROCEDURE ON CORPORATE SOCIAL RESPONSIBILITY

On 16 September 2006 the Operative Procedure on Corporate Social Responsibility was released and distributed throughout the Group.

Taking its cue from the shared Preface, which states "*Attention to all stakeholders (employees, customers, suppliers, shareholders, the environment, the community etc.) enables the company to manage and improve its impact on the environment and on society, and at the same time increasing the creation of value*", this document sets out and regulates the methods for internal management of activities associated with Corporate Social Responsibility, with particular attention to the roles and responsibilities of the departments involved. These regulations also govern the planning and control processes, the process of drawing up this Sustainability Report, and the processes of managing the dissemination of CSR information to the external community.

In particular, the Operative Procedure expressly specifies the full integration of CSR into the Group's financial reporting structure ("*The cycle of planning and control of CSR follows the Group's reporting and planning calendar*"), along with the approvals procedure for projects that have an impact on CSR, the process for planning objectives, and finally the methods of reporting CSR to the external community, to meet the increasing needs of the markets to assess a company's degree of sustainability at an international level.

NEW IT SYSTEM* FOR MANAGING CSR INFORMATION

The Group is developing a new IT system for managing CSR information. This system should be operational by the end of 2007.

The system is geared towards achieving further efficiencies in the process of contribution, validation, consolidation, analysis and management of information relating to CSR.

The new IT system will become an extremely valuable tool for everyone who deals with CSR within the Group. It will further improve the qualitative and quantitative monitoring of the progress of sustainability at all levels – local, Sector and Group.

1.3. MANAGEMENT SYSTEMS APPLIED AND REFERENCE STANDARDS

To implement the first principle of the Policy for Health, Safety, Environment and Social Responsibility, Pirelli devotes significant resources to management systems, availing of these tools to improve the quality, effectiveness and efficiency of its processes. This results in further reductions in the impacts on the health of its employees, on safety conditions in the workplace and on the environment.

These systems are fully described in their relevant paragraphs in the sections below.

In 2004 the international SA 8000* standard was adopted as the point of reference for assessing the consistency of the Group's conduct with the CSR principles defined in that standard.

1.4. SUSTAINABILITY INDEXES

Pirelli Group's commitment to CSR and the positive results achieved in thits area have won significant recognition by means of the company's inclusion in some of the most prestigious international stock exchange indices for sustainability.

DOW JONES SUSTAINABILITY INDEX

Pirelli was selected for the Dow Jones Sustainability STOXX (DJSI STOXX) index for the first time in 2002. Today it is included in both the Dow Jones Sustainability World index and the STOXX index.

Launched in 1999, the Dow Jones Sustainability Indices are the first global indices to track the financial performance of leading companies in terms of sustainability. The indices, which are based on the cooperative efforts of Dow Jones, STOXXLimited and SAM, provide reliable, objective information in terms of benchmarks for managers of sustainable fund portfolios.

FTSE INDEXES

Pirelli has been included in the FTSE Global and Europe indices since 2002.

FTSE is an independent company, held by the Financial Times and the London Stock Exchange.

The FTSE4Good Series indices were created by FTSE to measure the performance of companies in terms of their observance of internationally-recognised standards of social responsibility, and to facilitate investment in these companies.

FTSE4GOOD 2006 LOGO

ASPI INDEX

Pirelli has been included in the ASPI Eurozone® index since the beginning of 2005.

The family of ASPI Eurozone® indices (the acronym stands for Advanced Sustainable Performance Indices) includes the 120 best-performing companies in terms of sustainability (the reference world are the companies included in the DJ EURO STOXXSM index).

SIRI SUSTAINABILITY ASSESSMENT

Pirelli's assessment in 2006 was the second best in its industrial sector with a score that was approximately 30% higher than the sector average.

Sustainable Investment Research International Ltd is the biggest independent research and consulting body for socially-responsible investments worldwide for institutional investors and financial professionals. SIRI publishes detailed profiles of the 600 most important international groups.

AXIA INDEXES

Pirelli has been included in the Axia Ethical Index since 2004 (the year the index was created) and in the Axia CSR Index since 2005 (the year the index was created).

Pirelli is also included in the Axia Euro Ethical Index and the Axia Euro CSR Index.

Pirelli entered the Axia CSR indices with a rating of A++, one of the highest on the Axia scale. The Axia indices follow international best practices in corporate social responsibility, on a range of companies selected from those with the biggest capitalisations from the S&P MIB and Eurostoxx60. The Axia indices interact with the major international platforms for financial operators.

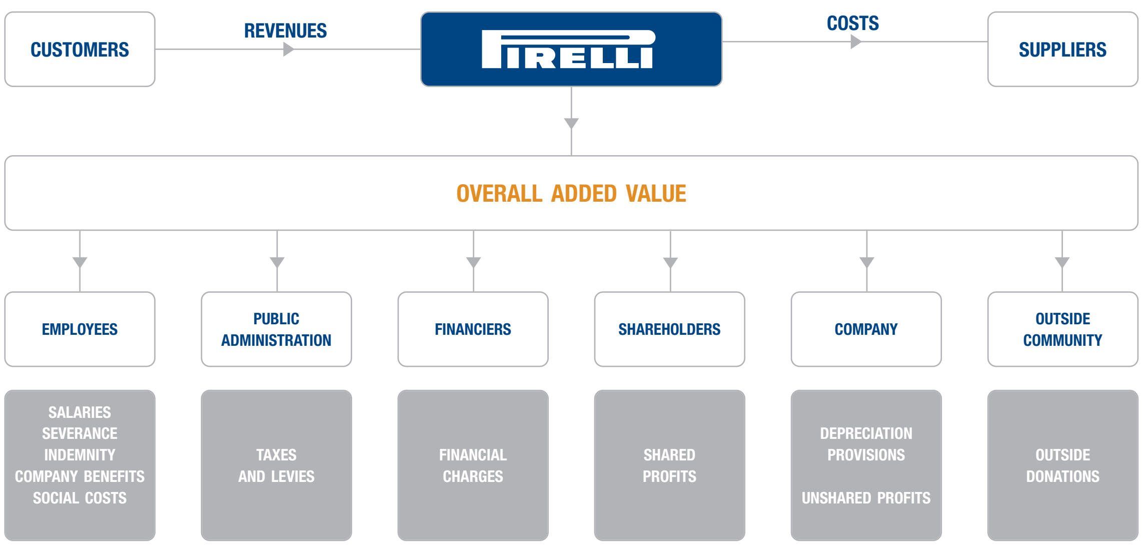
2. ECONOMIC DIMENSION

The companies in Pirelli Group are committed to contributing to the economic well-being and growth of the community in which they operate, by providing efficient and technologically advanced services. (article 5 of the Ethical Code - 'Community').

2.1. ADDED VALUE

Added value means the wealth created over a given period, calculated as the difference between the revenues generated and the external costs sustained in the period.

The distribution of added value between the stakeholders allows to express, in monetary terms, the existing relations between Pirelli and the major stakeholders, so shifting attention to the socio-economic system in which the Group operates (as shown in the diagram below).



The added value created by Pirelli & C. Group in 2006 was shared out as follows:

	Year 2006(1)		Year 2005	
	(thousands of euro)	%	(thousands di euro)	%
GROSS OVERALL ADDED VALUE	**1,996,516**		**1,836,320**	
A. Payments to personnel	(1,075,819)	53.9%	(1,029,880)	56.1%
B. Payments to Public Administration	(127,849)	6.4%	(128,484)	7.0%
C. Payments of credit capital	(126,976)	6.4%	(90,672)	4.9%
D. Payments of venture capital	(78,299)	3.9%	(149,492)	8.1%
E. Payments to the company	(579,535)	29.0%	(429,361)	23.4%
F. Ouside donations	(8,038)	0.4%	(8,431)	0.5%

[1] The gross overall added value for 2006 does not take into account non-recurring operations recorded in the period. In particular: the disposal to third parties of 38.9% of Pirelli Tyre SpA and the entire holding in Capitalia (631 million euro), and the costs sustained for the IPO (13 million euro) and the depreciation of the affiliate company Olimpia (2,110 million euro).

The table below shows the contributions and donations made by Gruppo Pirelli & C. in 2005 and 2006, subdivided by category:

AREA OF INTERVENTION	Year 2006 (thousands of euro)	Year 2005 (thousands of euro)
Education	1,246	799
Culture	5,188	5,533
Sport	244	450
Research	339	290
Solidarity	739	914
Other	282	445
TOTAL	**8,038**	**8,431**

It may readily be seen that the contributions and donations made in 2006 are mainly in line with the previous year.

Please see the 'Social dimension' section, subsection 'Corporate initiatives' for the external community', for a detailed description of the principal actions associated with these contributions and donations.

Finally, the companies in the Group "*do not contribute or confer advantages or other benefits upon political parties and trade union organizations or their representatives and candidates, without prejudice to compliance with the relevant prevailing legislation*" (from article 5, 'Community', of the Ethical Code).

2.2. Shareholders

"*Group companies are committed to ensuring equal treatment for all categories of shareholders, avoiding any preferential treatment. The reciprocal benefits that derive from belonging to a group of companies are pursued in accordance with the relevant legislation and the autonomous interests of each Group Company as it seeks to create value*" (article 3 of the Ethical Code - Shareholders).

Ordinary shares – the most common form of holding in the company's share capital – confer on their holders voting rights at ordinary and extraordinary shareholders' meetings. Among other functions, these meetings serve to approve the financial statements, nominate the members of the company organs and modify the articles of association.

Savings shares confer to their holders a series of rights listed in article 6 of the articles of association, in addition to a privileged position in the distribution of profits.

In this regard, article 18 of the articles of association of Pirelli & C. specifies the preferential withdrawal on annual earnings (known as the 'preferential dividend') as 7 per cent of the nominal share value of these shares (euro 0.52). In addition, the earnings that remain after assigning the preferential dividend are divided among all shares so that the savings shares receive a larger dividend than ordinary shares, by an amount of at least two per cent of the nominal share value.

Finally, it should be noted that if the company does not distribute profits (i.e. it distributes less than 7 per cent of the nominal value), savings shareholders have the right to recover the minimum dividend for this period in the following two periods.

Savings shareholders do not have voting rights or the right to ask questions at ordinary shareholders' meetings. However, they can attend the special savings shareholders' meeting to elect (or dismiss) their common representative and to deliberate resolutions on topics concerning their share category.

Among other things, the Common Representative of the savings shareholders has the right to attend (as an observer) the ordinary shareholders' meetings of the company, regardless of their nature or agenda, and to contest resolutions adopted by the meeting.

It is the company's constant and unwavering policy to take advantage of the shareholders' meetings to disseminate information about the company and its prospects to the shareholders. Obviously this activity is conducted in observance of regulations governing the confidentiality of information and hence where necessary this information is simultaneously released to the market. Great care is also taken in the choice of location, date and time of the meeting, in order to facilitate the attendance of shareholders. Finally, the company has adopted a series of "Regulations for Shareholders' Meetings". This document regulates ordinary and extraordinary shareholders' meetings, and it guarantees the right of each member to speak on topics under discussion.

Based on data in the shareholders' register, the body of ordinary shareholders is made up of a component of 'core' shareholders who hold approximately 52% of ordinary share capital. The remaining 48% of this capital (known as 'free float') is subdivided jointly between institutional investors (10% of which are foreign) and retail investors (numbering approximately 107,000).

The 'core' shareholders adhere to a shareholders' agreement, the "Pirelli & C. S.p.A. Block Share Syndicate". The objective of this agreement is to ensure a stable shareholder base and a uniform strategy in the management of the company. At the present time this agreement includes approximately 46.2% of the ordinary shares issued.

A top priority of Pirelli & C. S.p.A. is the establishment and maintenance of constant dialogue with its shareholders and with institutional investors. To this end, in the early 1990s the company set up an investor relations department, which was tasked with implementing an ongoing programme of communication and dissemination of information to the financial community and in particular to investors (institutional and retail), financial analysts and sales representatives.

Relations with the financial community are maintained through the organisation of meetings or conference calls (over 200 in 2006) to present the company's periodic economic & financial results and the related strategies for development.

One of the methods for disseminating information that deserves special mention is Pirelli's website. From the website's home page visitors can access the investor relations area, which contains all documents distributed at meetings with the financial community, documents containing published economic and financial information about the company, and all other documents relating to the company's corporate governance system.

A further indication of the importance that Pirelli accords the market is the fact that both the Group parent company, Pirelli & C. S.p.A., and its subsidiary, Pirelli & C. Real Estate S.p.A. (also listed on the electronic trading system organised and managed by the Italian stock exchange), have prepared an innovative information tool exclusively for retail investors: the Shareholders' Manual. This document is the end product of company experience based on international best practices, and it may be downloaded from the Pirelli website.

2.3. CUSTOMERS

TYPE OF GROUP CUSTOMERS

The types of customer served by Pirelli Group differ greatly from one business area to the next.

The tyre sector serves the following categories of customer:

- Original Equipment, which includes the leading international makers of cars, motorcycles, scooters, commercial vehicles (light, medium and heavy), buses and agricultural machinery.
- Replacements, a group which includes around fifteen distribution channels (for car, truck and motorcycle tyres), and whose importance differs from country to country.

In the real estate sector we have:

- Asset & Fund Management, whose customers consist of funds and property-owning companies in which Pirelli & C Real Estate generally has qualified minority shareholdings.
- Service companies, whose customers include, in addition to third parties, funds and property-owning companies and non-performing loans managed by the Asset Management departments of Pirelli & C Real Estate.
- The Franchising Network, made up of affiliate agencies distributed throughout Italy.

Customers of Pirelli Broadband Solutions can be divided into the following categories for the broadband access and photonics business areas:

Broadband Access (BBA) products:

- VARs (Value Added Resellers)
- System Integrators
- Telecom Operators

New-generation photonics products from the photonic business area:

- Operators/System Integrators (CWDM systems)
- Equipment Manufacturers (components and modules)

The companies under Pirelli Ambiente have the following categories of customer:

- Customers in the Renewable Energy sector, i.e. companies that convert urban solid waste to energy.
- Customers in the Site Remediation sector, i.e. companies – mainly in the Group and other closely-related companies – that assess, plan and manage the demolition and decontamination of buildings and/or lands.
- Customers of Pirelli Ambiente Eco Technology, i.e. companies that operate in public transport, goods transport, waste collection, the mining sector and in construction. Pirelli Ambiente Eco Technology also operates through partners that are licensees of its Gecam™ technology and which operate independently in Italy. In addition to receiving royalties on its licensees' sales, the company also (indirectly) performs the technical and marketing activities associated with the product.

DISTRIBUTION OF SALES BY GEOGRAPHIC AREA

	% on total number of customers	% on total sales value	
GEOGRAPHIC AREA	**Year 2006**	**Year 2006**	**Year 2005**
Italy	38%	27%	32%
Rest of Europe	38%	33%	36%
North America	2%	7%	7%
Central and South America	13%	21%	17%
Australia, Asia, Africa	9%	12%	8%

GROUP POLICIES

Customer orientation – a central element in the Values and Ethical Code of the Pirelli Group – presumes a constant and ongoing commitment from Pirelli in terms of:

- Comprehension of the market context in which the Group operates
- Consideration of the impact of the Group's actions and behaviour on the customer
- Exploiting every opportunity in doing business in order to satisfy the customer's needs

These principles are made explicit in articles 2 and 4 of the Pirelli Ethical Code. The relevant extracts are given below.

The companies of the Group:

- "*pursue market excellence and competitiveness, offering customers a quality of service that effectively meets their requirements;*" (from article 2, , of the Ethical Code - 'Aims and Values')
- "*the excellence of the Group's products and services is based on customer service and the readiness to meet customer needs. The aim is to offer immediate, thoroughgoing and competent responses, tailored to the needs of customers, and in keeping with the spirit of legality, courtesy and co-operation.*" (article 4 , of the Ethical Code - 'Customers')

The company's commitments to the customer described above are similarly made explicit in the General Conditions of Supply applied by the Group companies.

The great variety in the Group's categories of customer means that there is an equally wide variety of different methods for dialogue and interaction between the customers and the corresponding businesses. For the 2006 report, it was decided to present a case study of the relations between the tyre sector and its customers, describing the quality management systems adopted and the level of attention devoted to the customer's "safety".

FOCUS ON PIRELLI TYRE

METHODS OF DIALOGUE AND INTERACTION BETWEEN PIRELLI TYRE AND ITS CUSTOMERS

In addition to the daily contact with the sales organisation operating in the territories, customer relations are handled by the Sales and Marketing departments, mainly via the following channels and methods:

» *Contact Center**

» *B2B*

» Periodic Customer Satisfaction Surveys* periodically carried out to evaluate the satisfaction level using the following methods: :

1. Mystery Survey* (except for Brazil and the USA)
2. Computer Aided Telephone Interviews* with mother-tongue operators
3. Pirelli DB (universe)
4. Survey of satisfaction scores (on a scale of 1-5)

The table shows the results of the surveys for the last 2 years:

	Year 2005	Year 2006
Overall satisfaction level (range: 1 - 5)	3.88	3.94
Number of countries	11	13
Sample - weight on total business	69%	80%

ATTENTION TO QUALITY: CERTIFICATIONS AND RECOGNITION

The attention given to quality by Pirelli Tyre, both as producer and as supplier, is demonstrated by the certifications it has obtained, which conform to international standards and deal with aspects of both the processes and the products and services offered to customers.

In particular:

ISO 9001

Pirelli Group has had a quality management system since 1970 and since then has gradually introduced it in all its plants. From 1993 onwards the Group obtained certification of its quality system under the ISO 9001 standard. Currently 100% of the factories are certified to the most recent edition of this standard.

ISO/TS 16949

To meet the requirements of the car makers, from 1999 onwards Pirelli Group obtained certification for its quality management system under the ISO/TS 16949 standard, and has since maintained its certification under the standard in force. All factories that supply the car makers have obtained this certification.

ISO/IEC 17025

In 1993, the Materials and Products and Outdoor Experimentation Lab of the Pirelli Group introduced a quality management system which is accredited under the ISO/IEC 17025 standard. This quality management system is maintained in conformance with the standard in force.

Pirelli's car tyres are an excellent example of the company's focus on quality, which is confirmed by Pirelli's winning of a large number of product tests, and also by the company's close links with some very prestigious partners (famous car makers, specialist magazines, driving schools etc.) for product development and experimentation.

The table shown below gives the results of various different product tests on winter tyres, conducted by the leading specialist magazines:

MAGAZINE	ISSUE	TESTED PATTERN	SIZE	TEST VEHICLE	MARK	FINAL RESULT
ADAC motorwelt	Oct- 06	Pirelli W190 SnowControl	185/60 R 14 T	VW Polo	-	Very recommendable
Auto Bild	Oct- 06	Pirelli W210 SottoZero	195/65 R 15 H	VW Golf	-	Very recommendable
sport auto	Nov- 06	Pirelli W240 SnowSport	235/40 R 18 V	Audi S4	252/270 points	Very recommendable TEST WINNER
Auto Bild sportscars	Nov- 06	Pirelli W210 SottoZero	225/45 R 17 H	VW Golf	-	Recommendable
Auto Bild alles allrad	Nov- 06	Pirelli Scorpion Ice&Snow	235/65 R 17 H	MB M Class	-	Exemplary TEST WINNER
auto motor und sport	Oct- 06	Pirelli Scorpion Ice&Snow	255/55 R 18 H	MB M Class	279/300 points	Very recommendable TEST WINNER
	Oct- 06	Pirelli W210 SottoZero	205/55 R 16 H	VW Passat	262/300 points	Recommendable
POWERCAR	Oct- 06	Pirelli W240 SottoZero	225/40 R 18 V	Ford Focus	117/150 points	Very recommendable
promobil	Oct- 06	Pirelli Citynet Winter Plus	215/75 R 16	Ford Transit	8,9/10 points	Very recommendable TEST WINNER

PIRELLI TYRE'S COMMITMENT TO CUSTOMER SAFETY

Pirelli has always been foremost in pursuing product innovation to improve quality and safety for the end consumer.

To achieve this, Pirelli Tyre avails of its close cooperative links with the leading car makers in a market segment that is particularly thorough and demanding: the Ultra High Performance segment, an area where Pirelli is the leading brand.

An example is the breakthrough K-PRESSURE OPTIC product. This innovative safety device was developed to simplify the life of the motorist by automatically taking care of a routine vehicle check that is often overlooked or underestimated in terms of safety value.

THE K-PRESSURE OPTIC SENSOR

The K-PRESSURE OPTIC system is as intuitive as it is easy to use – no maintenance is required – which uses sensors inserted in place of the valve caps on tyres. These sensors clearly indicate, without the need for additional devices, if the pressure* in the tyres is correct or below the alert threshold.

This ease of use means that motorists can devote all their concentration on driving, knowing that their tyres are at the correct pressure and that they only need to stop at a service station when it is actually necessary to inflate the tyre. Checking tyre pressure, which has always been regarded as "something only petrol-heads do" although it is essential for the everyday safety of all motorists, is transformed into a quick and easy everyday task: a glance at the colour of the valve is all that is needed to dispel any doubts about tyre pressure.

Other innovative products introduced alongside K-PRESSURE OPTIC include:

- Run-flat or self-sealing tyres
- Specialist tyres for new types of vehicles and new uses, for example winter UHP tyres for ultra-high performance supercars for mixed road/track use, run-flat tyres for SUVs etc.
- Tyres with increasingly low noise emission levels, for decreased environmental impact
- Materials that are innovative and advanced in terms of increasing compatibility with the environment (for example the elimination of aromatic oils)

And it must not be forgotten that Pirelli assumes an active and direct role in the global increase in the attention that motorists pay to tyres and, consequently, to their safety. This role is partly fulfilled by means of special advertising campaigns, such as the winter tyres campaign in Italy which saw Pirelli play an institutional role in the dissemination of information on the equivalence of using winter tyres and snow chains.

2.4. SUPPLIERS

GROUP POLICIES

Pirelli Group maintains a sustainable approach to its suppliers. In this regard the Pirelli policy on Health, Safety, Environment and Social Responsibility expressly states the company's commitment "*to establish and actively maintain the procedures to evaluate and select contractors and subcontractors based on their commitment in the field of social and environmental responsibility.*"

CSR has been integrated in both the General Conditions for Purchase of Goods and Services, applied by the company to its suppliers, and the phases of Vendor Approval and Vendor Rating, as described in more detail below.

The purchasing processes are described in the Purchasing Manual. This document sets out guidelines and procedures that are aimed at ensuring both transparency in internal processes and honesty in business dealings, and also integrity and contractual impartiality in relations between the company and its suppliers.

The purchasing processes have been reinforced by the development of new technologies (e.g. electronic auctions) that by their nature help enforce the measures for contractual transparency put in place by Pirelli.

For the most important suppliers, the purchasing policies allow for long-term contracts, partnership contracts and, in some cases, shared growth strategies.

NEW GENERAL CONDITIONS FOR PURCHASE OF GOODS AND SERVICES

In 2006 Pirelli drew up its new General Conditions for Purchase of Goods and Services, which were to be introduced to all orders/tender contracts stipulated by the Group. This contract includes some clauses that specifically refer to Pirelli's Ethical Code and Policy for Health, Safety, Environment and Social Responsibility. The stipulation of a supply contract involves the supplier's signing of these clauses, which commit the supplier to adopting behaviours at their company that adheres to the content of the aforementioned ethical code and CSR policy. Pirelli also has the right to carry out audits to verify this adherence.

The new conditions are already applied to the Group's Italian suppliers and they will be extended to all foreign suppliers by the first months of 2007.

DISTRIBUTION OF PURCHASES BY GEOGRAPHIC AREA

The table below shows the geographical distribution of purchases, distinguishing between OECD and non-OECD countries. The table also gives the percentage weight of purchases made in each area over the total value of all purchases made.

DISTRIBUTION OF PURCHASES BY GEOGRAPHIC AREA

		% on total number of suppliers	% ov total purchases value	
GEOGRAPHIC AREA		Year 2006	Year 2006	Year 2005
OECD countries	EUROPE	73.0%	63%	67%
	NORTH AMERICA	4.0%	6%	9%
	OTHERS (1)	0.2%	2%	2%
Non-OECD	LATIN AMERICA	19.2%	15%	11%
	ASIA	1.6%	12%	10%
	AFRICA	1.8%	2%	1%

(1) Australia, New Zealand, Japan and Korea

Over 80% of all purchases made by the entire Group are made up of goods and services purchased by the tyre sector.

For this reason, for the 2006 sustainability report we decided to focus on Pirelli Tyre's relationships with its suppliers.

FOCUS ON PIRELLI TYRE

The table below shows the distribution by type of goods and services purchased by Pirelli Tyre in 2005-2006. The table also gives the percentage weight of purchases made in each area over the number of suppliers and over the total value of all purchases made.

DISTRIBUTION BY TYPE OF GOODS AND SERVICES PURCHASED BY TYRE SECTOR

	% of number of suppliers		% of total value of purchases	
TYPE	**Year 2006**	**Year 2005**	**Year 2006**	**Year 2005**
Raw materials	7%	8%	56%	37%
Consumables	5%	5%	4%	4%
Services	80%	78%	32%	30%
Plant and equipment	8%	9%	8%	29%

Dialogue and interaction between Pirelli Tyre and its suppliers

Raw materials suppliers

Relations with suppliers are defined and enforced by specific company processes.

There are two fundamental underlying phases to supplier management:

1) Supplier approval (more commonly known as *Vendor Approval*)

2) Supplier monitoring (more commonly known as *Vendor Rating*)

The homologation process

The process of approving new suppliers of materials already in use or of new materials is governed by the MP 063 Quality Standard, "Approval of materials for purchase and their vendors". This interdepartmental process of approval follows definite and specific rules, and it concludes with the addition of the approved material/vendor to the Vendor List. The Vendor List is the company's list of approved suppliers for each individual product.

The vendor rating process

The goal of the Vendor Rating process is to evaluate suppliers according to the following criteria:

» Quality of the product supplied or service provided

» Quality of commercial relations

» Technical/scientific cooperation

» Performance in terms of safety in the workplace, environmental responsibility and corporate social responsibility

In 2007 the Pirelli CSR policies will be integrated into the Vendor Approval phase.

The process owner* of this interdepartmental activity is the Sector Purchasing Department, which circulates the Vendor Ratings to the suppliers every year.

The Vendor Rating is periodically reviewed and commented on by the Purchasing Department. This process involves meetings organised with the suppliers, the aim of which is to identify any corrective action that may be regarded as necessary for improving results.

The procedures described above are followed by the entire Sector and are supported by a special website available on line via the Purchasing Portal. This website provides centralised support for surveys, feedback and the definition of support actions. This provides both an assurance of process uniformity and a guarantee of transparency, apart from being an excellent knowledge sharing tool.

MEASURES AND PROCESSES ADOPTED BY PIRELLI TYRE IN 2006

The processes of dialogue and interaction with suppliers are the object of continual process improvement, both in qualitative terms and in terms of tools. Several measures and processes were adopted by Pirelli Tyre in 2006 to improve the purchasing process, both internally and in terms of supplier relations:

- Training courses have been developed on buyer professionalism (EIMP) and buyer-supplier relations
- A Purchasing Portal has been set up as a tool for communications and ongoing training. All company standards and procedures (Purchasing Manual, Ethical Code) are available on the site, as well as the Vendor List and Vendor Ratings
- The main purchasing processes have been automated and linked to the company SAP platform. These processes include raw materials requirements planning (MRP project) and the entire process governing requirements and supply of natural rubber, from the individual units to the purchasing centre in Singapore (PTE S'pore project)
- The order/delivery/invoice flow with suppliers have been automated by means of WEB or HUB platforms (the RNC project), via EDI documents and document scanning

The above measures started in 2006 and their completion is projected for 2007 at all Pirelli Tyre facilities worldwide.

3. ENVINRONMENTAL DIMENSION

3.1. THE PIRELLI APPROACH TO ENVIRONMENTAL MANAGEMENT

"Group companies believe in sustainable international growth in the common interest of all-stakeholders, both current and future. Their investment and business decisions therefore reflect respect for the environment and public health. Without prejudice to compliance with specific prevailing legislation, Group companies are aware of the importance of environmental issues when making choices, not least in the adoption of specific technologies and manufacturing methods (where this is technically feasible and economically viable) that allow for the reduction of the environmental impact of their operations, even beyond the minimum limits set down by regulatory requirements." (article 7 of the Ethical Code - Environment)

Through the implementation of measures to apply the principles mentioned above, Pirelli Group is achieving and reporting appreciable results. In particular, progress has been made in the following fields:

- Mitigation of the environmental impact resulting from the company's own activities, products and services
- Rational use of natural resources and energy
- Promotion of a 'culture of prevention' with regard to pollution
- Conservation, development and appreciation of the territory

All this has been achieved despite the extremely wide and varied range of business areas that the Group's companies operate in, including:

- Manufacture of tyres for cars, industrial vehicles, goods transport vehicles, buses, motorcycles and steel cord, all produced by Pirelli Tyre
- Activities in the telephony sector, with products for photonics* and for broadband internet access (non-photonic), used to develop leading-edge innovative solutions for the latest generation of telecommunications infrastructures: Pirelli Broadband Solutions
- The real estate sector: Pirelli & C. Real Estate
- Environmental decontamination, waste-to-energy generation, and development of alternative eco-compatible technologies (i.e. new fuels, innovative systems for exhaust gas abatement etc.): Pirelli Ambiente Holding
- Research and development in the fields of new materials and optoelectronic components: Pirelli Labs

In the sector in which it operates, each of the above companies invests the maximum possible care in responsible management of the environmental aspects of its activities, products and services, and of the environmental impacts associated with them.

Wherever possible, and particularly in the case of companies that have Production Units, Pirelli Group promotes the use of international reference standards for developing and implementing environmental management systems that are effective, efficient and aimed at continual improvement of its environmental performance.

The following sections describe in detail the main environmental aspects of the various different sectors of the Group, together with the related initiatives undertaken by the companies involved.

3.2. PIRELLI TYRE S.P.A.

Pirelli Tyres engages in a vast range of activities, both in the production of tyres for cars, industrial vehicles, goods transport vehicles, buses and motorcycles, and the production of steel cord (a component used mainly in the manufacture of tyres).

The company has 24 Production Units located in Europe, the US, Latin America, Asia and Africa. They are divided into two types of business units: tyre (for manufacturing tyres, as noted above) and steel cord.

The sections below analyse these two main business units separately, both in terms of production and in terms of environmental aspects, impacts and indicators.

Pirelli Group is also a contributing member of the World Business Council for Sustainable Development (WBCSD), an association of 190 international companies distributed throughout 30 countries that have made a voluntary commitment to unite economic growth with sustainable development.

Since 2005 the WBCSD has identified a list of global problems (e.g. the protection of ecosystems and biodiversity, the promotion of sustainable production and consumption etc.). The inescapable result of addressing these problems is the transformation of the currently-existing system of doing business.

Pirelli's active participation in the WBCSD has undoubtedly contributed to expanding the Group's knowledge in terms of the methods it can use to achieve real sustainable development..

The environmental management system*

The Policy for Health, Safety, Environment and Social Responsibility adopted by Pirelli Group specifies the definition and implementation of management systems that enable it to govern its activities, products and services based on internationally-recognised standards.

In the area of prevention of pollution, the ISO 14001* standard has been identified as the reference standard for the environmental certification of management systems. In the area of health and safety in the workplace, the reference standard chosen is the OHSAS 18001* standard (see the section dedicated to the description of this standard).

For Pirelli Group, certification of the environmental management system is something that essentially concerns the manufacturing activities of Pirelli Tyre S.p.A., which comprise the Group's most important activities in terms of potential impacts on the environment.

Despite this, the same recognition has also been obtained by Group companies operating in the areas of design, research, logistics, and services, including the Tyre Test Track at Vizzola Ticino (Varese, Lombardy), and Pirelli & C. Real Estate Facility Management.

In the tyre and steel cord sector, of the 24 factories and facilities in the Group as at 31 December 2006, 22 have implemented and obtained environmental certification of their management systems.

The first certifications were obtained in November 1998 for the Brazilian factory in Santo André and the Turkish factory in Izmit.

Upcoming certifications are for the steel cord and tyre factories in Romania, which are currently in the development and startup phase.

The effort put in at Group level, to define common guidelines and procedures for the introduction of environmental management systems and their related ongoing maintenance and monitoring activities, has further expanded the Group's knowledge of environmental problems and its skills for their prevention and resolution and, in many cases, has paved the way for improvements in performance with consequent mitigation of environmental impacts.

This positive trend can be seen in the tables and graphs given in the sections below on the various different companies of the Group.

In 2006 no environment-related incidents occurred with negative consequences for health or the environment. However, one tyre-making facility was fined euro 10,000 for an anomaly detected in its water discharges. At the time of going to press, the solution to this problem (proposed and agreed with the local authority) is nearing completion.

ENVIRONMENTAL CERTIFICATION OF THE VIZZOLA TICINO TEST TRACK

In addition to the Production Units, the company also has centres for carrying out scientific tests of tyre/vehicle performance. These centres conduct experiments and trials of tyres under various different conditions of use, using subjective and instrument controlled techniques.

Of these test centres one deserves particular mention: the test track located in the town of Vizzola Ticino (in Varese province in Italy), which was designed and built at the end of the 1960s on a site close to the Ticino river. In early 2005 the track adopted an environmental management system certified under the UNI EN ISO 14001/2004 standard.

In addition to being used by the various Group companies for experiments and tests (in which it plays an essential role in researching the indirect environmental aspects associated with the development of new tyres and vehicles with reduced environmental impacts), the track is home to sports events, driving schools, and motoring clubs, as well as being used by car manufacturers and trade magazines for joint tests and shows.

THE VIZZOLA TICINO TEST TRACK

The achievement of environmental certification by the Vizzola track takes on a special importance when we consider that its 26 hectares lie within the *Parco Naturale Lombardo della Valle del Ticino* (Lombardy Ticino Valley Natural Park), an Italian nature reserve that is listed as a UNESCO MAB (Man and Biosphere) area – one of 425 biosphere reserves in 95 countries worldwide.

Implementing the environmental management system has enabled waste management optimisation targets to be defined and achieved. Similarly, programmes spanning over several years have been set up and are currently underway to rehabilitate and redevelop the internal green areas with plantings of indigenous plant species, elimination of ozone depleting substances*, and support for university programmes to develop vehicles with low environmental impacts.

Due to its special location in a protected area, the test track is in constant contact with the offices of the Municipality of Vizzola Ticino and of the Parco Naturale Lombardo della Valle del Ticino.

Through an agreement with the Park Administration, the test track contributes in economic terms to the environmental improvement of the external area. This work is carried out by the Park authorities.

HEALTH, SAFETY AND ENVIRONMENT DATA MANAGEMENT ("HSEDM" DATABASE)

In parallel with the definition of specific common guidelines and procedures for drawing up and implementing management systems in individual Production Units, the HSE Department has made a database available on the Pirelli company intranet. This database was developed using web-based logic, which allows enabled users to load data and related performance indicators and make them available in real time. In addition to monitoring the performance (and therefore the objectives) of each individual environmental management system, this database also enables the production of the document you are now reading, together with any other form of report that becomes necessary from time to time.

As in previous years, quantification of the equivalent emissions of greenhouse gases* (especially CO2 and NOx*) has been performed using conversion coefficients taken from the sources given below:

ENERGY CONVERSION FACTORS FOR CO_2 AND NO_x EMISSIONS

TYPE OF ENERGY	Source	Conversion factor	
Natural gas	BUWAL 250	57.0	kg CO_2/GJ
		0.06	kg NO_x/GJ
Diesel	Idemat 2001	2983.3	kg CO_2/t diesel
		9.7	kg NO_x/t diesel
GPL	Idemat 2001	2703.6	kg CO_2/t GPL
		13.2	kg NO_x/t GPL
Fuel oil	BUWAL 250	88.9	kg CO_2/GJ
		0.23	kg NO_x/GJ
Electricity	BUWAL 250	119	kg CO_2/GJ
		0.26	kg NO_x/GJ

TYRE PRODUCTION

The composition of a standard tyre

A tyre may be seen as a compound or, in other words, a solid assemblage of materials with very different properties, whose manufacture necessarily requires great precision.

Generally, we can define three distinct groups of raw materials::

- » Raw materials that make up the compounds
- » Raw materials that make up the structure of the tyre
- » Auxiliary raw materials which, although they are used in the production process, do not form part of the finished tyre

The first group includes:

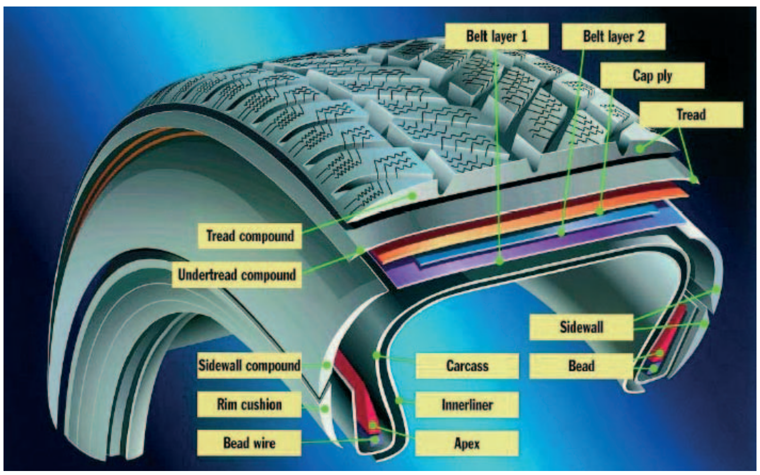
- » Natural and synthetic rubbers
- » Reinforcing fillers (in particular, carbon black)
- » Plasticisers
- » Ingredients for vulcanisation
- » Protectors: anti-ageing and anti-ozonant agents

The second group includes:

- » Brassed steel wire for the bead wires
- » Steel cord for the metal ply
- » Treated raw fabrics for the rubberised bonded fibre ply fabrics

Finally in the third group we have the "auxiliary process" materials (anti-adhesive agents, releasing agents, bonding agents etc.) and a series of auxiliary products specific to the various different phases of the production process.

To better understand the environmental aspects of tyre production, the figure below shows a cross-section through an 'average' tyre and identifies the various different parts (known in the industry as "semi-finished materials") that make up the composite tyre.



(Source: "Life Cycle Assessment of an Average European Car Tyre", PRe Consultants B.V., 2001)

The following components are particularly important:

» **Liner**: a layer of synthetic rubber on the inside surface of the tyre. It is perfectly sealed and acts as air chamber.

» **Carcass**: the load-bearing structure of the tyre, this is made up of thin threads or plies in fabric fibre (up to 1,400 per tyre) set in a straight arc and rubberised. The carcass is the key load-bearing element of the tyre since it withstands the pressure.

» **Bead**: a padding in the lower area (APEX), which transmits the motor torque and the braking torque from the wheel rim to the ground contact area

» **Bead wires**: metal rings (two per tyre) made of one or more parallel rubberised wires. The carcass plies are wrapped around the bead wires.

» **Sidewalls**: generally made of rubber strips that are extremely resistant to repeated bending and oxidation. As well as absorbing some of the dynamic stresses that the tyre is subjected to, the sidewalls protect and reinforce the carcass.

» **Belt layers**: made up of plies, normally reinforced with very thin but highly resistant steel wires. The belt layers are crossed over diagonally and glued together. The crossover of the belt wires with those of the carcass creates un-deformable triangles.

» **Tread**: the part of the tyre placed over the belts connecting the vehicle to the road surface. It is made by drawing and it has a trapezoidal shape, with the lower surface slightly hollow and shaped

PRODUCTION PHASES

In general, tyre production follows the phases described below:

Compound preparation

The process begins with the production of compounds in the "compound room", where large, fully-enclosed Banbury* mixers process the raw materials to correctly distribute the various different ingredients within the finished compound.

Normally the compound is produced via two successive passes with the Banbury: the first pass results in a paste and the second pass results in the proper compound. The compounds used to make tyres are blends of various different raw materials that undergo a processing technique that distributes them evenly throughout the treated mass.

Each raw material has a very specific function and it is added to the compound in well-defined proportions, in order to confer all the specific characteristics required on the finished product during operation.

Fabric rubberisation

Rubberisation of fibre and metal ply fabrics is done via a process of calendering (which consists of applying two sheets of rubber on both sides of the fabric). This operation is carried out using special machines called calenders.

The bonded fibre ply fabrics are normally purchased from third parties in pieces and then fed into the fabric calenders, which perform the rubberisation.

Similarly, metal fabrics are made from steel cord enclosed in a sheet of compound by means of special metal calenders.

Semi-finished products

Semi-finished materials are individual elements that are bonded together in the tyre-building phases. It is at this point that the tyre begins to take shape. Semi-finished materials can be classified into groups, based on the type of processing they undergo (e.g. bead wires, drawn wires, fabrics etc.)

Tyre-building

Tyre-building is the phase where all the semi-finished materials are brought together to be bonded together and made into a tyre.

Tyre-building is normally separated into two successive phases. In the first phase, which is performed on a manual or automatic tyre-building machine, the end result is a carcass which is made up of body-plies, bead wires and sidewalls.

Construction is completed in the second phase, which starting from the carcass made in the first phase produces a carcass with dimensions and profiles that are similar to those of the finished tyre. This is known as a "green" tyre.

Painting and vulcanisation

'Painting' is the name given to a phase of the process where an aqueous solution is sprayed inside a tyre that has just been made (a "green" tyre) to form a protective layer between the inside surface of the carcass and the vulcanising chamber. This is to prevent adhesion of the non-vulcanised tyre when it is removed after the vulcanisation phase, which could result in pieces of rubber coming away from the tyre.

Vulcanisation is an irreversible process of transformation, obtained by increasing the temperature and pressure to obtain the required shape and elasticity characteristics of the tyre.

Vulcanisation transforms the raw compound, with mainly plastic properties, into a vulcanised compound, with mainly elastic properties.

The vulcanisation process comes about as a result of a series of chemical reactions that progress over time and, accelerated by heat, modify the original molecular structure of the compound. The tyres are vulcanised on special machines that use moulds to determine the final shape of the tyre.

Finishing

In the finishing phase the tyre undergoes a series of visual and instrumental checks to ensure the safety and reliability of the tyres to be sold on the market..

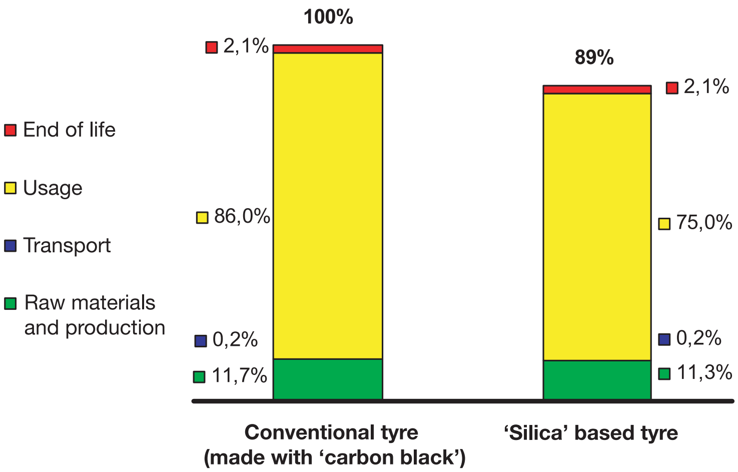
THE ENVIRONMENTAL IMPACT OF TYRES

The environmental impact of production

To arrive at a truly complete picture of the environmental impact of producing tyres, we need to widen the sphere of analysis to include the entire life cycle of the product. One methodology for doing this is described in the ISO 14040 standard ("Environmental management - Life Cycle Assessment - Principles and framework").

This approach was followed to analyse the life cycle of an average European car tyre. The analysis was carried out together with the major European tyre makers[1], and the results allow us to identify and quantify the major environmental impacts for each phase of the tyre's existence – production, use, end of life, and everything in between.

[1] "Life Cycle Assessment of an average European Car Tyre", PRè Consultants B.V. on behalf of BLIC, 2001. This study is representative of the entire range of car tyres, excluding snow tyres.



COMPARISON OF THE DISTRIBUTION OF THE POTENTIAL ENVIRONMENTAL IMPACTS OF TWO TYPE OF TYRES

The most interesting result of the study is the significant environmental impact associated with the usage phase of the tyre which, for a 'traditional' tyre, accounts for 86% of the total impact.

On average tyres account for around 20% of the overall consumption of a car, and this partly explains the high environmental impact generated during its use.

On closer inspection of the impact generated during the usage phase, we can see that around 90% of this impact is due to fuel consumption resulting from friction between the tyre and the road surface, while the rest is due to the outcome of the friction (the so called *tyre debris*).

The above chart also highlights the contribution of the raw materials supply and production stages, which together determine approximately 12% of the total impact (approx. 10% and 2% respectively).

The chart also shows a significant reduction in consumption (2.6%) in tyres containing silica compared to traditional tyres (whose main filler is only carbon black), resulting in an 11% reduction in the total environmental impact.

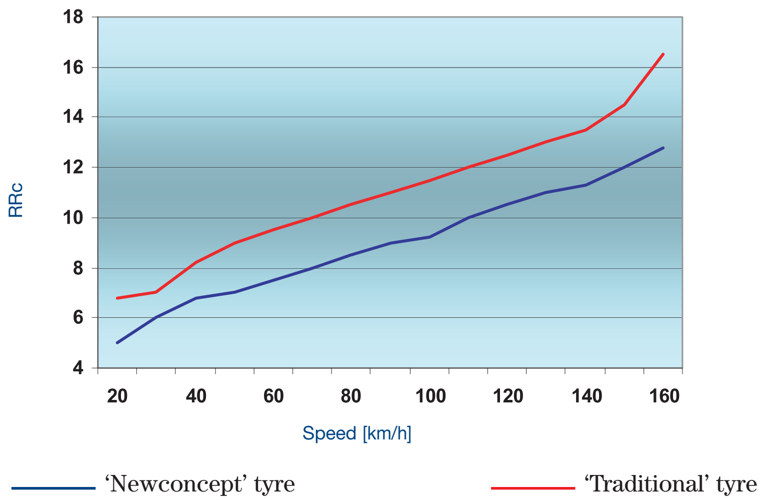
This has led to the development of new compounds for the tread (the part of the tyre responsible for the impact generated in the usage phase), containing silica instead of carbon black.

The environmental impact of a tyre in the usage phase

To reduce the environmental impact associated with the use of a tyre, Pirelli Group is constantly committed to the research and development of new compounds and new product lines which, through the use of new materials, innovative internal structures and new tread designs, capable of reducing the rolling resistance* while ensuring the same tyre life.

Without doubt, the overriding priority of research and development is driver safety: the tyre must ensure proper vehicle control in the widest possible range of situations; however, due to the inevitable friction, it is also responsible for some of the vehicle's fuel consumption.

In 2006 work continued on the optimisation of rolling resistance – the force that the tyre opposes against the advancement of the vehicle and which, together with wind resistance and the resistance offered by the mechanical components of the vehicle itself, influence fuel consumption and, consequently, the emission of exhaust gases per unit of distance travelled.



$$RRc = \frac{\text{Rolling resistance}}{\text{weight supported by the tyre}}$$

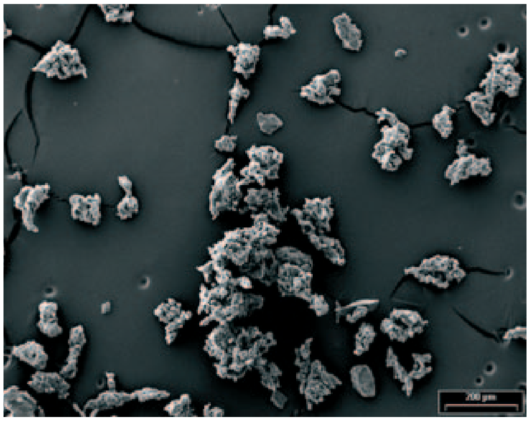
Rolling Resistance Index trend

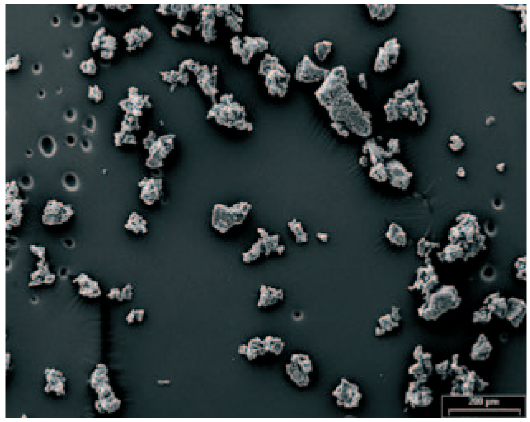
The value of this parameter is obviously different for different types of tyre and it depends on a series of factors such as the formulation of the tread compound, the inflated tyre pressure, the speed and weight of the vehicle, the composition and state of the road surface, the ambient temperature, how the tyre itself is used, and so on.

In this context the ELRR ("Extra Low Rolling Resistance") package has been available for some years affecting all components of the tyre to obtain improvements in general tyre performance, as well as further reductions in the rolling resistance.

As noted earlier, a small percentage of the total environmental impact is due to *tyre debris*, i.e. tyre particles worn away as a result of the friction between the tread and the road surface.

It has been estimated that during its life cycle, a tyre produces a quantity of tyre debris of between 10 and 14% of its original weight.





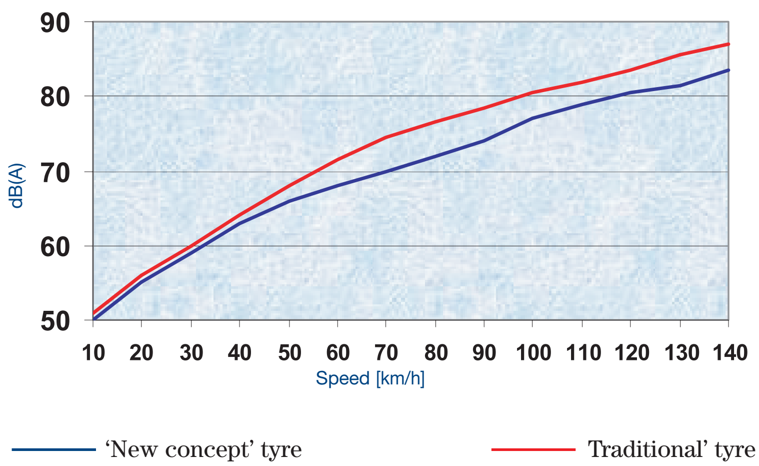
GRANULOMETRIC FRACTION OF UNDER 100 µm FROM THE **TYRE DEBRIS** GENERATED BY A TRUCK TYRE (LEFT) AND A CAR TYRE (RIGHT)

The environmental impact of these particles is still being studied worldwide and Pirelli Group plays its part in this international effort through the continual exchange of information and experience with other tyre makers partecipating to the specific work group set up under the aegis of the World Business Council for Sustainable Development (mentioned above) via the ETRMA (European Tyre & Rubber Manufacturers' Association).

Another environmental aspect of tyre usage is the noise generated by the tyre, which is studied using special software and by conducting experimental tests, both in the field and in special anechoic chambers.

The chart below shows the difference in sound levels generated by a 'traditional' tyre and a modern, new-generation tyre.

Noise level



In addition to the research aimed at mitigating the environmental impacts directly connected with Pirelli's activities (particularly in the production phase), measures have also been put in place to reduce the impacts generated in the other phases of the tyre's life cycle – phases that are only indirectly or partially related to the Group's activities. Of special note are the selection of raw materials and the rational use of natural resources and energy.

Selection of raw materials: to reduce as far as possible the use of substances that are dangerous

- Systematic assessment of the eco-toxicological characteristics of any new chemical before its introduction into the production cycle. In particular, following recent European regulations on the classification, labelling and packaging of dangerous substances and preparations, Pirelli has updated the list of substances that cannot be used in its production processes, or for which research programmes are underway to find a replacement.

  In this regard, in 2006 approximately one hundred new raw materials have been analysed and assessed.

- Consolidation of the supplier evaluation system (more commonly known as Vendor Rating), based on concise quantitative criteria to assess the quality and level of service offered, including the supplier's performance in terms of health, safety, environment and social responsibility.

Rational use of natural resources and energy: here the principal results achieved are due to the progress made in optimising the production of high-quality compounds using the CCM (*Continuous Compound Mixing*) system, and also the progressive consolidation of tyre production with MIRS™ (*Modular Integrated Robotized System*).

The CCM process

The CCM process for producing compounds uses a 100% computer-controlled pneumatic distribution system to transport the ingredients from their storage silos to the twin-screw extruders working continuously.

The CCM technology was designed to manage the complexity of the process deriving from the great many ingredients necessary to produce the compound. The computer-controlled management results in improved quality in the compound produced, and consequently in the finished tyre.

Via a specially-designed powder-capture and recycling system for solid materials, CCM technology has reduced dust levels in the production areas to extremely low levels.

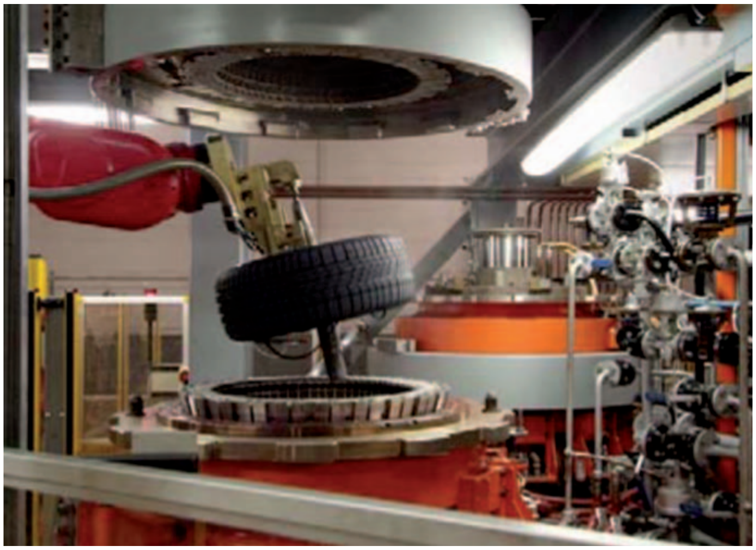
The CCM process also saves energy, enabling a reduction of approximately 20% of energy consumption per unit of product.

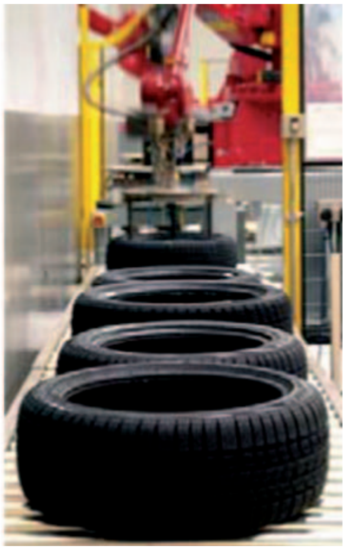
THE COMPOUND PRODUCTION PLANT USING THE CCM PROCESS

The MIRS™

MIRS™ is an integrated, modular robotic system for making tyres. It has a very high degree of flexibility due to its ability to optimise modularity and logistics.

VIEW OF A MIRS™ UNIT





(LEFT)
THE MIRS™
VULCANISATION PROCESS
(RIGHT)
TYRES COMING OFF
THE PRODUCTION LINE

Compared to the traditional, large-scale tyre-building systems with their exceptionally high production rates, designed for customers in different geographic locations, the MIRS™ is a compact production 'island', flexible and easily programmable for extremely rapid adaptation to the production of new models. This system represents a real improvement, obviously in terms of technology but also in terms of logistics, since it can be easily located near the manufacturing process that it serves.

In the MIRS™ process, tyres are built around a heated drum which is tailor-made for a particular tyre model. The drum is continuously rotated by a robot under an extrusion* device that distributes the rubber over the surface.

The drum rotation and compound feeding movements are coordinated so as to arrive at the correct distribution of materials to create the specific tyre model.

This new robotic process means real improvements in the quality of the product, since the geometric distribution of rubber fibres is extremely consistent over the tyre model.

End-of-life management of tyres

As noted above, a tyre's end-of-life phase makes a small contribution to the overall environmental impact of the entire life-cycle of the tyre and, among the various final disposal options, burial in landfill is by far the least desirable in terms of environmental compatibility.

For several years Pirelli Group has devoted considerable attention to research into the management of end of life tyres (ELTs), also in view of the Directive 1999/31/EC, which prohibits disposal in landfills of entire ELTs from 2003 onwards (and from July 2006, also fragmented ELTs).

This research has identified several different recycling opportunities for end of life tyres, both in terms of recovering the raw materials that make up the tyres ('material recovery') and in terms of recovering the tyre in the form of fuel with a high heat value* ('energy recovery'), as a valid alternative to the use of fossil fuels.

AVERAGE CHARACTERISTICS OF END-OF-LIFE TYRES [1]

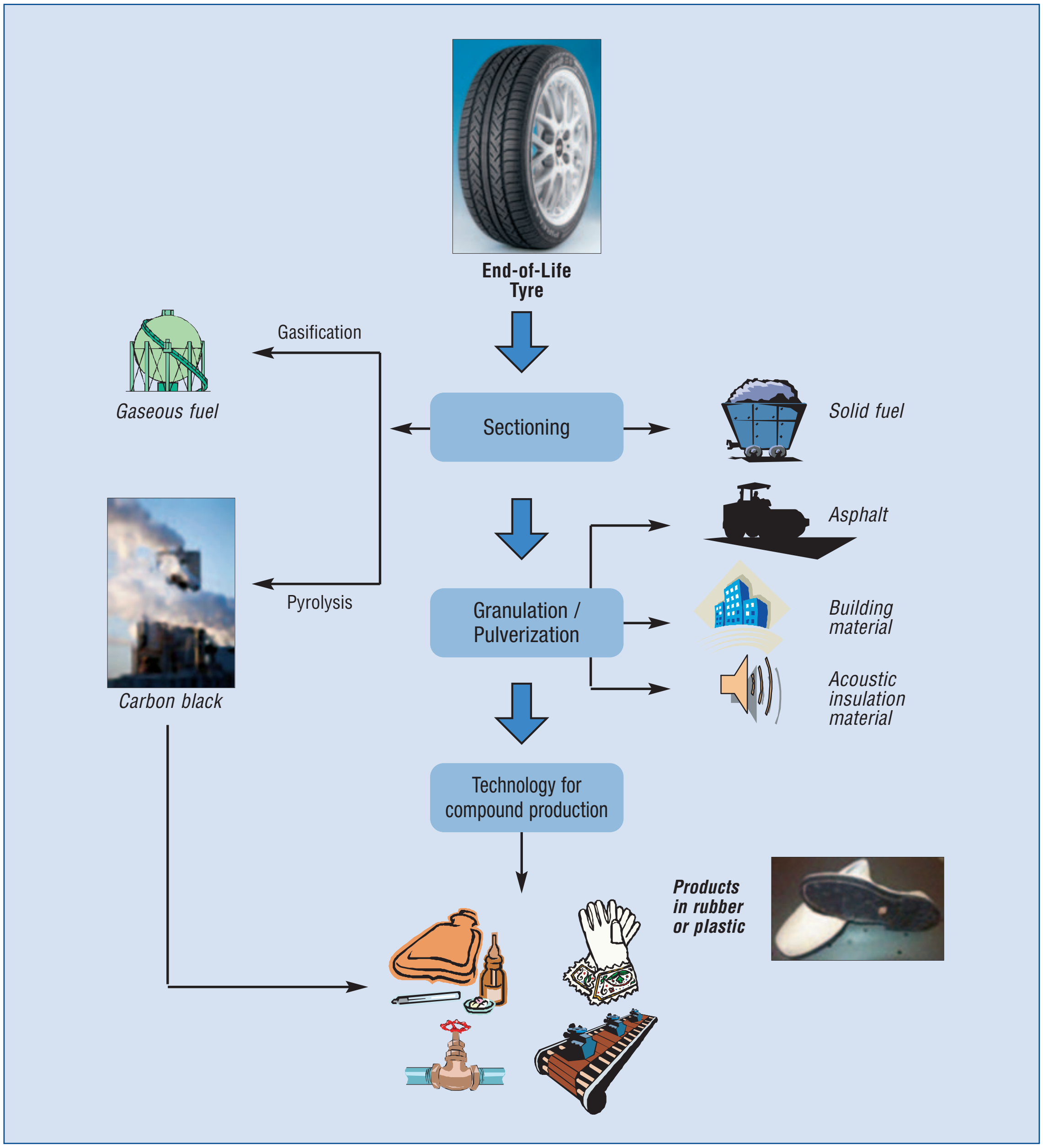
	Average values
Ferrous materials	15%
Ashes	2%
Fuel	81,5%
Sulphur	1,5%
Net heat value	> 7,400 Kcal/Kg
Volatile matrials (of the fuel component)	> 70%

[1] U. Ghezzi, M. Giugliano, M. Grosso, S. Pollo, G. Zerbo "The use of tyres as fuel in a cement furnace".

Thanks also to the commitment of Pirelli Labs a number of projects have been developed in the fields of recycling and energy recovery.

As the diagram below shows, the activities in question are focused on the recovery of materials (for example through granulation which, once the 'textile' and 'metal' fractions are separated, provides a rubber granulate that may in turn be ground further to produce a finer powder).

Tyre recycling diagram



SUMMARY OF ENVIRONMENTAL PERFORMANCE OF TYRE PRODUCTION

The figures given in this section are relative to the Production Units that manufacture tyres which come under the car, truck/agro and motorcycle business units.

Consumption figures for the factories in Yangzhou (People's Republic of China) are not considered, since these facilities are not yet fully operational.

In line with the sustainability reports of the last five years, the following factors and their environmental indicators are examined:

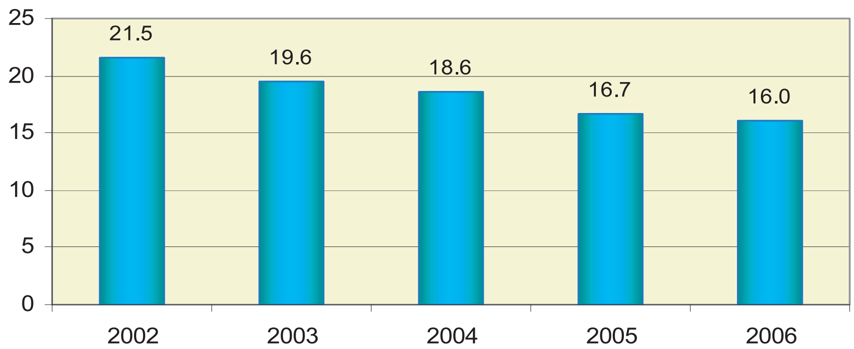
- Water consumption (expressed in $m^3/tonne_{finished\ product}$)
- Energy consumption (expressed in $GJ/tonne_{finished\ product}$)
- Solvent consumption (expressed in $kg/tonne_{finished\ product}$)
- Waste production (expressed in $kg/tonne_{finished\ product}$)
- Equivalent emissions of CO_2 and NO_x (expressed in $tonne/tonne_{finished\ product}$ and $kg/tonne_{finished\ product}$ respectively)
- Presence of dielectric oils containing PCBs* and/or PCTs (with concentrations higher than 50ppm)
- Presence of ozone depleting substances (in kg)

The calculation of the consumption figures given for each factor in the charts below takes into account the increase in production over the year: from over 825,000 tonnes in 2005 to over 890,000 tonnes produced in 2006 (an increase of approximately 7%).

As it can be seen from the charts below, almost all the indicators show perceptible trends of improvement. This can be ascribed to the implementation of environmental management systems and to the effects of environmental investments, but it is also in no small part due to an increasingly attentive management of production. This last area is where the positive contribution made by tyre production using the $MIRS_{TM}$ technology (described above) assumes particular importance.

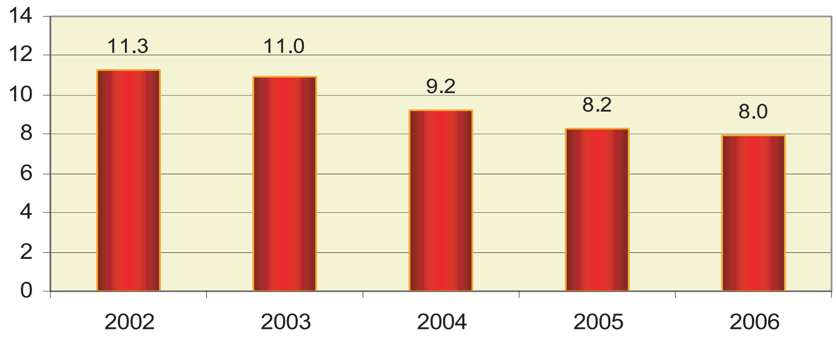
Consumption trends

Water procurement



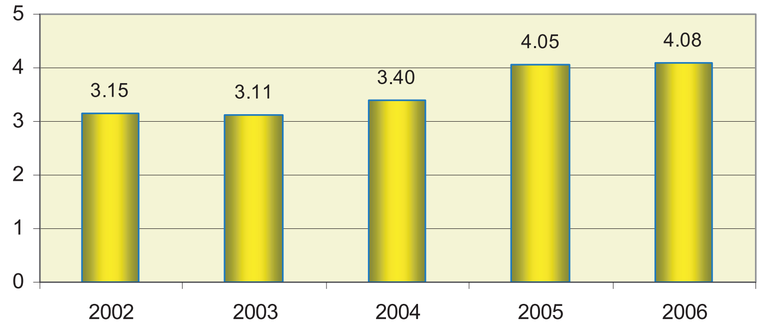
Tyre production
Water specific consumption
($m^3/tonne_{PF}$)

Energy consumption



Tyre production
Energy specific consumption
(GJ/tonne$_{PF}$)

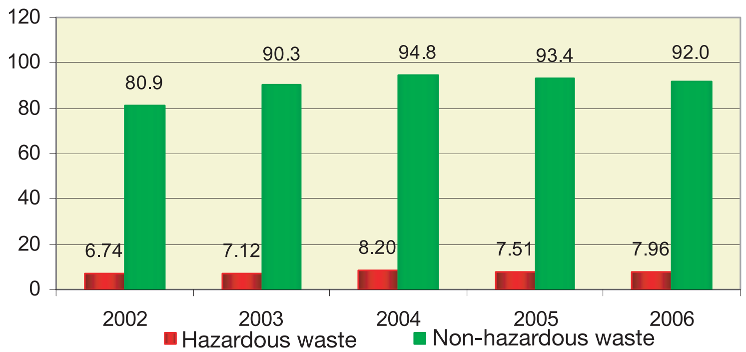
Solvents[1]



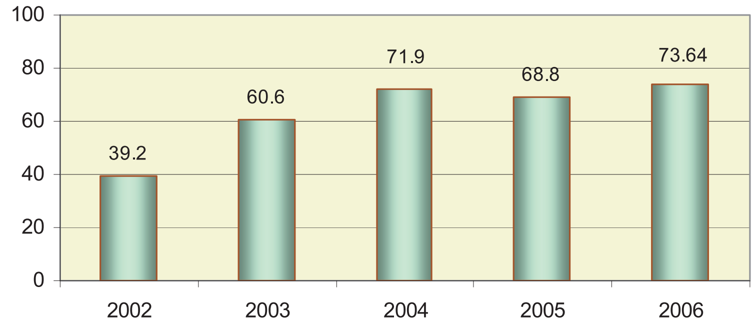
Tyre production
Solvent specific consumption
(kg/tonne$_{PF}$)

[1] **For the 2006 data, the criteria of Directive 1999/13/EC ("on the limitation of emissions of volatile organic compounds* due to the use of organic solvents in certain activities and installations") have been extended to cover sites outside the EU. For reasons of uniformity, this approach has also been used for 2005.**

Waste

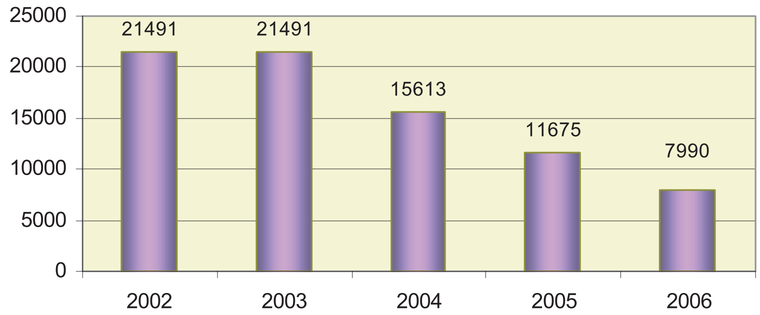


Tyre production
Waste specific production
(kg/tonne$_{PF}$)



Tyre production
Waste recycled (%)

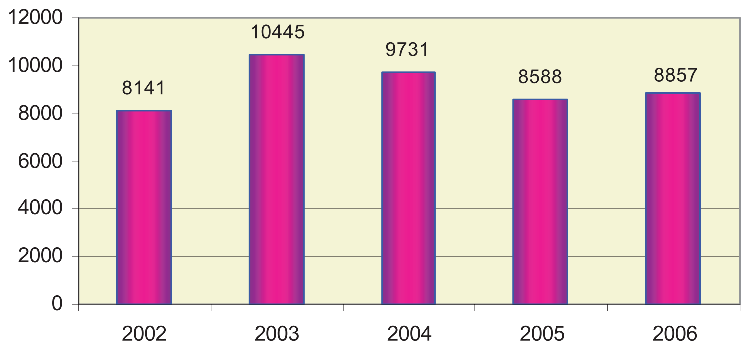
Dielectric oils containing PCBs / PCTs [2]



Tyre production
Presence of PCBs and/or PCTs in conc. > 50 ppm (Kg)

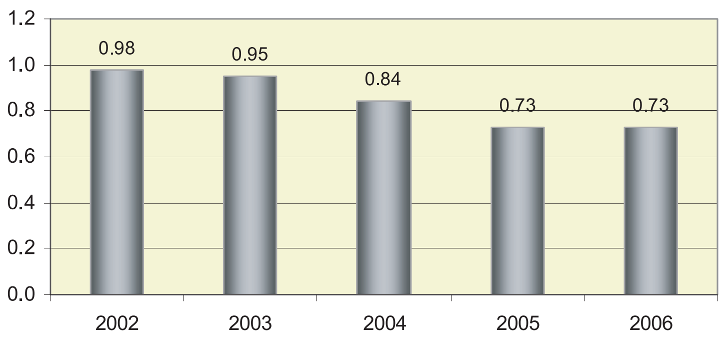
[2] The values from 2001 to 2005 differ from the values given in the previous sustainability report because a number of transformers – included in 2005, as a precautionary measure, in the transformers containing oils with a concentration of PCBs/PCTs* higher than 50ppm – after detailed analysis were found to contain dielectric oils with concentrations of PCBs/PCTs lower than 50ppm.

Ozone depleting substances

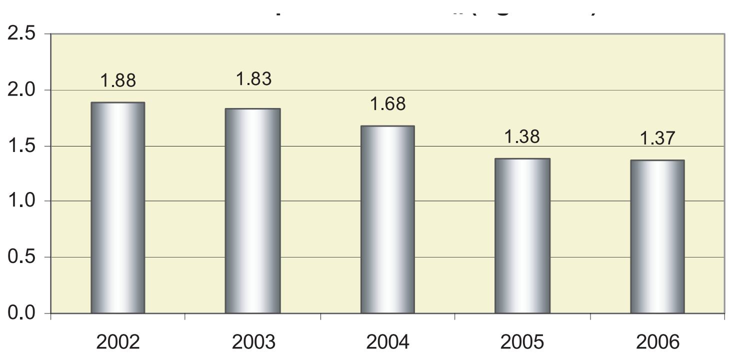


Tyre production
Ozone depleting substances (Kg)

Equivalent emissions of CO_2 and NO_x



Tyre production
Equivalent emissions of CO_2
(tonne/tonne$_{PF}$)



Tyre production
Equivalent emissions of NO_x
(kg/tonne$_{PF}$)

STEEL CORD PRODUCTION

Steel cord is mainly used in the production of tyres, in particular for making two semi-finished products: metal fabrics and bead wires.

The five Operating Units managed by the Steel Cord Business Unit of Pirelli Tyre S.p.A. are located in Brazil, Germany, Italy, Turkey and Romania (a new factory).

The final products of the steel cord technological cycle (described in the next section) can be divided into two main types:

- The actual steel cord, composed of several wires (drawn and brassed), for use in strengthening tyre structures
- A single drawn/brassed wire, for use in strengthening rubber tubes intended for high pressure use

For both products, the raw material is a steel wire rod (high carbon steel) with an initial diameter of approximately 5.5mm.

THE TECHNOLOGICAL CYCLE

Although there are some minor differences between the various different operating units, the processing of steel rod wire can be adequately explained in the following 9 main phases, which refer to the diagram on the following page:

a) *Stripping and preparation:* elimination of surface oxide flakes that form during the hot-rolling process in the steelworks.

b) *First drawing:* the prepared wire rod is reduced in diameter via cold drawing, using suitable lubricants (principally sodium stearate). The end products of this phase are divided into thick wires (diameter of 2.5-3mm) and medium wires (diameter of 1-1.7mm).

c) *Patenting for thick wires:* patenting is a heat treatment which is necessary to restore the wire's structure and prepare it for a subsequent reduction by cold drawing. The heat treatment is usually done in a furnace at a temperature of approximately 1,000°C, followed by cooling down in molten lead at approximately 550°C.

d) *Second drawing for thick wires:* a cold deformation process similar to that described in phase b) above.

e) *Patenting and brassing* (for medium wires and for wires produced by phase d) above): In this phase, the patenting is similar to that described in phase c), and the brassing process consists of depositing a very thin layer (2÷4mm) of brass (with a zinc content of approximately 30%). This is necessary for the rubber compounds to adhere to the bead wires.

This phase consists of the following activities:

» Sulphuric electrolytic pickling

» Copper deposition in an alkaline bath

» Copper deposition in an acid bath

» Zinc deposition in an acid bath

» Thermal diffusion to obtain the brass alloy

» Phosphoric pickling

f) *Third drawing:* necessary to obtain wires with usable diameters (in general these diameters are around 0.25mm). In this phase, both the wire and the die are immersed in lubricating baths made up of synthetic oils in water emulsion.

g) *Stranding:* the wires are assembled into strands, numbering from 2 to 10, which may in turn be further assembled to make larger strands.

h) *Cording:* single wires and strands are assembled to make cords of varying complexity, geometry and number of components, depending on their intended use (in car tyres, truck tyres etc).

i) *Testing and packaging:* the product is subjected to tests and checks, both global and statistical.

Diagram of steel cord production process

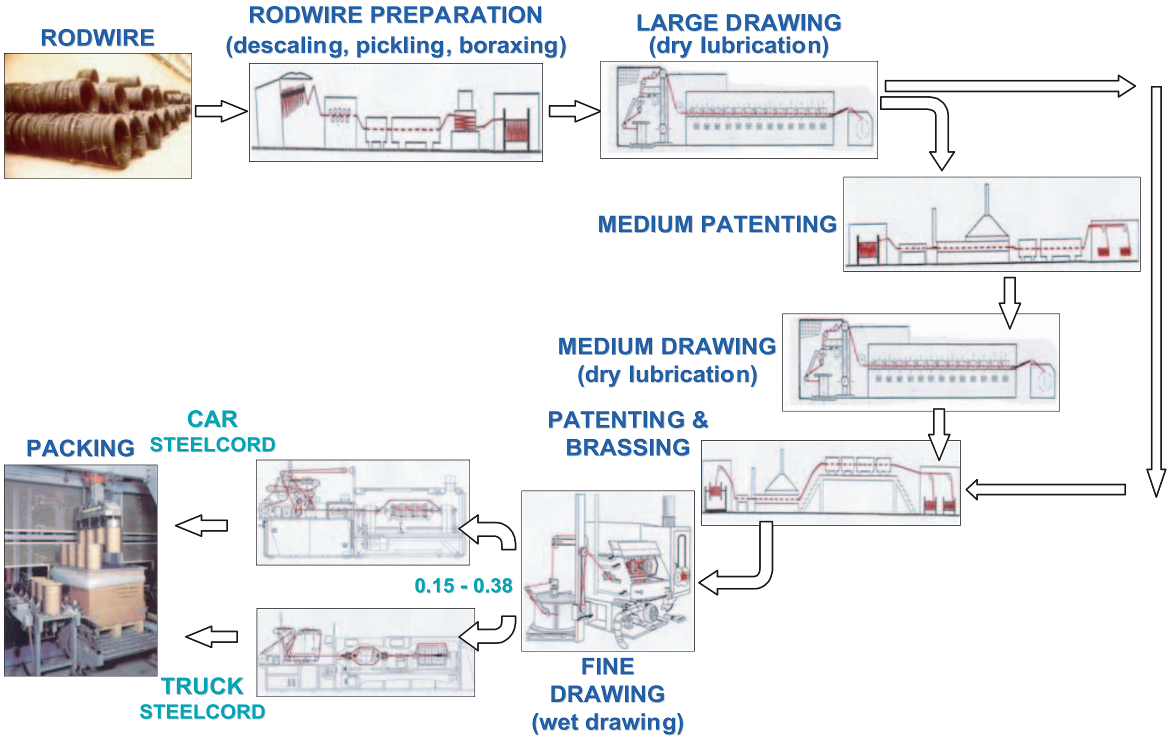


Diagram of steel cord production process

QUANTITATIVE DATA FOR METAL CORD PRODUCTION

The figures given in this section are for the five Production Units that manufacture steel cord and which come under the Steel Cord business unit.

In line with the sustainability reports of the last five years, the following factors and their environmental indicators are examined for this business unit:

» Water consumption (expressed in $m^3/tonne_{finished\ product}$)

» Energy consumption (expressed in $GJ/tonne_{finished\ product}$)

» Waste production (expressed in $kg/tonne_{finished\ product}$)

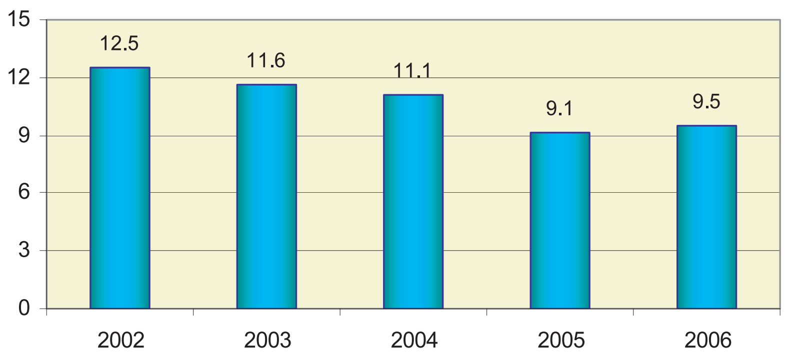
» Equivalent emissions of CO_2 and NO_x (expressed in $tonne/tonne_{finished\ product}$ and $kg/tonne_{finished\ product}$ respectively)

» Presence of ozone depleting substances (in kg)

The results of the consumption figures for each environmental indicator* are given in the charts below, and take into account the increase in production over the year: production rose by 5% over the previous year, i.e. from over 137,000 tonnes in 2005 to over 144,000 tonnes produced in 2006.

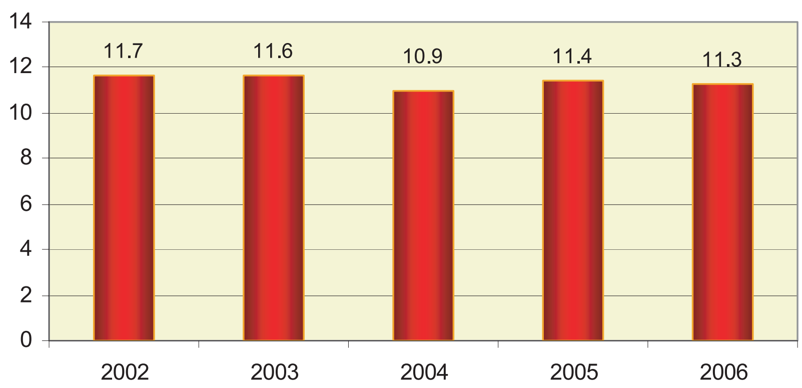
Consumption trends

Water procurement



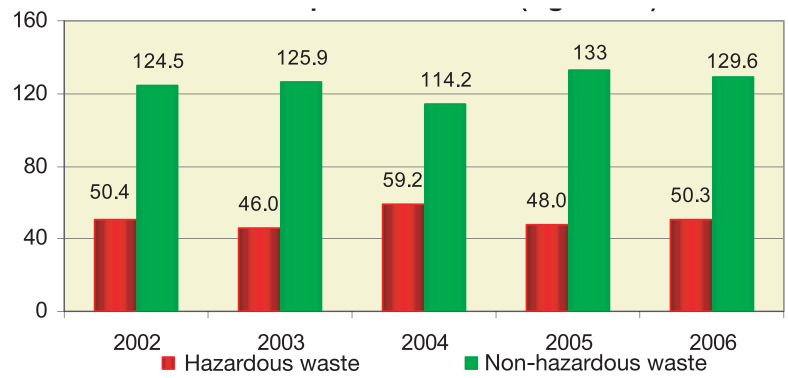
Steel cord production
Water specific consumption
(m^3/tonne$_{PF}$)

Energy consumption

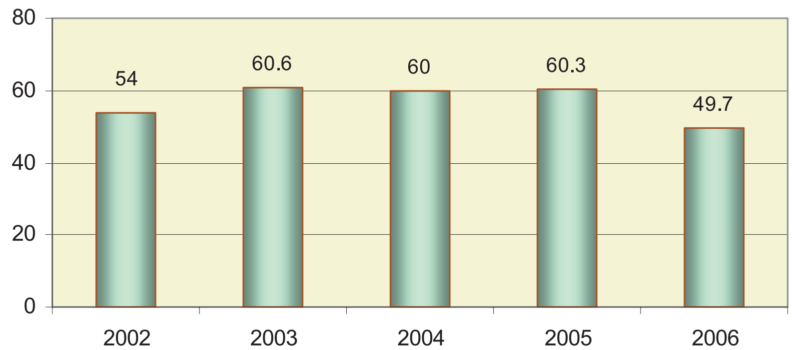


Steel cord production
Water specific consumption
(GJ/tonne$_{PF}$)

Waste



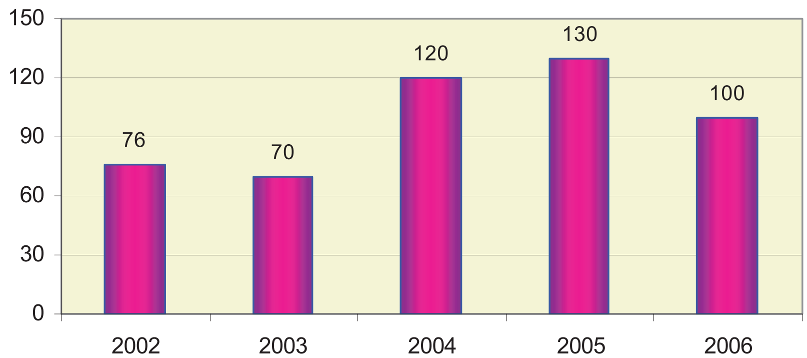
Steel cord production
Waste specific production
(Kg/tonne$_{PF}$)



Steel cord production
Waste recycled (%)

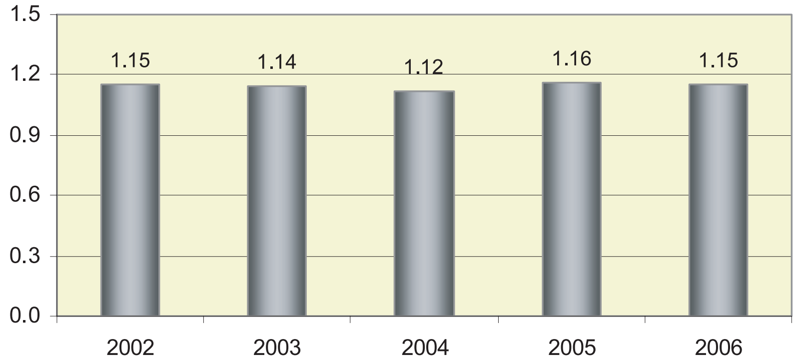
Dielectric oils containing PCBs/PCTs Not present in this business unit.

Ozone depleting substances

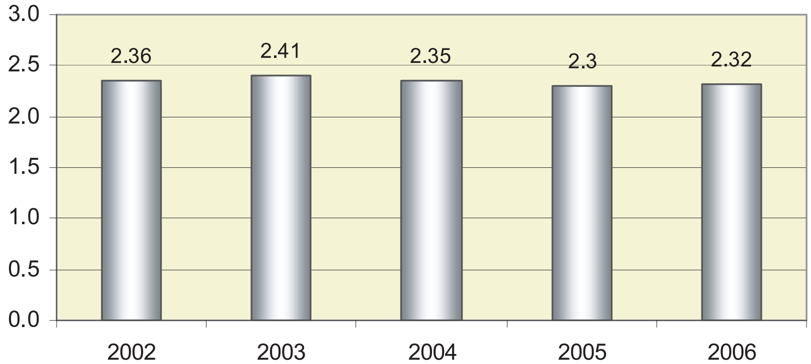


Steel cord production
Ozone depleting
substances (Kg)

Equivalent emissions of CO_2 and NO_x



Steel cord production
Equivalent emissions
of CO_2 (tonne/tonne$_{PF}$)



Steel cord production
Equivalent emissions
of NO_x (Kg/tonne$_{PF}$)

ENVIRONMENTAL TARGETS OF PIRELLI TYRE

For 2006, the targets for environmental improvement set by the General Management of Pirelli Tyre S.p.A. were a decrease of 2% in energy consumption (excluding the Steel Cord business unit) and a decrease of 4% in water consumption (for the entire sector, including steel cord production).

These objectives have been comfortably achieved and, in particular, energy consumption has been reduced by 5% while water consumption has been reduced by 4.9%.

The target for 2007 is to achieve further improvements in both of these parameters: 3% for the sector as a whole.

3.3. PIRELLI BROADBAND SOLUTIONS S.P.A.

Founded at the end of 2004, Pirelli Broadband Solutions operates in the research and development of advanced and innovative solutions for next-generation telecom infrastructures.

Supported by continual breakthroughs in technology from Pirelli Labs, Pirelli Broadband Solutions activities are based on integrating competences in the fields of photonics, nanotechnology and broadband access systems, both wired and wireless.

PBS develops competitive and innovative solutions that enable telecom operators to offer voice, data and multimedia services with customised products and end-to-end platforms. The products of Pirelli Broadband Solutions also enhance the increasing use of videoconferences and video calls, which in their turn help to reduce staff movements, and so creating positive effects, both direct and indirect, for the environment.

In 2006 PBS took steps to bring its product portfolio and processes up to the standards required by European Directives 2002/95/EC - RoHS (Restriction of the use of Hazardous Substances) and 2002/96/EC - WEEE (Waste of Electric and Electronic Equipment), reducing the presence of environmentally-damaging substances in its products and improving the product end-of-life management process.

In addition, in line with the Group's policy and in order to assist and improve the management of its environmental performance, the management of Pirelli Broadband Solutions has decided to govern its activities by adopting an Environmental Management System (EMS) in conformance with the UNI EN ISO 14001 standard.

The programme to introduce this system is to begin in 2007.

3.4. PIRELLI & C. REAL ESTATE S.P.A.

Pirelli & C. Real Estate operates in a particularly dynamic arena whose perimeters are subject to rapid changes. The company addresses its environmental aspects through three main activities.

The first is monitoring and reduction of the environmental impacts of activities in the company's sites. The second consists of offering customers who are properties owners solutions designed to reduce the potential environmental impacts deriving from the running of those properties.

The third activity is the development of designs for new building projects, in which particular attention is paid to aspects of social, economic and environmental sustainability, while simultaneously striving to preserve and enhance the territory in terms of attractiveness and competitiveness on a wider scale.

ENVIRONMENTAL IMPACTS

Together with the obvious occupation and use of land, energy consumption represents one of the main origins of the environmental impacts generated by the company's activities, products and services.

Consequently, the principal measures for mitigating these impacts are aimed at saving energy. For example the company has adopted the use of district heating (central heating supplied by the municipal electricity supplier, AEM, via a remote central heating system that produces hot and cold water and then distributes it via underground pipes). District heating now serves the entire head office (HQ) in Milan, and is being considered as a solution for the second head office (HQ 2) currently being planned.

Another example of rational use of energy is the cogeneration plant at the administration centre in the Ivrea district, where Pirelli RE and other companies (Vodafone, Wind, Olivetti, Olivetti MS etc.) have their offices.

This cogeneration plant, which is owned by the Group and managed by Pirelli & C. Real Estate Facility Management, provides heat and electricity not only to Pirelli but also to other companies that have premises in the area. A similar solution is currently being installed in the Pozzuoli district.

Energy and water consumption for 2006 at the main sites of Pirelli RE and managed districts

TOTAL CONSUMPTION	Milan HQ	Rome site	Naples site	Total	Pozzuoli District (3)	Ivea District (3) (4)
Water (m^3)	21,428	4,108	1,062	**26,598**	97,300	92,500
Electricity (MWh)	4,175	1,002	256	**5,433**	22,080	4,349
Fuel oil (Kg)	(1)	(2)	(2)		661,314	-

[1] Heat supplied by district heating system.

[2] Consumption not known because the building owner provides the heating and charges the cost as part of the rent.

[3] Other companies apart from Pirelli have premises in the district and therefore this figure does not apply to Pirelli Real Estate activities alone.

[4] Figures for office building 1.

Specific consumption per m^2 [5]	Milan HQ 27,078 m^2	Rome site 7,000 m^2	Naples site 1,619 m^2	Pozzuoli District 57,000 m^2	Ivrea District 30,500 m^2
Water (m^3)	0.79	0.59	0.66	1.71	3.03
Electricity (MWh)	0.15	0.14	0.16	0.39	0.14

[5] Figures are for consumption per square metre because parts of the premises are occupied by other companies, for which resource numbers are not known.

Waste production for 2006 at the main sites of Pirelli RE and managed districts

TOTTAL PRODUCTION	Milan HQ	Rome site	Total	Pozzuoli District [6]	Ivrea District [6]
Non-hazardous (Kg)	31,515	3,410	34,925	21,220	11,112
Hazardous (Kg)	500	938	1,438	593	7,596
Total	32,015	4,348	36,363	21,813	18,708

[6] Other companies apart from Pirelli have premises in the district and therefore this figure does not apply to Pirelli Real Estate activities alone.

ENVIRONMENTAL CERTIFICATION OF PIRELLI RE FACILITY MANAGEMENT

Among Group companies, Pirelli RE Facility Management has developed its environmental management system in conformance with the ISO 14001 standard, for which it received certification in 2002.

The process of certification covered the planning, coordination and provision of services for running and maintaining buildings and systems, managing heating and air conditioning for public and private civil systems, and providing services for people, spaces and companies limited to the activities conducted at the operations sites coordinated by the Milan office.

The management system involves approximately 150 persons in the operations department, who manage around 250 buildings belonging to external customers, 40 belonging to Pirelli Group and 1,250 sites belonging to Telecom Italia. Building management functions and services are provided partly through the use of other suppliers.

The main objectives achieved in 2006 are in the following areas:

» Limitation of the possibility of spills occurring during transport of diesel

» Extension of the spill management procedure to all suppliers

» Administrative management of waste

» Purchase and development of software for energy assessment of property

» Assessment of the environmental aspects and impacts of the 10 most important properties managed by the company

TERRITORIAL DEVELOPMENT

Pirelli RE is one of the foremost Italian companies operating in the area of large-scale urban development projects (principally the redevelopment of disused areas). The company was a pioneer in this area, and is responsible for some of the most important urban renewal programmes in Italy, as well as defining new standards at international level.

The company's development projects are guided by a theory of urban development that centres on the concept of "metropolitan city" and which views the contemporary city as a poly-centric system. Each urban 'pole' or extreme is characterised by its own identity and independence, while being at the same time perfectly integrated with its surrounding territory, and so overcomes fragmentation and contrast between city centre and periphery.

In this light, the design phase of the urban environment takes on crucial importance calling for strategic thought about social trends and dynamics: phenomena like globalisation, technological progress, de-industrialisation, and multi-culturalism have brought about changes rapid and radical enough to call for the rethinking of the very concept of "city" and its functions.

The following sections describe two projects drawing on the best practices internatinally available.

THE MALASPINA PROJECT

THE MALASPINA PROJECT

The area of the Malaspina project is located on the outskirts of Milan. The Pirelli RE project, developed as a joint venture with Aedes and Banca Antonveneta, has been devised with particular attention to well-being and quality of life, so that people can live and work in a lovely environmental setting.

Residential areas and offices both overlook the Malaspina lake, in one of the biggest green areas in Lombardy, as part of a regional project called "Ten Big Forests for the Plain", a breath of fresh air and nature extending over a total area of 720,000 m^2.

Residences 44,000 m^2 of gross floor area (GFA)

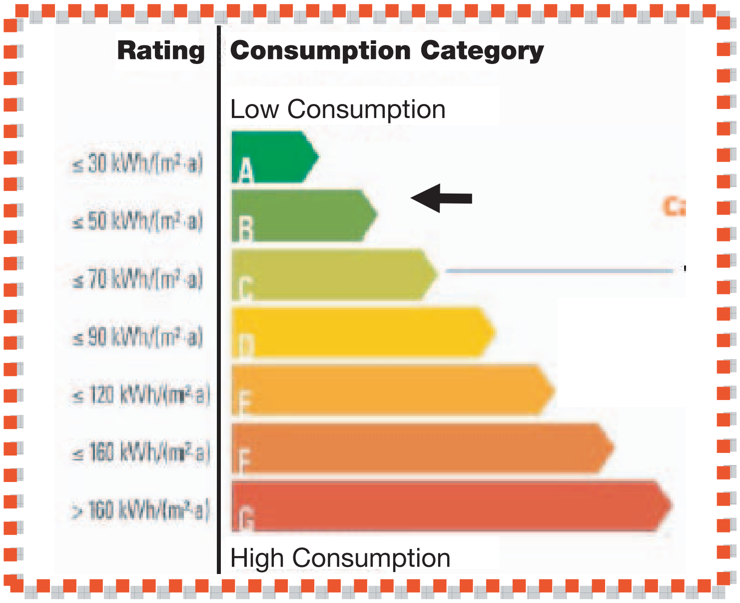
Business Park 22,000 m^2 of covered surfaces, 81,671 m^2 of total build able, 80,850 m^2 of green areas

Parking areas 20,000 m^2 of public parking, 54,115 m^2 of private parking

Phase 2 of the Malaspina project has been designed and construction has begun. The buildings are being constructed in conformance with the European energy certification requirements for residential properties and individual apartments, even though the provisions of Directive 2002/91/EC ("on the energy performance of buildings") specify that this certification will not be compulsory until July 2009 .

The certification specifies the annual amount of energy required to meet the needs associated with the standard use of the building, including winter heating and summer air conditioning, heating of water for sanitary use, ventilation and illumination.

Phase 2 of the project has been improved over Phase 1: the insulation of the building shell has been increased and the performance of the windows and doors has been improved, in order to raise the energy efficiency level from Class D (ranging from 70 to 90 kWh/m^2year) to the upper limit of Class B (ranging from 30 to 50 kWh/m^2year).



ENERGY EFFICIENCY CLASSES

Phase 3 of the Malaspina project has been designed in accordance with the requirements of energy efficiency certification. The following sections explain the main design choices that impact on energy savings:

Thermal cladding

The introduction of the so called thermal cladding increases the efficiency of the building shell insulation, eliminating heat bridges almost completely. In terms of energy efficiency, this brings an improvement of around 10%, all other factors being equal. Installing the cladding does not involve changes to the structural design; only minor construction details need to be introduced. Contracting and beginning construction do not need to be postponed.

Use of controlled ventilation

The project also features the use of a controlled ventilation system* to reduce the heat lost due to the external air.

In a class B building the percentage of external air is over 30% of the total air flow and cannot be desregarded.

Quality of door and window frames

Superior quality door and window frames are being installed in order to obtain low transmittance* levels. Transparent surfaces are in stratified double glazing. The overall transmittance of the doors and windows is expected to drop from 2.3 W/m² K to approx. 1.6 W/m² K, allowing the occupant to maintain optimal internal levels of temperature and humidity in the apartment, allowing considerable energy savings at the same time.

These improvements also enable the building to approach energy efficiency class A, representing a further step towards high quality housing..

Moving from energy efficiency class B to A saves around 20 KWh/m² per year which, for a 100 m² apartment, corresponds to a saving of around 180-200 euros/year, and a reduction in CO_2 emissions of around 1 tonne/year.

HQ2 - THE 'HEADQUARTERS 2" PROJECT

Known as HQ2, this project is the extension of the head office of Pirelli Real Estate S.p.A. The project has several features aimed at achieving major objectives in terms of energy efficiency and the use of renewable resources. The design criteria adopted are in line with current Italian legislation and with environmental sustainability criteria.

THE HQ2 PROJECT

The façade

To minimise the use of artificial lighting, the windows will be located as close as possible to the ceiling.

The south-facing side of the building will feature an interactive ventilated-module façade with shading curtains and external glass.

In order to reduce energy consumption for air-conditioning in summer and at the same time make the maximum possible use of solar radiation in winter, the orientation of the Venetian blind shutter blades can be adjusted.

The north and east-facing sides will have a single-layer cladding façade and window frames designed to accept curtains that can be rolled up internally, but which – unlike traditional curtains – extend bottom up instead of top down, in order to take maximum advantage of available natural light.

Particular attention has also been given to the non-transparent areas of the building shell, with the adoption of a layer of a 10cm-thick insulating material in front of the building structure, a ventilated chamber and a lining in porcelain stoneware slabs.

The air heating systems

The design of the heating systems allows energy needs to be controlled (this is in fact the principal cause of energy waste).

The building will be heated by the district heating system, powered by the Milano–Tecnocity cogeneration plant.

The energy needs of the HQ2 building will be just over 1 million kWh, with a gross heated volume of approx. 65,000m^3. Taking into account the performance figures on heating systems, these values imply a primary energy need (PEN) of 8.2 kWh/m^{3}year, which is largely less than the minimum requirements to be observed from 1 January 2010 onwards: 11.5 kWh/m^{3}year.

Consequently, the energy savings that can be obtained stands at around 3.3 kWh/ m^3 anno, which implies a reduction in CO_2 emissions of around 100 tonnes/year (not to mention the economic savings of around 21,000 euros/year in winter alone).

The project also enables reductions in consumption during summer as well, resulting in savings of 20-30% referred to a standard building.

In order to make use as far as possible of renewable energy sources to meet energy requirements, the building will be equipped with a photovoltaic system to cover the roof of the main body of the building.

As far as internal air conditioning, the building will be fitted with a system of ceiling radiating panels, allowing comfortable levels of heat/humidity.

3.5. PIRELLI & C. AMBIENTE S.P.A.

A Pirelli Group company founded in early 2005 following the merging of Pirelli & C. Ambiente activities with Cam Tecnologie, Pirelli Ambiente produces solutions for the environment and sustainable development and proposes to the market a vast range of products with low environmental impact and high technological content.

Thanks to the synergies with Pirelli Labs – the Group's advanced research centre –the company's ongoing commitment is addressed to develop increasingly eco-compatible products and processes and innovative solutions, e.g. technologies to reduce emissions of harmful gases, or in the field of renewable energy production, and materials science.

Pirelli Ambiente consists of three specialized companies, each dedicated to a different business area:

- Pirelli & C. Ambiente Renewable Energy – Renewable energy sources
- Pirelli & C. Ambiente Eco Technology – Technologies for sustainable development
- Pirelli & C. Ambiente Site Remediation – Environmental remediation

PIRELLI & C. AMBIENTE RENEWABLE ENERGY (PARE)

With regard to the recovery of energy from waste, Pirelli Ambiente Renewable Energy has developed and patented – in collaboration with Pirelli Labs – a high quality WDF (Waste-Derived Fuel).

The fuel is obtained by adding to the dry portion of solid urban waste (S.U.W.) a number of components with a high calorific power such as end-of-life tyres (ELTs) and non-chlorinated plastics.

It is mainly used for co-combustion as a partial replacement for conventional fossil fuels in existing energy generation and power stations, such as thermoelectric power stations and cement works.

The product, created using Pirelli Ambiente Tecnologie technology, is of a higher quality than fuels derived solely from urban waste. Its distinctive features are:

- the product's consistency and homogeneity;
- type of raw materials used;
- low humidity and chlorine content;
- high calorific rating;
- definition of the relations of mass;
- physical form of the fuel's components, designed to smoothly feed a combustion chamber.

In addition to its formula enriched with end-of-life tyres(ELTs) and non-chlorinated plastics and the calorific stability this entails, the fuel stands out for its contribution to improving emissions.

It is used to partially replace carbon in percentages varying between 10-25%.

The cost of generating electricity is a quarter of the cost of using biomasses.

All the projects promoted by Pirelli Ambiente Tecnologie based on the use of quality fuel quantify and analyse the environmental benefits involved by means of Life Cycle Assessment (LCA), which evaluates the entire manufacturing process and flows of materials and energy involved in each separate operation supporting the chosen technology.

WDF-P CHART

WDF-P in Italy

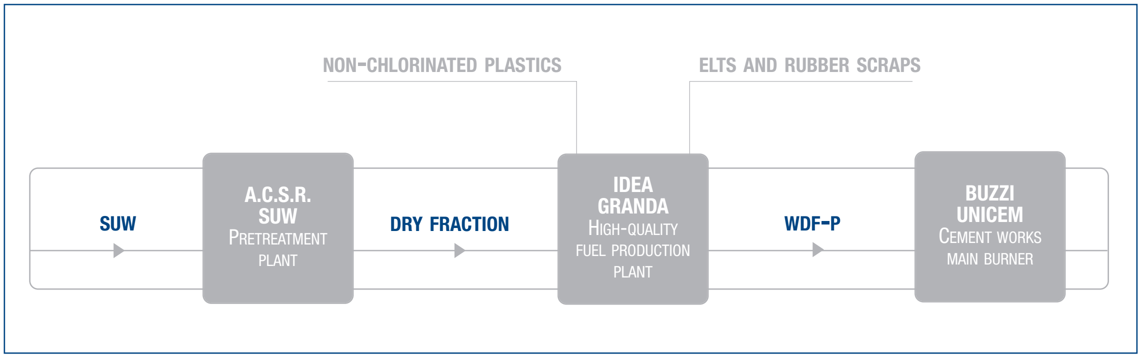
IDEA Granda is a consortium, 51% owned by ACSR (Azienda Cuneese Smaltimento Rifiuti, a waste disposal company in Cuneo) and 49% owned by PARE, whose objective is to produce a high-quality fuel derived from waste (WDF-P) at its plant in Roccavione (Cuneo), using as its main raw material the dry fraction of the urban solid waste produced by the 54 municipalities in Cuneo Province that have signed up to the ACSR consortium.

The integrated system, centred around IDEA Granda envisages that the waste produced by the municipalities adhering to the ACSR consortium, that was previously sent to the consortium landfill in Borgo San Dalmazzo, is processed to separate the dry fraction from the humid fraction. The dry fraction is then processed and enriched in the IDEA Granda plant to obtain high-quality CDR-P.

The actual energy recovery takes place when the fuel is burned in co-combustion at the largest cement works in Italy, owned by

VIEW OF IDEA GRANDA PLANT
IN ROCCAVIONE, CUNEO

Buzzi Unicem Group and located in the nearby municipality of Robilante. WDF-P directly feeds the main burner of two of the four furnaces in the plant, partly replacing the fossil fuel traditionally used.



The Integrated System

According to a study by the Bicocca University in Milan conducted using the Life Cycle Assessment method, the IDEA Granda integrated system is, respectively, 90 and 72 times better for the environment than alternative solutions like landfills and waste-to-energy incinerators, with a percentage of energy recovery from waste of 32% in the area served, compared with an average in Italy of 7% and a European average of 27%.

The use of WDF-P, in addition to contributing to the reduction of landfill waste disposal that today afflicts all industrialised countries, is an ideal opportunity for high energy consuming industries (particularly cement works and thermoelectric power stations) that are now required to increase the use of alternative energy sources over traditional fossil fuels, enabling them to make an important social contribution.

In the Buzzi Unicem cement works, use of WDF-P in 2006 resulted in a reduction of CO_2 emissions of over 30,000 tonnes into the atmosphere (each tonne of CDR-P used in co-combustion saves 1.75 tonnes of CO_2), making an important contribution to Italy's objectives taken on for the Kyoto Protocol*, and also a saving of over 20% of NO_X emissions, or approximately 300 tonnes. Furthermore due to the biodegradable fraction contained in the fuel (approximately 50%), CDR-P is recognised as a renewable energy source, and therefore eligible for the financial incentives available for these sources.

PARE is also committed to the technical standardisation of waste-derived fuels, and contributes to the development and validation of technical specifications and analysis methods for solid recovered fuels, for the purposes of their upcoming conversion to European standards.

WDF-P worldwide

In 2004 a study by the EEC (Earth Engineering Centre) in Columbia University gave its complete approval for the use of PARE's quality WDF in America, while a study conducted in 2005 by the IEFE (Institute of the Economics of Energy Sources) in the Bocconi University in Milan found it to be the cheapest renewable energy source available.

In 2005 Pirelli signed an agreement with the English company Re-Energy for the production and sale of WDF-P in the UK.

In 2006 the Clinton Global Initiative (CGI), a foundation set up by ex-US President William J. Clinton to collect resources to tackle the macro-problems faced by the planet, approved the PARE initiative in the area of "climate change". Through the spread of waste-to-energy technology, the PARE initiative aims to reduce CO_2 emissions by 5 million tonnes over 3-5 years in North America, Europe and Asia.

LOGO OF CLINTON GLOBAL INITIATIVE

PIRELLI & C. AMBIENTE ECO TECHNOLOGY – TECNOLOGIES FOR SUSTAINABLE DEVELOPMENT

GECAM, the White Diesel™

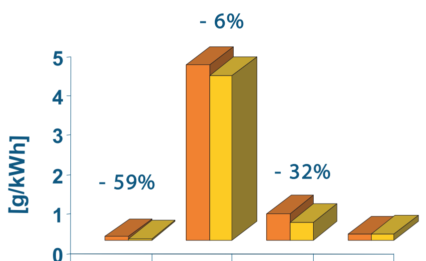
Pirelli & C. Ambiente Eco Technology operates with considerable success in the sustainable development technology sector, thanks to Cam Tecnologie's long lasting experience in low environmental impact fuels with GECAM, the white diesel™ and in antiparticulate filter technology with the Feelpure™ filtering system. The GECAM™, patented by the Group, reduces the pollutant emissions typical of diesel oil (fine particulates, carbon monoxide and nitrogen oxides*).

GECAM™ is an emulsion of water (10%) in diesel oil which is usable by diesel-powered vehicles and in power stations. The presence of water ensures a more complete combustion of the hydrocarbon, reducing the formation of particulate and improving the consumption efficiency. Furthermore, GECAM™ lowers the temperature in the combustion chamber, and reduces the formation of nitrogen oxides.

Many centres of excellence in the field of research and certification of engines and emissions have verified the environmental benefits of emulsions. In particular, the tests performed on GECAM™ by the European Commission Joint Research Centre in Ispra and Eni Tecnologie laboratories showed reductions of over 50% in emissions of particulates, 5-6% in nitrogen oxides, and over 30% in carbon monoxide.

GECAM™ TRACTION: ENVIRONMENTAL RESULTS

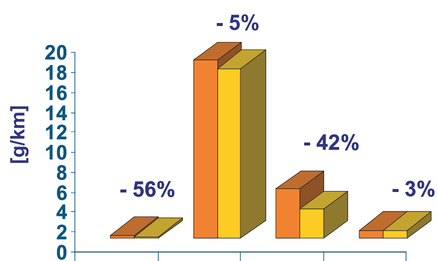
Engine: IVECO-Cursor Euro 3.
Cycle: stationary ESC



	PM	NOx	CO	HC
ULSD[1] (10 ppm)	0,088	4,435	0,665	0,145
GECAM (10 ppm)	0,036	4,175	0,454	0,167

Source: European Commission joint Research Centre in Ispra

Vehicle: IVECO Euro 2 urban bus.
Engine: IVECO 8360
Cycle: ATM (Milan transport authority) line no. 61



	PM	NOx	CO	HC
ULSD[1]	0,315	17,862	4,948	0,815
GECAM	0,139	17,036	2,891	0,794

Source: ENI TECNOLOGIE

[1] ULSD = *Ultra Low Sulphur Diesel*

Pirelli & C. Ambiente Eco Technology received a Special Award for the GECAM™ emulsified diesel and its innovative solutions in sustainable transport, at the 2006 World Renewable Energy Congress (WREC), an international conference held by the University of Florence and the ABITA Centre (Architecture, Bioecology and Technological Innovation for the Environment).

GECAM™ CHART

Gecam, the white diesel™ is an environmentally-friendly fuel, patented by the Group, that is capable of reducing particulates by 50%.
It is a an emulsion of water (10%) in diesel oil for use in vehicles and heating systems:

- largely adopted by over **10,000 diesel-powered vehicles** (buses, lorries, diesel trains, street-cleaning vehicles, waste collection and earth-moving vehicles) and over **400 public and private buildings**
- available at a **lower price than traditional diesel, such as to reduce operating costs**
- tested by **Eni Tecnologie** Laboratories, by the **European Commission Joint Research Centre** in Ispra, by the main engines and burners makers, by **the Municipality of Milan** in cooperation with the Experimental Fuel Station (**SSC**, *Stazione Sperimentale per i Combustibili*) and by **SGS Ecologia**
- available throughout Italy from 8 production sites and also in France and in the Czech Republic
- assists and improves the performance of particulate filtering systems in terms of emissions of PM and NO_x

Feelpure™

Feelpure™ is an exhaust gas treatment system for diesel vehicles already in circulation (via retrofit) with a mass of over 2.5 tonnes. Feelpure™ is made up of three elements:

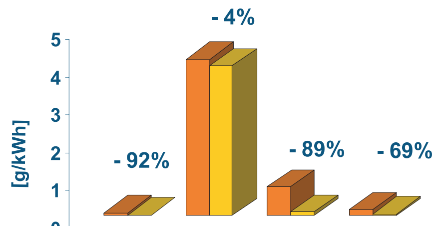
1. A **particulate filter** in porous silicon carbide (SiC) fitted in a stainless steel can inside the exhaust silencer.
2. An **additive** to be added to ordinary fuel, which allows for the complete combustion of the carbonaceous particulate previously trapped by the filter (a process of regeneration).
3. A **control unit** that monitors the entire system: this detects counterpressure at the exhaust and the exceeding of alarm thresholds. It doses the additive to be added to the fuel on vehicles with this kind of feature.

Recent tests, conducted by Eni Tecnologie Laboratories, the European Commission Joint Research Centre in Ispra and the University of Biel under the VERT programme, have shown reductions of over 90% in mass particulate and 99% in finer particles, over 90% in carbon monoxide and up to 69% of unburned hydrocarbons.

Nowadays several hundred buses in Italy are using the Feelpure™ filter system and more systems are being installed on earth-moving vehicles, heavy transport vehicles, diesel trains and electricity generators.

FELPURE™: ENVIRONMENTAL RESULTS

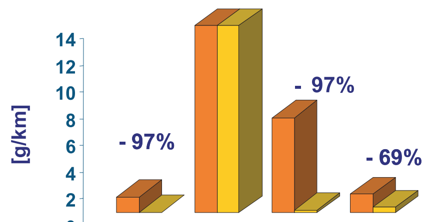
Engine: IVECO-Cursor Euro 3.
Cycle: stationary ESC



	PM	NOx	CO	HC
Without filter	0,076	4,13	0,761	0,15
With filter	0,006	3,965	0,084	0,047

Source: European Commission joint Research Centre in Ispra

Vehicle: IVECO Euro 2 urban bus.
Engine: IVECO 8360
Cycle: ATM (Milan transport authority) line no. 61



	PM	NOx	CO	HC
Without filter	1,169	14,293	7,139	1,403
With filter	0,033	14,342	0,206	0,433

Source: ENI TECNOLOGIE

Feelpure™ is an exhaust gas treatment system for diesel vehicles already in circulation (via retrofit). The Feelpure™ system can reduce particulates by over 90%.

The filtering system developed by Pirelli Ambiente Eco Technology:

- Contains a **silicon carbide filter (SiC).**
- Uses an organometallic **additive** molted in the fuel, which is necessary to regenerate the filter.
- Can be adapted to all engine types – from Euro 0 to Euro 4 – running on fuels with **normal sulphur content**.
- Can be used on buses, trucks, earth-moving vehicles (quarries, building sites, tunnels), diesel trains and electricity generators.
- Has been tested by **Eni Tecnologie** Laboratories, the European Commission Joint Research Centre **JRC in Ispra** and the TTM-University of Biel under the VERT qualification programme.
- Unlike other technologies on the market, the Feelpure™ filtering system **does not result in increased emissions of NO_2** (nitrogen dioxide), a dangerous pollutant with negative effects on health and which is on the rise in our cities.

FEELPURE™ CHART

In 2005 Pirelli & C. Ambiente Eco Technology was awarded the *Premio all'Innovazione Amica dell'Ambiente* (Friend of the Environment Innovation Award) by Italian environmental association Legambiente together with the Lombardy Region Council.

Quinta Edizione
Premio all'innovazione amica dell'ambiente

BANDO 2005
efficienza nei consumi ed eco-design
soluzioni per una progettazione sostenibile

PIRELLI & C. AMBIENTE SITE REMEDIATION S.P.A. ENVIRONMENTAL REMEDATION

The initial experience gained by Pirelli & C. Ambiente Site Remediation S.p.A. in environmental remediation was the redevelopment of Pirelli Group's historical industrial site in the Bicocca area in Milan in the early 1990s.

Over the years the company has widened its expertise by providing support to other companies in the Pirelli Group in the management of industrial areas throughout Italy, as well as providing support to Pirelli & C. RE in the acquisition and environmental remediation of new disused areas and/or property assets.

Pirelli & C. Ambiente Site Remediation has gained considerable experience in the remediation of disused industrial sites and offers a complete management service that includes all phases of the process, from the preliminary assessment of environmental liabilities (Environmental Due Diligence*) of property assets and/or sites that may require property broking services, to the development of the necessary engineering activities and management of relations with the relevant authorities through to complete redevelopment and valorization of the areas, with respect to the environmental aspects, timing and specific customer requirements..

Whenever possible, remediation operations make use of on-site decontamination systems (e.g. bioremediation) or in situ systems (e.g. bioventing), to reduce the volume of contaminated materials for disposal.

In situations where site remediation has required the excavation of contaminated materials, to reduce the overall volume of waste to be disposed off, the following activities have been carried out:

- » Enhanced characterisation during the investigation phase, to best determine the characteristics of the soil to be dug up
- » Riddling and separation of the fine fractions, for best reuse of uncontaminated materials on-site
- » Enhanced characterisation of the soil to be sent to landfill
- » Complete on-site recovery of materials originating from demolitions

The following table shows the extent of the work carried out by Pirelli & C. Ambiente Site Remediation to date:

Total surface area redeveloped or undergoing redevelopment	approx. 3,000,000 square metres
Buildings demolished	approx. 3,800,000 cubic metres
Material salvaged from demolition work	approx. 800,000 cubic metres
Earth dug up and processed for remediation	approx. 1,700,000 cubic metres
large-scale remediation projects via on-site remediation	4
large-scale remediation projects involving site safety	4

3.6. PIRELLI LABS S.P.A.

A Pirelli labs technician

Founded in May 2001 with an overall investment of 135 million Euros, Pirelli Labs represents the Pirelli Group's pole of technological excellence.

The research centre, extending for around 13,000 m^2 in the Milan Bicocca area , is active in the fields of photonics and new materials.

Organised into three departments – Optical Innovation, Material Innovation and Process Innovation – Pirelli Labs represents the point of reference for all Pirelli research activities worldwide and is directly linked to the research centres of the group's business units and also with leading privately-owned and university research centres in the US, Russia and Italy.

In 2006 Pirelli Labs continued its research into the development of components (membranes and electrodes) for fuel cells*, which are an ideal solution for producing electricity at a time when fossil fuels are coming ander increasing pressure and there is a growing demand for clean energy sources to reduce emissions of greenhouse gases.

Development work continues to be focused of SOFC (Solid Oxide Fuel Cells) and PEM (Polymer Electrolyte Membrane), concentrating on the optimisation of components for small-scale cells (max 1000 W) for powering mobile electronic devices and for cathodic protection of gas transport lines.

Results obtained in the synthesis of ceramic materials and their miniaturisation have been applied in the manufacture of electrodes for SOFC, as part of the cooperation with the prestigious Alberta Research Council (ARC) in Canada. The combination of the fuel cell miniaturisation technology developed by the ARC with the electrodes made from innovative materials developed at Pirelli Labs has resulted in efficient cathodic protection devices to be used on transcontinental gas pipelines in North America.

Unlike products already on the market, which are made from fluoridated polymers, the PEM membrane developed by Pirelli Labs has the capacity to operate at high concentrations of methanol, the fuel envisaged for use in consumer portable electronic devices.

These characteristics have been evaluated by the major players in the world market for fuel cells. Samples of the material were provided to these companies for evaluation of their performance as components in the main applications for mobile electronics. The outcome of these evaluations was positive and has led one major player to begin a joint programme of evaluation and development of the Pirelli Labs membrane, aimed at creating a next-generation industrial reference.

In the field of hydrogen-powered fuel cells, the technological development of a membrane has been completed and a technical/economic assessment of production *scale up** of this material has been completed.

Pirelli Labs continued its research into the development of applications based on the recovery of end-of-life tyres (ELTs). Of particular note is the initial industrial development of products obtained by mixing ELT granules with suitable bonding materials and so producing materials ideal for reducing footstep noise. A number of pilot sites have been identified and large-scale (over 1,000 m^2) trial installations performed in premium residential buildings.

Field tests have confirmed the product's noteworthy features, especially in terms of economy and ease of laying, while acoustic tests, conducted by an accredited laboratory in accordance with the ISO 140/7 standard, returned noise reduction values better than current market standards.

2006 saw the conclusion of another major development programme of great importance in terms of environmental impact. Pirelli Labs has developed poles for telecommunications networks, made of a composite material of recycled polypropylene and fibreglass. These poles will replace current wooden poles impregnated (to provide resistance to environmental agents) with CCA

(Chrome Copper Arsenic) compounds, now banned by the European Union. The cost benefit of the product has been demonstrated and a sound process has been implemented to make these new poles both competitive with older wooden poles and largely cheaper than fibre glass poles.

In 2006 progress was recorded in the joint research programme with Telecom Italia, involving the study of innovative materials suitable for use in radiofrequency devices for telecommunication applications.

In this particular field is worth mentioning the so called Telemedicine Project carried out with important international partners provides experts with innovative means of checking key medical parameters of non-hospitalised patients, without requiring them to change their usual lifestyle.

The project, through the field trial phase has demonstrated its applicability and reliability on a significant sample of patients and it has attracted significant interest from the medical community.

In the field of renewable energy, of note is the experimentation with a series of innovative prototypes based on photovoltaic concentration technology aimed at direct field evaluation of the efficiency of these systems compared with conventional systems made of flat panels in crystalline silicon.

4. SOCIAL DIMENSION

4.1. INTERNAL COMMUNITY

Group companies recognize the central importance of human resources in the belief that the key to the success of any business is the professional contribution of the people that work for it, in a climate of fairness and mutual trust. Group companies shall safeguard health and safety in the workplace and consider respect for workers' rights as fundamental to the business. Working relationships are managed with a view to guaranteeing equal opportunities and promoting the personal development of each employee. (Article 6 of the Ethical Code – Human Resources).

THE FIGURES - BREAKDOWN OF HEADCOUNT

Haedcount breakdown by sectors as at December 31th, 2006:

BREAKDOWN OF EMPLOYEES ON 12.31.2006

	Corporate[1]	Tyres	Real Estate	PBS	Ambiente	Total
Executives	89	210	194	15	9	**517**
Staff	1262	4946	1401	145	41	**7795**
Blue-collar	15	20013	269	6	2	**20305**
Total	**1366**	**25169**	**1864**	**166**	**52**	**28617**

Δ 2006 Vs 2005	Corporate[1]	Tyres	Real Estate	PBS	Ambiente	Total
Executives	(16)	22	28	4	1	**39**
Steff	15	246	256	41	7	**565**
Blue-collar	(8)	1228	(34)	(1)	1	**1186**
Total	**(9)**	**1496**	**250**	**44**	**9**	**1790**

Geographical breakdown by sectors as at December 31th, 2006:

GEOGRAPHICAL BREAKDOWN OF EMPLOYEES ON 12.31.2006

	Corporate[1]	Tyres	Real Estate	PBS	Ambiente	Total
Europe	1349	12993	1864	166	52	**16424**
North America	-	265	-	-	-	**265**
Latin America	16	9786	-	-	-	**9802**
Asia, Africa and Oceania	1	2125	-	-	-	**2126**

Δ2006 VS 2005

	Corporate[1]	Tyres	Real Estate	PBS	Ambiente	Total
Europe	2	332	250	44	9	**637**
North America	(14)	39	-	-	-	**25**
Latin America	3	663	-	-	-	**666**
Asia, Africa and Oceania	=	462	-	-	-	**462**

[1] **Pirelli & C. SpA, SSC, Pirelli Labs, PISEFI, CSAP, SAP, Polo Viaggi, Foreign Corporate Companies**

Type of employment contract as at December 31th, 2006 and comparison of 2006 vs 2005:

TYPE OF EMPLOYMENT CONTRACT	2006 VS 2005	
Permanent	87.9%	(0.5%)
Fixed term	9.4%	0.6%
Agency workers	2.7%	(0.1%)
Part-time (% on total of FTE*)	0.8%	0.1%
Stage / Other [4]	543	(72)

[4] **Non included in total employees.**

Employment flows as at December 31th, 2006:

EMPLOYMENT FLOWS ON 12/31/2006 [5]	
New Hiings	5016
Employee Leavings	3156
Average length of service (years):	
Executives	10
Staff (cadres included)	10
Blue-collar	9

[5] **Not including people involved in corporate acquisitions or assignments of companies or of company branches.**

The Group's workforce trend is characterised by consistent growth (+1790 employees), compared to the previous year. This increase especially results from the tyre sector's hiring of personnel to strengthen the new industrial plants in China and Romania, the increased labour workforce in Brazil subsequent to changes in the Campinas factory's work pattern and the increased production volumes in the Feira de Santana and Gravatai factories. An addition of 250 employees was recorded in Pirelli & C. RE due to the consolidation of the Credit Servicing Company.

Concerning the movements of incoming and outgoing personnel, we must take the issue of seasonal work into account - a typical phenomenon in the tyre sector that requires temporary workers to stand in for permanent workers (approx. 700 people between Germany and Turkey) to maintain production volumes constant during the summer months.

The group does not employ anybody under the age of 14.

The tyre sector employs 45 young workers aged between 16 and 18 years (26 in Brazil, 4 in UK and 15 in Germany) and as an exception 18 young workers aged between 14 and 16 years in Brazil, as part of training and induction schemes in line with local laws.

[6] **Human Resources**

HR[6] POLICIES

To steer the crucial phases of integration and development of human resources, the Pirelli Group applies an extensive policy system on both a group (Corporate initiatives) and Sector/foreign affiliate Company level.

Salary Review policies are locally applied by individual countries except for procedures involving Executives worldwide and key resources involved in international mobility schemes, since these categories are centrally coordinated by the Group's Parent Company according to a common rationale and always respecting the requirements of an international Management team. In 2006 a Development Centre phase coordinated by the Group's Parent Company and focused on objectively evaluating the potential of individual candidates was introduced to the assignment process of new executives.

Policies concerning **Performance Assessment/Improvement** are closely linked to salary review policies.

100% of Executives and 50% of Cadres take part in the Group's annual incentive scheme (MBO), which sets clear Group/Business and individual economic-financial targets and pays out bonuses varying according to assessment and the extent to which the said targets are achieved.

An important project is geared towards relaunching of an assessment and performance refining system (referred to as Performance Management), aimed at improving the relations betweem managers and thei staff. This system will be launched *en masse* in 2007, in the whole Group.

In 2006 Pirelli Tyre launched a worldwide project to map the skills of key resources in the Sales, Industrial and Quality Departments. The programme was geared towards creating a common platform to start planning and implementing dedicated training tracks and compensation and development actions along common lines and coordinated by the sector.

The **International Mobility** policy, which bears witness to the international framework's strategic value in the development of leadership within the Pirelli Group, deserves special focus and visibility.

Over the past ten years, an average of approx. 250 people, numbering executives, cadres and staff of various nationalities and cultures, have yearly compared notes, developed professional skills and made the most of new managerial opportunities, thus contributing to build a truly international Group.

Many features of the new global labour market have triggered the need to define a more flexible approach to the international framework to speedily meet both the organisation's requirements and the needs of individuals who work therein.

The new policy provides flexible answers to requests/demands that were once perceived as an obstacle to international mobility, i.e. dual careers (considering the partner's work-related/personal needs), family requirements, different schooling systems, etc.

Over the past 5 years the maximum duration of foreign travel has, for instance, been reduced from 5 to 3 years, thus enhancing the rotation of personnel in the Group's developing/strategic sites, while concurrently meeting family requirements and the issue of dual careers. The option of commuting (widely chosen especially in Europe, this involves a Monday to Friday routine and a relatively close location to enable an easy weekly return to the country of origin) has also been introduced.

Job transfers abroad and missions are still the most widely used methods.

Lastly, international mobility perceived as a real development opportunity can be fully considered as a supporting tool in the Group's Equal Opportunities project. At the close of 2006 the percentage of women on the total number of personnel transferred abroad was approx. 15% (slightly higher than the previous year). We believe this percentage, thanks to the grater flexibility adopted tools, is set to increase in the near future.

THE GROUP'S EQUAL OPPORTUNITIES PROJECT

The Group's **Equal Opportunities Project** was begun in 2005, in compliance with the principle *"...to ensure equal opportunity and to, promote the development of each individual"* declared in the aforementioned Policy for Health, Safety, Environment and Social Responsibility and to implement provisions in art. 6 of the Group's Ethical Code, in the section that says "....*Working relationships are managed with a view to guaranteeing equal opportunities and promoting the personal development of each employee*".

The goal of the Project is to guarantee equal opportunities for professional growth in all company functions and environments, thus enabling the entire Company to manage the "diversity" issue in an effective and cutting-edge manner as it strives to achieve its business goals.

From an organisational perspective, in 2005 the Project involved the appointment of an *Equal Opportunities Steering Committee*, a high standing body appointed to direct and safeguard corporate plans on the issue of equal opportunities. A *Group Equal Opportunities Manager* was concurrently appointed to direct the Project's operational implementation inside the Group, to pursue greater organisational balance and to monitor the progress of equal opportunities in all Affiliates.

The organisational framework was completed in 2006, when Country Equal Opportunities Managers were appointed to locally direct and monitor the progress of equal opportunities.

2006 also witnessed the early stage of communication of the project content.

The first step in this direction consisted in drafting and publishing the Group Equal Opportunities Statement (already mentioned in the first chapter of present sustainability section).

Translated into the 11 main languages commonly spoken in our Group, this statement has already been conveyed to all employees - both electronically and in hard copy - with an introductory note signed by the Chairman. The Document is published in the Pirelli Group's website and can be accessed by the external community in the "Sustainability" area.

The second initiative involved the draft of a leaflet describing the project's most relevant contents. This too has been translated into the main languages spoken by Group employees and is currently being distributed. Distribution will be completed in 2007.

Concerning contents, the Project envisages the Group's commitment in two main action areas: the first is human resources management, which is increasingly inspired by the principle of making the most of differences and guaranteeing equal opportunities for professional growth; and the second concerns a greater care on work-life balance issue, with a view to facilitating the reconciliation of the professional/private lives of company employees.

It is clear that the first area is a challenge that presumes the specific intention to really influence corporate mentality.

To this end, the Company has undertaken to implement specific "positive actions" for selecting, developing and training human resources.

In particular, the screening and development framework aims to:

» Establish a joint male-female *short list* as a basis for the selection process for all types of personnel search geared to the placement of said personnel at any level of the organisation.

» Promote tailor-made measures in functional areas that most lack balance

» Guarantee equal access opportunities to training initiatives, international mobility programmes, promotions and new responsibilities

» Guarantee the principle of equal opportunities in all analysis and assessment phases related to career tracks

» Implement local periodical control processes for the abovementioned actions throughout the different affiliates.

Training will be the tool aimed at raising awareness within the organisation as regards the issue of acknowledging and valorising diversity. encouraging personnel to really shoulder their responsibilities concerning the abovementioned topics.

The second action area, which is closely related to the typical socio–economic frameworks of individual countries where the Group operates involves corporate commitment to pay more heed to demands that may surface from time to time. Initiatives that can both influence working hours and support to employees' families have, for instance, been theorised.

The Internal Equal Opportunities Complaint Procedures – designed to totally defend the principles of equal opportunities announced by the Statement and to be implemented in all Group affiliates – reached the final drafting stage at the close of 2006. They will be enforced in all affiliates in 2007, consistently with local regulations.

Concerning the subdivision of headcount by gender, figures as at December 31th 2006 show an approx. 20% (vs. 17% in 2005) incidence of females holding managerial functions, 36% (same as 2005) of females in staff functions and 3% (vs. 2% recorded in 2005) in the labour group. Dynamics have improved, compared to last year, due to the natural course of events, since specific positive actions targeted at promoting /increasing female presence both in the areas that most lack balance and in managerial/leading posts will be launched in 2007.

Another aspect of **equality of treatment** that the company seeks to ensure and monitor group-wide is that of **remuneration**.

In this regard and as already recorded in the 2005 Sustainability Report, basically equal salary conditions for men and women have been confirmed at all organisational levels (i.e. executives, cadres and staff).

EMPLOYER BRANDING* AND SELECTION

Talent attraction initiatives tools*

To control the crucial phases of the human resource integration and growth process, the Pirelli Group applies an extensive system of policies both as Group (corporate initiatives) and in the various sectors/foreign affiliates.

Policies that define and regulate the Personnel Research & Selection process are locally applied by affiliate companies, consistently with currently enforced practices and local regulations. In Italy, for instance, the screening mode adopted for recent graduates is centralised and managed by the HR Department during the first stage of CV sourcing and screening . Later and with the collaboration of a specialized external company an assessment phase takes place, based on Group dynamics, tests and individual interviews; finally probing cognitive interviews are directly carried out with the Line Manager who is assisted by the HR Department. Positively evaluated candidates are integrated in the Company through a training and orientation track.

Talent Attraction initiatives through which the Group expresses itself include:

» ***Employer Branding:*** choice of reference universities/faculties/Master's Degree courses in leading universities in Italy, Romania, China and Brazil – the Group's international development centres; than brand management and Pirelli's presence there through contacts, corporate presentations, case hystories, practical training sessions and recruitment days held by the HR Department with the Line Managers from the various departments/business areas.

  This activity has lead in 2006 to an increased number of candidates, recording for instance an average 600 a month in Italy.

» ***Career Days:*** this international job meeting network envisages a cycle of events that yearly involve some of the leading university cities, thus enabling Pirelli to directly meet graduates, under-graduates and young professionals. Pirelli considers participation in such events an important employer branding tool. In 2006 Pirelli had its own stand at universities in Milan (Bocconi University, Polytechnic, Bicocca), Pavia, Turin and Naples.

» ***Career Books:*** this is a career service for work orientation, post-graduate training, recruitment and communication targeted at undergraduates, recent graduates and young professionals. These guide-books are organised into three sections – post-graduate orientation, company profile (which describes the corporate profile, screening procedures, career tracks and has a brief section on CV presentation) and training – and are distributed in placement offices in universities, orientation offices, internship programmes, associations for graduates, bookshops and during Career Days.

In this framework Real Estate has started an integration and "job rotation" programme called **Campus Project** for twelve recent graduates in economics, architecture and engineering.

The project envisages a one-year job rotation period in 3 corporate departments or areas through the scheme for transversal skills development to learn how to conduct real estate business in an all round perspective. The on the job training project is completed by a classroom training track designed to develop and transfer both technical and managerial skills.

Recruiting day 2006 in Vizzola

60% of participants in the project found employment in the Company. In 2007 the Campus Project will be organised for the second consecutive year.

Another project organised in 2006, in this case by Pirelli Tyre, was "**Recruiting day at the Vizzola track**". On this occasion 70 undergraduates from the most prestigious universities had the opportunity to attend a course on safe driving during the early part of the day; they later participated in a first screening phase held by means of an innovative team game.

Another initiative organised in the Career Days' framework was **Recruiting Day at the Milan Polytechnic** – "**Lunch with Pirelli**". This event saw the participation of staff from the Pirelli HR Department to explain the corporate framework and the Company's recruiting process.

A number of Line Managers belonging to three different areas (i.e. managerial, mechanical and electronic/TLC) also participated in the event. They elaborated on job openings and answered the participants' technical and specific questions on the type of work. Finally, all candidates participated in individual interviews.

TRAINING AND DEVELOPMENT

Training & development tools

Summarised below are the Group's main training & development tools:

» ***Skills Catalogue***: the Skills Catalogue is geared towards creating a common landmark to define training activities, in order to meet the need to develop skills and the organisational behavioural patterns required of Pirelli Group employees.

The Top Management defined reference skills (grouped into 10 categories to enable easy identification) during the Pirelli Values certification process. To enhance a common language, the Skills Catalogue backs the spreading and implementation of Group skills. It enables to perform a training analysis and meets the specific requirements related to the role of Pirelli managers.

- ***Potential Assessment Manual:*** Assessment Centres, Development Centres and overall Feedback Questionnaires sustain both moments of awareness enhancement and the monitoring of managerial potential. Such tools are also used in the Group Talent development framework (in various phases of corporate life) and they also photograph various professional family populations.

- ***Performance Gauge Tool (PM):*** based on a transparent, shared and objective performance evaluation system, it is an important tool both from a performance improvement perspective and to back manager-associate relations.

  In 2006 the Group focused on relaunching this process through a more slender and flexible online tool.

  Early in 2007 all managers will be involved in classroom training sessions.

- ***Global Grade System:*** this handbook provides guidelines for using the Global Grade System and how it is related to the Standard Positions. Each Standard Position may be broken down into: technical-professional skills, competencies/attitudes, background and organisational structure. Finally, it provides support in designating specific roles, recruiting, job posting, organisation charts, pay schemes, development schemes, and target-setting for the incentive scheme.

[8] **Pirelli's classification system of corporate positions/roles.**

Training & Development Projects

Described below are the main Training & Development projects:

- ***Executive Best Practices*** (designed for the Tyres Operations sector's senior management): project goals envisage the creation of dialogue, vision and common commitments to facilitate effective organisational changes, construct "teams of leaders and team leaders", spread managerial culture inside the organisation, provide self–development tools and opportunities, align managements and backing systems to promote and strengthen the constant development of management in the Tyre Business's Operations area.

  The programme includes the following 4 modules: Managing People, Managing Relations, Managing Innovation and Managing the Unexpected. The project's follow up was developed through two individual coaching meetings to define each manager's personal professional development and growth track.
- ***Intercultural Management in China:*** 2006 saw the close of the workshop cycle designed to enhance the skill to recognise differences in "cultural frameworks" resulting from the convergence of European and Chinese culture, besides acquiring more detailed knowledge and information on the latter's macroeconomic framework.

- ***Managerial Development in China:*** a Development Centre programme was organised for a group of fifty managers to define each one's progress concerning skills and a personal training programme.

- ***Training online on CSR:*** an awareness-raising tool on the topic that was spread through the Group's Intranet system to all employees.

  The communication project for all Pirelli Group employees was implemented by defining posters and leaflets dedicated to the topic of CSR; the distribution of material to all Group employees will be completed in 2007.

The material comprises part of the classroom training activities that will take place in 2007 for all employees who work by Pirelli's production facilities based in emerging countries

- ***Start-up Romania Tyres:*** training opportunities especially for on the job training were organised for approx. 125 workers during the start-up phase of the new Tyre production plant in Romania. These workers were provided with both theoretical and on the job training in the Group's production plants based in Italy, Turkey and Germany.

  Staff were given a prolonged training period (approx. 3–4 months) depending on the role played. Topics of discussion numbered Group values, its Ethical Code and multicultural differences.

In the framework of training activities provided by Pirelli Real Estate, 2006 saw the completion of the traditional training catalogue. It was designed to develop managerial and professional skills with targeted integrated training geared towards meeting the requirements of well defined professional families and sectors.

The following projects are worthy of note:

- ***Company Kitchen – Ingredients for a Team:*** this outdoor team building project resorted to the kitchen as a "metaphor of the corporate team".

  The Residence Business Unit's entire team experienced the 'innovative trend of learning by doing at the stove, based on the theory that high quality cuisine requires the use of resources, knowledge, organisation and methods, as basically occurs in a corporate team.

  It was an opportunity for everyone to exchange ideas and experiences and to engage in some healthy competition: the people involved were divided into three teams that competed in various tests by preparing savoury lunches under the guidance of a professional chef. The experience encouraged discussion on relational and communicational dynamics, in an entertaining manner in the breath-taking setting of the Barilla Academy in Parma.
- ***Training for Buyers:*** project inspired by a well defined organisational need, i.e. to group the professional family of buyers under a single Department, even if they come from different companies and experiences. The project commenced by mapping all buyers' skills to define the required training level. The training track, which is organised in 11 days (3 held in 2006 and 8 to be held in 2007) that alternate the development of technical expertise and managerial skills, is designed to encourage all round considerations on the various skills required of buyers in the current corporate framework.
- ***Training for Credit Servicing:*** this training project centres on the corporate framework of Credit Servicing, which in 2006 experienced a merger between Pirelli RE Credit Servicing and SIB. The training track is organised in different levels, ranging from training on newly adopted software (Fenice system) to course tracks with specific goals, such as integration, regulatory updates and the development of typical managerial skills for the activity performed.
- ***Mirror:*** this track differs from classical training modules in that it involves a preliminary phase for participants to evaluate and establish their self-development plan after the Development Centre experience. The project comprises 5 *Mirror Workshops* that are preceded by an introductory kick–off and an analysis of training

requirements, besides a wrap–up to summarise and evaluate the situation. Every workshop centres on a "set" of specific managerial skills, such as, for instance, leadership, negotiation, relational skills and self–development. Specific practical training sessions designed to create a sense of commitment and continuity in participants are launched between one workshop and the next.

» ***Getting Ready for Management:*** this is both a celebration and a training session targeted at newly appointed executives in the Real Estate Group. The meeting's training goal is to inform participants about the latest in the administrative field, providing food for thought in a managerial framework in the light of their new role

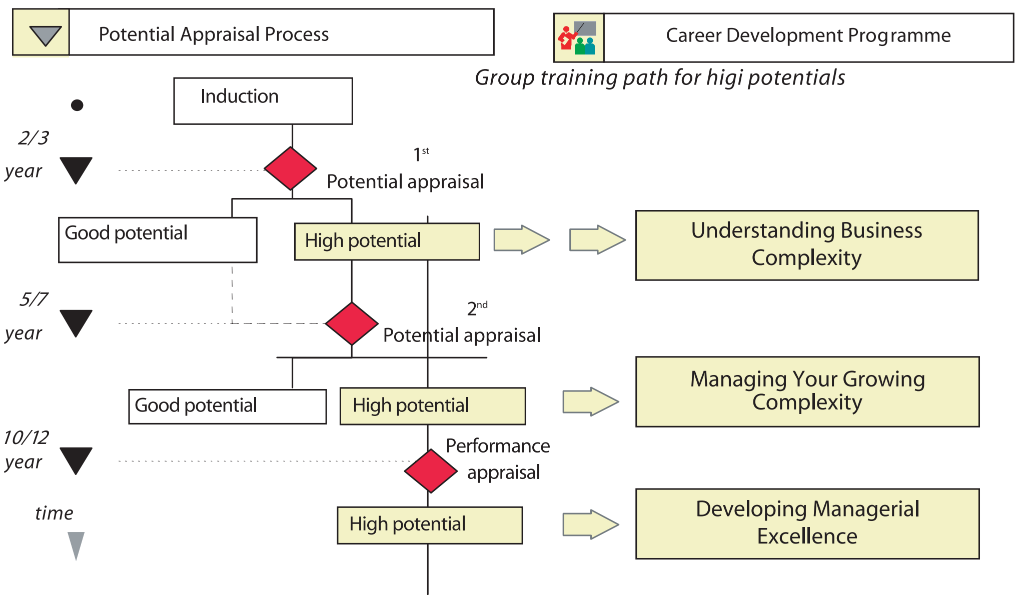
» ***Accelerating Self Enhancement:*** a 7–day training track targeted at newly appointed executives in the Real Estate Group. The meeting is geared towards developing and enhancing the participant's cognitive and emotional personal resources to achieve effective leadership that can produce significant changes in his or her progress.

Talent retention inititives and tools*

Talent Retention levers through which the Group operates are organised as follows:

» ***Career Development Programmes:*** these tracks are designed to promote the development process of High Potential Personnel in various phases of their professional life. In association with the best European business schools, these programmes are organised, managed and coordinated at a Group level to provide solid skills and the capacity to make the most of one's potential. Each step envisages a specific training and development plan.

The following diagram describes the entire process, course placement and the respective programmes:



The Career Development structure will be updated in 2007. This updating will include an increase in the number of Development Centres, including regional centres with courses in the local language.

The 3 main steps (i.e. UBC, MGC, DME workshops) that envisage one week periods of pure training remain unchanged.

The following is a concise but brief description of the contents of the three mentioned workshops

1) ***Understanding Business Complexity (UBC)*** – the workshop is designed to view business from the right perspective to move in multiple directions – to this end personal experiences are compared with those of colleagues from the other Group businesses corporate departments and different cultural frameworks; to encourage greater awareness of personal professional skills and values; to assess participants' alignment with both high potential profile skills and Pirelli values; and, to construct personal future development; in this regard instead Pirelli Real Estate envisages a Development Centre.

2) ***Managing Your Growing Complexity (MGC)*** – develops skills to help face the

managerial role's growing complexity, understand success factors in the decision making framework, provide participants with feedback on motivations, skills and areas open to improvement and provide assistance in defining a well structured development plan.

3) ***Developing Managerial Excellence (DME)*** – designed to understand the links between the various functional frameworks and their impact on the management of business projects and to develop complex managerial skills (i.e. analysis of difficult contexts, problem solving, multicultural teams, stress management).

The following tables show attendance at the three workshops held in 2006 and 2005 in terms of number of participants by country of origin:

CAREER DEVELOPMENT PROGRAMME 2006							
UBC	10 Italy	2 Germany	1 Spain	1 Turkey	2 Brazil	2 UK	1 Argentina
TOT UBC 2006: 19							
MGC	12 Italy	3 Germany	2 Egypt	1 Turkey	2 Brazil	1 UK	
TOT MGC 2006: 21							
DME	13 Italy	1 Germany	1 Japan	1 Greece	2 Brazil	-	
TOT DME 2006: 18							

CAREER DEVELOPMENT PROGRAMME 2005											
UBC	23 IT	3 GER	2 SP	5 BR	4 GB	1 US	1 VENEZ	1 FR	1 CINA	1 MEX	1 COM Units
TOT UBC 2005: 43											
MGC	21 IT	5 GER	1 SP	4 BR	2 GB	3 US	1 AUSTRALIA	1 UNGH	1 MIDDLE EAST	-	
TOT MGC 2005: 39											
DME	16 IT	1 GB	1 RUSSIA	1 BR	-						
TOT DME 2005: 19											

Further Talent Retention tools in the Training and Development framework, besides Talent enhancement and development, are *Development of Skills by Professional Area*, *Development of Professional and Managerial Skills*, the *Fostering ACF Skills* programme and the *Running the Market Project*.

» ***Development of Skills by Professional Area*** – this path includes training programmes that are geared towards improving, deep-rooting and spreading expertise of specific professional areas (e.g. Administration and Control; Sales and Marketing; Manufacturing and Quality; Personnel; R&D), focusing on the "hard" and "soft" professional skills required to achieve professional excellence. Talents required for the various roles are especially highlighted.

» ***Development of Professional and Managerial Skills*** – this path includes training programmes designed to improve, strengthen and spread Pirelli Group professional and managerial skills that are deemed necessary to hold increasingly complex posts (e.g. integration programmes for new recruits, transition programmes from junior to senior posts and programmes for recently appointed managers). In this case too special focus is reserved for Group Talents. In 2006 a new course called "Coaching & Feedback" dedicated to help managers better develop their associates' management skills through feedback and coaching techniques was added to Pirelli's training catalogue.

» ***Fostering ACF Skills*** – this training programme was developed for the professional family Administration, Control and Finance to construct a growth track for future CFOs, to improve specific skills and to enhance the sense of belonging to the professional family itself by capitalising the most significant best practices both inside and outside the Company. Designed and managed in collaboration with SDA Bocconi, the training track will continue in 2007 with further modules geared to develop managerial skills that are closely linked to the roles envisaged in the professional considered area.

» ***Running the Market*** – a project designed to map commercial skills required in the European area. A training plan focused on filling the gap in skills and on developing role skills has been defined on the basis of mapping results. The training course envisages technical, professional and managerial training modules. In 2007 the same courses will also be organised in English for personnel belonging to the European commercial units.

Training Activity Figures

The following table reports the number of average training days per person by professional category. The table also shows variations recorded in 2006, compared to 2005:

2006 (AND VARIATION 2006 VS 2005)

Personnel Training (average days per person)	Europe	U.S.A.	Latin America	Others	Total
Executives	2.2	0.0	6.9	1.1	2.4
Staff (including Cadres)	6.3	0.9	7.2	6.3	4.6
Blue-collar	2.4	0.5	5.2	1.5	3.5
Total 2006	**2.9**	**0.7**	**5.5**	**2.5**	**3.8**
total 2005	2.7	0.2	3.4	1.3	2.8
Variation 2006 vs 2005	**0.2**	**0.5**	**2.1**	**1.2**	**1**

The above reported increase in training days per person organised in Europe in 2006 is the outcome of more catalogued training activities dedicated to the Management and to initiatives implemented for specific professional families. We must also consider the impact of training provided in the new site in Romania (Slatina).

The significant increase in figures for Latin America is a result of training provided to blue-collars, especially concerning professional/legal activities (safety etc...).

The increasing training results in the "others" item stems from new training/development activities implemented at Pirelli's Chinese branch and targeted at enabling blue-collars and staff to correctly carry out their roles.

INTERNAL COMMUNICATION

COMMUNICATION CHANNELS

Pirelli Corporate Press

In the internal communication framework promoted by Pirelli, the corporate press plays a primary informative role, as witnessed by both the high number (currently 28 magazines) and quality of publications produced by the Group’s Affiliates and targeted at employees, stakeholders, authoritative institutions and external opinion makers.

This ‘mixed’ distribution is proof that the Pirelli Group’s corporate press plays an increasingly extensive role of information and interaction, since it is not solely designed for internal circulation, but also for ‘communities’ of associates, suppliers and, in a broad sense, for all those who operate around the Group and for local communities in whose framework Pirelli operates in the various countries.

2006, in particular, witnessed the release of a considerable number of magazines in countries with remarkable market differences. The Italian production plant in Figline Valdarno has created the exquisitely technical bulletin “Il Filo di Arianna” – designed solely for internal circulation, which witnesses the high standards of discussions on production and safety issues.

In Spain, HR and Marketing Departments have introduced two new magazines – “Pirelli News” and “Planet Pirelli” – that enhance and integrate communication with employees and external stakeholders in response to an increasingly mature market. In Brazil, the new monthly magazine called ‘Giro’ – published in recycled paper consistently with the Group’s environmental policy – has absorbed the previous three magazines, thus optimising the use of resources and distribution in the large South American area.

Lastly, a new publication – “Pirelli Newsletter” – published in two editions (English and Chinese) and targeted at all South–East Asia has been released in Singapore, where a Chinese version of the magazine Pirelli World published in Italy was already distributed. The first issue of “Pirelli Tre Newsletter”, whose print run of 20,000 copies has just been distributed in China and will reach and inform the drivers of Asian market dynamics,

The full colour 28 periodical magazines published by the Group both in Italy and worldwide are a highly relevant and significant asset for Pirelli because they spread information, strengthen corporate identity and promote visibility. The table below briefly reports their main details.

PIRELLI GROUP
CORPORATE MAGAZINES

[2] Published and distributed in the steelcord production plant in Figline Valdarno.

[3] 10,000 at the SEMA Show in Las Vegas.

[4] In 2006 it replaced Pirelli Flash and PQT Ativo.

[5] Distributed since January 2007.

[6] Distributed since January 2007.

[7] In 2006 it replaced Pirelli World in Chinese.

[9] From 2002 to 2006 also in Chinese.

COUNTRY	TITLE	LANGUAGE	TARGET	FREQUENCY	PRINT RUN
Italy	Fatti e notizie	Italian	Employees	Bimonthly	13,500
	Pirelli Flash	Italian	Employees	Monthly	6,600
	Pirelli World	English [9]	Management Pirelli (worldwide)	Quarterly	13,500
	Il Filo di Arianna [2]	Italian	Employees	Six-monthly	500
Germany	Pirelli News	German	Employees	Monthly	2,000
Great Britain	Pirelli News	English	Dealers and Consumers	Six-monthly	7,000
	Inside Pirelli	English	Employees	Quarterly	1,000
	Team Pirelli	English	Consumers	Six-monthly	8,000
Portugal	Planet Pirelli	Portuguese			
Czech Republic	Messaggero	Czech	External public	Four-monthly	20,000
Spain	Pirelli In	Spain (Castilian)	Employees	On special occasions	250
	Flash quality	Catalan	Employees	Quarterly	800
	Flash security	Catalan	Employees	Quarterly	800
	Pirelli News	Spanish (Castilian)	Employees	1,000	
	Planet Pirelli	Spanish (Castilian)	Dealers	Four-monthly	3,500
Turkey	Pirelli Radial	Turkish	Employees and External public	Bimonthly	7,500
United States of America	Pirelli Newsletter [3]	English	Dealers and Consumers	Quarterly	7,000
Argentina	Pirelliando	Spanish	Employees and External public	Bimonthly	1,000
	Mejorando	Spanish	Employees and External public	Bimonthly	1,000
	mkt [3]	Spanish	Employees, dealers and national press	Six-monthly	5,000
Brazil	Giro [4]	Portuguese	Employees	Monthly	7,200
	MotoPneu	Portuguese	Dealers	Quarterly	10,000
	MotoPasioN [5]	Spanish	Dealers	Quarterly	6,000
COUNTRY	TITLE	LANGUAGE	TARGET	FREQUENCY	PRINT RUN
Brazil			(Columbia, Argentina, Mexico)		
Chile	Pirelli E-News	Spanish	Employees and Dealers	Bimonthly	online
Mexico	Pnewss	Spanish	Employees and External public	online	
Venezuela	Mundo Pirelli	Spanish	Employees and External public	Bimonthly	online
China	Pirelli Tyre Newsletter [6]	Chinese	Dealers, Retailers, Consumers, the Press	Bimonthly	20,000
Singapore	Pirelli Tyre Newsletter [7]	English Chinese	Management and External public (Singapore, Malaysia, Indonesia, Thailand, South Korea, The Philippines, Taiwan, Hong Kong)	Quarterly	8,000

A rich and diversified publishing scene indeed: a family of magazines linked by goals and contents. Each magazine has its distinguishing features that mirror the specific traits of the country where it is conceived and circulated. The coordination and check of content consistency with the Group's ethical values and communication policies are ensured by the Milan–based Pirelli Corporate Human Resources and Media Relations Departments. Three Italian magazines are registered periodicals as they are of public interest,and not at prevalent advertising content; these magazines are edited by a pool of editors and are directed by a professional journalist.

Beyond language, format, periodicity and circulation differences, the content and function of all publications considered in this Sustainability Report are chiefly informative with low advertising content. They focus on the dual goal of conveying information that is as consistent, complete and capillary as possible and of encouraging the Pirelli Group, its associates, stakeholders and local communities where they operate to exchange and share facts and values.

Knowledge Management Methods

The Pirelli Group has always been committed to spreading knowledge within the corporate framework to generate wealth from its very intellectual capital.

Expertise development is valuable for the creation of increasingly efficient and effective processes that improve quality and reduce times and costs, thus creating value for the client on the one hand and for Pirelli personnel on the other.

Pirelli knowledge management activities can be divided into two macro–areas: online activities and offline activities.

Many online activities can be accessed by the corporate intranet system, which is the most widely used knowledge management tool by Pirelli worldwide employees. We can, for instance, mention the following tools and activities:

» *Learning communities* to learn content categorised by functional area

» *"Knowledge at work" platforms* for information exchange on the state of projects advancement

» *Electronic notice boards* targeted at conveying corporate messages to all employees

» *Handbooks* to refer to for technical expertise

» *Mailing lists* for internal communication campaigns and social promotion.

With regard to offline knowledge management, we note the following:

» The *Chief Knowledge Officer*'s role and activities – who is the reference corporate figure for technical expertise on product and research

» *Road shows* – meetings that convey corporate strategies at all organisational levels

» *Corporate training and targeted training* – large scale learning programmes designed to cover an extensive range of both business and managerial contents

» *Improvement Teams* in industrial areas designed to improve processes

» The use of *corporate notice-boards* to communicate with factory personnel. Tailor–made courses are also organised for factory employees to compensate for the impossibility of conducting online training.

Knowledge management tools are steadily developing to improve both employee satisfaction and customer-oriented performance.

In this perspective 2007 will see the implementation of a development project for the corporate intranet system and of new communication tools targeted at both the internal and external community (suppliers, clients, local communities, etc.).

Group Opinion Survey

2006 saw a wide-ranging communication action of results that emerged from the first worldwide opinion survey launched by Pirelli in November 2005.

Considering a result analysis conducted in a specific mode and differentiated by country, professional family and business, results were published in the corporate intranet systems with the same segmentation. Intranet communication was enhanced with informative moments and feedback first involving Country Managers and Central Department Directors and, gradually, other levels in each facility (through specially organised focus groups) to effectively share and interpret the results that surfaced and to encourage the identification of targeted bottom-up improvement actions.

Such a structured wide-ranging action was geared towards encouraging greater focus on effective internal communications (this need emerged from the survey outcome).

Awareness of the results obtained led to the Group's commitment to implement both local and Group improvement actions, in response. In particular, in response to areas defined in 2006 as requiring improvement, the *Performance Management process* that will be massively launched and implemented in 2007 was redefined (it is described exhaustively in the Training & Development section); the *Career Development Programme* was also revisited by highlighting and distinguishing assessment moments from training; and, lastly, worldwide communication of the *Equal Opportunities Project* was commenced. In 2007 the latter will involve the implementation of "positive actions" in the framework of Human Resources Management and work-life balance, based on the principle of optimising differences and equal opportunities.

In the light of the high participation rates in this first worldwide opinion survey (approx. 70%) – a sign of people's involvement and their wish to contribute towards the Pirelli Group's improvement – in 2007 the Group will conduct a second edition of the opinion survey, this time involving labour categories as well as management and staff.

INDUSTRIAL RELATIONS

The Group's Industrial relations are carried out as a constructive dialogue, fully respecting fairness and the respective roles. Guaranteeing and respecting employees' freedom to engage in union activities has always been one of the company's key points.

Relations and negotiations with Trade Union are managed locally, in accordance with the laws, national and/or company level collective agreements and customs and practices in force in each country. This is supported by the guidance and supervision of central Company Functions, which intervene to ensure the appropriate aspects of activity coordination and to guarantee the aforementioned principles.

In 2006 Industrial Relations activity reached important goals: the renewal of collective agreements in many of the Group's production plants without unrest, as occurred in Italy, United Kingdom, Germany, Turkey, Romania and Brazil. This confirms the relevant effects of the aforementioned policies on the outcome of negotiations.

Two important projects to establish two new modern production plants designed to replace the current sites in Settimo Torinese (Lombardy, Italy) and Manresa (Spain) have commenced, involving Trade Unions and the local Public Administration.

THE EUROPEAN WORKS COUNCIL

Set up in 1998, the Pirelli European Works Council (EWC) was designed to encourage dialogue between the Company and its employees, namely, the information and consultation through Delegates on the overall progress of the Group's European companies and and on its general directions.

EWC Delegates are provided with the IT tools required to perform their duties and a connection to the corporate Intranet system, for the real time communication of official Company's press releases.

The Council meets in ordinary session once a year, following the presentation of the financial statement, to learn about economic trends, financial-economic forecasts, investments carried out and planned, progress in research, etc.

Extraordinary meetings are also envisaged whenever information and consultation are required in the light of transnational events that concern important corporate changes, new openings, the restructuring or closure of sites and relevant widespread work organisation innovations, always in Europe.

During the 2006 annual meeting, the Equal Opportunities Project, the report of the relevant results achieved by Pirelli Real Estate and options for its future expansion abroad were introduced and discussed, besides the usual topics.

In light of the European Union's enlargement, as from 2007 participation in the Pirelli EWC will also be extended to Romania.

COMPLIANCE WITH LEGAL AND CONTRACTUAL REQUIREMENTS ON OVERTIME AND TIME-OFF

The policy of complying with all legal and/or contractual prescriptions concerning overtime work and the right to periodical days of rest applies to the entire Pirelli Group. These topics are often the focus of understandings both with trade unions and individual workers, respecting the many different regulatory contexts.

Every worker's right to use his or her total number of holidays suffers no restrictions. The holiday period is generally agreed between the worker and the Company.

LABOUR AND SOCIAL SECURITY LAWSUITS

Broadly speaking, conflicts recorded level is low, hence the low entity of labour and social security lawsuits.

In the entire Group, except for Brazil, 56 new lawsuits were filed in 2006.

In Brazil the incidence of labour-related lawsuits is traditionally high, numbering over 90% of lawsuits brought against the whole Group, to date.

This phenomenon is also present in other multinationals operating in this country, where,generally labour-related lawsuits are brought when an employment contract is terminated and the suits usually concern the interpretation of regulatory, legal and contractual issies that has long been controversial.

UNIONISATION INDEX AND INDUSTRIAL ACTION

The Group's unionisation index cannot be precisely calculated, since this information cannot be provided by all countries. We can however estimate that about half the Group's employees are trade union members.

The percentage of employees covered by collective agreement in 2006 remains unchanged compared to the previous year's and is around 85%. This percentage is the result of the various national frameworks' historical and cultural differences. In some countries, e.g. Italy, all employees' employment contract are regulated by collective agreement, while local laws are applied in other countries, like China.

Individual contracts are held by approximately 10% of the employee population, e.g. executives worldwide, except for Italy, *Managers* in the UK, "*Non Tarif*s" in Germany, "*Excluidos*" in Spain, "*Senior*" and "*Esecutivi*" in Brazil.

The overall conflict rate recorded in 2006 was very low.

Industrial actions during the year were only recorded in Italy and Brazil.

Concerning the Brazilian production plant Santo André, the two-hour strike demanded a better canteen service.

Disputes in Italian production plants, instead, concerned managerial aspects. They were all speedily and positively solved.

OCCUPATIONAL PENSION PLANS AND HEALTHCARE SCHEMES

Turning to pensions and healthcare plans, the situation has undergone no relevant changes in 2006. Most affiliates still provide supplementary pension schemes for their employees.

The Group's policy envisages removing defined-benefit funds to the advantage of defined-contribution funds. Almost all supplementary pension funds in the Group are indeed defined-contribution.

Defined-benefit funds can only be found in the UK (they concern employees who were hired prior to an established date, while those hired after that date participate in a defined contribution fund), in the USA (some years ago these funds were closed to active employees to the advantage of defined-contribution funds; since then they only cover retired personnel and they are not influenced by wage increases) and in Germany (the plan was closed to new hires in 1982).

Pension schemes are generally completed by insurance policies against death and permanent disability.

In Italy the subject is developing with the introduction of supplementary pension funds in recent years and with recent provisions on the allocation of the retirement allowance.

Even regarding supplementary healthcare schemes, 2006 is basically the same as 2005, since no essential events have influenced them.

Healthcare schemes envisaged by the Company offer levels and forms of coverage that differ from country to country, in compliance with local needs. Most of these schemes are managed by Insurance Companies and specially created Funds. The Company participates by paying a fixed rate, as occurs in Italy, or an insurance premium, as occurs in Brazil and in the USA.

Occupational Healt & Safety and Industrial Hygiene

Health, Safety and Hygiene Management complies with the Pirelli Group Policy for Health, Safety, Environment and Social Responsibility, whose contents can be found in the introductory section.

The Policy's complete text, which was conveyed to all Group employees in their respective languages, can also be accessed from the company website, www.pirelli.com, in the "Sustainability" area.

To ensure greater precision, the various topics discussed below will be divided under "Pirelli Tyre", "Pirelli Real Estate" and "The Group's Other Sectors/Companies".

SAFETY MANAGEMENT

Pirelli Tyre S.p.A.

A Safety Management System organised and certified to meet OHSAS 18001 standards has long been in operation in the Tyre Sector (which also comprises steel cord production plants).

At the close of 2006, the Operational Units certified to this standard numbered 19 (on a total of 24 production plants); 5 plants are now implementing their Safety Management System.

The Safety Management System implemented in the Group's production units has been developed on the basis of centrally drafted common procedures and guidelines. This has enabled the use of a "common language" inside the Group, in terms of key elements for Safety Management in workplaces and a common one-track operating mode.

Pirelli Real Estate S.p.A.

In the light of Pirelli Real Estate S.p.A.'s kind of performance, which is basically related to "services", a formal certification of the Safety Management System based on the OHSAS 18001 standards was not deemed necessary.

The corporate organisation is structured as follows:

A delegating process (delegating chain) for Safety Management, including a "spending power", envisaging a Control System for delegates has been implemented.

"Peripheral Management Committees" have been established – since 2006 Safety Department representatives have also participated in Peripheral Committees for Operational Areas (only Pirelli RE Facility's operating areas spread throughout the national territory: Milan, Ivrea, Genoa, Rome, Naples and the Italian islands) to sensitise all operational area personnel on topics concerning health, safety, accident prevention and work hygiene.

Moreover, from 2006 the Safety Manager has organised meetings with groups of Pirelli RE Facility operatives both to involve them and to hear their opinions on work safety issues.

These meetings were also extended to some Territorial Trade Union Organisations to describe the "Safety Management Models adopted by Pirelli RE" and to sensitise the workforce on the topic of prevention and safety, even with the external trade union's contribution.

Since 2005 Pirelli Real Estate SpA's Central Safety Department has participated in Periodical Committees for the General Management of Pirelli RE Property and of Pirelli RE Facility with the precise purpose of constantly updating Department Managers on the topic of Accidents, Prevention, Protection and on actions designed to gather information and to steadily manage and improve company's and managed real estate assets safety levels & standards.

A system was also introduced for emergency and First Aid services mapping and management.

Since March 2005 Prevention and Protection Department Managers have been present in all Pirelli RE Facility's territorial operations areas (i.e. Milan, Ivrea, Genoa, Rome, Pozzuoli and Palermo), while a dedicated department operates centrally for the other companies.

Besides receiving the legally envisaged training, appointed personnel are constantly updated about new legal provisions and they are provided specific technical updates through the documentation and implementation of sustaining actions.

The Prevention and Protection Service continues its assistance, information and "proactive control" service for all company operational facilities.

Pirelli Real Estate devotes special attention to safety management in building yards in compliance with Legislative Decree no. 494 dated 14 August 1996, which implemented the Directive 92/57/EEC concerning the minimum safety and health measures to be ensured in either temporary or mobile building yards (i.e. large building yards for construction works/extraordinary maintenance).

For such activity, a safety control and monitoring system has been established for individual building yards, in order to guarantee the specific law's application level and relevant requirements.

Though the following is not directly related to health and safety issues, to ensure completeness we wish to mention other actions implemented in the aforementioned large building yards:

- Definition of a periodical monitoring system to check that all contractors/subcontractors have regularly paid their tax contributions (INPS, INAIL, Cassa Edile)
- Creation of a special team to combat concealed labour and tax evasion (via surprise inspections in building yards: a project enforced from January 2007 onwards)
- Periodic meetings with control bodies (LHA, only in Milan) to compare notes on experiences, to discuss new regulations and to fight concealed labour / tax evasion

Other Group Sectors / Companies

As already implemented by the Group's operational units, Pirelli Broadband Solution, Pirelli Ambiente, Pirelli Labs and Corporate also encourage the development of a Safety Management System based on the Group Policy for Safety, Environment and Social Responsibility.

As already specified for Pirelli Real Estate and, in the light of the characteristics of the said facilities and the business performed therein, a formal certification of the Health and Safety System was not deemed necessary in the companies mentioned. It was, instead, deemed appropriate to encourage the local development of management systems that could better adapt to each facility's features.

A delegating system for Safety with Expenditure Value has been implemented at organisational level. There are also local organizational structures designed to support corporate safety management.

At corporate level, the Health, Safety and Environment Department directs and controls safety, work hygiene and environmental protection throughout the Group.

In particular, corporate structures have drafted the appropriate guidelines and procedures that have been locally adopted to define Management Systems.

HEALTH & SAFETY PERFORMANCE GAUGING

Pirelli Tyre S.p.A.

Concerning safety and focusing on injuries data recorded in **production plants**, the 2005 performance has been basically maintained.

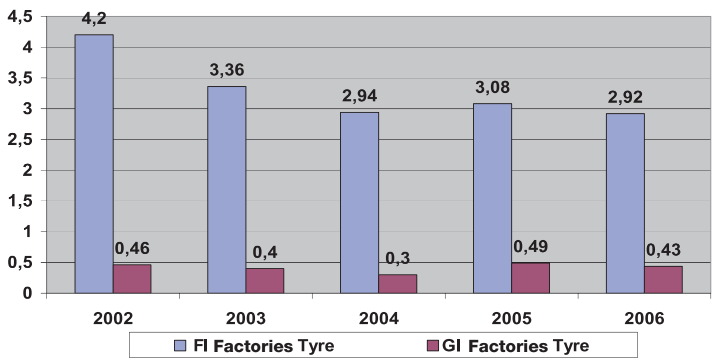
Including all injuries that have occurred in tyre factories and based on the sector perimeter considered in 2005 , the Frequency Index (FI) was exactly the same as in 2005, while the Gravity Index (GI = 0.45) recorded a 6.6% per cent improvement, compared to 2005.

Considering the total number of production plants and also data on the recently opened production plant in China, which did not exist during the 2005 survey, performance indexes improve further by reaching **FI = 2.92 and GI = 0.43,** due to the low injury rate recorded in the Chinese production plant.

To better understand this data, we remind that the GI was calculated by considering as "lost" all calendar days between the injured person's interruption of work and his/her return to the factory, without counting the day of the accident*. Holidays and weekly rest days that occurred in the said period have been included(10).

The calculation of the aforementioned indexes did not include the so called "*in itinere*" injuries, of wich we specify below.

See the graph below.



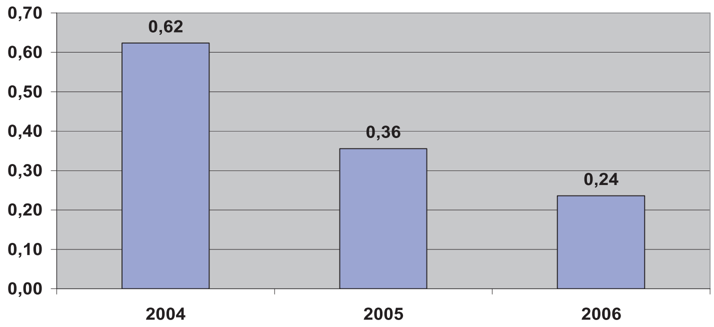
FI-GI Tyre Factories

[10] $$FI = \text{Frequency Index} = \frac{\text{Total number of injuries with work interruption}}{\text{Total actually worked hours}} \cdot 100.000$$

$$GI = \text{Gravity Index} = \frac{\text{Total days lost due to injuries}}{\text{Total actually worked hours}} \cdot 1.000$$

Remarking on the above data, we must take into account that the 2005 increase in indexes was basically due to the extension to all secotor's production plants of the European "definitions" adopted to calculate both injuries and lost working days, which generated a concurrent impact on indexes.

Referring now to employees' "Health" issue, the 2006 Frequency Index of new occupational disease cases was 0.24, marking a net improvement compared to previous years. This can be clearly noticed in the trend of the below graph.



Occupational diseases in Tyre Factories per 100,000 worked hours

Even though there is a net improvement recorded, continuous improvement of health, hygiene and work conditions remains our goal .

Shifting focus to injuries occurred in Tyre Sector's **non production units**, the following values were recorded in 2006:

FI = **1.61**

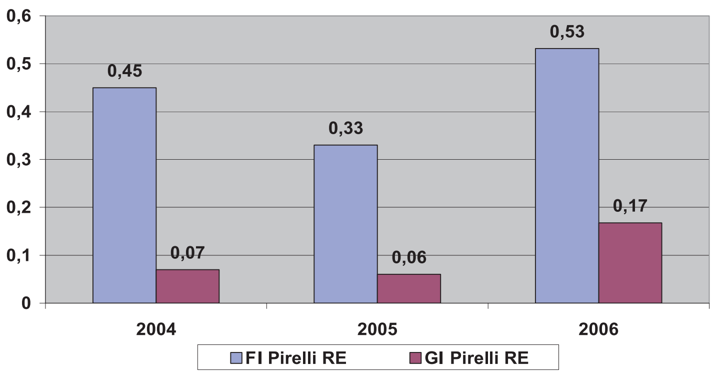
GI = **0.33**

Values given only considered injuries that caused the worker to interrupt work for more than 3 days (without counting the day of the injury). Data was, in fact, collected from legally required recordings, which, in most cases, only consider accidents that cause absences exceeding 3 days.

2007 will witness the extension of actions designed to reduce the number of injuries in non production areas, exactly as specified above for production areas.

Pirelli Real Estate S.p.A.

Considering injuries that required interruption of work for more than 3 days, 2006 recorded the following index values: FI = **0.53** and GI = **0.17**.



FI-GI PIRELLI RE

The increase in 2006 number of injuries compared to 2005 (due almost entirely to Pirelli RE Facility), was caused both by road accidents, which cannot be classified as "*in itinere*" injuries, and by the Company's effective industrial injury rate.

It should also be noted that, compared to the Sector Index (last INAIL available data), the Real Estate Group's accident rate was **approximately half** the sector's average rate.

To fight injuries'increase in 2006 the following initiatives were implemented:

» Raising of both Facility operations areas Managers and specially appointed personnel awarness (prevention campaign for operational personnel);

» Publication of a "Safe Driving" Handbook to prevent road accidents;

» Half-year injury analysis: classification and analysis of each injury and relevant circumstances;

» Prevention and Protection Department's on site visit, each time an injury has occurred

No work-related illnesses were recorded in 2006.

Other Group Sectors / Companies

Pirelli Broadband Solution, Pirelli Ambiente, Pirelli Labs and Pirelli Corporate's injury rate also highlight that 2006 basically maintained the 2005 performance, with FI = **0.05** and GI = **0.001**.

In itinere injuries:

Information on *in itinere* injuries (i.e. occurred during work transfers or while travelling to reach the workplace) was collected and elaborated in 2006.

The total number of *in itinere* injuries recorded by the whole Group was 128 (i.e. 4.5 accidents every one thousand workers).

Fatal accidents

In 2006 Pirelli Group employees met with no fatal accidents.

Yet, two employees employed by an external company died. The accident occurred in Brazil – in Pirelli Tyre's Feira de Santana production plant – during a work on electrical energy distribution cables.

SHARING OF EXPERIENCES BETWEEN PRODUCTION PLANTS

All information on injuries is collected in a tailor-made IT systems (injury analysis, corrective measures adopted, etc.). In case of significant accident dynamics, all production plants are informed and requested to: 1) internally check the existence of conditions being similar to the ones that have caused the specific injury and, 2) define corrective actions, if the case.

Through the IT systems the solutions adopted by the various production plants are recorded and solutions deemed as the best ones are shared.

Staying with this knowledge sharing perspective, along with the above information we also wish to mention Pirelli Real Estate's Web project. To better study and develop a sahred safety-oriented culture and to allow availability/access to useful information for safety issues practical management, in 2006 the Company developed a dedicated website. At the close of the year the website contained over 60 work tools that could be shared, many of which are highly innovative and targeted, among the others, also at operative employees, specially appointed personnel and project managers.

AWARENESS-RAISING AND TRAINING ACTIVITIES

Pirelli Tyre S.p.A.

As in previous years, 2006 too witnessed active actions in terms of sensitisation and training on health and safety issues with initiatives targeted at all responsibility levels and designed to encourage naturally safer conduct.

The Safety Training Programme for new hires and for those who, in various capacities (agencies, interns etc.), have commenced work with Pirelli was continued in 2006.

Training for personnel with operational assignments was provided through specific sessions held both in the classroom and, especially, on the workplace. Educational tools also numbered operational instructions that describe the typical duties of the various roles. Experience gained following risk analysis reviews and those resulting from past injuries were also shared.

All production plants trained a number of workers to handle emergencies.

Considering the different nature and potential gravity of injuries that can occur in the Group's production plants, every unit targeted and adjusted both the number of people trained and the type of training to suit its specific requirements.

Pirelli Real Estate S.p.A.

The *periodic information programme* targeted at all Safety Delegates and at specially appointed personnel for new regulations concerning safety, prevention, protection, environment and management of property assets was continued in 2006.

As in previous years, Health & Safety Training involved both new hires and personnel in service in both general and specific issues (e.g. electrical risks, building site safety, etc.).

"User request" training forms were also designed and customised in 2006. They led to courses on the "Facility Manager's Role and Responsibility for Prevention and Safety", on "Safety Operations Plans for Facility Workers" (with a special section on "extractable" risks for individual exposed workers) and, on "Work at Heights" (training for the use of Individual Protection Devices).

Other Group Sectors / Companies

Also in Pirelli Broadband Solutions, Pirelli Ambiente, Pirelli Labs and Corporate, Safety is a central element of training programmes for employees.

In 2006 training organised in the abovementioned companies also concerned, among the others, safe working practices in laboratories and during experimentation.

HEALTH & SAFETY EXPENDITURE AND INVESTMENTS

In 2006 the highest expenditure and investments were recorded by Pirelli Tyre and Pirelli Real Estate, as described in the following sections.

Pirelli Tyre S.p.A.

In 2006 safety investments and expenditure reached a total of approx. 6,500,000 euro.

Investments focused on improving machinery and plants and, in a broad sense, on the overall work environment (i.e. improvement of microclimate and lighting conditions, layout changes to improve operating ergonomics, interventions to protect infrastructures healthiness, etc.).

Expenses sustained for safety reasons, instead, basically focused on work environment controlling activities (i.e. sampling and analysis, consultations, etc.), purchasing individual protection devices (e.g. injury prevention shoes, gloves, safety eye-glasses, etc.) and collective protection devices (e.g. better protection of machinery, suction systems and, in general, workplace environment).

Pirelli Real Estate S.p.A.

Though expenses were faced for Safety Management, such expenses/investments were not separately recorded; hence it is not possible to report on a precise consolidated data.

Specific projects aimed at improving this reporting aspect will be implemented in 2007.

HEALTHCARE ASSISTANCE DURING WORKING HOURS

For decades Pirelli has implemented infirmaries operating at its production plants, with nurses and doctors available to provide employees with medical care during working hours.

These facilities provide first aid care, consultancy on non work-related health problems and supervision for workers exposed to specific risks.

Healthcare promotion campaigns developed in line with local programmes also make use of these facilities.

GROUP FLU PREVENTION CAMPAIGN

Again in 2006 Pirelli gave its workers the free of charge opportunity of being inoculated with the seasonal anti-flu vaccine.

This initiative takes into account the geographical location of Pirelli facilities; hence there is a need to provide vaccinations in different periods of the year, depending on the country, in order to follow the periods of the flu's seasonal spreading (workers in the northern hemisphere were the first to be vaccinated in autumn 2005).

In 2006 the anti-flu campaign was given new impetus through widespread information tools targeted at all organisational levels (it targeted workers in the southern hemisphere in spring and those in the northern hemisphere in autumn).

The number of employees who joined the initiative was approx. 8,000, as at 31/12/2006.

In view of the initiative's success, this prevention opportunity will be offered again to all personnel in 2007.

NO-SMOKING COMPANY

In June 2003 a letter sent by the Top Management to the Group's Chief Executive Officers announced the corporate decision to become a "No Smoking Company", to safeguard both smokers' and non smokers' health. This decision was consistent with Pirelli's long-standing policy of protecting the health of its employees in every country where the Group operates.

Specific training/information initiatives on damage caused by cigarette smoke were also implemented by distributing handouts, by organising conferences on nicotine addiction and by publishing questionnaires on smoking on the Company's Intranet System.

Three and a half years later the smoking ban is applied in most of the Group's sites, involving 97.6% of employees.

In most cases (78%) areas have been specially fitted out for smokers, while other facilities have totally prohibited smoking in all areas inside buildings.

In 2006 the Pirelli Group detected and fined 40 internal violations of the smoking ban.

COMPANY INITIATIVES FOR THE INTERNAL COMMUNITY

Initiatives implemented by the company for its internal community differ from country to country, to meet the typical needs of the various social contexts in which the affiliates operate.

Listed below are the most recurrent initiatives implemented in affiliates:

- Funded holidays for employees' children
- Scholarships and financial aid for employees' children training
- Corporate clubs for social and sports meetings
- Disease prevention activities through scheduled specialist visits, awareness-raising and vaccination campaigns
- Agreements with shops and medical practices to the advantage of employees

Starting this year Pirelli has decided to introduce a specific focus paragraph in its Sustainability Report – in the sections dedicated to both internal and external community initiatives - , aimed at describing its activities in a specific geographical area where the Group operates.

For 2006 Latin America was chosen. In this area the various Group Affiliates perform many targeted actions for the internal community, as well as activities aimed at involving and sustaining local communities.

FOCUS ON LATIN AMERICA

Pirelli's activities in Brazil are many and varied, also considering the Group's wide presence in the country. ***"Young Apprentice"*** is a national two-year programme for apprentices in industrial companies; it is financed by these companies. Participation in "Young Apprentice" is generally recognised both by Pirelli and by the market; hence it offers youth an important opportunity for professional development.

All Pirelli production frameworks in Brazil are involved in the programme. In Pirelli's case it is primarily targeted at employees' relations (i.e. brothers, children and cousins) aged at least 14 years.

During the training period, apprentices are registered as Pirelli employees, they enjoy all the relevant rights and guarantees (i.e. insurance, healthcare, etc.) and they are paid wages for the envisaged hours per month.

"Where does Dad Work" is another initiative that is proposed every Sunday in all Pirelli's Brazilian production sites. Booking is compulsory. Designed for employees' close family, it especially focuses on the youngest family members. Participants are initially welcomed to the production plant with breakfast. Some safety information and a corporate introductory video are followed by a tour round the production divisions and outside the production plant. The visit comes to a close with a demonstration of the fire-fighting unit and lunch in the Company's canteen. All participants are finally given a small gift to take home. Pirelli's ***"Children's Day Party"*** in Campinas, Sumaré and, especially, in Gravatai, are also targeted at employees' family members. They have recorded over 3,500 participants, numbering approx. 1,500 children. Around fifty employees will volunteer to organise games, competitions, shows, demonstrations, a visit to the fire-fighting unit and, naturally, a snack for the kids. Satisfaction levels, which are regularly gauged at the end of the event, exceed 98% of participants.

In Venezuela too Pirelli organises a day for employees'families to visit production plants (***"Dónde Trabaja Papá")***. In 2006 the same Affiliate also organised the ***"Concurso de Debujo Infantil"*** for kids - a drawing competition centring on the topic of Pirelli in Venezuela. In 2007 the Company means to select the best drawings done by kids for a special calendar targeted at all Pirelli employees in Venezuela.

Still in Venezuela Pirelli organises ***"Plan Vacacional"*** for employees' children aged between 6 and 12 years. In August and September approx. 160 children spent a three-day holiday packed with games and entertainment. As with all shared experiences, the holiday also had a high educational profile.

"Health Week" - concurrently held on Sundays in all production plants, this is an exceptionally relevant social responsibility initiative designed for Pirelli's Brazilian employees and extended to their family members. This dual phase programme initially involves tests and medical examinations, whose results enable the creation of homogeneous groups of people concerning health risks and diseases, to later adopt effective actions to ensure prevention and care. An equally important goal is to spread a strong prevention-oriented mentality through precise information, advice and practical suggestions on diet habits, sources of risks, etc.

In Argentina, Pirelli supports the studies of employees' children by providing them with books and educational material. The most deserving students are also given a study grant. Pupils and students who receive Pirelli's study grants number over 700.

CHILDREN'S DAY PARTY IN BRAZIL

Involvement of the internal community for the external community

FAI on line

In September/October 2006 a group of 60 Shared Service Centre employees participated in an outdoor training project organised in collaboration with MAP Responsibility and the Fondo per l'Ambiente Italiano (FAI) that has been created to safeguard and preserve the Italian cultural goods and heritage. The project involved participants in creating innovative tools to optimise information on certain sites belonging to the FAI heritage.

Participants performed field work to update photographic, historical and artistic documentation of six important artistic sites in Italy in order to update FAI Web pages on these sites. Accompanied by specialists in an enthusiastic interpretation of each monument's art and architecture and, assisted by the consultation of bibliographical material placed at their disposal by the FAI, participants focused on reconstructing the cultural and artistic history of each of these places.

The initiative was a remarkable tool to develop and optimise participants' skills with special reference to team building, team work and results-orientation. The same participants were also given the opportunity to place their qualified skills at the FAI's disposal; hence, the proposal of new Web pages with more items, texts and images. These pages will contain new photographs with many enlarged details and many pictures relating the "before and after" renovation works, the history of the architectural and pictorial works, cultural events, services offered and all information required to reach the site.

Children in Crisis Italy

"Children in Crisis Italy" is a lay and independent non profit NGO organisation designed to improve the lifestyle of children who are the victims of conflicts, poverty and illness. Considering the association's many activities, Pirelli Broadband Solution and Pirelli Labs – that are deeply convinced of the importance of spreading a solidarity–oriented culture and ethical behaviour – have decided to fully finance the reconstruction of the middle school in Bushushu, in the Democratic Republic of Congo. It was destroyed by an earthquake. Along with the school building, the project also envisages the construction of a cereal–grinding mill to enable the local community to start up a small business to face the new school's operating costs. But, besides the direct commitment, Pirelli also deemed it important to spread this sensitivity among its employees, suppliers and clients by informing them and inviting them to contribute with their own donations. The involvement of the entire corporate community, on the one hand, and of the business community in which Pirelli operates, on the other, is this project's most interesting detail. It shows the Group's authority and credibility with its interlocutors.

My time for Indonesia – reconstruction work completed

After the devastating tsunamis that struck South and South-East Asia at the close of 2004, Pirelli decided to contribute towards the reconstruction of damaged zones with the project ***"My Time for Indonesia"*.**

The project's financial goal was to collect – 500,000 to construct two schools in the Indonesian regions of Aceh, one of the most damaged sites.

Specifically, the schools are two upper secondary technical institutes – one is in the capital Banda

RECONSTRUCTION WORK IN BANDA ACEH THANKS TO MY TIME FOR INDONESIA

Aceh and hosts approx. 1,400 students and, one is in the Aceh Besar province, numbering approx. 400 students.

The decision to allocate funds was made in agreement with the Indonesian authorities with whom Pirelli signed an agreement on 28 April 2005, considering the essential social role played by schools and convinced that, besides training new generations, the facilities can also be a landmark for the entire population in the reconstruction process that followed the calamity.

The amount required to implement the project was collected through the voluntary offers of Group employees – payment for the number of hours they decided to donate was withheld by the Company – and a contribution from the Company.

Employees offered a total of 9,900 hours of work - equivalent to – 166,713 – while the Company donated – 333,287 to reach the sum of – 500,000. A further contribution was donated in 2006.

A Guarantee Committee for Italy (comprising Pirelli's Management, the Trade Union and a representative of Price Waterhouse Coopers) and a Guarantee Committee for Indonesia (comprising Pirelli's management, the Indonesian Minister for National Education and a representative of Deloitte) were formed in the project's framework to ensure transparent fund collecting operations, to ensure the use of funds in the envisaged modes and times, to approve projects proposed by the local work group and to authorise the transfer of funds to third parties for project implementation.

Construction work on the two schools was completed by the close of 2006 and early 2007. Both institutes, whose official inauguration is scheduled for the first half of the year, are already operating.

Updates on the progress of reconstruction works are constantly published in a special section of the corporate Intranet system; they can be accessed by all employees who are interested in the initiative.

4.2. EXTERNAL COMMUNITY

CORPORATE INITIATIVES FOR THE EXTERNAL COMMUNITY

Group companies encourage and, where necessary, provide support for social,cultural and educational initiatives geared towards promoting personal development and improving standards of living (Article 5 of the Ethical Code - Community).

The awareness of its role in promoting the civil and cultural progress of communities in which Group companies operate has always been a focal point in Pirelli's entrepreneurial culture.

Hence, the Pirelli Group organises and backs social, cultural and educational initiatives by collaborating with both public and private institutions, local administrations, associations and institutions in all countries where it operates.

This commitment is both consistent with the principles expressed in the Code of Ethics and it is an important part of Pirelli's positioning strategy, which aims at defending and improving the Company's role as one of the most integrated and active international companies in the various local communities where it operates.

From a promotional perspective and considering socially oriented actions, the Pirelli Group is involved in social, welfare, healthcare, cultural, educational and sports initiatives. All activities are carried out in association with authoritative partners, the choice of whom is based on criteria designed to guarantee their high quality profile.

Concisely described below are some of the most significant initiatives either promoted or supported by Group companies.

A Focus on Initiatives in favour of Latin America external community will also follow.

SOCIAL, WELFARE & HEALTH

THE "DIALOGUE IN THE DARK" EXHIBITION

"Dialogue in the Dark" is an exhibition that was organised in association with the Milan Institute for the Blind to enable anyone to experience the world of the blind by building confidence with their problems and, especially, with the extraordinary skills developed by their "disabled" status. Pirelli has decided to confirm its support for 2006 too, both for the important results achieved by supporting this activity organised by the institute and, for the excellent response met by the exhibition in 2005.

Concerning commitment in the healthcare sector, we must mention Pirelli's membership in ***"Global Business Coalition on AIDS"***, a private American body that combines the efforts of many companies throughout the world against the plague of the 21st century.

Of the various Italian non profit organisations partnered by Pirelli, a primary role is doubtless played by ***Emergency***. A neutral, non political association with independent humanitarian purposes, it is designed to assist the civil victims of war the world over. It is internationally famous.

Pirelli RE's ***"Piccolo Fratello"*** project plans on opening a new home for street children (Mdugu Ndogo, "small brother") in Kibera (Kenya) to enable deep permanent contact with street children's living frameworks and to interact with children who still live on the streets.

The house is, hence, designed to **physically remove children from the streets** by giving them the opportunity to **attend school** and to reside in an **environment that protects them**, in contact with **skilled youth workers** who love them. It will also be a place where young educationists who have already attended theoretical courses can experience full immersion in the real life of street children.

The project envisages **two phases:**

- Short term (6 months) as Reception Centre (refuge for the night and meal distribution during the day) and residence for two expert educationists;
- Middle term (within a year) – the house will permanently host 30 – 40 former street children who will regularly attend state–run schools in the neighbourhood. It will also host 4 – 6 young educationists during their training period.

A ***–Training Centre for*** Young Educationists**–** has also been built in close collaboration with the house to back people who are motivated to dedicate themselves to this work in order to give them high quality professional skills.

Hence, the intention – by working together with institutions like the Università Cattolica's Milan's Centre for Research and Studies on Social Difficulty and Maladjustment, directed by Prof. Giuseppe Vico – is to start a training centre for Educationists specialized on "street children education" in Nairobi. The programme initially envisages a three-year theoretical and practical course with a final diploma. The Centre may later organise a Degree Course and a Master's Degree.

Pirelli also pursues its mission of supporting the local Milanese youth by supporting associations such as ***"Fondazione Boccafogli"*** - dedicated to winning over street youth by encouraging their artistic and expressive potential and ***"Fondazione Benedetta d'Intino"*** which treats autism and perception disorders in childhood.

THEATRE AND VISUAL ARTS

The Pirelli Group actively supports the valorization of artistic heritage, intelligence, energy and local resources of all the countries where it operates. It promotes a model of active collaboration to integrate partners' skills with company's skills in the fields of technology, organisation and communication.

In this regard, Pirelli has always been involved in backing artistic, cultural and training initiatives. Historical operations like the construction of the Etruscan wing at the Louvre, Paris, or renovation works in the Victoria and Albert Museum's Italian Gardens, London, date back to the 1980s.

Even prior to these events, the Group has long distinguished itself as the Milanese area's cultural engine by developing the Pirelli Cultural Centre. The Pirelli magazine has been one of the most exciting examples of international "enterprise culture" for over twenty years.

It is precisely the prestige acquired on the Italian cultural scene that has associated Pirelli – since its formation – with ***Fondazione Teatro alla Scala***. In the early 20th century the Company was also one of the founding members of the theatre's museum, which has organised highly successful initiatives over the years, including Strehler's exhibition "The chamber of witchcraft" on dioramas in small 18th century theatres and "The Poet's Scene", which Ronconi dedicated to Gabriele D'Annunzio's works.

Again in the musical filed, we must also mention the Group's organisation of the "Concerts for Peace", which have been held since 1998. This series of musical events, wished by Maestro Riccardo Muti as part of the Ravenna Festival, were held in places that symbolise music's mission to restore peace: Beirut, Jerusalem, Sarajevo, Erevan, Istanbul and New York, one year after September 11. And again, over the past two years Pirelli has sponsored ***"Per non dimenticare"*** (Lest we forget) – a concert organised by Fondazione 8 Ottobre at the Scala Theatre every year in memory of the victims of the 2001 air accident at Linate airport.

During the two–year period when Piermarini's theatre was closed for renovation works, the ***Teatro degli Arcimboldi*** – which Pirelli RE built in record time in the framework of its project for the reconversion of Milan's industrial area Bicocca – became the base for the Scala Theatre. This theatre is today the property of the Milan Municipality, which has appointed the Arcimboldi as the second Milanese musical theatre that is open to all expressions of music and modern shows.

Always concerning theatres, Pirelli is the historical partner of ***Fondazione Pierlombardo***. It also backs activities organised by Teatro Franco Parenti – one of the most active theatres that is deeply rooted in the Milanese cultural fabric. This highly relevant role played by the Group has been acknowledged by naming the exhibition area the theatre dedicates to the artistic expressions of youth "Pirelli Hall".

In view of an intervention on the territory, one of the most significant experiences carried out in Italy is doubtless the ***Hangar Bicocca***. With a surface area of 15,000 m–, it was the Ansaldo factory's former production site, which Pirelli RE decided to convert into a space for Contemporary Art. Temporary exhibitions are the core of its activity, which is strongly oriented towards research and experimentation. Every space becomes an inspiration for the creations/interpretations of artists and curators; hence, the facility's key to its success is its skill in attracting and generating artistic and cultural creativity.

At the same time Hangar Bicocca is also a place at the disposal of the public, a privileged site that witnesses the convergence of art and visitors – a permanent centre for initiatives geared towards understanding visual culture and towards active participation in the role of art in contemporary culture.

Events are, hence, scheduled to ensure dialogue between the protagonists of contemporary culture and various audience types. International artists and curators play a central role and so do the protagonists of various cultural frameworks (i.e. music, drama and cinema) who are called to contribute towards research on contemporary visual culture.

The initiative's success, the great interest of both the public and of international contemporary art operators and, the very high response of schools (1,500 schools in northern Italy joined the educational programme launched by Hangar Bicocca in September) have convinced Pirelli RE to make the operation even more significant and noteworthy by forming an independent structure that is professionally related with interlocutors in the world of art, thus depersonalising the Company's role.

RESTORERS IN THE BRERA ART GALLERY

The "Hangar Bicocca Foundation" is currently being formed to meet the principles and legal pattern of a partner foundation, with the aim of spreading the expressions of contemporary culture, with special reference to art.

Very active in the world of art, it is almost a decade since Pirelli agreed to provide corporate support to the ***Brera Art Gallery***, the city of Milan's most ancient art collections and one of the most important in Europe.

This agreement envisages Pirelli's active collaboration with the Art Gallery to gradually renovate 16th century Veneto paintings that are displayed in the 14th Hall. After Giovan Gerolamo Savoldo's "Pala Pesaro", whose restoration was completed in 2005, 2006 witnessed the commencement of restoration works on Jacopo Palma il Vecchio's gigantic "Adoration of the Magi".

An example of a highly absorbing collaboration between partners, Pirelli's support for the Art Gallery has led to the design and creation of an innovative and rather unique machinery designed by architect Sottsass to perform renovation works in full view of the public, without concealing paintings from visitors.

Pirelli has also agreed on Company's cooperation with another great player on the Milanese cultural scene by recently becoming one of its "corporate members" – it is now an official supporter of the ***Poldi Pezzoli Museum***. Today the Company actively participates in the museum's initiatives, sharing its guidelines and strategies.

CULTURE & TRAINING

An initiative entirely promoted and organised by Pirelli is the ***"Pirelli International Award"***, which is, by now, extensively consolidated. Since 1996 it has been an important multimedia competition to spread scientific culture. It is entirely organised over the Web. Every year the prize is assigned to the best multimedia presentation in the field of physics, chemistry, mathematics, biology, information technology and communication.

In 2006 Pirelli participated in the exhibition ***"Science, City and Life"*** organised by the Università di Bicocca to celebrate one hundred years of the Sempione Universal Exhibition that was held in Milan in 1906. Pirelli was a protagonist at the event, featuring as an exemplary company for the remarkable Italian industrial development of the time. In fact, Pirelli has always been a landmark for corporate culture and, its over 130 years are doubtless a heritage of historical interest. Pirelli also preserves and optimises its corporate culture as a founding member of the Web portal *www.archiviefuturo.it*, which is dedicated to the history of leading Italian companies.

Pirelli's partnership with ***Fondazione Silvio Tronchetti Provera*** looks, instead, to the future by promoting research in economics, science, technology and management, besides talent development in these sectors. It allocates funds, prizes, study grants and contributions for the equipment of universities and scientific institutions. The activity is conducted either directly or in collaboration with other individuals, especially making use of the partnership with the three Milanese universities – Milan Polytechnic, Università Commerciale Luigi Bocconi and Università degli Studi di Milano Bicocca, whose rectors are members of the Foundation's Board of Directors.

On the other hand, scientific and technological culture is the very core of Group actions; hence the need to mention an initiative promoted by Fondazione Silvio Tronchetti Provera along with Fondazione Veronesi and Fondazione Cini – ***"The Future of Sciences"***. This cycle of conferences and debates on scientific topics witnessed the participation of many Nobel prize winners and internationally famous scientists and researchers. The three-day initiative, which has now been organised for the second time, is held at the Cini Foundation on the island of San Giorgio Maggiore in Venice.

Pirelli has long partnered the ***FAI – Fondo per l'Ambiente Italiano,*** in various initiatives, numbering also the organisation of courses on history of art for the extensive public. The two–year period 2005/2006 witnessed Pirelli and FAI committed – with the patronage of the Lombardy Regional Administration, the Lombardy Provincial Administration and the Milan Municipality – in a new edition of " Lunedì dell'Arte, a cycle of lessons held at the University of Milan by the most famous experts in the sector. They retraced and illustrated the works and experiences of international contemporary art.

Training plays a crucial role in a company's real estate sector. As process and product innovator, it is in line with Pirelli RE's "positioning responsibilities" and mission to encourage improvements in the sector's professional standards. The quest for professional excellence and training professionals to face the "new way" of conducting real estate business in an Anglo-Saxon style are perfectly summarised in the ***Master in Real Estate***, a postgraduate qualification designed, promoted and implemented in association with two of the most prestigious Italian universities – the Bocconi and the Milan Polytechnic. They both provide the skills required by current real estate professionals – finance, technical aspects, economics, architecture, business planning and town planning. The first year over 30 students participated in the Master (but applications were three times this number); they were immediately employed in high quality professional outlets;

THE 15th COLEÇAO PIRELLI HELD AT THE MASP

SPORT

Pirelli has always been involved in sports, not only in motoring competitions on either two or four wheels. The Group's other choice sports are historically also football – it sponsors FC Internazionale in Italy, Palmeiras in Brazil, Peñarol in Uruguay and Basel in Switzerland – and sailing – it yearly organises the Pirelli Coppa Carlo Negri Regattas in the waters of Santa Margherita.

But the Group's commitment to sports is not limited to participation in the highest professional standards. Quite the reverse; Pirelli is involved in the extensive promotion of a sports-oriented culture to spread social life based on values of solidarity and ethical conduct, even among the youngest.

In the field of "solidarity sailing", Pirelli created the initiative "*Matti per la Vela*" (Crazy about sailing). A group of healthcare professionals, voluntary workers and professional skippers with a passion for sailing designed the project in Genoa in 1998 to use sailing as a therapeutic tool to help and recover people who suffer from various psychic diseases and disorders.

Lastly, Pirelli has organised the ***"Derby del Cuore"*** for over ten years. Every summer famous figures from the show biz and sports world and Inter and Milan fans challenge each other before the typical audience of great occasions in a football game, whose profits are assigned to charity.

FOCUS ON LATIN AMERICA

As described for activities targeted at the internal community, even concerning those for the external community,, this year's social report will concentrate on Latin America where the Group's many frameworks perform a wide range of actions to both involve and sustain local communities.

Starting with kids, ***"The Kid Project"*** in Brazil is a governmental project to encourage the social and cultural integration of young Brazilian citizens aged between 8 and 18 years. Implemented in 1995, the project focuses on teaching music in 375 centres, many of which are sponsored by leading companies present in the country. The overall project today involves over 48,000 youth. Pirelli runs the Santo André Centre.

The Group's cultural activities in Brazil are many and highly differentiated. Pirelli, in fact, partners the ***MAM – San Paolo Museum of Modern Art***, the oldest and one of the most important museums of modern art in the continent. This sponsorship encourages the development of museum activities, also numbering cultural events, workshops and courses. Pirelli's sponsorship of the MAM also ensures employees and their relations a free visit to the exhibition.

Always in San Paolo, the famous ***MASP – Museu de Arte de São Paulo*** hosts "**Coleçao Pirelli**" with approximately 900 works portraying the many aspects of Brazilians' daily life photographed by over 200 leading photographers in the country over the past fifteen years. In fact, 2006 celebrated both the collection's 15th anniversary and such a close and significant partnership. Focus on local communities' social life was finally confirmed by Pirelli's participation in the cultural project ***"Projeto café"***, twelve monthly instalments annexed to the bilingual magazine "Panorama Rural" on coffee's three hundred-year history in Brazil. It highlights the social responsibility and related commitments of international companies operating in the global markets to the advantage of local communities, even by investing in educational, environmental and cultural projects to establish a sustainable development model.

Concerning training, Pirelli has undersigned an agreement in Venezuela to implement the ***"Centro Tecnológico y Conocimiento del Caucho Pirelli"***, a corporate unit created to offer the Company services on the use of new technologies in training human capital. The project is also targeted at suppliers, clients and especially employees' families.

In Argentina Pirelli has started a ***cooperative project with two technical institutes near Merlo*** to enable students to integrate educational training and factory work in order to build experience and expertise directly in the work framework. Students who have worked for Pirelli for two years are anyhow paid for their services.

But in countries where economic embarrassment and a precarious lifestyle primarily concern children, the passion for sports becomes a very precious aid for solidarity and educational programmes. Of all sports, football's popularity is unrivalled. Hence, following the model of Inter Campuses opened in Italy, when the team's ambassador was Ronaldo, Pirelli and Inter started the project ***"Inter Pirelli Campus Brazil"*** in San Paolo, Brazil, in 1997. Their goal was to offer youth aged from 8 to 14 the opportunity of leaving the alleys of the favelas, while facilitating social integration by associating school attendance with the opportunity to cultivate the passion for football.

The Brazilian initiative's success (i.e. over four thousand children are yearly won over to schools) led FC Internazionale to organise similar programmes in other "risk" areas in the world. Today 20 countries in the four continents host these "solidarity football" projects.

AN INTER PIRELLI CAMPUS IN BRAZIL

RELATIONS WITH PUBLIC ADMINISTRATIONS

Group companies maintain relationships with local, national and supranational authorities in a spirit of full and active cooperation and transparency that does not compromise their independence, economic targets or the values enshrined in this Code (Article 5 of the Ethical Code – Community).

Group companies are represented in national and super-national institutions in the framework of relations with Public Administrations (i.e. Governments, Parliaments, Public Institutions, central and local administrations, both Italian and foreign).

The dialogue on which relations with Public Administrations are based is conducted believing that business and relational ethics must be pursued along with the Company's success.

In 2006 Relations with Institutions actively concerned both the countries where the Pirelli Group's presence has long been consolidated and those where the Group's presence is more recent, such as. Romania and China.

In particular, in these two cases Relations with Institutions basically concerned Pirelli's integration in the local system from an industrial and social perspective (i.e. investments to open new production sites, professional integration/training programmes for human resources), always respecting the country's cultural specific features.

Pirelli's actions in the framework of Relations with Public Administrations number defining/monitoring modes and procedures envisaged by the specific reference regulations to obtain and manage information, contributions, grants and funds from national/foreign public bodies for investment, scientific and technological research and, social and economic projects (training programmes, upgrading programmes, etc). During the entire procedure, relations with PA are based on the utmost transparency and truthfulness of the information conveyed (i.e. from defining funding sources to checks and inspections conducted by the funding institution), thus avoiding technical and financial assessment errors, trends unduly directed to the advantage of Group interests and conflicts of interest.

Concerning systems adopted to further enhance the Company's internal control, the Group's Italian Affiliates have long adopted an organisational model geared towards perfecting a system that is modulated by specific requirements envisaged by the local legislation (Legislative Decree n° 231/2001) concerning companies' administrative responsibility in crimes committed by their employees to the advantage of the said companies. A special Supervisory Body that is envisaged in each Group's Italian Affiliate has been assigned the task of monitoring both the organisational model's correct function and the internal behaviours' compliance with the same.

In 2006 the Organisational Model was also reviewed to align it with the developments of Regulation n° 231.

To build further opportunities to improve the internal control system, other Group companies too adopted some control activities envisaged in Italian companies' Organisational Models, which are suitable to reasonably prevent the risk of crime, by issuing specific policies and operational rules.

In 2006 the Internal Audit Department carried out 60 auditing interventions in the Group's framework; 18 of these were carried out following a mandate issued by the Italian Companies' Supervisory Bodies. The audits were aimed at verifying the extent of compliance of company processes with the internal control procedures set down by the Organisational Model adopted.

GRI (Global Reporting Initiative) Table of contents

This section is designed to enable readers to relate topics discussed in the report to the international experience of the GRI and the Global Compact.

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Global Compact principles and GRI indicators

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Human rights	Principle 1 – Companies are requested to promote and respect globally recognised human rights in their respective influence frameworks; and,	HR 1-9	LA 4, LA13-14, SO1
	Principle 2 – To ensure that they are not indirect accomplices in the violation of human rights.	HR1-2, HR8	
Labour	Principle 3 – Companies are requested to support the free association of workers and to acknowledge the right to collective contracts;	HR5, LA4-5	
	Principle 4 – Remove all forms of either forced or compulsory labour;	HR7	HR1-3
	Principle 5 – Effectively remove child labour; and,	HR6	HR1-3
	Principle 6 – Remove all forms of employment and professional discrimination.	HR4, LA2, LA13, LA14	HR1-2, EC5, EC7, LA 3
Environment	Principle 7 – Companies are requested to follow a preventive approach towards environmental challenges;	Profile disclosure 4.11	EC2
	Principle 8 – Undertake initiatives that promote greater environmental responsibility; and,	EN2, EN 5-7, EN10, EN13-14, EN18, EN21-22, EN26-27, EN30	EC2, EN1, EN3-4, EN8-9, EN11-12, EN15-17, EN19-20, EN23-25, EN28-29, PR3-4
	Principle 9 – Encourage the development and widespread use of environment-friendly technologies.	EN2, EN5-7, EN10, EN18,	EN26-27
Combat corruption	Principle 10 – Companies undertake to fight all forms of corruption, including extortion and bribes.	SO2-4	SO5-6

GLOSSARY

Accident A damaging event caused by a violent occurrence during the performance of an employee's work duties, and which leads to death or a permanent inability (total or partial) to perform these duties, or a temporary inability requiring absence from work.

B2B Business to Business: the relationship that a company entertains with its suppliers or with its professional clients.

Banbury Machinery for preparing polymer blends, which are used as the raw material for producing plastic- or rubber-based components. The ingredients are put into the Banbury according to their various specified quantities and times, then mixed at a determined temperature and pressure until they form a blend, which is then extruded in granules or strips.

Best Practices These are practices that the company follows to analyse and measure the organisational processes, policies and indicators of its quality of service.

Body-ply Basic element used to make up the resistant structure of the tyre carcass.

Carbon dioxide (CO^2) Colourless and odourless, carbon dioxide is a naturally-occurring component of the Earth's atmosphere. It is one of the compounds produced during combustion of materials containing carbon, and it contributes to the **greenhouse effect** (see separate entry).

Coaching & Feedback The name of a course aimed at developing managers' skills in managing their staff by means of getting feedback on their work and then coaching them (i.e. providing assistance and support) to help them identify the resources they need to reach their objectives.

Company Health and Safety Management System Part of the global system of management that facilitates management of health and safety risks in the workplace that are connected with company activities. It includes the organisational structure, planning activities, responsibility, practices, procedures, processes and resources for developing, putting into place, implementing, re-examining and maintaining the workplace health and safety policy.

Computer-aided telephone interviews (CATI) An interactive system involving an interviewer and a computer, based on the use of a software package developed for data collection. The questionnaire resides on a computer and the questions are displayed on the video screen.

Controlled ventilation system System for extracting and recovering the heat from the air in the environments.

Corporate Social Responsibility(CSR) The voluntary acknowledgement of social and ecological concerns by a company in its commercial operations and in its relations with the parties concerned.

Employer Branding Defined as the set of activities implemented by a company to build and communicate its identity to a target that includes both candidates and employees, so that the company (as brand) will attract and retain persons who fit in with the company's culture and values.

Environmental Due Diligence A systematic survey of the environmental conditions on a site in order to establish its current or potential environmental liabilities.

Environmental impact Any change to the environment, detrimental or beneficial, total or partial, as a consequence of an organisation's activities, products or services.

Environmental indicator Numeric parameter or value that describes the impact of a human activity on the environment.

Environmental Management System Part of the overall system of management that includes the organisational structure, planning activities, responsibility, practices, procedures, processes and resources for developing, putting into place, implementing, re-examining and maintaining the environmental policy.

Extrusion A process of assembling blends to make semifinished products, via specific fusion processes on those blends.

FTE (Full-Time Equivalent) A method of accounting for part-time employees. The work hours of part-time employees are expressed taking the work hours of a full-time employee as a base. So a full-time employee is 1 FTE, and a part-time worker who works 50% counts as 0.5 FTE. For example, two part-time 50% workers (FTE=0.5) equal one full-time worker (FTE= 0.5 x 2 = 1).

Fuel cells Electrochemical devices that convert chemical energy to electrical energy. They are classed according to the electrolyte used in the process. Various different fuels can be used (natural gas, hydrogen etc.).

Global Reporting Initiative (GRI) The Global Reporting Initiative is an international programme for the global development and dissemination of guidelines for reporting on sustainability. The promoters of GRI are CERES (Coalition for Environment Responsible Economies) and UNEP (United Nation Environmental Programme).

Greenhouse effect An increase in the Earth's temperature due to the excessive presence of certain gases (mainly carbon dioxide, some oxides of nitrogen and ozone) which do not allow heat to dissipate.

Grooves Shallow engravings on the tread (the surface of a tyre that comes into contact with the road), generally indented and/or finely subdivided. The function of the grooves is to improve the road-holding and adherence of the tyre, especially on smooth or wet road surfaces.

Hazardous waste Categories of waste that present substantial or potential danger to human health or to the environment, classified according to European legislation (see also **non-hazardous waste**).

Heat value Quantity of thermal energy (heat) released by a determined mass of fuel burning under standard conditions. A distinction is made between *Gross Heat Value* (GHV), which represents all the thermal energy developed during burning, and *Net Heat Value* (NHV), which represents the difference between the total heat released and the heat lost due to evaporation of the water produced during combustion. Heat value is normally expressed in joules per kilogramme (J/kg) or kilocalories per kilogramme (Kcal/kg) for solid and liquid fuels, and in joules per cubic metre (J/m?) or kilocalories per cubic metre (Kcal/m?) for gaseous fuels.

Intermediate energy sources Forms of energy produced by converting primary energy into other forms. The two most common examples are electricity and steam.

ISO 14001 A standard, issued by the ISO (International Organisation for Standardization), specifying the requirements of an Environmental Management System that enables an organisation to formulate an environmental policy and establish objectives, taking account of legislation and information on significant environmental impacts.

IT systems Information technology systems.

Job meeting A work orientation meeting.

Job rotation Rotation of work duties. A number of workers are periodically assigned to different areas of the company, and this rotation of workers between different jobs creates a group of employees who have a knowledge of all the different phases of the production process and who also have a global view of the problems that can arise in the work environment, both in terms of production and in terms of human relations.

Kyoto Protocol An international agreement to reduce atmospheric emissions of gases that cause the **greenhouse effect** (see separate entry), which is responsible for global warming.

Life Cycle Assessment (LCA) A method of calculating the overall environmental impact of a product, by taking account of its entire life cycle, starting from the extraction and processing of the raw materials and including the processes involved in its manufacture, transport, distribution, use, recycling/reuse and finally disposal.

LPG Liquid Propane Gas.

MBO Management By Objectives: a system of annual incentives based on objectives defined at the start of the year.

Nanocomposite A blend of materials (ceramics, metals etc.) with dimensions in the order of nanometres.

Nanomaterials Materials with dimensions in the order of nanometres (10^{-9} m).

Nanotechnology Technology for developing nanomaterial-based applications.

Newton Unit of measurement of force (abbreviated to N) in the International System. One Newton is equal to the force necessary to impart an acceleration of 1 m/s^2 on a mass of 1kg.

NGO Non-Governmental Organisation.

Nitrogen oxides Gases produced by the combustion of fossil fuels. These gases contribute to the formation of ozone in the lower atmosphere and to 'acid' deposits during ordinary rainfall.

Non-hazardous waste Categories of waste that present no danger to human health or to the environment, classified according to European Community Directive 2000/532, modified by Directives 2001/118/EC, 2001/119/EC and 2001/573/EC.

NO^x See **nitrogen oxides**.

OECD Organization for Economic Co-operation and Development.

OHSAS 18001 International certification standard for safety in the workplace and industrial hygiene. The standard gives the requirements for a Health and Safety Management System in the workplace, enabling a company to manage its risks in this area and improve its performance.

Organic solvent Any **VOC** (see separate entry) used on its own or in combination with other agents to dissolve raw materials, products or waste material without undergoing chemical transformations, or used as a cleaning agent to dissolve contaminants, or as a dissolving agent, means of dispersion, viscosity correction agent, surface tension correction agent, plasticizing agent or preservative.

Ozone Allotropic form of oxygen with the chemical formula O^3. Ozone is found in minimal quantities in the air and it is formed by electrical discharges and ultraviolet rays, which convert oxygen molecules to ozone. Approximately 25km from the Earth's surface there is a concentrated layer of ozone that absorbs ultraviolet rays and essentially protects life on the planet; it is known as the ozonosphere. The reduction in the thickness of the ozone layer in the atmosphere (commonly known as 'the hole in the ozone layer') seems to be linked to activities of human origin and resulting in the release of **nitrogen oxides** (see separate entry) and **chlorofluorocarbons** (see separate entry) into the atmosphere.

Pascal Unit of measurement of pressure in the International System. One Pascal is equal to 1 Newton per square metre (Pa = N/m?).

PCB/PCT Acronym for polychlorinated biphenyls/polychlorinated triphenyls. These substances are potentially extremely dangerous and can be bioaccumulated. They have insulating properties and are fire-resistant, and are mainly used in electrical devices, e.g. capacitors and **transformers** (see separate entry).

Photochemical smog A type of atmospheric pollution mainly caused by gaseous emissions from urban vehicular traffic. It is the result of a complex chain of photochemical oxidation reactions, i.e. reactions resulting from sunlight and favoured by specific meteorological conditions (e.g. a temperature inversion). One of the consequences of photochemical smog is that it increases the concentration of ozone in the **troposphere** (see separate entry), which then becomes a secondary pollutant. In addition, the low-volatility organic compounds that form can condense, forming a mist of microscopic globules.

Photonics The science and technology of a class of devices that use photons. The term 'photonics' was invented by analogy with 'electronics': instead of electrons, photons are used in operations that we normally associate with information processing, transmission and storage.

Pressure A physical quantity expressing the relationship between the intensity of a force (expressed in Newtons) applied to a surface perpendicular to it, and the area of the surface (expressed in square metres).

Primary energy sources Energy sources consumed to provide final energy services (e.g. heating, transport) or to produce intermediate forms of energy like electricity or steam. Examples of primary energy sources are: coal, natural gas, liquid propane gas, fuel oil, and biomass.

Process owner The point of reference and person responsible for a process.

Rolling resistance The component of a vehicle's resistance to movement which is ascribed to the tyre alone.

SA 8000 International standard issued by the CEPAA (Council of Economical Priorities Accreditation Agency) on respect for human rights, respect for workers' rights, protection against the exploitation of minors, and standards of safety and proper conduct in the workplace.

Stakeholder "Holders of legitimate interests" in the company, i.e. parties (individuals or groups) who have an interest in the company's decisions, influence its success and/or are influenced by the organisation's activities.

Standard Positions A document that illustrates a task and the requirements for performing it.

Steering Committee CSR (Corporate Social Responsibility) The committee responsible for evaluating, directing and coordinating all activities of the Group that come under the heading of Corporate Social Responsibility. It includes managers from the following departments: Administration & Control Department, Public and Economic Affairs Department, Personnel Department, Health, Safety and Environment Department (this last department is also the Committee Secretariat).

Stranding Mechanical process of assembling brass-coated wires.

Sustainability See **Sustainable development**.

Sustainability rating An investment bond rating based on criteria regarding the sustainable performance of the company being evaluated. The rating is issued by an independent third party.

Sustainable development Development that meets the needs of the current generation without compromising the capacity of future generations to meet theirs. This type of development is not a pre-set harmonious state, but rather a process of change in which the use of resources, management of investments and institutional change are made compatible with future needs as well as with current needs.

toe Tonne of oil equivalent: a unit of energy that expresses the thermal energy that can be obtained from fuels other than oil, taking oil as a base. The conversion factors adopted by the Group are as follows:
1 toe = 41.86 GJ
Electricity: 1 kWh = 860 Kcal = 0.000086 toe
Fuel oil: 1 toe = 0.98 tep
Diesel: 1 toe = 1.08 tep
LPG: 1 toe = 1.10 tep
Natural gas: 1000 m? = 0.82 toe

Transformer A static (i.e. with no moving parts) electrical apparatus that transfers electricity from one circuit (*primary*) to another (*secondary*) and changes the voltage and current. In its simplest form, a transformer comprises a closed magnetic circuit, made with silicon iron core lamination, and two reels obtained by helically winding two conductors on an insulating base.

Transmittance A physical phenomenon that allows the conduction of heat from outside the environment to inside and vice-versa via contact with a vertical barrier.

Troposphere The lowest layer of the atmosphere, extending from the Earth's surface to the stratosphere. The troposphere is where the most common meteorological phenomena occur.

Volatile Organic Compounds (VOCs) Any organic compound – of natural or artificial origin – which has a vapour tension of 10 Pascals or higher at a temperature of 20°C, or which has a corresponding volatility under particular conditions of use. VOCs can contribute to the production of **photochemical smog** (see separate entry), with consequent impacts on health and the environment.

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