

**Pirelli & C. S.p.A. - Milan**

**Quarterly Report**  
**3<sup>rd</sup> Quarter 2004**

**PIRELLI & C. Società per azioni**

**Head office in Milan, Via G. Negri 10**

**Share Capital Euros 1,800,048,028.48**

**Milan Companies Register No. 00860340157**

**Economic Administrative File (REA) No. 1055**

**PIRELLI & C. S.p.A.****Board of Directors**


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Honorary Chairman	Leopoldo Pirelli
Chairman	Marco Tronchetti Provera
Deputy Chairman	Alberto Pirelli
Deputy Chairman	Carlo Alessandro Puri Negri
Managing Directors and General Managers	Carlo Buora Giovanni Ferrario
Directors	Carlo Acutis * Gilberto Benetton Carlo De Benedetti * Gabriele Galateri di Genola Giuseppe Gazzoni-Frascara * Mario Greco Georg F. Kraymer * Giulia Maria Ligresti Massimo Moratti Luigi Orlando Giovanni Perissinotto Giampiero Pesenti * Ennio Presutti * Carlo Secchi * Vincenzo Sozzani Frank Vischer *

\* Independent directors

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Secretary to the Board	Carlo Montagna
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**Board of Statutory Auditors**


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Chairman	Luigi Guatri
Standing members	Roberto Bracchetti Paolo Francesco Lazzati
Alternate members	Franco Ghiringhelli Sebastiano Guido

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**General Managers**


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Energy Cables and Systems Sector	Valerio Battista
Telecom Cables and Systems Sector	Valerio Battista
Tyres Sector	Francesco Gori
Administration and Control	Claudio De Conto
Finance	Luciano Gobbi

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**CONTENTS**

- <b>Report on operations</b>	<b>page</b>	<b>4</b>
Performance of the Group	page	4
Major events in the third quarter	page	6
The Group	page	9
Related party disclosure	page	18
Significant events subsequent to the third quarter	page	20
Outlook for the current year	page	21
Energy Cables and Systems Sector	page	22
Telecom Cables and Systems Sector	page	26
Tyres Sector	page	30
Real Estate Sector	page	34
Proforma data	page	38
- <b>Quarterly data and comments</b>	<b>page</b>	<b>42</b>
Quarterly data	page	43
Comments on quarterly data	page	44

## **REPORT ON OPERATIONS**

### **Performance of the Group**

Pirelli & C. S.p.A. Group reported a significant improvement in all economic indicators for the first nine months of 2004, consistent with the trends in the first half of the year.

Consolidated **sales** of the Group for the first nine months of 2004 amounted to Euros 5,305 million, up 7.7 percent compared to the corresponding period of 2003.

On a comparable basis, net of the effects of exchange rates and metal prices, sales grew by 4 percent.

Consolidated **operating profit** amounted to Euros 279 million, an increase of about 42 percent compared to Euros 197 million for the first nine months of 2003. It should be borne in mind that the first nine months of 2003 had benefited from the positive effects of the settlement of the dispute concluded with Ciena over its use of patents for Euros 10 million.

Operating profit as a percentage of sales was 5.3 percent, further increasing from 4 percent for the first nine months of 2003.

The consolidated **net income** for the nine months ending September 30, 2004 amounted to Euros 229 million (4.3 percent of sales), against a loss of Euros 33 million for the first nine months of 2003.

The net income attributable to Pirelli & C. S.p.A. was Euros 201 million compared to a loss of Euros 53 million for the first nine months of 2003.

The **net financial position** of the Group at September 30, 2004 was a net debt position of Euros 1,915 million, with an increase from Euros 1,745 million at the end of 2003 but a reduction compared to Euros 2,047 million at June 30, 2004. This is in line with targets for the period 2004-2006, taking into account the seasonal nature of the industrial activities, the payment of dividends (Euros 132 million), the purchase option exercised by Pirelli for more than 47 million Telecom Italia S.p.A. shares (Euros 110 million), the subscription to Eurostazioni S.p.A.'s capital increase (Euros 33 million) and the purchase of RCSMediaGroup shares (Euros 33 million) and, on the other side, cash provided by operating activities and cash receipts from the placement of Pirelli & C. Real Estate shares by Deutsche Bank (Euros 93 million).

At September 30, 2003, the net debt position had stood at Euros 1,518 million and had not yet included the effects of the Olimpia S.p.A. capital increase, subscribed prorata by Pirelli in the last quarter for a total of Euros 388 million.

**Industrial activities** displayed a strong growth in operating profit for the first nine of 2004 thanks especially to the excellent performance of the Tyres Sector and the Energy Cables and Systems Sector. An improvement in the operating result was also recorded by the Telecom Cables and Systems Sector in the face of continuing severe pressure over prices for cables and optic fibers. New Telecom Systems activities grew in terms of both volumes and profitability with sales to September 2004 (Euros 39 million) at double last year's figures.

In the **Real Estate Sector**, the operating result including the share of the earnings of equity investments amounted to Euros 88 million, compared to Euros 72 million for the same period of 2003, an increase of 23 percent.

Net income attributable to Pirelli & C. S.p.A. was Euros 66 million compared to Euros 52 million for the first nine months of 2003, with an increase of 26 percent.

**The parent company, Pirelli & C. S.p.A.**

The parent company, Pirelli & C. S.p.A., reported net income of Euros 26 million for the nine months ended September 30, 2004 compared to a net loss of Euros 53 million for the first nine months of 2003.

This result is essentially due to the gross gain realized on the placement of 3,400,000 Pirelli & C. Real Estate S.p.A. shares (equal to 8.37 percent of share capital) with Italian and foreign institutional investors reduced by financial expenses and investment writedowns.

Dividends from subsidiaries, accounted for on the accrual basis, will be booked in the annual financial statements for the year ending December 31, 2004.

**Major events in the third quarter**

- On July 8, 2004, the 84,060,667 Pirelli & C. S.p.A. ordinary shares and the 63,045,500 warrants 2003-2006 on Pirelli & C. S.p.A. ordinary shares which had been contributed to the shareholders voting trust, were sold prorata by RCSMediaGroup S.p.A. to the other participants in the Pirelli & C. S.p.A. Voting Trust (with the exception of Sinpar S.p.A. which did not exercise the right to purchase its share of the stock). The per share price, equal – in accordance with the clauses of the agreement – to the average market price recorded over the last three months, was Euros 0.825 per share and Euros 0.090 per warrant.

- On July 9, 2004, Pirelli & C. S.p.A. purchased 7,413,341 RCSMediaGroup S.p.A. shares placed on sale by Gemina S.p.A., equal to 1.01 percent of share capital, for a total equivalent amount of approx. Euros 33 million. Following this transaction, Pirelli & C. S.p.A. holds 2.92 percent of RCSMediaGroup ordinary share capital, which is entirely pledged to the Shareholders' Agreement. The average per share price of the RCSMediaGroup shares in Pirelli & C. S.p.A.'s portfolio is equal to Euros 2.74.

- On July 14, 2004, Pirelli sold its 50 percent non-controlling equity investment in Afcab Holdings, the sole shareholder of the South African manufacturer of power cables, African Cables Limited, to the parent company Reunert Limited for a sum of African rands 165.75 million (about Euros 22 million), realizing a gain of Euros 7 million.

Afcab Holdings had initially been a joint venture between Siemens and Reunert, a South African electronics group. Pirelli had taken over the investment in 1998 as part of the acquisition of the activities of Siemens in the power cables sector. Pirelli decided to sell its share in the company, in which it did not exercise control, preferring to focus on more strategic markets.

The deal was executed on September 30, 2004 after approval was obtained from the relevant authorities.

- On July 28, 2004, Pirelli & C. S.p.A. successfully concluded the placement of 3,400,000 Pirelli & C. Real Estate S.p.A. shares (equal to 8.37 percent of share capital) with Italian and foreign institutional investors.

Deutsche Bank AG London, in charge of the placement, informed Pirelli & C. S.p.A. that the demand for Pirelli & C. Real Estate shares far exceeded supply and that the placement price was equal to Euros 27.25 per share.

The gross gain realized by the Group in the consolidated financial statements amounts to more than Euros 56 million; settlement took place on August 3, 2004.

- On August 6, 2004, the binding agreement was signed to set up a joint venture between Pirelli RE and Morgan Stanley Real Estate Funds (MSREF) in the sector of non-performing loans along the basic guidelines agreed during the first half of the year. According to the agreement, SIB (MSREF) and Pirelli RE Credit Servicing will merge to create the number-one operator in Italy for non-performing loans. Shareholders in this company will be MSREF with a 51 percent stake and Pirelli RE with a 49 percent interest, with a put/call option on 51 percent of the investment beginning January 2007. Pirelli RE will acquire 15 percent of the non-performing loan portfolio held by MSREF for a gross book value of about Euros 2.5 billion. The agreement also states that when the strategic partnership has strengthened its position, MSREF will purchase about 2.1 percent of Pirelli RE's capital at a price of Euros 28.9 per share. The closing of the entire deal is expected to take place by the end of the year, subject to approval by the antitrust authority and the Bank of Italy and the trustees of the existing securitization.
- On September 2, 2004, the Ministry of Economy and Finance notified Pirelli Real Estate SGR that it will be appointed to manage of one of the three portfolios in the investment fund in public properties for non-residential use that the Ministry will shortly set up and with an estimated market value of between Euros 3.5 billion and Euros 4 billion.
- On September 30, 2004, Spazio Industriale 2, a joint venture between Pirelli Real Estate (25 percent) and Soros Real Estate Investors (75 percent), finalized the purchase of 26 formerly-owned Enel properties from New Real (the vehicle company controlled by the DB Real Estate Global Opportunities fund, managed by Deutsche Bank and by CDC-IXIS), for the sum of approx. Euros 93 million.

## THE GROUP

The highlights of the consolidated financial data of the Group for the first nine months of 2004 can be summarized as follows:

	(in millions of euros)				
	3 <sup>rd</sup> Quarter 2004	3 <sup>rd</sup> Quarter 2003	9 months to 9/30/2004	9 months to 9/30/2003	Year 2003
. Net sales	<b>1,732</b>	1,630	<b>5,305</b>	4,928	6,671
. Gross operating profit	<b>174</b>	146	<b>538</b>	468	628
% of net sales	<b>10.0%</b>	9.0%	<b>10.1%</b>	9.5%	9.4%
. Operating profit	<b>89</b>	55	<b>279</b>	197	268
% of net sales	<b>5.1%</b>	3.4%	<b>5.3%</b>	4.0%	4.0%
. Share of earnings (losses) of equity investments	<b>(14)</b>	(19)	<b>63</b>	(41)	(51)
. Operating profit including share of earnings (losses) of equity investments	<b>75</b>	36	<b>342</b>	156	217
. Financial income (expenses)	<b>(37)</b>	(31)	<b>(92)</b>	(105)	(134)
. Extraordinary items	<b>84</b>	3	<b>77</b>	1	(9)
. Income taxes	<b>(24)</b>	(20)	<b>(98)</b>	(85)	(70)
. Net income (loss)	<b>98</b>	(12)	<b>229</b>	(33)	4
% of net sales	<b>5.7%</b>	n.s.	<b>4.3%</b>	n.s.	0.1%
. Net income (loss) attributable to Pirelli & C. S.p.A.			<b>201</b>	(53)	(39)
. Earnings per share (in euros)			<b>0.06</b>	(0.02)	(0.01)
. Shareholders' equity			<b>3,828</b>	3,768	3,678
. Net equity attributable to Pirelli & C. S.p.A.			<b>3,547</b>	3,465	3,429
. Equity per share (in euros)			<b>1.02</b>	1.00	0.99
. Net financial (liquidity)/debt position			<b>1,915</b>	1,518	1,745
. R&D expenditures			<b>154</b>	159	204
. Employees (at period-end)			<b>37,476</b>	36,863	36,337
. Factories (number)			<b>74</b>	77	77
. Pirelli & C. S.p.A. ordinary shares (No. in millions)			<b>3,326.8</b>	3,325.6	3,325.6
. Pirelli & C. S.p.A. savings shares (No. in millions)			<b>134.8</b>	134.8	134.8
. Total Pirelli & C. S.p.A. shares (No. in millions)			<b>3,461.6</b>	3,460.4	3,460.4

For a more meaningful understanding of the performance of the Group in its various activity sectors, the following economic data and the net financial positions are provided according to activity sector.

(in millions of euros)

	Energy Cables & Systems		Telecom Cables & Systems		Tyres		Industrial Aggregate	
	9 months to	9 months to	9 months to	9 months to	9 months to	9 months to	9 months to	9 months to
	9/30/2004	9/30/2003	9/30/2004	9/30/2003	9/30/2004	9/30/2003	9/30/2004	9/30/2003
. Net sales	<b>2,187</b>	1,966	<b>308</b>	322	<b>2,448</b>	2,250	<b>4,943</b>	4,538
. Gross operating profit (loss)	<b>148</b>	116	<b>3</b>	(3)	<b>351</b>	311	<b>502</b>	424
% of net sales	<b>6.8%</b>	5.9%	<b>1.0%</b>	n.s.	<b>14.3%</b>	13.8%	<b>10.2%</b>	9.3%
. Operating profit (loss)	<b>88</b>	51	<b>(16)</b>	(31)	<b>217</b>	174	<b>289</b>	194
% of net sales	<b>4.0%</b>	2.6%	<b>n.s.</b>	n.s.	<b>8.9%</b>	7.7%	<b>5.8%</b>	4.3%
. Share of earn. (loss.) of equity invest.	-	(1)	<b>(3)</b>	-	-	-	<b>(3)</b>	(1)
. Oper.profit (loss) including share of earnings (loss.) of equity investm.	<b>88</b>	50	<b>(19)</b>	(31)	<b>217</b>	174	<b>286</b>	193
. Financial income (expenses)	<b>(23)</b>	(21)	<b>(9)</b>	(14)	<b>(27)</b>	(36)	<b>(59)</b>	(71)
. Extraordinary items	<b>10</b>	8	<b>4</b>	2	-	11	<b>14</b>	21
. Income taxes	<b>(16)</b>	(14)	<b>(3)</b>	-	<b>(69)</b>	(55)	<b>(88)</b>	(69)
. Net income (loss)	<b>59</b>	23	<b>(27)</b>	(43)	<b>121</b>	94	<b>153</b>	74
% of net sales	<b>2.7%</b>	1.2%	<b>n.s.</b>	n.s.	<b>4.9%</b>	4.2%	<b>3.1%</b>	1.6%
. Net financial (liquidity)/debt position	<b>363</b>	385	<b>302</b>	428	<b>341</b>	477	<b>1,006</b>	1,290

(in millions of euros)

	Industrial Aggregate		Pirelli & C. Real Estate		Other		TOTAL	
	9 months to	9 months to	9 months to	9 months to	9 months to	9 months to	9 months to	9 months to
	9/30/2004	9/30/2003	9/30/2004	9/30/2003	9/30/2004	9/30/2003	9/30/2004	9/30/2003
. Net sales	<b>4,943</b>	4,538	<b>383</b>	413	<b>(21)</b>	(23)	<b>5,305</b>	4,928
. Gross operating profit (loss)	<b>502</b>	424	<b>52</b>	54	<b>(16)</b>	(10)	<b>538</b>	468
% of net sales	<b>10.2%</b>	9.3%					<b>10.1%</b>	9.5%
. Operating profit (loss)	<b>289</b>	194	<b>36</b>	42	<b>(46)</b> *	(39)	<b>279</b>	197
% of net sales	<b>5.8%</b>	4.3%					<b>5.3%</b>	4.0%
. Share of earn. (loss.) of equity invest.	<b>(3)</b>	(1)	<b>52</b>	30	<b>14</b> **	(70)	<b>63</b>	(41)
. Oper.profit (loss) including share of earnings (loss.) of equity investm.	<b>286</b>	193	<b>88</b>	72	<b>(32)</b>	(109)	<b>342</b>	156
. Financial income (expenses)	<b>(59)</b>	(71)	<b>3</b>	-	<b>(36)</b>	(34)	<b>(92)</b>	(105)
. Extraordinary items	<b>14</b>	21	<b>(6)</b>	-	<b>69</b>	(20)	<b>77</b>	1
. Income taxes	<b>(88)</b>	(69)	<b>(20)</b>	(20)	<b>10</b>	4	<b>(98)</b>	(85)
. Net income (loss)	<b>153</b>	74	<b>65</b>	52	<b>11</b>	(159)	<b>229</b>	(33)
% of net sales	<b>3.1%</b>	1.6%					<b>4.3%</b>	n.s.
. Net financial (liquidity)/debt position	<b>1,006</b>	1,290	<b>41</b>	49	<b>868</b>	179	<b>1,915</b>	<b>1,518</b>

\* of which, goodwill amortization on purchases of Pirelli & C. S.p.A. shares, Euros 19 million (Euros 19 million in 2003)

\*\* accounting for Olimpia S.p.A. using the equity method, earnings of Euros 29 million (losses of Euros 65 million in 2003)

**Net sales**

Net sales amount to Euros 5,305 million for the nine months ending September 30, 2004, with an increase of 7.7 percent compared to the corresponding period of the prior year. Excluding the foreign exchange effect and metal prices, the increase is 4 percent.

Net sales for the third quarter of 2004 amount to Euros 1,732 million compared to Euros 1,630 million for the third quarter of 2003, an increase of 6.3 percent.

**Gross operating profit**

Gross operating profit for the first nine months of 2004 rose by 15 percent from Euros 468 million to Euros 538 million. Gross operating profit is equal to 10.1 percent of net sales, compared to 9.5 percent for the first nine months of 2003.

Gross operating profit for the third quarter of 2004 amounts to Euros 174 million (10 percent of net sales) compared to Euros 146 million for the third quarter of 2003 (9 percent of net sales).

**Operating profit**

Operating profit for the first nine months of 2004 is Euros 279 million, representing 5.3 percent of net sales, compared to Euros 197 million for the corresponding period of 2003 (4 percent of net sales).

Contributing to this result for the first nine months of 2004 were the industrial sector for Euros 289 million (Euros 194 million for the first nine months of 2003) and the real estate sector for Euros 36 million (Euros 42 million in the same period of 2003).

Operating profit for the first nine months of 2003 also comprised the positive impact of the settlement of the dispute concluded with Ciena over its use of patents (Euros 10 million).

The change in operating profit can mainly be attributed to:

<b>Operating profit for 9 months to 9/30/2003</b>		<b>197</b>
<hr/>		
• Currency exchange effect	(10)	
• Prices (excluding metals)/mix	1	
• Volumes	110	
• Per unit production costs	(58)	
• Efficiencies	50	
• Depreciation	12	
• Other	(23)	
		<b>82</b>
<b>Operating profit for 9 months to 9/30/2004</b>		<b>279</b>
<hr/>		

Operating profit for the third quarter of 2004 is equal to Euros 89 million (5.1 percent of net sales), an improvement compared to Euros 55 million for the third quarter of 2003 (3.4 percent of net sales).

**Share of earnings (losses) of equity investments**

The share of the earnings (losses) of equity investments is a positive balance of Euros 63 million compared to a negative balance of Euros 41 million for the first nine months of 2003 and includes the effect of the earnings (losses) of the companies accounted for using the equity method.

In particular, this caption comprises Olimpia S.p.A.'s result which, thanks to dividends from Telecom Italia S.p.A. received and booked in the second quarter of 2004, shows earnings of Euros 29 million (losses of Euros 65 million for the corresponding period of 2003), countered by financial expenses of the period.

The amount also includes the results of the companies in the Real Estate Sector which show earnings of Euros 52 million (Euros 30 million for the first nine months of 2003) and the writedown of the investment in F.C. Internazionale Milano S.p.A. for Euros 10 million.

**Financial income (expenses)**

Financial income (expenses) show an expense balance of Euros 92 million, an improvement compared to Euros 105 million for the first nine months of 2003.

This caption includes dividends collected from financial equity investments of Euros 14 million (Euros 8 million for the first nine months of 2003).

**Extraordinary items**

Extraordinary items show an income balance of Euros 77 million compared to Euros 1 million for the first nine months of 2003. Extraordinary items basically include the gross gain of Euros 56 million on the placement of 3,400,000 Pirelli & C. Real Estate S.p.A. shares (equal to 8.37 percent of share capital) with Italian and foreign institutional investors.

The balance also includes the gain of Euros 7 million on the sale of the non-controlling equity investment in Afcab Holdings, the sole shareholder of the South African power cables manufacturer African Cables Limited, to the parent company Reunert Limited.

**Net income (loss)**

Net income for the nine months ending September 30, 2004 is Euros 229 million (after income tax expenses of Euros 98 million) compared to a net loss of Euros 33 million for the first nine months of 2003 (after income tax expenses of Euros 85 million).

The net income attributable to Pirelli & C. S.p.A. for the nine months to September 30, 2004 is Euros 201 million compared to a net loss of Euros 53 million for the first nine months of 2003.

### Shareholders' equity

Consolidated shareholders' equity went from Euros 3,678 million at December 31, 2003 to Euros 3,828 million at September 30, 2004, with an increase of Euros 150 million.

The changes in shareholders' equity can be summarized as follows:

	in millions of euros
. Translation adjustments	22
. Net income for the period	229
. Dividends to third parties paid by:	(132)
- Pirelli & C. S.p.A.	(109)
- Pirelli & C. Real Estate S.p.A.	(19)
- Other Group companies	(4)
. Purchase of Pirelli & C. Real Estate treasury shares	(22)
. Sale of 8.37% of Pirelli & C. Real Estate S.p.A. shares	37
. Exercise of Pirelli & C. S.p.A. warrants	1
. Exercise of Pirelli & C. Real Estate S.p.A. stock options	12
. Other changes	3
	<u><b>150</b></u>

The shareholders' equity attributable to Pirelli & C. S.p.A. went from Euros 3,429 million (Euros 0.99 per share) at December 31, 2003 to Euros 3,547 million (Euros 1.02 per share) at September 30, 2004.

**Net financial position**

The net financial position is a net debt position of Euros 1,915 million compared to Euros 1,745 million at December 31, 2003; the change of Euros 170 million can be explained by the following analysis of cash flows:

	(in millions of euros)
. Operating profit	279
. Depreciation and amortization	259
. Net investments	(197)
. Change in working capital	(128)
. Change in provisions and other	(7)
<b>. Free cash flows</b>	<b>206</b>
. Purchases of Telecom Italia S.p.A. shares	(110)
. Purchases other equity investments	(66)
. Sale of 8.37% of Pirelli & C. Real Estate S.p.A. shares	93
. Purchase of Pirelli & C. Real Estate S.p.A. treasury shares	(22)
. Financial income (expenses)	(92)
. Extraordinary items	77
. Income taxes	(98)
. Dividends paid	(132)
. Other changes	(26)
<b>. Net cash flows</b>	<b>(170)</b>
. Change in shareholders' equity	1
<b>. Total changes in shareholders' equity</b>	<b>1</b>
<b>. Translation adjustment</b>	<b>(1)</b>
<b>Change in net financial position</b>	<b>(170)</b>

### **R & D expenditures**

R&D expenditures borne by the Group and completely expensed in the statement of income went from Euros 159 million for the first nine months of 2003 (3.5 percent as a percentage of industrial aggregate net sales) to Euros 154 million for the first nine months of 2004 (3.1 percent as a percentage of industrial aggregate net sales).

### **Employees**

Headcount of employees at September 30, 2004 is 37,476 (of which 3,744 employees with temporary contracts) compared to 36,337 at December 31, 2003 (of which 2,417 employees with temporary contracts) and 36,863 at the end of September 2003 (of which 2,839 employees with temporary contracts).

### **Related party disclosure**

With reference to the disclosure in respect of transactions by Group companies with related parties, a statement is made to the effect that all transactions, including those between the parent company and its subsidiaries, and those among subsidiaries, fall under the ordinary operations of the Group, are carried out at arm's length, and there are no transactions of an unusual and exceptional nature or constituting a potential conflict of interest.

The effects deriving from transactions between Pirelli & C. S.p.A. and its subsidiaries are disclosed in the financial statements of the parent company and, as with intragroup transactions among subsidiaries, are eliminated upon the preparation of the consolidated financial statements.

Furthermore, in order to provide complete disclosure, transactions for the first nine months of 2004 and at September 30, 2004 are presented below between:

- the Pirelli & C. S.p.A. Group and the Telecom Italia S.p.A. Group:
  - **revenues for goods and services**, relating to the supply of telecommunications cables and services rendered by Pirelli Cavi e Sistemi Telecom S.p.A, Pirelli & C. S.p.A., Shared Service Center S.c.r.l. and Pirelli & C. Real Estate S.p.A. (Euros 160 million);
  - **costs for goods and services**, mainly relating to telephone and computer services and the supply of electrical energy (Euros 30 million);
  - **trade receivables**, relating to the supply of the goods and services described above (Euros 71 million);
  - **trade payables**, relating to telephone and computer services and the supply of electrical energy described above (Euros 24 million);

- the Pirelli & C. S.p.A. Group and the Camfin S.p.A. Group:
  - **costs for goods and services**, mainly relating to the supply of natural gas (Euros 10 million);
  - **trade payables**, relating to the supply of the natural gas described above (Euros 2 million);
  - **trade receivables**, relating to the performance of services (Euros 1 million).

Such transactions fall under ordinary operations, are carried out at arm's length, and there are no transactions of an unusual and exceptional nature or constituting a potential conflict of interest.

**Significant events subsequent to the third quarter**

- On October 29, 2004, the transaction was finalized for setting up a joint venture for steel cord manufacturing in Rumania with Pirelli holding an 80 percent stake and Continental a 20 percent interest.

The joint venture, named Cord Romania S.r.l., will be directly involved in the building of a new factory at Slatina, which will directly serve the East Europe markets with a high growth rate. The new factory is slated for rapid development, with investments of up to Euros 40 million over the next three years which will make it possible to manufacture, when fully operational, about 30 thousand tons of steel cord per year, employing roughly 350 persons. Cord Romania will thus be able to meet the growing demand for this important tyre component, which today exceeds demand by almost two times the supply. Steel cord is used by tyre manufacturers as the chief material for reinforcing the radial structure.

- On November 4, 2004, Pirelli RE SGR obtained approval from Consob for the publication of a prospectus for the public offer of sale, subscription and listing of Olinda Fondo Shops, the seeded real estate fund specialized in stores, commercial structure and entertainment centers. The offer began November 10, 2004 and will end (unless it is closed earlier or extended) on December 6, 2004. The value of the fund is Euros 261 million. The fund's assets, after seeding and anticipated purchases, will consist of 44 buildings for a total market value of over Euros 740 million.

### **Outlook for the current year**

The results achieved in the first nine months of the year enable the Group to confirm its expectations for a significant improvement in results for the full-year 2004 in all sectors at both the operating profit and net income levels, barring outside factors of an extraordinary nature which are not predicable at this time.

The net financial position will be in line with the targets set out in the 2004-2006 plan.

In particular, with reference to **industrial activities**, the growth in profitability witnessed in the first nine months should be confirmed for the Energy Cables and Systems Sector. The Tyres Sector should carry on its positive trend, allowing for the seasonal impact. In the Telecom Cables and Systems Sector, pressure over prices should remain for cables and fibers with an increase of volumes in the U.S.A., while the growth of broadband services on fiber should allow for a further gain in the sales of access solutions.

As regards **real estate operations**, based on available information, it is reasonable to expect, for 2004, a growth in operating profit including the share of earnings (losses) of equity investments compared to the prior year as set out in the three-year plan.

## **ENERGY CABLES AND SYSTEMS SECTOR**

The consolidated figures for the Energy Cables and Systems Sector for the nine months ending September 30, 2004 can be summarized as follows:

	(in millions of euros)				
	3 <sup>rd</sup> Quarter 2004	3 <sup>rd</sup> Quarter 2003	9 months to 9/30/2004	9 months to 9/30/2003	Year 2003
. Net sales	<b>739</b>	654	<b>2,187</b>	1,966	2,637
. Gross operating profit	<b>54</b>	46	<b>148</b>	116	169
% of net sales	7.3%	7.0%	<b>6.8%</b>	5.9%	6.4%
. Operating profit	<b>34</b>	24	<b>88</b>	51	83
% of net sales	4.6%	3.7%	<b>4.0%</b>	2.6%	3.1%
. Financial income (expenses)	<b>(8)</b>	(6)	<b>(23)</b>	(22)	(23)
. Extraordinary items	<b>11</b>	1	<b>10</b>	8	(5)
. Income taxes	<b>(2)</b>	(5)	<b>(16)</b>	(14)	(16)
. Net income	<b>35</b>	14	<b>59</b>	23	39
% of net sales	4.7%	2.1%	<b>2.7%</b>	1.2%	1.5%
. Net financial (liquidity)/debt position			<b>363</b>	385	354
. R&D expenditures			<b>24</b>	25	33
. Employees (at period end)			<b>10,802</b>	11,038	10,746
. Factories (number)			<b>46 *</b>	48	48

\* three of these are shared with the Telecom Cables and Systems Sector

**Net sales for the nine months ending September 30, 2004** amount to Euros 2,187 million, with an increase of 11.2 percent compared to the same period of the prior year. Excluding the effects of foreign exchange and metal prices, net sales are more or less in line with those of the same period of the prior year.

The change in net sales is the result of the following:

• Volumes	+	1.7%
• Prices/mix	-	1.5%
<b>Change on a comparable basis</b>	+	<b>0.2%</b>
• Currency exchange effect	-	1.1%
• Metal prices	+	12.1%
<b>Total change</b>	+	<b>11.2%</b>

An analysis of net sales by geographical area shows an increase in Europe, due mainly to higher metal prices.

Net sales in North America also rose as a result of the effect of higher metal prices, in that the increase in volumes and mix was offset by the negative impact of the weakness of the U.S. dollar.

The trend in net sales in South America was positive, with a negative currency exchange effect, which only partly reduces the improvement in volumes, prices and mix.

Net sales in the Asia Pacific area (Australia, Indonesia and China) show a decline in connection with sales volumes and a negative currency exchange effect which was not sufficiently compensated by the increase in the price of metals.

In terms of business, net sales of the Industrial Market grew 12 percent; the General Market area, excluding the metals component, recorded an increase of 6 percent in net sales compared to the prior year.

**Net sales for the third quarter of 2004** amount to Euros 739 million compared to Euros 654 million for the same quarter of 2003.

**Operating profit for the nine months ending September 30, 2004** is Euros 88 million, compared to Euros 51 million for the first nine months of 2003. Operating profit is equal to 4.0 percent of net sales and compares to 2.6 percent for the same period of the prior year.

The change in operating profit is due to the following:

<b><u>Operating profit for 9 months to 9/30/2003</u></b>	<b>51</b>
• Currency exchange effect	(2)
• Prices (excluding metals)/mix	13
• Volumes	19
• Per unit production costs	(7)
• Efficiencies	17
• Depreciation	3
• Other	(6)
	<b>37</b>
<b><u>Operating profit for 9 months to 9/30/2004</u></b>	<b>88</b>

**Operating profit for the third quarter of 2004** is Euros 34 million, compared to Euros 24 million for the third quarter of 2003.

**Net income for the first nine months of 2004** is Euros 59 million (after financial expenses of Euros 23 million, extraordinary income of Euros 10 million and income tax expenses of Euros 16 million) compared to Euros 23 million for the same period of the prior year (after financial expenses of Euros 22 million, extraordinary income of Euros 8 million and income tax expenses of Euros 14 million).

Net income reflects the extraordinary income mostly from the gains realized on the sale of the industrial sites previously closed down (Erith-U.K. and Torredembarra-Spain) for about Euros 12 million and the sale of the equity investment in African Cables Holding Ltd. for Euros 7 million. This was offset by the costs for the replacement of a 230kV high-voltage cable in Singapore for about Euros 8 million. This contract (which dates back to 1998) had originally been executed by BICC between 1999 and 2000 and then transferred to the Pirelli group when BICC was purchased during the course of 2000.

The **net financial position** is a net debt position of Euros 363 million; this is a slight increase compared to Euros 354 million at December 31, 2003.

Headcount of **employees** at September 30, 2004 is 10,802 (of which 773 employees with temporary contracts), with an increase of 10,746 compared to December 31, 2003 (of which 502 employees with temporary contracts); the higher headcount is entirely due to the increase in employees with temporary contracts.

The number of **factories** went from 48 to 46 due to the closing of the production facilities at San Giuliano Milanese (Italy) and the sale of the factory manufacturing enameled wires in Brazil (Cerquillo).

## **TELECOM CABLES AND SYSTEMS SECTOR**

The consolidated figures for the Telecom Cables and Systems Sector for the first nine months ending September 30, 2004 can be summarized as follows:

	(in millions of euros)				
	3 <sup>rd</sup> Quarter 2004	3 <sup>rd</sup> Quarter 2003	9 months to 9/30/2004	9 months to 9/30/2003	Year 2003
. Net sales	<b>103</b>	94	<b>308</b>	322	427
. Gross operating profit (loss)	<b>3</b>	(1)	<b>3</b>	(3)	(1)
% of net sales	<b>2.9%</b>	n.s.	<b>1.0%</b>	n.s.	n.s.
. Operating loss	<b>(1)</b>	(10)	<b>(16)</b>	(31)	(39)
% of net sales	n.s.	n.s.	n.s.	n.s.	n.s.
. Financial income (expenses)	<b>(6)</b>	(5)	<b>(12)</b>	(14)	(20)
. Extraordinary items	<b>5</b>	1	<b>4</b>	2	4
. Income taxes	<b>(2)</b>	-	<b>(3)</b>	-	(1)
. Net loss	<b>(4)</b>	(14)	<b>(27)</b>	(43)	(56)
% of net sales	n.s.	n.s.	n.s.	n.s.	n.s.
. Net financial (liquidity)/debt position			<b>302</b>	428	302
. R&D expenditures			<b>23</b>	26	34
. Employees (at period end)			<b>2,120</b>	2,257	2,218
. Factories (number)			<b>9 *</b>	11	11

\* three of these are shared with the Energy Cables and Systems Sector

**Net sales for the nine months ending September 30, 2004** amount to Euros 308 million, with a reduction of about 4.3 percent compared to the same period of the prior year. Excluding the foreign exchange effect and metal prices, the reduction is 4 percent.

The change in net sales is the result of the following:

• Volumes	+	14.2%
• Prices/mix	-	18.2%
<b>Change on a comparable basis</b>	-	<b>4.0%</b>
• Currency exchange effect	-	2.6%
• Metal prices	+	2.3%
<b>Total change</b>	-	<b>4.3%</b>

The upswing in volumes during the quarter still displayed a certain amount of price pressure, especially in North America.

As for access products, volumes are growing and market positions with the major customers have been consolidated.

**Net sales for the third quarter of 2004** amount to Euros 103 million compared to Euros 94 million for the same quarter of 2003.

**The operating loss for the nine months ending September 30, 2004** is Euros 16 million compared to an operating loss of Euros 31 million for the first nine months of 2003.

The change in the operating loss is due to the following:

<b><u>Operating loss for 9 months to 9/30/2003</u></b>		<b>(31)</b>
• Currency exchange effect		
• Prices (excluding metals)/mix	(45)	
• Volumes	17	
• Per unit production costs	7	
• Efficiencies	17	
• Depreciation	10	
• Other	9	
		<b>15</b>
<b><u>Operating loss for 9 months to 9/30/2004</u></b>		<b>(16)</b>

The result reflects the adjustment to the estimated useful lives of property, plant and equipment for the manufacture of fibers, which was increased from five to eight years, with a positive impact of Euros 3 million on the first nine months of 2004 due to lower depreciation.

The change was made in view of a slowdown in the technological evolution of the machinery and therefore its use over a longer period of time.

**The operating loss for the third quarter of 2004** amounts to Euros 1 million, compared to Euros 10 million for the third quarter of 2003.

**The net loss for the first nine months of 2004** is Euros 27 million (after financial expenses of Euros 12 million, extraordinary income of Euros 4 million and income tax expenses of Euros 3 million) compared to a net loss of Euros 43 million for the same period of the prior year (after financial expenses of Euros 14 million and extraordinary income of Euros 2 million).

The **net financial position** is a net debt position of Euros 302 million, unchanged compared to December 31, 2003.

Headcount of **employees** at September 30, 2004 is 2,120 (of which 128 with temporary contracts), with a reduction of 98 compared to December 31, 2003.

The number of **factories** went from 11 at December 31, 2003 to 9 following the closing of Arco Felice and Paderno Dugnano.

## TYRES SECTOR

The consolidated figures for the Tyres Sector for the nine months ending September 30, 2004 can be summarized as follows:

	(in millions of euros)				
	3 <sup>rd</sup> Quarter 2004	3 <sup>rd</sup> Quarter 2003	9 months to 9/30/2004	9 months to 9/30/2003	Year 2003
. Net sales	<b>802</b>	741	<b>2,448</b>	2,250	2,970
. Gross operating profit	<b>107</b>	92	<b>351</b>	311	399
% of net sales	<b>13.3%</b>	12.4%	<b>14.3%</b>	13.8%	13.4%
. Operating profit	<b>63</b>	45	<b>217</b>	174	220
% of net sales	<b>7.9%</b>	6.1%	<b>8.9%</b>	7.7%	7.4%
. Financial income (expenses)	<b>(8)</b>	(11)	<b>(27)</b>	(36)	(45)
. Extraordinary items	-	1	-	11	(1)
. Income taxes	<b>(18)</b>	(16)	<b>(69)</b>	(55)	(45)
. Net income	<b>37</b>	19	<b>121</b>	94	129
% of net sales	<b>4.6%</b>	2.6%	<b>4.9%</b>	4.2%	4.3%
. Net financial (liquidity)/debt position			<b>341</b>	477	317
. R&D expenditures			<b>95</b>	96	123
. Employees (at period-end)			<b>21,531</b>	20,620	20,437
. Factories (number)			<b>22</b>	22	22

Net sales for the nine months ending September 30, 2004 amount to Euros 2,448 million, with an increase of 8.8 percent compared to the corresponding period of the prior year.

The change in net sales can be attributed to:

• Volumes	+	8.4%
• Prices/mix	+	2.6%
<b>Change on a comparable basis</b>	+	<b>11.0%</b>
• Currency exchange effect	-	2.2%
<b>Total change</b>	+	<b>8.8%</b>

## **CONSUMER MARKET**

The **Passenger Car/Light Truck** segment shows higher sales than the prior year mainly as a result of an increase in sales volumes (+10 percent) in all areas. Particular mention should be made of the growth in North America and South America.

The **Motorcycle** segment grew in terms of volumes and sales compared to performance in 2003.

## **INDUSTRIAL MARKET**

Sales volumes are higher overall compared to the first nine months of 2003 (+6 percent) thanks foremost to the good performance of South America, Turkey and Egypt.

The **Steel Cord** area also displays a positive trend mainly on account of the growth in sales volumes and mix.

**Net sales for the third quarter of 2004** amount to Euros 802 million, with an increase of 8.2 percent compared to the third quarter of 2003, which reported net sales of Euros 741 million.

**Operating profit for the nine months ending September 30, 2004** is Euros 217 million compared to Euros 174 million for the corresponding period of the prior year (+24.7 percent).

The percentage of operating profit to net sales is 8.9 percent, compared to 7.7 percent in the first nine months of 2003.

The change in operating profit can be summarized as follows:

<b><u>Operating profit for 9 months to 9/30/2003</u></b>	<b>174</b>
• Currency exchange effect	(8)
• Prices/mix	33
• Volumes	74
• Per unit production costs	(52)
• Efficiencies	13
• Depreciation	(1)
• Other	(16)
	<b>43</b>
<b><u>Operating profit for 9 months to 9/30/2004</u></b>	<b>217</b>

**Operating profit for the third quarter of 2004** is Euros 63 million (ROS of 7.9 percent), with an increase compared to Euros 45 million for the same period of 2003 (ROS of 6.1 percent).

**Net income for the nine months ending September 30, 2004** is Euros 121 million (after financial expenses of Euros 27 million and income tax expenses of Euros 69 million) compared to Euros 94 million for the first nine months of 2003 (after financial expenses of Euros 36 million, extraordinary income of Euros 11 million and income tax expenses of Euros 55 million). Extraordinary income for the first nine months of 2003 referred to the consideration paid to the company under the “Milan-Turin High-Speed Train Project”.

The **net financial position** is a net debt position of Euros 341 million, after dividend payments of Euros 85 million to Pirelli & C. S.p.A., compared to Euros 317 million at December 31, 2003.

Headcount of **employees** at September 30, 2004 is 21,531 (of which 2,692 with temporary contracts), with an increase compared to 20,437 at December 31, 2003 (of which 1,705 with temporary contracts).

**Factories** remained unchanged compared to December 31, 2003.

## REAL ESTATE SECTOR

The first nine months of 2004 were particularly important and displayed a strong trend of growth.

Net income - attributable is equal to Euros 65.9 million compared to Euros 52.1 million for the first nine months of 2003, with an increase of 26 percent.

### Economic review

Bearing in mind the Real Estate Sector's business model, the aggregate production value, net of acquisitions, and the operating profit including the share of earnings (losses) of equity investments are the most important indicators expressing business volumes managed and operating results.

	9 months to 9/30/2004	9 months to 9/30/2003	
(in millions of euros)			
<b>Aggregate production value, net of acquisitions</b>	<b>1,228.6</b>	<b>982.4</b>	25%
Consolidated production value	354.5	388.9	
<i>- of which, net of acquisitions</i>	<i>329.7</i>	<i>348.2</i>	
<b>Operating profit including the share of earnings (losses) of equity investments</b>	<b>88.4</b>	<b>71.7</b>	23.0%
<b>Income before extraordinary items</b>	<b>91.5</b>	<b>71.8</b>	
<b>Net income - attributable</b>	<b>65.9</b>	<b>52.1</b>	26.0%

**Aggregate production value**, net of acquisitions, amounts to Euros 1,228.6 million with a growth of 25 percent compared to Euros 982.4 million for the first nine months of 2003. Consolidated production value alone for the first nine months of 2004 is Euros 354.5 million, compared to Euros 388.9 million in the first nine months of 2003. The decrease is due, in keeping with the Group's business model, to the growing impact of initiatives in minority-owned investments rather than consolidated investments.

**Operating profit** including the share of earnings (losses) of equity investments amounts to Euros 88.4 million, compared to Euros 71.7 million for the first nine months of 2003, a growth of 23 percent.

**Net income** - attributable is Euros 65.9 million, compared to Euros 52.1 million for the first nine months of 2003, with an increase of 26 percent.

### **Balance sheet and financial review**

	<u>9/30/2004</u>	<u>12/31/2003</u>	<u>9/30/2003</u>
(in millions of euros)			
<b>Fixed assets</b>	<b>368.1</b>	<b>313.4</b>	<b>266.1</b>
including invest. in real estate funds and companies	183.2	149.7	126.6
<b>Net working capital</b>	<b>160.5</b>	<b>162.3</b>	<b>207.7</b>
including inventories	273.3	325.0	331.6
<b>Net invested capital</b>	<b>528.6</b>	<b>475.7</b>	<b>473.8</b>
<b>Shareholders' equity</b>	<b>452.2</b>	<b>424.8</b>	<b>372.2</b>
including minority interest	6.5	3.2	0.7
<b>Provisions and contributions</b>	<b>35.5</b>	<b>41.7</b>	<b>52.9</b>
<b>Net financial (liquidity)/debt position</b>	<b>40.9</b>	<b>9.2</b>	<b>48.7</b>
<b>Total net invested capital financed</b>	<b>528.6</b>	<b>475.7</b>	<b>473.8</b>

**Shareholders' equity - attributable** at September 30, 2004 is Euros 445.7 million compared to Euros 421.6 million at the end of 2003. The increase is due to the difference between dividends paid (Euros 53.8 million) and the net income for the period (Euros 65.9 million), as well as a capital increase with share premium (Euros 11.9 million) following the exercise of stock options.

The **net financial position** shows a net debt position of Euros 40.9 million at September 30, 2004, an improvement of Euros 7.8 million compared to Euros 48.7 million at September 30, 2003 (Euros 9.2 million at the end of 2003).

The **adjusted net financial position** (expressed gross of the financing made to minority-owned companies) is a net debt position of Euros 295.3 million compared to Euros 248 million at September 30, 2003 (a net debt position of Euros 223.7 million at the end of 2003). The gearing ratio is 0.65 compared to 0.67 at September 30, 2003 and 0.53 at the end of 2003; these ratios reflect the targets set out in the three-year plan.

**Fixed assets** total Euros 368.1 million at September 30, 2004, compared to Euros 313.4 million at the end of 2003, with a growth of Euros 54.7 million, of which Euros 21.5 million refers to the purchase of 2 percent of the shares of Tecla Fondo Uffici and 5 percent of the shares of Cloe Fondo Uffici by Pirelli RE SGR.

**Net working capital** is equal to Euros 160.5 million, compared to Euros 162.3 million at the end of 2003. The decrease is attributable to the reduction in inventories following the sale of properties finalized during the first nine months of 2004.

### **Outlook for the current year**

On the basis of available information, a growth in operating profit, including the share of earnings of equity investments, can reasonably be expected for 2004, in line with the targets of the three-year plan.

## PROFORMA DATA

### **Proforma consolidated financial data assuming the line-by-line consolidation of Olimpia S.p.A. and the use of the equity method to value the investment in Telecom Italia S.p.A..**

Proforma consolidated financial data at September 30, 2004 of Pirelli & C. S.p.A. is presented below, assuming the consolidation line-by-line of Olimpia S.p.A. and the use of the equity method to value the investment in Telecom Italia S.p.A..

	Consolidated financial statements at 9/30/2004 Pirelli & C. S.p.A. (1)	Proforma adjustments					Proforma consolidated financial data at 9/30/2004 Pirelli & C S.p.A. (2)
		Elimination of Olimpia S.p.A. net result attributable to Pirelli & C. S.p.A. (50.4%)	Olimpia S.p.A. line-by-line consolidation	Adjustments to Olimpia financial statements to take into account the valuation made by Pirelli when the merger surplus was allocated	Consolidation adjustments and valuation of investment in Telecom Italia S.p.A. using the equity method	Total proforma adjustments	
<i>(in millions of euros)</i>							
<b>Condensed Statement of Income</b>							
Net sales	5,305	-	-	-	-	-	5,305
Operating profit	279	-	(1)	-	-	(1)	278
Financial income (expenses)/ Valuation adj. to financial assets	(29)	(31)	62	-	(247)	(216)	(245)
Extraordinary items	77	-	-	-	-	-	77
Income taxes	(98)	-	-	-	-	-	(98)
Net income	229	(31)	61	-	(247)	(217)	12
Net income - Pirelli & C S.p.A.	201	(31)	31	-	(125)	(125)	76
Goodwill amortization effect	2	-	-	-	253	253	255
Net income (loss) (excluding goodwill amortization)	231	(31)	61	-	6	36	267
Net income - Pirelli & C S.p.A. (excluding goodwill amortization)	203	(31)	31	-	3	3	206
<b>Reclassified Balance Sheet</b>							
Fixed assets	6,049	(31)	9,561	(1,245)	(5,483)	2,802	8,851
Net working capital	692	-	35	-	-	35	727
Total net invested capital	6,741	(31)	9,596	(1,245)	(5,483)	2,837	9,578
Financed by:							
Shareholders' equity	3,828	(31)	6,386	(1,245)	(5,483)	(373)	3,455
- of which shareholders' equity - Pirelli & C S.p.A.	3,547	(31)	3,219	(627)	(4,026)	(1,465)	2,082
Provisions	998	-	-	-	-	-	998
Net financial (liquidity)/debt position	1,915	-	3,210	-	-	3,210	5,125

(1) Pirelli & C. S.p.A. consolidated financial statements (investment in Olimpia S.p.A. accounted for using the equity method)

(2) Proforma data (line-by-line consolidation of Olimpia S.p.A. and equity method valuation of Telecom Italia S.p.A.)

The proforma consolidated financial data has been prepared using the statutory financial statements of Olimpia S.p.A. at September 30, 2004 and the consolidated financial statements of the Telecom Italia S.p.A. Group at the same date.

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

- in the column “Elimination of Olimpia S.p.A. net result attributable to Pirelli & C. S.p.A. (50.4%)”: elimination of the statement of income and balance sheet effects of valuing Olimpia S.p.A. with the equity method in the Pirelli & C. S.p.A. consolidated financial statements at September 30, 2004;
- in the column “Olimpia S.p.A. line-by-line consolidation”: inclusion of the assets, liabilities, revenues and costs resulting from the financial statements for the nine months ended September 30, 2004 of Olimpia S.p.A., attributing the share of net equity and results of operations to the minority interest;
- in the column “Adjustments to Olimpia financial statements to take into account the valuation made by Pirelli when the merger surplus was allocated”, the amount of Euros 1,245 million derives from the effect of the allocation of the merger surplus of Pirelli & C. S.p.A. in 2003 which was booked as a deduction of the goodwill posted by Olimpia on the investment in Telecom Italia S.p.A.;
- in the column “Consolidation adjustments and valuation of investment in Telecom Italia S.p.A. using the equity method”: inclusion of the effect of accounting for Telecom Italia S.p.A. using the equity method, giving rise to a negative valuation adjustment of Euros 247 million, of which Euros 146 million relates to the amortization of implicit goodwill for nine months out of a total twenty-year period, Euros 81 million to Olimpia S.p.A.’s share of the first nine months 2004 net income of the Telecom Italia Group and Euros 182 million to the reversal of Telecom Italia S.p.A. dividends collected by Olimpia.

In order to represent the diluting effect of Euros 2,250 million deriving from the reduction of Olimpia S.p.A.'s percentage holding in Telecom Italia S.p.A. following the merger of Olivetti S.p.A. and Telecom Italia S.p.A., from 28.5 percent at December 31, 2002 to 7.4 percent (referring to the total of capital issued) at December 31, 2003, the amount was directly deducted from shareholders' equity.

The "goodwill amortization effect" on the net result is detailed as follows:

- in the column "Consolidated financial statements at September 30, 2004 Pirelli & C. S.p.A.", the amount of Euros 2 million refers to the amortization charge for the nine months on the goodwill booked by Pirelli & C. S.p.A. in respect of Olimpia S.p.A.;
- in the column "Consolidation adjustments and valuation of investment in Telecom Italia S.p.A. using the equity method", the amount of Euros 253 million includes Euros 146 million for the goodwill booked by Olimpia S.p.A. in respect of Telecom Italia S.p.A. and Euros 107 million for the original goodwill booked by Olivetti S.p.A. in 1999 in respect of Telecom Italia S.p.A..

A comparison of shareholders' 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 September 30, 2004 and December 31, 2003 is presented below, assuming:

- the line-by-line consolidation of Olimpia S.p.A. and the valuation of the investment in Telecom Italia S.p.A. using the equity method;
- the line-by-line consolidation of both Olimpia S.p.A. and the Telecom Italia Group.

<i>(in millions of euros)</i>	Shareholders' equity		Net debt		Net debt/Shareholders' equity		Shareholders' equity - Pirelli & C. S.p.A.	
	9/30/2004	12/31/2003	9/30/2004	12/31/2003	9/30/2004	12/31/2003	9/30/2004	12/31/2003
Pirelli & C. S.p.A. Group: consolidated financial statements	3,828	3,678	1,915	1,745	0.50	0.47	3,547	3,429
Pirelli & C. S.p.A. Group: proforma consolidated data with Olimpia S.p.A. consolidated line-by-line and Telecom Italia S.p.A. valued using the equity method	3,455	3,524	5,125	5,023	1.48	1.43	2,082	2,089
Pirelli & C. S.p.A. Group: proforma consolidated data with Olimpia S.p.A. and Telecom Italia Group consolidated line-by-line	21,197	22,362	36,546	38,369	1.72	1.72	2,082	2,089

The Board of Directors

Milan, November 11, 2004

**QUARTERLY DATA  
AND  
COMMENTS**

**QUARTERLY DATA**

(in millions of euros)

Statement of Income	3 <sup>rd</sup> Quarter 2004	3 <sup>rd</sup> Quarter 2003	9 months to 9/30/2004	9 months to 9/30/2003	Year 2003
. Net sales	1,732	1,630	5,305	4,928	6,671
. Other revenues	90	(17)	255	29	186
<b>. Production value</b>	<b>1,822</b>	1,613	<b>5,560</b>	4,957	6,857
. Cost of sales	<b>(1,304)</b>	(1,133)	<b>(3,951)</b>	(3,467)	(4,857)
. Labor costs	<b>(344)</b>	(333)	<b>(1,071)</b>	(1,021)	(1,371)
. Amortization and depreciation	<b>(85)</b>	(92)	<b>(259)</b>	(272)	(361)
<b>. Operating profit</b>	<b>89</b>	55	<b>279</b>	197	268
. Financial income (expenses), net	<b>(51)</b>	(50)	<b>(29)</b>	(146)	(185)
<b>. Income before extraordinary items and income taxes</b>	<b>38</b>	5	<b>250</b>	51	83
. Extraordinary items	<b>84</b>	3	<b>77</b>	1	(9)
<b>. Income before taxes</b>	<b>122</b>	8	<b>327</b>	52	74
. Income taxes	<b>(24)</b>	(20)	<b>(98)</b>	(85)	(70)
<b>. Net income (loss)</b>	<b>98</b>	(12)	<b>229</b>	(33)	4

(in millions of euros)

Balance Sheet	9/30/2004	6/30/2004	12/31/2003
. Fixed assets	6,049	6,059	5,902
. Net working capital	692	688	566
<b>. Net invested capital</b>	<b>6,741</b>	<b>6,747</b>	<b>6,468</b>
. Shareholders' equity	3,828	3,685	3,678
. Provisions	998	1,015	1,045
. Net financial (liquidity)/debt position	1,915	2,047	1,745
<b>. Financed</b>	<b>6,741</b>	<b>6,747</b>	<b>6,468</b>

(in millions of euros)

<b>Net financial position</b>	<b>9/30/2004</b>	<b>6/30/2004</b>	<b>12/31/2003</b>
. Short-term financial payables	1,058	1,244	902
. Accrued and prepaid interest expenses	56	41	50
. Cash and banks	(303)	(268)	(264)
. Other marketable securities	(295)	(309)	(284)
. Short-term financial receivables	(56)	(44)	(60)
. Accrued and deferred interest income	(15)	(15)	(14)
<b>Net short-term (liquidity)/debt</b>	<b>445</b>	<b>649</b>	<b>330</b>
. Medium/long-term financial payables	1,791	1,695	1,695
. Medium/long-term financial receivables	(317)	(293)	(276)
. Other securities	(4)	(4)	(4)
<b>Net medium/long-term debt</b>	<b>1,470</b>	<b>1,398</b>	<b>1,415</b>
<b>Net financial (liquidity)/debt position</b>	<b>1,915</b>	<b>2,047</b>	<b>1,745</b>

## **COMMENTS ON QUARTERLY DATA**

### **Form and content**

The accounting policies, valuation criteria and principles of consolidation used in preparing the quarterly data at September 30, 2004 are the same as those adopted for the financial statements at December 31, 2003 and disclosed in the previous annual report.

## Net sales

Net sales for the nine months ending September 30, 2004 amount to Euros 5,305 million compared to Euros 4,928 million for the nine months ending September 30, 2003.

The increase of 7.7 percent in net sales compared to the corresponding period of 2003 can be analyzed as follows:

• Volumes	+	4.7%
• Prices/mix	-	0.7%
<b>Change on a comparable basis</b>	+	<b>4.0%</b>
• Currency exchange effect	-	1.7%
• Metal prices	+	5.4%
<b>Total change</b>	+	<b>7.7%</b>

The distribution of net sales by sector and by geographical area of destination is as follows:

Sector	9 months to 9/30/2004	9 months to 9/30/2003	Geographical area	9 months to 9/30/2004	9 months to 9/30/2003
Energy Cables and Systems	41%	40%	Italy	25.2%	21.0%
			Other European countries	40.5%	41.8%
Telecom Cables and Systems	6%	7%	North America	9.9%	11.4%
Tyres	46%	46%	Central and South America	14.0%	12.2%
Real Estate	7%	7%	Australia, Africa and Asia	10.4%	13.6%

**Labor costs**

Labor costs for the first nine months of 2004 amount to Euros 1,071 million and represent 20.2 percent of net sales, compared to Euros 1,021 million for the corresponding period of the prior year (20.7 percent of net sales).

**Amortization and depreciation**

Amortization and depreciation total Euros 259 million, of which Euros 58 million refers to the amortization of intangible assets and Euros 201 million to the depreciation of property, plant and equipment.

The depreciation charge reflects the adjustment to the estimated useful lives of property, plant and equipment for the manufacture of fibers, which was increased from five to eight years, with a positive impact of Euros 3 million on the first nine months of 2004.

The change was made in view of a slowdown in the technological evolution of the machinery and therefore its use over a longer period of time.

**Operating profit**

Operating profit for the first nine months of 2004 is Euros 279 million (5.3 percent of net sales). This is a considerable increase over the same period of 2003 (Euros 197 million and 4 percent of net sales).

The change in operating profit is principally due to:

<b>Operating profit for 9 months to 9/30/2003</b>		<b>197</b>
• Currency exchange effect	(10)	
• Prices (excluding metals)/mix	1	
• Volumes	110	
• Per unit production costs	(58)	
• Efficiencies	50	
• Depreciation	12	
• Other	(23)	
		<b>82</b>
<b>Operating profit for 9 months to 9/30/2004</b>		<b>279</b>

### **Net income (loss)**

Net income for the nine months ending September 30, 2004 is Euros 229 million compared to a net loss of Euros 33 million for the first nine months of 2003.

Net income for the first nine months of 2004 includes extraordinary income mostly from the gross gain realized on the placement of 3,400,000 Pirelli & C. Real Estate S.p.A. shares (Euros 56 million) with Italian and foreign institutional investors, the gain on the sale of the industrial sites previously closed down at Erith and Torredembarra (Euros 12 million) and the gain on the sale of the equity investment in African Cables Holding Ltd (Euros 7 million), offset by the extraordinary expenses for the costs to replace the high-voltage cable in Singapore (Euros 8 million).

**Net financial position**

The net debt position at September 30, 2004 is Euros 1,915 million compared to Euros 1,745 million at December 31, 2003, but with a reduction from Euros 2,047 million at June 30, 2004.

The change from December 31, 2003 is principally due to the payment of dividends (Euros 132 million), the purchase option exercised by Pirelli for more than 47 million Telecom Italia S.p.A. shares (Euros 110 million), the subscription to Eurostazioni S.p.A.'s capital increase (Euros 33 million) and the purchase of RCSMediaGroup shares (Euros 33 million) and, on the other side, cash provided by operating activities and cash receipts from the placement of Pirelli & C. Real Estate shares by Deutsche Bank (Euros 93 million).

At September 30, 2003, the net debt position had amounted Euros 1,518 million and had not yet included the effects of the Olimpia S.p.A. capital increase, subscribed prorata by Pirelli in the last quarter for a total of Euros 388 million.