

CORPORATE GOVERNANCE

A good system of Corporate Governance puts the board of directors at the center of the enterprise as the main body delegated to manage the company in the interests of the shareholders. On the basis of this system, a proper practice for disclosure of the choices and formative processes of corporate decisions must be established, along with an effective internal control system and rigorous monitoring of potential conflicts of interest. There must also be solid principles of conduct governing interactions with related parties.

As disclosed in the annual report - in a specific section and available on the corporate website, to which reference should be made - these benchmarks are firmly inscribed in the system of values Pirelli has established for the definition, preparation and adoption of codes, principles and procedures regulating corporate life. These codes, principles and procedures are periodically reviewed and, where necessary, updated to account for legislative and regulatory innovations, changes in the international best practices, and developments in the company's operations.

In this section of the interim report, disclosure is provided of the updates and the supplements made to the corporate governance system of the company in the first half of the year.

In particular, the ordinary shareholders' meeting held on April 21, 2006 elected the new board of statutory auditors.

The following were elected statutory auditors of the company for the three years 2006-2008:

- Luigi Guatri (Chairman of the Board of Statutory Auditors)
- Enrico Laghi (Standing Auditor)
- Paolo Francesco Lazzati (Standing Auditor)
- Franco Ghiringhelli (Alternate Auditor)
- Luigi Guerra (Alternate Auditor)

The members of the board of statutory auditors were elected using the slate system of voting.

In the manner established in the bylaws and in compliance with the recommendations contained in the new Self-Regulatory Code of listed companies, a single slate was presented (by the components of the Pirelli & C. Voting Trust). The list was made public by the company in the 15 days prior to the shareholders' meeting by publication of the list on the corporate website together with the curriculum vitae of the candidates running for the posts.

In accordance with the provisions of art. 148 of Legislative Decree No. 58/1998, the election of the chairman of the board of statutory auditors was passed by resolution of the shareholders' meeting of the company, since the bylaws no longer provide for the chairman of the board of the statutory auditors to be chosen from the top of the list presented by the majority shareholders. The immediate application of this new law was rendered public when the notice of the shareholders' meeting was published. The same shareholders' meeting also voted to set the gross annual compensation for each standing auditor at Euros 41,500 and the gross annual compensation for the chairman of the board of statutory auditors at Euro 62,000. It also established that the statutory auditor who is called to sit on the Oversight Committee, as set forth by Legislative Decree No. 231/01 (Paolo Francesco Lazzati), will receive additional gross annual compensation of Euros 10,000.

The shareholders were able to vote on each single point separately (election of the standing and alternate auditors, election of the chairman of the board of statutory auditors and determination of the compensation for the standing auditors).

During the first half, Carlo De Benedetti, an independent director of the company, resigned his post, indicating that he wished to relinquish all posts held as director in companies other than those of the Group he heads.

To replace him, on September 12, 2006, the board of directors appointed Alberto Bombassei, also an independent director.

The subject of transparency with regard to transactions involving the company's shares or financial instruments related thereto carried out directly or through persons by relevant parties or by persons closely connected thereto (insider dealing) is, at this time, fully regulated by Legislative Decree No. 58/1998 (art. 114) and by Consob (articles 152-sexies and subsequent articles the Regulation of Issuers). As a result, beginning from the date of April 1, 2006, the Code of Conduct relative to insider dealing adopted by the company in November 2002 is superseded.

Following the recent introduction into national law (Community Law 2004) of the so-called Market Abuse Directive, enactment of the so-called law on savings and the "new" Self-Regulatory Code of Borsa Italiana (March 2006) to which the company adheres, in light of the whole of the new law, Pirelli has set up a working group to examine and review certain governance documents, including the bylaws, the Rules of Proceeding for Shareholders' Meetings and the continuous and periodical disclosure of information to the company's governing boards. The results of these actions taken by the company with regard to the whole of the law, besides recommendations and indications formulated in the Self-Regulatory Code, will be specifically disclosed to the public inside the Annual Report on the corporate governance system which will, as usual, be included in the next annual financial statements.

Composition of the share capital

At September 12, 2006, the share capital of Pirelli & C. S.p.A. is Euros 2,791,311,344.64, divided into 5,367,906,432 shares of par value Euros 0.52 each, of which 5,233,142,003 are ordinary shares and 134,764,429 are non-convertible savings shares.

The share capital may be increased up to a maximum nominal amount of Euros 2,819,508,786.64 for:

- the issuance of a maximum of 54,225,850 ordinary shares of par value Euros 0.52 each, at the price of Euros 1.15 each, of which Euros 0.63 is for the share premium, for the possible exercise of the options granted to senior and junior executives of the companies and its subsidiaries and their subsidiaries as part of the “Pirelli to People” and “Group Senior Executives” stock option plans set up by the merged company, Pirelli S.p.A., in 2001.

During the course of the first half, the Pirelli & C. ordinary share warrants 2003-2006 lapsed and are therefore without value. The warrants had been issued in execution of the resolution passed by the shareholders’ meeting held on May 7, 2003. At the end of the period to exercise the warrants (June 20, 2006), 99.84 percent of the total warrants issued had been exercised.

To the best of the company’s knowledge, no legal or natural person can exercise control pursuant to art. 93 of Legislative Decree 58/1998.

Participants in the Pirelli & C. S.p.A. Voting Trust - the purpose of which is to ensure Pirelli & C. share structure stability and uniformity in corporate management policy - along with an extract from the agreement’s text, and are available on the corporate website: www.pirelli.com.

Relations with investors and other shareholders

In line with its tradition of transparency and fairness, the company actively promotes relations with shareholders, institutional investors and with financial analysts within the proper limits of their respective roles and periodically organizes meetings with representatives from the Italian and international financial communities.

Furthermore, since 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 Managing Director Carlo Buora, is headed by Alberto Borgia and has its own section in the corporate website at www.pirelli.com.

In this section of the website, investors can find every document of interest, in English as well as Italian, related to financial reporting (for example, the annual financial statements and the half-yearly and quarterly reports) and the company's corporate governance system (for example, the Rules of conduct for transactions with related parties, the Procedure for satisfying the requirements of Article 150.1 of Legislative Decree 58/1998, 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 issued by the company and the documentation that the company makes available to the financial community in presentations and/or meetings and information on the company's share capital and shareholders (including the publication of any shareholders' agreements).

Pirelli & C. was one of the first companies in Italy and Europe to publish specific inserts 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.: +39.0264422949; fax: +39.0264424686.

PIRELLI & C. S.p.A. – SUMMARY DATA**Balance sheet and financial position**

(in millions of euros)

	6/30/2006	12/31/2005
Property, plant and equipment	105	52
Intangible assets	2	2
Financial assets	6,531	6,433
Net working capital	(442)	(391)
	6,196	6,096
Equity	4,756	4,661
Provisions	192	193
Net financial (liquidity)/debt position	1,248	1,242
	6,196	6,096

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

- **property, plant and equipment** increased by Euros 53 million mainly as a result of a finance lease contract relating to a building taken over by Pirelli Tyre S.p.A. (Euros 55 million).
- **financial assets** increased by Euros 98 million partly as a result of the measurement at fair value of the available-for-sale assets (Euros 49 million) and partly due to the investments made in Capitalia S.p.A. (Euros 38 million), Mediobanca S.p.A. (Euros 14 million), Assicurazioni Generali S.p.A. (Euros 5 million) and Banca Leonardo S.p.A. (Euros 4 million). The above investments were in part offset by the sale of a 15.3 percent stake in F.C. Internazionale Milano S.p.A. (Euros 11 million) and the writedown of G.I.M. Generale Industrie Metallurgiche S.p.A. (Euros 1 million).

- **equity** increased by Euros 95 million compared to the prior year. The changes in equity are presented in the following table:

(in millions of euros)	
Equity at 12/31/2005	4,661
Dividends paid	(114)
Share capital increase for exercise of warrants	27
Income (expenses) recognized directly in equity:	
- Fair value adjustment of available-for-sale financial assets	49
- Other	1
Total income (expenses) recognized directly in equity	50
Income for the period	132
Equity at 6/30/2006	4,756

- the **net debt position** went from Euros 1,242 million at December 31, 2005 to Euros 1,248 million at June 30, 2006, with a net increase of Euros 6 million. A summary of the changes is detailed in the following table:

(in millions of euros)	
Net debt position at 12/31/2005	1,242
Financial investments	(61)
Investments in property, plant and equipment	(55)
Dividends collected	165
Dividends paid	(114)
Share capital increase	27
Change in net working capital	60
Other changes	(16)
Net debt position at 6/30/2006	1,248

Income statement

	(in millions of euros)	
	1st Half 2006	1st Half 2005
Financial income (expenses)	(24)	(33)
Investment income	173	175
Valuation adjustments to financial assets	(2)	(18)
Other operating income (expenses)	(16)	(2)
Income before income taxes	131	122
Income taxes	1	9
Income for the period	132	131

The income for the first half of 2006 amounts to Euros 132 million compared to Euros 131 million in the first half of 2005.

- **financial income (expenses)** compared to the first half of 2005 show an improvement of Euros 9 million. This improvement is due principally to the effect of the sale of the Energy and Telecom cables businesses to Goldman Sachs Capital Partners, concluded on July 28, 2005, and the gain realized on the sale of F.C. Internazionale Milano S.p.A. (Euros 2 million) and lower banking charges (Euros 2 million).
- The decrease in **valuation adjustments to financial assets** is basically the result of the writedown of the investment in F.C. Internazionale Milano S.p.A. effected in the first half of 2005 (Euros 15 million).
- The net expense balance of **other operating income (expenses)** is higher due to the IPO costs and the change/reduction in the services rendered following the sale of the cables activities on July 28, 2005.

The Board of Directors

Milan, September 12, 2006