

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

Quarterly Report
1st Quarter 2005

PIRELLI & C. Società per azioni

Registered office in Milan, Via G. Negri 10

Share Capital - Euros 2,763,969,020.28

Milan Companies Register No. 00860340157

Economic Administrative File (REA) No. 1055

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

Honorary Chairman	Leopoldo Pirelli
Chairman	Marco Tronchetti Provera
Deputy Chairman	Alberto Pirelli
Deputy Chairman	Carlo Alessandro Puri Negri
Managing Director and General Manager	Carlo Buora
Directors	Carlo Acutis *
	Carlo Angelici *
	Gilberto Benetton
	Franco Bruni *
	Carlo De Benedetti *
	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 directors

Secretary to the Board	Anna Chiara Svelto
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Board of Statutory Auditors

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

General Managers

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

Independent Auditors

PricewaterhouseCoopers S.p.A.

PIRELLI & C. S.p.A. - MILAN
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DIRECTORS' REPORT ON OPERATIONS

The first quarter of 2005 of the Pirelli & C. S.p.A. Group and the periods presented in comparison have been prepared in accordance with IAS/IFRS international accounting principles.

The comments and the comparisons in this report (although historical data is also presented) have therefore been presented using uniform principles.

The section "Application of IAS/IFRS" presents the following information in detail:

1. accounting treatments elected from among the accounting options provided by IAS/IFRS;
2. reconciliations of consolidated net equity under previous accounting principles (GAAP) and under IAS/IFRS at the following dates:
 - January 1, 2004: date of transition to IAS/IFRS;
 - December 31, 2004: closing date of the last year annual reporting period in accordance with previous GAAP;
 - January 1, 2005: date of transition to IAS 32 and IAS 39;
3. reconciliation of the net income shown in the last annual financial statements prepared in accordance with previous GAAP (year 2004) and the net income in accordance with IAS/IFRS for the same year;
4. comments on the principal changes in the net financial position following the introduction of the new accounting principles.

The principal impact on the 2004 financial statements and on the opening net equity at January 1, 2005 as a result of the transition to the new international accounting principles can be summarized as follows:

- net sales increased from Euros 7,114 million to Euros 7,298 million with an increase of Euros 184 million principally due to a different time frame for the recognition of revenues on contract work in progress (construction contracts), mainly in the Energy Cables and Systems Sector. Under IAS/IFRS, in fact, revenues on contracts, including the margin, must be recognized in sales on the basis of the stage of completion of the work, whereas under Italian GAAP, the margin is recorded in the change in inventories and the revenue is recognized at the completion of contract;
- operating profit rose from 380 million to Euros 399 million with an increase of Euros 19 million. In particular, Euros 37 million of that increase is due to: lower amortization of intangible assets (goodwill and differences on consolidation) of Euros 39 million, lower personnel costs of Euros 10 million as a result of the total recognition of the actuarial losses on employee benefits at transition (previously allocated over the remaining lives of the participants in the plans) and negative components (such as stock options, non-capitalizable expenses and other minor expenses) of Euros 12 million, for a total of Euros 37 million. Conversely, the remaining difference of Euros -18 million is produced by the reclassification of the balance of extraordinary and operating expenses (principally restructuring expenses) and income (principally the sale of assets) to operating expenses and income, therefore, without an impact on net income;
- consolidated net income increased by Euros 35 million (from Euros 274 million to Euros 309 million);

- total shareholders' equity at January 1, 2005 shows a reduction of Euros 52 million (from Euros 4,088 million to Euros 4,036 million), principally as a result of the impact of the measurement of employee defined benefit plans (Euros -147 million), previously disclosed in the notes, the measurement of securities and financial instruments at fair value (Euros +138 million) and other minor negative variations for Euros 43 million. Particular mention should be made, in respect of the foregoing plans, of the fact that the Group opted to fully record the actuarial gains and losses at transition to IAS/IFRS. As for the measurement of securities and financial instruments, the Group elected, as allowed by IFRS 1, to adopt IAS 32 and IAS 39 starting from January 1, 2005. The change to opening shareholders' equity attributable to Pirelli & C. S.p.A. at January 1, 2005 is a decrease of Euros 40 million (from Euro 3,736 million to Euros 3,696 million);
- the net financial debt position at January 1, 2005 went from Euros 1,469 million to Euros 1,586 million, principally as a result of the measurement of the put options held by the shareholder banks of Olimpia S.p.A. in accordance with IAS/IFRS. This increases the investment carried in the balance sheet corresponding to an increment in the net financial debt position of Euros 130 million;
- Olimpia, in accordance with IAS 31, is considered a jointly-controlled investment, accounted for by the equity method; therefore, the attributable net equity of Olimpia must be determined in accordance with IAS/IFRS.
As defined by IAS 28, the investment held by Olimpia in Telecom Italia qualifies as an associate and must therefore be accounted for by the equity method.

The audit work by PricewaterhouseCoopers is still in the process of being completed with regard to: the IAS/IFRS opening balance sheet at January 1, 2004, the IAS/IFRS net equity at December 31, 2004 and the 2004 net income and the IAS/IFRS opening net equity at January 1, 2005 following the introduction of IAS 32 and IAS 39.

The report on the verification work will be made known when it becomes available and, in any case, not after the date of the publication of the six-month report.

Performance of the Group

During the first three months of the year, all economic indicators of the Group continued to show a significant improvement thanks to the focus placed on the segments with higher value-added. The first quarter of 2005 thus ended with a net income attributable to the Group of Euros 83 million, twice the net income of Euros 40 million reported for the first quarter of 2004.

As far as **industrial activities** are concerned, net sales recorded an increase of 8.7 percent, partly as a result of the rise in the prices of metals in the Energy Sector, and a considerable growth in operating profit, which jumped to Euros 115 million from Euros 89 million, a gain of 29 percent.

In particular, there was a further increase in the profitability of the Tyres Sector, which exceeded 10 percent, thus breaking all previous records and reaching the top levels of the reference market. The growth trend continues both in North America, where Pirelli aims to achieve 10 percent of all sales in the sector by 2006, and in South America where the market reported positive growth in all segments. On the European market, Pirelli consolidated its role of key player in the high-performance car, SUV and motorcycle segments. In the Industrial market, top-of-the-range Truck products, partly developed using innovative technologies, were enthusiastically received by the market, both in Europe and in other market areas. Steelcord activities also reported a positive trend.

In the Energy Cables and Systems Sector, Pirelli confirmed its role as international leader both in terms of the technological level and the market, with an operating profit of Euros 30 million, representing growth of more than 40 percent. During the first quarter of 2005, Pirelli strengthened its role as the partner of excellence for the world's leading utility companies. In this market, the company is involved in the most important international interconnection projects currently in progress, which have the aim of improving the efficiency of power transmission grids.

In the Trader&Installers market, measures geared to improving efficiency are leading to a recovery of profitability, whereas, in the special cables sector, efforts are being focused on the segments with the highest technological content.

In the Cables and Optical Fibers area, pressure is still affecting prices and margins. However, the sector reported marked growth in volumes of fibers, especially in North America, where Pirelli is one of the suppliers selected by the operator Verizon to expand its fiber optic network. In Europe, the growth trend of copper cables continues as a result of investments made by telecommunications operators on ADSL networks.

Activities in the sphere of broadband access and in second-generation photonics developed by Pirelli Broadband Solutions, the new Group company which markets the innovative products developed in conjunction with Pirelli Labs, have effectively tripled net sales (equal to Euros 31 million). In the access market, the solutions being developed by Pirelli Broadband Solutions are regarded as some of the most innovative in Europe; in photonics, leading international telecommunications operators are showing great interest in new products currently being developed.

Compared to the first quarter of 2004, the **real estate sector**, represented by the Pirelli & C. Real Estate group, ended the first quarter with a growth of 17 percent in operating profit including earnings (losses) from equity investments, the parameter which best identifies the business model.

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

The net result of the parent company, Pirelli & C. S.p.A., for the three months ended March 31, 2005, is a loss of Euros 18 million compared to a loss of Euros 19 million for the first quarter of 2004.

Major events for the first quarter

The major events which occurred during the first quarter of 2005 are described below:

Corporate

- On January 28, 2005, an agreement was signed by the shareholders of Olimpia S.p.A. (Pirelli & C. S.p.A., Edizione Finance International S.A., Hopa S.p.A., Banca Intesa S.p.A. and Unicredito Italiano S.p.A.) amending and integrating the pacts stipulated by them in 2003.

The integration to the agreement, in particular, gives the shareholders the right – always to the extent that the total does not exceed, taking into account also the shares already held by Olimpia and its shareholders, the ownership threshold of 30 percent of Telecom Italia S.p.A. share capital – to purchase Telecom Italia S.p.A. ordinary shares in the quantities described:

Pirelli & C. S.p.A.	300 million shares
Ediz. Finance International SA/Ediz. Holding S.p.A.	100 million shares
Hopa S.p.A.	100 million shares
Banca Intesa S.p.A.	100 million shares
Unicredito Italiano S.p.A.	100 million shares

The Olimpia shareholders also agreed to amend certain understandings concerning the increase premium to which Hopa S.p.A. would be entitled in the event of the spin-off of Olimpia. In particular, the parties have established an all-inclusive amount of Euros 208 million in the event the spin-off occurs as a result of a deadlock or the pact is not renewed at its expiration date of May 8, 2006.

- March 17, 2005 marked the date of the entirely successful closing of the share capital increase by Pirelli & C. S.p.A. – voted by the extraordinary shareholders' meeting of January 21, 2005 – with the subscription of all 1,517,672,178 new ordinary shares at the price of Euros 0.70 each, for a total equivalent amount of Euros 1,062,370,524.60, without the need for the intervention of the underwriting syndicate promoted, arranged and conducted by Banca Caboto S.p.A. (Intesa Group), JPMorgan, MCC S.p.A. – Capitalia Gruppo Bancario, Mediobanca S.p.A. and UBM.

Pirelli & C. S.p.A.'s new share capital now totals (taking into account a further increase as a result of requests to exercise Pirelli & C. ordinary share warrants 2003-2006 last February and March) to Euros 2,763,969,020.28 and is represented by 5,315,325,039 shares of par value Euros 0.52 each, of which 5,180,560,610 are ordinary shares and 134,764,429 are savings shares.

The resources raised from the capital increase are designated for the subscription of Euros 2 billion of Olimpia S.p.A. capital, with the objective being both to raise the investment in Telecom Italia S.p.A. and to neutralize the diluting effect consequent to the announced Telecom Italia merger. In particular, Pirelli & C. subscribed to its share of the increase (50.4 percent) and the shares of the increase that was not subscribed to by the banks (16.8 percent), with an outlay of Euros 1,344 million. At the end of the subscription period, Pirelli & C.'s investment in Olimpia rose to 57.7 percent.

Industrial activities

- On February 2, 2005, Pirelli Telecomunicações Cabos e Sistemas do Brasil S.A. – a Brazilian subsidiary of Pirelli Cavi e Sistemi Telecom S.p.A. – and Furukawa Industrial Produtos Elétricos signed an agreement to set up a joint venture for the manufacture of optical fibers in Brazil. The new company, named SPF - Sociedade Produtora de Fibras Ópticas S.A. is owned 51 percent by Pirelli and 49 percent by Furukawa; headquarters are in Sorocaba (San Paolo) at Pirelli's actual production site.

Pirelli and Furukawa have decided to unite their activities in the manufacture of optical fibers in Brazil to take advantage of the opportunities that could arise from the recovery of the Brazilian telecommunications market: after the slowdown of the last few years, in fact, SPF aims to become the benchmark operator for the market while at the same time conferring momentum to its growth for the future.

The transaction is subject to the approval of the competent authorities.

- In March 2005, Pirelli Cavi e Sistemi Energia, through the subsidiary Comergy Ltd, won an approx. Euros 25 million contract from Singapore SP PowerAssets Ltd (Singapore Power group) for a high-voltage turnkey connection to increase the power of the electrical grid of the Asian country.

This is the second contract in one year awarded to Comergy in Singapore and a further confirmation of Pirelli's world leadership position in the power cables sector. The projects entrusted to Pirelli in the country in the last year are worth approx. Euros 75 million.

The contract provides for Comergy to supply and install oil-filled insulated 400 kV cables, auxiliary cables and accessories, with the aim of expanding the power network in the southwest of the country. The project also includes the installation of cables

inside a undersea tunnel being built by Comergy and commissioned by SP PowerAssets under a separate contract.

The 400 kV cables and accessories will be manufactured in the Pirelli plants at Eastleigh and Bishopstoke (United Kingdom), whereas the auxiliary cables will be produced in Pirelli cable plants in Turkey and Indonesia.

- On March 9, 2005, Pirelli Cavi e Sistemi Energia S.p.A. won the contract for the supply of a very high-voltage cable under the project for the new 380 kV connection between Turbigo and Rho, in the suburbs of Milan. Designed by Terna S.p.A., owner of more than 90 percent of the high and very high-voltage electrical energy transmission grid, the new interconnection project, worth Euros 21 million, is part of the program for the expansion of the national power transmission grid drawn up by GRTN (National Transmission Grid Operator) and approved by the Ministry of Production Activities last year.
- In March 2005, in keeping with the Group's plan for development of the Chinese market, Pirelli initiated exclusive talks with the Roadone Tyre Co. Ltd – China's most important and leading private Chinese manufacturer of industrial conveyor belts. The aim is to set up a joint venture by the end of 2005 in Shangdong province to manufacture giant tyres using metallic radial technology for trucks, destined primarily for the Chinese market and other markets in southeast Asian. These talks began after certain conditions in the letter of intent signed with Aeolus Tyre last year were not met.

Real estate activities

- On March 13, 2005, the Pirelli & C. Real Estate S.p.A. and Deutsche Bank Real Estate Global Opportunities joint venture grouped together with the Borletti family and Investitori Associati and concluded its first transaction, purchasing Rinascente S.p.A. from Eurofind Textile S.A. for Euros 888 million. The Pirelli Re - DB Real Estate holds 50 percent of Tamerice S.r.l., the company through which the transaction was carried out, while the remaining 50 percent is shared by Investitori Associati and the Borletti family. Pirelli & C. Real Estate S.p.A. indirectly holds 20 percent of Rinascente S.p.A.. Closing of the transaction took place on May 6, 2005 after formal approval was received from the antitrust authorities.
- On March 24, 2005, Morgan Stanley Real Estate Funds (MSREF) and Pirelli RE along with the Special Situations Group of Morgan Stanley, specialized in the purchase and management of corporate loans, executed an agreement for the purchase of a portfolio of mortgage loans and corporate loans from BNL for Euros 77.5 million. The acquired portfolio consists of receivables for loans, more than half of which are guaranteed by industrial properties.
- On March 31, 2005, Orione Immobiliare Prima purchased various units mainly destined for service-related occupation located in various cities in Italy from the company Spinoffer Real Estate for a total amount of Euros 127.9 million.
- During the first quarter of 2005, under the agreement signed in 2004 between Pirelli & C. Real Estate and Morgan Stanley Real Estate Funds (MSREF) in the non-performing loan sector, the following transactions were carried out:

- the sale, on March 24, 2005, on the part of Pirelli RE, of the 100 percent stake in Pirelli & C. Real Estate Credit Servicing S.p.A. (now New Credit servicing) to Servizi Immobiliari Banche – S.I.B. S.p.A. (SIB) and the sale, on the part of MSREF, of 47 percent of SIB to Pirelli RE. A subsequent merger of the two companies is planned in order to create one of the leading operators in Italy for the management of non-performing loans. The new company resulting from the merger will be held indirectly by MSREF (mainly through FONSPA – Istituto di Credito Fondiario e Industriale S.p.A.) for a 53 percent interest and by Pirelli RE for a 47 percent stake, with a call option by Pirelli RE for 53 percent of the company exercisable from January 2007 and a put option by MSREF exercisable from January 2008.
- formation of the company Asset Management NPL, jointly owned by Pirelli RE and MSREF (75 percent - 25 percent) which manages non-performing loan portfolios, through the portfolios currently owned by the two Groups.

THE GROUP

The highlights of the consolidated financial data of the Group for the first quarter of 2005 can be summarized as follows:

	(in millions of euros)				
	1 st Quarter ending	1 st Quarter ending		Year ending	
	3/31/2005 (IAS/IFRS)	3/31/2004 (IAS/IFRS)	3/31/2004 (Italian GAAP)	12/31/2004 (IAS/IFRS)	12/31/2004 (Italian GAAP)
. Net sales	1,870	1,700	1,677	7,298	7,114
. Gross operating profit	192	167	172	699	725
% of net sales	10.3%	9.8%	10.3%	9.6%	10.2%
. Operating profit	118	87	83	399	380
% of net sales	6.3%	5.1%	4.9%	5.5%	5.3%
. Share of earnings (losses) of equity investments	50	31	(3)	143	76
. Operating profit (loss) incl. share of earnings (losses) of equity invest.	168	118	80	542	456
. Financial income (expenses)	(46)	(45)	(35)	(139)	(108)
. Extraordinary items			(2)		20
. Income taxes	(39)	(33)	(33)	(94)	(94)
. Net income	83	40	10	309	274
% of net sales	4.4%	2.4%	0.6%	4.2%	3.9%
. Net income attributable to Pirelli & C. S.p.A.	70	32	2	256	217
. Earnings per share (in euros)	0.01	0.01	0.00	0.07	0.06
. Shareholders' equity	5,276	3,549	3,751	3,903	4,088
. Net equity attributable to Pirelli & C. S.p.A.	4,909	3,294	3,486	3,563	3,736
. Equity per share (in euros)	0.92	0.95	1.01	1.03	1.08
. Net financial (liquidity)/debt position	2,120	2,089	1,959	1,601	1,469
. R&D expenditures	54	51	51	198	198
. Employees at period-end (number)	38,011	36,663	36,663	37,154	37,154
. Factories (number)	76	77	77	74	74
. Pirelli & C. S.p.A. ordinary shares (No. in millions)	5,180.5	3,326.6	3,326.6	3,327.5	3,327.5
. Pirelli & C. S.p.A. savings shares (No. in millions)	134.8	134.8	134.8	134.8	134.8
. Total Pirelli & C. S.p.A. shares (No. in millions)	5,315.3	3,461.4	3,461.4	3,462.3	3,462.3

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

(in millions of euros)

	Energy Cables and Systems		Telecom Cables and Systems		Pirelli Broadband Solutions		Tyres	
	1 st Quarter ending		1 st Quarter ending		1 st Quarter ending		1 st Quarter ending	
	3/31/2005	3/31/2004	3/31/2005	3/31/2004	3/31/2005	3/31/2004	3/31/2005	3/31/2004
	IAS/IFRS		IAS/IFRS		IAS/IFRS		IAS/IFRS	
. Net sales	759	686	93	86	31	10	862	824
. Gross operating profit (loss)	47	40	4	5	(1)	(3)	133	120
. % of net sales	6.2%	5.8%	4.3%	5.8%			15.4%	14.6%
. Operating profit (loss)	30	21	(2)	(4)	(1)	(3)	88	75
. % of net sales	4.0%	3.1%	n.s.	n.s.			10.2%	9.1%
. Share of earnings (losses) of equity investments	-	-						-
. Operating profit (loss) incl. share of earnings	30	21	(2)	(4)	(1)	(3)	88	75
. Financial income (expenses)	(8)	(7)	(2)	(3)	(1)		(8)	(10)
. Income taxes	(8)	(6)	-	(1)			(27)	(27)
. Net income (loss)	14	8	(4)	(8)	(2)	(3)	53	38
. % of net sales	1.8%	1.2%	n.s.	n.s.			6.1%	4.6%
. Net financial (liquidity)/debt position	348	444	292	285	27	23	313	404

(in millions of euros)

	Industrial Aggregate		Pirelli & C. Real Estate		Other		TOTAL	
	1 st Quarter ending		1 st Quarter ending		1 st Quarter ending		1 st Quarter ending	
	3/31/2005	3/31/2004	3/31/2005	3/31/2004	3/31/2005	3/31/2004	3/31/2005	3/31/2004
	IAS/IFRS		IAS/IFRS		IAS/IFRS		IAS/IFRS	
. Net sales	1,745	1,606	113	107	12	(13)	1,870	1,700
. Gross operating profit (loss)	183	162	16	10	(7)	(5)	192	167
. % of net sales	10.5%	10.1%					10.3%	9.8%
. Operating profit (loss)	115	89	14	8	(11)	(10)	118	87
. % of net sales	6.6%	5.5%					6.3%	5.1%
. Share of earnings (losses) of equity investments	-	-	20	21	30 *	10	50	31
. Operating profit (loss) incl. share of earnings	115	89	34	29	19	-	168	118
. Financial income (expenses)	(19)	(20)			(27)	(25)	(46)	(45)
. Income taxes	(35)	(34)	(7)	(5)	3	6	(39)	(33)
. Net income (loss)	61	35	27	24	(5)	(19)	83	40
. % of net sales	3.5%	2.2%					4.4%	2.4%
. Net financial (liquidity)/debt position	980	1,156	12	40	1,128	893	2,120	2,089

* valuation of Olimpia S.p.A. by the equity method produced earnings of Euros 30 million (Euros 10 million in 2004)

Net sales

Net sales amount to Euros 1,870 million for the three months ending March 31, 2005, with an increase of 10 percent compared to the corresponding period of the prior year. The effective change is 8.3 percent.

• Volumes	+	5.0%
• Prices/Mix	+	3.3%
Change on a comparable basis	+	8.3%
• Foreign exchange effect	-	0.6%
• Change in scope of consolidation	-	1.1%
• Metal prices	+	3.4%
Total change	+	10.0%

Gross operating profit

Gross operating profit grew by 15 percent increasing from Euros 167 million to Euros 192 million. Gross operating profit is equal to 10.3 percent of net sales, compared to 9.8 percent for the first three months of 2004.

Operating profit

Operating profit for the first three months 2005 is Euros 118 million, representing 6.3 percent of net sales compared to Euros 87 million for the corresponding period of 2004 (5.1 percent of net sales).

Contributing to the operating profit are the industrial sector with Euros 115 million (Euros 89 million for the first three months of 2004) and the real estate sector with Euros 14 million (Euros 8 million in the corresponding period of 2004).

The change can be summarized as follows:

(in millions of euros)	
Operating profit 1st Quarter ending 3/31/2004	87
. Foreign exchange effect	1
. Prices (excluding metals)/Mix	37
. Volumes	21
. Production factors per unit cost	(35)
. Efficiencies	5
. Depreciation	1
. Other	1
	31
Operating profit 1st Quarter ending 3/31/2005	118

Share of earnings (losses) of equity investments

The share of earnings (losses) of equity investments is earnings of Euros 50 million compared to earnings of Euros 31 million for the first quarter of 2004. It includes the results of the companies in the real estate sector which show earnings of Euros 20 million (Euros 21 million for the first quarter of 2004). It also comprises the valuation by the equity method of the investment in Olimpia S.p.A., which reported earnings of Euros 30 million (Euros 10 million for the first quarter of 2004).

It should be pointed out that the financial statements of Olimpia, in accordance with IAS/IFRS, included in the consolidated financial statements of the Group, comprise the valuation by the equity method of the investment in Telecom Italia S.p.A..

Net income

The net income for the three months ending March 31, 2005 is Euros 83 million (after income tax expenses of Euros 39 million) compared to a net income of Euros 40 million for the first three months of 2004 (after income tax expenses of Euros 33 million).

The net income attributable to Pirelli & C. S.p.A. for the three months to March 31, 2005 is Euros 70 million compared to a net income of Euros 32 million for the first quarter of 2004.

Shareholders' equity

Consolidated shareholders' equity went from Euros 3,903 million at December 31, 2004 to Euros 5,276 million at March 31, 2005.

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

	<u>(in millions of euros)</u>
. Translation adjustments	31
. Impact of IAS/IFRS 32 and 39 on 1/1/2005 values	133
. Net income for the period	83
. Exercise of Pirelli & C. Real Estate S.p.A. stock options	11
. Capital increase (net of costs incurred)	1,047
. Measurement of securities at fair value	57
. Other changes	11
	<u>1,373</u>

The shareholders' equity attributable to Pirelli & C. S.p.A. went from Euros 3,563 million (Euros 1.03 per share) at December 31, 2004 to Euros 4,909 million (Euros 0.92 per share) at March 31, 2005, partly as a result of the capital increase executed during the first quarter.

Net financial position

The net debt position at March 31, 2005 is Euros 2,120 million compared to Euros 1,601 million at December 31, 2004.

The change from December 31, 2004 is principally attributable to the capital increase in Olimpia S.p.A. subscribed to by Pirelli & C. S.p.A. (Euros 1,344 million) and countered by the capital increase (Euros 1,062 million) voted on December 7, 2004 by the Board of Directors of Pirelli & C. S.p.A. and the increase in working capital due to the seasonal factors. Free cash flow is a negative Euros 163 million, compared to a negative Euros 154 million for the first quarter of 2004.

	(in millions of euros)	
· Operating profit	118	
· Depreciation and amortization	74	
· Net investments	(29)	
· Change in working capital	(334)	
· Change in provisions and other	8	
· Free cash flows	(163)	
· Olimpia share capital increase	(1,344)	
· Financial income (expenses)	(46)	
· Income taxes	(39)	
· Dividends paid	(2)	
· Other	(10)	
· Net cash flows		(1,604)
· Changes in net equity due to capital increase		1,062
· Total changes in net equity		1,062
· Impact of IAS/IFRS on 1/1/2005 values		15
· Translation adjustments		8
· Change in net financial position		(519)

R & D expenditures

R&D expenditures borne by the Group and completely expensed in the statement of income went from Euros 51 million for the first three months of 2004 (3.2 percent of the industrial aggregate net sales) to Euros 54 million for the first quarter of 2005 (3.1 percent of the industrial aggregate net sales).

Employees

At March 31, 2005, employees number 38,011 (including 4,104 temporary employees), compared to 37,154 at December 31, 2004. This is a total increase of 857 due to higher utilization of workers with temporary contracts (591) and the opening of the new Steelcord production site in Romania and the reorganization of distribution in Brazil.

Related party disclosure

Related party transactions, including intragroup transactions, are neither unusual nor exceptional but fall under the normal business operations 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 effects deriving from transactions between Pirelli & C. S.p.A. and its subsidiaries are disclosed in the financial statements of the parent company and in the notes, and, as with the transactions among subsidiaries, are eliminated upon the preparation of the consolidated financial statements.

For purposes of full disclosure, transactions for the first quarter ending March 31, 2005 refer to the following:

1. Pirelli & C. S.p.A. Group and 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 Italia S.p.A., Pirelli & C. S.p.A., Shared Service Center s.c.r.l. and Pirelli & C. Real Estate S.p.A. (Euros 66 million);
- **costs for goods and services**, mainly relating to telephone and computer services and the supply of electrical energy (Euros 7 million);
- **receivables**, relating to the supply of the goods and services described above (Euros 81 million);
- **payables**, relating to telephone and computer services and the supply of electrical energy described above (Euros 7 million).

2. **Pirelli & C. S.p.A. Group and Camfin S.p.A. Group:**

- **revenues for goods and services**, relating to services rendered by companies of Pirelli & C. Real Estate S.p.A. Group (Euros 0.3 million);
- **costs for goods and services**, mainly relating to the supply of natural gas (Euros 5.8 million);
- **receivables**, relating to the supply of services described above (Euros 1.5 million);
- **payables**, relating to the supply of natural gas described above (Euros 4.7 million).

3. **Pirelli & C. S.p.A. Group and FC Internazionale Milano S.p.A.:**

- **revenues for goods and services**, relating to services rendered by Polo Viaggi S.p.A. (Euros 0.8 million);
- **costs for goods and services**, mainly relating to sponsorship costs by Pirelli & C. S.p.A. (Euros 1.5 million);
- **receivables**, relating to the supply of the goods and services described above (Euros 1.5 million).

Significant events subsequent to the end of the first quarter

- In April 2005, Pirelli Ambiente, the Pirelli Group's new environmental pool, developed an innovative system to treat exhaust gases that will reduce the fine dust emissions generated by diesel engines by approximately 90 percent. The technology is based on filters made of porous silicon carbide, a material which has unique properties in terms of heat resistance and sudden changes in temperature. The capacity of the new Pirelli filters to reduce dramatically the finer dust emissions from diesel engines was demonstrated by tests conducted by the ENI Tecnologie laboratories and by the European Commission's JRC Research Center at Ispra.
- At the end of April, 2005 Pirelli began work to build a new factory in the Brazilian state of Espirito Santo which will produce the special "umbilical" cables used in the offshore oil industry. Once the new factory becomes operational, Pirelli will be able to strengthen its offering in the OGP (Oil, Gas and Petrochemical) sector, supplying its customers with the most cutting-edge cables on the market. Through its new Brazilian factory, Pirelli intends to focus its development strategy in the sector on special "umbilical" cables, which are top-of-the-range in OGP applications, and also take advantage of its know-how and world leadership in supplying submarine power transmission systems. Strong growth (+50 percent per year) in the "umbilicals" segment is expected during the 3-year period 2006-2008.

- On April 29, 2005, Pirelli RE purchased an additional 10 percent of the portfolio of about Euros 1 billion (net book value) of non-performing loans owned by MSREF for a total of Euros 22.8 million. The assets under management and in which Pirelli RE has about a 27 percent stake amount to approximately Euros 1.2 billion.
- On April 29, 2005, the Pirelli RE and Morgan Stanley Real Estate Funds (MSREF) joint venture signed a binding agreement with Glenbrook Operae for the purchase of a portfolio of 131 buildings, mainly for office use, for a total value of Euros 255 million, on which deeds have been drawn up for Euros 82.3 million.

Outlook for the current year

The results achieved for the first quarter of the year confirm the forecasts for an increase in the profitability of the Group for 2005, unless external extraordinary events occur which cannot be foreseen at the time.

In particular, in **industrial activities**, an improvement is expected in the results of the Tyres Sector compared to the prior year, thanks to the continuing focus on high-performance tyres and the growth of business in North and South America.

In the Energy Cables and Systems Sector, Pirelli is directing its attention towards further consolidating its recovery of profitability by concentrating on higher-margin products.

In the Telecom Cables and Systems Sector, where price competition still dominates the market, Pirelli aims to consolidate the improvement in the 2004 result as a consequence of the recovery of the North American market.

Pirelli Broadband Solutions should carry on its trend of growth in the sale of broadband access products, in line with forecasts in 2004-2006 plan. As for second-generation photonics, still in the start-up phase, the research and development of innovative products continues.

Real Estate activities, based upon the results recorded for the first quarter and available information, are forecast to show a growth in 2005 in operating profit, including the earnings of equity investments, such as to attain the goals set in the 2003-2005 three-year plan.

ENERGY CABLES AND SYSTEMS SECTOR

The highlights of the consolidated financial data of the Energy Cables and Systems Sector for the first quarter of 2005 can be summarized as follows:

(in millions of euros)

	1 st Quarter ending	1 st Quarter ending		Year ending	
	3/31/2005 (IAS/IFRS)	3/31/2004 (IAS/IFRS)	3/31/2004 (Italian GAAP)	12/31/2004 (IAS/IFRS)	12/31/2004 (Italian GAAP)
. Net sales	759	686	671	3,051	2,888
. Gross operating profit	47	40	40	199	199
% of net sales	6.2%	5.8%	6.0%	6.5%	6.9%
. Operating profit	30	21	20	124	119
% of net sales	4.0%	3.1%	3.0%	4.1%	4.1%
. Financial income (expenses)	(8)	(7)	(7)	(22)	(29)
. Income taxes	(8)	(6)	(6)	(12)	(12)
. Net income	14	8	7	90	78
% of net sales	1.8%	1.2%	1.0%	2.9%	2.7%
. Net financial (liquidity)/debt position	348	444	444	182	183
. R&D expenditures	8	8	8	32	32
. Employees at period-end (number)	10,725	10,912	10,912	10,385	10,385
. Factories (number)	46*	48	48	46	46

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

Net sales for the three months ending March 31, 2005 amount to Euros 759 million, and present an increase of 10.6 percent compared to the same period of the prior year.

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

. Volumes	+	1.7%
. Prices/Mix	+	4.4%
Change on a comparable basis	+	<u>6.1%</u>
. Foreign exchange effect	-	0.7%
. Change in scope of consolidation (Brazil enameled wires)	-	2.7%
. Metal prices	+	7.9%
Total change	+	<u>10.6%</u>

An analysis of net sales by geographical area shows an increase of net sales in Europe, mainly due to a rise in prices – principally the prices of metals – and an improvement in the mix, which offset the decrease in volumes, especially in France and the UK.

The sales trend in South American is constant compared to the prior year: the increase in prices is completely neutralized by lower sales volumes.

In contrast, net sales in North America grew, since the positive effect of prices and mix is only partly offset by lower volumes and the decrease in value of the U.S. dollar.

Net sales in the Asia Pacific area (Australia, Indonesia and China) show a considerable increase associated with a growth in sales volumes.

The positive performance of sales is most evident in the Trade and Installers segment and Utilities. The Industrial Market reports a 15 percent growth in net sales over the prior year, excluding the change in the scope of consolidation of the enameled wire companies.

Operating profit for the three months ending March 31, 2005 is Euros 30 million, compared to Euros 21 million for the same period of the prior year. Operating profit is equal to 4 percent of net sales and compares to 3.1 percent for the same period of the prior year.

The change in operating profit is due to the following:

		(in millions of euros)
<u>Operating profit 1st Quarter ending 3/31/2004</u>		<u>21</u>
. Prices (excluding metals)/Mix	18	
. Production factors per unit cost	(9)	
. Efficiencies	1	
. Depreciation	2	
. Other	(3)	
		9
<u>Operating profit 1st Quarter ending 3/31/2005</u>		<u>30</u>

Net income for the first three months of 2005 is Euros 14 million (after financial expenses of Euros 8 million and income tax expenses of Euros 8 million) compared to a net income of Euros 8 million for the same period of the prior year, thanks to the improvement in operating profit.

The **net financial position** is a net debt position of Euros 348 million compared to Euros 182 million at December 31, 2004. The increase is mainly due to seasonal factors which caused an increase in working capital, partly due to the trend in the prices of metals.

At March 31, 2005, **employees** number 10,725 (including 927 temporary employees). Compared to December 31, 2004, this is an increase over the headcount of 10,385 (including 666 temporary employees) due above all to the increase in employees with temporary contracts.

The number of **factories** has remained unchanged compared to December 31, 2004 at 46 units.

TELECOM CABLES AND SYSTEMS SECTOR

The highlights of the consolidated financial data of the Telecom Cables and Systems Sector for the first quarter of 2005 can be summarized as follows:

	(in millions of euros)				
	1 st Quarter ending 3/31/2005 (IAS/IFRS)	1 st Quarter ending 3/31/2004 (IAS/IFRS) 3/31/2004 (Italian GAAP)		Year ending 12/31/2004 (IAS/IFRS)	Year ending 12/31/2004 (Italian GAAP)
. Net sales	93	86	86	372	367
. Gross operating profit	4	5	5	30	19
% of net sales	4.3%	5.8%	5.8%	8.1%	5.2%
. Operating loss	(2)	(4)	(4)	7	(5)
% of net sales	n.s.	n.s.	n.s.	n.s.	n.s.
. Financial income (expenses)	(2)	(3)	(3)	(13)	(13)
. Extraordinary items					11
. Income taxes		(1)	(1)	3	3
. Net loss	(4)	(8)	(8)	(3)	(4)
% of net sales	n.s.	n.s.	n.s.	n.s.	n.s.
. Net financial (liquidity)/debt position	292	285	285	280	280
. R&D expenditures	3	8	8	25	25
. Employees at period-end (number)	1,821	2,087	2,087	1,979	1,979
. Factories (number)	9*	11	11	9	9

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

Net sales for the three months ending March 31, 2005 amount to Euros 93 million, with an increase of 13.4 percent compared to the same period of the prior year and on a comparable consolidation basis.

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

• Volumes	+	37,6%
• Prices/Mix	-	24,2%
Change on a comparable basis	+	13,4%
• Foreign exchange effect	-	6,7%
• Metal prices	+	1,4%
Total change	+	8,1%

There was a recovery of volumes especially in the North American area. The South America and Asia Pacific markets reported a slight increase whereas volumes in the European area remained stable. Pressure on prices continued both in Europe and North America but prices remained constant in the other geographical areas.

The demand for optic fiber worldwide is showing signs of a recovery, but the higher volumes are offset by lower prices and an unfavorable mix.

Volume growth was recorded in optical cables where the increase is principally due to the development project of the customer Verizon in the United States. The market for copper cables, instead, is stable in terms of both volumes and prices. The connectivity business is in line with the prior year.

The **operating loss** for the first quarter of 2005 amounts to Euros 2 million, compared to Euros 5 million for the first quarter of the prior year. The operating result in 2004 included the loss reported by the submarine cables activities (equal to Euros 5 million) which were sold during 2004.

The change can be summarized as follows:

(in millions of euros)	
Operating loss 1st Quarter ending 3/31/2004	(4)
· Prices (excluding metals)/Mix	(9)
· Volumes	7
· Production factors per unit cost	1
· Efficiencies	4
· Depreciation	(1)
	2
Operating loss 1st Quarter ending 3/31/2005	(2)

The **net loss** for the first three months of 2005 is Euros 4 million (after financial expenses of Euros 2 million) compared to a net loss of Euros 8 million for the same period of the prior year, thanks to an improvement in the operating result.

The **net financial position** is a net debt position of Euros 292 million, an increase compared to Euros 280 million at December 31, 2004.

At March 31, 2005, total **employees** number 1,821 (including 86 employees with temporary contracts), with a decrease of 158 compared to December 31, 2004.

The number of **factories** has remained unchanged compared to December 31, 2004 at 9 units.

PIRELLI BROADBAND SOLUTIONS

The highlights of the consolidated financial data of Pirelli Broadband Solutions for the first quarter of 2005 can be summarized as follows:

(in millions of euros)

	1 st Quarter ending	1 st Quarter ending		Year ending	
	3/31/2005	3/31/2004	3/31/2004	12/31/2004	12/31/2004
	(IAS/IFRS)	(IAS/IFRS)	(Italian GAAP)	(IAS/IFRS)	(Italian GAAP)
. Net sales	31	10	10	63	63
. Gross operating loss	(1)	(3)	(3)	(10)	(10)
% of net sales					
. Operating loss	(1)	(3)	(3)	(10)	(10)
% of net sales					
. Financial income (expenses)	(1)			(4)	(4)
. Net loss	(2)	(3)	(3)	(14)	(14)
% of net sales					
. Net financial (liquidity)/debt position	27	23	23	21	21
. Employees at period-end (number)	101	36	36	79	79

Net sales for the three months ending March 31, 2005 amount to Euros 31 million compared to Euros 10 million for the corresponding period of the prior year. Sales are three times higher on account of the introduction of new ADSL access products.

Net sales of fiber network access products also achieved good results, even though these were lower than past years owing to a certain contraction of the Italian market in fiber investments.

The **operating loss** for the three months ending March 31, 2005 is Euros 1 million, with an improvement over the corresponding period of the prior year.

The change in operating loss can be summarized as follows:

	(in millions of euros)
Operating loss 1st Quarter ending 3/31/2004	(3)
. Prices (excluding metals)/Mix	3
. Efficiencies	(2)
. Depreciation	(1)
. Other	2
	2
Operating loss 1st Quarter ending 3/31/2005	(1)

The result of the BBA business unit is positive while the New Photonics Products business unit is still in the pre-industrial phase and thus recorded a negative result.

The positive position of the BBA business unit is connected with higher volumes/mix (due to new products) and strong action to reduce costs applied to all strategic suppliers.

Fixed overheads, instead, show an increase connected with the growth of the structure which is preparing itself for the development of new products and technologies which should generate sales starting from next year.

The **net financial position** is a net debt position of Euros 27 million.

At March 31, 2005, **employees** number 101, with a headcount increase of 22 compared to December 31, 2004, concentrated in the Engineering and Commercial functions.

TYRES SECTOR

The highlights of the consolidated financial data of the Tyres Sector for the first quarter of 2005 can be summarized as follows:

(in millions of euros)

	1 st Quarter ending	1 st Quarter ending		Year ending	
	3/31/2005 (IAS/IFRS)	3/31/2004 (IAS/IFRS)	3/31/2004 (Italian GAAP)	12/31/2004 (IAS/IFRS)	12/31/2004 (Italian GAAP)
. Net sales	862	824	819	3,253	3,255
. Gross operating profit	133	120	120	452	454
% of net sales	15.4%	14.6%	14.7%	13.9%	13.9%
. Operating profit	88	75	75	275	276
% of net sales	10.2%	9.1%	9.2%	8.5%	8.5%
. Financial income (expenses)	(8)	(10)	(10)	(33)	(33)
. Extraordinary items					(1)
. Income taxes	(27)	(27)	(27)	(72)	(73)
. Net income	53	38	38	170	169
% of net sales	6.1%	4.6%	4.6%	5.2%	5.2%
. Net financial (liquidity)/debt position	313	404	404	214	215
. Net financial (liquidity)/debt position	34	32	32	124	124
. Employees at period-end (number)	22,226	20,659	20,659	21,513	21,513
. Factories (number)	24	22	22	22	22

Net sales for the three months ending March 31, 2005 amount to Euros 862 million, with an increase of 4.6 percent compared to the corresponding period of the prior year.

The change in net sales can be attributed to:

• Foreign exchange effect	-	0.0%
• Volumes	+	0.1%
• Prices/Mix	+	4.5%
Total change	+	4.6%

Passenger car/Light truck tyre volumes are basically in line with those of the corresponding period of the prior year, for both the Replacements and the Original Equipment channels.

In particular, the growth of North America, South America and Japan compensate for the falloff in Turkey and Europe. The Premium segments reported gains in all areas but particularly in North America.

Truck tyre volumes are in line with the first quarter of 2004 and register a growth in the Original Equipment channel and a slight reduction in the Replacements channel.

Volumes in the **Motorcycle** segment show an increase compared to the first quarter of the prior year, both in the Replacements channel (thanks to two-digit gains in South America) and in Original Equipment.

The positive trend of prices and mix confirm the growth strategy in the Performance segments, where the focus is on higher added value, and the success of Pirelli's new technologies and new products.

Operating profit for the three months ending March 31, 2005 is Euros 88 million compared to Euros 75 million for the corresponding period of the prior year.

The percentage of operating profit to net sales is 10.2 percent, compared to 9.1 percent for the first three months of 2004.

The change in operating profit can be summarized as follows:

	(in millions of euros)
Operating profit 1st Quarter ending 3/31/2004	75
. Prices/Mix	25
. Volumes	14
. Production factors per unit cost	(25)
. Efficiencies	2
. Depreciation	1
. Other	(4)
	13
Operating profit 1st Quarter ending 3/31/2005	88

Commercial performance is positive, especially in the South America area thanks to the good trend in sales prices.

The increase in costs can essentially be ascribed to higher raw material costs that were partly compensated by the favorable trend in exchange rates for purchases in U.S. dollars in both Europe and Brazil.

Net income for the three months ending March 31, 2005 is Euros 53 million (after financial expenses of Euros 8 million and income tax expenses of Euros 27 million) and compares to Euros 38 million (after financial expenses of Euros 10 million and income tax expenses of Euros 27 million) for the first three months of 2004.

The **net financial position** is a net debt position of Euros 313 million compared to Euros 214 million at December 31, 2004 and Euros 404 million at March 31, 2004. The increase compared to December 31, 2004 can principally be ascribed to the seasonal impact of working capital.

At March 31, 2005, **employees** number 22,226, including 1,010 temp employees and 1,939 employees with temporary contracts. Compared to December 31, 2004 (21,513), the increase is mainly due to the opening of the Steelcord production site in Romania and the reorganization of distribution in Brazil.

Factories, now at 24, grew in number from December 31, 2004 with the addition of the previously-mentioned site in Romania and the DrahtCord Saar's Steelcord unit which entered the scope of consolidation.

REAL ESTATE SECTOR

Net income attributable amounts to Euros 26.9 million for the first three months of 2005 compared to Euros 24.1 million for the first quarter of 2004, with an increase of 12 percent. The net income for the first quarter of 2004 under Italian GAAP amounted to Euros 25 million.

Economic review

The highlights of the statement of income are presented below. In reading these figures, it should be pointed out that the aggregate production value, net of acquisitions, and the operating result including the share of earnings (losses) of equity investments, because of the type of business conducted by the Pirelli & C. Real Estate S.p.A. Group, are the most important indicators expressing, respectively, the business volumes managed and the trend in results at the operating level.

	(in millions of euros)				
	IAS/IFRS	IAS/IFRS	ITALIAN GAAP	IAS/IFRS	ITALIAN GAAP
	1 st Quarter ending 3/31/2005	1 st Quarter ending 3/31/2004	1 st Quarter ending 3/31/2004	Year ending 12/31/2004	Year ending 12/31/2004
Aggregate production value, net of acquisitions	727.2	560.2	-	-	-
Consolidated production value	121.8	104.6	104.4	605.2	559.9
Operating profit	14.3	7.8	9.9	39.0	60.7
Share of earnings (losses) of equity investments	19.6	21.1	20.7	94.0	96.8
Operating profit including the share of earnings (losses) of investments	33.8	28.8	30.6	133.0	157.5
Financial income from equity investments	3.2	3.1	3.1	14.2	14.2
Operating profit including the share of earnings (losses) of equity investments and financial income from investments	37.0	31.9	33.7	147.2	171.7
Other financial income (expenses)	(2.8)	(3.0)	(2.8)	0.8	(9.3)
Income before extraordinary items and taxes	34.1	29.0	31.0	148.0	162.4
Extraordinary items	-	-	(1.7)	-	(3.4)
Income before taxes	34.1	29.0	29.3	148.0	159.0
Income taxes	(7.0)	(4.9)	(4.6)	(30.4)	(31.3)
Net income	27.1	24.1	24.7	117.6	127.7
Net income attributable to minority interest	(0.2)	-	0.3	(0.5)	0.3
Net income attributable to parent company	26.9	24.1	25.0	117.1	128.0

Aggregate production value, net of acquisitions, amounts to Euros 727.2 million, with a growth of Euros 560.2 million compared to the first three months of 2004 (+30 percent).

Consolidated production value alone for the first three months ending March 31, 2005 is Euros 121.8 million, with an increase compared to Euros 104.6 million for the first quarter ending March 31, 2004 (+16 percent).

The **operating profit (loss) including the share of earnings (losses) of equity investments** is a profit of Euros 33.8 million compared to Euros 28.8 million for the first quarter of 2004, with an increase of 17 percent.

The **net income attributable** to the parent company is Euros 26.9 million, compared to Euros 24.1 million for the first quarter ending March 31, 2004, with a growth of 12 percent.

Balance sheet and financial review

	IAS/IFRS	IAS/IFRS	ITALIAN GAAP
	3/31/2005	12/31/2004	12/31/2004
(in millions of euros)			
Fixed assets	343.9	375.7	372.1
<i>. Including investments in real estate funds and investment companies</i>	241.6	241.5	225.1
Net working capital	211.6	204.6	231.5
Net invested capital	555.5	580.3	603.6
Shareholders' equity	496.5	491.9	520.0
<i>. including minority interest</i>	6.5	6.3	9.6
Provisions and contributions	46.6	48.2	48.2
Net financial (liquidity)/debt position	12.4	40.2	35.4
Total net invested capital financed	555.5	580.3	603.6

Shareholders' equity attributable to the parent company at March 31, 2005 is Euros 490 million compared to Euros 485.5 million at the end of 2004. The change is due to the combined effect of the net income for the period (Euros 26.9 million), the capital increase with a share premium servicing stock options (Euros 11.2 million) and the reduction in shareholders' equity due mainly to the reclassification of treasury shares, in accordance with IAS/IFRS 32 and 39 (Euros 32.9 million).

The **net financial position** at March 31, 2005 shows a net debt position of Euros 12.4 million, with an improvement of Euros 27.8 million compared to Euros 40.2 million at December 31, 2004.

The **adjusted net financial position** (expressed before financing made to minority-owned companies) is a net debt position of Euros 200.1 million compared to Euros 250 million at December 31, 2004.

The **gearing** ratio is 0.40; this is an improvement from 0.51 at December 31, 2004.

Fixed assets total Euros 343.9 million at March 31, 2005 compared to Euros 375.7 million at the end of 2004, with a decrease of Euros 31.8 million mainly attributable to the reclassification of treasury shares as mentioned above.

PROFORMA DATA

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

Proforma consolidated financial data at March 31, 2005 of Pirelli & C. S.p.A. is presented below, assuming the consolidation line-by-line of Olimpia S.p.A..

(in millions of euros) IAS/IFRS						
	Proforma adjustments					
	Consolidated financial statements 3/31/2005 Pirelli & C S.p.A. (1)	Elimination of Olimpia S.p.A net result attributable to Pirelli & C. S.p.A. (57.7%)	Olimpia S.p.A. line-by-line consolidation	Olimpia consolidation entries	Total proforma adjustments	Proforma consolidated financial statements 3/31/2005 Pirelli & C S.p.A. (2)
Condensed statement of income						
Net sales	1,870	-	-	-	-	1,870
Operating profit	118	-	-	-	-	118
Financial income (expenses)/valuation adjustments to financial assets	4	(30)	52	-	22	26
Income taxes	(39)	-	-	-	-	(39)
Net income	83	(30)	52	-	22	105
Net income - attributable to Pirelli & C. S.p.A.	70	(30)	30	-	-	70
Reclassified balance sheet						
Shareholders' equity	5,276	(30)	8,331	(5,444)	2,857	8,133
- of which shareholders' equity attributable to Pirelli & C. S.p.A.	4,909	(30)	4,807	(4,777)	-	4,909
Net financial (liquidity)/debt position	2,120	-	3,644	-	3,644	5,764

(1) Pirelli & C. S.p.A. consolidated financial statements (investment in Olimpia S.p.A. accounted for by the equity method with Olimpia which accounts for Telecom Italia by the equity method)

(2) proforma data (line-by-line consolidation of Olimpia S.p.A.)

The proforma consolidated financial data has been prepared using:

- the financial statements of Olimpia S.p.A. at March 31, 2005, adjusted to conform to IAS/IFRS, wherein the investment in Telecom Italia is accounted for by the equity method (in financial statements prepared in accordance with IAS/IFRS);
- the consolidated financial statements of Pirelli & C. S.p.A. at March 31, 2005 (prepared in accordance with IAS/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. net result attributable to Pirelli & C. S.p.A. (57.7%)”: elimination of the statement of income and balance sheet effects of valuing Olimpia S.p.A. by the equity method in the Pirelli & C. S.p.A. consolidated financial statements for the three months ended March 31, 2005;
- in the column “Olimpia S.p.A. line-by-line consolidation”: inclusion of the assets, liabilities, costs and revenues resulting from the financial statements for the three months ended March 31, 2005 of Olimpia S.p.A., prepared in accordance with IAS/IFRS consistent with the Pirelli Group, attributing the share of net equity and results of operations to the minority interest. The forward purchase of 124,129,937 Telecom Italia ordinary shares, concluded by Olimpia in 2001, was accounted for at original cost as an increase in the investment in Telecom Italia with a contra-entry to the relative payable account;
- in the column “Olimpia S.p.A. consolidation entries”, the accounting value of the Olimpia S.p.A. investment in the Pirelli & C. S.p.A. financial statements was eliminated against the underlying share of the accounting net equity.

For purposes of this representation, the difference between the carrying value of the Olimpia S.p.A. investment in the Pirelli & C. S.p.A. consolidated financial statements and the corresponding share of the net equity (Euros 910 million for Pirelli & C. S.p.A.'s share equal to 57.7 percent and Euros 1,577 million for the entire amount) was directly deducted from shareholders' equity (with a contra-entry to the carrying amount of the Telecom Italia investment).

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 December 31, 2004 and at March 31, 2005 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 Italia Group.

	<i>(in millions of euros) IAS/IFRS</i>							
	Shareholders' equity		Net debt		Net debt/Shareholders' equity		Shareholders' equity - attributable to Pirelli & C. S.p.A.	
	3/31/2005	12/31/2004	3/31/2005	12/31/2004	3/31/2005	12/31/2004	3/31/2005	12/31/2004
Pirelli & C. S.p.A. Group: consolidated financial data	5,276	3,903	2,120	1,601	0.40	0.41	4,909	3,563
Pirelli & C. S.p.A. Group: proforma consolidated data with Olimpia S.p.A. consolidated line-by-line	8,133	6,417	5,764	5,175	0.71	0.81	4,909	3,563
Pirelli & C. S.p.A. Group: proforma consolidated data with Olimpia S.p.A. and Telecom Italia Group consolidated line-by-line	27,137	25,369	49,266	38,037	1.82	1.50	4,909	3,563

The Board of Directors

Milan, May 12, 2005

APPLICATION OF IAS/IFRS

FORM AND CONTENT

The first quarterly report 2005

As set forth in CONSOB resolution No. 14990 of April 14, 2005, issuing entities can elect one of the following options in the preparation of the first quarterly consolidated report for the year 2005;

- preparation according to the accounting standards for the 2005 annual and consolidated financial statements, under IAS/IFRS. In that case, a separate appendix must be published containing the reconciliations provided by paragraphs 39 and 40 of the international accounting standard “IFRS 1: *First-time Adoption of International Financial Reporting Standards*”, together with explanatory notes on the accounting policies applied and the items in the reconciliations. The information requested by Appendix 3D of the regulation issued by CONSOB for issuing entities, or, alternatively, the information requested by IAS 34 on “Interim financial reporting” should also be presented.
- preparation according to the accounting standards applied in the previous year’s annual and consolidated financial statements and on the basis of the criteria indicated in Appendix 3D. In that case, detailed information should be provided on the procedures applied for the transition to international accounting principles, as defined in article 6 of EU Regulation No. 1606/2002 and the extent to which they have been applied.

The Pirelli & C. Group elected the first option and is presenting the information required by Appendix 3D of the regulation for issuing entities.

Evolution of the benchmark regulatory framework

The guidelines and the benchmark regulatory framework applicable to companies listed within the European Union regarding the transition to IAS/IFRS are:

- the adoption of Regulation No. 1606 issued by the European Parliament and by the Council of the European Union in July 2002 which provides for the mandatory adoption of IAS/IFRS, beginning from 2005, for the consolidated financial statements of companies listed on regulated markets of the European Union; moreover, this Regulation accorded to the Member States the authority to permit or to require the application of IAS/IFRS also for the preparation of the annual statutory accounts of listed companies and the annual statutory accounts and consolidated financial statements of unlisted companies;
- the European Commission's adoption of Regulation No. 1725 dated September 29, 2003 which approved the international accounting standards, and related interpretations, existing at September 14, 2002; IAS 32 and IAS 39, relating to the disclosure and measurement of financial instruments, respectively, and the related interpretations (SIC 5, 16 and 17) were excluded from that approval process;
- the issue, by Italian legislators, of Law No. 306 dated October 31, 2003 (2003 EU Law) by which the Italian legislators exercised (art. 25) the option permitted by the above-cited EU Regulation No. 1606/2002, and, accordingly, delegating the Government to adopt one or more legislative decrees implementing the authority provided by the above-mentioned EU Regulation within one year of the law coming into force (i.e. within November 30, 2004);

- the issue of Legislative Decree No. 38 dated February 28, 2005, implementing the EU Law in the previous point, which provides that listed companies required by EU Regulation No. 1606/2002 to prepare their consolidated financial statements in accordance with IAS/IFRS may, from 2005, also draw up their annual statutory financial statements in accordance with those standards (obligatory from 2006). The possibility to apply IAS/IFRS, in the preparation of both the annual statutory financial statements and the consolidated financial statements, is also conceded to the unlisted subsidiaries starting from 2005;
- the recommendations of CESR (Committee of European Securities Regulators) published on December 30, 2003 and containing guidelines for companies listed within the EU regarding the transition to IAS/IFRS;
- the European Commission's adoption of Regulations No. 707 dated April 6, 2004, which approved IFRS 1 "First-time adoption of International Financial Reporting Standards", No. 2086 dated November 19, 2004, which approved, with certain limitations, IAS 39, and No. 2236, No. 2237 and No. 2238 dated December 29, 2004 which approved IAS 32 and the other accounting standards reviewed by the IASB in December 2003 and March 2004, the new IFRSs issued in March 2004 (with the exception of IFRS 2, approved by the European Commission with Regulation No. 211 dated February 4, 2005), and the interpretation document IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities", thereby achieving a stable system of accounting standards.

However, the version of IAS 39 approved by the EU in the above-cited Regulation No. 2086 differs from the text approved by the IASB with regard to certain aspects of the measurement of liabilities at fair value and of the macro-hedging of the interest rate risk associated with portfolios of assets and liabilities.

First-time adoption of International Financial Reporting Standards (IFRS 1)

The opening balance sheet at the date of transition to IAS/IFRS (January 1, 2004) has been prepared according to the following criteria:

- all the assets and liabilities which require recognition under IAS/IFRS have been recorded;
- those assets and liabilities which are not allowed to be recognized under IAS/IFRS have not been recorded;
- appropriate reclassifications have been made to ensure correct classification under IAS/IFRS; all assets and liabilities recognized have been measured in accordance with IAS/IFRS; all adjustments resulting from the first-time adoption of IAS/IFRS have been recorded with a contra-entry to shareholders' equity;

The valuation and measurement of accounting values, both with regard to the adjustments of the 2004 consolidated financial statements and the data for the first quarter of 2005, are based upon IAS/IFRS in force today and on their current "interpretation" resulting from the documents issued to date by the "International Financial Reporting Interpretation Committee – IFRIC"; IAS/IFRS in force at December 31, 2005 could be different from those used in the preparation of this document, as a result of the future approval of new standards by the European Commission, new interpretations or guidelines issued by the "International Financial Reporting Interpretation Committee". The consolidated financial statements at December 31, 2005 could be influenced by these changes.

The audit work by PricewaterhouseCoopers is still in the process of being completed with regard to: the IAS/IFRS opening balance sheet at January 1, 2004, the IAS/IFRS net equity at December 31, 2004 and the 2004 net income and the IAS/IFRS opening net equity at January 1, 2005 due to the introduction of IAS 32 and IAS 39.

The report on the verification work will be made known when it becomes available and, in any case, not after the date of the publication of the six-month report.

The Pirelli & C. Group has applied the following accounting standards described below retrospectively, except where it has elected to adopt the exemptions allowed by IFRS 1.

The optional exemptions chosen by the Group are indicated below:

1. business combinations: the Pirelli & C. Group has elected to adopt IFRS 3 prospectively beginning from January 1, 2004;
2. accumulated translation reserve: the Pirelli & C. Group has elected to use the exemption allowed by IFRS 1, at the date of transition, for resetting the cumulative translation adjustment reserve in the consolidated financial statements at December 31, 2003 to zero with a contra-entry to other reserves in net equity;
3. employee benefits: the Pirelli & C. Group has elected to use the exemption for the prospective adoption, at the date of transition, of the corridor approach in the recognition of the actuarial gains and losses resulting from the measurement of employee benefits under the defined benefit plans;
4. financial instruments: the Pirelli & C. Group has elected to use the exemption for the deferral to January 1, 2005 of the adoption of IAS 32 and IAS 39 for the recognition and measurement of financial instruments. All financial instruments as defined by IAS 32 and IAS 39 have thus been measured consistently with the principles applied in the consolidated financial statements drawn up in accordance with Italian GAAP for purposes of the preparation of the IAS/IFRS opening balance sheet at January 1, 2004, the statement of income for the year 2004 and the balance sheet at December 31, 2004.

The other exemptions provided by IFRS 1 are not applicable to the Pirelli & C. Group.

Principles of consolidation

The financial statements used for purposes of consolidation are the financial statements at March 31, 2005 of the companies included in the scope of consolidation, prepared on the basis of the accounting principles of the Group.

The scope of consolidation includes subsidiaries, associates and investments in joint ventures.

The financial statements of subsidiaries operating in countries with hyperinflationary economies have been corrected to adjust them to the changed purchasing power of the local currency, in accordance with the principles for inflation accounting.

The financial statements expressed in foreign currency have been translated into euros at rates prevailing at period-end for the balance sheet and at average exchange rates for the statement of income, except for the financial statements of companies operating in countries with hyperinflationary economies, whose statements of income have been translated at period-end rates.

The differences arising from the translation of opening shareholders' equity at period-end exchange rates have been recorded in cumulative translation adjustments in shareholders' equity, together with the difference between the result in the statement of income and in the balance sheet.

Subsidiaries are consolidated line-by-line and intragroup transactions and any unrealized gains or losses on transactions between group companies are eliminated. Acquisitions of subsidiaries are accounted for using the purchase method of accounting and the assets and liabilities acquired are measured at fair value at the acquisition date, which coincides with the date of exchange of the consideration paid. The excess of the cost of acquisition over the fair value of the assets and liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value, the difference is recognized in the statement of income.

Investments in associates are accounted for by the equity method; the carrying amount of investments in associates includes the goodwill paid on acquisition. The associates' economic results and movements in shareholders' equity are recognized in the consolidated statement of income and in net equity, respectively.

Investments in joint ventures or jointly controlled entities are accounted for by the equity method.

The effects of transactions with associates or joint ventures that have not been realized with independent parties are eliminated.

Summary of significant accounting policies

Intangible assets

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

Amortization starts when the asset is available for use.

Goodwill

Goodwill is not amortized but is subjected to an annual test to identify any impairment in value.

Trademarks and licenses

Trademarks and licenses are stated at cost less accumulated depreciation and accumulated impairment losses. Cost is amortized over the contract period or the useful lives of the assets, whichever is sooner.

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 and development expenditures for new products and/or processes are expensed when incurred.

Property, plant and equipment

Property, plant and equipment is stated at the cost of acquisition or production and includes directly attributable incidental expenses.

Property, plant and equipment is 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 for 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 charged 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 investment grants relating to property, plant and equipment are recorded as deferred income and credited to the statement of income 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 cost incurred. The depreciation period corresponds to the remaining useful life of the asset or the residual period of the lease contract, whichever is sooner.

Spare parts of a significant amount are capitalized and amortized over the estimated useful life of the assets to which they refer; other spare parts are expensed when the cost is incurred.

Assets acquired under finance lease contracts are accounted for as property, plant and equipment with a contra-entry to the relative financial liability. The lease payment is split between interest expense, recorded in the statement of income, and the repayment of principal, recorded as a deduction of the financial liability.

Impairment of property, plant and equipment and intangible assets

Whenever specific indicators point to an impairment, property, plant and equipment and 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.

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 which is recognized in the statement of income.

For assets that are not subject to depreciation and amortization, and for intangible assets that are not yet available for use, the impairment test is performed annually, regardless of the presence of specific indicators.

Investments in other companies and other securities

Investments in other companies and other securities which are not held for trading are classified, for purposes of their valuation, as available-for-sale financial assets and measured at fair value. The gains and losses are recognized in a specific reserve in equity.

In the case of impairment or in the event of sale, the gains and losses recognized up to that time in shareholders' equity are removed from equity and recognized in the statement of income.

Any permanent impairment losses recognized on available-for-sale financial assets in the statement of income are not be reversed through the statement of income.

Deferred taxes

Deferred taxes are calculated on temporary differences arising between the asset and liability amounts in the balance sheet and their tax bases (liability method). They are classified in non-current assets and liabilities.

Deferred tax assets are only recognized when there is a high probability of future recovery.

Inventories

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

Contract work in process

Contract work in progress is stated using the percentage of completion method.

When it is probable that the contract costs will be in excess of total revenues, the estimated loss is recognized immediately in the statement of income.

Receivables and payables

Receivables are initially recorded at fair value and subsequently measured at amortized cost, less provision for impairment. Payables are stated at amortized cost.

Receivables and payables in currencies other than the functional currency of the individual companies are adjusted to the period-end exchange rates.

Financial assets held for trading

Financial assets held for trading are measured at fair value through profit or loss.

Derivatives

Derivative financial instruments are measured at fair value through profit or loss.

Except for derivatives put into place to hedge the price risk of strategic metals, the Group has decided not to adopt the hedge accounting option.

Cash and banks

Cash and banks are stated at nominal value.

Provisions

The provisions include the 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 (post-employment benefits of the type called defined benefits) 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, together with adjustments for unrecognized actuarial gains or losses.

The Pirelli & C. Group has adopted the corridor approach for recognition in the statement of income of the part of the actuarial gains and losses exceeding a corridor of 10 percent of the greater of the fair value of the plan assets and the present value of the obligation at the balance sheet date.

Any excess is amortized over the expected average remaining lives of the participating employees.

For other long-term benefits, the actuarial gains and losses are recognized immediately in the statement of income.

Stock options

- For equity-settled stock options, 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 shareholders' equity;
- For cash-settled plans, 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 a liability. The expense is remeasured from time to time to ensure that the liability accrued is representative of the effective expense at expiration for the Group.

Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortized cost, calculated using the effective interest rate.

Current 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.

Shareholders' equity**Treasury shares**

Treasury shares are classified as a deduction from shareholders' equity.

In the event of sale, re-issue or cancellation, the gains and losses as a result thereof are classified in shareholders' equity.

Costs of equity transactions

Costs directly attributable to equity transactions of the parent company are recognized as a deduction from shareholders' 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:

- significant risks and benefits connected with ownership of the goods are transferred to the buyer;
- effective control over the goods sold and the usual continuing level of activity associated with ownership have ceased;
- the amount of revenues is determined in a reliable manner;
- it is probable that the economic benefits deriving from the sale will be enjoyed by the enterprise;
- the costs incurred or to be incurred are determined in a reliable manner.

Rendering of services

Revenues from rendering of services are recognized by reference to their completion at the balance sheet date.

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 are recognized as a deduction from the value of the investment.

2. Summary of the principal balance sheet, economic and financial effects on the 2004 financial statements and the opening net equity at January 1, 2005 as a result of the application of IAS/IFRS

The effects on the statement of income and balance sheet can be summarized as follows:

- net sales increased from Euros 7,114 million to Euros 7,298 million with an increase of Euros 184 million principally due to a different time frame for the recognition of revenues on contract work in progress (construction contracts), mainly in the Energy Cables and Systems Sector. Under IAS/IFRS, in fact, revenues on contracts, including the margin, must be recognized in sales on the basis of the stage of completion of the work, whereas under Italian GAAP, the margin is recorded in the change in inventories and the revenue is recognized at the completion of contract;
- operating profit rose from 380 million to Euros 399 million with an increase of Euros 19 million. In particular, Euros 37 million of that increase is due to: lower amortization of intangible assets (goodwill and differences on consolidation) of Euros 39 million, lower personnel costs of Euros 10 million as a result of the total recognition of the actuarial losses on employee benefits at transition (previously allocated over the remaining lives of the participants in the plans) and negative components (such as stock options, non-capitalizable expenses and other minor expenses) of Euros 12 million. Conversely, the remaining difference of Euros - 18 million is produced by the reclassification of the balance of extraordinary expenses (principally restructuring expenses) and income (principally the sale of assets) to operating expenses and income, therefore, without an impact on net income;
- consolidated net income increased by Euros 35 million (from Euros 274 million to Euros 309 million);

- total shareholders' equity at January 1, 2005 shows a reduction of Euros 52 million (from Euros 4,088 million to Euros 4,036 million), principally as a result of the impact of the measurement of employee defined benefit plans (Euros - 147 million), previously disclosed in the notes, the measurement of securities and financial instruments at fair value (Euros + 138 million) and other minor negative variations for Euros 43 million. Particular mention should be made, in respect of the foregoing plans, of the fact that the Group opted to fully record the actuarial gains and losses at transition to IAS/IFRS. As for the measurement of securities and financial instruments, the Group elected, as allowed by IFRS 1, to adopt IAS 32 and IAS 39 starting from January 1, 2005. The change to opening shareholders' equity attributable to Pirelli & C. S.p.A., at January 1, 2005 is a decrease of Euros 40 million (from Euro 3,736 million to Euros 3,696 million);
- the net financial debt position at January 1, 2005 went from Euros 1,469 million to Euros 1,586 million, principally as a result of the measurement of the put options held by the shareholder banks of Olimpia S.p.A. in accordance with IAS/IFRS. This increases the investment carried in the balance sheet corresponding to an increment in the net financial debt position of Euros 130 million;
- Olimpia, in accordance with IAS 31, is considered a jointly-controlled investment, accounted for by the equity method; therefore, the attributable net equity of Olimpia must be determined in accordance with IAS/IFRS.
As defined by IAS 28, the investment held by Olimpia in Telecom Italia qualifies as an associate and must therefore be accounted for by the equity method.

3. Reconciliation of net equity at January 1, 2004, at December 31, 2004 and at January 1, 2005 and of the 2004 net income in accordance with IAS/IFRS

(in millions of euros)

	1/1/2004	2004 Net income	Dividends	Other changes	12/31/2004	Adjustments IAS 32/39	1/1/2005
Total net equity - Italian GAAP	3678	274	(132)	268	4088		4088
1. Goodwill		39			39		39
2. Other intangible assets	(25)	1			(24)		(24)
3. Impairment	(21)	4			(17)		(17)
4. Spare parts	(27)	(3)			(30)		(30)
5. Employee benefit	(157)	10			(147)		(147)
6. Recognition of revenues on real estate sales	(9)	(2)			(11)		(11)
7. Stock options		(6)		1	(5)		(5)
8. Other	(11)	(7)		6	(12)		(12)
9. Treasury shares						(5)	(5)
10. Measurement of securities at fair value						238	238
11. Financial instruments						(100)	(100)
Tax effect	23	(1)			22		22
Total net equity - Italian GAAP - IAS/IFRS difference	(227)	35		7	(185)	133	(52)
Total net equity - IAS/IFRS	3451	309	(132)	275	3903	133	4036
Net equity attributable to minority interest - Italian GAAP	249	57	(23)	69	352		352
Net equity attributable to minority interest - Italian GAAP - IAS/IFRS difference	(8)	(4)			(12)		(12)
Net equity attributable to minority interest - IAS/IFRS	241	53	(23)	69	340		340
Net equity attributable to Parent Company - Italian GAAP	3429	217	(109)	199	3736		3736
Net equity attributable to Parent Company - Italian GAAP - IAS/IFRS difference	(219)	39		7	(173)	133	(40)
Net equity attributable to Parent Company - IAS/IFRS	3210	256	(109)	206	3563	133	3696

4. Explanatory notes to the reconciliation prepared in accordance with IFRS 1

The principal adjustments, as a result of the adoption of IAS/IFRS, to net equity at January 1, 2004, at December 31, 2004 and at January 1, 2005 due to the introduction of IAS 32 and IAS 39, as well as to 2004 net income, are presented as follows:

Effects on net equity at January 1, 2004, on 2004 net income and on net equity at December 31, 2004

1. Goodwill:

in accordance with IAS/IFRS (IAS 38), goodwill may no longer be amortized systematically in the statement of income but should be subject to a test, carried out at least annually, in order to identify any impairment in value (impairment test). This different accounting policy results in a higher net income for the year 2004 of Euros 39 million, due to the reversal of the amortization charge recorded during the year under Italian GAAP.

2. Other intangible assets:

certain types of costs, that can be capitalized under Italian GAAP, do not meet the requisites for recognition under IAS 38 (for example, formation costs, start-up costs, costs of equity transaction, etc.). The opening balance sheet at January 1, 2004 shows a reduction in shareholders' equity due to the effect of the reversal of such intangible assets of Euros 25 million. The positive effect on 2004 net income is Euros 1 million, due to lower amortization charges for the year net of uncapitalized expenses of the year.

3. Impairment (property, plant and equipment):

following the application of the models for impairment tests provided in IAS 36, the opening balance sheet at January 1, 2004 reflects the impairment of some fixed assets for Euros 21 million (of which Euros 14 million is allocated to property, plant and equipment and Euros 7 million to goodwill). The 2004 net income benefits from an increase of Euros 4 million as a result of corresponding lower depreciation charges.

4. Spare parts:

in accordance with IAS 16, spare parts of significant amount relating to plant and machinery should be capitalized and depreciated over the useful life of the asset to which they refer. Spare parts of non-significant amount should be expensed in the statement of income when the expense is incurred. The balance sheet at January 1, 2004 shows a reduction in opening shareholders' equity of Euros 27 million due to the combined effect of the derecognition of spare parts of non-significant amount, previously recorded in inventories, and the accumulated depreciation of spare parts of significant amount, from the date of their original purchase. The 2004 net income is Euros 3 million lower owing to the immediate recognition in the statement of income of costs relating to the purchase of spare parts of non-significant amount and the depreciation charge for the year of spare parts of significant amount.

5. Employee benefits:

in accordance with IAS 19, post-employment benefits and other long-term benefits are subject of actuarial calculations to express the present value of the benefit due at the balance sheet date. The opening balance sheet at January 1, 2004 shows a reduction in shareholders' equity of Euro 157 million basically referring to plans existing in the U.K. and the U.S.A. The 2004 net income benefits from Euros 10 million in lower costs for the year due to the full recognition of the actuarial losses at transition, previously allocated over the remaining lives of the participants in the plans.

6. Recognition of revenues on real estate sales:

in accordance with IAS 18, revenues on real estate sales should normally be recognized when ownership is transferred to the buyer. In some cases, the sale may not interrupt a certain involvement on the part of the seller, therefore the risks and rewards of ownership are not, in fact, transferred. The nature and degree of the seller's involvement establishes how the transaction should be recorded. The opening balance sheet at January 1, 2004 under IAS/IFRS shows a reduction in shareholders' equity due to the deferral of part of the result of certain real estate transactions equal to Euros 9 million. The 2004 net income shows a decrease of Euros 2 million.

7. Stock options:

IFRS 2 provides for the recognition of the cost in the statement of income for stock options granted to employees.

The opening balance sheet at January 1, 2004 shows a reduction in shareholders' equity as a result of the recognition of costs connected with the plans for stock options granted by the Pirelli Real Estate Group of Euros 0.2 million. The 2004 net income presents a reduction of Euros 6.4 million due to the recognition of such costs with a contra-entry for an increase in the reserves in shareholders' equity of Euros 0.7 million (relating to equity-settled stock options) and an increase in liabilities of Euros 5.7 million (relating to cash-settled stock options).

Effects of the valuation of Olimpia:

- the investment held by Olimpia S.p.A. in Telecom Italia S.p.A., stated at cost less any permanent impairment in accordance with Italian GAAP, qualifies as an associate under IAS/IFRS (IAS 28) and, as such, is accounted for by the equity method. The 2004 result of Olimpia S.p.A. benefits from an increase of Euros 4 million owing to the valuation by the equity method of the investment in Telecom Italia S.p.A., which, in the financial statements of Pirelli & C. S.p.A., gives rise to a consequent increase in the share of Olimpia S.p.A.'s result of Euros 2 million (included in item 8 Other).

- in accordance with IAS/IFRS (IAS 38), goodwill may no longer be amortized systematically in the statement of income but should be subject to a test, carried out at least annually, in order to identify any impairment in value (impairment test). This different accounting policy determines a higher result for the year 2004 of Euros 3 million, due to the reversal of the amortization charge recorded on Olimpia (included in item 1 Goodwill).

Extraordinary items:

although there is no impact on the 2004 net income, under IAS/IFRS, extraordinary items may no longer be recorded separately in the statement of income but should be classified as ordinary items.

Effects on net equity at January 1, 2005 due to the introduction of IAS 32 and IAS 39

9. Treasury shares:

in accordance with IAS/IFRS, treasury shares may no longer be recorded as an asset but should be recorded as a deduction from shareholders' equity (for the par value) and retained earnings (for the excess amount). The balance sheet at January 1, 2005 shows a reduction in shareholders' equity for the effect of this different presentation in the financial statements under IAS/IFRS of Euros 5 million.

10. Measurement of securities at fair value:

the increase in shareholders' equity at January 1, 2005 of Euros 238 million is due to the following effects:

- investments included in financial assets under Italian GAAP are classified, in accordance with IAS/IFRS, as available-for-sale financial assets and should be measured at fair value with a contra-entry to shareholders' equity (IAS 39). The balance sheet at January 1, 2005 benefits from an increase in shareholders' equity of Euros 223 million.

- in accordance with IAS/IFRS, securities held for trading purposes are classified as financial assets held for trading and should be measured at fair value with a contra-entry to the statement of income. The balance sheet at January 1, 2005 benefits from an increase in shareholders' equity of Euros 15 million.

11. Financial instruments:

the reduction in shareholders' equity at January 1, 2005 of Euros 100 million is due to the following effects:

- the deadlock premium granted to Hopa under Olimpia shareholders' agreements, accounted for on a prorata basis in accordance with Italian accounting principles, has the nature of a liability under IAS/IFRS (IAS 32), and should therefore be recognized in the liabilities of the Group, at its present value, with a contra-entry to shareholders' equity. The balance sheet at January 1, 2005 shows a reduction in shareholders' equity of Euros 69 million.

in accordance with IAS/IFRS, derivative instruments should be recognized in the financial statements at their fair value (IAS 39). The balance sheet at January 1, 2005 shows a reduction in shareholders' equity of Euros 31 million due principally to the effect of Pirelli's share of the interest rate swap at fair value held by Olimpia S.p.A..

5. Analysis of the effects of the application of IAS/IFRS on the net financial position

The principal effects on the consolidated net financial debt position at December 31, 2004 due to the introduction of IAS/IFRS and at January 1, 2005 following the adoption of IAS 32 and IAS 39 are as follows:

	(in millions of euros)
Net debt position - Italian GAAP 12/13/2004	1,469
1. Effect of Olimpia put options held by banks	130
2. Effects on Pirelli Real Estate Group	5
Other	(3)
	132
Net debt position - IAS/IFRS 12/31/2004	1,601
3. Securities held for trading	(15)
Net debt position - IAS/IFRS 1/1/2005	1,586

1. Effect of the put options on Olimpia held by the shareholder banks:

in accordance with IAS/IFRS, the put options on Olimpia S.p.A., held by the shareholder banks, imply that the economic benefits relative to the possession of the investment in Olimpia are, for the predominating part, transferred immediately to Pirelli. This causes an increase in the investment with a contra-entry to the liability inclusive of the derivative for Euros 130 million.

2. Effects on Pirelli Real Estate Group:

such effects are principally in relation to the recognition of a financial liability equal to the benefit on the net financial position which previously originated as a result of the sale of stakes in subsidiaries which, under IAS/IFRS, may not be recognized due to the commitments deriving from the put options granted and the call options obtained, for Euros 5 million.

3. Measurement of securities held for trading at fair value:

due to the adoption of IAS 39, the fair value adjustment of securities held for trading causes an improvement in the net financial position at January 1, 2005 of Euros 15 million.

**QUARTERLY DATA
AND
COMMENTS**

Net sales

Net sales for the three months ending March 31, 2005 amount to Euros 1,870 million compared to Euros 1,700 million for the three months ending March 31, 2004.

The increase compared to the corresponding period of 2004 can be analyzed as follows:

• Volumes	+	5.0%
• Prices/Mix	+	3.3%
Change on a comparable basis	+	8.3%
• Foreign exchange effect	-	0.6%
• Change in scope of consolidation	-	1.1%
• Metal prices	+	3.4%
Total change	+	10.0%

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

Sector	1 st Quarter 2005	1 st Quarter 2004	Geographical area	1 st Quarter 2005	1 st Quarter 2004
Energy Cables and Systems	40%	40%	Italy	21.3%	25.4%
			Other European countries	43.8%	40.9%
Telecom Cables and Systems	6%	6%	North America	9.8%	8.9%
			Central and South America	14.1%	13.9%
Tyres	47%	48%			
Real Estate	7%	6%	Australia, Africa and Asia	11.0%	10.9%

Labor costs

Labor costs for the first three months of 2005 amount to Euros 370 million and represent 19.8 percent of sales, compared to Euros 351 million for the corresponding period of the prior year (20.6 percent of sales).

Operating profit

Operating profit for the first three months of 2005 is Euros 118 million (6.3 percent of net sales), with a considerable increase of Euros 87 million compared to the same period of 2004.

The change compared to the corresponding period of the prior year is principally due to:

	(in millions of euros)
Operating profit 1st Quarter ending 3/31/2004	87
. Foreign exchange effect	1
. Prices (excluding metals)/Mix	37
. Volumes	21
. Production factors per unit cost	(35)
. Efficiencies	5
. Depreciation	1
. Other	1
	31
Operating profit 1st Quarter ending 3/31/2005	118

Net income

The net income for the three months ending March 31, 2005 is Euros 83 million compared to Euros 40 million for the first three months of 2004.

Net financial position

The net debt position at March 31, 2005 is Euros 2,120 million compared to Euros 1,601 million at December 31, 2004 and Euros 2,089 million at March 31, 2004.

The change, compared to December 31, 2004 is principally due to the capital increase in Olimpia S.p.A. subscribed to by Pirelli & C. S.p.A. (Euros 1,344 million), compensated by the share capital increase (Euros 1,062 million) voted by the Board of Directors of Pirelli & C. S.p.A. on December 7, 2004 and the increase in working capital due to seasonal factors.

	(in millions of euros)		
	3/31/2005	12/31/2004	
Net financial position	IAS/IFRS	IAS/IFRS	Italian GAAP
. Short-term financial payables	1,052	799	783
. Accrued and deferred interest expenses	62	49	49
. Cash and banks	(298)	(551)	(551)
. Other non-current securities	(307)	(242)	(242)
. Short-term financial receivables	(35)	(53)	(53)
. Accrued and prepaid interest income	(12)	(16)	(16)
Short-term net financial (liquidity)/debt position	462	(14)	(30)
. Medium/long-term financial payables	1,908	1,885	1,769
. Medium/long-term financial receivables	(246)	(266)	(266)
. Other securities	(4)	(4)	(4)
Medium/long-term net financial (liquidity)/debt position	1,658	1,615	1,499
Total net financial (liquidity)/debt position	2,120	1,601	1,469