



Società per azioni

Quarterly Report

First Quarter 2003

PIRELLI Società per azioni

Registered office in Milan, Viale Sarca 222

Share Capital - Euros 1,043,707,463.24 fully paid-in

Milan Companies Registry No. 00886890151

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

Chairman and Chief Executive Officer	Marco Tronchetti Provera
Deputy Chairman	Alberto Pirelli
Managing Directors and General Managers	Carlo Buora Giovanni Ferrario
Directors	Gilberto Benetton Carlo Ciani Eugenio Coppola di Canzano Carlo De Benedetti Alberto Falck Giuseppe Gazzoni-Frascara Mario Greco Georg F. Kraye Massimo Moratti Luigi Orlando Giampiero Pesenti Ennio Presutti Carlo Alessandro Puri Negri Vincenzo Sozzani Frank Vischer

Secretary to the Board	Sergio Lamacchia
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Board of Statutory Auditors

Chairman	Luigi Guatri
Standing members	Rosalba Casiraghi Paolo Francesco Lazzati
Alternate members	Franco Ghiringhelli Sebastiano Guido

General Managers

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

PIRELLI S.p.A. - MILAN
Quarterly Report – 1st Quarter 2003

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MANAGEMENT'S REPORT

PERFORMANCE OF THE GROUP

Economic activity in the first quarter was affected once again by the difficulties and the climate of uncertainty which continued to dominate the world scenario. More specifically, in the Telecommunications Cables and Systems Sector, volumes remained very low, putting further pressure on manufacturers to reduce prices; in the Energy Cables and Systems Sector the weakness in demand from Utilities persisted, especially in Europe in the low and medium voltage segments; furthermore, the strong pressure on distribution prices in the General Market continued. In the Tyres Sector, the market of the Replacements channel reported an increase in Europe and a contraction in North America, whereas the Original Equipment market remained steady in the passenger car segment and reported an increase in the truck segment.

In this context, the Group reported an increase in the operating profit compared to the same period of the prior year and the last quarter of 2002; there was an increase both in absolute value and as a percentage of net sales.

The improvement reflects the continued growth of profitability in the Tyres Sector and the benefits realized as a result of timely reorganization measures implemented especially in the Energy and Telecommunications Cables and Systems Sectors, which more than offset the difficulties being encountered on the main reference markets, and the increase in per unit costs.

Net income, before the consolidation of Olimpia is again positive.

The net debt position rose due to seasonal factors affecting working capital, especially in the Tyres Sector; the increase, however, is lower than that of the first quarter of 2002 and was affected by the impact of restructuring expenses on cash for about Euros 52 million.

The parent company, Pirelli S.p.A.

The net result of the parent company, Pirelli S.p.A., for the first quarter ending March 31, 2003 was a loss of Euros 2.5 million, compared to a net income of Euros 241.7 million for the first quarter of 2002, which basically reflected the dividends distributed by Optical Technologies The Netherland B.V. (Euros 250 million), connected with the sale of the optical components business to Corning.

Major events in the first quarter

On March 11, 2003, the Board of Managing Partners of Pirelli & C. and the Board of Directors of Pirelli S.p.A. voted on a project aimed at the simplification and strengthening of the corporate structure through a series of transactions of an extraordinary nature.

In particular:

The Board of Managing Partners of Pirelli & C. voted: to transform the legal entity from a limited partnership (Società in Accomandita per Azioni) to a corporation (Società per Azioni) and consequently adopt new by-laws; to change the name from Pirelli & C. A.p.A. to Pirelli & C. S.p.A.; to immediately increase share capital by a maximum amount of Euros 1,014 million through the issue of ordinary shares cum free warrants for a future increase of share capital for a further maximum amount of Euros 254 million; to merge Pirelli & C. Luxembourg and Pirelli S.p.A. by incorporation in Pirelli & C. A.p.A..

The Board of Directors of Pirelli S.p.A. voted the merger by incorporation of Pirelli S.p.A. in Pirelli & C. A.p.A..

After the transformation of Pirelli & C. A.p.A. to Pirelli & C. S.p.A., the Pirelli & C. A.p.A. ordinary and savings shareholders will have the right to withdraw within the terms and according to the conditions established by law. The shareholders who withdraw may not receive dividends nor are they entitled to the option rights granted with the capital increase.

During the first quarter, Pirelli S.p.A. purchased 9,384,518 ordinary shares on the market at an average price per share of Euros 0.73.

After these purchases, Pirelli S.p.A. holds 172,648,217 ordinary shares equal to 9 percent of voting share capital.

THE GROUP

The consolidated figures for the first quarter ending March 31, 2003 are as follows:

	(in millions of euros)			
	1st Quarter 2003 (excluding Olimpia)	1st Quarter 2003	1st Quarter 2002	2002
. Net sales	1,449	1,449	1,688	6,311
. Gross operating profit	141	141	137	480
% of net sales	9.7%	9.7%	8.1%	7.6%
. Operating profit	59	59	42	117
% of net sales	4.1%	4.1%	2.5%	1.9%
. Financial income (expenses)	(37) (:)	(37) (:)	(35) (:)	(173) (:)
. Share of earnings (losses) of equity investments	0	(25)	(27)	(230)
. Extraordinary items	8	8	0	(262)
. Income taxes	(27)	(27)	(19)	(62)
. Net income (loss)	3	(22)	(39)	(610)
% of net sales		n.s.	n.s.	n.s.
. Net income (loss) attributable to Pirelli S.p.A.		(21)	(37)	(614)
. Earnings per share (in euros)		(0.01)	(0.02)	(0.31)
. Shareholders' equity		4,526	5,629	4,576
. Net equity attributable to Pirelli S.p.A.		4,347	5,422	4,394
. Equity per share (in euros)		2.17	2.70	2.19
. Net financial (liquidity)/debt position		1,646	1,406	1,469
. R&D expenditures		50	59	219
. Employees (at period-end)		34,608	38,260	36,079
. Factories (number)		77	82	79

(:) includes adjustments to securities for Euros 1 million for the first quarter of 2003, Euros 6 million for the first quarter of 2002 and for Euros 38 million for the year 2002

Net sales

Net sales for the first quarter of 2003 amount to Euros 1,449 million, with a decrease of 14.2 percent compared to the prior year. Excluding the foreign exchange effect (-8.6 percent), the variation in metal prices in the Energy business (-1.6 percent) and the change in the scope of consolidation due to the sale of the Enameled Wires business (-1.5 percent), the effective change is equal to -2.5 percent and this was essentially caused by lower volumes in the Energy and Telecom Cables and Systems Sectors, while net sales increased in the Tyres Sector.

Gross operating profit

Gross operating profit (Euros 141 million) is equal to 9.7 percent of net sales, compared to 8.1 percent in the first quarter of 2002.

Operating profit

Operating profit in the first quarter of 2003 is Euros 59 million, representing 4.1 percent of net sales compared to Euros 42 million in the corresponding period of 2002 (2.5 percent of net sales). The negative impact due to the market trend and exchange rates are more than compensated by the results of the restructuring measures taken by the Group, which brought gross efficiencies totaling Euros 57 million in the first quarter, Euros 33 million of which are for the gross reduction in labor costs.

Operating profit for the period comprises the impact of the settlement concluded with Ciena relating to the dispute over the use of patents by the latter, for an amount for Euros 10 million, and also benefited from insurance compensation for damages to the Battipaglia factory of Fibre Ottiche Sud for Euros 6 million.

The change in operating profit can mainly be attributed to:

	<u>in millions of euros</u>	
• Currency exchange effect	-	12
• Prices (excluding metals)/mix	+	13 (*)
• Volumes	-	5
• Per unit production costs	-	44 (**)
• Net efficiencies	+	57
• Depreciation	+	6
• Other	+	2
	+	<u>17</u>

(*) of which South America +30

(**) of which South America -35 for raw materials

Financial income (expenses)

Financial income (expenses) shows an expense balance of Euros 37 million compared to Euros 35 million in the corresponding period of the prior year. The change is mainly due to higher net indebtedness during the period.

Share of earnings (losses) of equity investments

The share of the earnings (losses) of equity investments is a negative balance of Euros 25 million due to the share of the result of Olimpia S.p.A., accounted for using the equity method.

Extraordinary items

Extraordinary items show an income balance of Euros 8 million and principally comprise the gain on the sale of properties by the Energy Cables and Systems Sector to companies in the Pirelli & C. Real Estate Group.

Net income (loss)

The net result for the first quarter ending March 31, 2003 is a net loss of Euros 22 million (after financial expenses of Euros 62 million, extraordinary income of Euros 8 million and income tax expenses of Euros 27 million) compared to a net loss of Euros 39 million in the first three months of 2002 (after financial expenses of Euros 62 million and income tax expenses of Euros 19 million).

Excluding the impact of Olimpia's result for the first quarter of 2003, the result would be a net income of Euros 3 million.

Shareholders' equity

Consolidated shareholders' equity went from Euros 4,576 million at December 31, 2002 to Euros 4,526 million at March 31, 2003.

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

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. Translation adjustments	(38)
. Net loss for the period	(22)
. Other changes	10
<hr/>	
	(50)
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Net financial position

The net debt position at March 31, 2003 is Euros 1,646 million compared to Euros 1,469 million at December 31, 2002 and Euros 1,406 million at March 31, 2002. The change, compared to December 31, 2002, can be ascribed to seasonal factors which caused an increase in working capital (especially in the Tyres Sector) and disbursements relating to accruals made in 2002 for reorganization programs.

R&D expenditures

The Group's priority commitment to research and technological innovation is again reconfirmed in the first quarter of 2003 with expenditures sustained of Euros 50 million, and representing the same percentage of net sales (3.5 percent).

Employees

Employees number 34,608 at March 31, 2003 compared to 36,079 at December 31, 2002. The reduction from the end of 2002 is 1,471 and from March 31, 2002 is 3,652.

Factories

There were 79 factories at December 31, 2002 and 77 at March 31, 2003 owing to the closing of factories in the Energy Cables and Systems Sector in Erith (U.K.) and Colusa (U.S.A.), as set forth in the restructuring programs announced last year.

Related party disclosure

According to Consob Communications No. 97001574 of February 20, 1997 and No. 98015375 of February 27, 1998 which deal with related party transactions among Group companies, the effects of such transactions on the balance sheet and statement of income of the consolidated financial statements at March 31, 2003 are presented in the following table.

All the transactions, including those between the parent company and its subsidiaries and among the subsidiaries, fall within the ordinary operations of the Group, are governed by market terms, and there are no transactions of an unusual and exceptional nature, or constituting a potential conflict of interest.

The following table presents the major transactions at March 31, 2003 that Pirelli S.p.A. Group has entered into with the parent companies (Pirelli & C. A.p.A. and Pirelli & C. Luxembourg S.A.) and the subsidiaries of the latter companies, which are included in the scope of consolidation of Pirelli & C. A.p.A..

(in millions of euros)			
Type of transaction	With parent companies	With subsidiaries of Pirelli & C. A.p.A.	Total
TRADE RECEIVABLES AND OTHER	0.7	11.1	11.8
TRADE PAYABLES AND OTHER	(2.2)	(2.4)	(4.6)
FINANCIAL RECEIVABLES	15.2	0.0	15.2
FINANCIAL PAYABLES	(0.5)	(26.7)	(27.2)
REVENUES FOR GOODS AND SERVICES	0.3	1.0	1.3
COSTS FOR GOODS AND SERVICES	(1.4)	(1.7)	(3.1)
FINANCIAL INCOME	0.9	0.1	1.0
FINANCIAL EXPENSES	(5.6)	(0.0)	(5.6)
EXTRAORDINARY INCOME	0.0	11.7	11.7

Transactions of Pirelli S.p.A. and its subsidiaries with the **parent companies** mainly refer to the following:

- . **financial receivables**, relating to loans receivable by Pirelli Servizi Finanziari S.p.A. (subsidiary of Pirelli S.p.A.) from Pirelli & C. A.p.A.;
- . **revenues for goods and services**, relating to the performance of various services rendered by Pirelli S.p.A. and Pirelli Informatica S.p.A. to Pirelli & C. A.p.A.;
- . **costs for goods and services**, relating to costs for corporate secretarial services and internal auditing rendered by Pirelli & C. A.p.A. on behalf of Pirelli S.p.A.;
- . **financial income and expenses**, relating to interest income and expenses on the aforementioned current account transactions and loans, as well as costs and revenues for hedging transactions carried out by Pirelli International Ltd. (subsidiary of Pirelli S.p.A.) on behalf of Pirelli & C. A.p.A..

Transactions of Pirelli S.p.A. and its subsidiaries with the **subsidiaries of Pirelli & C. A.p.A.** mainly refer to the following:

- . **trade receivables and other**, relating to sales of properties by Pirelli Cavi e Sistemi Energia S.p.A. (subsidiary of Pirelli S.p.A.) to Kappa S.r.l. (indirect subsidiary of Pirelli & C. A.p.A.);
- . **trade payables and other**, relating to services rendered by companies in the Pirelli & C. Real Estate S.p.A. Group (subsidiary of Pirelli & C. A.p.A.) to Pirelli S.p.A. and its subsidiaries;
- . **financial receivables and payables**, relating to transactions on the current account by Pirelli Servizi Finanziari S.p.A. with companies in the Pirelli & C. Real Estate S.p.A. Group (subsidiary of Pirelli & C. A.p.A.);
- . **revenues for goods and services**, relating to cost recoveries for various services rendered by Pirelli S.p.A. and Pirelli Informatica S.p.A. (subsidiary of Pirelli S.p.A.) on behalf of Pirelli & C. Real Estate S.p.A. and its subsidiaries;

- . **costs for goods and services**, relating to costs for property management services incurred by Pirelli S.p.A. and its subsidiaries for the services rendered by companies in the Pirelli & C. Real Estate S.p.A. Group (subsidiary of Pirelli & C. A.p.A.);
- . **extraordinary income**, relating to the sale of properties by Pirelli Cavi e Sistemi Energia S.p.A. (subsidiary of Pirelli S.p.A.) to Kappa S.r.l. (indirect subsidiary of Pirelli & C. A.p.A.).

Furthermore, in order to provide more complete information, the transactions in 2003 between the Pirelli S.p.A. Group and the Olivetti-Telecom group are described below. These transactions fall within the ordinary operations of the Group, are carried out at arm's length and there are no transactions of an unusual and exceptional nature or in potential conflict of interest. Such transactions refer to:

- **revenues for goods and services**, relating mainly to the supply of telecommunications cables (Euros 14.3 million);
- **costs for goods and services**, relating mainly to telephone and computer services and the supply of electricity (Euros 8.2 million);
- **trade receivables**, relating to the supply of the goods and services described above (Euros 17.5 million);
- **trade payables**, relating to telephone and computer services and the supply of electricity described above (Euros 7.2 million).

Outlook for the current year

In a market scenario that continues to be dogged by factors of uncertainty, the results achieved in the first quarter allow us to confirm, to date, our objective for the current year of achieving an increase in the operating profit of the Energy Cables and Systems and Tyres Sectors and reaching a breakeven in the last quarter in the Telecom Cables and Systems Sector.

ENERGY CABLES AND SYSTEMS SECTOR

The consolidated figures for the Energy Cables and Systems Sector for the first quarter ending March 31, 2003 can be summarized as follows:

	(in millions of euros)		
	1st Quarter 2003	1st Quarter 2002	2002
. Net sales	623	796	3,021
. Gross operating profit	31	28	158
% of net sales	5.0%	3.5%	5.2%
. Operating profit	8	1	55
% of net sales	1.3%	0.1%	1.8%
. Financial income (expenses)	(9)	(12)	(44)
. Extraordinary items	8	0	(121)
. Income taxes	(5)	(6)	(10)
. Net income (loss)	2	(17)	(120)
% of net sales	0.3%	n.s.	n.s.
. Net financial (liquidity)/debt position	418	585	373
. R&D expenditures	9	13	44
. Employees (at period-end)	11,282	14,320	12,479
. Factories (number)	48 *	49	50

* 4 of which shared with the Telecommunications Cables and Systems Sector

Net sales for the first quarter of 2003 are Euros 623 million, with a decrease of 21.7 percent compared to the corresponding period of the prior year. This decrease is reduced to 6.9 percent if sales are considered net of the effects of foreign exchange, metals prices and the change in the scope of consolidation as a result of the sale of the Enameled Wires business.

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

• Currency exchange effect	-	7.9%
• Volumes	-	7.0%
• Metals prices	-	3.6%
• Prices/Mix/other (change in scope of consolidation)	-	3.2%
	-	<u>21.7%</u>

An analysis of net sales by geographical area, excluding the foreign exchange effect, shows that the reduction is almost totally concentrated in Europe.

On the other hand, sales volumes in North and South America are higher and the trend of sales in the Asian Pacific area (Australia, Indonesia and China) is favorable.

As far as business areas are concerned, the negative performance of sales was more accentuated in the General Market and in the low/medium voltage segment for Utilities.

Operating profit shows an improvement thanks to efficiencies achieved on both variable and fixed overheads, which compensate the reductions in terms of volumes, prices and mix.

To this end, restructuring projects that are already underway are continuing into 2003. The aim of such projects is to render production operations increasingly more efficient and to cause the structure of fixed overheads to become even more competitive.

At the beginning of the year, as announced, the sale was finalized for the production and marketing operations of the enameled wires and transposed conductors business in Europe and China. Moreover, in March, some owned buildings were sold to a company in the Pirelli & C. Real Estate Group, which led to extraordinary income of Euros 9 million.

Operating profit for the first quarter of 2003 is Euros 8 million, compared to Euros 1 million in the first quarter of the prior year; as a percentage of net sales, operating profit is 1.3 percent compared to 0.1 percent in the first quarter of 2002.

The change in operating profit is due to the following:

	<u>in millions of euros</u>	
• Currency exchange effect	-	3
• Prices (excluding metals)/mix	-	12
• Volumes	-	14
• Per unit production costs	-	1
• Net efficiencies	+	35
• Depreciation	+	3
• Other	-	1
	+	<u>7</u>

The **net result** for the first three months of 2003 is a net income of Euros 2 million compared to a net loss of Euros 17 million for the same period of the prior year, thanks to the improvement in operating profit, lower financial expenses and the gain on the sale of real estate properties.

The **net financial position** is a debt position of Euros 418 million compared to Euros 373 million at December 31, 2002.

Research expenditures for the first quarter of 2003 amount to Euros 9 million.

Employees number 11,282 at March 31, 2003, with a reduction of 1,197 compared to 12,479 at December 31, 2002.

Factories now number 48 from 50 as a result of the closing of production facilities in Erith (U.K.) and Colusa (U.S.A.).

TELECOMMUNICATIONS CABLES AND SYSTEMS SECTOR

The consolidated figures for the Telecommunications Cables and Systems Sector for the first quarter ending March 31, 2003 can be summarized as follows:

	(in millions of euros)		
	1st Quarter 2003	1st Quarter 2002	2002
. Net sales	89	164	468
. Gross operating profit	(4)	14	(22)
% of net sales	n.s.	8.5%	n.s.
. Operating loss	(17)	(2)	(84)
% of net sales	n.s.	n.s.	n.s.
. Financial income (expenses)	(5)	(5)	(54)
. Extraordinary items	1	0	(121)
. Income taxes		4	(4)
. Net loss	(21)	(3)	(263)
% of net sales	n.s.	n.s.	n.s.
. Net financial (liquidity)/debt position	465	431	431
. R&D expenditures	9	13	45
. Employees (at period-end)	2,348	3,067	2,546
. Factories (number)	11 *	12	11

* 4 of which shared with the Energy Cables and Systems Sector

Net sales for the first quarter of 2003 are Euros 89 million, posting a sharp reduction from the same period of the prior year.

This change in net sales is due to:

• Currency exchange effect	-	4.6%
• Volumes	-	22.2%
• Prices/Mix	-	26.2% (*)
	-	<u>45.7%</u>

(*) calculated on the basis of the prior year adjusted by the volume variance

Sales volumes declined sharply in Europe and North America due to the persistent contraction of investments by telephone operating companies. South America and Australia, instead, reported a lower reduction in sales than the two above-mentioned areas, which was particularly linked to an increase in investments in copper cables which partially offset the decrease in fiber optic cables. However, this upturn in investments does not yet constitute a real and true sign of market recovery. Meanwhile, the fiber optic market still appears to be suffering from negative effects lingering from the prior year. Indeed, price pressures are still strong and this in turn is having repercussions on the prices of fiber optic cables. One positive result worthy of mention is that Pirelli won a contract to produce OPGW in Romania for Transelectrica.

Although the profitability of the sector suffered from the above-mentioned contraction in volumes and the pressure over prices, there was a positive impact on the submarine cables sector owing particularly to progress on the installation work for the Sumatra Backbone contract (scheduled for completion at the end of the first half of 2003), and the start-up of production of cable and optical amplifiers for the Farice contract won by Pirelli at the end of 2002.

Despite the sharp fall in sales revenues, the timely restructuring measures implemented began to yield the first results and should become fully operational by the second quarter of the year. The restructuring plans currently underway in the Telecom Sector should ensure that the aim of a breakeven is achieved towards the last part of the year.

In the second half of 2002, work began to reposition the activities of the so-called new businesses, especially in the area of Network Access where work focused mainly on broadband access equipment, an area where an increase in volumes is expected.

Despite the extremely turbulent context, efforts being made in the area of R&D were not forgotten and, in the second half of the year, the first embryos of new businesses deriving from the development activities of Pirelli Labs should begin to take shape.

The **operating result for the first quarter of 2003** is a loss of Euros 17 million, compared to a loss of Euros 2 million in the first quarter of the corresponding period of the prior year.

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

	<u>in millions of euros</u>	
• Currency exchange effect	-	0
• Prices (excluding metals)/mix	-	15
• Volumes	-	20
• Per unit production costs	+	9
• Net efficiencies	+	13
• Depreciation	+	2
• Other	-	4
	-	<u>15</u>

The **net result** for the first three months of 2003 is a net loss of Euros 21 million.

The **net financial position** is a debt position of Euros 465 million compared to Euros 431 million at December 31, 2002. The change is mainly due to operating requirements during the period.

Research expenditures for the first three months of 2003 amount to Euros 9 million.

Employees number 2,348 at March 31, 2003, with a further reduction of 198 compared to December 31, 2002.

Factories remained unchanged compared to December 31, 2002.

TYRES SECTOR

The consolidated figures for the Tyres Sector for the first quarter ending March 31, 2003 can be summarized as follows:

	(in millions of euros)		
	1st Quarter 2003	1st Quarter 2002	2002
. Net sales	741	758	2,857
. Gross operating profit	108	101	365
% of net sales	14.6%	13.3%	12.8%
. Operating profit	65	54	191
% of net sales	8.8%	7.1%	6.7%
. Financial income (expenses)	(14)	(19)	(55)
. Extraordinary items		0	(11)
. Income taxes	(19)	(12)	(47)
. Net income	32	23	78
% of net sales	4.3%	3.0%	2.7%
. Net financial (liquidity)/debt position	595	806	492
. R&D expenditures	31	31	122
. Employees (at period-end)	20,144	19,992	20,222
. Factories (number)	22	21	22

Net sales for the first quarter of 2003 are Euros 741 million, with a decrease of 2.2 percent compared to the same period of the prior year. Excluding the foreign exchange effect, there was an increase in sales of 10.8 percent.

The change in net sales can be attributed to:

• Currency exchange effect	-	13.0%
• Volumes	+	5.9%
• Prices/Mix	+	4.9%
	-	2.2%

The negative foreign exchange effect due both to the weakness of the U.S. dollar against the Euro and loss of value of the main currencies of South America and Egypt is particularly high compared to the first quarter of 2002.

In the **Consumer** market (Cars and Motorcycles), net sales increased by 1 percent at historical exchange rates and by 11 percent excluding the foreign exchange effect, both in the Replacements channel, where growth was generalized in all the main markets, and in the Original Equipment channel, where the first tyre deliveries have begun in North America.

Volumes in the **Passenger Car/Light Truck** segment reported a positive trend compared to the same period of 2002; Replacements reported a generalized increase on all the main markets, as did Original Equipment, owing particularly to Europe and North America.

Volumes in the **Motorcycle** segment show a marked increase compared to the first quarter of the prior year, both in the Replacements market (in all geographical areas), and in the Original Equipment market, thanks to the positive trend in South America.

In the **Commercial vehicles** market, net sales contracted by 9 percent at historical exchange rates but increased by 12 percent excluding the foreign exchange effect, thanks to generalized growth in all the main markets, including those in South America, where the weakness of the local currencies compared to the first quarter of 2002 is particularly significant.

Truck tyre volumes closed the first quarter with a two-digit growth compared to the first quarter of 2002, both in the Replacements channel, which reported an increase in all the markets, and in the Original Equipment channel, which reported contractions in Europe that were more than compensated by growth in other markets.

The positive trend of **prices and mix** was common to all the main geographical areas, confirming the growth in the high value-added performance segments, and the success being enjoyed by Pirelli's new technologies and products.

Operating profit for the first quarter of 2003 is Euros 65 million compared to Euros 54 million for the corresponding period of the prior year.

The percentage of operating income to net sales is 8.8 percent, compared to 7.1 percent in the first quarter of 2002.

The change in operating profit can be summarized as follows:

	<u>in millions of euros</u>	
• Currency exchange effect	-	11
• Prices (excluding metals)/mix	+	40
• Volumes	+	29
• Per unit production costs	-	49
• Net efficiencies	+	7
• Other	-	5
	+	<u>11</u>

Positive commercial changes (volumes and prices/mix) in all main geographical areas more than compensated the higher cost of raw materials, energy and the negative foreign currency effect compared to the first quarter of 2002.

The efficiencies more than compensate the inflation of labor costs and other expenses.

Net income is Euros 32 million in the first quarter of 2003 (after financial expenses of Euros 14 million and income tax expenses of Euros 19 million) compared to Euros 23 million in the first three months of 2002 (after financial expenses of Euros 19 million and income tax expenses of Euros 12 million).

The **net financial position** is a debt position of Euros 595 million compared to Euros 492 million at December 31, 2002 and Euros 806 million at March 31, 2002. The increase from December 31, 2002 is principally due to the operating requirements of the period.

Research expenditures for the first three months to March 31, 2003 amount to Euros 31 million, in line with the same period of last year.

Employees number 20,144 at March 31, 2003, including 1,532 employees with temporary contracts. Compared to December 31, 2002, the number of permanent senior executives and staff as well as the number of permanent blue-collar workers are lower as a result of the rationalization of the workforce.

Factories remained unchanged compared to December 31, 2002.

Furthermore, during the first quarter of 2003, four important targets were achieved in the Tyres Sector, described as follows:

- in March, the **first motorcycle tyre production plant** was opened in Milan based on the revolutionary MIRS™ (Modular Integrated Robotized System) process, which is the result of Pirelli advanced research. Built with a total investment of more than Euros 10 million, the MIRS™ Motorcycle tyres plant today also operates in the German factory at Breuberg, in the Land of Hesse. At the Breuberg plant, the first MIRS™ Motorcycle tyres system produces 125,000 **Diablo Corsa high-performance radial motorcycle tyres** a year. This is a product with absolutely innovative characteristics in

terms of performance, reliability and structural integrity, being produced by machines with an unprecedented degree of precision;

- at the same time as the MIRS™ Motorcycle tyres plant became operational, in the United States, the **mini MIRS™ factory at Rome (Georgia)** began working at full capacity. The plant specializes in the production of Pirelli Scorpion Zero Asimmetrico and P Zero Nero M+S tyres for the **Sport Utility Vehicles (SUV)** segment and **American sports cars**;
- also in the SUV segment, Pirelli launched its new line of **Scorpion STR** tyres on the international markets. This is an all-purpose product for the new generation of all-terrain four-wheel drive vehicles. Vehicles adopting the new Scorpion STR as original equipment include the Ford line of F250/F350 pick-ups and the SUV Ford Excursion;
- in addition, the first three months of 2003 saw the strengthening of **Original Equipment** operations, involving both European and American car manufacturers. Some of the most recent products to receive homologation include the Ferrari Challenge Stradale with the high-performance **P Zero Corsa** radials, the Porsche Cayenne and the VW Touareg with the Scorpion A/T and **Scorpion Zero**, the Volvo XC90 with the Scorpion STR, the new Audi A3 with the **P7**, the Jaguar X350 and Lamborghini Gallardo with the P Zero Rosso, while, across the ocean, the **Pirelli P6 Four Seasons** has been adopted as original equipment for the top models of Mercury, Lincoln and Ford.

PROFORMA DATA

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

Proforma consolidated financial data at March 31, 2003 of Pirelli S.p.A. is presented below, assuming the consolidation line-by-line of Olimpia S.p.A. and the use of the equity method to value Olimpia S.p.A.'s investment in Olivetti S.p.A..

Consolidated financial statements at 3/31/2003 Pirelli S.p.A. (1)	Proforma adjustments			Total proforma adjustments	Proforma consolidated financial data at 3/31/2003 Pirelli S.p.A. (2)
<i>(in millions of euros)</i>	Elimination of Olimpia S.p.A. net result attributable to Pirelli S.p.A. (60%)	Olimpia S.p.A. line-by-line consolidation	Consolidation adjustments and valuation of investment in Olivetti S.p.A. using the equity method		
Condensed Statement of Income					
- Net sales	1,449	-	-	-	1,449
- Operating profit	59	-	-	-	59
- Financial income (expenses)/ Valuation adj. to financial assets	(62)	24	(37)	(164)	(177)
- Extraordinary items	8	-	(3)	-	(3)
- Income taxes	(27)	-	-	-	(27)
- Net income (loss)	(22)	24	(40)	(164)	(180)
- Net income (loss) - Pirelli S.p.A.	(21)	24	(24)	(98)	(98)
- Goodwill amortization effect	1	-	-	145	145
- Net income (loss) (excluding goodwill amortization)	(21)	24	(40)	(19)	(35)
- Net income (loss) - Pirelli S.p.A. (excluding goodwill amorti	(20)	24	(24)	(12)	(12)
Reclassified Balance Sheet					
- Fixed assets	6,009	191	8,231	(3,581)	4,841
- Net working capital	924	-	51	-	51
- Total net invested capital	6,933	191	8,282	(3,581)	4,892
- Financed by:					
- Shareholders' equity	4,526	191	4,883	(3,581)	1,493
- of which shareholders' equity - Pirelli S.p.A.	4,347	191	2,930	(3,396)	(275)
- Provisions	761	-	-	-	-
- Net financial (liquidity)/debt position	1,646	-	3,399	-	3,399

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

(2) proforma data (line-by-line consolidation of Olimpia S.p.A. and equity method valuation of Olivetti S.p.A.)

The proforma consolidated financial data has been prepared using the statutory financial statements of Olimpia S.p.A. at March 31, 2003 and the consolidated financial statements of the Olivetti S.p.A. Group at the same date.

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

- in the column “Elimination of Olimpia S.p.A. net result attributable to Pirelli S.p.A. (60%)”: elimination of the statement of income and balance sheet effects of valuing Olimpia S.p.A. with the equity method in the Pirelli S.p.A. consolidated financial statements at March 31, 2003;
- in the column “Olimpia S.p.A. line-by-line consolidation”: inclusion of the assets, liabilities, revenues and costs resulting from the financial statements for the year ended March 31, 2003 of Olimpia S.p.A., attributing the share of net equity and results of operations to the minority interest;
- in the column “Consolidation adjustments and valuation of investment in Olivetti S.p.A. using the equity method”: inclusion of the effect of accounting for Olivetti S.p.A. using the equity method, giving rise to a negative valuation adjustment of Euros 164 million, of which Euros 55 million relate to the amortization of implicit goodwill for three months out of a total twenty-year period, and Euros 109 million to Olimpia S.p.A.’s share of the first-quarter 2003 results of the Olivetti Group.

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

- in the column “Consolidated financial statements at March 31, 2003 Pirelli S.p.A.”, the amount of Euros 1 million refers to the amortization charge for three months on the goodwill booked by Pirelli S.p.A. in respect of Olimpia S.p.A.;
- in the column “Consolidation adjustments and valuation of investment in Olivetti S.p.A. using the equity method”, the amount of Euros 145 million includes Euros 55 million for the goodwill booked by Olimpia S.p.A. in respect of Olivetti S.p.A. and Euros 90 million for the goodwill booked by Olivetti S.p.A. in respect of Telecom Italia S.p.A..

A comparison of shareholders' equity and net debt between the consolidated financial statements of Pirelli S.p.A. and the proforma consolidated financial data of Pirelli S.p.A. at March 31, 2003 and December 31, 2002 is presented below, assuming:

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

<i>(in millions of euros)</i>	Shareholders' equity		Net debt		Net debt/Shareholders' equity		Shareholders' equity Pirelli S.p.A.	
	3/31/2003	12/31/2002	3/31/2003	12/31/2002	3/31/2003	12/31/2002	3/31/2003	12/31/2002
Pirelli S.p.A. Group: consolidated financial statements	4,526	4,576	1,646	1,469	0.36	0.32	4,347	4,394
Pirelli S.p.A. Group: proforma consolidated data with Olimpia S.p.A. consolidated line-by-line and Olivetti S.p.A. valued using the equity method	6,019	6,071	5,045	5,145	0.84	0.85	4,072	4,111
Pirelli S.p.A. Group: proforma consolidated data with Olimpia S.p.A. and Olivetti Group consolidated line-by-line	23,600	23,378	36,936	38,544	1.57	1.65	4,072	4,111

The Board of Directors

Milan, May 5, 2003

**QUARTERLY DATA
AND
COMMENTS**

QUARTERLY DATA

	(in millions of euros)		
Statement of Income	1st Quarter 2003	1st Quarter 2002	2002
. Net sales	1,449	1,688	6,311
. Other revenues	80	17	88
. Value of production	1,529	1,705	6,399
. Cost of sales	(1,072)	(1,200)	(4,567)
. Labor costs	(316)	(368)	(1,352)
. Amortization and depreciation	(82)	(95)	(363)
. Operating profit	59	42	117
. Financial income (expenses)	(62)	(62)	(403)
. Income before extraordinary items and income taxes	(3)	(20)	(286)
. Extraordinary items	8	0	(262)
. Income (loss) before taxes	5	(20)	(548)
. Income taxes	(27)	(19)	(62)
. Net loss	(22)	(39)	(610)

	(in millions of euros)	
Balance Sheet	3/31/2003	12/31/2002
. Fixed assets	6,009	6,114
. Net working capital	924	768
. Net invested capital	6,933	6,882
. Shareholders' equity	4,526	4,576
. Provisions	761	837
. Net financial (liquidity)/debt position	1,646	1,469
. Financed	6,933	6,882
. Memorandum accounts	4,432	4,474

(in millions of euros)

Net financial position	3/31/2003	12/31/2002
. Short-term financial payables	926	592
. Accrued and prepaid interest expenses	58	50
. Cash and banks	(405)	(329)
. Other securities	(209)	(190)
. Short-term financial receivables	(55)	(27)
. Accrued and deferred interest income	(18)	(22)
Net short-term debt	297	74
. Medium/long-term financial payables	1,433	1,466
. Medium/long-term financial receivables	(83)	(70)
. Other securities	(2)	(1)
Net medium/long-term debt	1,349	1,395
Net financial debt position	1,646	1,469

COMMENTS ON QUARTERLY DATA

Form and content

The accounting policies, valuation criteria and principles of consolidation used in preparing the quarterly data at March 31, 2003 are the same as those adopted for the financial statements at December 31, 2002 and disclosed in the previous annual report.

Economic review

Net sales

Net sales for the first quarter of 2003 amount to Euros 1,449 million compared to Euros 1,688 million for the first quarter of 2002.

The decrease of 14.2 percent in net sales compared to the corresponding period of 2002 can be analyzed as follows:

• Currency exchange effect	-	8.6%
• Volumes	-	4.1%
• Prices/Metals	-	1.6%
• Prices/Mix	+	0.1%
	-	<u>14.2%</u>

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

Sector	1st Quarter	1st Quarter	Geographical area	1st Quarter	1st Quarter
	2003	2002		2003	2002
Energy Cables and Systems Sector	43%	46%	Italy	20.0%	19.0%
			Other European countries	42.7%	42.0%
Telecommunications Cables and Svstems Sectc	6%	9%	North America	10.6%	12.0%
			Central and South America	12.8%	13.0%
Tyres Sector	51%	45%	Australia, Africa and Asia	13.9%	14.0%

Labor costs

Labor costs for the first three months of 2003 amount to Euros 316 million and represent 21.8 percent of sales, unchanged compared to the corresponding period of the prior year.

Amortization and depreciation

Amortization and depreciation for the first quarter of 2003 total Euros 82 million, of which Euros 11 million refer to the amortization of intangible assets and Euros 71 million to the depreciation of property, plant and equipment; the total shows a reduction compared to the same period of the prior year.

Operating profit

Operating profit is Euros 59 million (4.1 percent of net sales), an increase compared to the same period of 2002.

Such change in operating profit is principally due to:

	<u>in millions of euros</u>	
• Currency exchange effect	-	12
• Prices (excluding metals)/mix	+	13
• Volumes	-	5
• Per unit production costs	-	44
• Net efficiencies	+	57
• Depreciation	+	6
• Other	+	2
	+	<u>17</u>

Net loss

The result for the first quarter ending March 31, 2003 is a net loss of Euros 22 million compared to a net loss of Euros 39 million for the first quarter of 2002. The change reflects the improvement in the operating profit and the lower impact of valuing the investment in Olimpia S.p.A. using the equity method.

Net financial position

The net debt position at March 31, 2003 is Euros 1,646 million compared to Euros 1,469 million at December 31, 2002 and Euros 1,406 million at March 31, 2002. The change from December 31, 2002 is mainly due to seasonal factors, which caused an increase in working capital, and disbursements relating to the reorganization programs.