



Quarterly Report
Third quarter 2002

PIRELLI Società per azioni

Registered office in Milan, Viale Sarca 222

Share Capital - Euros 1,043,604,420.04 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

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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 – 3rd Quarter 2002

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MANAGEMENT'S REPORT

PERFORMANCE OF THE GROUP

The unprecedented crisis that has for over a year impacted the market for telecommunications infrastructures continues to sharply influence the performance of the companies in the sector throughout the principal developed world markets. This has resulted in a contraction of world demand of over 70 percent in terms of value. In addition, in the last few months, international economic development suddenly cooled, impacting the energy sector, which has suffered as a result of the non-resumption of capital spending.

Both phenomena have frustrated Group management's extraordinary and timely action aimed at countering the falling markets through improved efficiency. This far-reaching action - which in only nine months has produced savings of Euros 137 million - has proved to be insufficient.

Against this backdrop, the Group has recorded revenues of Euros 4,810 million for the nine months to September 30, 2002 (down 11 percent from the same period last year, net of exchange effects). In terms of gross operating profit, the Tyres Sector posted an improvement (from Euros 277 million to Euros 284 million), the Energy Cables and Systems Sector held its ground despite lower capital spending (from Euros 110 million to Euros 109 million) and the Telecommunications Cables and Systems Sector reported a fall due to continuing deterioration of the market and the anticipated end of the supply agreement with Cisco Systems (for a total of Euros 207 million). Gross operating profit for the first nine months of 2002 was Euros 368 million against Euros 569 million in the corresponding period of 2001.

Operating profit was Euros 95 million (Euros 290 million for the nine months ended September 30, 2001), the reduction being entirely due to the Telecommunications

Cables and Systems Sector and the anticipated end of the supply agreement with Cisco Systems.

Group management has therefore decided to accelerate and step up the measures currently under way to raise efficiency in order to be in the best possible position to take advantage of any signs of a market upturn.

Furthermore, new measures will be carried out to rationalize the Energy Cables and Systems Sector, aimed at increasing efficiency, and to take more incisive action in restructuring the Telecommunications Cables and Systems Sector. Across the board initiatives in the various businesses in the different countries will mean the closing of six production units and a reduction of about 2,400 employees in the workforce, some 200 of whom will come from Italy.

These measures will have an impact of Euros 260 million in the 2002 financial year. Financial pay-back is expected in 12 months, economic pay-back in 18 months.

In particular, the new measures, which will capitalize on synergies among sectors in various countries and on the acceleration of research and innovation programs, call for:

Energy Cables and Systems Sector

- redirection of volumes towards low cost production facilities and greater specialization in factories, with the closing of three units;
- focus on higher added value sectors.

Telecommunications Cables and Systems Sector

- re-sizing of production capacity to reflect the new market conditions, with the closing of three plants;
- the acceleration of time to market for new generation opto-electronic components from Pirelli Labs.

The Group management and staff headcount fell by about 900 at the end of September 2002 compared to the end of 2001. The new efficiency measures will entail a loss of approximately a further 900 jobs, representing in total a 16 percent reduction compared to the end of 2001, or a reduction of 32 percent for management and 15 percent for staff.

The new efficiency measures will also affect the industrial headcount of the Energy and Telecommunications Cables and Systems Sectors: in addition to the reduction in the workforce of 1,000 employees by the end of September 2002 since year-end 2001, there will be further reduction of 1,500, representing a total of about 9 percent.

As already noted, the market for telecom infrastructures is undergoing an unprecedented crisis, while the energy sector is itself being assailed by the deterioration of the macroeconomic scenario.

The Tyres Sector, albeit also operating in a negative economic context, has continued to record growth that in itself has not been sufficient to compensate for the performance of the other sectors.

Notwithstanding the above, in the third quarter, the Pirelli S.p.A. Group showed decisively higher free cash flows (from Euros 59 million at the end of June 2002 to Euros 168 million at September 30, 2002), increased efficiency and a slightly improved financial position compared to June 30, 2002.

During the first nine months of 2002, in particular:

- net sales of the Group totaled Euros 4,810 million, with a reduction of 11.1 percent compared to the corresponding period of the prior year, net of exchange effects (-4.4 percent); net sales in the third quarter of 2002 amounted to Euros 1,458 million compared to Euros 1,749 million in the third quarter of 2001;

- operating profit was Euros 95 million (2 percent of net sales) compared to Euros 290 million for the nine months ended September 30, 2001 (5.1 percent of net sales); operating profit in the third quarter of 2002 was Euros 2 million compared to Euros 47 million in the same period of 2001. The change during the first nine months was entirely due to the lower contribution made by the Telecommunications Cables and Systems Sector (equal to about Euros 150 million) and the end of the supply agreement with Cisco Systems (Euros 59 million). Specifically:
 - a) gross efficiencies achieved as a result of the previously mentioned actions currently under way had a positive effect of Euros 137 million;
 - b) effects of commercial variances record a fall of Euros 208 million (on which the Telecommunications Cables and Systems Sector alone had a negative impact of Euros 269 million);
 - c) the unit cost of production factors, lower volumes, the exchange effect and other changes produced a negative impact of about Euros 65 million;
 - d) the end of the supply contract with Cisco Systems led to lower revenues of some Euros 59 million;

- the net result, excluding Olimpia S.p.A., was a loss of Euros 325 million (compared to a net income of Euros 215 million for the first nine months of 2001). The loss was impacted by restructuring costs, extraordinary items and nonrecurring financial expenses of Euros 274 million. Including the share of the losses of Olimpia S.p.A., the loss for the nine months to September 30, 2002 was Euros 407 million. This result could benefit in the last quarter from Olivetti dividends booked by Olimpia S.p.A..

The parent company, Pirelli S.p.A.

The net income of the parent company, Pirelli S.p.A., for the nine months ended September 30, 2002 amounted to Euros 230 million, mainly as a result of dividends paid by the subsidiary Optical Technologies The Netherlands B.V., compared to Euros 492 million for the nine months ended September 30, 2001.

THE GROUP

The consolidated figures for the third quarter and the nine months ended September, 2002 can be summarized as follows:

	(in millions of euros)					
	3rd quarter 2002	3rd quarter 2001	9 months to 9/30/2002 (excluding Olimpia)	9 months to 9/30/2002	9 months to 9/30/2001	Year 2001
. Net sales	1,458	1,749	4,810	4,810	5,695	7,509
. Gross operating profit	90	137	368	368	569	666
% of net sales	6.2%	7.8%	7.7%	7.7%	10.0%	8.9%
. Operating profit	2	47	95	95	290	295
% of net sales	0.1%	2.7%	2.0%	2.0%	5.1%	3.9%
. Financial income (expenses)	(39)	(21)	(121) (:)	(121) (:)	12	(22)
. Share of earnings (losses) of equity investments	(46)	(15)	(18)	(100)	(15)	(33)
. Extraordinary items	(262)	24	(238)	(238)	76	(16)
. Income taxes	(10)	(20)	(43)	(43)	(148)	(138)
. Net income (loss)	(355)	15	(325)	(407)	215	86
% of net sales	n.s.	0.9%	n.s.	n.s.	3.8%	1.1%
. Net income (loss) attributable to Pirelli S.p.A.				(408)	211	82
. Earnings per share (in euros)				(0.20)	0.11	0.04
. Shareholders' equity				4,800	5,739	5,660
. Shareholders' equity attributable to Pirelli S.p.A.				4,613	5,555	5,462
. Equity per share (in euros)				2.30	2.77	2.72
. Net financial (liquidity)/debt position	(24) *	2,283 *		1,594	58	1,089
. R&D expenditures	60 *	59 *		175	168	237
. Employees (at period-end)	(811) *	(907) *		37,232	39,767	39,127
. Factories (number)	(1) *	0 *		80	86	84

* the figures indicated refer to the change from the end of the previous quarter

(:) includes adjustments to securities for Euro 18 million

Net sales

Net sales for the nine months ended September 30, 2002 amount to Euros 4,810 million and decreased by 15.5 percent compared to the corresponding period of the prior year. The main changes are in the volumes (-9.1 percent), in prices/mix (-2.0 percent) and in the currency exchange effect (-4.4 percent).

Net sales for the third quarter of 2002 total Euros 1,458 million compared to Euros 1,749 million for the third quarter of 2001.

Gross operating profit

Gross operating profit for the first nine months of 2002 (Euros 368 million) is equal to 7.7 percent of net sales, compared to 10 percent in the first nine months of 2001.

In 2001, the figure included Euros 59 million from the supply contract with Cisco Systems.

The gross operating profit in third quarter of 2002 is Euros 90 million compared to Euros 137 million in the same period of 2001.

Operating profit

Operating profit for the first nine months to September 30, 2002 is Euros 95 million and is equal to 2 percent of net sales compared to Euros 290 million in the same period of the 2001 (5.1 percent of net sales).

The change is primarily due to the lower contribution made by the Telecommunications Cables and Systems Sector (equal to Euros 150 million) in addition to the previously-mentioned end of the supply contract with Cisco Systems (Euros 59 million).

Details of the change are due to:

	<u>in millions of euros</u>	
• Currency exchange	-	26
• Prices (excluding metals)/mix	-	51
• Volumes	-	157
• Net efficiencies	+	112
• Materials	+	14
• Per unit labor costs	-	27
• Supply agreement with Cisco Systems	-	59
• Other	-	1
	-	<u>195</u>

Net efficiencies led to a gross reduction in overheads and process costs of Euros 137 million (including Euros 94 million of labor costs) which were countered by the negative effects on costs caused by volume reductions equal to Euros 25 million.

The operating profit for the third quarter of 2002 is Euros 2 million compared to Euros 47 million in the same period of 2001.

Financial income (expenses)

Financial income (expenses) shows an expense balance of Euros 121 million compared to an income balance of Euros 12 million in the corresponding period of the prior year. The balance includes Euros 18 million for the adjustment of securities in portfolio to market value and the remaining Euros 103 million refer to net financial expenses connected with net debt.

Share of earnings (losses) of equity investments

The share of the earnings (losses) of equity investments of Euros 100 million refers to the share of the result of Olimpia S.p.A., valued by the equity method (Euros 82 million), and the writedown of the investment in F.C. Internazionale Milano S.p.A. (Euros 18 million).

Extraordinary items

Extraordinary items for the nine months to September 30, 2002 present a net expense balance of Euros 238 million. The balance includes mainly restructuring costs connected with the new rationalization measures directed to the Energy and Telecommunications Cables and Systems Sectors (Euros 260 million) and the gains realized by Pirelli S.p.A. (Euros 17 million) under the comprehensive process for the reallocation of real estate. Mention should be made of the sale of the representative

offices in Rome and the historical building of Bicocca degli Arcimboldi to Pirelli & C. A.p.A..

In the same period of the period of the prior year, extraordinary items included the pre-tax gain on the sale of Pirelli S.p.A. treasury shares on the open market (Euros 30 million) and Euros 36 million paid by Cisco Systems as part of the sale of the Terrestrial Optical Systems business in 2000.

Net income (loss)

The net result for the nine months to September 30, 2002 is a loss of Euros 407 million (after income tax expenses of Euros 43 million) compared to a net income of Euros 215 million for the first nine months of 2001 (after income tax expenses of Euros 148 million).

Excluding the share of the net loss of Olimpia, the net loss for the first nine months of 2002 is Euros 325 million.

Shareholders' equity

The consolidated shareholders' equity went from Euros 5,660 million at December 31, 2001 to Euros 4,800 million at September 30, 2002.

This reduction can be summarized as follows:

	(in millions of euros)
. Translation adjustments	(296)
. Net loss for the period	(407)
. Dividends to third parties paid by:	
- Pirelli S.p.A.	(148)
- Other Group companies	(1) (149)
. Directors' remuneration	(13)
. Other changes	5
	(860)

Shareholders' equity attributable to Pirelli S.p.A. at September 30, 2002 is Euros 4,613 million, compared to Euros 5,462 million at December 31, 2001.

Net financial position

The net financial position shows a debt position of Euros 1,594 million compared to Euros 1,089 million at December 31, 2001, with an improvement over June 30, 2002 (Euros 1,618 million). The change from December 31, 2001 can principally be ascribed to the payments for the reorganization programs accrued in the previous years, the payment of the final taxes due on the sale of Optical Technologies to Corning and the payment of dividends, countered partly by the sale of tax receivables to Unicredit Factoring S.p.A. and Mediofactoring S.p.A..

R&D expenditures

Notwithstanding the adverse economic scenario, the priority commitment to research and technological innovation is again confirmed with an increase in R&D expenditures by the Group which rose from Euros 168 million for the nine months to September 30, 2001 (2.9 percent of net sales) to Euros 175 million (3.6 percent of net sales) for the nine months to September 30, 2002.

Employees

Employees number 37,232 at September 30, 2002, compared to 39,127 at December 31, 2001. There was a reduction of 1,895 from the end of the prior year.

Factories

At September 30, 2002, the number of factories had fallen from 84 at December 31, 2001 to 80. The decrease refers to the following: three plant facilities in the Energy Cables and Systems Sector and two in the Telecom Cables and Systems Sector were closed while, in the Tyres Sector, a new factory was opened in the United States.

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 September 30, 2002 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 September 30, 2002 that the 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	0.5	1.0	1.5
TRADE PAYABLES AND OTHER	(1.5)	(2.5)	(4.0)
FINANCIAL RECEIVABLES	0.1	36.5	36.6
FINANCIAL PAYABLES	(155.2)	(8.0)	(163.2)
REVENUES FOR GOODS AND SERVICES	0.9	2.9	3.8
COSTS FOR GOODS AND SERVICES	(3.5)	(6.8)	(10.3)
FINANCIAL INCOME	1.4	7.6	9.0
FINANCIAL EXPENSES	(17.2)	(0.6)	(17.8)
EXTRAORDINARY INCOME	16.5	0.0	16.5
EXTRAORDINARY EXPENSES	0.0	(1.1)	(1.1)

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

- **financial payables**, relating to payables from transactions on the current account by Pirelli Servizi Finanziari S.p.A. with 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.;
- **extraordinary income** relating to the gain realized by Pirelli S.p.A. on the sale of the representative offices in Rome and Bicocca degli Arcimboldi to Pirelli & C. A.p.A.. Such sale originated from the possibility of allocating the assets to the parent company Pirelli & C. A.p.A. since these properties are used by the entire group.

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

- **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.);
- **financial income and expenses**, relating to interest income and expenses on the aforementioned current account and loan transactions.

Furthermore, in order to provide more complete disclosure, related party transactions at September 30, 2002 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 constituting a potential conflict of interests:

- **revenues for goods and services**, relating mainly to the supply of telecommunications cables (Euros 42 million);
- **costs for goods and services**, relating mainly to telephone services received (Euros 5.7 million);
- **trade receivables**, relating to the supply of the goods and services described above (Euros 26.1 million);
- **trade payables**, relating to the telephone services described above (Euros 1.6 million);
- **other income**, relating to the gain of Euros 6.8 million on the sale of the 25 percent stake held by Pirelli S.p.A. in Epiclink (sales price of Euros 17.7 million) and the gain realized by Pirelli Informatica of Euros 0.8 million on the sale of a business segment to Epiclink (sales price of Euros 3 million).

SIGNIFICANT SUBSEQUENT EVENTS AND THE OUTLOOK FOR THE CURRENT YEAR

October 29, 2002 marked the date of the conclusion of the first stage of the Tiglio project, with the formalization of the deeds for the transfer of the assets and the real estate designated for the initiative. For the Pirelli S.p.A. Group, the assets transferred to Tiglio I totaled a sum of about Euros 15 million (of which about Euros 10 million were relative to Pirelli S.p.A. and Euros 5 million to Pirelli Cavi e Sistemi Energia Italia S.p.A.). The transaction led to a gross gain, on consolidation, of about Euros 8 million.

The fourth quarter of 2002 is expected to record an improvement compared to the previous quarter and the corresponding quarter of the prior year.

Expectations are for a further growth in the result of the Tyres Sector and a marked improvement in the Energy Cables and Systems Sector, whereas the Telecommunication Cables and Systems Sector is expected to confirm the present negative trend.

Bearing in mind the above, the operating profit for 2002 is expected to react favorably to the improvement anticipated in the fourth quarter, but will be lower than forecast owing to the serious deterioration in the market for telecommunications infrastructures and the delay in the resumption of capital spending by the energy sector.

CABLES AND SYSTEMS SECTOR

For a comparison with the prior year, the combined highlights of the Cables and Systems Sector for the nine months ended September 30, 2002 are presented in the following table:

	(in millions of euros)				
	Combined 3rd quarter 2002	Total 3rd quarter 2001	Combined 9 months to 9/30/2002	Total 9 months to 9/30/2001	Total Year 2001
. Net sales	788	1,093	2,686	3,571	4,688
. Gross operating profit	11	68	99	319	357
% of net sales	1.4%	6.2%	3.7%	8.9%	7.6%
. Operating profit (loss)	(29)	26	(23)	187	179
% of net sales	(3.7%)	2.4%	(0.9%)	5.2%	3.8%
. Financial income (expenses)	(12)	(23)	(49)	(14)	(33)
. Extraordinary items	(241)	28	(232)	50	11
. Income taxes	6	(6)	(6)	(81)	(81)
. Net income (loss)	(276)	25	(310)	142	76
% of net sales	n.s.	2.3%	n.s.	4.0%	1.6%
. Net financial (liquidity)/debt position	(3) *	160 *	927	889	890
. R&D expenditures	21 *	30 *	70	78	112
. Employees (at period-end)	(687) *	(521) *	15,954	18,871	18,314
. Factories (number)	(1) *	0 *	58	65	63

* the figures indicated refer to the change from the end of the previous quarter

ENERGY CABLES AND SYSTEMS SECTOR

The consolidated figures for the Energy Cables and Systems Sector for the third quarter and the nine months to September 30, 2002 can be summarized as follows:

	(in millions of euros)				
	3rd quarter 2002	3rd quarter 2001	9 months to 9/30/2002	9 months to 9/30/2001	Year 2001
. Net sales	692	796	2,306	2,487	3,532
. Gross operating profit	32	41	109	110	149
% of net sales	4.6%	5.2%	4.7%	4.4%	4.2%
. Operating profit	7	17	33	37	52
% of net sales	1.0%	2.1%	1.4%	1.5%	1.5%
. Financial income (expenses)	(8)	n.d	(35)	n.d	n.d
. Extraordinary items	(126)	n.d	(116)	n.d	n.d
. Income taxes	(3)	n.d	(13)	n.d	n.d
. Net loss	(130)	n.d	(131)	n.d	n.d
% of net sales	n.s.	n.d	n.s.	n.d	n.d
. Net financial (liquidity)/debt position	(19) *	n.d	502	n.d	526
. R&D expenditures	10 *	n.d	33	n.d	n.d
. Employees (at period-end)	(532) *	n.d	12,889	n.d	14,135
. Factories (number)	0 *	n.d	47	n.d	50

* the figures indicated refer to the change from the end of the previous quarter

Net sales for the nine months ended September 30, 2002 amount to Euros 2,306 million, with a reduction of 7.3 percent from the same period of the prior year, of which 2.3 percent can be attributed to the price of metals. Net sales were affected by the economic slowdown which caused business activities and capital spending to decline, especially in the developed world.

With regard to the various geographic areas: Europe reported a contraction on account of the marked fall in the number of orders in the general market (especially France, Italy and Germany). North America reported a deterioration, due principally to lower volumes and exchange effects (a stronger euro). South America reported lower sales on account of the sharp devaluation of local currencies, but also because of lower volumes which were only partly compensated by improved prices and mix. The Asia Pacific region registered improvements.

The change is due to:

• Currency exchange	-	3.4%
• Volumes	-	2.0%
• Prices-metals	-	2.3%
• Prices/mix	+	0.4%
	-	<u>7.3%</u>

Net sales for the third quarter of 2002 come to Euros 692 million compared to Euros 796 million for the same quarter of 2001.

Operating profit for the nine months ended September 30, 2002 is Euros 33 million, compared to Euros 37 million for the first nine months of the prior year; the operating profit is equal to 1.4 percent of net sales against 1.5 percent in the prior year.

Details of the change are provided as follows:

	<u>in millions of euros</u>	
• Currency exchange	-	6
• Prices (excluding metals)/mix	-	15
• Volumes	-	25
• Net efficiencies	+	41
• Materials	+	5
• Per unit labor costs	-	9
• Other	+	5
	-	<u>4</u>

Operating profit for the third quarter of 2002 is Euros 7 million, compared to Euros 17 million for the same period of 2001.

The **net loss for the first nine months of 2002** is Euros 131 million after financial expenses of Euros 35 million, extraordinary expenses of Euros 116 million (of which Euros 125 million are for restructuring) and income tax expenses of Euros 13 million.

The **net financial position** is a debt position of Euros 502 million. This is an improvement over Euros 526 million at December 31, 2001 and Euros 521 million at June 30, 2002.

At September 30, 2002, **employees** number 12,889, with a reduction of 1,246 compared to 14,135 at December 31, 2001.

TELECOMMUNICATIONS CABLES AND SYSTEMS SECTOR

The consolidated figures for the Telecommunications Cables and Systems Sector for the third quarter and the nine months to September 30, 2002 can be summarized as follows:

	(in millions of euros)				
	3rd quarter 2002	3rd quarter 2001	9 months to 9/30/2002	9 months to 9/30/2001	Year 2001
. Net sales	96	312	380	1,124	1,230
. Gross operating profit (loss)	(21)	26	(10)	138	134
% of net sales	(21.9%)	8.3%	(2.6%)	12.3%	10.9%
. Operating profit	(36)	12	(56)	94	76
% of net sales	(37.5%)	3.8%	(14.7%)	8.4%	6.2%
. Financial income (expenses)	(4)	n.d	(14)	n.d	n.d
. Extraordinary items	(115)	n.d	(116)	n.d	n.d
. Income taxes	9	n.d	7	n.d	n.d
. Net loss	(146)	n.d	(179)	n.d	n.d
% of net sales	n.s.	n.d	n.s.	n.d	n.d
. Net financial (liquidity)/debt position	16 *	n.d	425	n.d	367
. R&D expenditures	11 *	n.d	37	n.d	n.d
. Employees (at period-end)	(155) *	n.d	3,065	n.d	4,077
. Factories (number)	(1) *	n.d	11	n.d	13

* the figures indicated refer to the change from the end of the previous quarter

Net sales for the nine months to September 30, 2002 amount to Euros 380 million with a contraction of 66.2 percent compared to the same period of the prior year.

The Sector continues to be negatively affected by market conditions, which have been gradually deteriorating since the third quarter of 2001. The year 2002 has been characterized by a continuous fall in volumes, accompanied by an even more marked downturn in prices and a deterioration of the mix.

The change is due to:

• Currency exchange	-	2.7%
• Volumes	-	47.8%
• Prices/mix	-	15.7%
	-	<hr/> 66.2% <hr/>

Net sales for the third quarter of 2002 stand at Euros 96 million compared to Euros 312 million for the same quarter of 2001.

The **operating loss for the nine months ended September 30, 2002** is Euros 56 million, compared to an operating profit of Euros 94 million for the corresponding period of the prior year.

The improvements in efficiency achieved with regard to structures and processes (numbers of employees are down 30 percent compared to the end of September 2001) were not able to offset the negative impact caused by the market trend, for which no significant improvement is expected in the short term. The result includes insurance compensation for damages of Euros 6 million (already included since the first quarter of 2002) from an insurance claim for the fire that broke out in 2001 at the Fibre Ottiche Sud factory in Battipaglia.

The change can be summarized as follows:

	<u>in millions of euros</u>	
• Currency exchange	-	6
• Prices (excluding metals)/mix	-	99
• Volumes	-	170
• Net efficiencies	+	37
• Materials	+	38
• Per unit labor costs	-	4
• Other (*)	+	54
		<hr/>
	-	<u>150</u>

(*) of which Euros 24 million for lower accruals, Euros 6 million for insurance compensation relating to Fibre Ottiche Sud, Euros 10 million for fixed overheads charged to/from stock and effect of hyperinflation and Euros 14 million for adjustments to provisions and other.

The **operating loss for the third quarter of 2002** is Euros 36 million, compared to an operating profit of Euros 12 million for the same period of 2001.

The **net loss for the first nine months of 2002** is Euros 179 million after financial expenses of Euros 14 million and extraordinary expenses of Euros 116 million (of which Euros 114 million are for restructuring).

The **net financial position** is a debt position of Euros 425 million compared to Euros 367 million at December 31, 2001 and Euros 409 million at June 30, 2002. The change from December 31, 2001 can principally be ascribed to operating requirements to fund operations during the period, as well the continuing decline in results that were partly compensated by measures taken to reduce working capital.

At September 30, 2002, **employees** number 3,065, a reduction of 1,012 from 4,077 at December 31, 2001.

TYRES SECTOR

The consolidated figures of the Tyres Sector for the third quarter and the nine months to September 30, 2002 can be summarized as follows:

	(in millions of euros)				
	3rd quarter 2002	3rd quarter 2001	9 months to 9/30/2002	9 months to 9/30/2001	Year 2001
. Net sales	667	656	2,155	2,133	2,831
. Gross operating profit	82	76	284	277	347
% of net sales	12.3%	11.6%	13.2%	13.0%	12.3%
. Operating profit	39	33	150	144	172
% of net sales	5.8%	5.0%	7.0%	6.8%	6.1%
. Financial income (expenses)	(10)	(19)	(42)	(52)	(75)
. Extraordinary items	(8)	0	(9)	0	(27)
. Income taxes	(14)	(11)	(37)	(38)	(36)
. Net income	7	3	62	54	34
% of net sales	1.0%	0.5%	2.9%	2.6%	1.2%
. Net financial (liquidity)/debt position	(45) *	10 *	562	719	684
. R&D expenditures	38 *	29 *	99	90	125
. Employees (at period-end)	(130) *	(403) *	20,403	20,072	19,994
. Factories (number)	0 *	0 *	22	21	21

* the figures indicated refer to the change from the end of the previous quarter

Net sales for the nine months ended September 30, 2002 total Euros 2,155 million, with an increase of 1 percent compared to the corresponding period of the prior year.

The change can be summarized as follows:

• Currency exchange	-	6.6%
• Volumes	+	4.4%
• Prices/mix	+	3.2%
	+	<u>1.0%</u>

Car/Light Truck volumes for the nine months to September 30, 2002 were 2 percent higher than the same period of the prior year, thanks to a generalized improvement in market share in all the main Replacement and Original Equipment markets. The contribution of Performance products was particularly positive.

Truck volumes rose by 6 percent compared to 2001, contrary to the market trend. The good performance in South America and in other extra-European markets more than compensated for the downturn connected with the negative trend of the European market.

The **Motorcycle** market was positive, with total volumes showing an increase of 9 percent, and growth above the average of Replacements in Europe and North America.

Net sales for the third quarter of 2002 come to Euros 667 million, with an increase of 1.7 percent compared to the third quarter of the prior year (Euros 656 million).

Operating profit for the nine months ending September 30, 2002 is equal to Euros 150 million compared to Euros 144 million for the corresponding period of the prior year.

Operating profit, as a percentage net sales, is 7 percent, compared to 6.8 percent for the first nine months of 2001.

The change can be summarized as follows:

	<u>in millions of euros</u>	
• Currency exchange	-	14
• Volumes	+	38
• Prices/mix	+	63
• Net efficiencies	+	14
• Materials	-	28
• Per unit labor costs	-	14
• Other (*)	-	53
	+	<u>6</u>

(*) of which Euros 6 million for amortization and depreciation, Euros 9 million for the start-up of Mirs/CCM, Euros 9 million for fixed overheads charged to/from stock and effect of hyperinflation and Euros 29 million for brand support, South America inflation and other.

Operating profit for the third quarter of 2002 is Euros 39 million, with an increase over Euros 33 million reported for the same period of 2001.

Net income for the nine months ended September 30, 2002 is Euros 62 million (after financial expenses of Euros 42 million, extraordinary expenses of Euros 9 million and income tax expenses of Euros 37 million) compared to Euros 54 million in the first nine months of 2001 (after financial expenses of Euros 52 million and income tax expenses of Euros 38 million).

The **net financial position** shows a debt position of Euros 562 million compared to Euros 684 million at December 31, 2001 and Euros 607 million at June 30, 2002. The reduction in the debt position from December 31, 2001 is due to the share capital increase (with payment of a share premium effected by the parent company Pirelli

S.p.A.) equal to Euros 80 million, countered by the payment of dividends to the same parent company of Euros 30 million. The rest of the decrease is due to measures taken to improve working capital.

At September 30, 2002, **employees** number 20,403, an increase of 409 compared to December 31, 2001 due entirely to temp work.

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 September 30, 2002 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 investment in Olivetti S.p.A..

	Consolidated financial statements at 9/30/2002 Pirelli S.p.A. (1)	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	Total proforma adjustments	Proforma consolidated financial data at 9/30/2002 Pirelli S.p.A. (2)
<i>(in millions of euros)</i>						
Condensed statement of income						
- Net sales	4,810	-	-	-	-	4,810
- Operating profit	95	-	(1)	-	(1)	94
- Financial income (expenses)/ Valuation adj. to financial assets	(221)	80	(131)	(412)	(463)	(684)
- Extraordinary items	(238)	-	(1)	-	(1)	(239)
- Income taxes	(43)	-	-	-	-	(43)
- Net income (loss)	(407)	80	(133)	(412)	(465)	(872)
- Net income (loss) - Pirelli S.p.A.	(408)	80	(80)	(247)	(247)	(655)
- Goodwill amortization effect	2	-	-	443	443	445
- Net income (loss) (excluding goodwill amortization)	(405)	80	(133)	31	(22)	(427)
- Net income (loss) - Pirelli S.p.A. (excluding goodwill amortization)	(406)	80	(80)	19	19	(387)
Reclassified balance sheet						
- Fixed assets	6,358	99	8,610	(3,618)	5,091	11,449
- Net working capital	1,085	-	63	-	63	1,148
- Total net invested capital	7,443	99	8,673	(3,618)	5,154	12,597
- Financed by:						
- Shareholders' equity	4,800	99	5,036	(3,618)	1,517	6,317
- of which shareholders' equity - Pirelli S.p.A.	4,613	99	3,022	(3,419)	(298)	4,315
- Provisions	1,049	-	-	-	-	1,049
- Net financial (liquidity)/debt position	1,594	-	3,637	-	3,637	5,231

(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 financial statements of Olimpia S.p.A. for the nine months ended September 30, 2002 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 percent)”: elimination of the statement of income and balance sheet effects of valuing Olimpia S.p.A. by the equity method in the Pirelli S.p.A. consolidated financial statements for the nine months ended September 30, 2002;
- in the column “Olimpia S.p.A. line-by-line consolidation”: inclusion of the assets, liabilities, revenues and costs resulting from the financial statements for the nine months ended September 30, 2002 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 412 million, of which Euros 165 million relate to the amortization of implicit goodwill for nine months out of a total twenty-year period, and Euros 247 million to Olimpia S.p.A.’s share of the first nine months 2002 earnings of the Olivetti Group.

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

- in the column “Consolidated financial statements at September 30, 2002 Pirelli S.p.A.”, the amount of Euros 2 million refers to the amortization charge for nine 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 443 million includes Euros 165 million for the goodwill booked by Olimpia S.p.A. in respect of Olivetti

S.p.A. and Euros 278 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 September 30, 2002 and December 31, 2001 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.	
	9/30/2002	12/31/2001	9/30/2002	12/31/2001	9/30/2002	12/31/2001	9/30/2002	12/31/2001
Pirelli S.p.A. Group: consolidated financial statements	4,800	5,660	1,594	1,089	0.33	0.19	4,613	5,462
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	6,317	7,739	5,231	4,598	0.83	0.59	4,315	5,469
Pirelli S.p.A. Group: proforma consolidated data with Olimpia S.p.A. and Olivetti Group consolidated line-by-line	25,848	30,435	39,190	42,960	1.52	1.41	4,315	5,469

**QUARTERLY DATA
AND
COMMENTS**

QUARTERLY DATA

(in millions of euros)

Statement of income	3rd quarter 2002	3rd quarter 2001	9 months to 9/30/2002	9 months to 9/30/2001	Year 2001
. Sales revenues	1,458	1,749	4,810	5,695	7,509
. Other revenues	15	11	61	151	80
. Value of production	1,473	1,760	4,871	5,846	7,589
. Cost of sales	(1,069)	(1,265)	(3,473)	(4,136)	(5,421)
. Labor costs	(314)	(359)	(1,030)	(1,142)	(1,502)
. Amortization and depreciation	(88)	(90)	(273)	(279)	(371)
. Operating profit	2	47	95	290	295
. Financial income (expenses), net	(85)	(36)	(221)	(3)	(55)
. Income (loss) before extraordinary items and income	(83)	11	(126)	287	240
. Extraordinary items	(262)	24	(238)	76	(16)
. Income (loss) before taxes	(345)	35	(364)	363	224
. Income taxes	(10)	(20)	(43)	(148)	(138)
. Net income (loss)	(355)	15	(407)	215	86

(in millions of euros)

Balance sheet	9/30/2002	6/30/2002	12/31/2001
. Fixed assets	6,358	6,471	6,686
. Net working capital	1,085	1,122	971
. Net invested capital	7,443	7,593	7,657
. Shareholders' equity	4,800	5,207	5,660
. Provisions	1,049	768	908
. Net financial (liquidity)/debt position	1,594	1,618	1,089
. Financed	7,443	7,593	7,657
. Memorandum accounts	5,089	5,095	5,108

(in thousands of euros)

Net financial position	9/30/2002	12/31/2001
. Short-term financial payables	987,686	1,236,708
. Accrued and prepaid interest expenses	72,781	11,702
. Cash and banks	(590,590)	(442,061)
. Other securities	(324,329)	(552,952)
. Short-term financial receivables	(71,152)	(439,864)
. Accrued and deferred interest income	(23,245)	(7,294)
Net short-term liquidity	51,152	(193,761)
. Medium/long-term financial	1,622,792	1,370,701
. Medium/long-term financial	(60,458)	(80,193)
. Other securities	(19,616)	(7,462)
Net medium/long-term debt	1,542,718	1,283,046
Net financial (liquidity)/debt position	1,593,870	1,089,285

COMMENTS ON QUARTERLY DATA

Form and content

The accounting principles, valuation criteria and principles of consolidation used in preparing the quarterly data at September 30, 2002 are the same as those adopted for the financial statements at December 31, 2001 and disclosed in the previous annual report.

Economic review

Net sales

Net sales for the first nine months ended September 30, 2002 amount to Euros 4,810 million compared to Euros 5,695 million for the first nine months of 2001.

The 15.5 percent reduction compared to the corresponding period of 2001 can be analyzed as follows:

• Currency exchange	-	4.4%
• Volumes	-	9.1%
• Prices/mix	-	2.0%
	-	<u>15.5%</u>

A breakdown of net sales by sector and geographical area is presented below:

Sector	9 months to		Geographical area	9 months to	
	9/30/2002	9/30/2001		9/30/2002	9/30/2001
Energy Cables and Systems	48%	43%	Italy	18%	14%
			Other European countries	43%	42%
Telecommunications Cables and Systems	8%	20%	North America	12%	15%
Tyres	44%	37%	Central and South America	13%	16%
			Australia, Africa and Asia	14%	13%

Labor costs

Labor costs for the first nine months ended September 30, 2002 total Euros 1,030 million and represent 21.4 percent of net sales compared to 20 percent in the corresponding period of last year.

Amortization and depreciation

Amortization and depreciation for the nine months to September 30, 2002 total Euros 273 million, of which Euros 38 million refer to the amortization of intangible assets and Euros 235 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 95 million (2 percent of net sales), with a decrease from Euros 290 million in the corresponding period of 2001.

The change in operating profit is due to the following:

	<u>in millions of euros</u>	
• Currency exchange	-	26
• Prices (excluding metals)/mix	-	51
• Volumes	-	157
• Net efficiencies	+	112
• Materials	+	14
• Per unit labor costs	-	27
• Supply agreement with Cisco Systems	-	59
• Other	-	1
	-	<u>195</u>

Net income (loss)

The net loss for the nine months ending September 30, 2002 is Euros 407 million compared to a net income of Euros 215 million for the first nine months of 2001. The net loss mainly reflects the lower contribution made by the operations of the Telecommunications Sector (Euros 150 million), the end of the supply contract with Cisco Systems (Euros 59 million), higher financial expenses due to greater average debt compared to the same period of 2001 (Euros 136 million), the valuation of the investment in Olimpia S.p.A. using the equity method (Euros 82 million) and higher extraordinary expenses (Euros 314 million) connected principally with the new rationalization measures, only partly compensated by lower income taxes (Euros 105 million).

Balance sheet**Shareholders' equity**

Shareholders' equity went from Euros 5,660 million at December 31, 2001 to Euros 4,800 million at September 30, 2002 due to the loss for the period (Euros 407 million), the payment of dividends (Euros 149 million) and negative translation adjustments of Euros 296 million.

Net financial position

The net financial position shows a debt position of Euros 1,594 million compared to Euros 1,089 million at December 31, 2001 and Euros 1,618 million at June 30, 2002. The change from December 31, 2001 can primarily be ascribed to the payment of Euros 103 million for product-optimization programs (accrued in the prior year) and the payment of the final taxes due on the sale of Optical Technologies to Corning,

countered partly by the sale of tax receivables to Unicredit Factoring S.p.A. and Mediofactoring S.p.A..

Memorandum accounts

Memorandum accounts at September 30, 2002 total Euros 5,089 million compared to Euros 5,108 million at December 31, 2001 and Euros 5,095 million at June 30, 2002.

Commitments and contingencies substantially represent the nominal value of the put options given to the shareholder banks of Olimpia S.p.A., IntesaBci S.p.A. (Euro 520,000 thousand) and Unicredito Italiano S.p.A. (Euro 520,000 thousand), (hereinafter “Banks”), and to Edizione Holding S.p.A. (Euro 1,040,000 thousand), under the Olimpia S.p.A. shareholder agreements.

The put options granted to the Banks can be exercised from September 2006 or before that date, in the case of unreconcilable differences among the shareholders (so-called “deadlock”), or the withdrawal of Pirelli S.p.A. from the shareholder agreements, at a price equal to the value of the economic capital of Olimpia S.p.A., plus a premium (the “Price”). This Price shall be determined by the parties and shall not be less than the outlays made by the Banks (Floor) nor higher than an amount that in relation to such outlays, less dividends eventually received, implies an annual IRR, before income taxes, equal to 15 percent (Cap).

The put option granted to Edizione Holding S.p.A. can be exercised in the case of (I) a deadlock among the shareholders, (II) withdrawal by Pirelli S.p.A. from the shareholder agreements and (III) verification of a substantial change in the controlling structure of Pirelli S.p.A. (including, for these purposes, Pirelli & C. Accomandita per Azioni), meaning the exercise by parties other than the present parties of the determining power to appoint the majority of the members of the governing boards, with a consequent potential change in the strategic guidelines.

The exercise price of the put option granted to Edizione Holding S.p.A. is equal to, respectively, (I) the Price, (II) the Price increased by an amount of 50 percent of the Price and (III) the Price increased by an amount equal to 200 percent of the Price. However, in this case, there is no Floor or Cap as envisaged in the above-described agreements with the Banks.

To this end, the six-month report at June 30, 2002 contained certain material errors in the description of what has been explained above with regard to the “put options” granted by Pirelli S.p.A. on Olimpia S.p.A. shares.

In particular:

- reference to the possible withdrawal of Pirelli S.p.A. as a condition for exercising the put option by the Banks was omitted;
- as for the right of Edizione Holding S.p.A. to exercise the put option, the original text was reported, later modified, as disclosed to the market in the prescribed form.

Memorandum accounts also include the nominal value of the option given to Cisco Systems on the Pirelli Submarine Telecom Systems Holding B.V. shares which it holds. This amount is already shown in the financial statements under the minority interest in shareholders' equity.