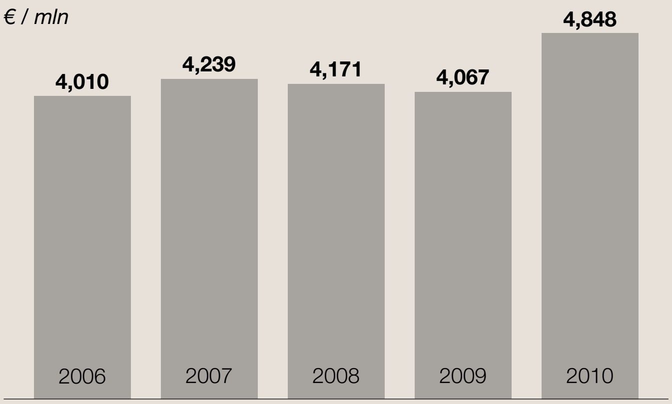
Action,

Pirelli & C. S.p.A. Consolidated Figures

[1] 2006-2009 figures restated excluding Pirelli RE and Pirelli Broadband Solutions (discontinued operations)

SALES[1]

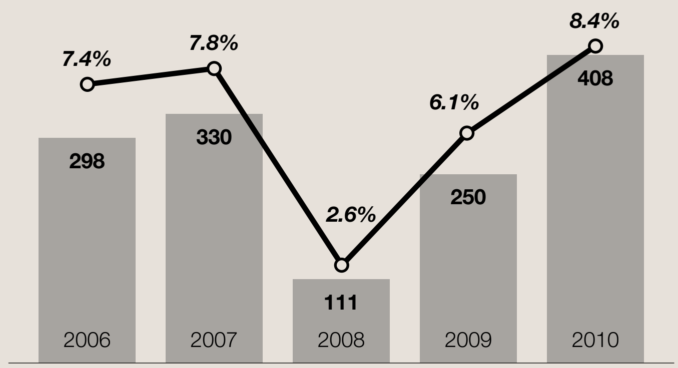
€ / mln



Δ% yoy	+5.7%	-1.6%	-2.5%	+19.2%

EBIT[1]; EBIT MARGIN[1]

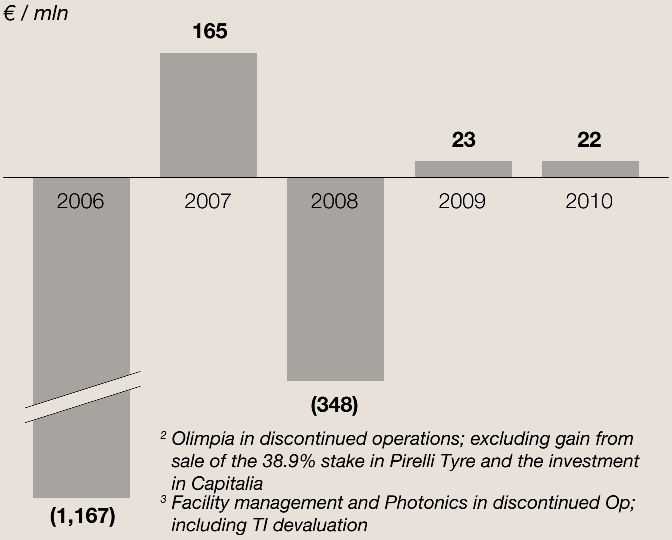
€ / mln



Δ% yoy	+10.7%	-66.5%	+126.0%	+63.3%

ATTRIBUTABLE NET INCOME

€ / mln



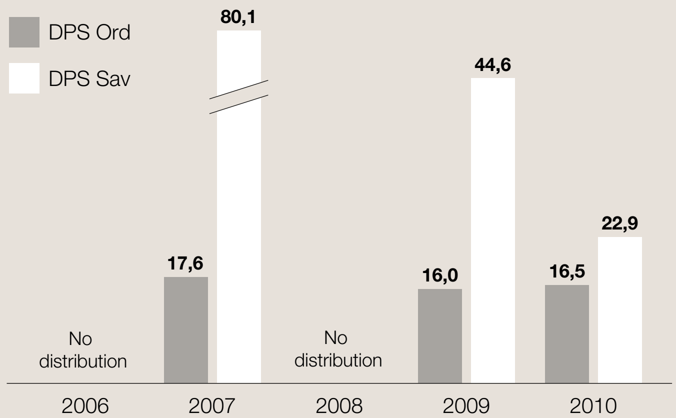
[2] Olimpia in discontinued operations; excluding gain from sale of the 38.9% stake in Pirelli Tyre and the investment in Capitalia

[3] Facility management and Photonics in discontinued Op; including TI devaluation

INCOME BEF. DISCONTINUED OPERATION[1]				
131[2]	147	-210[3]	78	228

DIVIDEND PER SHARE[4]

€ / cent

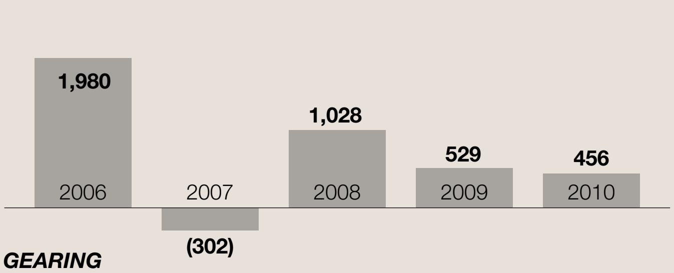


	2006	2007	2008	2009	2010
Dividends €/mln		93		81	81
Pay out on Parent company net income		93%		72%	93%

[4] DPS 2006-2009 restated following P&C shares reverse stock split with the ratio of 1 new share per each 11 old shares

NET DEBT

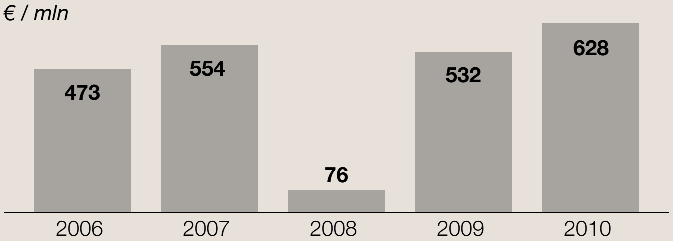
€ / mln



GEARING				
42%	n.m.	43%	21%	22%

NET CASH FLOWS FROM OPERATING ACTIVITIES

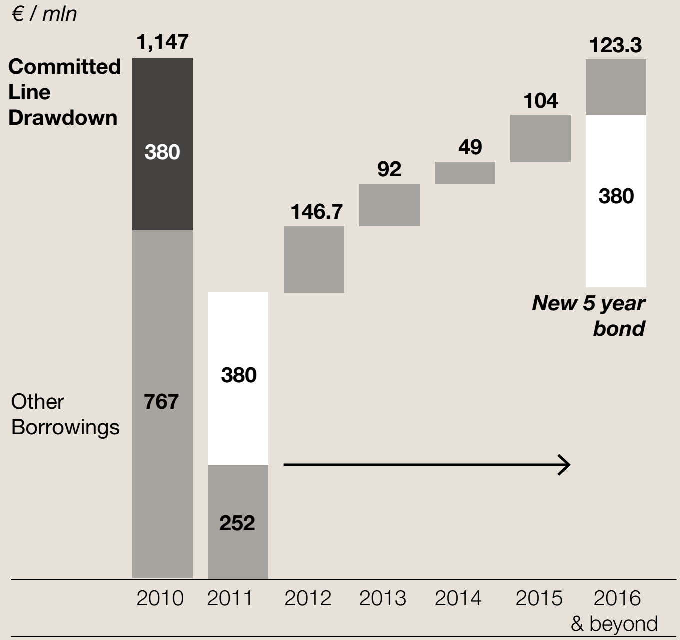
€ / mln



% ON SALES				
9.8%	11.6%	1.6%	13.1%	13.0%

GROSS DEBT 2010 YE

€ / mln



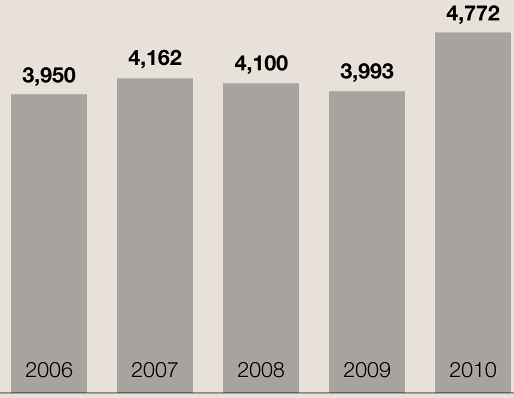
Gross Debt 2010	22.0%	12.8%	8.0%	4.3%	9.1%	43.8%

Committed Line not Drawdown *1,200 mln € maturing in 2015*

Pirelli Tyre

SALES

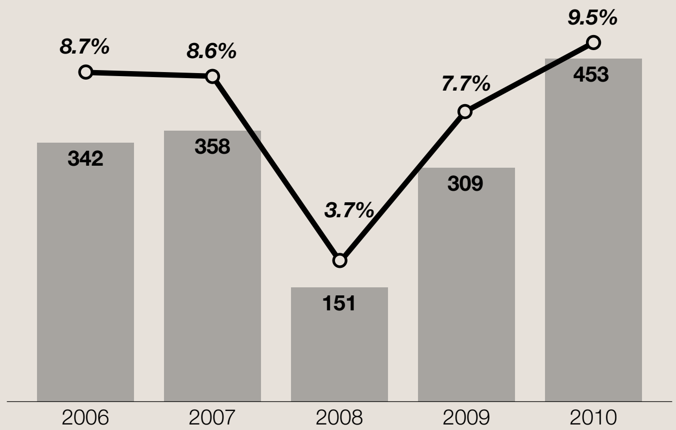
€ / mln



Δ% yoy	***8.7%***	***5.4%***	***-1.5%***	***-2.6%***	***19.5%***
Volume	*3.9%*	*1.8%*	*-6.0%*	*-5.8%*	*7.3%*
Price/Mix	*3.1%*	*4.7%*	*7.3%*	*4.2%*	*8.9%*
Revenues organic	*7.0%*	*6.5%*	*1.3%*	*-1.6%*	*16.2%*

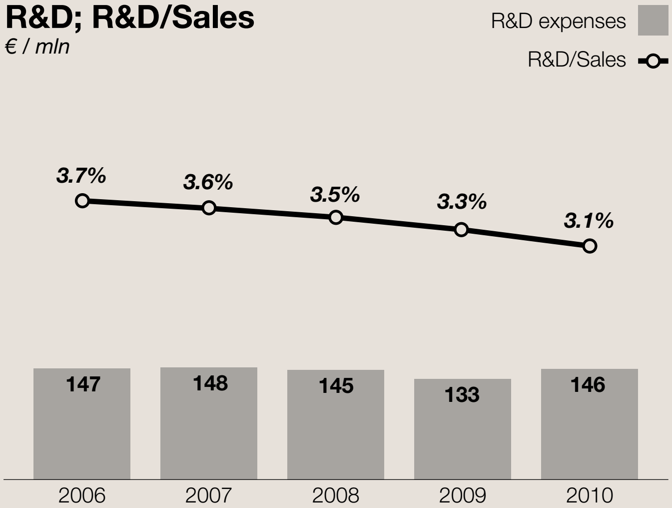
EBIT; EBIT MARGIN

€ / mln



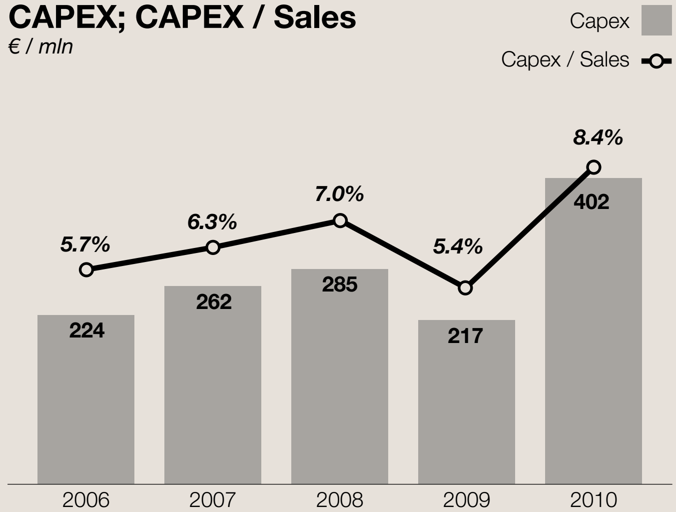
R&D; R&D/Sales

€ / mln

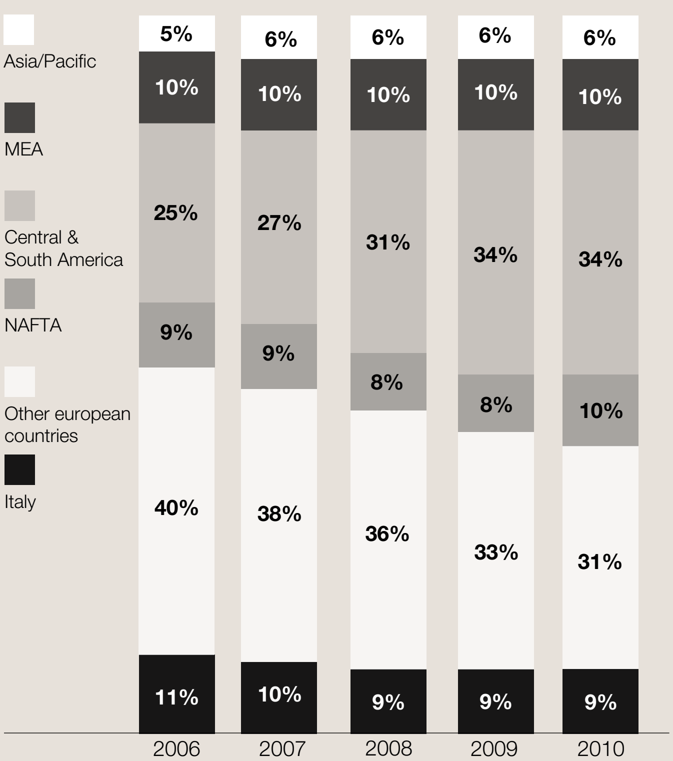


CAPEX; CAPEX / Sales

€ / mln



SALES BY GEOGRAPHY



	2006	2007	2008	2009	2010
Consumer	*69%*	*69%*	*68%*	*71%*	*70%*
Industrial	*31%*	*31%*	*32%*	*29%*	*30%*
OE	*21%*	*24%*	*24%*	*23%*	*25%*
Replacement	*79%*	*76%*	*76%*	*77%*	*75%*

19 INDUSTRIAL PLANTS IN 11 COUNTRIES

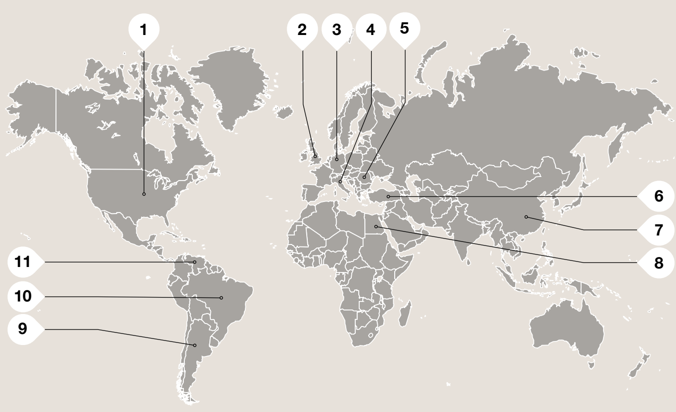
1. USA
Rome — *Car*

2. GB
Burton — *Car*
Carlisle — *Car*

3. Germany
Breuberg — *Car/Moto*
Merzig — *Steelcord*

4. Italy
Bollate (MI) — *Car*
Settimo Torinese — *Car/Truck*
Figline Valdarno — *Steelcord*

5. Romania
Slatina — *Car/Steelcord*



11. Venezuel
Guacara — *Car*

10. Brazil
Campinas — *Car*
Feira de Santana — *Car/Truck*
Santo Andrè — *Truck/Agro*
Gravatai — *Moto/Truck*
Sumarè — *Steelcord*

9. Argentina
Merlo — *Car*

6. Turkey
Izmit — *Car/Truck Steelcord*

7. China
Yanzhou — *Car/Truck*

8. Egypt
Alexandria — *Truck*

Year end Capacity (mln pz)	**2010**	**% in low cost countries – 2010**
Consumer	56.0	71%
Industrial	5.8	93%

Many of the images used were produced by the students of NABA (Nuova Accademia di Belle Arti Milano) at Pirelli's request.

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The results' documentation can be found online at **www.pirelli.com**

Pirelli & C. S.p.A. — Milan

Annual Financial Report at December 31, 2010

Volume 1

CALL OF GENERAL MEETING

The ordinary shareholders of Pirelli & C. Società per Azioni are called to the Ordinary and Extraordinary Shareholders' Meeting in Milan, Viale Sarca n. 214,
– at 10:30 a.m. on Wednesday, April 20, 2011 on the first call;
– at 10:30 a.m. on Thursday, April 21, 2011 on the second call,
to discuss and resolve on the following

AGENDA

ORDINARY PART

1. Annual Report at December 31, 2010. Relevant and consequent resolutions.
2. Election of the Board of Directors:
   - determination of the number of seats on the Board of Directors;
   - determination of the term of the Board of Directors;
   - election of the Directors;
   - determination of the annual compensation of members of the Board of Directors;
3. Discussion of the General Policy for Group Remuneration.

EXTRAORDINARY PART

1. Amendment of Articles 5 (Share Capital), 7 and 8 (General Meeting), 10 and 11 (Management), 16 (Board of Directors) of the Bylaws. Relevant and consequent resolutions.
2. Voluntary reduction of Share Capital by Euro 32,498,345.12, pursuant to Section 2445 Italian Civil Code, to be charged to Net Equity; consequent amendments to Article 5 of the Bylaws. Relevant and consequent resolutions.

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REPORT ON CORPORATE GOVERNANCE AND THE STRUCTURE OF SHARE OWNERSHIP**
Volume 2

SUSTAINABILITY REPORT 2010
Volume 3

* *The Annual Report on Corporate Governance and Ownership Structure included in Volume 2 is a specific, integral section of the Directors' Report on Operations.*

** *This volume is a specific, integral section of the Directors' Report on Operations.*

PIRELLI & C. S.P.A. BOARD OF DIRECTORS[1]

Chairman	Marco Tronchetti Provera
Deputy Chairman	Alberto Pirelli
Deputy Chairman	Vittorio Malacalza
Directors	Carlo Acutis *
	Carlo Angelici * o
	Cristiano Antonelli * o
	Gilberto Benetton
	Alberto Bombassei * ^
	Franco Bruni * o
	Luigi Campiglio *
	Enrico Tommaso Cucchiani
	Giulia Maria Ligresti
	Massimo Moratti
	Renato Pagliaro
	Umberto Paolucci * ^
	Giovanni Perissinotto
	Giampiero Pesenti * ^
	Luigi Roth * o
	Carlo Secchi * o

***** Independent director
o Member of the Internal Control, Risks and Corporate Governance Committee
^ Member of the Remuneration Committee

Secretary to the Board	Anna Chiara Svelto
BOARD OF STATUTORY AUDITORS[2]	
Chairman	Enrico Laghi
Statutory Auditors	Paolo Gualtieri
	Paolo Domenico Sfameni
	Franco Ghiringhelli
Alternate Auditors	Luigi Guerra
GENERAL MANAGER	
Tyre General Management	Francesco Gori
INDEPENDENT AUDITOR[3]	Reconta Ernst & Young S.p.A.
CORPORATE FINANCIAL REPORTING MANAGER[4]	Francesco Tanzi

1 Appointment: April 29, 2008. Expiry: Shareholders' Meeting called to approve the financial statements at December 31, 2010. Vittorio Malacalza was co-opted by the Board of Directors on July 29, 2010 to replace Carlo Alessandro Puri Negri, who resigned on the same day. Posts conferred by the Board of Directors to Marco Tronchetti Provera and Alberto Pirelli on April 29, 2008 and Vittorio Malacalza on October 14, 2010.
2 Appointment: April 21, 2009. Expiry: Shareholders' Meeting called to approve the financial statements at December 31, 2011.
3 Post conferred by the Shareholders' Meeting held on April 29, 2008.
4 Appointment: post conferred by the Board of Directors meeting held on September 16, 2009. Expiry: Shareholders' Meeting called to approve the financial statements at December 31, 2010.

STRUCTURE OF PIRELLI GROUP AT DECEMBER 31, 2010

PIRELLI CORPORATE STRUCTURE

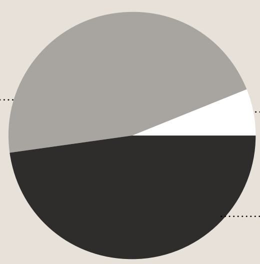
PIRELLI & C. S.p.A.[1]

PIRELLI TYRE S.p.A.	PIRELLI & C. ECO TECHNOLOGY S.p.A.	PIRELLI & C. AMBIENTE S.p.A.	PZERO S.r.l
100%	51%	51%	100%

[1] Pirelli businesses are supported by Pirelli Labs (100% Pirelli & C), a centre of technological excellence and engine of innovation

% on total sales **~98%** **~1.3%**

SHAREHOLDERS STRUCTURE 2010



Free Float 47.9%

Camfin[1] 5.9%

Shareholders Agreement 46.2%

[1] Stake not conferred to the Shareholders Agreement. Camfin totally owns 26.2% of ordinary share capital

FREE FLOAT: 47.9%[2]

Institutional Investors	**29.0%**
— *UK*	*6.3%*
— *Italy*	*7.3%*
— *Continental Europe*	*8,6%*
— *US & Canada*	*5.8%*
— *Rest of the World*	*1.0%*
Retail	**16.8%**
Other Shareholders	**2.1%**

[2] Source: Sodali (Shareholder ID August 2010) and Shareholders Register

SHAREHOLDERS AGREEMENT: 46.2%

— *Camfin S.p.A.*	*20.32%*
— *Mediobanca S.p.A.*	*4.61%*
— *Edizione S.r.l.*	*4.61%*
— *Fondiaria SAI S.p.A.*	*4.42%*
— *Allianz S.p.A.*	*4.41%*
— *Ass. Generali S.p.A.*	*4.41%*
— *Intesa Sanpaolo S.p.A.*	*1.62%*
— *Massimo Moratti*	*1.19%*
— *Sinpar S.p.A.*	*0.63%*

MARKET CAPITALIZATION (€mln)[3]

	2010YE	2009YE	2008YE
Pirelli Ordinary *(Reuters: PECI.MI; Bloomberg: PC IM)*	2,940.6	2,097.9	1,284.4
Pirelli Saving *(Reuters: PECIn.MI; Bloomberg: PCP IM)*	70.1	56.9	33.7
Total	3,010.7	2,154.8	1,318.1

[3] Based on December average price

SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

(in milions of euro)

	2010	2009[1]	2008	2007	2006
				(historical)	
Net sales	**4.848**	**4.067**	**4.660**	**6.076**	**4.841**
Net sales (excluding DGAG * - PRE)			4.660	4.780	4.841
Gross operating profit	**629**	**453**	**252**	**573**	**614**
% of net sales	13.0%	11.1%	5.4%	9.4%	12.7%
Operating income	**408**	**250**	**43**	**364**	**401**
% of net sales - ROS	8.4%	6.1%	0.9%	6.0%	8.3%
Net income (loss) from continuing operations	**228**	**77**			
Net income (loss) from discontinued operations	**(224)**	**(100)**			
Total net income (loss)	**4**	**(23)**	**(413)**	**324**	**(1.049)**
Net income attributable to owners of Pirelli & C. S.p.A.	**22**	**23**	**(348)**	**165**	**(1.167)**
Total net earnings (losses) per share attributable to the owners of Pirelli & C. S.p.A. (in euro)	0.044	0.047[2]	(0.065)	0.031	(0.217)
Non-current assets	3.164	3.596	3.665	3.815	6.924
Net working capital	117	222	418	298	463
Net invested capital	**3.281**	**3.818**	**4.083**	**4.113**	**7.387**
Equity	2.028	2.495	2.374	3.804	4.687
Provisions	797	795	681	611	720
Net financial (liquidity)/debt position	**456**	**529**	**1.028**	**(302)**	**1.980**
Equity attributable to the owners of Pirelli & C. S.p.A.	**1.991**	**2.175**	**2.172**	**2.980**	**3.880**
Equity per share attributable to the owners of Pirelli & C. S.p.A. (in euro) (*)	4.08	4.46[2]	0.40	0.56	0.72
Operating income/Net invested capital ** - ROI	11.49%	6.32%	1.05%	6.33%	5.36%
Net income (loss)/Equity ** - ROE	0.19%	(0.93%)	(13.35%)	7.63%	(20.37%)
Net cash flows provided by/(used for) operating activities	**628**	**532**	**76**	**554**	**473**
Research and development expenses	**150**	**137**	**156**	**173**	**171**
% of net sales	3.1%	3.4%	3.3%	2.8%	3.5%
Amortization and depreciation	217	198	199	214	201
Capital expenditure	**433**	**225**	**311**	**287**	**255**
Capital expenditure/depreciations	2.00	1.14	1.56	1.34	1.27
Net financial position/Equity - Gearing	0.22	0.21	0.43	n.s.	0.42
Sales * per employee (in thousands of euro)	160	138	148	155	172
Ordinary shares of Pirelli & C. S.p.A. (no. millions)	475.7	5,233.1	5,233.1	5,233.1	5,233.1
Savings shares of Pirelli & C. S.p.A. (no. millions)	12.3	134.8	134.8	134.8	134.8
Total shares of Pirelli & C. S.p.A. (no. millions) (°)	488.0[3]	5,367.9	5,367.9	5,367.9	5,367.9
Treasury ordinary shares (no. millions)	0.4	3.9	3.9	2.6	2.6
Savings ordinary shares (no. millions)	0.4	4.5	4.5	-	-
Employees (number at end of period)	29,573	29,570	31,056	30,823	28,617
of which temporary workers	2,426	2,245	2,913	3,642	3,479

[1] *Comparative income statement figures for 2009 related to Pirelli RE (now Prelios) and Pirelli Broadband Solutions segments. discontinued in 2010. have been reclassified to "net income (loss) from discontinued operations"*

[2] *2009 per share figures has been reclassified on a comparable basis after the reverse stock split pursuant the Shareholders' Meeting resolution of July 15. 2010*

[3] *Reverse stock split in execution of the resolution passed by the Shareholder's Meeting on July 15. 2011 (ratio 1 to 11)*

* *Excluding net sales for deconsolidation DGAG real estate assets*

** *Average amounts*

Dear shareholders,

The year 2010 was an important one for Pirelli. The targets set in the 2009-2011 industrial plan were reached ahead of schedule and exceeded, both in terms of strategic positioning and in terms of economic results.

First of all, strategy. In line with our goal of focusing Pirelli on the industrial activities of Pirelli Tyre, 2010 saw the completion of the process of separation of the real estate activities of Pirelli Re and the disposal of non-strategic activities, with the consequent transformation of Pirelli into a 'pure Tyre company'. This transformation enables a more immediate reading of our industrial strategy and our economic data by the market. In 2010, these data benefited from the worldwide recovery in demand for tyres and our ability to adapt strategies to the economic climate, as well as our continued attention to costs, constant commitment to greater efficiency, financial rigour, and product and process innovation. The business's good performance and the effectiveness of operations' management allowed us to conclude 2010 not only with a result superior to the targets set for 2011, but also with a positive net result notwithstanding the negative impact on accounts of the Pirelli Re operation.

In the light of these results, we can look to the future with confidence and determination. And we demonstrated this with the presentation of a new industrial plan for the 3-year period 2011-2013, based on a vision of strategy and scenarios that extends to 2015. It is a plan which will see Pirelli focused on satisfying the growing demand from the Premium segment, where our company already excels at the global level, and ready to seize opportunities for geographical diversification linked to the growth of rapidly developing economies and, given the constant increase in the cost of raw materials, also committed to research and the development of agreements in the area of materials as alternatives and complements to the use of natural rubber.

The strengthening of our financial and asset structure, achieved with the cash flow generated by Pirelli Tyre and through actions to diversify funding sources and lengthen debt maturities taken during the year, allowed us to immediately embark on a new phase of expansion, particularly in rapidly developing countries. Among these expansion projects, I would note Mexico, where Pirelli's first and future plant in the country will also serve Nafta area markets, Russia, where the finalization of agreements with local partners could lead to our having a production

capability in the country, China, where we will extend production to include motorcycle tyres, and Italy, where the new technology hub at Settimo Torinese represents a new frontier in terms of product and process innovation, as well attention to sustainability and the environmental quality of the workplace.

The Settimo Torinese project was the result of a constant commitment to research, which was also a factor in one of our greatest successes in 2010: winning the contract as exclusive supplier to Formula One. For the 3-year period 2011-2013, the Pirelli mark will be a protagonist on the most important car circuits of the world.

This year, again, we have made ambitious commitments to you and the market. As always, we will approach them with seriousness, rigour and responsibility. Our challenge is not only to achieve them, but to exceed them again.

Thank you to all of you, our shareholders, for sharing in our commitment.

The chairman
Marco Tronchetti Provera

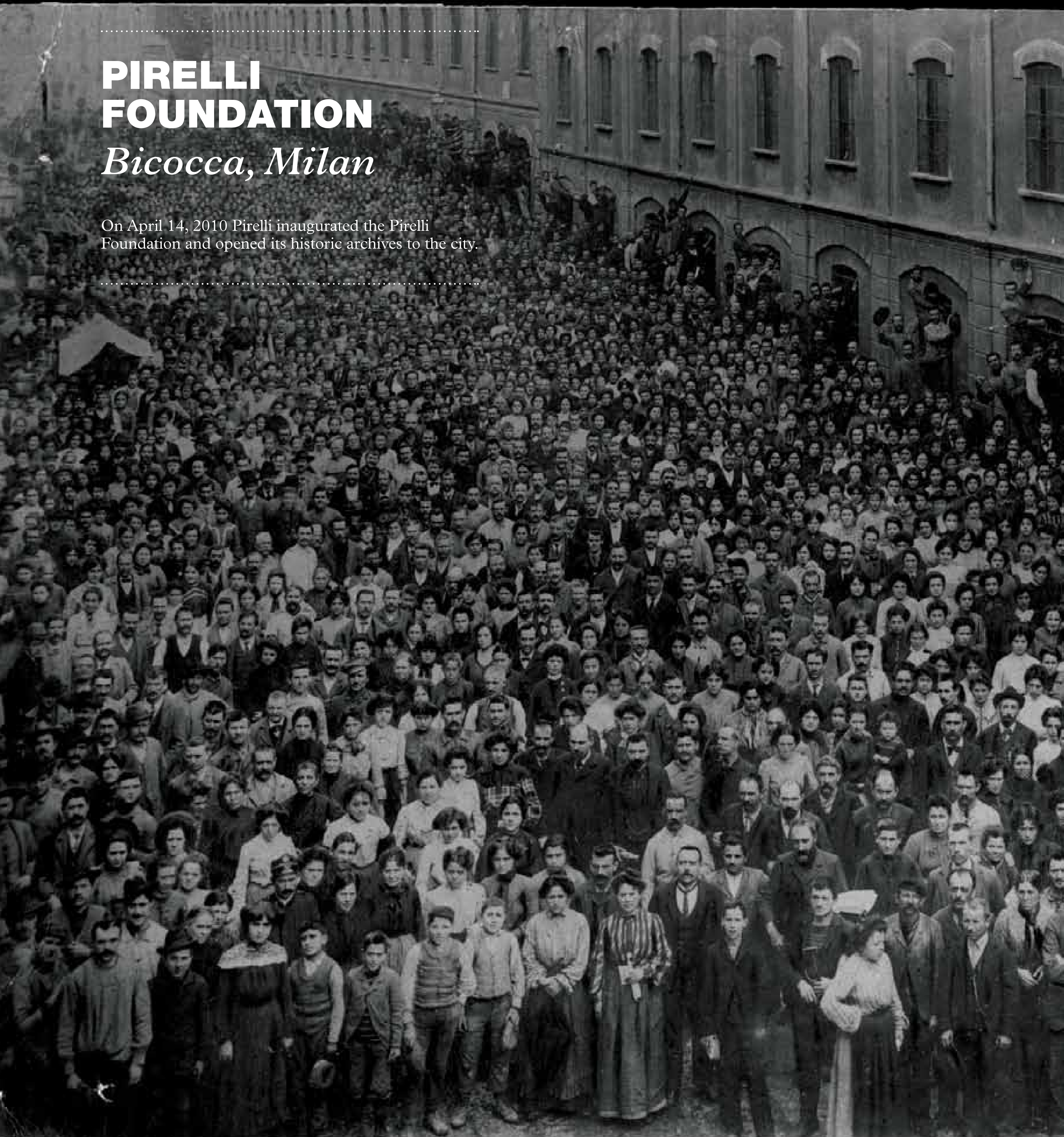
"We love challenges. To achieve them we rely on our culture of enterprise, vigilant Governance, ambitious Sustainability goals, passion and courage"

MARCO TRONCHETTI PROVERA,
Chairman Pirelli & C. S.p.A.

PIRELLI FOUNDATION

Bicocca, Milan

On April 14, 2010 Pirelli inaugurated the Pirelli Foundation and opened its historic archives to the city.




STORIA DELLE INDUSTRIE PIRELLI
ARCHIVIO STORICO
PIRELLI
40
FONDAZIONE PIRELLI

INDUSTRIAL CENTER

Settimo Torinese

In 2010 the construction of the new industrial centre at Settimo Torinese goes ahead. This will be the most technologically advanced and efficient Pirelli Plant.

FORMULA 1
Exclusive supplier

On June 23, 2010, the FIA, the teams represented by FOTA and the Formula 1 organisation chose Pirelli as their exclusive supplier for the period 2011-2013.

THE CAL
2011

On November 30, 2010 Mithology
the news Pirelli's calendar signed by
Karl Lagerfeld was presented in Moscow

CAR
Scorpion Verde SUV tyre®


SCORPION VERDE
ECOIMPACT


ROSSO

MOTO

Diablo Rosso II®


ST
REGROOVABLE

TRUCK

The Regional®

Prof. Berardino Libonati, an internationally famous jurist who had served as Director of Pirelli & C. S.p.A. and as Chairman of the Remunerations Committee since 2005, died on November 30, 2010.

Professor Libonati's passing was a harsh blow for the entire legal and corporate world.

Professor Libonati was a dedicated member of the Pirelli & C. S.p.A. Board of Directors. He also made invaluable contributions to elaboration of the Pirelli Corporate Governance system.

DIRECTORS' REPORT

DIRECTORS' REPORT ON OPERATIONS

The process of transforming the Pirelli Group into a *Pure Tyre Company* was completed in 2010. This transformation was undertaken in accordance with the 2009-2011 business plan and completed in 2010 with the spin-off of Pirelli & C. Real Estate S.p.A., now Prelios S.p.A. (following Pirelli RE – now Prelios) and the disposal of non-strategic assets, including Pirelli Broadband Solutions S.p.A. and Oclaro Inc. (formerly Avanex). Conclusion of this process, together with the achievement of the 2011 targets a year earlier than scheduled in the 2009-2011 business plan, resulted in the preparation of the new business plan for 2011-2013 with a forward view to 2015, which was presented to the financial community on November 4, 2010.

This plan focuses on the production for the *Premium* segment, which is growing faster than the market as a whole, and on the development of business in rapidly developing economies. Two such countries are Mexico, where Pirelli is building its first local plant, and Russia, where agreements are being finalised as envisaged in a memorandum of understanding signed with the local partner Russian Technologies and local producer Sibur Holding, for the development of joint activities in the tyre and steelcord sectors. There are also plans for making an agreement with these Russian partners for the supply and high-technology production of synthetic rubber. This venture would fall in the framework of initiatives undertaken by Pirelli to identify raw materials to be used as alternatives and/or in addition to natural rubber.
Additionally there are plans for an official opening of the new industrial centre at Settimo Torinese in 2011. This will be the most technologically advanced and efficient Pirelli plant for the production of High-Performance, Ultra High-Performance and lower environmental impact tyres, as part of the Group's established *green performance* strategy.

Pirelli has always been committed to research and development, continuous process and product innovation, and it has also been involved in motorsports since 1907. All these qualities contributed to it being named in 2010 as exclusive supplier to the Formula 1 championship for the three-year period 2011-2013.

The value of its investments **in research and development activity** amounted to about 3% of sales in 2010, one of the highest levels in the industry. This has enabled Pirelli to continue turning out new patents (currently over 4,500), maintain its capacity to turn out innovative *Premium* products, continue perfecting innovative processes for the *mixing* of materials and *building* of tyres in all product segments, and develop alternative materials to replace traditional ones, in view of reducing costs and pursuing environmental sustainability.

The construction of the industrial centre at Settimo Torinese

Pirelli finished the year with sharply higher operating results, bettering the targets announced on October 14, 2010, which had in turn been repeatedly revised upwards over the course of the year. This outstanding earnings performance was due to the efficient operating management and the recovery in tyre sector demand, which began at the end of 2009 and continued through 2010.

The positive performance of operating results was sustained by volume growth at Pirelli Tyre, which now accounts for 98.4% of Pirelli Group sales, and effective measures impacting the price/mix component. The 19.5% growth in Pirelli Tyre sales (+16.2% on a comparable exchange rate basis) stemmed from a 7.3% contribution by volume and 8.9% by the price/mix component. The price component made it possible to offset the growth in costs for productive factors, particularly raw materials, while the mix component permitted expansion of the product range in the *Premium* segment, on which the Company has focused its business.

Based on volumes, sales recovered in all geographical areas, in both sales channels (Replacement and Original Equipment) and in the different business units. Consumer segment sales climbed by 16.7%, while Industrial segment sales jumped by 26.3%, with ROS (i.e. the ratio of operating income after restructuring expenses on sales) improving to 9.6% (from 7.4% in 2009) and 9.2% (from 8.5% in 2009), respectively. Overall, the ROS of Pirelli Tyre (EBIT/sales) was 9.5%, up decisively from 7.7% in 2009.

In regard to **Group results**, the activities connected with **Pirelli RE** (now Prelios) and **Pirelli Broadband Solutions** are considered ***discontinued operations*** and included in the net income (loss), so that the comparative figures for 2009 have been restated. The highlights for 2010 are as follows:

- **sales**: euro 4,848.4 million, compared with the target of "about euro 4.8 billion," up 19.2% from 2009. Of this amount, 37% was generated by "*green*" activities (25% for 2009);
- **EBIT margin after restructuring expenses:** 8.4% as compared with the target of "over 7.5%;
- **net financial position**: negative for euro 455.6 million, compared with the target of "less than euro 700 million.".

Over the year, the refocus on the Group's industrial activities in the tyre sector led to the spin-off of Pirelli RE (now Prelios) from the Pirelli & C. S.p.A. Group (concluded on October 25, 2010 with the assignment of Pirelli RE (now Prelios) shares to the shareholders Pirelli & C. S.p.A. and a consequent voluntary reverse stock split by the latter) and disposal of Pirelli Broadband Solutions S.p.A.

Even when the impact of these *discontinued operations* is included (aggregate net loss of euro 223.8 million), **consolidated net income** amounted to euro 4.2 million at December 31, 2010, compared with a consolidated net loss of euro 22.6 million in 2009. **Consolidated net income attributable to owners of the Parent** was euro 21.7 million, compared with euro 22.7 million in 2009. **Consolidated net income before the effect of *discontinued operations*** was euro 228.0 million, almost three time the amount of euro 77.6 million reported in 2009.

Consolidated operating income, which reflects euro 24.7 million in restructuring expenses (euro 55.2 million in 2009), was euro 407.8 million, compared with euro 249.7 million in 2009, and the ROS was 8.4%, compared with 6.1% in 2009.

Consolidated net financial (liquidity)/debt position at December 31, 2010 is negative for euro 455.6 million (after having paid euro 81 million in dividends to shareholders), compared with a negative net financial position of euro 528.8 million at December 31, 2009. This reduction reflected the proceeds from disposal of non-strategic assets and especially the contribution made by Pirelli Tyre operating cash flow (positive euro 167.7 million, compared with euro 395.4 million in 2009), despite the near doubling in capital expenditure (euro 405.0 million in 2010, compared with euro 217.4 million in 2009), in particular on projects to expand production capacity.

Growing sales volumes, continuous price/mix adjustments, and continuing cost-cutting measures enabled **Pirelli Tyre** to counter effectively rising costs for product inputs, specifically raw materials, and conclude the financial year **with positive results that easily topped targets**:
- **sales**: euro 4,772.0 million, compared with the target of "over euro 4.7 billion," up 19.5% from 2009;
- **EBIT margin after restructuring expenses**: 9.5%, higher than both the target of "more than 8.5%" and the 7.7% achieved in 2009.

SIGNIFICANT EVENTS DURING THE YEAR

On **January 19, 2010,** the Pirelli & C. S.p.A. Block Shareholders Agreement was renewed with expiry on April 15, 2013. All parties to the agreement had expressed their intention to renew the agreement by January 15, 2010, the contractual deadline for any withdrawals.

On **April 14, 2010** Pirelli inaugurated the Pirelli Foundation and opened its historic archives to the city. These archives represent the "heart" of the Foundation.
Marco Tronchetti Provera, Alberto Pirelli, Cecilia Pirelli and Antonio Calabrò, Foundation Director, attended the opening. The Pirelli Foundation, founded in 2009, has an international outlook, promoting and spreading the Group's cultural, historic and documentary heritage, which represents an integral part of Italian business, social and intellectual history. The objectives of the Foundation include the promotion and appreciation of cultural initiatives that are related to and consistent with Pirelli corporate culture.
The Historic Archives preserve documents, writings, films, objects, art works and photographs that cover the

Pirelli Foundation

138 years of Company industrial and cultural history, from its foundation in 1872 to the present day.

On **May 4, 2010** the Board of Directors of Pirelli & C. S.p.A. resolved to submit a motion to the Shareholders for approval of a spin-off of the assets and activities of Pirelli RE (now Prelios) from the other activities operated by the Pirelli Group. The purpose of this spin-off was to focus Pirelli Group activities on the tyre business in view of streamlining its operations as part of the programme launched in 2008 and continued in 2009. This programme was outlined in the 2009-2011 three-year strategic business plan, while simultaneously allowing its shareholders, who already had an indirect equity interest in the Real Estate business, to acquire a direct shareholding in Pirelli RE (now Prelios).

The spin-off was executed by assigning to Pirelli & C. S.p.A. shareholders almost all of the ordinary shares of Pirelli RE (now Prelios) owned by the Company, representing about 58% of the share capital. This was carried out through a reduction in share capital whose actual amount was determined by the **Extraordinary Shareholders' Meeting of Pirelli & C. S.p.A. on July 15, 2010**, and equal to the fair *value* of the investment in Pirelli RE (now Prelios) being assigned (euro 178,813,982.89). That fair value had been determined on the basis of the official price of Pirelli RE (now Prelios) shares (euro 0.367) quoted on July 14, 2010, the trading date prior to the Extraordinary Shareholders' Meeting.

Pursuant to Article 2445(3) Italian Civil Code, the spin-off was completed on **October 25, 2010**, 90 days after the resolution by the Extraordinary Shareholders' Meeting of Pirelli & C. S.p.A. had been recorded at the Companies Register.

In accordance with accounting rules, the Parent Pirelli & C. S.p.A. restated the liability resulting from the spin-off on its **separate financial statements**, on the basis of the official price of Pirelli RE (now Prelios) shares reported on the previously mentioned closing date of the spin-off (euro 0.4337). This restatement resulted in that liability increasing from euro 178,813,982.89 to euro 211,312,328, with a change in Equity of euro 32,498,345. At the same time, it recognised a loss of about euro 118.3 million in the income statement, with this amount corresponding to the difference between the value of the restated liability as indicated above and the book value of Pirelli RE (now Prelios) shares. The impact of the spin-off on the **consolidated financial statements** was negative for approximately euro 219 million.

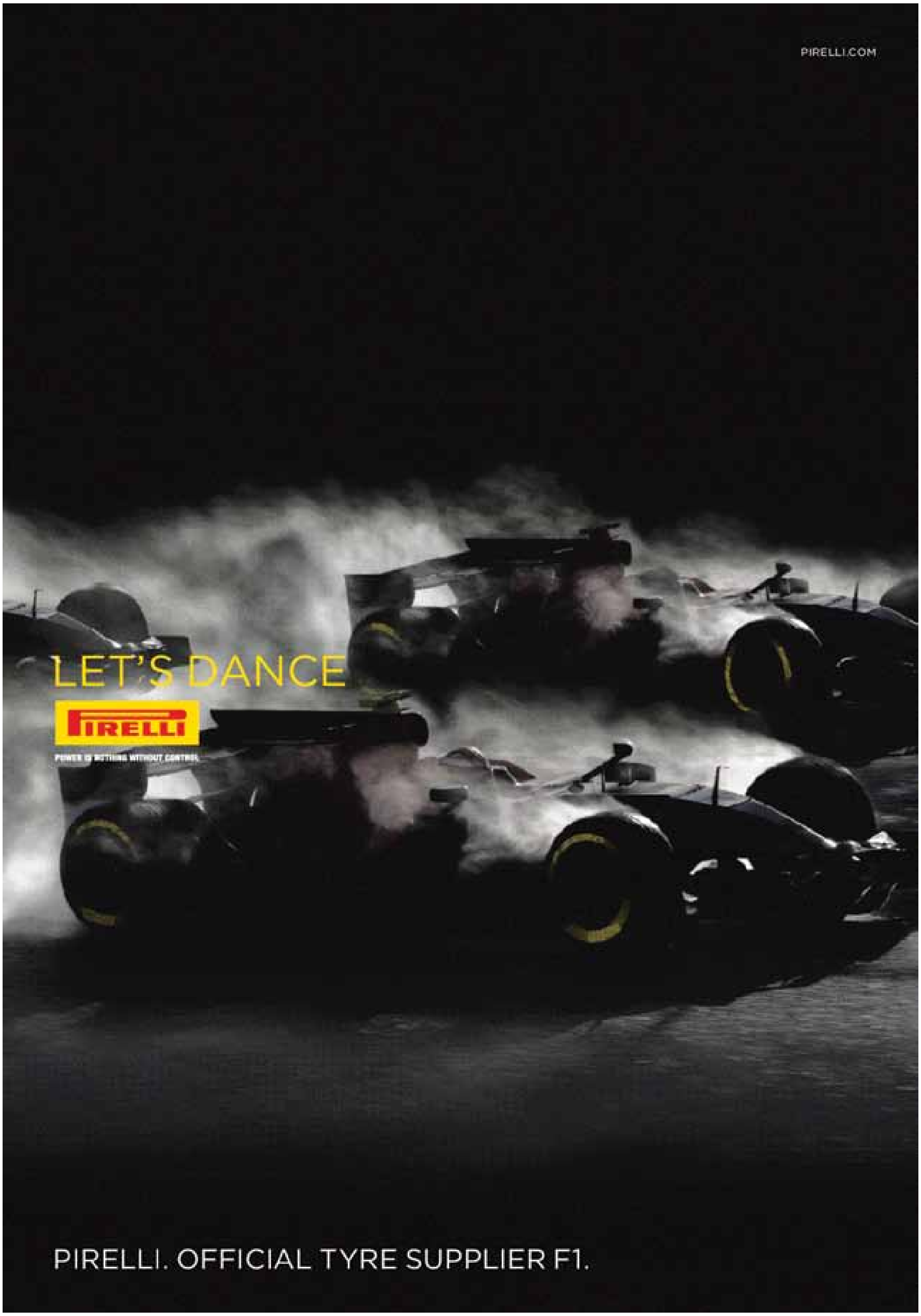
On June 23, 2010, the FIA, the teams represented by FOTA and the Formula 1 organisation chose Pirelli as their exclusive supplier for 2011-2013.

The spin-off resulted in the proportional assignment of 487,231,561 ordinary shares in Pirelli RE (now Prelios) to Pirelli & C. S.p.A. based on a ratio of one Pirelli RE (now Prelios) share for each Pirelli & C. S.p.A. ordinary or savings share owned, compared to a total of 487,798,972 shares owned by Pirelli & C S.p.A.(after the reverse stock split at the ratio of 1 new share for every 11 shares owned) prior to the spin-off. The failure to assign all the Pirelli RE (now Prelios) shares owned is due entirely to technical reasons, in order to determine an unfractioned ratio of assignment to the shareholders of Pirelli & C. S.p.A.

On **June 22, 2010** Pirelli & C. Ambiente S.p.A., the Pirelli Group company operating in the renewable energy sources sector, signed a licensing agreement with Bosco International, which promotes environmentally sustainable industrial systems and processes. The agreement will allow the Australian company to use the Pirelli patent for production of high quality solid recovered fuel (HQ-SRF) derived from municipal solid waste (MSW).

Pirelli technology will initially be used in the Latrobe area, in the Australian state of Victoria, as part of the "*Towards Zero Waste Policy*" programme introduced by local government authorities for containment of waste. Its goal is to convert the 600 thousand tonnes of MSW produced annually by the city of Melbourne into HQ-SRF. In particular, the exchange of technology will stimulate investment by Bosco International to develop an HQ-SRF plant in Australia, once authorisation is obtained from local authorities. According to a study conducted by Milan Bicocca University on the Life Cycle Assessment (LCA) method, the use of Pirelli HQ-SRF is 90 and 72 times more beneficial for the environment than alternative systems such as waste dumps and waste to energy plants, respectively.

On **June 23, 2010**, the FIA (Fédération Internationale de l'Automobile), the teams, represented by FOTA (Formula One Team Association), and the Formula 1 organisation, represented by FOM (Formula One Management), chose Pirelli as their exclusive supplier, after approving the solutions proposed by the Italian Group aimed at guaranteeing technological and qualitative continuity to the competitive teams. In accordance with current Formula 1 regulations issued by FIA, the supply agreement envisages that Pirelli provide the teams with six different types of tyres for the entire season: four slick type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tyres, made of different compounds for use in races on dry asphalt; one rain tyre, developed for heavy rain; and an intermediate type tyre for use on damp asphalt and in light rain.
The new global economic situation has imposed a realistic, collaborative approach for sharing the industrial and logistic costs related to supply of the tyres with the teams. Pirelli's return to Formula 1 originated with the prospect, previously agreed with the teams, to undertake wide-ranging research on technically innovative solutions for technological evolution of current tyres in various contexts.
Pirelli has also been engaged as exclusive supplier to the GP2 Series World Championship for the three-year period 2011-2013.
The Company's upcoming participation in these championships comes on top of its participation in the GP3 Series since 2010, making Pirelli the official supplier for the most prestigious one-seater car races in the world.
Pirelli will also invest in advertising to promote the industrial and technological commitment required for participation in Formula 1, dedicating resources previously budgeted by the Company for this new venture. This advertising will focus primarily in support of the expected growth by Pirelli operations in developing economies such as Latin America and the Asia-Pacific areas, where numerous Formula 1 events are scheduled to be held.
Formula 1 will thus become an important driving force for further promotion of the Pirelli brand and its commercial and industrial growth, without involving any changes to the Company's business and financial plans. The global visibility resulting from Formula 1 media coverage and brand promotion activities closely linked to the Company's core business will enable Pirelli to maximise the return on its advertising investment.
The Formula 1 supply agreement crowns the long-standing commitment of Pirelli to car racing, dating back to 1907, when the Italian Group won the Peking-Paris Raid. Pirelli is currently the exclusive supplier to the world's most important car and motorcycle races, such as the GP3 World Championship, the WRC World Rally Championship, the Rolex Sports Car Series in North America, the Superbike World Championship and the Motocross World Championship. It is also involved in over 70 other national and international championships.

On **July 15, 2010** Pirelli & C. Ambiente S.p.A., through its subsidiary Solar Utility S.p.A., and GWM Group Inc., through its subsidiary GWM Renewable Energy S.p.A., signed a strategic agreement for joint development of business in the photovoltaic sector in Italy. In performance of this agreement, Solar Utility S.p.A., a wholly-owned subsidiary of Pirelli & C. Ambiente S.p.A. operating in the photovoltaic sector, granted its production assets to a new company named GP Energia S.p.A., of which GWM Renewable Energy S.p.A. acquired 60% of the share capital. The remaining 40% was initially owned by Solar Utility S.p.A. (now 35%). The initial value of the joint venture amounts to about euro 20 million, and it aims to acquire about 100 MW of capacity in Italy.

On **September 23, 2010** Pirelli opened the "Factory of Champions" at the Izmit industrial centre in Turkey. This is the plant where the Group will make the tyres to be used by all Formula 1 teams for the three-year period 2011-2013. The Izmit facility, which celebrated its fiftieth anniversary in 2010, has been home to motorsport tyre production since 2007 and will soon become the heart of Pirelli Formula 1 activities, together with the Milan research and development centre. The Izmit plant produces 8 million motorsport, car and truck tyres annually, the highest output of any Pirelli factory.
With the start-up of the Formula 1 division, Pirelli is now expanding its production line to make tyres for all automotive sports activities. In 2011, the Company will produce a total of 200 thousand racing tyres, including 50 thousand tyres for F1 teams and about 70 thousand for the GP2 and GP3 championships, of which Pirelli is the exclusive supplier.
The remainder will go to the 60 international road and track competitions for which the Milan-based tyre maker is the sole supplier, as well as to the most prestigious single-brand championships, such as the Ferrari Challenge, Lamborghini Super Trofeo and Maserati Trofeo.
Overall, the complete Pirelli automotive sports range is represented by 200 types of racing tyres, including rally tyres.
The Izmit facility, in synergy with the Pirelli centre for preparation of sports tyres at Burton-on-Trent, England, will also be the centre of all Formula 1 logistics activities.
In line with the Pirelli Group *green performance* strategy, aimed at developing products and solutions that combine maximum performance and safety with respect for the environment, Formula 1 production is based on the principles of environmental sustainability.

The supply of tyres to Formula One is inspired by our criteria of sustainability

On **October 20, 2010** Pirelli illustrated its development plans in Argentina, where the Group began operations 100 years ago. These plans, which aim to increase production capacity and to consolidate the leadership of Pirelli in Latin America, are part of the Company's international expansion strategy. Over these last several years, that strategy has steadily expanded its direct industrial operations in the markets that offer higher growth rates and competitive industrial costs. In particular, expansion of its presence in Argentina ensures that Pirelli has a major platform both for meeting growing demand on the domestic market, which is allocated about 50% of output, and satisfying demand on important export markets, especially Brazil and the United States.

On **October 21, 2010** Pirelli & C. S.p.A. and Advanced Digital Broadcast Holdings SA (ADB), a company listed on the Swiss stock exchange, signed an agreement for acquisition by ADB of 100% of the share capital of Pirelli Broadband Solutions S.p.A. (PBS), a wholly-owned subsidiary of Pirelli & C. S.p.A. This transaction was completed on November 29, 2010, with the sale by Pirelli of 100% of PBS to the ADB Group. The price paid by ADB consisted of about euro 25 million in cash and 400 thousand listed shares in ADB, representing approximately 7.2% of its share capital. Pirelli & C. agreed to a *lock-up* of these shares for the first two months after *closing*, while an agreement for a Pirelli *put* option and an ADB *call* option were also signed, exercisable within two years.
The divestiture of the Pirelli Broadband Solutions business is part of Pirelli's stated strategy of focusing on its core tyre business. Its sale to a leading industrial Group is intended to ensure the continued growth and development of PBS on the broadband access systems market.
The deal contributed about euro 21 million to consolidated income.

Chairman Pirelli & C. S.p.A, Marco Tronchetti Provera with Argentinian President Cristina Fernández de Kirchner

On **November 26, 2010** Pirelli, Russian Technologies and Sibur Holding signed a *memorandum of understanding* (MOU) in Moscow to define a series of agreements for the development of joint activities in the tyre and steelcord sectors, as well as the supply and high-technology production of synthetic rubber derivatives in Russia. The closing is expected to take place by June 2011. Regarding the tyre sector in particular, the agreement lays the basis for joint launch of a process to streamline and reorganise the tyre activities of Sibur Holding, one of the largest Russian operators in the petrochemical sector. The agreements envisage a process of reorganisation to select the assets of Sibur Russian Tyres that will be granted to two joint ventures set up by Pirelli and Russian Technologies (JV1 and JV2). This process will be based on guidelines and business plans drawn up jointly by the three partners. The first joint venture will receive the assets of Sibur Russian Tyres that are convertible to Pirelli standards in the car, agro radial and truck all steel sectors. Certain of these assets, pending finalisation of the transactions, will be managed by Pirelli from the outset on the basis of a "*manufacturing and technology agreement*".
The second joint venture, instead, will receive the assets that can be used for original equipment car tyres, targeting growing demand on the Russian market, as well as the assets for production of truck and conventional agro tyres. JV2 will also hold a significant stake in Sibur Russian Tyres. Pirelli will also directly acquire 10% of Sibur Russian Tyres in exchange for signing an agreement to provide its technical and managerial input. To this end, Pirelli will provide its technologies and production processes under license, participate in technological upgrade of the plants, and provide its know-how in the areas of logistics, quality control and organisation.
The tyre activities of the Sibur Group will benefit from cutting-edge Pirelli technology. With industrial support from the Italian Group, Sibur expects to significantly improve its own business results.
The new technological tie-up between the two Groups in the synthetic rubber sector will also facilitate the introduction of new kinds of synthetic rubber to improve tyre performance, especially in high-end products, where this component is more important than natural rubber. The agreement will also help create synergies between the automotive, tyre and synthetic rubber sectors in Russia, improve the products offered to customers and enhance the international competitiveness of the Russian tyre and automotive industry. The partnership between Russian Technologies, Sibur and Pirelli will also support the development of the Russian automotive and tyre industries and, by attracting investment to the tyre sector, enable the creation of modern high-technology and high-quality products for both industries. This agreement will lead Pirelli to have its own production plants ever in the Russian Federation. Also within the scope of the MOU, Pirelli and Russian Technologies will build a factory for the production of steelcord, the metallic cord used in radial tyres and giant tyres, at Samara, in the Togliatti special economic zone.
On **November 30, 2010** Pirelli signed a new, five-year *revolving* credit line agreement worth euro 1.2 billion, which will replace existing lines of credit for a total of euro 1.475 billion granted in 2005 and 2007 and having maturities in 2011 and 2012, which will consequently be cancelled in advance. The 2015 maturity is aligned with the time horizon of the recently presented Pirelli business plan. Execution of this new agreement is one of the actions aimed at streamlining Group debt, by lengthening its average duration and diversifying funding sources. The loan agreement was made with twelve major Italian and foreing banks. The credit line is subject to a floating rate, with the initial interest rate set at Euribor plus 110 basis points.

On **December 10, 2010** the Ministry for Equal Opportunity, the Region of Lombardy and Pirelli signed an agreement to expand and renew until 2013 the international health cooperation programme launched in 2008 between the Milan Niguarda Ca' Granda Hospital and Slatina Hospital in Romania. This programme aims to support the professional training of Romanian medical and nursing professionals through a training course coordinated by the Milan hospital. Pirelli will contribute about euro 0.4 million to the project over the three-year duration of the agreement, which will bring its total commitment to the project to over euro 1 million since its launch. The agreement is part of the social initiatives that Pirelli undertakes in support of local communities wherever it has production facilities.

Slatina hospital

THE GROUP

SELECTED ECONOMIC AND FINANCIAL DATA

In addition to the financial performance measures established by the International Financial Reporting Standards (IFRSs), this report presents certain measures that are derived from, although not required by IFRSs ("*Non-GAAP Measures*"). These performance measures are presented to facilitate the understanding of the Group operating performance and should not be considered as substitutes for the information required by IFRSs.

Specifically, the *Non-GAAP Measures* used are the following:

— **Gross Operating Profit (EBITDA)**: this financial measure is used by the Group as a *financial target* for internal presentations (business plans) and external presentations to analysts and investors. It is a useful unit of measurement to assess the overall operating performance of the Group and its individual business segments in addition to operating income. Gross operating profit is an intermediate economic measure deriving from operating income, but excluding depreciation and amortisation of property, plant and equipment and intangible assets;

— **Non-current assets**: this measure is the sum of "property, plant and equipment," "intangible assets," "investments in associates and joint ventures" and "other financial assets";

— **Provisions**: this measure is the sum of "provisions for liabilities and charges (current and non-current)," "provisions for employee benefits" and "provisions for deferred tax liabilities";

— **Net working capital**: this measure consists of all items not included in the two measures above, in "Equity" and "net financial (liquidity)/debt position";

— **Net financial (liquidity)/debt position**: this performance measure is represented by gross financial debt less cash and cash equivalents and other financial receivables. The section "Explanatory notes to the consolidated financial statements" presents a table showing the line items used to calculate this measure.

Recalling that the figures for the activities of Pirelli RE (now Prelios) and Pirelli Broadband Solutions are shown in the income statement under "*discontinued operations*", and that the 2009 figures have been restated for comparative purposes, the Group's consolidated accounts may be summarised as follows:

(in millions of euro)

	12/31/2010	12/31/2009
Net sales	**4,848.4**	**4,067.5**
Gross operating profit before restructuring expenses	653.7	507.8
% of net sales	13.5%	12.5%
Operating income before restructuring expenses	432.5	304.9
% of net sales	8.9%	7.5%
Restructuring expenses	(24.7)	(55.2)
Operating income	**407.8**	**249.7**
% of net sales	8.4%	6.1%
Net income (loss) from equity investments	23.4	(11.6)
Financial income/(expenses)	(65.8)	(70.1)
Income tax	(137.4)	(90.4)
Net income (loss) from continuing operations	**228.0**	**77.6**
Net income (loss) from discontinued operations	**(223.8)**	**(100.2)**
Total net income (loss)	**4.2**	**(22.6)**
Net income attributable to owners of Pirelli & C. S.p.A.	21.7	22.7
Total net earnings per share attributable to the owners of Pirelli & C. S.p.A. (in euro) *	0.044	0.047
Non-current assets	3,164.1	3.596.2
Net working capital	116.7	221.8
Net invested capital	**3,280.8**	**3,818.0**
Equity	**2,028.0**	**2,494.7**
Provisions	797.2	794.5
Net financial (liquidity)/debt position	**455.6**	**528.8**
Equity attributable to the owners of Pirelli & C. S.p.A.	1,990.8	2,175.0
Equity per share attributable to the owners of Pirelli & C. S.p.A. (in euro) *	4,080	4,457
Capital expenditure	433.1	225.2
Research and development expenses	149.7	137.1
% of net sales	3.1%	3.4%
Employees (number at end of period)	29,573	29,570
Industrial sites (number)	20	21
Pirelli & C. S.p.A. shares		
Ordinary shares (number in millions)	475.7	5,233.1
of which treasury shares	0.4	3.9
Savings shares (number in millions)	12.3	134.8
of which treasury shares	0.4	4.5
Total shares (number in millions)	**488.0**	**5,367.9**

* *The equity per share attributable to owners of the Company in 2009 has been restated on a comparable basis after the reverse stock split pursuant to the Shareholders' Meeting resolution of July 15. 2010 (at a ratio of 1:11).*

To facilitate understanding of Group performance, the income data and net financial (liquidity)/debt position are presented below as broken down by business segment.

(in millions of euro)

	Tyre		Other businesses *		Total	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Net sales	**4,772.0**	**3,992.9**	**76.4**	**74.6**	**4,848.4**	**4,067.5**
Gross operating profit before restructuring expenses	684.3	538.0	(30.6)	(30.2)	653.7	507.8
Operating income before restructuring expenses	476.3	345.5	(43.8)	(40.6)	432.5	304.9
Restructuring expenses	(23.2)	(37.0)	(1.5)	(18.2)	(24.7)	(55.2)
Operating income	**453.1**	**308.5**	**(45.3)**	**(58.8)**	**407.8**	**249.7**
Net income (loss) from equity investments	0.3	4.2	23.1	(15.8)	23.4	(11.6)
Financial income/(expenses)	(66.4)	(76.1)	0.6	6.0	(65.8)	(70.1)
Income tax	(134.4)	(90.0)	(3.0)	(0.4)	(137.4)	(90.4)
Net income (loss) from continuing operations	**252.6**	**146.6**	**(24.6)**	**(69.0)**	**228.0**	**77.6**
Net income (loss) from discontinued operations					**(223.8)**	**(100.2)**
Net income (loss)					**4.2**	**(22.6)**
Net financial (liquidity)/debt position of continuing operations	1,109.9	1,027.3	(654.3)	(504.1)	455.6	523.2
Net financial (liquidity)/ debt position of discontinued operations						5.6
Net financial (liquidity)/debt position					**455.6**	**528.8**

* *This item includes the Pirelli Eco Technology Group, the Pirelli Ambiente Group, PZero S.r.l., all holding companies (including the Parent), the other service companies and, for the item "net sales", elimination of intercompany transactions*

NET SALES

Net sales in 2010 totalled euro 4,848.4 million, up 19.2% from euro 4,067.5 million in 2009.
The percentage breakdown of activities shows that 98.4% of sales were generated by the tyre business (98.1% in 2009).

OPERATING INCOME

Operating income before restructuring expenses totalled euro 432.5 million (8.9% of sales), compared with euro 304.9 million (7.5% of sales) in 2009.
Restructuring expenses totalled euro 24.7 million, as compared with euro 55.2 million in 2009, and stem mainly from on-going measures launched in 2009 to streamline Pirelli Tyre staff organisations in Europe (euro 23.2 million, compared with euro 37 million in 2009).
Operating income totalled euro 407.8 million, compared with euro 249.7 million the previous year.

NET INCOME (LOSS) FROM EQUITY INVESTMENTS

Net income from equity investments was euro 23.4 million, compared with a net loss of euro 11.6 million in the previous year. The figure for 2010 consists principally of the proceeds from disposal of the entire investment held in Oclaro Inc. (formerly Avanex), which generated a gain of euro 18.4 million, in addition to euro 5.8 million earned as dividends on financial investments and the recognition of associates in Equity. In this last category, the carrying value of the associate RCS MediaGroup S.p.A. (RCS) not only reflected the Group's interest in the RCS net loss for the year of about euro 3 million, but also its impairment to value in use by an additional euro 0.5 million, or euro 1.48 per share.
In 2009 this item was largely impacted by the negative effect from disposal of the remaining equity investment in Telecom Italia S.p.A. (euro 17.5 million).

NET INCOME (LOSS)

Net income from continuing operations was euro 228.0 million, nearly triple the amount of euro 77.6 million generated in 2009. This change resulted primarily from the improvement in operating income.
The **net loss from discontinued operations**, totalling euro 223.8 million, related to the activities of the Pirelli RE (now Prelios) Group and Pirelli Broadband Solutions that were sold in 2010.
In regard to **Pirelli RE** (now Prelios), the result consists of the operating loss for the first nine months of 2010 (euro 29 million, compared with euro 104.8 million for all of 2009), the loss on assignment of Pirelli & C. S.p.A. shares (euro 156.3 million), the derecognition of the goodwill previously allocated on asset (euro 32.9 million), the riclassification to income statement of gains/losses previously recognized in Equity (euro 32.2 million), the reversal of a real estate gain previously eliminated in the consolidated financial statements (euro 3.7 million), and *spin-off* expenses (euro 1.2 million).
Pirelli Broadband Solutions contributed a total of euro 24.1 million to net income, including euro 21.1 million for the gain realised on disposal of the equity investment and

euro 3.4 million in operating income for the first nine months of 2010 (euro 4.6 million in all of 2009), net of disposal costs (euro 0.4 million).

Total net income was euro 4.2 million, compared with a net loss of euro 22.6 million in the previous year.

The **total net income attributable to owners of Pirelli & C. S.p.A.** was euro 21.7 million (euro 0.044 per share), compared with euro 22.7 million (euro 0.047 per share) the previous year.

EQUITY

Consolidated Equity fell from euro 2,494.7 million at December 31, 2009 to euro 2,028.0 million at December 31, 2010.
Equity attributable to owners of Pirelli & C. S.p.A. at December 31, 2010 was euro 1,990.8 million, compared with euro 2,175 million at December 31, 2009.

The change is summarised as follows:

(in millions of euro)

	Group	Non-controlling interests	Total
Equity at 12/31/2009	**2,175.0**	**319.7**	**2,494.7**
Translation differences	101.4	3.3	104.7
Net income (loss) from continuing operations	233.8	(5.8)	228.0
Net income (loss) from discontinued operations	(212.0)	(11.8)	(223.8)
Adjustment to fair value of other financial assets/derivative instruments	(45.5)	-	(45.5)
Other changes to items recognised in Equity for continuing operations	3.9	-	3.9
Net actuarial gains/(losses) on employee benefits	(21.6)	-	(21.6)
Total items recognised in Equity for discontinued operations	36.6	3.3	39.9
Reduction for spin-off of Pirelli RE (now Prelios)	(215.3)	(274.8)	(490.1)
Dividends paid	(81.1)	(4.0)	(85.1)
Venezuela inflation effect	15.0	0.6	15.6
Capital increases	-	4.8	4.8
Other changes	0.6	1.9	2.5
Total changes	**(184.2)**	**(282.5)**	**(466.7)**
Equity at 12/31/2010	**1,990.8**	**37.2**	**2,028.0**

The statement of reconciliation between the Equity of the Parent Pirelli & C. S.p.A. and the consolidated Equity attributable to the owners of the Parent is presented below, pursuant to the Consob Comunication of July 28, 2006.

(in millions of euro)

	Share capital	Treasury reserves	Net income	Total
Equity of Pirelli & C. S.p.A. at 12/31/2010	**1,375.7**	**121.5**	**87.4**	**1.584.6**
Net income for the year of consolidated companies (before consolidation adjustments)	-	-	261.9	261.9
Share capital and reserves of consolidated companies (before consolidation adjustments)	-	818.4	-	818.4
Consolidation adjustments:				
— carrying value of equity investments in consolidated companies	-	(668.9)	-	(668.9)
— intercompany dividends	-	258.8	(258.8)	-
— others	-	63.7	(68.9)	(5.2)
Consolidated equity of group at 12/31/2010	**1,375.7**	**593.5**	**21.6**	**1,990.8**

+4.2

million euro

TOTAL NET INCOME

NET FINANCIAL (LIQUIDITY)/DEBT POSITION

The Group's net financial position which was negative for euro 528.8 million at December 31, 2009 improved to euro 455.6 million at December 31, 2010.
The change for the year is summarised by the following cash flow, which totalled a positive euro 73.2 million:

(in millions of euro)

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	2010	2009
Operating income (EBIT) before restructuring expenses	90.2	109.6	119.9	112.8	432.5	304.9
Amortisation and depreciation	51.7	53.7	55.0	60.8	221.2	202.9
Purchase of property. plant and equipment and intangible assets	(49.9)	(85.2)	(91.5)	(212.0)	(438.6)	(223.8)
Change in working capital/other	(143.5)	42.2	(18.0)	214.5	95.2	211.7
Operating cash flow	**(51.5)**	**120.3**	**65.4**	**176.1**	**310.3**	**495.7**
Financial income/(expenses)	(17.6)	(22.9)	(14.0)	(11.3)	(65.8)	(70.1)
Income tax	(30.4)	(40.0)	(40.1)	(26.9)	(137.4)	(90.4)
Net operating cash flow	**(99.5)**	**57.4**	**11.3**	**137.9**	**107.1**	**335.2**
Financial investments/disinvestments	-	-	9.8	21.9	31.7	219.1
Dividends paid	-	(85.1)	-	-	(85.1)	(2.4)
Cash out for restructuring expenses	(34.0)	(9.9)	(7.4)	(2.0)	(53.3)	(65.8)
Net cash flow of Pirelli Broadbands Solutions	(12.1)	0.7	(11.4)	(12.9)	(35.7)	20.7
Net cash flow of Pirelli RE (now Prelios)	(14.0)	(6.5)	(26.5)	88.3	41.3	248.2
Pirelli RE (now Prelios) rights issue subscribed by Pirelli & C. S.p.A.	-	-	-	-	-	(231.9)
Foreign exchange differences/other	10.0	24.9	16.2	16.1	67.2	(24.2)
Net cash flow	**(149.6)**	**(18.5)**	**(8.0)**	**249.3**	**73.2**	**498.9**

The following table breaks down the net financial position by business segment:

(in millions of euro)

	Tyre	Other businesses	Corporate	Consolidated continuing operations
Gross debt	1,613.6	83.3	123.0	1,147.0
of which due to Corporate	589.6	83.3		
Financial receivables	(98.3)	(4.8)	(806.7)	(236.9)
of which receivable from Pirelli RE (now Prelios)			(140.4)	(140.4)
Cash. cash equivalents. securities held for trading	(405.4)	(6.6)	(42.5)	(454.5)
Net financial (liquidity)/debt position	**1,109.9**	**71.9**	**(726.2)**	**455.6**

The column "Other businesses" includes Pirelli & C. Eco Technology. Pirelli & C. Ambiente and PZero

The financial receivables include use of the credit facility granted to Pirelli RE (now Prelios) for euro 150 million, due in July 2012 or July 2017 (depending on whether Pirelli RE - now Prelios - fails to realise the targets set in its business plan), referring to assignment of its shares. This credit facility complements the bank credit facilities available to Pirelli RE (now Prelios).

The structure of gross debt is broken down by type and maturity as follows:

(in millions of euro)

	Financial Statements 12/31/2010	Maturity date			
		2011	2012	2013	2014 and beyond
Use of committed credit facilities	380.0	-	-	-	380.0
Other financing	767.0	252.0	146.7	92.0	276.3
Total gross debt	**1,147.0**	**252.0**	**146.7**	**92.0**	**656.3**
		22.0%	12.8%	8.0%	57.2%

At December 31, 2010 the Group had unused *committed* credit facilities totalling euro 1,220 million, with the liquidity margin (construed as the sum of liquidity and unused credit facilities) consequently totalling euro 1,674 million.

CAPITAL EXPENDITURE

Capital expenditure during the period, totalling euro 433.1 million, was concentrated in Pirelli Tyre (euro 402.1 million, or 93% of the total), and mainly targeted growth and expansion in production capacity.

EMPLOYEES

Group headcount at December 31, 2010 was 29,573 (including 2,426 temporary workers), as compared with 28,303 employees at December 31, 2009 on a comparable consolidation basis (29,570 employees overall), i.e. net of employees at Pirelli RE (now Prelios) and Pirelli Broadband Solutions, which were sold in 2010.

GEOGRAPHICAL AREAS

	12/31/2010		12/31/2009	
Europe:				
— Italy	3,587	12.13%	4,454	15.07%
— Rest of Europe	7,714	26.09%	8,156	27.58%
Nafta	285	0.96%	280	0.95%
Central and South America	12,522	42.34%	11,722	39.64%
Middle Est/Africa	2,983	10.09%	2,834	9.58%
Asia/Pacific	2,482	8.39%	2,124	7.18%
	29,573	100.00%	29,570	100.00%

BUSINESS SEGMENTS

	12/31/2010		12/31/2009	
Tyre	28,865	97.60%	27,481	92.94%
Eco Technology	295	1.00%	284	0.96%
Real Estate	-	-	1,139	3.85%
Broadband Solutions	-	-	128	0.43%
Other businesses	413	1.40%	538	1.82%
	29,573	100.00%	29,570	100.00%

RESEARCH AND DEVELOPMENT ACTIVITIES

Pirelli Group research and development activities are key to pursuit of its growth strategy. Product and process innovation and exploitation of new business opportunities depend on Reseach and Development.

Group reseach and development **costs**, which are fully expensed in the annual income statement, totalled **euro 150 million**, representing a 3.1% ratio to sales.

Research and development activities are concentrated in **Pirelli Tyre**, with costs of **euro 146 million**. This Group subsidiary has a research centre in Italy and eight application centres worldwide, and is staffed by over 1,000 employees – 60% of whom are from countries other than Italy. The value of investments in research activity is expected to remain at about 3% of sales over the next three years, one of the highest levels in the industry. All of these factors will enable the Group to increase the number of its patents (currently over 4,500), maintain its capacity to produce innovative Premium products, continue perfecting innovative processes used for materials mixing and tyre building in all product segments (car, motorcycle and commercial vehicles), and develop alternative materials to replace traditional ones. This will reduce production costs and improve the environmental sustainability of Group products.

The exchange of know-how amongst the Group's various businesses, partnership with best-of-class suppliers and continuous collaboration with leading university research centres and major car makers provide the Group with the technology necessary to develop cutting-edge products, which are successfully tested in the most important motorsport disciplines and then put on the road to satisfy specific customer requirements.

Traditionally focused on the development of new high-end products (UHP, winter, runflat, SUV and motorcycle tyres), Reseach and Development activity has been complemented by increasing strategic attention to the reduction of environmental impact, through the exploitation of technological components and the most advanced know-how. These resources are the result of intense research on materials, prototypes, profiles, tread patterns and processes.

As a result of its research and development activity in 2010, Pirelli has confirmed its leadership as measured by performance, safety and ecocompatibility, demonstrating

that it has fully adopted the philosophy and fundamental values of Green Performance.

This Green Performance strategy is based on comprehensive technological innovation:

— engineering times and costs have been substantially reduced, with a consequent positive impact on total product cost. In the production processes area, the application of cutting-edge systems like MIRS (a robotised tyre production process owned exclusively by Pirelli) and the innovative compound system CCM (Continuous Compound Mixing System) make it possible to develop products by means of extremely high quality and flexible processes using low amounts of energy;

— use of new organic bio-materials, with a beneficial impact on the environment and costs. Plans call for development of Green Performance products in different segments, especially by reinforcing the Group's leadership in the Premium segment;

— technological partnerships with other leaders in the industry. Pirelli has collaborated for several years with several of the world's most important research institutions, including the Milan Polytechnic, the Turin Polytechnic, the University of Craiova and Shandong University, while it develops new technology on an "open innovation" basis with STM, Comau, Sinteco, Evotek and many other industrial partners;

— development of the technological and production centre at Settimo Torinese, with the aim of creating the Group's most technologically advanced and efficient "green" tyre production facility. This project is part of a process that guarantees higher standards of factory efficiency and productivity.

Pirelli is also in the vanguard with development of the Cyber Tyre project. This is an intelligent tyre that can transmit information to the vehicle essential for its stability and driving safety. In 2010, the Cyber Tyre Lean sensor was given its world première at Geneva. The sensor complies with the

new European standard that requires adoption of a system for measuring the pressure of tyres on all vehicles that are newly approved for road use beginning in 2012. This development was realised in collaboration with Schrader-Tomkin, leading world maker of pressure sensors, and marks the first step towards the creation of a sensor-equipped tyre that can communicate with vehicle control systems for the realisation of new vehicle safety functions while simultaneously providing data useful for designing and perfecting the tyre.
The Group has received various forms of recognition for its research activity.
Pirelli was recognised as the best tyre supplier of the year in Japan. This award was received from Autobacs, the historic Japanese reseller of automotive spare parts and accessories founded in 1947 with locations worldwide. It awarded Pirelli for the major contribution made to Autobacs sales in 2009, which were driven by the success of the P4 Four Season.
Another form of recognition came in the form of the "*Original Equipment Tire Satisfaction Index Study*", conducted by the prestigious JD Power & Associates research institute, which annually surveys the general level of driver satisfaction. This study showed that American drivers prefer Pirelli high-performance tyres for sports cars.
The trade press rewarded Pirelli with numerous forms of recognition in 2010. "Exemplary, with no weaknesses": this was the brilliant result achieved by the Cinturato P7 in ecologically focused summer tests organised in Germany by the specialised magazine "Autobild." These tests were held to assess the capacity of this type of product to combine energy savings and safety features, even under the most demanding conditions on wet roads.
When compared with four other 205/55R16 V tyres, the Pirelli "green" tyre designed for medium and high-powered cars received the highest overall score. It stood out especially for its performance on wet road surfaces – handling and braking distance – and aquaplaning on curves.
"Exemplary" was the final judgement of "Autobild," which did not find any drawbacks with the Pirelli Cinturato P7, remarking only on "its convincing talent, satisfying energy savings characteristics, smooth driving performance, stable grip on curves and limited braking distances both on dry and wet pavement, and quiet ride."
Pirelli passed the 2010 summer tests organised by the German press with brilliant results. Various Pirelli tyre models topped the test rankings, from the high-performance PZero to the reliable Chrono, as well as the Cinturato family of tyres.
Pirelli can offer the best products, establishing new standards that are recognised by the most prestigious trade magazines and toughest automobile clubs in Germany.

In particular:
— PZero won top prize from "AutoZeitung" hands-down for its excellent balancing;
— Scorpion ATR won the "AutoBildallrad" test of safety and grip on all types of terrain;
— Cinturato P6 was ranked "highly recommended" by ADAC for its excellent balancing, performance on wet pavement, and low wear;
— Cinturato P7 is "highly recommended" by ADAC, "AutoZeitung" and "Automotorsport" for its excellent balancing, low rolling resistance and sportiness;.
— Chrono was recognised by "Promobil" for its excellent braking on wet and dry payment and aquaplaning performance.

Positive recognition was also received from China. According to the magazine "Auto news," the Pirelli Cinturato P7 is "The best balanced tyre of the year." The Cinturato P7 stood out for its road hold, stability, tread pattern optimised to reduce its noise level and the low-carbon emissions production process. Pirelli was considered the best brand on the Chinese spare parts market. This was the finding made by the China Automobile Aftermarket Summit, the forum that is held in Beijing at the end of April, and promoted by the prestigious magazine "Motor Trend."
Twenty-seven tyre brands competed for the prize. They were reviewed by industry experts attending the meeting, who named Pirelli the "*recommended brand*" for 2010.
For the fifth year in a row, Pirelli won the "Best Tuning Cars & Best Brands 2010" competition, the most popular amongst readers of Auto Illustrierte (AI), a prestigious independent car magazine published in Switzerland. Pirelli was proclaimed the best tyre brand of the year by over 1,600 readers.
For the third consecutive year, Pirelli has been rewarded by the readers of SportAuto, the authoritative German magazine for automotive enthusiasts. In response to the survey of SportAuto readers, Pirelli was especially appreciated in the sportsmanship category, for the score it achieved in the areas of "stability in curves," "high-speed safety" and "excellent braking performance." Pirelli also won in the "emotionality" category on the basis of how readers voted in the "I like the brand" and "sport look" areas.

In 2010, Pirelli also consolidated its collaboration with the Turin Polytechnic as part of a project partly funded by the Region of Piedmont, with the development of several important technologies for the Cyber Tyre, the application for several patents to protect the original solutions discovered, and the continuation of projects connected with "Next MIRS" and development of a new technology based on the production of high-performance compounds ("PTSM"). Various patent applications are being prepared on the basis of this collaboration.
The innovations resulting from this joint effort are also being implemented at the New Industrial Centre in Settimo Torinese, one of the most modern and efficient tyre manufacturing plants in the world.

Pirelli's collaboration with the academic world also involves the University of Milan - Bicocca. Once again in 2010, Pirelli funded research doctorates in the School of Science, through the Corimav (Consorzio ricerca materiali avanzati – advanced materials research consortium). In the car tyre area, Pirelli research and development activity in 2010 turned out new *green* products like the Scorpion Verde, the first high-performance ecological tyre for SUV and crossover vehicles realised as part of the corporate *Green Performance* strategy.

Pirelli maintains close relationships with many of the world's leading carmakers, for the purpose of supplying original equipment tyres. They are also fundamental to the development of new products and implementation of new technologies.

In 2010, Pirelli received the following final approval for use as original equipment on the following makes of car, among others: Maserati GranTurismo MC Stradale, Lamborghini New Murcielago, McLaren MP4-12C, Porsche Cayenne, Aston Martin One-77, BMW M3 and X3, Daimler GLK and CLS, Audi A8 and A7, Chrysler-Fiat 500 USA, Volkswagen Touareg, Phaeton and Scirocco.
The new Maserati GranTurismo MC Stradale debuted at the Paris Motor Show. This was the first car to be fully equipped with Pirelli PZero Corsa tyres, which were specifically developed and made using the new Next MIRS process.
The new 2011 SMS Mustang 302, from the Signature line designed by Steve Saleen, will be equipped with new, exclusive Pirelli PZero tyres.
Another example of avant-garde technology and design is represented by Pagani custom-made cars, which have set two records on the Nürburgring track. In partnership with Pirelli, the Pagani Zonda R set the new record on the Nordschleife circuit at Nürburgring, covering 20.83 km in 6'47" with Pirelli PZero Slick tyres (in the 265/645-19TL, 325/705-20TL sizes). This time was made possible by the excellent road holding characteristics and ability of Pirelli PZero Slick tyres to transfer all of the car's power to the ground. The tyres themselves were fabricated in Milan on the first prototype Next MIRS line, which represents the state of the art of Pirelli technology dedicated to the manufacture of ultra-high performance and motorsport tyres.
In 2010 Pirelli Tyre's research and development efforts produced important results on the race track, which are

Pirelli Diablo Rosso II

Scorpion Verde

the de facto testing grounds for new technological solutions under conditions where vehicles are pushed to their limits.
Pirelli will supply the tyres of the Formula 1 World Championship during the three-year period 2011-2013. The FIA (Fédération Internationale de l'Automobile), the teams, represented by FOTA (Formula One Team Association), and the Formula 1 organisation, represented by FOM (Formula One Management), chose Pirelli as their exclusive supplier, after approving the solutions proposed by the Italian Group to guarantee technological and qualitative continuity to the racing teams.

Pirelli has also been engaged as exclusive supplier to the GP2 Series World Championship for the three-year period 2011-2013.
The Formula 1 supply agreement crowns the long-standing commitment of Pirelli to car racing, dating back to 1907, when the Italian Group won the Peking-Paris Raid.
Pirelli is currently the exclusive supplier to the world's most important car and motorcycle races, such as the GP3 World Championship, the WRC World Rally Championship, the Rolex Sports Car Series in North America, the Superbike World Championship and the Motocross World Championship. It is also involved in over 70 other national and international championships.

The Motorcycle business unit launched the new Supersport Diablo Rosso motorcycle tyre in 2010. Diablo Rosso II is characterised by the new tread pattern designed using the FGD (Functional Groove Design) technology, which enhances regular wear and tear and further increases the contact surface. To improve road hold, Pirelli used the Enhanced Patch Technology (EPT) developed on the basis of Superbike championship experience. The tyre contact area was maximised using ICS (Integrated Contour Shaping) design, which enhances motorcycle road hold and power output and guarantees unprecedented results in terms of stability, performance on wet surfaces and safety on curves.
In April 150 motorcycle racers met at the Zolder track in Belgium, after being invited by Metzeler to test the new Sportec M5 Interact. In October the Feelfree Wintec tyre was presented to the international press at the Pirelli test track at Vizzola Ticino. This is the first tyre designed for using scooters on wet or slippery roads, typical in autumn and winter, while guaranteeing safety and reliability.
Scorpion Trail, an innovative set of enduro street radial tyre measurement, was introduced. This was the first of its kind and created on the basis of the long, close collaboration between Pirelli and Ducati, which has used Pirelli tyres as original equipment on all its models since January 1, 2010.

In addition to the activities connected with its core Tyre business, the Group has also invested in brand support activities, like PZero. Solutions have been studied even in the apparel sector, to improve shoe comfort and performance while following fashion trends. All materials used have been classified to establish a correlation between material characteristics and product performance.
Testing procedures have also been implemented at PZero suppliers to monitor compliance with REACH regulatory requirements governing the potential toxicity of any materials we supply.

In the **photovoltaic** sector, work continued on the design and construction of prototype solar trackers for conventional photovoltaic modules. The complete prototypes, which feature innovative designs and large dimensions, have a total capacity of about 4 kWp and guarantee up to 40% more energy output than fixed modules and the photovoltaic solar concentration project, which guarantees extremely high performance in terms of efficiency, in addition to the possibility of major reductions in component and process costs.

SIGNIFICANT EVENTS SUBSEQUENT TO THE END OF THE YEAR

On **January 13, 2011** Pirelli & C. S.p.A. sold its equity investment in CyOptics Inc. (34.41% shareholding) for USD 23.5 million.

On **February 10, 2011** Pirelli & C. S.p.A. successfully concluded its placement of an *unrated* bond issue worth a nominal euro 500 million with international institutional investors on the Eurobond market.
This issue was enthusiastically received by investors, with requests totalling more than euro 4.5 billion, or over nine times the amount offered. More than 93% of the bond issue was placed with foreign investors. The placement, executed in accordance with the Pirelli & C. S.p.A. Board of Directors resolution of July 29, 2010, is one of the actions being taken to streamline the Group debt structure by lengthening the average duration of debt and diversifying funding sources.
The notes have the following characteristics:
- issuer: Pirelli & C. S.p.A.
- guarantor: Pirelli Tyre S.p.A.
- amount: euro 500 million
- settlement date: February 22, 2011
- maturity: February 22, 2016
- coupon: 5.125%
- issue price: 99.626%
- redemption price: 100%
- minimum denomination: euro 100 thousand and additional multiples of euro 1000

The effective yield at maturity is 5.212%, corresponding to a yield of 230 basis points above the corresponding reference rate (*mid swap*). The notes will be listed on the Luxembourg Stock Exchange. The placement was handled by Barclays Capital, acting as *global coordinator*, Banca IMI, Mediobanca, SG CIB and Unicredit as *joint bookrunners*.

This issue was enthusiastically received by investors, with requests totalling more than euro 4.5 billion, or over nine times the amount offered

RISKS AND UNCERTAINTIES

The current macroeconomic situation, financial market volatility, complex management processes and continuous legislative and regulatory evolution force successful businesses to renew their ability to protect and maximise tangible and intangible sources of value that characterise their own business model. Assessing and preventing risks that might compromise the Group's values and objectives have always been an integral part of Pirelli's distinctive spirit of innovation and professional excellence. For these reasons, the Board of Directors decided in 2009 to upgrade its corporate governance system by introducing a pro-active risk management system. It uses a systematic and organised process of identifying, analysing and assessing risk-prone areas that could compromise the attainment of strategic objectives, provides the Board of Directors and top management with decision-making tools so that they can anticipate and manage the effects of these risks and, more in general, govern them, guided by the awareness that the assumption of risk is a fundamental part of business management.
Reference is made to the Corporate Governance Report for details on the new risk management system.
The principal types of risk to which the Group may be exposed are listed as follows:
- **Strategic risks**, which are closely tied to the Group's objectives and consequent strategic choices. This category includes the exogenous risks stemming from evolution in the external context where the Group operates and the risks stemming from internal factors, such as financial risks, the risks connected with typical business processes and human resource/organisation risks;
- **Cross business risks**, which can always affect operating activities regardless of current strategies. This category includes business interruption risks, information system risks and financial disclosure risks (in regard to the latter, see the section "Risk Management System" in the Corporate Governance Report).

1. STRATEGIC RISKS

EXTERNAL RISKS

General economic risks

The **Tyre** segment has expanded steadily over the past decade, and the contraction that occurred during the global economic crisis between 2008 and 2009 was turned around in 2010. Driven in part by demand from rapidly developing economies (RDE), the total number of cars on the road worldwide is constantly growing. Even higher growth rates have been observed in the segment of cars equipped with Premium tyres. These types of tyres are no longer associated strictly with performance and luxury, but with products that are increasingly linked with sustainability and safety aspects, areas effectively covered by Pirelli with its cutting-edge know-how and technology.
However, due to the difficulty of predicting the magnitude and duration of business cycles, Pirelli cannot give any assurance as to future demand and supply trends for Group products sold on the markets where it operates.
In this regard, realisation of the strategic plan might run the risk of slower recovery in economic and productive activity, especially in Western markets, with the consequent possibility of lower than expected turnover for the sector. In addition, the level of competition on markets where the Group operates has increased over the last several years, especially in Europe and Latin America, partly due to the entry of new, *low-cost* producers from Asian countries. Finally, Group profitability might be slightly reduced if the upward trend for raw material prices (especially for raw rubber) witnessed over the last several months continues through 2011 and if the Group is unable to counteract this tendency with changes to the commercial price/mix component and internal cost efficiency measures.

On the other hand, Tyre segment revenue is based principally on sales volumes that are only partially affected by negative business cycles. Sales are actually heavily driven by the spare parts segment, which now accounts for about 75% of revenue, leaving the Group more flexible and less exposed to any slowdown in the automotive sector and demand in the original equipment segment. About 50% of Pirelli sales are now made outside of Western markets, and this simple fact, combined with execution of a joint venture agreement for local production on the Russian market mitigates the Group's exposure to slowdowns on Western markets. Finally, the Group's preeminent position in the *Premium* segment, constant innovation of its product line, a complete line of "*green*" tyres (which now represent 37% of turnover) and brand enhancement following the supply agreement made with Formula 1 are all powerful factors that differentiate Pirelli products from those of its *low-cost* competitors and help support sales prices.

Country risk

The Pirelli Group operates in countries such as Argentina, Brazil, China, Egypt, Turkey and Venezuela, where the general political and economic context and tax systems might prove unstable in future.
The risks generally connected with these areas may be associated with:
- changes in local economic and political conditions;
- implementation of import and/or export restrictions;
- changes in tax law;
- introduction of policies restricting foreign investment and/or trade, as well as currency control policies and associated restrictions on the repatriation of capital;
- introduction of more restrictive laws or regulations.

The occurrence of political or economic instability in these areas might impact the Group's earnings and/or financial position.

FINANCIAL RISKS

As also reported in the notes to the consolidated financial statements, the Group is exposed to financial risks. These are principally associated with fluctuations in foreign exchange rates, raising funds on the market, fluctuations in interest rates, and the ability of customers to honour their obligations to the Group.
Financial risk management is an integral part of Group business management and is handled directly by headquarters in accordance with guidelines issued by the Finance Department on the basis of general risk management strategies defined by the Managerial Risk Committee. These guidelines define the risk categories and specify the applicable operating procedures and limits for each type of transaction and/or instrument.

Exchange rate risk

The varied geographical distribution of Pirelli production and commercial activities entails exposure to transaction and translation exchange rate risk.

a) Transaction exchange rate risk

This risk is generated by the commercial and financial transactions executed in currencies other than the functional currency due to exchange rate fluctuations between the time when the commercial or financial relationship is established and when the transaction is completed (collection or payment).
The Group aims to minimise the impact of transaction exchange rate risk on income statement. To do so, internal pro-

cedures make the operating units responsible for collecting complete information about the assets and liabilities that are subject to transaction exchange rate risk. This risk is hedged with futures contracts made with the Group Treasury.
The items subject to exchange rate risk are mainly represented by receivables and payables denominated in foreign currency.
The Group Treasury is responsible for measuring and managing the net position for each currency. In accordance with established guidelines and restrictions, it closes all risk positions by trading derivative hedging contracts on the market, which typically take the form of futures contracts.
Furthermore, as part of the annual and three-year planning process, the Group makes exchange rate forecasts according to these time horizons by using the best information available on the market. The fluctuation in exchange rates between the time when the forecast is made and the time when the commercial or financial transaction is established represents the transaction exchange rate risk on future transactions.
In accordance with established policy, the Group monitors the opportunity to hedge future transactions, with each hedge being authorised by the Finance Department on a case-by-case basis.

b) Currency translation risk

Pirelli owns controlling interests in companies that prepare their financial statements in currencies other than the euro, which is the Group presentation currency. This exposes the Group to currency translation risk, which is generated by the conversion of assets and liabilities of those subsidiaries into euro.
The principal exposures to currency translation risk are monitored, but the Group has no policy to hedge this exposure.

Liquidity risk

The principal instruments used by the Group to manage the risk of having insufficient resources to meet its financial and commercial obligations according to agreed terms and due dates are comprised by its annual and three-year cash-pooling plans. These allow complete and fair detection and measurement of incoming and outgoing cash flows. The differences between the plans and the final balances are constantly analysed.
Prudent management of the risk described above requires maintaining an adequate level of cash equivalents and/or highly liquid short-term financial instruments, the availability of funds through an adequate amount of *committed* credit facilities, recourse to the capital market and/or the ability to close outstanding positions on the market. Due to the dynamic nature of the business in which it operates, the Group prefers flexibility in sourcing funds, resorting to *committed* credit facilities.
Accordingly, a new five-year *revolving* credit facility for euro 1.2 billion was obtained in November 2010. This new facility will replace existing credit facilities totalling euro 1.475 billion that were obtained in 2005 and 2007, fall due in 2011 and 2012, and will consequently be cancelled prematurely. Furthermore, the placement of an *unrated* bond issue for euro 500 million with international institutional investors on the Eurobond market was successfully completed in February 2011.
The Group has implemented a cash pooling system for the management of collection and payment flows in compliance with various local currency and tax laws. Banking relationships are negotiated and managed centrally, in order to ensure coverage of short and medium-term financial needs at the lowest possible cost. The procurement of medium and long-term resources on the capital market is also streamlined through centralised management.

Interest rate risk

Fluctuations in interest rates impact the market value of Group financial assets and liabilities and net financial expenses.
Group policy is to attempt to maintain the following ratio between fixed rate and variable rate exposures: 65% fixed and 35% variable.
The Group makes derivative contracts, *typically interest rate swaps* that are authorised by the Finance Department in order to maintain this target ratio.

Price risk associated with financial assets

Group exposure to price risk is limited to the volatility of financial assets, such as listed and unlisted stocks and bonds, which represent 7.1% of total Group assets.

Credit risk

Credit risk represents Group exposure to contingent losses resulting from default by commercial and financial counterparties.
To limit commercial counterparty default risk, the Group has implemented procedures to evaluate its customers' potential and financial solidity, monitor expected incoming cash flows and take credit recovery action if necessary.
The aim of these procedures is to define customer credit limits. Further sales are suspended when those limits are exceeded.
In certain cases customers are asked to provide guarantees. These mainly consist of standby letters of credit is-

sued by parties with excellent credit or personal standing. Less frequently, mortgage guarantees may be requested.

Insurance policies are another instrument used to manage commercial credit risk. These policies aim to prevent the risk of non-payment through careful selection of covered customers in collaboration with the insurance company, which undertakes to indemnify the Group in the event of customer insolvency.
The Group deals only with highly rated financial counterparties for the management of temporary surplus cash or for trading in derivatives.
The Group does not have significant concentrations of credit risk.

RISKS ASSOCIATED WITH ORDINARY PROCESSES

Environmental risks

The activities and products of the Pirelli Group, a multinational that does business worldwide, are subject to numerous environmental laws that vary from country to country. In any case, these laws share a common tendency to become increasingly restrictive over time, partly in response to the growing commitment by the international community to environmental sustainability.
It is likely that stricter laws will be gradually introduced, regulating the various types of environmental impact that businesses might have (air pollution, waste output, soil contamination, water use, etc.). Consequently, the Pirelli Group expects that it will have to continue to invest and/or incurring costs for what might become significant amounts.
Reference is made to the Sustainability Report chapter "Environmental Dimension" for details on the process of managing and controlling environmental risks described above.

Employee health and safety risks

As part of operating its business, the Pirelli Group bears liabilities and costs for the measures necessary to guarantee full compliance with its obligations under workplace health and safety protection laws. Specifically in Italy, the workplace health and safety law (Legislative Decree 81/08), as amended (Legislative Decree 106/09), has introduced new obligations impacting the management of activities at Pirelli sites and the systems for allocating responsibility. Failure to comply with applicable laws and regulations results in the imposition of criminal and/or civil penalties on the persons responsible and, in certain cases where health and safety laws are violated, on the firms themselves, in accordance with a European standard of objective business liability that has also been received in Italian law (Legislative Decree 231/01). Reference is made to the Sustainability Report for details on the process of managing and controlling these risks.

Product defect risk

Pirelli might be affected by product liability suits or by product recalls due to presumed defects in sold materials. Although no major events of this sort have occurred in recent years and notwithstanding insurance coverage against these risks, the Pirelli brand might be negatively impacted should they ever occur.

Litigation risks

In the course of operating its business, Pirelli might be involved in legal actions, tax litigation, commercial lawsuits or labour lawsuits. The Group takes all measures necessary to prevent and attenuate any penalties that might result from these proceedings, including the accrual of provisions for liabilities detailed in the Explanatory Notes to the Consolidated Financial Statements (note 22).

RISKS ASSOCIATED WITH HUMAN RESOURCES

The Group is exposed to the loss of human resources holding key positions or possessing critical *know-how*, which might have a negative impact on future results. To face this risk, Pirelli has adopted bonus policies that are periodically revised according to general macroeconomic conditions, among other factors. Moreover, in the various countries where the Group operates, its employees are protected by laws and/or collective agreements that guarantee them the right to be consulted through local and national representatives in regard to specific organisational or industrial issues, including downsizing or the closure of departments and staff redundancies.

2. CROSS BUSINESS RISKS

RISKS ASSOCIATED WITH INFORMATION SYSTEMS AND NETWORK INFRASTRUCTURE

Group operating activities rely increasingly on the proper, uninterrupted functioning of information systems and network infrastructure in support of business processes. The complexity of the information system environment used, the distribution of activities worldwide and links between them may increase the level of risks connected with *information and communication technology*. Human error, access by unauthorised persons, vulnerable security systems, and system breakdowns or malfunctions might impact the performance of operating activities and cause the disclosure of critical, confidential corporate information, with consequent repercussions on the Group's corporate image, financial losses, competitive disadvantages and the risk of statutory and regulatory violations. To manage and control these risks, the Group has taken appropriate measures to protect its business operations and the confidentiality of corporate information.

BUSINESS INTERRUPTION RISKS

The global scale of Group operations exposes it to a plethora of risks that might even cause an interruption in business activities for an indefinite period of time, consequently impacting its operating and financial results.

Risks associated with natural or accidental events (fire, flood, earthquake, etc.), malicious acts (terrorism, sabotage, etc.), malfunctions in auxiliary plants or interruption of utilities (e.g. power supply) may cause serious damage and production losses, with a particular impact on production sites that have high volumes or specific products.

Other risks might also result from the unavailability of information systems essential to production activities and the interruption of telecommunication links between the various Group sites. These risks are monitored and managed both with preventive measures and insurance, and with response procedures and measures to manage emergencies and restore operations.

BUSINESS OUTLOOK

On the basis of the strategic guidelines set out in the 2011-2013 Business Plan and in response to the continued growth in demand, in 2011 the Company will focus more and more on the development of *Premium* products and expansion of its production capacity, mainly in rapidly developing economies. In the absence of currently unforeseeable events and considering that raw material prices are rising faster than assumed in the Business Plan presented last November, price increases will be greater than originally assumed. Consequently, the 2011 target for Group sales, 99% of which are accounted for by Pirelli Tyre, is now being increased from "over euro 5.15 billion" to "over euro 5.55 billion." This reflects expected growth in the volume component of 6% or more (+ 4% was the previous estimate) and about 12% in the price/mix component (+ 4% was the previous estimate). The target ROS is expected to grow from 2010 as forecast in the Business Plan (8.5%-9.5% for the Group and 9%-10% for Pirelli Tyre), due to continuation of the cost efficiency recovery programme. Plans forecast euro 500 million in capital expenditure in 2011. Net financial position is expected to rise negative to about euro 700 million.

In 2011 the Company will focus more and more on the development of Premium products and expansion of its production capacity, mainly in rapidly developing economies.

PIRELLI TYRE

SELECTED ECONOMIC AND FINANCIAL DATA

The consolidated results for 2010 as compared with those for 2009 are highlighted in the following table:

(in millions of euro)

	12/31/2010	12/31/2009
Net sales	**4,772.0**	**3,992.9**
Gross operating profit before restructuring expenses	684.3	538.0
% of net sales	14.3%	13.5%
Operating income before restructuring expenses	476.3	345.5
% of net sales	10.0%	8.7%
Restructuring expenses	(23.2)	(37.0)
Operating income	**453.1**	**308.5**
% of net sales	9.5%	7.7%
Net income (loss) from equity investments	0.3	4.2
Financial income/(expenses)	(66.4)	(76.1)
Income tax	(134.4)	(90.0)
Net income (loss)	**252.6**	**146.6**
% of net sales	5.3%	3.7%
Net financial (liquidity)/debt position	1,109.9	1,027.3
Net operating cash flow	168	395
Capital expenditure	402	217
Research and development expenses	146	133
% of net sales	3.1%	3.3%
Employees (number at end of period)	28,865	27,481
Industrial sites (number)	19	20

Net sales in 2010 totalled euro 4,772.0 million, up 19.5% from the previous year. Sales grew in both business segments, with the consumer segment rising by 16.7% and the industrial segment by 26.3%.

The like-for-like change, excluding the effect of exchange rate fluctuations, was an increase of 16.2%.
Growth was driven by the positive contribution made by all components, with volume up by 7.3% and the product/mix component up by 8.9%. The exchange rate effect was a positive 3.3%.

Sales in Q4 2010 confirmed their positive performance compared to the same period of 2009, continuing the trend established during the preceding quarters, with a total increase of 17.3% (+14.7%). The price/mix component weighed heavily in Q4 2010, just as in the previous quarter, with a positive change of 11.3%, while volume increased by 3.4%.

Sales grew in both business segments, with the consumer segment rising by 16.2% and the industrial segment by 19.7%.

The following table summarises the individual components of changes in sales during 2010, detailing the trend for each quarter:

	Q1		Q2		Q3		Q4		Total	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Volumes	17.4%	-18.1%	7.5%	-13.3%	1.8%	-3.3%	3.4%	15.6%	7.3%	-5.8%
Prices/Mix	1.4%	6.9%	10.1%	5.6%	12.3%	4.7%	11.3%	-1.7%	8.9%	4.2%
Change on a like-for-like basis	**18.8%**	**-11.2%**	**17.6%**	**-7.7%**	**14.1%**	**1.4%**	**14.7%**	**13.9%**	**16.2%**	**-1.6%**
Foreign exchange effect	1.0%	-2.7%	5.3%	-1.5%	4.2%	-3.3%	2.6%	4.8%	3.3%	-1.0%
Total change	**19.8%**	**-13.9%**	**22.9%**	**-9.2%**	**18.3%**	**-1.9%**	**17.3%**	**18.7%**	**19.5%**	**-2.6%**

The distribution of net sales by geographical area and product category is set forth as follows:

GEOGRAPHICAL AREA

	2010			2009
		euro/mln	Δ yoy	
Italy	9%	409,0	11%	9%
Rest of Europe	31%	1,503.5	13%	33%
Nafta	10%	477.4	32%	9%
Central and South America	34%	1,632.1	26%	33%
Asia/Pacific	6%	286.9	24%	6%
Middle East/Africa	10%	463.1	13%	10%
Total	**100%**	**4,772.0**	**20%**	**100%**

PRODUCT CATEGORY

	2010			2009
		euro/mln	Δ yoy	
Car tyres	62%	2,938.6	17%	63%
Motovelo tyres	8%	361.7	15%	8%
Consumer	**70%**	**3,300.3**	**17%**	**71%**
Industrial vehicle tyres	28%	1,364,2	26%	27%
Steelcord	2%	107.5	25%	2%
Industrial	**30%**	**1,471.7**	**26%**	**29%**

Sales grew in all geographical areas in absolute terms, while the weight of NAFTA area increased, partially due to the positive average performance of the benchmark currency (USD) against the euro as compared with 2009.

The following table shows the changes in **operating income** for 2010 on a quarter-by-quarter and cumulative basis in comparison with the same periods of the previous year:

(in millions of euro)

	Q1		Q2		Q3		Q4		Cumulative	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Net sales	1,110.0	926.9	1,215.3	989.0	1,233.8	1,042.7	1,212.9	1,034.3	4,772.0	3,992.9
Δ yoy	19.8%	-13.9%	22.9%	-9.2%	18.3%	-1.9%	17.3%	18.7%	19.5%	-2.6%
Gross operating profit before restructuring expenses	146.4	107.8	177.5	133.0	173.0	142.0	187.4	155.2	684.3	538.0
% of sales	13.2%	11.6%	14.6%	13.4%	14.0%	13.6%	15.5%	15.0%	14.3%	13.5%
Operating income before restructuring expenses	98.1	61.0	127.1	85.5	121.5	94.3	129.6	104.7	476.3	345.5
% of sales	8.8%	6.6%	10.5%	8.6%	9.8%	9.0%	10.7%	10.1%	10.0%	8.7%
Operating income	95.5	57.5	121.8	79.3	117.0	85.9	118.8	85.8	453.1	308.5
% of sales	8.6%	6.2%	10.0%	8.0%	9.5%	8.2%	9.8%	8.3%	9.5%	7.7%

Just as in all preceding quarters of the year, **operating income in Q4 2010** was up from the same period of 2009, and specifically:

— **gross operating profit before restructuring** expenses was euro 187.4 million (15.5% of sales), up 21% from the same period of 2009 (euro 155.2 million, or 15.0% of sales);

— **operating income before restructuring expenses** reached euro 129.6 million (10.7% of sales), compared with euro 104.7 million in the same period of 2009 (10.1% of sales).

Again in Q4 2010, the effects of growing sales volumes and continuous action on the price/mix component, combined with cost efficiency measures, effectively offset rising input costs, especially for raw materials.

4,772
million

NET SALES

Throughout all 2010, gross operating profit before restructuring expenses was euro 684.3 million (14.3% of sales), up euro 146.3 million (+27%) from 2009, when it totalled euro 538.0 million (13.5% of sales).

Operating income before restructuring expenses in 2010 totalled euro 476.3 million (10.0% of sales), up euro 130.8 million compared to the same period of 2009, when it totalled euro 345.5 million (8.7% of sales). The growth in return on sales is particularly significant, notwithstanding a significant increase in raw material costs (which totalled euro 270 million for the year, and euro 125 million in the fourth quarter alone), achieved through the previously mentioned actions on the price/mix component and cost efficiency gains.
The change in operating income before restructuring expenses during 2010 from the previous year is summarised as follows:

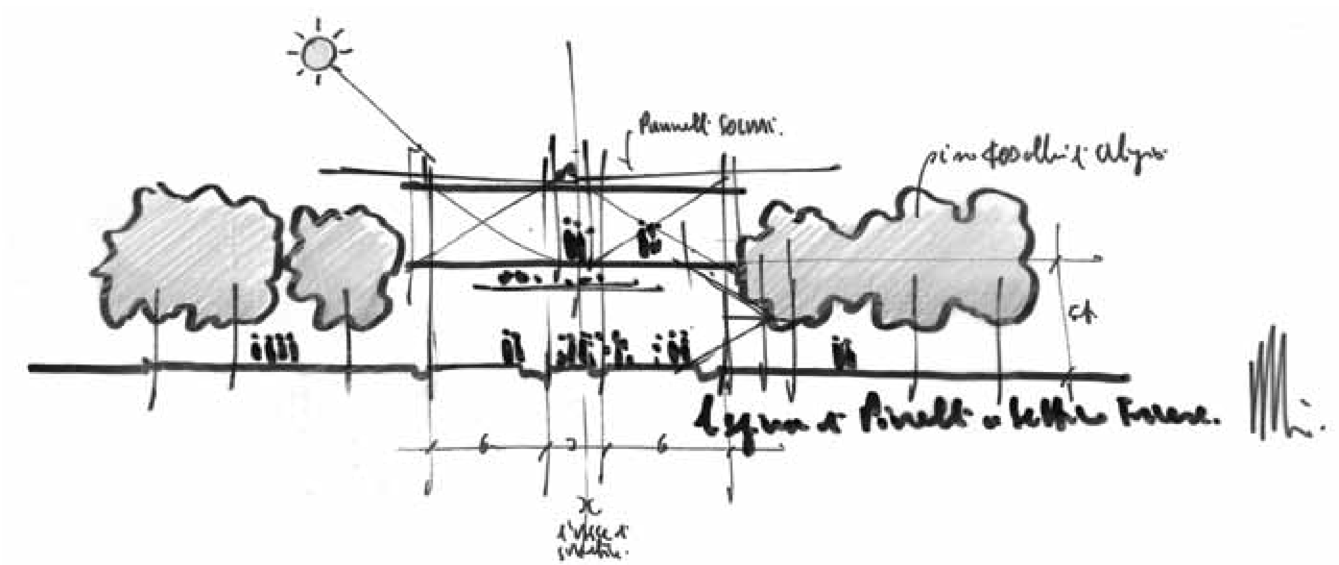
(in millions of euro)

	Q1	Q2	Q3	Q4	Cumulative
2009 operating income before restructuring expenses	**61.0**	**85.5**	**94.3**	**104.7**	**345.5**
Foreign exchange effect	(5.2)	2.2	2.7	3.5	3.2
Prices/mix	6.1	86.6	107.3	131.9	331.9
Volumes	50.8	25.2	5.2	19.8	101.0
Cost of production factors (raw materials)	(6.7)	(62.1)	(76.4)	(125.1)	(270.3)
Cost of production factors (labour/energy/others)	(7.4)	(12.8)	(14.7)	(12.6)	(47.5)
Efficiency gains	7.6	5.3	14.4	22.8	50.1
Amortisation. depreciation and other	(8.1)	(2.8)	(11.3)	(15.4)	(37.6)
Change	**37.1**	**41.6**	**27.2**	**24.9**	**130.8**
2010 operating income before restructuring expenses	**98.1**	**127.1**	**121.5**	**129.6**	**476.3**

Operating income for 2010 was euro 453.1 million, up from 2009, when it totalled euro 308.5 million, with ROS (return on sales) of 9.5%. These results topped even the latest forecasts for 2010.
Restructuring measures continued in 2010. Focused on the European area, they aimed to improve the overall Group cost structure by euro 23.2 million.

Net income for 2010 totalled euro 252.6 million (after total financial expenses of euro 66.1 million and income taxes of euro 134.4 million, with a *tax rate* of 34.7%). This compares to net income of euro 146.6 million in previous year (after total financial expenses of euro 71.9 million and income taxes of euro 90.0 million, with a *tax rate* of 38.0%).

Settimo Torinese's project disegned by Renzo Piano



Net financial position is negative and totalled euro 1,109.9 million, after paying dividends of euro 226.6 million to the Parent company, in comparison with a negative net financial position of euro 1,027.3 million at December 31, 2009. This figure is euro 95.1 million lower than in September 2010.

The change may be summarised as follows:

(in millions of euro)

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	2010	2009
Operating income (EBIT) before restructuring expenses	98.1	127.1	121.5	129.6	476.3	345.5
Amortisation and depreciation	48.3	50.4	51.5	57.8	208.0	192.5
Purchase of property. plant and equipment and intangible assets	(47.6)	(84.5)	(88.1)	(184.8)	(405.0)	(217.4)
Change in working capital/other	(132.2)	37.0	(9.9)	194.3	89.2	240.9
Operating cash flow	**(33.4)**	**130.0**	**75.0**	**196.9**	**368.5**	**561.5**
Financial expenses/tax charges	(45.6)	(61.7)	(50.8)	(42.7)	(200.8)	(166.1)
Net operating cash flow	**(79.0)**	**68.3**	**24.2**	**154.2**	**167.7**	**395.4**
Dividends paid to non-controlling interests	-	(3.8)	-	-	(3.8)	(2.3)
Purchase of non-controlling interests in Turkey and disposal of assets	-	-	-	-	-	11.0
Cash out for restructuring expenses	(22.2)	(8.3)	(7.0)	(2.0)	(39.5)	(62.4)
Foreign exchange differences/other	6.0	9.4	(9.3)	13.5	19.6	(38.0)
Net cash flow before dividend payment to parent	**(95.2)**	**65.6**	**7.9**	**165.7**	**144.0**	**303.7**
Dividends paid to parent		(156.0)	-	(70.6)	(226.6)	(64.2)
Net cash flow	**(95.2)**	**(90.4)**	**7.9**	**95.1**	**(82.6)**	**239.5**

Net operating cash flow for the year was positive for euro 167.7 million (positive for euro 154.2 million in the last quarter), despite the significant increase in capital expenditure that was almost double of depreciation. This was achieved on the good earnings performance and constant focus on efficient management of working capital.

In the last quarter, working capital contributed euro 194.3 million to the Group's cash position, partly reflecting the seasonal variation in sales receipts for the Winter product in Europe, and made a positive contribution to *cash flow* overall despite the increase in activity.
Net cash flow for the year, before dividends paid to the parent, totalled a positive euro 144.0 million.

A new Settimo Torinese production centre, which is destined to become the Group's most technologically advanced production site in the world

Capital expenditure totalled euro 402 million, up sharply from 2009, when it totalled euro 217 million. Seventy per cent of capex was focused on growth projects undertaken in Italy (with completion of construction on the new Settimo Torinese production centre, which is destined to become the Group's most technologically advanced production site in the world), South America, Romania and China. Construction also began on new plants in Mexico for the production of Vettura tyres and in China for the production of radial motorcycle tyres. Other capital expenditure targeted the Group's remaining production sites, to increase the product mix, launch new "*Green Performance*" products, and make improvements to employee health and safety conditions and environmental management of factories.

When broken down by business segment, 77% of capex targeted activities in the consumer segment and improvement in production capacity in Romania, China and Brazil, growth in the high-end segment in Europe, and completion of the new Technological Centre at Settimo Torinese with construction of the new, innovative "Next MIRS" process line for the production of high-end tyres.

The remaining 23% was targeted at supporting activities in the industrial segment, focused on consolidating production growth in South America, Egypt and Turkey, while installation continued on machinery used to manufacture products with SATT (Spiral Advanced Technology for Trucks), derived from MIRS technology.
At December 31, 2010, installed production capacity was about 56.0 million units in the consumer segment and about 5.8 million units in the industrial segment.

Total headcount at December 31, 2010 was 28,865 employees, including 2,301 temporary workers and 119 agency workers.
Headcount rose by a total of 1,384 employees from December 31, 2009, including 1,300 blue collar workers, mainly due to growth in activity in South America, Romania and China.

At December 31, 2010, the workforce (excluding employees with temporary contracts) is broken down as follows:

	2010	2009
Executives	1.0%	0.9%
White collar	18.8%	19.3%
Blue collar	80.2%	79.8%
	100.0%	100.0%

CONSUMER BUSINESS

The table below shows 2010 operating results broken down on a quarterly basis, the total for all of 2010, and comparisons with the same periods of 2009:

(in millions of euro)

	Q1		Q2		Q3		Q4		Cumulative	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Net sales	780.9	670.5	835.8	701.5	847.1	736.0	836.5	719.8	3,300.3	2,827.8
Δ yoy	16.5%	-10.4%	19.1%	-6.0%	15.1%	3.1%	16.2%	21.3%	16.7%	0.9%
Gross operating profit before restructuring expenses	106.0	77.4	122.4	90.4	118.9	100.4	141.1	111.5	488.4	379.7
% of sales	13.6%	11.5%	14.6%	12.9%	14.0%	13.6%	16.9%	15.5%	14.8%	13.4%
Operating income before restructuring expenses	69.5	41.9	84.7	54.5	80.5	64.1	99.9	73.2	334.6	233.7
% of sales	8.9%	6.2%	10.1%	7.8%	9.5%	8.7%	11.9%	10.2%	10.1%	8.3%
Operating income	67.0	39.9	80.3	51.0	77.2	59.2	92.5	59.7	317.0	209.8
% of sales	8.6%	6.0%	9.6%	7.3%	9.1%	8.0%	11.1%	8.3%	9.6%	7.4%

Net sales in 2010 totalled euro 3,300.3 million, up 16.7% from 2009. On homogeneous basis and excluding the exchange rate effect, the change was +14.0%, attributable for 6.4% to the volume component and 7.6% to the price/mix component. **Gross operating profit before restructuring expenses** totalled euro 488.4 million, or 14.8% of sales (+29% from 2009). **Operating income before restructuring expenses** reached euro 334.6 million (10.1% of sales), in comparison with euro 233.7 million generated in 2009 (8.3% of sales). **Operating income** grew by 51% from the previous year, to euro 317.0 million (with ROS of 9.6%), compared with euro 209.8 million in 2009 (ROS of 7.4%).
In Q4 2010 net sales totalled euro 836.5 million (+16.2% from the same period of 2009), with profitability up both in absolute terms (**operating income before restructuring expenses** of euro 99.9 million, compared with euro 73.2 million) and in percentage terms, with a return on sales of 11.9% (10.2% in the same period of 2009).

In regard to sales, the positive structural change in Q4 2010 (+13.5%) was driven both by a 4.2% increase in volumes and continuous use of the price/mix component, which contributed 9.3% to growth.
These were the elements that, together with the positive effects of efficiency measures, substantially made it possible to increase profitability during the fourth quarter, in spite of cost pressures due to higher raw materials prices.
Turning to the performance of the Group's various target markets, the **Original Equipment** segment expanded in 2010, with growth rates ranging from +13% in Europe (+5% in the fourth quarter), +39% in NAFTA (+6% in the fourth quarter) and +13% in the Mercosur area (+6% in the fourth quarter).

In comparison with 2009, the **Replacement** segment posted higher growth rates in all areas, with +8% in Europe (+7% in the fourth quarter), +4% in NAFTA (with +1% in the fourth quarter), and +11% in the Mercosur

area (+4% in the fourth quarter). In 2010, Pirelli made 75% of its sales in the Replacement segment and 25% in the Original Equipment segment.

The **Winter** market continued expanding in Europe during 2010 (+21%), with a low level of stock on the distribution network at year end.

In the **Car** business, which accounts for 89% of segment turnover, net sales soared by 17% from 2009, while the **Motorcycle** business, which accounts for 11% of the segment, climbed by 15% overall.

In 2010, the Pirelli **Motorsport Car** business won the prestigious distinction of being named exclusive supplier to the Formula One Championship for the three-year period 2011-2013.

During the year, the Group remained the exclusive tyre supplier to the Rolex Grand Am in the United States and the World Rally Championship (WRC). At the end of the three-year supply contract, special mention should be made of the excellent performance of tyres supplied to all WRC teams. For example, just 0.15% of the 27,995 tyres used over three seasons suffered a puncture.
Pirelli also reconfirmed its leading position in European rallies, triumphing in the Italian, Swiss, Austrian, Portuguese, Greek and Turkish championships. Other major successes were achieved in the Chinese, Lebanese and Ukrainian championships. Pirelli remained the exclusive supplier to the British Rally Championship, the Swedish Rally Championship, the Finnish Rally Championship, the Argentine Rally Championship and the South American Codasur Rally Championship. The Group also participates as partner of various Italian car makers, supplying racing tyres to their single-brand championships. Finally, the Pirelli Star Driver programme for selection of young rally talents worldwide continued: six teams will participate in six European WRC 2011 races at the new WRC Academy.
Pirelli continued supplying road racing tyres on an exclusive basis to the Ferrari Challenge championships in Italy,

Europe and the United States, and the Lamborghini Super Trofeo in Europe, and also became exclusive supplier to the Maserati Trofeo championship in 2010.
In the FIA-GT series, it continued participating in national single-tyre championships (UK GT, Scandinavia GT, Portugal GT and Brazil GT).
In the **Motorcycle** business, Pirelli confirmed its technological leadership in 2010 by obtaining approval for important products, including new tyres launched on the market during the year.
Pirelli brand tyres were introduced for the Ducati Diavel with the Diablo Rosso II dual compound; Aprilia RSV4 APRC with the Diablo Supercorsa SP in the new WSBK version; KTM all motocross range the Scorpion MX; Triumph Tiger 800 with the Scorpion Trail; Honda Cross Runner with the Scorpion Trail.
Metzeler brand tyres were introduced for the Honda Scooter concept with the Roadtec Z8 Interact and SH300 with the Feelfree; BMW K1600 GT with the Roadtec Z8 Interact, R1200 R/RT with the Roadtec Z8 Interact and F800 R with the Sportec M5 Interact; Triumph Tiger 800 XC with the Karoo and Speed Triple with the Racetec K3.
Pirelli enjoyed great success on all racetracks during 2010.
Participation as the sole supplier to the World Superbike series, with the participation of seven motorcycle makers (Aprilia, BMW, Ducati, Honda, Kawasaki, Suzuki and Yamaha), continued to garner Pirelli major visibility in the media. In Motocross, it racked up numerous prestigious wins, including the Motocross MX1 and MX2 World Championship, the World Rally Championship, and Le Touquet Championship. Metzeler reconfirmed its status off road, winning first place at the World Enduro Championship in the E2 and E3 classes, and second and third place in the E1 class.
Our participation in road and off-road racing, ranging from major world championships to local ones, offers the ideal opportunity for developing new solutions and affirming our leadership.

INDUSTRIAL BUSINESS

The table below shows 2010 operating results broken down on a quarterly basis, the total for all of 2010, and comparisons with the same periods of 2009:

(in millions of euro)

	Q1		Q2		Q3		Q4		Cumulative	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Net sales	329.1	256.4	379.5	287.5	386.7	306.7	376.4	314.5	1,471.7	1,165.1
Δ yoy	28.4%	-22.0%	32.0%	-16.3%	26.1%	-12.2%	19.7%	13.4%	26.3%	-10.3%
Gross operating profit before restructuring expenses	40.4	30.4	55.1	42.6	54.1	41.7	46.3	43.6	195.9	158.3
% of sales	12.3%	11.9%	14.5%	14.8%	14.0%	13.6%	12.3%	13.9%	13.3%	13.6%
Operating income before restructuring expenses	28.6	19.1	42.4	31.0	41.0	30.2	29.7	31.5	141.7	111.8
% of sales	8.7%	7.5%	11.2%	10.8%	10.6%	9.8%	7.9%	10.0%	9.6%	9.6%
Operating income	28.5	17.6	41.5	28.3	39.8	26.7	26.3	26.1	136.1	98.7
% of sales	8.7%	6.9%	10.9%	9.8%	10.3%	8.7%	7.0%	8.3%	9.2%	8.5%

Net sales in 2010 totalled euro 1.471.7 million, up 26.3% from 2009. On a like-for-like basis and excluding the exchange rate effect, the change was +21.7%, attributable for 9.4% to the volume component and 12.3% to the price/mix component. **Gross operating profit before restructuring expenses** totalled euro 195.9 million, or 13.3% of sales (+24% from 2009). **Operating income before restructuring expenses** reached euro 141.7 million (9.6% of sales), in comparison with euro 111.8 million generated in 2009 (9.6% of sales). **Operating income** totalled euro 136.1 million (with ROS of 9.2%), up 38% from 2009, when it totalled euro 98.7 million (with ROS of 8.5%).

In Q4 2010 net sales totalled euro 376.4 million (+19.7% from the same period of 2009), **operating income before restructuring expenses** of euro 29.7 million (ROS of 7.9%), compared with euro 31.5 million in operating income before restructuring expenses in the same period of 2009 (ROS of 10.0%).
The percentage figure was impacted by the increase in raw material costs, which have a greater impact on this segment particularly in regard to natural rubber. These costs were offset in absolute terms by price increases.
The positive structural change in sales during Q4 2010 (+17.3%) was mainly driven by the price/mix component of 15.7%, which offset the cost increases that were largely tied to raw material prices, while the volume component contributed 1.6% to growth.

Turning to the performance of the Group's various target markets, the **Original Equipment** segment expanded in 2010, with growth rates ranging from +57% in Europe (+90% in the fourth quarter) and +47% in the Mercosur area (+22% in the fourth quarter).

In comparison with 2009, the **Replacement** segment posted higher growth rates in all areas previously highlighted in previous quarters, with growth of +23% in the Mercosur area (+22% in the fourth quarter) and +18% in Europe (+9% in the fourth quarter).

In the **Truck** business, which represents 81% of the segment, aggregate net sales grew by 25% from 2009. In the **Agro** business, which represents 12% of the segment, aggregate net sales growth was 43%. The **Steelcord** outsourcing business, which represents 7% of the segment, posted aggregate growth of 25%.

OTHER BUSINESSES

The other businesses are comprised by Pirelli & C. Eco Technology S.p.A., Pirelli & C. Ambiente S.p.A., PZero S.r.l., and all Group holding and service companies, including the Parent, Pirelli & C. S.p.A.. Both Pirelli & C. Eco Technology S.p.A. and Pirelli & C. Ambiente S.p.A. are 51% owned by Pirelli & C. S.p.A. and 49% by Cam Partecipazioni S.p.A., a Camfin Group company.

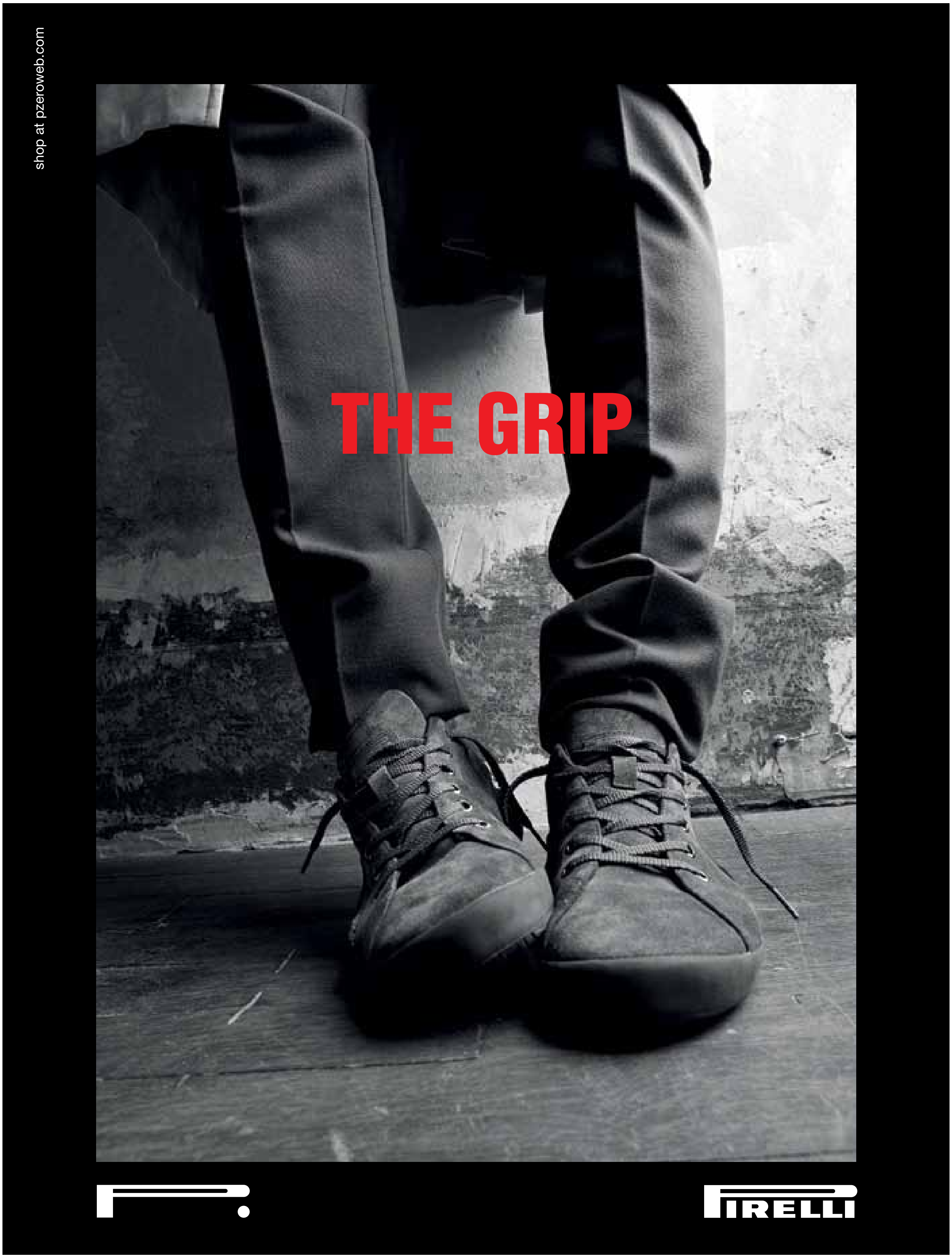
(in millions of euro)

	Pirelli Eco Technology		Pirelli Ambiente		PZero		Other		Total other businesses	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Net sales	61.4	56.6	4.4	3.6	7.7	5.0	2.9	9.4	76.4	74.6
Operating income	(12.9)	(10.8)	(6.3)	(3.7)	(0.3)	(3.8)	(25.8)	(40.5)	(45.3)	(58.8)
Net income (loss)	(14.9)	(13.7)	(8.2)	(5.3)	(0.4)	(3.9)	(1.1)	(46.1)	(24.6)	(69.0)
Net financial (liquidity)/debt position	**38.0**	**47.2**	**30.1**	**44.0**	**3.8**	**3.5**	**(726.2)**	**(598.8)**	**(654.3)**	**(504.1)**

Taken together, these other businesses show an **operating loss** of euro 45.3 million for the year (including euro 1.5 million in restructuring expenses), compared with an operating loss of euro 58.8 million in 2009 (including 18.2 million for restructuring expenses). Aside from the performance of the businesses commented on below, non-recurring costs were incurred during the year for studies to reorganise the Group and provisions for a lawsuit connected with assets disposed of in the 1990's. These costs were offset by a real estate gain in Brazil and sale of the Ceat brand.

PIRELLI ECO TECHNOLOGY

This business was impacted by delayed growth in sales volumes, partly due to slow definition of applicable regulatory procedures, and consequent under-utilisation of the production plant. During the year, 5,128 Feelpure filter systems were sold (4,677 in December 2009) for a total of euro 23.4 million (euro 18.5 million in December 2009). The operating loss totalled euro 12.9 million.
Full operation also started up at the production plant in China, which serves the local market.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THE GRIP
PIRELLI

PIRELLI AMBIENTE

This business operates in the environmental sector through its subsidiaries and associates, and is active in the following specific segments: the production of electric power from photovoltaic panels; environmental clean-up; energy certification; the production of high quality waste-to-fuel.
In 2010 this business posted an operating loss of euro 6.3 million and a net loss of euro 8.2 million.
In the photovoltaic panel sector, the subsidiary Solar Utility S.p.A. completed start-up of production at the plants located in towns of Alessano, Nardò, Vaglio, Torremaggiore and Ugento, with total output of 7 MW. Following the strategic agreement for joint development of activity in the Italian photovoltaic panel sector, signed on July 15, 2010 between Solar Utility S.p.A. and GWM Group Inc., these plants with a combined capacity of 7 MW were granted to a new company named GP Energia S.p.A. The latter was initially 60% owned by GWM Renewable Energy S.p.A. and 40% by Solar Utility S.p.A.. The shareholding in GP Energia S.p.A., which was reduced in September 2010 to 31% due to the disposal of shares, rose to 35% in early 2011 following the grant of additional plant.

PZERO S.R.L.

Created at the end of 2007, Pzero S.r.l. is the natural evolution of a *licensing and brand extension* project launched about ten years ago to exploit the *brand equity* of Pirelli.
In synergy with Pirelli corporate communication activities, Pzero offers the vehicle for developing the value of Group brands through major advertising campaigns in the italian and international media, high exposure in press reports and the visibility of products sold at high-end retail outlets.
In spite of persistent softness in aggregate consumer demand, Pzero S.r.l. continued to grow in 2010. This improvement is mainly attributable to an increase in shoe sales volumes, stemming from improved penetration by the brand amongst individual customers and the growing number of customers both inside and outside Italy. Outside Italy, the brand's principal markets are Spain, Russia and Eastern Europe, Great Britain and China. The best growth prospects are represented by China, the United States and South America.
In 2010, the company prepared a two-pronged growth plan. The first choice was to apply the same business model used for shoes to the apparel lines. Upon expiration of a brand license granted to others, the company decided to take over direct management of apparel production and marketing. The company has also prepared a plan to develop a single-brand retail chain, with the opening of its first store in Milan scheduled within 2011.

PIRELLI & C. S.P.A.: HIGHLIGHTS

The following table illustrates highlights of the Parent's main income, balance sheet and financial data:

(in millions of euro)

	12/31/2010	12/31/2009
Operating income	(39.6)	(39.5)
Net financial income and net income from equity investments	229.5	150.9
Net income of continuing operations	191.0	112.6
Net income (loss) of discontinued operations	(103.6)	-
Net income	87.4	112.6
Non-current financial assets	965.2	1,548.5
Equity	1,584.6	1,822.8
Net financial (liquidity)/debt position	**(597.2)**	**(253.1)**

Net financial income and net income from equity investments, totalling euro 229.5 million, principally consist of euro 226.6 million in dividends received from the subsidiary Pirelli Tyre S.p.A., dividends of euro 24.6 million from other subsidiaries, impairment of the subsidiary Pirelli UK Ltd for euro 21.2 million, impairment of the equity investment in the subsidiary Pirelli & C. Ambiente S.p.A. for euro 2.2 million and impairment of the equity investment in RCS MediaGroup S.p.A. for euro 8.6 million (which now has a book value of euro 1.48 per share).

Net income was negatively impacted by the assignment of former Pirelli RE (now Prelios) shares (euro 119.7 million), which was partly offset by the net gain on disposal of Pirelli Broadband Solutions S.p.A.(euro 16.1 million).

The reduction in **non-current financial assets** reflects not only the impairments mentioned above, but also the previously mentioned assignment of the shares held in Pirelli RE (now Prelios) to shareholders for euro 329.6 million, winding-up of the two Dutch holding companies Pirelli Holding N.V. and Sipir Finance N.V. for euro 204.2 million, and the previously mentioned sale of Pirelli Broadband Solutions S.p.A. for euro 26.3 million.

The following table summarises the carrying values of the principal non-current financial assets at December 31, 2010:

(in millions of euro)

	12/31/2010
Equity investments in subsidiaries	
Pirelli Tyre S.p.A.	585.9
Pirelli Societè Generale S.A. - Switzerland	17.5
Pirelli & C. Eco Technology S.p.A.	16.9
Pirelli Finance (Luxembourg) S.A. - Luxembourg	13.8
Pirelli Ltda - Brazil	9.7
Pirelli & C. Ambiente S.p.A.	3.6
Pirelli Labs S.p.A.	4.1
Other	7.9
Total equity investments in subsidiaries	**659.4**
Equity investments in associates and other financial assets	
Mediobanca S.p.A.	105.3
RCS Mediagroup S.p.A.	57.9
Eurostazioni S.p.A.	52.9
CyOptics Inc. - U.S.A.	17.5
Fin. Priv. S.r.l.	14.4
Anastasia Real Estate Investment Trust	13.3
Alitalia S.p.A.	12.8
Advanced Digital Broadcast Holdings SA - Switzerland	9.8
Istituto Europeo di Oncologia S.r.l.	7.2
F.C. Internazionale Milano S.p.A.	6.0
Gruppo Banca Leonardo S.p.A.	5.2
Other	3.5
Total equity investments in associates and other financial assets	**305.8**
Total non-current financial assets	**965.2**

Equity fell from euro 1,822.8 million at December 31, 2009 to euro 1,584.6 million at December 31, 2010. The change is illustrated as follows:

(in millions of euro)

Equity at 12/31/2009	**1,822.8**
Effect of reduction in share capital	(211.3)
Net income	87.4
Dividends paid	(81.1)
Gains/(losses) recognised directly in Equity	(33.2)
Equity at 12/31/2010	**1,584.6**

The following table illustrates the breakdown of Equity at December 31, 2010 and comparative figures for the year at December 31, 2009:

(in millions of euro)

	12/31/2010	12/31/2009
Share capital	1,375.7	1,554.3
Share premium reserve	229.4	229.7
Legal reserve	99.9	94.3
Business combinations reserve	22.5	22.5
Reserve from assignment of Pirelli RE (now Prelios) shares	(32.5)	—
IAS transition reserve	(239.4)	(239.4)
IAS operating reserve	15.7	48.8
Retained earnings	25.9	—
Net income	87.4	112.6
	1,584.6	**1,822.8**

The **net financial position** is positive for euro 597.2 million, which largely reflected the receipt of euro 258 million in dividends from subsidiaries, euro 208 million in cash received from the liquidated companies, and payment of a euro 81 million dividend to shareholders.

(in thousands of euro)

Surname and name	Office held	Period for which the office was held	Office expiry	Emoluments for the office in the company that draws up the financial statements (9)		Non-monetary benefits		Bonuses and other incentives (10)		Other compensation	
Tronchetti Provera Marco	Chairman	01/01//2010 - 31/12/2010	2010 fin. statements appr.	2,490				2,385		1,075	(1)
Pirelli Alberto	Deputy Chairman	01/01//2010 - 31/12/2010	2010 fin. statements appr.	640		5	(1)	110	(1)	368	(1)
Puri Negri Carlo Alessandro	Deputy Chairman	01/01/2010 - 29/07/2010	-	224							
Malacalza Vittorio	Deputy Chairman	29/07/2010 - 31/12/2010	2010 fin. statements appr.	21	(2)						
Acutis Carlo	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Angelici Carlo	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	74	(3)						
Antonelli Cristiano	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	74	(3)						
Benetton Gilberto	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Bombassei Alberto	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	70	(4)						
Bruni Franco	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	74	(3)						
Campiglio Luigi	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Cucchiani Enrico Tommaso	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Libonati Berardino	Director	01/01//2010 - 30/11/2010	-	64	(6)						
Ligresti Giulia Maria	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Moratti Massimo	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Pagliaro Renato	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50	(5)						
Paolucci Umberto	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	70	(4)						
Perissinotto Giovanni	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	50							
Pesenti Giampiero	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	70	(4)						
Roth Luigi	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	74	(3)						
Secchi Carlo	Director	01/01//2010 - 31/12/2010	2010 fin. statements appr.	89	(7)						
Gori Francesco	General Manager	01/01/2010 - 31/12/2010				7	(1)	901	(1)	1,350	(1)
Laghi Enrico	Chairman, Board of Auditors	01/01//2010 - 31/12/2010	2010 fin. statements appr.	62							
Gualtieri Paolo	Statutory auditor	01/01//2010 - 31/12/2010	2010 fin. statements appr.	42							
Sfameni Paolo Domenico	Statutory auditor	01/01//2010 - 31/12/2010	2010 fin. statements appr.	57	(8)						
Other executives with strategic responsibility						11		947		1,700	

1) From Pirelli Tyre
2) In office since 29 July 2010
3) Of which Euro 24 thousand as member of the Internal Control, Risks and Corporate Governance Committee
4) Of which Euro 20 thousand as member of the Remuneration Committee
5) Emoluments deposited again in the company he/she belongs to
6) Of which Euro 18 thousand as member of the Remuneration Committee
7) Member of the Internal Control, Risks and Corporate Governance Committee (Euro 24 thousand) and of the Supervisory Body (Euro 15 thousand)
8) Of which Euro 15 thousand as member of the Supervisory Body
9) The items shown in this column contain Euro 50 thousand (except for Deputy Chairman Malacalza, for whom the item contains Euro 21 thousand and for Puri Negri, for whom it contains Euro 29 thousand) of compensation pertaining to the year 2010, to be received in 2011
10) The items shown in this column contain compensation pertaining to the year 2010, to be received in 2011

The Chairman, Deputy Chairman A. Pirelli, General Manager and the other executives with strategic responsibility are included in the LTI three-year incentive plan that according to the coinvestment mechanism, envisages disbursement of 50% of the incentive achieved for the years 2009 and 2010, while the remaining 50% accrued as a whole would be disbursed in 2012, increased by 100% in case three-year goals envisaged by the LTI 2009-2011 Plan are attained, otherwise reduced by 50% should said goals not be attained. Please refer to the text of the Corporate Governance Report, section "Remuneration of directors and remuneration policy" for more details on how the incentive plan works.

OTHER INFORMATION

EQUITY INTERESTS HELD BY DIRECTORS, STATUTORY AUDITORS, GENERAL MANAGERS AND KEY MANAGERS

Pursuant to Article 79 of the Consob Regulation approved with Resolution no. 11971 of May 14, 1999, the table below shows the equity interests held in the company Pirelli & C. S.p.A. and in its subsidiaries by Directors, Statutory Auditors, General Managers and key managers, by their spouses if not legally separated and by their minor children, directly or through controlled companies, trust companies or intermediaries, as resulting at December 31, 2010 from the Shareholders' Register, from notices received and from other information acquired from the same Directors, Statutory Auditors, General Managers and key managers.

Surname and name	Investee company	Number of shares held at 12/31/2009	Number of shares purchased/ subscribed	Number of shares sold	Number of shares held at 12/31/2010
Tronchetti Provera Marco	Pirelli & C. S.p.A.	13,764	-	-	1,251*
	Pirelli & C. S.p.A. (held indirectly)	1,369,504,398[1]	-	-	124,500,500*
	Pirelli & C. S.p.A. (held indirectly)	1,217,398[2]	-	-	110,673*
	Pirelli & C. Ambiente S.p.A. (held indirectly)	2,998,800[2]	1,605,779	2,364,299	2,240,280[3]
	Pirelli & C. Eco Technology S.p.A. (held indirectly)	16,228,800[2]	-	7,501,900	8,726,900[3]
Pirelli Alberto	Pirelli & C. S.p.A.	1,447,925	-	-	131,629*
Puri Negri Carlo Alessandro[4]	Pirelli & C. S.p.A.	66,500	-	-	66,500
Moratti Massimo	Pirelli & C. S.p.A.	11,551,427	-	-	1,050,129*
	Pirelli & C. S.p.A. (held indirectly)	37,427,732[5]	-	-	3,402,521*
	Pirelli & C. S.p.A. (held indirectly)	13,435,544[6]	-	-	1,221,413*
Roth Luigi	Pirelli & C. S.p.A.	44,000[7]	-	-	4,000[7]*

* *The number of shares takes into account the reverse stock split carried out by Pirelli & C. S.p.A. on July 26, 2010.*
[1] *Shares held through Camfin S.p.A.*
[2] *Shares held through Cam Partecipazioni S.p.A.*
[3] *The number of shares has been reduced due to share capital decrease and a further share capital increase (this for Pirelli & C. Ambiente S.p.A.), carried out during 2010.*
[4] *Post of Director and Vice President held until July 29, 2010.*
[5] *Shares held through CMC S.p.A.*
[6] *Shares held in trust by Istifid S.p.A.*
[7] *Shares held by spouse.*

STOCK OPTION PLANS

The information on stock option plans disclosed pursuant to Consob Regulation no. 11971 of May 14, 1999 has been provided in the Explanatory Notes to the Financial Statements. The Company did not have any stock option plan in place at December 31, 2010.

INFORMATION ON OWNERSHIP STRUCTURE (PURSUANT TO ART. 123 BIS OF THE CONSOLIDATED LAW ON FINANCE-TUF)

The information pursuant to Article 123 bis of Legislative Decree 58 of February 24, 1998 can be found in the Corporate Governance Report that accompanies the Financial Report and published in the Governance section of the Company website (www.pirelli.com).

SECURITY POLICY DOCUMENT

In accordance with the provisions of Appendix B, paragraph 26 of Legislative Decree 196 of June 30, 2003, notice is given that Pirelli & C. S.p.A. has updated its Security Policy Document for the year 2010.

FOREIGN SUBSIDIARIES NOT IN THE EUROPEAN UNION (NON-EU COMPANIES)

Pirelli & C. S.p.A. directly or indirectly controls a number of companies with registered offices in countries that are not members of the European Union (Non-EU Companies) and which are of material interest pursuant to Art. 36 of Consob Regulation 16191/2007 on market regulation ("Market Regulation").

At December 31, 2010, the Non-EU Companies that were directly or indirectly controlled by Pirelli & C. S.p.A. and of material interest pursuant to Article 36 of the Market Regulation were: Pirelli Pneus Ltda (Brazil); Pirelli Tire LLC (USA); Pirelli Tyre Co. Ltd (China); Turk Pirelli Lastikleri A.S. (Turkey); Pirelli de Venezuela C.A. (Venezuela); Alexandria Tire Company S.A.E. (Egypt); Pirelli Neumaticos S.A.I.C. (Argentina).

Also under the terms of the same regulations, the Company has in place specific and appropriate "Group Operating Rules" which ensure immediate, constant and full compliance with the provisions contained in the said Consob Regulations[1]. Under the terms of the said Operating Rules, the competent corporate functions of the Parent precisely and periodically identify and disclose all Non-EU Companies of material interest under the Market Regulations, and – with the necessary and timely collaboration of the companies involved – guarantee collection of the data and information and verification of the circumstances as required by Article 36 of the Market Regulations, ensuring that the information and figures provided by the subsidiaries are available in the event of a request by Consob. Furthermore, a regular flow of information is provided for in order to ensure that the Board of Statutory Auditors of the Company can carry out the required and appropriate audits. Finally, the above "Operating Rules," in keeping with the regulatory provisions, prescribe how the financial statements (balance sheet and income statement) of significant Non-EU Companies prepared for the purpose of the consolidated financial statements are to be made available to the public.

Therefore, it is certified that the Company has fully complied with the provisions of Article 36 of Consob Regulation 16197/2007 and that its conditions have been satisfied.

1 Even before adoption of the aforementioned "Group Operating Rules," the administrative, accounting and reporting systems in place at the Pirelli Group already allowed the Company to comply substantially with the regulatory requirements.

RESOLUTIONS

ALLOCATION OF NET RESULT

Shareholders,
The financial year at December 31, 2010 closed with net income of euro 87,404,079.

The Board of Directors proposes to distribute a dividend, net of the required allocation to the legal reserve and gross of the required withholding taxes, of:
— euro 0.165 for each ordinary share;
— euro 0.229 for each savings share.

COVERAGE FOR THE IAS TRANSITION RESERVE

An "IAS transition reserve" in the negative amount of euro 239,425,665.64 is reported in the 2010 financial statements. This *reserve* was generated as a result of adopting IFRSs and represents the effect of restating the financial statements of Pirelli & C. S.p.A. in application of the aforesaid accounting standards with respect to the previously applied Italian GAAP. In essence, the transition resulted in higher costs and lower revenues than the Company would have had if it had adopted IFRSs even before their application, and the cumulative effect was reflected in the Company Equity in the first year of adoption (2005).

Because of its nature, the amount of that reserve cannot be changed. The Board thus proposes to utilise other Equity reserves to fully cover the "IAS transition reserve." More specifically, we propose drawing from the "Share premium reserve" the amount of euro 229,431,693.83, reducing that reserve to zero, and drawing the remaining amount of euro 9,993,971.81 from the "Business combinations reserve", which would thus be reduced to euro 12,466,896.66.

From the tax standpoint, the proposed coverage will have no effect on profit and loss.

If you agree with our proposals, we ask you to pass the following

Resolutions

The Shareholders' Meeting:
— having examined the Annual Financial Report at December 31, 2010;
— have taken note of the Board of Directors report on operations;
— having taken note of the reports of the Board of Statutory Auditors and the independent auditors;
— having taken note that financial statements at December 31, 2010 contain a reserve designated "IAS transition reserve" for a negative amount of euro 239,425,665.64, and that those same financial statements contain reserves designated "Share premium reserve" for a total of euro 229,431,693.83 and "Business combinations reserve" for a total of euro 22,460,868.47

Resolves

a) to approve the Financial Statements of the Company for the year ended December 31, 2010, as presented by the Board of Directors, in its entirety and its individual captions, with the provisions proposed, which show a net income of euro 87,404,079;

b) to allocate the 2010 net income of euro 87,404,079 as follows:
- 5% to the legal reserve euro 4,370,204
- to the shareholders:
  - euro 0.165 (*) to each of the 475,388,592 (**) ordinary shares, for a total of euro 78,439,118
  - euro 0.229 (*) to each of the 11,842,969 (**) savings shares, for a total of euro 2,712,040
- the remainder to retained earnings euro 1,882,717

(*) Before the required withholding taxes
(**) Net of the 351,590 ordinary shares and 408,342 savings shares currently held by the Company

c) to authorise the directors, if the dividends specified at sub-indent b) above are paid prior to the sale of the treasury shares, to draw the amount of the dividend related to those shares from retained earnings and to allocate to that item the balance of the rounding that may result from the dividend payment operation;

d) to cover the "IAS transition reserve" entirely by utilising the entire amount of the "Share premium reserve," equal to euro 229,431,693.83, and euro 9,993,971.81 drawn from the "Business combinations reserve."

The dividend for 2010 will be collectible from May 26, 2011, with coupon detachment date on May 23, 2011.

APPOINTMENT OF THE BOARD OF DIRECTORS

— Determination of the number of members of the Board of Directors;
— determination of the term in office of the Board of Directors;
— appointment of Directors
— determination of the annual compensation of the members of the Board of Directors.

Dear Shareholders,
the Board of Directors in office was appointed by the General Meeting of Shareholders on April 29, 2008, which established in three years term the length of its office.
Therefore, the office of the Board of Directors will expire upon approval of the Company's Financial Statements as December 31, 2010.
The General Meeting of Shareholders has therefore to resolve upon the appointment a new Board of Directors, after the determination of the number of its members, their term of office and remuneration.
On this point, Article 10 of the Company's By-Laws (fully quoted below) provides that the Board of Directors of the Company must be composed of no less than 7 (seven) and no more than 23 (twenty three) members who shall remain in office for three financial years, providing also that at the time of the Board's appointment, the General Meeting of Shareholders can establish a shorter term at the time and that the Directors may be re-elected.
According to the same Article 10 of the Company's By-Laws, the Board of Directors shall be appointed on the basis of slates presented by the shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 1,5 percent of the share capital entitled to vote at the Ordinary Shareholders' meeting (threshold set by Consob Resolution No. 17633 of January 26, 2011), subject to their proving ownership of the number of shares needed for the presentation of slates within the term specified for their publication by the Company.
Shareholders planning to submit a slate shall identify themselves and prove their shareholding in the ordinary share capital of the Company.
The slates of candidates, listed by consecutive number, must be undersigned by the parties submitting them and filed at the Company's registered office, and be available at least 25 days before the date set for the Shareholders' meeting to be held on first call.
Together with each slate, statements must be filed in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet any requisites prescribed for the positions.
Together with such statements, a curriculum vitae must be filed for each candidate, setting out their relevant personal and professional data and mentioning the offices held in management and supervisory bodies of other companies and specifying, where appropriate, the grounds on which they qualify as an independent candidate in accordance with the criteria established by law (art. 148, paragraph 3 of the TUF) and by the Corporate Governance Code for the Listed Companies issued by Borsa Italiana S.p.A. (adopted by the Company).
Any changes that occur up to the date of the Shareholders' meeting must be promptly notified to the Company.
Any slates submitted without complying with the foregoing provisions shall be disregarded.
For your information – according to the provisions of the Corporate Governance Self Code for Listed Companies – the Board of Directors has set the general criteria for determination of the maximum number of offices of its members. On this matter, please make reference to the appropriate document containing the relevant details on the Company's website *www.pirelli.com*, Corporate Governance section.

Having said that, the Board of Directors,
— acknowledging the provisions of the By-Laws concerning the composition and terms for appointing the Board of Directors;
— invites the General Meeting:
  • to determine the number of members of the Board of Directors, also determining their term of office and remuneration;
  • to vote on the slates of candidates for the office of Director submitted and published according to the provisions and with the terms provided by Article 10 of the Company's By-Laws.

Article 10 By-Laws

10.1 The Shareholders' meeting shall establish the number of members of the Board of Directors, which shall remain unchanged until said meeting resolves otherwise.
10.2 The Board of Directors shall be appointed on the basis of slates presented by the Shareholders pursuant to the following paragraphs hereof, in which the candidates are listed by consecutive number.
10.3 The slates presented by the , which must be undersigned by the parties submitting them, shall be filed at the Company's registered office, and be available at least twenty five days before the date set for the shareholders' meeting to be held on first call. They are made available to the public at the registered office, on the Company website and in the other ways specified by Consob regulations at least 21 days before the date of the general meeting.

10.4 Each shareholder may present or take part in the presentation of only one slate and each candidate may appear on only one slate on pain of ineligibility.

10.5 Only shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 2 percent of the share capital entitled to vote at the ordinary shareholders' meeting or the minor percentage, according to the regulations issued by Commissione Nazionale per le Società e la Borsa, are entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates within the term specified for their publication by the Company.

10.6 Together with each slate, and within the respective terms specified above, statements must be filed in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet any requisites prescribed for the positions.

Together with such statements, a curriculum vitae must be filed for each candidate, setting out their relevant personal and professional data and mentioning the offices held in management and supervisory bodies of other companies and specifying, where appropriate, the grounds on which they qualify as an independent candidate in accordance with the criteria established by law and the Company.

Any changes that occur up to the date of the Shareholders' meeting must be promptly notified to the Company.

10.7 Any slates submitted without complying with the foregoing provisions shall be disregarded.

10.8 Each person entitled to vote may vote for only one slate.

10.9 The Board of Directors shall be elected as specified below:

a) four-fifths of the directors to be elected shall be chosen from the slate which obtains the highest number of votes cast by the shareholders, in the order in which they are listed on the slate; in the event of a fractional number, it shall be rounded-down to the nearest whole number;

b) the remaining directors shall be chosen from the other slates; to this end, the votes obtained by the various slates shall be divided by whole progressive numbers from one up to the number of directors to be elected.

The quotients thus obtained shall be assigned to the candidates on each slate in the order they are respectively listed thereon. On the basis of the quotients assigned, the candidates on the various slates shall be ranked in a single list in decreasing order. Those who have obtained the highest quotient shall be elected.

If more than one candidate obtains the same quotient, the candidate from the slate that has not yet elected a director or that has elected the lowest number of directors shall be elected.

If none of such slates has as yet elected a director or they have all elected the same number of directors, the candidate from the slate which obtained the highest number of votes shall be elected. If the different slates obtain the same number of votes and their candidates are assigned the same quotients, a new vote shall be held by the entire shareholders' meeting and the candidate who obtains the simple majority of the votes shall be elected.

10.10 If the application of the slate voting system shall not ensure the appointment of the minimum number of independent Directors required by the law and/or regulation, the appointed non-independent candidate indicated with the higher progressive number in the slate which has obtained the higher number of votes shall be replaced by the non-appointed independent candidate included in the same slate on the basis of the progressive order of the presentation and so on, slate by slate, until the minimum number of independent Directors shall be appointed.

10.11 When appointing directors who, for whatsoever reason were not appointed under the procedure established herein, the shareholders' meeting shall vote on the basis of the majorities required by law.

10.12 If one or more vacancies occur on the Board during the course of the financial year, the procedure established in article 2386 of the Italian Civil Code shall be followed.

10.13 In the event a Director cease to comply with the independence requirements, this does not cause his/her ceasing to be a Director provided that the Directors in office complying with legal independence requirements are a number at least equal to the minimum number requested by laws and/or regulations.

10.14 The Board of Directors shall elect its own Chairman, if the shareholders' meeting has not already done so, and may also appoint one or more Deputy Chairmen.

10.15 In the absence of the Chairman, a Deputy Chairman or a Managing Director, in that order, shall act in his/her stead; should there be two or more Deputy Chairmen or Managing Directors, the Board shall be presided over by the elder of same respectively.

10.16 The Board of Directors shall appoint a Secretary, who need not be a director.

10.17 Until the shareholders' meeting resolves otherwise, the directors shall not be subject to the prohibition contemplated in article 2390 of the Italian Civil Code.

REMUNERATION GROUP REPORT

FOREWORD

The General Remuneration Policy for the year 2011 ("**Policy**") sets out the principles and guidelines which the Pirelli Group refers to in order to (i) determine and (ii) monitor the implementation of remuneration practices described below.
The Policy has been drafted in the light of the recommendations contained in Article 7 of the Self-Governance Code of Borsa Italiana S.p.A., as amended in March 2010, which Pirelli has adopted and which will enter into force as from the financial year 2012, and for the effects of Article 14 of the Procedure for Related-Party Transactions approved by the Company's Board of Directors on November 3, 2010.
The 2010 Statement, presented for information purposes to the Shareholders' Meeting, provides a final statement about remunerations for the year 2010.
To make it easier to read and understand this Report, please find below a glossary of the terms most frequently used herein:
Target-based Annual Total Direct Compensation: the sum of (i) the gross annual fixed component of remuneration; (ii) the annual variable component that is based on the achievement of given target-based objectives; (iii) the medium/long term annualization of the variable component (the so-called LTI) that is based on the achievement of medium/long-term target-based objectives.
General Directors: those appointed by the Board of Directors in connection with the organizational structure of the Company and the Group.
Managers with strategic responsibilities: the managers identified by the Board of Directors of the Company, who have the power or responsibility to plan and control the Company's activities or to take decisions which may affect its development or future prospects.
Executives: Pirelli Group employees who meet specific requirements, set out in more detail in the Application Criteria (as defined in paragraph 1 of the Policy), which take account of the employee's position within the organizational structure, his autonomy, his decision-making power with respect to the company's choices, his potential and performances.
Group or Pirelli Group: all the companies included in the consolidation of Pirelli & C. S.p.A..
Management: General Directors, Managers with strategic responsibilities, Senior Managers and Executives taken as a whole.
MBO: the annual variable component of remuneration that is based on the achievement of pre-set business objectives.
LTI Plan: the Long Term Incentive Cash Plan described in paragraph 9 of this Policy.
Pirelli & C.: Pirelli & C. S.p.A..
GAS: the gross annual fixed component of remuneration of the employees of any Group Company.
Senior Managers: the managers whom (i) Directors holding special offices and who are assigned specific functions and (ii) the General Directors of the Company whose activities have a significant impact on business results, first report to.
Company: Pirelli & C. S.p.A..

1. PRINCIPLES

The Company defines and applies a General Remuneration Policy that is designed to attract, motivate and retain the resources that have the professional skills necessary to successfully pursue the Group's objectives.
The Policy is defined so as to align the interests of the *Management* with those of shareholders, pursuing the primary objective of creating sustainable value in the medium-long term through the creation of a strong link between remuneration, on the one hand, and individual and Group performances, on the other.
The Policy is the result of a clear and transparent process in which the Remuneration Committee and the Board of Directors of the Company play a key role.
The Board of Directors adopts, upon proposal of the Remuneration Committee, the "Criteria for the Implementation of the General Remuneration Policy" ("**Application Criteria**").
Any deviations from the Application Criteria when setting the remuneration:
- of Directors holding special offices, of General Directors and of Managers with strategic responsibilities, are first examined and approved by the Remuneration Committee and the Board of Directors;
- of Senior Managers and Executives are first approved by the Chief People Officer of the Company.

At least once a year, during the presentation of the Remuneration Statement, the Chief People Officer reports about compliance with the Policy and about the corresponding Application Criteria to the Remuneration Committee.

2. REMUNERATION COMMITTEE

Since 2000, the Board of Directors has established among its members the "Remuneration Committee" that has investigative, advisory and proactive functions. In particular, the Remuneration Committee:
- makes proposals to the Board of Directors for the remuneration of Directors holding special offices so as

to ensure its alignment with the objective of creating value for shareholders over the medium-long term;
- periodically reviews the remuneration criteria that are applied to the Company's Management and, upon request of the Directors holding special offices who are assigned specific functions, makes proposals and recommendations on this issue, especially for the adoption of *stock option*/share-allocation plans;
- monitors the implementation of all decisions taken and of corporate *policies* on remuneration.

The members of the Remuneration Committee, appointed by the Board of Directors during the meetings of April 29, 2008 (Directors Berardino Libonati, Alberto Bombassei, Giampiero Pesenti) and July 29, 2009 (Director Umberto Paolucci), are all independent directors.

On November 30, 2010, Director Berardino Libonati (Chairman) passed away. Consequently, at the time of this Report, the Remuneration Committee's members are:
- Alberto Bombassei;
- Umberto Paolucci;
- Giampiero Pesenti

The Board of Directors has granted the Remuneration Committee the powers of the Committee for Related-Party Transactions though solely with respect to any decisions regarding the remuneration of Directors holding special offices and of Managers with strategic responsibilities.
For a full description of the operation and activities carried out in 2010 by the Remuneration Committee, please refer to the Report on Corporate Governance and Ownership Structure for the year 2010.

3. PROCESS FOR THE DEFINITION AND ADOPTION OF THE POLICY

The Policy is submitted by the Remuneration Committee to the Board of Directors every year.
The Board of Directors, after reviewing and approving the Policy, submits it to the advisory vote of the Shareholders' Meeting.
The Remuneration Committee submits also the "Application Criteria" to the Board of Directors' approval and oversees their implementation.
The Policy, which was approved by the Remuneration Committee at its meeting on February 23, 2011, was also evaluated during a specific meeting of all Independent Directors; it was then approved by the Board of Directors at its meeting on March 8, 2011 and submitted to the examination and advisory vote of this Shareholders' Meeting.

4. CONTENTS OF POLICY

The Policy, as stated above, sets out the principles and guidelines which:

(i) the Board of Directors follows when setting the remuneration of:
- the members of the Board of Directors and in particular of Directors holding special offices;
- General Directors;
- Managers with strategic responsibilities;

(ii) the Group refers to in order to set the remuneration of Senior Managers and, in general, that of the Executives of the Group.

5. THE REMUNERATION OF DIRECTORS

Within the Board of Directors, we can distinguish between:

(i) Directors holding special offices, who may also be assigned specific functions;

(ii) Directors who do not hold special offices.

The granting of powers to Directors only for urgent matters does not qualify them as Directors who have been assigned specific functions.
As of December 31, 2010:
- the Chairman of the Board of Directors, Marco Tronchetti Provera, and the Deputy Chairmen, Alberto Pirelli and Vittorio Malacalza, were Directors holding special offices; the Chairman had also been assigned specific functions (for further information on this issue, please refer to the Report on Corporate Governance and Ownership Structure);
- the following Directors did not hold special offices: Carlo Acutis; Carlo Angelici; Cristiano Antonelli; Gilberto Benetton; Alberto Bombassei; Franco Bruni; Luigi Campiglio; Enrico Tommaso Cucchiani; Giulia Maria Ligresti; Massimo Moratti; Renato Pagliaro; Umberto Paolucci; Giovanni Perissinotto; Giampiero Pesenti; Luigi Roth; Carlo Secchi.

In April 2008, the Shareholders' Meeting of Pirelli, upon appointment of the Board of Directors, set the Directors' total remuneration (under art. 2389(1) Italian Civil Code), granting the Board of Directors the task of determining its allocation.
In particular, the Shareholders' Meeting of April 2008 approved a total gross annual remuneration of euro 1.2 million, allocated as follows by the Board of Directors:
- euro 50,000 for each member of the Board of Directors;
- euro 24,000 for each member of the Internal Audit, Risk and Corporate Governance Committee;
- euro 20,000 for each member of the Remuneration Committee.

In line with best practices, Directors not holding special offices (as defined above) were not granted a variable component of their remuneration.

A euro15,000 salary was granted to the Director who was a member of the Supervisory Board.
Directors were also entitled to a refund of expenses incurred for business reasons.
In line with best practices, the Company applies an insurance policy called D&O (*Directors & Officers*) *Liability* covering the third party liability of corporate bodies, General Directors, Managers with strategic responsibilities, Senior Managers and Executives in the performance of their functions, which is designed to indemnify the Group against the cost of any ensuing compensation deriving from the relevant provisions of the applicable national collective agreement and from the provisions on assignments, though excluding the case of willful misconduct and gross negligence.
Please note that upon approval of the Financial Statements of the year that ended on December 31, 2010, the Shareholders' Meeting will also be required to renew the Board of Directors.

6. REMUNERATION OF DIRECTORS HOLDING SPECIAL OFFICES

At the time of their appointment or at the first meeting thereafter, the Remuneration Committee proposes to the Board of Directors the remuneration package for Directors holding special offices.
The remuneration package of Directors holding special offices generally consists of the following elements:
— a gross annual fixed component;
— an annual variable component that is based on the achievement of pre-set business objectives (the so-called MBO);
— a medium/long term, variable component (the so-called LTI).
When setting remuneration and its single elements, the Board of Directors takes into account whether the Director holding a special office has been assigned specific functions. In particular, salary levels are set on the basis of the following indicative criteria:
a) the fixed component generally represents no more than 50% of the target-based *Annual Total Direct Compensation*;
b) the (annual) target-based MBO incentive is a predetermined percentage of the fixed salary of Directors holding special offices in the Company (excluding, therefore, the remuneration received for other offices in other Group companies) representing generally not less than 70% of their salary. In any case, the maximum incentive can not be 2 times greater than the gross annual fixed component/GAS;
c) The medium/long term, variable, target-based annualized component (the so-called LTI) generally represents at least 50% of the total variable component (target-based MBO and target-based LTI) of the target-based *Annual Total Direct Compensation*.
For further information, also about maximum incentive limits, please refer to paragraph 9 ("MBO and LTI Plan").
If a Director holds special offices though is not assigned specific functions, his remuneration package consists exclusively of an annual fixed component that takes into account the particular office held thereby.
With reference to the variable components of the remuneration package of Directors holding special offices, please note that the Remuneration Committee proposes the MBO objectives to the Board of Directors on an annual basis and then checks, in the following year, the Directors' performances to verify their achievement of the MBO objectives in the previous year.
The Remuneration Committee is also responsible for evaluating the proposed allocation and quantification of the LTI in case of achievement of the objectives of the LTI Plan.
By analogy with what is guaranteed by law and/or by the National Collective Agreement for the Italian managers of the Group, the Board of Directors may also grant Directors holding special
offices and who have been assigned specific functions, provided they do not have a management contract with the Group:
— a Retirement Bonus (Trattamento di Fine Mandato -T.F.M.) as under art. 17(1), letter c) of the Consolidated Income Tax Law No 917/1986 with characteristics similar to those of the Severance Pay (Trattamento di Fine Rapporto - TFR) as under art. 2120 Italian Civil Code, granted by law to the Italian managers of the Group and including the contributions to be paid by the employer which would be due to social security institutions or funds in the case of a management contract with the Group..
— a policy (i) against personal accidents occurred while fulfilling their assignment, and (ii) against extra-professional accidents with premiums charged to the Company; for the latter accidents, the premium is payable by the Company according to tax and fiscal regulations;
— compensation in case of permanent disability and death due to disease;
— further benefits typical of their office and currently granted within the Group to Managers with strategic responsibilities and/or Senior Managers.
The Board of Directors may provide for (or, if required by law, may suggest to the Shareholders' Assembly) incentive mechanisms through the award of financial instruments or options on financial instruments which, where approved, are disclosed in the Annual Remuneration Statement at the latest (without prejudice to any further transparency obligations required by applicable laws).

As of the date of this Report, the Company has no incentive plans through financial instruments.

It is a policy of the Group not to award discretionary bonuses to Directors holding special offices.
The Board of Directors, upon proposal of the Remuneration Committee, may grant bonuses to these figures for specific transactions that are deemed exceptional in terms of strategic importance and effects on the results of the Company and/or the Group.

The Remuneration Committee and the Board of Directors evaluate and approve in advance, respectively, any further remuneration elements awarded to Directors for any other special offices granted thereto within the Boards of Directors of the Company's subsidiaries.
It is up to the Remuneration Committee and to the Board of Directors to analyse the composition and, more generally, the competitiveness of the remuneration packages of Directors holding special offices. When doing so, they are assisted by independent firms specialized in *executive compensation* on the basis of methodological approaches that allow for the complexity of the Directors' offices to be assessed in organizational terms, according to their specific assigned functions and to their individual impact on final business results.

7. GENERAL DIRECTORS AND MANAGERS WITH STRATEGIC RESPONSIBILITIES

As of December 31, 2010, Mr. Francesco Gori was the sole General Director of Pirelli & C., while the Managers with strategic responsibilities were:
— Atty. Francesco Chiappetta;
— Mr. Francesco Tanzi;
— Mr. Maurizio Sala.
The Board of Directors, assisted by the Internal Audit, Risk and Corporate Governance Committee, checks at least once a year that these conditions are not met with respect to further executives of the Company and/or the Group.
The remuneration package of General Directors and of Managers with strategic responsibilities generally consists of the following elements:
— a gross annual fixed component (the so-called GAS);
— an annual variable component that is based on the achievement of pre-set business objectives (the so-called MBO);
— a medium/long term, variable component (the so-called LTI).
— benefits typically granted to Pirelli executives.
When setting remuneration and its single elements, the Board of Directors considers the following indicative criteria:
a) the fixed component generally represents no more than 50% of the target-based *Annual Total Direct Compensation*;
b) the (annual) target-based MBO incentive for General Directors is a predetermined percentage of their fixed gross annual salary, representing generally not less than 70% of their salary, while for Managers with strategic responsibilities it represents not less than 40% of their fixed gross annual salary.
c) The medium/long term, variable, target-based annualized component (the so-called LTI) generally represents at least 50% of the total variable component (target-based MBO and target-based LTI) of the target-based *Annual Total Direct Compensation*.
For further information, also about maximum incentive limits, please refer to paragraph 9 ("MBO and LTI Plan").
Just like for Directors holding special offices, the Board of Directors may provide for (or, if required by law, may suggest to the Shareholders' Assembly) incentive mechanisms through the award of financial instruments or options on financial instruments which, where approved, are disclosed in the Annual Remuneration Statement of the following year at the latest (without prejudice to any further transparency obligations required by applicable laws).
As said in the previous paragraph, as of the date of this Report the Company has no incentive plans through financial instruments.
It is a policy of the Group not to award discretionary bonuses to General Directors and to Managers with strategic responsibilities.
The Board of Directors, upon proposal of the Remuneration Committee, may grant bonuses to these figures for specific transactions that are deemed exceptional in terms of strategic importance and effects on the results of the Company and/or the Group.
The process for setting the remuneration of General Directors is similar to that described for Directors holding special offices.
With regard to Managers with strategic responsibilities, the Remuneration Committee checks whether their remuneration is consistent with the Policy.
Also the remuneration of General Directors and of Managers with strategic responsibilities is analyzed with the assistance of independent firms specialized in *executive compensation*, and its levels are reviewed annually and announced in the Annual Remuneration Statement.

8. SENIOR MANAGERS AND EXECUTIVES

The remuneration package of Senior Managers and Executives in general consists of the following elements:
— a gross annual fixed component (the so-called GAS);
— an annual variable component that is based on the achievement of pre-set business objectives (the so-called MBO);
— a medium/long term, variable component (the so-called LTI).

— benefits granted according to corporate practices.

When setting the remuneration of Senior Managers and Executives and its single elements, the Pirelli Group considers the following indicative criteria:

a) the fixed component: (i) for Senior Managers generally represents no more than 60% of the target-based *Annual Total Direct Compensation* and (ii) for Executives it generally represents no more than two thirds of the target-based *Annual Total Direct Compensation*;

b) an (annual) target-based MBO incentive that is a percentage of the fixed component;

c) The medium/long term, variable, target-based annualized component (the so-called LTI) (i) for Senior Managers represents at least 50% of the total variable component (target-based MBO and target-based LTI) of the target-based *Annual Total Direct Compensation* and (ii) for Executives (unless the executive is not included, for management purposes, in the LTI Plan) it represents at least 30% of the total variable component (target-based MBO and target-based LTI) of the target-based *Annual Total Direct Compensation*.

For further information, also about maximum incentive limits, please refer to paragraph 9 ("MBO and LTI Plan").

The Group may grant exceptional bonuses in case of urgent management needs or in case of the achievement of specific extraordinary targets, and may include these workers in incentive mechanisms through the allocation of financial instruments or options on financial instruments adopted by the Group. In this respect, as said above, as of the date of this Report the Company has no incentive plans through financial instruments.

9. MBO AND LTI PLAN

The annual variable component (the so-called MBO) is used to evaluate the recipient's performance on an annual basis. The MBO objectives for Directors holding special offices and who are assigned specific functions, of General Directors and of Managers with strategic responsibilities, are set by the Board of Directors upon proposal of the Remuneration Committee, and are connected to the Company's and the Group's annual performances.

The annual variable component is based on the achievement of a financial condition of access (the so-called *on/off* condition) - in 2010, the Net Financial Position - and is related to a quantitative benchmark of annual profitability (in 2010, PBIT).

The MBOs of Senior Managers and Executives are defined by their hierarchical superiors together with the HR Department and the Group Management Control Department and may include, in addition to the Company's and/or Group's performances, objectives related to the economic and/or quality performance of the unit/function which the worker is a member of.

The Group sets a "cap" on the incentive payable in case the target objectives are exceeded.

In particular, in the case of MBOs granted to Directors holding special offices and to General Directors, the maximum incentive can not be 2 times greater than the gross annual fixed component/GAS. In the case of Managers with strategic responsibilities, the maximum incentive can not be 1.5 times greater than their GAS. Lastly, the maximum incentive for Senior Managers and Executives cannot be 2 times greater than the target-based incentive.

Also for the purposes of fostering the achievement of medium/long term interests, the Group has adopted since 2009 a medium/long term incentive system that is based on the achievement of the objectives set out in the three-year plan (the "2009/2011" plan - involving some 90 people, in particular Directors holding special offices and who are assigned specific functions, General Directors, Managers with strategic responsibilities, Senior Managers and some Executives - and then the "2011/2013" plan, essentially extended to all other Executives of the Group).

The LTI Plan also includes a mechanism for the "co-investment" of a portion of the MBO: the participant in the LTI Plan "co-invests" 50% of his MBO 2011 and 2012, eventually achieved thereby, to "support" the achievement of the objectives of the Three-Year Business Plan.

If the objectives of the Three-Year Business Plan are achieved, the participant acquires an LTI incentive which is a percentage of his gross annual fixed component/GAS applied at the time of joining the Plan; this percentage takes into account the role played thereby. The maximum incentive cannot be 1.5 times greater than the incentive granted for the achievement of target objectives.

In case of failure to achieve the target objectives, the worker is not entitled, not event pro-rata, to receive the LTI incentive.

With regard to the portion of co-invested MBO, the worker - if the three-year objectives are achieved - may claim the "return" of the "invested" amount, increased by a sum amounting to the "invested" one; if the three-year objectives are not achieved, the worker is entitled to claim only a refund of half the amount invested.

Therefore, the incentive plan provides for the partial deferment of payment of MBOs 2011 and 2012 (and of MBOs 2009 and 2010 for the LTI Plan 2009/2011).

The costs of LTI incentives are included in the objectives of the Three-Year Business Plan, so that the cost of the LTI Plan is "self-financed" by the achievement of these objectives.

The allocation of a portion of the amount granted on top of the "invested" one (10% of that amount) is connected

to the *Total Shareholder Return*, which measures Pirelli performances compared to the FTSE/MIB *Total Return* index, periodically calculated by FTSE and available in the Italian Stock Exchange database, which Pirelli's TSR must be at least aligned with in order to ensure an even greater alignment between the Management's performances and the expectations of shareholders. This relation is aimed at guaranteeing a direct link between pay and sustainable performances, meant in terms of value growth in the medium and long term.
The LTI Plan also has *retention* purposes: in the event of termination, for any reason, of the worker's assignment and/or employment relationship before the end of the three-year period, the worker no longer takes part in the Plan and thus the three-year incentive is not paid thereto, not even pro-rata (this applies also to MBO shares that may have already been "invested").

10. ALLOWANCES IN THE EVENT OF RESIGNATION, DISMISSAL OR TERMINATION

It is a policy of the Pirelli Group not to enter into agreements with Directors, Managers with strategic responsibilities, Senior Managers and Executives that regulate ex ante the economic issues arising in case of early termination of their relationship by the Company or the worker (the so-called "golden parachutes").
If the worker's relationship with the Group is terminated other than for good cause, it is preferable to "close" the relationship by mutual agreement. Subject to statutory and/or contractual obligations, any agreement on termination of the worker's relationship with the Group is based on the applicable benchmarks in this field and is subject to the case-law/customary limits applied in the country where the agreement is reached.
The Company defines internally the criteria which also the other companies of the Group must follow for the management of agreements on the early termination of relationships with managers and/or Directors holding special offices.
With regard to Directors holding special offices and who are assigned specific functions and who do not have a management contract with the Group, the Company does not provide for the payment of allowances or extraordinary compensation related to termination of their office. Payment of a specific allowance may be granted, subject to the prior assessment of the competent corporate bodies, in the following cases:

- termination by the Company without good cause;
- termination by the Director for good cause; for example, in case of substantial changes to his role or to his assignments and/or in case of a so-called "hostile" tender offer.

In these cases, the allowance amounts to 3 times the worker's gross annual salary, this meaning the sum of (all gross annual fixed salaries for the offices held; the average annual MBO paid while in office; Severance Pay on these amounts).

11. NON-COMPETITION AGREEMENTS

The Group may enter into non-competition agreements with its General Directors, Managers with strategic responsibilities and for especially important professional roles of Senior Managers and Executives, providing for payment of a GAS-related fee in relation to the term and scope of the obligation resulting from the agreement itself. The obligation is referred to the industry which the Group works in at the time of the agreement and to its geographical scope. The scope of the obligation varies according to the worker's role at the time of execution of the agreement and may cover, as in the case of General Directors, all the countries which the Group works in.

The Board of Directors
Milan, March 8, 2011

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET (in thousands of euro)

		12/31/2010		12/31/2009	
			of which related parties		of which related parties
8	Property, plant and equipment	1,977,106		1,727,391	
9	Intangible assets	848,761		1,047,474	
10	Investments in associates and joint ventures	152,927		593,237	
11	Other financial assets	185,267		228,106	
12	Deferred tax assets	69,642		91,164	
14	Other receivables	315,531		557,230	395,220
15	Tax receivables	10,755		9,578	
	Non-current assets	**3,559,989**		**4,254,180**	
16	Inventories	692,259		678,977	
13	Trade receivables	676,681	8,067	735,792	91,484
14	Other receivables	174,982	149,754	197,144	19,094
17	Securities held for trading	209,770		161,024	
18	Cash and cash equivalents	244,725		632,113	
15	Tax receivables	25,235		41,464	
27	Derivative financial instruments	35,159		26,567	
	Current assets	**2,058,811**		**2,473,081**	
	Total Assets	**5,618,800**		**6,727,261**	
19.1	Equity attributable to owners of the Parent:	1,990,831		2,175,023	
	— Share capital	1,375,733		1,554,269	
	— Reserves	593,346		598,009	
	— Net income	21,752		22,745	
19.2	Equity attributable to non-controlling interests:	37,152		319,648	
	— Reserves	54,675		364,979	
	— Net income	(17,523)		(45,331)	
19	**Total Equity**	**2,027,983**		**2,494,671**	
24	Borrowings from banks and other financial institutions	894,711		1,505,805	
26	Other payables	41,664		34,008	2,608
22	Provisions for liabilities and charges	165,732		167,793	
12	Provision for deferred tax liabilities	33,733		44,000	
23	Employee benefit obligations	481,724		451,880	
21	Tax payables	5,547		10,037	
	Non-current liablities	**1,623,111**		**2,213,523**	
24	Borrowings from banks and other financial institutions	247,515	77	289,305	2,473
25	Trade payables	1,066,361	5,434	987,873	24,067
26	Other payables	403,373	1,174	491,035	10,798
22	Provisions for liabilities and charges	115,984		130,783	3,279
21	Tax payables	64,559		43,918	1,080
27	Derivative financial instruments	69,914		76,153	
	Current liabilities	**1,967,706**		**2,019,067**	
	Total Liabilities and Equity	**5,618,800**		**6,727,261**	

Related party transactions in respect of the individual line items in the financial statements are presented in Note 42 of the Explanatory Notes to which the reader is referred

CONSOLIDATED INCOME STATEMENT (in thousands of euro)

		2010		2009	
			of which related parties		of which related parties
29	Revenue from sales and services	4,848,418	5,597	4,067,461	1,455
30	Other income	154,333	1,798	147,144	
	— of which non-recurring events	-		5,900	
	Change in inventories of work in progress, semi-finished and finished products	34,404		(109,143)	
	Raw materials and consumables (net of change in inventories)	(1,904,980)		(1,372,727)	
31	Personnel expense	(1,063,648)	(5,334)	(949,217)	(12,693)
	— of which non-recurring events	(18,192)		(52,124)	
32	Amortisation, depreciation and impairment	(228,598)		(219,348)	
	— of which non-recurring events	(6,500)		(8,000)	
33	Other costs	(1,443,082)	(22,959)	(1,317,172)	(16,367)
	— of which non-recurring events	-		(1,000)	
	Additions to property, plant & equipment for internal work	10,916		2,681	
	Operating income	**407,763**		**249,679**	
34	Net income (loss) from equity investments	23,457		(11,600)	
	— share of net income of associates and joint ventures	256	256	225	225
	— gains on equity investments	23,831		17,893	
	— losses on equity investments	(6,465)		(36,619)	
	— dividends	5,835		6,901	
35	Financial income	297,534	1,134	344,760	
36	Financial expenses	(363,327)	-	(414,873)	
	Net income (loss) before income taxes	**365,427**		**167,966**	
37	Income taxes	(137,358)		(90,350)	
	Net income (loss) from continuing operations	**228,069**		**77,616**	
38	Net income (loss) from discontinued operations	(223,840)		(100,202)	
	Net income (loss)	**4,229**		**(22,586)**	
	Attributable to:				
	Owners of the Parent	21,752		22,745	
	Non-controlling interests	(17,523)		(45,331)	

39	**Earnings (losses) per share (euro/thousand shares)**				
	basic earnings per share				
	— continuing operations	479,66		161,39	
	— discontinued operations	(435,04)		(114,73)	
		44,62		**46,66**	

Related party transactions in respect of the individual line items in the financial statements are presented in Note 42 of the Explanatory Notes to which the reader is referred

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (in thousands of euro)

		12/31/2010		
		Gross	Income taxes	Net
A	**Net income (loss) for the period**			**4.229**
	Other components recognised in Equity:			
	(Gains)/losses on associates and joint ventures transferred to income statement, previously recognised in Equity	38,854	(1,335)	37,519
	(Gains)/losses on other financial assets transferred to income statement, previously recognised in Equity	(8,656)	-	(8,656)
	(Gains)/losses on cash flow hedges transferred to income statement, previously recognised directly in Equity	5,683	(1,508)	4,175
B	**(Gains)/losses transferred to income statement previously recognised directly in Equity**	**35,881**	**(2,843)**	**33,038**
	Exchange differences from translation of foreign financial statements	104,667	-	104,667
	Fair value adjustment of other financial assets	(33,678)	-	(33,678)
	Net actuarial gains/(losses) on employee benefits	(21,618)	3,053	(18,565)
	Fair value adjustment of derivatives designated as cash flow hedges	(8,893)	2,967	(5,926)
	Share of other components recognised in Equity related to associates and joint ventures	(561)	-	(561)
	Other components recognised in Equity related to discontinued operations	2,691	(368)	2,323
C	**Income/(losses) recognised directly in Equity in the period**	**42,608**	**5,652**	**48,260**
B+C	**Total other components recognised in Equity**	**78,489**	**2,809**	**81,298**
A+B+C	**Total comprehensive income/(losses)**			**85,527**
	Attributable to:			
	— Owners of the Parent			96,525
	— Non-controlling interests			(10,998)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (in thousands of euro)

		12/31/2009		
		Gross	Income taxes	Net
A	**Net income (loss) for the period**			(22.586)
	Other components recognised in Equity:			
	(Gains)/losses on associates and joint ventures transferred to income statement, previously recognised directly in Equity	11,406	-	11,406
	(Gains)/losses on other financial assets transferred to income statement, previously recognised in Equity	(792)	-	(792)
	(Gains)/losses on cash flow hedges transferred to income statement, previously recognised directly in Equity	(1,934)	-	(1,934)
B	**(Gains)/losses transferred to income statement previously recognised directly in Equity**	**8,680**	**-**	**8,680**
	Exchange differences from translation of foreign financial statements	37,589	-	37,589
	Fair value adjustment of other financial assets	34,739	(226)	34,513
	Net actuarial gains/(losses) on employee benefits	(86,643)	9,157	(77,486)
	Adjustment to fair value of derivatives designated as cash flow hedges	(18,639)	5,223	(13,416)
	Reversal of reserve for reclassification of Equity investments from other financial assets to associates	12,281	(506)	11,775
	Share of other components recognised in Equity related to associates and joint ventures	(13,566)	463	(13,103)
C	**Income/(losses) recognised directly in Equity in the period**	**(34,239)**	**14,111**	**(20,128)**
B+C	**Total other components recognised in Equity**	**(25,559)**	**14,111**	**(11,448)**
A+B+C	**Total comprehensive income/(losses)**			**(34,034)**
	Attributable to:			
	— Owners of the Parent			10,307
	— Non-controlling interests			(44,341)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (in thousands of euro)

	attributable to owners of the Parent					Non-controlling interests	Total
	Share capital	Translation reserve	Total IAS reserves*	Other reserves/ Retained earnings	Total attributable to owners of the Parent		
Total at 12/31/2008	**1,554,269**	**(15,422)**	**(292,214)**	**925,171**	**2,171,804**	**202,558**	**2,374,362**
Total other components recognised in Equity	-	40,656	(53,094)	-	(12,438)	990	(11,448)
Net income (loss)	-	-	-	22,745	22,745	(45,331)	(22,586)
Total gains/(losses)	**-**	**40,656**	**(53,094)**	**22,745**	**10,307**	**(44,341)**	**(34,034)**
Pirelli RE capital increase	-	-	986	(3,588)	(2,602)	165,527	162,925
Dividends paid	-	-	-	-	-	(2,313)	(2,313)
Changes in non-controlling interests	-	-	-	-	-	(4,349)	(4,349)
Other	-	-	(1,905)	(2,581)	(4,486)	2,566	(1,920)
Total at 12/31/2009	**1,554,269**	**25,234**	**(346,227)**	**941,747**	**2,175,023**	**319,648**	**2,494,671**
Total other components of continuing operations recognised in Equity	-	101,358	(63,204)	-	38,154	3,301	41,455
Total other components of discontinued operations recognised in Equity	-	835	35,736	-	36,571	3,272	39,843
Net income (loss) from continuing operations	-	-	-	233,821	233,821	(5,752)	228,069
Net income (loss) from discontinued operations	-	-	-	(212,069)	(212,069)	(11,771)	(223,840)
Total gains/(losses)	**-**	**102,193**	**(27,468)**	**21,752**	**96,477**	**(10,950)**	**85,527**
Reduction for spin-off of Pirelli RE	(178,814)	-	(3,976)	(32,498)	(215,288)	(274,831)	(490,119)
Dividends paid	-	-	-	(81,114)	(81,114)	(3,968)	(85,082)
Venezuela inflation effect	-	-	-	15,017	15,017	558	15,575
Capital increases	-	-	-	-	-	4,794	4,794
Other	278	-	(1,238)	1,676	716	1,901	2,617
Total at 12/31/2010	**1,375,733**	**127,427**	**(378,909)**	**866,580**	**1,990,831**	**37,152**	**2,027,983**

BREAKDOWN OF IAS RESERVES* (in thousands of euro)

	Reserve for adjustment to fair value of available-for-sale financial assets	Reserve for cash flow hedges	Reserve for actuarial gains/losses	Reserve for Equity settled stock options	Reserve for deferred taxes	Total IAS reserves
Balance at 12/31/2008	**17,323**	**(37,983)**	**(297,339)**	**3,500**	**22,285**	**(292,214)**
Total other components recognised in Equity	40,886	(21,746)	(86,323)	-	14,089	(53,094)
Other changes	(454)	(1,049)	(231)	-	815	(919)
Balance at 12/31/2009	**57,755**	**(60,778)**	**(383,893)**	**3,500**	**37,189**	**(346,227)**
Total other components of continuing operations recognised in Equity	(42,334)	(3,771)	(21,608)	-	4,509	(63,204)
Total other components of discontinued operations recognised in Equity	710	37,288	(765)	-	(1,497)	35,736
Other changes in discontinued operations	-	-	380	(3,500)	(856)	(3,976)
Other changes in continuing operations	-	(248)	(3)	-	(987)	(1,238)
Balance at 12/31/2010	**16,131**	**(27,509)**	**(405,889)**	**-**	**38,359**	**(378,909)**

CONSOLIDATED STATEMENT OF CASH FLOWS (in thousands of euro)

		2010		2009	
			of which related parties		of which related parties
	Net income (loss) from continuing operations before taxes	365,427		167,966	
	Amortisation, depreciation, impairment losses and reversals of property, plant and equipment and intangible assets	228,598		219,348	
	Reversal of financial expenses	363,327		414,873	
	Reversal of financial income	(297,534)		(344,760)	
	Reversal of dividends	(5,835)		(6,901)	
	Gains/(losses) on equity investments	(17,366)		18,726	
	Share of net income from associates and joint ventures (net of dividends received)	(256)		(225)	
	Income taxes	(137,358)		(90,350)	
	Change in inventories	(109,919)		245,391	
	Change trade receivables/payables	127,959		(101,565)	
	Change in other receivables/payables	51,046		5,598	
	Change in provisions for employee benefits and other provisions	41,947		67,912	
	Other changes	18,052		(64,034)	
A	**Net cash flows provided by/(used in) operating activities**	**628,088**		**531,979**	
	Purchase of property, plant and equipment	(433,069)	(17,901)	(223,221)	
	Disposal of property, plant and equipment	17,954		37,303	
	Purchase of intangible assets	(4,828)		(4,563)	
	Disposals of intangible assets	2,832		10,116	
	Acquisition of equity investments in associates and joint ventures	(16,904)		(13,791)	
	Acquisition of other financial assets	(23,516)	(1,117)	(1,527)	
	Disposal of other financial assets	-		223,839	
	Acquisition of non-controlling interests	-		(4,166)	
	Dividends received	5,835		6,901	
B	**Net cash flows provided by/(used in) investing activities**	**(451,696)**		**(30,891)**	
	Increase/(reduction) in Equity	4,794			
	Change in financial payables	(186,448)		(95,787)	
	Change in financial receivables	(235,416)		(6,099)	
	Financial income/(expenses)	(65,793)		(70,113)	
	Dividends paid	(85,082)	(20,780)	(2,313)	
C	**Net cash flows provided by/(used in) financing activities**	**(567,945)**		**(174,312)**	
	Net cash flows provided by/(used in) operating activities	(8,025)		(8,823)	
	Net cash flows provided by/(used in) investing activities	(1,020)		5,163	
	Net cash flows provided by/(used in) financing activities	11,275		1,164	
D	**Net cash flows provided by/(used in) discontinued operations**	**2,230**		**(2,496)**	
E	**Total cash flows provided/(used) during the year (A+B+C+D)**	**(389,323)**		**386,062**	
F	**Cash and cash equivalents at beginning of year**	**610,779**		**227,077**	
G	**Exchange differences on translation of cash and cash equivalents**	**5,314**		**(2,360)**	
H	**Cash and cash equivalents at end of year (E+F+G) °**	**226,770**		**610,779**	
°	**of which:**				
	cash and cash equivalents	244,725		632,113	
	bank overdrafts	(17,955)		(21,334)	

The Statement of Cash Flows shows transactions with related parties only if they cannot be directly deduced from the other statements.
Related party transactions in respect of the individual line items in the financial statements are presented in Note 42 of the Explanatory Notes to which the reader is referred

1. GENERAL INFORMATION

Pirelli & C. S.p.A. is a corporation organised under the laws of the Republic of Italy.
Founded in 1872 and listed on the Italian Stock Exchange, Pirelli & C. S.p.A. is a holding company that manages, coordinates and finances the operations of its subsidiaries.
At the reporting date, the Group's operations are principally represented by investments in:
— Pirelli Tyre S.p.A. – a company operating in the Tyre sector – 100% Stake in Share capital;
— Pirelli & C. Eco Technology S.p.A. – a company active in the field of emission reducing technologies – 51% stake in Share capital;
— Pirelli & C. Ambiente S.p.A. – a company operating in the field of renewable sources of energy – 51% stake in Share capital.

The head office of the company is located in Milan, Italy.

Pursuant to Article 5(2) of Italian Legislative Decree 38 of February 28, 2005, these financial statements have been prepared using the euro as the functional currency, and all amounts have been rounded to the nearest thousand euro unless indicated otherwise.

The consolidated financial statements are audited by Reconta Ernst & Young S.p.A., pursuant to Article 159 of Italian Legislative Decree 58 of February 24, 1998, the Consob recommendation of February 20, 1997, and the shareholders' meeting resolution of April 29, 2008, which engaged this accounting firm for the period 2008-2016.

On March 8, 2011 the consolidated financial statements have been authorised for issue by the Board of Directors.

2. BASIS OF PRESENTATION

FINANCIAL STATEMENT FORMATS

The Company has applied the provisions of Consob Resolution No. 15519 of July 27, 2006 in regard to the formats of financial statements and Consob Notice No. 6064293 of July 28, 2006 in regard to corporate disclosure.
The consolidated financial statements at December 31, 2010 consist of the Balance Sheet, the Income Statement, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Cash Flow Statement and the Explanatory Notes, and are accompanied by the Directors' Report on Operations.
The format adopted for the Balance Sheet classifies assets and liabilities as current and non-current.
The Group has opted to present the components of profit or loss for the year in a separate Income Statement, rather than include these components directly in the Statement of Comprehensive Income. The Income Statement classifies costs by nature.
The Statement of Comprehensive Income includes the result for the period and, for homogeneous categories, the revenues and costs which, in accordance with IFRSs, are recognised directly in Equity.
The Group has decided to present both the tax effects and reclassifications to the Income Statement of gains/losses recognised directly in equity in previous periods directly in the Statement of Comprehensive Income and not in the Explanatory Notes.
The Statement of Changes in Equity includes the amounts of transactions with the Equity holders and the movements that occurred during the period in retained earnings.

In the Cash Flow Statement, the cash flows deriving from operating activities are presented using the indirect method, according to which the profit or loss for the period is adjusted by the effects of non-monetary transactions, by any deferment or accrual of past or future operating receipts or payments, and by any revenue or cost items connected with the cash flows arising from investing activities or financing activities.

When reading the financial statements, it should be recalled that the assets and activities of Pirelli & C. Real Estate S.p.A., now Prelios S.p.A. (following Pirelli RE – now Prelios) were spun off from the Pirelli Group effective October 25, 2010 so that the Group could concentrate on the Tyre business. This spin off simultaneously allowed shareholders, who already had an indirect equity interest in the real estate business, to acquire a direct investment in Prelios S.p.A..
On November 29, 2010, the Advanced Digital Broadcast (ADB) Group acquired 100% of Pirelli Broadband Solutions S.p.A. (PBS), a wholly-owned subsidiary of Pirelli & C. S.p.A..
Both of these transactions have been classified as discontinued operations, and thus contributed only to the net income (loss). Therefore, the comparative income statement figures for 2009 have been restated on a comparable consolidation basis.

SCOPE OF CONSOLIDATION

The scope of consolidation includes subsidiaries, associates and investments in joint ventures.
All companies and entities whose financial and operating policies are subject to control by the Group are considered subsidiaries. This condition is normally satisfied when the Group owns more than half of the voting rights.
The financial statements of subsidiaries are included in the consolidated financial statements beginning on the date when control is acquired until the time when control

is lost. Non-controlling interests in Equity and net income (loss) are separately indicated on the consolidated Balance Sheet and Income Statement.
All companies over which the Group can exercise significant influence (as defined by IAS 28 – Investments in Associates) are considered associates. This influence is normally assumed to exist if the Group holds between 20% and 50% of the voting power of the investee or – even with a smaller proportion of voting rights – it has the power to participate in determining the financial and operating policies of the investee on the basis of particular legal relationships. Such relationships may take the form of shareholders' agreements together with other forms of significant exercise of governance rights.
Companies in which two or more parties operate a business under joint control on the basis of a contractual or statutory agreement are considered *joint ventures*.

CONSOLIDATION POLICIES

The financial statements used for consolidation purposes are those of the companies included in the scope of consolidation, prepared at the reporting date of the Parent and adjusted, as necessary, in accordance with the IAS/IFRSs applied by the Group.
The financial statements expressed in foreign currencies have been translated into euro at the year-end rates for the Balance Sheet and at the average exchange rates of the year for the Income Statement, with the exception of financial statements of companies operating in high-inflation countries, whose Income Statements are translated at the year-end exchange rates.

The differences arising from the translation of opening Equity at year-end exchange rates have been recognised in the reserve for translation differences, together with the difference between the result for the year translated at the year-end rate and at the average rate for the year. The reserve for translation differences is recognised in the Income Statement upon disposal of the company that generated the reserve.
The consolidation policies may be summarised as follows:

- subsidiaries are consolidated on a line-by-line basis, according to which:
  - the assets, liabilities, revenue, and costs of the financial statements of subsidiaries are recognised in their full amounts, regardless of the percentage of ownership;
  - the carrying amount of investments is eliminated against the underlying share of Equity;
  - the financial and operating transactions between companies consolidated on a line-by-line basis, including dividends distributed within the Group, are eliminated;
  - the non-controlling interest in Equity and in income (loss) is presented separately on the Balance Sheet and Income Statement;
- investments in associates and joint ventures are accounted for using the equity method, on the basis of which the carrying amount of the investments is adjusted by:
  - the investor's share of the post-acquisition results of the associate or joint venture;
  - the allocable amount of gains and losses recognised directly in the Equity of the associate or joint venture, in accordance with the reference accounting standards;
  - dividends paid by the associate or joint venture;
  - when the Group's share, if any, of the associate's/joint venture's losses exceeds the carrying amount of the investment in the financial statements, the carrying amount of the investment is eliminated and the share of any further losses is recognised in the "Provisions for liabilities and charges," to the extent that the Group has a contractual or implicit obligation to cover the losses;
- profits resulting from sales made by subsidiaries to *joint ventures* or associates are eliminated in proportion to the share held in the acquiring entity.

3. ACCOUNTING POLICIES

3.1 ADOPTED ACCOUNTING STANDARDS

Pursuant to Regulation 1606 issued by the European Parliament and the European Council in July 2002, the consolidated financial statements of the Pirelli & C. Group have been prepared in accordance with the current International Financial Reporting Standards ("IRFSs") issued by the International Accounting Standards Board ("IASB") and endorsed by the European Union at December 31, 2010, as well as the measures issued in implementation of Article 9 of Legislative Decree 38/2005. The term "IFRSs" also refers to all revised International Accounting Standards ("IAS") and all interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"), formerly known as the Standing Interpretations Committee ("SIC").
The consolidated financial statements have been prepared in accordance with the historical cost method, with the exception of:

- derivative financial instruments, financial instruments held for trading, and available-for-sale financial assets, which are measured at fair value;
- financial statements of companies operating in hyperinflationary economies, which are prepared according to the current cost method.

Intangible assets

Intangible assets having finite useful lives are measured at cost less accumulated amortisation and accumulated impairment losses.
Amortisation begins when the assets is available for use or capable of operating in the manner intended by the management and ceases on the date when the asset is classified as held for sale or is derecognised. Gains and losses resulting from the sale or disposal of an intangible asset are determined as the difference between the net sale proceeds and the carrying amount of the asset.

GOODWILL

When a controlling interest in a company is acquired, goodwill is calculated as the difference between:

- the price paid plus any non-controlling interests in the acquired entity. These latter interests are measured at fair value (if this option is chosen for the acquisition in question) or in proportion to the share of the non-controlling interest in the net assets of the acquired entity;
- the *fair value* of the acquired assets and liabilities.

If this difference is negative, that difference is immediately recognised as income in the Income Statement.
In the case of equity interests acquired after acquisition of a controlling interest (i.e. acquisition of non-controlling interests), any positive difference between the purchase cost and the corresponding fraction of acquired Equity is recognised in Equity. Likewise, the effects of disposing non-controlling interests without loss of control are also recognised in Equity.
Goodwill is tested for impairment in order to identify any impairment losses at least annually or whenever there are indications of an impairment loss, and is allocated to cash generating units for this purpose.
Since this is an intangible asset with an indefinite useful life, goodwill is not amortised.
Upon disposal of the equity investment with consequent loss of control, the gain or loss from that disposal includes the corresponding residual value of goodwill.

TRADEMARKS AND LICENSES

Trademarks and licenses are measured at cost less accumulated amortisation and accumulated impairment losses. The cost is amortised over the contract period or the useful lives of the assets, whichever is shorter.

SOFTWARE

Software license costs, including direct incidental costs, are capitalised and recognised net of accumulated amortisation and accumulated impairment losses. Software is amortised over its useful life on a straight-line basis.

RESEARCH AND DEVELOPMENT

Research costs for new products and/or processes are expensed when incurred.
There are no development costs that satisfy the conditions for capitalisation under IAS 38.

The useful lives of intangible assets are illustrated as follows:

Trademarks and licenses	5 years
Software	from 2 to 3 years

Property, plant and equipment

Property, plant and equipment are recognised at the cost of acquisition or production, including directly attributable incidental expenses.
Subsequent expenditure and the cost of replacing certain parts of property, plant and equipment are capitalised only if they increase the future economic benefits inherent in the affected asset. All other costs are expensed as incurred. When the cost of replacing certain parts is capitalised, the carrying amount of the replaced part is recognised in the Income Statement.
Property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses, except for land, which is not depreciated and is measured at cost less accumulated impairment losses.
Depreciation is recognised starting from the month in which the asset is available for use, or is potentially capable of providing the economic benefits associated with it.
Depreciation is charged monthly on a straight-line basis at rates that allow depreciating the assets until the end of their useful life or, in the case of disposal, until the last month of use.

The applied depreciation rates are illustrated as follows:

Buildings	3% - 10%
Plant	7% - 20%
Machinery	5% - 20%
Equipment	10% - 33%
Furniture	10% - 33%
Motor vehicles	10% - 25%

Government grants related to assets referring to property, plant and equipment are recognised as deferred income and credited to the Income Statement over the period of depreciation of the relevant assets.
Borrowing costs directly attributable to the purchase, construction or production of a qualifying asset are capitalised as part of the cost of the asset. A qualifying asset is one that requires substantial time in order to be ready for use. The capitalisation of borrowing costs ceases when substantially all the activities necessary to render the qualifying asset available for use have been completed.
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 agreement, whichever is shorter.
Spare parts of significant value are capitalised and depreciated over the estimated useful life of the assets to which they refer.
Any dismantling costs are estimated and added to the cost of property, plant and equipment with a corresponding accrual to provisions for liabilities and charges if the prerequisites for building such provisions are satisfied. They are then depreciated over the remaining useful life of the assets to which they refer.
Assets acquired under finance lease agreements, in which substantial all the risks and rewards of ownership are transferred to the Group, are recognised as property, plant and equipment at their fair value or, if lower, at the present value of the minimum lease payments, with a corresponding entry for the relevant financial payable. The lease instalment payments are allocated between interest expense, which is recognised in the Income Statement, and principal repayment, which is recorded as a reduction of the financial payable.
Leases in which the lessor maintains substantially all the risks and rewards associated with ownership are classified as operating leases. The costs referring to an operating lease are recognised as an expense in the income statement over the lease term on a straight-line basis.

Property, plant and equipment are derecognised at the time of disposal or retirement from use and, consequently, when no future economic benefits are expected to derive from their sale or use.

Gains and losses resulting from the sale or disposal of property, plant and equipment are determined as the difference between the net proceeds from the sale and the carrying amount of the asset.

Impairment of assets

PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

Whenever there are specific indicators of impairment, and at least annually for intangible assets with indefinite life, including goodwill, 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.
The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use, where the latter is the present value of the expected future cash flows arising from the use of the asset and those deriving from its disposal at the end of its useful life, excluding income taxes and applying a discount rate, which should be the pre-tax rate which reflects the current market assessments of the time value of the money and the risks specific to the asset.
If the recoverable amount is lower than the asset carrying amount, the latter is reduced to the recoverable amount. This reduction constitutes an impairment loss, which is recognised in the Income Statement.
In order to assess impairment, assets are allocated to the lowest level at which independent cash flows are separately identifiable (cash generating units). Specifically, goodwill must be allocated to the cash generating unit or group of cash generating units, complying with the maximum level of aggregation allowed, which must never be greater than the operating segment.
When there is evidence that an impairment loss recognised in previous years and relating to property, plant and equipment or intangible assets other than goodwill may no longer exist or can be reduced, the recoverable amount is estimated again. If it is higher than the net carrying amount, then the net carrying amount should be increased to the revised estimate of its recoverable amount. The reversal of an impairment loss may not exceed the carrying amount that would have been recognised (net of impairment and depreciation or amortisation) had no

impairment loss been recognised in previous years.
The reversal of an impairment loss other than goodwill is recognised in the income statement.
An impairment loss recognised for goodwill may not be reversed in subsequent years.
An impairment loss recognised for goodwill on the interim financial statements may not be reversed in the subsequent annual period.

INVESTMENTS IN ASSOCIATES AND JOINT VENTURES
For the purpose of impairment testing, the value of investments in associates and joint ventures, accounted for using the Equity method, must be compared with the recoverable amount. The recoverable amount corresponds to the higher of the fair value, less selling costs, and the value in use. There is no need to estimate both amounts because it is sufficient to verify that one of the two amounts is higher than the carrying amount in order to establish that no impairment has occurred.
For the purposes of impairment testing, the fair value of an investment in an associate or joint venture with shares listed on an active market is always equal to its market value, irrespective of the percentage of ownership.
For the purpose of determining the value in use of an associate or joint venture accounted for using the Equity method, the following estimates should be made alternatively:

a) the share of the present value of estimated future cash flows that are expected to be generated by the associate or joint venture, including cash flows deriving from the operating activities of the associate or joint venture and the consideration that will be received upon final disposal of the investment (known as the discounted cash flow – asset side method);
b) the present value of estimated future cash flows that are expected to arise from dividends to be received and from final disposal of the investment (known as the dividend discount model – equity side method).

If there is evidence than an impairment loss recognised in previous years may no longer exist or can be reduced, the recoverable amount of the investment is estimated again, and if it is higher than the amount of the investment, then the latter amount should be increased up to the recoverable amount.
The reversal of an impairment loss may not exceed the amount of the investment that would have been recognised (net of impairment) had no impairment loss been recognised in previous years.
The reversal of an impairment loss on investments in associates and joint ventures is recognised in the Income Statement.

Available-for-sale financial assets

The category of available-for-sale financial assets includes investments in entities other than subsidiaries, associates and joint ventures and other financial instruments not held for trading. They are recognised in the Balance Sheet item "Other financial assets."
They are measured at fair value, if this can be reliably determined.
Gains and losses deriving from changes in fair value are recognised in a specific Equity reserve.
When a reduction in fair value has been recognised directly in Equity and there is objective evidence that the asset was impaired, the losses recognised up to that time in Equity are recognised in the Income Statement. A prolonged (meaning more than 12 months) or significant (meaning more than one-third) reduction in the fair value of equity securities as compared with their cost is considered an indicator of impairment.
In the event of disposal, the gains and losses recognised up to that time in Equity are recognised in the Income Statement.
Any impairment losses recognised on available-for-sale financial assets in the Income Statement cannot be reversed through the Income Statement.
Impairment losses recognised in the interim Financial Statements on equity securities classified as available for sale cannot be reversed to the Income Statement in the subsequent financial year.
Available-for-sale financial assets, whether debt or equity instruments for which fair value is not available, are accounted for at cost, reduced by any impairment losses based on the best market information available at the Balance Sheet date.
Purchases and sales of available-for-sale financial assets are accounted for at the settlement date.

Inventories

Inventories are measured at the lower of cost, determined according to the FIFO method, and their estimated realisable value.
The measurement of inventories includes direct costs of materials and labour and indirect costs. Provisions are calculated for obsolete and slow-moving inventories, taking into account their expected future use and estimated realisable value. The realisable value is the estimated selling price, net of all costs estimated to complete the asset and selling and distribution costs that will be incurred.
Cost includes incremental expenses and borrowing costs qualifying for capitalisation, similarly to what has been described for property, plant and equipment.

Construction contracts

A construction contract is a contract specifically negotiated for the construction of an asset, based on the instructions of a principal who, as a preliminary step, designs the plans and the technical characteristics.
Contract revenues include the consideration initially agreed with the customer, as well as changes in the con-

struction work and price variations envisaged by the contract that can be determined reliably.
When the outcome of a contract can be estimated reliably, the contract revenues and costs are measured using the percentage of completion method. The stage of completion is determined with reference to the costs incurred up to the Balance Sheet date as a percentage of the total estimated costs for each contract.
Costs incurred in connection with future activities on the contract are excluded from contract costs when determining the stage of completion and are recognised as inventories.
When total contract costs are expected to exceed total contract revenues, the expected loss is immediately recognised as an expense.
The gross amount due from customers for contract work for all the contracts in progress and for which the costs incurred plus recognised profit (or net of recognized losses) exceed progress billings is recognised as a receivable, under the item "trade receivables."
The gross amount due to customers for contract work for all the contracts in progress and for which the progress billings exceed the costs incurred plus recognised profit (or net of recognised losses) is recognised as a payable, under the item "trade payables."

Receivables

Receivables are initially recognised at their fair value, which normally corresponds to the consideration agreed or to the present value of the amount that will be collected. They are subsequently measured at amortised cost, less provisions for impairment losses.
Amortised cost is calculated by using the effective interest rate method, which is equivalent to the discount rate that, when applied to future cash flows, renders the present value of such flows equal to the initial fair value.
Impairment losses on receivables are calculated according to counterparty default risk, which is determined by considering available information on the solvency of the counterparty and historic data. The carrying amount of receivables is reduced indirectly by building provisions. Individual material positions that are objectively found to be partially or entirely uncollectable are impaired individually. The amount of the impairment loss reflects the estimate of future recoverable flows and the applicable date of collection, recovery costs and expenses, and the fair value of guarantees, if any.
The positions that are not written down individually are included in groups with similar characteristics in terms of credit risk, and they are impaired on a collective basis according to a percentage that increases as the period during which they are overdue increases. The group impairment procedure also applies to receivables not yet due.
The impairment percentages are determined on the basis of historic experience and statistical data.
When the conditions that led to impairment of the receivables no longer exist, the impairment losses recognised in previous periods are reversed by crediting the income statement up to the amortised cost that would have been recognised had no impairment loss been recognised.
Receivables in currencies other than the functional currency of the individual companies are adjusted to the year-end exchange rates, with a balancing entry in the Income Statement.
Receivables are derecognised when the right to receive cash flows is extinguished, when substantially all the risks and rewards connected with holding the receivable have been transferred, or when the receivable is considered definitely irrecoverable after all necessary credit recovery procedures have been completed. When the receivable is derecognised, the relative provision is also derecognised, if the receivable had previously been impaired.

Payables

Payables are initially recognised at their fair value, which normally corresponds to the consideration agreed or to the present value of the amount that will be paid. They are subsequently measured at amortised cost.
Amortised cost is calculated by using the effective interest rate method, which is equivalent to the discount rate that, when applied to future cash flows, renders the present value of such flows equal to the initial fair value.
Payables in currencies other than the functional currency of the individual companies are adjusted to the year-end exchange rates, with a balancing entry in the Income Statement.
Payables are derecognised when the specific contractual obligation is extinguished.

Financial assets carried at fair value through profit or loss

This category includes financial instruments that are purchased mainly for resale in the short term and classified under current assets as "securities held for trading," financial assets that are initially recognised at fair value through profit or loss, classified as "other financial assets," and derivatives (except those designated as effective hedging instruments), classified as "derivative financial instruments."
They are measured at fair value with a balancing entry in the Income Statement. Transaction costs are expensed to the Income Statement.
Purchases and sales of these financial assets are accounted for at the settlement date.

Cash and cash equivalents

Cash and cash equivalents include bank deposits, postal deposits, cash and cash equivalents on hand.

Provisions for other liabilities and charges

Provisions for other liabilities and charges include accruals for current obligations (legal or constructive) deriving from a past event, for the fulfilment of which an outflow of resources will probably be necessary and whose amount can be reliably estimated.
Changes in estimates are recognised in the Income Statement of the period when the change occurs.
If the effect of discounting is material, provisions are presented at their present value.

Employee benefit obligations

Employee benefits paid after termination of the employment relationship under defined benefit plans and other long-term benefits are subject to actuarial valuations. The liability recognised in the Financial Statements is the present value of the Group's obligation, net of the fair value of any plan assets.
With regard to defined benefit plans, the Pirelli Group has elected the option allowed by IAS 19, under which actuarial gains and losses are fully recognised in Equity in the financial year when they arise.
For other long-term benefits, actuarial gains and losses are recognised immediately in the Income Statement.
The interest cost and expected return on plan assets are recognised under personnel costs.
The costs relating to defined contribution plans are recognised in the Income Statement when incurred.
Until December 31, 2006, the provision for post-employment benefits (TFR) of Italian companies was considered a defined benefit plan. The rules governing this provision were amended by Law 296 of December 27, 2006 ("2007 Italian Budget Act") and subsequent decrees and regulations issued in the early months of 2007. In light of these changes, and specifically in reference to Group companies with more than 50 employees, the provision is now considered a defined benefit plan for the portion accrued prior to January 1, 2007 (and not yet paid out at the reporting date), whereas subsequent to that date, it is considered a defined contribution plan.

Stock options

Stock options are divided into two types that require different accounting treatment according to the features of the plan:

- *equity-settled*: these are plans where the grantee is given the right to purchase shares of the company at a fixed price whenever specific conditions are met. In these cases, the fair value of the option, determined at the grant date, is recognised as an expense in the Income Statement over the duration of the plan, with a corresponding entry increasing the reserves in Equity;
- *cash-settled*: these are plans that provide for put options in favour of the recipient, combined with call options in favour of the issuer, or plans where the recipient directly receives the monetary equivalent amount of the benefit deriving from exercise of the stock option. The fair value of the option, which is remeasured at the end of every reporting period, is recognised in the Income Statement over the vesting period of the plan, with a corresponding liability entry in the Balance Sheet. Changes in the fair value of the liability subsequent to the vesting period are recognised in the Income Statement.

Derivative financial instruments designated as effective cash flow hedges

These derivative instruments are measured at fair value, in accordance with IAS 39.
In relation to such instruments, the Group formally documents the relationship between the hedging instrument and the hedged item, its risk management objectives and the strategy followed in putting in place the hedge transaction.
The Group also assesses the effectiveness of the hedging instrument in offsetting the changes in cash flows attributable to the hedged risk. This assessment is carried out at hedge inception and on an on-going basis for the duration of the hedge.
The effective portion of the change in the fair value of the derivative that was designated and qualifies as a hedging instrument is recognised directly in Equity. The gain or loss relating to the ineffective part is recognised in the Income Statement.
The amounts recognised directly in Equity are reversed to the Income Statement when the hedged item produces an effect in the Income Statement.
When a hedging instrument expires or is sold, or no longer meets the criteria to be designated as a hedge, or whenever the Group revokes the designation, the relevant fair value adjustments accumulated in Equity remain in Equity until the hedged item produces an effect in the Income Statement. Subsequently they are reclassified to the Income Statement over the periods in which the acquired financial asset or assumed financial liability impact the Income Statement.
When the hedged item is no longer expected to impact the Income Statement, the fair value adjustments accumulated in Equity are immediately recognised in the Income Statement.
Purchases and sales of these derivative financial assets are accounted for at settlement date.

Determination of the fair value of financial instruments

The *fair value* of financial instruments traded on an active market is based on listed market prices at the reporting date. The listed market price used for financial assets is the *bid price*, while for financial liabilities it is the *ask price*.
The *fair value* of instruments that are not traded on an active market is determined by using measurement techniques with a variety of methods and assumptions that are based on market conditions at the balance sheet date.
The *fair value of interest rate swaps* is calculated as the present value of expected future cash flows.
The *fair value* of forward exchange contracts is determined by using the forward rate at the reporting date.

Income taxes

Current taxes are determined on the basis of a realistic forecast of the taxes payable under the current tax law of the country.
Deferred taxes are calculated according to the temporary differences existing between the asset and the liability amounts in the Balance Sheet and their tax basis (full liability method), and are classified under non-current assets and liabilities.
Deferred tax assets on tax loss carry-forwards, as well as on temporary differences, are only recognised when there is a likelihood of future recovery.
Current and deferred tax assets and liabilities are offset when the income taxes are levied by the same tax authority and when there is a legally enforceable right to offset.
Deferred tax assets and liabilities are determined according to enacted tax rates that are expected to be applicable to taxable income in the years when those temporary differences are expected to be recovered or settled, with reference to the jurisdictions where the Group operates.
The deferred tax liabilities related to equity investments in subsidiaries, associates and joint ventures are not recognised if the participating entity can control the turnover of temporary differences and if it is unlikely that such turnover will arise in the foreseeable future.
Deferred taxes are not discounted.
Deferred tax assets and liabilities are credited or debited to Equity if they refer to items that have been credited or debited directly in Equity during the period or during previous periods.

Equity

TREASURY SHARES

Treasury shares are recognised as a reduction in Equity.
If they are sold, reissued or cancelled, the resulting gains or losses are recognised in Equity.

COSTS OF EQUITY TRANSACTIONS

Costs that are directly attributable to Equity transactions of the Parent are recognised as a reduction in Equity.

Recognition of revenue

Revenue is measured at the fair value of the consideration received for the sale of products or provision of services.

SALES OF PRODUCTS

Revenue from the sale of products is recognised when all the following conditions are met:
- the material risks and rewards of ownership of the goods are transferred to the buyer;
- effective control over the goods and the normal continuing level of activities associated with ownership have ceased;
- the amount of revenue is reliably determined;
- it is likely that the economic benefits deriving from the sale will be enjoyed by the enterprise;
- the costs incurred or to be incurred are determined reliably.

If the nature and extent of involvement of the seller are such as to cause that the risks and rewards of ownership are not in fact transferred, then the recognition date of the revenues is deferred until the date on which this transfer can be considered to have taken place.

RENDERING OF SERVICES

Revenue from the rendering of services is recognised only when the results of the transaction can be measured reliably, by reference to the state of completion of the transaction at the balance sheet date.
The results of a transaction can be measured reliably only when all the following conditions are met:
- the amount of revenue can be determined reliably;
- it is likely that that company will enjoy the economic benefits of the transaction;
- the stage of completion of the transaction at the reporting date can be reliably measured;
- the costs incurred for the transaction and the costs to be incurred to complete it can be determined reliably.

INTEREST INCOME

Interest income is recognised on a time proportion basis that considers the effective return of the asset.

ROYALTY INCOME

Royalty income is recognised on an accrual basis, according to the substance of the relevant agreement.

DIVIDEND INCOME

Dividend income is recognised when the right to receive payment is established, which normally corresponds to the resolution passed by the Shareholders' Meeting for the distribution of dividends.

Earnings (losses) per share

Earnings (losses) per share are calculated by dividing the income (loss) attributable to the equity holders of the company by the weighted average number of outstanding shares during the year. To calculate diluted earnings per share, the weighted average number of outstanding shares is adjusted by assuming the conversion of all shares having a potentially dilutive effect.

Operating Segments

The operating segment is a part of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by top management in view of making decisions about resources to be allocated to the segment and assessing its performance, and for which discrete financial information is available.

Accounting policies for hyperinflationary countries

Group companies operating in high-inflation countries recalculate the amounts of their non-monetary assets and liabilities in their individual Financial Statements to eliminate the distorting effects caused by the loss of purchasing power of the currency. The inflation rate used for implementation of inflation accounting corresponds to the consumer price index.
Companies operating in countries where the cumulative inflation rate over a three-year period approximates or exceeds 100% adopt inflation accounting and discontinue it in the event that the cumulative inflation rate over a three-year period falls below 100%.
Gains or losses on the net monetary position are recognised in the Income Statement.
The Tyre sector company based in Venezuela is the only Group entity operating in a hyperinflationary country.

Non-current assets held for sale and disposal groups

Non-current assets and disposal groups are classified as held for sale if their carrying amount is recovered mainly through sale rather than through continuing use. This occurs if the non-current asset or disposal group are available for sale under current conditions and the sale is highly probable, or if a binding programme for sale has already begun, activities to find a buyer have already commenced and it is expected that the sale will be completed within one year after the classification date.
On the consolidated Balance Sheet, the non-current assets held for sale and the current and non-current assets/liabilities of the disposal group are presented as a separate item from other assets and liabilities, and their totals are reflected in current assets and liabilities, respectively.
Non-current assets classified as held for sale and disposal groups are measured at the lower of their respective carrying amounts and fair value less costs to sell.
The property, plant and equipment and intangible assets classified as held for sale are not depreciated or amortised.

Discontinued operations

A discontinued operation is a component that has been disposed of or classified as held for sale and that represents an important business unit or geographical area of activity, and pertains to a single, coordinated disposal programme.
On the consolidated Income Statement for the period, the net income (loss) of the discontinued operations, as well as the gain or loss resulting from fair value measurement less costs to sell or from disposal of the assets or disposal groups constituting the discontinued operation are combined in a single item at the end of the income statement separately from the income (loss) from continuing operations.
The cash flows for discontinued operations are shown separately in the Statement of cash flows.
The foregoing information is also presented for the comparative period.

3.2 ACCOUNTING STANDARDS AND INTERPRETATIONS ENDORSED AND IN FORCE FROM JANUARY 1, 2010

IFRIC 12 – Service Concession Arrangements

IFRIC 12 addresses private sector operators contracted for the supply of typical public sector services (e.g. roads, airports and energy and water distribution under concession arrangements). Under these arrangements, the assets granted are not necessarily controlled by the private operators, although the latter are responsible for constructing, operating or maintaining the public infrastructure. Assets under these arrangements are not necessarily recognised as property, plant and equipment in the financial statements of the private operators but rather as financial assets and/or intangible assets depending on the type of service concession arrangement. Application of this interpretation has no impact on the consolidated Financial Statements.

IFRIC 15 – Agreements for the Construction of Real Estate

This interpretation provides guidance on how to determine whether an agreement for the construction of real

estate units is within the scope of IAS 11 – Construction Contracts or of IAS 18 – Revenue, by defining the moment when the revenue must be recognised.
In the light of this interpretation, residential development comes within the scope of IAS 18 – Revenue, entailing recognition of the revenue on completion of sale. Construction service work, if carried out on the basis of the client's technical specifications, comes within the scope of IAS 11 – Construction Contracts.
Application of this interpretation has no impact on the consolidated Financial Statements.

IFRIC 16 – Hedges of a Net Investment in a Foreign Operation

This interpretation clarifies certain issues relating to the accounting treatment, in the consolidated Financial Statements, of hedges of net investments in foreign operations, specifying which types of risks qualify for application of hedge accounting. In particular, it states that hedge accounting is only applicable to exchange rate differences arising between the functional currency of the foreign entity and the functional currency of the Parent, and not between the functional currency of the foreign entity and the presentation currency of the consolidated financial statements.
Application of this interpretation has no impact on the consolidated Financial Statements.

IFRIC 17 – Distributions of Non-cash Assets to Owners

This interpretation clarifies that:
- dividend payables should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity;
- dividend payables should be measured at the fair value of the net assets to be distributed;
- the difference between the dividends paid and the carrying amount of the net assets distributed should be recognised in the Income Statement.

Assignment to shareholders of the equity investment in Pirelli RE (now Prelios), which was completed on October 25, 2010, has been recognised in compliance with this interpretation, as mentioned in note 38 elsewhere in this report.

IFRIC 18 – Transfers of Assets from Customers

This interpretation is particularly significant for companies operating in the utilities sector and clarifies the rules applicable to agreements under which an entity receives from a customer an asset that the entity uses to connect the customer to a network or to ensure the customer ongoing access to the provision of goods and services (e.g. electricity, water or gas).
Application of this interpretation has no impact on the consolidated Financial Statements.

Revision of IFRS 3 – Business Combinations

This revision is part of the project for convergence with US GAAP, and has the purpose of aligning the accounting treatment of business combinations. The principal changes from the previous version are:
- recognition in the Income Statement – when incurred – of expenses relating to business combination transactions (legal, advisory, valuation, audit and professional fees in general);
- the option of recognising non-controlling interests at fair value (i.e. full goodwill); this option may be chosen for each individual business combination;
- specific rules applicable to recognition of step acquisitions: in the case of acquisition of control of an entity in which a non-controlling interest is already held, the investment held previously must be measured at fair value through profit or loss;
- contingent consideration, i.e. the obligations of the acquirer to transfer additional assets or shares to the seller if certain future events occur or specific conditions are fulfilled, should be recognised and measured at fair value at the acquisition date. Subsequent changes in the fair value of these agreements are normally recognised in the Income Statement.

The introduction of this new standard has had no impact on the Group Financial Statements.

Amendments to IAS 27 – Consolidated and Separate Financial Statements

The revision of IFRS 3 – Business Combinations also resulted in amendments to IAS 27 – Consolidated and Separate Financial Statements. These are summarised as follows:
- changes in a Parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions. In other words, the difference between the price paid/received and the share of net assets acquired/sold must be recognised in Equity;
- if control of a subsidiary is lost, but a non-controlling interest in it is retained, this interest must be measured at fair value at the date on which the loss of control occurs.

The introduction of this new standard has had no material impact on the Group Financial Statements.

Amendment to IAS 39 – Financial Instruments: Recognition and Measurement – eligible hedged items

This amendment illustrates and clarifies what may be designated as a hedged item in certain specific situations:

- designation of a one-sided risk in a hedged item, i.e. when only changes in cash flow or fair value over or below a certain value, instead of the total change, are designated as a hedged item;
- designation of inflation as a hedged item.

Application of this interpretation has no impact on the Group Financial Statements.

Revised IFRS 1 – First-time Adoption of International Financial Reporting Standards

IFRS 1 has been revised several times over the years, following the issue of new standards or amendments to existing standards that made it less clear. The latest revision of IFRS 1 has not resulted in any substantial changes from its previous version, but it has modified its structure. This standard has no impact on the Group financial statements.

"Improvements" to IFRSs (issued by the IASB in April 2009)

As part of the project begun in 2007, the IASB has issued a series of amendments to twelve current standards.

The following table summarises the standards and issues addressed by these amendments:

IFRS	Subject of the amendment
IFRS 2 – Share-based Payment	Scope of application of IFRS 2 and revised IFRS 3
IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations	Disclosure of non-current assets (or disposal groups) classified as held for sale or discontinued operations
IRFS 8 – Operating Segments	Disclosure of activities of operating segments
IAS 1 – Presentation of Financial Statements	Classification of convertible instruments as current / non-current
IAS 7 – Cash Flow Statements	Classification of expenditures on unrecognised assets
IAS 17 – Leases	Classification of leases of land and building
IAS 18 - Revenue	Definition of characteristics useful for determining whether an entity acts as an agent (e.g. is not exposed to the significant risks and rewards of a transaction) or on its own behalf (e.g. it is exposed to the significant risks and rewards of a transaction)
IAS 36 – Impairment of Assets	Dimension of the cash generating unit for carrying out the impairment test on goodwill
IAS 38 – Intangible Assets	— Additional amendments resulting from revision of IFRS 3 — Fair value measurement of an intangible asset acquired through a business combination
IAS 39 – Financial Instruments: Recognition and Measurement	— Fair value measurement of an intangible asset acquired through a business combination — Scope exemption for business combination agreements — Cash flow hedge accounting
IFRIC 9 – Reassessment of Embedded Derivatives	Scope of IFRIC 9 and revised IFRS 3
IFRIC 16 – Hedges of a Net Investment in a Foreign Operation	Amendment to the restriction on the entity that may hold hedge instruments

Application of these amendments has had no material quantitative impact on the Group Financial Statements.

Amendments to IFRS 2 – Share-based Payment

These amendments aim to clarify the accounting treatment of cash-settled stock option plans in the Financial Statements of a subsidiary, if benefits are paid to employees by the Parent or a Group entity other than the one where the employee works. These amendments also include guidelines previously set out in IFRIC 8 "Scope of IFRS 2" and IFRIC 11 "IFRS 2 – Group and Treasury Share Transactions," which have been abrogated.
The amendments to IFRS 2 have no impact on the Group Financial Statements insofar as they are not applicable to the Group.

Amendments to the revised IFRS 1 – First-time Adoption of International Financial Reporting Standards – additional exemptions in the case of first-time adoption

These changes govern the retrospective application of IFRSs in certain cases, and are intended to avoid excessive costs and effort during the transition to IFRSs.
These amendments have had no impact on the Group consolidated Financial Statements.

3.3 INTERNATIONAL ACCOUNTING STANDARDS AND/OR INTERPRETATIONS THAT HAVE BEEN ISSUED BUT NOT YET IN FORCE AND/OR ENDORSED

Pursuant to IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, the new standards and/or interpretations that have been issued but are not yet in force or not yet endorsed by the European Union, and which are therefore not applicable, are mentioned and described briefly as follows. None of these standards and interpretations has been early adopted by the Group.

Amendments to IAS 32 – Financial Instruments: Disclosure and Presentation – classification of rights issues

The amendments address rights issues, such as warrants and similar rights, that are denominated in a currency other than the issuer's functional currency. Previously, these rights issues were recognised as derivative financial liabilities. Now, if certain conditions are satisfied, these rights issues may be classified as Equity instruments, regardless of the currency in which the exercise price is denominated.
These amendments were endorsed by the European Union in December 2009 (EC Regulation 1293/2009) and are applicable from January 1, 2011. It is not expected that future application of these amendments will have any impact on the Group Financial Statements.

Amendments to revised IFRS 1 – First-time Adoption of International Financial Reporting Standards – limited exemptions from the comparative disclosure required under IFRS 7 upon first-time adoption

This amendment grants an exemption from having to provide the additional comparative disclosure data required under IFRS 7 regarding the measurement of fair value and liquidity risk upon first-time adoption of IFRSs.
These amendments were endorsed by the European Union in June 2010 (EC Regulation 574/2010) and are applicable from January 1, 2011. They will have no impact on the Group consolidated Financial Statements.

Revised IAS 24 – Related Party Disclosures

The revised IAS 24 simplifies the disclosures requirements regarding related parties when state-controlled entities are involved and provides a new, simplified and more coherent definition of related parties.
This standard was endorsed by the European Union in July 2010 (EC Regulation 632/2010) and is applicable from January 1, 2011. It is not expected that future application of this standard will have any material impact on Group disclosures.

Amendments to IFRIC 14 – Prepayments of a Minimum Funding Requirement

The amendments to IFRIC 14 govern the rare case where an entity that is subject to minimum funding requirements for defined benefit plans makes prepayments to guarantee compliance with these requirements. The benefits resulting from prepayments may be recognised as assets.
The amendments to IFRIC 14 were endorsed by the European Union in July 2010 (EC Regulation 633/2010) and are applicable from January 1, 2011. These amendments do not apply to the Group.

IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments

This interpretation provides guidelines on how to account for the extinguishing of a financial liability through the issue of equity instruments (debt for equity swap), i.e. when an entity renegotiates the terms of a debt with its lender, which agrees to receive shares in the entity or other equity instruments to settle the debt in full or in part.
This interpretation clarifies that:
- the shares issued are part of the consideration paid to extinguish the financial liability;
- the shares issued are carried at fair value. If the fair value cannot be determined reliably, the equity instruments issued must be measured in such a way as to reflect the fair value of the liability that is extinguished;
- the difference between the carrying amount of the financial liability being extinguished and the initial value of the shares issued must be recognised by the entity in the income statement for the period.

This interpretation was endorsed by the European Union in July 2010 (EC Regulation 662/2010) and is applicable from January 1, 2011. Future application of this interpretation is not expected to have any impact on the Group Financial Statements.

IFRS 9 – Financial Instruments

IFRS 9 represents the completion of the first of three stages of the planned replacement of IAS 39 – Financial Statements: Recognition and Measurement, which has the principal aim of reducing its complexity. In the version issued by the IASB in November 2009, the scope of IFRS 9 was restricted to financial assets only. In October 2010 the IASB amended IFRS 9 by adding the requirements for classification and measurement of financial liabilities, thereby completing the first phase of the project.
The second stage of the project, concerning the impairment of financial instruments, and the third stage, concerning hedge accounting, led to the issue of two Exposure Drafts in November 2009 and December 2010, respectively. It is

expected that the final standards will be issued in the second quarter of 2011.
The principal changes introduced by IFRS in regard to financial assets can be summarised as follows:
— financial assets may be classified in only two categories, at fair value or at amortised cost. The categories of loans and receivables, available-for-sale financial assets and financial assets held to maturity are therefore eliminated. Classification within the two categories is made on the basis of the entity's business model and on the basis of the features of the cash flows generated by the assets themselves. Financial assets are measured at amortised cost if both the following requisites are met: the entity's business model envisages that financial assets are held to collect their cash flows (thus, substantially, not to make trading profits) and the characteristics of the cash flows of the assets correspond only to payment of principal and interest. Otherwise, financial assets must be measured at fair value;
— the accounting rules for embedded derivatives have been simplified: separate accounting for the embedded derivative and the "host" financial asset is no longer required;
— all equity instruments – both listed and unlisted – must be measured at fair value. IAS 39 stated instead that if fair value could not be determined reliably, unlisted equity instruments had to be measured at cost;
— the entity has the option of presenting in Equity any change in the fair value of equity instruments not held for trading, while this option is forbidden for those held for trading. This designation is permitted at the time of initial recognition, may be adopted for a single financial instrument and is irrevocable. If this option is taken, the fair value changes of such instruments can never be reclassified from Equity to the Income Statement (either in the event of impairment or in the event of sale). Dividends instead continue to be recognised in the Income Statement;
— IFRS 9 does not allow reclassifications between the two categories of financial assets except in rare cases where there is a change in the entity's business model. In this case, the effects of the reclassification are applied prospectively;
— the disclosure required in the notes has been adapted to the classification and measurement rules introduced by IFRS 9.

In regard to financial liabilities, the IASB has substantially confirmed the provisions of IAS 39, except for the requirements applicable to the fair value option. When the fair value option is adopted for financial liabilities, the change in fair value attributable to the change in the issuer's credit risk must be recognised in the Statement of comprehensive income and not in the Income Statement.
The process of endorsement of IFRS 9, which will come into force on January 1, 2013, has been temporarily suspended. It is currently impossible to quantify the impact resulting from future application of this standard to the classification and measurement of financial assets. The changes affecting financial liabilities are not applicable to the Group.

"Improvements" to IFRSs (issued by the IASB in May 2010)

As part of the project begun in 2008, the IASB has issued a series of amendments to eight current standards.
The following table summarises the standards and issues addressed by these amendments:

IFRS	Argomento della modifica
IFRS 3 – Business Combinations	— Transitional provisions regarding contingent consideration for business combinations completed before 01/01/2010 — Measurement of non-controlling interests at the acquisition date — Impact of business combinations on accounting of share-based payments
IFRS 7 – Financial Instruments: Disclosures	Clarification in regard to the disclosures to be published for each class of financial assets
IAS 1 – Presentation of Financial Statements	Clarifications regarding the schedule of changes in Equity
IAS 27 – Consolidated and Separate Financial Statements	Transitional provisions for amendments to certain standards resulting from the changes introduced by IAS 27 (2008): — IAS 21 – Effects of changes in foreign exchange rates: accounting of translation differences accumulated in Equity following total or partial sale of an investment in a foreign entity — IAS 28 – Investments in Associates/IAS 31 – Interests in Joint Ventures: accounting treatment if significant influence or joint control are lost
IAS 34 – Interim Financial Reporting	Disclosures required by IFRS 7 – Financial Instruments: Disclosures and its applicability to Interim Financial Statements
IFRIC 13 – Customer Loyalty Programmes	Fair value of award credits

These amendments were endorsed by the European Union in February 2011 (EC Regulation 149/2011) and are applicable from January 1, 2011. It is not expected that they will have a material impact on the Group consolidated Financial Statements.

Amendments to IFRS 7 – Financial Instruments: Disclosures

These amendments seek to improve Financial Statement disclosure and consequently improve the transparency and comparability of transactions involving the transfer of financial assets (e.g. securitisations), including the possible effects of risks for which the transferor remains liable.
These amendments, which are expected to come into force on July 1, 2011, have not yet been endorsed by the European Union. It is not expected that they will impact the Group consolidated Financial Statements.

Amendments to IAS 12 – Income Taxes – Deferred Taxes: recovery of underlying assets

IAS 12 requires measurement of deferred taxes related to an asset or liability according to whether the book value of the asset is recovered through use or through sale. In the case of assets carried at fair value pursuant to IAS 40 – Investment Property, determining whether recovery is realised through use or sale might be difficult and subjective. These changes offer a practical solution to the problem, by allowing one to assume that investment property will be recovered entirely through sale. Consequently, SIC 21 – Income Taxes - Recovery of Revalued Non-Depreciable Assets is no longer applicable to investment property carried at fair value. The guidelines of SIC 21 that are still applicable have been incorporated in the amended version of IAS 12, and SIC 21 will consequently be abrogated.
These amendments, which are expected to come into force on July 1, 2012, have not yet been endorsed by the European Union and are not applicable to the Group.

Amendments to IFRS 1 – First-time Adoption of International Financial Reporting Standards – Hyperinflation and elimination of fixed dates on first-time adoption

The amendments that have been introduced concern:
guidelines for preparing the Financial Statements in accordance with IFRSs after a period when application of IFRSs was suspended due to hyperinflation;
elimination of fixed dates upon first-time adoption of IFRSs. The entities that adopt IFRSs apply the requirements applicable to prospective derecognition of financial assets and liabilities, i.e. they are no longer obligated to reconstruct transactions that occurred before first-time adoption of IFRSs and that led to derecognition of financial assets and liabilities.
These amendments, which are expected to come into force on July 1, 2011, have not yet been endorsed by the European Union and are not applicable to the Group.

4. FINANCIAL RISK MANAGEMENT POLICIES

Financial risk management is an integral part of managing the Group's business. It is carried out centrally in accordance with guidelines issued by the Finance Department on the basis of general risk management strategies defined by the Managerial Risk Committee. These guidelines define the risk categories and specify the applicable operating procedures and limits for each type of transaction and/or instrument. In accordance with these guidelines, the Group uses derivative contracts in relation to underlying financial assets or liabilities or future transactions. Within the Finance Department, financial risk management is centralised at the Group Treasury, which is responsible for assessing risks and implementing hedges against them. The Group Treasury acts directly on the market on behalf of the Business Units and, when external constraints prevent it from acting directly, coordinates the operations of the Local Treasury Units.

TYPES OF FINANCIAL RISKS

Exchange rate risk

The varied geographical distribution of Group production and commercial activities entails exposure to transaction exchange rate risk and translation exchange rate risk.

A) TRANSACTION EXCHANGE RATE RISK

This risk is generated by the commercial and financial transactions executed in currencies other than the functional currency due to exchange rate fluctuations between the time when the commercial or financial relationship is established and when the transaction is completed (collection or payment).
The Group aims to minimise the impact of transaction exchange rate risk on income statement. To do so, Group procedures make the operating units responsible for collecting complete information about the assets and liabilities that are subject to transaction exchange rate risk. This risk is hedged with forward contracts negotiated with the Group Treasury.
The items subject to exchange rate risk are mainly represented by receivables and payables denominated in foreign currency.
The Group Treasury is responsible for measuring and

managing the net position for each currency. In accordance with established guidelines and restrictions, it closes all risk positions by trading derivative hedging contracts on the market, which typically take the form of forward contracts. The Group has decided not to adopt hedge accounting pursuant to IAS 39, insofar as representation of the effects of the transaction exchange risk hedging strategy in the income statement and in equity is substantially guaranteed even without adopting hedge accounting.
Furthermore, as part of the annual and three-year planning process, the Group makes exchange rate forecasts according to these time horizons by using the best information available on the market. The fluctuation in exchange rates between the time when the forecast is made and the time when the commercial or financial transaction is established represents the transaction exchange rate risk on future transactions.
In accordance with established policy, the Group monitors the opportunity to hedge future transactions, with each hedge being authorised by the Finance Department on a case-by-case basis. Hedge accounting in accordance with IAS 39 is used when the conditions for doing so are satisfied.

B) TRANSLATION EXCHANGE RATE RISK
The Group owns controlling interests in companies that prepare their financial statements in currencies other than the euro, which is the Group presentation currency. This exposes the Group to translation exchange rate risk, which is generated by the conversion of assets and liabilities of those subsidiaries into euro.
The principal exposures to translation exchange rate risk are monitored, but the Group has no policy to hedge this exposure.
About 35% of total consolidated equity at December 31, 2010 was expressed in euro (about 54% at December 31, 2009). The most important currencies for the Group other than the euro are the Brazilian Real (25%; 19% at December 31, 2009) and the Turkish Lira (10%; 8% at December 31, 2009).
The table below shows the effects on total consolidated Equity deriving from a hypothetical appreciation/depreciation of the above currencies against the euro, with all other conditions being equal:

(in thousands of euro)

	Appreciation of 10%		Depreciation of 10%	
	12/31/2010	12/31/2009	12/31/2010	12/31/2009
Brazilian Real	55,967	50,922	(45,791)	(41,664)
Turkish Lira	22,989	21,878	(18,809)	(17,900)
Total out of consolidated Equity	**78,956**	**72,800**	**(64,600)**	**(59,564)**

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of a financial asset or liability will change due to fluctuations in market interest rates.
Group policy is to attempt to maintain the following ratio between fixed rate and variable rate exposures: 65% fixed and 35% variable.
The Group makes derivative contracts, typically *interest rate swaps* with hedging objective that are authorised by the Finance Department in order to maintain this target ratio. For such derivatives hedge accounting is adopted, when conditions set by IAS 39 are met.

The table below shows the effects on net income (loss) and direct effects on total equity deriving from an increase or decrease of 0.50% in the level of interest rates of all currencies to which the Group is exposed – all other conditions being equal:

(in thousands of euro)

	+0,50%		-0,50%	
	12/31/2010	12/31/2009	12/31/2010	12/31/2009
Impact on net income (loss):				
— companies consolidated line-by-line	(388)	(1,355)	388	1,339
— companies accounted for by the Equity method*	-	(2,682)	-	3,273
Total	**(388)**	**(4,037)**	**388**	**4,612**
Direct impact on Equity:				
— companies consolidated line-by-line	8,488	9,027	(15,502)	(16,552)
— companies accounted for by the Equity method*	-	5,844	-	(6,037)
Total	**8,488**	**14,871**	**(15,502)**	**(22,589)**

* *Related to discontinued operations*

Price risk associated with financial assets

The Group's exposure to price risk is limited to the volatility of financial assets such as listed and unlisted equities and bonds, for approximately 7% of total consolidated assets at December 31, 2010 (5.8% at December 31, 2009). Such assets are classified as available-for-sale financial assets or financial assets held for trading.
The available-for-sale financial assets, represented by equities, represent 33.2% of all financial assets subject to price risk (43.1% at December 31, 2009). A 1% change in the aforementioned listed securities, all else being equal, would entail a change of euro 1,306 thousand (euro 1,619 thousand at December 31, 2009) in the Group's equity.

Credit risk

Credit risk represents Group exposure to contingent losses resulting from default by commercial and financial counterparties.
The Group is exposed to credit risk as part of its operating activities and financing activities.
To limit commercial counterparty default risk, the Group has implemented procedures to evaluate its customers' potential and financial solidity, monitor expected incoming cash flows and take credit recovery action if necessary. The aim of these procedures is to define customer credit limits. Further sales are suspended when those limits are exceeded.
In some cases customers are asked to provide guarantees. These are mainly bank guarantees, issued by parties with the highest credit standing, or personal guarantees. Less frequently, mortgage guarantees may be requested.
Insurance policies are another instrument used to manage commercial credit risk. These policies aim to prevent the risk of non-payment through careful selection of covered customers in collaboration with the insurance company, which undertakes to indemnify the Group in the event of customer insolvency.
The Group deals only with highly rated financial counterparties for the management of temporary surplus cash or for trading in derivatives.
The Group does not have significant concentrations of credit risk.
The disclosure related to the maximum credit exposure, which is represented by the gross receivables, is included in the note 13 "Trade receivables" and 14 "Other receivables".

Liquidity risk

Liquidity risk represents the risk that the company's available financial resources be insufficient to meet its financial and commercial obligations pursuant to the contractual terms and conditions.
The principal tool used by the Group to mitigate liquidity risk is a meticulous financial planning process to forecast its funding requirements exactly. This process entails that every operating company prepare three-year and one-year plans, as well as monthly treasury plans that are consolidated at the Group level. The differences between plans and actual figures are constantly analysed.
Then, the Group holds cash and cash equivalents and/or highly liquid short-term financial instruments and, in particular, committed revolving credit facilities that are adequate in terms of their amount and duration. The typical flexibility of this type of credit facility is perfectly suited to the dynamic nature of the business.
The Group also monitors the possibility of tapping the capital markets. In order to optimise the management of financial resources and thus further limit liquidity risk, the Group has implemented a centralised cash pooling system for the management of collection and payment flows in compliance with various local currency and tax laws. Short-term and long-term bank credit facilities are negotiated and managed centrally, partly in view of maximising the economic benefits for the Group.
At December 31, 2010 the Group had, besides cash and cash equivalents and securities held for trading of euro 454,495 thousand, unused committed credit facilities of euro 1,220,000 thousand (euro 819,000 thousand at December 31, 2009), with the following maturities:

(in thousands of euro)

	12/31/2010	12/31/2009
2011	20,000	155,000
2012	-	664,000
2015	1,200,000	-
	1,220,000	**819,000**

The maturities of financial liabilities at December 31, 2010 can be broken down as follows:

(in thousands of euro)

	within 1 year	1 to 2 years	2 to 5 years	over 5 years	Total
Trade payables	1,066,361	-	-	-	1,066,361
Other payables	403,373	3,243	34,773	3,648	445,037
Derivative financial instruments	69,914	-	-	-	69,914
Borrowings from banks and other financial institutions	247,515	146,833	624,967	122,911	1,142,226
	1,787,163	150,076	659,740	126,559	2,723,538

Use of the syndicated credit facility (granted to Pirelli Tyre S.p.A. and Pirelli International Limited) of euro 380,000 thousand at December 31, 2010 has been classified under non-current borrowings from banks and other lenders due after 2014 (from 2 to 5 years). See note 24.
The maturities of financial liabilities at December 31, 2009 can be broken down as follows:

(in thousands of euro)

	within 1 year	1 to 2 years	2 to 5 years	over 5 years	Total
Trade payables	987,873	-	-	-	987,873
Other payables	491,035	19,141	8,939	5,928	525,043
Derivative financial instruments	76,153	-	-	-	76,153
Borrowings from banks and other financial institutions	289,305	149,972	1,248,383	107,450	1,795,110
	1,844,366	169,113	1,257,322	113,378	3,384,179

Additional information: categories of financial assets and liabilities

The table below shows the carrying amounts for each class of financial asset and liability identified by IAS 39:

(in thousands of euro)

	Note	Carrying amount at 12/31/2010	Carrying amount at 12/31/2009
FINANCIAL ASSETS			
Financial assets carried at fair value through profit or loss			
Held for trading			
Securities held for trading	17	209,770	161,024
Current derivative financial instruments	27	33,454	26,567
Loans and receivables			
Non-current other financial assets	11	-	6,755
Non-current other receivables	14	315,531	557,230
Current trade receivables	13	681,181	735,792
Current other receivables	14	174,982	197,144
Cash and cash equivalents	18	244,725	632,113
Available-for-sale financial assets			
Non-current other financial assets	11	185,267	221,351
Hedging financial instruments			
Current derivative financial instruments	27	1,705	-
		1,846,615	**2,537,976**

	Note	Carrying amount at 12/31/2010	Carrying amount at 12/31/2009
FINANCIAL LIABILITIES			
Financial liabilities carried at fair value through profit or loss			
Held for trading			
Current derivative financial instruments	27	41,896	52,408
Financial liabilities carried at amortised cost			
Non-current borrowings from banks and other financial institutions	24	894,711	1,505,805
Non-current other payables	26	41,664	34,008
Current borrowings from banks and other financial institutions	24	247,515	289,305
Current trade payables	25	1,066,361	987,873
Current other payables	26	403,373	491,035
Hedging financial instruments			
Current derivative financial instruments	27	28,018	23,745
		2,723,538	**3,384,179**

Additional information: fair value hierarchy

The classification of financial instruments carried at fair value on the basis of a hierarchy of levels pursuant to IFRS 7 is illustrated as follows. This hierarchy reflects the significance of the inputs used to determine fair value. The following levels are distinguished:

- Level 1 – unadjusted quotations recorded on an active market for the assets or liabilities to be measured;
- Level 2 – inputs different from the quoted prices referred to at the preceding sub-indent, and that are observable on the market either directly (as in the case of prices) or indirectly (because they are derived from prices);
- Level 3 – inputs that are not based on observable market data.

The following table shows assets and liabilities carried at fair value at December 31, 2010, divided into the three levels defined above:

(in thousands of euro)

	Note	Carrying amount at 12/31/2010	Level 1	Level 2	Level 3
FINANCIAL ASSETS:					
Financial assets carried at fair value through profit or loss					
Held for trading					
Securities held for trading	17	209,770	11,910	197,860	-
Current derivative financial instruments	27	33,454	-	33,454	-
Hedging financial instruments					
Current derivative financial instruments	27	1,705	-	1,705	-
Available-for-sale financial assets					
Other financial assets					
Equities		171,969	115,724	15,641	40,604
Closed-end real estate funds		13,298	48	13,250	-
	11	**185,267**	**115,772**	**28,891**	**40,604**
FINANCIAL LIABILITIES:					
Financial liabilities carried at fair value through profit or loss					
Held for trading					
Current derivative financial instruments	27	(41,896)	-	(41,896)	-
Hedging financial instruments					
Current derivative financial instruments	27	(28,018)	-	(28,018)	-

The situation at December 31, 2009 was as follows:

(in migliaia di euro)

	Note	Carrying amount at 12/31/2009	Level 1	Level 2	Level 3
FINANCIAL ASSETS:					
Financial assets carried at fair value through profit or loss					
Held for trading					
Securities held for trading	17	161,024	53,709	107,315	-
Current derivative financial instruments	27	26,567	-	26,567	-
Available-for-sale financial assets					
Other financial assets					
Equities		213,576	143,426	18,983	51,167
Closed-end real estate funds		7,775	5,461	2,314	-
	11	**221,351**	**148,887**	**21,297**	**51,167**
FINANCIAL LIABILITIES:					
Financial liabilities carried at fair value through profit or loss					
Held for trading					
Current derivative financial instruments	27	52,408	-	52,408	-
Hedging financial instruments					
Current derivative financial instruments	27	23,745	-	23,745	-

During 2010, there were no transfers from level 1 to level 2 or vice-versa.

The following table shows the changes that occurred in level 3 during 2010:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**51.167**	**104.235**
Change in scope of consolidation	-	(3.665)
Discontinued operations	(2.781)	-
Subscription of capital	1.848	2.758
Disposals	-	(47.593)
Impairment	(5.743)	(761)
Adjustment to fair value through Equity	(4.087)	(2.287)
Other changes	200	(1.520)
Closing balance	**40.604**	**51.167**

During the year, there were no transfers from level 3 to other levels or vice-versa.

5. CAPITAL MANAGEMENT POLICIES

The Group's objective is to maximise the return on net invested capital while maintaining the ability to operate over time, ensuring adequate returns for its shareholders and benefits for the other stakeholders, with a sustainable financial structure.
In order to achieve these objectives, as well as pursue satisfactory economic results and generate cash flows, the Group may adjust its dividend policy and the configuration of the Company's capital.

The main indicators used by the Group to manage its capital are:

1. Ratio between operating income and average net invested capital: the indicator represents the capacity of business results to remunerate net invested capital, construed as the sum of non-current assets and net working capital. The Group's objective is for this ratio to be greater than the weighted average cost of capital (WACC);
2. Gearing: this is calculated as the ratio between net financial position / and equity. It is an indicator of the sustainability of the ratio between debt and equity, which takes into account the market situation and trend in the cost of capital and debt at different times;
3. R.O.E (return on equity): this is calculated as the ratio between net income (loss) and the average book value of equity. It is an indicator representing the Group's ability to remunerate its shareholders. The objective is for the indicator to be higher than the rate of return on a risk-free investment, correlated to the nature of the operated businesses.

The figures for 2010 and 2009 are shown below:

	2010	2009
1 Ratio between operating income and average net invested capital	11.49%	6.32%
2 Gearing	0.22	0.21
3 R.O.E. (Return on Equity)	0.19%	(0.93%)

6. ESTIMATES AND ASSUMPTIONS

The preparation of the consolidated financial statements entails that management make estimates and assumptions which, under certain circumstances, are based on difficult and subjective assessments and estimates that are based on historical experience, and assumptions which are periodically considered reasonable and realistic in light of the circumstances. The results that actually emerge could therefore differ from such estimates. Estimates and assumptions are reviewed regularly and the effects of each change made to them are recognised in the income statement of the year when the estimate is revised if the revision itself only affects that year, or also in subsequent periods if the revision affects both the current period and future ones.
In this context it is important to note that the situation caused by the current economic and financial crisis has entailed making extremely uncertain assumptions about future performance. Therefore, it cannot be ruled out that next year's results will be different from those estimated and that adjustments to the carrying value of the relevant items might be necessary, including significant adjustments, which obviously cannot be estimated or foreseen at this time. Such estimates affect the carrying amounts of certain assets and liabilities, costs and revenues, and also disclosures relating to contingent assets/liabilities at the reporting date.
The estimates and assumptions relate mainly to assessments of the recoverability of intangible assets, to the definition of the useful lives of property, plant and equipment, to the recoverability of receivables and to the recognition/measurement of provisions, pension schemes and other post-employment benefits and are based on data that reflect the current state of available knowledge

ESTIMATES ENTAILING GREATER SUBJECTIVITY AND HAVING A PARTICULARLY MATERIAL IMPACT

What follows is a brief description of the accounting policies that, more than others, require management to exercise greater subjectivity in the calculation of estimates, and for which a change in the conditions underlying the assumptions used could have a material impact on the Consolidated Financial Statements, or for which there is a risk that material adjustments to the carrying amount of assets and liabilities may emerge in the year subsequent to the reference period.

Goodwill

In accordance with the accounting standards adopted for preparation of the financial statements, goodwill is tested annually in order to ascertain the existence of any impairment losses to be recognised in the income statement. In particular, the test in question entails allocation of goodwill to cash generating units and subsequent determination of their recoverable amount, understood as the greater of fair value and value in use.
If the recoverable amount proves to be less than the carrying amount of the cash generating units, the goodwill allocated to them must be impaired. Determination of the recoverable amount of the cash generating units entails using estimates that depend on subjective assessments and on factors that can change over time, with consequent and possibly material effects on the measurements made by management.

Impairment of property, plant and equipment and intangible assets

In accordance with the reference accounting standards, non-current assets are tested to ascertain whether there has been an impairment loss, which must be recognised through impairment, when there are signs that difficulties are to be expected for recovery of their net carrying amount through use. Testing whether these symptoms exist requires that the directors use subjective assessments based on information available from both internal and external sources, and on historical experience. Moreover, if it is determined that a potential impairment loss may be generated, this loss is calculated using appropriate measurement techniques. The proper identification of elements indicating the existence of a potential impairment loss, and the estimates for calculating the amount of such losses, depend on subjective assessments and factors that may vary over time, affecting the assessments and estimates made by management.

Pension plans and other post-employment benefits

Group companies have set up pension plans, healthcare plans and other defined benefit plans in different countries for their employees, mainly in the United States, the United Kingdom and Italy.
Management uses different actuarial assumptions to calculate the liabilities and the future returns on plan assets related to these employee benefit plans. Actuarial assumptions of a financial nature regard the discount rate, the expected return on plan assets, the rates of future salary increases and trends in healthcare costs.
Demographic actuarial assumptions essentially regard the rates of mortality, disability and resignations.
The Group has identified discounting rates deemed to be balanced, considering the context.

Deferred taxes

Deferred tax assets are accounted for on the basis of expected future income expectation. The measurement of prospective income to account for deferred taxes depends on factors that may change over time and materially impact the measurement of deferred tax assets.
The determination of adjustment items reflects budget figures and plans consistent with those used for the impairment tests and described in the previous paragraph in relation to the recoverable amount of non-current assets. It is also believed that the adjustment items are sufficient to cover the risk of a further worsening of the assumptions of the plan, taking into account the fact that the net deferred tax assets accrued in this way relate to temporary differences/tax losses, a significant amount of which can be recovered over a very long period of time. This is compatible with a scenario where the emergence from crisis and economic recovery are delayed with respect to the time horizon implicit in the plans mentioned above.

Provisions for liabilities and charges

Provisions are set aside against contingent legal and fiscal liabilities, representing the risk of losing lawsuits. The amount of provisions recognised in relation to these liabilities represents the best estimate at the reporting date made by management for lawsuits and tax claims regarding a vast range of issues which are subject to the jurisdiction of various countries. Such an estimate entails making assumptions that depend on factors that may change over time and which could therefore have a material impact with respect to the current estimates made by management for preparation of the Consolidated Financial Statements.

7. OPERATING SEGMENTS

The Tyre segment is the only operating segment for which separate information has been reported at December 31, 2010.

The structure of the operating segments reflects the organisation of the Group's internal reporting. The following changes have occurred in regard to the operating segments for which separate information was reported at December 31, 2009:
— the Real Estate and Broadband Access operating segments were spun off and sold, respectively, during 2010. They are classified as discontinued operations at December 31, 2010. The spin-off and sale transactions are described in detail in the Directors' Report on Operations and in the Explanatory Notes;
— in accordance with the 2011-2013 Business Plan, separate information is no longer reported for the Eco Technology segment.

Segment results for 2010 are as follows:

(in thousands of euro)

	Tyre	Other activities	Eliminations and adjustments	Total 2010
Sales to Third parties	4,771,141	77,277	-	4,848,418
Sales to Group companies	860	17,529	(18,389)	-
Total net sales	**4,772,001**	**94,806**	**(18,389)**	**4,848,418**
Gross operating profit	**661,135**	**(32,144)**	**-**	**628,991**
Depreciation and amortisation	(208,039)	(13,189)	-	(221,228)
Operating income	**453,096**	**(45,333)**	**-**	**407,763**
Net income (loss) from equity investments	277	244,506	(221,326)	23,457
Financial income/(expenses)	(66,392)	599	-	(65,793)
Net income (loss) before income taxes	**386,981**	**199,772**	**(221,326)**	**365,427**
Income taxes	(134,429)	(2,929)	-	(137,358)
Net income (loss) from continuing operations	**252,552**	**196,843**	**(221,326)**	**228,069**
Net income (loss) from discontinued operations				**(223,840)**
Net income (loss)				**4,229**

Segment results for 2009 are as follows:

(in thousands of euro)

	Tyre	Other activities	Eliminations and adjustments	Total 2009
Sales to Third parties	3,992,869	74,592	-	4,067,461
Sales to Group companies	3	20,729	(20,732)	-
Total net sales	**3,992,872**	**95,321**	**(20,732)**	**4,067,461**
Gross operating profit	**500,977**	**(48,036)**	**(400)**	**452,541**
Depreciation and amortisation	(192,444)	(10,418)	-	(202,862)
Operating income	**308,533**	**(58,454)**	**(400)**	**249,679**
Net income (loss) from equity investments	4,239	42,902	(58,741)	(11,600)
Financial income/(expenses)	(76,177)	6,064	-	(70,113)
Net income (loss) before income taxes	**236,595**	**(9,488)**	**(59,141)**	**167,966**
Income taxes	(89,960)	(390)	-	(90,350)
Net income (loss) from continuing operations	**146,635**	**(9,878)**	**(59,141)**	**77,616**
Net income (loss) from discontinued operations				**(100,202)**
Net income (loss)				**(22,586)**

The **assets, liabilities and capital expenditure broken down by segment at December 31, 2010** are as follows:

(in thousands of euro)

	Tyre	Other activities	Eliminations and adjustments	Total 12/31/2010
Segment assets	4,127,756	274,010	(42,596)	4,359,170
Investments in associates and joint ventures	13,590	133,493	5,843	152,926
Total allocated assets	4,141,346	407,503	(36,753)	4,512,096
Unallocated assets				1,106,704
Total assets				**5,618,800**
Segment liabilities	1,954,560	271,044	(22,696)	2,202,908
Unallocated liabilities				1,387,909
Total liabilities				**3,590,817**
Purchase of property, plant and equipment	402,091	30,978	-	433,069
Purchase of intangible assets	2,948	1,880	-	4,828

The **assets, liabilities and capital expenditure broken down by segment at December 31, 2009** are as follows:

(in thousands of euro)

	Tyre	Other activities	Discontinued operations	Eliminations and adjustments	Total 12/31/2009
Segment assets	3,599,538	294,324	547,767	(60,011)	4,381,618
Investments in associates and joint ventures	1,200	129,191	458,256	4,590	593,237
Total allocated assets	3,600,738	423,515	1,006,023	(55,421)	4,974,855
Unallocated assets					1,752,406
Total assets					**6,727,261**
Segment liabilities	1,620,040	268,274	341,279	(34,350)	2,195,243
Unallocated liabilities					2,037,347
Total liabilities					**4,232,590**
Purchase of property, plant and equipment	217,059	5,285	2,887	-	225,231
Purchase of intangible assets	367	3,981	15,367	-	19,715

Segment assets consist mainly of property, plant and equipment and intangible assets, leased assets, inventories, trade receivables and other receivables. Financial receivables, cash and cash equivalents, other financial assets, securities held for trading and both current and deferred tax assets are excluded.

Segment liabilities mainly comprise trade payables and other payables, advances from customers and provisions for contingent liabilities and employee benefits. Financial payables and both current and deferred tax liabilities are excluded.

Capital expenditure mainly relates to the purchase of property plant and equipment.

Net sales by geographical area are shown below. They are allocated on the basis of the country in which the customer is resident.

(in thousands of euro)

	2010		2009	
Europe:				
— Italy	485,450	10.01%	443,103	10.89%
— Rest of Europe	1,503,531	31.00%	1,326,326	32.60%
NAFTA	477,394	9.85%	361,454	8.89%
Central and South America	1,632,044	33.66%	1,296,285	31.87%
Asia/Pacific	286,922	5.93%	231,237	5.69%
Middle East/Africa	463,077	9.55%	409,056	10.06%
	4,848,418	**100.00%**	**4,067,461**	**100.00%**

The geographical areas of 2009 have been reclassified to reflect the new definitions given in the 2011-2013 Business Plan and are consistent with the categories used for internal management reports.
The geographical areas at December 31, 2009 were as follows:
- Italy
- Rest of Europe
- North America
- Central and South America
- Oceania, Africa and Asia.

Non-current assets by geographical area are shown below. They are allocated on the basis of the country where these assets are located.

(in thousands of euro)

	12/31/2010		12/31/2009	
Europe:				
— Italy	395,275	13.99%	385,345	13.88%
— Rest of Europe	535,884	18.96%	516,268	18.61%
NAFTA	58,191	2.06%	45,422	1.64%
Central and South America	589,762	20.87%	484,285	17.45%
Asia/Pacific	216,597	7.66%	170,703	6.15%
Middle East/Africa	195,697	6.93%	154,988	5.59%
Non current assets not allocated	834,461	29.53%	1,017,854	36.68%
	2,825,867	**100.00%**	**2,774,865**	**100.00%**

The allocated non-current assets shown in the table above consist of property, plant and equipment and intangible assets, excluding goodwill. The unallocated non-current assets pertain to goodwill (see note 9).

8. PROPERTY, PLANT AND EQUIPMENT

At December 31, 2010 the breakdown and changes are as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Gross Amount	Accumulated Depreciation	Net Amount	Gross Amount	Accumulated Depreciation	Net Amount
Land	86,826	-	86,826	87,458	-	87,458
Buildings	822,873	(369,371)	453,502	735,295	(337,542)	397,753
Plant and Machinery	3,142,269	(1,911,773)	1,230,496	2,791,177	(1,731,094)	1,060,083
Industrial and commercial equipment	645,340	(510,293)	135,047	598,038	(471,172)	126,866
Other assets	216,489	(145,254)	71,235	230,698	(175,467)	55,231
	4,913,797	(2,936,691)	1,977,106	4,442,666	(2,715,275)	1,727,391

GROSS AMOUNT (in thousands of euro)

	12/31/2009	Discontinued operations	Change in scope	Hyper-inflation effect	Translation differences	Increase	Decrease	Reclassification	Other	12/31/2010
Land	87,458	(1,530)	-	-	2,851	2,558	(4,869)	279	79	86,826
Buildings	735,295	(15,286)	(23,579)	6,454	29,283	85,298	1,430	3,582	396	822,873
Plant and Machinery	2,791,177	(3,081)	2,196	6,903	140,070	266,813	(44,253)	(10,686)	(6,870)	3,142,269
Industrial and commercial equipment	598,038	(4,745)	(4,767)	2,073	30,802	37,596	(24,478)	15,311	(4,490)	645,340
Other assets	230,698	(26,223)	1,374	256	7,154	40,804	(25,548)	(8,486)	(3,540)	216,489
	4,442,666	(50,865)	(24,776)	15,686	210,160	433,069	(97,718)	-	(14,425)	4,913,797

ACCUMULATED DEPRECIATION (in thousands of euro)

	12/31/2009	Discontinued operations	Change in scope	Hyper-inflation effect	Translation differences	Reclassification	Decrease	Depreciation	Other	12/31/2010
Buildings	(337,542)	7,751	982	(5,513)	(14,299)	(248)	1,577	(22,785)	706	(369,371)
Plant and Machinery	(1,731,094)	2,193	(873)	(5,003)	(76,998)	(1,246)	36,430	(140,018)	4,836	(1,911,773)
Industrial and commercial equipment	(471,172)	2,952	2,881	(1,714)	(24,751)	4,752	16,880	(43,860)	3,739	(510,293)
Other assets	(175,467)	17,747	(886)	(224)	(5,760)	(3,258)	24,878	(10,200)	7,916	(145,254)
	(2,715,275)	30,643	2,104	(12,454)	(121,808)	-	79,765	(216,863)	17,197	(2,936,691)

NET AMOUNT (in thousands of euro)

	12/31/2009	Discontinued operations	Change in scope	Hyper-inflation effect	Translation differences	Increase	Decrease	Reclassification	Depreciation	Other	12/31/2010
Land	87,458	(1,530)	-	-	2,851	2,558	(4,869)	279	-	79	86,826
Buildings	397,753	(7,535)	(22,597)	941	14,984	85,298	3,007	3,334	(22,785)	1,102	453,502
Plant and machinery	1,060,083	(888)	1,323	1,900	63,072	266,813	(7,823)	(11,932)	(140,018)	(2,034)	1,230,496
Industrial and commercial equipment	126,866	(1,793)	(1,886)	359	6,051	37,596	(7,598)	20,063	(43,860)	(751)	135,047
Other assets	55,231	(8,476)	488	32	1,394	40,804	(670)	(11,744)	(10,200)	4,376	71,235
	1,727,391	(20,222)	(22,672)	3,232	88,352	433,069	(17,953)	-	(216,863)	2,772	1,977,106

At December 31, 2009, the changes were as follows:

GROSS AMOUNT (in thousands of euro)

	12/31/2008	Change in scope	Hyper-inflation effect	Translation differences	Increase	Decrease	Reclassifi-cation	Other	12/31/2009
Land	83,456	-	-	2,967	837	(1,570)	33	1,735	87,458
Buildings	625,712	19,080	16,353	19,775	50,901	(15,100)	9,484	9,090	735,295
Plant and Machinery	2,549,392	15,863	15,545	147,970	125,000	(32,232)	(14,102)	(16,259)	2,791,177
Industrial and commercial equipment	525,374	-	3,970	33,756	25,416	(12,855)	11,886	10,491	598,038
Other Assets	226,136	-	661	4,328	23,077	(16,941)	(7,301)	738	230,698
	4,010,070	**34,943**	**36,529**	**208,796**	**225,231**	**(78,698)**	**-**	**5,795**	**4,442,666**

ACCUMULATED DEPRECIATION (in thousands of euro)

	12/31/2008	Change in scope	Hyper-inflation effect	Translation differences	Reclassifi-cation	Decrease	Deprecia-tion	Other	12/31/2009
Buildings	(296,474)	-	(13,760)	(10,779)	(10)	5,358	(21,248)	(629)	(337,542)
Plant and Machinery	(1,537,876)	-	(10,809)	(83,741)	172	26,230	(125,013)	(57)	(1,731,094)
Industrial and Commercial Equipment	(410,590)	-	(3,214)	(27,907)	3,329	10,450	(43,273)	33	(471,172)
Other Assets	(167,084)	-	(466)	(5,860)	(3,491)	15,545	(12,153)	(1,958)	(175,467)
	(2,412,024)	**-**	**(28,249)**	**(128,287)**	**-**	**57,583**	**(201,687)**	**(2,611)**	**(2,715,275)**

NET AMOUNT (in thousands of euro)

	12/31/2008	Change in scope	Hyper-inflation effect	Translation differences	Increase	Decrease	Reclassifi-cation	Deprecia-tion	Other	12/31/2009
Land	83,456	-	-	2,967	837	(1,570)	33	-	1,735	87,458
Buildings	329,238	19,080	2,593	8,996	50,901	(9,742)	9,474	(21,248)	8,461	397,753
Plant and Machinery	1,011,516	15,863	4,736	64,229	125,000	(6,002)	(13,930)	(125,013)	(16,316)	1,060,083
Industrial and Commercial Equipment	114,784	-	756	5,849	25,416	(2,405)	15,215	(43,273)	10,524	126,866
Other Assets	59,052	-	195	(1,532)	23,077	(1,396)	(10,792)	(12,153)	(1,220)	55,231
	1,598,046	**34,943**	**8,280**	**80,509**	**225,231**	**(21,115)**	**-**	**(201,687)**	**3,184**	**1,727,391**

The **increases** in 2010 mainly involved the Tyre segment and were mainly dedicated to increasing manufacturing capacity in Brazil, China and Romania, as well as completion of the new production site at Settimo Torinese in Italy, which will be opened in 2011.

The ratio of increases of property, plant and equipment to depreciation in 2010 was 2.

Construction in progress at December 31, 2010, included the individual categories of property, plant and equipment, totalled euro 220,361 thousand (euro 142,629 thousand at December 31, 2009).

The **impairment losses** for 2010, included in the "gross amount - decrease" column in the above table, totalled euro 7,369 thousand (euro 13,970 thousand at December 31, 2009). They refer mainly to plant and machinery no longer used at the site of Pirelli Tyre S.p.A. at Settimo Torinese (former car plant).
They are accounted for in the income statement under the item "Amortisation, depreciation and impairment" (note 32).
In regard to restrictions on the ownership of assets, note that:

— the subsidiary Pirelli Tyres Alexandria Co. posted the value of plant and machinery totalling euro 8,206 thousand (euro 9,039 thousand at December 31, 2009) as collateral for loans granted by the National Bank of Egypt;
— the subsidiary Pirelli Pneus Ltda pledged its machinery and land as collateral for a total of euro 62,403 thousand (euro 52,788 thousand at December 31, 2009) against bank loans granted by BNDES (Banco Nacional de Desenvolvimento) and litigation with the national social security institution INSS (Instituto Nacional de Seguridade Social).

No borrowing costs were capitalised on property, plant and equipment.

8.1. FINANCE LEASES

The value of land, buildings, plant, machinery and other assets for which the Group has entered into a financial leasing agreement is included in the respective categories of property, plant, and equipment.

The breakdown is shown as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Cost	Accumulated depreciation	Net Amount	Capitalised cost	Accumulated depreciation	Net Amount
Leased land	10,184	-	10,184	10,470	-	10,470
Leased buildings	46,158	(8,338)	37,820	66,320	(8,082)	58,238
Other leased assets	454	(115)	339	17,311	(9,606)	7,705
Leased plant and machinary	95	(95)	-	92	(92)	-
	56,891	(8,548)	48,343	94,193	(17,780)	76,413

The value of leased land and leased buildings mainly refers to the lease agreement made by Pirelli & C. S.p.A. with a pool of banks (SG Leasing S.p.A. and UniCredit Leasing S.p.A.) for the building that hosts the structures and activities of the Tyre Segment in Italy. The agreement, in place since May 2000, has a term of 13 years and includes a purchase option on expiry. The lease instalments are indexed to 3-month Euribor. The net carrying amount of the building is euro 36,925 thousand (euro 38,585 thousand at December 31, 2009) and the carrying amount for the land is euro 10,184 thousand (unchanged from December 31, 2009).

The decrease in leased buildings from the previous year is principally related to the grant of productive assets in the photovoltaic sector, owned by the subsidiaries Solar Utility S.p.A. and Solar Prometheus S.r.l., to the new company GP Energia S.p.A., of which GWM Renewable Energy (a company belonging to GWM Group and specialised in investments in renewable energy) owns 60% and Solar Utility S.p.A. the remaining 40% (see note 9).

The decrease in other leased assets from the previous year stems from purchase by the subsidiary Perseo S.r.l. of the airplane previously held under a finance lease. The airplane was subsequently sold to third parties.

The payables for finance leases are included in financial payables (note 24). The change in finance lease payables from the previous year stems from the change in finance lease agreements in effect at December 31, 2010 as compared with the previous year.

The minimum payments due (i.e. the payments required from the lessee during the remaining term of the lease) can be broken down as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
up to 1 year	4,537	9,744
from 1 to 5 years	16,835	33,659
more than 5 years	370	18,429
Total	**21,742**	**61,832**
Future financial expenses	(2,276)	(13,904)
Amount of leasing payables (note 24)	**19,466**	**47,928**

The table below shows the amount of financial lease payables broken down by maturity:

(in thousands of euro)

	12/31/2010	12/31/2009
up to 1 year	3,234	7,005
from 1 to 5 years	15,963	27,858
more than 5 years	269	13,065
Total (note 24)	**19,466**	**47,928**

9. INTANGIBLE ASSETS

The breakdown and changes for intangible assets are shown as follows:

(in thousands of euro)

	12/31/2009	Translation differences	Discontinued operations	Increase	Decrease	Amortisation	Other	12/31/2010
Patents and intellectual property rights	292	-	-	-	-	(131)	-	161
Concessions/licenses/ trademarks	19,601	638	(12,099)	167	-	(926)	253	7,634
Goodwill	1,017,855	71	(181,038)	-	(2,372)	-	(55)	834,461
Application software	7,779	26	(3,731)	2,039	(2)	(2,654)	93	3,550
Other intangible assets	1,947	24	(55)	2,622	(458)	(655)	(470)	2,955
	1,047,474	**759**	**(196,923)**	**4,828**	**(2,832)**	**(4,366)**	**(179)**	**848,761**

(in thousands of euro)

	12/31/2008	Translation differences	Change in scope	Increase	Decrease	Amortisation	Other	12/31/2009
Patents and intellectual property rights	424	-	-	-	-	(132)	-	292
Concessions/licenses/ trademarks	25,070	(203)	-	253	(3,854)	(1,614)	(51)	19,601
Goodwill	1,007,685	(10)	-	16,414	(6,262)	-	28	1,017,855
Application software	12,129	7	(243)	2,242	(10)	(6,458)	112	7,779
Other intangible assets	800	13	90	806	-	(1,222)	1,460	1,947
	1,046,108	**(193)**	**(153)**	**19,715**	**(10,126)**	**(9,426)**	**1,549**	**1,047,474**

In regard to "**Goodwill**" the "**decreases**" in 2010 resulted from the grant of productive assets in the photovoltaic sector, owned by the subsidiary Solar Utility S.p.A., to the new company GP Energia S.p.A., of which GWM Renewable Energy (a company belonging to GWM Group and specialised in investments in renewable energy) owns 60% and Solar Utility S.p.A. the remaining 40%. The shareholding of Solar Utility S.p.A., which was reduced in September 2010 to 31% due to the disposal of shares, rose to 35% in early 2011 following the grant of additional plant. The "**discontinued operations**" column refers entirely to the Real Estate operating segment, which was spun off in 2010.

The allocation of goodwill by operating segment, the cash generating units (or Groups of cash generating units) to which it was allocated for the impairment testing and the method used to assess the recoverable amount are shown in the following table:

(in thousands of euro)

Operating segment	Cash generating unit/ Groups of cash generating unit	12/31/2010	12/31/2009	Recoverable amount
Tyre	Consumer	517,174	517,165	Value in use
Tyre	Industrial	312,427	312,419	Value in use
Other	Eco Technology	4,860	4,860	Value in use
Other	Environment		2,372	Fair value
Real Estate	Real Estate		32,910	Value in use
Real Estate	Agency		5,814	Value in use
Real Estate	Credit Servicing		4,226	Value in use
Real Estate	Property		13,356	Value in use
Real Estate	Poland		3,257	Value in use
Real Estate	Fund management		26,139	Value in use
Real Estate	Germany		95,184	Value in use
Real Estate	Non-performing Loans		152	Value in use
		834,461	**1,017,854**	

Goodwill was tested for impairment at December 31, 2010, relying on the assistance of an external appraisal. This involved estimating the recoverable amount of the cash generating units and comparing it with the net carrying amount of the relevant assets, including goodwill.
Value in use corresponds to the discounted value of the future cash flows that are expected to be associated with the cash generating units, using a rate that reflects the specific risks of the single cash generating units at the measurement date.
In applying this method management uses many assumptions, including estimates of future sales increases, operating cash flows, the rate of growth of terminal values and the weighted average cost of capital (discount rate). More specifically, the cash flows approved by management used to determine the value in use cover a time horizon of two years for the Consumer and Industrial cash generating units and three years for the Eco Technology cash generating unit. It was decided to use a time horizon of two years for the Consumer and Industrial cash generating units due to the divergence in the 2013 financial year between the value of certain variables forecast by management in the Business Plan and consensus data accepted by leading financial analysts.

The calculation also factored in the hypothetical flow deriving from the disposal of cash generating units at the end of the explicit period (assumed to be the discounted value of the perpetual return of the flow generated in the last year of the projection). This flow was extrapolated without applying a growth factor for the Consumer and Industrial cash generating units (2% in 2009), while a growth factor of 2% was applied for the Eco Technology cash generating unit (2% in 2009).

The discount rates, defined as the average cost of capital net of taxes, applied to prospective cash flows are shown in the following table:

Operating segment	Cash generating unit/Groups of cash generating units	Discount rate	
		2010	2009
Tyre	Consumer	8.06%	9.16%
Tyre	Industrial	8.06%	9.16%
Other	Eco Technology	9.80%	9.20%
Real Estate	Real Estate		6.5% - 8%
Real Estate	Agency		6.50%
Real Estate	Credit Servicing		6.50%
Real Estate	Property		6.50%
Real Estate	Poland		6.5% - 8%
Real Estate	Fund management		6.50%
Real Estate	Germany		6.50%
Real Estate	Non performing Loans		6.50%

The tests did not reveal any impairment loss.
A sensitivity analysis of the results was also carried out. In all cases the values in use remain higher than the carrying amounts even assuming a change in key parameters such as:
- a change in discount rates by 50 basis points (hundredths of a percentage point);
- a change in the growth rate by 50 basis points.

10. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Equity investments in associates and joint ventures amounted to euro 152,927 thousand compared with euro 593,237 thousand at December 31, 2009.

The following changes occurred during the year:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**593,237**	**515,300**
Discontinued operations	(458,055)	-
Acquisition/change in share capital and reserves	16,904	40,247
Distribution of dividends	(2,288)	(10,105)
Impairment	(529)	(16,000)
Reversals of impairment	3,956	-
Disposals and liquidations	-	(166)
Share of net income (loss)	256	(61,161)
Share of other components recognised in Equity	(561)	(1,629)
Decrease in financial receivables	-	114,629
Reclassifications and other	7	57,513
Changes in provisions for liabilities and charges	-	(45,391)
Closing balance	**152,927**	**593,237**

The following table shows in detail the changes in equity investments in **associates**:

(in thousands of euro)

	12/31/2009	Discontinued operations	Acquisitions/ changes share capital and reserves	Components recognised in Equity	Distribution of dividends and reserves	Impairment	Reversals of impairment	Share of net income (loss)	Other	12/31/2010
Associates of Pirelli RE	150,693	(150,693)	-	-	-	-	-	-	-	-
Eurostazioni S,p,A,	57,757	-	-	-	(1,523)	-	-	2,564	-	58,798
CyOptics Inc,	13,579	-	-	-	-	-	3,956	-	-	17,535
RCS MediaGroup S,p,A,	61,901	-	-	(561)	-	(514)	-	(2,975)	-	57,851
Sino Italian Wire Tech, Co, Ltd	-	-	12,984	-		-	-	(405)	-	12,579
GP Energia S,r,l,	-	-	3,920	-	-	-	-	-	-	3,920
Other companies	1,945	-	-	-	(765)	(15)	-	1,072	7	2,244
Associates	**285,875**	**(150,693)**	**16,904**	**(561)**	**(2,288)**	**(529)**	**3,956**	**256**	**7**	**152,927**

The equity investment in the company RCS MediaGroup S.p.A (5.3% of the voting shares) is owned by Pirelli & C. S.p.A., one of the major shareholders. It is represented on the Board of Directors and is a party to the shareholders' agreement, which aims to ensure the stability of the shareholding structure and coherent strategies in the management of the RCS Group (the parties to the agreement hold shares representing 63.5% of the share capital).
The last published accounts (the interim financial statements at September 30, 2010) were used to consolidate this equity investment according to the equity method.
The fair value attributable to the Equity investment in the associate RCS MediaGroup S.p.A., which is listed on the Milan Stock Exchange, calculated using the reference price at December 31, 2010 (euro 1.04 per share), was euro 40.7 million (euro 49.6 million in 2009, using the reference price of euro 1.268 per share at December 31, 2009).
The decrease in the share price of this stock from December 31, 2009 is an indicator of impairment. Consequently, the equity investment was tested for impairment and adjusted to its value in use (euro 1.48 per share). Its value in use was determined with the assistance of an external appraisal, resulting in an impairment loss of euro 514 thousand that was charged to income statement.

The equity investments in **joint ventures**, totalling euro 307,365 thousand at December 31, 2009, referred entirely to the Real Estate business, which was spun off in 2010. At December 31, 2010 the Group did not have any equity investments in joint ventures.

The "**Acquisitions**" mainly consist of the purchase by Pirelli Tyre S.p.A. of 49% of Sino Italian Wire Tech. Co. Ltd, based in China and operating in the steel cord business.

The "**Reversals of impairment**" refers to the equity investment in CyOptics Inc. and stems from the increase in the recoverable amount of the equity investment with respect to its carrying value. The amount of the reversal, euro 3,956 thousand, was determined by considering the consideration resulting from disposal of the investment at the beginning of 2011.

In regard to the column "**Share of net income (loss)**," see the comments made below at note 34.1 "share of net income (loss) of associates and joint ventures."

The highlights for the principal associates at December 31, 2010 are illustrated as follows:

(in thousands of euro)

	12/31/2010
Non current assets	2,480,481
Current assets	1,089,953
Non current liabilities	1,187,200
Current liabilities	1,153,154
Revenues from sales and services	1,644,700
Production costs	(1,642,062)
Net income (loss)	**733**

11. OTHER FINANCIAL ASSETS

These amount to euro 185,267 thousand, compared with euro 228,106 thousand at December 31, 2009. They are broken down as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Available-for-sale financial assets	185,267	221,351
Financial assets carried at amortised cost	-	6,755
	185,267	**228,106**

The following changes took place during the year in **available-for-sale financial assets:**

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**221,351**	**476,300**
Discontinued operations	(10,552)	-
Increases	23,516	3,031
Decreases	(1,478)	(241,984)
Impairment	(5,881)	(20,102)
(Gains)/losses transferred to income statement for disposal or impairment losses, previously recognised in Equity	(8,656)	(792)
Adjustment to fair value	(33,342)	34,739
Reclassification	388	(41,646)
Reversal of reserve for reclassification of equity investments from other financial assets to associates	-	12,281
Other	(79)	(476)
Closing balance	**185,267**	**221,351**

At December 31, 2010 available-for-sale financial assets included:

(in thousands of euro)

	12/31/2010	12/31/2009
Listed securities		
Mediobanca S,p,A,	105,330	131,011
Oclaro (formerly Avanex Corporation)	-	10,440
Prelios S,p,A, (formerly Pirelli & C, Real Estate S,p,A,)	251	-
Advanced Digital Broadcast Holdings SA	9,805	-
Other companies	386	1,975
	115,772	**143,426**
Unlisted securities		
Alitalia S,p,A,	12,805	17,171
Fin, Priv, S,r,l, (Mediobanca shares)	14,399	17,945
Gruppo Banca Leonardo S,p,A,	5,155	8,337
Istituto Europeo di Oncologia S,r,l,	7,177	6,677
FC Internazionale Milano S,p,A,	6,017	6,008
TIcom I LP	1,482	2,114
Equinox Two SCA	3,566	3,536
Other companies Pirelli RE Group	-	2,781
Other companies	5,644	5,581
	56,245	**70,150**
Real Estate Investment funds		
Fondo Anastasia	13,250	-
Tecla Fondo Uffici	-	5,461
Armilla	-	1,826
Fondo Abitare Sociale 1	-	488
	13,250	**7,775**
	185,267	221,351

The **increases** relate mainly to the Anastasia Real Estate Investment Fund, in which 29 units were subscribed (euro 7,250 thousand), while another 24 units were acquired from Tiglio I S.r.l. (euro 6,000 thousand); 400,000 shares of Advanced Digital Broadcast Holdings S.A. (7.2% of the share capital, equal to euro 8,479 thousand at November 29, 2010, the closing date of the transaction) obtained as part of the consideration received for the sale of Pirelli Broadband Solutions S.p.A.

The **decreases** mainly include the sale of the entire equity investment in Oclaro Inc. (formerly Avanex Corporation).

The **impairments** refer principally to the equity investment in the Banca Leonardo S.p.A. Group for euro 3,042 thousand and to the equity investment in Prelios S.p.A. for euro 138 thousand. The latter refers to 567,411 shares in Pirelli RE (now Prelios) that were not assigned to shareholders and consequently impaired to their fair value at the assignment date. This impairment loss is included in the income statement item "net income (loss) from discontinued operations."

The **(gains) losses transferred to income statement**, previously recognised in Equity, mainly refer to sale of the equity investment in Oclaro Inc. (gains of euro 9,017 thousand transferred to the income statement).

The **adjustment to fair value**, totalling a negative euro 33,342 thousand, mainly refer to the equity investments in Mediobanca S.p.A. (negative euro 25,681 thousand), in Alitalia S.p.A. (negative euro 4,367 thousand) and Fin. Priv. S.r.l. (negative euro 3,547 thousand).
The fair value of listed financial instruments corresponds to their stock market price at December 31, 2010.
The fair value of unlisted financial instruments and real estate investment funds was determined by making estimates on the basis of the best information available.

12. DEFERRED TAX ASSETS AND LIABILITIES

This item is broken down as follows:

(in thousands of euro)

	12/31/2010	12/31/2009 (*)
Deferred tax assets	69,642	91,164
Provision for deferred tax liabilities	(33,733)	(44,000)
	35,909	**47,164**

* *including discontinued operations totalling euro 27,225 thousand*

Deferred tax assets and liabilities have been recognised on the balance sheet if they satisfied the applicable conditions and considering the offsets made for each legal entity. They are broken down as follows, gross of offsets:

(in thousands of euro)

	12/31/2010	12/31/2009
Deferred tax assets	**170,799**	**177,826**
— of which recoverable within 12 months	56,889	59,403
— of which recoverable after 12 months	113,910	118,423
Provision for deferred tax liabilities	**(134,890)**	**(130,662)**
— of which recoverable within 12 months	(4,448)	(1,311)
— of which recoverable after 12 months	(130,442)	(129,351)
	35,909	**47,164**

The tax effect of temporary differences and of tax losses carried forward which make up the item at December 31, 2010 and at December 31, 2009 is shown in the following table:

DEFERRED TAX ASSETS (in thousands of euro)

	12/31/2010	12/31/2009
Provisions for future liabilities and charges	30,204	30,281
Provisions for employee benefits	38,236	38,044
Stocks	11,727	13,498
Tax losses carried forward	43,649	43,121
Amortisation and depreciation	865	2,060
Trade receivables and other receivables	5,800	16,216
Trade payables and other payables	31,602	17,607
Intercompany transactions	-	3,292
Derivatives	7,565	6,386
Other	1,151	7,321
	170,799	**177,826**

PROVISION FOR DEFERRED TAX LIABILITIES (in thousands of euro)

	12/31/2010	12/31/2009
Amortisation and depreciation	(123,971)	(120,409)
Other	(10,919)	(10,253)
	(134,890)	**(130,662)**

At December 31, 2010 unrecognised deferred tax assets relating to temporary differences amounted to euro 139,228 thousand (euro 95,522 thousand at December 31, 2009), and those relating to tax losses amounted to euro 319,327 thousand (euro 439,862 thousand at December 31, 2009). These amounts refer to situations where recovery is not deemed likely at this time.
Tax losses broken down by maturities, against which no deferred tax assets were recognised, are shown below:

(in thousands of euro)

Year of expiry	12/31/2010	12/31/2009
2010	-	136,608
2011	11,992	37,796
2012	496,897	518,144
2013	46,280	100,389
2014	5,740	53,353
2015	6,312	24,859
2016	3,321	33,382
2017	15	15
2018	1,163	1,163
2019	1,239	-
2022	13,400	48,663
2024	343	343
2025	12,690	-
with no expiry	522,986	628,364
	1,122,378	**1,583,079**

The tax effect of gains and losses recognised directly in equity was a positive euro 2,810 thousand (a positive euro 14,111 thousand at December 31, 2009), and is shown in the statement of comprehensive income. These changes were mainly due to the tax effects associated with actuarial gains/losses on employee benefits, to the adjustment to fair value of available-for-sale financial assets and of derivatives in cash flow hedges.

13. TRADE RECEIVABLES

Trade receivables may be broken down as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Total	Non-current	Current	Total *	Non-current	Current
Associates and joint ventures	3,127	-	3,127	89,803	-	89,803
Customers	736,728	-	736,728	721,061	-	721,061
Receivables for contract work	207	-	207	2,802	-	2,802
	740,062	**-**	**740,062**	**813,666**	**-**	**813,666**
Provision for bad debts	(63,381)	-	(63,381)	(77,874)	-	(77,874)
	676,681	**-**	**676,681**	**735,792**	**-**	**735,792**

* *including discontinued operations totalling Euro 163,246 thousand*

The **receivables from associates and joint ventures** in 2009 (euro 89,803 thousand) refer almost exclusively to the Real Estate segment, spun off in 2010.

Gross trade receivables totalled euro 740,062 thousand (euro 813,666 thousand at December 31, 2009), and of these euro 102,075 thousand were past due (euro 155,323 thousand at December 31, 2009).

Receivables past due and not yet due were impaired in accordance with the Group accounting policies described in the paragraph on the accounting standard adopted.

Impaired receivables include both significant single positions subject to individual impairment and positions sharing similar credit risk characteristics that have been grouped together and impaired on a collective basis.

The change in the provision for bad debts is shown below:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**77,874**	**59,989**
Discontinued operations	(18,361)	-
Translation differences	2,101	1,350
Accruals	12,995	26,057
Utilization / releases	(11,322)	(8,970)
Changes in scope of consolidation	-	(552)
Other	94	-
Closing balance	**63,380**	**77,874**

Accruals to the provision for bad debts are recognised in the income statement at the item "Other costs" (note 33).

For trade receivables, the carrying amount is considered approximate to the fair value.

14. OTHER RECEIVABLES

Other receivables may be broken down as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Total	Non-current	Current	Total *	Non-current	Current
Receivables from associates and joint ventures						
— financial receivables	5,926	-	5,926	405,010	394,554	10,456
— other receivables	3,466	-	3,466	8,507	884	7,623
Financial receivables from third parties	230,097	222,757	7,340	93,900	91,879	2,021
Trade & other accrued income and prepaid expenses/others	11,002	338	10,664	24,152	4,952	19,200
Receivables from employees	8,799	2,091	6,708	6,989	2,746	4,243
Receivables from social security and welfare institutions	7,061	-	7,061	4,617	-	4,617
Receivables from tax authorities not related to income taxes	88,653	8,929	79,724	67,086	17,492	49,594
Other receivables	135,681	81,415	54,263	161,738	44,723	117,015
	490,685	**315,531**	**175,154**	**771,999**	**557,230**	**214,769**
Provision for other bad debts	(172)		(172)	(17,625)	-	(17,625)
	490,513	**315,531**	**174,982**	**754,374**	**557,230**	**197,144**

* *including discontinued operations totalling euro 483,950 thousand*

For **current and non-current other receivables**, the carrying amount is considered approximate to the fair value.

The **financial receivables from associates and joint ventures** at December 31, 2009 (euro 405,010 thousand) refer almost exclusively to the Real Estate segment.

Non-current financial receivables from third parties (euro 222,757 thousand) refer primarily:

— to euro 140,419 thousand for the used portion of the short-term variable rate credit line granted to Prelios S.p.A. by Pirelli & C. S.p.A. as part of the spin-off of Real Estate segment assets from the Pirelli Group. This amount is due on July 31, 2012 and might be extendable until July 31, 2017. The total amount of the credit line is euro 150,000 thousand;

— to euro 78,409 thousand deposited to guarantee tax and legal disputes in relation to the subsidiary Pirelli Pneus Ltda (Brazil), remunerated at market rates.

The **receivables from tax authorities not related to income taxes** refer mainly to receivables for VAT and similar taxes.

Non-current other receivables (euro 81,415 thousand) refer mainly to amounts deposited as security in lawsuits and tax litigation involving the Brazilian unit Pirelli Pneus Ltda (euro 68,800 thousand) and to a receivable of euro 7,400 thousand relating to a cash grant paid in connection with the execution of an equity partnership agreement.

The **current other receivables** (euro 54,263 thousand) mainly consist of:

— receivables of euro 8,591 thousand for the disposal of property, plant and equipment;

— advances of euro 20,014 thousand;

— receivables of euro 4,500 thousand from Ceat Ltd following disposal of the Ceat brand.

The change in the provision for current other bad debts is shown below:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**17,625**	**8,079**
Discontinued operations	(17,557)	-
Translation differences	2	9
Accruals	171	6,088
Utilization/releases	(69)	(143)
Changes in scope of consolidation	-	3,592
Closing balance	**172**	**17,625**

15. TAX RECEIVABLES

Tax receivables refer to income taxes and total euro 35,990 thousand (including euro 10,755 thousand in non-current assets), compared with euro 51,042 thousand at December 31, 2009 (including euro 9,578 thousand for non-current assets).

16. INVENTORIES

Inventories can be broken down as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Pirelli Tyre	682,048	559,579
Pirelli RE	-	96,637
Others	10,211	22,761
	692,259	**678,977**

(in thousands of euro)

	12/31/2010	12/31/2009
Raw and auxiliary materials and consumables	200,793	140,923
Sundry materials	1,787	745
Trading properties held for sale	-	55,335
Buildings under construction/renovation	-	9,603
Work in progress and semi-finished products	64,628	39,659
Finished products	415,672	390,178
Goods purchased for resale	3,723	9,274
Building plots	-	31,698
Advances to suppliers	5,656	1,562
	692,259	**678,977**

Impairment losses on inventories recognised in 2010 totalled euro 6,525 thousand (euro 18,914 thousand at December 31, 2009). The reversal of previous impairment totals euro 10,077 thousand (euro 5,455 thousand at December 31, 2009).
The reduction from December 31, 2009 of inventories of trading properties held for sale, buildings under construction/renovation and building plots stems from the spin-off of the Real Estate segment in 2010. Inventories were not subject to any collateral pledges.

17. SECURITIES HELD FOR TRADING

Securities held for trading amount to euro 209,770 thousand (euro 161,024 thousand at December 31, 2009) and consist of:
- unlisted floating-rate bonds for euro 188,209;
- fixed-rate bonds for euro 16,794 thousand, including euro 7,502 thousand in listed bonds;

- equities for euro 4,731 thousand, including euro 4,408 thousand in listed stock;
- other securities for euro 36 thousand.

The fair value of listed financial instruments corresponds to their stock market price at December 31, 2010.

The fair value of unlisted financial instruments was estimated using the best information available.

The changes in fair value are recognised in the income statement at “financial expenses” (note 36).

18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are concentrated in the Group’s financial companies, holding and sub-holding companies. They are used essentially on the market for short-term maturity deposits with major banking counterparties at interest rates in line with the prevailing market terms.

In the statement of cash flows, the balance of cash and cash equivalents was indicated net of bank overdrafts, totalling euro 17,955 thousand at December 31, 2010 and euro 21,334 thousand at December 31, 2009.

19. EQUITY

19.1 EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT

The subscribed and paid-up Share capital at December 31, 2010 (including treasury shares) is represented by 475,740,182 ordinary shares and 12,251,311 savings shares, without par value and having normal entitlements, for a total of euro 1,377,879 thousand.
As prescribed by IAS 32, the **Share capital** is presented net of the value of treasury shares. Treasury shares amounts to euro 2,146 thousand (351,590 ordinary shares, representing 0.07% of ordinary shares, and 408,342 savings shares, representing 3.33% of savings shares). Share capital thus totals euro 1,375,733 thousand.
The total of treasury shares represents 0.16% of Share capital.

The following events altered the share capital in 2010:
- elimination of the par value of ordinary and savings shares and reverse stock split;
- reduction of share capital through proportionate assignment to ordinary and savings shareholders of Pirelli & C. S.p.A. of 487,231,561 ordinary shares of Prelios S.p.A. (formerly Pirelli RE owned by Pirelli & C. S.p.A.).

Elimination of the par value of ordinary and savings shares and reverse stock split

In execution of the resolutions passed by the Extraordinary Shareholders’ Meeting of Pirelli & C. S.p.A. on July 15, 2010, one ordinary share and eight savings shares owned by Pirelli & C. S.p.A. were first annulled on July 26, 2010, for the sole purpose of allowing the overall operation, with a corresponding reduction in Share capital from euro 1,556,692,865.28 to euro 1,556,692,862.67. Following this reduction, the following transactions were carried out:
- reverse stock split of the outstanding 5,233,142,002 ordinary shares, without indication of par value, at the ratio of 1 new ordinary share, without indication of par value, for every 11 ordinary shares, without indication of par value, currently held;
- reverse stock split of the 134,764,421 savings shares outstanding, without indication of par value, at the ratio of 1 new bearer savings share, without indication of par value and with full entitlements, for every 11 bearer savings shares, without indication of par value, currently held; and 1 new registered savings share, without indication of par value and with full entitlements, for every 11 registered savings shares, without indication of par value, currently held.

Following this reverse stock split, the Share capital of Pirelli & C. S.p.A. was euro 1,556,692,862.67, represented by a total of 487,991,493 shares without indication of par value, including 475,740,182 (euro 1,517,611,180.58) ordinary shares and 12,251,311 (euro 39,081,682.09) savings shares.

Reduction of Share capital through proportionate assignment of 487,231,561 ordinary shares of Pirelli & C. Real Estate S.p.A. (now Prelios S.p.A.) owned by Pirelli & C. S.p.A. to ordinary and savings shareholders of Pirelli & C. S.p.A.

The Extraordinary Shareholders’ Meeting of July 15, 2010 also resolved to reduce the Share capital through assignment of 487,231,561 ordinary shares of Pirelli & C. Real Estate S.p.A. (now Prelios S.p.A.) owned by Pirelli & C. S.p.A. to ordinary and savings shareholders of Pirelli & C. S.p.A., on the basis of one share in Prelios S.p.A. for each ordinary and/or savings share in Pirelli & C. S.p.A. held by the shareholders of Pirelli & C. S.p.A. after the reverse stock split.
The Share capital was reduced by an amount equal to the fair value of Prelios S.p.A. shares (euro 178,813,982.89), i.e. the shares that were assigned, which was determined

on the basis of the official market price for Prelios S.p.A. shares reported on July 14, 2010 (the Stock Exchange trading day prior to the date of the Extraordinary Shareholders' Meeting).
The share assignment was executed in compliance with applicable regulatory provisions upon expiry of the statutory waiting period on October 25, 2010.
In compliance with applicable accounting rules, the amount payable to shareholders was adjusted (from euro 178,813,982.89 to euro 211,312,328.01) on the basis of the official market price of Prelios S.p.A. (euro 0.4337) on the same date. The euro 32,498.345.12 difference has been accounted for in a negative Equity reserve named "Reserve for assignment of Prelios S.p.A. shares." At the same time, a loss of euro 156,268 thousand was recognised in income statement in consequence of the assignment of Prelios S.p.A. shares. This amount corresponds to the difference between the amount payable to shareholders, which was determined as illustrated above, and the carrying value of the net assets that were assigned.
Moreover, the value of treasury shares was adjusted to the average unit value of outstanding shares (euro 278,460.73) in order to standardise the unit value of shares recognised at the item "Share capital," including treasury shares. A balancing entry for this adjustment was made in the "Share premium reserve."
Following this operation, the Share capital of Pirelli & C. S.p.A. was euro 1,377,878,879.78 gross of treasury shares, represented by a total of 487,991,493 shares without indication of par value, including 475,740,182 (euro 1,343,286,427.00) ordinary shares and 12,251,311 (euro 34,592,452.78) savings shares.

19.2 EQUITY ATTRIBUTABLE TO NON-CONTROLLING INTERESTS

Non-controlling interests in Equity fell from euro 319,648 thousand at December 31, 2009 to euro 37,152 thousand at December 31, 2010. The change stems primarily from the spin-off of Real Estate activities (now Prelios S.p.A.) from the Pirelli Group, with a reduction of euro 274,831 thousand.

The principal non-controlling interests in Equity are illustrated as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Drahtcord Saar Gmbh & Co. K.G. (Germany)	50.00%	50.00%
Pirelli & C. Eco Technology S.p.A. (Italy)	49.00%	49.00%
Pirelli & C. Ambiente S.p.A. (Italy)	49.00%	49.00%
Euro Driver Car S.L. (Spain)	47.18%	49.10%
Driver Polska Sp.ZO.O. (Poland)	38.00%	35.50%
Driver Italia S.p.A. (Italy)	27.46%	27.63%
Pirelli Tyre Co. Ltd (China)	25.00%	25.00%
S.C. Cord Romania S.R.L (Romania)	20.00%	20.00%
Alexandria Tire Co. S.A.E. (Egypt)	10.90%	10.90%
Pirelli de Venezuela C.A. (Venezuela)	3.78%	3.78%
Turk Pirelli Lastikleri A.S. (Turkey)	0.01%	0.01%
Pirelli & C. Real Estate S.p.A. (Italy)	-	41.93%

20. STOCK OPTION PLANS

The Company did not have any stock option plan in place at December 31, 2010.
The Pirelli to People and Group Senior Executives plans, reserved for executives and employees of Pirelli & C. S.p.A. and other Group entities, who had been granted non-transferrable options to subscribe/buy ordinary shares of Pirelli & C. S.p.A., were extinguished during the year without the issuance of any shares by the Company (in particular, all the unexercised options of both these plans expired on November 5, 2010).
The following tables illustrate the changes in these plans during 2010, up to November 5, 2010, the expiration date set by both plans for exercising the options.

PIRELLI TO PEOPLE

	2010			2009		
	Number of shares	Average exercise price in euro[1]	Market price in euro	Number of shares	Average exercise price in euro	Market price in euro
Options existing at 01/01/10	14,537,334	0,996	0,42	15,697,334	0,996	0,26
Options granted during year up to 11/05/10	-	-	-	-	-	-
(Options exercised during year up to 11/05/10)	-	-	-	-	-	-
(Options expired during year up to 11/05/10 for persons who left the group)	477,334	-	-	1,160,000	-	-
Options expired for all intents and purposes on 11/05/10[3]	14,060,000	-	-	-	-	-
Options exixting at 12/31/10	-	-	-	14,537,334	0,996	0,42

GROUP SENIOR EXECUTIVES

	2010			2009		
	Number of shares	Average exercise price in euro[1]	Market price in euro	Number of shares	Average exercise price in euro	Market price in euro
Options existing at 01/01/10	4,032,001	0,996	0,42	9,789,185	0,996	0,26
Options granted during year up to 11/05/10	-	-	-	-	-	-
(Options exercised during year up to 11/05/10)	-	-	-	-	-	-
(Options expired during year up to 11/05/10 for persons who left the group)	298,667	-	-	5,757,184[2]	-	-
Options expired for all intents and purposes on 11/05/10[4]	3,733,334	-	-	-	-	-
Options exixting at 12/31/10	-	-	-	4,032,001	0,996	0,42

1 *On July 15, 2010, the extraordinary shareholders' meeting of Pirelli & C, S,p,A, approved a reverse stock split of ordinary and savings shares, at a ratio of 1 new ordinary or savings share for every 11 shares of the same class owned, In consequence of this reverse stock split, the purchase price of each new share subscribed in exercise of the Options was recalculated in the amount of euro 10,956, The same shareholders' meeting also approved a reduction in the share capital of Pirelli & C, S,p,A,, to be implemented upon expiry of the legal deadline through assignment to ordinary and savings shareholders of 487,231,561 ordinary shares in Pirelli & C, Real Estate owned by the Company, In consequence of this reduction, the purchase price for each new share subscribed in exercise of the Options was recalculated again - as at October 25, 2010 - in the amount of euro 10,589 (the total number of unexercised shares that expired for all intents and purposes on November 5, 2010 also includes the options that expired in consequence of this latter operation),*
2 *Unexercised options of the Group Senior Executives Plan granted definitively on May 10, 2002 expired for all intents and purposes on May 31, 2009,*
3 *The General Manager, Dr Francesco Gori, owned 666,667 unexercised options that expired for all intents and purposes on November 5, 2010,*
4 *The General Manager, Dr Francesco Gori, owned 426,667 unexercised options that expired for all intents and purposes on November 5, 2010,*

21. TAX PAYABLES

Tax payables refer to income taxes and total euro 70,106 thousand (including euro 5,547 thousand in non-current liabilities), compared with euro 53,955 thousand at December 31, 2009 (including euro 10,037 thousand for non-current liabilities).

22. PROVISIONS FOR LIABILITIES AND CHARGES

The changes that occurred during the period are shown below:

PROVISIONS FOR LIABILITIES AND CHARGES – NON-CURRENT PORTION (in thousands of euro)

Opening balance at 12/31/2009	**167,793**
Discontinued operations	(26,949)
Translation differences	12,461
Increases	12,255
Utilization / releases	(8,484)
Reclassification	9,000
Other	(344)
Closing balance at 12/31/2010	**165,732**

PROVISIONS FOR LIABILITIES AND CHARGES – CURRENT PORTION (in thousands of euro)

Opening balance at 12/31/2009	**130,783**
Discontinued operations	(35,533)
Translation differences	2,714
Increases	35,514
Utilization / releases	(6,315)
Reclassification	(9,000)
Other	(2,179)
Closing balance at 12/31/2010	**115,984**

At December 31, 2010 **provisions for liabilities and charges – non-current portion** refer mainly to provisions set aside for legal and tax disputes concerning the subsidiary Pirelli Pneus Ltda in Brazil (euro 115,302 thousand), contingent tax liabilities (euro 26,610 thousand) and other contingent liabilities/charges of a commercial nature and employment disputes (euro 14,232 thousand) involving the Parent company Pirelli & C. S.p.A.

Increases in the non-current portion in the year involved mainly adjustments related to the needs to cover commercial risks, compensation and disputes (euro 3,357 thousand of the Parent Pirelli & C. S.p.A. and euro 7,514 thousand of the Tyre segment).

Provisions for liabilities and charges – current portion mainly include amounts set aside for disputes, industrial risks and product warranties in the Tyre segment (euro 102,822 thousand).

Increases in the current portion concern mainly the Italian based units for disputes on occupational diseases and site clean-up work related to disused tracts of land connected with the construction of the new Settimo Torinese site, and in the United States for product warranties and addition to provisions for litigation resulting from the businesses sold in the Cable segment.

Utilization of the current portion during the period related mainly to closure of the disputes for occupational diseases and product warranties of the Italian based units, and to the closure of the plant in Spain.

Certain amounts have been **reclassified** from provisions for liabilities and charges – current portion – to provisions for risks and charges – non-current portion, due to a change in the time horizon by which the liability related to the guarantees offered upon disposal of Pirelli assets in the Cables Energy and Telecommunication Systems segments to Goldman Sachs Capital Partner in July 2005 might arise.

23. EMPLOYEE BENEFIT OBLIGATIONS

This item includes:

(in thousands of euro)

	12/31/2010	12/31/2009 *
Pension funds:		
— funded	216,762	222,368
— unfunded	85,819	92,310
Employees' leaving indemnity (Italian companies)	44,470	51,454
Healthcare plans	19,768	17,899
Other benefits	114,905	67,849
	481,724	**451,880**

* *including discontinued operations totalling euro 15,372 thousand*

PENSION FUNDS

The following table shows a breakdown of pension funds at December 31, 2010:

(in thousands of euro)

	12/31/2010					
	Germany	Total unfunded pension funds	USA	UK	Other countries	Total funded pension fund
Funded funds						
Present value of funded liabilities			133,851	868,573	3,351	1,005,775
Fair value of plan assets			(81,878)	(704,434)	(2,701)	(789,013)
Unfunded funds						
Present value of unfunded liabilities	85,819	85,819				
Net liabilities recognized	**85,819**	**85,819**	**51,973**	**164,139**	**650**	**216,762**
of which:						
— Tyre	85,819	85,819	51,973	90,641	650	143,264
— Other				73,498		73,498

The following table shows a breakdown of pension funds at December 31, 2009:

(in thousands of euro)

	12/31/2009					
	Germany	Total unfunded pension funds	USA	UK	Other countries	Total funded pension fund
Funded funds						
Present value of funded liabilities			122,199	783,307	2,981	908,487
Fair value of plan assets			(76,860)	(606,856)	(2,403)	(686,119)
Unfunded funds						
Present value of unfunded liabilities	92,310	92,310				
Net liabilities recognized	**92,310**	**92,310**	**45,339**	**176,451**	**578**	**222,368**
of which:						
— Tyre	84,168	84,168	45,339	91,681	578	137,598
— Real Estate	8,142	8,142				
— Other				84,770		84,770

The characteristics of the principal pension funds existing at December 31, 2010 are described as follows:

- Germany / Tyre segment: this is an unfunded defined-benefit plan based on the final salary. It provides a supplementary pension in addition to the state pension. The plan was closed in October 1982, consequently the members of the plan are employees whose employment began prior to that date;
- USA / Tyre segment: this is a funded defined-benefit plan based on the final salary. It provides a supplementary pension in addition to the state pension and is administered by a trust. The plan was closed in 2001 and frozen in 2003 for employees who were transferred to a defined-contribution scheme. All members of the plan are retired;
- UK: these are funded defined-benefit plans based on the final salary. They provide a supplementary pension in addition to the state pension and are administered in trusts. The plans were closed in 2001. The Tyre segment plan was frozen in 2010 for employees hired before 2001, who were transferred to a defined contribution plan. The plan operated by the subsidiary Pirelli UK Ltd, which includes the employees in the Cables and Systems segment sold in 2005, had already been frozen at the time of the sale in 2005.

The changes in the period in the present value of the liabilities for pension funds (funded and unfunded) are as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**1,000,797**	**817,557**
Traslation differences	34,245	38,925
Discontinued operations	(8,142)	-
Movements through Income Statement:		
— current service cost	2,128	4,195
— interest cost	56,820	51,479
— curtailment/settlement	(1,049)	-
Actuarial (gains)/losses recognized in Equity	60,478	138,070
Employee contributions	317	1,182
Benefits paid	(53,442)	(53,114)
Other	(558)	2,503
Closing balance	**1,091,594**	**1,000,797**

The changes during the year in the fair value of the pension plan assets are as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**(686,119)**	**(571,437)**
Translation differences	(25,116)	(33,372)
Movements through Income Statement:		
— expected return on plan assets	(48,864)	(40,416)
Actuarial (gains)/losses recognised in Equity	(39,665)	(56,062)
Employer contributions	(22,829)	(29,171)
Employee contributions	(13,916)	(1,689)
Benefits paid	46,937	45,403
Other	559	625
Closing balance	**(789,013)**	**(686,119)**

The assumptions used to calculate the expected return on the pension plan assets are based on the expected returns of the underlying assets (shares, bonds and deposits). The expected return is derived from the general average of the returns expected from the assets for each separately identified investment class, with reference to an effective or objective composition of the assets.

The expected return of each investment class is derived from the market returns available at the reporting date. In particular, the expected return on stock is derived from a risk-free rate of return with the addition of an adequate risk premium.

The following table shows a breakdown of funded pension plan assets:

	12/31/2010			12/31/2009		
	UK	USA	Other countries	UK	USA	Other countries
Shares	63%	70%	-	62%	70%	-
Bonds	27%	25%	-	27%	25%	-
Deposits	2%	-	-	-	-	-
Other	8%	5%	100%	11%	5%	100%
	100%	100%	100%	100%	100%	100%

The effective return of pension plan assets was as follows:

(in thousands of euro)

	USA	UK	Other countries	Total
Effective return 2010 - (Gains)/losses	(6,961)	(81,399)	(290)	(88,650)
Effective return 2009 - (Gains)/losses	(13,268)	(83,057)	(250)	(96,575)

The pension fund costs expensed to income statement are as follows:

(in thousands of euro)

	2010	2009
Current service cost	2,128	3,812
Interest cost	56,820	51,660
Expected return on plan assets	(48,864)	(40,416)
Curtailment	(1,049)	-
	9,035	15,056

The amounts expensed to income statement are included in the item "Personnel Expense" (note 31).
The contributions expected to be paid into the pension funds during 2011 total euro 35,552 thousand.

EMPLOYEES' LEAVING INDEMNITIES (TFR) – ITALIAN COMPANIES

Leaving indemnities (Italian companies) changed as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**51,454**	**56,783**
Discontinued operations	(5,538)	-
Movements through Income Statement	2,341	3,333
Curtailment	371	1,987
Actuarial (gains)/losses recognised in Equity	314	2,809
Payments/advances	(4,621)	(13,453)
Other	149	(5)
Closing balance	**44,470**	**51,454**
of which:		
— Tyre	34,767	33,809
— Real Estate	-	4,877
— Other	9,703	12,768

The changes recognized in the income statement for 2010 relate only to interest expenses accried on leaving indemnities (Italian companies) at December 31, 2009. Following the reform introduced in the 2007 Italian Budget Act, leaving indemnities were transformed into a defined-contribution plan.
The amounts expensed to the income statement are included in the item "Personnel Expenses" (note 31).

HEALTHCARE PLANS

Healthcare plans are broken down as follows:

(in thousands of euro)

	USA
Liabilities recognised at 12/31/2010	19,768
Liabilities recognised at 12/31/2009	17,899

The healthcare plan existing in the United States (Tyre segment) covers white collar staff and factory workers, both active and retired.
The plan is divided into two components "pre-Medicare" and "post-Medicare"; the latter is reserved for participants more than 65 years old.
Contributions are paid by both the employer and the employees.
The changes in the period in liabilities recognised for healthcare plans are as follows:

(in thousands of euro)

	12/31/2010	12/31/2009
Opening balance	**17,899**	**18,442**
Translation differences	1,390	(661)
Movements through Income Statement:		
- current service cost	5	6
- interest cost	1,070	1,090
Actuarial (gains)/losses recognised in Equity	448	(15)
Benefits paid	(1,044)	(963)
Closing balance	**19,768**	**17,899**

The effect of an increase or decrease of one percentage point in the projected healthcare cost trend rates is as follows:

	1% increase		1% decrease	
	12/31/2010	12/31/2009	12/31/2010	12/31/2009
Effect on current service cost and interest cost	38	40	(36)	(39)
Effect on liabilities recognised in balance sheet	711	626	(692)	(609)

The healthcare plan costs expensed to the income statement are as follows:

(in thousands of euro)

	2010	2009
Current service costs	5	6
Interest expense	1,070	1,090
	1,075	1,095

The amounts expensed to income are included in the item "Personnel Expense" (note 31).

ADDITIONAL INFORMATION REGARDING POST-EMPLOYMENT BENEFITS

Net actuarial losses accrued in 2010 and recognised directly in Equity totalled euro 21,618 thousand (at December 31, 2009 net actuarial losses totalled euro 86,633 thousand, including the portion relating to companies carried at Equity, represented by gains of euro 10 thousand). The cumulative amount of net losses recognized in Equity at December 31, 2010, euro 405,911 thousand, including euro 405,889 thousand attributable to the owners of the Parent (at December 31, 2009 net losses totalled euro 383,502 thousand, including euro 383,893 thousand attributable to the owners of the Parent), is broken down as follows:

(in thousands of euro)

	Cumulative 12/31/2010					
	Italy	Germany	USA	UK	Other countries	Total
Pension funds	-	(8,924)	(85,461)	(307,234)	(10,404)	(412,023)
Healthcare plans	-	-	(9,689)	-	-	(9,689)
Employees' leaving indemnity	15,801	-	-	-	-	15,801
Total actuarial gains/(losses) recognised in Equity	**15,801**	**(8,924)**	**(95,150)**	**(307,234)**	**(10,404)**	**(405,911)**

The breakdown by country at December 31, 2009 was as follows:

(in thousands of euro)

	Cumulative 12/31/2009					
	Italy	Germany	USA	UK	Other countries	Total
Pension funds	-	(5,684)	(80,705)	(296,227)	(8,902)	(391,518)
Healthcare plans	-	-	(9,242)	-	-	(9,242)
Employees' leaving indemnity	17,258	-	-	-	-	17,258
Total actuarial gains/(losses) recognised in Equity	**17,258**	**(5,684)**	**(89,947)**	**(296,227)**	**(8,902)**	**(383,502)**

The principal actuarial assumptions used at December 31, 2010 and for determining the projected cost for 2011 are as follows:

	Italy	Germany	Netherlands	UK	USA
Discount rate	4.75%	4.75%	4.75%	5.40%	5.10%
Inflation rate	2.00%	2.00%	2.00%	3.45%	-
Expected return on plan assets	-	-	-	6.56%	7.25%
Expected rate of wage and salary increases	2.00% (*)	2.50%	2.00%	3.30%	-
Healthcare cost trend rates - initial	-	-	-	-	8.00%
Healthcare cost trend rates - final	-	-	-	-	4.50%

* *indicator valid only for companies with less than 50 employees*

The principal actuarial assumptions used at December 31, 2009 and for determining the projected cost for 2010 are as follows:

	Italy	Germany	Netherlands	UK	USA
Discount rate	5.00%	5.20%	5.20%	5.70%	5.75%
Inflation rate	2.00%	2.00%	2.00%	3.45%	-
Expected return on plan assets	-	-	-	6.84%	7.39%
Expected rate of wage and salary increases	3.00% (*)	2.50%	2.00%	2.70% - 3.45%	-
Healthcare cost trend rates - initial	-	-	-	-	8.00%
Healthcare cost trend rates - final	-	-	-	-	4.50%

* *indicator valid only for companies with less than 50 employees*

The discount rates are used to measure the obligation and the financial component of the net present cost. The Group selected these rates on the basis of the yield curve of fixed-income securities (corporate bonds) of major companies (with AA+ ratings) at the valuation date of the plans.
The healthcare cost trend rate represents the projected increase in expenses for medical assistance. This rate is determined on the basis of the specific experience of the segment and of various trends, including the specific inflation projections in the healthcare sector.
The initial rate used represents a short-term trend based on recent experience and on prevailing market conditions. The final rate used is a long-term assumption which takes into account, among other factors, inflation in healthcare costs on the basis of the general inflation trend, incremental medical inflation, technologies, new drugs, the average age of the population and a different mix of medical services.
The expected rates of return on the assets reflect the estimates of the trend in average long-term rates of the pension plan assets for the entire duration of the obligation. The expected return is defined for each asset class (equities, bonds, cash, and real estate) and is net of the projected administrative costs. The historical trend and the correlation of the returns, estimates of future trends and other significant financial factors are analysed to ensure that they are reasonable and consistent.

(in thousands of euro)

	12/31/2010	12/31/2009	12/31/2008	12/31/2007	12/31/2006
Experience adjustments on plan liabilities - (Gains)/losses	19,295	942	(9,553)	16,097	(7,527)
Experience adjustments on plan assets - (Gains)/losses	(39,786)	(56,158)	224,875	(744)	(32,733)

The adjustments based on past experience, in relation to defined benefit plans, are as follows:
The adjustments of liabilities represent the change of the actuarial liability not deriving from modifications of the actuarial assumptions. They normally include changes in the demographic and compensation structure. Changes to the plan rules (past service costs) are excluded from the past experience.

The adjustments of the assets represent the difference between the effective return of the assets and the return expected at the beginning of the year.

OTHER BENEFITS

Other benefits are broken down as follows:

(in thousands of euro)

	12/31/2010	12/31/2009 *
Long term bonus plan	57,847	18,681
Jubilee awards	13,249	15,035
Benefits similiar to employees' leaving indemnity - non Italian companies	23,840	18,369
Other long term benefits	19,969	15,764
	114,905	67,849

* *including discontinued operations totalling euro 2,353 thousand*

The **long-term bonus plan** for management, amounting to euro 57,847 thousand (euro 18,681 thousand at December 31, 2009) reflects the amount accrued during the year for that plan, approved by the Board of Directors of Pirelli & C. S.p.A. on April 21, 2009 and reserved for approximately 80 senior managers.

24. BORROWINGS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

Borrowings from banks and other financial institutions can be broken down as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Total	Non-current	Current	Total *	Non-current	Current
Borrowings from banks	1,028,898	798,960	229,938	1,661,280	1,402,524	258,756
Borrowings from other financial institutions	80,039	78,982	1,057	62,134	60,899	1,235
Financial lease payables	19,466	16,232	3,234	47,928	40,923	7,005
Financial accrued expenses and deferred income	9,037	537	8,500	14,168	789	13,379
Other financial payables	4,786	-	4,786	9,600	670	8,930
	1,142,226	894,711	247,515	1,795,110	1,505,805	289,305

* *including discontinued operations totallling euro 454.078 thousand*

Financial payables backed by secured guarantees (pledges and mortgages) totalled euro 16,593 thousand (euro 23,845 thousand at December 31, 2009).
For current payables, the carrying amount is considered approximate to their fair value.

Current payables include the portion of non-current financial payables, totalling euro 150,000 thousand (euro 141,000 thousand at December 31, 2009), that will be settled within one year.
The fair value of non-current payables is shown below, compared with their carrying amount:

(in thousands of euro)

	12/31/2010		12/31/2009	
	Carrying amount	*Fair value*	Carrying amount	*Fair value*
Non-current financial payables	894,711	901,485	1,505,805	1,503,800

At December 31, 2010, the breakdown of payables by interest rate and by currency of origin of the debt is as follows:

(in thousands of euro)

	Fixed rate		Variable rate		12/31/2010
EUR	17,307		53,201		70,508
USD	-		-		-
BRL (Brazil Real)	93,617		-		93,617
CNY (Chinese Renminbi)	30,681		31,861		62,542
Other currencies	20,848		-		20,848
Current payables	**162,453**	**66%**	**85,062**	**34%**	**247,515**
EUR	579,861		120,696		700,557
USD	6,705		-		6,705
BRL (Brazil Real)	8,306		48,038		56,344
CNY (Chinese Renminbi)	-		61,050		61,050
RON	-		70,055		70,055
Non-current payables	**594,872**	**66%**	**299,839**	**34%**	**894,711**
	757,325	**66%**	**384,901**	**34%**	**1,142,226**

The situation at December 31, 2009 was as follows:

(in thousands of euro)

	Fixed rate		Variable rate		12/31/2009
EUR	117,507		68,683		186,190
USD	-		-		-
BRL (Brazil Real)	43,541		-		43,541
CNY (Chinese Renminbi)	27,509		21,315		48,824
Other currencies	10,750		-		10,750
Current payables	**199,307**	**69%**	**89,998**	**31%**	**289,305**
EUR	999,043		361,788		1,360,831
USD	7,581		-		7,581
BRL (Brazil Real)	39		32,718		32,757
CNY (Chinese Renminbi)	-		54,762		54,762
RON	-		49,874		49,874
Non-current payables	**1,006,663**	**67%**	**499,142**	**33%**	**1,505,805**
	1,205,970	**67%**	**589,140**	**33%**	**1,795,110**

The value of fixed-rate payables indicated above includes those established by contract as fixed-rate payables and those established by contract as variable-rate payables to offset which hedging derivatives have been put in place.

The Group's exposure to fluctuations in interest rates on financial payables, both in terms of the type of rate and their resetting date, are summarised below:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Total	Fixed rate	Variable rate	Total	Fixed rate	Variable rate
Up to 6 months	476,220	96,304	379,916	457,765	114,132	343,633
From 6 to 12 months	68,646	68,646	-	100,714	100,714	-
From 1 to 5 years	596,148	591,163	4,985	1,135,116	889,609	245,507
More than 5 years	1,212	1,212	-	101,515	101,515	-
	1,142,226	**757,325**	**384,901**	**1,795,110**	**1,205,970**	**589,140**

On November 30, 2010 the Group (and specifically Pirelli & C. S.p.A., Pirelli International Limited and Pirelli Tyre S.p.A., acting as guarantor) entered into a new five-year revolving credit facility for euro 1,200,000 thousand. This new facility was contracted in order to replace similar existing credit facilities totalling euro 1,475,000 thousand (of which euro 800,000 thousand granted to Pirelli & C. S.p.A. and euro 675,000 thousand granted to Pirelli Tyre S.p.A. and Pirelli International Limited), which had been previously contracted with due dates falling in 2011 and 2012.

In particular, the syndicated credit facility (granted to Pirelli Tyre S.p.A. and Pirelli International Limited), signed on February 2007 for a total of euro 675,000 thousand, was initially reduced to euro 400,000 thousand at December 31, 2010. Utilisation of this facility for euro 380,000 thousand at December 31, 2010, was classified under non-current payables due after 2014.
This credit facility was fully repaid and cancelled on February 23, 2011.

The new loan agreement was signed with 12 major domestic and international banks: Bank of America-Merrill Lynch, Barclays, BNP Paribas, Commerzbank, HSBC, Intesa Sanpaolo, Mediobanca, Mizuho, Société Générale, The Bank of Tokyo-Mitsubishi, The Royal Bank of Scotland and UniCredit, which all had equal shares. Banca IMI and BNP Paribas acted as Global Co-ordinators for the deal. Banca IMI is the Facility Agent for the deal.

At December 31, 2010 the Group had, besides cash and cash equivalents and securities held for trading of euro 454,495 thousand, unused committed credit facilities of euro 1,220,000 thousand (euro 819,000 thousand at December 31, 2009), with the following maturities:

(in thousands of euro)

	12/31/2010	12/31/2009
2011	20,000	155,000
2012	-	664,000
2015	1,200,000	-
	1,220,000	**819,000**

It should be noted that some of the following credit facilities, all of which are revolving, are subject to financial covenants and negative pledge clauses, as follows:
Tyre:
- syndicated facility (granted to Pirelli Tyre S.p.A. and Pirelli International Ltd), in which 12 banks participate for a total amount of euro 675,000 thousand, reduced to euro 400,000 thousand at December 31, 2010 and utilised for euro 380,000 thousand (fully repaid and cancelled on February 23, 2011), for which no covenants are envisaged. There is a negative pledge clause which provides for a commitment not to grant secured guarantees, above a threshold defined as the greater of euro 100,000 thousand and 3% of Total Assets (as defined in the consolidated financial statements of Pirelli Tyre S.p.A.), with the exception of secured guarantees on the existing debt or debt to replace it, to be granted pursuant to law, relating to "export finance," "project finance" and subsidised finance;
- syndicated credit line for a total of euro 1,200,000 thousand, which was not used and for which just one financial covenant applies, i.e. the undertaking to maintain a certain ratio between consolidated net indebtedness and gross operating profit. This parameter was fully satisfied at December 31, 2010.In regard to the negative pledges, the credit facility provides for a commitment not to grant secured guarantees, above a threshold defined as the greater of euro 100,000 thousand and 3% of Total Assets (as defined in the consolidated financial statements of Pirelli & C. S.p.A.), with the exception of secured guarantees on the existing debt or debt to replace it, to be granted pursuant to law, relating to "export finance," "project finance" and subsidised finance.

The other outstanding financial payables do not contain financial covenants.
Five other loans were outstanding at December 31, 2010, having been granted by the European Investment Bank (EIB) in favour of Pirelli & C. S.p.A. and Pirelli Tyre S.p.A. for research and development projects and in favour of S.C. Pirelli Tyres Romania S.r.l. for local industrial investments. These loans total euro 400,000 thousand, with utilisation of euro 370,000 thousand, and are classified under non-current payables.

Please see note 8.1 "Finance leases" in regard to finance lease payables. The change in finance lease payables from the previous year stems from the change in finance lease agreements in effect at December 31, 2010 as compared with the previous year.

25. TRADE PAYABLES

Trade payables may be broken down as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Total	Non-current	Current	Total *	Non-current	Current
Associates and joint ventures	1,439	-	1,439	20,983	-	20,983
Suppliers	1,053,222	-	1,053,222	959,996	-	959,996
Notes payable	11,700	-	11,700	1,933	-	1,933
Payables on contract work	-	-	-	4,961	-	4,961
	1,066,361	-	1,066,361	987,873	-	987,873

* *including discontinued operations totalling euro 164,073 thousand*

For trade payables, the carrying amount is considered approximate to their fair value.

26. OTHER PAYABLES

Other payables may be broken down as follows:

(in thousands of euro)

	12/31/2010			12/31/2009		
	Total	Non-current	Current	Total *	Non-current	Current
Associates and joint ventures	1,210	-	1,210	12,003	2,608	9,395
Trade and other accrued liabilities and deferred receivables	85,180	6,930	78,250	84,963	4,421	80,542
Tax payables	70,811	17,171	53,640	67,593	10,926	56,667
Payables to employees	127,411	74	127,337	141,105	75	141,030
Payables to social security and welfare institutions	50,252	11,130	39,122	44,723	5,078	39,645
Dividends approved	1,125	-	1,125	1,070	-	1,070
Other payables	109,048	6,359	102,689	173,586	10,900	162,686
	445,037	41,664	403,373	525,043	34,008	491,035

* *including discontinued operations totalling euro 97,125 thousand*

Other current payables (euro 102,689 thousand) include:
— payables of euro 48,131 for the purchase of property, plant and equipment;
— payables of euro 4,079 thousand to agents, professionals and consultants;
— payables of euro 3,035 thousand to Directors and Supervisory Body;
— payables of euro 580 thousand to Statutory Auditors;
— euro 1,678 thousand in advances paid by the European Union to the Tyre segment for research projects;
— euro 5,240 thousand in advances paid by the Region of Piedmont to the Tyre segment for research projects;
— payables of euro 5,603 thousand for withholding tax owed by the Tyre segment;
— earnest money of euro 1,800 thousand paid for the sale of land in Settimo Torinese;
— advances from customers of euro 3,280 thousand.

For other current and non-current payables, the carrying amount is considered approximate to the fair value.

27. DERIVATIVE FINANCIAL INSTRUMENTS

This item includes the fair value measurement of derivative instruments outstanding at December 31, 2010. They are broken down as follows:

(in thousands of euro)

	12/31/2010				12/31/2009			
	Assets		Liabilities		Assets		Liabilities	
	Non-current	Current	Non-current	Current	Non-current	Current	Non-current	Current
No hedge accounting adopted								
Foreign currency derivatives - commercial transactions		32,539		(37,086)		22,745		(22,810)
Foreign currency derivatives - included in net financial position		915		(4,810)		3,822		(29,598)
Hedge accounting adopted								
Foreign currency derivatives - commercial transactions		1,705						
Interest rate derivatives				(28,018)				(23,745)
		35,159		**(69,914)**		**26,567**		**(76,153)**

The value of **foreign currency derivatives** for which hedge accounting was not adopted corresponds to the fair value of forward currency purchases/sales outstanding at the closing date of the period. These involve hedges of Group commercial and financial transactions for which hedge accounting was not adopted. The fair value is determined by using the exchange rate at the reporting date.

The value of **foreign currency derivatives** for which hedge accounting was adopted corresponds to the fair value of forward currency purchases for the Tyre segment. By means of this hedge, implemented in Q4 2010, the Tyre segment aims to limit its exposure to the economic effects resulting from a change in the exchange rate on future purchases planned in Q1 2011 that are denominated in U.S. dollars, mainly for natural rubber.
A positive euro 1,705 thousand was recognised in Equity for 2010.

The value of **interest rate derivatives** for which hedge accounting was adopted corresponds to the measurement of "plain vanilla" interest rate swaps made to hedge against a rise in interest rates on a notional amount of euro 1,050 million, with euro 375 million maturing in February 2012 and euro 675 million for forward start transactions beginning in February 2012 and expiring in February 2015. The amount recognised in Equity for the year was a negative euro 5,212 thousand (compared with a negative euro 17,814 thousand for 2009), and is broken down as follows:

— euro 10,598 thousand for losses recognised in Equity during the year;
— euro 5,386 thousand for immediate reclassification in the income statement (due to the interruption of hedge accounting) of losses that had previously accumulated in Equity for derivative instruments unwound in June 2010 and having a notional value of euro 300 million and original maturity in February 2012 (in this regard, also see note 36 "Financial expenses").

28. COMMITMENTS AND CONTINGENCIES

GUARANTEES GRANTED IN FAVOUR OF OTHER COMPANIES

These totalled euro 123 thousand at December 31, 2010 and were granted in favour of other companies against loans.

COMMITMENTS TO PURCHASE PROPERTY, PLANT AND EQUIPMENT

The commitments to purchase property, plant and equipment relate mainly to the Tyre segment and amount to euro 197.8 million (euro 128.6 million at December 31, 2009), mostly regarding companies in Brazil, China, Italy, Romania, Germany and Mexico.

COMMITMENTS FOR PURCHASE OF EQUITY INTERESTS/FUND UNITS

These refer to call options and consist of commitments by Pirelli Finance (Luxembourg) S.A. to subscribe units of the company Equinox Two S.c.a., a private equity company specialised in investments in listed and unlisted companies with high growth potential, for a maximum countervalue of euro 5,887 thousand.

GUARANTEES GIVEN ON THE SALE OF OLIMPIA

On the sale of the equity interest in Olimpia S.p.A., the sellers (Pirelli and Sintonia) remained contractually liable for all the contingent tax liabilities regarding the years up to the date of sale.
The current tax litigation can be summarised as follows.
At the end of 2006, the Italian Internal Revenue Agency (“Agenzia delle Entrate”) served Olimpia S.p.A. with an assessment notice for **2001**, concerning IRAP (regional tax on productive activity).
More precisely, for this financial year, on the basis of an assumption which is entirely groundless both legally and economically, the Agenzia delle Entrate had found that non-existent financial income had been realised on the Bell Bond Loan redeemable with Olivetti shares, with a consequent IRAP tax of euro 26.5 million, plus penalties for the same amount.
The Company appealed against this tax assessment, claiming that the ascertained taxable income was manifestly non-existent.
At the trial level, the Trial Tax Court accepted the Company’s appeal, cancelling the entire tax assessment.
The Agenzia delle Entrate subsequently appealed this decision.
The appeal by the Agenzia delle Entrate was also rejected by the Regional Tax Court.
Notwithstanding the double judgements against it, the Agenzia delle Entrate filed an appeal with the Court of Cassation, against which the Company has filed a cross-appeal.
In the assessment for the **2002** tax year, served at the end of 2007, Olimpia was characterised as a “shell company,” on the basis of perfectly arbitrary reclassification of items on its financial statements and arbitrary statutory interpretations. The Company’s appeal was not only accepted by the trial court, but the Ministry of Finance was also ordered to pay all legal costs. The IRPEG (corporate income tax) claim amounted to euro 29.3 million, plus penalties for the same amount.
Despite such a clear judgement, the Agenzia delle Entrate lodged its own appeal, which was heard before the Regional Tax Court. We are awaiting the judgement on this appeal, which we expect will uphold the trial court decision.
At the end of 2008, a second notice of assessment was served for the **2003** tax year, in which Olimpia was once again characterised as a “shell company.”
The IRPEG (corporate income tax) claim amounted to euro 28.5 million, plus penalties for the same amount.
The Company appealed to the Tax Court of first instance against this tax assessment, which was, like the other ones, absolutely unfounded. The Tax Court ruled in favour of the Company.
Finally, at the end of 2009, a third notice of assessment was served for the **2004** tax year, in which Olimpia was yet again characterised as a “shell company.”
The IRES (corporate income tax) claim amounts to euro 29.6 million, plus penalties for the same amount.
This assessment, just like the ones that preceded it, is absolutely unfounded. Therefore, the Company lodged an appeal against it too before the Tax Court of first instance, which ruled in favour of the Company just as it had done before.

29. REVENUE FROM SALES AND SERVICES

The revenue from sales and services is broken down as follows:

(in thousands of euro)

	2010	2009
Revenue from sales of goods	4,764,372	3,994,153
Revenue from services	84,046	73,308
	4,848,418	**4,067,461**

30. OTHER INCOME

The item amounts to 154,333 thousand compared with euro 147,144 thousand in 2009, and includes revenues for rents, fees, royalties, compensation, insurance indemnities and other minor items.
The amount for 2009 included income from **non-recurring events** of euro 5,900 thousand (4% of the total) referring to the Tyre segment and excess provisions for restructuring carried out in 2008.

31. PERSONNEL EXPENSE

This is broken down as follows:

(in thousands of euro)

	2010	2009
Wages and salaries	790,250	708,087
Social security and welfare contributions	165,518	143,621
Expenses for employees' leaving indemnity and similar costs *	36,491	26,334
Expenses for defined-contribution pension funds	16,543	14,005
Expenses for defined-benefit pension funds	9,035	15,056
Expenses for defined-benefit healthcare plans	1,075	1,095
Expenses for jubilee awards	1,041	1,769
Expenses for defined-contribution healthcare plans	30,715	24,955
Other costs	12,980	14,295
	1,063,648	**949,217**

* *includes Italian and foreign companies*

The item "wages and salaries" includes euro 39,207 thousand relating to the portion accruing in the year for the long-term bonus plan of the management, approved by the Board of Directors of Pirelli & C. S.p.A. on April 21, 2009. These accruals totalled euro 18,681 thousand in 2009.

In regard to the amounts relating to employees' leaving indemnity (TFR), pension funds and defined benefit healthcare plans, see the comment on the item "Employee benefit obligation" (note 23).

This item also includes euro 18,192 thousand in voluntary redundancy expenses, mainly relating to the Tyre segment and classified as **non-recurring events** (1.7% of the total for the item), compared with euro 52,124 thousand in 2009 (5.5% of the total item). In 2009, these expenses included euro 33,957 thousand for voluntary redundancy payments made by the Tyre segment and euro 18,167 thousand by other Group companies.

32. AMORTISATION, DEPRECIATION AND IMPAIRMENT

The amortisation, depreciation and impairment of property, plant and equipment and intangible assets are broken down as follows:

(in thousands of euro)

	2010	2009
Amortisation	4,366	5,105
Depreciation	216,863	197,755
Impairment of intangible assets	-	2,518
Impairment of property, plant and equipment	7,369	13,970
	228,598	**219,348**

The item includes euro 6,500 thousand (2.8% of the total) for impairment associated with the restructuring plans implemented by the Tyre segment, which are classified as **non-recurring events**. This compares with euro 8,000 thousand (3.6% of the total) for the previous year.

33. OTHER COSTS

This item is broken down as follows:

(in thousands of euro)

	2010	2009
Selling costs	239,957	216,255
Purchases of goods for resale	213,634	249,463
Fluids and power	185,346	162,753
Advertising	143,796	139,086
Professional advice	42,046	34,786
Maintenance	51,080	41,738
Warehouse operating costs	40,984	43,431
Leases and rentals	55,181	43,615
Outsourcing	23,203	23,588
Travel expenses	31,541	25,730
IT expenses	24,885	24,018
Compensation of key managers	8,552	5,871
Other provisions	35,051	65,876
Duty stamps, duties and local taxes	30,941	22,880
Canteen	17,674	13,459
Bad debts	12,991	16,474
Insurance	23,227	20,587
Lease instalments	13,082	13,083
Cleaning expenses	13,482	10,430
Waste disposal	9,241	8,712
Security expenses	7,620	7,504
Telephone expenses	9,279	6,374
Other	210,289	121,459
	1,443,082	1,317,172

Selling costs mainly include contractual expenses for the signing of sales contracts, shipments and transport on domestic and foreign markets, commissions to agents and sales staff, customs duties and the operating costs of external warehouses.

34. NET INCOME (LOSS) FROM EQUITY INVESTMENTS

34.1 SHARE OF NET INCOME OF ASSOCIATES AND JOINT VENTURES

The Group's share of net income of associates and joint ventures accounted for using the Equity method was a positive euro 256 thousand, compared with a positive euro 225 thousand in 2009.

34.2 GAINS FROM EQUITY INVESTMENTS

This item is broken down as follows:

(in thousands of euro)

	2010	2009
Gains on disposal of available-for-sale financial assets	19,539	14,385
Gains on disposal of equity investments in Group companies	-	142
Reversal of impairment of equity investments in associates	3,956	-
Gains from purchase of non-controlling interests	-	3,366
Other gains on equity investments	336	-
	23,831	17,893

The **gains on disposal of available-for-sale financial assets** for 2010 refer mainly to disposal of the entire equity investment held in Oclaro Inc. (formerly Avanex), with a gain of euro 18,366 thousand.
In 2009 this item included the gain realised on sale of shares held in Alcatel-Lucent Submarine Networks (euro 11,195 thousand) and the gain realised on sale of Telecom Italia S.p.A. shares held directly and indirectly by Pirelli & C. S.p.A. (euro 2,251 thousand).

The **reversal of impairment of equity investments in associates** refers to the equity investment in CyOptics Inc. and stems from the increase in the recoverable amount of the equity investment with respect to its carrying value. The amount of the reversal, euro 3,956 thousand, was determined by considering the price received for disposal of the investment at the beginning of 2011.

The **gains on purchase of non-controlling interests** for 2009 was related to the Tyre segment for the gain of euro 3,366 thousand realised as the difference between the purchase price of the non-controlling interests in Turkey and the corresponding Equity determined in accordance with the Group's accounting policies.

34.3 LOSSES FROM EQUITY INVESTMENTS

This item is broken down as follows:

(in thousands of euro)

	2010	2009
Losses on disposal of available-for-sale financial assets	30	-
Impairment of equity investments in associates and joint ventures	585	16,000
Impairment of available-for-sale financial assets	5,850	20,619
	6,465	36,619

The item **impairment of equity investments in associates and joint ventures** mainly refers to the equity investment in RCS MediaGroup S.p.A., while in the previous year, the item referred exclusively to the equity investment in CyOptics Inc.

The item **impairment of available-for-sale financial assets** refers mainly to the equity investment in the Gruppo Banca Leonardo S.p.A. (euro 3,042 thousand), in TlCom I Ltd (euro 632 thousand), in Tiglio I S.r.l. (euro 580 thousand) and in Equinox (euro 372 thousand).
In 2009 it consisted principally of impairment of the equity investment in Telecom Italia S.p.A. (euro 19,754 thousand).

34.4 DIVIDEND INCOME

The amount of euro 5,835 thousand for 2010 is comprised mainly of euro 2,728 thousand from the Gruppo Banca Leonardo S.p.A., euro 2,678 thousand from Mediobanca S.p.A. and euro 348 thousand from Fin. Priv. S.r.l..
In 2009, this item included euro 6,196 thousand from Telecom Italia S.p.A., euro 202 thousand from Gruppo Banca Leonardo S.p.A. and euro 252 thousand from Vittoria Capital N.V.

35. FINANCIAL INCOME

Financial income is broken down as follows:

(in thousands of euro)

	2010	2009
Interest	22,258	25,901
Other financial income	11,506	14,321
Gains on exchange rates	263,770	304,199
Fair value measurement of securities held for trading	-	339
	297,534	344,760

Gains on exchange rates include the adjustment to the year-end exchange rates of items expressed in currencies other than the functional currency still open at the reporting date and gains made on items realised during the year.

36. FINANCIAL EXPENSES

These are broken down as follows:

(in thousands of euro)

	2010	2009
Interest to banks	47,098	48,196
Other financial expenses	36,449	36,897
Losses on exchange rates	263,784	288,609
Fair value measurement of securities held for trading	1,916	-
Fair value measurement of currency derivatives	8,376	41,117
Fair value measurement of other derivative instruments	5,704	54
	363,327	414,873

Other financial expenses are mainly comprised of the euro 11,702 thousand effect of adopting inflation accounting by Pirelli de Venezuela C.A. (also see note 41).

Losses on exchange rates include the adjustment to the year-end exchange rates of items expressed in currencies other than the functional currency still open at the reporting date and losses made on items realised during the year.

The item **fair value measurement of currency derivatives** relates to forward purchases/sales of foreign currencies to hedge commercial and financial transactions. For transactions open at the end of the year, the fair value is determined using the forward exchange rate at the reporting date. Measurement at fair value is made up of two elements: the interest component linked to the interest rate spread between the two currencies subject to the individual hedges, a net hedging cost of euro 9,959 thousand, and the exchange rate component, a net gain of euro 1,584 thousand. Comparing the latter with the exchange differences on items in foreign currencies, a net loss of euro 14 thousand (losses on exchange rates of euro 263,784 thousand and gains on exchange rates of euro 263,770 thousand, included in financial income), it can be seen that the management of exchange rate risk is essentially balanced.

The **fair value measurement of other derivative instruments** includes euro 5,386 thousand for losses accumulated in Equity and reclassified to Income Statement at December 31, 2010 following unwinding of interest rate swaps for a notional value of euro 300 million (see note 27).

37. INCOME TAXES

Income taxes for the year are broken down as follows:

(in thousands of euro)

	2010	2009
Current taxes	150,979	80,105
Deferred taxes	(13,621)	10,245
	137,358	**90,350**

The reconciliation between theoretical taxes and effective taxes is presented below:

(in thousands of euro)

		2010	2009
	Income (loss) before income taxes	365,427	167,966
	Reversal of net income (loss) of associates and joint ventures	(256)	(225)
A	**Total Taxable Income**	**365,171**	**167,741**
B	**Theoretical taxes**	**124,080**	**60,459**
	Main causes for changes between theoretical and effective taxes:		
	— Income not subject to taxation	(39,278)	(31,085)
	— Non-deductible costs	42,735	54,353
	— Use of tax losses carried forward	(38,764)	(18,881)
	— Unrecognised deferred tax assets	7,556	16,633
	— Taxes not related to income and costs for tax assessments	53,801	29,251
	— Other	(12,772)	(20,380)
C	**Effective taxes**	**137,358**	**90,350**
	Theoretical tax rate (B/A)	34%	36%
	Effective tax rate (C/A)	38%	54%

The Group's effective tax burden for 2010 (of euro 137,358 thousand) is attributable mainly to taxes payable by the Tyre segment (of euro 134,429 thousand) for the positive taxable incomes of its subsidiaries.
It also reflects the use of tax losses carried forward and, on the other hand, the existence of taxes not related to income, such as the regional business tax on personnel expenses in Italy (IRAP), and costs for tax assessments.

The amount of taxes includes, finally, accounting by Pirelli & C. S.p.A. for the positive effects deriving from the option for domestic tax consolidation.

The Group's theoretical tax burden is calculated taking into account the nominal tax rates of the countries where the Group's principal companies operate, as shown below:

	2010	2009
Europe		
Italy	31.40%	31.40%
Spain	30.00%	30.00%
Germany	29.41%	29.44%
Great Britain	28.00%	28.50%
Turkey	20.00%	20.00%
North America		
USA	40.00%	40.00%
South America		
Argentina	35.00%	35.00%
Brazil	34.00%	34.00%
Venezuela	34.00%	34.00%

38. NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS

The following table shows the breakdown of this item, which refers to the Real Estate and Broadband Access operating segments, which were spun off and sold, respectively, in 2010 and which qualify as discontinued operations.

(in thousands of euro)

	01/01 - 09/30/2010	2009
Revenue from sales and services	295,271	403,847
Other income	22,898	43,972
Change in inventories of work in progress, semi-finished and finished goods	(549)	(7,778)
Raw materials and supplies used (net of changes in inventories)	(58,809)	(26,672)
Personnel expense	(57,849)	(104,515)
Amortisation, depreciation and impairment	(4,570)	(12,107)
Other costs	(185,888)	(329,026)
Operating income (loss)	**10,504**	**(32,279)**
Net income (loss) from equity investments	(28,577)	(45,135)
— share of net income (loss) from associates and joint ventures	(29,522)	(61,385)
— gains from equity investments	1,961	15,531
— losses from equity investments	(2,239)	(81)
— dividends	1,223	800
Financial income	25,653	36,900
Financial expenses	(22,961)	(52,141)
Net income (loss) before taxes	**(15,381)**	**(92,655)**
Income taxes	(10,223)	(7,547)
Net income (loss)	**(25,604)**	**(100,202)**
Loss on Pirelli RE assignment net of selling costs	(219,002)	-
Gain on disposal of Pirelli Broadband Access net of selling costs	20,766	-
Net income (loss) from discontinued operations	**(223,840)**	**(100,202)**

REAL ESTATE SPIN-OFF

On May 4, 2010 the Board of Directors of Pirelli & C. S.p.A. resolved to submit a motion to the Shareholders for approval of a spin-off of the assets and activities of Pirelli RE (now Prelios) from the other activities operated by the Pirelli Group. The purpose of this spin-off was to focus Pirelli Group activities on the Tyre segment in view of streamlining its operations, as part of the programme launched in 2008 and continued in 2009. This programme was outlined in the 2009-2011 three-year strategic business plan and aimed at focusing the Group on its core industrial activities, while simultaneously allowing its shareholders, who already had an indirect equity interest in the Real Estate segment, to acquire a direct investment in Pirelli RE (now Prelios).
The spin-off was executed by assigning to Pirelli & C. S.p.A. shareholders almost all of the ordinary shares of Pirelli RE (now Prelios) owned by the Company, representing about 58% of the Share capital. This was carried out through a reduction in Share capital whose actual amount was determined by the Extraordinary Shareholders' Meeting of Pirelli & C. S.p.A. on July 15, 2010, and equal to the fair value of the investment in Pirelli RE (now Prelios) being assigned (euro 178,813,982.89). That fair value had been determined on the basis of the official price of Pirelli RE (now Prelios) shares (euro 0.367) quoted on July 14, 2010, the trading date prior to the Extraordinary Shareholders' Meeting.
Pursuant to Article 2445(3) Italian Civil Code, the spin-off was completed on October 25, 2010, upon expiration of the statutory term of 90 days after the resolution by the Extraordinary Shareholders' Meeting of Pirelli & C. S.p.A. had been recorded at the Companies Register.
In accordance with IFRIC 17 (Distribution of Non-cash Assets to Owners), the liability resulting from the spin-off was recalculated on the basis of the official market price of Pirelli RE (now Prelios) shares reported on the aforementioned closing date of the spin-off (euro 0.4337), from euro 178,813,982.89 to euro 211,312,328, with a balancing entry of euro 32,498,345 to reduce Equity. At the same time, a loss of euro 156,268 thousand was recognised in Income Statement, corresponding to the difference between the value of the liability as calculat-

ed above and the carrying value of the assigned net assets. The total impact of the assignment, a loss of euro 219,002 thousand, is obtained by adding to the aforementioned loss of euro 156,268 thousand the transfer to the Income Statement of euro 32,242 thousand of losses that had previously been recognised in Equity, the reversal of a real estate gain for euro 3,660 thousand that had previously been eliminated from the consolidated Financial Statements, the elimination of goodwill associated with this asset (euro 32,909 thousand) and the costs connected with the spin-off (euro 1,243 thousand).
The net loss made by the Real Estate segment in the first nine months of 2010 was euro 28,986 thousand (compared with a net loss of euro 104,844 thousand in all of 2009).
The spin-off resulted in the proportional assignment of 487,231,561 ordinary shares in Pirelli RE (now Prelios) to Pirelli & C. S.p.A. shareholders at a ratio of one Pirelli RE (now Prelios) share for each Pirelli & C. S.p.A. ordinary or savings share owned, compared to a total of 487,798,972 shares owned by Pirelli & C S.p.A. prior to the spin-off. The failure to assign all the Pirelli RE (now Prelios) shares owned is entirely due to technical reasons, in order to determine an unfractioned ratio of assignment to the shareholders of Pirelli & C. S.p.A.

SALE OF BROADBAND ACCESS

On October 21, 2010 Pirelli & C. S.p.A. and Advanced Digital Broadcast Holdings SA (ADB), a company listed on the Swiss stock exchange, signed an agreement for acquisition by ADB of 100% of the Share capital of Pirelli Broadband Solutions S.p.A. (PBS), a wholly-owned subsidiary of Pirelli & C. S.p.A. This transaction was completed on November 29, 2010, with the sale by Pirelli of 100% of PBS to the ADB Group. The price paid by ADB consisted of about euro 25 million in cash and 400 thousand listed shares in ADB, representing approximately 7.2% of its Share capital. Pirelli & C. S.p.A. agreed to a lock-up of these shares for the first two months after closing, while an agreement for a Pirelli put option and an ADB call option was also signed, exercisable within two years.
Net of selling costs, the gain realised on the sale amounted to euro 20,766 thousand (with selling costs totalling euro 358 thousand). The Broadband Access segment had net income of euro 3,382 thousand in the first nine months of 2010 (compared with net income of euro 4,642 thousand in all of 2009).

39. EARNINGS (LOSSES) PER SHARE

Basic earnings (losses) per share are given by the ratio between net income (loss) attributable to the owners of the Parent (adjusted to take into account the minimum dividend allocated to savings shares) and the weighted average of the number of ordinary shares outstanding during the period, with the exclusion of treasury shares.

(in thousands of euro)

	2010	2009
Net income (loss) attributable to owners of the Parent from continuing operations	233,821	78,671
Net income (loss) attributable to savings shares reflecting 2% minimum dividend	(5,794)	(1,950)
Adjusted net income (loss) attributable to owners of the Parent from continuing operations	228,027	76,721
Weighted average of outstanding ordinary shares (in thousands)	475,389	475,389
Basic earnings (losses) per ordinary share from continuing operations (in euro per thousand shares)	**479.66**	**161.39**

(in thousands of euro)

	2010	2009
Net income (loss) attributable to owners of the Parent from discontinued operations	(212,069)	(55,926)
Net income (loss) attributable to savings shares reflecting 2% minimum dividend	5,255	1,386
Net income (loss)attributable to owners of the Parent from discontinued operations	(206,814)	(54,540)
Weighted average of outstanding ordinary shares (in thousands)	475,389	475,389
Basic earnings (losses) per share from discontinued operations (in euro per thousand shares)	**(435.04)**	**(114.73)**

The **diluted earnings (losses)** per share at December 31, 2010 have not been calculated because, following expiration of the stock option plans, the prerequisites for such calculation are not met.

40. DIVIDENDS PER SHARE

In 2010, Pirelli & C. S.p.A. paid to its shareholders dividends based on 2009 earnings equal to euro 0.0145 per each of the 5,229,274,503 ordinary shares (excluding treasury shares) and euro 0.0406 per each of the 130,272,660 savings shares (excluding treasury shares). The total dividends paid out amounted to euro 81,114 thousand. Pirelli & C. S.p.A. had not paid out any dividend in 2009.

In execution of the resolutions approved by the Extraordinary Shareholders' Meeting of Pirelli & C. S.p.A. on July 15, 2010, the par value of the ordinary and savings shares was eliminated on July 26, 2010, with a concurrent reverse stock split at the ratio of 1 new share for every 11 shares owned. Therefore, following these transactions, there were 475,388,592 ordinary shares (excluding treasury shares) and 11,842,969 savings shares (excluding treasury shares). In consequence of this reverse stock split, the dividend for 2009 was euro 0.1595 per ordinary share (excluding treasury shares) and euro 0.4466 per savings share (excluding treasury shares).
For the year ended December 31, 2010, it is proposed to the Annual General Meeting that it vote a dividend of euro 0.165 for the 475,388,592 ordinary shares (excluding the treasury shares), and euro 0.229 for the 11,842,969 savings shares (excluding the treasury shares). The total dividends paid out will amount to euro 81,151 thousand.

41. HYPERINFLATION

In accordance with Group accounting policies regarding the criteria for introducing/ending inflation accounting, the subsidiary Pirelli de Venezuela C.A. adopted inflation accounting beginning with preparation of the consolidated financial statements at December 31, 2009. For this purpose, a blended price index has been used: a consumer price index (IPC) covering only the cities of Caracas and Maracaibo was used until December 31, 2007. Beginning in 2008 the Banco Central de Venezuela and the National Institute for Statistics started to publish a national consumer price index (Indice Nacional de precios al consumidor - INPC) that covers the entire country and uses December 2007 as its basis for calculation.
These indices and the related conversion factors are presented in the table below:

	Index	Conversion factor
December 31. 2007	100.0	1.6370
December 31. 2008	130.9	1.2506
December 31. 2009	163.7	1.2718
December 31. 2010	208.2	1.0000

The losses on the net monetary position are recognised in the income statement under the item "Financial expenses" (note 36) for an amount of euro 11,702 thousand (euro 6,495 thousand at December 31, 2009).

42. RELATED PARTY TRANSACTIONS

Related party transactions, including intercompany transactions, are neither unusual nor exceptional, but are part of the ordinary course of business of Group companies. Such transactions, when not carried out at standard conditions or dictated by specific laws, are in any case settled on an arm's length basis.

The statement below shows a summary of the Balance Sheet and Income Statement items that include transactions with related parties and their percentage impact:

(in millions of euro)

	Total reported at 12/31/2010	of which related parties	% share	Total reported at 12/31/2009	of which related parties	% share
BALANCE SHEET						
Non-current assets						
Other receivables	315.5	-	0.0%	557.2	395.2	70.9%
Current assets						
Trade receivables	676.7	8.1	1.2%	735.8	91.5	12.4%
Other receivables	175.0	149.8	85.6%	197.1	19.1	9.7%
Non-current liabilities						
Other payables	41.7	-	0.0%	34.0	2.6	7.7%
Current liabilities						
Borrowings from banks and other financial institutions	247.5	0.1	0.0%	289.3	2.5	0.9%
Trade payables	1.066.4	5.4	0.5%	987.9	24.1	2.4%
Other payables	403.4	1.2	0.3%	491.0	10.8	2.2%
Provisions for liabilities and charges	116.0	-	0.0%	130.8	3.3	2.5%
Tax payables	64.6	-	0.0%	43.9	1.1	2.5%
INCOME STATEMENT						
Revenue from sales and services	4.848.4	5.6	0.1%	4.067.5	1.5	0.0%
Other income	154.3	1.8	1.2%	147.1	-	0.0%
Personnel expense	(1.063.6)	(5.3)	0.5%	(949.2)	(12.7)	1.3%
Other costs	(1.443.1)	(23)	1.6%	(1.317.2)	(16.4)	1.2%
Financial income	297.5	1.1	0.4%	344.8	-	0.0%
Financial expenses	363.3	-	0.0%	(414.9)	-	0.0%

The effects of related party transactions on the consolidated Income Statement and Balance Sheet of the Pirelli Group at December 31, 2010 are shown below.
Transactions with associates and joint ventures:

RELATIONS WITH ASSOCIATES AND JOINT VENTURES (in millions of euro)

Revenue from sales and services	3.7	The amount consists principally of services provided by: Pirelli Tyre S.p.A. to Sino Italian Wire Technology Co. Ltd (euro 1.9 million); Pirelli & C. Ambiente S.p.A. to Idea Granda Società Consortile r.l. (euro 0.8 million); Pirelli & C. Ambiente Site Remediation S.p.A. to Spazio Industriale (euro 0.4 million)
Other costs	0.3	The amount refers to Corimav Consorzio for Research on Advanced Materials (euro 0.1 million).
Current trade receivables	3.1	They principally refer to receivables for services provided by: Pirelli & C. Ambiente S.p.A. to Idea Granda Società Consortile r.l. (euro 0.9 million); by Pirelli Tyre S.p.A. to the associate Sino Italian Wire Technology Co. Ltd (euro 0.9 million); Pirelli Labs S.p.A to CyOptics Inc. (euro 0.4 million); Pirelli Sistemi Informativi S.r.l. to Cyoptics Inc. (euro 0.3 million)
Non-current other receivables	3.4	The amount refers to receivables of Solar Utility S.p.A. from G.P. Energia S.r.l.
Current financial receivables	5.9	The amount refers to receivables of: Solar Utility S.p.A. (euro 4.4 million) from the associate Solar Prometheus S.r.l.; Pirelli Tyre S.p.A. from the associate Sino Italian Wire Technology Co. Ltd (Euro 1.3 million); Pirelli & C. Ambiente S.p.A. from Serenergy S.r.l. (euro 0.2 million)
Current trade payables	1.4	The amount consists principally of payables by Pirelli Labs S.p.A. (euro 1.3 million) to CyOptics Inc.
Current other payables	1.2	The amount consists principally of payables by Solar Utility S.p.A. (euro 1.2 million) to G.P. Energia S.r.l.
Borrowings from banks and other financial institutions	0.1	

TRANSACTIONS WITH PARTIES RELATED TO PIRELLI THROUGH DIRECTORS (in millions of euro)

Revenue from sales and services	1.9	This refers to services provided to the Camfin Group by Pirelli & C. S.p.A. (euro 0.1 million) and by Pirelli & C. Ambiente Site Remendation S.p.A. (euro 0.9 million); to the Prelios Group by Pirelli & C. S.p.A. (euro 0.3 million) and by Centro Servizi Amministrativi Pirelli S.r.l. (euro 0.5 million)
Other income	1.8	This refers principally to services provided by Pirelli Sistemi Informativi S.p.A. to the Prelios Group (euro 1.3 million) and to the Camfin Group (euro 0.2 million); and to lease income and related operating expenses of Pirelli & C. S.p.A. to Camfin S.p.A. (euro 0.2 million) and Prelios S.p.A. (euro 0.2 million)
Other costs	14.1	The amount refers principally to sponsorship costs owed to F.C. Internazionale Milano S.p.A. (euro 13.7 million).
Financial income	1.1	The amount refers to interest accrued on the outstanding loan to Prelios S.p.A. (euro 1.1 million).
Tax	0.2	Pirelli & C.S.p.A. taxes to the Prelios group for tax consolidation.
Current trade receivables	4.9	The amount refers to receivables connected with the aforementioned services to the Camfin Group (euro 1.1 million) and to the Prelios Group (euro 3.7 million) of which the following in detail: Pirelli Sistemi Informativi (euro 1.2 million); Pirelli & C. S.p.A. (euro 1.3 million); Pirelli & C. Ambiente Site Remediation S.p.A. (euro 0.6 million)
Current other receivables	140.4	The amount refers to the loan to Prelios S.p.A. as part of the spin-off.
Current trade payables	4.0	This amount refers mainly to the sponsorship costs mentioned above (euro 3.2 million); to payables to the Prelios Group (euro 0.7 million).
Dividends paid (cash outflow)	20.8	Dividends to Camfin S.p.A. (euro 19.9 million) and C.M.C. S.p.A. (euro 0.9 million).
Capital expenditure (cash outflow)	17.9	The amount refers principally to the acquisition of land and buildings in the Milan Bicocca area from Lambda S.p.A. and from Pirelli RE (now Prelios) for euro 14.2 million.
Investments in other financial assets (cash outflow)	1.1	This item refers to the capital increase of F.C. Internazionale Milano S.p.A.

BENEFITS FOR KEY MANAGERS OF THE COMPANY

At December 31, 2010, fees payable to key managers, i.e. to those who have the power and responsibility, directly or indirectly, for planning, managing and controlling the business of Pirelli & C. S.p.A., including executive and non-executive directors, amounted to euro 13,885 thousand (euro 18,564 thousand at December 31, 2009). The portion relating to employee benefits was recognised in the Income Statement item "personnel expense" for euro 5,333 thousand of which euro 589 thousand relating to employees' leaving indemnity (euro 12,694 thousand in 2009, of which euro 492 thousand relating to employees' leaving indemnity) and for euro 8,552 thousand in the Income Statement item "other costs" (euro 5,871 thousand in 2009).

43. SIGNIFICANT EVENTS SUBSEQUENT TO THE END OF THE YEAR

On **January 13, 2011** Pirelli & C. S.p.A. sold its equity investment in CyOptics Inc. (34.41% shareholding) for USD 23.5 million.
On **February 10, 2011** Pirelli & C. S.p.A. successfully concluded its placement of an unrated bond issue worth a nominal euro 500 million with international institutional investors on the Eurobond market. This issue was enthusiastically received by investors, with requests totalling more than euro 4.5 billion, or over nine times the amount offered. More than 93% of the bond issue was placed with foreign investors. The placement, executed in accordance with the Pirelli & C. S.p.A. Board of Directors resolution of July 29, 2010, is one of the actions being taken to streamline the Group debt structure by lengthening the average duration of debt and diversifying funding sources. The notes has the following characteristics:
— issuer: Pirelli & C. S.p.A.
— guarantor: Pirelli Tyre S.p.A.
— amount: euro 500 million
— settlement date: February 22, 2011
— maturity date: February 22, 2016
— coupon: 5.125%
— issue price: 99.626%
— redemption price: 100%
— minimum denomination: euro 100 thousand and additional whole multiples of euro 1000.

The effective yield to maturity is 5.212%, corresponding to a yield of 230 basis points above the correspeonding reference rate (mid-swap). The notes will be listed on the Luxembourg Stock Exchange. The placement was handled by Barclays Capital, acting as global coordinator, Banca IMI, Mediobanca, SG CIB and Unicredit as joint bookrunners.

44. OTHER INFORMATION

RESEARCH AND DEVELOPMENT EXPENSES

Research expenses rose from euro 137 million in 2009 (3.4% of sales) to euro 150 million in 2010 (3.1% of sales). They were expensed on the Income Statement insofar as they did not satisfy IFRS requirements for capitalisation.

COMPENSATION OF DIRECTORS AND STATUTORY AUDITORS

Fees paid to directors and statutory auditors of Pirelli & C. S.p.A. for performance of their duties at the Parent and also at other consolidated companies were as follows:

(in thousands of euro)

	2010	2009
Directors	8,377	7,949
Statutory Auditors	161	129
	8,538	8,078

EMPLOYEES

The average headcount of employees at consolidated companies is as follows, broken down by category:

(in thousands of euro)

	2010	2009
Executives and white collar staff	6,543	6,941
Blue collar staff	20,926	20,242
Temporary workers	2,860	2,382
	30,329	29,565

COMPENSATION OF INDEPENDENT AUDITORS

The following statement, prepared pursuant to Art. 149–duodecies of the Consob Issuers Regulation, shows the fees accruing to financial year 2010 for auditing services and for services other than auditing, rendered by the accounting firm Reconta Ernst & Young S.p.A. and by entities belonging to its network:

(in thousands of euro)

		Partial fees	Total fees	
Independent auditing services	Pirelli & C. S.p.A.	256		
	Subsidiaries	1,871	2,127	75.9%
Certification services	Pirelli & C. S.p.A.	116		
	Subsidiaries	123	239	8.5%
Tax assistance services	Pirelli & C. S.p.A.	-		
	Subsidiaries	234	234	8.3%
Services other than auditing	Pirelli & C. S.p.A.	170		
	Subsidiaries	34	204	7.3%
			2,804	100%

TRANSACTIONS RESULTING FROM ATYPICAL AND/OR UNUSUAL OPERATIONS

Pursuant to Consob Notice of July 28, 2006, the Group certifies that it did not carry out any atypical and/or unusual operations in 2010, as defined in the Notice itself.

EXCHANGE RATES

The main exchange rates used for consolidation purposes are as follows:

(local currency against euro)

	Period-end		Change in %	Average		Change in %
	12/31/2010	12/31/2009		2010	2009	
British pound	0.8608	0.8881	(3.07%)	0.8582	0.8910	(3.68%)
Swiss franc	1.2504	1.4836	(15.72%)	1.3810	1.5101	(8.55%)
Slovakian koruna	30.1260	30.1260	-	30.1260	30.1260	-
American dollar	1.3362	1.4406	(7.25%)	1.3263	1.3941	(4.86%)
Canadian dollar	1.3322	1.5128	(11.94%)	1.3657	1.5853	(13.85%)
Brazilian real	2.2264	2.5084	(11.24%)	2.3334	2.7791	(16.04%)
Venezuela bolivar	5.7457	6.1946	(7.25%)	5.7457	2.9973	91.70%
Argentinean peso	5.3127	5.4743	(2.95%)	5.1893	5.2006	(0.22%)
Australian dollar	1.3136	1.6008	(17.94%)	1.4431	1.7735	(18.63%)
Chinese renminbi	8.8493	9.8367	(10.04%)	8.9785	9.5229	(5.72%)
Singapore dollar	1.7136	2.0194	(15.14%)	1.8069	2.0238	(10.72%)
Egyptian pound	7.7553	7.8995	(1.83%)	7.4807	7.7252	(3.16%)
Turkish lira	2.0590	2.1707	(5.15%)	1.9982	2.1612	(7.54%)

NET FINANCIAL (LIQUIDITY)/DEBT POSITION (ALTERNATIVE PERFORMANCE MEASURE NOT ENVISAGED BY THE ACCOUNTING STANDARDS)

Net financial (liquidity)/debt position is broken down as follows:

(in thousands of euro)

	Note	12/31/2010		12/31/2009 °	
			of which related parties		of which related parties
Current borrowings from banks and other financial institutions	24	247,515	77	289,305	2,473
Current derivative financial instruments (liabilities)	27	4,810		29,598	
Non-current borrowings from banks and other financial institutions	24	894,711		1,505,805	
Total gross debt		**1,147,036**		**1,824,708**	
Cash and cash equivalents	18	(244,725)		(632,113)	
Securities held for trading	17	(209,770)		(161,024)	
Current financial receivables	14	(13,266)	(5,926) **	(12,477)	(10,456)
Current derivative financial instruments (assets)	27	(915)		(3,822)	
Net financial debt *		**678,360**		**1,015,272**	
Non-current financial receivables	14	(222,758)		(486,432)	(394,337)
Total net financial (liquidity)/debt position		**455,602**		**528,840**	

* *Pursuant to Consob Notice of July 28, 2006 and in compliance with CESR recommendation of February 10, 2005 "Recommendations for the consistent implementation of the European Commission Regulation on Prospectuses"*

** *receivables from associates/jv*

° *including discontinued operations totalling euro 5,648 thousand*

COMPANIES CONSOLIDATED LINE-BY-LINE

Company	Business	Headquarters	Currency	Share Capital	% holding	Held by
Europe						
Austria						
Pirelli GmbH	Tyre	Vienna	Euro	726,728	100.00%	Pirelli Tyre (Suisse) S.A.
Belgium						
Pirelli Tyres Belux S.A.	Tyre	Brussels	Euro	700,000	100.00%	Pirelli Tyre (Suisse) S.A.
France						
Gecam France S.a.S	Sustainable mobility	Villepinte	Euro	130,205	70.00%	Pirelli & C. Eco Technology S.p.A.
Pirelli Solutions France S.a.r.l. (ex Pirelli Broadband Solutions France S.a.r.l.)	Telecommunica-tions	Villepinte	Euro	10,000	100.00%	Pirelli & C. S.p.A.
Pneus Pirelli S.a.S	Tyre	Villepinte	Euro	1,515,858	100.00%	Pirelli Tyre (Suisse) S.A.
Germany						
Deutsche Pirelli Reifen Holding GmbH	Financial	Breuberg / Odenwald	Euro	7,694,943	100.00%	Pirelli Tyre S.p.A.
Drahtcord Saar Geschaeftsfuehrungs GmbH	Tyre	Merzig	Deut. Mark	60,000	50.00%	Pirelli Deutschland GmbH
Drahtcord Saar GmbH & Co. KG	Tyre	Merzig	Deut. Mark	30,000,000	50.00%	Pirelli Deutschland GmbH
Driver Handelssysteme GmbH	Tyre	Breuberg / Odenwald	Euro	26,000	100.00%	Deutsche Pirelli Reifen Holding GmbH
Pirelli Deutschland GmbH	Tyre	Breuberg / Odenwald	Euro	26,334,100	100.00%	Deutsche Pirelli Reifen Holding GmbH
Pirelli Personal Service GmbH	Tyre	Breuberg / Odenwald	Euro	25,000	100.00%	Deutsche Pirelli Reifen Holding GmbH
PK Grundstuecksverwaltungs GmbH	Tyre	Hoechst / Odenwald	Euro	26,000	100.00%	Deutsche Pirelli Reifen Holding GmbH
Pneumobil GmbH	Tyre	Breuberg / Odenwald	Euro	259,225	100.00%	Deutsche Pirelli Reifen Holding GmbH
Greece						
Elastika Pirelli S.A.	Tyre	Kallithea (Athens)	Euro	1,192,000	99.90%	Pirelli Tyre (Suisse) S.A.
					0.10%	Pirelli Tyre S.p.A
Pirelli Hellas S.A. (in liquidation)	Sundry	Athens	US $	22,050,000	79.86%	Pirelli Tyre S.p.A.
The experts in wheels – Driver hellas S.A. of marketing and trading and supply of services of development. promotion and strategic organization of network in tires and spare parts	Tyre	Kallithea (Athens)	Euro	100,000	72.00%	Elastika Pirelli S.A.
Hungary						
Pirelli Hungary Tyre Trading and Services Ltd	Tyre	Budapest	Hun. Forint	3,000,000	100.00%	Pirelli Tyre (Suisse) S.A.
Ireland						
Pirelli Reinsurance Company Ltd	Reinsurance	Dublin	US $	7,150,000	100.00%	Pirelli Finance (Luxembourg) S.A.
Italy						
Centro Servizi Amministrativi Pirelli S.r.l.	Services	Milan	Euro	51,000	67.00%	Pirelli & C. S.p.A.
					33.00%	Pirelli Tyre S.p.A.
Driver Italia S.p.A.	Commercial	Milan	Euro	350,000	72.54%	Pirelli Tyre S.p.A.
EPRE S.r.l.	Enviroment	Milan	Euro	10,000	100.00%	Solar Utility S.p.A.
Green&Co2 S.r.l.	Enviroment	Milan	Euro	10,000	100.00%	Pirelli & C. Ambiente S.p.A.
IESS Pachino S.r.l.	Enviroment	Rome	Euro	10,000	85.00%	Solar Utility S.p.A.
Maristel S.p.A.	Telecommunications	Milan	Euro	1,020,000	100.00%	Pirelli & C. S.p.A.
P.A. Società di Gestione del Risparmio S.p.A.	Financial	Milan	Euro	2,000,000	100.00%	Pirelli & C. Ambiente S.p.A.
Perseo S.r.l.	Services	Milan	Euro	20,000	100.00%	Pirelli & C. S.p.A.
Pirelli & C. Ambiente S.p.A.	Enviroment	Milan	Euro	4,572,000	51.00%	Pirelli & C. S.p.A.
Pirelli & C. Ambiente Site Remediation S.p.A.	Enviroment	Milan	Euro	155,700	100.00%	Pirelli & C. Ambiente S.p.A.
Pirelli & C. Eco Technology S.p.A.	Sustainable mobility	Milan	Euro	17,810,000	51.00%	Pirelli & C. S.p.A.

Company	Business	Headquarters	Currency	Share Capital	% holding	Held by
Europe						
Italy						
Pirelli Cultura S.p.A.	Sundry	Milan	Euro	1.000.000	100.00%	Pirelli & C. S.p.A.
Pirelli Industrie Pneumatici S.r.l.	Tyre	Settimo Torinese (To)	Euro	31,000,000	100.00%	Pirelli Tyre S.p.A.
Pirelli Labs S.p.A.	Research and Development	Milan	Euro	5,000,000	100.00%	Pirelli & C. S.p.A.
Pirelli Nastri Tecnici S.p.A. (in liquidation)	Sundry	Milan	Euro	384,642	100.00%	Pirelli & C. S.p.A.
Pirelli Servizi Finanziari S.p.A.	Financial	Milan	Euro	1,976,000	100.00%	Pirelli & C. S.p.A.
Pirelli Sistemi Informativi S.r.l.	Information Systems	Milan	Euro	1,010,000	100.00%	Pirelli & C. S.p.A.
Pirelli Tyre S.p.A.	Tyre	Milan	Euro	256,820,000	100.00%	Pirelli & C. S.p.A.
Poliambulatorio Bicocca S.r.l.	Services	Milan	Euro	10,000	100.00%	Pirelli Tyre S.p.A.
PZero S.r.l.	Sundry	Milan	Euro	10,000	100.00%	Pirelli & C. S.p.A.
Servizi Aziendali Pirelli S.C.p.A.	Services	Milan	Euro	104,000	90.25%	Pirelli & C. S.p.A.
					2.00%	Pirelli Tyre S.p.A.
					1.00%	Pirelli & C. Ambiente S.p.A.
					0.95%	Centro Servizi Amministrativi Pirelli S.r.l.
					0.95%	Pirelli Labs S.p.A.
					0.95%	Pirelli Sistemi Informativi S.r.l.
					0.95%	PZero S.r.l.
					0.95%	Pirelli & C. Eco Technology S.p.A.
Solar Utility S.p.A.	Enviroment	Milano	Euro	14,000,000	100.00%	Pirelli & C. Ambiente S.p.A.
Solar Utility Sicilia S.r.l.	Enviroment	Milano	Euro	10,000	100.00%	Solar Utility S.p.A.
Luxembourg						
Pirelli Finance (Luxembourg) S.A.	Financial	Luxembourg	Euro	13,594,910	100.00%	Pirelli & C. S.p.A.
Poland						
Driver Polska Sp.ZO.O.	Tyre	Warsaw	Pol. Zloty	100,000	62.00%	Pirelli Polska Sp.ZO.O.
Pirelli Polska Sp.ZO.O.	Tyre	Warsaw	Pol. Zloty	625,771	100.00%	Pirelli Tyre (Suisse) S.A.
Romania						
S.C. Pirelli & C. Eco Technology RO S.R.L.	Sustainable mobility	Oras Bumbesti-Jiu	Rom. Leu	55,000,000	100.00%	Pirelli & C. Eco Technology S.p.A.
S.C. Cord Romania S.R.L.	Tyre	Slatina	Rom. Leu	36,492,150	80.00%	Pirelli Tyre S.p.A.
S.C. Pirelli Tyres Romania S.R.L.	Tyre	Slatina	Rom. Leu	442,169,800	100.00%	Pirelli Tyre S.p.A.
Russia						
OOO Pirelli Tyre Russia	Commercial	Moscow	Russian Rouble	54,685,259	95.00%	Pirelli Tyre (Suisse) S.A.
					5.00%	Pirelli Tyre S.p.A .
Slovakia						
Pirelli Slovakia S.R.O.	Pneumatici	Bratislava	Euro	6,638,78	100.00%	Pirelli Tyre (Suisse) S.A.
Spain						
Euro Driver Car S.L.	Tyre	Barcelona	Euro	852,000	26.056%	Pirelli Neumaticos S.A.
					26.761%	Proneus S.L.
Omnia Motor S.A.	Tyre	Barcelona	Euro	1,502,530	100.00%	Pirelli Neumaticos S.A.
Pirelli Iniciativas Tecnologicas S.L.	Tyre	Barcelona	Euro	10,000	100.00%	Pirelli Neumaticos S.A.
Pirelli Neumaticos S.A.	Tyre	Barcelona	Euro	25,075,907	100.00%	Pirelli Tyre S.p.A.
Proneus S.L.	Tyre	Barcelona	Euro	3,005	100.00%	Pirelli Neumaticos S.A.
Tyre & Fleet S.L.	Tyre	Barcelona	Euro	20,000	100.00%	Pirelli Neumaticos S.A.
Sweden						
Pirelli Tyre Nordic A.B.	Tyre	Bromma	Swed. Krona	950,000	100.00%	Pirelli Tyre (Suisse) S.A.
Switzerland						
Pirelli Société Générale S.A.	Financial	Basel	Swiss Franc	28,000,000	100.00%	Pirelli & C. S.p.A.
Pirelli Tyre (Suisse) S.A.	Tyre	Basel	Swiss Franc	1,000,000	100.00%	Pirelli Tyre S.p.A.

Company	Business	Headquarters	Currency	Share Capital	% holding	Held by
Europe						
The Netherlands						
Pirelli China Tyre N.V.	Tyre	Heinenoord	Euro	38,045,000	100.00%	Pirelli Tyre S.p.A.
Pirelli Tyres Nederland B.V.	Tyre	Heinenoord	Euro	18,152	100.00%	Pirelli Tyre (Suisse) S.A .
Turkey						
Celikord A.S.	Tyre	Istanbul	Turkish Lira	29,000,000	98.73%	Pirelli Tyre S.p.A.
					0.63%	Pirelli UK Tyre Holding Ltd
					0.37%	Pirelli UK Tyres Ltd
					0.27%	Pirelli Industrie Pneumatici S.r.l.
Turk-Pirelli Lastikleri A.S.	Tyre	Istanbul	Turkish Lira	140,000,000	99.839%	Pirelli Tyre S.p.A.
					0.152%	Pirelli Industrie Pneumatici S.r.l.
					0.009%	Pirelli Tyre (Suisse) S.A.
United Kingdom						
CPC 2010 Ltd (ex CPK Auto Products Ltd)	Tyre	Burton on Trent	British Pound	10,000	100.00%	Pirelli UK Tyres Ltd
CTC 1994 Ltd	Tyre	Burton on Trent	British Pound	984	100.00%	CTC 2008 Ltd
CTC 2008 Ltd	Tyre	Burton on Trent	British Pound	100,000	100.00%	Pirelli UK Tyres Ltd
Pirelli International Ltd	Financial	Burton on Trent	Euro	250,000,000	75.00%	Pirelli UK Tyre Holding Ltd
					25.00%	Pirelli Tyre S.p.A.
Pirelli Motorsport Services Ltd	Tyre	Burton on Trent	British Pound	1	100.00%	Pirelli Tyre S.p.A.
Pirelli Tyres Ltd	Tyre	Burton on Trent	British Pound	16,000,000	100.00%	Pirelli UK Tyres Ltd
Pirelli UK Ltd	Finance Holding Company	Burton on Trent	British Pound	97,161,278	100.00%	Pirelli & C. S.p.A.
Pirelli UK Tyre Holding Ltd	Holding Company	Burton on Trent	British Pound	96,331,000	100.00%	Pirelli Tyre S.p.A.
Pirelli UK Tyres Ltd	Tyre	Burton on Trent	British Pound	85,000,000	75.00%	Pirelli UK Tyre Holding Ltd
					25.00%	Pirelli Tyre S.p.A.
North America						
Canada						
Pirelli Tire Inc.	Tyre	Fredericton (New Brunswich)	Can. $	6,000,000	100.00%	Pirelli Tyre (Suisse) S.A.
U.S.A.						
Pirelli North America Inc.	Tyre	Atlanta	US $	10	100.00%	Pirelli Tyre S.p.A.
Pirelli Tire LLC	Tyre	Wilmington (Delaware)	US $	1	100.00%	Pirelli North America Inc.
Central/South America						
Argentina						
Pirelli Neumaticos S.A.I.C.	Tyre	Buenos Aires	Arg. Peso	101,325,176	95.00%	Pirelli Tyre S.p.A.
					5.00%	Pirelli Pneus Ltda
Brazil						
Comercial e Importadora de Pneus Ltda	Tyre	Sao Paulo	Bra. Real	12,913,526	100.00%	Pirelli Pneus Ltda
Cord Brasil - Industria e Comercio de Cordas para Pneumaticos Ltda	Tyre	Santo Andrè	Bra. Real	84,784,342	100.00%	Pirelli Pneus Ltda
Ecosil - Industria Quimica do Brasil Ltda	Tyre	Meleiro	Bra. Real	1,370,000	75.0 0%	Pirelli Pneus Ltda
Pirelli Ltda	Financial	Sao Paulo	Bra. Real	28,000,000	100.00%	Pirelli & C. S.p.A.
Pirelli Pneus Ltda	Tyre	Feira de Santana	Bra. Real	341,145,811	100.00%	Pirelli Tyre S.p.A
TLM - Total Logistic Management Serviços de Logistica Ltda	Holding Company	Santo Andrè	Bra. Real	1,006,000	99.98%	Pirelli Pneus Ltda
					0.02%	Cord Brasil - Industria e Comercio de Cordas para Pneumaticos Ltda
Chile						
Pirelli Neumaticos Chile Limitada	Tyre	Santiago	Chile Peso/000	1,918,451	99.98%	Pirelli Pneus Ltda
					0.02%	Comercial e Importadora de Pneus Ltda

Company	Business	Headquarters	Currency	Share Capital	% holding	Held by
Central/South America						
Colombia						
Pirelli de Colombia S.A.	Tyre	Santa Fe De Bogota	Col. Peso/000	3,315,069	92.91%	Pirelli Pneus Ltda
					2.28%	Pirelli de Venezuela C.A.
					1.60%	Cord Brasil - Industria e Comercio de Cordas para Pneumaticos Ltda
					1.60%	TLM - Total Logistic Management Serviços de Logistica Ltda
					1.60%	Comercial e Importadora de Pneus Ltda
Mexico						
Pirelli Neumaticos de Mexico S.A. de C.V.	Tyre	Mexico City	Mex. Peso	35,098,400	99.98%	Pirelli Pneus Ltda
					0.02%	Comercial e Importadora de Pneus Ltda
Pirelli Neumaticos S.A. de C.V.	Tyre	Mexico City	Mex. Peso	50,000	99.00%	Pirelli Tyre S.p.A.
					1.00%	Pirelli Pneus Ltda
Pirelli Servicios S.A. de C.V.	Tyre	Mexico City	Mex. Peso	50,000	99.00%	Pirelli Tyre S.p.A.
					1.00%	Servicios Pirelli Mexico S.A. de C.V.
Servicios Pirelli Mexico S.A. de C.V.	Tyre	Mexico City	Mex. Peso	50,000	99.00%	Pirelli Pneus Ltda
					1.00%	Comercial e Importadora de Pneus Ltda
Venezuela						
Pirelli de Venezuela C.A.	Tyre	Valencia	Ven. Bolivar/000	20,062,679	96.22%	Pirelli Tyre S.p.A.
Africa						
Egypt						
Alexandria Tire Company S.A.E.	Tyre	Alexandria	Egy. Pound	393,000,000	89.08%	Pirelli Tyre S.p.A.
					0.03%	Pirelli Tyre (Suisse) S.A.
International Tire Company Ltd	Tyre	Alexandria	Egy. Pound	50,000	99.80%	Alexandria Tire Company S.A.E.
South Africa						
Pirelli Tyre (Pty) Ltd	Tyre	Centurion	S.A. Rand	1	100.00%	Pirelli Tyre (Suisse) S.A.
Oceania						
Australia						
Pirelli Tyres Australia Pty Ltd	Tyre	Sydney	Aus. $	150,000	100.00%	Pirelli Tyre (Suisse) S.A.
New Zealand						
Pirelli Tyres (NZ) Ltd	Tyre	Auckland	N.Z. $	100	100.00%	Pirelli Tyres Australia Pty Ltd
Asia						
China						
Pirelli Scientific and Technological Consulting (Shangai) Co. Ltd	Tyre	Shangai	US $	700,000	100.00%	Pirelli China Tyre N.V.
Pirelli Tyre Co, Ltd	Tyre	Yanzhou	China Renmimbi	1,210,110,000	75.00%	Pirelli China Tyre N.V.
Yanzhou Hixih Ecotech Environment CO. Ltd	Sustainable mobility	Yanzhou	China Renmimbi	130,000,000	60.00%	Pirelli & C, Eco Technology S.p.A.
Japan						
Pirelli Japan Kabushiki Kaisha	Tyre	Tokyo	Jap. Yen	2,700,000,000	100.00%	Pirelli Tyre S.p.A.
Singapore						
Pirelli Asia Pte Ltd	Tyre	Singapore	Sing. $	2	100.00%	Pirelli Tyre (Suisse) S.A.

INVESTMENTS ACCOUNTED FOR BY THE EQUITY METHOD

Company	Business	Headquarters	Currency	Share Capital	% holding	Held by
Europe						
Germany						
Industriekraftwerk Breuberg GmbH	Cogeneration	Hoechst / Odenwald	Euro	1,533,876	26.00%	Pirelli Deutschland GmbH
Greece						
Eco Elastica S.A.	Tyre	Athens	Euro	60,000	20.00%	Elastika Pirelli S.A.
Italy						
A.P.I.C.E. - società per azioni	Enviroment	Rome	Euro	200,000	50.00%	Pirelli & C. Ambiente S.p.A.
Eurostazioni S.p.A.	Holding	Rome	Euro	160,000,000	32.71%	Pirelli & C. S.p.A.
G.P. Energia S.r.l.	Enviroment	Rome	Euro	1,666,667	31.00%	Solar Utility S.p.A.
Idea Granda Società Consortile r.l.	Enviroment	Cuneo	Euro	1,292,500	49.00%	Pirelli & C. Ambiente S.p.A.
RCS MediaGroup S.p.A.	Finance Holding Company	Milan	Euro	762,019,050	5.33%	Pirelli & C. S.p.A.
Serenergy S.r.l.	Enviroment	Milan	Euro	25,500	50.00%	Pirelli & C. Ambiente S.p.A.
Romania						
S.C. Eco Anvelope S.A.	Tyre	Bucarest	Rom. Leu	160,000	20.00%	S.C. Pirelli Tyres Romania S.r.l.
Spain						
Signus Ecovalor S.L.	Tyre	Madrid	Euro	200,000	20.00%	Pirelli Neumaticos S.A.
North America						
U.S.A.						
CyOptics Inc.	Photonics	Breinigville	US $	631,352,501	34.41%	Pirelli & C. S.p.A.
Asia						
China						
Sino Italian Wire Technology Co. Ltd	Tyre	Yanzhou	Remimbi	227,500,000	49.00%	Pirelli Tyre S.p.A.

OTHER INVESTMENTS CONSIDERED SIGNIFICANT AS PER CONSOB RESOLUTION NO. 11971 OF MAY 14, 1999

Company	Business	Headquarters	Share	Capital	% holding	Held by
Europe						
Belgium						
Euroqube S.A. (in liquidazione)	Services	Brussels	Euro	84,861,116	17.79%	Pirelli & C. S.p.A.
France						
Aliapur S.A.	Tyre	Lion	Euro	262,500	14.29%	Pirelli Tyre S.p.A.
Hungary						
HUREC Tyre Recycling Public Benefit Company	Tyre	Budapest	Hun. Forint	50,000,000	17.00%	Pirelli Hungary Tyre Trading and Services Ltd
Italy						
Fin. Priv. S.r.l.	Financial	Milan	Euro	20,000	14.29%	Pirelli & C. S.p.A.
Poland						
Centrum Utylizacji Opon Organizacja Odzysku S.A.	Tyre	Warsaw	Pol. Zloty	1,008,000	14.29%	Pirelli Polska Sp. ZO.O.
Tunisia						
Société Tunisienne des Industries de Pnéumatiques S.A.	Tyre	Tunis	Tun. Dinar	12,623,472	15.83%	Pirelli Tyre S.p.A.
United Kingdom						
Tlcom I Ltd Partnership	Financial	London	Euro	1,204	10.39%	Pirelli Finance (Luxembourg) S.A.

CERTIFICATION OF THE CONSOLIDATED FINANCIAL STATEMENTS PURSUANT TO ARTICLE 154 BIS OF LEGISLATIVE DECREE 58 OF FEBRUARY 24, 1998, AND PURSUANT TO ARTICLE 81-TER OF CONSOB REGULATION NO. 11971 OF MAY 14, 1999, AS AMENDED

1. The undersigned Marco Tronchetti Provera, in his capacity as Chairman of the Board of Directors, and Francesco Tanzi, in his capacity as Corporate Financial Reporting Manager of Pirelli & C. S.p.A. hereby certify pursuant to, inter alia, Article 154-bis, clauses 3 and 4, of Legislative Decree 58 of February 24, 1998:

- the adequacy in relation to the characteristics of the company and
- the effective application

of the administrative and accounting procedures for preparation of the consolidated financial statements, during the period January 1, 2010 – December 31, 2010.

2. In this regard it should be noted that the adequacy of the administrative and accounting procedures for preparation of the consolidated financial statements for the year ended December 31, 2010 was determined on the basis of an assessment of the internal control system. This assessment was based on a specific process defined in accordance with the criteria laid down in the "*Internal Control – Integrated Framework*" guidelines issued by the "Committee of Sponsoring Organizations of the Treadway Commission" (COSO), which is a reference framework generally accepted at the international level.

3. We also certify that:

3.1 the consolidated financial statements:

a. were prepared in accordance with the applicable international accounting standards recognised in the European Union under the terms of Regulation (EC) 1606/2002 of the European Parliament and Council, of July 19, 2002;

b. correspond to the information in the account ledgers and books

c. give a true and fair view of the assets, liabilities, income, expenses and financial position of the reporting entity and of the Group of companies included in the scope of consolidation.

3.2 The report on operations includes a reliable analysis of the performance and results of operations, and of the situation of the reporting entity and of the Group of companies included in the scope of consolidation, together with a description of the principal risks and uncertainties to which they are exposed.

March 8, 2011

The Chairman of the Board of Directors

(Marco Tronchetti Provera)

The Corporate Financial Reporting Manager

(Francesco Tanzi)

INDEPENDENT AUDITOR'S REPORT

ERNST & YOUNG

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Independent auditors' report
pursuant to art. 14 and 16 of Legislative Decree n. 39 dated January 27, 2010
(Translation from the original Italian text)

To the Shareholders
of Pirelli & C. S.p.A.

1. We have audited the consolidated financial statements of Pirelli & C. S.p.A. and its subsidiaries (the "Pirelli & C. Group") as of and for the year ended December 31, 2010, comprising the balance sheet, the income statement, the statement of comprehensive income, the statement of changes in equity, the statement of cash flows and the related explanatory notes. The preparation of these financial statements in compliance with International Financial Reporting Standards as adopted by the European Union and with art. 9 of Legislative Decree n. 38/2005 is the responsibility of Pirelli & C. S.p.A.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. Our audit was performed in accordance with auditing standards recommended by CONSOB (the Italian Stock Exchange Regulatory Agency). In accordance with such standards, we planned and performed our audit to obtain the information necessary to determine whether the consolidated financial statements are materially misstated and if such financial statements, taken as a whole, may be relied upon. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, as well as assessing the appropriateness and correct application of the accounting principles and the reasonableness of the estimates made by management. We believe that our audit provides a reasonable basis for our opinion.

   For the opinion on the consolidated financial statements of the prior year, which are presented for comparative purposes, reference should be made to our report dated April 2, 2010. As described in the explanatory notes, management has restated certain comparative data related to the prior year with respect to the data previously presented, on which we issued our auditor's report dated April 2, 2010, to apply the International Financial Reporting Standard IFRS 5. We have examined the method used to restate the comparative financial data and the information presented in the explanatory notes in this respect, for the purpose of expressing our opinion on the consolidated financial statements as of and for the year ended December 31, 2010.

3. In our opinion, the consolidated financial statements of the Pirelli & C. Group as of December 31, 2010 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and with art. 9 of Legislative Decree n. 38/2005; accordingly, they present clearly and give a true and fair view of the financial position, the results of operations and the cash flows of the Pirelli & C. Group for the year then ended.

Reconta Ernst & Young S.p.A.
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4. The management of Pirelli & C. S.p.A. is responsible for the preparation of the Directors' Report on Operations in accordance with the applicable laws and regulations. Our responsibility is to express an opinion on the consistency with the financial statements of the Directors' Report on Operations and the specific section on Corporate Governance system and Ownership Structure, regarding the information included therein in compliance with art. 123-bis of Legislative Decree n. 58/1998, paragraph 1, letters c), d), f), l), m) and paragraph 2, letter b), as required by the law. For this purpose, we have performed the procedures required under Auditing Standard 001 issued by the Italian Accounting Profession (CNDCEC) and recommended by CONSOB. In our opinion, the Directors' Report on Operations and the information reported therein in compliance with art. 123-bis of Legislative Decree n. 58/1998, paragraph 1, letters c), d), f), l), m) and paragraph 2), letter b) included in the specific section of the report, are consistent with the consolidated financial statements of the Pirelli & C. Group as of December 31, 2010.

Milan, March 24, 2011

Reconta Ernst & Young S.p.A.
Signed by: Pietro Carena, Partner

EXTRAORDINARY PART

EXPLANATORY REPORT BY THE DIRECTORS AND PROPOSALS OF RESOLUTION

Report of the Board of Directors issued in accordance with Article 72, first paragraph, of Consob Regulation No. 11971 of May 14, 1999, as amended.

Dear Shareholders,

1. You have been convened also to attend this extraordinary meeting to discuss our proposal regarding (i) some amendments to the Company's By-Laws, (ii) the voluntary reduction of the share capital by the amount of € 32,498,345.12 pursuant to article 2445 of the Italian civil code, to be allocated to stockholders' equity; consequent amendments to article 5 of the By-Laws.

As regards the first proposal:

Amendment to articles 5 (Share Capital), 7 and 8 (Shareholders' Meeting), 10 and 11 (Management), 16 (Board of Statutory Auditors) of the By-Laws. Inherent and consequent resolutions.

1. THE REASONS FOR THE PROPOSED AMENDMENTS TO THE BY-LAWS

Firstly, we wish to recall that on January 27, 2010, Legislative Decree No. 27 (the "**Decree**") was approved. The Decree, implementing "*Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies*", has introduced some changes into the Italian Civil Code and into Legislative Decree No. 58 of February 24, 1998 ("**TUF**") with the aim of promoting the participation of shareholders in general meetings and of facilitating the exercise (including cross-border ambit) of the right to vote.

It should be recalled that the shareholders' meeting (resolution of April 21, 2010) has already incorporated in the Company's By-Laws the right - reintroduced into the Italian system by the said Decree - to call the meeting to approve the Financial Statements within 180 days after the end of the company's financial year (in lieu of the previous term of 120 days).

Furthermore, by virtue of the powers granted thereto (Article 2365, second paragraph, of the Italian Civil Code, art. 11.2 of the By-Laws), the Board of Directors of the Company (meeting of November 3, 2010) has approved some amendments to the By-Laws. In particular:

— following the entry into force of Legislative Decree No. 39 of January 27, 2010 (the so-called "Consolidating Act on Legal Revision"), the term "accounting audit" has been changed into "statutory audit";
— pursuant to the so-called "record date" mechanism, introduced for the first time into the Italian system by the said Decree, the term "shareholder" has been replaced with that of "holder of the right to vote". In fact, under the amended Article 2370 Italian Civil Code and the new art. *83-sexies* TUF, the subject who is entitled to participate in the general meeting and exercise his voting rights is no longer (only) that who, on the date of the meeting, is a shareholder of the company but that who holds the right to vote and intervene on the so-called "record date" (i.e. "*at the end of the accounting day of the seventh trading day preceding the date of the meeting to be held on first* [or single] *call*");
— since the new art. 135-novies, paragraph 6, TUF, has introduced the possibility of «*appointing a proxy holder by electronic means*» (according to rules to be prepared by the Minister of Justice) establishing that «*the companies indicate in their By-Laws at least one effective method of notification by electronic means of the proxy that shareholders are entitled to use*», Article 7.3 of the new By-Laws allows for the proxy itself to be notified via: (i) a dedicated section of the Company website or (ii) certified electronic mail;
— Article 7.5 of the By-Laws has been suited to Article *126-bis* TUF regarding (i) procedures and time limits that members must comply with to put new items on the agenda, and (ii) the report on the new items which the applying members propose to discuss;
— the time limits (from 15 days to 25 days before the meeting) for the submission of slates for the appointment of the Board of Directors (Article 10) and of the Board of Statutory Auditors (Article 16) have been changed.

At its meeting on March 8, 2011, the Board of Directors of the Company deemed it appropriate to make further amendments and additions to the By-Laws which, therefore, it now proposes to adopt. In particular, these proposals are intended to give effect to certain rights granted to companies as under the Decree. In order to fully understand the proposed amendments and the reasons thereof, please find below a description of the non-mandatory provisions contained in the aforementioned Decree.

a) Provisions contained in the Decree which we propose to adopt:

(i) MEETINGS HELD ON SINGLE CALL

The amended Article 2369 Italian Civil Code allows companies to "*exclude second or subsequent calls, establishing that the majorities indicated in the third and fourth paragraph [of art. 2369] as well as in the first paragraph, second sentence, of art. 2368, apply to single-call ordinary meetings, while the majorities laid down in the seventh paragraph* [of art. 2369] *apply to single-call extraordinary meetings*. In other words, companies can provide for a single call which the quorums reported below will apply to.

As for the ordinary meeting held on single call, this (i) will be duly constituted regardless of the capital represented at the meeting, and (ii) will decide by absolute majority, unless the By-Laws require a higher majority (the *quorums* for ordinary meetings held on second call will thus apply).
As for the extraordinary meeting held on single call, this will be duly constituted in the presence of members representing at least 1/5 of the share capital, unless the By-Laws require a higher capital share, and will decide with the favourable vote of at least 2/3 of the share capital represented at the meeting (the *quorums* for extraordinary meetings held on third and subsequent calls will thus apply).
The possibility of having a single-call meeting, with the application of the above mentioned *quorums*, is an opportunity to simplify the organizational activities of general meetings with potential cost savings benefits, and it facilitates the members' participation in general meetings because of the certainty as to the actual date thereof.
For this reason, we propose to incorporate this option in the By-Laws, subject to the possibility for the Board of Directors to call the general meeting more than once in case of circumstances where subsequent calls to the first one are appropriate.

(ii) Shareholders' representative designated by the company

The new art. 135-undecies TUF introduces into the Italian system the so-called "*designated representative*". In particular, unless otherwise provided in the By-Laws, "*listed companies designate for each general meeting a person who may be appointed as a proxy holder by the members by the end of the second trading day preceding the date of the meeting held on first or single call, with voting instructions for all or some of the items on the agenda*".
Although the decision as to the appointment of the "designated representative" for each general meeting may be completely excluded or referred to the Board of Directors, we propose to include an express provision in the By-Laws according to which, for each general meeting, one or more persons be (necessarily) designated who may be appointed as proxy holders by those entitled to participate in the general meeting, leaving it to the notice of call to set solely the method and time limits for the issue of such proxy. To include this statutory provision in the By-Laws underlines the importance given by the Company to this option to intervene in the general meeting, on the one hand, and allows the shareholder to become aware of this option by merely reading the By-Laws, on the other.

(iii) "Record date" and other amendments connected to the decree

As said above, the Decree has introduced for the first time into the Italian system the so-called "record date" mechanism, so that the person who is entitled to participate in the general meeting and exercise his voting rights is no longer (and necessarily) the person who, on the date of the meeting, is a shareholder of the Company; rather, the person who holds the right to vote and intervene in the meeting "*at the end of the accounting day of the seventh trading day preceding the date of the meeting to be held on first call*".
Given this innovative provision that substantially changes the mechanism of entitlement to attend general meetings, we propose to underline in the By-Laws the essential elements that characterize the so-called record date in order to make it easier for shareholders to understand its content.
For the same reason, we propose to underline in the By-Laws the main points regarding convocation of general meetings and the option of putting new items on the agenda.

b) Further proposals to amend the By-Laws which we propose to adopt

We also propose (i) to introduce an amendment related to the Company's adoption of the so-called "*Procedure for Related Party Transactions*" (see explanation below) and (ii) further amendments to refine the By-Laws and make them clearer, more systematic and complete, including minor changes of a purely terminological and/or formal nature.

* * * * *

For the sake of completeness, please find below the other provisions contained in the Decree which the Board of Directors has decided not to propose to adopt for the time being.

(i) Voting by electronic means

Under the new art. 2370, fourth paragraph, of the Italian Civil Code, the By-Laws may provide that votes may be cast by electronic means, as is already the case of postal voting.
Given the limited success of this option in the Italian experience and given, more importantly, the lack of a regulatory framework that fully and clearly regulates this issue, the Company has decided to postpone to a later stage its assessment as to the incorporation of this right in the By-Laws.

(ii) Dividend bonus

Pursuant to the new art. 127-*quater* TUF, the By-Laws may provide for the possibility of awarding to "*each share held by the same shareholder for an uninterrupted period*

[…] of not less than one year" the "*right to a bonus of up to 10 per cent of the dividend awarded to the other shares*".
This benefit is limited to those who (directly or indirectly) have a shareholding that does not exceed 0.5% of the company's capital (or the lower percentage indicated in the By-Laws).
The bonus cannot be attributed to (i) the shares held by those who during the said period have exercised, even temporarily or together with other members through a shareholders' agreement, a dominant influence or significant influence over the company, (ii) the shares that have been transferred, even temporarily, to a shareholders' agreement concerning a total shareholding of more than 0.5% (or the lower percentage indicated in the By-Laws).
The uncertainty that currently arises from the relevant regulatory framework and the difficulties encountered in applying in practice the dividend bonus mechanism (not least, the difficulty of identifying the persons entitled to the bonus), have induced the Board to postpone its evaluation to a later stage.

(iii) IDENTIFICATION OF SHAREHOLDERS

Under the new art. 83-duodecies TUF "*where provided by the By-Laws, Italian* [listed] *companies may ask intermediaries, at any time and at the former's own cost and through a central management company, for the identification data of shareholders who have not expressly prohibited disclosure thereof, together with the number of shares registered in their accounts*".
Where the By-Laws provide for this option, "*the company must make this request upon the demand of members representing half the minimum shareholding set by Consob*" for the submission of slates for the appointment of the management, and "costs are shared between the company and the requesting members according to criteria established by Consob".
In this latter regard, please note that the so-called Issuers' Regulations establish that "*if the right* [to identify shareholders] *is exercised by members within six months of year-end and in any case before the annual ordinary meeting and no request for identification is made in the same period […], the company shall bear the full cost of disclosure of the shareholder's identification data and of the number of shares registered in their accounts*".
Given (i) the absence of rules establishing, in a clear and comprehensive way, the concrete method which intermediaries must follow to determine the disclosure costs borne by issuers and (ii) the current shareholding structure of the Company that is "nominally" public for more than 50% of the share capital, the Board has decided to postpone its decision on the implementation of this right to a later stage.

* * * * *

Given that the general meeting that is called to approve the Financial Statements at December 31, 2010 is also required to decide on the renewal of the Board of Directors which has lost office due to expiry of its term, it is essential to give the following information.
According to Article 10, fifth paragraph, of the By-Laws, slates may be submitted only by members who, either alone or together with other members, hold shares representing at least 2% of the share capital with voting rights in the ordinary shareholders' meeting, or the minor percentage required by the regulations issued by Consob which, for the year 2011, was 1. 5% of the share capital (cfr. Consob Resolution No. 17633 of 26/01/2011).
The Board has deemed it appropriate not to propose to reduce the percentage established by the By-Laws in order to align it with that established by Consob since, on the one hand, the current formulation is already designed to facilitate the submission of slates by minorities for the renewal of Management bodies (establishing in any case a "cap" to the percentage required for the presentation of minority slates which, in any case, may be reduced according to an assessment of the parameters set by Consob, among which market capitalization) and, on the other hand, this allows for the By-Laws provision to be adequately flexible.

* * * * *

The following paragraphs describe in detail the amendments indicated above with reference to the single articles of the By-Laws.

ARTICLE 5 (SHARE CAPITAL)

The current Article 5, fourth paragraph, gives evidence (i) of the resolution adopted by the extraordinary shareholders' meeting of May 7, 2003 by which Directors were authorized to issue, on one or more occasions, up to a maximum of 100,000,000 ordinary shares to be allocated to executive managers and cadres of the company and its subsidiaries, and (ii) of the resolution adopted by the Board of Directors, in partial implementation of the authorization granted to it, to increase the share capital by issuing new ordinary shares to be reserved for subscription to executive managers and cadres of the company and its subsidiaries.
Having expired the authorization granted by the shareholders' meeting on May 7, 2003 and being terminated the stock option plans by which, as resolved by the Board of Directors, the share capital increase has been inplemented as under point (ii), we propose to fully amend the said paragraph 4 and thereby re-number the current paragraph 5.

ARTICLE 7 (SHAREHOLDERS' MEETINGS)

For the reasons outlined above, we propose to revise paragraph 2 of Article 7 of the By-Laws establishing that the Board of Directors may provide for the meeting to be held on single call or on more calls.
In the same article, we also propose to revise:

(i) in part and to supplement paragraph 3 of Article 7 in order to incorporate art. 135-*undecies*, paragraph 1 TUF, on the designation of the representative who may be appointed as a proxy holder with voting instructions by those entitled to vote;

(ii) paragraph 5 and to add the "new" paragraphs 6, 7, 8 and 9, which reaffirm the essential elements of the reformed regulations on the convocation of the general meeting and on the right to put new items on the agenda. As a result of these amendments, we propose to re-number paragraph 6 as paragraph 10.

ARTICLE 8 (SHAREHOLDERS' MEETINGS)

As stated above, the proposed amendments consist of introducing paragraphs 3, 4, 5 and 6, which state again the provisions of Art. 83-*sexies* TUF regarding the entitlement to attend the general meeting and the exercise of voting rights (the so-called "record date").

ARTICLE 10 (ADMINISTRATION OF THE COMPANY)

The proposed amendments to Article 10 are (i) designed to foster greater explanatory clarity, and/or of a purely formal nature or (ii) due to other changes proposed in this report (in particular, the inclusion in paragraph 3 of the reference to the general meeting held on single call).

ARTICLE 11 (ADMINISTRATION OF THE COMPANY)

On November 3, 2010, the Board of Directors approved a new "*Procedure for Related-Party Transactions*", published on the Company website in compliance with the prescriptions on this issue contained in the "*Regulation of related-party transactions*", adopted by Consob Resolution No. 17221 of March 12, 2010, as amended by Consob Resolution No. 17389 of June 23, 2010, taking into account the guidelines and clarifications provided by Consob in its Communication No. DEM/10078683 of September 24, 2010.
This Procedure includes the possibility (under article 13, sixth paragraph, of the said Regulation issued by Consob), in case of urgent matters, to enter into transactions with related parties of greater or lesser importance (as defined in the Procedure) by derogating from the respective authorization processes required therefor, provided this is allowed by the By-Laws and in cases where the transaction does not pertain to the Shareholders' meeting and needs not be approved thereby, subject to the obligations in terms of "information to the public about related-party transactions".
Therefore, we propose to introduce a new paragraph 3 which allows for the enforcement of this option.
Hence, we also propose to re-number the subsequent paragraphs of Article 11.

ARTICLE 16 (BOARD OF STATUTORY AUDITORS)

The proposed amendments concern the re-wording of paragraph 7, taking into account the provisions of art. 144-*sexies* of the Issuers' Regulations and art. 147-ter TUF) about disclosure of the slates presented by the shareholders to appoint the Statutory Auditors candidates.
Further amendments proposed in relation to Article 16 are (i) designed to foster greater explanatory clarity, and/or of a purely formal nature or (ii) due to other changes proposed in this report (in particular, also in this case, the inclusion in paragraph 7 of the reference to the general meeting held on single call).

2. COMPARED ILLUSTRATION OF THE ARTICLES OF THE BY-LAWS WHICH WE PROPOSE TO AMEND

The comparison between the current articles of the By-Laws which we propose to amend and those which we submit for your approval is contained in the following resolution proposal.

3. EVALUATION BY THE BOARD OF DIRECTORS AS TO THE POTENTIAL ENFORCEABILITY OF THE RIGHT OF WITHDRAWAL

The Board of Directors believes that the amendments to the By-Laws described above do not give rise to the right of withdrawal as under Article 2437 Italian Civil Code.

4. RESOLUTION PROPOSAL

Based on the foregoing, the Board of Directors submits the following resolution proposals for your approval:

"The extraordinary shareholders' meeting of Pirelli & C. S.p.A.,

— having examined the Directors' Report explaining the proposed amendments to Articles 5 (Share capital), 7 and 8 (Shareholders' meetings), 10 and 11 (Administration of the company), 16 (Board of Statutory Auditors) of the By-Laws;

RESOLVES

1. to amend Articles 5 (Share capital), 7 and 8 (Shareholders' meetings), 10 and 11 (Administration of the company), 16 (Board of Statutory Auditors) of the By-Laws of Pirelli & C. S.p.A. as follows:

TEXT IN FORCE

Article 5

5.1 The Company shall have a subscribed and paid-in share capital of EUR 1,377,878,879.78 (onebillionthreehundredandseventysevenmillioneighthundredandseventyeightthousandeighthundredseventyninepointseventyeight) divided into no. 487,991,493 (fourhundredeightysevenmillionninehundredninetyonethousandfourhundrednineythree) shares without par value consisting of 475,740,182 (fourhundredseventyfivemillionsevenhundredfortythousandonehundredeighty) ordinary shares and 12,251,311 (twelvemilliontwohundredfiftyonethousandthreehundred-eleven) savings shares.

5.2 In resolutions to increase the share capital by issuing shares against payment, pre- emption right may be excluded for up to a maximum of ten percent of the previously existing capital, provided that the issue price corresponds to the market value of the shares and that this is confirmed in a specific report prepared by the firm appointed to audit the accounts.

5.3 If so resolved by the shareholders' meeting, the share capital may also be increased by means of contributions in kind or of receivables.

5.4 By resolution of the extraordinary shareholders' meeting held on May 7, 2003, the directors were authorised to issue, on one or more occasions within April 30, 2008, up to a maximum of 100,000,000 ordinary shares, to be allocated to executive managers and cadres employed by the Company, by its subsidiaries and by the subsidiaries of the latter, in Italy and abroad, in compliance with article 2441, paragraph 8, of the Italian Civil Code and article 134 of Legislative Decree no. 58/1998. On February 25, 2005 the Board of Directors resolved, in partial implementation of the authorisation granted to it by the extraordi-

SUGGESTED TEXT

Article 5

5.1 The Company shall have a subscribed and paid-in share capital of EUR 1,377,878,879.78 (onebillionthreehundredandseventysevenmillioneighthundredandseventyeightthousandeighthundredseventyninepointseventyeight) divided into no. 487,991,493 (fourhundredeightysevenmillionninehundredninetyonethousandfourhundrednineythree) shares without par value consisting of 475,740,182 (fourhundredseventyfivemillionsevenhundredfortythousandonehundredeighty) ordinary shares and 12,251,311 (twelvemilliontwohundredfiftyonethousandthreehundred-eleven) savings shares.

5.2 In resolutions to increase the share capital by issuing shares against payment, pre- emption right may be excluded for up to a maximum of ten percent of the previously existing capital, provided that the issue price corresponds to the market value of the shares and that this is confirmed in a specific report prepared by the firm appointed to audit the accounts.

5.3 If so resolved by the shareholders' meeting, the share capital may also be increased by means of contributions in kind or of receivables.

TEXT IN FORCE

nary shareholders' meeting held on May 7, 2003, to increase the share capital by a maximum nominal amount of EUR 15,725,496.50, re-determined as EUR 15,725,494.18 after the reverse stock split in a ratio of 1 new share for every 11 ordinary or savings shares held, resolved by the extraordinary shareholders meeting held on July 15, 2010, by issuing, taking account of said reverse stock split and of the reduction of share capital through assignment of Pirelli & C. Real Estate S.p.A. shares resolved by the extraordinary shareholders' meeting held on July 15, 2010, a maximum of 4,929,622 ordinary shares without par value, at a price of EUR 10.589 per share, inclusive of a EUR 7.399 share premium and EUR 3.190 to impute to capital, to be reserved for subscription by executive managers and cadres employed by the Company, by its subsidiaries and by the latter's subsidiaries, in Italy and abroad.

5.5 If resolved by the Shareholders' Meeting, the share capital may be reduced also by assignment of non-cash assets to the shareholders.

Article 7

7.1 The calling of shareholders' meetings, which may be held anywhere in Italy, including in a place other than the Company's registered office, the right to attend meetings and representation at same are all regulated by law and by these By-laws.

7.2 The notice of call of an extraordinary shareholders' meeting may provide for it being held on third call.

7.3 Persons with voting rights are entitled to attend the meeting and may appoint a representative by proxy issued as provided by the current law and regulations.
The proxy may be notified to the Company by electronic means, making alternative use of one of the following methods:
a) use of the dedicated section of the Company website, indicated by the Company in the notice of call;
b) dispatch of a message to the certified electronic mail address at the address indicated by the Company in the notice of call.
The notice of call may also circumscribe the method to be used for the specific shareholders' meeting to which the notice refers to one of the aforementioned methods.

SUGGESTED TEXT

5.4 If resolved by the Shareholders' Meeting, the share capital may be reduced also by assignment of non-cash assets to the shareholders.

Article 7

7.1 The calling of shareholders' meetings, which may be held anywhere in Italy, including in a place other than the Company's registered office, the right to attend meetings and representation at same are all regulated by law and by these By-laws.

7.2 The notice of call of the meeting may provide **for it being held on single call or on first and second call and**, in case of an extraordinary shareholders' meeting, also on third call. **The corresponding resolutions are adopted by the majorities required by law for meetings held on single call or on different calls**.

7.3 Persons with voting rights may appoint a representative by proxy issued as provided by the current law and regulations.
The proxy may be notified to the Company by electronic means, making alternative use of one of the following methods:
a) use of the dedicated section of the Company website, indicated by the Company in the notice of call;
b) dispatch of a message to the certified electronic mail address at the address indicated by the Company in the notice of call.
The notice of call may also circumscribe the method to be used for the specific shareholders' meeting to which the notice refers to one of the aforementioned methods.
The Company designates, for each general meeting, one or more persons who may be

TEXT IN FORCE	SUGGESTED TEXT
	appointed as a proxy holder by those entitled to vote at the meeting, with voting instructions for all or some of the items on the agenda. The proxy has no effect with respect to the items for which no voting instructions have been given. The designated proxy holders, the method and time limits for the issue of proxies are set in the notice of call.
7.4 The ordinary shareholders' meeting must be called in accordance with the law within a maximum of 180 days after the end of the Company's financial year.	7.4 The ordinary shareholders' meeting must be called in accordance with the law within a maximum of 180 days after the end of the Company's financial year.
7.5 Requests to add items to the agenda of the general meetings presented by shareholders in accordance with the law must be detailed, by the same shareholders, with a report to the Board of Directors filed at the Company's registered office before the last date indicated for submission of the request for additions to be made to the agenda.	7.5 **The directors, in the cases and manners provided by law, must forthwith call the general meeting when this is required by members representing at least a twentieth of the share capital.**
	7.6 **The members who require the meeting to be called prepare a report on the proposed items to be discussed. The Board of Directors, together with the publication of the notice of call and in the manner prescribed by law, makes available to the public the report prepared by the members, along with its potential assessment thereof.**
	7.7 **The members who, even together, represent at least one fortieth of the share capital may ask, in the cases and in the manner prescribed by law, to add items to the agenda, specifying in their request the new items proposed thereby.**
	7.8 **The new items submitted under paragraph 7 of Article 7 of these By-Laws, are published, according to the provisions of law, in the same manner prescribed for the publication of the notice of call.**
	7.9 **The members who ask to put new items on the agenda prepare a report on the items which they propose to discuss, and deliver it to the Board of Directors by filing it at the Company's offices before the last date indicated for submission of the request for additions to be made to the agenda. The Board of Directors, simoultaneously to the publication of the notice of additions to the agenda and in the manner prescribed by law, makes available to the public the report prepared by the members, along with its potential assessment thereof.**
7.6 Special meetings of savings shareholders shall be convened by the common representative of savings shareholders or by the Board of Directors of the Company whenever they deem necessary or in accordance with the law.	7.10 Special meetings of savings shareholders shall be convened by the common representative of savings shareholders or by the Board of Directors of the Company whenever they deem necessary or in accordance with the law..

TEXT IN FORCE

Article 8

8.1 The due constitution of shareholders' meetings and the validity of the resolutions adopted by same are governed by law.

8.2 The proceedings of shareholders meetings are governed by law, by these By-laws, and – solely for the ordinary and extraordinary general meetings – by the Rules of Proceeding approved by resolution of the Company's ordinary shareholders meeting.

Article 10

10.1 The Company shall be managed by a Board of Directors composed of no less than seven and no more than twenty three members who shall remain in office for three financial years (unless the shareholders' meeting establishes a shorter term at the time of their appointment) and may be re-elected.
The shareholders' meeting shall establish the number of members of the Board of Directors, which shall remain unchanged until said meeting resolves otherwise.

SUGGESTED TEXT

Article 8

8.1 The due constitution of shareholders' meetings and the validity of the resolutions adopted by same are governed by law.

8.2 The proceedings of shareholders meetings are governed by law, by these By-laws, and – solely for the ordinary and extraordinary general meetings – by the Rules of Proceeding approved by resolution of the Company's ordinary shareholders meeting.

8.3 **The right to attend the general meeting and to exercise voting rights is governed by the applicable provisions of law.**

8.4 **The right to attend the general meeting and to exercise voting rights is certified by a notice given to the Company by the authorized intermediary, in accordance with its accounting records, in favour of the person who is entitled to vote.**

8.5 **The notice referred to in paragraph 4 of Article 8 of these By-Laws is given by the intermediary on the basis of evidence relating to the end of the accounting day of the seventh trading day preceding the date of the meeting to be held on first or single call. The credit and debit recordings made on the accounts after that term are not relevant for the purposes of the right to exercise voting rights at the general meeting.**

8.6 **The notice referred to in paragraph 4 of Article 8 of these By-Laws must be received by the Company by the end of the third trading day preceding the date of the meeting to be held on first or single call or within the different deadline established by the applicable regulations. This is without prejudice to the right to participate in the meeting and to vote where the notice referred to in paragraph 4 of Article 8 of these By-Laws is received by the Company after the deadline specified in this paragraph though prior to the beginning of the meeting held on single call.**

Article 10

10.1 The Company shall be managed by a Board of Directors composed of no less than seven and no more than twenty three members who shall remain in office for three financial years (unless the shareholders' meeting establishes a shorter term at the time of their appointment) and may be re-elected.
The shareholders' meeting **establishes** the number of members of the Board of Directors, which **remains** unchanged until said meeting resolves otherwise.

TEXT IN FORCE	SUGGESTED TEXT
10.2 The Board of Directors shall be appointed on the basis of slates presented by the shareholders pursuant to the following paragraphs hereof, in which the candidates are listed by consecutive number.	10.2 The Board of Directors **is appointed** on the basis of slates presented by the shareholders pursuant to the following paragraphs hereof, in which the candidates **are** listed by consecutive number.
10.3 The slates presented by the shareholders, which must be undersigned by the parties submitting them, shall be filed at the Company's registered office, and be available at least twenty five days before the date set for the shareholders' meeting to be held on first call. They are made available to the public at the registered office, on the Company website and in the other ways specified by Consob regulations at least 21 days before the date of the general meeting.	10.3 The slates presented by the shareholders, which **must be** undersigned by the parties submitting them, must be filed at the Company's registered office, and be available at least twenty five days before the date set for the shareholders' meeting to be held on first **or single** call **that is required to decide upon the appointment of the members of the Board of Directors**. They are made available to the public at the registered office, on the Company website and in the other ways specified by Consob regulations at least 21 days before the date of the general meeting.
10.4 Each shareholder may present or take part in the presentation of only one slate and each candidate may appear on only one slate on pain of ineligibility.	10.4 Each shareholder **may** present or take part in the presentation of only one slate and each candidate **may** appear on only one slate on pain of ineligibility.
10.5 Only shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 2 percent of the share capital entitled to vote at the ordinary shareholders' meeting or the minor percentage, according to the regulations issued by Commissione Nazionale per le Società e la Borsa, are entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates within the term specified for their publication by the Company.	10.5 Only shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 2 percent of the share capital entitled to vote at the ordinary shareholders' meeting or the minor percentage, according to the regulations issued by Commissione Nazionale per le Società e la Borsa, are entitled to submit slates, subject to their proving ownership of the number of shares needed for the presentation of slates within the term specified for their publication by the Company.
10.6 Together with each slate, and within the respective terms specified above, statements must be filed in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet any requisites prescribed for the positions. Together with such statements, a curriculum vitae must be filed for each candidate, setting out their relevant personal and professional data and mentioning the offices held in management and supervisory bodies of other companies and specifying, where appropriate, the grounds on which they qualify as an independent candidate in accordance with the criteria established by law and the Company. Any changes that occur up to the date of the Shareholders' meeting must be promptly notified to the Company.	10.6 Together with each slate, statements **must be** filed in which the individual candidates agree to their nomination and attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet any requisites prescribed for the positions. Together with such statements, a curriculum vitae **must be** filed for each candidate, **including** their relevant personal and professional data and mentioning the offices held in management and supervisory bodies of other companies and **their satisfaction of the requisites of independence prescribed for directors of listed companies by the law or by the governance code endorsed by the Company**. Any changes that occur up to the date of the Shareholders' meeting must be promptly notified to the Company.
10.7 Any slates submitted without complying with the foregoing provisions shall be disregarded.	10.7 Any slates submitted without complying with the foregoing provisions shall be disregarded.
10.8 Each person entitled to vote may vote for only one slate.	10.8 Each person entitled to vote **may** vote for only one slate.
10.9 The Board of Directors shall be elected as specified below: **a)** four-fifths of the directors to be elected shall be chosen from the slate which obtains the highest number of votes cast by the shareholders, in the	10.9 The Board of Directors **is elected** as specified below: **a)** four-fifths of the directors to be elected **are** chosen from the slate which **obtains** the highest number of votes cast by the shareholders, in the

TEXT IN FORCE

order in which they are listed on the slate; in the event of a fractional number, it shall be rounded-down to the nearest whole number;

b) the remaining directors shall be chosen from the other slates; to this end, the votes obtained by the various slates shall be divided by whole progressive numbers from one up to the number of directors to be elected.

The quotients thus obtained shall be assigned to the candidates on each slate in the order they are respectively listed thereon. On the basis of the quotients assigned, the candidates on the various slates shall be ranked in a single list in decreasing order. Those who have obtained the highest quotient shall be elected. If more than one candidate obtains the same quotient, the candidate from the slate that has not yet elected a director or that has elected the lowest number of directors shall be elected. If none of such slates has as yet elected a director or they have all elected the same number of directors, the candidate from the slate which obtained the highest number of votes shall be elected. If the different slates obtain the same number of votes and their candidates are assigned the same quotients, a new vote shall be held by the entire shareholders' meeting and the candidate who obtains the simple majority of the votes shall be elected.

10.10 If the application of the slate voting system shall not ensure the appointment of the minimum number of independent Directors required by the law and/or regulation, the appointed non-independent candidate indicated with the higher progressive number in the slate which has obtained the higher number of votes shall be replaced by the non-appointed independent candidate included in the same slate on the basis of the progressive order of the presentation and so on, slate by slate, until the minimum number of independent Directors shall be appointed.

10.11 When appointing directors who, for whatsoever reason were not appointed under the procedure established herein, the shareholders' meeting shall vote on the basis of the majorities required by law.

10.12 If one or more vacancies occur on the Board during the course of the financial year, the procedure established in article 2386 of the Italian Civil Code shall be followed.

10.13 In the event a Director cease to comply with the independence requirements, this does not cause his/her ceasing to be a Director provided that the Directors in office complying with legal independence requirements are a number at least equal to the minimum number requested by laws and/or regulations.

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order in which they are listed on the slate; in the event of a fractional number, it **is** rounded-down to the nearest whole number;

b) the remaining directors **are** chosen from the other slates; to this end, the votes obtained by the various slates **are** divided by whole progressive numbers from one up to the number of directors to be elected. The quotients thus obtained are assigned to the candidates on each slate in the order they are respectively listed thereon. On the basis of the quotients assigned, the candidates on the various slates are ranked in a single list in decreasing order. Those who have obtained the highest quotient **are** elected.

If more than one candidate obtains the same quotient, the candidate from the slate that has not yet elected a director or that has elected the lowest number of directors **is** elected.

If none of such slates has as yet elected a director or they have all elected the same number of directors, the candidate from the slate which obtained the highest number of votes **is** elected. If the different slates obtain the same number of votes and their candidates are assigned the same quotients, a new vote **is** held by the entire shareholders' meeting and the candidate who obtains the simple majority of the votes **is** elected.

10.10 If the application of the slate voting system shall not ensure the appointment of the minimum number of independent Directors required by the law and/or regulation, the appointed non-independent candidate indicated with the higher progressive number in the slate which has obtained the higher number of votes is replaced by the non-appointed independent candidate included in the same slate on the basis of the progressive order of the presentation and so on, slate by slate, until the minimum number of independent Directors shall be appointed.

10.11 When appointing directors who, for whatsoever reason were not appointed under the procedure established herein, the shareholders' meeting shall vote on the basis of the majorities required by law.

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10.13 In the event a Director cease to comply with the independence requirements, this does not cause his/her ceasing to be a Director provided that the Directors in office complying with legal independence requirements are a number at least equal to the minimum number requested by laws and/or regulations.

TEXT IN FORCE	SUGGESTED TEXT
10.14 The Board of Directors shall elect its own Chairman, if the shareholders' meeting has not already done so, and may also appoint one or more Deputy Chairmen.	10.14 The Board of Directors shall elect its own Chairman, if the shareholders' meeting has not already done so, and may also appoint one or more Deputy Chairmen.
10.15 In the absence of the Chairman, a Deputy Chairman or a Managing Director, in that order, shall act in his/her stead; should there be two or more Deputy Chairmen or Managing Directors, the Board shall be presided over by the elder of same respectively.	10.15 In the absence of the Chairman, a Deputy Chairman or a Managing Director, in that order, shall act in his/her stead; should there be two or more Deputy Chairmen or Managing Directors, the Board shall be presided over by the elder of same respectively.
10.16 The Board of Directors shall appoint a Secretary, who need not be a director.	10.16 The Board of Directors shall appoint a Secretary, who need not be a director.
10.17 Until the shareholders' meeting resolves otherwise, the directors shall not be subject to the prohibition contemplated in article 2390 of the Italian Civil Code.	10.17 Until the shareholders' meeting resolves otherwise, the directors shall not be subject to the prohibition contemplated in article 2390 of the Italian Civil Code.
Article 11	**Article 11**
11.1 The Board of Directors shall conduct the management of the company and is accordingly vested with the broadest powers of administration, except for those remitted by law or by these By-laws to the authority of the shareholders' meeting.	11.1 The Board of Directors shall conduct the management of the company and is accordingly vested with the broadest powers of administration, except for those remitted by law or by these By-laws to the authority of the shareholders' meeting.
11.2 Within the limits established by law, the Board of Directors shall be authorised to decide on the merger of companies in Pirelli & C. S.p.A. or demerger in favour of Pirelli & C. S.p.A of companies in which Pirelli & C. S.p.A. owns at least 90 percent of the shares or quotas, the reduction of the share capital in the event of the withdrawal of shareholders, the revision of the By-laws to conform with statutory provisions, the relocation of the Company's registered office within Italy, and the opening and closing of branch offices.	11.2 Within the limits established by law, the Board of Directors shall be authorised to decide on the merger of companies in Pirelli & C. S.p.A. or demerger in favour of Pirelli & C. S.p.A of companies in which Pirelli & C. S.p.A. owns at least 90 percent of the shares or quotas, the reduction of the share capital in the event of the withdrawal of shareholders, the revision of the By-laws to conform with statutory provisions, the relocation of the Company's registered office within Italy, and the opening and closing of branch offices.
	11.3 **In case of urgent matters, transactions with related parties of greater or lesser importance, as defined in the Procedure for related-party transactions adopted by the Board of Directors of the Company, which do not pertain to the shareholders' meeting and need not be approved thereby, may be entered into also by derogating from the respective authorization processes required in the Procedure, as long as this happens at the terms laid down therein**.
11.3 The Board of Directors and the Board of Statutory Auditors shall be kept informed, also by corporate bodies with delegated powers, on the activities carried out, the general performance of operations and their foreseeable development, and the transactions of greatest economic, financial and equity-related significance concluded by the Company or its subsidiaries; in particular, said corporate bodies with delegated powers shall report on transactions in which they have an interest, directly or on behalf	11.4 The Board of Directors and the Board of Statutory Auditors shall be kept informed, also by corporate bodies with delegated powers, on the activities carried out, the general performance of operations and their foreseeable development, and the transactions of greatest economic, financial and equity-related significance concluded by the Company or its subsidiaries; in particular, said corporate bodies with delegated powers shall report on transactions in which they have an interest, directly or on be-

TEXT IN FORCE

of third parties, or that are influenced by the party that performs management and coordination activities, if any. Such reports shall be made promptly, on a quarterly basis at the least, in a written memorandum.

11.4 In accordance with the established times and procedures for disclosing information to the market, the representative of the holders of savings shares must be informed by the Board of Directors or by the persons delegated for such purpose about any corporate events that might affect the price of the shares in that class.

11.5 In the context of the management of the Company, the Board of Directors shall be authorised to delegate those powers which it deems appropriate to one or more of its members, possibly with the title of Managing Director, and grant them the single or joint signature powers it decides appropriate to establish.

11.6 It may also delegate its powers to an Executive Committee composed of some of its own members, whose remuneration shall be established by the shareholders' meeting.

11.7 It may also establish one or more committees with consulting and propositional functions, also for purposes of adjusting the corporate governance structure in line with the recommendations issued from time to time by the pertinent authorities.

11.8 The Board of Directors shall appoint - with the consent of the Board of Statutory Auditors - the manager responsible for preparing the Company's financial reports. His office shall expire at the same time as that of the Board of Directors that appointed him/her, unless annulment for good cause, with the consent of the Board of Statutory Auditors.

11.9 The manager responsible for preparing the Company's financial reports must be an expert on administration, finances and auditing of companies and satisfy the integrity qualifications required to be a directors. Failing of such qualifications shall determine the termination of the office to be resolved by the Board of Directors within thirty days since the acknowledgement of the defect.

11.10 Lastly, the Board may appoint general managers, deputy general managers, managers and deputy managers and attorneys-in-fact to carry out certain operations or categories of operations, establishing their powers and functions. The appointment of managers, deputy managers and attorneys-in-fact to carry out certain operations or categories of operations may also be remitted by the Board to the Managing Directors and the General Managers.

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half of third parties, or that are influenced by the party that performs management and coordination activities, if any. Such reports shall be made promptly, on a quarterly basis at the least, in a written memorandum.

11.5 In accordance with the established times and procedures for disclosing information to the market, the representative of the holders of savings shares must be informed by the Board of Directors or by the persons delegated for such purpose about any corporate events that might affect the price of the shares in that class.

11.6 In the context of the management of the Company, the Board of Directors shall be authorised to delegate those powers which it deems appropriate to one or more of its members, possibly with the title of Managing Director, and grant them the single or joint signature powers it decides appropriate to establish.

11.7 It may also delegate its powers to an Executive Committee composed of some of its own members, whose remuneration shall be established by the shareholders' meeting.

11.8 It may also establish one or more committees with consulting and propositional functions, also for purposes of adjusting the corporate governance structure in line with the recommendations issued from time to time by the pertinent authorities.

11.9 The Board of Directors shall appoint - with the consent of the Board of Statutory Auditors - the manager responsible for preparing the Company's financial reports. His office shall expire at the same time as that of the Board of Directors that appointed him/her, unless annulment for good cause, with the consent of the Board of Statutory Auditors.

11.10 The manager responsible for preparing the Company's financial reports must be an expert on administration, finances and auditing of companies and satisfy the integrity qualifications required to be a directors. Failing of such qualifications shall determine the termination of the office to be resolved by the Board of Directors within thirty days since the acknowledgement of the defect.

11.11 Lastly, the Board may appoint general managers, deputy general managers, managers and deputy managers and attorneys-in-fact to carry out certain operations or categories of operations, establishing their powers and functions. The appointment of managers, deputy managers and attorneys-in-fact to carry out certain operations or categories of operations may also be remitted by the Board to the Managing Directors and the General Managers.

TEXT IN FORCE

Article 16

16.1 The Board of Statutory Auditors shall be composed of three standing and two alternate auditors, who must be in possession of the requisites established under applicable laws and regulations; to this end, it shall be borne in mind that the fields and sectors of business closely connected with those of the Company are those stated in the Company's purpose, with particular reference to companies or corporations operating in the financial, industrial, banking, insurance and real estate sectors and in the services field in general.

16.2 The ordinary shareholders' meeting shall elect the Board of Statutory Auditors and determine its remuneration. The minority shareholders shall be entitled to appoint one standing auditor and one alternate auditor.

16.3 The Board of Statutory Auditors shall be appointed in compliance with applicable laws and regulations and with the exception of the provisions of the third-to-last paragraph of this article 16, on the basis of slates presented by the shareholders in which candidates are listed by consecutive number.

16.4 Each slate shall contain a number of candidates which does not exceed the number of members to be appointed.

16.5 Shareholders who, alone or together with other shareholders, represent at least 1,5 percent of the shares with voting rights in the ordinary shareholders' meeting or the minor percentage, according to the regulations issued by Commissione Nazionale per le Società e la Borsa for the submission of slates for the appointment of the Board of Directors shall be entitled to submit slates.

16.6 Each shareholder may present or take part in the presentation of only one slate.

16.7 The slates of candidates, which must be undersigned by the parties submitting them, shall be filed in the Company's registered office at least twenty five days prior to the date set for the shareholders' meeting to be held on first call except for those cases in which the law and/or the regulation provide an extension of the deadline.

Without limitation to any further documentation required by applicable rules, including any regulatory provisions, a personal and professional curriculum, mentioning also the offices held in management and supervisory bodies of other companies, of the individuals standing for election must be enclosed with the slates together with statements in which the individual candidates agree to:

— their nomination

— attest, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet the requisites pre-

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Article 16

16.1 The Board of Statutory Auditors shall be composed of three standing and two alternate auditors, who must be in possession of the requisites established under applicable laws and regulations; to this end, it shall be borne in mind that the fields and sectors of business closely connected with those of the Company are those stated in the Company's purpose, with particular reference to companies or corporations operating in the financial, industrial, banking, insurance and real estate sectors and in the services field in general.

16.2 The ordinary shareholders' meeting shall elect the Board of Statutory Auditors and determine its remuneration. The minority shareholders shall be entitled to appoint one standing auditor and one alternate auditor.

16.3 The Board of Statutory Auditors shall be appointed in compliance with applicable laws and regulations and with the exception of the provisions of **paragraph 17** of this article 16, on the basis of slates presented by the shareholders in which candidates are listed by consecutive number.

16.4 Each slate shall contain a number of candidates which does not exceed the number of members to be appointed.

16.5 Shareholders who, alone or together with other shareholders, represent at least 1,5 percent of the shares with voting rights in the ordinary shareholders' meeting or the minor percentage, according to the regulations issued by Commissione Nazionale per le Società e la Borsa for the submission of slates for the appointment of the Board of Directors shall be entitled to submit slates.

16.6 Each shareholder **may** present or take part in the presentation of only one slate.

16.7 The slates of candidates, which must be undersigned by the parties submitting them, shall be filed in the Company's registered office at least twenty five days prior to the date set for the shareholders' meeting to be held on first **or single** call **that is required to decide upon the appointment of the members of the Board of Statutory Auditors**, except for those cases in which the law and/or the regulation provide an extension of the deadline. **They are made available to the public at the registered office, on the Company website and in the other ways specified by Commissione nazionale per la Società e la Borsa regulations at least 21 days before the date of the general meeting**.

Without limitation to any further documentation required by applicable rules, including any regulatory provisions, a personal and professional curriculum **including also** the offices held in management and

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scribed by law, by these By-laws and by regulation for the position.

Any changes that occur up to the date of the Shareholders' meeting must be promptly notified to the Company.

16.8 Any slates submitted without complying with the foregoing provisions shall be disregarded.

16.9 Each candidate may appear on only one slate, on pain of ineligibility.

16.10 The slates shall be divided into two sections: one for candidates for the position of standing Auditor and one for candidates for the position of alternate Auditor. The first candidate listed in each section must be selected from among the persons enrolled in the Register of Auditors who have worked on statutory audits for a period of no less than three years.

16.11 Each person entitled to vote may vote for only one slate.

16.12 The Board of Statutory Auditors shall be elected as specified below:

a) two standing members and one alternate member shall be chosen from the slate which obtains the highest number of votes (known as the majority slate), in the consecutive order in which they are listed thereon;

b) the remaining standing member and the other alternate member shall be chosen from the slate which obtains the highest number of votes cast by the shareholders after the first slate (known as the minority slate), in the consecutive order in which they are listed thereon; if several slates obtain the same number of votes, a new vote between said slates will be cast by all those entitled to vote attending the meeting, and the candidates on the slate which obtains the simple majority of the votes will be elected.

16.13 The chair of the Board of Statutory Auditors shall pertain to the standing member listed as the first candidate on the minority slate.

16.14 The position of a standing auditor which falls vacant due to his/her death, forfeiture or resignation shall be filled by the alternate auditor chosen from the same slate as the former. In the event of the replacement of the Chairman of the Board of Statutory Auditors, the chair shall pertain to the candidate listed in the same slate of the former Chairman, following the order contained in the list; if it proves impos-

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supervisory bodies of other companies, of the individuals standing for election must **accompany** the slates together with the statements in which the individual candidates agree to:

— their nomination
— declare, under their own liability, that there are no grounds for their ineligibility or incompatibility, and that they meet the requisites prescribed by law, by these By-laws and by regulation for the position.

Any changes that occur up to the date of the Shareholders' meeting must be promptly notified to the Company.

16.8 Any slates submitted without complying with the foregoing provisions shall be disregarded.

16.9 Each candidate may appear on only one slate, on pain of ineligibility.

16.10 The slates shall be divided into two sections: one for candidates for the position of standing Auditor and one for candidates for the position of alternate Auditor. The first candidate listed in each section must be selected from among the persons enrolled in the Register of Auditors who have worked on statutory audits for a period of no less than three years.

16.11 Each person entitled to vote may vote for only one slate.

16.12 The Board of Statutory Auditors shall be elected as specified below:

a) two standing members and one alternate member shall be chosen from the slate which obtains the highest number of votes (known as the majority slate), in the consecutive order in which they are listed thereon;

b) the remaining standing member and the other alternate member shall be chosen from the slate which obtains the highest number of votes cast by the shareholders after the first slate (known as the minority slate), in the consecutive order in which they are listed thereon; if several slates obtain the same number of votes, a new vote between said slates will be cast by all those entitled to vote attending the meeting, and the candidates on the slate which obtains the simple majority of the votes will be elected.

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TEXT IN FORCE

sible to effect substitutions and replacements under the foregoing procedures, a shareholders' meeting shall be called to complete the Board of Statutory Auditors which shall adopt resolutions by relative majority vote.

16.15 When the shareholders' meeting is required, pursuant to the provisions of the foregoing paragraph or to the law, to appoint the standing and/or alternate members needed to complete the Board of Statutory Auditors, it shall proceed as follows: if auditors elected from the majority slate have to be replaced, the appointment shall be made by relative majority vote without slate constraints; if, however, auditors elected from the minority slate have to be replaced, the shareholders' meeting shall replace them by relative majority vote, selecting them where possible from amongst the candidates listed on the slate on which the auditor to be replaced appeared and in any event in accordance with the principle of necessary representation of minorities to which this By Laws ensure the right to take part to the appointment of the Board of Statutory Auditors.
The principle of necessary representation of minorities shall be considered complied with in the event of the appointment of Statutory Auditors nominated before in the minority slate or in slates different other than the one which obtained the highest number of votes in the context of the appointment of the Board of Statutory Auditors.

16.16 In case only one slate has been presented, the shareholders' meeting shall vote on it; if the slate obtains the relative majority, the candidates listed in the respective section shall be appointed to the office of standing auditors and alternate auditors; the candidate listed at the first place in the slate shall be appointed as Chairman of the Board of Statutory Auditors.

16.17 When appointing auditors who, for whatsoever reason, were not appointed under the procedures established herein, the shareholders' meeting shall vote on the basis of the majorities required by law.

16.18 Outgoing members of the Board of Statutory Auditors may be re-elected to office.

16.19 Meetings of the Board of Statutory Auditors may, if the Chairman or whoever acts in his/her stead verifies the necessity, be attended by means of telecommunications systems that permit all attendees to participate in the discussion and obtain information on an equal basis.

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impossible to effect substitutions and replacements under the foregoing procedures, a shareholders' meeting shall be called to complete the Board of Statutory Auditors which shall adopt resolutions by relative majority vote.

16.15 When the shareholders' meeting is required, pursuant to the provisions of the foregoing paragraph or to the law, to appoint the standing and/or alternate members needed to complete the Board of Statutory Auditors, it shall proceed as follows: if auditors elected from the majority slate have to be replaced, the appointment shall be made by relative majority vote without slate constraints; if, however, auditors elected from the minority slate have to be replaced, the shareholders' meeting shall replace them by relative majority vote, selecting them where possible from amongst the candidates listed on the slate on which the auditor to be replaced appeared and in any event in accordance with the principle of necessary representation of minorities to which this By Laws ensure the right to take part to the appointment of the Board of Statutory Auditors.
The principle of necessary representation of minorities shall be considered complied with in the event of the appointment of Statutory Auditors nominated before in the minority slate or in slates different other than the one which obtained the highest number of votes in the context of the appointment of the Board of Statutory Auditors.

16.16 In case only one slate has been presented, the shareholders' meeting shall vote on it; if the slate obtains the relative majority of the share capital, the candidates listed in the respective section shall be appointed to the office of standing auditors and alternate auditors; the candidate listed at the first place in the slate shall be appointed as Chairman of the Board of Statutory Auditors.

16.17 When appointing auditors who, for whatsoever reason, were not appointed under the procedures established herein, the shareholders' meeting shall vote on the basis of the majorities required by law.

16.18 Outgoing members of the Board of Statutory Auditors may be re-elected to office.

16.19 Meetings of the Board of Statutory Auditors may, if the Chairman or whoever acts in his/her stead verifies the necessity, be attended by means of telecommunications systems that permit all attendees to participate in the discussion and obtain information on an equal basis.

2. to grant the Board of Directors - and on its behalf, the Chairman and Deputy Chairmen of the Company, all acting separately - all powers necessary to satisfy the necessary formalities to enter the decisions taken in the Companies' Registry, accepting and introducing therein any formal and non-substantial amendments, additions or deletions required by the relevant Authorities".

As regards the second proposal:

Voluntary reduction of the share capital by the amount of € 32,498,345.12 pursuant to article 2445 of the Italian civil code, to be allocated to stockholders' equity; consequent amendments to article 5 of the By-Laws. Inherent and consequent resolutions.

PREFACE

The proposed voluntary reduction of share capital is related to the assignment (the "Assignment") of shares in Prelios S.p.A. (formerly Pirelli & C. Real Estate S.p.A.) by the company in 2010 and represents the natural completion thereof.
As you know, the Assignment was carried out by assigning to the shareholders of Pirelli & C. S.p.A. almost all the Prelios S.p.A. ordinary shares owned by the company and implemented through a reduction of share capital, the actual amount of which was determined by the shareholders of Pirelli & C. S.p.A., at their extraordinary meeting of July 15, 2010, to be equivalent to the fair value of the Prelios equity holding that was assigned (equal to € 178,813,982.89), determined on the basis of the official price of Prelios stock (€ 0.367) on July 14, 2010, the market trading day preceding the date of the meeting.
The Assignment was made on October 25, 2010, pursuant to Article 2445(3) Italian Civil Code, 90 days after the resolutions by the Pirelli & C. shareholders at their extraordinary meeting of July 15, 2010 had been filed with the Companies Register.
In compliance with IFRSs, Pirelli & C. S.p.A. restated the liability deriving from the Assignment in the company financial statements from € 178,813,982.89 to € 211,312,328.01, based on the official market price of the Prelios S.p.A. stock reported on the aforesaid closing date of the Assignment (€ 0.4337), with a balancing entry of € 32,498,345.12 to reduce equity, reported under the item "Reserve for the assignment of Prelios S.p.A. shares." At the same time, Pirelli & C. recorded a loss on the income statement of € 118.3 million against the assignment of Prelios shares, corresponding to the difference between the value of the liability, as restated above, and the net book value of the Prelios S.p.A. shares.
Thus, in order to adjust the book value of the share capital of Pirelli & C. S.p.A. to equity, it is advisable to cancel the entire "Reserve from the assignment of Prelios S.p.A. shares," in its restated amount of negative € 32,498,345.12, and hence voluntarily reducing share capital by an equal amount (the "Reduction").

THE REDUCTION PROCEDURE

In terms of implementation, since the company share capital is divided into shares without par value, the Reduction will not entail writing off company shares but rather a decrease in the implicit value of their accounting parity. The Reduction will not alter the overall amount of company equity, since the entire amount of the reduction will permit the write-off of the negative reserve designated "Reserve from the assignment of Prelios S.p.A. shares."
In procedural terms, the reduction of share capital cannot be executed, pursuant to Article 2445(3) Italian Civil Code, until 90 days have passed from the date the resolution of the extraordinary shareholders' meeting has been filed with the Companies Register, provided that no creditor on the books prior to filing has raised opposition during that time period. Pursuant to Article 2445(4) Italian Civil Code, if opposition is presented before that date, the Court may order that the Reduction may take place anyway, if it finds that no harm has been caused to creditors or the company has posted adequate security.
On the first Monday of market trading following the expiration of the time period granted to company creditors under Article 2445 Italian Civil Code to oppose the reduction in share capital, or on any other day agreed with the competent authorities, the company will charge the amount of the capital reduction to the "Reserve from the assignment of Prelios S.p.A. shares," which at December 31, 2010 showed a negative balance equal to the amount of the reduction. The shareholders of Pirelli & C. will, in any case, be informed of the date on which the transaction will be carried out in accordance with current law
Regarding the treasury shares in the company portfolio (equal, at the date of this report, to 351,590 ordinary shares and 408,342 savings shares), their number will be unaffected by the Reduction, and their new accounting par value will be identical to that of the other shares outstanding.
Regarding the amendments to the Bylaws necessitated by the reduction of capital, we propose adding a new paragraph to Article 5 that reflects the proposed resolution to reduce share capital, as indicated in this report.
Please note, lastly, that the amendments to the Bylaws do not constitute grounds for withdrawal.
More specifically, the procedure for executing the Reduction in no way alters the rights assigned to the savings shares. In fact, the equity privileges associated with those shares remain at the fixed value (Euro 3.19). This fixed value will therefore be unaffected by the change in the accounting par value of the company shares resulting from the reduction in company share capital.

Therefore, the resolution to reduce share capital and the related amendments to the Bylaws need not be submitted for approval by an extraordinary meeting of savings shareholders pursuant to Article 146(1)(b) of Legislative Decree 58 of February 24, 1998, since they in no way prejudice the rights of the category.

ACCOUNTING AND TAX EFFECTS OF THE REDUCTION

The table below shows the pro-forma accounting composition of the equity of Pirelli & C. S.p.A. at December 31, 2010, including the effects of the proposed reduction of share capital.

Description item	Equity at December 31, 2010	Effects of the proposed reduction of share capital on equity at December 31, 2010	Equity at December 31, 2010 after the proposed reduction of share capital (*)
Share capital (**)	1,377,878,879.78	(32,498,345.12)	1,345,380,534.66
Legal reserve	99,906,065.17	-	99,906,065.17
Share premium reserve	229,431,693.83	-	229,431,693.83
Business combinations reserve	22,460,868.47	-	22,460,868.47
Reserve from the assignment of Prelios shares	(32,498,345.12)	32,498,345.12	-
IAS transition reserve	(239,425,665.64)	-	(239,425,665.64)
IAS operational reserve	15,687,342.07	-	15,687,342.07
Retained earnings	25,932,216.81	-	25,932,216.81
Net income for 2010	87,404,078.79	-	87,404,078.79
Total	**1,586,777,134.16**	**-**	**1,586,777,134.16**

(*) The data in the table do not reflect the resolutions submitted for shareholder approval at the general meeting, i.e. (i) the proposal for allocation of the net income reported on the 2010 company financial statements and (ii) the proposal to cover the IAS transition reserve through total utilisation of the share premium reserve and the difference by partial use of the business combinations reserve).

(**) Includes the treasury shares held by the company, equal at the date of this report to 351,590 ordinary shares and 408,342 savings shares.

From the tax standpoint, the reduction of capital in the proposed terms will have no effect on profit and loss.

PROPOSED RESOLUTIONS

Based on the foregoing, the Board of Directors submits the following proposed resolutions for your approval:

"The extraordinary meeting of the shareholders of Pirelli & C. S.p.A.:

— having examined the explanatory report of the Board of Directors;

— having taken note that the general shareholders' meeting has resolved to approve the 2010 financial statements and that those financial statements include a negative reserve in the total amount of € 32,498,345.12 under the item "Reserve from the assignment of Prelios S.p.A. shares";

RESOLVES

1. to reduce the share capital, pursuant to Article 2445 Italian Civil Code, by an amount of € 32,498,345.12, i.e. from € 1,377,878,879.78 to € 1,345,380,534.66, without cancelling the shares, and to establish that the entire amount of the reduction be allocated to reserves and be utilised specifically to cancel the negative equity reserve designated "Reserve from the assignment of Prelios S.p.A. shares";
2. to take note that, pursuant to Article 2445(3) Italian Civil Code, the resolution to reduce share capital may not be executed by the Board of Directors until ninety days have passed after its filing with the Companies Register, without prejudice to the provisions of Article 2445(4) Italian Civil Code;
3. consequently, to amend Article 5 of the company By-Laws, by adding a final paragraph as indicated below:

TEXT IN FORCE*	SUGGESTED TEXT
Article 5	**Article 5**
5.1 The Company shall have a subscribed and paid-in share capital of EUR 1,377,878,879.78 (onebillionthreehundredandseventysevenmillioneighthundredandseventyeightthousandeighthundredseventyninepointseventyeight) divided into no. 487,991,493 (fourhundredeightysevenmillionninehundredninetyonethousandfourhundredninetythree) shares without par value consisting of 475,740,182 (fourhundredseventyfivemillionsevenhundredfortythousandonehundredeighty) ordinary shares and 12,251,311 (twelvemilliontwohundredfiftyonethousandthreehundred-eleven) savings shares.	5.1 The Company shall have a subscribed and paid-in share capital of EUR 1,377,878,879.78 (onebillionthreehundredandseventysevenmillioneighthundredandseventyeightthousandeighthundredseventyninepointseventyeight) divided into no. 487,991,493 (fourhundredeightysevenmillionninehundredninetyonethousandfourhundredninetythree) shares without par value consisting of 475,740,182 (fourhundredseventyfivemillionsevenhundredfortythousandonehundredeighty) ordinary shares and 12,251,311 (twelvemilliontwohundredfiftyonethousandthreehundred-eleven) savings shares.
5.2 In resolutions to increase the share capital by issuing shares against payment, pre- emption right may be excluded for up to a maximum of ten percent of the previously existing capital, provided that the issue price corresponds to the market value of the shares and that this is confirmed in a specific report prepared by the firm appointed to audit the accounts.	5.2 In resolutions to increase the share capital by issuing shares against payment, pre- emption right may be excluded for up to a maximum of ten percent of the previously existing capital, provided that the issue price corresponds to the market value of the shares and that this is confirmed in a specific report prepared by the firm appointed to audit the accounts.
5.3 If so resolved by the shareholders' meeting, the share capital may also be increased by means of contributions in kind or of receivables.	5.3 If so resolved by the shareholders' meeting, the share capital may also be increased by means of contributions in kind or of receivables.
5.4 If resolved by the Shareholders' Meeting, the share capital may be reduced also by assignment of non-cash assets to the shareholders.	5.4 If resolved by the Shareholders' Meeting, the share capital may be reduced also by assignment of non-cash assets to the shareholders.
	5.5 **Pursuant to the resolution adopted by the extraordinary shareholders' meeting held April [•], 2011, the share capital has been voluntarily reduced from Euro 1,377,878,879.78**

TEXT IN FORCE	SUGGESTED TEXT
	to Euro 1,345,380,534.66, to be accomplished by allocating the entire amount of the reduction to equity. This reduction shall be carried out in accordance with Article 2445(3) Italian Civil Code.

(*) Text resulting from approval of the proposed resolutions as set forth in the first point of the agenda of the extraordinary general meeting

4. to grant to the Board of Directors – and on its behalf the Chairman and Deputy Chairmen, separately – full authority and all rights necessary to implement the foregoing resolutions, to fulfil any act and/or formality necessary to have them filed with the Companies Register, accepting and effecting any formal and non-substantive, changes, additions or deletions requested by the competent authorities, to agree with the competent authorities on the terms, conditions and procedure for executing the reduction of share capital, and to adjust the numerical amounts specified in Article 5 of the Bylaws once the resolved reduction of capital has been accomplished."

The Board of Directors

Milan, March 8, 2011