

CORPORATE GOVERNANCE

Awareness of the importance of Corporate Governance for value creation for all shareholders and for progress in sustainable development induces the Company to keep its own corporate governance system constantly in line with national and international best practices, as well as making sure that it is up to date with legislative changes.

As already mentioned in the Annual Report, which is included in the relevant section of the balance sheet and is available on the website of the Company, such system is specified in the Code of Ethics, in the Company's By-laws, in the Rules of Proceedings for the Shareholders' Meeting and in a series of principles, rules and procedures.

Such documents (available on the website of the Company) are verified and where necessary updated in order to keep pace with developments in regulations and best international practices, as well as changes in practices.

In this section of the six-monthly Report, updates and additions to the corporate governance system of the Company during the current financial year up to the date of this report are highlighted.

The Board of Directors

The Ordinary Shareholders' meeting held on April 23, 2007 resolved, among other things, the appointment of two directors: Alberto Bombassei (already appointed by the Board of Directors on September 12, 2006, in substitution of Carlo De Benedetti) and Luigi Roth (in substitution of Carlo Buora who, on November 6, 2006, resigned from all offices held in the Pirelli Group). Moreover, following the resignation of Paolo Vagnone from his position on July 20, 2007, the Board of Directors, in the meeting of July 26, 2007 appointed Enrico Tommaso Cucchiani as Director of the Company.

These directors, as well as the entire Board, will expire on the occasion of the Shareholders' Meeting which will be convened to approve the financial statements as of December 31, 2007.

Both Mr. Bombassei and Mr. Roth hold the requirements provided by the Legislative Decree February 24, 1998, n.58 ("Testo Unico della Finanza") and by the Corporate Governance Code issued by the "Corporate Governance Committee" (Borsa Italiana) to be qualified as independent; their appointment has brought the entire number of independent directors to 55% (eleven over twenty) of the total number of directors.

The current composition of the Board of Directors, in addition to being included in the beginning of this six-monthly Report, is also available on the website of the Company, together with the curricula vitae of each director.

By-laws and Rules of Proceedings for the Shareholders' Meeting

The Extraordinary General Meeting of Shareholders of April 23, 2007 has also approved some amendments to the Company By-laws in consideration of the new discipline introduced by the so-called Savings Protection Law (law n. 262 December 28, 2005) and the recommendations of the new Corporate Governance Code issued by Borsa Italiana (in particular: appointment of the manager responsible for preparing the company's financial reports; rules relevant to the request to add items to the agenda of the general meetings; rules relevant to the terms for the submission of slates for the appointment of directors).

The shareholders expressed their vote on the amendments proposed for each article with different voting.

Following such General Meeting, Commissione Nazionale per le Società e la Borsa ("Consob") has introduced regulations relevant to the Savings Protection Law and the relevant decree of coordination (Decreto Legislativo December 29, 2006, n. 303).

The Company's By-laws were substantially already in compliance with the new regulatory framework but the Company has deemed appropriate to proceed in particular with reference to the procedure of appointment of the Board of Statutory Auditors, prior to its expiry date, and with some amendments to the text of the By-laws.

The shareholders have also resolved to update the Rules of Proceedings for the Shareholders' Meeting. The main amendment is relevant to the effects on the organization of the General Meeting's works pursuant to the right granted to the shareholders by the Savings Protection Law to add items to the agenda of the meeting; other amendments aim at better clarifying the new regulations.

The current text of the By-laws and Rules of Proceedings for the Shareholders' Meeting are available on the website of the Company.

Organizational model, principles, rules and procedures

On March 12, 2007 the Board of Directors verified and amended the Organizational Model of the Company (adopted on July 31, 2003 pursuant to Legislative Decree June 8, 2001, n. 231) in accordance with the new regulatory framework. The Organizational Model of the Company consists of a set of principles and procedures arranged in a pyramidal system which can be summarized as follows: Group Code of Ethics, General Principles of Internal Control, Lines of Conduct, Internal Control Checklist.

Further changes to the corporate governance system of the Company following the provisions of the new Corporate Governance Code issued by Borsa Italiana were relevant to the "Rules of Conduct for Effecting Transactions with Related Parties" and to the "Procedure for Information Flows to Directors and Auditors".

The results of the above mentioned amendments according to the new regulatory framework, together with the recommendations and instructions expressed by the Code of Conduct, have already been published in the Annual Report on the corporate governance system included in the financial statements as of December 31, 2006.

Manager responsible for preparing the Company's financial reports

In compliance with the Savings Protection Law, which introduces the new role of a Manager responsible for preparing the company's financial reports, and further to the acknowledgement of such rule in the Company's By-laws, on May 10, 2007 the Board of Directors appointed Claudio De Conto (General Manager and Chief Operating Officer of the Company, responsible for all fiscal and administrative departments) Manager responsible for preparing the Company's financial reports, granting him any organizational and managerial powers for the exercise of the tasks assigned, together with full economic independence.

The Manager responsible for preparing the Company's financial reports, together with the Chairman of the Board of Directors (the member delegated by the Board) will sign the report required by article 154-bis of the Testo Unico della Finanza starting from the financial statements as at December 31, 2007,

Composition of share capital

On September 11, 2007 the share capital of Pirelli & C. S.p.A. was equal to Euros 2,791,311,344.64 divided in n. 5,367,906,432 shares with nominal value of Euros 0.52 each, of which n. 5,233,142,003 ordinary shares and n. 134,764,429 non convertible savings shares.

The share capital could be increased up to a maximum nominal value of Euros 2,819,508,786.64 by way of issuance of up to n. 54,225,850 ordinary shares of Euros 0.52 each, for a price of Euros 1.15 each, of which Euros 0.63 as a share premium, against the possible exercise of options granted to managers and others employed by the Company, by its subsidiaries and by the subsidiaries of the latter as part of the “Pirelli to People” and “Group Senior Executive” stock-option plans approved by Pirelli S.p.A. in 2001.

To the Company’s knowledge, no legal or natural person can exercise control on the Company itself, according to Article 93 of the “Testo Unico della Finanza”.

The names of the participants in the “Pirelli & C. S.p.A. Block Share Syndicate”, whose purpose is to ensure Pirelli & C. S.p.A. share structure stability, and an excerpt of the relevant agreement are available on the website of the Company www.pirelli.com.

Relations with investors and other shareholders

In accordance with its tradition of transparency and fairness, the Company actively promotes relations with shareholders, institutional and private investors and with financial analysts, with other market operators and with the financial community in general within the proper limits of their respective roles, and periodically organizes meetings with representatives from the Italian and international communities.

In March 1999, the Company established an Investor Relations Department to foster dialogue with the financial market. The Investor Relations Department, (which reports directly to the Manager for Finance and Strategic Planning) is headed by Alberto Borgia and has its own section in the website of the Company at www.pirelli.com.

In this section investors can find every document published by the Company, including in the English language, related to financial reporting (e.g., the annual financial statements and the six-month interim period and quarterly reports) and the Corporate Governance system of the Company (e.g., the By-laws, the Regulations for Shareholders' Meetings, the Rules of Conduct for Effecting Transactions with Related Parties, the Procedure for Information Flows to Directors and Auditors, the Procedure for the Management and Communication to the Public of Privileged Information and the minutes of Shareholders' meetings). The section also gives access to press releases distributed by the Company and the documentation that the Company makes available to the financial community in presentations and/or meetings and information on the share capital of the Company and shareholders (including the publication of shareholders' agreements).

Pirelli & C. was one of the first companies in Italy and Europe to publish specific inserts giving economic and financial data in the mass media, as well as one of the first to set up a kit on the website for small investors.

Investors queries may be sent: *ir@pirelli.com*, *Tel: 02.64422949*; *fax: 02.64424686*.

PIRELLI & C. S.p.A. – SUMMARY FINANCIAL DATA

Balance sheet

	<i>(in millions of euro)</i>	
	6/30/2007	12/31/2006
Property, plant and equipment	99.5	103.4
Intangible assets	1.7	1.7
Financial assets	1,479.3	5,353.2
Net working capital	(32.0)	(186.1)
Non-current assets held for sale (Olimpia)	3,309.9	-
	4,858.4	5,272.2
Equity	3,012.2	2,882.3
Provisions	180.4	221.4
Net financial (liquidity)/debt position	1,665.8	2,168.5
	4,858.4	5,272.2

The above interim statement presents the balance sheet and financial position of the company. The most significant changes during the first half of 2007 refer to the following:

- **financial assets** decreased by Euros 3,873.9 million. An analysis of the changes is presented in the following table:

*(in millions of euro)***Investments:**

Banca Leonardo S.p.A.	3.6
RCS Mediagroup S.p.A.	2.8
Pirelli Cultura S.p.A.	1.3

Divestitures:

Intek S.p.A.	(6.8)
KME Group S.p.A.	(1.8)
Consortium S.r.l.	(0.3)

Writedowns:

Pirelli Holding N.V. (formerly Pirelli Tyre Holding N.V.)	(378.3)
Telecom Italia S.p.A.	(9.4)
Pirelli Cultura S.p.A.	(0.2)

Reclassification of investment to "Non-current assets held for sale"

Olimpia S.p.A.	(3,474.9)
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Other	(0.1)
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Measurement at fair value and income /expenses recognized in income at the time of sale of available-for-sale financial assets or in the presence of impairment losses previously recognized in equity	(9.8)
	(3,873.9)

- The change in **“net working capital”** is mainly due to the payment of the liability contracted with Pirelli Holding N.V. (formerly Pirelli Tyre Holding N.V.) for the purchase of the investment in Pirelli Tyre S.p.A. during the year 2006 (Euros 151.5 million).
- **“Non-current assets held for sale”** include the investment in Olimpia S.p.A. which was classified under financial assets in the financial statements at December 31, 2006. The investment in Olimpia S.p.A. (Euros 3,474.9 million at December 31, 2006) was written down by Euros 165 million to adjust the value of the investment to the estimated sales price;

- **Equity** increased by Euros 129.9 million compared to December 31, 2006. The changes in equity are presented in the following table:

(in millions of euro)

Equity at December 31, 2006	2,882.3
Income/(expenses) recognized directly in equity:	
- Fair value adjustment of available-for-sale financial assets	(16.6)
- Income /expenses reversed to income at the time of sale of available-for-sale financial assets or in the presence of impairment losses	6.8
- Actuarial gains (losses) on employees' leaving indemnity	0.7
Total income (expenses) recognized directly in equity	(9.1)
Income for the period	139.0
Equity at June 30, 2007	3,012.2

- **“Provisions”** decreased from the end of 2006 mainly as a result of the payment of the price adjustment (Euros 39.9 million) on the sale of the Pirelli activities in the Energy and Telecom Cables and Systems sectors to Goldman Sachs Capital Partners in July 2005.
- The **net debt position** went from a net debt position of Euros 2,168.5 million at December 31, 2006 to Euros 1,665.8 million at June 30, 2007, with a net decrease of Euros 502.7 million. The analysis of the changes is detailed in the following table:

(in millions of euro)

Net financial debt position at 12/31/2006	(2,168.5)
Financial investments	(7.7)
Payment of price adjustment on sale of cables and systems sectors	(39.9)
Financial divestitures	106.4
Dividends collected	657.5
Change in net working capital	(154.1)
Financial expenses and other changes	(59.5)
Net financial debt position at 6/30/2007	(1,665.8)

Income statement

(in millions of euro)

	1st Half 2007	1st Half 2006
Financial expenses, net	(427.6)	(25.7)
Financial investments	657.5	173.3
Other operating income (expenses)	(4.7)	(16.3)
Income before income taxes	225.2	131.3
Income taxes	2.7	0.5
Income from continuing operations	227.9	131.8
Income (loss) from discontinued operations	(88.9)	0.1
Income for the period	139.0	131.9

The income for the period amounts to Euros 139.0 million compared to Euros 131.9 million for the corresponding period of 2006.

The most important items are described below:

- Details of **net financial expenses** are as follows:

(in millions of euro)

	1st Half 2007	1st Half 2006
- Interest expenses	(49.4)	(37.5)
- Other financial expenses	(2.9)	(4.1)
- Impairment losses on available-for-sale financial asset and investments in subsidiaries	(387.7)	(1.4)
- Interest income	5.8	14.1
- Other financial income	0.2	0.5
- Gains on the sale of available-for-sale financial assets and investments	6.4	2.7
Total net financial expenses	(427.6)	(25.7)

Impairment losses refer mainly to Pirelli Holding N.V. (Euros 378.3 million).

- Details of “investment income” are as follows:

	<i>(in millions of euro)</i>	
	1st Half 2007	1st Half 2006
Subsidiaries:		
Pirelli Holding N.V.	550.0	100.0
Pirelli & C. Real Estate S.p.A.	44.1	40.7
Pirelli Tyre S.p.A.	42.7	-
Sipir Finance N.V.	5.5	7.0
Other minor companies	1.8	0.9
Associates:		
Eurostazioni S.p.A.	1.7	1.6
Other companies:		
Consortium S.r.l.	-	2.6
Capitalia S.p.A.	-	9.9
Telecom Italia S.p.A.	6.6	6.6
RCS Mediagroup S.p.A.	3.9	3.9
Other minor companies	1.2	0.1
Total	657.5	173.3

- “Other operating income (expenses)” show an improvement of Euros 11.6 million compared to the prior year. Details are as follows:

	<i>(in millions of euro)</i>	
	1st Half 2007	1st Half 2006
- Operating income (excluding nonrecurring income)	63.7	64.7
- Operating expenses (excluding nonrecurring expenses)	(71.2)	(77.8)
- Nonrecurring income	2.8	-
- Nonrecurring expenses	-	(3.2)
Total other operating income (expenses)	(4.7)	(16.3)

- The improvement in “**income taxes**” mainly refers to higher income, net, deriving from the national tax consolidation, which was partly offset by higher IRAP income taxes.

- “**Income (loss) from discontinued operations**” includes the gain realized on the sale to Goldman Sachs International of the warrants that had been assigned following the sale of the Energy and Telecom Cables and Systems Sectors in July 2005 (Euros 91 million) and the negative effect including the impairment loss and the costs connected with the transaction for the sale of the investment in Olimpia S.p.A. (Euros 179.9 million).

The Board of Directors

Milan, September 11, 2007