KME Group S.p.A

Quarterly Report at September 30, 2006

(Third Quarter of 2006)

Registered office: 184 via del Corso, Rome
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Share capital: €189,775,023.00 fully paid in
Company Register of the Court of Rome and Tax I.D. Number: 00931330583

Report of the Board of Directors on Operations in the Third Quarter of 2006

In 2006, the European economy, which in recent years has experienced only modest growth, began to show signs of a more robust rate of expansion.
Earlier in the year, the economic recovery was driven by exports, spurred by vigorous growth in the world economy and the normal inventory rebuilding process. Subsequently, internal demand also revived, due mainly to a major upturn in capital investments.

This favorable economic environment gradually had a beneficial impact on the demand for copper and copper-alloy semifinished products, but the signs of improvement were not reflected evenly in all areas.
Specifically, while shipments of products used in industrial applications increased steadily, demand for construction-related products was more tentative, especially in Germany and Italy.

On an industry-wide basis, demand patterns continue to be affected by changes in raw material prices, particularly the price of copper, which is the material that the Group uses most.
The continuing high level and extreme volatility of raw material prices are a source of market uncertainty that causes customers to postpone spending decisions and maintain minimal inventories, opting for replacement solutions with low tech applications.
The portion of the average sales price of semifinished products attributable to the value of raw materials increased from 64% to 76%.

A more favorable economic environment and the marketing programs introduced to launch and maximize the value of new products and to enter new markets caused the Group's **revenues** to increase by 65% in the first nine months of 2006, rising to 2,633.3 million euros, up from 1,595.6 million euros at September 30, 2005. Net of the effect of changes in the value of raw materials, revenues show a gain of 10.8% (from 573.1 million euros to 634.9 million euros).

The increase in sales, coupled with the impact of the industrial reorganization and streamlining programs implemented by the various manufacturing units, enabled the Group to report operating results that showed a significant improvement in profitability.
In the nine months ended September 30, 2006, **consolidated profit** before taxes rose to 146.5 million euros, up from 9.6 million euros in the same period last year.
This improvement was made possible by a higher degree of profitability at the operating level and reflects the revaluation of the raw materials inventory, which was carried out to recognize the corresponding price increases.

At the operating level, **EBITDA** increased to 99.3 million euros, or 34.5 million euros more (+53.2%) than in the first nine months of 2005. EBITDA were equal to 15.6% of the value of sales (11.3% in the first nine months of 2005).
The impact of the revaluation of the raw materials inventory (the gross amount of which was 137.9 million euros), which was offset in part by additions to the industrial reorganization provisions totaling 17.8 million euros, boosted **EBIT** to 19.5 million euros, an amount more than 4.8 times greater than the 37.1 million euros earned in the first nine months of 2005.

As for operating performance in the third quarter of 2006, consolidated profit before taxes totaled 48.0 million euros (9.1 million euros in 2005). This increase reflects improvements in EBITDA, which grew from 19.2 million euros to 37.4 million euros, and in EBIT, which rose from 14.1 million euros to 60.3 million euros. The EBIT gain reflects in part a 22.7-million-euro revaluation of the raw materials inventory.

Both cumulative nine-month results and third quarter data show that the Group's profitability continued to increase in 2006, consistent with the trend that characterized previous periods.
As for the outlook for the coming months, updated estimates for all of 2006 point to a further strengthening of the upward trend in profitability.

The Group is continuing to implement the structural initiatives outlined in its Industrial Plan, with the dual goal of achieving a more competitive cost structure and providing its industrial operations with a more flexible manufacturing organization that is capable of responding more quickly to changes in market conditions.
At September 30, 2006, the Group had 6,628 employees, 219 fewer (-3.2%) than at the end of 2005, even though production volume was up 8%.
The implementation of reorganization programs, which were carried out between January 2005 and the end of September 2006, affected both the concentration of manufacturing locations (two facilities were closed) and the streamlining of the central services departments, enabling the Group to reduce its staff by 641 employees (-8.8%).
The operating results show that the Group's performance exceeded the targets of the Industrial Plan that was approved at the beginning of the year.

Insofar as the balance sheet is concerned, the increase in the prices of raw materials caused the value of working capital to increase due to a higher level of trade receivables and an increase in inventory value, which, in turn, absorbed additional financial resources.
As a result, the Group's **net indebtedness** at September 30, 2006 was 165.5 million euros greater than at the beginning of the year, rising from 559.1 million euros to 724.6 million euros, with working capital reaching 1,032 million euros.

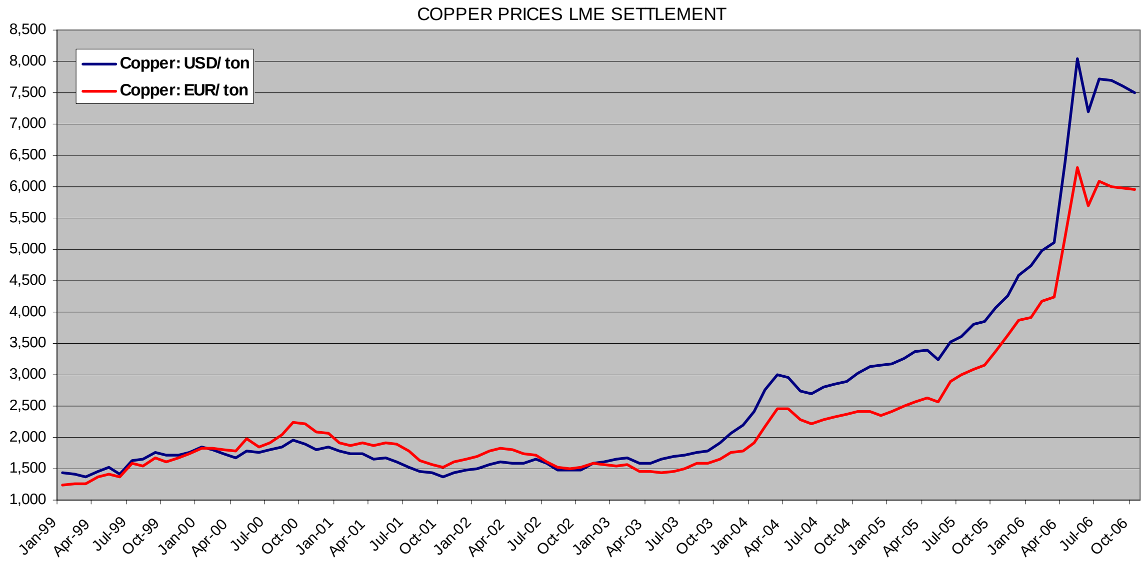
Copper Market and Prices

During the first nine months of 2006, the average price of copper was higher than it was in the same period last year, rising by 90.3% in U.S-dollar terms (from US$3,471 to US$6,606 per metric ton) and 91.8% in euro terms (from 2,756 euros to 5,286 euros per metric ton).

Looking at price trends, in the third quarter of 2006 the average price of copper was higher than it was in the fourth quarter of 2005 by 78.3% in U.S-dollar terms (from US$4,301 to US$7,670 per metric ton) and 66.3% in euro terms (from 3,620 euros to 6,020 euros per metric ton).

During the early months of the year, the price of copper reached record levels. The daily price reached a record US$8,788 per metric ton on May 12, 2006 and stabilized at a slightly lower level in the ensuing months.

It is important to keep in mind that the raw material used is invoiced to customers at a price equal to the hedging cost, which is set at the time of the order. As a result, price changes do not have a direct impact on the results from operations of Group companies. They do cause changes in the valuation of Company-owned raw material inventories, in accordance with the new IAS/IFRS accounting principles (more detailed information is provided in the section of this Report that reviews the operating results for the period).
However, as mentioned earlier, continued high prices of raw materials and price volatility bring uncertainty to the market and to customer behavior, making it difficult to forecast demand patterns.



Operating Performance of the Group

The table below presents, in summary form, the consolidated results of the Group in the first nine months of 2006.

The 2005 figures shown in the table below can be compared to the current data because the new International Financial Reporting Standards (IAS/IFRSs) were applied to both periods.

In order to present a more meaningful picture of the Group's operating performance, certain components of the data used to compute **EBITDA** were reclassified.(*) Specifically:

- The impact of the change in the accounting principle used to value inventory of raw materials and the effect of valuing London Metal Exchange hedging contracts at fair value was derecognized. It is also important to keep in mind that the adoption of the new international accounting principles required a switch in the method used to value the metal inventory, which was changed from the LIFO method to the weighted average coast method. This change, which was made during a period of rising prices, produced a revaluation of the inventory of raw materials that is not reflected in the reclassified EBITDA for the period.
- Nonrecurring items were reclassified below the EBITDA line, so as to eliminate their impact on EBITDA for the period.

The amount shown for **EBIT** is the same as the figure used in the consolidated income statement included in the financial statements, which were prepared in accordance with the IAS/IFRSs.

(*) Breakdown of reclassifications:

(in millions of euros)	*9/30/06 IAS*		*Reclassifications*	*9/30/06*	
Gross revenues	2,633.3			2,633.3	
Raw material costs	-		**(1,998.5)**	(1,998.5)	
Revenues net of raw material costs	**2,633.3**	*100.0%*		**634.9**	*100.0%*
Labor costs	(260.9)			(260.9)	
Other materials and costs	(2,153.0)		**1,878.4**	(274.7)	
EBITDA	**219.4**	*8.3%*		**99.3**	*15.6%*
Non recurring income (expense)	-		**(17.8)**	(17.8)	
Impact of IFRS valuation of inventory and LME contracts	-		**137.9**	137.9	
Depreciation and amortization	(39.9)			(39.9)	
EBIT	**179.5**	*6.8%*		**179.5**	*28.3%*
Net financial expense	(33.0)			(33.0)	
Interest in the result of companies valued by the equity method	-			-	
Profit before taxes	**146.5**	*5.6%*		**146.5**	*23.1%*

KME Group — Consolidated Income Statement

2005 full year		**(in millions of euros)**	*9/30/06*		*9/30/05*		*Change*
2,176.1		Gross revenues	2,633.3		1,595.6		*65.0%*
(1,417.9)		Raw material costs	(1,998.5)		(1,022.5)		*95.4%*
758.1	*100.0%*	**Revenues net of raw material costs**	**634.9**	*100.0%*	**573.1**	*100.0%*	*10.8%*
(341.8)		Labor costs	(260.9)		(254.8)		*2.4%*
(323.5)		Other materials and costs	(274.7)		(253.5)		*8.3%*
92.8	*12.2%*	**EBITDA**	**99.3**	*15.6%*	**64.8**	*11.3%*	*53.2%*
(29.7)		Nonrecurring income (expense)	(17.8)		(0.7)		*n.m.*
36.5		Impact of IFRS valuation of inventory and LME contracts	137.9		16.2		*n.m.*
(54.8)		Depreciation and amortization	(39.9)		(43.2)		*-7.7%*
44.8	*5.9%*	**EBIT**	**179.5**	*28.3%*	**37.1**	*6.5%*	*n.m.*
(37.8)		Net financial expense	(33.0)		(27.6)		*19.6%*
0.3		Interest in the result of companies valued by the equity method	-		0.1		*n.m.*
7.3	*1.0%*	**Profit before taxes**	**146.5**	*23.1%*	**9.6**	*1.7%*	*n.m.*

In the first nine months of 2006, **revenues** totaled 2,633.3 million euros, or 65% more than in the same period last year.
Restated to eliminate the impact of the value of raw materials, revenues show an increase of 10.8%, rising from 573.1 million euros to 634.9 million euros. Unit sales were up 8%.

Operating costs increased 5.4% overall, with labor costs showing virtually no change, despite an increase in production volume. The increase in other operating costs reflects a higher level of activity and a rise in unit prices paid for the means of production, particularly energy and transportation.

EBITDA grew by 53.2% to 99.3 million euros, an amount equal to 15.6% of revenues, net of raw material costs, compared with 11.3% at September 30, 2005.

EBIT amounted to 179.5 million euros (37.1 million euros in 2005).
The figure for the first nine months of 2006 reflects the significant beneficial impact of a revaluation of the raw materials inventory (137.9 million euros), which became necessary to account for the sharp rise in their prices, and the adoption of a new IFRS/IAS accounting principle. These benefits were offset in part by extraordinary charges incurred in connection with the restructuring plan (17.8 million euros).

At September 30, 2006, the **Group's consolidated profit** before taxes totaled 146.5 million euros, compared with a profit of 9.6 million euros at September 30, 2005.

Financial Position of the Group

At September 30, 2006, the Group's **net indebtedness** totaled 724.6 million euros, an increase of 165.5 million euros and 55.9 million euros compared with the amounts owed at December 31, 2005 and June 30, 2006, respectively.

The table below provides a breakdown of the consolidated net financial position(*):

(in thousands of euros)	9/30/06	6/30/06	12/31/05
Short-term indebtedness	289,411	287,355	234,146
Long-term debt	438,277	437,207	459,379
Loans payable to unconsolidated Group companies	59,256	20,096	18,472
Total indebtedness	**786,944**	**744,658**	**711,997**
Liquid assets	(61,382)	(75,059)	(151,992)
Loans receivable from unconsolidated Group companies	(921)	(918)	(920)
Total liquid assets and loans receivable	**(62,303)**	**(75,977)**	**(152,912)**
Net financial position	**724,641**	**668,681**	**559,085**

The financial position data shown above do not reflect the potential outlays that may be required for two fines imposed by the European Commission on the Group's manufacturing companies for two alleged antitrust violations. These fines, which total 107 million euros, will have an impact on cash flow only at the end of the judicial process before the various EU entities with jurisdiction over such issues and only for the amount adjudicated. Until such time, payment is being guaranteed by security deposits (17 million euros) and bank sureties (90 million euros). However, this payment deferral will cause the Group to incur finance charges.

As explained earlier in this Report, the increase in indebtedness compared with December 31, 2005 and June 30, 2005 reflects the higher price of raw materials, which caused working capital to increase due to a rise in trade receivables and inventory value, which, in turn, absorbed additional financial resources.

In April and May 2006, the Company began negotiations with the Group's lender banks and other financial institutions to increase the existing lines of credit and discuss the possibility of adding new lines of credit structured in a manner that would permit greater flexibility in terms of the amount of available financing and utilization methods, as needed to address changing working capital needs.

(*) The above amounts are net of factoring transactions that involved the assignment, without recourse, of receivables totaling 183.6 million euros at September 30, 2006, 176.1 million euros at June 30, 2006 and 60.3 million euros at December 31, 2005.

On September 30, 2006, following the abovementioned negotiations, the Company signed a comprehensive agreement for two new lines of credit totaling 1.6 billion euros. These lines of credit replace those received under the Bank Agreement of January 2005.
The first agreement, which was signed with Deutsche Bank (Initial Mandated Lead Arranger, Agent and Coordinating Bank) and seven other major Mandated Lead Arrangers (Banca Nazionale del Lavoro, Unicredit, Capitalia, Mediobanca, Commerzbank, Dresdner Bank and HSH Nordbank), includes two loans:

- A revolving credit line of up to 650 million euros, which will be used to cover the working capital needs of Group companies (inventory requirements in particular) and has a term of three years (extendable for a further two years);
- A five-year loan of 200 million euros to be used to cover additional funding needs of the Group. This facility has a three-year preamortization period.

A second agreement, signed with General Electric Corporate Finance Bank S.A., is for a five-year revolving line of credit of up to 800 million euros that can be used to factor trade receivables with recourse.
The terms governing these two new lines of credit will result in a significant reduction in financial expense, estimated at several million euros.
In addition, commitments undertaken by Group companies under the previous Bank Agreement, which allow them to pay dividends only if they could meet certain conditions, no longer apply.

The obligation to repay the abovementioned lines of credit was secured with the following:

- A pledge on the shares of KM Europa Metal A.G. and its subsidiaries;
- A first mortgage on all of the real estate and other non-current assets of KM Europa Metal A.G.;
- The pledge of the inventories of the Group's industrial companies, except those located in Spain;
- A lien on all factoring and insurance contracts.

The loan agreements also call for compliance with certain economic and financial covenants that are based on the levels of consolidated shareholders' equity, indebtedness and EBITDA and the ratio of EBITDA to net consolidated interest expense.

The refinancing of the Group's indebtedness and the 129.9-million-euro capital increase approved by the Shareholders' Meeting on May 19, 2006 and carried out in July and August 2006, which was used to repay in full the subordinated shareholder loan received in 2005 from by G.I.M. – Generale Industrie Metallurgiche S.p.A., the Group's Parent Company, streamlined and strengthened the Group's balance sheet.
Following the abovementioned capital increase, the Company's share capital totaled 319.6 million euros, while total consolidated shareholders' equity amounted to more than 520 million euros.

Financial Statements

The Quarterly Report at September 30, 2006, which has not been audited, was prepared in accordance with the guidelines provided by the National Commission on Companies and the Securities Markets (CONSOB) in Issuers' Regulations and in Annex 3D.

Consolidated income statement data are provided for the third quarter and the first nine months of 2006. They are also compared with the data for the same periods in 2005. The presentation of the financial statements is consistent with the presentation used in the Semiannual and Annual Reports.

The Quarterly Report at September 30, 2006 was prepared in accordance with the valuation and measurement criteria set forth in the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) and adopted by the European Commission in accordance with the procedure set forth in Article 6 of Regulation (CE) No. 1606/2002 of the European Parliament and Council of July 19, 2002.

More detailed information about the impact of the transition to the IAS/IFRSs is provided in the notes to the Semiannual Report at June 30, 2006 and the Annual Report at December 31, 2005.

There were no changes in the scope of consolidation in the first nine months of 2006.

Consolidated Financial Statements of KME Group S.p.A.
at September 30, 2006

Income Statement *(amounts in thousands of euros)*	**9/30/06 (9 months)**	**9/30/05 (9 months)**	**% change**	**Third quarter 2006**	**Third quarter 2005**	**% change**
Sales and service revenues	2,633,343	1,595,578	*65.04%*	927,715	543,198	*70.79%*
Change in inventory of finished products and semifinished goods	13,847	(7,793)	*n.m.*	9,290	(4,611)	*n.m.*
Capitalization of Company-produced assets	1,864	1,641	*13.59%*	676	807	*-16.23%*
Other operating revenues	8,522	29,195	*-70.81%*	2,421	9,260	*-73.86%*
Purchases of and changes in inventory of raw materials	(1,941,736)	(1,046,893)	*85.48%*	(737,679)	(361,738)	*103.93%*
Labor costs	(260,932)	(254,825)	*2.40%*	(83,229)	(75,189)	*10.69%*
Depreciation, amortization, writedowns and additions to provisions	(39,853)	(48,743)	*-18.24%*	(12,543)	(20,918)	*-40.04%*
Other operating expenses	(235,517)	(231,015)	*1.95%*	(46,307)	(76,699)	*-39.63%*
EBIT	**179,538**	**37,145**	*383.34%*	**60,344**	**14,110**	*327.67%*
Financial income (expense)	(32,996)	(27,597)	*19.56%*	(12,296)	(5,057)	*143.15%*
Interest in the results of associates valued by the e	-	139	*n.m.*	-	3	*n.m.*
Profit before taxes	**146,542**	**9,687**	*1413%*	**48,048**	**9,056**	