

Business combinations. In May 2005, the Group, through Benetton International S.A., a Luxembourg sub-holding company, acquired from third parties 50% of the shares and voting rights in a Turkish company named Benetton Giyim Sanayi A.S. The accounting method used was the “purchase method”.

The assets acquired and goodwill were as follows:

(thousands of euro)	Acquiree's carrying amount	Fair value adjustments	Fair value
Property, plant and equipment	2,536	-	2,536
Intangible assets	155	2,356	2,511
Financial assets	2	-	2
Receivables	6,583	-	6,583
Inventories	3,153	-	3,153
Payables	106	-	106
Net debt	12,323	-	12,323
<b>Total net equity</b>	<b>-</b>	<b>2,356</b>	<b>2,356</b>
Share purchased by the Group (50%)			1,178
Goodwill			5,472
<b>Purchase cost</b>			<b>6,650</b>

The fair value of intangible assets refers specifically to the “Deferred charges” category and relates to the fair value of the expenses for fifteen lease contracts for stores with rental charges lower than current market value. An industry-specific appraisal determined, for each contract, the differential between the monthly rental charge paid as per contractual agreements and the potential market value price. This differential was subsequently recorded based on the duration of each contract.

The goodwill is attributable to Benetton Giyim Sanayi A.S. production and know-how, which cannot be separately recognized as an intangible asset.

Highlights of the company's income statement at the acquisition date and of the main balance sheet data as of December 31, 2005, are as follows:

(thousands of euro)	
Revenues	17,336
Contribution margin	5,975
Net income for the year	1,414
Working capital	12,193
Capital employed	14,569
Net financial position	8,926
Shareholders' equity	5,643

Immediately prior to acquisition by Benetton Giyim Sanayi A.S. benefited from the transfer of a business unit from another company of the Boyner Group, BBA Beymen Bogazici Albay Magazacilik Tekstil Sanay ve Ticaret A.S. This company used to manage activities other than those related to Benetton, and as a result it is impossible to reconstruct a balance sheet relating exclusively to Benetton business for the entire 2005 financial year.

In July 2005, an amount of 7,500 thousand euro was paid for residual liabilities linked to the purchase of the residual 15% interest in Olimpias S.p.A., the first installment of which was

paid during 2004. Also in 2005, the Group acquired minority interests for a total amount of approximately 240 thousand euro.

In 2004, the acquisition of subsidiary of 14,107 thousand euro related to:

- the payment of the first installment of 7,520 thousand euro for Olimpias S.p.A.;
- the acquisition by New Ben GmbH, at a purchase price of 4,066 thousand euro, of 100% of the share capital of Mari Textilhandels GmbH, which subsequently merged into New Ben GmbH;
- purchase of the residual 50% interest of DCM Benetton India Ltd. for 2,521 thousand euro.

**Retirements benefit obligations.** The amounts recognized on the income statement on the basis of "corridor approach", with respect to defined benefit plans, are as follows:

(thousands of euro)	12.31.2005	12.31.2004
Current service cost	7,414	6,137
Interest costs	2,046	2,044
Net actuarial (gains)/losses	-	-
Cost relating to past work/services	-	-
<b>Total</b>	<b>9,460</b>	<b>8,181</b>

The total amount of expenses for defined benefit plans appears in the item "Payroll and related costs".

The principal actuarial assumptions used were as follows:

	12.31.2005	12.31.2004
Discount rate	4.0%	4.5%
Rate of inflation	2.0%	2.0%
Expected salary increase rate	5%-3.5%	5%-3.5%

**Derivative financial instruments.** As of December 31, 2005, the notional principal amount of outstanding derivative instruments was as follows:

(thousands of euro)	Notional amounts	Fair value		
		Positive	Negative	Net
<b>Economic exchange risk</b>	<b>187,709</b>	<b>736</b>	<b>(1,622)</b>	<b>(886)</b>
- fair value hedge	121,677	231	(1,325)	(1,094)
- cash flow hedge	29,403	270	(277)	(7)
- cash flow hedge - option	36,629	235	(20)	215
<b>Translation exchange risk</b>	<b>115,897</b>	<b>82</b>	<b>(901)</b>	<b>(819)</b>
- fair value hedge	5,669	48	-	48
- cash flow hedge	110,228	34	(901)	(867)
<b>Transaction exchange risk - fair value hedge</b>	<b>512,355</b>	<b>1,750</b>	<b>(1,669)</b>	<b>81</b>

The notional amounts represent the absolute value sum of all transactions valued at the relevant forward exchange rate.

Fair value was calculated by discounting and translating future cash flows using market rates as of the balance sheet date (in particular, interest and exchange rates).

Exchange rate risk is managed with currency forwards, swaps, and options (zero cost collars - shown separately).

As of December 2005, interest rate swaps for a notional principal amount of 57 million euro with maturities of 2006-2008 were in place.

**Stock options plan.** The "Supplementary information" section of the Directors' report details the stock options plan approved by the Group's shareholders meeting in September 2004. The estimated fair value of each share option granted by the plan is of 1.874 euro (weighted average price). The fair value was calculated using the Black-Scholes option price valuation method. The data considered for modeling purposes was as follows:

	Vesting period		
	2 years	4 years	Total
Number of options granted	1,616,788.5	1,616,788.5	3,233,577
Grant date	09.09.2004	09.09.2004	
First exercise date	09.09.2006	09.09.2008	
Expiring date	09.09.2013	09.09.2013	
Average exercise date (estimated as mid-point between first exercise and expiring dates)	03.10.2010	03.11.2011	
Dividend yield	4.16%	4.16%	
Expected volatility (historic at 260 days)	27.60%	27.60%	
Risk-free interest rate	3.493%	3.671%	
Option life (years)	9	9	
Expected average life (years)	5.5	6.5	
Unit fair value in euro (Black-Scholes)	1.831042	1.916344	1.873693
Total fair value in thousands of euro	2,960,408	2,850,457	5,810,865

Further details on the stock options plan are given below:

	Year 2005		Year 2004	
	No. options	Weighted average exercise price	No. options	Weighted average exercise price
At the beginning of the year	3,233,577	8.984	-	-
Granted	-	-	3,233,577	8.984
Annulled	-	-	-	-
Exercised	-	-	-	-
Circulating at year end	3,233,577	8.984	3,233,577	8.984
Exercisable at year end	-	-	-	-

As of December 31, 2005, the weighted average residual life of outstanding stock options was 7.7 years. The cost recorded on the income statement for the 2005 financial year was 2,202 thousand euro (722 thousand euro in 2004).

Impairment test procedure. As required by IAS 36, the Group has made sure to:

- verify the existence of possible losses of value of property, plant and equipment and of intangible assets of finite useful life;
- compare the realizable value and the carrying value of intangible assets of indefinite useful life and of intangible assets not yet available for use. This occurs independently from any intervening factors which may indicate the loss of carrying value as recognized on the financial statements.

The results of the impairment test carried out in 2005 are summarized in the table below, broken down by business segment, which shows the impairment recorded during the financial year and included among "Impairment of assets" on the income statement.

(thousands of euro)	Apparel	Textile	Other and unallocated	Total
Property, plant and equipment:				
- land and buildings	8,782	-	-	8,782
- plant, machinery and equipment	1	2,009	-	2,010
- furniture, furnishings and electronic devices	6,901	-	-	6,901
- leasehold improvements	11,705	-	-	11,705
<b>Total property, plant and equipment</b>	<b>27,389</b>	<b>2,009</b>	<b>-</b>	<b>29,398</b>
Intangible assets:				
- goodwill and other intangible assets of indefinite useful life	2,551	-	-	2,551
- intangible assets of finite useful life	18,391	-	-	18,391
<b>Total intangible assets</b>	<b>20,942</b>	<b>-</b>	<b>-</b>	<b>20,942</b>
<b>Total</b>	<b>48,331</b>	<b>2,009</b>	<b>-</b>	<b>50,340</b>

The main impairment identified during the 2005 financial year following impairment testing are as follows:

- commercial assets (i.e. assets linked to stores), for a total impairment of 30,446 thousand euro. These assets include furniture and fittings, deferred commercial expenses (so-called "key money"), leasehold improvements, and "fonds de commerce". With the exception of the latter, which are subject to external appraisal, all assets were recognized at their value in use, estimated on the basis of future cash flow projections. The pre-tax discount rate used was 7.2%;
- goodwill and trademarks: the goodwill relating to the purchase of Killer Loop was fully impaired for a total of 2,168 thousand euro, whereas brand was impaired by 4,169 thousand euro. The discount rate applied to determine the value in use was 7.2%;
- industrial assets: for Olimpias S.p.A., assets pertaining to Cassano Magnago factory, which is no longer operational, were impaired for a total of 2,009 thousand euro. The valuation was carried out by estimating the assets' market value;
- land and buildings: Villa Spineda-Gasparini-Loredan, no longer utilized for operational purposes since December 2004, was impaired by 7,119 thousand euro following a valuation based on cash-flow projections of potential rental revenue;
- software and IT licenses: a number of decisions regarding the Group's IT strategy made in 2005 resulted in the obsolescence of intangible assets linked to information systems which had not yet been fully amortized. The impairment for these assets amounts to 2,344 thousand euro.

Earnings. The assumptions made to determine basic and diluted earnings per share are as follows:

	12.31.2005	12.31.2004
Earnings used to calculate basic earnings per share (*)	111,873	108,795
Effect of dilutive potential ordinary shares (*)	-	-
<b>Earnings used to calculate diluted earning per share (*)</b>	<b>111,873</b>	<b>108,795</b>
Weighted average number of ordinary shares used to calculate diluted earnings per share	181,558,811	181,558,811
Effect of dilutive potential ordinary shares: stock options plan	-	23,217
<b>Weighted average number of ordinary shares used to calculate basic earnings per share</b>	<b>181,558,811</b>	<b>181,582,028</b>

(\*) In thousands of euro.

Relations with the parent company, its subsidiaries, and other related parties. The Benetton Group has limited trade dealings with Edizione Holding S.p.A. (the parent company), with its subsidiaries, and with other parties which, directly or indirectly, are linked by common interest with this majority shareholder. Trading relations with such parties are conducted on an arm's-length basis and using the utmost transparency. These transactions relate mostly to purchases of tax credits and services.

In addition, Italian Group companies have applied consolidated taxation pursuant to Article 117 et seq. of the Consolidated Tax Act (DPR 917/86), based on a proposal by the consolidating parent Edizione Holding S.p.A., which opted for this type of tax treatment on December 30, 2004. This method is to last for three years beginning with the 2004 financial year. The relationships arising from participation in this consolidated taxation are governed by specific rules, which have been approved and signed by all participating companies.

Below is a detail of the related information:

(thousands of euro)	12.31.2005	12.31.2004
Receivables	40,959	32,864
- including for participation in the Edizione Holding S.p.A. tax consolidation	39,567	32,283
Payables	39,110	19,825
- including for participation in the Edizione Holding S.p.A. tax consolidation	37,466	18,664
Purchase of raw materials	1,773	2,982
Purchase of assets	2,800	-
Other costs and services	14,832	13,229
Sales of products	-	17
Revenue from services and other income	641	937

The Group has also undertaken a number of transactions with companies directly or indirectly controlled by or otherwise under the influence of senior managers serving within the Group. The management of Benetton Group S.p.A. (the "Parent Company") feels that such transactions were completed at going market rates. The total value of such transactions was not, in any event, significant in relation to the total value of the Group's production. No director, manager, or shareholder is a debtor of the Group.

Key senior management. Senior management positions within the Group are as follows:

	<b>Function</b>
Silvano Cassano	Chief Executive Officer
Biagio Chiarolanza	Chief Operations Officer
Fabrizio De Nardis	Commercial Director
Pier Francesco Facchini	Chief Financial Officer
Andrea Negrin	Human Resources Director
Adolfo Pastorelli	Chief Information Technology Officer

In March 2006, Fabrizio De Nardis left the Benetton Group by mutual agreement.

Compensations (net of that for the CEO, as Director) are shown in the table below:

<b>(thousands of euro)</b>	<b>2005</b>	<b>2004</b>
Short-term benefits	2,032	1,690
Deferred compensation	-	-
Other long-term benefits	-	-
Severance indemnity	-	-
Stock-based compensation	2,202	722
<b>Total</b>	<b>4,234</b>	<b>2,412</b>

Research. Research costs incurred by the Group in 2005 for the development of new collections have been fully recognized on the income statement for a total of 21 million euro.

Operating lease contracts. As of the balance sheet date, the amount of rental costs still payable by the Group for lease contracts which cannot be terminated is as follows:

<b>(thousands of euro)</b>	<b>12.31.2005</b>
Less than one year	95,288
From 1 to 5 years	316,087
Beyond 5 years	283,309
<b>Total</b>	<b>694,684</b>

As of the balance sheet date, the amount of rental income payable to the Group for lease contracts which cannot be terminated is as follows:

<b>(thousands of euro)</b>	<b>12.31.2005</b>
Less than one year	39,081
From 1 to 5 years	82,118
Beyond 5 years	29,299
<b>Total</b>	<b>150,498</b>

Significant events after December 31, 2005. In line with its commercial expansion strategy in eastern Europe, Benetton Real Estate International S.A. formalized the purchase of the entire shareholding of Real Estate Russia Z.A.O. in order to execute an investment in real estate in St. Petersburg (Russia).

#### Guarantees, commitments, and other contingent liabilities

(thousands of euro)	12.31.2005
<b>Guarantees granted</b>	
Guarantees	122,953
<b>Commitments</b>	
Purchase commitments	11,768
<b>Other</b>	
Currency to be sold forward	522,735
Currency to be purchased forward	293,226
Notes presented for discount	-
<b>Total</b>	<b>950,682</b>

#### Other Group commitments and rights

##### *Benetton Giyim Sanayi A.S. (Turkey)*

In May 2005, Benetton International S.A. purchased a 50% interest in Benetton Giyim Sanayi A.S. (Turkey).

The shareholders' agreements establish that, in the event of strategic "deadlock" in company management or breach of contract, Benetton should be granted a call option on the remaining 50% of the shares. Conversely, the other shareholder, Boyner Holding A.S., would be granted a "put option" on its 50% share.

The option's exercise price is calculated as follows:

- in the event of deadlock, should Benetton wish to exercise its call option, then it would have to pay a price equal to the fair value of the shares plus a 20% premium. Conversely, should Boyner Holding A.S. wish to exercise its put option, the price collectable would be equal to the fair value of the shares minus 20%;
- in the event of breach of contract, a 30% penalty over the fair value of the shares is payable by the party responsible for the breach.

It is to be noted that, at present, the possibility of these rights being exercised is deemed to be unlikely.

##### *Benetton Korea Inc.*

Benetton Korea Inc. is a Korean company which is 50%-owned by Benetton Japan Co. Ltd. (a company indirectly wholly-owned by Benetton Group S.p.A.), 25%-owned by Mr. Chang Sue Kim (an individual investor), and 25%-owned by F&F Co., Ltd. (a Korean company).

The shareholders' agreements include a call option in favor of Benetton over the shareholdings held by the Korean partners. This option can be exercised at any time, given that the proposed price formula considers the shareholders' equity at the exercise date of the option, as well as a perpetuity calculated on the basis of the average net profit over the previous two years.

It is to be noted that, at present, the possibility of this option being exercised is deemed to be unlikely.

**Contingent liabilities.** With respect to other contingent liabilities linked to pending disputes for an estimated amount of approximately 24 million euro, the Group has not deemed it to be necessary to make related provisions because it believes that the possibility of an outlay is very remote. It is, however, prudent to highlight a dispute generated by a letter of intent signed by Benetton Group S.p.A. and an Argentinean company in 1985 in order to formalize a licensing agreement which was not subsequently converted into a contract. The dispute includes two claims: one in Italy, which was resolved in 1996 with a judgment in Benetton's favor (which became final the following year), and one in Argentina, which was resolved in 2001 with a judgment against Benetton and damages awarded in the amount of 2.2 million euro. Based on the 1987 Italo-Argentinean agreement of mutual assistance and recognition and execution of sentences related to civil matters, the judgments delivered by Argentinean courts cannot be recognized in Italy if they go against another judgment issued by Italian courts for a dispute on the same issue between the same two parties. This rule was subsequently confirmed by Italian Law no. 218/95, which regulates Italian private international law, establishing that foreign judgments are recognized in Italy only if, among other things, they do not contradict another judgment delivered by an Italian court which has passed *in rem judicatem*. Therefore, in 2002, the company requested the Venice Court of Appeal, which has jurisdiction over this matter, to issue a declaration of non-enforceability of the Argentinean judgment in Italy. Although the opposing party petitioned for an opposing claim and belatedly appealed against the Italian judgment in 2003, the risk of losing the case is deemed to be remote.