

# Pirelli & C. S.p.A. 1H 2019 Results Conference Call Transcript

*August 1, 2019*

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening Ladies and Gentlemen, Thank you for joining us today.

Let me start with a brief overview on the current market dynamics and how Pirelli is addressing the new challenges both in the short and medium terms.

The car industry is grappling with:

- An external environment that continues to be uncertain, with trade tariff negotiations slowly proceeding, Brexit approaching and a weak demand
- The transition to hybrid or full electric powertrain combined with the introduction of future stricter emission regulations are calling for higher Research & Development efforts and heavier investments
- the transformation of Mobility supply chain, more skewed towards services, is getting more complex and requiring new skills and capabilities

As a consequence, Car makers are adopting exceptional cost measures:

- temporary factory shut-downs
- revision of the workforce base
- new partnerships to share development and production costs

1H car production was weaker than expected (-6.7%) - with a worsening trend in 2Q (-7.5%) - leading to:

- a decline in the O.E. tyre market demand, and
- an increased pressure on pricing in both the O.E. and Replacement channels, with major tyre makers re-directing production originally planned for the OEMs to the Aftermarket

In this context, Pirelli choice of positioning in the High Value is bringing to a better resilience. However, we are not completely immune to this downturn:

- in the first half, the more prolonged crisis of the O.E. impacted our volumes, while
- price/mix improvement - still at the top of the industry - was dented by a challenging pricing environment in the Standard segment and in the non-specialties High Value

We limited the impact of these headwinds on EBIT through increased efforts in our cost-cutting program, raising the full year target to €70 million (1.3% on sales).

For the second half of the year, we expect:

- a milder than expected recovery of the O.E. ≥18" tyre market driven by an increase in Prestige and Premium Car production, while
- a double-digit growth in Replacement ≥18" is confirmed

As a consequence we are adjusting our full year guidance providing a floor in case of a further market deterioration.

The mid-range of the guidance is: €5.3 billion for revenues, €980 million of adjusted EBIT and a €370 million of Net Cash Flow before dividends and extraordinary operations.

In case of a weaker market environment, the floor of our guidance is €950 million of adjusted EBIT and a €350 million of Net Cash Flow before dividends and extraordinary operations.

The tough car industry situation is challenging us to be even more selective, technologically advanced and efficient, requiring structural actions that we are already implementing.

As with the Standard market decline, we are promptly reacting to the O.E. crisis. We are already setting the ground for several actions that will be better explained in the new plan.

We are re-calibrating our Original Equipment presence by:

- reducing the exposure to clients and products where the integrated profitability (with Replacement) is low, and not due to improve
- increasing our presence in new O.E. customers and fitments for electric cars, also in Asia, whose profitability stands out

In the Replacement business we are planning to:

- strengthen our focus on Prestige, high rim sizes and Specialties whose products are characterized by a high technological content and less exposed to pricing pressure
- reinforce our distribution coverage expanding partnerships and increasing our share of wallet

On the cost side, we will:

- continue the restructuring of the Standard footprint, and
- work on de-complexity, product development costs and plant overhead reduction

Our new 3 year plan to be released next November, will address:

- the deployment of all these actions, and
- the continuous innovation in products and services offering, capable of capturing future shifts in mobility consumption

Finally on the Shareholders Agreement, the current Governance has been confirmed:

- ChemChina and Camfin are stable shareholders, and
- I will continue to guide Pirelli up to spring 2023, ensuring a succession

Let us now briefly review Pirelli's key performance in 1H 2019.

The top line trend was marked by a strengthening in High Value, now accounting for more than 67% of total revenues and the ongoing reduction of the Standard segment.

We recorded, once again, an outstanding price/mix improvement: +6.4% - around 3 times versus our peers - despite a more challenging environment. Our performance was driven by the solid trend in the Replacement channel – due to the pull-through effect – and by the on-going product mix improvement.

In a very tough market environment, we were able to limit the impact of the external headwinds on our profitability, namely weak demand, pressure on prices and the increase in the cost of production factors, through our internal levers such as price/mix, efficiency and further efforts in our cost-cutting program.

A better financial management and the one-off positive impact related to the Brazilian tax credit recognition, worth €102 million, drove to a Net Income increase of +69%.

Finally, we closed the 1st half, with a Net Financial Position of €4 billion, or €4.5 billion including the IFRS 16 impact, discounting the usual seasonality of the working capital and the dividend payments – in the first and second quarter of the year, respectively.

In a couple of slides, Mr. Sala will show you how the net cash flow before extraordinary operations and dividends improved YoY, with a lower cash absorption than in the first half of 2018.

On the basis of the new assumptions on the market scenario and pricing environment, we are revising our Full Year guidance.

We introduced a target range for all indicators, considering the low end as the floor in case of a further deterioration of the external scenario.

Revenues are expected to be approximately €5.3 billion, €5.4 billion the top line implied in the previous guidance, where the delta is attributable to:

- the new assumptions on the O.E. High Value sales and on the Standard business, taking a more cautious view on LatAm
  - a more contained price/mix contribution
- Mr. Casaluci will comment on that later.

High Value weight is confirmed at 67% of our Revenues and 85% of the adjusted EBIT before start-up costs.

On profitability, we now forecast an adjusted EBIT margin between of 18% and 19%, with further efforts in our cost cutting program, to limit the impact of the external headwinds.

We revised our CapEx estimates to €380 million or 7.2% of revenues.

Finally, our leverage target is now raised to 2.33 / 2.20 times Net Debt over Adjusted EBITDA without start-up costs, due to the more contained growth in operating profit. In any case, we confirm a solid net cash flow generation before dividends and extraordinary operations between €350 and €380 million.

To summarize, the mid-range of the guidance is: €5.3 billion for revenues, €980 million of Adjusted EBIT and a €370 million of Net cash flow before dividends and extraordinary operations.

In case of a weaker market environment, the floor of our guidance is slightly below €5.3 billion for revenues, €950 million of adjusted EBIT and a €350 million of Net Cash Flow before dividends and extraordinary operations.

I now hand over to Mr. Casaluci, our General Manager Operations, who will review our first half results and expand on our full year market expectations and the operational drivers underpinning our guidance.

Later on, Mr. Sala will give you an overview of net cash flow dynamics in both the first half and the full year.

## Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti and good evening, Ladies and Gentlemen.

The 1st half of 2019 closed with €2.6 billion revenues, recording an organic growth of 1.4% with a solid price/mix more than offsetting the volume trend.

High Value volumes grew by +3.9% in the 1st half, a performance marked by a different trend in the Replacement and in the O.E. channel.

In the Replacement, we improved our market share in  $\geq 18''$  across regions recording a +13% in the first half, +3,1 percentage points more than the market, as a result of a pull-through effect of 83%. The over-performance was more marked in the second quarter with Pirelli growing +14% vs. a +9% of the market.

In the O.E. business, we discount in 1H'19

- the weakness of the Premium Car production in Europe and in China (-7.3% and -6.3% respectively in 1H; -8,4% in both regions in 2Q)
- the tough year-over-year comparison, since last year we recorded a +23% growth in O.E.  $\geq 18''$ , mainly in Europe and in China, and
- Pirelli's decision to adopt a more selective policy, and more oriented to value, with regard to some supplies to Original Equipment to safeguard profitability

In the Standard business, we reduced volumes by 13.9%, at a lower pace on a quarter-on-quarter basis. We are progressively phasing out products with lower rim diameters and profitability, given the general slowdown of the Standard market.

We recorded a solid price/mix improvement (+6.4% in the first half) which stands at the top the industry. Mix was the driver of such improvement, given the strong Replacement weight, the progressive migration from Standard to High Value and the mix improvement within each segment. Compared to the first quarter, the price/mix trend in the second quarter reflects:

- a lower contribution of the migration from Standard to High Value
- the worsening of the pricing environment. Many tyre players are re-directing production originally intended for the Original Equipment channel to the Replacement market. This impact is more contained on High Value due to specialties that account for more than 50% of our High Value Sales

Forex was negative (-0.5%) due to the volatility of exchange rates in emerging countries versus the Euro, mitigated by the revaluation of the US Dollar and the adoption of high inflation accounting in Argentina.

Looking at profitability, Pirelli adjusted EBIT closed at €441 million for the first half, with a 16.6% margin.

Internal levers contributed to containing the impacts of the external scenario (exchange rate volatility, increase in the cost of production factors, weakness in market demand and the pressure on prices). In more detail:

- our industrial efficiencies are generating savings of 1.4% of sales, offsetting rising inflation costs
- price/mix and cost-cutting plan were not sufficient to fully offset the volume decline and raw mat and forex headwind, since the drop through of the price/mix (55% in the second quarter and 60% in the first half) reflects the tough pricing scenario in the second quarter.

Let's now move to the performance by Region.

EMEA closed the first six months with an organic sales of -3.2%, impacted by the fall in Car production in Europe during the first half and a more challenging pricing scenario. In this volatile market, we maintained our market share in Car  $\geq 18''$ , supported by

- our diversified homologations portfolio in the O.E., and
- the pull-through effect in the Replacement channel

Reduction of exposure to the less profitable products continued in the Standard segment.

Overall, profitability was in the mid-teen range for the Region, lower than the first half of 2018, due to the previously mentioned slowdown in the O.E. channel.

In North America, we recorded an organic growth of +4.6%, driven by High Value Sales, where we improved our market share, through the success of our Specialties  $\geq 18''$ , and our regional All-Season products.

Profitability improved by more than 2 percentage points to the “Twenties” range, as a result of the higher weight of High Value sales, cost efficiencies and the progressive strengthening of the U.S. Dollar.

Asia Pacific remains the Pirelli Region with the highest adjusted EBIT margin. The 5% organic growth in High Value Sales was mainly driven by the Replacement channel, with a better market share in Car tyres  $\geq 18''$  supported by the pull-through effect and a vast distribution network, counting over 4,500 points of sale.

The negative performance on the O.E. side reflects the weak demand, the tough year-over-year comparison and the selective approach to OEMs supply.

Standard organic sales were up about 2%, thanks to the recovery in the Replacement market for  $\leq 17''$  rim diameter tyres.

Russia and Nordics recorded an organic growth of +2.5%. The focus on the most profitable segments and the market recovery boosted the results of the first 6 months, with an organic growth in High Value revenues of +34%, compared to a decline of Standard organic sales of -6%.

Profitability keeps improving in the Region: adjusted EBIT margin is now in the mid-teen range, vs. a mid-single-digit level for the same period of 2018.

South America grew organically by about 9%, and was the result of:

- a drop in volumes (about 11%) in a weak market environment both in the O.E. and in the Replacement channel)
- a marked improvement of the price/mix, thanks to price increases in Brazil during the fourth quarter of 2018 and to the strong improvement in the product mix, with the progressive reduction in sales of less profitable Standard products with lower rim diameters

Profitability (now high single-digit) has improved in the first half of 2019, due to continued efforts aimed at cost efficiencies and to the improvement and conversion of the mix. Price/mix hit a +20% in the first half.

Let's now move to the market outlook for 2019.

2Q trends are pointing to a more prolonged weakness of the O.E. market for 2019, with 2H recovery expected to be slower than previously estimated:

- in Europe, fleet channels have brought forward many orders to 1H (pre-buy), so that the 2H might suffer lower demand from them.
- in China, final government car incentive schemes (announced on the 6th June) are supportive, but below the initial expectations (i.e. no tax cut as drafted in April); The early introduction of China VI lower emission system has pushed sales in June (discounts up to -45%) creating another pre-buy effect that will likely hurt 3Q / 2H sales

Given this car scenario, our view on the High Value O.E. is more cautious, with a market expected to be almost flat for the FY 2019 (+2%/+3% the previous expectation).

In Replacement:

- we confirm the soundness of demand driven by the Car Parc shift towards higher rims
- a (double-digit) growth is confirmed at around 10% within all High Value Regions – accounting for 95% of ≥18" Global demand

In this scenario, we are reinforcing our cost-cutting program by additional €20 million as a results of further actions on:

- Marketing and Advertising, reducing budget on Standard Regions while exploiting more digital tools on High Value
- Purchasing Negotiation, by extending the revision of contracts especially in non-core products and services
- G&A and other, leveraging on new travel policy and other discretionary costs rationalizations

At the same time, we are working on a more structural and extensive plan that will allow us to further optimize our cost structure, also streamlining our Standard capacity. This is one of the chapters of our new Business Plan.

Let's finally move to the Operational Drivers of our guidance.

On the basis of the O.E. market outlook before mentioned, we foresee a High Value growth between 7.5% and 8% in volumes (>+9% the previous indication), outperforming the market in both channels.

- in the O.E., we will leverage our homologations and new supply contracts in North America and Asia Pacific becoming effective in the second half of the year
- in Replacement we will benefit from the pull-through effect (83%)

The low part of the range reflects a potentially more prolonged weakness of the O.E. market, especially in China where the demand is affected by both macro-economic and regulatory issues.

For Standard we forecast a double digit decline: between -11.5% and -12% assuming a further slowdown on the O.E. channel, especially in Brazil.

The combined trend of High Value and Standard will bring volumes down between -2.5% and 2% (-1% the previous indication):

- price/mix improvement is now expected at +4.5% ÷ +5% (+5% ÷ +5.5% the previous indication) due to a different product and regional mix and the more challenging pricing environment in the Standard business and in the non-specialties High Value
- FX slightly negative (-0.5%), in line with the first half
- hence, the top line is expected at approximately €5.3 billion

High Value weight over sales is confirmed at 67% (in line with the previous indication).

Adjusted EBIT margin is expected to in the range of 18% or 19% ( $\geq 19\%$  the previous indication), with:

- lower volume and price/mix contribution partially offset by higher cost cutting measure (€70 million, +€20 million vs. previous indication) and lower raw mat impact (now at -€70 million vs. -€85 million previously indicated)
- for volumes we confirm a 40% drop-through
- for Price/mix the drop through will be in the range of 45% to 60%, where the low end reflects mainly a worsening of the price trend
- efficiencies will more than offset the increasing cost inflation (labour, energy, etc.) (€10 million of net effect)
- D&A and other almost zero since Cost cutting, worth almost €70 million, will offset the increase of Depreciation and other costs

Start-up costs are confirmed at €40 million, mainly linked to additional efforts in the digital transformation program, Cyber; Velo business is almost at breakeven.

I now leave the floor to Mr. Sala.

## Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

Thank you, Mr. Casaluci and good evening, ladies and gentlemen.

We closed the first 6 months of 2019 with a Net income of €307 million, or 6.7% of sales.

The improvement from the first half of 2018 was driven by:

- a higher EBIT reported which benefits mainly from the one-off income equal to €72 million due to the recognition of tax credits in Brazil, following the judgement of the Brazilian Regional Federal Court which recognized the right to exclude the local Value added Taxes from the base calculation of PIS and COFINS contributions; this positive non-recurring item more than offset the lower adjusted EBIT (-€9 million) and the increased non-recurring and restructuring costs (-€15 million).
- better financial income and charges, which reflected the one-off positive effect of €100 million, deriving from the mentioned tax credits, lower financial charges for €8 million including the impact of IFRS 16 – Leases

Tax expenses were negative for €110 million: the tax rate in 1H was at 26.4%, consistent with the expected tax rate for the 2019 financial year, and including the impact of the Brazilian tax credit.

Excluding all the one-offs and non-recurring items, Net Income adjusted amounted to €256 million, vs. €233 million in the first half of 2018.

We ended the first half with a Net Debt of €4 billion, excluding the impact of the IFRS 16, reflecting:

- the usual trend of the working capital, in line with the seasonality of the business, and
- the dividend payment in the second quarter

In the first half, the net cash flow before extraordinary operations, dividends and equity transactions amounted to -€623 million, €207 million less negative than last year.

This improvement is attributable to the operating Cash Flow, with €214 million less in terms of cash absorption, mainly related to Working Capital which benefitted from

- the continuing improvement of payment conditions with suppliers, and
- the recovery actions on receivables and inventories

More specifically:

- on trade receivables, we realigned the payment terms with the main dealers in Brazil, which had temporarily been extended to the end of 2018, due to difficult market conditions
- on inventories, we reduced volumes by 4%
  - with a 16% decline in Standard products, in line with the recovery plan announced earlier this year
  - with a 6% increase on High Value products to guarantee a better service level to final customers

The stock mix improvement and Forex impact brought a slightly increase of the value of the stocks versus full year 2018, but stable versus the end of the first quarter.

In the second quarter, we recorded a positive net cash flow before dividends and extraordinary items equal to €73 million, twice the value of 2Q 2018.



For the Full Year 2019, we expect to generate a net cash flow before extraordinary operations and dividends between €350 and €380 million. This result will be achieved through:

- the operating performance improvement
- a tight control on the working capital. Over the year, we are taking actions on stock to reduce the incidence on sales of between 20.5% and 21%, based on the new revenues guidance, vs. almost 22% in 2018;
- lower Investments (€380 million vs €400 million, previously indicated, and €463 million in 2018)

In the second half, we expect a positive reversal and contribution in working capital and other by around €800 million, concentrated in 4Q, for the usual seasonality, with collections of winter sales within year end (considering the sell-out season in Europe and Russia), and for the further reduction on inventories, and benefitting from the expected improved result.

Pirelli's Gross Debt amounted to €5.5 billion at the end of June 2019, with an average life of 2.7 years, as more than 66% of it is now due beyond 2021.

These figures include IFRS 16 impact while they do not include the discretionary Borrower's only extension option up to 2 years on our committed bank lines which can therefore be extended at unchanged economic conditions to 2022 and 2024 respectively.

By considering such extension option, our €1.4 billion liquidity margin allow to cover 2.5 years of forthcoming maturities.

Our cost of debt on an annual basis (related to the last twelve months) stands at 2.97%, from 2.95% in December 2018. The reduced exposure of the net financial debt to high interest rate currencies made it possible to offset the negative effects mainly related to the exit from the perimeter of net positive accounting effects (repricing of the debt and the make-whole option for the early repayment of the bond loan) during the first half of 2018.

Now I leave the floor back to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you Mr. Sala, this ends our presentation, and we may open the Q&A session.

## Questions & Answers

### Kai Mueller – Bank of America Merrill Lynch Analyst

The first one is really on the OEM trend. Can you give us a little bit of colour on how you see that in 2H? And on pricing. You mentioned the European market, is that a European phenomenon, or do you see it somewhere else as well? And is that really related to OE contracts? Or is it those OE volumes going into the Replacement markets that caused somewhat more pressure in the Replacement market itself?

### Andrea Casaluci – General Manager Operations

So concerning the first question, on the market of the original equipment, I will give you our vision on the  $\geq 18''$  market, which is our core. In the first half, we had a decline of roughly 3% in the market. In the second half, we do expect a market growing roughly 7%.

This is mainly due to a favourable comparison with last year because last year, in the second half in Europe, we had a negative effect of the introduction of the WLTP regulation that influenced the seasonality of the market.

If we move on North America, we do expect a stable market, which is basically flat during the first half, and we do expect the same trend in the second half, slightly negative, maximum 1% negative. While in Asia Pacific, the picture is similar to Europe. We had a negative 2% market in the first half, and we do expect a positive market in the second half in the region of +2.5%, +2.6%. And again, here, the major effect is a favourable comparison with the last year, where the car registration started to decline in the last quarter, mainly in China, and also the introduction of some new incentives that, as I said before, have been less effective than was expected before.

As far as price environment, the price pressure that we perceived in the High Value regions is mainly due to the fact that the decline of the Original Equipment demand is creating, let me say, capacity available and the need for finding volumes and demand that is moving into the Replacement channel. And as a consequence, a little bit more of pressure on the price environment as far as the Replacement is concerned. But this pressure is concentrated on the Standard segment and in the High Value not protected by Specialties or market size or Prestige, which accounts today, in the High Value regions, roughly half for our sales.

### Monica Bosio – Banca IMI Analyst

The first one is on the price/mix drop-through. If I heard well, the price/mix drop-through will be in the range of 45% and 60%. Can you just highlight how much it was in the second quarter? I can imagine, close to 40%, 45%. And what can we expect in the third and then the last quarter? And as for competition and pricing pressure, can you just give us a flavour of the inventories, the original equipment level and also the Replacement one? And in which regions do you mostly see the competition? And very last, given that there is competition, your price/mix assumption, I can imagine that they may derive from the mix and not from pricing. Is it correct?

### Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

For what concerns the price/mix in the second quarter, the drop-through was in the region of 55%, while in the first quarter was 62%. And this came from the more pressure on price that we suffer, in particular in Europe, but concentrated on the Standard part of the business and on the non-specialties of the High Value. Our guidance for the full year, taking into consideration the current situation of the market, is in

the range from 45% to 60%, in which the lower level of the drop-through of the price/mix is considering the continuous pressure on price. Thank you.

Monica Bosio – Banca IMI Analyst

It should be very high if the price/mix drop might fall to 45%, do you see additional pressures for the second part of the year?

Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

We gave this range, so in case the pressure on price will be less negative, we will position ourselves in terms of drop-through price/mix in the top part of the range.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We have to keep in mind that the price effect is going down 100%. The drop-through is 100%. So that's the reason why 1 point of price is dropping drastically. So the effect is negative because of price.

Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

If I may add also another point. In the second half of the year, we will have a lower channel mix versus the first half of the year due to the rebalancing of the O.E. / Replacement sales.

And the second element is that the reduction of Standard will be lower than the previous year because of the fact that last year there was a strong reduction in the volumes in Standard and in particular in South America. So we will have also a channel mix negative, a regional mix negative from this point of view. But the final drop-through is in the range of from 45% to 60%.

Monica Bosio – Banca IMI Analyst

Okay. That's very clear.

Andrea Casaluci – General Manager Operations

For what concerns the stock of cars into the trade: No major relevant information from the U.S. and Europe, while there is good news coming from China, where after the month of June we have recorded a strong sell-out and a very low production. So there was a high improvement in the car registration and we saw reduction in car production. So we do expect a normalization of the stock of cars into the trade. This is due to the China 6 regulation that was introduced before than expected. And so we had a discount effect on the old stock of cars produced before these new regulations.

While if you move into the Replacement channel, again, we see a level of stock that is a bit higher than the normal and a bit higher than last year. And this is mainly due to a weak sell-out summer, mainly in Europe. And now, we do expect that this will go back to the normal level in a couple of months. While for winter, the stock that we measure into the trade is in low level compared to the normal situation in this period of time. So this is opening a good opportunity for the winter season.

Martino De Ambroggi – Equita Sim Analyst

On the sales by division. If I take the figures in the guidance, I realize that the High Value, but please correct me if I'm wrong, the High Value EBIT margin should be down for the full year by 150 bps. While the Standard roughly 50 bps. So first of all, if it's not correct, please stop me. But I was wondering why the impact on profitability is more evident in High Value where you have aftermarket, which is holding up and price pressure, which is more on Standard.

### Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

I guess you referred to the second quarter versus the first quarter. So the lower pace of growth in the High Value of the second quarter versus the first one is mainly due to the slowdown of the Original Equipment, okay? There is a limited impact of the price in this part of the range. The measure is negatively impacting. The difference of pace, of course, the High Value in the second quarter versus the first one is related to the slowdown of the Original Equipment, mainly in China and Europe.

### Martino De Ambroggi – Equita Sim Analyst

Actually, I was referring to the full year guidance, taking the 67% High Value sales and 85% High Value rate on adjusted EBIT. So I derived 150 bps of lower recognized savings that are the 25% of last year. So this was my real question.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We don't see what you are mentioning in our second half forecast because we see, let's say, a stable second half compared to last year in terms of profitability of the High Value. We can see a drop in High Value. What we see is the risk that we have underlined on volumes that could come from the Original Equipment. But the effect you see is to be considered only related to the original equipment. And in case the Standard is continuing to reduce more than expected. But we don't see a deterioration on High Value in the second half.

### Martino De Ambroggi – Equita Sim Analyst

Okay. And on volumes, what's the saturation of the plans in the High Value? Do you have a rough indication today compared to 1 year ago, when the market was, let's say, skyrocketing compared to today?

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

If you look at the adjusted EBIT margin, we estimate for the full year is in the range of last year. So to achieve this, it's obvious that we stay in the same range of profitability for what concern the High Value. And we put a floor on building worst-case scenario, at least in line with last year.

### Martino De Ambroggi – Equita Sim Analyst

Okay. That's referring to the first question. But in terms of saturation of the plan for capacity utilization for High Value, there is a big difference compared to 1 year ago?

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Now it's fully saturated.

Martino De Ambroggi – Equita Sim Analyst

Okay. And the very last, in your floor scenario, is there a possibility to further cut in CapEx? Or CapEx cannot be touched anymore?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, we consider that we have done what is necessary and what was feasible, considering also the volumes that are lower than expected. The €380 million will remain the number.

Sascha Gommel – Jefferies Analyst

The first one would actually be on pricing in NAFTA. I think some of your competitors are talking about price increases. So I was wondering if you can share your view on how you see pricing at the moment in NAFTA and how you see it evolving for the rest of the year.

Then my second question would be on restructuring charges, I think the initial guidance was €50 million. So I was wondering if this has changed, given that you stepped up your cost-saving efforts. And then my last question would actually be on the item other input costs. Maybe you can remind us what exactly that is, and why we should assume that the impact in the second half should be lower than in the first half.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

First of all, price, NAFTA to me. For the other questions, Mr. Sala, the €50 million restructuring cost.

Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

Exactly. Probably when you mentioned the €50 million were related to the guidance on non-recurring and restructuring cost. We added in the first half €15 million of additional write-off in Brazil and Italy for further restructuring action. So our current guidance for the full year is in the region of €70 million for what concerns restructuring cost and/or non-recurring costs, because we are increasing the actions to face the current situation of the industry.

For what concerns input costs, they include labour cost, energy, and cost of transportation. We are seeing a trend that will be slightly lower in terms of inflation in the second half versus the first half.

What will be definitely lower in the second half versus the first half is the headwind related to the raw material cost because in the first half, raw material were negative by almost €50 million. And our guidance for the full year is a negativity of €70 million.

Sascha Gommel – Jefferies Analyst

Perfect. And can I sneak one quick one? Your factoring level at the end of the quarter, how much was that roughly?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Payable versus the corresponding period of the previous year.

## Gaetan Toulemonde – Deutsche Bank Analyst

It's Gaetan Toulemonde speaking. The first one is when I look at your volume in Standard tyres, you end up with approximately minus 25% in 2 years. So is there a limit there if we project ourselves to next year? Do you still expect Standard volumes to decline by this type of magnitude? That's my first question.

## Andrea Casaluci – General Manager Operations

Yes. We have a target of a floor level of Standard. We don't want to go completely out from the Standard because in the Standard segment there is a niche of value products with different technologies. I'm talking, for example, about the all-season, the winter tires even for small rim size. So we have a target by region, and we will communicate during the next plan. We are not so far in the High Value regions from the target as far as Asia Pacific and North America is concerned. Otherwise, we still have opportunities to optimize it in Europe.

## Gaetan Toulemonde – Deutsche Bank Analyst

Okay. But if I understand well, we are close to the floor in terms of volume decline, is it correct?

## Andrea Casaluci – General Manager Operations

Yes, of course, we are not really close to the minimum, but from the third quarter 2019 on, we do expect to reduce the speed of declining of the Standard, so no more but the double-digit reduction that we saw in the last 5, 6 quarters.

## Gaetan Toulemonde – Deutsche Bank Analyst

Okay, that's pretty clear. I have a second question regarding the free cash flow. You gave us a number which is around €350 million, €370 million. I get that number pretty easily without including any positive from Latin America, negative working capital of last year where I thought that you wanted to recuperate part of it this year. Does that mean that there will be no positive working capital impact for the full year this year? Is it the way I should understand that?

## Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

We mentioned from €350 million and €380 million. And for the concern working capital, we are doing further actions on stocks. We already reduced the stocks in terms of volume by 4%. But we are continuously reducing the stock, and we will have a further reduction of stock in September. For the concern in working capital, we are forecasting a cash absorption in the region of €50 million, due to the fiscal receivables coming from the Brazilian fiscal credits that will be used starting from next year. So we will not immediately get cash benefits during this year.

## Gaetan Toulemonde – Deutsche Bank Analyst

Okay. But some parts you don't expect to recover from Latin America, from last year, where the fourth quarter has been very negative?

## Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We see already in the first half of the year, the recovery. So the cash flow traction shows that we're cleaning out what was the excess of stock in Latin America end of last year.

## Thomas Besson – Kepler Cheuvreux Analyst

I'd like to continue on the inventories. If you look at Page 19 of your presentation, the absolute inventory figure you show is that nearly €1.2 billion or nearly 2 points higher in terms of proportion of revenues in the previous year. So can you help us reconcile this with the comments you just made on the reduction of inventories by 4 points and also explain the big change we've seen in payables year-on-year that are up €150 million year-on-year. That's my first question.

## Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

For what concerns stocks, we mentioned the reduction of stock in volume terms. So I mentioned a reduction of stock of 4% from the end of last year until June in total volumes, out of which minus 16% was a reduction of stock in volumes for what concerns Standard, and the most important part of it happened in South America, where the reduction of stock was more than 20%.

We had an increase in High Value by 6% in volumes, coming from better service levels.

For the full year, we are targeting to arrive at the end of the year with further reduction to a level that is not already the level that we have in June. That will be in the region of 20.5% / 21% of net sales versus a 22% of net sales that we had at the end of last year.

For what concerns payables, we are in continuity versus the previous year. So we are not doing any further actions.

## Thomas Besson – Kepler Cheuvreux Analyst

Okay. Second question is on High Value volumes and on price/mix. So your volumes have improved versus the market, but your price/mix deteriorated. And your new guidance suggests that you're going to have a lower price/mix in 2H again. Would you say that the rapid price positioning of Pirelli has come down? Or would you say that the absolute market has come down a lot, and therefore, you have to address as well to just follow the market?

## Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

As far as the price/mix of the second quarter versus the first quarter, we have roughly 2 points of difference mainly driven by 2 factors. The first one is the lower reduction of Standard. So we had a lower reduction of Standard in the second quarter compared to the first quarter. And you will see in the second half, this will also contribute negatively to the price/mix. So less reduction in Standard.

The second aspect in the performance of the second quarter compared to the first one, as we said before, is the negative price effect.

If we go into the second half, we'll have 2 negative impact on the price/mix. One, as I said, is the lower reduction of Standard. And the second is the negative channel mix because we do expect a recovery of the Original Equipment and with a favourable comparison with the last year. And also because we are enlarging the customer base, and we will start new supplies and new contracts mainly in the U.S. and in Asia Pacific.

### Thomas Besson – Kepler Cheuvreux Analyst

Okay. I have a last question on start-up costs? Initially, it was supposed to end. Should we expect 0 start-up costs in 2020? Or are we going to continue to have start-up costs in 2020, please?

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Start-up costs are in line with what we forecasted, €40 million this year. For next year, we expect to go down to €10 million, as it was in our plan. So no news on start-up costs.

### Henning Cosman – HSBC analyst

I'm afraid I'm still a bit confused with respect to the range and floor communication that you've now introduced. I calculated an adjusted EBIT range of €950 million to €1 billion and €10 million roughly. And I think you said for free cash flow, you have €350 million to €380 million range. That's only €30 million difference. So besides the change in EBIT, can you help us what moves the range in the free cash flow? And then I also wasn't sure if you suggested that the €380 million compares to the €980 million adjusted EBIT midpoint, whereas for the free cash flow, it seems like you meant the top end. So if you could just clarify that again, please.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We are referring to the expected results. We put a floor just to consider the market environment, considering the worst-case scenario. All of the numbers you see, the €30 million you see in terms of cash is due to tax. So the difference you see from the €60 million and €30 million is just related to the tax rate. Nothing more than this.

### Henning Cosman – HSBC analyst

Okay. And just to reconfirm, the €380 million free cash flow corresponds to the midpoint of the adjusted EBITDA range which is €980 million?

### Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

The cash flow of €380 million correspond to the level of results in the top part of the range. The floor correspond to the level of result in the bottom part of the range.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

€380 million means €980 million in terms of EBIT.

### Henning Cosman – HSBC analyst

Okay. So midpoint, midpoint. Okay, fine. And then just to clarify on the changed net financial position over adjusted EBITDA that appears to suggest a larger change in the net financial position than what's implied by the net financial cash flow itself. So I was just wondering if there are other moving parts in your net financial position bridge outside of the free cash flow, please.



Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, nothing else.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Since there are not further questions I am concluding the today's program.

Thank you for your attendance, and have a good evening, and enjoy your summer holidays. Thank you, everybody.