Pirelli & C. S.p.A. 3Q / 9M 2017 results transcript

November 6, 2017

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good afternoon Ladies and Gentlemen and thank you for attending this conference call which is our first after the IPO.

We are back in the Financial Market as a global Consumer tyre company focused on High Value, with a governance keeping abreast of the best international practices.
We proactively apply the best international standards to protect the interest of minorities and underline the independence of the board, as set forth in our bylaws.

As a global High Value player we are well placed in an attractive market, which is expected to outgrow the Standard market 4 times on the long run, being linked to the dynamics of the Prestige and Premium car parc.

We belong to a healthy sector with high barriers to entry, namely:

› Technology, for the continuous requirements of innovation from our clients
› Brand: a key differentiating factor for the engagement of the final customers

There is a tight supply & demand for High Value products, with no overcapacity risk, and this should support pricing power.

Our strategy is based on 3 key pillars:

› a focus on High Value, particularly in Europe, APac and NAFTA
› a digital-enabled transformation program along our value chain
› …and the reduction of our exposure to the standard segment

This strategy is already bearing fruits, giving us an edge over full-liners, allowing for a strong growth rate both in the top line and profitability.

Indeed, our distinctive positioning in High Value is clearly visible in our 9M results where High Value is gaining weight.

Our price/mix trend is once again at the top of the industry, twice the average of our peers, as a result of a successful shift to the very High End of the market and a sound pricing policy. This was one of the main drivers of our performance.

Our outlook for 2017 is consistent with what is envisaged in the plan:

› A strengthening on High Value which will account for 83% of the EBIT adjusted before start-up costs, where the 2020 target is 85%
› A gradual de-leveraging which will bring the Net Financial Position to EBITDA ratio below 3 times. And here the 2020 target is below 2

Before diving into the numbers, please let me give you a brief recap of the Pirelli Strategy

We started our journey focusing on Premium, defined as tyres with rim sizes ≥17”. In 2016, this meant 65% of our Revenues.

More recently, we refined our definition of Premium, to focus on a narrower and more exacting market space which we call High-Value.
Our strategy is now focused on High-Value, which encompasses the whole Consumer Business:

- In Car, High-Value means the market for tyres fitted by Prestige Car brands, plus New Premium tyres (≥18”), plus Specialties (like Run-flat or Noise Cancelling or Seal Inside...) and Super Specialties (like Colored). Specialties may have smaller rim sizes, but are very challenging to make, and command high margins (e.g. Run-flat homologated on BMW smaller series...)
- In Motorbikes, High-Value consists of all Radial, plus XPly tyres, with a speed index equal or higher than H
- High-Value Revenues so defined are 55% of 2016 Consumer Revenues. In the future, all Businesses including the New Cyber and Velo will be focused on the High-Value Consumer Market Space

Our 2020 target is to bring High Value revenues weight over the total to ~63%, an average yearly increase of 2 percentage points. This year, High Value weight will already be more than 57%.

We’ve positioned ourselves in the right portion of the market:

- The ≥18” segment has grown and will be growing faster, 4 times the Standard market by 2020
- The 2017 market outlook is confirming this trend, the ≥18” market will grow at ~+10.2% vs. +1.4% on ≤17”

Car Parc evolution is one of the key elements supporting this growth.

- Premium and Prestige cars on the road will be ~154 million in 2020 compared to ~129 million in 2016 and ~135 million in 2017

Other important trends I wish to mention, which are all supporting growth and entry barriers to the upper part of the market, are:

- the increasing demand of Homologations and specialties from car manufacturers and end users
- the success of SUVs and CUVs, typically fitting large rim sizes
- …and new technologies related to connected, electric, shared and autonomous cars, all demanding specific and highly technological tyre solutions, developed hand in hand with car manufacturers

The overall High Value market is important, but it is also currently concentrated in three Regions, where Pirelli is well rooted: Europe, APAC and NAFTA

- Prestige and Premium Car Parc is expected to reach 154 million cars in 2020, of which 93% in these 3 Regions, growing with a 4.6% CAGR in the period;
  Growth for the end of 2017 is expected in line with the average growth per year that we see in our Plan
- In terms of New Premium, the tyre market, including O.E. and Replacement, will total ~280 million pieces in 2020, growing +9% / year on average, with a 95% concentration in these 3 Regions
- During the first 9M of this year, New Premium Tyre market grew by +11%, while Pirelli volumes grew at the much faster pace of +15%;

As planned, Pirelli is gaining shares, and we expect to continue outpacing the market in the next years

Moving to slide 7, as briefly introduced before, Pirelli is executing its strategy based on 3 pillars. Let's have a quick look at them, one by one.

The focal point is High Value. The foundations of our business model are based on 4 strategic levers:
1. O.E. homologations portfolio
2. New product innovation
3. Shifting Car capacity towards High Value
4. A consumer-centric approach

Our model can be summarized as follows:
We develop high performance products; products that are mounted on Prestige and Premium Cars, Cars that are bought by Premium Consumers, typically high spenders, whom we follow during their entire journey, offering products and services for tyre Replacement when and where needed.
We manage the entire process based on a consistent and focused value chain that is fed by the inputs from the Automotive Industry. Indeed, we have visibility of future demand through new Car registrations, registrations that are the basis for tyre demand in the O.E. channel and are captured through homologations.

Lever 1 – Homologations
- More than 50% of O.E. sales, and more important, more than 60% of Replacement sales for the next three years of the Plan come from products with homologations and shares already acquired. In the first year of the Plan, the visibility is higher considering the high loyalty rate. Therefore over 70% of our retail sales in 2018 are linked to past homologations.

In the last five years, we doubled our yearly average of homologations reaching a portfolio of more than 2,050 High Value homologations (of which 86% Marked). Between now and 2020 we are developing more than 1,150 projects.
During the first 9M of the year, we have been able to achieve ~230 new High Value Homologations (>90% Marked), 1 out of 5 for Prestige cars, 1 out of 4 for winter products
- We also homologated tyres for Electric vehicles of our Premium and Prestige partners

Lever 2 – new product innovation
As far as new product innovation, 18 new product lines are in the pipeline to 2020, covering global and regional lines, specialties and traditional, Winter, All-Season and Summer tyres. New launches will strengthen our product range, our brand and support our pricing strategy.

During this year:
- we already launched 2 regional lines for the Americas like the Scorpion Strada A/S - an SUV product for the North American clients - and the new Scorpion ATR Plus, a pick-up product for both North and South America
- we unveiled what we think is the future of our industry: the “smart” tyre. I am glad to share with you that Connesso will be available at our Pzero World in LA, starting from this month, for our Prestige clients
- Car manufacturers' interest in Color Edition tyres is rising, we are now discussing with them on how to partner for their bespoke programs
- …and we are receiving very positive feedbacks from the Market on the comeback into bicycle tyres, after the PZero Velo commercial launch in 3Q 2017

Lever 3 – shifting Car capacity towards High Value

To meet High Value demand, Pirelli has designed its capacity with a vision into the future. According to our Business Plan, Car capacity will go from a total 71 million pieces in 2016 (with 38 million High Value, or 54% of total Car tyres), to 79 million pieces in 2020 (with 53 million High Value, or 67% of total Car tyres). We will make investments to increase High Value capacity by over 14 million pieces, of which 11 million pieces of new High Value capacity, and over 3 million pieces from Standard conversion into High Value. In 2017, we expect to add 3 million out of 14 million pieces already included in the Plan.

Lever 4 – A consumer-centric approach

The 4th strategic lever is based on a consumer-centric approach. We have created a dedicated consumer marketing unit active on both dealer and consumer engagement to further develop this approach. In our Business Plan, a strong growth is envisaged in distribution within the categories where a better cooperation can increase value for Pirelli brand through an improvement of demand and price control.

In particular:

- The Car Dealer channel, the strongest link with our Prestige and Premium car owners, where Pirelli is overweight vs. the market, is expected to grow from 10% to 15% by 2020
- Tier 1 Distributors, a selected group of partners sharing into our long-term commercial strategy and product positioning, will grow in weight from 9% to 20% by 2020
- Pirelli branded shops (from the Pzero World flagship stores, to retail networks under the logos of Driver, or Dackia in Nordics), will go from 12,500 in 2016 to 17,000 in 2020. In the first 9M of 2017, we added over +1,000 Pirelli branded shops. We opened the first European Pzero World store in Munich, one of the top 10 cities in the world in terms of Prestige car density. The shop is already a benchmark for end user engagement and relationship management excellence.
- E-commerce will be close to 1% by 2020 when we look at direct Pirelli Brand e-commerce only. However, we expect that 10% of consumers will buy Pirelli tyres on line by 2020. That's why our online strategy will include the development of e-commerce for our retail network and the consolidation of partnerships with the best online e-tailers.

Let us now focus on our second pillar: the Transformation Program

We have selected 4 projects chosen for their cross-functional nature.

1. Integrated Forecasting: we are applying predictive models to vehicle life cycle and vehicle parc data, integrating O.E. homologations and Replacement tyre dynamics to better forecast demand and optimize investments and stocks along the whole value chain
2. Smart Manufacturing and Flexible Factory: IOT data from process machinery is feeding applications aimed at improving process and labour productivity, as well as finished product yield. This program together with additional initiatives such us de-complexity and design-to-cost are producing their first results already in 2017 economics, with 1% efficiencies on sales.
3. Prestige is the most demanding segment of High Value Market. All the key levers of the Prestige value chain have been united in a specific global Business Unit, also as a source for many best practices
4. Supply Chain: we are designing 5 supply chains, better addressing customer and consumer segments ,capitalizing on greater integration and digital tools:
   i. Super-Specialties and consumer e-commerce
   ii. Prestige Pzero world network
   iii. Premium and Prestige OEMs
   iv. Tier 1 Distributors
   v. Rest of the Aftermarket

Now, moving to our last Pillar, to conclude the Pirelli Strategy recap, the Company is reducing its exposure to standard, while keeping its assortment in line with client expectations and trimming less profitable products.

Over the next few years, we will reduce our standard capacity from 33 million tyres in 2016 by >20%, reaching 26 million tyres at the end of 2020.

- Most of the reduction is concentrated in LatAm, MEAI and Russia.
- It is consistent with the pruning of unprofitable customers or C-brands products.

We are reducing more than 2 million / tyres standard capacity in those Regions before the end of 2017, while upgrading Aeolus capacity into Pirelli products in APac.

This reduction needs to be combined with a strengthening of our standard product positioning:

- After the first 9M of this year, we see that our phase-out plan for low profitable products is underway at a faster speed than expected, especially with legacy brands, such as Amtel
- Profitability recovery is also producing its benefits: the 9M 2017 Russian EBIT adj. margin is now positive and low-teens

The results of the first 9M of this year reflect the strategy and the programs I have just described:

- A solid 9% top-line growth driven by:
    - the strengthening of our position in the High Value segment, which accounts for 58% of revenues, +2 pp against the same period last year
    - a top price/mix in the industry (+6.5%, more than twice our peers average, equal to 3%), resulting from both mix improvement and the price increases put in place starting from April 1st
- Profitability grew by 10%, with an EBIT margin before restructuring costs reaching ~17% in the first 9M, and 17.6% in 3Q. The profitability improvement was based on the quality drivers of the top line and the delivery of our efficiency program, 1% of sales, in line with 2017-2020 Strategic plan.
- The net Income adjusted, i.e. net of all the one-off and non- recurring items - Mr. Sala will talk about them later - doubled, with a 6.4% ratio over sales, as a result of the improvement in the operating performance and of our action in the financial and fiscal areas.
- A Net Debt to EBITDA ratio of 3.7x as against 4.6x at the end of 2016, benefiting from the capital increase subscribed by Marco Polo at the end of June. Net Debt to EBITDA ratio is expected to get down below 3 times at the end of 2017.

Let's move to the regional performance, starting from High Value regions, namely Europe, NAFTA and APac which account for 76% of our total revenues, 92% of the High Value turnover.

In Europe, we consolidated our leadership in the Prestige segment, and more in general in the ≥18", gaining in the first 9M almost 1 percentage point in both O.E. and Replacement channels, accelerating in 3Q. Our past investments into strengthening our partnership with Prestige and Premium Car Manufacturers continue bearing their fruits through an increased pull-through effect.

At the same time, in line with the Business Plan, we are reducing our exposure to the Standard segment, especially in 3Q, and lower rims (≤16'') characterized by a lower profitability.

As of today, the weight of Standard ≤16'' on our total volumes is almost half of the market average in Europe.

As a consequence, we recorded a sound price/mix improvement, also benefitting from the progressive implementation of the price increases announced on April 1st.

In NAFTA, we recorded a sound performance with a 9% Top-Line growth both in the first 9M and in 3Q, excluding the FX impact which was negative in 3Q.
We over-performed the ≥18" Replacement market leveraging on:

- the launch of new products, such as Scorpion Verde All Season Plus
- an increased penetration on Pirelli Retail points of sale
- an improved service level benefitting from LatAm imports (+9% YoY the growth of volumes imported from LatAm)

We were recently appointed preferred partner for Mercedes-Benz Aftersales Tire Program in the Americas (Canada, U.S., Mexico and Brazil).

In APac, the Region growing the most, we recorded our best performance, +17.9% in total sales, with the support of the High Value segment.
Due to the increase of market exposure to the O.E. channel, we added new homologations with European and local car brands and expanded our commercial presence in the Region reaching ~4,000 points of sale.
In the ≥18" segment, we increased our market share in the Replacement channel by almost 2 percentage points in the first 9M, leveraging on the pull-through effect deriving from the strong homologation activities in the last 3 years.

Briefly on Standard regions. They account for 24% of our sales and 8% of our High Value revenues and we were in line with our strategic plan to reduce our exposure to less profitable products.

In LatAm, we are maintaining our focus on mix improvement, phasing out products with lower rim size and reducing our exposure to the low value O.E. contracts.
We are accelerating the conversion of our Brazilian plants (Bahia and Campinas) to High Value production, to better serve the North American market and be ready to exploit further opportunities arising in the region.

In MEAI, despite an overall market scenario slowing down compared with 2016, we have increased our High Value sales by 21%, which now account for more than 50% of the regional sales. This has been done through a commercial performance driven by a careful channel mix management and over-performing the market.
Most of the growth has occurred in Turkey and the Gulf Countries, that account for ~70% of our sales in the High Value segments in the region.

Finally in Russia, we have strictly followed a value map approach:

- accelerating the discontinuation of legacy brands, such as Amtel,
- limiting the imports of less profitable products, and
- concentrating our efforts on more profitable products both for the local market and for the exports

This move, combined with an efficiency program, led to a significant profitability improvement.

And now I leave the floor to Mr. Maurizio Sala, who will comment our financial results in detail.

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

Thank you, Mr. Tronchetti and good afternoon, everybody.
In the first 9M 2017, sales grew by 9%, or +7.7% before FX impact and Aeolus consolidation.
The analysis of the organic performance by Quarter shows:

- a double-digit High Value volume growth gaining momentum in 3Q, after a 2Q affected by the pre-buy impact in view of the announced price increases to counteract the increase of the raw materials
- a gradual reduction of the exposure to the Standard segment (5% drop in volumes in 9M, -5.8% in 3Q), with the phasing-out of the less profitable range and products in South America, Russia, MEAI and Europe, mainly low-rim sizes and an accelerated discontinuation of legacy brands in Russia
- the resulting price/mix improvement reached its highest level, +7.3%, in 3Q, reflecting the impact of the price increases made from April

The quality of our top-line drivers translated into a profitability improvement in the first 9M of the year, with an acceleration in 3Q. EBIT margin before start-up costs reached 17.6%, 1.4 percentage points more against 3Q 2016.

The profitability improvements both in the first 9M and 3Q, i.e. +10% the growth of our EBIT adjusted without start-up costs, and +15% in 3Q, were driven by our internal levers

- namely, price mix, efficiencies and volumes,
- that more than offset raw materials headwind, inflation and the increase of D&A and other costs related to the development of High Value.

In particular:

- the strong price mix improvement covered 1.5 times raw material headwind in the first 9M, and almost twice in 3Q
- cost inflation was counterbalanced by efficiency gains mostly related to some of the mentioned transformation programs, and linked to Industrial and product activities such as:
    - raw materials' cost optimization, and reduction of tyre weight,
    - increase of production in low-cost countries,
    - improvement of productivity and processes streamlining
    - energy and others cost optimization
- Finally, just a brief comment on the limited FX impact on EBIT which shows how we are more balanced on FX than with the previous perimeter, being naturally hedged, in particular in the EUR/USD exchange rate

Net income, before discontinued operations, recorded a strong improvement, resulting from our solid operating performance combined with:

- the improvement of the results from equity participations (lower losses from Prelios and lower impact from devaluations)
- lower net financial charges as a result of credit facility refinancing worth €4.2 billion entered into at the end of June 2017 with positive impacts starting from 3Q, granted by a pool of ~20 banks
- lower tax rate: 14.5% in 9M 2017, against 67% in the same period of 2016, benefitting from the one-off booking of deferred tax assets on tax losses and on other timing differences (including the Italian ACE, the Allowance for Corporate Equity, an incentive related to capital increases)
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At the same time we have filed an application for the Patent box regime, a tax relief on intangible income.

The average tax rate before tax incentives for the period 2017-2020 is estimated to be of ~34%.

ACE and Patent box incentives are estimated to be of ~6%

Therefore, the indicative average tax rate for the period results to be below 30%.
Normalizing the trend from all the one-off and non-recurring items affecting the EBIT as well as financial and tax expenses, Net Income adjusted amounted to €257 million, or 6.4% of revenues, almost twice the value recorded in 9M 2016.

Let us now move to reviewing our Net Financial Position trend in 9M 2017, which was €4.3 billion, €625 million less than at the end of 2016. This positive trend is the result of the capital increase subscribed by Marco Polo at the end of June.

The Operating cash flow was negative for €391 million in 9M 2017 (-€198 million in the same period of last year). The trend was impacted by:

- a CapEx of €328 million (€106 million more comparing with the same period of 2016) to increase High Value Capacity in Europe and NAFTA, to implement strategic conversion of standard into High Value production in our Brazilian plants (Campinas and Bahia), to upgrade Aeolus plant and to continuously improve both mix and quality in all our plants
- a cash absorption linked to Net Working Capital: €900 million in 9M 2017, €100 million more compared with the same period of 2016, due to higher sales. The Net Working Capital trend is going to revert in the last quarter of the year mostly as a consequence of higher volumes of collections, especially linked to winter sales in high seasonal regions, like Europe and Russia.

The seasonal reversal of the working capital trend expected in 4Q will translate into a positive trend of the operating cash flow bringing down the Net Financial Position to EBITDA ratio below 3 times.

Pirelli's Gross Debt is worth ~€4.8 billion.
Due to the end of June refinancing of our main bank facilities for a total amount of €4.2 billion, we have extended the average life of our debt to 3 years (from 2 years) and 73% of our debt is now due beyond 2019.

Cost of Debt stands at 5.5%, down from 6.2% last year, benefiting from the reduced all-in cost of the new syndicated facility in the last 3 months only.

Our exposure to low-cost countries with high cost of money affects our cost of debt through local financing and infra-group loans as we fully hedge them out of any FX risk.

At the end of September 2017, ~17% of our average Gross Debt was in high-yield countries, such as Russia, Mexico, Brazil, Argentina and Turkey with interest rates averagely higher than 10%.

For the years covered by the Plan, a ~5% cost of debt is expected. This forecast is based on a cautious assumption of a general scenario where interest rates increase and credit worsens.

And now I leave the floor back-up to Mr. Tronchetti for 2017 outlook.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

On the basis of the data for 9M 2017, and in line with the 2017-2020 Business Plan, we forecast for 2017:

- A revenue growth of ~9%, with an increased weight of the High Value component, which will account for above 57% of total revenues (55% at the end of 2016)
- Adjusted EBIT before non-recurring and restructuring charges and before start-up costs, is expected at ~€930 million, a YoY growth of ~10%, with the High Value segment accounting for ~83%, up from 81% at the end of 2016
- Adjusted EBIT is expected at ~€880 million
- A Ratio between the net financial position and Adjusted EBITDA before non-recurring and restructuring charges and before start-up costs below 3 times compared with 4.6 times at the end of 2016
- CapEx increasing to ~9% of revenues (6.8% at the end of 2016) as a consequence of increased investments in Romania and Mexico, the upgrade to High Value in Brazil, and the reconversion of Aeolus Car to Pirelli brand

This ends my presentation, we may open the Q&A session.

Questions & Answers

Kai Mueller – Bank of America Merrill Lynch

Hello, thank you very much for your time. I have three questions, if I may.
First of all, you have very strong volume growth obviously in your high Value business, you've been saying the market is developing nicely and obviously it's going to of course on the Repl. side four times. The standard market over the next year, how do you see that developing and how do you see yourself versus the peer group, especially as others are also going into that space?
And on the same point your price mix at 7.3%. Obviously, in 3Q was very strong. Can you give us some colour in terms of what's underlying mix effect and what sort of price action you've been taking and how that flows into next year?

Second question, on your South American market.
You mentioned you've already started to ship some volumes from South American to the North American markets. I remember you mentioned that before. Can you give us a timeline and scale, possibly, how big these volumes can become?
And is there a big differentiation in terms of the margins, you can make given your lower cost of top out and South America.

And then the third point on the cash flow generally, the CapEx, in particular, you've now said this year 9% CapEx on revenues. Can you give us a little bit of colour you mentioned an average of 7% between 2017 and 2020. How should we see the trend?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. So looking to our growth in price mix, we see in 3Q and effect also coming from prices. Prices, as you know, in 1Q below the growth of raw material effect and we see the price effect has been ~2.5 % in 3Q. And the rest is mix.

In South America next year 25% of our production will be dedicated to export. This year, we are still at ~15%.

CapEx this year we have an effect of around 100 million coming from the reshaping of the Chinese factoring to Pirelli capacity and to Brazilian factories upgrade to high value.
Next year, we see the CapEx going down to an average of ~7%. That means that the last year, the plan should be below 7%.

Martino De Ambroggi – Equita SIM Analyst

Good afternoon everybody. The first question is on the operating leverage of the incremental margin. If you look at 3Q and the 9M, it was 44% and 47% respectively. So, much higher than the past. Should we take these as a normal operating leverage for your new perimeter or yet to be slightly lower or higher? Thank you.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

It is right, we can keep these as a reference.

Martino De Ambroggi – Equita SIM Analyst

Okay, also going forward. And, a follow-up on the previous question on the price and mix, I don't know if you are willing to share with us the split in order to have a better idea of the balance between raw material and prices in the first 9M and maybe going forward.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So, the last quarter should see an effect of price mix that will continue and the effect of raw material should be lower than the 9M.

Martino De Ambroggi – Equita SIM Analyst

OK, if I may just one question on the financial cost trend.
And a more general question in terms of geographical areas focusing on margin expansion, what are the most promising geographical areas as you see or, on the contrary, the most critical areas for your 2020 business plan? Thank you.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

For the financial expenses average a bit less than in 3Q, so for the next year looking forward we should see a bit lower.
Talking about different areas, we see APac continue to outperform the other regions, Europe maintains a speed like the one we see with some increase and NAFTA continue to increase. These are the main regions. The trend in Russia & CIS and LatAm has become positive and we'll continue to be positive, so we consider this option value.

Thomas Besson – Kepler Cheuvreux Analyst

Two quick questions for you.
The first one is, can you remind us remaining links that the new perimeter has with the industrial business, please, because I see that in your discontinued operations, you still have losses that derive, I understand, from your exposure to Egypt which I think comes from the industrial business.
So can you explain us where it comes from exactly and what are the remaining links with the industrial, please? Or maybe I misunderstood.

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

Result coming from the discontinued operation includes the financial data for 1Q 2017 for the industrial business, that you may remember that was assigned to Marco Polo only at the end of March, so practically we have all the first quarter results of the industrial business in the result for the discontinued operation.
And then we have for 9M some residual industrial activities, currently undergone in separation, the result was negative by €75 million, out of which the ordinary results, net result, was positive by €5 million and €80 million was a negative result from the accounting point of view, coming from the translation differences of the reserves, mature at the date of the assignment and the most important part was related to the Egypt translation, so what does it mean? It means that, for the future period, we have still in our number for few months the results of China and Argentina, for what concerns

truck, that we are going to separate, in terms of activities, and without any further problems from this point of view.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

By year end will be over

Thomas Besson – Kepler Cheuvreux Analyst

Okay, very clear.
Second, very simple question, can you give us an idea of your 2017 tax rate please, because I mean in the first part of the year, it was impacted by some taxes as carry forward it in 3Q, it look for the first 9M. Should we think that we are going to stay ~15% for 2017? Or it is going to be higher than that?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, will be in line 14.5%.

Victoria Greer – Morgan Stanley Analyst

Good afternoon. Two questions, please.
One on the working capital.
You were clear in the presentation, this is going be a reversal in 4Q, could you just give us what cash impact you expect from working capital for the FY? So, 2016 was ~€100 million cash inflow, is that a reasonable assumption for us to use for FY 2017?
And then secondly on the raw materials, you know, at the analysts' presentation you talked about quite a lot of raw material inflation, you know, natural rubber at $2.20 / kg for 2018, for example, you know, do you think these are still the right assumptions, looking at, you know, how the raw materials have moved over the past 6 months or so, and, you know, in the next 2/3 years how would you think about the raw material outlook? Thanks.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So, on working capital, the seasonality will be in line with what Mr. Sala already explained, in the last quarter there will a reverted trend due to the payment on Winter season that are made in the last two months of the quarter and the end game will be that the Net Debt / EBITDA ratio will go below 3.

On raw materials trend, in our plan we have a 10% increase average in the next 3 years with bit less in the end in 2020, so that's the average expectation. We start year end more or less in the same position of 2016, with some increase on Brent and oil in general, so that's the situation, we don't change our view on the future and we have based our expectation on that 3 years.

Henning Cosman – HSBC Analyst

Hi, thank you. My first question is on the start-up cost, seeing that you are including this in your guidance now, which I think is a little bit different from the guidance scope at the analyst presentation. Could you please remind us what start-up costs you're budgeting ideally for every year between 17 and 2020. That's my first question.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So, the start-up cost for this year is ~€50 million, next year 40, and will be no start-up cost in 2019 and 2020. This is what we expect and we are in line with our expectation.

Henning Cosman – HSBC Analyst

The second question on the mix maybe, you said in Q3 pricing was 2.5%, implying that mix was almost 5%, is that in line with what you're budgeting going forward? Or, what's your budget again in terms of how much mix you would expect?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We expect to continue with the mix trend in line with what has happened in the last few years, we don't see major changes happening, on prices it obviously will depend on the trend of raw materials in the future, so for this year it is clear what is happening and has happened, for next year we put it in line with the raw material growth expectation so prices should stick to that balance between raw mat and prices.

Henning Cosman – HSBC Analyst

Sure. Just on the mix itself, I don't think we actually have the historic breakdown between price and mix so are you prepared to confirm that it's in the regional 4 to 5%?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Yes, yes of course.

Henning Cosman – HSBC Analyst

And finally, on the homologations I think you gave us a number of 230 as a run rate for the 9M, which appears to be slightly down versus FY 2016 number, can you talk about that a little bit? How important that is for your cases as stabilizing now at roughly that level and that's consistent with your budget or are you expecting this to start growing a little bit again?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

As you have seen, 3Q has been increase in the number of homologations, we expect the trend to continue and to stay over 300 homologations as it was planned.

Henning Cosman – HSBC Analyst

Okay, so you don't need this number to go up much further to remain consistent with the plan. It's okay that stabilizes at a number just above 300 for the remaining years of the plan?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Yes, we have already visibility on 1,150 homologations in our pipeline, so we can, let's say, maintain the shape we had and continue this strength.

Monica Bosio – Banca IMI Analyst

Thanks for taking my question, good afternoon everyone.
The first question is on the reduction in standard. My feeling is that the group is accelerating the reduction in standards, and this is also the reason why price mix is growing is this sound level and maybe it's also the reason behind a higher CapEx, am I right? Are you accelerating the cut in standard?
The second question is on the any potential impact from FX on the EBIT, did you have any potential impact? So far, you are not strongly exporting from Brazil to U.S., but I'm just wondering if Pirelli had some impact in the third quarter on the EBIT?
And the third question is if you can give us an update on the restructuring costs for the full year? Thank you very much.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So, the Standard reduction, we confirm our strategy to continue to reduce 5% per annum ≤16”, with a growth on 17” in areas where it is profitable, that is obviously part of the mix improvement.

We have, the effect on U.S. export from Brazil will be enhanced in 2018, is partially visible in 2016 but I think in second half of 2018 we should see the full exploitation on this.

On efficiency and cost reduction, we confirmed this 1% on our turnover by year end. As we mentioned when we presented the plan, we expect in the next year something more coming from digital, that should improve productivity and provide us higher efficiencies.

Monica Bosio – Banca IMI Analyst

Just a follow up: on one side we have efficiency, and on the other side we have restructuring cost, but if I remember well over the 9M were in the region of €20 million, do you have an expectation for FY 2017 in terms of restructuring?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, we confirm the €20 million, plus, obviously, there are the IPO cost and lay-off cost. Lay off is what I mention, the €20 million. The IPO costs are €70 million.

Gaetan Toulemonde – Deutsche Bank Analyst

I have two questions.
The first one is on the raw material, can you give us the magnitude of the headwind you expect in the first quarter, which is expect around a similar number to the third quarter, is it correct or it's a little bit less? Can you summarize that a little bit?

And regarding 2018 too, because I'm a little bit lost with the previous question that issue, where you mentioned that you expect an increase of raw material next year, I'm not totally sure that I understood that well.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

For the headwind last quarter, we expect a bit better than what was planned ~€30 million, that is what we expect, for next year we still stick to the 10% increase in raw material prices which is partially confirmed on oil and brand side, we see some volatility in natural rubber in these weeks, so we don't have any new, let's say, forecast for the next year.

Gaetan Toulemonde – Deutsche Bank Analyst

My second question: when I look at your standard tyres, it looks like that you're for the first time the volume are -5% and the revenues are +4%. Can you explain a little bit the difference? Does that mean that you increase pricing much more on Standard tyres than on Premium?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So, in fact we have the reduction of 5% on the ≤16", but we have a growth on 17", that is why you see the difference between 5% and 4%, is one is reduction on ≤16" and partially compensated from the growth. So if you compare volumes and revenues you see +5% for both.

Gaetan Toulemonde – Deutsche Bank Analyst

Ok, so that means that price and mix have been very significant, is that correct?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Obviously. Yes, it has been because we cut: 13" to zero, 14" by half and so the effort continues to reduce on ≤16", that's why we have a strong effect on mix.

Gaetan Toulemonde – Deutsche Bank Analyst

Okay and that trend should maintain in the coming quarters, there's no reason that you would change the strategy in that respect, is that right?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No reason to change it.

Marshall Wace – Earl Austin Analyst

Hi, good afternoon everyone, I just have one question remaining, which is in terms of the price increase which you said started in April, has that been implemented across the whole range of products? And if not would you therefore expect a stronger effect of pricing in 4Q?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, we saw a better effect in 3Q that will continue in 4Q, so that is the price mix, the 1Q was negative, an improvement in 2Q, full effect in 3Q and 4Q.

Sloane Robinson – Agarwal Rohit

Hi, I just had one question on start-up costs: you broken them up on 9M, you've given an EBITDA of €866 million, excluding start-up costs. The adjusted EBITDA that you reported for 1H 2017 results, you've given two EBITDA numbers €866 and €836 million and they're just adjusting the start-up cost, so I just wondered shall I be comparing the €546 million of 1H to €866 or to €836 million?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

You have to compare the €546 with €836 million and €567 with €866 million. Last year there were no start-up costs, this year we had €30 million in 9M that will be €50 million by year-end. Last year it was zero start-up cost.

Sloane Robinson – Agarwal Rohit

Okay, so, I'll just ask the question a bit differently. Should I just throw out that €39 million of cost this year, per quarter, so just divide it by three to roughly get an idea of how much it is per quarter?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

€15 million in 1Q, €12 million in 2Q and 3Q.

Lello Della Ragione – Intermonte Analyst

Hi, thank you for taking my question.

I have actually two left, one again on pricing. You mentioned the breakdown, that was very helpful, on the price mix, so assuming that 5% coming from mix, going back on the price, the increase was in the tyre and I didn't get if you answered completely the question before, if you implemented increase in price on all over the product sold on the High Value and the Standard one and if you expect a stronger and sooner acceleration in 4Q, especially coming from price, at this point, since you started this just in 2Q.

And the second question is on, again, start-up cost, you gave the indication for this year and next year, I was wondering if you can give us a split mostly to the cost related, I mean, even roughly to the one related to China versus Velo or Cyber, and if we have to assume that all this will be cash in the same year.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So, cost, let's say, ~€15 million is the China reshaping cost, €14 million is Digital, ~€4/5 million is Velo and ~€11 million is the Cyber. Then, the price will continue for the last quarter, 2.5%, we expect to have more or less the same price increase.

Lello Della Ragione – Intermonte Analyst

If can add one on price, one of you competitors mentioned lately that they have some 10% premium against you in your so-called high-value segment and I was wondering if this is related to different pricing strategy or is it related to the fact that you have still to implement some price increase compared to them?
I was wondering if it is strategic or just a question of timing.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

On products, so in the very high-end we don't have differences. In regions like the United States where we are building our capacity and our network, while we have a lower market share, we have a difference and that is right, the evaluation that has been made, so we have to split between regions and different categories of product lines. That's an opportunity we have and we are catching up.

Alessandro Tortora – Mediobanca Analyst

Good evening to everybody, I have two questions if I may.
The first one is just to come back to the non-recurring item and restructuring costs because compared to 1H results so basically a lower amount of cost year for the ~€46 million I saw in the first half so, just to understand better what is the trend here in the third quarter, implied third quarter and then if you can, sorry, just repeat the indication of the additional cost that we have, I heard, ~€70 million from IPO cost but also some other cost that we may see in 3Q.

The second question: we expect a working capital release in the last part of the year, what I would like to understand is what is generally the impact for you in terms of receivable factoring for this year, thanks.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Starting with the last question, factoring has a minor impact and the cost is paid over the EBIT margin. By year end the factoring will be ~€250 million factoring. There are peaks during the year but the total cost is in the EBIT and in our account is helpful because we have a very low cost on factoring and is reducing the risk of credit that we cover and so no major effects on this.

On working capital at the last quarter as I mentioned before, last year was ~€750 million. The effect in the last quarter related to the payments on Winter season, so we have to expect something similar, non-major effects. The outcome of all this is that the Net Debt / EBITDA ratio will go down below 3 times, as I mentioned before.

Going to the non-recurring cost, we have €26 million in 3Q, in 1H minus €46 million, 4Q will be -€110 million. This is related to IPO, so we have not factor the €26 million in 3Q.

Ashik Kurian – Jefferies Analyst

Hi, thanks for taking my question, I just got a couple left.
First, I'm just trying to understand you volume growth going forward. From what you've shown on ≥18", you're probably growing at 15%, which is higher than the 13% target over the next four years, yet the growth volumes have come in ~1%, I believe this is due to the faster than expected run down on the standard tyres and you said this is expected to continue for the foreseeable future so is this the

target volume growth that we should expect in the coming quarters or this is a one off and we should expect volumes to improve drastically in the coming quarters?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

On High Value we continue the trend we mentioned in our plan: we expect a two digit growth in this segment. The market is expected to be ~+9%, we have in our plan +13% growth, this year (until now) we are a bit better and we expect by the year-end to be a bit better than what was in our plan, so we expect to keep a 15% growth in ≥18”.
We see the car parc continue to grow in the Prestige segment, in a shape that is in line with our forecast, so Premium and Prestige are growing in line with our expectation.

I have to complete the answer to the previous question, the 3Q we have a positive effect related to the fact that the special award has not been achieved in terms of target for the management, so there are, in 3Q, €26 million of positive effect on non-recurring costs.

Ashik Kurian – Jefferies Analyst

Sorry, probably I wasn't clear, my question was more on the total group volumes growing at +1%, I totally agree that ≥18” is growing at +15%, so just wanted to confirm that, at the Group level, given the expected decline for Standard, is the growth rate that we see at the Group level, which is ~+1%, is that the expected volume for total group going forward, or at least for the forthcoming quarters?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Yes we confirmed obviously: the growth for us in the plan in the next year is average +13% in High Value. And the market is expected to grow +9%.
This year we see +15 %, so we are better than the plan in our growth and we see the markets at ~+10%; a bit better than what we planned.

Ashik Kurian – Jefferies Analyst

Just a quick follow-up on the price mix and then you have 2.5% of the price and the price mix, somehow the drop through to the EBIT base is a lot higher, I think it's almost close to 100% in 3Q, is this the expected drop through that we should factor in on your price mix going forward?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No. When we talk about drop through of prices, obviously 100%. When we talk about mix is ~60%.

Ashik Kurian – Jefferies Analyst

It seems a bit higher on 3Q, but I'll follow it up later.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Ok.

So, if there are no more questions I just want to thank all of you for your attention and after the blackout period will come to an end, we'll start our road-show in the U.S. starting from the 13th of November.

Thank you very much to everybody.