# Pirelli & C
# 1Q 2013 Conference Call
# May 07, 2013

**Marco Tronchetti Provera**

SLIDE 3:KEY MESSAGES

Good evening Ladies and Gentlemen, and welcome to this conference call on Pirelli's 1Q 2013 results.

The global tyre market is still lagging, although there are some interesting islands of growth in the emerging markets. Europe is still grappling with its economic problems that cause a depression in consumption levels. The US are embarked in the so-called "soft patch" towards recovery, since, in the short term, their economic growth profile is very much dependent on the sequester.

In this context, we have a distinctive profile within the tyre industry.

56% of our revenues and over 60% of our operating profit come from the emerging markets where, faced with a strong demand, our sales are gaining momentum, especially of premium tyres which are growing three times faster than the others.

Another island of growth is our industrial business where we had a strong volume growth – +12% - and the top profitability in the industry.

The conversion of our Settimo Torinese plant into premium car makes us now fully delocalized in low-cost manufacturing countries, and we will soon collect the benefits from this strategy.

In Europe, where demand is still slow also in the Premium segment, we are investing in the future and increased our premium sales in the OE channel which will bring about positive repercussions in the replacement business in the future.

Our global tyre car market estimate for the full year 2013 is of 1,327 million pieces, approximately 20 million pieces less than our assumptions in March this year. This is entirely attributable to Europe which will settle on 315 million pieces at the end of this year.
According to our estimates, the tyre volume reduction is of 1/3 in the premium replacement and 2/3 in the non-premium replacement.

The premium trend confirms "the multiple of 3 rule", both in terms of growth and reduction trends. In this case when on the downturn, it drops by 1/3 of the non-premium as it is occurring now in Europe (-3% compared to -10% in Replacement).

Our overall estimate is that at the end of 2013, the premium business in Europe will account for approximately ¼ of the total market, that is 77 million pieces. In the Nafta, it will reach 13% of the total car tyre business, and in the emerging markets, it will exceed 8% of the total.

In this context, where demand is weak in the old continent and the cost of raw materials is lower than expected by the whole industry, prices were adjusted in line with this environment from the beginning of the year.

We believe that, from now on, each player will adopt a pricing policy based on their value proposition.

We also believe that market shares of value segments are not so sensitive to price as to quality of the product, service supplied and brand.

We believe that the loyalty level increases in the segment of marked tyres and large sizes, and for this reason, in spite of the present market crisis, we are investing even more in the Original Equipment.

At a time of discontinuity, we are trying to create long-term value opportunities.

The assumption we are making on the industry pricing is supported by the fact that at the end of the reporting season in the first quarter, all peers have confirmed the profitability guidance and FCF. Therefore, the industry remains disciplined.

In this context, the question we raised at Pirelli and that led us to postpone the presentation of our Industrial Plan after the closing of the first nine months of 2013, is to which extent the European crisis is structural.

It goes without saying that after six quarters of negative trends in the replacement clients will have to change their tyres, but the question mark is about the rebound curve and timing.

Therefore, until we gain a better understanding of the correlation between customers' spending capacity in a macro-economic context of long-lasting crisis and changeover rate/time, we at Pirelli decided to do our best to keep our European plants at high utilization rate for what concerns the production of the high Premium exporting our high-end tyres to non-European countries, where premium demand is growing more than expected and allows us to be flexible in the installation of new premium capacity in the medium/long term.

SLIDE 5. KEY FINANCIAL RESULTS

Now, let us go through Quarter one 2013 results.

Our distinctive geographical reach allowed us to capture growth opportunities in different markets, channels and businesses, resulting in a 3.6% increase in Revenues before the impact of exchange rates.

The market downturn in Europe was mitigated by:

- a development in Emerging markets above expectations, particularly for Premium tyres,
- a strong performance of our Industrial business, which outperformed the industry confirming our leadership in the key reference markets.

- the profitability trend mainly reflects:
- the slowdown in Europe, the world's largest Premium market
- a diluting impact of both channel and country mix (full contribution of Russian JV)
- additional industrial costs for our Premium production footprint (Settimo Torinese truck conversion) and start-up costs
- higher depreciation in line with our investment activity in the past

Below the Ebit line, the increased financial charges are due to a higher cost of debt and to the devaluation of the Venezuelan Bolivar.
The higher tax rate should not be considered as a pro-quota for the year, and will decrease progressively in the coming quarters, in line with our guidance of 35%.
Finally, Capital Expenditure totaled €80 million, and our Net Financial Position increased in connection with Net Working Capital dynamics, as cash absorption is usually heavier in the early months of the year.

SLIDE 6. PERFORMANCE BY REGION

Let us review our performance by Region:

- Emerging markets kept growing at a double-digit rate and contributed 56% of Pirelli sales and more than 60% of Ebit;
- In the Nafta, we improved our positioning in the Premium segment with positive repercussions on profitability despite a general market slowdown;
- Our performance in Europe was affected by the continued economic crisis which spread from the peripheral to the core markets and, since the Fourth Quarter of 2012, included the Premium segment.

Let's focus on our Premium performance in Europe.

It is worth to mention that the first quarter of 2012 was the strongest quarter in terms of Premium sales, accounting for approximately 30% of the yearly total and mostly on the replacement channel.
In addition, the quarter fully benefited from the price increases made starting from the second quarter of 2011, when we were faced with an inflationary scenario for input costs.

Besides the unfavorable comparison base, the 13% decrease of Premium sales reflects the weak demand in the Region.

In this environment, Pirelli strategy was to invest in its future, and seize the opportunity of Premium OE that will bring about future benefits due to the high Replacement pull-through . In the short term, this produced a negative effect in the price/mix trend.

Furthermore, current expectations on raw materials led us to distribute among our clients a portion of the benefits achieved in this Quarter, by lowering prices by a low single-digit percentage.

**Asia Pacific** remains the Region with the highest growth in the Premium segment, with Revenues on the surge by 46% year-on-year. The OE Channel had a good performance, due to the strong link with German Premium Car Makers. Similarly, the Replacement Channel benefited from the association with Formula 1 and a strengthening of our Brand Image. Pirelli is the second best Brand in terms of Brand Consideration by Chinese car owners according to GfK.

In **South America**, Pirelli improved its market positioning, especially in Brazil where we continue to drive the development of the Premium segment with a wide range of products, a strong brand and a pervasive distribution network.

The Premium trend in the First Quarter in Russia discounts the strong slowdown of sales in summer tyres, approximately –11% in volumes. This is due to a shift in the winter/summer tyre changeover to the Second Quarter of the year due to long-lasting bad weather through the month of March. This phenomenon is confirmed by the positive market data in April.
Overall Sales are definitely on the rise, (+26%), especially of locally manufactured tyres, partially meant for the OE channel, a different channel mix as compared with the first quarter of 2012.

SLIDE 7 RUSSIA PROJECT UPDATE

Now, specifically on our JV

First of all, we are reinforcing our winter line-up with two new studded products, specifically engineered to match the demand of the Russian and Nordic markets. The brand new Pirelli Ice Zero was successfully launched in Finland in March, and many of our customers also had the opportunity to personally test it in our new factory in Voronezh.
Feedback was very good and we think that this new product will be an outstanding chance for Pirelli to grow stronger in the winter segment.
Ice Zero will couple with Formula Ice, the second Pirelli brand meant for a wider medium-to-low range of cars and marked “powered by Pirelli”.

Together with strengthening our product range, we are continuing our "made in Russia" homologations with a number of OEMs like Mercedes and Volkswagen, as well as maintaining a selective partnership with local OEMs.
We are also working hard to expand our distribution network which we had already much improved in 2012. This year, together with increasing the number of points of sale, we will open six “Pzero Platinum” Flagship stores, of which two in Moscow, another three in big Russian cities and one in Sochi, the city that will host the next Winter Olympics as a result of our recent cooperation with our local partner Rosneft.

Our marketing investments in Russia are still in line with our effort to increase Pirelli footprint and awareness of Pirelli brand. Our new advertising campaign, made in cooperation with different prestigious European OEMs is now on air, and we are strengthening our ties with our trade partners, recently involved in an innovative e-learning program.

Finally, the industrial ramp-up of our plants is proceeding towards Premium production, with a total investment in 2013 of €50 million.
Our new mixing rooms are now up and running in both sites of Kirov and Voronezh.
Most important, we are forecasting about 100 new industrialization projects for 2013, focused on Pirelli Premium products and Formula branded tyres.

SLIDE 8: PIRELLI NET INCOME Q1'13 VS Q1'12

The first quarter of 2013 shows a positive Net Result of €72 million.

The year-over-year trend is determined by both Operating Performance and Non-recurring items.

The Cost of Debt was 6.5%, increasing quarter-on-quarter due to:

- a greater exposure to the emerging markets in which we operate, characterized by higher interest rates, and
- a different debt mix which allowed us to postpone maturities and diversify debt sources.

During the remainder of 2013, the cost of debt is expected to come down to 6.3% due to different mix of currencies.

Among other things, Financial Charges went up due to:

- the devaluation of the Venezuelan Bolivar (€8.3 million),
- a non-recurring positive one-off in Q1 2012 linked to our Russian JV (€8.7 million)

Finally, Net Income benefited from lower tax charges worth €23 million, in connection with a lower taxable income. The higher tax rate – at 37% due to business seasonality and a different country mix – is expected to progressively come down in line with our yearly target of 35%.

SLIDE 9: PIRELLI Q1 2013 DEBT STRUCTURE

At the end of the First Quarter of 2013, Pirelli's Gross Debt was worth approximately €2.5 billion, 77% of which maturing in 2015 and later.

Improved debt maturity as compared with year-end 2012 was the result of our recent diversification of financing sources, which now rely on debt capital markets for more than 30%.

Our financing policy gains further flexibility based on the approved Euro Medium-Term Note program, giving us ease of access to debt capital markets, which we may use in the current year, allowing us to reduce our time-to-market and execute transactions with various currencies, maturities and amounts.

Finally, our sound liquidity margin of €1.1 billion covers debt maturities until Q4 2015.

Now I leave the floor to Mr. Sala

**Maurizio Sala**

SLIDE 10: PIRELLI Q1 2013 NET FINANCIAL POSITION

Thank you, Mr.Tronchetti, and good evening everyone.
A few words on the development of cash flow in the first quarter.
We recorded a €475 million cash absorption, essentially due to the seasonality of the business which implies growing trade receivables at the beginning of the year.
This impact, which will reverse its course in the coming Quarters of 2013, discounts the full contribution of our Russian business and Daekia retail chain and is in line with our stated target of bringing Operating Working Capital at or below 10% of Sales by year-end.

Inventories are almost stable, compared with December 2012, at 18.4% on sales. This was achieved in an environment of continued weakness in European markets and a delayed changeover of winter tyres.
Bearing in mind that Quarter 1 is typically characterized by lower investment levels, Capex totaled approximately €80 million, or 1.1 times depreciation.

These resources were deployed with a clear focus on our consumer operations. Capacity investments - approximately 40% of total – allowed us to ramp up our Premium plants in Mexico, Romania, China and Russia.

We are in line with the ramp-up of our Mexican plant. The capacity target for the end of 2013 is confirmed at 1.5 million pieces.
Our plan to convert standard car capacity into Premium continues to progress. As you may remember, our goal is to cut 5 million pieces of standard capacity, 4 of which will be converted into high mix and we are on track with this plan.
Additionally, Foreign Exchange variations impacted the Net Financial Position of approximately €50 million, 50% related to the Venezuelan Bolivar devaluation and 50% to the UK Pound devaluation and Mexican Peso revaluation.
Let us now turn to reviewing the quarterly results of the tyre business.

SLIDE 12: KEY TYRE RESULTS

The performance of the tyre business in the first quarter of 2013 shows:

- Revenues up 3.9% year-on-year, before the negative impact of Foreign Exchange, worth 4.9 percentage points
- Profitability at €186 million, or 12.2% of sales after restructuring costs.
- Our geographic exposure, geared towards Rapidly Developing Economies and with a unique regional focus in the Industrial Business, allowed for a positive development of volumes, up 3.9% in the Quarter.
- Emerging markets provided the bulk of growth, +19% versus Q1 2012
- Nafta posted a slight decline, with Pirelli still able to outperform the market
- And Europe was down in line with a difficult market environment.

Premium volumes continue to be an important growth factor, up 4% and growing in all Regions with the exception of Europe (-6%) and with unabated momentum in Emerging Markets (+42%).

The volume decrease of the Premium segment in Europe, as well as the mentioned increase in OE sales and the full contribution of our Russian JV, affected the price/mix component, which was flat during the First Quarter of 2013 as compared with the same period of 2012.
Excluding the difference in channel mix and the contribution of Russia, our price/mix would be up +2.8%.
In the coming quarters, these diluting effects will fade away thanks to the improved production mix at our Russian JV and a more homogeneous comparison year on year for both perimeter and total tyre channel mix .

SLIDE 13 PIRELLI TYRE Q1 2013 OPERATING PERFORMANCE

The first three months of 2013 yielded an operating income (Ebit) of €185.6 million, or 12.2% as a percentage of Sales. Compared with Q1 2012, lower raw material costs worth €37 million were able to nearly offset:

- labor and energy cost inflation (€24.2 million), as well as
- the price/mix component (-€19.6 million), which reflects the price adjustment and the negative channel and regional mix already explained.
- Volume growth was worth €18 million in profitability.
- The additional costs determining the drop in Ebit margin are mainly attributable to:
- higher industrial costs by approximately €10 million, associated with the conversion of Settimo truck capacity into Premium car and the start-up of the Mexican plant
- lower capacity utilization of €5.5 million;
- an increase in depreciation charges (€10.8 million), in line with our past investments;
- a negative Forex impact (€9.6 million), and
- an unfavorable comparison base, in that Q1 2012 included non-recurring benefits of €10 million.

Finally, cost efficiencies for €13 million were achieved in the Quarter, 20% of our Full Year target, a percentage in line with 2012 trend. The main areas of efficiencies were:

- labour, productivity and scale – mainly on the industrial business –
- raw materials implying a reduction of product weight and waste
- and SG&A in roughly proportional split.

65% of total efficiencies were achieved in the Industrial business.
We confirm our target of €70 million for the full year.

SLIDE 14: PIRELLI CONSUMER BUSINESS PERFORMANCE

Let us now review our performance by business, starting with Consumer tyres which accounted for 73% of total sales in the First Quarter of 2013.
The top-line trend discounts the distinctly divergent trends that markets are experiencing, with overall sales growing 0.7% year-on-year, before a 3.7% negative exchange rate impact.

Sales volume was up 1.2% due to the continued strength of Emerging markets (+16%), which counterbalanced the slowdown in Europe (-16.9%), where consumption trends weakened.
Volumes in North America were stable as compared with the First Quarter of 2012, and Russia accounts for more than 3% of the overall volume growth.
Premium volumes continued to outperform the market, with regional differences: Emerging Markets grew strongly once again, outperforming Europe – lower yoy – while Nafta remained flat.

Profitability of the consumer business was €136 million after restructuring costs, which is to say an Ebit margin of 12.2%. Lower Ebit as compared with Q1 2012 was mainly attributable to:

- ➢ the mentioned increase in industrial costs (approximately €10 million), which weigh on Consumer profitability and will gradually produce increasing benefits in the Industrial Business;
- ➢ higher costs of input (approximately €20 million);
- ➢ the impact of Forex (7€/mln);
- ➢ higher depreciation cost (7€/mln), and
- ➢ higher business seasonality associated with the recently acquired assets in Russia and Sweden.

Finally, lower raw material cost counterbalanced the negative impact of the price/mix which shrank as a result of the difficult market environment in Europe.

SLIDE 15: PIRELLI INDUSTRIAL BUSINESS PERFORMANCE

Pirelli Industrial Business delivered an industry-leading performance in the Quarter, growing revenues and profitability at a sustained pace.

Our unique positioning in key Emerging Markets allowed us to capture volume growth and improve market share.

This is particularly true of Latin America, where we recorded a volume growth in the high-teen range both in All-Steel truck tyres and in Agro tyres.

Top-line growth was however hampered by the strong impact of Foreign Exchange (8.2%), limiting Total Revenue Growth to approximately 5% year-on-year.

Mix continued to be positive, up 1.4%, sustained by the ongoing introduction in the market of our renewed O1 Series truck product line and by supportive pricing in high-inflation countries.

As for profitability, the impressive Ebit growth of approximately 50% year-on-year is due to:

- Volume growth and price/mix improvement
- favorable raw material input cost.

Ebit margin was up 3.6 percentage points year on year, at 12.1% after restructuring costs.

Following the conversion of Italian truck capacity into Premium car tyre, our production footprint is now entirely based in countries with a competitive cost base. This will bring benefits going forward.

SLIDE 16 RAW MATERIALS

Finally, the revised raw material price assumptions led us to update our full year 2013 tailwind target to €110 million.

As you can see, there is no variations in Foreign Exchange and Oil price impact.

An extra €55 million tailwind is essentially due to a lower price assumption for both Natural Rubber and Synthetic Rubber, at $2,800 and €1,700 per tons respectively.

This concludes the review of our tyre results, I now give the floor back to Mr. Tronchetti Provera.

**Marco Tronchetti Provera**

SLIDE 18: OUTLOOK BY REGION

Thank you Mr. Sala.
Let us now go through our assumptions for the global tyre market as well as our regional revenue and profitability targets for 2013, highlighting the main differences with what we shared during the last conference call.

The situation in **Europe** has worsened, with the tyre market down in the mid-single digit range year-over-year, or some 20 million pieces below our previous forecast.

The Premium market, although resilient, is not immune to the slowdown and leads us to a lower profitability target for the region, in the high single-digit Ebit margin range.

Factoring in a modest, if any, volume recovery in the second part of the year, we expect European revenues to fall slightly short of the 2012 figure.

In **North America**, what was seen so far makes us comfortable with our past assumptions. We do expect a better development of Premium sales, with a profitability improvement.

Instead, the **Russian** economy is going through a slowdown. The Association of European Businesses forecast on new car registrations is flat for the rest of this year, like in this first quarter.
The standstill is also reflected in the overall Russian tyre market, while the Premium segment is set at a steady 16% growth, thus confirming our guidance.

Except for a very slight adjustment in Latam, all the other Premium Regional markets show some better signs of growth compared to our past forecast. In both Latam and Asia-Pacific, this is also coupled with a revenue growth.

Through our flexibility and distinctive footprint in the Emerging markets, part of our European overcapacity will be channeled to other Regions that need further volumes.

SLIDE 19: 2013 PIRELLI TARGETS CONFIRMED

Based on the regional trends we have just described and in the light of a better raw material scenario, we confirm our targets for 2013.

The growth above our expectations in the Emerging Markets will offset the weak European demand, making more likely our achievement of the high end of the volume target range.

Premium volume target is confirmed due to the strong demand from Emerging Markets. In Europe, we expect a progressive recovery of Premium demand and the early signs have already become visible in April.

As for the price/mix, we are more likely to reach the low end of the target range, considering the price adjustment made in the first quarter and channel mix effect.

The profitability range is also confirmed thanks to the combined effect of a higher raw material tailwind and an improved profitability in Latin America, APAC and NAFTA offsetting the lower figure in Europe.

Finally, we confirm our cash flow generation of above €200 million, as well as the Net Financial Position before Prelios impact.

SLIDE 20 – 2013 CONSUMER & INDUSTRIAL TARGETS

Finally, we confirm our top line targets in both the Consumer and Industrial businesses.

The different geographic exposure of the two businesses is affecting the profitability. In the Consumer business where Europe weight is approximately 40% of revenues, we expect an EBIT margin below 14%, slightly down compared with our previous assumption.

On the contrary, in the Industrial business, where Emerging Markets account for 84% of the top line, profitability will exceed the 12% mark.

This concludes our presentation and we are ready to answer your questions.

Now, ladies and gentlemen, we may open the Q&A session.

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Ladies and gentlemen,
We have come to the end of our conference call.
We thank you very much for your attention

## Question & Answers

**Niels Fehre** - HSBC - Analyst
So I have a couple of questions; first on pricing. I think you mentioned in your press release that premium revenues have been down 13% in Europe in the first quarter and you mentioned also that volumes have been down 6% only. So that means that the remaining 7% is coming mostly from price mix. Could you clarify how much is pricing and how much is mix?
Then the second question on Europe on the full year assumption, for consumer tires you're assuming for the full year now 4.5% price mix effect roughly from 4.5% to 5.5% previously. I think it's mostly coming from pricing again. Could you clarify what is your pricing assumption globally for consumer tires in 2013 and probably also for Europe? I think your old guidance was globally roughly flattish pricing. What is your new guidance here?
And then the next question is again on Europe, you're seeing European revenues stable in the full year, as I understand that, despite a mid-single decline in volumes and pricing being under pressure. That means a huge positive impact from mix for the full year in Europe 2013. Maybe you can clarify how much is the mix component in Europe in 2013? And then just a housekeeping question, if you could give us an update what is the Pirelli real estate impact on the full year net debt figure for 2013? Thanks very much

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Thank you. So first of all, the variance in price mix for Europe Premium is 50-50 between price and mix.

**Niels Fehre** - HSBC - Analyst
For full year or Q1?

**Marco Tronchetti Provera**
[Q1.] So one thing is OE channel mix – [high OE weight versus last year] – accounting 50% of price/mix decline and another 50% is price.

**Niels Fehre** - HSBC - Analyst
Okay.

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Then for the turnover in Europe, we expect, as we mentioned, that the growth in Europe would be in the lower

range for consumer. In industrial, we expect revenue in a high range. So we see that even the profitability will be year-end not over 14% as it was expected for consumer, but below 14%. And in industrial business, we consider to have a profitability over 12% instead of having around 12%. And more than this, we expect volumes, revenues in industrial business be in the high range. So in the lower range, volumes in consumer; in the high range volume in industrial -- and the EBIT is what I mentioned. For the other answer about Pirelli, I leave the floor to Mr. Tanzi.

**Francesco Tanzi** - Pirelli & C. SpA - SVP Administration and Finance
Thank you. For what is concerning Pirelli's impact, the impact on the transaction on our account, the financial credit will be transformed probably after the second Quarter of 2013 into equity instrument for the full amount, which is €173.5 million. As of today, we have not forecasted any P&L impact on this transaction.

**Niels Fehre** - HSBC - Analyst
Okay, so €175 million net debt increase, right, as of Q2?

**Francesco Tanzi** - Pirelli & C. SpA - SVP Administration and Finance
After the second Quarter.

**Niels Fehre** - HSBC - Analyst
Okay. And just on price mix again, so you said 50/50 price mix. That means in Q1 pricing was [in Europe] down roughly 3%, 3.5% and for the full year you assume for the consumer tire business globally price/mix to be up to [4% to 4.5%], right?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Yes, right.

**Niels Fehre** - HSBC - Analyst
Okay, thanks.

**Monica Bosio** - Banca Imi - Analyst
I would have three questions. The first one is still on price reductions and lower contribution from mix due to the different sales channels in Europe.
I'm just wondering if you believe that the worst is over in term of price reduction and lower contribution from mix? And more in detail I would wish if you can comment on your feeling on the second quarter in term of mix and volumes, on overall, not only in Europe? And I'm just trying to figure out if the situation is stabilizing.
And the third question is on the pricing policy in premium segment into emerging markets. Can you comment on this and do you expect different pricing policy and different operating margin in premium in emerging markets in comparison with the European market?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
First of all, I will leave the floor for the answer to Mr. Pirondini just to give the detailed picture. We don't see a price war. We see the fact that we are getting back the headwind we had in the raw material. So that's what we see in the market today. But I leave the floor to Mr. Pirondini, who is the Chief Commercial Officer.

**Andrea Pirondini** - Pirelli & C. SpA - Chief Commercial Officer
Good evening. So I think the first question was about the dynamic of price mix. We have seen some adjustments during the first quarter. We think that this is partly connected to a certain dynamic of raw materials. As far as the expectations for the quarters to come, obviously, this will depend a lot on the value proposition of Pirelli versus the various other players.
Overall, we don't see an environment with a price war, especially talking about certain specific segments we play in. And we also see that the launch of new products in the winter will be a very important element to support our price mix in the second half of the year. We think that about one-third of our sales in the second half of the year of winter products will be new products.
Then you were asking me how I see the situation in terms of markets, in terms of market dynamics. As we said

before, we are less optimistic today then we were some months ago about Europe. We thought Europe might have bottomed and we might have seen a recovery in volume. At the moment we don't see that. And if we have to give an estimate of our volumes for the total of the year, we today see a slight negative on European volumes, low single-digit negative.
We see on the other hand a North American market pretty much stable between OE and replacement; slightly positive on the original equipment side, slightly negative on the replacement side. As far as Asia-Pacific is concerned, this is an area where we continue, we confirm an important growth for the area overall, something close to a high single-digit; for China, it might be even double-digit. Now we have to see the dynamics of the next quarter, but we see a good dynamic especially in China, OE and replacement.

The Latin American area is an area that today is giving some good satisfaction. There is a market that is showing a positive trend. This is again single-digit, mid-single-digit. And as far as the Middle East, also a positive trend and other mid-single digit.
Overall, worldwide, all channels, all market we see a relative stability. So there is a decrease in the mature markets that is compensated by an important increase in emerging market.

**Monica Bosio** - Banca Imi - Analyst
Okay. Just a final check –

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Sorry, I think one more element that could be important for you is that after six quarters seeing the replacement down, there will be the rebound. The question is to see the right timing. In the next months we will see a rebound. And so that is why on volumes we are not so worried that the future months will be so low in the replacement market in Europe. In the same time we are more and more integrating our production high end we have in Europe with the other markets, where the profitability on premium segment is higher than in Europe. So that's the move we made and that's one of the reason why we delayed our five years plan to November.

**Monica Bosio** - Banca Imi - Analyst
Okay, so that's very clear. Thanks.

**Andrea Pirondini** - Pirelli & C. SpA - Chief Commercial Officer
Thank you.

**Stephan Puetter** - Goldman Sachs - Analyst
The first one, I just want to come back on price mix just to understand the progression throughout the year and also to make sure that I got your comment correct. So you are saying that for the first quarter price mix was roughly split equally, so let's say plus 3% and minus 3%. And then for the full year you expect plus 2% to 2.5%. So that would indicate that in the second quarter you are already seeing quite a significant improvement with better volumes I assume? That's my question.
And then I've got two other small bits. The first one is, I noticed that your financial receivables within the net debt calculation have gone up by €70 million. If you could elaborate what has been driving this? And then finally, your minority line is at a negative and I think also your guidance for Russia now in terms of the margin now includes the import business, which I assume is quite profitable. Does that imply that joint venture right now is still loss making and how quickly do you think margins can improve with the mix improvement you are guiding to for the rest of the year?
Thank you very much.

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Thank you. So first of all, for the price mix, we are comfortable with the figure we gave you. And if you look to what happened in April, all what we see is confirming, even the expectation for May. We have to keep in mind that both in Russia and in Europe we had a very special season where the changeover of the tires was delayed and the seasonality added months of delay. And we see that the running rate in the last months have been absolutely outstanding.

The joint venture in Russia is not having losses. So the joint venture in Russia we see, as we mentioned even during the last call, that we will have a mid-single-digit profitability in 2013. We are running to have a high speed of industrialization of Pirelli products in order to fulfill our product mix we sell directly from Russian production to the Russian market.
Then I repeat that what we see with the export from Europe is providing us a better profitability. We started to increase this process last year and we accelerate this year when we saw the weakness of the European market, thanks also to the price, to the better profitability we have in the other regions. That is just partly offset by the descent of the dollar because one of the phenomenon we see in our P&L is definitely linked to the regional mix that with the strength of the euro penalize our results in rest of the world.

**Stephan Puetter** - Goldman Sachs - Analyst
Okay, thank you. And the increase in the other receivables in the net debt?

**Maurizio Sala** - Pirelli & C. SpA - Head of Group Planning and Control Department
Okay, commercial receivables grew by €320 million in first quarter 2013 versus €315 million of first quarter 2012. So, practically we don't have many major variation of this number; it's in line with the seasonality of the business.

**Stephan Puetter** - Goldman Sachs - Analyst
I am sorry, I was talking about your net debt calculation. So I think you gave about €2.5 billion of gross debt and then €470 million of gross cash. And then the other financial receivables they have gone up by €70 million. Basically my question I think is whether that already relates in some form to Pirelli, or what else is caused by this increase because that has been a number which has been relatively stable in the past?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
If we go to the next question because we don't see any increase in the working capital. Mr. Sala is checking. And so while he is checking we can go to the next question.

**Stephan Puetter** - Goldman Sachs - Analyst
Okay. Thank you.

**Martino De Ambroggi** - Equita - Analyst
I don't want to bother you on price mix, but plus 4%, plus 5% for the full year seems challenging following zero in Q1. So maybe it could be useful for us to have your feeling on how it will progress during the year, just to have a double check on second quarter at least?
And the second question is on slide 25. You are confirming there are further efficiencies if market deteriorates, but actually the market deteriorated.
So what's your additional flexibility that you are mentioning in that slide that was already presented in the previous call, and if you already include something -- or I don't know, if anything -- in the confirmation of your guidance? And obviously for the same reason because the market deteriorated, don't you plan any slowdown in CapEx going forward? Thank you.

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Thank you. First of all, looking to the different quarters, we expect to have in the next quarter something that is, let's say, around 5%, 6% price mix average, so we can cope with the expected results. If we look to what we see in April and May, we see that we feel comfortable. So we confirm that the trend we saw in the first quarter in the industry was really quite unique related to the what we usually see in the market. And it's outstanding what happened in April.
So everybody -- we have seen that any of our competitors saw the same things in the market. So we are confident in confirming this trend, which represents something that is between five and something as average price mix for the next month. We know what we have in our hand, so we see that some of this phenomenon will not continue like the imbalance between OE and replacement. So we have a number of signs that make us very confident in confirming.
So talking about the other efficiency, we don't need looking for what we see -- and also with the volumes we

produce and the volumes in the market, we don't see any reason to introduce any slowdown or to introduce extra action that we always have available in case volumes are below the expectation. What we see now do not push us in this direction. In case -- as we had last year, we have a number of actions that could introduce efficiency; first, is the extra time. We have an 8%; we can activate it. So there are a number of actions that can be in place. The largest part of these actions are in Europe because the extra time is only in Europe. So available, but we don't see today any need to implement them.

**Martino De Ambroggi** - Equita - Analyst
Okay. And on CapEx?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
CapEx we confirmed the running rate that gives us end of the year €400 million, around €400 million CapEx.

**Martino De Ambroggi** - Equita - Analyst
Okay, thank you. If I may, a quick follow-up on pricing. Are you following Michelin in each and every market of what they define as a tactical adjustment on prices or or in some cases you have a different policy?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
You see that each of us has his peculiarity as different companies. So we are focused on some segments of the market. We have a strong pull through, so we are in a position not to compare our business model to the others' business model.
And so the pull through of the original equipment is such that in many segments we are leaders, so we have not to follow the policy of the others -- same others are doing. So we don't see signs that make us uncomfortable confirming the guidelines we gave you.

**Martino De Ambroggi** - Equita - Analyst
Okay, thank you.

**Philip Watkins** - Citi - Analyst
Was there a material difference between premium and non-premium in terms of pricing in the first quarter?

**Andrea Pirondini** - Pirelli & C. SpA - Chief Commercial Officer
Okay, thank you. Well, as we have seen, there was a readjustment across the board. There was readjustment in the premium as well as in the non-premium. I think what is important is to define the price on the basis of your specific value proposition that is based on the pull through that you have created through years of investment in original equipment, on specific model, on specific part of the product range. It's important to capitalize in this moment on the service level.
We are now in a good position in that respect. I think we have the best level of service in the industry today. And on the basis of this, then we define our pricing policy and our position. So it is something that has to be seen customer by customer. When I mean customer by customer, original equipment by original equipment. So we have to leverage on our elements of strength. We are not connected so much to the policies of competition.

**Philip Watkins** - Citi - Analyst
And my second question is on -- and I just wanted to be absolutely sure. I don't know if I really heard this properly, but in terms of full year price mix, 4% to 5%, that's very clear. But that is pricing flat and mix of 4%. I'm looking at slide 25 of the presentation. I think I might have heard it was a split of 50/50 price and mix. So it seems, it's written on page 25, it is pricing is flat and mix is 4%. Am I right in that interpretation?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
50/50 is Europe. So the figures we mentioned about the split between original equipment and replacement that has increased up to some points over the last year in more OE and less replacement, [it's more] for Europe. And in Europe this effect was 50%, so 3.5 points, which is up of the price mix effect in first quarter. This will be reduced in the next quarter, because we see that the replacement is increasing and we have a plan to reduce

the OE push. And so we are comfortable in this.
And to add something to the previous question, when you talk about price war, it looks like something that was fought in the '90s. Price war was enough to say 5% less and was 5% less for anybody, any product. Today the mix is much more complex. We are talking about thousands of items, in which there are some micro-segmentation of pull through from original equipment in measures of products where we are the sole supplier or there are two suppliers.
So in this case there is no price war. In these segments, the price is made just because one is the sole supplier or there is scarcity of the product.
And it's more and more war with the mix and this is one of reason why we are focus on premium, because the segmentation of the market means also more difficulties in providing the service. That's why Mr. Pirondini was underlining the importance of the service we provide to the clients.
The value proposition is linked to the pull through of original equipment in an environment where you cannot imagine that reducing price – even the volume leaders reduces prices. The other players, they are not obliged to reduce price in any manner because there is not anymore volume leader as a whole. There are leaders in any different segments.
I can say that Michelin in Europe is leader in volumes. Continental is leader in winter tires. Who is the leader in winter tire? It's Conti. That effects, so the price effect is related to the mix and the market share that each of the players in the different segments.
So that guarantees that today we can talk about value proposition and not anymore about price.

**Philip Watkins** - Citi - Analyst
That's fair, but you are saying prices are still flat for the full year, because that's what I'm reading, for the Company? I mean –

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Of course, it's right because raw materials are down and we give back part of it in environment where the volumes are lower, because the environment in which we are it is European crisis. European crisis means that we have to give back part of the advantage we had with raw materials to the customers. That's what is happening in this month.

**Philip Watkins** - Citi - Analyst
No, I understand. But for the full year, I meant really. That was it. The full year you expect to obviously increase prices somewhere to be flat pricing, so maybe in Latin America. Is that right?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Yes, in the other region -- the prices are up in some regions. So in Latin America prices are up. In the UK there is a re-balance between the devaluation of the currency and the prices. So when we say flat, means putting together the different regions with the effects we have in Europe that – we remain negative. We don't say Europe will have a rebound. We just say that Europe won't have an erosion. That's our vision. And for what we do in the market, we see that we will continue the same way and will not expect surprises.
In the other regions we have already implemented -- implementing prices increase. There are prices increase in China in some cases, and we have an exchange rate effect in Japan that is negative. So putting together all these effects, we confirm that we see as a whole for the full year a flat effect taking into account the raw materials.

**Philip Watkins** - Citi - Analyst
That's very clear. A final question if I can, the industrial business, how core is that to your overall plan?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
This is a question that we raise to ourselves many times in the past and even today. What we see is that the efforts we made in the last few years to move our production out of the high cost countries to concentrate our business in regions where there is high growth gave us a number of opportunities.
First of all, to be out of the regions where the macroeconomic effects are more visible, which is the western world, Europe and US; and having the production concentrated outside Europe and US. So 100% today is in low cost agro countries. We see the effects on profitability. We are leader in profitability thanks to this. But we

have been leader in profitability even in 2008 and 2009, where the market dropped. Thanks to our better exposure to emerging markets, we were more profitable. So that's one of the reason why we confirm that we feel comfortable to stay in this business. And we have also opportunities because our products today improved a lot. I think that the product range Pirelli has today in the truck business has never been so strong. That is one of the reasons why our profitability is sound and we see opportunities in this business.

**Philip Watkins** - Citi - Analyst
Right. Thank you very much.

**Austin Earl** - Marshall Wace - Analyst
I have three questions if I can take them one by one. The first is on the raw material, the benefit. You are talking about €110 million for the full year. If I understand correctly, it was €37 million in the first quarter; therefore, leaving €73 million for the rest of the year. And I just wondered that €73 million benefit to come for the rest of the year, will that mostly be in the second quarter or will that also be a bit in the third quarter as well?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
The raw materials is related to the last three months prices. So we have visibility on what will be the input cost until, let's say, July. So we already know what is the effect, because each month we see three months after. So that's why we see that the concentration of the effect will be in the second and third quarter. So that's the major effect we see.

**Austin Earl** - Marshall Wace - Analyst
But presumably more in Q2 than Q3?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
In fourth quarter last year we had the effects of the drop that happened the quarter before.

**Austin Earl** - Marshall Wace - Analyst
Sure. I was just trying to get a sense -- I assume there will be more of a benefit in the second quarter than the third?

**Maurizio Sala** - Pirelli & C. SpA - Head of Group Planning and Control Department
If you take into consideration what happened last year, last year between the first and the third quarter the natural rubber price moved from $3,600 to $3,800 per ton, and in the last quarter considering the cost of goods sold came to around $2,800, around $2,800. The same happened for butadiene. It moved in the first three quarter from $1,900 to $2,200, and then in the last quarter was reduced to $1,500 more or less. This means that, as you may remember, in the last quarter of 2012 we had a strong tailwind versus the corresponding period of 2011. This means that the advantages are more concentrating in the first three quarter on the year because last quarter 2012 was already with lower raw material cost.

**Austin Earl** - Marshall Wace - Analyst
Okay, thank you. My second question is just -- you were just referring now to the raw material -- sorry, to the price increases you put through in emerging markets and also in the UK. And I just wondered, is that price adjustment just to offset the currency or is that underlying? Maybe another way of asking it is, are those price increases in countries like Brazil or the UK, are they in euro terms or just in local currency?

**Andrea Pirondini** - Pirelli & C. SpA - Chief Commercial Officer
Yes. There are countries where our increases have reflected a certain devaluation of the currency, where we have managed to recover. We have to say that these dynamism of currencies gives an opportunity to move prices typically and then depending on the specific situation, you might even anticipate and therefore capitalize out of this dynamism. I think it is important to remember that about one-third of our turnover -- slightly more than one-third of our turnover -- comes from the Latin American region, where at the moment we have had some important satisfaction in the area of prices. So it is currency, it is products, it is a positive market

dynamics at OE and replacement level.

**Austin Earl** - Marshall Wace - Analyst
And my last question is just to understand in terms of the full year guidance for the EBIT of €810 million to €850 million. Given it was €186 million in the first quarter, that implies that the following quarters will obviously be more than the EBIT in the first quarter. And I just wanted to understand what might be the drivers that will lead to better EBIT in the subsequent three quarters of the year?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
The drivers are the European trend that was the worst in first quarter, comparing apple with apples with first quarter last year, first quarter this year. Second is the mix that I mentioned before between replacement and original equipment that will improve in Europe, so providing high profitability in Europe. Volumes premium, which in the first quarter were very low, and looking just to what happened last year and what is happening in this quarter, we have a much, much stronger volumes in premium. So the growth in premium that we confirm for the full year is already confirmed from what we saw in the market in the last few weeks.
And then we have the pull through of the original equipment in the premium segment that shows that our market share when we move to get it is in line in the replacement market, and we have room to get back part of the market share that naturally can come because of the pull through of the original equipment. And this is happening. So we feel comfortable that the premium segment will protect our profitability in this year.

**Austin Earl** - Marshall Wace - Analyst
Understood. Thank you very much for your answers.

**Gaetan Toulemonde** - Deutsche Bank - Analyst
I will be short on my question. It's concentrating on the premium. In the first quarter the volume were 4% in the premium segment and you confirmed the target of plus 13% for the full year, which underlines a very strong growth in the last three quarters. Can you give us an idea about what is the volume growth in the premium segment in the second quarter just to get an idea if it's very much backend loaded or it's already visible in the second quarter?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
So volumes is plus 4%. The guidance is 13%, 14%. And I said many times that what we see happening in the market is supporting what we gave as a target. So we are comfortable because it was really extraordinary what happened in the first quarter. I don't see any risk in the mix, so we feel very comfortable.

**Gaetan Toulemonde** - Deutsche Bank - Analyst
Okay.

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
April premium, I cannot tell you the number, but April premium was really plus, plus, plus. I mean, that's it.

**Gaetan Toulemonde** - Deutsche Bank - Analyst
Okay. And the second question, when you look at the margin on the premium, is there a big difference between emerging market and Europe in terms of margin in the premium?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Yes, in emerging markets it's higher.

**Gaetan Toulemonde** - Deutsche Bank - Analyst
It's higher in emerging market than in Europe?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Yes, it is higher and even taking into account the exchange rate effect.

**Gaetan Toulemonde** - Deutsche Bank - Analyst
Okay. Super. Thank you very much.

**Michele Baldelli** - Exane BNP Paribas - Analyst
I just have three questions. So first of all about the split of OE versus aftermarket sales, could you provide us the percentages on Group sales in Q1 of last year and in Q1 of this year just to understand how this mix has shifted? And the second question relates to the startup costs you mentioned in the presentation about Mexico, Russia and Turin. Could you provide just an overview of what was a similar amount that you sustained in 2012, what will be the expected one in 2013 and when these costs will breakeven so that you will not have any more this negative impact? Thank you.

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Thank you. So the first question, the OE replacement went up from 26% OE in Europe to more than 29%. So that's what happened in the first quarter, which will be decreasing and will go back to normality within the next three quarters. And I leave the floor to Mr. Sala for the startup costs.

**Maurizio Sala** - Pirelli & C. SpA - Head of Group Planning and Control Department
For all concern, the conversion of Settimo Torinese truck plant into car premium production, practically at the end of last year we shut down the machinery and the production for truck that can be used in other countries, in the emerging market. And this year we are preparing the grow, for all concern, the grow in term of car production, premium production. So practically this year we have the cost, which are in the region of €10 million for the year. And for all concern next year, we will have the full benefit. The full benefit will appear in particular in the industrial business because the industrial business will be a 100% production in low cost countries and with 84% of sales in the emerging market. So it's the perfect combination to have a good profitability.

**Michele Baldelli** - Exane BNP Paribas - Analyst
Sorry, just a follow-up on these, because this refers to Settimo Torinese. But the other two plants in Mexico and Russia, could you provide us a similar overview?

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
To give you one figure that gives you the feeling of what is happening, in Mexico this year we will produce 1.5 million tires. Next year we should produce around 2.5 million, 2.7 million. As soon as we go close to 3 million tires, any million tire production you add as a payback that is worth one year. So keeping in mind this, you understand that the startup cost stays until 3 million, then next year we will have a benefit from any additional product we will make. And that's one of the reason why we accelerated the shutdown of production in Settimo Torinese of the truck business and we are moving more capacity in Settimo Torinese to profit of the volume increase; that means profitability.
In Mexico we will reach this by 2015. In Settimo Torinese, we will have a significant benefit because Mr. Sala was mentioning the €10 million of costs. But what we do not consider in this is the profitability we lose because we invested the money and we don't have the return. The return will start coming for Settimo Torinese in the next year and the return will start coming in Mexico within the next two years.

**Michele Baldelli** - Exane BNP Paribas - Analyst
Thank you.

**Operator**
As there are no further questions in the queue, I like to hand back to today's speaker for any closing or additional remarks.

**Marco Tronchetti Provera** - Pirelli & C. SpA - Chairman & CEO
Thank you. I know that we didn't answer one question which was about the €70 million, we will directly speak to the person that called us and asking the question. So Mr. Sala will take care to give the answer because we

don't see any change in our working capital as was mentioned. So thank you for your attention, even until 7.45 Italian time. And so we have come to an end of our conference call. We thank you very much for your attention. Thank you and good evening.

**Operator**
That will conclude today's presentation by Pirelli, financial results for the first quarter 2013. Thank you for your participation, ladies and gentlemen.
You may now disconnect.