

# Pirelli & C. S.p.A. 4Q / FY 2017 results transcript

*February 26, 2018*

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good afternoon, Ladies and Gentlemen, and thank you for joining our conference call.

2017 Results confirmed our head start over full-liners with a strong growth rate both in top line and profitability.

This performance is the outcome of our High Value strategy which brought about:

- › a top price/mix improvement, more than double vs. peers average (+6.9% vs. +3.2% peers average)
- › a 10% growth of Adjusted EBIT before start-up cost driven by the quality of our internal levers.

This momentum is expected to continue throughout 2018, in line with the Industrial Plan:

- › in the High Value, we expect to continue outperforming the market with a growth rate equal or above 13%
- › new products are contributing to boost our price/mix, while
- › our efficiencies program will bring cost savings of about 1% of sales

We are well placed to benefit from future technology trends and we are bringing our projects forward:

- › in Electric Vehicles, we are working with major Global car makers and building new partnerships with Chinese front-runners
- › in the Connected and autonomous driving, we have developed the Cyber Car technology and its adoption is currently under evaluation by some car manufacturers, with on-going field tests; on Connesso, market tests - based on current products - were completed; this is a continuously evolving platform
- › in the new mobility, we are working on the e-bike tyre segment through a co-development partnership with a premium e-bike manufacturer

Let's start from 2017 achievements

Pirelli closed 2017 with a solid operating performance, in line with the Industrial plan.

We strengthened our positioning in the High Value segment,

- › with a market share increase in the key Regions (Europe, North America and APac), and
- › with a higher contribution from High Value to the overall results: approximately 58% of total revenues (+2 percentage points year over year) and approximately 83% of EBIT

We posted a sound profitability improvement: the adjusted EBIT before start-up costs reached €927 million (+10% year over year), well in line with the target, despite the lower than expected Top Line growth. The gap versus our Revenue target was mainly attributable to:

- › a higher Forex volatility, and
- › an accelerated reduction of our exposure to Standard, even faster than we anticipated for the whole year

Our optimal management of financial and fiscal charges resulted into a strong increase of the Net Income (+60% year over year).

Finally, a strong cash flow generation (€200 million before extraordinary transactions) that led to a Net Financial Position to adjusted EBITDA ratio of 2.7 times.

Let's now move to the regional performance, starting from the High Value Regions that account for 75% of our total revenues and 92% of the High Value turnover.

In Europe, we consolidated our leadership:

- › in the Prestige segment, our market share now includes almost half of the O.E. market
- › in the 18 inches and above, we increased our market share by almost 1 percentage point in both the O.E. and Repl. Channels, and
- › finally, in the Specialty segment, our share of the Run-flat reached almost 1/3 of the market

At the same time, we lowered our exposure to less profitable Standard segment, thereby achieving a sound price/mix improvement, also benefitting from the gradual implementation of the price increases announced on April 1st.

In NAFTA, despite the O.E. market slowdown, we achieved a sound performance: +7.4% organic top line growth combined with a strong profitability.

We worked on improving our position in the New Premium Replacement market leveraging on:

- › new tailor-made product launches, such as Scorpion Verde All Season Plus
- › a stronger foothold by expanding our retail network by almost 600 points of sale, reaching over 2,300
- › an improved service level, benefitting from LatAm imports (+9% YoY the growth of volumes imported from LatAm)

We consolidated our leadership in the O.E.-marked tyre segment, with a market share increase of 1.5 percentage points.

APac is the Region where we grew the most: we recorded +14.3% organic growth, driven by the High Value segment.

Through the increased market exposure to the O.E. channel, we obtained new homologations with European and Chinese car brands; we also expanded our commercial footprint in the Region, reaching well over 4,000 points of sale.

In the New Premium segment, we increased our market share in the Replacement channel by almost 2 percentage points, following the pull-through effect from the strong homologation activities in the last 3 years.

Standard Regions account for 25% of our sales and 8% of our High Value revenues. Here we are making progress 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 upgrading our Brazilian plants in Bahia and Campinas to High Value production for the North American market while exploiting any opportunity arising in the Region.

In MEAI, we increased our High Value sales reaching more than 50% of the regional revenues. This has been achieved through our dedicated marketing and trade actions, with a careful channel mix management.

Most of the growth has occurred in Turkey and the Gulf Countries, that account for about 70% of our sales in the High Value segments in the Region.

Finally in Russia, our priority has been to concentrate on value:

- › accelerating the discontinuation of legacy brands, like Amtel
- › limiting the imports of less profitable products, and
- › focusing our efforts on more profitable products both for the local and the export market

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

Our negative performance on High Value followed the decision to reduce High Value products imports, mainly in the last quarter of the year, given:

- › the situation of the local market (-5% the 18 inches and above market in the second half, and -11% in the fourth quarter), and
- › the stronger demand of those products in Europe

The execution of our strategy, which is based on 3 pillars, brought about our achievements in 2017 which set the ground for 2018 targets.

The 4 High Value levers contribute to strengthen our operational model: We develop high performance products for Prestige & Premium Car Manufacturers and Premium Consumers, typically high spenders, whom we follow during their entire journey, offering products and services for tyre Replacement when and where needed.

#### Lever 1 – Homologations

Homologations and the analysis of registration and car parc trends, allow us to gain medium to long-term visibility into the Original Equipment market and Replacement demand:

- › More than 50% of O.E. and more than 60% of Replacement sales for the next three years come from homologated products; in 2018, around 75% of our retail sales will be linked to homologation portfolio built up until 2017

Last year contributed with a record 402 new homologations, of which 337 High Value, 1 out of 5 for Prestige cars, 1 out of 4 for Winter products. We assembled a portfolio of more than 2,160 High Value homologations.

The focus for 2018 will be in continuity with this trend:

1. More than 65% of the main Premium and Prestige car projects we are working on are already for sizes equal or greater than nineteen inches
2. We are developing new materials and technologies, such as bio-materials and nano-technologies, to enhance our technical performance and the sustainability of our products

Between now and 2020 we have more than 800 homologation projects in the pipeline. In addition to that, we are already working for homologation for beyond the plan horizon.

#### Lever 2 – Product innovation

As for product innovation, new launches are key to strengthen our product range, our brand and support our pricing strategy.

In 2017, we saw the launch of “Scorpion Zero All Season” at a worldwide level and 3 dedicated regional lines:

- › the “Cinturato All Season Plus” and the renewed “Cinturato P7 Blue”, for the European market
- › and the “Cinturato Strada Sport” for North America

The year also saw the comeback into bicycle tyres, with the PZero Velo launch, and several new Moto products such as the off-road Metzler MC360 and the Pirelli Diablo Supercorsa SP.

In 2018 our main priorities are:

- › the new “Cinturato”, the new “Ice Zero studded” and “Ice Zero friction”, power lines for far east markets and several facelifts
- › The extension of the Scorpion family with 2 new “premieres” to improve our SUV/Crossover portfolio. SUVs are a very important segment, accounting for around 30% of total new car registrations (34% in 2020)
- › The development of Cyber solutions: we are working hard on both the consumer product, “Connesso”, and OE product and services, “Cyber car” and “Cyber tyre”
- › And we are also planning a new e-bike tyre, co-developed with a premium e-bike manufacturer, and several Moto products

### Lever 3 – Shifting Car capacity towards High Value

To meet the rising High Value demand, Pirelli is continuously shaping its capacity. We are perfectly on track to reach 79 million pieces in 2020, of which 53 million High Value (67% vs. 55% in 2017 and 60% in 2018).

In 2017, we added almost 4 million High Value capacity of the 15 million pieces set as a target for 2020.

In 2018, our priorities are the conversion of Standard capacity into High Value in Brazil and China<sup>2</sup>, around 1.5 million pieces, and the installation of new High Value capacity in Romania and Mexico<sup>3</sup>, around 2 million pieces.

In addition, we will update approximately half a million pieces from Premium to equal or greater than 21 inches for our cutting edge technological products.

### Lever 4 – A consumer-centric approach

To conclude the list, the 4th lever. Our new trade and consumer engagement approach is bearing the first fruits.

We ended 2017 with almost half of the volumes sold going through the distribution channels over which we exercise a better control. This network weight on sales increased from 41% to 48%.

- › The Car Dealer channel, the strongest link with our Prestige and Premium car owners, grew 3 percentage points.
- › Tier 1 Distributors, a selected group of partners sharing into our long-term commercial strategy and product positioning, also grew 3 percentage points. The development of this channel is a clear priority for 2018
- › Pirelli branded shops weight also increased. Since 2017, we added around 2,000 points of sale. We can now count on around 14,600 Pirelli retail shops, in line with our expected

trajectory towards 17,000 in 2020. Expansion in APAC is a priority for 2018, targeting potential high mix partners and less served geographic areas

Consumer Marketing will be very active in 2018 in digital marketing, CRM , F1 activation, co-marketing initiatives with Prestige O.E. and new PDesign products.

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

Its 4 cross-functional projects are progressing:

1. Integrated Forecasting successfully redesigned an integrated O.E. / Replacement business management in 2017. All the underlying analytical forecasting algorithms are been optimized. In 2018, we will extend this methodology through the entire value chain, to reach an end to end integrated Business Planning, starting from the Prestige business unit.
2. Smart Manufacturing and Flexible Factory, together with initiatives such as de-complexity and design-to-cost, reached the target of 1% efficiencies on sales. Technological challenges has been tackled mainly last year, and this year the focus is on People Engagement within plants: training on new technologies and tools will be extended to all white collars world wide, a pervasive training program involving 10 times as many people as in 2017.
3. Prestige, our new lean and Interfunctional Business Unit was able to increase our Global O.E. market share, now close to almost half of the market. Remarkable in 2017 was the launch of the new Aston Martin Vantage, fitting P Zero tyres. One of the 2018 priorities is to fully capitalize the pull-through effect in the Replacement market, leveraging a renewed approach to sales based on digital tools, and all the innovative processes we are incubating and testing within this agile team.
4. Pirelli has defined several ad hoc supply chains, after a deep segmentation process. In 2017, we have worked particularly on:
  - The activation of the brand new “customize to order” supply chain for Color Edition tyres (with direct online model), and
  - The revision of the Prestige supply chain, in order to improve both product availability and optimize production scheduling (less fragmented)

In 2018, we will focus on the activation of additional Tier 1 agreements with key clients, to gradually move towards a “make to order” model. This will allow us to have a closer data integration with our clients & suppliers and fully leverage our new digital capabilities within the entire value chain.

Now, moving to our last Pillar, our strategy is to reduce our exposure to Standard capacity by 20% in 2016-2020. We are cutting our capacity mainly in the lower rim sizes – namely, 13, 14 and 15 inches, and focusing more on profitable products.

In 2017, we reduced more than 2 million / tyres standard capacity, mainly in MEAI, and started to upgrade Aeolus capacity into Pirelli products.

Our priorities for 2018 are:

- › To continue cutting our standard capacity by another 3 million pieces, mainly in MEAI and LatAm
- › Upgrade part of Aeolus capacity into High Value to fill the strong demand in the APac region
- › Within Standard Regions, increase our focus on value through mix improvement and a pricing policy responsive to Forex volatility, and
- › Efficiencies focus

This should contribute to improve the profitability of our Standard business.

Moving to 2018 market outlook, we confirm our IPO scenario on the car tyre market:

- › The 18" and above segment is expected to grow by 9% in 2018, significantly outgrowing the Standard market by 8x
- › This growth will come from Europe, APac and NAFTA, accounting for 94% of the total High Value market

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

- › Premium and Prestige cars on the road will be ~141 million in 2018 compared to ~135 million in 2017, reaching 154 million in 2020

In this context, Pirelli is expected to continue outperforming the 18 inches and above market in 2018, growing in line with our mid-term target.

The 2018 outlook confirms the operating trends and assumptions in our Industrial Plan, with the Forex scenario being the only exception.

Recent euro/dollar trends made us review our Forex IPO assumptions for 2018, as illustrated in slide 27.

For 2018, we expect a solid operating performance:

- › an organic revenue growth of around 10%, equal or higher than 6% including the Forex impact
- › High Value will account for approximately 60% of total revenues (57.5% at the end of 2017)
- › Adjusted EBIT, before start-up costs and non-recurring and restructuring charges, is expected to be above €1 billion, with the High Value segment accounting for equal or above 83%. The year-on-year improvement will be achieved through the soundness of our internal levers (volume, price/mix and efficiencies) that will more than offset the Raw Mat and Forex headwind as well as the higher inflation. Our 2018 assumptions on the raw mat scenario are illustrated in slide 28
- › Adjusted EBIT is expected to be of approximately €1 billion, net of approximately €40 million start-up costs
- › A gradual deleveraging of the company, with a ratio of Net Financial Position on Adjusted EBITDA before start-up costs, about 2.3 times; and
- › CapEx to about 8% of revenues (9.1% at the end of 2017) mainly to sustain High Value capacity increase in Europe, NAFTA, APac and LatAm, and promote mix and quality improvement in our plants

After going through our 2018 priorities and targets, I wish to remind you that Corporate Governance is another pillar of our Strategy. Indeed, our Governance is based on the best International practices. With the next Shareholders' Meeting, on May 15, we are expanding the number of Independent directors, electing a representative of minority shareholders. Independent directors will represent more than 50% of the Board with 8 Members over a total of 15.

Now, let's move to Sustainability, where Pirelli is very committed, as acknowledged with two global awards.

Our Sustainability Plan is based on our Industrial Plan and in line with Pirelli focus on High Value.

The 2020 Sustainability Plan, with selected 2025 targets, has been drafted according to:

- › The Pirelli Value Driver Model

and impacts on:

- › 12 of the United Nations Sustainable Development Goals for 2030

In 2017, meaningful improvements were achieved in terms of environmental, social and economic performance, and our 2020 targets will be even more challenging.

I will only give you the highlights.

Based on 2009 data:

- › the Green Performance target for 2020 is 50%, with more than 65% on High Value
- › we further reduced the accident frequency index in line with the company “zero injuries at work” philosophy
- › CO2 emissions decreased by 9% and our 2020 target is a further 17% decrease;
- › in energy consumption, we achieved a -15% in 2017 and we target a further -19% by 2020
- › in water withdrawal reduction, we achieved a -62% in 2017 with an envisaged further reduction of 66% by 2020, and
- › finally, we issued the «Sustainable Natural Rubber Policy» after a multi-stakeholder consultation

In January 2018, Pirelli achieved the status of:

- › World Leader in Sustainability in the Auto Components sector (with a score of 83.2 times vs. sector average)
- › and Gold Class Company in the 2018 Sustainability Yearbook edited by RobecoSAM

Sustainability engagement by the Company is proved by its inclusion into our new Long Term Management Incentive Plan.

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

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

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

The results in 2017 reflect the strategy and the programs which have been described so far:

- › about +8% top-line growth, mainly driven by:
  - the strengthening of our position in the High Value segment, now accounting for almost 58% of revenues, improving by more than 2 percentage points vs. 2016
  - top Industry price/mix, +6.9%, more than twice our main peers average of more than 3%, resulting from both mix improvement and the price increases put in place since April 1st, 2017
- › Profitability grew by 10%, both in FY and 4Q 2017, with an EBIT margin adjusted before start-up costs reaching 17.3% in 2017 and a record 18.7% in the fourth quarter. The profitability improvement was based on the quality drivers of the top line and the delivery of our efficiency program, around 1% of sales, in line with the 2017-2020 Strategic plan.
- › The net Income from continuing operations grew more than 60%, with a 4.9% ratio over sales, as a result of the improvement in the operating performance and of our actions in the financial and fiscal areas
- › A Net Financial Position to EBITDA ratio of 2.7x (4.6x at the end of 2016), following
  - the sound cash flow generation (€200 million of net cash flow before extraordinary operations)
  - the capital increase underwritten by Marco Polo at the end of June

In 2017, sales grew by about 8%.

By looking at the organic performance by Quarter, we can see:

- › a sound, double-digit High Value volume growth (+12.5%, of which +15% on ≥18") across quarters, which confirms our outperformance in the segment vs. the market
- › a simultaneous, accelerated reduction of the exposure to the Standard segment (5.3% drop in volumes in 2017, -5.8% in the fourth quarter), 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 a new peak, +7.8%, in the fourth quarter, reflecting the impact of the price increases made from April and a continued focus on High Value

The quality of our top line drivers translated into a profitability improvement in 2017, with an acceleration of the trend in the fourth quarter. Adjusted EBIT margin before start-up costs reached 17.3% over the full-year and a record high 18.7% in the fourth quarter 2017, 1.1 percentage points more than the fourth quarter of 2016\*.

The profitability improvements in 2017 were driven by our internal levers, namely:

- › price/mix (+€278 million), efficiencies (+€47 million) and volumes (+€23 million)
- › that more than offset raw materials headwind (-€165 million), inflation (-€54 million), the increase of D&A and other costs (-€40 million) related to the development of High Value and FX headwind (-€7 million)
- › energy and others cost optimization

In particular:



- › the strong price/mix improvement covered about 1.7 times the raw material headwind in 2017, & more than twice in 4Q
- › cost inflation was counterbalanced by efficiency gains mostly related to some of the mentioned transformation programs
- › start-up costs (€50 million) are related to:
  - programs intercepting new needs of the final customer, such as connectivity (CyberTM) and the Velo business
  - activities related to the digitalization of the company, and
  - conversion of the Aeolus Car plant to Pirelli standards

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 (capital gain from Prelios stake sale and dividends from Mediobanca)
- › lower net financial charges as a result of a lower cost of debt (5.36% at 31-Dec-17 from 5.82% at 31-Dec-16), mainly related to the capital increase underwritten by Marco Polo and the credit facility refinancing, both at the end of June 2017
- › lower tax rate, 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)

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 €387 million, or 7.2% of Sales, +1.2 percentage points versus the value recorded in 2016.

Moving to the Net Financial Position evolution in 2017, we see that it is now €3.2 billion, €1.7 billion less than the one at the end of 2016. This is the result of:

- › strong net cash flow before extraordinary items (+€0.2 billion), through an improving profitability and the positive contribution of working capital, in line with the seasonality of the business, with high volumes collection, especially linked to Winter sales in high seasonal regions (like Europe and Russia)
- › the capital increase underwritten by Marco Polo at the end of June (+€1.2 billion), and
- › the industrial reorganization (+€0.3 billion)

The increase in Capital Expenditure (€489 million, 9.1% on Sales, +€147 million vs. 2016) is attributable to:

- › the additional investments in High Value capacity (+3.3 million pieces), mainly in Europe, APac and NAFTA
- › the strategic conversion of Standard into High Value production in Brazil (Campinas / Bahia)
- › the upgrade of former Aeolus plant in China to Pirelli standards
- › In general, the continuous improvement of both mix and quality in all our plants

Year End Pirelli's Gross Debt stood at €4.5 billion, with an average life of 2.8 years as approximately 75% of it is now due beyond 2019.

Cost of Debt at 5.36% is down from 5.82%. This result has been mainly achieved through the €1.2 billion capital injection as well as to the refinancing of our committed bank lines which occurred in June 2017 and despite a change in mix of our debt with the high yield currencies now representing 20%.

However, increased exposure to high interest rate countries is mainly due to our deleverage which led to the reimbursement of part of the Euro debt, so it remains overall positive from a cash-flow perspective.

I now leave the floor back to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

This ends our presentation.

We may open the Q&A session.

## Questions & Answers

### Victoria Greer – Morgan Stanley

Hi I have just two questions. First on your revenue growth outlook for 2018, you've talked about -4% FX impact to get to the reported 6% growth. Could you talk about your expectations for volume and price/mix in that 10% organic growth number? And secondly, on your finance costs for 2018. At the IPO, we were talking about around €200 million interest cost for 2018, should that come down with the recent bond issuances you have done and also the renegotiations on your bank facility? Thanks.

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

Thank you: Organic top line growth would be around 10%, 6% without Forex effect. Volume guidance is between 2.5% and 3%. Price/mix is between 6.5% and 7.5%, and Forex is negative between 3.5% and 4%.

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

For what concerns interest costs, the amount that we guide for 2018 is in the region of €200 million, that is definitely lower than what we had in 2017 and this is coming from the refinancing that we had also at the beginning of the year.

### Victoria Greer – Morgan Stanley

OK, but shouldn't we also get some benefits from the €600 million bond that you have issued recently and also in your statement you've talked about renegotiating some of your bank facilities on top of that, because the €200 million was where we have talked about IPO before the bond issuance.

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

The total amount is equal to an interest average of 4%, so there is a quite significant reduction of the cost of debt plus the commissions and the total financial expenses will be about €185 million.

### Ashik Kurian – Jefferies

Thanks for taking my question. Just coming back to Victoria's question on the price/mix, what is the underlying assumption for raw material price increases for 2018? Or, in other words, have you baked in a fair bit of pricing within this 7% price/mix guidance that you've given? Because if I remember what you told us in the previous calls, the reduction in Standard capacity has been much sharper in 2017 and will not be to the same extent in 2018? So I was expecting the mix element in 2018 to be lower than what you had in 2017, so if you can maybe share a bit of colour on that, it would be helpful.

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

It is obvious that we continue the reduction of Standard and the changing mix within the Standard together with the double digit growth in the High Value segment. The underlying actions we have in our plan are providing us a price/mix between 6.5% and 7.5% improvement, which means that is

mainly coming from the High Value growth that continues to be strong and a trend that is steady on the reduction of Standard in 16 inches and below. Obviously we will take any opportunity to reduce the lower end during the year, we did it in the past and we will continue the same trend.

### Ashik Kurian – Jefferies

Is most of that mix then? I mean, if you can give us a guide of how much is the price/mix, is probably leftover pricing from 2017 kicking in?

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

As you know, we continue to base our strategy on maintaining the price in line with the inflation of costs and facing the different situation on exchange rate and that is the strategy in each region. The base on which we create values is obviously the mix. The mix makes also our mix of price higher, at the end of the day the mix is also creating an average price increase.

### Thomas Besson – Kepler Cheuvreux

Hi, sorry, it's Thomas Besson from Kepler Cheuvreux. The first question: I'll start with simple accounting questions please. Can you help us understanding the development on the minority interest line in your P&L that has gone to a bit more than we thought, and explain us what are the remaining links with Aeolus in your operations. The second is: can you help us understand the tax rate we should assume for Pirelli in 2018? And the third question is: on your balance sheet your spread between receivables and payables has been at very high level, is that sustainable or what should we assume between the two in 2018, is it going to be a headwind or a tailwind for your figures of free cash flow generation in 2018. Thank you.

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

Thank you.

We don't have interest of the minorities in our management of the company, so Aeolus as a brand is disappearing in our portfolio, as we underlined during the presentation, we are reshaping the entire production of the excluding Aeolus factory into Pirelli and by the end of the year there would be no Aeolus production anymore in our facility. As far as the fiscal aspects, I will leave the floor to Mr Tanzi, that will elaborate on this, finally on the spread between receivable and payables I will leave the floor to Mr Sala.

The strategy for this year is to reduce the exposure towards the payables in order not to add a border of an environment in which the interest rates are expected to grow, so we have some consciousness in our strategy, taking to account this point. The effect will be less positive that it has been in the last few years. Anyhow I leave now the floor to Mr.Tanzi for the fiscal aspect, reminding you that our fiscal burden is going down, below 30% average in the next three years.

### Francesco Tanzi – Senior Vice President and Chief Executive Officer

Thank you Mr Tronchetti. Good afternoon to everybody. For what is concerning 2017 we have a 13.5% tax rate thanks to a tax asset that we have this year for €80 million, this was ere already expected during the IPO process and therefore for 2018 we have no reason to change the target that

has a tax rate below 29%. As Mr. Tronchetti mentioned, this 29% was the average for the next three years, as per our current plan. Now I move to Mr. Sala.

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

Thank you.

On working capital, for what concerns receivables, we reduced our weight on sales, from 13.7% to 12.2% and this is coming from the fact that the season of collection for winter was good, and this data is continued to remain very efficient, and we want to continue to work in the same way for what concerns trade receivables. For what concerns trade payables, we did also, at the end of the year, certain reverse factoring activity with suppliers and, as was mentioned before by Mr. Tronchetti, in the guidance of 2.3 times net financial position to EBITDA at the end 2018 we kept certain consciousness of this point but in any case keeping the operative activity of the working capital always under control and always with a very strong efficiency.

### Thomas Besson – Kepler Cheuvreux

Sorry, I'm not sure my question was clear initially, I was referring to the net loss related to the industrial activities in your P&L which was €88 million versus €60 million in 2016, is that going to repeat in 2018 or are any link with the industrial business gone from here. That was the question, sorry if I wasn't clear.

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

Sorry, we didn't understand as well. Mr. Sala will now give you the answer.

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

Ok, thank you. For what concerns the result coming from the discontinued operation, the most important part of the negative results came from the effect on the reverse of the equity coming from the position that we had in Egypt in terms of liquidity and in terms of activity before registering equity and when we dispose the industrial activity came to profit and loss, this will not happen anymore in 2018. So, in 2018 this data will be close to zero.

### Henning Cosman – HSBC Analyst

Thank you. Please can I ask about the performance and the outperformance that you were talking about in the high value segment, I don't know if the data is fully comparable but your main competitor, Michelin, they've also been giving data for the market and themselves and I believe you said in your presentation your volume growth in the high value segment was 15.4%, Michelin had said the market was 13, their own growth in 18 and above was 19% so they seem to have outperformed even more than yourselves and interestingly on the 19-inch segment the spread is even bigger so I'm wondering if I think in the past we said that segment grows enough for everybody to play for, in a way, if you could just comment, if they are just winning even more market share than yourselves and why that might be, or if you see that differently and we're maybe talking about different data points. The other question is if you could please comment on the maturity, if you like, on your business a little bit, my understanding is your O.E. growth is still higher than the Replacement tyre business growth, where

the replacement tyres oversee much higher profitability still, so I was wondering if you could comment a bit on when you see that narrowing or reversing even with effects on your profitability. Thank you.

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

Thank you. So starting with the last question, we continue our strategy to have a higher market share in the most valuable part of the market. That comes from the Original Equipment in a phase in which mainly in China, where we had the largest growth, we want to be in the major High Value projects, including hybrid and electric; we do the same, obviously, in Europe and U.S., but we see that following this strategy we continue to improve our profitability and we capitalise for the next years a portfolio of products that makes us in a position to continue to grow in our replacement market share. This is our strategy, some years we will have a higher level, average will stay between 75-25 Original Equipment and replacement turnover. This year, in Original Equipment, we grew much more than any of our competitors in the high value segment, having more than 330 homologations. We continue this trend and the profitability growth is rewarding us; taking into account your first question, Michelin is talking about volumes, we are talking about value. On 18 inches and above, as well as on 19 inches and above, we outperformed the market.

### Henning Cosman – HSBC Analyst

Sorry, if I can just clarify, the number that you gave in the presentation, the 15.4% that was the value or volume?

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

The 15.4% on higher or equal 18 inches are related to volumes, volumes growth of Pirelli sale.

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

And Michelin figures were for 19 inches in tons. We are talking about volumes, they are talking about tons. Volume is number of pieces of tyres and tonnes is tons.

### Monica Bosio – Banca IMI Intesa Sanpaolo Analyst

Yes, good afternoon everyone and thanks for taking my questions. The first question is on the trend across the year, given your guidance for the full year 18 do you see a homogenous growth or do you believe that the first part of the year might be more challenging than the second part? And if yes, if you can give us some flavour on the potential different trend quarter by quarter and the second question is a follow-up on the mix effect. If I remember well, during the third quarter conference call the company indicated for a pure mix effect at 5%, now you gave us the guidance for the price/mix for 2018, I was wondering if the pure mix fact might be seen at +5% as well, even in 2018 and third question is on LatAm, expectations for LatAm seem, in term of market, demands seem positive, this was not a case at the time of the IPO or the expectation were more modest and I was wondering if you see LatAm as an upside on top of the guidance delivered in occasion of the plan, and if you see some recovery in place? Thank you very much.

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

Thank you, so on exchange rate, we see an effect that is different between first and second part. The negative effect in our plan will be higher in the first part and with lower effect on the second part of the year. Mix, we continue the trend, so you mentioned a 5%, we are always considering that this is a figure that we can continue to maintain, in some part of the years, it happened in the second part of last year we have done a bit better than this. LatAm, there are some improvements, is not a booming market, is a market in which there are opportunities obviously, considering the low level that has been achieved in the first part of last year. So, since the second part of last year some good sign is coming, but still we cannot be bullish on LatAm, we see that we touched the bottom and there are improvements.

## Martino De Ambroggi – Equita Sim Analyst

Thank you. Good afternoon everybody, the first question is on the EBIT bridge concerning the volumes drop-through. It was 46% for the full year, even higher in 4Q, was 47%, so the first question is on this issue, if this level may be confirmed going forward or the 50% is a threshold which can be achieved and could you give us a rough idea what is the drop through for the High Value, stand-alone?

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

For the High Value, the drop-through is obviously higher. We consider a 40% average and so considering 40% average we can say that for the high value is over 50%.

## Martino De Ambroggi – Equita Sim Analyst

Yeah but if you achieved 46% in 2017, are you confirming the 40% which was provided at the time of the IPO? Is there any specific reason for the very high drop-through in 2017?

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

We have also some improvements in a turnover also called control distribution. So, there are no major effects.

## Martino De Ambroggi – Equita Sim Analyst

They are just a non-recurring outperformance, let's say. The second question is on networking capital, if you could provide us an idea of what is the impact attributable just to raw materials in 2017 and based on your expectation, what could be a rough impact just referring to raw materials price changes for the current year?

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

In terms of capital, for what concerns raw material there was an inflation effect coming during the year for certain issues, in particular for what concern oil that grew during the year, with a reduction of the

other commodities, that started in a very strong way in the second quarter of 2017 then came down during the remaining part of the year but we didn't have major impact coming from raw materials in term of working capital, we had positive contribution coming from the receivables, with a strong collection that we did in the end of the year, and, in terms of payables, we did certain reversal factors in order to permit also to certain supplier to advance their payment for their situation of cash. But no particular effort is coming from other elements.

### Martino De Ambroggi – Equita Sim Analyst

Ok, thank you. Very last on the high value return on sales, it was 25% last year, which was the high end of the target you had. Is there any possibility to see this level exceeded, going forward?

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

Obviously possibilities are always to be taken and we are working for it, just to take opportunities.

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

Thank you very much for your time. The first one is really on competition, you know, we had a few questions regarding your closest peer Michelin. I just want to understand a little bit, you know, one of your key areas for growth is North America, which you outlined during the IPO process, which is also very high margin area for you, now one of your peers has gone, you know, straight into the distribution, tying up with Sumitomo Corporation. How does that affect, so, your planning in the outer years? Then secondly on LatAm we had the question before but just to your colour, you said you are getting towards the troughs, could this be quite a big recovery? And can you actually remind us in terms of how much your profitability fell over the last three years in this region and whether you believe that could come back as you're also concentrating on the High Value segment in that area? And lastly, on your raw material guidance, on page 28, can you just explain how you get to your EBIT impacts? Because what we can see here is despite raw material cost going up for natural rubber and butadiene, you're actually showing that as a positive effect on your EBIT bridge, could you just explain how that works? And similarly, could you just outline again, how we have to think about the FX impact in your raw material guidance and especially which regions that refers to?

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

For the U.S. market and the LatAm market I leave the floor to Mr. Righi and then on raw material Mr. Sala will elaborate on.

### Roberto Righi – Executive Vice President and Chief Commercial Officer

So, regarding what's going on in the U.S. market, you are mentioning the situation of the announcement made during the course of the month of January by Michelin and the JV with Sumitomo. We think it's going to take probably a little while in order to see what the actual effects of this transaction will be; as far as we are concerned, we believe this will actually turn into some potential opportunities with the existing business partners that we are already working with. Our strategy, as you were mentioning is to keep growing in a market which provides interesting margins for us, our strategy is clear, we keep capitalising on the pull-through effect and improving our relationships with the top customers while increasing the geographical footprint, including some of the



top players and we might benefit also from what has been announced in January by our competitor. As far as LatAm is concerned I just go by what Mr. Tronchetti mentioned before, the situation is that in 2017 the market has significantly rebounded from the situation of 2016, especially in the O.E. but also in the Replacement channel. We are ready to take all the opportunities that might arise in terms of mix improvement, both in high value which remains still relatively low, on total revenues, and also in terms of micro mix within the Standard segment.

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

For what concerns raw materials, the guidance that we gave is represented in slide 28 of our presentation in which we are considering an headwind, for what concerns 2018, of €95 million, out of which the commodities are giving an headwind of €55 million and the Forex another negative impact of €40 million coming from the production in low cost country and so the devaluation in Brazil, in Argentina and in the emerging markets.

The negative impact of the commodities coming mostly from the oil derivatives (-€80 million). So, the total impact will be negative of €95 million with a 6.5% / 7.5% increase in price/mix, this impact, as we did in 2017 where there was practically the price/mix that covered 1.7 times the raw materials cost, this at least is what will happen according to our assumption in 2020. So, also in 2020 with price/mix we will definitely cover, in an important way, and more than the cost of raw material, in a continuative way according to our strategy. Raw material costs are also, as you can see from the slide 28, lower versus what we forecasted in the industrial plan.

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

OK. And just to follow up on that, so I understand, you know, when we look at the number that Mr. Tronchetti outlined earlier about 6.5% to 7.5% price/mix benefits for next year that some price increases will be backed for that or not?

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

One part of the price will be only for the continuity of the price increase is done during the year and considering the fact that we are present in countries which there is inflation, there is devaluation, we target also in our assumption certain increase of price to cover these elements.

### Lello Della Ragione – Intermonte Analyst

Hi, thank you for taking my question. Actually one on the split between high value margin and standard one, you said that you're decreasing capacity and so final output in the standard tyres, below 15 inches. I'm still wondering why profitability of those standard is actually below last year and we if we should model for the around 5% that you reached this year as EBIT contribution from Standard or that was just an effect due to the fact that you are converting capacity? And the other one, just to be clear on the outperformance in the High Value, above 18-inches, tyres, from your point of view, are you outperforming the overall market and, in particular, going back to NAFTA, are you gaining market share there, or not? Thank you.

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

Starting from the last part of your question, yes, we are growing market share in U.S. and we grew more than the market. The market grew around 11%, between 10% / 11% and we grew 15.6%, so obviously we grew more than the market. Your first question, the profitability on Standard, you mentioned, so we are average in 2018 we expect a growth in profitability from 7% to 7.5% average and this trend will continue, so we compensate thanks to the growth in 17 inches and reduction in 16 inches and below.

### Lello Della Ragione – Intermonte Analyst

And that means that profitability in standard will not improve just from the fact that you're exiting markets that the business in tyre is below 15 inches, correct?

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

We are slightly improving in profitability, I mentioned before, from 7% to 7.5%, that is what we expect, so some growth, but the target is to reduce all in all the weight of the standard on our turnover and volumes and that is affecting positively the entire profitability.

### Akshat Kacker – J.P. Morgan Analyst

Hi, this is Akshat Kacker on for Jose Asumendi. I just have a few questions left, on the price/mix split for 2017, what is the split between price and mix at 6.9% and it looks like the dropped through from mix in the fourth quarter was also 70%, what is a good dropped through number as you are going forward and my second question: I just wanted to reconcile that high value segment will still contribute 83% of EBIT in 2018 versus 2017, how does this fall in place given the shift in capacity from Standard tyres to High Value. Thank you.

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

For 2018 we keep the same figures, starting with the second question you made, and, sorry, but for price/mix we don't give the split. So, we will continue to lead the growth of price/mix in industry, but there is such a volatility that we always provide the combined numbers.

What is clear, as I mentioned before, is that mix is the largest part of it. So that has been last year, in the last few years and it will be also in 2018.

### Henning Cosman – HSBC Analyst

Yes, thank you. Kai Mueller has asked you before but if I can just ask again about the €40 million FX impact in isolation on page 28. If you could just help us how you calculate that or what drives that, and what would have to happen for this number to become positive. So, I understand a devaluation of emerging market currencies but if you buy the raw materials and these devalue, I understand that but doesn't that reverse when you translate into euros which is the ultimate effect in your P&L? If you could just help us with that -€40 million again. Thank you.

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

No, in the €55 million of negative headwind, we are including the cost of the commodity, as you are seeing from the chart number 28. In the forex impact we are considering the fact that we are purchasing, you are right, raw material cost in dollar, but you are purchasing this raw material cost in dollar in Brazil, in Argentina, in U.K., in Romania, where we included in our plan certain assumptions of devaluation versus the dollar. So when we consider these in the local currency we had also a negative impact coming from the devaluation, that in local currency, at the end, we will recover in term of pricing policy with the prices. This is the effect combined from commodity cost in strong currencies and the impact coming from the devaluation in the different countries.

### Henning Cosman – HSBC Analyst

So, this is seen an isolation and you don't actually account for that in euros, if you like, you're leaving that in the country and you don't translate it back at that point and the reverse translation only comes later through revenue.

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

Yes, correct.

### Alessandro Tortora – Mediobanca Analyst

Yes, hi and good afternoon to everybody, I have three questions, if I may. The first one is on the CapEx guidance that you provided for this year, around 8% of sales, what I would like to understand is, looking at the medium term if therefore you believe, given the business plan target to reach an average of 7% of sales in terms of CapEx, a sort of strong reduction and 2018 and 2019. The second question is on if you can give an idea, or a guidance on the non-recurring costs, structuring costs that you are going to spend in 2018 and the last question is on just a clarification on the outlook on the raw material cost and the positive price effect that you expect this year, I understood that there's a sort of tale coming from the price increases made last year, what I would like to understand if the company has already announced some price increases, given the cost outlook that you mentioned before or we need, we are going to expect something to happen in the second part of the year? Thanks.

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

For the CapEx we confirm that the average will be around 7%, that has been a slight improvement also because the top line has been reduced, the profitability remain equal, so that is one effect to take into account but is decreasing year-after-year the percentage of investment in turnover. I leave the floor now to Mr. Sala.

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

For what concern raw materials our guidance is €95 million of headwind that means in percentage around 6 percentage points versus the previous year. So, consider the fact that there is this impact, mostly impacted in the countries in which we have devaluation, in this case also our pricing policy will act to compensate for the rising cost of raw materials.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thanks for your attention and good evening to everybody.