Pirelli & C. S.p.A. 1Q 2018 results

Conference Call Transcript

May 14, 2018

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

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

Our 1st quarter results confirmed the soundness of our strategy.

Despite multiple headwinds, namely:

- market slowdown,
- high exchange rate volatility, and
- heavier raw material impact,

we recorded a solid organic growth and a profitability improvement.

In the quarter:

- we strengthened our High Value positioning, with a global market share increase of more than 1 percentage point in 18 inches and above, both in the OE and Replacement channels.
- At the same time, we reduced our exposure to Standard to less than 40% of total Revenues (almost -6 percentage points year over year).
- In the general slowdown of the standard market, we intensified our actions on the less profitable products, in Europe, LatAm, MEAI and Apac, and decreased the sales of 17 inches tyres in the Original Equipment channel, in favor of higher rim sizes and specialties, to meet the higher demand from car makers.

These actions resulted in:

- A top price mix improvement, more than double vs. peers average (+7.2% vs. +2.7% peers average),
- Which, in turn, led to an EBIT margin before start-up costs of 17.5%, improving more than 1 percentage point year on year.

We are fully on track with our plan implementation, as we will see in the next few slides, and the new organization just approved by the Board is aimed at ensuring greater operational effectiveness by:

- enhancing inter-functionality, and
- ensuring a better operational control over execution.

We confirm our outlook for 2018 with just a few adjustments to the Top Line, that are not affecting the delivery of our value strategy.

- Our expectation to outperform the market in the High Value segment is confirmed, with a volume growth rate equal or greater than 13%

- In the Standard segment, where demand is lagging, we are going away from less profitable products at a faster pace than previously indicated. We now forecast a Standard volume reduction in the -5% to -6% range (February guidance was -4%, -5%).
- This will result in a lower total volume growth: +2% / +2.5%, a touch lower than the previous guidance (+2.5% / +3%)
- Price mix improvement is confirmed in the +6.5% / +7.5% range
- Hence, the organic top line growth is expected to be equal or above 9% (almost 10% as in our previous guidance)
- Sustained by a lower raw material headwind, the profitability target and cashflow are confirmed.

Let's now briefly review our first quarter performance

Our 5.7% organic growth was backed by the strengthening of our positioning in the High Value segment, which now accounts for approximately 64% of our 2018 first quarter net sales.

The Top line trend was affected by:

- a strong forex headwind (-7.3%), due to the weaker US dollar and the volatility of emerging market currencies, as well as
- the already mentioned accelerated reduction in standard tyres (-10.6% in volumes, -5% in organic revenues)

We posted a solid profitability improvement, as witnessed by the adjusted EBIT before start-up costs which reached €229 million (+4.5% year on year) driven by the quality of our internal levers, namely price/mix and efficiencies.

In addition, improvements in financial charges management, also supported by the 1,2 € billion capital increase underwritten by Marco Polo in June 2017, contributed to the strong increase of the Net Income (+87% year on year).

Finally, the increase of the net financial position reflects the trend of the working capital in connection with the usual seasonality of the business. Mister Sala will give more color on that.

Let's now move to the regional performance, starting from the **High Value Regions** that account for 78% of our Group revenues in the quarter and 93% of the High Value turnover.

In **Europe**, we strengthened our leadership of High Value, gaining more than 2 percentage points of market share in 18 inches and above, as a results of:

- the increasing demand of specialties (run flat and noise cancelling) from Prestige and Premium Car makers,
- the expanded homologation portfolio, as well as
- the strong pull-through effect on Replacements, coupled with a higher penetration in the car dealer channel.

On the contrary, in the Standard segment, the overall market recorded a -5.5% drop year on year, and we reduced our exposure to less profitable products, making 18 inches and above our top priority in capacity.

The Mix improvement produced a year on year profitability increase of 2 percentage points with an Adjusted EBIT margin in the "*Mid-Teens" range.*

In **NAFTA**, we consolidated our positioning in High Value.

We outperformed the market in the Replacement channel, through the success of our Regional All-Season products and the increased penetration in the retail channel.

The strong Forex headwind impacted the profitability with an adjusted EBIT margin in the High teens range, therefore marginally lower than previous year.

APac confirms its profitability as the highest among Regions, in the "*Twenties*" range, improving year on year.

High Value sales were the main driver of the 23% organic growth.

In a market that recorded a double digit growth (+13%), we gained almost 2 percentage points of market share as a result of:

- our strengthened partnership with global Prestige and Premium car makers, as well as new contracts with the most innovative Chinese brands, and
- the pull-through effect and a wide distribution network of over 4,000 points of sale.

The reduction of standard tyre sales is attributed to

- lower O.E. volumes in 17 inches, in favour of bigger rims, and
- reduction of Aeolus brand sales, with the conversion of its capacity to Pirelli standards

Standard Regions account for 22% of our Sales and 7% of our High Value revenues. Here, our strategy is based on improving the mix by reducing our exposure to less profitable products.

In **Latin America**, we are expanding our market share in 18 inches and above and upgrading our Brazilian plants of Bahia and Campinas to High Value production for the local, as well as North American market.

The actions on the mix are boosting profitability in the Region with Adjusted EBIT margin in the range of "*High Single-digits"*

In **MEAI**, despite exchange rate volatility, we increased our High Value sales, which now account for almost 60% of the regional revenues. This has been achieved through a commercial performance driven by a careful channel mix management.

Finally in **Russia**, our focus on the most profitable segments and a very favourable market environment, allowed us to grow both sales and profitability in the Region, with an EBIT margin reaching the *Mid-Teens* range.

The execution of our strategy is proceeding as expected.

- Our focus on High Value led to more than 120 New homologations during the first quarter, the development of High Value capacity by 0.7M pieces, and the growth of the distribution channels over which we exercise a better control (Car dealers, Tier 1 clients and Pirelli retail).
- Each of the Transformation programs is launching new processes and digital tools, strengthening the coordination of the various functions in our operational model and increasing Pirelli service level to distribution and end consumers.
- Finally, we are accelerating the reduction in the Standard segment, as already described.

The implementation of the 3 strategic pillars will be supported and enhanced by the new organization approved by the Board of Directors today. The new organization is specifically aimed at increasing effectiveness:

- by promoting a greater interaction among functions, and
- ensuring a greater operational control over execution.

The newly appointed General Manager Operations, Mr. Casaluci who I will be pleased to introduce you during the Q&A session - is entrusted with all key operational levers:

- from sales to marketing, from operations to supply chain organization, and
- will work with the Executive Vice President of Technology, Mr. Boiocchi, on technology and innovation.

The **2018 market outlook** we outlined during last call is confirmed.

- The 18 inches and above segment is expected to grow by 9%, outperforming the Standard market 8 times
- The 3 High Value regions, accounting for 94% of the total High Value market, are in line with expectations:
  - In Europe both replacement and OE market are expected to grow by around 9%
  - In NAFTA, we expect a high single digit growth, mainly driven by Replacement, while the OE market is recovering after the 2017 slowdown.
  - In APac, demand keeps growing around mid teens thanks to sustained Premium & Prestige car park expansion. This year, said car park is expected to go up by 11%.

The 18 inches and above market is indeed showing resilient growth and Pirelli aims at outperforming it, in line with its mid-term target growth

Let’s now go through **our targets for 2018**.

- We confirm our expectations on High Value with a volume growth of at least 13%
- The above mentioned accelerated reduction of standard exposure will translate into a Standard volume drop between -5% and -6% (-4%, -5% in our February guidance)

- This will result in a more contained total volume growth, between 2% and 2.5% (0.5 percentage points less than the previous guidance)
- Price/Mix is confirmed to improve in the 6.5% / 7.5% range
- Hence, top line organic growth is due to be equal or above 9% (approximately 10% the previous guidance)
- Including a more prudent Forex scenario (between -5% and -4.5%, 1 percentage point lower versus previous guidance) and the impact of IFRS 15, that Mr. Sala will illustrate, top line growth will be approximately 4% (versus equal or above 6% the previous guidance)
- High Value will account for more than 60% of total revenues
- Adjusted EBIT, before start-up costs is confirmed to be above €1 billion supported by a lower raw material headwind that will compensate for the volume and forex impact. IFRS 15 is for us neutral on profitability.
- High Value weight on Adjusted Ebit before start-up costs is expected to be equal or above 83%.
- Adjusted EBIT is confirmed to be of approximately €1 billion, net of approximately 40 million euro start-up costs
- Net Debt and Capex targets are in line with the previous guidance

And now I leave the floor to Mr. Sala for a detailed review of the first quarter results.

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

Thank you, Mr. Tronchetti and good evening.

In the first quarter 2018, sales organically increased by approximately 6%, driven by the strong performance of High Value.

In this segment, we recorded another robust volume growth (+12.8%), after the record results of the 1st quarter 2017 (+17.1%). The growth rate was even greater in 18 inches and above Car tyres, where Pirelli outgrew the market : +18.6% vs. +7.9% of the market.

The different performance between High Value and the 18 inches and above Car segment was mainly related to:

- the increasing demand for specialty products above 18'', compared to the smaller sizes included in the High Value range, and
- the general slowdown of the Premium motorcycle market (-4% in 1Q 2018) due to the unfavourable weather conditions in Europe.

On the contrary, the performance of Standard tyres (-10.6% drop in volumes in 1Q 2018) discounts:

- the slowdown of demand in Europe (-5.5%), NAFTA (-5.5%), APac (-1.6%), and
- the decision of Pirelli to reduce its exposure to less profitable segments

These factors, along with the price increases in 2017, concurred to strongly improve the price/mix (+7.2% vs. +5.5% in 1Q'17), which was once again the best in the Industry*.

The negative FX impact (-7.3% vs. +4.0% in 1Q'17) reflects the strengthening of the Euro against the U.S. dollar and the volatility of the Chinese yuan and of currencies of emerging countries such as Brazil, Russia, Argentina and Turkey versus the euro.

Finally, just a few words on the IFRS 15 introduction: starting from January 1st 2018, costs incurred for sales promotion are now taken off the top-line without any impact on EBIT for Pirelli. The current 0.6 % impact will repeat in the next quarters of 2018.

If the Forex impact and the application of the new accounting standards are factored in, sales decreased by about 2%.

The quality of our top line drivers translated into a profitability improvement in 1Q 2018. **Adjusted EBIT before start-up costs** improved by 6% year on year, with a margin of 17.5%, improving by 1.1 percentage points, compared to the same period of last year.

The profitability increases resulted from our internal levers, namely:

› price mix, efficiencies and lower start-up costs, from 15 mln euro in 1Q 2017 to 11 mln euro in 1Q 2018.

› which more than offset the external headwinds (raw materials, inflation and forex) as well as the increase of D&A and the other costs related to the development of High Value.

In particular:

› the strong price mix improvement countered the raw material headwind about 4 times, confirming our strong track record;

› efficiency gains basically offset the cost inflation.

Net income, before discontinued operations, was almost twice as much as in the first quarter of 2017.

This is the results of:

› our solid operating performance,

› the improvement of the results from equity participations (capital gain from Mediobanca, held until January 2018)

› lower net financial charges as a result of a lower cost of debt (5.01% at the end of the fist quarter 2018 from 5.42% of the previous year), as well as the impact of the 1,2 billion euro capital increase underwritten by Marco Polo in June 2017

› the tax rate (28.7%) in line with the FY 2018 target.

Excluding all the one-offs and non-recurring items, Net Income adjusted amounted to €113 million, vs. €76 million in the first quarter of 2017.

We ended the first quarter with a Net Debt of €3.9 billion. The trend reflects the usual seasonality of the working capital.

In particular, the cash absorption was mainly attributed to:

- trade receivables increase, linked to the Summer season sell-in, to be cashed-in during the second quarter;
- the payment of payables also linked to investments that concentrated in the last quarter of 2017 and were paid in the first months of 2018.
- a decrease of trade payables, in line with the trend of previous years.

The cash flow before extraordinary operations was negative for €726 million.

Excluding the impact of the Mediobanca disposal* (€152 million), the net cash flow before extraordinary items and sale of stakes would be negative for €878 million, in line with the -€882 million in the first quarter of 2017.

Pirelli’s Gross Debt stood at €4.7 billion at the end of March 2018, with an average life of 2.8 years as more than 80% of it is now due beyond 2019.

Last Twelve Month Cost of Debt at 5.01%* is down from 5.42%. This result has been mainly achieved through

- the January 2018 €600 million bond issue with 1.375% coupon and maturity 2023,
- the June 2017 refinancing of our committed bank lines, and
- the net positive effect of their re-pricing only partially offset by the early redemption of the €600 million bond occurred in January and March 2018

We would like to remind you that cost of debt as of end of March 2018, only partially benefit from June 2017 new funding as it is still affected by the wash-down fee of the previous credit line (i.e. €61.3 mln). Starting from the second quarter 2018, the cost of debt will fully benefit from the above mentioned refinancing.

We confirm our 2018 guidance of average cost of debt below 4%.

I now leave the floor to Mr. Tronchetti.

This ends our presentation.

We may open the Q&A session.

Questions & Answers

Monica Bosio - BANCA IMI

Thanks for taking my questions. The first one is on the price mix, which was a bit better than my expectations.

I remember that during the last conference call the Group has indicated a mix, a pure mix effect in the region of 5%. Is it still the case and do you still confirm +5% for the only mix effect for the current year and do you expect any difference between quarters?

The second question is on the high-value tyres growth: should we expect a pace of growth for the rest of the year in the region of 13%? And, if yes, do you expect some differences amongst countries? My question is, amongst the High Value regions, which is the most challenging one? I can imagine Europe, if you can elaborate on this, I would really appreciate. Thank you very much.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. Price mix trend will be in line with the past, benefitting in third quarter by the winter season, while second quarter a bit weaker. So we confirm our guidance and we are quite comfortable with it.

The growth in High Value is confirmed in the range on 13% as mentioned in our plan. In the different regions we don't see major changes, compared to our plan, if not some, let's say, better performance in Europe, in the first quarter that could, in the next quarters, be aligned with our forecast, so that's the only major change. All the rest is in line.

Monica Bosio - BANCA IMI

Thank you very much, thank you.

Marco Tronchetti Provera

Thank you.

Martino De Ambroggi - Equita

Good evening everybody.

My first question refers to the acceleration in the Standard products reduction. If I am not wrong, this is not the first time you mentioned such an acceleration, and you already achieved the 63% of sales in High Value products, which was the target in your 2020 guidance. So, my question is should we change, or should you change your assumption for 2020 because you already achieved the 63% and this could change the picture going forward for your long-term targets?

Marco Tronchetti Provera

For the time being we confirm the target for 2020, what we do is to profit of any opportunity; this quarter, we had a strong demand on 18'' and up and we switched the production faster than expected. There was a slow down on 17'' and below and, in a way, we profit of it increasing our decrease in standard, but this, this is what happened in the quarter. We cannot say that this affects our 2020 target. Obviously, any opportunity where we can reduce the less profitable side will be captured.

Martino De Ambroggi - Equita

Ok, so it's temporary.

The second question is still a follow-up on the price mix, if you could maybe elaborate on the pricing environment and the split between price and mix, also taking into account starting from the second quarter the pricing comparison will become tougher. So, if I remember correctly, your guidance for price/mix was 6.5, 7.5 for the full year.

Marco Tronchetti Provera

So as you know, we don't give the split between price and mix, our strength is the mix and so obviously you have the answer through this.

We don't see, looking forward, changes, because first quarter we had in Europe the effect of the previous increases in prices, looking forward we still have some opportunities to increase prices in countries where the weakening of the currencies are allowing a price increase, like is going to happen in Brazil, in Latin America and Russia, so we confirm the guidance.

Martino De Ambroggi - Equita

Okay, very last one, LATAM profitability. It's the only region in Q1 still delivering single digit profitability. Could you update on the medium-term perspective for LatAm standalone?

Marco Tronchetti Provera

The LATAM had an improvement, so, looking forward we are positive on LATAM, even if the time lag of the recovery of the country is affected by the political situation. What is really our target in shorter term is the increase of mix exported to NAFTA thanks to the investments we made and we are making mainly in Brazil; we are now supporting the growth in NAFTA quite strongly, and so the profitability of the region considering the export it continues to improve, sorry.

Martino De Ambroggi - Equita

Ok, thank you.

Gaetan Toulemonde- Deutsche Bank

Yes, good evening. Gaetan Toulemonde, Deutsche Bank speaking.

I want to come back on LATAM. I want to understand a little bit better, because currencies are moving all over the place and I am thinking about Argentinian pesos, a little bit the real in Brazil. Can you give us a little bit some colour on the proportion of Brazil which is exported to the US, where can that go in the coming quarters to help me to better understand the risk on the currency in LATAM. That's my first question, then I've a second one afterwards, if you don't mind.

Marco Tronchetti Provera

So, 20% of the production is exported, and we are planning to increase I; the more we improve the mix of production in Bahia and Campinas the more we increase the export.
So we confirm the 20%, but we see a potential increase.

Gaetan Toulemonde- Deutsche Bank

And is there any risk in Argentina, with the currency devaluating significantly? Can you increase prices there or in the end Argentina is so small for you that the impact is negligible? Can you remind us a little bit the sensitivity on Argentinian pesos?

Marco Tronchetti Provera

It's really negligible... The price increase in, now in Argentina is passing through easily, so we don't see risks on our results coming from Argentina, for both reasons: price increase and the small portion of our profitability that comes from Argentina.

Gaetan Toulemonde- Deutsche Bank

Ok. Thank you, last small question regarding the premium tire volume, are you still going significantly faster in OE than replacement or there is a better equilibrium between both?

Marco Tronchetti Provera

OE continues to maintain its shape, we are now having positive results with Asian OEMs and so the proportion remains equal.

Gaetan Toulemonde- Deutsche Bank

So, is still... proportion equals at what? 50-50 between OE and replacement? I remember, I think in the past it was much more 60% plus in OE, if I remember correctly.

Marco Tronchetti Provera

No, is, is much less. It was 45-55, more or less.

Gaetan Toulemonde- Deutsche Bank

Ok, thank you.

Lello Della Ragione - Intermonte

Hi, thank you for taking my questions.
Just remaining on OE and replacement, if I look at the volume growth in High Value, the difference between the organic level and the volume growth is not that different, meaning that probably the price effect is relatively small. I was wondering if you are having issue in tyres adjustment, because if I remember correctly this should be last quarter with the effect of the price increase that you

implemented last year or is just really due to the fact that OE is probably growing faster than replacement at this point in time?

The other question relates on the raw material guidance at EBIT level. I was just checking at your slides on raw material and the one on Forex.

The headwind on raw mat before Forex is almost the same compared to the last guidance and it seems that the changes that you are implementing at that level are mostly related to Forex; but if I look at you indication in terms, for instance, of US dollar, we are moving back to the level 1.17 that you mentioned before, so I was wondering if we have to look at this in an evolving way, meaning that if the dollar returns to the level that you got it before, we will go back to 95 million, or you have some edging that can slow down this effect? Thank you.

Marco Tronchetti Provera

Starting with the second question, we don't have an edging, a particular edging, on the dollar. The only effect we see on raw materials is the one coming from oil, that's why we have these figures, but we don't see any major change on the dollar, at least in our plan.
The first question you made on High Value: the organic growth is 13.5% and volumes is 12.8%. That shows that the price mix effect is positive.

Lello Della Ragione – Intermonte

It means that price contribution is smaller than the mix. Is it correct to assume that the price improvements are mostly related to the standard tyre rather than the high-value tyres in proportion or not?

Marco Tronchetti Provera

This is true, that there is an improvement. The heavier reduction for Standard created, within Standard, an improvement in mix, an improvement in mix and price. Better mix means also better price, in that case, because the 17'' are priced average better than the 16 or 15, which shows that we have a double effect on price and mix, improvement of mix and improvement in price.

Lello Della Ragione – Intermonte

Ok, got it. Thank you.

Victoria Greer – Morgan Stanley

Hi, good evening, just a couple please, both on NAFTA.

Your net organic growth was very strong. Could you talk about the drivers there and what has got you that level of share gain? The NAFTA market in general has been very weak, you've talked about your expectations for the premium market but for the overall NAFTA passenger market, do you expect to get stronger from the weak Q1?

And then secondly staying on NAFTA please, I wanted to ask you about the changes in the distribution framework that we have seen there, so the Goodyear Bridgestone tie-up, Michelin and

Sumitomo, does that have any impact for your strategy? Is it an opportunity, for example, maybe with American tyre distributors as Goodyear withdraws? Thank you.

Marco Tronchetti Provera

For the first question I will leave the floor to Mr. Casaluci.

For the second question, obviously, for us, it is, as you mentioned, an opportunity, because it leaves more room within the independent distributors and so can facilitate our growth and obviously within the network that belongs to our competitors, we are in, because no-one has a mono-brand structure, so all what we see is within a multi-brand strategy of all players. So we keep, obviously, a share within the network that is controlled by our competitors and we have an opportunity to increase shares with the independents.

Andrea Casaluci – General Manager Operations

Thank you, Mr Tronchetti, nice to meet you, Casaluci speaking.

Yes, we do see strong opportunity to grow in the High Value segment, to keep the growth in the North American countries.

In the first quarter we grew on market share and we do plan to do the same thanks to the enlargement of the customer base and thanks to the introduction of new All Season product lines.

Coming back to what Mr Tronchetti said, the change in the structure and the concentration of the trade is also representing, for us, a further opportunity to grow, because with our pull-through strategy also the new joint ventures will need our products, because of the natural demand of the Pirelli homologated product and because for the independent players it goes without saying, that is a good opportunity to have a partner into the trade to support the commercial development.

Henning Cosman - HSBC

Hi, thank you, good afternoon.
I'd like to come back to the price mix as well and maybe the first question of clarification. Mr. Tronchetti said the reduction in Standard tyres had a mix and a price effect at the same time, so I was just hoping you could remind me what the difference is between price and mix there. So I thought when the ASP changes as a function of fewer small tyres within Standard, that's mix; but I thought you were saying the ASP changes is also price at the same time. What's the distinction, exactly, please?

Marco Tronchetti Provera

Mix means that if I have more 17'' than 16'' this is mix, then we have the average price of the standard, if I sell more 17'' than 16'' the average price increases also, so this is an effect that has a double positive effect, the reduction of lower priced products and compensated by an increase of higher price products. I think should be simple.

Henning Cosman - HSBC

And then if I can just ask for a little bit more granularity, as you run into this tougher price mix comes in the coming quarters, what would have to happen within mix for you to reach the upper end of your

6.5% to 7.5% price mix guidance? Is it mainly really driven by OE mix or how do you get to 7.5% against the tougher competitors in the coming quarters?

Marco Tronchetti Provera

Competition was tough also in the first quarter and our price mix was good. We always fight for the best and then, at the end of the year, we will see if we will be able to stay in the higher part of the range, in the mid or in the lower, but in the first quarter we did prove we were able to stay in the higher end... of our targets, so... that said, quarter by quarter we will be explained what has happened in the market?

Henning Cosman - HSBC

Sure, I'm just being conscious that you have a tough comparison base, right? There's 2.3 percentage point higher in Q4, for example, than it was in Q1, that's what I was referring to.

Marco Tronchetti Provera

So if we replicate the performance of last year we have more probabilities to stay in the higher part of our range.

Henning Cosman - HSBC

Okay.
And final question on the new organization of structure, my impression was that the previous setup was still relatively recent and the way you had the separate regions reporting into the more corporate Functions. Could you just remind us what has changed in you thinking and what's exactly triggered the new organization structure and how you think you are better positioned now?

Marco Tronchetti Provera

The organizational structure now has one responsible for the operations that is taking care of the alignment between the market and the factories, simplifying things, so, as I mentioned presenting the plan, we are accelerating the process of digitalization of the company, so we are linking more and more the market and the factories, and having a single responsibility in taking care of the operation it's easier to change what we are changing within our processes and to have a better control of all functions. In the meantime we are keeping full control of innovation and R&D, in the hands of Mr Baiocchi; we guarantee the continuity of our speed, continuous acceleration in R&D, supporting the action of the responsible of the operations, so this is also supported by the creation to a direct report to me of the digital, that is a new manger coming with an experience, a deep experience in digital and is helping creating the company shorter decision-making process, which helps in implementing digitalization.

Henning Cosman - HSBC

But we shouldn't perceive this as a defensive move to protect the financial mid-term targets which would have, otherwise, maybe come under jeopardy?

Marco Tronchetti Provera

This is done in order to try to improve them, it is not to sustain them, so the challenge is to deliver the best, not to protect the worst. And so, as I mentioned before we are targeting the best part of the range of profitability and the best part of the mix, and the, let's say, the appointment of Mr Casaluci is made in order to get to the best.

Henning Cosman - HSBC

Thank you, thank you very much.

Massimo Vecchio - UBI BANCA

Good afternoon everybody. I was impressed by the number of new homologations in the quarter: 120 is a very high number. My question is: were you expecting this or this was better than your internal expectations?
And also, can you give some granularity on the real size of those homologations, how much of that is electric and hybrid, and also ideally some granularity also from the geographic point of view? Thanks.

Marco Tronchetti Provera
I leave the floor to Mr. Boiocchi.

Maurizio Boiocchi – Senior Vice President Technology and Innovation
Boiocchi speaking
Yes, the number of homologation is very important, we have really push on the High Value, as usual. More or less, there does not exist any homologation below 18''; the most popular homologation we have are from 20'' over, so really you can see how we can follow all the changes in the OE market.
Looking about the electric and hybrid, this is a very booming and growing activities, on which homologation starts to have an important number. We have more than 25/30 homologations, already, in this field but a lot is arriving.

Massimo Vecchio - UBI BANCA

Thank you very much, very useful.

Josè Asumendi - JP Morgan

Thank you, José JP Morgan, a couple of questions please. On the bridge on the D&A and the other line can you explain a little bit more what's behind that figure please and how we should we think about that category of the coming three quarters, three quarters?
And then, with regards to the product mix in Russia, High Value and standard, can you speak a little bit about the product positioning in, in Russia? Where we stand on High Value, on standard and what could be the strategy there to improve the product mix for the coming years? Thank you.

Marco Tronchetti Provera
Mr Sala.

Maurizio Sala

For the first question, in the first quarter we had a negative impact of 21 million on Depreciation and Other: 9 million were related to depreciation coming from the investment we did in the recent years, and the remaining part is related to costs for the development of the High Value. So practically all the cost that we are having in the research and development in the factories and in the marketing activities, in order to grow our presence in the points of sales in the different regions.

Alessandro Tortora - Mediobanca

Good evening to everybody, I have very quick questions if I may.
Can you give us any update on patent box?
The second question is just a confirmation that as of today, basically, you didn't announce any price increases despite the recent, let's say, oil price increase.
And the last question, do you have any backup plan in the event of an unhappy negotiation of the NAFTA agreement? Thanks.

Marco Tronchetti Provera

I'll answer for the NAFTA agreement, then Mr. Casaluci will answer the other question.
NAFTA agreement, as you know, we supply the NAFTA market from, directly from US, from Mexico and from Brazil. We supply also from Europe something, so all in all we don't see any risk coming from the revision of the negotiation on NAFTA, and as far as we know, there are no major changes effecting our results even in the worst case scenario.

Andrea Casaluci

Yes, thank you.
As far as pricing is concerned, the price increase that we do expect for the rest of the year are mainly linked to the raw material scenario and the exchange rate scenario, mainly affecting the Standard regions, while if we move to the High Value region, talking mainly about Europe, we do not expect a strong price pressure, mainly in the High Value segment where we are focussing, because the highest we go in the product range and the more the technological barrier and the limited product offered into the market is supporting us into the full implementation of the price policy.

Marco Tronchetti Provera

There is another question, the one about the patent box, the negotiation process is up and running and we expect it will come to a conclusion in the next month. Pirelli, obviously, is not in control of the timing of the agreement, but we don't see any delay coming from the offices, so we expect to end process, as others already did, so we don't see a major threat coming on that side.

Alessandro Tortora - Mediobanca

Okay. Thanks. Very clear.

Marco Tronchetti Provera

Thank you.

Edoardo Spina – Exane BNP Paribas

Good afternoon and thank you. I also have three quick questions. Can we start a follow-up on the tax rate, if you can confirm for this year the guidance of 28% for this year?

Marco Tronchetti Provera

Oh, yes, we confirm the 28% guidance for the full year.

I will take the opportunity to answer to another question I didn't answer before, the, someone asked the improvement on the price mix in Russia. The price mix in Russia is due to the better mix of our sales in the market, where we have improved the profitability both in the winter and in the summer season and we see this trend will continue in the next months, we see opportunities also improving the export from Russia.

Edoardo Spina – Exane BNP Paribas

Thank you. I have two follow-up, if I can, on China first, because of the changes now in Europe, with import duties, there are some already in US, so do you expect any reaction from Chinese authorities against European or US makers? I know you are local production, but it would be interesting to know your opinion.

The other question is related to the market: it seems the volume are not very strong... we understand that you have opportunity to grow more in the High Value, but would you say that the standard markets are a little weaker than expected, in terms of market?

Marco Tronchetti Provera

Yes, you are right. The standard, mainly in Europe, was decreasing in the first quarter by 5%, which is a huge number and we have to see that in the High Value the double-digit growth is confirmed and so we continue to see that the pull-through effect we have on our marked tyres is providing us the opportunity to continue our growth, so is the business model that is functioning. Reduction in standard and increase in High Value is in line with what is happening in the market.

About China we don't see any reaction related to the tyre business; the tyre business, for us, is not even an issue because our export in China is from China to the region, so we don't have an issue. In general we have at least 80% and more on local for local in every region. In the case of China, we have more than 90% in the region, so no risks on that side.

Edoardo Spina – Exane BNP Paribas

Thank you.

Marco Tronchetti Provera

Thank you.

Ashik Kurian - Jefferies

Good afternoon, just a couple of quick questions: your market forecast for 18'' and above for the full year looks for flat, a bit weaker than in the first quarter.
In Q2 so far, so April and May, have volumes improved substantially in Europe and North America, in line with your guidance?
Just a couple of questions on the free cash flow. Your CAPEX was down on absolute terms in Q1, should the trend continue or should be expected a ramp up in the upcoming quarters to hit the 8% guidance?
Also, to hit your leverage target for the full-year you need to assume a significant working capital outflow for the full year. Am I right in assuming a working capital outflow for the full year?

Marco Tronchetti Provera

So, for the cash flow, I leave the floor to Mr. Sala.

Maurizio Sala

So, first of all I want to remember you that our plan forecast a cash flow generation for the period 2017-2020 of 1.3 billion of euro, out of which more than 300 million euro we're expecting in 2017 and 2018.
We closed 2017 with a net cash flow above expectations, plus 200 million euro.
For 2018 we expect to generate almost 200 million euro including the sales of Mediobanca, so be in line with the plan for the year 2017 and 2018.

Marco Tronchetti Provera

Yes, and for the CAPEX we confirm the 8% guidance for the full year and I leave the floor to Mr Casaluci on the NAFTA growth.

Andrea Casaluci

Thank you.
As far as NAFTA High Value market, we expect a high single digit growth, mainly driven by Replacement, while the UE market is recovering after the 2017 slowdown.So we can confirm our guidance.

Ashik Kurian - Jefferies

You said 200 million of free cash flow in ‘18 including the Mediobanca sale and the Mediobanca stake was sold for around 150 million, so basically on an underlying basis, it's still guiding from only 50 million of free cash flow in 18. Is that correct?

Maurizio Sala

No, practically, as I mentioned before, we closed 2017 with a net cash flow that was above expectation. 200 million more versus the expectation due to the savings of restructuring cost versus the plan and certain activities that we did also with agreement with supplier on payment optimization was cash out happening first quarter 2018. So, in the first Quarter 2018 we normalised this situation.

For sure what we expect for 2018 is to be at minimum in line versus the guidance that we had for the Strategic Plan for what concerns 2017 and 2018, we know that the consensus currently is almost 100 million better than our cash flow and we are confident also with this number.

Marco Tronchetti Provera

So, thank you to all people that attended and we wait you tomorrow at the Annual General Meeting. Have a good evening.