Pirelli 1H Results Conference Call

Milan, July 26, 2012

Good evening, Ladies and Gentlemen

Welcome and thank you for attending our conference call on Pirelli First Half 2012 results approved today by the Board of Directors.

Slide 3: Key messages

The Key Messages we shall be focusing on during this hour of work together are:

- A 1Half 2012 during which we did hit half of our yearly targets;

- A 13.3% EBIT margin, worth 400 mln euro despite a 60 mln euro impact which I would call an investment for a faster and more profitable growth. An investment which will amount to 90 million € for the full year 2012, and represent a faster exit from the low-end segment and an accelerated Premium Strategy. We shall soon analyze this important topic.

- An outlook for 2H2012, where the macro-economic scenario remains critical for Europe and with somewhat of a growth in the Emerging markets. Yet, we feel ready to take this crisis as a better opportunity for change. Therefore, we confirm our value driver targets: premium volumes growth (+20%) and price/mix (+11/12%), and EBIT of at least 800 mln euro and NFP <1.1 bnl euro.

- We are accelerating our focus on the Premium segment, because the addressable market is confirmed to be resilient and offers wide margins of growth and value.
  Our positioning is increasingly more distinctive, with a stronger presence in the Premium OEMs. Pirelli has one of the widest homologation portfolios in the Prestige and Premium segments (over 500 items) and the highest number of tailor-made for the Premium OEMs. All this gives a wide range of opportunities to increase the value of our Replacement Channel on the market.

- In Russia, we are progressing with our start-up plan in the Kirov and Voronezh plants, while we are busy raising brand awareness and setting up a pervasive distribution network in areas populated by a high number of Premium customers.

- Finally our start-up in Mexico is advancing very smoothly. After the official opening production activity is ramping up to approximately 500,000 Premium Tyres by the end of the year.

Slide 4: 2H 2012 Pirelli outlook

Let's talk about the outlook for the second half of the year

The demand side of the market is not due to improve for the time being. We are definitely faced with a tough economic scenario affecting:

- the most cyclical part of the business, namely Truck, Moto and Non-Premium Tyres, -
- Southern Europe where demand is weak due to poor consumer confidence.

However, the economic context is not the same everywhere and for each business.

We have the advantage of a broad geographic exposure: over 50% of our revenues come from Emerging Markets and we are increasing our market share in areas, such as the U.S., where demand is still picking up.

Even in this situation, Premium has proved to keep its resilience and is expected to grow at a sustained rate in the second half of the year.

Raw materials are easing up.

Natural rubber came down 27% from the peak reached last February and if it stays at the current level, we can have an advantage in the P&L from the Q4 on.

A similar trend was followed by Synthetic rubber and oil prices, which, however, remain very volatile.

Forex is limiting the positive impact from raw materials since the Brazilian Reail, Turkish Lira, Euro and Egyptian sterling are continuing to devaluate to the US dollar.

We expect to post a good performance in the second half of the year due to our relentless action on efficiency due to offset the slowdown and Premium acceleration costs.

Finally on the Cash Flow: we have all the measures, as Mister Sala will better explain, to maintain our net financial position target.

Slide 5: 2H Pirelli regional market overview

Let's have a look at our view of the market on a regional basis.

Europe is experiencing the most complex and domestically differentiated situation.

All economic indicators show a gradual deterioration in Southern Europe, as well as the decision taken by end-users to delay the purchases of consumer goods.

The United Kingdom and North Western Europe are negatively influenced by the turmoil in the Eurozone, whilst Germany and Central Europe have at the moment a less critical general situation.

In this scenario, our Value Strategy focused on the Premium Segment shows its resilience. Indeed, in the second half of 2012, we expect a single-digit growth on the Premium segment against an overall double-digit reduction.

In North America, given the uncertainty of the macroeconomic recovery, we are selectively strengthening our focus on Premium OEMs and on Tier 1 distributors, positively influencing the Regional mix trend.

This effort will produce an overall high-single digit growth as well as a definite outperformance of the premium segment where we expect a growth higher than 25%.

The economic growth slowdown in Latam has been addressed proactively through fostering demand and credit access policies. Therefore in the second Half, the outlook is improving with Pirelli volumes confirming a positive mid-single digit trend and a Premium Segment strongly expanding with a growth expectation of over 50%, thus further strengthening our leadership positioning. For this purpose, we recently acquired the majority share of Campneus, one of Brazil's major distribution network whose flag stores are located in the most relevant areas of the country.

APAC is confirmed to be one of the major contributors to Pirelli growth, in spite of the signs of slowdown coming from China.

The widespread development of our distribution network in all countries, the benefits from media exposure in Formula 1 and the widening of our partnership with the local Premium OEMs support our view of a double-digit growth, with the Premium segment growing twice as fast.

When it comes to F1, our programs and events reached more than 30% of our customers, providing an excellent booster to Premium sales and clientele.

Finally, a slight decrease in terms of overall volumes is expected in Middle-East Africa. This is also due to the temporary discontinuation of production in our Egyptian plant, which is now back to be operational.
Our focus in the Region is concentrated in top-end segments, both in Industrial and Consumer businesses: we expect a growth well over 50% in the Premium.

Slide 6: Change vs. November 2011 Industrial Plan

As I mentioned at the beginning of my presentation, we learned from previous crises, to anticipate reorganization programs, and accelerate strategic decisions, which we would have waited a few more months to implement, under other more favorable economic circumstances.

Like we did in 2008-2009, we addressed the economic downturn by anticipating production reorganization programs - Manresa in Spain and the old plant in Settimo Torinese in Italy. We accelerated delocalization plans to low-cost countries, benefiting from a greater profitability. Now, faced with an economic scenario that has rapidly deteriorated if compared to the assumptions in our Industrial Plan of last November, we are accelerating our exit from the low-end segment which is more exposed to system overcapacity and price pressures in this current weak economic scenario.

Therefore, it is worth making a number of points on the consequences of our exit from this low-end segment and what this means in real terms versus our 2011 plans:
- in terms of 2012 volume growth, we went from an overall target of +2% in the Industrial Plan to a current -3 / -4%.
As a consequence, we reduced our volume growth by approximately 5 to 6 pp through:

1. Volume cut in the Non-Premium Car Segment of 3.8 mln pieces of which 3.3 mln in Europe, 0.3 mln in MEA and 0.2 mln pieces in APAC;
2. Reduction of demand for bike and moped of approximately 2.4 mln pieces - mainly in LatAm and very concentrated in the OEM business.

For the Consumer Segment, growth reduction is approximately equal to 6 pp - from +3% to approximately -3% currently - while in terms of revenues of - 370 mln euro;

3. In the Truck Segment, we have reduced our volume growth by approximately 6 to 7 pp - from +1% in the Industrial Plan to the current -5%/-6%, connected to a one-off effect - strikes in Egypt and the residual import licenses in Argentina cumulatively worth approximately 5% of volume growth -

In absolute value, the figure amounts to approximately -110 mln euro.

Therefore, by taking into account the overall volume impact, we have a sales reduction worth -480 mln euro compared with the Plan, offset however by a better price/mix dynamics worth 180 mln euro.

The net effect on Industrial and Consumer sales is of -300 mln euro. Therefore, from our initial 2012 target of 6.7 bln euro last November to approximately 6.4 bln euro, with an EBIT impact of - 35 mln euro.

Clearly, the low-end volume cut causes a lack of saturation of our plants capacity which means costs due to a slow down worth approximately 33 mln euro. A further 15 mln euro must be added due to the acceleration of expenses for Premium product industrialization in order to be able to meet more quickly the market demand which keeps on being resilient. We also have increased our restructuring actions worth 10 mln euro versus the Plan – (20 to 30 mln euro) - concentrated in Southern Europe.

To summarize, the acceleration of exiting the low-end segment, the faster Premium product industrialization, together with structural rationalization programs in Southern Europe and the effect on the Industrial business due to events in Egypt and Argentina, have an overall impact on EBIT worth 90 mln euro, that we can compensate as follows:

- 30 mln euro with a more exacting Efficiency Plan;
- 80 mln euro with a lower raw materials headwind.

Therefore, we guarantee an EBIT floor at 800 mln euro and, during such a critical year, we are ahead in investing for a profitable future growth!

<u>Slide 7: 2012 enhanced efficiency plan</u>

Looking at this Slide, I wish to point out that, we increased our Efficiency Plan by 30 mln euro, with a target that is now up to 150 mln euro of which 41% is already into the 1H 2012 results.

Better efficiencies will be concentrated on the following:

- major production capacity in the low-cost countries;
- crash program on discretional costs;
- enhanced efficiencies in major countries

Slide 8: Pirelli 2012 Targets update

The next 3 slides show our update on 2012 targets.

Ebit and cash flow are confirmed:

- profitability is expected to be at least 800 mln €
- Net Financial Position is due to stay below 1.1 billion euro after dividends

Our value paradigm remains intact:

- Premium is confirmed at +20%
- Price/mix at +11% to 12%

despite an expected sales volume reduction of 3 to 4% due to:

- a drop of the Non-Premium segment, and
- lower sales of Industrial Radial Tyres, as a consequence of the production stoppage in Egypt and the import constraints in Argentina.

The impact of the volume slowdown and the cost of our acceleration on Premium/high margin products will be absorbed through:

- additional efficiencies (30 million € more than planned in November), and
- an expected lower raw material headwind in the last part of the year

Finally, we trimmed our capex for the year, maintaining our priorities on Premium, Quality and Mix.

Let's now move to the Russian business, slide number 11

Slide 11: Russia – Premium on the upsurge, trend confirmed

We confirm our view of the 2012 Russian Car and Tyre Market we gave at the beginning of the year.

Without losing sight of the close link between Russian economy and raw materials, our Tyre market view is still based on the assumption that the country's GDP remains consistent with the trend of early 2012.

- Registrations posted a positive trend in the first half of 2012, with a year-on-year growth of 14% . The second half compares to a higher second half of 2011, so the final figure should be left unvaried at 2.8 million with an overall pace of the growth on a full year base of about 5-6%. Most important, 43% of new cars will be produced in local plants of foreign manufacturers, growing 26% YoY and boosting the improvement of the overall car park
- Tyre market follows closely. Our estimates for 2012 are confirmed, with a growth in volumes of 3% to a total of 37 million units, concentrated on the high-end mix - A and B brands. This will lead a much higher growth in value, of about 13%. Class A brand in particular – where the unit value of a tyre is around 84 euro – will grow by 18% compared to 2011, exceeding 800 million euro of market value at year end. Therefore, the main driver of the Premium Tyre market is progressing at a good pace!

Slide 12: Russia – work in progress on marketing levers

In this scenario, Pirelli is working on its marketing levers: brand awareness and pervasive urban distribution network in cities with top density of Premium clientele.

We are fully on track with our Industrial Plan for media and advertising. We have been the top spender in the Tyre Industry in the first half of 2012, and results in terms of top-of-mind, spontaneous brand awareness and brand consideration are all clearly improving. The setting up of our sales network is also in line with our plan:

- We already achieved 70% of our target in terms of retail presence (800 Points of Sale at year end)
- We are well on track with over 320 Premium stores, and we are already operational in Moscow, St. Petersburg and the 10 major cities with over 1 million people
- We launched a reward program to improve our shelf presence, and in June we obtained the second best shelf space on over 180 points of sale we monitored.

These efforts on the marketing side are giving a very positive return on the sales: our summer sell-in was 68% higher in volume than last year, with a double digit price increase; winter order collection up to now is 70% higher than 2011, and the high-end mix (tyres 17 inches and up) is doubled. Last but not least, we are successfully moving our legacy brand towards a higher value positioning.

Slide 13: Russia – Pirelli approach to value

Moving from marketing to product, production and organization we can confirm that on these dimensions we are following our Industrial Plan, too.

As regards our products, we have a comprehensive portfolio for Winter Tyres, accounting for 60% of the Russian Tyre market. Also, we launched 2 new cutting-edge products in St. Petersburg: Winter Scorpion e Winter Carving Edge.

This was the first international launch of a Tyre in Russia and the dealers' feedback was very positive.

The Summer Tyre line is well perceived and we wish to capitalize on:

- the extensive presence of European Premium OE;
- the wide and diverse range of Pirelli Car Summer UHP Tyres;
- the undeniable strength of the Scorpion lines for SUVs, a fast growing market segment in Russia.

We are also implementing our "Pirelli model" from an organizational point of view, reducing the number of direct reports to the plant general managers and applying a lean and rational organizational structure.

From a qualitative point of view, together with the integration of the local management with Italian engineers, we are improving the overall level of new hired white collars, that are all graduated and, at least, bilingual.

As regards the plants, let me confirm once again our scheduled targets:

- we confirm our Capex plan;
- we are in line with the technological upgrade and with the intensive staff training;
- we have already industrialized 14 Pirelli products in Kirov and 4 in Voronezh, and the production of Pirelli has successfully started in both factories
- we confirm a capacity of 8.5 million pieces by 2012

I think we have touched upon the most relevant aspects of our Business in Russia. I confirm a mid-single-digit EBIT on sales that should reach approximately 250 million euro .

We are not revising our profitability targets upward, because we are focusing on seizing the Premium development opportunities offered by the local market, which entails an acceleration on start-up costs.

Let's now briefly review our major results in the 2nd quarter of 2012 on slide 15.

Slide 15: Pirelli Key Financial Results

- Our quarterly results show a robust performance and prove our ability to adapt to a fast changing world.

- Our value strategy resulted in a strong growth of Premium (revenues +22%) with a remarkable contribution from Emerging Markets and NAFTA, where our revenues from this segment increased by 53.5%.

- We kept a firm pricing policy across markets and segments. This, combined with continuous mix improvement, led to a double digit-price/mix growth in line with our FY 2012 guidance.

- The result of our value strategy is a 30% Ebit growth in Q2 with a 13.1% margin (+2.5 percentage points year over year), 13.9% before restructuring costs, with an improvement versus Q1 (+0.4pp).

- We rounded off the quarter with a Net Income of 96.6 million euro, 22% higher than last year.

- Net Debt reached 1.7 billion euro with an increase in the quarter of 400 million euro. We expect to bring that level down to below 1.1 billion € by the end of the year.

Slide 16: Performance by Region in 1H 2012

- At a Regional level, Pirelli results show the continued outperformance of the Premium segment with respect to the overall market. This was coupled with a clear increase in profitability, up 2.5 pp yoy, thanks to the strong contribution coming from the U.S., APAC and European business.

- **Southern Europe** is still grappling with the current economic crisis; in this environment, we stick to our value strategy and further reduce our exposure to Standard Tyres.

- **The rest of Europe** is proving more resilient, also due to the growth in Premium sales, and helps sustain the growth in profitability of the region overall, up in the semester also due to efficiency gains.

- As mentioned, the start-up phase of our **Russian JV** operations progresses according to plan, with positive indications coming from Premium products in the region. Including imports, revenues amounted to 125 million euro with profitability at break-even.

- Growth in the **NAFTA** comes with a tremendous increase in profitability. Penetration of our Premium products in the region is increasing, helped by:

    - OEM agreements with BMW and Daimler;
    - our supply to iconic domestic sports cars such as Mustang and Camaro
    - a further segmentation of our distribution agreements in favor of tier-1 chains.

- Despite signs of economic slowdown, our results in **LatAm** continue to show growth overall, thanks to Car sales more than offsetting the softness in the most cyclical businesses. Particularly buoyant are Premium sales, with clear market share gains. This shows our impact on the increasing acceptance of Premium Tyres in the region. Higher mix helps sustain the profitability in the region, flat yoy in the semester.

- **Asia Pacific and Middle East & Africa** continue to post booming Premium sales and improving profitability, even after the impact of production stoppage at our Egyptian factory.

Slide 17: Pirelli Net Income 1H12 vs. 1H11

Our focus on value across Regions led to a significant operating performance.

In 1H 2012 Ebit grew by 38% or 110.6 mln € yoy, due to:

- Price mix performance that largely offset raw material impact and volume slowdown by 51 mln euro
- Efficiency gains (50 mln € net of slowdown costs)
- Lower losses from minor businesses (10 mln €)

Net financial income and expenses were almost in line with previous year, with a cost of debt of 5.5%.

Tax rate was 36.5% in this first half. In the second quarter, the trend reflected the lower contribution of Southern European countries to the Company's results, like Italy, where there are additional tax items, not strictly linked to income, such as IRAP[1].

For the Full year, we confirm our target of 36% tax rate.

Slide 18: Pirelli 1H 2012 Net Financial Position

Net debt in the quarter increased by almost 400 million euro due to:

- dividend payment
- the acquisition of retail networks in Brazil (Campneus) and in Sweden (Dackia), consistently with our Premium Strategy
- investments on Premium and Mix, and
- a negative net working capital variation, illustrated in the chart.

Mr. Sala will give you more details on this item and will discuss the actions taken by Pirelli to reduce our Net Debt to below 1.1 bln € by the end of the year, consistently with our Industrial Plan.

Slide 19: Pirelli Debt structure as of June 30, 2012

By the end of June 2012, our Gross Debt amounted to approximately 2.4 billion euro, showing an increase of 393 mln € during 2Q2012, mainly due to:

- our investment in the retail business in Brazil and in the Nordic countries with Campneus and Dackia, respectively;
- the seasonality of the business
- dividend distribution and payments linked to the 2009-2011Incentive plan

[1] **Italy's contribution**: taxes paid in Italy amounted to 54% of the total, as against a contribution to the taxable income of 38%.

Our liquidity margin (765 million euro) made up of:

- committed undrawn credit lines for 385 million euro, and
- liquidity for approximately 380 million euro

allow us to cover our debt maturities up to 2015.

This sound financial situation also allows Pirelli to confirm its strategic approach to financial markets in terms of currencies and financial instruments.

And now I leave the floor to Mr. Sala who will tell you about the Tyre Business Results.

Slide 21: Key tyre results

The Tyre Business in Q2 2012 posted a

- mid-single-digit improvement of revenues and
- as much as a 24% growth in profitability

Pirelli value strategy came out clearly with topline growth, as it allowed us to maintain a firm pricing policy, while grabbing growth opportunities across markets and segments.

Revenues in Emerging Markets and NAFTA were up 18% and 35%, respectively, and Premium volumes outgrew the market, recording a 12.3% increase quarter on quarter, sustaining a positive 11% price/mix trend.

Quality growth underpinned the 198 million euro operating profit in the quarter, or 13.6% of sales.

Excluding the impact of restructuring costs, Ebit margin is up, compared with both the previous quarter and previous year, as a result of:

- cost efficiencies worth 32 million euro in the quarter (reaching 41% of the updated 2012 target in the 1st half), and
- an easing negative impact of raw material costs, 5 million euro in the quarter.

In the last quarter, the Russian JV provided a 48 million euro contribution to revenues, that should not be taken as a yearly pro-quota, given the current speed of ramp-up affecting our business in Russia.

Slide 22: Pirelli Tyre operating performance

Let us now discuss our profitability drivers that have brought about a 38 million euro Ebit increase.

As in the first quarter, the price/mix variable accounted for a significant contribution: 102 million euro increase, that largely offset the negative impact of volumes and higher cost of inputs.
Efficiencies were in line with the first Quarter of 2012, producing a benefit of 32 million euro due to:

- a shift of capacity to low-cost plants, with a strong increment of capacity usage, in particular Romania and China
- optimized use of raw materials
- enhancement of our actions aimed at efficiencies in mature economies.

In the last quarter, we accelerated our conversion process to high margin products, and the impact of the volume slowdown was 7.4 million euro.

In addition, we boosted our restructuring activities with 12.5 million worth of lay-offs.

Finally, depreciation & others were negative by 5.8 million euro, due to ordinary operations, and no longer incorporate the one-off benefit which totaled 20 million euro in the previous quarter.

Slide 23 – Consumer business: key market trends

Let's review briefly what happened in the markets in the Second Quarter.

- The European market trend was in line with the First Quarter, with repercussions especially in the Replacement Segment. Notwithstanding, the Premium trend proved its resilience against the run of the market also in the Second Quarter.

- In North America, instead, the market trend improved with OE on the upsurge and the Replacement channel basically stable yoy.

- In Mercosur, OE and Replacement channels followed opposing trends.

Slide 24 consumer business: Pirelli performance

The Consumer Segment sales went up by 12.5% yoy in the Second Quarter of 2012.

Prices held well in all Regions and Premium sales increased 22% yoy. This has produced a double-digit price mix increase of 13.6%.

Profitability remained very high with an Ebit margin of 15.1% before restructuring costs, an improvement of almost 2 percentage points.

Slide 25 industrial business: key market trends

All segments of the Industrial Business are still negatively affected by the deteriorated macroeconomic scenario.

In the Second Quarter, the Replacement channel had a remarkable drop, in line with the trend of the First Quarter.

In Mercosur, the OE sales of this year were not supported by the same incentives as those granted by the government last year for the switch to Euro 5.

Slide 26 industrial business: Pirelli performance

The Industrial Business is cyclical and suffers the current climate.

In addition, our volume drop in the quarter was affected by:

- The production stoppage in our plant in Egypt, due to a strike that started early June and now brought to an end successfully
- The import constraints in Argentina.

These two events, which impacted volumes by 7% in the quarter, led us to assume a 5 to 6 % volume shrinkage as a guidance for the full year 2012.

Despite the drop in volumes, profitability was up strongly with a margin of 11.9% (+3.3 percentage points versus last year).

This is thanks to:

- price mix improvement in the quarter to the tune of 5.3% through the actions on prices taken in 2011, and a positive mix for higher reduction in the Conventional segment
- lower raw material impact

Slide 27 Raw materials

This slide shows our updated guidance on raw materials (30 mln euro better than previous guidance and 80 mln euro better than Industrial Plan guidance)

Slide 28: A Walk Through 2H 2012

Finally, I want to accompany you through the highlights for the rest of the year.
The positive outcome of the First Half of 2012 is a sound platform to start from and achieve the targets set for the current year, based on the following:

- **cautious assumptions on market trends** in the second half of the year with flat volumes, positive Premium trend and winter down 10%.

- **an ongoing contribution from the Price/Mix**

- **internal levers to improve efficiencies** amounting to 87 million euro, 60% of the new 2012 target. These efficiencies are expected to off-set the impact of reduced production activity and conversion to high margin products

Supportive Raw material environment is going to produce 30 million euro of minor costs.
These factors make us be confident that the EBIT margin in the second semester will exceed 400 million euro.

Let's move to the cash flow drivers:
As represented in slide 18, the 2 quarter operative working capital movement accounts for a value of 50 mln euro (including new retail network acquisitions). We are still high on stocks , but the other components of operative working capital are in line with the seasonality of the business
In the second half. We expect to reduce our operating working capital by almost 500 million euro through:

- year-end seasonality of the business and
- stronger stock reductions, by 20% vs June, (almost 200 million euro)

This will results in operative working capital absorption of 100 million euro by the end of the year, in line with our November 2011 Industrial Plan

Other payables and receivables , negative in the second quarter by 190 mln euro as represented in slide 18, will come back to a normal trend in the second half.
At the end of the year we will have around 100 mln euro negative operative working capital , almost 80 mln euro absorption for the payment in 2012 of the 2009 – 2011 incentive plan and 45 mln euro for pension fund contribution , as already considered in our Industrial Plan.

I thank you for your attention especially at this late time of the day. Back to you Mr. Tronchetti.

Mr Tronchetti

Thank you Mr Sala. We are now to take your questions.

QUESTION AND ANSWER

Monica Bosio - Banca Imi - Analyst

Good evening, everyone. I will have three questions. The first one is regarding Brazil. I was just wondering if you can give us some indication on the market share on the premium segment that the Company enjoys now, and if you can give us an update on the weight of the premium tires on the total market in Brazil.

The second question is regarding the stocks. Could you please give us an indication of the current stocks and inventories of the Company both including Campneus and excluding Campneus, in order to do a comparison between the first half 2012 and the first half 2011?

And the third question is regarding Europe. I've seen the slide 16 and it's quite interesting to see that the north and central countries are still performing very, very well for premium. Do you expect these results could be replicated over the second half of the year, or maybe you see a softening due also to the uncertainties in Europe?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO

Okay. So, first Brazil. We expect by year-end to have around 4.5 million tires sold in Latin America premium. And in this specific segment, we have over 40% of the market share.

Stocks, I'll give you some hints and then Mr. Sala will elaborate specifically on it. So, the stocks we have today are only stocks related to standard tires. And we already, in July, decreased the stocks quite drastically because the slowdown of production in Italy; in Turkey the reduction of seasonal workers give us the opportunity to cut definitely production of standard we wanted to cut in the months to come. So, we are anticipating actions on standard, and that will reduced drastically the stocks in the next months. But, Mr. Sala will provide you some figures.

Maurizio Sala - Pirelli & C. S.p.A. - Head, Group Planning & Control Department

For local sale stock, you will find the exact value in page 32 in the appendix. The value is EUR1.2 billion. And the difference versus the full year value of 2011 is EUR170 million. So, the action that we will have to reduce the stock by EUR200 million we did in the end of the year will bring to the same level of stocks of the previous year.

Monica Bosio - Banca IMI - Analyst

Sorry. This is including Campneus, the first half?

Maurizio Sala - Pirelli & C. S.p.A. - Head, Group Planning & Control Department

Yes. Yes, this is including also the new retail acquisition of Campneus, of Dackia, and also the second consolidation of all of it, because the first part is already including at the end of 2011. Clear off stocks are already included in December 2011 results.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO

And now coming to your third question, Europe, we expect Europe to continue our growth in the premium segment, the indication we gave the market and in the presentation I gave. So, we don't see, in the premium segment, any risk on our figures for year-end.

And so, we continue to be cautious, being cautious on volumes in Europe, but being in line with our expectations with the premium growth.

Philip Watkins - Citigroup - Analyst

Oh, good evening, and thank you for taking my questions. I just had a couple, please.

The first one was on pricing and mix. I'm just wondering how do you think that will develop in Q3 and Q4.

On inventory, I just wanted to know if you could just indicate, actually, of the EUR1.2 billion, how much is winter tire and how much, in reference to the last question, relates to the Campneus and Dackia acquisitions.

And then finally, you're bringing down inventory, clearly that suggests you think production is less. The negative impact from producing less for this year is also included in your guidance? Thank you.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO

Thank you. So, first question was about the price mix. We confirm the price mix for second half being around 11%. So, we don't give the figures for the third and fourth quarter. But, that remains in line with the guidance we gave in May last saying that the price difference will go down and the mix effect will continue to be strong, because the price is related to the price increase of last year that came out in July and September.

So, in the last quarter, the price value will be very low, going down to zero in the last month. But, the mix will continue being higher in the third quarter and also in the fourth quarter.

Then, about the value of our stocks, Mr. Sala will give you all the details. I already mentioned that we are talking mostly, if not totally, of standard tires. And the actions taken are the use of all social benefits in Europe, mainly Italy, and in Turkey eliminating the seasonal workers from May on. These reductions in Turkey will remain structural. So, the standard production will go down more rapidly than we planned in 2012.

Maurizio Sala - Pirelli & C. S.p.A. - Head, Group Planning & Control Department

To look inside the trend, the stocks, Campneus and Dackia stocks, amount to EUR30 million. If we will consider winter tire stocks, the value is around EUR100 million.

Philip Watkins - Citigroup - Analyst

Thank you very much. And just generally, actually on pricing, I mean, I can clearly understand what you're saying about how it should progress. Are you seeing any extra pressure on pricing on the sell-in than you were three months ago?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
We don't see any price pressure on premium segment. So, as you know, premium is resilient on prices. And the main growth is in areas like US, Asia. In Europe, we don't see any pressure on premium. There is some pressure on standard. There is more imports from China and Korea, but we don't see any affect on premium as it happened in the last year.

Giuseppe Puglisi - Intermonte Securities SIM - Analyst
Good afternoon. Giuseppe Puglisi from Intermonte. I have one question in regard to the utilization rates. Now, I am supposing that the utilization rate for standard is really low, and just would like to know if you'd give some color about the utilization rate for the premium, so if it's still at 100% or you have some unloaded steps. Thank you.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
On the standard utilization, it's around 56%. And we talk about a split between Turkey and Italy. Italy is 56%. Turkey is around 60%. So, we scaled down by around 30pp because it used to be between 85% and 90%. Premium is around 95%.
Part of the standard in some plants where we still have standard produced with premium machinery in plants, like we have some in Romania, we profit off the situation to switch to premium, accelerating the process of industrialization of the factories. It happened in Romania. It happened in China. So, that's the way we are changing the mix.

Giuseppe Puglisi - Intermonte Securities SIM - Analyst
Okay. If I may follow up, I just wanted to know about the pricing. Do you think that price mix in 2013 can be positive overall for Pirelli under this new environment?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
In fact, this new environment is an environment we live in since, let's say, at least the last months of last year. If we look to the summer tires, we had a slowdown starting in July last in southern Europe. Greece, Spain, Italy was a very lousy market for summer tires from July on.
So, we consider this environment will continue in the next months as it has been in the first half of this year. And the price mix, as I mentioned before, will be on price a reduction, because of the alignment to the prices of end of last year going closer to year-end, and on mix if we continue the trend we have. And we see also in July that we go on in line with our plan.

Giuseppe Puglisi - Intermonte Securities SIM - Analyst
So, do you think that overall in 2013 it will be positive, the price mix?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Yes. We see that the demand for premium continues. We see that the stocks continue to increase, because the OEMs that were resilient this year were the OEMs on premium. That means that the stock of premium cars is increasing. It's in great shape.

So, we are confident not only for now on, but also for the years to come because the premium car park is the one that is increasing worldwide compared to the standard that is going down.

Martino De Ambroggi - Equita SIM - Analyst
Good evening everybody. My first question is on the raw material costs. You represented in slide 27 EUR190 million of ForEx effect. So, I was wondering what is the impact in the first half of the year, just to have a sensitivity to this figure.
And still on raw materials, just to have an idea of what is, all other things being equal and taking the current prices of raw material costs, what could be the positive impact next year? Just as an example, I have EUR100 million of positive impact from natural rubber if you assume that it stays in the region of $3,000 per ton as it is today.
The second question is on costs, because you presented additional EUR30 million cost savings on top of the EUR120 million this year, EUR130 million next few years. What's your additional flexibility on the cost structure going forward?
And the last question is on premium volumes. So, I agree on the full year guidance, but I have some problems in matching the guidance of plus 20% year-on-year on premium volumes, taking into account they were up only 14% in the first half. So, I was wondering if you could elaborate a bit on these recoveries in the second half, taking into account winter tires down 10% year-on-year. Thank you.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Starting with your last question about the premium, in the second part of the year we will benefit from the homologation we had in our factory in China. And with BMW, Mercedes, Audi, and Volvo, we have the only factory that has been homologated by the four players. And so, we started delivering and we will have a strong second half in China.
Then, we have in US already under contract an increase our volumes and we continue to see a strong market in replacement around the world.
So we have, let's say, the protection of the orders we have already taken with the OE in China and US and also in Germany where we have a strong position. So, the figures we gave are in line with what we already have confirmed in our portfolio.

On ForEx effects, in first half of the year it's been EUR60 million and it will be EUR130 million in the second half. Then, it will also depend on the weakness of the dollar. That could change a bit, these figures, from now on.
Looking to the efficiencies, in our slide number seven, we have EUR7 million that are anticipation of restructuring and EUR9 million the crash program, staff reductions, so on and so forth, and efficiency in low cost was EUR13 million. So, these are actions that we are implementing now. Thank you.

Martino De Ambroggi - Equita SIM - Analyst
And if I may, the remaining question on the potential, but all other things being equal, for next year starting from the current level of the raw materials.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO

All the figures that we see in the market and we see inside the Company confirm our vision for 2013 because the switch we are making in our mix is such that we consider the volume reduction in standard tyres.

And the action we have made make us in a position to deliver to the replacement market what we are not yet able to deliver, because comparing our OE portfolio, we are short in terms of volumes we sell in the replacement market. The market share we have in the OE doesn't have the pull through that could and should have.

So, the mix of actions we are putting in place are such that we will be in a better position next year to profit off the strong market we already have in the premium segment in the replacement market. If you consider the market share we have in many countries, it's not in line with the market share we have in original equipment.

Stephan Puetter - Goldman Sachs - Analyst

Good afternoon, and also thank you very much for taking my questions. This first one is what is your current assessment of dealer inventory levels in Europe? Where do you think they stand?

And then secondly, when you're saying that you are planning to significantly destock, and if I square this with your comments that the majority of your inventory is currently summer tires, and the summer tire season, particularly in Europe, seems to be sort of over, so are you going to do this through incentives, or how do you think you can get the dealers to buy now summer tires from you?

And then, last question is you seem to be vertically integrating by buying more dealers. Do you have further deals on the agenda? And can you maybe elaborate a little bit on the rationale behind this?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO

Thank you. So, the dealer sentiment, to be analyzed from country to country, or at least from regions of Europe north, southwest, and southern Europe. The sentiment in central Europe is positive because they had a summer seasonality that came late. Because central Europe, mostly Germany and north and central Europe, had a very late winter, until end of April, beginning of May, customers delayed the changeover from summer to winter.

And so, the dealers in Germany and in northern Europe, they didn't buy. So, there was a drop in sell-in in Germany in April and May. And April and the beginning of May are the months of the changeover and of the summer tires. Now we are already in the winter tire in that region. That is the most important.

And so, they destocked summer. And in southern Europe, there has been a low level of stock of summer even last year. So, they didn't buy from July on. So, we have a situation where the dealers in southern Europe don't have a huge summer stock. In central Europe, they destocked because of delayed seasonality of summer.

Then, looking forward, we already have in our plan the outcome of last year winter season. So, we see a season where the sell-in of winter will be down average 10% in Europe and a bit more. But, the sell-out won't be bad. So, all the data we have are showing that this season for the sell-out will continue to be a good year, because the winter tires are having a penetration in the market that is larger and larger.

So, that's, all in all, in the major countries of Europe the dealer sentiment. In the premium market with dealers, it's still an attractive market for them and is the part of the market that continues to grow.

So, the problem of stock is going to be solved in the next months. And we expect that next year the level of stocks will be low, both in winter and summer tires.

It's always like we see this year. When you have a seasonality like last year, then you have a drop in winter this year, and then next year we will have a good year in winter sell-in. So, it is the normal way in a market that is becoming larger and larger.

And looking to the strategy with dealers, we have a strategy that is quite precise. In Latin America, we are full range. We are the number one and that is why we already have a large chain. That is why we bought Campneus. We sell from agro to OTR, from motorbike or passenger car tires and trucks. So, we will continue the way we are doing to have a strong chain in Latin America.

Then selectively, in the areas that we consider important for us, we have a position specifically in the premium segment that gives us two basic strengths. One is visibility in the market and second is also brand image to have our own equity as we have in Germany. And we are going to launch a flagship also for winter tires next year in Germany.

And the move we made in Sweden was in line with our strategy in northern Europe and Russia. We have already a good distribution. We are becoming stronger and stronger in Russia with the system of hard and soft franchisees. In Sweden, we have an entrance in Scandinavia that is key. And the opportunity we got with Dackia is to have immediately market share in a region where winter tires, studded tires, are a key product and very profitable.

So, buying this asset that is a good asset is profitable itself. We also bought an entrance in a market where our position was very weak. And this can be supplied from Russia. So, I think that we will continue this way with specific acquisition just in line with our premium strategy.

Stephan Puetter - Goldman Sachs - Analyst

Okay. Thank you very much. Maybe just to quickly follow up on the inventory situation. So you are very confident that you can reduce the summer tire inventories in the third quarter. And maybe you can clarify a bit. Have you already made good progress in July, or do you think the majority of this destocking of summer tires will happen in August and September? Thanks.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
I have to tell you that the destocking is moving at a very good shape because the actions we took cutting production is giving a positive outcome already in July. So, we see that this trend will continue.
We made an important cut in production that is much stronger than the exposure we have to the standard business. So, we are really confident that our stock will be or end in line with our expectations.

Kristina Church - Barclays - Analyst
Yes. Thank you for taking my question. I just have one remaining question relating to CapEx in your guidance now, that it'll be below EUR500 million for the year. I was just wondering if you could give a little bit of an indication if there are any specific projects that are being cut, and are you getting a little bit more nervous about your free cash flow target for year-end? I know you've talked about inventory cuts but, just specifically, is that the reasoning behind the CapEx cuts? Thank you.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
So, we definitely will tell you one simple thing. We cut investments in standard maintenance where there is no need of maintenance because we are cutting production. So, when we have a plan to reduce the production of 3.6 million pieces, as we did show in our presentation, this means a cost at the beginning. But, looking forward, you drastically reduce any costs related to this production. So, that is why we don't see any risk.

There is another reduction of investment that is related to the delay of the Argentinean planned site buy in Argentina because of the situation of the country. And I mean that we don't see any issue of cash flow. It's just a better cash flow, reducing this investment. So, no, we don't see any critical point out of it.

Niels Fehre - HSBC - Analyst
Yes. Good evening. There is only one question left from my side. On your industrial business margin, if I exclude the Egypt effect, is it right that your margin wasn't already close to 13% or at least well above 12.5%? And how you expect this to be in the second half? Because it seems that the tailwind or that the margins price was mainly coming from a huge raw material tailwind. Is that right? And with raw materials remaining relatively low, I don't see the margin here falling back to a level of roughly 10% to 12%. So, maybe you can elaborate a bit more on that, because your price mix was only 5% in the second quarter. And despite that, you have a margin of almost 12%, which is a new record margin for you. So, maybe you can just give me a number how much was the raw material a tailwind in Q2 on the industrial business. Thanks.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
The effect of raw materials is clearly one of the drivers of the growth in profitability. And we expect to have a better profitability in second half because we do not expect to have the same issues we had in the first half, mainly in Egypt, where we lost one month.

And so, also the issue between Brazil and Argentina, for the time being, is better than it was in January. So, we can think that July is better than January. So, there is room to have this improvement. And in the next months, we will have the full expectation of the raw material drop. So, that is why we are confident that we will reach the target.

Niels Fehre - HSBC - Analyst
So, Q2 --.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
So, the first half was 10.2% and we expect second half being 12%. That's the headwind of raw materials.

Niels Fehre - HSBC - Analyst
Yes. But, the margin was already at 12% in Q2, right? And with all the negative effects diminishing, then you should approach something like 14%, 15% on it, or am I missing here something?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
No, let's say 12% will continue, because we expect that price will continue for some months, the effect of price. But, could be that in the last months of the year there could be a price pressure.

So, we want to be cautious because we know that the headwind in prices in truck is much stronger than in passenger car tires. It has been stronger because of the natural rubber. We start profiting now, and we put in our vision a possibility to have a price reduction before year-end not in the region where we are strong, because the price reduction is mostly expected in Europe and US. In US, we are not. In Europe, we have not a huge presence. So, we don't see a major effect, but we can see some effect that will offset part of the advantages coming from the raw material headwind.

Niels Fehre - HSBC - Analyst
Okay. And maybe just one final question. What will be your mix between summer and winter tires then in Q3? Is it right then to assume that you're selling consumer tires, 80% summer tires, or more even?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
But, you mean in percentage of volumes?

Niels Fehre - HSBC - Analyst
Yes. Yes, exactly, in volumes. In volumes, yes.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
The winter tires are 13% in our plan of our total volumes. And in winter tires, 85%, 88% is premium.

Niels Fehre - HSBC - Analyst
Okay. That is Q3 or full year figure? It's Q3, right?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Full year. This is full year.

Gaetan Toulemonde - Deutsche Bank - Analyst
Yes, good evening. This is Gaetan from Deutsche Bank. A couple of questions. First one is do you have any indication today that Europe is recovering, or the European market remains as weak as in the first half?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
We see a market that is weak. We don't see any recovery of the market in the second half. That's my personal opinion, and that is what we have in our figures.

Gaetan Toulemonde - Deutsche Bank - Analyst
Okay. In that case, why do you expect a recovery of natural rubber or some raw material by your end? And I'm a little bit lost when you gave us the work down of the impact of the raw material within the first half and the second half, because I would have imagined that, with the lag effect, that already the $3.00 we face today in natural rubber should have a much bigger positive impact on your P&L in the second part of the year.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
We are talking about our market. We see a premium single-digit growth overall in Europe. That's what we see. South, we see a high single-digit reduction. That is the vision we have of the market.

And about raw materials, we don't expect raw materials picking up in the second half. We expect raw materials staying down. And so, perhaps I have not been clear giving my view, our view about the raw materials. But, the effect of raw materials is coming, in our case in natural rubber, three months after, because we buy in January and the price of January goes into the cost of goods sold in April.

So, we expect that the strong reduction we had in May and June will come from October on. So, in the last quarter where there will be the full exploitation of the benefit of the raw material.

We also see that, in the last quarter, there could be, in the truck business, some price reduction in some countries.

Gaetan Toulemonde - Deutsche Bank - Analyst
Okay. Because it seems to me that, if I'm right, that you buy approximately 300,000 tons of natural rubber per annum. And when I look at the current price compared to what you paid last year, I get a much bigger tailwind than what you're guiding for for the second part of this year.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
First of all, we bought 200,000, not 300,000 tons of natural rubber.
So, we think that you are right saying that if we had the full exploitation of the headwind, we could even have a better result. But, we put into account there could be a price reduction in the last quarter. So, if you balance these figures, you will see that our forecast is in line with a normal market trend when there is such a headwind.

Gaetan Toulemonde - Deutsche Bank - Analyst
Okay. And if I understand well, and I'm over with that, the pricing reduction in the fourth quarter to balance some of these raw material tailwind will come exclusively on the truck side, absolutely not on the premium side, correct?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Yes, correct.

Austin Earl - Marshall Wace - Analyst
Hi. Good evening, everyone. I have two questions. Perhaps if I can take them one by one, the first is I'm just having a little bit of a difficulty on the mathematics on the guidance that you provided for price mix in the second half, that you said it would be roughly 11%. But, what I don't understand is you're guiding for the full year to be 11% to 12%, and yet is was 13.9% in the first half. Can you maybe let me know where I'm going wrong in my assumptions?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Now, we say for 2012 between 11% and 12%. That's the figure that we see as for the full year. And that means the price mix effect in the second half will be around 11%.

Austin Earl - Marshall Wace - Analyst
But that's where I'm getting confused. If it was almost 14% in the first half and you're guiding to 11% in the second half and 11% for the full year, what am I missing? I mean, surely it has to be below 11% in the second half to get to 11% to 12% for the full year.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
We are talking about comparison base. So, these figures are compared to last year. So, if you take the comparison base, we say that full year will be between 11% and 12% on the

comparison base year-on-year. So, you have to take the volumes of the first part of the year, the volumes of the second half, and then share it if it's in all the quarters. The total outcome of it will be around 12%.

This means that from April 2011 we started to increase prices. The price effect will go down in our curve of price effect in a comparison base. So, the full effect was in the first quarter because there was no price increase in first quarter of last year. So, this year we have full exploitation of the price increases of last year, and the effect of price mix was 16.5%.

We mentioned also when we presented our first quarter results that the second quarter already we will have and had an increase in price mix but lower than the first quarter, because the effect of prices is reduced because we had a price increase in second quarter. These phenomena will continue in third and fourth quarter. At year-end, the price effect will be zero because we will be in line with the price of this year, not having price reduction.

That's the reason why probably you cannot fix the figures, because the comparison base changes from quarter to quarter because we had a price increase in each quarter of last year.

Austin Earl - Marshall Wace - Analyst
Okay. I'll have a look at that. Thank you.
And the second question was just a repeat. I think Martino asked a question earlier about what you guided on the raw material effect of being a tailwind of about EUR30 million in the second half of 2012. I think he asked what would be the raw material effect in 2013 year-on-year if prices remain where they are.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
If they remain as they are, we will have a reduction of about 5%, 6%.

Austin Earl - Marshall Wace - Analyst
And what would that be in millions of euros?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Definitely if we stay with prices in raw material like we have today, first quarter of next year will have a comparison base with first quarter of 2012 where we did have still a high price of raw materials, so natural rubber, because in first quarter the price of natural rubber was the price we paid end of September of 2011.
So will have definitely the positive effect on first quarter 2013. Second quarter still a positive effective if prices remain where they are today, because the comparison base remains more or less the same. We start at having outcome of the drop in natural rubber from end of May on.

Austin Earl - Marshall Wace - Analyst

Sure. I guess what I was trying to understand is, for the full year 2012, you're guiding to a headwind of EUR60 million for raw materials. And therefore, what I'm wondering is what would your guidance be for 2013 if raw material prices remain where they are today.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
That means that we will have an advantage of 5%, 6% on the total value of raw materials. Imagine that natural rubber could be around EUR150 million out of EUR3 billion raw materials cost, EUR2.8 billion. It's 5% of EUR2.8 billion.

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

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
You can have also -- to make this calculation, you can look at the annexes, page 37, where you have the raw material breakdown. And it represents 38% of costs on sales. So, then out of it, you can make all the comparisons year-on-year. There is also the raw material price range in the same chart. So, I think you can easily make the comparison.

Edoardo Spina - Morgan Stanley - Analyst
Thank you. Good evening. Thanks for taking the questions. I have just two. I'll try to be very quick. The first one on your debt guidance, EUR1.1 billion at the end of the year. In terms of development through the third quarter, how should we think about what happens at the end of the third quarter? Should we expect a big drop in the third quarter, or maybe in the fourth? And is it kind of linear, or do you want to make us aware of what sort of dynamic is in that?

And the second question is on incentives for management at Pirelli. Of course, I'm not talking certainly about top management, but the operating management. Are they compensated more based on cash performance or profit? I'm trying to understand if the markets end up being weaker than you expect, will you privilege pricing or will you look at inventory more? That's kind of what I'd like to know. Thank you.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
I'll give you the answer to the second question and then Mr. Sala will provide you the answer for the first question. So, for our management, we have incentives that are related, first of all, to the EBIT and value creation. These are the two main drivers of our LTI program. And there is on/off on the financial position, net financial position. So, these are the key: EBIT, net financial position.

Then, going to the different functions, there are specific incentives related to the strategy of the Company. Definitely there are incentives related to the premium. Definitely there are also incentives on specific items to improve the quality of the service. So, we have really tailor made incentives, taking into account that the driver is always the on/off, which is net financial position, EBIT and EVA, plus TSR, so the total shareholders' results.

Sorry. Probably you didn't get since the line wasn't okay. I'll repeat what I was saying. So, the on/off is on three main drivers: net financial position, EBIT, and total shareholder return. This is your on/off.

And there are specific incentives for the different areas of the Company related to the strategy of the Company. The premium is a driver in the factory, is a driver in the market for the different responsible in each country.

Then we have specific incentives related to the point of the service, the improvement on the service, improvement on any kpi -- let's say the fill rate is one. Just to give you an example, improvement of the fill rate is part of incentives of the logistic function. The improvement on premium is a specific incentive for the sales force and so on and so forth. But, all these are linked to the total return of shareholders', EBIT margin, and net financial position.

Edoardo Spina - Morgan Stanley - Analyst
Sorry. If I can ask you, so you said on/off, which means - if I understand - that they don't get the incentive unless all the three criteria are met. Is that the right interpretation?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
Yes. So, they are linked one to the other, PFN and the EBIT. One would be the first step to enter, but the minimum is PFN and EBIT. Then, the second, to increase and have access to a higher part of the incentive, there is also the total return of shareholders'.

More than this, every year just half of the incentives are given to the management, and we put half of the incentives in a so-called bonus bank, the long-term incentive. So, if the three year plan is achieved, then there is access to the so-called bonus bank. And it is doubled because we link the yearly, let's say, achievement of the results to the three year plan result achievement. So, this is a long term incentive that it's linking the management to the long term strategy of the Company.

Edoardo Spina - Morgan Stanley - Analyst
Okay. That's clear. Thanks.

Maurizio Sala - Pirelli & C. S.p.A. - Head, Group Planning & Control Department
To look inside the trend on net financial position, talking about working capital, the last two years registered a reduction for seasonality of EUR300 million in 2011, EUR230 million in 2010 from September to December. So, the seasonality is more concentrated in the last quarter, because in the last quarter we are collecting all the winter sales in Europe. So, the big effect will be in the last quarter.

This is talking about EUR300 million. We need to reduce the working capital by almost EUR500 million. The part which is already in progress is the action on the stock which started already. We are doing all the activity in the factory to reduce the production. So, we will see already a reduction in the stock in September, but the final effect on the working capital will be in the last quarter.

Philip Watkins - Citigroup - Analyst

Oh, thank you for taking my question again. I just had an operational question. I'm trying to understand how this works. But, you're hastening the sort of withdrawal from the nonstandard tires. And when you're in a factory, how do you do that so quickly? It seems like it's a quick process here. You're able to move off production from making the standard tires to the premium tires. Are you using the same machines? How does it work really is my question. Thank you.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO

First of all, we have good managers. But, in fact, we planned this. It's not something that comes out suddenly. So, when we presented the recovery plan last year, we gave some drivers on how we could have phased the reduction in volumes.

There were three guidelines. One was control of investments. Two, reduction in temporaries and a reduction in seasonal workers, a reduction in extra hours. So, these are two of the three drivers.

The third driver was to do this all in the standard business because we knew that we were in a position to improve our presence thanks to the back orders that were creating us a headache in the last few years, so preparing our factories in order to be ready to deliver more premium.

We were also ready to cut step by step the standard. But, we were also ready to cut the standard quickly to face an economic environment that could have been deteriorating more than expected. And that is what happened.

So, we already had all the plans in each factory for the standard from the small part we still have in UK, the small parts we have in Germany, the huge parts we have in Italy, the huge parts we have in Turkey, and in China too. In each country, we had a specific action to reduce the production of standard.

That is why we have been able to deliver quickly the reduction in volumes. Part of it has not yet been achieved. That is why the stocks are still high. We will achieve this in the next months thanks to the structured changes we are making.

Gabriele Gambarova - Banco Akros - Analyst

Yes. Good evening to everybody. Just a very quick question which is not on your plate inside, I am afraid. You still have a loan, I think a EUR150 million, versus Prelios, the former Pirelli Real Estate, which is reportedly experiencing some, I think, liquidity issue. Could you elaborate a little bit on this aspect? I mean, what would be the option you would consider if these rumors should materialize? I mean, if Prelios runs out of cash or similar scenarios, I am interested in understanding if you would rule out any, I don't know, debt to help with the swap something similar?

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman, CEO
So, as of today, we have been informed that Prelios could be involved in an extraordinary operation. We know that there are discussions going on, which at a certain stage may involve also creditors like banks and Pirelli.
As you know, Pirelli has a part also with the banks. And therefore, as of now we do not have elements in order to evaluate if -- any impact on Pirelli financial credit position. So, we keep the data link with the banks. The banks inform us about evolution. It seems there is a positive evolution, but we don't know really the outcome, and we think that the banks do not know yet the outcome. Otherwise, they would inform us, because we are in the same position of the banks.

Thank you. Today our conference call took place later than usual, and I thank you for attending until now. I am glad to have this opportunity to wish you the best of summers. And I'm sure I'll meet some of you at the next few Formula 1 Grand Prix and our September road show. Have a nice evening. Bye-bye.