Pirelli & C

9M 2014 Conference Call

November 6th, 2014

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Good evening ladies and gentlemen and thank you for joining us at this Conference Call on the results for the first nine months of 2014.

I believe that, based on the results just approved by the Board of Directors, the following key messages can be drawn:

The Premium segment continues to be the backbone of our results.

Whenever customers make their choice based on technology and driving experience, we consistently outperform our peers and are able to generate significant value.

This market segment is proving to be resilient, with volume growth approximately three-times faster than non-premium, and less prone to cost-based competition.

The investments made over the last few years, developing products and obtaining homologations partnering with the top OEMs, are paying off today in terms of pull-through on Replacement sales.

- In the first nine months of 2014, we added more than 150 items to our already wide homologation portfolio, consistently being among the only 2 or 3 players able to supply tyres to cars such as Ferrari California and Porsche Macan.
- In the Premium segment, we are key partners to Audi, Mercedes and BMW, which recently awarded us most innovative supplier in 2014.
- Sales of our marked items, that perfectly replicate the OEM performance specifications in the aftermarket channel, grew by 31% year-on-year in value, with a significant market share gain in the Premium segment.

In Super-Premium which means tyres with rim size of at least 18 inches, our volumes grew twice as fast as the market. Growth was achieved in all regions, particularly in Europe, North America and Asia Pacific, where our volume growth was nearly 4 times that of the market.

This volume outperformance was achieved while keeping firm focus on value, since our price positioning versus our main competitors has improved.

This trend can be appreciated by looking at our price/mix improvement, +4.7%. Once again, the best in the Industry and in line with our 2014 guidance.

In the current volatile market environment, with localized weaknesses, our geographic and product positioning proved an asset and allowed us to generate solid returns.

In South America, the prolonged market slowdown in the OE channel, above our expectations, led us to temporarily reduce production output, with the aim of protecting cash flow and the value of our products in the market. While this has a short-term impact on our profitability, it will reinforce our positioning as soon as the market returns to positive growth rates;

As we come close to the end of the quarterly reporting season, we can see how the tyre industry stays healthy despite the uneven end markets. Price moves are not disruptive, despite the current raw material environment. Profitability and cash flow remain the focus in the Industry.

SLIDE 4: PIRELLI KEY FINANCIAL RESULTS

The Third Quarter of 2014 displays a solid revenue trend, sound profitability and further progress in the premium segment.

For the first time in 2014, quarterly sales were up year-on-year. This is due to a market outperformance in terms of volumes, specifically in the Consumer Business, and a price/mix growth in line with our yearly target and, once again, the best in the Industry.

We improved our positioning in the Premium segment, with volumes up 17% despite a difficult comparison base; this segment accounts for 55% of our Consumer sales (+4pp yoy).

Q3 profitability was stable year-on-year, reflecting:

- The concentration in the quarter of marketing expenses for Premium development - ~70% of the total expected for H2 - such as advertising expenses, trade marketing activities and dealers support; and
- the contraction of the OE market in South America, to which we responded by adjusting production.

We continued to work on improving our efficiency and saved another 22 million euro. So far, in 2014, cumulative savings amount to 71 million euro.

Net Income was approximately 106 million euro, and our Net Financial Position is basically unchanged vs last June at 2 billion euro.

SLIDE 5: 9M PERFORMANCE BY REGION

On a Regional basis, our nine months results were characterized by:

- Strong growth in our core Premium markets: Europe, Asia Pacific and North America that we will cover in detail in the next Slide.

- Positive progress for our business in Russia, despite the challenging macroeconomic and market scenario. In the first 9 months we recorded a double-digit Volumes growth coupled with Mix improvement with Premium Revenues growing 41% yoy. Mix improvement, higher Productivity and Efficiencies gains lead us to a high single-digit Profitability.

  Turnaround is progressing in line with our expectations.

  Our winter portfolio counts on a wider product range:
  - the new Pirelli Sottozero is available in a wide range of sizes,
  - Pirelli Ice Zero (the new generation of studded tyre) has more than doubled its sizes versus 2013 and
  - we also extended the studded Formula Ice range.

  In terms of industrializations, we are ahead of schedule in both Voronezh and Kirov plants, and are ready for our new products in 2015 such as the new friction winter tyre and prepared to meet demand for export.

  In Retail, our development continues to be supported by geo-localization and by the partnership with Rosneft with the opening of the first shops this year.

Despite the tough market scenario, we recorded a mid-single digit Organic Growth in South America. We outperformed the market in the Replacement channel – especially in the high value segments of the car business - and recorded a sound Profitability with a low-teen Ebit Margin.

Year over year, the Ebit trend reflects:

- the sharp contraction of the OE market for both Car (-19% in 9M and Q3) and truck (-20% in the first 9 months, -29% in Q3);
- the lower utilization rate of our plants in South America, our response to a stronger than anticipated market contraction with the objective of safeguarding stocks levels and ensure a healthy development of Net Working Capital;
- the increasing Input Costs due to inflation and currency devaluation vs. the Dollar.

The Original Equipment market is not yet showing meaningful signs of improvement and we reacted to this scenario by:

- increasing our Efficiency and Cost Reduction Programs
- pushing on Replacement, where we gained share also due to our wide network of equity distribution, including the recently acquired Abouchar in Brazil, which allowed us to protect value.

SLIDE 6: PREMIUM: OUR GROWTH ENGINE ACROSS REGIONS

Our investments in Premium are paying off and translate into a superior growth across our main markets.

In Europe we leveraged our privileged partnerships with the best automakers which awarded us 70 new homologations in Q3, including Audi Q7, BMW 7 series, Jaguar E, Porsche Macan and the new Ferrari California. Today, our European portfolio includes around 1400 Premium homologations.

The positive effect of the OE Pull-through strategy continues. Premium replacement sales of Marked Tyres account for about 50% of the total Premium replacement sales, an increase of approximately 2 percentage points year-on-year.

Our outperformance is even more apparent in the Super Premium Segment (18 inches and above) where we are gaining market share in the core markets.

Our retail strategy supported this growth: we increased our market coverage and increased channel penetration in Car dealers networks. Tailored marketing actions were taken during the year for those outlets most exposed to Premium consumers.

In North America our OE business benefitted from the extended homologation portfolio. Our partnership with Premium European OEM is getting stronger: we are a key supplier for BMW with the recent inclusion of the X5 and among the top supplier for Mercedes.

In Replacement, growth came from key UHP clients who appreciated our extremely high level of service and drove a better distribution of our Premium tyres.

Our tailored products Made in Mexico, for North America, are a key asset for our future growth in the Region. Specifically, we have successfully introduced the Scorpion Verde AS plus line which covers the Premium SUV line.

In Russia, we now rely on new winter product range, including OE marked winter tyres, like our Sottozero III, a new friction range (extreme winter non studded) that will be introduced in 2015, as well as studded products specifically designed for Russia like Ice Zero and Formula Ice.

In South America, we are driving the expansion of the Premium Replacement Market (today more than 6% of the Car tyre market and +18% yoy in the first 9 months) leveraging on the evolution of regulations on green products and car market trends.

Finally, we are reinforcing our position in Premium OE in APAC. We are growing rapidly with our customer Mercedes that has recently introduced our runflat technology which helped our mix.

SLIDE 7: PIRELLI NET INCOME 9M’14 VS 9M’13

In the first nine months of 2014, net income was positive for 300 million euro, or 60 cents per share in terms of attributable income.

This is a growth of nearly 42 million euro compared with the first nine months of 2013, more than 16% yoy and above our percentage growth in Ebit.

Ebit growth was the main driver of this performance, adding about 52 million euro during the period.

Financial charges were lower by about 11 million euro year-on-year, as they discount a cost of debt lower than 6%.

Results from Equity Participations, negative for 9.4 million euro year-on-year, mainly relate to valuation adjustments of our stake in both Prelios and Alitalia.

Better operating results led to higher Tax Charges for approximately 13 million euro, despite a tax rate slightly lower year-on-year at 35.6%, in line with our full-year target of 36%.

SLIDE 8: PIRELLI DEBT STRUCTURE AS OF SEPTEMEBER 30, 2014

Pirelli’s Gross Debt is worth approximately 2.7 billion euro.

Our main maturities become due in 2015 and 2016 and they will be refinanced in both banking and capital markets.

Finally, the Cost of Debt stood below 6%, well within our announced target of 6.5%, also due to a change in the currency mix of our debt.

SLIDE 9: PIRELLI 9M’14 NET FINANCIAL POSITION

Let us now move to reviewing our Net Financial Position, which increased by nearly 69 million euros over the third quarter of 2014.

Operating cash flow was positive for approximately 29 million euro, due to:

- our Ebit
- Capital Expenditure of 101 million euro in the Third Quarter, on track with our full year Guidance of approximately 380 million euro; and
- cash absorption linked to Net Working Capital.

The development of Net Working Capital is strictly linked to the seasonality of our business. This year, in particular, cash-in will be strong in the last Quarter of the year due to our winter sales campaign in

Europe and Russia, where we sold higher volumes than last year. In addition, Q4 is the seasonality peak in South America, which will support Inventory reduction and Working Capital improvement.
Inventories currently stand at 17.9% of sales, approximately stable as compared with the end of June 2014 and in line with our full year target of below 17%.
These elements make us confident of the sustainability of our Cash generation targets, and early Q4 indicators confirm our view.

SLIDE 11: 2014 PIRELLI OUTLOOK BY REGION

Let us now review the evolving scenario we are dealing with in global tyre markets.

Although the overall picture remains unchanged and our targets are confirmed, I would like to address the updated assumptions versus our 2014 first half disclosure.

In short, we now expect a stronger development in Asia Pacific and North America, where Premium is growing above our original expectations with positive impacts on our results.

Europe and Middle East Africa are developing in line with our expectations, whereas Russia and South America are impacted by a more pronounced market contraction.

The Russian Car Market is now expected down in the high single digit range and the Ruble will probably continue to devaluate against the Euro. As a result, our Revenues in the Region will grow double digit in organic terms and decline to the low single digit range including Forex impact. Profitability is confirmed at a high-single-digit figure.

In South America, the expected rebound of the Original Equipment Channel of both Car and Truck did not materialize. We now expect for Car OE -16% (4 percentage points less than previously assumed) and -22% for Truck (7 percentage points less than our assumptions last August) .

The Replacement channel continues to grow in the Car business and is expected to be marginally down in Truck. We still expect growth in Organic Sales, while Profitability will decrease to the low-teens, discounting higher inflation costs and lower plant utilization.

SLIDE 12: FY 2014 TARGETS CONFIRMED

For the full year 2014, we confirm our targets of 850 million euro in Profitability and approximately 1.2 billion euro negative Net Financial Position. I wish to remind you that our targets still include our Steel Cord business, which is shown as Discontinued Operations in the quarterly statements.

Revenues are expected to be flat year over year, slightly less than what previously assumed, as a result of:

- price/mix improvement confirmed between 4.5% and 5.5%
- Premium volumes confirmed at above 16%
- Overall volumes now expected at above +2.5%, due to slower markets in South America, Russia and Middle-east Africa; and
- Foreign Exchange impact marginally better, between -7% and -7.5%.

<u>SLIDE 13: FY 2014 CONSUMER AND INDUSTRIAL TARGETS</u>

Breaking down our Guidance by business, nothing material has changed in our Consumer business expectations, where a slightly lower growth in volumes is counterbalanced by better Forex, leaving both revenues and Ebit targets unchanged.

In the Industrial business, we expect slightly lower Revenues as a result of a more pronounced contraction of volumes only partially mitigated by Forex. Profitability will be impacted by this revised market scenario, which causes a suboptimal utilization rate of our plants as well as higher inflation in emerging markets.

<u>SLIDE 14: FY 2014 PROFITABILITY GUIDANCE CONFIRMED</u>

Our Profitability Guidance is confirmed at 850 million euro after restructuring costs.

A more benign scenario in Raw Material Prices as well as Foreign Exchange rates will allow us to compensate for:

- a lower contribution from Volume growth, approximately 45 million euro, coming mainly from the Industrial Business
- higher Input costs, including plant saturation costs; and
- lower asset devaluations, included in the non-recurring items line, while restructuring costs are confirmed.

And now I leave the floor to Mr. Sala.

Maurizio Sala - Pirelli & C. SpA – Head of Group Planning and Control

SLIDE 16: KEY TYRE RESULTS

Thank you Mr. Tronchetti, and good evening everyone.

The Third Quarter results of the Tyre Business mark a return to top-line growth and another step towards reaching our Profitability targets for the year.

Revenue growth of 3.3% was achieved through an improvement of both:

- Volumes, at +3.1%, improving quarter on quarter due to a stronger performance in the Consumer business and a lower negative contribution from the Industrial one; and
- Price/mix, at +3.3%, in line with our full year Guidance which implies a stronger H1.

Positive price/mix relied on Premium growth – volumes were up 17.3% in the quarter – balanced pricing and a favorable channel mix.

Foreign exchange impact eased, but was still negative at -3.1%. Without Forex, Organic Revenue Growth reached 6.4% in the quarter, improving from 5.8% in Q2 2014.

Profitability in absolute value increased only marginally in the Quarter: the positive contribution of top-line value levers was counterbalanced by a higher cost burden as:

- we anticipated in the Quarter the majority of 2H marketing investments to support future Premium growth; and
- we faced higher inflation costs and lower plant saturation in LatAm.

Ebit margin stood at 13.4%, or 13.8% before non-recurring items.

SLIDE 17: PIRELLI TYRE OPERATING PERFORMANCE

Let us now turn to analyzing the internal levers which brought about a profitability of 206.3 million euro in 3Q 2014:

- The effectiveness of our value strategy translated into a 22.7 million euro Net Gain deriving from:
    - 34 million euro price/mix growth; and
    - a small raw material benefit of 4 million euro;

despite 15 million euro foreign exchange translation headwind.

Efficiencies, 22 million euro in 3Q, mitigated the quarterly impact of cost inflation and totaled 71 million euro in the first 9 months of 2014, slightly above the pro-quota of our yearly target of 90 million euro.

Profitability trend discounts an increase in Input Costs and the impact of lower saturation rate of our plants in South America; this trend is reflected in our revised assumptions for the year. Finally, Profitability was also affected by higher marketing expenses, concentrated in Q3, in relation to further development of Premium such as:

- F1 partnership activation;
- Premium retail and equity expansion projects, with trade marketing activities and dealers support, and
- Premium and Prestige car dealers relationships, such as co-marketing activities and marketing partnerships

SLIDE 18: CONSUMER BUSINESS: PIRELLI PERFORMANCE

The Consumer business – 77% of Tyre sales - was the main driver of our quarterly performance. Our unique value proposition yielded a 5% Revenue growth, after a 3.5% FX headwind, and 13€/mln in additional Ebit.

The top-line performance rests on the unabated momentum of Premium volumes – up 17.3% in the Quarter, 20.1% in the 9 months, clearly outperforming the market and our main peers .

This trend supported:

- the overall Volume development, +5.3% in the Quarter, in line with our full-year Guidance and growing in particular in Asia Pacific, Europe and North America; and
- the Price/Mix, where new Product introduction, Product Mix improvement, the higher weight of the Replacement channel and positive pricing in emerging markets more than compensated pricing trends in mature markets, especially in OE and non-Premium Replacement.

Profitability – Ebit margin – stood at 13.9% in the Quarter, an improvement of 0.4 percentage points as against Q3 2013, thanks to the positive contribution of Volume and Price/Mix as well as efficiency gains, whereas raw materials were about neutral.

SLIDE 19: INDUSTRIAL BUSINESS: PIRELLI PERFORMANCE

Pirelli's industrial business performance discounts the difficult market scenario in LatAm OE (-29% in Q3) and the slowdown in MEAI and Europe.
Despite this environment the business proved resilient, on the back of its exposure to:

- the Replacement channel and
- value added segments.

Revenues in the third Quarter tracked above the year-to-date trend and posted a slight decline of 1.4 percentage points, +0.4% before a negative Foreign Exchange impact worth 1.8 percentage points; given the current spot rates, and in line with the Guidance, the quarterly FX impact seen in Q3 will be the lowest in 2014 and we do expect an increase in Q4.

Volume reduction was limited in the quarter, -3.6%, improving significantly from Q2 2014 as the Replacement channel turned positive both in the South American and the Middle-East Africa markets; this is especially the case for the All Steel segment, which grew in the double digits.

As for Original Equipment, volumes continued to be depressed in line with truck production.

The phase-out of products with lower technological content, the successful market growth of our top-of-range 01 Series and positive pricing made it possible to achieve a 4% growth in the price/mix component.

Our internal levers and a slight relief from raw materials allowed us to mitigate the effect on Profitability of:

- market slowdown, which caused a degree of insaturation of our truck and agro factories [capacity utilization rate in Q3 at 80% from 100% in FY 2013]
- an increase in input costs linked with inflation in our key Regions

As a results profitability in the third quarter stands at 12.3% Ebit margin before restructuring.

SLIDE 20: 2014 RAW MATERIALS GUIDANCE

Now, briefly on Raw Materials, our updated scenario for 2014.

We now expect natural rubber prices to average 2,000 dollars per ton in 2014.

We still expect Brent oil at about 110 $/barrel, while butadiene is now expected at an average of 1,000 euro per ton.

The impact of foreign exchange is now seen at a negative 175 million euro, maintaining a degree of cautiousness due to the recent increased volatility of foreign exchange rates and the appreciation of the US dollar.

Total raw material headwind of 5 million euro on 2014 Ebit, or 30 million euro better than previously assumed.

Thank you for your attention and I give the floor back to Mr. Tronchetti.

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Thank you. So now ladies and gentlemen, we may open the Q&A session.

Questions and Answers:

Fraser Hill - Bank of America - Analyst

Yeah, hi. I just wanted to ask firstly about your other cost line that you showed in your bridge on page 17. You had a particularly large impact to EUR38 million in the quarter. That seems to relate to these temporary shutdowns in Brazil. How long did those shutdowns last in the third quarter? How long will that the fourth quarter? And should that begin to become a tailwind as we move into the path of next year?

Maurizio Sala - Pirelli & C. SpA – Head of Group Planning and Control

This is the inflation that we have in our accounts , labor costs, energy costs and other costs. And this is particularly important in the quarter, in particular for all of the South American countries. In certain cases inflation rate was higher than the previous year and what we forecasted, in particular in certain countries with higher devaluation like Venezuela accounts.

The slowdown of the original equipment in Latin America was very high in the third quarter, in particular for as you said industrial business, where the stock increased.

So, practically we are adjusting the production. We did already some adjusting in the third quarter and want to continue to adjust in the last quarter in order to arrive at the end of the year with the level of stock under control, and as was said, below 17% as it was last year. These are the major issues that we have.

The impact that we will have in term of slowdown for the full year is around EUR18 million, EUR19 million.

Fraser Hill - Bank of America - Analyst

Okay, thanks. And do you think your production will be returning to the more normal levels in Brazil, so, at the beginning of next year, as far as you can see? What would you say about that?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Looking forward, we do not expect an immediate change in the first months of next year in Brazil. We do expect that some actions will be taken by the government in order to revamp the demand. But what we are doing is an action inside to guarantee the growth of our profitability in Brazil in an environment that doesn't change as compared to the today environment.

So, we are working on our network. We are working on our distribution. And we think that we can connect here with this new environment even better than we did in 2014.

Fraser Hill - Bank of America - Analyst

Okay, great, thanks. And then just one follow-up question on raw materials. I think your guidance at the moment implies a negative impact on your profits in the fourth quarter. So, at the end of the year, I mean, is that what we should take from the comments at the moment? I mean, is it just driven by FX? Maybe if you could give me a bit of granularity around that. Thank you.

Maurizio Sala - Pirelli & C. SpA – Head of Group Planning and Control

Okay, we have two effects on the raw materials increased guidance for the last quarter that is forecasting a negative impact of EUR20 million but in any case all included in today's guidance.

On one side, the difference in terms of the cost of the commodity is the lowest in terms of advantage versus the previous year because we are consolidating the result progressively -- the result that during the year and the comparison there versus the last quarter of 2013 is the more difficult, in terms of comparison because in last quarter 2014, the raw materials were already low.

And looking at our exchange rate, we took some cautions in the exchange rate assumption. But on one side, we adjusted in terms of ForEx a positive impact in terms of EBIT, in terms of sales coming from the US dollar revaluation. But this is impacted negatively in the raw materials for us because of the fact that the raw materials cost purchase in Europe are impacted negative from the exchange rate.

In any case, this guidance that is around minus EUR20 million in the last quarter is already included in our assumption for the full-year results.

Fraser Hill - Bank of America - Analyst

Okay, thank you very much.

Gaetan Toulemonde - Deutsche Bank - Analyst

Good afternoon, it's Gaetan Toulemonde, Deutsche Bank. I have three questions and I'll try to be very brief.

In the price mix effect for the first nine months approximately plus 3%, did I understand well that there is no negative pricing? And if it's true, is there a difference between Latin America where you might probably have increased prices to offset the raw material increase in local currencies and eventually a decline of prices in Europe?

Can you give us a little bit of an update on the situation? Because it strikes me a little bit when I compare those data with Continental, for example.

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

So, for the price mix, it's all mix what we see in our figures. And we see that it will continue like this. Price -- it is balanced comparing the different regions. As you know, there has been some erosion in Europe, beginning of the year. And now we see the situation on Pirelli end not going to change. So, we continue with the mix with the balance between regions.

Gaetan Toulemonde - Deutsche Bank - Analyst

And do you agree with your competitors that the pricing in Europe is in a magnitude of minus 3%?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Yes, you're right.

Gaetan Toulemonde - Deutsche Bank - Analyst

Okay, thank you. My second question is that on the super premium, 18 inches and above, did I understand well that you mentioned that it was approximately 60% of your premium business?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Could you please repeat the question?

Gaetan Toulemonde - Deutsche Bank - Analyst

Yeah, okay, I'm sorry. My question is, when you look at prices between 17 inches and 18 and above, there is very significant gap. So, can you -- and since you are pretty confident or pretty happy about your performance in the super premium, can you give us a little bit of an idea how big that portion is? I remember the Capital Market Day last year, you told us it was approximately 50% of your premium revenues. What is the remainder for the first nine months? Is it 60%?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

You're right that that's the figure we gave last year. Now Mr. Borgo will provide you the answer.

Gaetan Toulemonde - Deutsche Bank - Analyst

Thank you.

Gregorio Borgo - Pirelli & C SpA - General Manger Operations

Yes, in terms of volume, our super premium is 50% of the total premium. Of course, in terms of value, it is slightly more around I think 70%. But in terms of volume, it is exactly 50% of the total premium.

Gaetan Toulemonde - Deutsche Bank - Analyst

Okay. And when you have 17% increase in the premium, can you give us a little bit of an idea between super premium and the premium, in terms of growth rate compared to last year?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

So, the growth of percentage of the super premium compared to 2013, this trend will continue because the new homologations are more and more driven by growth in sizes.

Gaetan Toulemonde - Deutsche Bank - Analyst

Okay. And the order of magnitude -- can you give us an idea compared to that 17% premium volume growth?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Between 23% and 25%.

Gaetan Toulemonde - Deutsche Bank - Analyst

Okay, that's super. Thank you very much.

Thomas Besson - Kepler Cheuvreux - Analyst

Thank you very much. Quick question on the sequential diversion in price mix and your guidance that seems to imply an improvement again in Q4. Should we see that in connection with your comments about ForEx being at its lowest level of impact in Q3 or are you expecting any positive development on price mix sequentially Q4 versus Q3?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Yes, we confirm that we continue to have a fourth quarter that will have better pricing.

Thomas Besson - Kepler Cheuvreux - Analyst

Okay, so you think you'd expect a sequential improvement in price mix versus Q3?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Yes, right.

Thomas Besson - Kepler Cheuvreux - Analyst

Okay, great. Can you comment as well on your net financial debt guidance for the end of the year and mention what you expect in terms of timing for the sell out cash inflows, please?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

We confirm that we will be able to achieve the target for cash flow and net debt. And this is due to the fact that now we have a portfolio of winter tires that already sold higher and better than last year. And so, the payments in the last quarter will be higher than last year. So, all the figures are confirmed.

Thomas Besson - Kepler Cheuvreux - Analyst

Okay. And on the sell-out timing?

Marco Tronchetti Provera - PIRELLI & C. SPA - CHAIRMAN AND CEO

During the month of December because as you know, the contracts for the winter tires are based largely in last months of the year.

Nikhil Bhat – JP Morgan - Analyst

Good evening. Thank you for the opportunity. I had a couple of questions, starting off with at the current raw material prices, what are the tailwinds that we should expect in the first half of 2015 or full-year 2015, please?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Good question. What we see is that the trend of natural rubber lately has reached a bottom, let's say, and is floating around 1,500 or some plus and minus. But this is something we think we should continue this way. So, should be in 2015 flat-ish if we consider all forecasts that are made by the different analysts.

Nikhil Bhat – JP Morgan - Analyst

Thank you. The second question from me is how do you see the winter tire season sell in and sell out progressing third quarter and what are your expectations for the fourth quarter, please?

Gregorio Borgo - Pirelli & C SpA - General Manger Operations

Okay, we have to talk about the different regions, but let's start from Europe. I think sell in was still positive even with a little bit low speed in the Q3. And we are expecting more or less the same speed in the Q4.

As far as sell out, as you know, the winter season is a little bit on delay -- was not a good month, October. But the positive news is that finally November was starting and we are tracking this every day thanks to the sales of our shop in Germany and in Scandinavia and since the beginning of the month, we have seen an important increase.

As far as the other regions, I think in North America, no main changes of the trend for sell in, sell out. The same is valid for China. While if we talk about Latin America, Brazil and the consumer business, we are entering now in the peak season; so, the next three months, we are expecting a very positive sell out.

Nikhil Bhat – JP Morgan - Analyst

Thank you. And the last question my side is could you give us an outlook for the replacement tire demand in South America and Russia that is seen probably in the fourth quarter of this year and going into FY15, please?

Gregorio Borgo - Pirelli & C SpA - General Manger Operations

So, in Latin America we are expecting a positive sell out and so, consequently, a positive sell in, especially for Brazil, because we are entering in the peak season. As far as Russia now, of course, the sell-out is already in the winter season while sell in, we have to put the new summer campaign and then we will start to sell the summer to order for booking for summer in the final part of the year and beginning of next year.

As far as replacement, in Russia we don't see any major changes. So, we are confident we can reach the target we put in our forecast.

Martino de Ambroggi - Equita - Analyst

Thank you. Good evening, everybody. The first question is on CapEx because some of your competitors have slowed down capital expenditures and those are projected lower CapEx going forward. So, are you planning to adjust your CapEx plan? And this year, if I remember correctly, last time you mentioned EUR380 million. So, confirmation for this year and expectation for the next couple of years, if possible.

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

As you remember well, we had in mind to have EUR400 million this year. And we will land around EUR380 million, which is lower than what was in the plan. And looking forward -- too early to say. But we continue being very careful on investment.

Where there is growth like Mexico, or parts of Asia obviously we continue to invest. Romania for us is a key factory we continue to invest. And then we look cautiously to what is happening around.

Anyhow all the investments we make are high end.

Martino de Ambroggi - Equita - Analyst

Okay, in any case, reduction is the most likely scenario going forward?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

We have to say that we look forward -- it depends from region to region, with some cautiousness, but all the investments we are making are basically in the premium segment. So, I don't see today a reason to cut investments looking forward because the market is still sound everywhere; grows at the rate -- it is three times the average growth of the sector. And so, I think it's going to continue investing in premium.

Martino de Ambroggi - Equita - Analyst

Okay. My second question concerns the ongoing screening for potential M&A, potential partner in the industrial segment in Asia. Have you any update on it?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

There are no news. We have players that we are in touch with just because it's worth it to continue having this target. We are sharing views with a few players. And so, as I have been saying lately, I think that it will take months during 2015 to make a decision.

Martino de Ambroggi - Equita - Analyst

Okay. My last question is on the restructuring costs. Okay, it's a small amount, the reduction you announced at EUR10 million over restructuring. But I was wondering if it's due to some change in decision or you were just too prudent when you announced the EUR50 million or they are just postponed to next year?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

No, the restructuring is going ahead as it has been planned. It's only minor asset devaluation.

Martino de Ambroggi - Equita - Analyst

Okay. And you know the exit on some of the minor business?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

No, we don't have a short term -- any news. We, as you know, Grandi Stazioni, we are in touch in order to find a way to divest in 2015. This should be finalized; everything is going into the right direction. There are no major obstacles. And so, and nothing in terms of some more has been planned.

Martino de Ambroggi - Equita - Analyst

Okay, thank you very much.

Philippe Barrier – Societe Generale - Analyst

Yes, good evening. Three questions, if I may. First question regarding the LATAM operation. I would like to know if we see some change in the competition in LATAM. I think for a more import for Asian makers saw some increase of competition for the premium segment. I would like to know if there is some impact on the group volume in the coming months in LATAM.

Second question is regarding the utilization of capacities. I'd like to know on your capacities what is now the rate of utilization? And as well on the truck tire segment, if actually you have some time to adjust the capacity in this business.

And the last point is regarding the disposal of steel cord business. It seems to have been postponed a bit. Just I'd like to know when this could take place, maybe only 2015 instead of late in 2014?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Starting with the last question, the divestment is in line with what was forecasted. We don't know yet if it will be finalized by year end or beginning of next year because there are still authorizations going on by the antitrust authorities. But they are minor issues where Bekaert has to give answers that seems are easy to be given. So, it's just a bureaucratic timeframe that has to be respected. That's why we don't know yet if the process will be end of the year or beginning of next year.

Looking to the Brazilian and Latin America competitive environment, what we see is one positive news that the mix is improving the requirements of green car, the requirements -- even the attractiveness of more quality is growing. And we have seen that lately we also have increased our market share in the replacement market.

Our action now is to reshape a bit our portfolio of products, reducing the very low end of our production in Brazil and testing a process of conversion of the mix which has been taking place and was very new years ago and now it's starting in Brazil.

So, we want to cut production of very low end and increase the mix high end. And we feel that volume-wise, we have reduced the production of the truck business not in the passenger car side business lately because of market condition. Looking forward, also the truck business we are changing the mix with the 01 line, the new line, the more advanced technologically that will be growing in our portfolio in Brazil.

We see Brazil and Latin America as a great opportunity for the mix. The technology we developed for the European market and for the American national market now is being developed in Brazil also for the Brazilian market and for the Latin American market. So, all in all, even in an environment that is not so positive, I think that the good news is the mix.

Philippe Barrier – Societe Generale - Analyst

Okay, just to complete the question, what is roughly now the part of revenues of premium segment in Brazilian operations?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Today it's around 6% of our turnover; represents 25% of our EBIT margin.

Philippe Barrier – Societe Generale - Analyst

Okay, good. Thank you very much.

Austin Earl - Marshall Wace - Analyst

Hi, good evening, everyone. I just had a question regarding the bridge on slide 17. The raw material -- the EUR4.2 million -- I wonder whether it would be possible as you've kindly done in the past is break that done. Because I believe that's a net effect of the benefit of raw materials offset by the negative on the currency effect on raw materials. And so, is it possible to get the two numbers that make up that EUR4.2 million?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Just a second. Mr. Sala is collecting the figures.

Maurizio Sala - Pirelli & C. SpA – Head of Group Planning and Control

Okay, so the EUR4.2 million positive impact of raw material in the third quarter is coming from EUR49 million positive in terms of commodity price, out of which the most important part is the natural rubber and negative impact on ForEx by EUR45 million, lower than the impact of ForEx on the second quarter that was EUR56 million.

For the last quarter of the year, fourth quarter, we are forecasting less positive for all the commodity. Butadiene in the last quarter of last year was already EUR850 per ton and now we have a cost that is EUR950. And the natural rubber was already low also in the last quarter of last year.

So, practically in terms of commodity, we will have a positive advantage of EUR15 million and the exchange rate negative will be around minus EUR38 million.

This is on one side lower versus the third quarter because of the ForEx comparison base of the South American currency that is better. But on one side, it's worse because of the comparison base -- because of revaluation of the US dollar that is impacting negatively in this date for all the purchase of raw material that are mostly based in dollars coming in Europe. These are the effects of the third quarter on the fourth quarter.

Henning Cosman - Berenberg - Analyst

Yes, hi, thank you. I have two questions left. The first one would be on your premium revenue development as compared to your premium volume development. And I can see that your premium volumes continue to grow at a higher rate than your premium revenues. Can you please update us what your planning is on when you expect this to coverage and where you see the inflection point? And just an update on how you see homologations coming through and then that's obviously paying off in the replacement tire market.

And then the second question is on your Russian operation. I understand you're about EUR8 million capacity in Russia is mostly in the C segment. So, could you update us on your plans, given the environment and the Russian market, on your plans of converting these into more like tier two capacity and just generally maybe give us a bit of granularity around your Russian operation? Thank you very much.

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

First Russia and then Mr. Sala will answer about the mix volumes towards turnover. Russia -- we have improved the mix, as I mentioned before, by 41% with a growth of our Pirelli brand in Russia. That means a huge growth in the premium segment.

We are now increasing also the volumes coming out of Kirov where that is dedicated more to the lower end B/C segment. What we started doing and what will affect positively 2015 is the part of exports we are dedicating from Kirov, taking into account the slowdown of the market. And also the exchange rate of the rubles and the transformation costs of Russia. Next year, we will move to quite an important volume exported from Russia to Europe. And so, we go full speed in the factories in Russia that are very effective.

Mr. Sala?

Maurizio Sala - Pirelli & C. SpA – Head of Group Planning and Control

Concerning the question on premium volumes growth and sales growth, the premium volumes growth were plus 20% in the nine months and plus 17% in the third quarter. The growth of the sales in the nine months were plus 12%. But the difference between the growing volume of plus 20% and the growing sales by plus 12% is coming from two major aspects.

On one side, a negative impact of exchange rates that is negative by four or five points in the consolidation of the premium results. On the second aspect, the increase that we have in term of sales from the region like Asia Pacific and Russia plus 26% in term of net sales growth and plus 41% in term of sale growth higher than the increase that we are having in Europe. This is adding to our portfolio of sales new volumes of premium tire with unit price in term of sales, unitary sales lower than the value of, for instance, Europe.

And this is related to the fact that there is a regional negative mix in the growth of premium. This is what is impacting on the sales but is not the same impact on the EBIT because the EBIT that is coming from Asia Pacific growth is already higher than 20%.

So, is let me say negative regional mix because the growth that we are having in the emerging countries is higher than the growth that we are having in the major ones. But it's not a negative element in the results.

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

And so to the other question, talking about the homologation, trying not to give too many information to our competitors. But being transparent with you, I just say that in the first nine months, we added more than 150 items to our portfolio of homologation that is already wide. And we were able to get some key homologation in the premium segment.

We were also awarded by BMW this year for the quality by last year by the VW group. So, I have to say that all this is providing some good results in super premium, which means that tires with premium size are at least 18 inches, our volumes grew twice as fast as the market. That is due to the actions dedicated to the technology that we have put in place.

Lately in the last few years, we grew in the Premium segment from 36% market share in a original equipment to more than 50%. And we grew in the replacement and the premium segment -- sorry, in the original equipment segment from 14% in 2011 to more than 20% the actual number.

Henning Cosman - Berenberg - Analyst

Thank you. Can I just follow up on this anyway? So, is it right that as compared to the -- as you explained the foreign exchange effect and the regional mix effect, the fact that you're maybe selling or that your volume growth into OEs on lower prices is maybe higher than in the after-market? That's the smaller effect as compared to the regional mix and the currencies. Is that correct?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Concerning the currencies, as you're seeing a market that has been very volatile, we had a peak of more than 9% with the ForEx that has lately decreased. The exception was the value of the euro that was nonsense and still for some reason is not at the right value, at least in my mind. And now the situation is a bit more balanced. Lately a decreasing value of the euro compared to the dollar made it more normal.

The real's devaluation seems for the time being, being a bit light. On the reals, we cannot say anything because they are in the process of choosing ministers for the new cabinet. And so, it really would depend on the attitude of the government.

In that scenario, we are not really much concerned because we have been able to handle the situation where the ForEx was accounted for 10% and now it's around 7%. And at a certain point in time, it has always been possible to play on prices when the ForEx is too volatile. So, all in all, it's not a concern.

Henning Cosman - Berenberg - Analyst

Okay, thank you. And very finally, just to confirm on Russia, of the 8 million of your capacity in Russia, you said 41% are now on the Pirelli brand. But it's fair to assume that they're small rim sizes?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

Sorry, not 41% in Pirelli brand -- not yet. Otherwise the profitability would be much higher. It will happen in the future. But for the time being, it's still much lower, the percentage of Pirelli brand.

The growth in Pirelli brand has been 41% year on year. So, I'm happy you mention it because you see we have room to improve our profitability.

Henning Cosman - Berenberg - Analyst

What is the split, roughly premium to non-premium of that 8 million?

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

In Russia today, the premium is no more than 15% in volume.

Henning Cosman - Berenberg - Analyst

Thank you so much. Very helpful.

Operator

As there are no further questions in the queue, that will conclude today's Q&A session. I would now like to turn the call back over to Mr. Marco Tronchetti Provera for any additional or closing remarks.

Marco Tronchetti Provera - Pirelli & C. SpA - Chairman and CEO

So, thank you. I have no other comments -- just to thank all of you for the attention. We have come to the end of our conference call. So, thank you again.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.