Pirelli H1 2015 Results Confernce call

August 6, 2015

Good evening, Ladies and Gentlemen, and thank you for joining us at this Conference Call.

“With reference to the Camfin - ChemChina deal announced to the market on March 22, 2015 and the prospect PTO on Pirelli, I wish to make clear that since Pirelli is the “scope” of this deal, no assessment and /or information further from those already announced by the parties in the press release dated March 22, 2015 shall be made public.

I only wish to point out that on March 31, 2015 upon the approval of the Full Year 2014 results, the Pirelli Board of Directors acknowledged - based on the information made public - the amicable nature of the deal whose details are consistent with the strategy of the Pirelli’s "Industrial business” focused on growth and aggregation in geographically strategic areas, such as Asia. All this, subject to the assessments still to be made that the independent members and the Board of Directors must make on the PTO, when such offer be made.

Before analyzing the second quarter results, there are a few highlights I would like to draw your attention to.

The Premium segment continues to clearly outperform overall market trends across the board, with a yearly growth of 9% in the Second Quarter against an overall +3% of the Car Tyre market. This confirms our view of the Premium market growing more than three times as fast as Non Premium.

Particularly encouraging were the results in Asia Pacific, Europe and North America, the three largest markets where consumer preferences and car designs continue to privilege highly technological products.

In China, where the overall OE tyre market has slowed down to a mid single-digit growth, Premium volumes grew about 20% year-on-year.

Our Premium sales, for yet another quarter, outperformed the market in all regions resulting in a market share gain of around 1 percentage point. This is one of our priorities for the year 2015, and we are executing it in line with our Plan.

This led to a price/mix growth of +3.4%, the highest in the Industry (-3.2% the peers average), also due to price increases in emerging markets and despite the challenging comparison base. The second quarter of 2014 recorded a +6% increase in price/mix, the best quarterly performance of the last 2 years.

Another priority for 2015 is strengthening our links with the best car makers: we can now count on a record portfolio of more than 1,600 homologated products with Premium and Prestige car makers, an investment in technology and a solid platform for future replacement growth. During the second quarter we added 58 new Premium and Prestige homologations, a strong increase against the 40 homologations added in the same period of 2014.

Industry results and the updated sector outlook for 2015 confirm the positive trend in mature markets and a volatile environment in emerging markets, such as South America and Russia.

The pricing scenario is improving, as seen in Europe with a low single-digit increase in summer and winter products.

Therefore, these factors have been supportive of an overall industry increase in Profitability levels as well as Cash Flow generation.

Our first-half results allow us to confirm the targets for the year of 930 million euro Ebit, a growth of more than 90 million euro, and Cash Flow generation of more than 300 million euro before Dividends.

We are dealing with volatile demand and foreign exchange scenario in South America and Russia through our flexible production setup and by rearranging product flows among Regions to optimize capacity utilization.

Additionally, we are working on price increases, mainly in South America, Russia and Europe, to cope with currency devaluation, and cost cutting in line with the new volume scenario to protect our Profitability and Cash Flow.

In the second quarter of 2015, we successfully delivered solid growth in Sales and Profitability in an environment where our ability to find value across businesses, channels and Regions was put to the test.

Starting from the top-line, the 4% organic sales trend, improving quarter-on-quarter, is mainly due to a Price/mix growth of +3.4%, the highest in the Industry. This is attributable to a higher weight of Premium products in our sales, which now account for 59% of total Consumer.

Premium is indeed the most resilient and value-driven market segment that continues to show impressive growth rates, especially in Asia Pacific, South America and the Middle-East Africa Region.

In the second quarter of 2015, the volume trend went back to grow not only supported by the Premium segment, but also by sequential improvement in volumes trends across businesses, especially in the Replacement channel.

Areas of market weakness remain in the Non-Premium segment *(-4% volumes drop in 2Q, -5% in 1H)* and the OE Channel in South America and Russia where market went down 16% and 30% respectively.

Our continued focus on quality growth and internal value drivers, including efficiency gains worth about 25 million euro, allowed for an year-on-year Ebit growth of 5% and an Ebit margin at 14.7%, rather stable compared with last year. As for what concerns efficiency we are in line with the program having achieved 50% of 2015 target in 1H.

Despite a small increase in financial expenses, which I will briefly touch upon in a few slides, Net Income before discontinued operations was up 8% year-on-year in the quarter, due to:

- A slightly better tax rate; and
- Lower negative equity contribution.

Finally, strong Cash Flow Generation in the second quarter, worth 212 million euro before dividends and Steel Cord cash-in, due to our solid operating performance and sound Working Capital management.

The regional performance of the Tyre business reflects the uneven development of end markets and our response to volatility, leveraging on our strong assets and the flexibility of product flows.

Organic sales growth of 3.2% in the first half of the year is the result of a strong performance by the Consumer business at +5.7%, more than offsetting a mid single-digit decline in Industrial.

Profitability followed a similar trend, which on the whole is about unchanged at a 14.2% Ebit margin.

On a regional basis, Asia Pacific and North America, mostly Consumer markets for us, were the main sources of top-line growth over the second quarter and accounted for 26% of total revenues, an increase of nearly 5 percentage points year on year.

Here, the pillars of our Premium strategy are all in place and performing well:

- State-of-the-art plants are growing capacity at a competitive cost: our Mexico source in particular is already at a profitability level in line with our Group average and continues to improve and create economies of scale as the ramp-up continues; and
- Our established links with top car makers are paying off in terms of Replacement sales with high levels of pull-through, improving Mix and Profitability.

We also performed well in Europe, with a gradual improvement in sales growth as compared with the first quarter. The Consumer Replacement market gained a little strength and we were able to grow significantly in the Premium and Super Premium segments. Pricing conditions are virtually unchanged as compared with Q1 and consistent with price indexation clauses and the current raw material environment, while our positioning allows us to maintain or improve our relative pricing against our peers.

The Russian market is not showing signs of improvement and contracted into the low teens over the second quarter, particularly in the OE channel with a reduction of about 30% yoy (28% in the first quarter).

We continued to do better than the market by:

- Posting positive growth rates in Replacement, improving our market share by a few percentage points; and
- Recording a more moderate decline in OE.

We also successfully made price increases and, in an environment where some players are pushing their low product range, we are on track with our Premium targets. We are also expanding our exports into Europe and maintaining a high level of saturation in our plants. These factors supported our profitability, which is in the high single-digit range.

In South America, the macro outlook continues to be weak, with a negative impact on tyre markets: the Industrial Business deteriorated further over the course of Q2, and the OE channel neared a 50% contraction.

On the Revenues front:

- We are enjoying a still positive Car Replacement market, especially in the Premium segment where we continue to gain market share and confirm our leadership;
- We are defending our positioning in Car OE and Industrial Business, outperforming the negative market trends and improving our sales mix.

We reacted to forex volatility by increasing prices: this was more limited in the Industrial business (+1.5% in Q2) given the weak demand.

These factors allowed us to end the first 6 months of the year with flat organic sales in the region.

In the Consumer business, we are rearranging product flows to limit the impact of factory slowdown. If we include the impact of forex depreciation, this means a very competitive production source for North America. In addition, we are introducing temporary measures to reduce production days and adjusting our capacity utilization in the Industrial Business to protect cash flow.

Our approach is still geared on protecting value. Despite the difficult market environment, the resilience of our business model delivered profitability in the double digit range.

Finally, the Middle-East and Africa Region continues to be one of the most profitable areas. Our mid single-digit organic growth rate in the quarter rests on above average volumes and mix improvement in the car business, as well as the success of our renewed product and solution offer for truck.

Now, switching to the regional performance of our Premium tyres, with rim size of at least 17 inches:

The results reinforce the validity of our strategy.

This segment continues to be:

- Resilient to market trends, showing a gradual improvement in the growth rate, with Q2 revenues up 19% year on year, and
- several percentage points more profitable than Consumer average.

More in detail, the strong Q2 trend is linked to the two largest Premium markets: Europe and North America.

In Europe, the most prestigious car makers continued to award us new product homologations, strengthening our technological partnership and building a platform for future growth. For European production alone, we added 49 Prestige and Premium homologations in the second quarter of 2015, out of which 35 for marked tyres. Among these, were the new BMW 5 and 7 series with fitments up to 20 inches, the Jaguar SUV F-pace and the Mercedes E-Class.

On the Replacement side, we are acting on several levers to grow in this very sophisticated and segmented market:

- In Super-Premium, our pull-through is tracking above our expectations;
- On the product side, we are targeting our competition in sizes where we are not homologated, mostly fitments of Asian Car Makers where we are increasing our market coverage;
- In our go-to-market strategy, we are partnering with car dealers and specialized distributors – in order to be closer to the final customer - reducing our reliance on wholesalers by 4 percentage points in the first half of the year.

The gradual improvement in year-on-year growth of North American Premium sales was mostly due to a strong growth in the Super-Premium range of marked tyres, which continue to win business with our largest clients and improve product mix within our Premium range.

If we consider Premium volumes overall, we outgrew the market and gained market share, especially in the Replacement channel with the contribution of our P-Zero All Season Plus which was recently supported by a wider product range and a dedicated digital marketing campaign.

Asia Pacific continued to show impressive Premium growth rates, in spite of the foreign exchange tailwind.

Over the course of the second quarter, our Product Mix accelerated significantly with strong Super-Premium sales. We had to manage the pricing environment, which proved less volatile in our niche as against the overall market.

Our market share gains are also the result of our work on the distribution network. We are on track to reach 3,000 shops this year and are also working on additional training programs for our distributors; these will be performed in 5 different training centers which will also provide the basis for scouting of new commercial partners.

Premium sales in South America grew in the high-teen range in the second quarter, and our market positioning improved both in the Premium and the SuperPremium segments, confirming our leadership. This trend was sustained by a successful product renewal and an optimization of our channel strategy.

In Russia, we outperformed the market with a mid-teen Premium volume growth. We are extending our product portfolio offering adding 17 additional sizes on our ICE Zero studded. We are also introducing the new ICE Zero Friction, a studdless product that completes our offerings for very cold Nordic winters.

In the first half of 2015, Net Income was positive for 196.5 million euro, or 40 cents per share in terms of attributable income.

Net Income included one-off charges of 14.9 million euro related to the exchange rate losses of the Turkish Steelcord subsidiary. Such losses, previously recorded in equity, have been reclassified to profit and loss in the first quarter of 2015, as a consequence of the Company sale in February 2015.

Net Income Before Discontinued Operations was 211.4 million euro. This means a growth of 19 million euro compared with the first quarter of 2014, or 10% yoy and above our percentage growth in EBIT.

Results from Equity Participations improved year-on-year by 23.2 million euro. This was mainly related to the lower losses arising from the consolidation of our stake in Prelios S.p.A. with the equity method, which was negative for 3.9 million euro compared to the loss of 16.4 million euro in the same period of 2014. The first half of 2014 was also negatively impacted by an 11.2 million euro devaluation of the investment in Alitalia S.p.A.

Financial charges were higher by 21.3 million euro year-on-year, of which 14.2 million euro related to the Venezuelan Bolivar devaluation impact on trade receivables, already factored in the guidance, and to the rise of interest rates in countries outside the Eurozone in which Pirelli operates, in particular Russia. Overall, the average cost of debt in the first half was 6.24%.

Finally, fiscal charges amounted to 117.8 million euro, slightly above the same period of 2014 due to the improvement of pre-tax results. The tax Rate is in line with our guidance of 35% and improved year-on-year thanks to the increasing contribution from Regions with a lower tax rate.

Pirelli's Gross Debt is worth approximately 2.7 billion euro, about 40% of which in currencies other than the Euro.

Following our debt capital market and banking transactions, a sound liquidity margin of 1.6 billion euro grants coverage of maturities well into 2019.

Cost of Debt was 6.24%, discounting interest rate increases mainly in Russia.

Let us now move to reviewing our Net Financial Position, which decreased by almost 70 million euro over the second quarter of 2015.

Net Cash Flow generation before dividends and the impact of Steelcord units disposal was positive by 212 million euro, improving year on year by over 25 million euro despite higher negative forex variations for 26 million euro.

Positive Cash Flow generation was mainly achieved through an improvement in Net Working Capital which almost doubled as compared to the second quarter of 2014 benefiting from the cash-in of the summer season in those markets characterized by business seasonality, such as Europe and Russia. Inventories went below 18% of sales thanks to production adjustments in LatAm. We expect to bring the level of inventories to 17% by the end of the year, a level which is consistent with increasing production flows from Brazil to NAFTA and the need to maintain high service levels in regions where demand is stronger (NAFTA and APac).

We invested approximately 103 million euro during Q2 (190 million euro in 1H), mainly allotted to:

- increasing Premium capacity in our top high mix plant (Mexico, China and Romania)
- improving mix.

Let us now review the main changes to our 2015 expectations on a Regional basis, starting from tyre markets.

Based on the 1st half trend, Premium market growth is confirmed at about 7% globally, outperforming the overall Tyre Market, which is confirmed to grow by 1%.

The resilience of Premium mitigates the slower growth of non-Premium markets and the Original Equipment channel in particular, as it is the case for South America and Russia where trends are expected to be weaker, with no meaningful changes compared with the 1st half, due to the challenging economic environment. At the other hand, NAFTA and Europe are developing ahead of our expectations.

Turning to Truck Tyre markets, we now forecast a decrease by 1%, about 2 percentage points lower than previously assumed. This is a consequence of greater contraction in South American OE, since vehicle production failed to recover, and a slowdown of the Replacement channel in both South America and APac.

Compared to our May guidance, our NAFTA business shows an improved Profitability profile, due to:

- a stronger Dollar
- a better than expected mix with a higher weight on Super Premium
- a favorable source mix from our Premium plant in Mexico, which has reached a profitability level in the mid-teens, and imports from Brazil.

This Profitability improvement makes up for the results in South America which were lower than expected and where demand is not due to improve in the short term, with a negative impact on our EBIT. In this scenario, we are re-arranging product flows, reducing the capacity utilization rate in Truck in Brazil below 80% and dealing with costs.

Regarding the other Regions, we confirm the expectations shared with you in May. On a year-on-year basis, we expect

- Profitability to grow above 20% in APac and nearly 20% in Middle East Africa thanks to our exposure to Premium;
- Europe to stay in the mid-teen EBIT margin range supported by a renewed approach to distribution and to Price increases on Replacement in 2H (+3% on summer product starting from July and on winter from October);

- Russia to continue to outperform the market, especially in the Premium segment, closing the year with organic Revenues up in the mid single-digit range and a growth in profitability, with an EBIT margin reaching high single digits.

Quickly, on our full-year Guidance: what is new in our current update is slightly lower volume growth assumption for our LatAm and APac Industrial business and our Car OE in Russia and South America.

The Revenue target is now above 6.35 billion euro without changes in expected Premium volumes, Price/Mix and Forex.

The Profitability target is confirmed at 930 million euro after 30 million euro restructuring costs.

Our revised volume assumption has a limited impact on profitability since it only affects low margin businesses.

This headwind will be offset by:

- lower marketing costs consistent with our new volume scenario; and
- raw material costs expected to be lower

Non-recurring items are now 30 million euro (40 million the previous indication) due to lower asset devaluation vs. our original plan

Cash Flow assumptions are unchanged: we expect Cash Flow to be above 300 million euro (around 5% of revenues) and Net debt to reach ~850 million euro.

Now, let us break down our Targets by Business.

We expect slightly better Revenues from our Consumer business, now above 5 billion euro, through

- A Price/Mix improvement of 4.5% due to both a better Mix (higher regional mix) and Pricing
- A slightly lower support from volumes, between +1.5% +2%; and
- A Foreign exchange impact at +2%.

Profitability is now seen at above 16% as a consequence of a better Price/Mix.

Industrial Business, whose revenues are likely to be slightly lower now at around 1.35 billion euro, as a result of

- Volume down approximately 3%, linked to the demand dynamics in South America and China; and
- 1% increase in Price/Mix, discounting a limited price increase due to weak market demand
- Forex confirmed at -2%

These factors, as well as costs linked to lower plant saturation in South America, had an impact on Profitability. The EBIT margin is expected to be approximately 10%.

Now, I leave the floor to Mr. Sala who will comment our performance in more details

Thanks Mr. Tronchetti, and good evening everybody

In a mixed market scenario in Regions and sales channels, the second quarter results show the resilience of our Business Model and the quality of our internal value levers, marking an important step towards full-year targets.

We delivered mid-single-digit growth in both revenues and profitability, reaching 1.6 billion euro in sales and an EBIT margin of nearly 15% before restructuring costs.

The top-line trend is based upon:

- A change of pace in volumes, turned positive at +0.6% year-on-year.

Premium growth was sustained at +11%, especially in the Replacement channel, while non-Premium and Industrial business volumes shrunk at a slower rate. Yet for another quarter, both Consumer and Industrial businesses gained or confirmed market their share in the key markets.

- Improved Product and channel mix sustained price/mix growth of +3.4%, in line with our expectations and significantly above our peers. Our Pricing behavior continued to be rational and in line with OE indexation clauses and raw material trends.

Organic sales trend gradually improved to +4% year on year. This, together with a lower FX tailwind, mostly due to the devaluation of the Reais against the Dollar, brought the overall sales growth figure to +6.4% in the quarter.

Profitability in absolute value increased by 4% in the quarter, mainly on the back of internal levers, such as Price/Mix and Efficiency. On the other hand, raw materials and forex tailwind mitigated the higher inflation cost.

EBIT margin was 14.9% before non-recurring items, a slight decrease as compared with the second quarter of 2014.

Let us now look at the drivers behind the 9.1 million euro quarterly increase in Ebit, starting from the internal value creation levers.

- Our focused commercial strategy delivered Price/Mix growth worth in excess of 25 million euro Ebit, about a 50% drop-through from sales.
- Improved efficiency of operations accounted for nearly 25 million euro in savings, or 50% of our yearly target if we sum what was achieved in Q1.

These positives allowed us to compensate for rising costs linked to:

- Higher marketing expenses – related to the growth of Premium and to the FX impact on US dollar denominated costs;
- Lower plant saturation in South America, both Brazil and Venezuela;
- the impact of the different steelcord sourcing, produced internally last year and currently purchased from Bekaert; and
- higher depreciations and input cost inflation, mainly labour cost in emerging markets.

Given its volatility, the external environment provided a limited support: +8.5 million euro from raw materials, and +4.8 million euro from foreign exchange.

Let us now move to the performance by Business Unit, starting with Consumer.

With growth picking up and Revenues nearly +11% year-on-year in the second quarter, the Consumer business accounts for 80% of Tyre Revenues, up from 77% a year ago.

If we focus on the second quarter of 2015:

Volume growth gradually improved, up 2.2% year-on-year, with better trends in both car and motorcycle tyres. More in particular for the car business:

- Replacement sales were strong in Asia Pacific and North America and grew faster also in Europe, allowing us to gain or maintain share in key markets;
- the OE trend continued to discount the drop in our relevant markets, such as South America (-16%) and Russia (-30%)

Premium volumes were strong at +11% yoy, driving the improvement in Price/Mix, at +4.1% year-on-year despite a challenging comparison base.

Organic revenues were up 6.3% in the quarter and a positive FX impact brought this figure up to an overall +10.8% growth year-on-year.

Growing product and channel mix, price increases and efficiency gains, led us to achieve an EBIT margin of 16.2% in the second quarter, up 0.6 percentage points yoy.

Now the Industrial Business, which is weathering the current market environment in South America, worth more than 50% of our sales:

- recording a gradual improvement in the organic revenue trend and
- dealing with capacity utilization and cost efficiency to limit the impact on Profitability.

If we focus on the second quarter of 2015:

- The already challenging market in South America turned more negative, with a contraction of -47% in the Original Equipment channel and -12% in the Replacement Channel.
- We were able to maintain or improve our market share, due to our capillary distribution network and renewed approach to fleets which allowed us to attract 55 new large clients.

- On the whole, our volumes were down 4.7% yoy in the second quarter, 2 percentage points better than Q1.
- This was achieved while executing price increases, which, together with our improving product mix, returned an overall price/mix figure of +1.3% in the second quarter, another gradual improvement from the 0% price/mix of Q1.

Revenues in the second quarter were therefore down 3.4% year on year in organic terms, while the devaluation of the Brazilian Reais against the US dollar was the main factor behind the negative FX trend which brought the total revenue figure down 7.8% year on year.

Our actions to mitigate the top-line impact on profitability and cash generation were mainly aimed at:

- reducing the utilization rate of our plants to below 80% in Brazil; and
- keeping a tight control on costs.

Allow me to remind you that the yearly decrease in EBIT margin discounts the sourcing of Steelcord from third parties, having an impact of over 1 percentage point on the EBIT margin.

Over the next two quarters, the Profitability of the Industrial Business should track slightly above H1, in line with our revised FY 2015 targets, on the back of continuously improving Mix and the impact of Price increases.

Finally, just a re-cap on our 2015 Profitability Guidance:

The revised Revenue assumptions are

- Volumes expected to grow between 0.5% and 1% (+2% the original guidance)
- a price/mix confirmed at +4% with Consumer business counterbalancing the lower growth on the Industrial business, and
- Forex up 1%, in line with the previous Guidance

The lower volumes growth will translate into a slight Ebit reduction, in the range of 20 million euro, since these volumes are mainly non-Premium and OE Car and Truck businesses, with a profitability below Group average.

This is offset by lower commercial costs, in line with the new Volume scenario, and higher benefits from Raw Materials.

The lower saturation costs in LatAm are offset by lower asset devaluations, included in the non-recurring items line, while restructuring costs are confirmed.

Finally our updated raw material assumptions.

Following the trend seen in the first six months of the year, we revised down our natural rubber cost estimates for the year, now at 1,500 Dollars per tonne.

Oil prices is confirmed at 70 Dollars per barrel, and Butadiene at 750 €/ton. We remind you that these are the costs of goods sold.

This will imply a positive impact of 40 million euro on our EBIT in 2015.

This is all from for the moment, thank you very much for your attention.

I now give the floor back to Mr. Tronchetti.

Marco Tronchetti Provera

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

Henning Cosman ***- HSBC - Analyst***

Hi, good evening. Thank you. I have two questions. First question would be on the price changes. You said that you had seen a low-single-digit price improvement in the environment in Europe. If you could please comment on your particular changes, I think Michelin has commented about the impact of price increases after respective ends of the selling seasons for both summer and winter tires, not really expecting any influence or impact for this calendar year.
Can you please comment as to what your strategy is with respect to price increases? Do you think you can maybe keep some marginal benefits from the price increases into next year over and above what your potential anticipation of increasing raw material cost is? That's my first question.

And second question, on Russia, could you please comment on the further conversion or increase in your capacities in Russia, seeing the weak volume development, and also maybe elaborate a little bit on the market development that you're seeing? Do you anticipate increasing volumes from 2016 again already, maybe just a little bit of color on that Russian market? Thank you very much.

Marco Tronchetti Provera

Before giving the floor to Mr. Borgo, two general answers, one is on price. All effects of price increase are included in our targets. Second, Russia, so, the increase in volumes we had is related to the continuous improvement of our exports to Europe and also to the gain in market share in a very weak market in which we are gaining in all areas, mostly in the premium segment. But for more details, I give you the floor to Mr. Borgo.

Gregorio Borgo - Pirelli & C SpA - General Manager, Operations

So, starting from the price in Europe, we just raised the price list as far as summer product since the 1st of July. And the price list increase was 3.5%. We already had a small capitalization of this in the month of July. In October, we are going to raise as well the price of winter for the seasonal market. What we are expecting is around 2.5 percentage points of price increase that will account for more than EUR10 million in the second half.

Henning Cosman - HSBC - Analyst
Okay. Thank you. Will that price increase mainly impact next year, right? So, are you anticipating it to have a marginal benefit from that then? Is that increase more than what you're anticipating for raw material headwinds next year?

Marco Tronchetti Provera
As you know, for raw materials, what we pay today is the price we will have in our input costs three months from now.
And so, the evolution of raw mat prices for what we see today is expected to remain weak in the next months. To go beyond the next months, it's really betting on something. And what we want to underline is that we confirm that all these effects are included in our plan, in the plan that continues to deliver what was forecasted when we presented the three-years plan in London.

Henning Cosman - HSBC - Analyst
Understood. And could you just confirm your current capacity in Russia, please, in terms of millions of units of tires?

Marco Tronchetti Provera
The capacity we have in Russia now is running at full speed. Today's capacity is already around 7 million and is expected to reach 8 million by year end.

Henning Cosman - HSBC - Analyst
That's great. Thank you very much.

Austin Earl - Marshall Wace - Analyst
Hi, good evening, everyone. I just wondered if Mr. Sala could be very kind and provide a data point which he's been able to provide before on the actual currency effect on the raw material. For example, on slide 20, on your new guidance, you have quoted the FX as minus EUR240 million, and you give the raw material as EUR280 million. I just wondered if you could break down the second quarter in the same way as you provide that breakdown.

Maurizio Sala - Pirelli & C SpA - Head of Group Planning & Control Development
Yes. So, when we talk about the exchange rate variation that is for the full year is forecasted EUR240 million, likely below what was forecast in the previous guidance that was EUR244 million, only because of the fact that we are reducing the production in South America, as we mentioned before, in order to take under control the stocks level and the cash.
Practically, in the second quarter we had a positive impact coming from raw material of EUR93 million compensated by a negative ForEx impact equal to EUR84 million. This determined a positive impact of the quarter that was EUR8.5 million.
Of that EUR240 million of negative exchange rate for the full year, as you may imagine, the major part is related to the South American currencies that are already devaluated or we are taking into consideration our guidance that is assuming a further devaluation of both Venezuela Bolivar and

Argentinian pesos, and a revaluation of the US dollar versus euro that is determining a negative impact in Europe for the purchase of the raw material cost that is based in US dollar currency.

Austin Earl - Marshall Wace - Analyst
Great. That's very helpful. And I just have one additional question. On the guidance, the slightly lower volume guidance, you explained that that was to do with Latin America and APAC. Does that imply that your outlook for the Russian market hasn't changed at all, or is it just too small a market for you to commenting on?

Maurizio Sala
The Russian market is going at two speeds. One is the original equipment, which is dramatically down. And the other is the replacement market, which continues to grow a bit. That's why we continue to keep our factory in line with the plan increasing capacity.

Austin Earl - Marshall Wace - Analyst
Great. Understood. So, you're saying, it's the replacement market because of the continued increase in the car part that's keeping that demand going.

Marco Tronchetti Provera
We maintain the plan of growth, thanks both to the replacement and to the export that balances the decrease in supply of the original equipment.

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

Martino De Ambroggi - Equita SIM - Analyst
I have two questions. The first is on the consumer return on sales because, despite not particularly favorable environment in LatAm and Russia, you are achieving 16% return on sales, if I remember correctly, is even above what you targeted with the last business plan dated October or November 2013.
So, I was wondering what could be a reasonable medium-term target which must be updated because the 16% target, if I remember correctly, or 15%, was the target for next year.

Marco Tronchetti Provera
We didn't change the guidance for next year. The results we have are due to a better price mix that is leading the sector as a fact. But, we don't see today any reason to change our targets.

Martino De Ambroggi - Equita SIM - Analyst
Okay. But, anyway, price mix should not change the contribution going forward, or at least should not become suddenly negative. So, this is my personal view, there is room to improve the target. I know maybe now is not the right moment, but that is my feeling.

Marco Tronchetti Provera
Yes, but we see also the original equipment. So, we have to consider consumer as all business, which is not only the price mix we have, but is also related to the weakness of the original equipment in Latin America that could even go to the worst if we continue this way, taking into account that our expectation, the currency can also be devalued. Figures around it are not very positive.

Martino De Ambroggi - Equita SIM - Analyst
Okay. And indeed, on Latin America, you are still mentioning in your press release Venezuela and Argentina as a risk for your EBIT guidance, with a potential EUR30 million negative impact. I know it's difficult to make predictions on Venezuela in particular, but we are in August. You probably have two, three months of additional visibility. So, what's your feeling regarding the risk concerning your EBIT guidance for the current year?

Marco Tronchetti Provera
For Venezuela, we keep the same targets. We are now at 50% capacity. We are planning to go a bit higher because payments in dollars of the raw materials have been in the last months open. So, we stopped importing for many months. And so, we wait because it's so unstable, the situation, that before making any possible positive forecast, we want to see something more consistent than what we see today. So, it's still very, very volatile.
Back for a while to the previous question, we confirm the plan because, in our plan in London, we expected to have our higher volumes and lower price mix effect. So, if you look to figures, we are now rebalancing through the price mix the lower volume that we had. That's why we did not change any guidance.

Martino De Ambroggi - Equita SIM - Analyst
Okay. Perfect. And just a brief comment on Argentina, if I understand correctly, Venezuela is a little bit improving in your projection in the second half, remaining volatile. For Argentina?

Marco Tronchetti Provera
No, we don't seen any improvement in Venezuela in the next months. So, what we see is that the trend we had, if continues, can provide us more confidence that the contingencies we have in our plan will have lower probabilities to be used. But, we put a provision of EUR30 million. And before say anything, we have to wait.
As you know, in Argentina, there are also the elections. In a month, month and a half, everything could change. We don't know what is going to happen to the currency. And so, I think that it's good to keep the provision we have and to continue to be very careful in handling the situation.

Martino De Ambroggi - Equita SIM - Analyst
Okay. Thank you.

Philippe Barrier - Société Générale - Analyst
Good evening. Two questions. First question is regarding the LatAm operation. Actually, given the drop in the volume on the OE or also on our replacement market on the truck tire market, I'd like to

know if there is some risk regarding the capacity, assuming there was no improvement coming in the next year. Actually, there is some risk to see some restructuring taking place in the Brazilian operation in order to reduce the capacities.

And the second question regards the winter tires. I'd like to know what is now the level of stocks? And actually, what is your view regarding orders and deliveries of winter tires for Pirelli in 2015?

Marco Tronchetti Provera
Back to LatAm industrial, we expect the trend to continue to be very weak. We do not see for the next six months any good news. And that weakness is also enhanced by the currency effects.
About the second question was about the winter season, the winter season, I leave the floor to Mr. Borgo. Anyhow, stocks in our case in our channel are normal. So, we cannot say that there is nothing specific.

Gregorio Borgo
Yes. As anticipated by Mr. Tronchetti, I think our channels, they have the right stock.
I think as well, the pre-booking activity we carried over so far was pretty much positive and slightly higher than a year ago. And as well, the fact day-to-day matriculation of the new car was growing in Europe, especially in countries like Germany and Italy, it is bringing probably more first installment of the winter tire.
So, having said that, for the time being, we are optimistic. Then we will understand the reality of the winter season only when we will see the first snow that hopefully will happen end of November.

Philippe Barrier - Société Générale - Analyst
Okay. Thank you. Just coming back to the first question, I'd like to know if actually we may see some adaptation measures decided to reduce the size of the capacities in Brazil and that actually if your group may face some additional costs which were not accounted initially in the forecast for 2015.

Marco Tronchetti Provera
No, we balance some cost savings. We had added in the last few months with the, let's say, reduction of headcount we already have planned and agreed in Latin America. So, we don't see any extra cost cutting now. What we can see obviously is a stronger slowdown, and we are prepared to face it.

Philippe Barrier - Société Générale - Analyst
Okay. Thank you very much.

Marco Tronchetti Provera
So, thank you. Thank you for your attendance, and thank you for your questions. And enjoy your evening.