Pirelli & C. S.p.A. 9M 2022 results conference call transcript

November 3rd, 2022

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening, Ladies and Gentlemen,

The first 9 months of 2022 were characterized by a growing volatility of the macroeconomic scenario, worsened by the Russia-Ukraine war and the COVID emergency in China.

Despite these headwinds, Pirelli closed the first 9 months with a clear year-on-year improvement. Our performance proves the resilience of our business model, as highlighted by:

- The strengthening on High Value, the market segment growing the most, where we gained share despite price increases
- Our price/mix, one of the best in the industry, that offset the growing impact of raw materials and inflation
- A sound cash flow trend, with a cash generation in the third quarter, resulting from an efficient management of the working capital

These results allow us to upgrade our 2022 targets and close the first part of our Industrial Plan – the 2021-22 period - with a cash generation before dividends of approximately €910 million versus the Plan target of €700/800 million.

The scenario outlining for 2023 is uncertain and yet more volatile. The major uncertainties are the trend of the Demand and the inflation rate of input costs, from energy to labour cost, to raw materials.

Pirelli is ready to navigate this scenario by relying on its assets, namely price/mix and efficiencies, and on its ability to react to the external headwinds, with the objective of minimizing them.

Our 2023 targets are to be disclosed to the market next February together with 2022 preliminary results. Then, in the first half of next year, we will update the Plan up to 2025, confirming our de-leverage target of a net debt / Adj. Ebitda to approximately 1 time by the end of 2025.

In the first 9 months of 2022, our results rank among the best in the industry, with:

- a 26% Top Line growth, supported by the price/mix;
- a 15% profitability;
- a Net Income at 359 million euro, up 52%YoY;
- a net Cash absorption improving against the same period of 2021, and a cash generation before dividends in the third quarter at 141 million euro.

Our performance confirms the resilience of our business model:

- our commercial strategy allowed us to seize the growth opportunities in the High Value market in all Regions, and strengthen our positioning especially in the Replacement;
- price/mix and efficiencies more than offset input cost inflation and preserved profitability.
- our lean organization, together with a flexible production and logistic structure, allowed us to promptly deal with the impacts of various emergencies (the Russia-Ukraine conflict, the

lockdown in China, and the gas shortage in Europe). We were able to ensure the appropriate service level to our customers and an efficient inventory management.

Finally, on Debt: We continue our deleverage process that will take our Net Debt / Adj. Ebitda to approximately 1.9 times at the end of this year. In the first half of 2022, we refinanced our debt and diversified our funding sources. We can count on a liquidity margin to meet the next debt maturities. A balanced exposure between fixed and variable rates enables us to deal with the current interest rates increase.

Before addressing our economic and financial performance, I would like to draw your attention on an important achievement on Sustainability.

In 2022, Pirelli is confirmed to be Global Leader in the Auto Components sector by the S&P Global Sustainability Assessment. This is an outstanding acknowledgement of our commitment in promoting sustainable growth.

Pirelli is the global leader with a definitely higher score compared to last year and a significant gap versus our competitors: 85 points compared to an average of 24 points by our peers.

Pirelli got a top score in a number of areas of management, like Health & Safety policy, Due Diligence as to human rights, natural resources management and CO2 emission reduction.

Top score also in innovation, cyber security and on social and environmental reporting.

I now leave the floor to Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti, and good evening.

Let us analyze both the market dynamics and Pirelli’s performance.

In the first 9 months of 2022, the Global Car tyre demand was flat year-on-year, with a very different trend for each segment.

Car ≥18’’ is up +6.8% benefitting from:

- the rebound of O.E. tyre demand (+9.2% in 9M), particularly marked in 3Q (+25.2%), due to the easing of supply chain tensions, and
- a mid single digit Replacement demand (+5.3% in 9M), which, however, slowed down in the third quarter in all geographies.

Car ≤17’’, instead, was down -1.4% in 9M. Positive the trend in Q3 (+1.6%) supported by the strong recovery of car production (+21.2% the OE demand), which is expected to continue in 4Q. Replacement demand was still down -3.1% in 3Q.

In this context, we increased our market share in Car ≥18’’ as I will tell you in a couple of slides.

Let’s now discuss the “Key Programs” of the Industrial Plan and their results in the first nine months of 2022

In the Commercial Program:

In line with our strategic focus on High Value, we:

- strengthened our positioning in the Car ≥18" and overperformed the market (+9.4% the volume growth compared with +6.8% of the market)
- increased our exposure to Original Equipment ≥19" and EVs
- reduced our exposure to Standard tyres that now account for around 39% of Car volumes, -3 percentage points compared with the same period of 2021

In the Innovation Program

- we achieved approximately 230 technical homologations, 76% of the yearly target, concentrated in the ≥19" (~80%), Specialties and EVs
- we introduced 8 new high-performance products, with a special focus on the regional needs of consumers. In addition, we expanded our offering in the two-wheel business, motorbikes and cycling, now accounting for 8% of our revenues.

In the Competitivity Program: we progressed to Phase 2 of our efficiency plan and achieved 60% of our yearly target, in line with the objectives and the development of the different projects.

In the Operations Program: the saturation level of High Value plants remains above 90%, 73% in Standard, due to lower production levels in Russia. Finally, we launched a capacity increase program in North America, that will reach 8.5 mln High Value tyres by 2025, in line with our Industrial Plan.

Our commercial strategy allowed us to fully seize High Value growth opportunities. At the same time, we kept decreasing our exposure to the least profitable segments of the Standard business.

In Car ≥18", we recorded a +9.4% growth, driven by the most technological and high-end products, namely:

- Rim sizes ≥19" contribute 94% of the growth posted in the Car ≥18" segment,
- Specialties account for over 77% of volume increase in the ≥18" in the first nine months, with the major contribution of EV products, accounting for approximately 14% of volumes in O.E. ≥18")

The Replacement channel ≥18" is the driver of this growth:

- in «Pull» volumes, especially in N. America and APac, and in EV products, as well as
- in «Push» volumes, where the new dedicated lines of this channel show very good results in the three HV Regions.

In Original Equipment ≥18", on the contrary, Pirelli is taking an approach of growing selectivity of OE projects, with particular care of EV products.

Pirelli Innovation program continued in 3Q'22, with an offering covering the different needs of consumers in all Regions.

In North America, we expanded our offering with the launch of two new All-Season products: Weather Active Cinturato, for the sedan segment, and Weather Active Scorpion for SUVs.

These two product lines comply with high performance and safety standards:

- both are suitable for different weather conditions, as certified by the Three-Peak Mountain Snow-Flake Certification
- both have a warranty linked to mileage;
- both offer extraordinary wet performances; and
- are 2 decibels more silent than competitors' products.

In Europe, our Cinturato Winter 2, launched in 2Q, was pointed out by major magazines, like Auto Bild and Tyre Sekeer, as the best Winter Tyre, due to its high performance and safety standards.

Our EV portfolio is growing steadily. Now it includes over 300 homologations with the most innovative and well-known brands in the world, in both Premium and Prestige.

Our EV positioning is unique in the industry, as our vast portfolio of EV-market products proves. Pirelli offering is approximately 2.5 times wider than the average of our competitors.

Electric Vehicles make up the fastest growing segment with Pirelli aiming at doubling its sales in the segment.

In the first nine months of this year, 3 years earlier than expected, we already achieved our market share target in High Value EV, equal to approximately 1.5 times that of Premium / Prestige vehicles with internal combustion engines.

In the Two-Wheel Business (moto and cycling), High Value product innovation is continuing.

In the Motorbike top-of-the-range business, Pirelli is the leader with two Premium brands: Pirelli and Metzler.

In the first 9 months, we expanded our product range:

- in the Pirelli brand, we introduced Diablo Rosso IV Corsa, devoted to the super-sport segment and motorbikes with high displacement;
- in the Metzeler brand, we launched Tourance Next 2, with very good wet performance, and Karoo 4, for off-road driving.

In Cycling, we keep-on our growth journey by leveraging on:

- the expansion of our product range with the launch of 10 new products in the first nine months of 2022;
- the ramp-up of our Bollate plant in Italy;
- commercial partnerships with Trek, and
- the on-going co-operation with key partners in the High Value and electric segments, such as Pinarello, Colnago and Stromer

In the first nine months of the year, the Competitiveness program posted efficiencies worth €86mln, equal to approximately 60% of the yearly target. This target has been updated to around €140 million, against the initial €150 million, in consideration of the new volume estimates and the resulting production levels.

Let us review the performance of the single projects in the first nine months:

In the Product cost project, which contributes around 34% of efficiencies, we made progress in the adoption of a modular and design-to-cost approach.

- In Manufacturing (41% of efficiencies), we continued optimizing our industrial footprint and the implementation of efficiency programs.
- In SG&A (13% of efficiencies), we achieved efficiencies by using different levers, like the optimization of the logistic and warehouse network and purchase negotiation actions.
- Finally, in the Organization (14% of efficiencies), we went ahead with process digitalization and people upskilling.

Finally, our update on the energy issue and our mitigation plan.

As known, the lower supply from Russia has produced a hike of gas prices, with the resulting impact on energy costs, which are estimated to be 3.7% of revenues in 2022, 1 percentage point higher than in 2021.

From the operational point of view, gas shortage risks are confined to Germany and Italy, where Pirelli has a capacity of 8 million tyres, equal to 11% of the Group's capacity. Therefore, our exposure appears to be definitely lower than our peers.

To minimize both economic and production impacts, Pirelli immediately established a Cross-functional Committee and set up a Contingency Plan.

The Plan sets out:

- the use of alternative energy sources to natural gas already available for our plant in Italy and Germany;
- containment of risks connected with suppliers. Based on our assessment, exposure to the risk of shortage is limited and where needed, we increased the stocks of products and semi-finished products.
- As to economic impacts:
  - to date, over 40% of our global energy costs has already been fixed, also based on hedging actions
  - while we are accelerating the implementation of our projects to reduce energy consumption:
    - working on the curing and mixing processes in order to reduce thermal energy consumption and waste;
    - encouraging the introduction of photovoltaic panels, the use of LED lamps and, more generally, accelerating the use of renewable energy sources.

Thank you, and I now give the floor to Mr. Bocchio

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Thank you, Mr. Casaluci, and good evening to all.

Let's analyze more in detail our economic and financial performance, starting from Top-Line dynamics in the first nine months of 2022:

- Volumes were flat YoY, yet with a different trend between our Car business with a 2% growth, and our Moto business with a minus 7.5% discounting the reduction of our exposure to the Moto Standard segment and, consequently, the shutdown of our Brazilian plant in the third quarter of 2021.
- Focusing on our High Value and Standard segments (car + moto), the following factors should be highlighted:

    - A gradual High Value volume improvement (+6.6% in the first 9 months, +8.2% in the third quarter), supported by the OE demand rebound, as well as by a higher market share in Car $\geq$ 18" Replacement, despite price increases.
    - Standard volumes are indeed declining (-7.6% in the first nine months, -5.7% in the third quarter), impacted by a greater selectivity in Car OE, the Russian-Ukrainian crisis and the already-mentioned shutdown of our Moto tyre plant in Gravatai.
- Price/mix (+20% in 9M, +19.4% in the 3Q), due to:
    - <u>price increases</u> to compensate for higher inflation in the raw materials business and other production costs
    - <u>mix improvement</u>, mainly product mix, from both the migration from Standard to High Value as well as the micro-mix improvement in both segments.
- The positive exchange rate (+€257 million euro, +6.5%), reflecting the strong appreciation of the major currencies versus the Euro

In the first nine months, Adjusted EBIT was 754 million euro, with a YoY growth of 155 million euro, with a 15% margin, flat YoY, due to the strong contribution of the internal levers which more than compensated the impacts of the external scenario.

More specifically, this trend reflects:
- the positive price/mix (+677 million euro) and efficiencies impacts (€86 million euro) which have more than compensated for the increased costs of the raw materials (-365 million euro, including the exchange rate impact) and of the other input costs (-227 million euro), mainly energy and logistics, as well as higher amortization charges (20 million euro) and of other costs (25 million euro, all concentrated in the third quarter).
- a positive exchange rate contribution (€28 million euro), and a flat volume contribution due to the dynamics mentioned above.

In the third quarter, Adjusted Ebit is of 272 million euro, with a 23% growth.

The 14.8% Ebit Margin marks a slight decrease versus 15.7% in the third quarter of 2021, due to:
- the dilutive effect of the exchange rate, and
- the increase of other costs, mainly connected to the impact of the reduction in stocks and higher provisions for the short-term management Incentive Plan.

Let us look at the Net Income dynamics for the first nine months of the year.

Net Income strongly increased YoY. The trend takes into account:
- the already mentioned improvement in operating performance, and
- lower restructuring and non-recurring costs.

The year-on-year increase of the Net Financial Charges reflects the rise of interest rates and currency hedging costs in Brazil and in Russia, partially counterbalanced by the reduction of financial charges at the parent company level. We will discuss this trend in a couple of slides.

The €46 million increase in tax charges relates to the higher operating results, as tax rate is stable at about 27%.

Adjusted Net Income, meaning excluding all the one-offs and non-recurring items, is positive for €446 million at the end of September 2022.

Let's look now at the net financial position.

Pirelli closes its first 2022 nine-month report with a negative Net Financial Position of 3.4 billion euro and a cash absorption before dividends of 323 million euro, lower than the one of the nine months of previous year.

The Net Operating Cash Flow has improved by €172mln compared to last year, reaching €87mln and reflecting:

- Ebitda growth
- lower investments, connected to a different timing expected in the implementation of the 2022 projects, due to their geographic reallocation, as well as delays in delivering some equipment due to electronic components' shortage;
- limited working capital absorption due to an efficient finished product stock management with a reduction of approximately 600,000 car tyres, while raw material stocks increase due to inflation and in response to the need to mitigate supply chain risk.
    - At the end of September, overall stocks accounted for 23% of revenues, minus 0.5 percentage points versus the first six months of the year. The stock reduction process will continue in the fourth quarter with the target of reaching at the end of this year a weight on revenues of 21%/22%, a figure closer to 2021 results.
    - The Working Capital was also influenced by the growth of trade receivables, in line with our business seasonality and the increased trade payables, which reflect the growth of our business as well as the increase in stocks.

It is important to point out the significant reduction of non-recurring and restructuring charges which partially offset:

- the increase in financial charges and higher taxes, as well as
- dividends paid to minorities (24.4 million euro)
- and the negative impact of the exchange rates of -43 million euro due to the revaluation of the Russian Ruble and Brazilian Real, partially offset by the positive impacts on liquidity because of the revaluation of the Chinese Renmimbi.

The Net Cash Flow before Dividends in the third quarter of 2022 was positive:141 million euro, with a 37 million euro increase year-on-year thanks to our operating management.

The Group Gross debt as of September 30, 2022, is of approximately 5.4 billion euro, while our Net Financial position is of 3.4 billion euro due to 2-billion-euro worth of financial assets.

During the first nine months of 2022, our Group:

- subscribed banking lines benchmarked at sustainability targets worth 2 billion euro and
- refinanced the debt due in 2023, as well as
- established a 2.5-billion-euro liquidity margin which allows to cover maturities due by the first quarter of 2024.

The liquidity so generated allowed to advance in October 2022 the refund of the 553-million-euro bond originally due in January 2023.

The amount was refunded on October 25, 2022, on a par, therefore with no financial penalty for our Group.

The cost of debt is 3.51%, or 113 basis points more than in December 2022, mainly due to the interest rate dynamics and hedge management of the exposure to financial risks of both Brazil and Russia.

Finally, as for next year, we have already set 50% of our Euro-denominated debt at a fixed rate to cope with the current interest rate increases.

Thank you for the attention, I now give the floor to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you, Mr. Bocchio.

Let us now discuss the 2022 outlook.

Based on the trends in these first nine months, we have updated our expectations in the Car market for this year.

We are now forecasting a slightly declining demand (-0.4% vs flat previous outlook)

- Due to a more cautious view on Replacement, both in Europe, following a late start of the winter season, and in China, due to several lockdowns.
- On the contrary, the recovery in our OE segment continues and it is now also led by the Standard Tyre segment.

Resilience in terms of High Value demand is confirmed, with a 6% growth in the Car ≥18'' segment with a clearcut overperformance compared to the Car ≤17'' segment which is expected to decline by 2%.

More specifically, on Car ≥18'' segment, we expect:

- a 10% growth in OE, in line with the previous estimates, and mainly driven by China, due to subsidies and aids by the Government;
- a 4% growth in Replacement (previous indication was +5%) due to the dynamics mentioned before.

Our solid performance led us to upgrade our 2022 FY targets.

- Revenues are now expected to be of approximately 6.5 billion euro, almost 250 million euro more than the previous targets, with a 22% YoY growth.
- Volumes are expected to be flat, with High Value growing approximately +5%. The reduction of the exposure to the Standard segment continues with volumes at a -6%. The lower growth of total volumes compared to the previous guidance reflects the slowdown of demand in the Replacement channel.
- Price/Mix ≥+17%, over 3 percentage points more than our August target, due to price increases, as well as a better trend in terms of product mix.
- Exchange rates increasing by 5%, with a cautious forecast of the devaluation of the Argentinian Pesos in the last quarter of the year and, more generally, a higher volatility of the currencies in the emerging countries.
- The Profitability target (adj Ebit margin) is confirmed at approximately 15%, yet with an absolute value increase due to the growing contribution of the Price/Mix which more than offsets:
    - a stronger headwind of both raw materials and inflation
    - and a lower volume contribution
- CapEx confirmed at approximately 390 million euro, or approximately 6% of revenues.
- Net Cash Generation before Dividends now expected to be ~480 million euro, due to an improved operating performance and an efficient management of the Working Capital.

- Expected Net Financial Position at ~-2.6 billion euro, with an improved leverage which is now expected to be approximately 1.9 times the Adjusted Ebitda compared to 2.4 times at the end of 2021.

This ends our presentation. We may open the Q&A session.

Questions & Answers

Monica Bosio – Intesa San Paolo Analyst

Good evening, everyone. Thanks for taking my question. The first question was on the replacement market and the market scenario ahead. I was wondering if you're seeing any sign of trading down and if yes, if you can elaborate a little bit more. Is it possible to have a rough idea of the current dealers' inventories level?

The second question is on the market share gains in replacement which were quite significant and impressive. Do you expect a similar trend also in 2023, and if yes, could you elaborate more on this and on the price/mix associated to a potential further market share gain?

And the very final question is on the Standard segment. If I remember well, the Group was expecting to approach a double-digit margin. So, is this target still valid on the back of inflation and of the trend in the Standard segment? Thank you.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. Mr. Casaluci, please.

Andrea Casaluci – General Manager Operations

Good evening and thank you for the questions. There is a trade-down in periods of crisis, as far as we see concentrated on the Standard segment where the weight of the Tier 1 is decreasing. While in the High Value segment, where we focus on ≥18'' and mainly Specialties, the weight of the Tier 1 brands is stable, so we don't see a major risk in our focus market.

Stock in the trade is back to normal level in United States, so it has normalized. Also in Europe is what we consider in healthy position and in Russia as well, as far as the Standard is considered.

While, if we look at the winter, due to the weather conditions, the stock today is quite high. So, we all wait to have a clear and better understanding of the sell-out performance based on the weather conditions of the coming months. For the time being, after a good and successful selling season, we have delay in the sell-out, thus stock is quite high.

China stock level is below the average because of the lockdown and the restriction on mobility which are affecting sales. As a consequence, we are working on the stocking of our partners in distribution in order to protect our business together.

Market share on the High Value of course is our main focus and we target to continue our growth in the Replacement channel in all the High Value markets, with a clear focus on North America where we still have a lot of opportunities of growth, because we are growing in the local Original Equipment, and we are enlarging our product portfolio in the Replacement channel with new offers.

We are going to be a bit more selective in the market share of the Original Equipment mainly in Europe, where we focus more and more on the EV, Specialties, and most profitable businesses. So, the market share in the OE could be more or less stable with a declining share in Europe and the growing share in Asia-Pacific and North America.

For Profitability of Standard of course we do confirm our target of double-digit.

We have a small delay in 2022 because of the Russian crisis and thus the reduction of production and factory saturation over there, but we are very close to the double-digit and we plan to reach this target in 2023 with, I would say, six months delay.

Nevertheless, the target is remaining at double-digit as we presented in our plan. Thank you.

Martino De Ambroggi – Equita SIM Analyst

Thank you, good evening everybody, two questions on price mix.

The first is on the main reason for the revision from the previous quarter and the drop through for the full year to be expected.

And the second, always on price mix is: I clearly understand it's too early to think about next year, but are you confident to be able to offset raw materials, probably lower, and inflation next year with further price mix improvement? And is 15% adjusted return on sales achievable in the current environment based on the current visibility?

And very last one on Russia. Could you just give us some figures about the Q3 performance? And in the last call you mentioned EUR25 million - EUR30 million is the negative effect at operating level; just to check if it is confirmed.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you for the questions. On Russia is confirmed what we have said. We were able to offset the negative impact thanks to the performance we had in price mix in general. So, this negative impact obviously was there because we had to cut the production and to increase production of some Standard in Turkey and Romania, but all in all it is included in our numbers.

The second question was about the 2023. We continue to see growth in the Premium and Prestige segment even in an environment that is today very uncertain. Considering the inflation, we have already embedded in our prices a positive impact on replacement in 2023 and also in the Original Equipment there is some positive impact on prices, because of the cost matrix.

So, what we see today, and it's obviously too early to say, is that at least half of the inflation that we can foresee today is already protected by what we have in our portfolio. Then as you correctly mentioned, there is the obvious continuity in our business model and embedded in our business model on the mix. So, we are building for 2023 with the uncertainties that everybody knows, but with some protection embedded in the business model. For the first question I leave the floor to Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Thank you. I will compare the price mix performance of full year with the price mix performance expected for the last quarter to explain the difference between the two.

Price mix full year at 17.7% as a consequence the last quarter would be roughly 11% with the biggest difference related to price, because of the comparison year-over-year. So, in the last quarter of 2021, we already started to increase the price, and if we sum the price increase of the two years, we confirmed the performance of the first nine months of the year.

Having said that, the weight of the price performance on a full year basis is roughly 67% out of the 17.7%. While in the last quarter is 73% out of the 11%. As a consequence, the drop through of the full year is 86% and the drop through of the price mix over the last quarter is 90%.

Pierre-Yves Quéméner – Stifel Analyst

Good evening and thanks for taking my question. I guess the key concern for the tyre space into 2023 is the non-raw material cost inflation for both energy costs and labor costs. Could you roughly quantify the additional hurdle you will have in 2023 regarding energy after the rise to 3.7% of sales in 2022? And maybe same on the labor cost, as the claim from wage increases are close to double-digit in Italy, if I'm not mistaken, to try to gauge the additional hurdle you will face in 2023? Thank you very much.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. Part of the inflation that you rightly mentioned on raw material, on energy and on labor is protected by the prices we have already for our products globally. Also, part of it by the cost matrix on original equipment. So, in the full package of the expected growth in inflation and on cost, at least half of it is already protected.

We consider that energy cost, that will have a weight of 3.70% of our turnover, could have a growth in 2022-2023 of a couple of points, which means that could be something between 5% and 6% of revenues. In addition, we will have the impact from labor cost since we are going through renegotiation in in Europe, Latin America and Mexico. But considering even this impact and the impact of the cost of transportation, we start 2023 with half of these impacts already covered by the increase on prices we did in 2022.

Obviously, there will be other actions: there are efficiencies coming and there is the support that the new product lines are providing. They are protecting the mix that is structurally our profitability driver. Consider that in the mix we have, within the product portfolio, protection coming from Specialties. The growth of our market share this year in the high value was more than 70% coming from Specialties and we expect them to represent even in 2023 more or less 70% of the profitability of the 18’’ and above.

So, this model should protect from the obvious increase in inflation that we are going to face.

Pierre-Yves Quéméner – Stifel Analyst

Thanks very much. Just, just a quick follow-up on the pricing side. Would it be reasonable to model a mid-single digit price/mix increase in 2023 after what you have achieved already on a two-year stack in '21 and '22 or is it too optimistic? Thanks very much.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr. Casaluci.

Andrea Casaluci – General Manager Operations

No, it's not too optimistic but all will depend on the stability of the demand. We are quite confident that our business model would be more resilient than the average of the industry, because of the mix and because of the resilience on price of the segment where we play.

Today is a reasonable assumption, but it’s too early to have a clear understanding because a lot will depend on the development of the demand in the market of the coming months. Thank you.

Giulio Pescatore – BNP Exane Analyst

Well, thanks very much for taking my questions as well. The first one on efficiencies. The program has run out as we approach the end of 2022. Can you quantify how much more can you do on the efficiency side and where these efficiencies are coming from?

Then the second one on working capital. It's really impressive how you manage to limit the increase in working capital on the inventory side, especially compared to your peers. How did you manage to offset the price increases?

And then the last one on interest rates. There was a significant rise in the last quarter, what should we expect for 2023? Can you maybe help us with the modelling of interest rates?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. Mr. Bocchio for the working capital. Go ahead.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Thank you. I will take the question on the working capital. In 2022 what we are forecasting is a tight management of the working capital, with the decrease of the finished product of car stock compared to 2021, despite the increase in the sales volume improving thus the inventory efficiency and counterbalancing the increase in the unitary value, as a consequence of the high inflation recorded in 2022 on the raw materials.

What we see for sure, is an increase of the raw materials incidence on net sales, because the inflation, and increase even in raw material quantity to mitigate supply chain risk.

Based on the above, what we expect for the FY2022 inventory is to increase in absolute value, but remaining substantially stable year-on-year in terms of incidence on sales. Last year we ended the full year 2021 with an incidence of inventories on sales of 20.5%. What we expect at the end of 2022 is to remain at about 21% to 22%.

Our target is to keep the working capital under strict control, because obviously cash generation is target number one for us.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr. Bruno, on the interest rate.

Giorgio Luca Bruno – Deputy CEO

Related to the 2023 we are expecting a cost of debt at least between 3.5% and 4%, taking into account that we are achieving deleveraging as mentioned by Mr. Tronchetti. Our position in terms of fixed and floating is between 50% and 60%. Our expectation related to the debt maturities till 2024 is that we have already managed our maturity for 2022 and 2023. So, in our position we have €2.5 billion in terms of liquidity margin that can cover maturities till the first half of 2024.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr Casaluci on Efficiencies.

Andrea Casaluci – General Manager Operations

As far as efficiencies are concerned, we don't have the final number for 2023 because we are going to review our plans of efficiencies in order to be able to compensate the inflation with price mix as much as possible, since mainly labour and energy will affect Europe.

So, we are redesigning the plan of efficiencies, mainly focusing on Europe at 360 degrees and taking advantage of the acceleration of our digitalization program. We will be able to give you a clear number of the final efficiency plan with the 2023 target. Thank you.

Michael Jacks – Bank of America Analyst

Hi, good evening. Thanks for the presentation. If I can just go back to the question on working capital, there has been a net increase in absorption of around €900 million this year. Based on your free cash flow guidance, around €300 million of that could potentially come out in the fourth quarter, which still leaves around €600 million of debt absorption.

Given that raw material prices are coming down, which I would imagine at some point that could potentially drive some unwind in the inventory balance, and receivables also is up almost 2 times year-on-year, it strikes me that perhaps there is more in the receivables balance than just pricing.

So, how should we think about the magnitude and timing of the potential working capital unwind?

That's my first question, I'll ask the second one after that.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr Bocchio for the working capital.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes, you're right. If raw materials will reduce in value, there will be a positive impact on the value of the stock in 2023. But it is not really in our control.

What we can control for sure is the management of the internal KPIs in terms of number of pieces of finished products, where we have great visibility thanks to the link with our customers.

As we have had this year, we'll have the same strict management and then there will be possibly an upside on the raw material stock if the tensions between Russia-Ukraine and the logistic supply chain will ease a little in the second half of 2023.

There will be the possibility to manage in a more efficient way the raw material stock that we have in the nine months, and we already foresee a slight decrease for the full-year 2022.

Michael Jacks – Bank of America Analyst

Then if I can just go back to the comment on becoming more selective on tyres in OE channels, can you please elaborate a little bit more on the reasons for that? Is this because pricing pressure is growing in this segment? Is competition growing or are you more worried about using up capacity on lower margin sales?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr. Casaluci, please.

Andrea Casaluci – General Manager Operations

So, thank you for the very good question.

What is driving the choice of the Original Equipment is basically profitability, but not the profitability of the Original Equipment itself, rather the profitability of the integrated business: Original Equipment plus Replacement.

So, based on the past year's figures, we have a quite clear understanding of our pull-through rate, meaning the capability to maximize the after sales in the Replacement; so, we are able to be more selective today. For example, an internal combustion engine car that will start production in 3 years and today is the time to choose the Original Equipment project, in 5 years from now, if it will replace tyres, the residual value of the car will be much lower that what is expected today.

Another reason is that new customers are coming in the arena of the car industry, Premium as well as Prestige, and so we target to enlarge our customer base and to catch opportunity in the new premium segment that is coming.

Today we have in our customer portfolio newcomers like the one that we mentioned before (Tesla, Rivian, Nio etc.). So, newcomers all playing in the premium and prestige segment targeting EV.

That's the reason why we decided to be more selective mainly in Europe and enlarge our customer base in the US and Asia Pacific always targeting Specialties, EV, where there is a value, with the expectation of the pull-through that is as high as possible.

Michael Jacks – Bank of America Analyst

All right. Understood. I just have one more question if I may. I know this is less of a concern for Pirelli relative to some of your peers, but can you please comment on the impact of Asian tyre imports or the strong increase that we've seen in Asian tyre imports on the standard tyre channel inventories? Are you seeing any impact on pricing power in the standard tyre segment? Thank you.

Andrea Casaluci – General Manager Operations

Well, yes, there is an impact, it's mainly in Europe for the car industry. But, as it was for the trade down, it is mainly focused on the Standard segment where the Chinese and Asian brands are importing in the last month, more than what happened in the first half of the year, because of less logistic cost and better availability.

So you are right, but it is not affecting our segment. Thank you.

Sanjay Bhagwani - Citigroup Analyst

Thank you. So, my first question is: can you please provide a bigger picture on how the business mix and competitive position of Pirelli has changed compared to the prior prices?

More on the top-line and the mix side, but also on the operational resilience side, what could be the volume drop through in a declining replacement tyre market?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

The price/mix drop through, as Mr. Casaluci was mentioning, in the last quarter is going to be close to 90% and so this is the effect of prices, as you know go down straight to the bottom line, and of the mix.

Then there is part of the exchange rate that is obviously also affecting. What we see is that the business model is focused on the high value, where the profitability is obviously higher and the pull through effect is evidently supporting our business. We expect that, thanks to the market share we are getting in the high-end electric vehicles, it will be in the future even more profitable because there is a price premium on tires on electric vehicles, because of the technology embedded in our products.

Sanjay Bhagwani - Citigroup Analyst

Thank you. That is very helpful. And my second question is: could you please provide some color on how big the freight and logistics costs are? And are you seeing any signs of these becoming a tailwind next year? I mean, the spot rates in the US specifically have been coming down this quarter. So, do you expect this to be probably a tailwind for next year?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

On logistic cost, it's easy in our business model to transfer them to the trade and to the end users. So, we did it during the 2022, when for some months was very, very high level.

We expect a growth also in in 2023, but our business model is protecting us because we have 80% of our sales that are local-for-local, so we produce where we sell the product. We have less exposure than our competitors to the Maritime costs and this is something that will continue to be the protection of our business model and we expect for next year that also if there will be some increases, we will be able to protect the profitability.

Thank you, ladies and gentlemen, this will conclude today's program. Thank you for your attendance and I wish to all of you a very good evening.

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