

# Pirelli & C. S.p.A. FY 2022 Preliminary Results conference call transcript

*February 22<sup>nd</sup>, 2023*

## Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening, Ladies and Gentlemen.

2022 was characterized by a high volatility in the macroeconomic scenario, further stressed by geopolitical tensions and Covid in China.

Despite these headwinds, Pirelli closed the year with results exceeding November targets and among the best in the industry, thanks to the resilience of our business model.

2023 scenario is still uncertain and even more volatile, where the main concerns are consumption trend and inflation of input costs, like energy, labor cost, and raw materials.

Pirelli is navigating this scenario by relying upon its assets:

- seizing market opportunities in the segments offering the highest value and growth (19 inches and above and Electric), and, at the same time,
- taking all the actions to deal with the volatility of the external context.

In 2023, we are progressing in our de-leverage path, through a solid cash generation.

Before commenting 2022 results and 2023 outlook and targets, I believe I should inform you that the shareholder CNRC Sinochem has indicated that it will submit the notification pursuant to DL 21/2012 (Golden Power Regulation) in relation to the renewal of the shareholders' agreement entered into on 16 May 2022 by and between, among the others, CNRC, Marco Polo International Italy S.r.l., Camfin S.p.A. and Marco Tronchetti Provera & C. S.p.A., which will come into force with the convening of the shareholders' meeting for the approval of the financial statement at 31 December 2022".

2022 results are confirmed to be among the best in the industry.

- Top Line growth (+24%) supported by a strong improvement of the price/mix (+19.7%), better than the average of our peers.
- Profitability at 14.8%, the highest in the Tier 1 panel and the most resilient in a context of high inflation, thanks to the effectiveness of internal levers.
- Sound cash generation before dividends, above our targets and higher than our peers, as a result of an efficient working capital management.

2022 marked the end of the first phase of the Industrial Plan, with a strong outperformance both against the Industrial Plan targets presented in March 2021 and against our peers.

Over the last two years, we recorded an average annual revenue growth of +24% (+14 percentage points vs. the Plan and +4 percentage points vs. our peers):

- supported by a strengthening in High Value, where, in line with the Plan, we increased our global market share by 1 percentage point, fully seizing the strong demand recovery over the last two years;
- Our price mix was above the Plan expectations and our peers through price increases and continuous mix improvement.

Furthermore, we achieved also a better-than-peers profitability trend over the two-year period, with

- Strong margin recovery in 2021, where we fully seized the post-Covid market rebound,
- Resilient Ebit Margin in 2022, in a context of high volatility and inflation, thanks to our business model

It should be noted that the lower profitability in 2022 versus our industrial plan is affected by different macroeconomic and market scenarios, namely:

- demand slowdown, more specifically in the Standard segment within a high-inflation environment;
- the diluting impact of exchange rates and
- the high raw material and inflation impact, 8 times higher than in our Industrial Plan assumption, more than offset by the strong price/mix improvement.

Finally, Cash Generation, approximately €950 million in the two years, €190 million higher than in our Industrial Plan, thanks to our better operating performance and the efficient working capital management.

Hence, we accelerated our deleveraging process ending 2022 with a lever of 1.8x the Adjusted Ebitda, better than our Industrial Plan target of 2x.

We remind you that the updated Plan up to 2025 will be presented in the second quarter of 2023.

Moving to Sustainability achievements, we are progressing on 2025 Targets.

In line with our “Towards zero accident at work” vision, we further decreased our Accident Frequency Index through prevention and training.

We also achieved considerable results in our Eco & Safety product roadmap, which aims at significantly cutting the environmental impact of our products, without compromising on safety. Mr. Casaluci is going to update you with more details.

2022 was another year of strong progress in decarbonization: as much as 74% of the electricity purchased around the world by Pirelli comes from renewable sources, with North America and Europe at 100%.

Absolute CO<sub>2</sub> emissions from our plants went down 41% compared with 2015, and the emissions from the supply chain decreased by 8.9% compared with the base year, 2018.

We are therefore working already at new Science Based Targets, always in line with the 1.5 Celsius degrees scenario, and with our commitment to Net Zero.

As for sustainable finance, in 2022, Pirelli positioned itself as global Leader in relevant ESG Indices, like the Global Sector Top score in S&P Dow Jones Indices, and was included in CDP Climate “A” list. Pirelli also obtained the top rating in the sector in the FTSE4Good, Ecovadis platinum indices, etc.

I now leave the floor to Mr. Casaluci.

## Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti, and good evening.

Now, let's analyze both the market dynamics and Pirelli's performance.

In 2022, the Global Car tyre demand declined by 1.7% year-on-year.

Car  $\geq 18''$  confirmed its resilience with a demand growth of +5.4%, compared with -3.4% for  $\leq 17''$ .

Pirelli outpaced the market thanks to the strong performance on  $\geq 18''$  segment.

More specifically, on

- the Original Equipment we seized the market rebound due to easing supply chain tensions, keeping a more selective strategy, with a focus on  $\geq 19''$  and Electric
- On Replacement we gained market share particularly in North America and APAC.

The reduction of the exposure to Standard continued, because of better focus on product/mix and a greater selectivity in the Original Equipment. In this channel we were also impacted by the halting of car production in Russia.

In the fourth quarter, the negative car market trend (-7.1% market YoY) was mainly related to weak replacement demand (-9.9% market), which was heavily impacted by the lockdown in China and the late start of winter campaigns in Europe due to mild weather. Positive OE momentum also slowed down to +0.8%.

Pirelli's performance was broadly in line with the market in total car tyre, with better performance on  $\geq 18''$ .

Now, Let's turn to the results achieved in 2022 on the 'Key Programmes' of our industrial Plan

On the Commercial Program:

We have enhanced our positioning on the High Value.

On the Innovation Program:

- Over 300 technical homologations were achieved, focused on the  $\geq 19''$  segment, Specialties and EV;
- 9 new Car products were introduced of which 4 for the SUV segment, with a specific focus on EVs and Hybrids. We have also expanded our offerings on the two wheels business with 3 new Moto and 10 Cycling products;

On the Competitiveness Program: the second phase of the programme was concluded, recording gross efficiencies of €136 million, in line with our Target.

On the Operations Program: The saturation level of our High Value plants stood at approximately 90% and the external headwind mitigation programme was also implemented to guarantee business continuity in a volatile external scenario.

Our commercial strategy let us seize the growth opportunities in the High Value segment while in Standard segment, we continued our strategy of reducing exposure to lower profitability product segments.

In the Car  $\geq 18$ " segment, the +7.6% growth was driven by high-tech and high-end products, more specifically:

- $\geq 19$ " rim sizes accounted for 70% of the total  $\geq 18$ " (+4 pp year-on-year),
- Specialties increased by 10% yoy, mainly driven by EV

The  $\geq 18$ " Replacement channel was supported by:

- «Pull» volumes, particularly in North America, Europe and EV products
- «Push» volumes, where new lines for this Channel show a 15% growth

On Original Equipment, the growth was also driven by EV, whose weight reached 17% of the  $\geq 18$ " OE volumes (+10 pp yoy).

In 2022, Pirelli's Innovation Program continued to feature offerings with a greater focus on consumers' needs and regional differentiation.

Out of the 9 products launched in 2022 (6 in 2021), 3 are part of the All Season, 2 Winter and 4 Summer segments.

In North America, Pirelli entered the All Season Snowflake segment, with high-grip products on snow and wet surfaces.

In Europe, the renewal of the SUV Scorpion line has been achieved, with the launch of :

- the new Pirelli Scorpion, featuring an asymmetrical tread pattern for better braking on both dry and wet surfaces;
- Scorpion All Season SF2, guaranteeing top performance also in winter; and
- Scorpion Winter 2, with tread sipes changing shape based on the degree of wear and tear of the tread and which help tyres last longer.

Our Innovation program places sustainability at the core of our strategy with the goal of achieving high braking performance in dry and wet conditions while improving environmental performance.

50% of our new products are in line with the top classes (A or B) of Rolling Resistance according to the parameters of the European labelling regulations. Furthermore, the average Rolling Resistance of Pirelli Tyres decreased by 3 percentage points versus 2021 and by 13.6% versus 2015.

93% of our new products are in line with the top European Labelling Classes (A or B) in terms of wet grip.

These results were reflected on sales which we are monitoring as «Eco and Safety Performance Revenues», which grew by 4 percentage points to 67% of total car tyre sales.

Innovation in materials is the key of all. The weight of innovative materials such as bio-based and circular materials, reached 38% in some products, up 5pp versus 2021, and this weight is expected to increase to 48% by 2025.

Research on materials, virtualization and tests under real driving conditions allowed us to make important steps also on the wear rate of our tyres. The new product lines launched in 2021-22 (Cinturato and Scorpion) show an improvement up to 30% versus the previous generation.

In the two-wheels business (moto e cycling), we keep on working on product innovation to confirm our High Value positioning.

On Moto, Pirelli is the leader on Top Range with its two brands Pirelli and Metzler. We are sole supplier of World Superbike.

In 2022, we expanded our product range with 3 new products:

- Diablo Rosso IV corsa dedicated to the supersport segment;
- Metzler Tourance Next 2 a special performing product on wet surfaces; and
- Metzler Karoo 4 for the off-road segment.

In our Cycling business, we continue to grow. We have started production in our Bollate plant in Italy, and the launch of 10 new products in different segments with a target of over 30 products in 3 years.

In 2022, we established partnership with Team Trek-Segafredo to enhance our brand impact on young people and cycling amateurs. Further collaborations with key partners in the High Value segment are now in place with Pinarello, Colnago and Stromer.

In 2022, through our Competitiveness Program we achieved €136mln worth of efficiencies, in line with our target of approximately €140 million.

Taking a closer look to the performance of each Project:

- In the Product cost area, accounting to approximately 31% of the efficiencies, we continued to follow our modularity and design-to-cost approach;
- In the Manufacturing area (43% of efficiencies), we kept on optimizing our industrial footprint as well as the implementation of efficiencies programs;
- In the SG&A (13% of the efficiencies), we achieved efficiencies through actions on several levers, such as optimizing the logistic network and our warehouses, as well as negotiations on purchases; and finally,
- In the Organization area (13% of efficiencies), the digitization process and up-skilling programs continue.

Thank you, I now leave the floor to Mr. Bocchio

**Fabio Bocchio – Senior Vice President Strategic Planning & Controlling**

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

Let's now review the dynamics that had an impact on our 2022 results.

Pirelli closed the year with revenues growing by +24.1% compared with 2021.

- Volumes declined slightly (-1.0%) because of a weak demand in the last quarter of the year. On the other hand, High Value recorded a positive trend and grew in line with our targets (+4.7%) with a market share gain in Car $\geq$ 18” and a lower exposure to Standard.
- Price/Mix +19.7%, better than our peers (16% the average) underpinned by:
  - Price increases to compensate for the headwinds coming from the inflation in raw material and other input costs.
  - Improvement in the product mix due to an increasing demand for larger rim sizes, especially those equal or above 19 inches, and a greater technological content.
- Exchange rates had a positive impact (+287mln +5.4%) reflecting the strong appreciation of the major currencies against the Euro.

Pirelli closed 2022 with an adjusted EBIT of 978 million euro, with an increase of €162 mln compared with 2021, and a 14.8% margin thanks to the strong contribution of internal levers (price/mix and efficiencies) that more than offset a negative external scenario.

More in detail, the adjusted EBIT growth is the result of the price/mix (+€891 million) and efficiencies (+€136 million) that more than compensated for:

- The increase in the cost of raw materials (-492 million euro)
- The inflation of input costs (-327 million euro, increasing in 4Q),
- Volume decline (-22 million euro) due to a weak market demand in the fourth quarter
- The increase in amortizations (-30 million euro) and other costs (-25 million euro)

Forex had a positive effect amounting to 31 million euro, however with a dilutive impact on marginality. In the fourth quarter of 2022, Adjusted Ebit grew by 3.2% to 224.3 million euro.

Adjusted Ebit margin was 14.2% (16.0% in the fourth quarter of 2021). It reflected the mentioned demand decline and a greater impact of the inflation of input costs, mainly energy and transportation, compared with the previous quarters.

Let's move to Net Income dynamics.

Net Income strongly increased by +€114 million in 2022 versus 2021. The trend takes into account:

- the already mentioned improvement in operating performance lower restructuring and non-recurring costs, vs. 2021.

The result from equity holdings was +€6 million.

The Net Financial Charges increased by €57 million YoY,

- reflecting the rise of interest rates and currency hedging costs in Brazil and in Russia,
- partially counterbalanced by a reduction of the parent group's financial charges, thanks to an improvement of the economic conditions as contractually foreseen by the reduction of the financial lever.

The €45 million increase in tax charges was impacted by the higher operating results, as tax rate is stable at around 27%.



Adjusted Net Income, i.e. excluding all the one-offs and non-recurring items, is positive for €570 million in 2022.

Pirelli closed 2022 with a negative Net Financial Position amounting to €2.55 billion and a cash generation before dividends of €516 million.

The operating net cash flow improved by € 215mln compared with last year, to €1 billion, as a result of:

- Ebitda growth
- Greater investments, to increase High Value capacity and improve the mix
- Better management of the working capital through a careful management of finished product inventories and the raw material reduction in the fourth quarter. At the end of the year, overall stock reached an incidence on revenues of 22%, a reduction of 1 percentage point compared with September 30th 2022.
  - working capital was also affected by the increase in trade payables as a result of input costs inflation (down as a percentage of sales vs. PY, from 30.6% to 29.8%) and an improvement in trade receivables as a result of excellent collections from customers and lower sales growth in the fourth quarter (+17%) compared to the first nine months of the year (+26.5%), thus reducing the percentage of sales to 10% compared to 13% in the previous year

It should be noted that non-recurring and restructuring charges decreased significantly compared with 2021 when the figure included the costs relating to the transfer of Moto production in Brazil from the factory in Gravatai to the one in Campinas and costs linked to rationalization plans for the structures.

This reduction partially offset:

- the increase in financial charges (+€57 mln yoy to -€202 million in 2022] and higher taxes (+€80 mln yoy), and
- the dividends paid to minorities (€24.4 million), as well as the negative FX impact of -€4 million.

In the fourth quarter, the net cash flow before dividends was positive and amounted to €839 million, increasing by 30.8 million compared to 807.9 million in 2021, due to the trend of the operating net cash flow.

The Group's gross debt on December 31st 2022 amounted to approximately 4.5 billion euro. Taking the 2 billion euro of financial assets into account, the Net Financial Position is therefore 2.55 billion euro.

Despite market volatility, Pirelli maintained a solid liquidity margin throughout 2022 and, at the end of the year, was able to confirm that debt maturities are covered until the end of the first quarter of 2025.

The main debt maturing in 2023 was fully refinanced in the course of last year. Using its available cash, Pirelli repaid the 5-year Schuldschein tranche in advance, whose original maturity was in July 2023.

Pirelli has already started dealing with the refinancing of debts maturing in 2024 through the issue of a 600 million euro bond with ESG characteristics in January 2023, the first in the world of benchmark size in the Tyre sector. This bond – the first since Pirelli obtained a rating – was positively received by the market, with an oversubscription which exceeded the supply by 6 times. The Group has proved to be able to finance itself time after time at the best market conditions. In addition, this issue confirms once

more how central the sustainability strategy is for Pirelli. Already on December 31st 2022, approximately 50% of our gross debt consisted in financing with ESG characteristics.

The cost of debt is 4.04%, with an increase of 166 basis points compared with December 2021. Such increase reflects the rise in interest rates and costs, due to low liquidity in the financial markets, to cover risks especially in Brazil and Russia.

Thank you, 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 2023 Outlook within a reference framework which remains extremely volatile, also in consideration of the growing geo-political tensions.

The global GDP is expected to grow by 2%, slowing down versus the +3% in 2022, with:

- risks of recession in the US and Europe in the first part of the year, due to increased interest rates; while
- in China, the economy is expected to recover with a 5.2% GDP growth due to the lifting of the zero-Covid policy.

Inflation remains high, with a 5.3% increase in consumer prices globally, which is lower than +7.6% in 2022, due to the impact on the supply chain normalization process, the reduction of energy costs and a shrinking of consumers' demand.

A set of pressures remain on input costs, more specifically:

- High volatility is expected in oil prices, given the current geo-political tensions;
- The cost of energy in Europe, although lower than the peak reached in 2022, remains high with upside risks connected to the supply in the second semester of this year as well as a growing demand in Asia;
- Finally, the cost of labour discounts contract re-negotiations in the major countries.

Forecasts made on the overall Car Tyre segment indicate a substantially flat demand yoy.

Resilience in the High Value segment is confirmed, Car  $\geq 18''$  growing mid single-digit and Standard segment decreasing by 2%.

More specifically, on the Car  $\geq 18''$  segment, we expect:

- a high-single digit growth in the OE segment (+7%) supported by the backlog from European production<sup>1</sup> as well as gradual normalization of the supply chain;
- a Low-single digit growth, is expected for the Replacement (+3% yoy) channel, with a first Quarter substantially flat yoy that compares with demand which was particularly strong in the first three months of 2022 (+13.3% yoy) in Europe and in North America. Demand in the Replacement channel is expected to gradually recover starting from the second quarter of 2023 due to the recovery in China and on the major markets.

Given this scenario, Pirelli will count on the resilience of its business model:

- Thanks to its distinctive positioning in the High Value segment, increasingly focused on specialties,  $\geq 19''$  and EV, with the aim of overperforming the market in both Channels, through:
  - an increasingly richer homologation portfolio, with over 300 homologations of which approximately 60% on EVs (40% in 2022); and



- the renewal of our product range with the launch of 6 new lines for both Channels and a strong focus on sustainability.
- The recent increases in prices announced in Europe in December and North America in January confirm our solid price discipline.
- We are deploying the third phase of our Efficiencies Plan (Wave 3) in line with our forecasts in the 2021-25 Industrial Plan, with benefits worth approximately 100 million Euro, also from the digitization of all our corporate processes as well as an high level of saturation of our capacity in spite of the reduced level of production in Russia.
- Price/mix and efficiencies will allow to offset the impact from the increase in raw materials, inflation and Forex.
- On cash generation we will continue to leverage on a careful management of the working capital, specifically on stock management, whose weight on revenues is expected to go back to the levels in 2021 (21%), mainly due to a reduction of raw material stocks.

Based on the 2022 results as well as the scenario previously discussed, expectations for 2023 are:

Revenues between 6.6 and 6.8 billion Euro;

Volumes between flat and +1% yoy with a mid-single digit growth in the High Value segment while exposure on the Standard segment keeps on being reduced.

Price/Mix improvement between approximately ~+4.5% and +5.5% due to price increases in 2022 and those announced earlier on this year, as well as a continuous product-mix improvement.

Exchange rates between -4.5% and -3.5%, prudentially assuming a greater Euro-to-Dollar volatility as well as for the currencies in the emerging countries.

Profitability (adj Ebit margin) between >14% and approximately 14.5% with a mid-range Adjusted Ebit substantially flat yoy and where the price/mix and efficiencies will offset the growing impact of the raw materials, inflation and exchange rates.

Investments of approximately 400 million euro (~6% of revenues), for technology upgrade at the factories, improving the mix and increasing High Value capacity in Romania and North America, where the expansion will be completed by 2025.

Expected Net Cash Flow before Dividends between ~440 and ~470 million euro, due to operational performance and efficient working capital management. This target includes the payment of management's long-term incentives, relating to the three-year period 2020-2022 and based on shareholder return, cash and sustainability targets, the last two calculated at the maximums. Please note that from 2024, following the transition to the "rolling" system, incentive payments will be on an annual basis with a substantial alignment expected between impact on the income statement and cash outflow.

Net financial position of ~€2.35 billion with leverage between ~1.65 and 1.7 times Adjusted Ebitda, in line with the deleverage process outlined in the 2021-2025 Industrial Plan.

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

## Questions & Answers

### Giulio Pescatore – BNP Exane Analyst

Hi. Thanks for taking my question. Being the first one, I guess, I have to address the elephant in the room. We saw headlines in the last couple of weeks saying that Chinese shareholders are looking for an exit. Can we just please have a comment from your hand on this? I know that the shareholders in question have denied. But what is in your mind the long-term game for these shareholders? And is there any truth to those headlines? I'll follow up with my other questions later. Thanks.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you for the question. The shareholder made a clear statement so nothing changes. And so we have nothing to comment because all comments have been made by the shareholder. Thank you.

### Monica Bosio – Intesa San Paolo Analyst

Yes, good evening, and thanks for taking my questions. The first one is on the competitive environment in Replacement segment. Are you seeing some trading down in your core business? I know that there is some trading down between Tier 2 and Tier 3. I'm just wondering if you're seeing some trading down also in 18-inches and above?

And the second question is on the guidance, on the price/mix, which looks to me quite robust plus 4.5%, plus 5.5%. I was wondering if you can tell us how much is the price and how much is mix?

And the very last question is on the guidance. What is your level of confidence in meeting the top end of the guidance? And what are the assumptions behind potential achievement of the top end of the guidance? Thank you very much.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. I give the floor to Mr. Casaluci for the answer.

### Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti. Yes, starting from the trade down: there is a trade down effect in the market but is related to the Standard segment. So, if we focus on our addressable market, which is the 18-inches and above, and the high value itself, the impact of the trade down is very, very limited. If we stay for a while on the marked tires, where there is a high content of technology, today, more than 95% of the European market is Tier 1. And we don't see any kind of trade down in this segment, not at all.

Moving to the price/mix, let me say if we consider the average point of 5% of growth in the price/mix expected for 2023, around 60% is expected to be price coming from the rollover of the price increase already announced during 2022, plus the one announced in Europe in December and the one announced in January in the United States. And 40% is expected to be mix, with the usual good performance on the pure product mix of 3% to 3.5% and the negative impact on the channel mix. Because the expectation is to have an original equipment market and demand growing more than the replacement channel because of the rebound of the shortage in the supply chain.

So, all in all, today, we will try to do our best and to match the high part of the guidance, but there is still a high level of volatility in the market because of different elements in the input cost, inflation, demand and so on. So, we maintain our guidance, of course, targeting to do as much as we can. Thank you.

### Monica Bosio – Intesa San Paolo Analyst

Thank you. Sorry, if I insist, but which is the main issue that could prevent the achievement of the top end of the guidance, inflation, and cost energy, or the renegotiation on the labor cost side? Sorry, if I insist.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We think that it's linked really to the macroeconomic scenario. If Europe and U.S., are able to serve on the inflation and on the recession in a way that lately has been forecasted, we feel comfortable with the numbers. Obviously, if something unexpected happens, the scenario changes and the profitability can be affected. But in an average scenario, we see today, we are confident we can achieve these targets.

### Philipp Koenig – Goldman Sachs Analyst

Good evening, and thank you so much for taking my questions. My first question is just on the costs. Can you maybe provide a bit more of a detailed breakdown sort of what you're expecting between raw materials and inflation? And maybe sort of the total headwind that you're currently seeing for this year?

And then my second question is on the price/mix. Does the 4.5% to 5.5% that you're forecasting, does it imply any further price increases this year? Or does that basically imply that prices stay where they are from this point onward?

And then my last question is just on the volumes again. Can you maybe just comment on Europe, in particular, where your inventories are sitting? Thank you so much.

### Andrea Casaluci – General Manager Operations

Yes. Thank you. As Mr. Bocchio presented, we do expect a headwind in terms of inflation of around EUR350 million, all in all. The building blocks of this inflation are mainly inflation of raw materials. Just to give you a rough number, raw mat will account 37% of our sales in 2023 with an adj Ebit impact of around EUR70 million and EUR80 million

Logistics inflation impact is around EUR40million, mainly land transport in Europe and United States where we still see some negative impact coming from the shortage of drivers and trucks. Some positive signals are coming from the international freights and sea freights.

Energy cost inflation is expected for around EUR100 million; we have already hedged around 75% of the total 2023 energy cost, which is a way to protect ourselves from further volatility on this market that is not expected to be stabilized yet.

And between EUR90 million and EUR100 million of negative impact coming from labor cost, where we are renegotiating the labor contracts in the majority of the countries where we are present. These are the headwinds. As we said before, more than compensated by the sum of efficiency plans and price/mix.

Then I move to the second question, price/mix. 5% is including already the announced price increase of Europe in December up to 3% and United States in January up to 10%. No further price increases are included in our numbers. So only the rollover effect of the announced price increase. Eventually, further price increases will depend on the trend of the demand and the global inflation. So far, we don't see major changes in the price scenario.

Last point, related to volumes. Well, the start of the year in Europe has not been very positive, generally recorded in double-digit negative market around 10%. But there are good reasons that filled our confidence that the recovery of the market will come from the second quarter. The main reasons of the slowdown of the demand in Europe are related to a not favorable comparison versus last year because at the end of 2021 and beginning of 2022 there was a stronger rush to pre-buying and pre-booking because on expectations of price increases. Today it's more stabilized. Then there is the winter season that is not performing as expected, generally speaking, in the market because of the weather conditions that is leading to a high level of stock in the trade.

So all in all, Pirelli is gaining market share. Despite the tough environment, we are overperforming the market, and we expect from the second quarter an improvement of the external scenario. Thank you.

### Giulio Pescatore – BNP Exane Analyst

So, I had a second question and a third one as well. So, the second question on volumes. Based on the market assumptions you're making, I'm just struggling to reconcile your guidance for flat to plus 1%, when you see the high value market actually growing 4%. Are you expecting -- are you being conservative? Are you expecting potential market share losses as you focus on the higher end of high value if that makes sense, or in 19-inches and above?

Then the second one is a bit more long term, it's on regulation. So unlike for car makers, the regulator has so far chosen at last, tire makers set their own standards in terms of emission. And I really appreciated all the colours you decided to share today in terms of recycled materials and all the rest. Do you see these changing in terms of regulation? Do you expect the regulator to become more kind of prescriptive in terms of what tiremakers can produce and sell? And do you think this is a potential opportunity for Pirelli, given how well you do in this level? Thank you.

### Andrea Casaluci – General Manager Operations

Well, the market for 2023, yes, we do confirm the expectation is for the flat market. But it's important to remind that in this market, the High Value is expected to be more resilient. Despite the flat market, the High Value replacement is expected to be in between +3% and +4%, and the High Value original equipment is expected to be at +7%. So, all in all, we are confident that this market is reflecting the slowdown of the demand all in all, but mainly concentrated in Standard. So we feel confident that this market is the best estimation we can do for the foreseeable future.

On the second point. We see opportunity for Pirelli due to the acceleration of the EV car registration. Also, we can see the acceleration on the regulation in Europe that targeted within 2035 the disappearance of internal combustion engines and that is supporting the acceleration of the EV penetration starting from the Premium and Prestige segment. And high-value EV represents for a premium tiremaker like Pirelli an enormous opportunity, because it means tires with higher level of content of technology because of rolling resistance, because of load index, because of noise control, because of grip. And, as a consequence, we see it as opportunity. And we see the pace of growth or the EV Tyres is higher than expected. Thank you.

## Christoph Laskawi – Deutsche Bank

Good evening. Thank you for taking my questions as well. The first one would be on the energy cost. And you've shown in the presentation that you expect the cost relative to sales to move up by 100 bps. You also said that 75% of those is hedged. Is that expectation of 100 bps higher based on the current spot? Or on other prices potentially been higher in case the prices move up again?

And then on the volume trends in the regions and your Q4 performance. That was slightly weaker than I thought. Is there anything that is spilling over outside of the general market into Q1? And did you have to adjust your production run rate as a reaction to the volume that you saw in Q4? Or for example, also logistical issues on the road freight in Europe and the U.S. impact your production footprint?

And then, just lastly, on the phasing of the year, could you give us a rough sketch of how the margin will be phasing throughout '23? Thank you.

## Andrea Casaluci – General Manager Operations

Thank you for the question. Talking about energy cost, you are right. As we said, we had hedged roughly 75% of the total energy cost for 2023. We do consider that this is the right level to enter into this year. Hedging at this level, we paid more than the spot price of today, that's right, but we assured the stability of the cost for the entire year. And so we stay at this level and we will monitor the volatility of the market. But we are protected because with 75% of hedging already including the number we presented, we are protected from the volatility.

What we can do more and more is to accelerate the reduction of energy consumption. And there is a set of projects that we have in place, mainly in Europe, curing machines, lighting, all we can do to reduce the gigajoule per ton that we consume in our factories. And we will never stop because this is also consistent with our roadmap of carbon neutrality.

And market-wise, the trend of the first months of 2023 are expected in line with the last quarter of 2022 in terms of market speed, with the slowdown of the replacement mainly in Europe because of the reasons I mentioned before, a tough comparison versus last year and a weak winter season. And also in North America because of the tough comparison versus last year. While we do expect a recovery in China after the Chinese New Year, where we see first the positive signals coming from the demand of China.

Pirelli performed in line with the market in the last quarter, because we decided not to accept any compromise in the price performance and not following wholesalers that were looking for pre-buying based on our already announced price increase in January and December. And we expect and we target to overperform the market for the entire 2023 as we did in the last three quarters of 2022. And I have to say that, generally, already started with the right speed.

## Christoph Laskawi – Deutsche Bank

Thank you. A quick follow-up, if I may, just on the energy cost. Because I have been after the 25% that you didn't hedge. Is the expectation that you gave in the presentation for the 100-bps uptick factoring a certain assumption for the unhedged part already? Or is it basically at current spot? Thank you.

## Andrea Casaluci – General Manager Operations

No. It's already included, of course. Well, our estimations include the hedging we did at the price we know because it's already fixed in our numbers, and the expectation for the 25% not covered already. To be honest, a bit higher than what is the spot price today. But the spot price today is around EUR50 per megawatt. So is the lowest of the last 2.5 years. So we do prefer to be a more conservative on these forecasts.

## Michael Jacks – Bank of America

Hi. Good evening. Thanks for taking my questions, I have two. Perhaps, just going back on your cost assumptions for 2023. Firstly, are there any materials that you would point to specifically that are materially higher year-on-year? And just sort of looking at spot prices for materials such as natural rubber, butadiene, and oil. It seems as if they're actually tracking lower versus the 2022 level. And then secondly, could you just, please, comment on the magnitude of the sea freight-related headwinds that you incurred in 2022? I would have imagined as a cost item that this component would be larger than road transport. Thank you.

## Andrea Casaluci – General Manager Operations

Well, on the cost side, our expectation on labor cost, energy cost, and logistics cost we are confident that we are on the safe side. So we don't expect measured changes because of what I said before, we already hedged 75% of energy. Half of the labor contracts we have to negotiate in 2023 are already closed or close to be finalized in the coming weeks.

Logistics is going in the right direction. So, we see a positive signal on the logistic cost, all in all, compared to our numbers. Where we can expect more volatility of the raw material, but every time that there is a significant movement in the raw material cost then we can in our segment to the high value and with the price discipline, whereby we can always pass through the increase, of course, into the selling price.

## Michael Jacks – Bank of America

Sorry, if I could maybe just follow upon the raw materials. I mean, just in terms of your planning assumption, are you using estimates for natural rubber and butadiene and some of the other inputs that are higher than the current spot prices?

## Andrea Casaluci – General Manager Operations

We look at the future. We've expectations of the futures in the market and we consider the best estimation coming from our internal analysis, banks, analysts and we take the best estimation for the next month. We have covered on our COGS, the coming three months. So we can assume that the cost of the natural rubber till April are already fixed in our numbers, and the best estimation we can do for the following months.

But again, the cost increase on raw material in our segment, the high value is easily to be transferred to the selling price, as we did in the last years.



## Martino de Ambroggi – Equita Analyst

Thank you. Good evening, everybody. The first one is very quick, on price/mix. You didn't mention the drop-through, or I missed it, I don't know.

The second is on Russia. Just to understand, what was the contribution in 2022? Because you mentioned 4% of sales. Just to understand, if it was still profitable in terms of EBIT and what is the net financial position, and what you have embedded in your 2023 guidance from Russia?

And still on Russia, I'm a little bit surprised hearing you do not mention any negative effect due to the need to transfer part of your capacity from Russia to other countries. So should we consider it a minor cost? Or could it have weighed quite a lot on '22 results? And how is progressing the transfer of capacity?

## Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Before leaving the floor to Mr. Casaluci, there is an impact that is in the numbers of 2023 of the reduction of the results coming from Russia in the second part of the year. Because the first part, we have the export coming to Europe, convenient and profitable. In the second part there wasn't obviously. And so this year, there will be the full year impact of the Russian situation. But now, I leave the floor to Mr. Casaluci.

## Andrea Casaluci – General Manager Operations

Yes. Staying for a while to the Russia and then moving to the price/mix question. Yes, as Mr. Tronchetti said, we are discounting in our numbers the not-full saturation of our operations in Russia. We target to have a saturation around 70%, 75% of our factories. It's difficult to have a clearer understanding, because the environment, as you can see, is not stabilized at all. But with the 70%, 75% of saturation, we have a negative impact on the efficiencies plan included in our numbers. It means that we target basically 100% of the production for the local market. A local market under strong pressure, because it's a shrinking market, it's a trade down market, but it's purely 90% standard market. So we stay there to keep the operation running, protecting our people and our asset and nothing more than that. And we already reduced the expectation of the result.

Moving to the price/mix. Drop-through is between 60% and 65% the mix and between 40% and 45% the volume. Thank you.

## Martino de Ambroggi – Equita

If I may on Russia. It was -- EBIT in '21 was a positive EUR29 million. So should we assume in your guidance it's basically zero in '23, or profitable, or maybe negative?

## Andrea Casaluci – General Manager Operations

It's in between 2% and 3% of our total EBIT result, so it's a positive, but very, very limited.

## Martino de Ambroggi – Equita

But in any case, positive. Okay. And the last question is on BEV. Because I remember, in your last call, you mentioned 14% of your original equipment sales for 18 inches and above was already equipped for BEV cars. What is your projection? What was in full year '22, and what's your projection for this

year? And when you believe the aftermarket will become visible in terms of contribution to sales and, obviously, margins?

And very last, if I may. Profitability for the standard products in '22?

### Andrea Casaluci – General Manager Operations

Well, the EV replacement will start to give positive contribution to the result in 2023. It will be limited. We do expect around the 700,000, 800,000 pieces sold in the replacement EV in 2023, while we plan to go around the 5 million in the original equipment. So it starts to be visible already this year.

Then from 2024 on, we will take the pull-through of the original equipment sold in '21 and '22. What is positive? We confirm the 15 percentage point of average selling price in the replacement higher compared to the internal combustion engine, which is the way we see the good opportunity coming from the EV.

We confirm our target to reach the double-digit Ebit margin on the standard. But as we said last time, we have a delay in this target because of the Russian effect, both because we run with not saturated plants that generate inefficiencies 100% linked to the Standard.

And secondly, because we lost the Russian source for the European sales. So we transferred the demand to Romania and Turkey, but today we discount a delay, high-single-digit for 2023.

### Sanjay Bhagwani – Citi analyst

Hi. Thank you very much for taking my question also. I have got three questions as well. My first one is on your free cash flow. And it is actually very impressive that you were able to meet your free cash flow target, where it's some of your peers actually missed their target. So just wanted to know, what do you think you did differently versus your peers? Were you more efficient on the ground in terms of like proactively getting the receivables? So any colour on that will be very helpful.

Then my second question is on price/mix. So, sorry, this is a bit more confirmation than a question. So if I understood it correctly, first of all, can you please remind me, what portion is coming from the price and what is from the mix? And if I understood this correctly, price is just based on the price increases you have already done. So no further price increase is required to meet this price/mix target, right? That is my second question.

And my final question is a bit more structural. I think you just mentioned that EV tires will be making somewhere around 15% higher on the average selling price. So my question is, like, how sustainable do you think this is be expected to remain for like next five to ten years? Or do you expect that this can eventually normalize? Thank you.

### Andrea Casaluci – General Manager Operations

So I will start from the last questions. EV is a new technology and so we are in a growing phase of the technology, both for the car makers and the tire makers. And so the premium price is recognized and is expected to be recognized for the coming years.

To be honest, I'm not able to say, if 10 years will remain the same price gap or not. What is sure, that in 10 years from now, the internal combustion engine and the electric vehicle will co-exist in the market,

more than 10 years, for a couple of decades at least. And these will create more complexity, more differentiation in the commercial offer, and as a consequence, more opportunity for us to leverage on these in terms of innovation, technology, and as a consequence in price point.

The price/mix, as I said before is 60% price, so around 3%, out of the 5%, and 40% mix. Of this 2% of mix, there is a 3 percentage point positive of product mix and roughly 1 percentage point negative of channel mix, because as you see the original equipment is growing, it is expected to grow to rebound in 2023 more than the replacement. And now leave to Mr. Tronchetti for the cash flow.

### Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Cash flow, we have to consider compared to our competitors that the EBITDA adjusted was higher and we are more efficient in handling the cash flow. We commented last time that we have more visibility on our dealership and so we have a better forecast on stocks, and so we can handle better the stocks. So that is why. Thank you.

### Edoardo Spina – HSBC Analyst

Good evening. Thank you very much for taking my questions. I have three. First on the midterm and 2025. I mean inflation was higher in forecast for the cost and revenue in the last two years. So, I wonder if you reviewed your internal plans for the near term and how you look at the 2025 targets, the consensus really that EBIT and net debt target are still achievable if I'm not wrong.

The second question is still on the midterm. What is your outlook for volume growth after 2023, for Pirelli? Do you still expect an acceleration toward mid-single-digit growth at some point? Or will this change for the moment?

And finally, on the cost of debt. What is the forecast for 2023? And for 2024 debt maturities, if you plan to refinance soon? Or you prefer to wait for lower interest rate later? Thank you.

### Andrea Casaluci – General Manager Operations

Related to the 2025. We will give to the market our updated plan in June. So, it's early to say. As far as inflation is concerned, we just can summarize what the best, let's say, analysis providing today that is decreasing inflation both in U.S. and Europe but it's really early to say. I leave the floor to Mr. Giorgio Bruno about cost of debt.

### Giorgio Luca Bruno – Deputy CEO

So, good evening. So related to the cost of debt, what we have in mind is, for 2023, we have already managed all the debt maturities. So, we are targeting cost of debt is at least 20% higher compared to 2022. For 2024, we are working now in order to manage the maturities related to 2024.

Because as you have seen lastly, we have launched an ESG bond. So, our approach is to maintain a well-balanced profile between debt capital market and the bank loan. So, all in all, we are taking opportunistic approach. And we see for sure that also counting on the cash flow that we are generating, and so we are targeting for 2025 a net debt to EBITDA ratio at least 1x.

So, we are quite confident to handle the volatile scenario in terms of interest rates.

## Gianluca Bertuzzo – Intermonte SIM

Hi, good evening, and thank you for taking my question. First one is on inventories. What is the level of inventories on winter, all-season, and summer tires.

Second question is on North America. Where it seems that your actions are getting grip as you're gaining market share. Do you plan further growth in 2023? And what are your expectations? And the last question is on the CapEx plan. Can you give us the split maybe between capacity increase, transformation, and other elements? Thank you.

## Andrea Casaluci – General Manager Operations

So, starting from the stock, the trade in winter is a high level, above average of the season because of the weather conditions that has not been as severe as expected in Europe, in North America and Canada mainly and in Russia as well. So, we need to wait another month to see to have a final conclusion on the level of stock. And as a consequence, the expectation of the coming winter season.

While on Summer and All-Season, the stock is, let me say, consistent with the seasonal average. We see that there are opportunities to increase the stock in trading China, that is quite low. While North America and Europe, both summer and all-season are in line with the average of the season.

In U.S., you are fully right, our target is to grow. We see that we have a lot of opportunities in the U.S. market because we have a lower market share compared to the other regions in the high-value markets in the High-Value segment. We were able to gain share in 2022 and we'll target clearly to gain share in 2023 and the coming years.

We are planning everything to do it in terms of new product launches. The vast majority of the new product lines have been launched in the United States. We are entering in U.S. Original Equipment partners that were not customers of Pirelli five years ago, GM, the Chrysler, the Tesla, all the most important and the iconic cars of U.S., like the F-150, the Dodge Ram. And we are enlarging our customer base with long-term agreements with the most important distributors in the region. Last but not least, we are investing in the production capacity, as we already announced in our Mexico plant, up to EUR8.5 million within 2025.

As for CapEx, in 2023, I would say, more or less 30% will be related to capacity increase, mainly concentrated in Europe and North America on the already announced projects in Romania and Mexico. Then around 44%, 45% is related to technology upgrade and digital transformation, which is always the most important part of our CapEx concentrated in technology, innovation, sustainability, and digital. And the remaining part, around 25%, is what we call business continuity, it's basically base load molds and things like that. Thank you.

## Valentin Moroy – Apha Value Analyst

Good evening, everyone. Thanks for taking my questions. I have actually one question remaining. I was wondering if you could share your thoughts on the price sustainability versus decreasing costs. In other words, what would make you consider any price decreases? Thank you.

## Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

As far as we see today, there are no reasons to decrease the price in our segment. The price can be affected only by a strong recession. So, for the time being, there are, obviously, pressure in many areas, but the volatility of the raw materials keeps everybody quite stable. So that's why we don't see short term anything happening. I remind you that in our segment, in general, the price is more resilient than average.

Thank you, ladies and gentlemen. This concludes our today's program. Have a good evening.