Pirelli & C. S.p.A. 1Q 2023 Results conference call transcript

May 11th, 2023

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening, Ladies and Gentlemen.

Q1 2023 results confirm the resilience of our business model with a performance that is improving year-on-year and among the best in the industry.

The scenario we foresee for 2023 remains characterised by:

- a slowdown in economic growth, substantially in line with February expectations, and
- an inflation rate staying high, especially of consumer prices, despite a reduction in energy, transportation and raw material costs.

All 2023 targets are confirmed and supported by the delivery of our strategic programs.

On Golden Power, final measure is expected to be issued after the 4th of June, term for filing the slates for Board of Directors renewal.

- In compliance with the best Corporate Governance principles, today the Board has resolved to submit to the AGM, taking place on June 29th, the proposal to postpone the renewal of the Board after the conclusion of the Golden Power Procedure. A subsequent General Meeting would be called presumably before July 31st, 2023 and consequently current Directors would remain in power until the renewal of the Board.
- The update of the Industrial Plan is postponed and is now due before the end of 2023. The deleverage target of a Net Debt on Adjusted Ebitda ratio of 1 time by 2025 is confirmed.

Pirelli closes the first quarter of 2023 with a solid economic and financial performance:

- Top Line growth (+12% year-on-year) driven by price/mix and strengthening on High Value, now equal to 75% of the Group revenues
- adjusted EBIT of €248 million (+9% year-on-year) with a margin of 14.6%, in line with FY target
- net income of €115 million, growing +5%
- net cash absorption in line with the same period last year and discounting the build-up of investments in the fourth quarter of 2022.
- Efficient inventory management, particularly of raw materials, continued in the quarter.

We remind you that the high incidence of these inventories in 2022 was due to both rising inflation and actions to contain supply chain risks.

Moving on, I would like to give you an update on **Sustainability.**

Our commitment to Health and Safety at work is continuing, with the launch of a global awareness campaign on the World Day promoted by the International Labour Organization (ILO) on April 28th.

On Product Sustainability:

- We will introduce new product lines with a high content of renewable and recycled materials already in 2023;
- while the collaboration with key stakeholders is being intensified in view of the introduction of the Euro 7 tyre wear regulation, which will come into force in June 2025.

On the industrial front, the de-carbonisation of plants through the transition to renewable energy and energy efficiency programmes continues.

Our commitment to the fight against climate change has once again been recognised by CDP, which confirmed “A rating” for Pirelli last February.

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 the first 3 months of 2023, the Global Car tyre demand declined by 4% yoy, with a very different trend by segments and channels. Pirelli outperformed the market thanks to our further strengthening in High Value.

O.E. market growth (+3% YoY) was supported by easing supply chain tensions (particularly in semiconductors); more specifically:

- In the High Value segment, Pirelli saw over 7% volume growth YoY, in line with the market
- while in Standard, Pirelli’s performance reflects greater selectivity in this channel and the halting of car production in Russia due to the Ukraine conflict.

Replacement demand remained weak (-7% YoY), reflecting the volatile macroeconomic environment;

- In ≥18”, Pirelli outpaced the market by around 3 percentage points (PI +3% vs. flattish market) driven by market share gain in North America
- In ≤17” (PI -11% vs. Mkt -8%), we continue to focus on a mix more oriented towards higher rim sizes

The first quarter results reflect the implementation of the 'key programmes’ in the Industrial Plan.

On the **Commercial Programme, c**onsistent with our strategy, we have:

- outperformed the Car ≥18" market by gaining share in Replacement, particularly in North America;
- increased exposure to Original Equipment ≥19" (reaching 82% of Car ≥18" O.E. volumes, +9pp YoY) and EV;
- reduced exposure to Standard, which accounted for 36% of car volumes in Q1.

On the **Innovation Programme:**

- achieved ~60 technical homologations, concentrated in ≥19" (about 85%) and Specialties (about 70%)
- strengthened EV positioning and focus on sustainability, while the two-wheeler business saw the launch of two products based on racing experience.

On the **Competitiveness Programme:** gross benefits of about €10 million were achieved, in line with expectations and project development schedules.

On the **Operations Programme:** the saturation level of the plants stands at about 90% (>95% on High Value) in view of the lower level of production in Russia. In addition, the programme to de-carbonise plants through the use of renewable energy sources and energy efficiency programmes continues.

Let's start from the **Commercial Program**.

In the Car ≥18" segment, we recorded growth of ~5%, compared to +2.6% for the market, driven by products with higher technological content: the ≥19" and Specialties.

In the Original Equipment Car ≥18", our performance (+7.5% volumes, +7.1% market) is characterised by an increasing selectivity in favour of EV:100% of the year-on-year volume delta is related to EV homologations.

In the Replacement ≥18" channel (volumes +3% compared to a -0.2% of the market), growth was driven mainly by the Replacement product lines introduced in 2022, particularly in North America.

On the **product innovation** front our activity continued in the first quarter, with an increasing focus on sustainability and performance.

In Car, our EV portfolio stands at more than 350 homologations worldwide, mainly in ≥19" and Specialties, with an OE market share of 1.5 times that of Premium and Prestige ICE vehicles.

In addition, the sustainability roadmap continues, with a strong focus on renewable and recycled materials. In 2023 our products will already have a sustainable material content, well above our standards and becoming a benchmark for the industry.

As for motorbikes, Pirelli has been confirmed Sole Supplier for all classes of the FIM Superbike World Championship until 2026. Our portfolio was further expanded with the introduction of Diablo Supercorsa, the result of twenty years of experience in racing.

In cycling, the Pzero Race TLR was introduced, produced in Italy and aimed at performance, with low rolling resistance and excellent handling.

The Competitiveness Program in the first quarter recorded gross efficiencies of **~**€10M**,** equal to 10% of the annual target and in line with the timing of project development. The contribution of the efficiencies will be more evident starting from the second quarter.

Reviewing our performance in the first quarter:

- in the Product cost area, the adoption of a modular design and design-to-cost approach continued, aimed at reducing structure complexity and tire weight;
- in the Manufacturing area, the results of which will be visible starting in the second quarter, projects are being implemented. Said projects are aimed at improving the production process by leveraging IoT (Internet of Things), predictive maintenance and energy efficiency programs;
- in the SG&A, the process of optimizing the logistics network and supply chain continues
- Finally, in the Organization area, the process digitization and staff upskilling is progressing.

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 us analyse the dynamics of the top line in the first quarter.

The volume trend (-3.1% at Group level) reflects the weakness of market demand. As Mr Casaluci already explained:

- we gained share in Car ≥18", despite price increases
- while we reduced our exposure to Standard, in line with our strategy.

Strong improvement in the price/mix (+15.1%), supported by

- a solid price discipline to counteract input cost inflation, and
- the continued improvement of the product mix, through increased exposure to High Value and improved micro-mix.

The Forex impact was broadly neutral (-0.3% in 1Q, or -€4 million), where the year-over-year devaluation of Renminbi and Argentine Peso was offset by the dollar's appreciation.

In the first quarter 2023 the adjusted EBIT amounted to €248 million, up 9% year-on-year, with a margin of 14.6%, in line with the FY target (>14%/ ~14.5%).

The contribution from internal levers more than offset the weakness of the external scenario. In particular Price/mix (+€198m) and efficiencies (+€10m) more than covered:

- the drop in volumes (-€20 million), linked to a weak market demand,
- the increase in the cost of raw materials (€78 million, including the related exchange rate impact), which was particularly significant in the first quarter. This impact, which reflects the growth in the oil price, its derivatives and rayon, is expected to improve in the coming quarters.

The internal levers also offset:

- the inflation of other production factors (-€69 million): energy, labour and transport;
- Finally, the negative exchange rate effect (-€15m), due to the revaluation of the currencies in our main production hubs, particularly Mexico, whose currency appreciated by 15% against the euro.

Let's move to Net Income dynamics.

Net Income increased YoY. The trend takes into account:

- the already mentioned improvement in the operating performance
- the €2 million higher restructuring and non-recurring costs
- the year over year increase of the net financial charges reflects the rise of interest rates in eurozone and high costs of hedging forex risks in Russia. We will discuss this trend in a couple of slides.
- the €6 million increase in tax charges relates to the higher operating results, as tax rate is at 28.5%, reflecting the different region mix.

Net Income adjusted, i.e. excluding all the one-offs and non-recurring items, is positive for €142 million at the end of March.

Net cash flow in the first three months was negative €691 million, in line with the seasonality of the business and the first quarter 2022 figure. The change in operating net cash flow mainly reflects:

- the improvement in operating performance
- absorbed by higher investment activity (higher capex and leasing) and higher working capital. The trend reflects the usual seasonality of the business with:
  - the increase in trade receivables following the start of the summer campaign,
  - and the reduction in trade payables linked to the trend in investments and raw materials.

<u>The careful management of inventories</u> is to be highlighted, with an incidence on sales that is reduced to 21.5% thanks to the actions on raw materials. It should be remembered that in 2022 the high incidence of these inventories was due to both rising inflation and actions to contain supply chain risks. By contrast, finished product inventories were stable.

The group's gross debt as at 31 March 2023 amounts to approximately EUR 4.9 billion. Considering the approximately EUR 1.6 billion of financial assets, the Net Financial Position is therefore EUR 3.2 billion.

The 2023 debt has already been fully managed and the liquidity margin allows for the coverage of maturing debt until 2Q 2025.

In the first quarter of 2023 Pirelli:

- repaid early a Schuldschein loan, for a residual amount of €223m, maturing in July 2023, and a €125m bilateral bank line maturing in August 2023;
- it also issued a €600m five-year bond. The loan, which was very well received by the market, is Pirelli's bond debut since obtaining an investment grade rating. It is the first Sustainability-linked issue with benchmark size by a company in the tyre sector.

Financing with ESG characteristics came to 57%, confirming the centrality of the sustainability strategy.

Finally, the cost of debt stood at 4.31%, up 27 basis points from December 2022. This increase reflects both the rise in interest rates, mainly in Euro, and the higher costs for hedging against currency risks, particularly in Brazil and Russia.

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

<u>Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer</u>

Thank you, Mr. Bocchio.

Let us now turn to the outlook for 2023. The framework remains extremely volatile with a general slowdown in the economy and consumption.

We confirm last February's outlook: the Car tyre market is expected to be broadly stable year-on-year, but with opposite trends between High Value and Standard.

High Value confirms its resilience, with growth in Car ≥18" mid single-digit compared to a 2% drop in Standard.

More specifically on Car ≥18", expectations are for:

- high-single-digit growth in Original Equipment (+7%) supported by the progressive normalisation of the supply chain;

- the Replacement channel, on the other hand, is expected to grow at a low-single-digit rate (+3% yoy), with a gradual recovery in demand in the second half of the year, thanks to recovery in China and other major markets.

Based on the results achieved in Q1 2023 and the scenario just described, we confirm all 2023 targets:

- Revenues between EUR 6.6bn and EUR 6.8bn;
- Volumes between flat and +1% yoy with mid-single digit growth on High Value, while continuing to reduce exposure on Standard;
- Price/Mix improving between ~+4.5% and ~+5.5%, benefiting from price increases in 2022 and those announced earlier this year, as well as continued improvement in product mix;
- Exchange rates declining between -4.5% and -3.5%;
- Profitability (adj Ebit margin) between >14% and around 14.5% with Adjusted Ebit in the mid-range essentially flat yoy and where price/mix and efficiencies will offset the impact of the external scenario.
- Investments of ~€400m (~6% of revenues), in technology upgrades of factories, mix improvement and increase in High Value capacity in Romania and North America, the expansion of which will be completed by 2025.
- Expected Net Cash Generation before dividends between ~€440m and ~€470m due to operational performance and efficient working capital management. This target includes the payment in the second quarter of 2023 of management's long-term incentives, relating to the three-year period 2020-2022 and based on shareholder return, cash and sustainability targets, the latter being the maximum. 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 Business Plan.

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

Questions & Answers

Giulio Pescatore – Exane BNP

Hi. Good evening, everybody, and thanks for taking my question.

The first one on the price/mix guidance. I would like to understand how you get from 15% in Q1 to 5% on the full year.

And on the 15% Q1 price/mix improvement, can you share some comments on how much was pricing and how much was mix and give as some colors on the various drivers of the mix effect. I'm just trying to understand how steeply the mix effect we saw in Q1 will be in the coming quarters.

The last one on the governance, I understand that you might not be able to share anything incremental on the Golden Power procedure which is creating a significant level of uncertainty. So anything you can share in addition to your initial remarks, on the potential implication of an adverse decision from the current government, or anything like that, would be much appreciated. Thank you very much.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

I will start with the answer to the Golden Power question. So, we just know that there will be a postponement because of questions raised by other countries, which is normal in such a process.

And so, that's why we split the AGM in two parts.

About the outcome of the Golden Power, it's really impossible to say anything, because it's an ongoing process and we will be aware of the outcome not before, let's say, the end of May, beginning of June. So, until then, really, there is nothing we can add to the fact that the procedure is an ongoing procedure

I give the floor to Mr. Casaluci for the other question.

Andrea Casaluci – General Manager Operations

Yes. Thank you. So, price mix in Q1 was 15.1%, roughly 2/3 coming from price and 1/3 from mix.

Then the following question was related to the expectation of the price mix for the coming quarters. We are comfortable on the upper range of our guidance, expecting price/mix for the full year at 5.5%. This implies a mid/low single-digit price mix in the coming quarters.

This will be driven by roughly a price-positive performance of 2%/3%, mainly driven by the rollover of the price increases of last year, and the price increase applied in North America in January up to10% and in Europe end of 2022. The price contribution is expected to be below the one in Q1 simply because of the less favorable comparison year-over-year, because in 2022, we started to apply the price increase from Q2. In addition, some minor impact on price is related to the OE cost matrix in the second half. All in all, the price will be maintained, there is a full price discipline in our segment in the High Value, and so we keep on performing as we are doing till now maintaining a price discipline, price control is the priority number one of our commercial campaign.

If we move to the mix, we do expect:

- the usual 4 / 5 percentage points of positive product mix, mainly driven by the micro-mix effect, the growth in specialties, the reduction of Standard, and
- the negative impact of 2 / 3 percentage points related to channel and region mix, because as we saw the Original Equipment market is expected to perform better than the Replacement and because the Replacement demand in North America and Europe is expected to [remain] weak [for part of the year] and these two regions have normally a positive impact on the region mix. Thank you.

Thank you very much.

Monica Bosio – Intesa San Paolo

Yes, good evening. I was wondering if you can update us with the total impact of the hadwinds from inflation and raw materials for the full-year.

I remember that in occasion of the full-year 2022 release, you gave an indication in the region of EUR 250 million, if I'm not wrong.

The second question is on the dealer network in the Replacement channel in Europe. I was wondering if there are some pricing pressures and more visible signs of trading down.

And the very last question is on the EV tires. In occasion of the Full Year 2022 results, I remember that EV tires reached 17% of the Original Equipment in the tires above 18 inches. I was wondering if you can give us an update for the Full Year 2023, if you had it. Thank you very much.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you.

Inflation impact [including raw mat] is expected to be around EUR310 million and here I leave the floor to Mr. Casaluci for the other questions.

Andrea Casaluci – General Manager Operations

Yes. Thank you. So, the inflation headwind [including raw mat] already mentioned by Mr. Tronchetti has been lowered by EUR35 million compared to the previous guidance.

On the dealer channel price now, as I said before, there is a good level of price discipline in the market in our reference segment which is the High Value. We keep on growing in market share but always having the price discipline as the priority one in our commercial policy.

As far as the weight of the EV into the Original Equipment today in the 18 inches and above is around 25% in the first quarter and expected to reach by the end of the year a weight 31%, 32%. So, this is the fastest growing segment inside our Original Equipment in High Value.

Martino De Ambroggi – Equita SIM

Good evening, everybody. Just to clarify and complete your answer on EV: are you referring to weight on volumes or on sales for the Original Equipment? And for the Aftermarket the EV weight still at 1% to may be 3% or maybe a little bit more?

Andrea Casaluci – General Manager Operations

I was referring to the volume weight.

Yes, and if we move to the Replacement, it's still very low. It's around 3%, and within year-end, it's expected to go up at 3.5%, 4%. So we are still waiting for the impact on the pull-through rate in the Aftermarket.

Martino De Ambroggi – Equita SIM

Okay, the second question is on price discipline. It's very clear, you already mentioned it, in High Value is always respected. But what is going on, on the Standard segment overall? So let's say also how your competitors are acting in this business?

Andrea Casaluci – General Manager Operations

Alright.

Thank you for the question. In High Value, we are also supported from what mentioned before, from the high level of saturation of our production capacity.

In the High Value, and mainly in the Specialty segment, the demand is still higher than the installed capacity and this is supporting the price discipline and the resilience of the demand. While in the Standard, some negative impacts in the market are visible, also accelerated by the trade-down of the 16 inches and below segment.

Let's consider that the Tier 1 weight on the 16 inches and below segment today is around 35%, 34% of the entire market, so today this is an arena of Tier 2 and Tier 3 brand. That's the reason why we accelerated the phase-out from this segment since years ago, and now we have the less exposure inside the Italian industry to the segment. Thank you.

Martino De Ambroggi – Equita SIM

Thank you.

And the last question from a geographical perspective, if you could elaborate on China, how the market is going on?

And in Russia, you mentioned the utilization capacity was penalized. What's the current utilization capacity in Russia, and is it still profitable for the full-year?

Andrea Casaluci – General Manager Operations

Our reference market (the18 inches and above market) in the first quarter has been positive, around +4%, more or less with the same pace of growth in Original Equipment and in the Replacement. We do expect a recovery, a fast recovery in the second quarter, because of the comparison versus last year. The expectation for the second quarter in the 18 inches and above market is for a growth of around 23%, again more or less with the same speed in Original Equipment and in Replacement. It is worth to remember that last year in the second quarter, China was strongly affected by the lockdowns related to the COVID-19 and by the restriction to mobility.

Russia today accounts for less than 3% of our total result, so it is less and less meaningful. The capacity is utilized at around 65% of the total capacity available and fully dedicated to the local market.

Sanjay Bhagwani - Citi

Hi. Thank you very much. I've got three questions again.

My first one is on a pricing. Could you please remind us what the proportion of your volumes are tied to the index pricing. What components are included in the indexing? Is it just the raw materials? Are other inflationary components, like energy, or logistics included in the indexed? So what I'm trying to assess if raw material prices are going down, then when do we start to see this coming into the lower index prices? So that is my first questions.

Andrea Casaluci – General Manager Operations

Okay, thank you. I will answer to this first question. When I talk about price indexation, it's only referred to the Original Equipment, and to the 70% of this channel.

The channel waits for 25% of our sales, so 70% out of 25%, it means that no more than16%, 17% of our total sales are affected by the indexation.

And the indexation is fully related to raw material, no more than raw material. And if the raw material will go down, OE prices are adjusted after three/six months, depending by customers. So, we can consider that the impact on Original Equipment price is already fully included in our current guidance.

Thank you.

Sanjay Bhagwani - Citi

Thank you. Very, very helpful. And my next question is on the Q2 volumes.

Could you please provide some update on what are you expecting for the volumes going into the Q2?

There's finally a last question on EV tires. So could you please provide some latest updates on what the price difference is between the like for like EV versus conventional engine tires?

And how do you see this frame developing in the next few years? And depending on the order of the pipeline you have. Thank you.

Andrea Casaluci – General Manager Operations

Thank you.

So Q1 volumes market is expected to be more or less equal to the first quarter in Europe and North America, with a positive Original equipment around 10% positive, from 8% to 10% positive, in both regions, and as always, more resilient in the 18 inches and above, that goes up normally 4 / 5 percentage point more than the overall market.

We do expect a rebound of the market in China, as I said before, compared to the first quarter, the first quarter the market was slightly positive, while in the second quarter in China, we expect for the total market, as I said before, a +12% / +13% of growth year over year, more or less same pace of growth in Original Equipment and Replacement, and for the 18 inches and above we forecast a growth average of 20%.

EV is going to represent one of the most important opportunities we have in front of us, as a High Value leader. The average selling price on Electric Vehicles in Replacement is around 15 percentage points higher than the equal size for the internal combustion engine. And the weight on our sales, as I said before starting from Original Equipment and then moving to Replacement is expected to grow year-after-year.

We have already reached a market share on EV 1.5x higher vs the one on internal combustion engine and this is expected to be reflected in the replacement channel starting from 2024.

Sanjay Bhagwani - Citi

Thank you, that's very helpful. And this 15% price gap, do you see this remain for the next two, three years?

Andrea Casaluci – General Manager Operations

So our estimation is that this price gap will remain for the coming two or three years because the technology is still in the growing phase.

In addition, the lower presence of competitors in this arena will protect the price gap between internal combustion engine and electric vehicles. I am always talking about the High Value segment, of course, Premium and Prestige car park.

Thank you

Michael Jacks – Bank of America

Hi, good evening. Thank you for taking my questions. The first one, apologies if you've already answered this. I joined the call slightly late.

But what is the split between price and mix within the Q1, 15% price mix tailwind? And perhaps just touching on the guidance with 15% in the back for Q1, it would appear that you should have a carryover effect of at least seven or eight percentage points for Q2, which assuming that the second half is zero, would suggest that the 4.5% to 5.5% is already basically achieved for the year. Just wondering if that's a fair assessment or if there is something that I'm missing there?

And then on forex, should we expect a similar negative effect impact at an EBIT level for the coming quarters?

One final question, I hope it's a quick one if I may. Can you please just comment on the expected development of raw materials for Q2, as I'm sure you already have visibility on this in your inventories. Thank you.

Andrea Casaluci – General Manager Operations

So back to the question of the price mix, we expect to land at the end of the year at the upper range of our guidance, around 5.5%. Starting from a very positive Q1 of 15, it means in the following 9 months a mid-low single-digit price mix, but always positive price mix. The positive price mix of mid-low single-digit will be driven, as I said before, from a positive price, we keep on with the price discipline, that's a priority one of our commercial policy. And so, we will have a positive price effect of 2 / 3 percentage points for the following nine months. This is mainly driven by the rollover of the price increases of last year. The impact is expected to be lower than Q1, because of the less favorable comparison with last year. The vast majority of the price increases last year have been applied starting from the second quarter, that's the reason why you see this reduction in the percentage impact.

Then we will have the usual positive impact of the product mix, driven by specialties and growth in the micro-mix, partially compensated by a negative channel and region mix, because as we saw before, the OE market is expected to perform much better than the replacement, and the slowdown of the demand in Europe and North America will negatively affect the region mix. But that's how the measure is. It is important to remind that price will be priority one, with maximum level of price discipline in our products offer.

The second question was related to raw material. No, we don't expect major changes in the raw material market for the second quarter. Let's also consider that the impact on our COGS is covering the following from four to six months, depending by raw material. So, we can consider that in 2023, the potential impact of raw material movement and volatility for the coming months is for the vast majority already included in our cost phase.

Michael Jacks – Bank of America

Understood. Thank you. Sir, should we expect the incremental raw material headwind again in Q2?

Andrea Casaluci – General Manager Operations

Yes. we expected a headwind. That is the result of commodity price versus last year and forex impact on the purchasing of commodities, even if it is expected to be less than what has been in the first quarter, much less.

Michael Jacks – Bank of America

Thank you. And then my final question is just on the forex impact.

If we should expect a similar high drop-through rate at an EBIT level for the coming quarters?

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Thank you for the question. The answer is, yes. Actually, we are considering in our guidance a negative impact of the effects on EBIT even higher in the coming quarters. It is already factored in the guidance, but for 2023, the full-year, we are expecting the drop through of the effects to be a little bit higher than what we experienced in 2022, due to the mix of currencies. And we are taking into consideration an evaluation of the United States dollar, revaluation of the Mexican peso, and some uncertainty related to the Latin American currencies. Particularly, we are taking into consideration the valuation of the Argentine pesos. So all of this is included, but the answer is yes, we are foreseeing a similar negative impact even more for the next quarters. Thank you.

Thomas Besson – Kepler Cheuvreux

Good evening. Thank you. Two questions, please. First, could you comment on the level of inventories for your main business in North America and in Europe? And tell us whether you believe there is a kind of waiting game or then waiting basically for potential price cuts or whether you think there is already an excess level of inventory at the levels, for instance in winter tyres in Europe?

The second question is on BEV tires. Can you tell us what you have learned over the last 12 to 18 months, about the driving patterns of the customers who have bought an EV? What do you expect in terms of replacement cycle compared with someone driving an internal combustion vehicle, either in terms of months or kilometers driven? Thank you.

Andrea Casaluci – General Manager Operations

About stock in the trade, I would say to simplify that the stock we see is at the normal level basically, no markets and regions with the sole exception of winter in Europe. The stock in winter in Europe is above the average of the season. Normally at this point of the year, we have from 15% to 20% of leftover and what we measure today is from 20% to 25%. So, despite the winter has been longer than normal, the stock is still high.

About EV, this is a very important question again. What we see is that the tire for the electric vehicle will cover a more and more important role, in the driving experience of our end users. The electric vehicle is an easier car, requires less maintenance than an internal combustion engine with the sole exception of tyre, because tire is going to influence the comfort in terms of noise control, the safety in terms of grip, because the torque momentum is much stronger, in terms of load index because EV are heavier, and also the durability of the battery is affected by the tire maintenance.

Also, the consumption of the tread pattern is expected to be from 15 to 20 percentage points higher than the internal combustion engine. All in all, the maintenance of tires and the role of the trade and the retail in this process becomes more and more important. That's also one of the reasons we see this huge opportunity. But we need, together with the current makers and the trade partner, to educate the consumer more and more in this process of maintenance.

Thomas Besson – Kepler Cheuvreux

So, you have no equation in mind in terms of the time it takes between the first purchase and the first replacement as an average to indicate us?

Andrea Casaluci – General Manager Operations

It's faster. Thank you.

Philipp Koenig – Goldman Sachs

Thank you very much for the presentation and for taking my questions.

My first one is on the standard segment. You clearly reduced the exposure quite quickly, with another 4% reduction compared to last year. Can you give us a bit of guidance around at what point you see sort of a floor for your standard exposure, where you want to land? How much more capacity or more exposure you're willing to take out? And at what point will you have to invest more to convert some of the standard capacity into high value capacity, if it takes up more share within your business?

My second question is on Russia. I know it's only 3% of the sales, but it’s 8% of the production. Is that production just being redirected to other regions in the world where you can sell export from Russia? Or what is the strategy that you pursue there if you are not only supplying the local market?

Thank you very much.

Andrea Casaluci – General Manager Operations

Well, the first question is the standard for us is mainly the 17 inches and below.

In 2023, it's expected to reach, in terms of volumes, a maximum of 25 million of tyres. A reasonable landing point for us in the coming two years, as we always explain, is around 20 million tyres. In terms of market share, it means below 2% of the global market share, mainly concentrated in South America. And always keeping the most profitable products inside this segment.

Moving to Russia, yes, you are right. We were used to exporting the past around 3.5 million tires from Russia. Today the export is finished. We are not exporting anymore.

And the tires that we were used to export mainly to Europe today, are delivered from local production in Romania, Europe for Europe, increasing the local for local percentage. And so the risk can go to the company and partially from Turkey through an off-take agreement.

Thank you.

Ross MacDonald – Morgan Stanley

Thanks, Ross MacDonald from Morgan Stanley.

Maybe, I can ask Philipp's earlier question slightly differently. It looks like high-value tires are now 75% of group revenues, up 1.4 percentage points. Is there a target internally that you're shooting for in terms of high-value revenues versus standard over the medium term?

Secondly, you mentioned in your slides that Pirelli is working to reduce tire emissions as part of EURO7, I'm just curious how much further you have to go in that process and if that's driving higher R&D spend or if the change towards lower abrasion products is relatively straightforward for Pirelli.

And then finally, on the Wave 3 competitiveness program. Obviously this is currently EUR 10 million of savings in the first quarter, EUR 100 million for the full year. Do I infer correctly that this should now rise in the second quarter to around about the EUR30 million mark? And perhaps you can comment on the key drivers that mostly energy consumption or something else.

Thank you.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Today the local for local is around 85% in our business model. It is a strategy we have for decades. We are continuing this strategy and it increased lately.

In emissions, all targets are public. We have a continuous process, and it is an endless process.
By 2025, 100% energy will come from renewable electricity, which in 2022 was 74%.
Our target 2025 is -42% [of scope 1&2 absolute] CO_2 emissions compared with 2015, and -9% [of scope 3 absolute CO_2 emissions] versus 2018. So, we always target the leadership on the climate change actions, which is confirmed by CDP with ‘A rating’.
For sustainable finance, we have made the first ever tire sector benchmark sustainability-link bond placed in January 2023.

On the third question, we are quite balanced between dollar and euro. So, we are much hedged, but a slightly stronger euro would still be better for us.

Ross MacDonald – Morgan Stanley

Yeah, I think that covers things. I maybe follow up separately.

The real thing I'm interested in is on tire abrasion - the Euro7 regulations specifically. You talked about a 30% improvement across your products in recent years. Is that costing significantly more in terms of R&D spend? And is that extending the duration or the replacement cycle for your products?

That would be my one key question. Thanks.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, this is equal. We don't have a higher cost for it.

What is worth underlining is that being high-end and producing tyres with specific materials, the PM10 in our products are less dangerous, because the size is a bit bigger.

So all in all, that is our situation.

Gianluca Bertuzzo – Intermonte SIM

Hi everybody and thank you for taking my question. I have just one. Given the positive set of results, do you feel more confident on reaching the high end of the guidance? Thank you.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We will fight for it obviously. A bit of cautiousness is better to keep in an environment that is very volatile. But as it was explained before by Mr. Casaluci, in our segment, in the high end, we see we have opportunity to deliver the best part of our range. Anyhow, it's early to say it's the first quarter, so we still have to see what is going to happen in the future. For the time being, we stick to prices and so we see opportunities looking forward. It's really a very volatile market.

Operator

Mr. Tronchetti, there no further questions to register at this time. Back to you for any closing remarks.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you, ladies and gentlemen