Pirelli & C. S.p.A. 1H 2021 results conference call transcript

August 5th, 2021

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening Ladies and Gentlemen, and welcome to our conference call.

The scenario - that is taking shape - highlights a faster recovery from the pandemic, both in the global economy and in the tyre industry, where High Value demand is already exceeding 2019 levels. The ≥18" market in 2021 is now expected to grow at +15% YoY, +2pp more than the initial expectations.

Our Industrial Plan implementation continues in line with expectations on all programs:
- our High Value share increased sensibly, in particular in Car ≥19" (almost 2 share points gained in the 1H)
- a further commitment in Sustainability is witnessed by the production of the first ever tyre made with natural rubber and rayon certified and traced by an important international NGO

The results of 2Q show the strengthening of our performance, with a 15.8% adj. EBIT margin, close to the 2Q 2019 level, and a high Cash Flow Generation (13% of sales).

The good results in 2Q and the improvement of the external scenario have led us to upgrade our Full Year targets on Revenues, Profitability and Cash Flow.

The economic recovery is accelerating compared with the initial expectations, thanks to the massive governments aids and the vaccination plan proceeding at a fast pace. The average yearly growth rate of global GDP is currently estimated to exceed 5% in 2021 and '22, with the major economies on the way to a full recovery of Pre-Covid levels, especially the high Value Regions (U.S., EU and China). The volatility of exchange rates is decreasing and the trend has become clear already in the results of 2Q.

In the Tyre Industry:
- the expectations for High Value demand have improved. The global H.V. market is expected to exceed 2019 levels by 5% for the Full Year. The view is different according to the channel:
  - due to the good sell-out demand and still limited inventories in the trade, the expectations for Replacement demand are on the rise
  - instead, in the OE channel, expectations are modest, due to the uncertain trend of Vehicle production caused by semiconductor shortage
  - in this context, we keep on monitoring the market to deal with slowdowns and seize every opportunity in the Replacement channel
- the price scenario remains favourable; the announced price list increases were applied by our sales network in all Regions
- the levels of trade inventories are normal; this will facilitate the acceptance of the announced price increases, effective for Pirelli, for instance, in the U.S. from July, 1st (up to +6%), or planned in other Regions, given the inflationary scenario of raw materials and transportation.
- what we aim at is offsetting raw material and exchange rate headwinds over the year through the Price/mix increase

1H results reflect the progressive implementation of our "Key Programs" in the Industrial Plan.

At Commercial level, we strengthened our leadership in High Value through:
- a product portfolio with high technological content, and
- production and logistics structures that allowed us to fully capture demand recovery

In line with our objectives, we increased our exposure to ≥19", that now account for 66% of High Value volumes, +3pp YoY, and to new technologies, where the Electric business experienced a volume growth equal to 9 times that of 1H 2020.
In these six months, we consolidated our leadership in the High End of the market in China, with a +2.5 percentage point increase of our share in the ≥18", both in the:
- Original Equipment, with a share increase of +2.3pp, thanks to our strong exposure to Premium Car makers and our partnerships with the major local Premium producers of Electric Vehicles, and
- Replacement channel, share +3.4pp, where we intercepted demand recovery through our distribution chain and the strong development of the on-line business (~27% of volumes)

As for Innovation:
- in 1H, we completed ~170 technical homologations, exceeding 50% of our FY target; they were concentrated in the ≥19" (~85%) and Specialties (~50%); and
- we launched four product lines dedicated to Replacements: 2 lines in the EU and 2 in North America; they expand our All-Season offering and the range of tyres for the CUV-SUV segment

In the Competitiveness Program: Phase 2 of the efficiencies plan is proceeding, with gross benefits of €83 million (€50 million net of inflation). In 1H, we achieved 60% of the FY target.

In the Operations Program: we completed the reorganization of our plant in Burton, UK, while the saturation level of the other facilities is improving.

On the ESG front, we maintain our commitment to support People and the Environment:
- in co-operation with local authorities, where allowed, the initiatives in favour of vaccination of our employees and their families are proceeding, with Pirelli facilities, made available as vaccination hubs
- we intensified our activities for the development of new skills to support our business transformation. In R&D, we started with the Politecnico of Milan a Master Degree course to specialise in tyre technologies, for the development of a new generation of researchers and engineers
- lastly, we started the production of tyres certified by the Forest Stewardship Council (FSC), an international NGO promoting the responsible management of forests in the world; their certification confirms the sourcing of materials (natural rubber and rayon) from plantations that preserve biological diversity and support local communities and workers

A solid performance was achieved in 1H 2021, with a strong contribution from 2Q:
- the strong Top Line growth was supported by a marked increase in High Value, coupled with a sound price/mix;
- profitability improved, driven by the strong commercial performance and efficiency gains;
- Net Income rebounded, posting €132 million in 1H, 67% of which in 2Q; and
- a Cash Flow generation of €173 million (13% of sales) was recorded in 2Q, €100 million more than in the same period of 2019.

Let's review the outlook for 2021.

The expectations for the full year market growth are confirmed at 10%. What changed are the dynamics among segments and channels.

The very good performance of the ≥18” segment already in 1H 2021 prompted us to revise upward our expectations for the market: +15% year over year, +2pp more than our initial guidance.

- the Replacement channel drives the growth, with an expected increase of +18% against the initial estimate of +12%
- more caution is advisable for the O.E. channel due to semiconductor shortage: the growth of the High End of the market is expected at ~+10%, ~5 percentage points less than the initial assumption

In this context, we confirm our ambition to outperform the High Value market. Hence, our target for volumes has been raised, as I will discuss in the next slide.

The sound performance recorded in 1H, the improved market outlook we just reviewed, and a more favourable pricing environment led us to revise upward our 2021 targets.
The expectations for the FY are:

- Revenues between ~€5.0 and €5.1 billion, ~€300 million more than in the Plan, with:
    - Volumes on the rise between 14% ÷ 15% (the old guidance was between +11% ÷ +13%) driven by High Value with volumes at +18% ÷ +19% (the old target was +15% ÷ +17%)
    - price/mix improving between +4.5% ÷ 5% (in the Plan the target was between +2.5% ÷ +3%) due to the already mentioned price increases and a more favourable channel and product mix
    - Exchange rates are going to be negative: -2.5% ÷ -2% (the old guidance was -3.5%)
- EBIT Margin between ~15% ÷ ~15.5% (the previous target was >14% ÷ ~15%) with an improvement of the Adjusted EBIT of ~€60 million compared with the implicit value of the Plan target due to the greater contribution from volumes and price/mix
    - the latter will compensate for the increase of raw material cost, mainly Oil and derivatives
    - all the other components of the EBIT bridge are confirmed
- Net Cash Flow generation before dividends is improving by between ~€360 ÷ ~€390 million (in the Plan the target was between ~€300 ÷ ~€340 million), supported by the operating performance and an efficient management of the working capital
- Investments confirmed at ~€330 million

I now leave the floor to Mr. Casaluci who will discuss the operating performance.

Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti, and good evening, Ladies and Gentlemen.

Let's review market dynamics and Pirelli performance in 1H 2021.

Car Tyre demand recorded a significant +25%, particularly marked in 2Q at +41% YoY.
- Pirelli outperformed the market by ~18 percentage points, gaining share in both channels.
- total demand, however, remained lower than Pre-Covid levels (-6% vs 1H 2019)

In the High End segment, the market grew +35% YoY and demand has already exceeded 2019 levels by ~+7%.
- in line with our Full Year targets, Pirelli consolidated its leadership in the Car ≥18" segment, with volumes growing by +51% YoY. In the rim sizes ≥19", the increase was even higher at +58% YoY

In Original Equipment, the already constant share increase of 2020 continued, with volumes of the ≥18" segment growing +60%, compared with the 37% of the market. This is due to the consolidation of Pirelli leadership in China in the High End segment and its growing exposure to the Electric Vehicle market.

In the Replacement Channel, volumes of the ≥18" went up +44% compared with +34% of the market. Although inventories are still lower than pre-Covid levels, Pirelli intercepted the demand recovery through its distribution chain and the strong development of the on-line channel.

Pirelli performance above the market in the Standard business, with volumes at +35%, +12pp more than the market, discounts a favourable comparison basis with last year and a share increase in South America, concentrated in the higher rim sizes.

The share increase in the High End market I have just mentioned confirms that our commercial plan is being implemented correctly.

The more technological part of our product offering keeps on expanding:
- over 70% of our growth is concentrated in the ≥19", and
- more than 60% in the Specialties

The Replacement volumes coming from O.E. homologations were fundamental for the growth of "pull" volumes, especially in APac.

The new lines exclusively dedicated to Replacements allowed "Push" volumes to perform very well, particularly in Europe and North America.

In the O.E., Pirelli gained share uniformly in all Regions. The Company keeps focusing on fitments for Electric Vehicles, that accounted for 10% of the growth.

The Innovation Program proceeds at a fast pace, as outlined in the Industrial Plan.

In 2Q 2021, we launched our first High Load tyre, a new technology primarily meant for electric or hybrid cars and SUVs.
- this new tyre is made to support 20% heavier loads than Standard tyres, without affecting performance, with low rolling resistance and high levels of driving comfort.

- Lucid Air, the new luxury American electric sedan, is the first car to be fitted with the new P ZERO «High Load» tyres, developed together with the car maker and provided with Pirelli «Elect» technology and Pirelli Noise Cancelling System

The introduction of this novelty contributed to grow our market share in the Premium EV business as expected, bringing us closer to our objective of reaching a share in the EV business 1.5 times that of the traditional car market by 2025. We expect that our share in the EV business will exceed that of traditionally powered cars already next year.

The ability to combine technologies and processes to develop cutting edge tyres for the electric High Value segment is certainly going to be a competitive advantage.

After we launched two products for the European market in 1Q, in May we expanded our offering in North America with the introduction of Scorpion AS Plus 3, a new Touring All-Season tyre for crossovers, SUVs and pick-ups.

- this new product is, in fact, part of the Pirelli “PLUS” line, developed precisely to meet the needs of North American drivers
- with a new tread pattern, compound and construction, Scorpion AS Plus 3 was developed to offer extra mileage, with 70,000 miles tread wear warranty, placing it among the best in class in its category
- the use of the 3D sipe technology, together with innovative materials, allows this new tyre to deliver smooth wear, improved snow traction, excellent wet performance and a comfortable ride with reduced noise in the cabin

Finally, as a witness of the strong attention Pirelli pays to sustainability, I would like to mention that we have recently launched the first ever tyre line certified by the «Forest Stewardship Council».

- these products were designed for the new BMW Plug-In Hybrid X5 (xDrive45e) and contain FSC-certified natural rubber and rayon; they are a significant milestone towards an increasingly sustainable tyre production
- the FSC certification guarantees full traceability of raw materials all along the supply chain, with plantations managed so as to preserve biological diversity and benefit local communities and workers, while ensuring economic sustainability
- besides contributing to the environment-friendly philosophy of hybrid engines, this PZERO tyre was developed by Pirelli according to the Perfect Fit strategy and ensures a low rolling resistance (A class of the European label), with the resulting fuel savings, and low noise

The Competitiveness Program is progressing according to our Plan, with expected gross efficiencies for the Full Year of €155 million, or net €80 million (~2.1% of the baseline).

During 1H 2021, the gross benefits of the Competitiveness Program amounted to €83 million or €50 million net of inflation, equal to ~60% of the overall target for the year, with the bulk achieved in 2Q.

Getting into the detail of the single projects:

- in Product cost, which is worth ~40% of 1H gross benefits, we continued to implement the new approach to modular design and the search for a better efficiency in the purchase of materials.
- in Manufacturing, which accounts for ~50% of the 1H efficiencies, we progressed in our flexibility increase, digitalization and sustainability effort; the reorganization of our UK plant in Burton was completed in 2Q.
    - consistent with the rebound of volumes and the saturation levels reached in our plants, Manufacturing has already reached 80% of its Full Year target in the first half of the year

- in SG&A, we achieved further efficiencies by redesigning the distribution network and with warehousing optimization
- lastly, in Organization, we continued digitalizing our processes and upskilling our people

Thanks for your attention and I give the floor to Mr. Bocchio.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Thank you, Mr. Casaluci, and good evening Ladies and Gentlemen.

Pirelli closed 1H 2021 with revenues of €2.6 billion, up +41.2% YoY.

More in detail, revenues grew by €749 million, with a negative impact of exchange rates of €74 million (-4.1%), due to the depreciation of the US Dollar and the major currencies of the Emerging Countries against the Euro. Excluding exchange rates, the organic growth of revenues in the first six months accounted for +45.3%.

Let us review the single commercial components:
- Volumes grew by +42.3%, driven by High Value (+46.3%) that climbed back to Pre-Covid levels both in the Car and in the Moto business.
- price/mix improved by +3.0% supported by:
  - price increases in the Replacement channel both for High Value and Standard
  - an improved product mix, with a strong High Value growth, especially in the higher rim sizes and Specialties
- in 2Q, the price/mix grew significantly, +4.0%, due to price increases; the already mentioned product mix improvement offset
  - a negative channel mix: due to the rebound of sales in Original Equipment after the lows of 2Q 2020, and
  - a negative region mix, which discounts the comparison with last year

Let's now review the profitability trend. The Adjusted EBIT amounted to €377 million in 1H, with a margin of 14.7%.
The strong contribution of internal levers (volumes, price/mix, efficiencies) more than compensated for the external scenario headwinds (raw materials, inflation, exchange rates). More in detail, the improved profitability of 1H reflects:
- the strong contribution of volumes (+€315 million)
- the improvement in price/mix (+€47 million) which offset the impact of raw materials (-€39 million) and exchange rates (-€13 million)
- the implementation of the Competitiveness plan with net efficiencies amounting to €50 million which more than compensated for:
  - the "reversal impact" of the Covid Plan of -€10 million, and
  - higher amortizations (-€6 million)

Lastly, the trend of the «other costs». This item includes three cost clusters:
- the first is made up of R&D, sponsoring activities and Marketing which in 1H recorded an increase of €32 million, €27 million in 1Q and €5 million in 2Q
- the second cluster includes the provisions for short- and long-term Management incentives with an impact of €23 million in 1H; in 2020, due to the Covid emergency, management incentive plans were cancelled
- the third cluster comprises the impacts of inventories, royalties and other costs; in 1H, this cluster produced a positive contribution of €21 million (+€42 in 2Q); it reflects the normalization of cost seasonality, compared with 2020, but also the positive impact of inventory reconstitution

The overall impact of the three clusters on the year is confirmed to be ~-€30 million.

Just a couple of comments on the profitability trend in 2Q 2021, that recorded an adjusted EBIT margin of 15.8%, close to 2019 levels (16.5% in 2Q 2019).

The improvement of adj. EBIT (€209 million) is to be attributed mostly to:
- the strong contribution of commercial variables (and namely, volumes +€219 million and price/mix +€31 million)
- net efficiencies (+€36 million, around 44% of the FY target), and
- the already mentioned dynamics of the «Other Costs» (+€24 million)

Let us move to the Net Income dynamics.
Net Income showed a strong improvement in 2021: ~+€230 million YoY. The trend discounts:
- the already mentioned improvement in the operating performance (Δ adjusted EBIT +€311 million)
- restructuring and non-recurring costs, slightly improving from 1H 2020

Results from Equity participations was positive by €2 million, a +€7 million improvement related mainly to the results of our JVs in China and Indonesia.

Net financial charges were basically flat at €72 million YoY, as higher costs for commissions related to the early reimbursement of part of the major credit line were compensated for by lower exposure to high-yield currencies and lower financial charges in Argentina.

The €80 million increase in tax charges was mainly related to the greater operating results while the tax rate remained basically stable at 26%.

1H Net Income adjusted, i.e. excluding all the one-offs and non-recurring items, is positive for €224 million.

We closed 1H with a net cash flow before dividends equal to -€481 million, with a strong improvement versus the same period of both 2020 and 2019.

The improvement against 2020 was mostly underpinned by:
- the already mentioned better operating performance, and
- a lower absorption of working capital / other mainly in connection with debts that benefit from business recovery, with higher investments than in 2020

The €160 million improvement against 2019 is mainly related to working capital management, resulting from:
- a better management of receivables, with the improvement in collections, and
- the trend of payables just described

In line with the seasonality of the business, 2Q showed a net cash flow before dividends amounting to €173 million, 13% of revenues, up €100 million against 2Q 2019, due to the dynamics already mentioned.

Gross Debt at the end of June 2021 stood at ~€5 billion, €1 billion less than at the end of December 2020 thanks to early repayment of financial debts.

The liquidity margin amounted to ~€1.5 billion and allows the usual coverage of debt maturities for at least two years, until June 2023.

The cost of debt, in the last 12 months, was 2.27%, a touch higher than in Full Year 2020, due to the temporary increase of the leverage, resulting from Covid effects, only partially offset by efficiencies at the level of local debt.

For the full year, we expect the cost of debt to be equal to 2.6%, in line with the Plan assumption, due to:
- the already mentioned dynamics, and
- the increase in local interest rates, namely Brazil

Net financial charges are projected to be ~€145 million, ~€15 million less than the Plan assumption, due especially to favourable dynamics of iper-inflation in Argentina and commercial hedging.

Thanks for your attention and I give the floor to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you Mr. Bocchio, this ends our presentation, and we may open the Q&A session.

Questions & Answers

Gabriel Adler – Citi Analyst

My first one is on imports. How are lower imports supporting the pricing environment in Europe and North America at the moment? When do you expect imports to normalize? And do you anticipate weaker pricing when it happens?
My second question is coming back to raw mat, since you mentioned it in the presentation. I might have missed it, but can you please just confirm your assumptions on raw mats for the full year? And if raw material prices do continue to rise, will you be able to put further price increases during the coming months?
And then my final question is on M&A. We've seen some consolidation in the tire market this year already. Do you think Pirelli would benefit as part of a bigger group, being with another tire manufacturer or maybe another auto suppliers focused on the premium segment? I just really want to understand whether M&A is a topic of interest for the Pirelli Executive Board currently.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. I'll answer the second question, and then I'll leave the floor to Mr. Casaluci. We don't have in M&A in our plans. We don't see opportunity around. We are always open to look around, but we don't have anything related to M&A. And now I leave the floor to Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti. As far as North America is concerned, we see that today among the high value regions is the region with the highest rebound in demand. The stock level on the trade is still below what we consider a normal level and also below pre-COVID scenario. So we do expect another third quarter with a strong increase in the Replacement demand. And most probably, we will go towards a stabilization within the end of the year, as far as Replacement is concerned. In the Original Equipment, North America is affected, as Europe, by the shortage of the semiconductor. And as a consequence, we are facing some call off from carmakers. But all in all, the situation is under control also because the carmakers are prioritizing high end range of their product portfolio. As for price increase, of course, we have announced and implemented price increase all around the regions. And we have, for example, announced a price increase up to 6% in July in North America. Another price increase in Europe has been announced for August, roughly +3 percentage points. And the same has been announced in China (around 2%) being effective in April and May

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

And Mr. Bocchio on raw materials, please

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes. Thank you for the question. Actually, you saw in the presentation that for the first half of '21, we already recorded a negative impact from raw material compared to last year for about EUR 39 million, comprising EUR 10 million in commodities and EUR 29 million in FX. For the second half, we are expecting a much higher headwind because we see costs rising month after month. The expectation for the full year is a headwind that is weighting around 3% of our full year revenues. Another important point to say is that actually we foresee for the second part of the year that price/mix will be able to fully compensate this expected negative impact from the raw materials jointly with an additional small negative impact from the ForEx.

Monica Bosio – Intesa San Paolo Analyst

Pricing power and price increases in the high value segment is evident. I'm just wondering if you can comment on the pricing scenario for standard tires and if you can give us an indication of the profitability of this segment. I remember that in the first quarter was in the region of 7/8%, in line with your assumption. Just an update on this or if you see some pressure due to raw material.
And the second is on the working capital going forward. I'm just wondering if you expect some impact on the working capital from the supply chain shortages. And that's it for the time being.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

First of all, on working capital, no, we do not expect any effect. But I leave the floor to Mr. Casaluci for what concerns the raw material prices.

Andrea Casaluci – General Manager Operations

Yes. Thank you, Mr. Tronchetti. Starting with the question related to standard. Well, the price increase has been transferred to standard without major issues because of two reasons. First, in the high value regions, we are following our exit strategy on standard segment. So we maintain the point of the price increase, managing eventually trade-off between price increase and volume, always protecting the price increase and supporting the exit strategy. Second, in the standard regions, where the inflation is running high like South America or Turkey, we are able to transfer the price increases supported by both FX raw material and local inflation. So no major issues in the price increase on standard. As far as the profitability of standard is concerned, you are right, we confirm that we are in the direction of the low double digit, which is our target for 2022. For 2021oday, we confirm a high single-digit level of profitability on standard.

Monica Bosio – Intesa San Paolo Analyst

Okay. Sorry, just a follow-up regarding the price/mix effect for the second half, should we expect a higher impact of mix in the last part of the year. Am I wrong?

Andrea Casaluci – General Manager Operations

Yes, the price performance is expected to improve in the second half compared to the first half because of two reasons. Firstly, we continue to implement price increase in the Replacement (before I mentioned a couple of cases that will be implemented within July and August). And secondly, even more important, the cost metrics in the Original Equipment channel will start to be effective from second half on. So all in all, the price performance of the second half is expected to be better than the first half.

Martino De Ambroggi – Equita SIM Analyst

The first question is just a quick confirmation on the price/mix drop-through being roughly 100%. Does it mean it’s 100% price while the mix among channel, regions and products is basically 0%?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

The normal drop through is 100% for price and 65/70% for Mix. In 2Q the price/mix drop through was 100%

Martino De Ambroggi – Equita SIM Analyst

Okay. Okay. The second question is on the net working capital because in your slide talking about the trade receivables, you specify general improvement in collection. Is it just a matter of a better market environment? Or is there a structural change in the terms of collection or maybe higher factoring and maybe, can you provide the amount of factoring?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr. Bocchio?

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes, I can confirm that the reason is a better collection related to the better environment that we are experiencing. So both in Europe and in North America, we see that the payment inflow is getting much better obviously than 2020 and even better than 2019. So we are not opening new operations, higher operational factor compared to previous times.

Martino De Ambroggi – Equita SIM Analyst

Okay. So no change in terms of collection and basically no jump in factoring?

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

We foresee the same trend similar to the past for the second part of the year.

Martino De Ambroggi – Equita SIM Analyst

Okay. My last question is on Camfin. Since it is going to round up its stake, 4% now, probably another 3-or-more-percent going forward. How should we interpret such a move?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

The move has been explicated in our press release. We maintained some governance inside Camfin. We enlarge the shareholder structure with a share's fee. We have a different category, so no change in governance. And we are strengthening the role that continues to be kept by Camfin as I think we did in the last 30 years. So we continue to remain co-shareholder within Pirelli.

Martino De Ambroggi – Equita SIM Analyst

I personally believe this may be interpreted as preliminary step before a deal in order to avoid dilution. I clearly understood your answer to the previous question, but I just share my view. I don't know if you are totally against such a view.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We do not envisage any, let's say, extraordinary transaction, as I mentioned in the beginning of this call, and so it's not a dilution. It's just a strengthening of our position.

Thomas Besson – Kepler Cheuvreux Analyst

The financial question. I'd like to come back to the 3 elements of the other costs that you projected for the year to be at minus EUR 30 million. I'd like to know if you're prepared to give us an idea of where each of the [EUR 39 million] is going to be to get to minus EUR 30 million. And also, at which level we should expect the other costs in 2022. That's my first question. The second question is on CapEx. You maintained the CapEx at a relatively low level compared with historic levels in 2021 in the plan, so EUR 330 million. With the acceleration in volumes we see in 2021, which is great. Should we expect CapEx to accelerate to some extent in '22, '23 versus the initial plan? Or could you give us an idea of where to put more CapEx assumptions for next year? And I have a last question, please. You report PPA since a few years now. Is it visible for us to remind you how long your P&L earnings are going to be penalized by PPA? What is the year when that stops, please?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. So for the other costs, Mr. Bocchio.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Over the full year, as we have previously mentioned, the overall cost for growth and the other are expected to amount to about minus EUR 30 million. Approximately half of the value that we recorded, if you remember in the first quarter. More specifically looking at the 3 cluster. The R&D, marketing and sponsoring costs are expected to be approximately at EUR 30 million. The provision for management incentives are expected to amount for the full year to around EUR 35 million. Obviously, in 2020, this item had a very minor or a nil impact because of the cancellation of the incentive plan for the short term and for the long term. And for the other costs, instead, we foresee a positive impact of full year at approximately plus EUR 30 million expected, first of all, for the normalization of cost seasonality offsetting the negativity of the first quarter and the normalization increase of the stock compared to 2020 with a positive accounting impact of about EUR 40 million. Obviously, the increase in stock is in line with the expected increase of our sales at the end of the year.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Going to CapEx. We confirm what we had in our plan, where we had flexibility on volume, covering all the needs. There are no changes compared to what we had in our plan. On PPA, PPA started 5 years ago. So we have another 15 years left.

Christoph Laskawi– Deutsche Bank Analyst

The first one will be on the bridge for Q2. The efficiencies went up quite a bit versus Q1, almost 2x. Could you just comment on what was driving that in a bit more detailed way, what kind of measures led to that? Then the second question will be on the working capital that you've shown in the Q2 free cash flow. Do you expect that to slightly reverse in the second half? Or should we expect fairly stable levels in case there is no disruption on the volume side? And lastly, could you comment on the inventories that you have also across the regions? Are you selling essentially everything that you produce? Or could you by now establish quite healthy inventory levels so that you are prepared in case demand -- as we expect in the OE side as well?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr. Casaluci on efficiencies and stock and then Mr. Bocchio.

Andrea Casaluci – General Manager Operations

Yes. Thank you. So as far as inventories is concerned, as I said before, in the trade, the inventories of China are back to normal. In Europe are still a bit below the level of pre-COVID, while in North America, the level of the stock in the trade is far away from the pre-COVID level. So there are still opportunities to restock. As far as our inventory is concerned, we have a level of efficiencies and inventory that we consider optimal to support service level and the rebound of the demand in Replacement. So we don't see major changes looking forward in the second half. As far as competitiveness plan is concerned, the biggest contribution in the second quarter compared to the first quarter is coming from manufacturing and this is mainly related to the rebound of the production and the overall saturation. And as I mentioned in my presentation, the program related to the digitization of our plants and the major efficiencies also coming from the finalization of the program of the restructuring in our plant in Burton, United Kingdom.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

One more comment on the cash flow. We expect to achieve the higher part of the range we gave today to the market. Mr. Bocchio, please?

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes. I would like to add just a quick comment about the cash flow. We foresee to maintain the seasonality of the cash flow as previous year. So in the first quarter, you know that in our business, we have a cash absorption even if this year has been better than previous years. In second quarter, we had a very good cash generation this year with EUR 173 million. We foresee a trend similar to previous year for quarter 3 and quarter 4. So in quarter 3, still a quarter of cash generation where we are expecting to keep the trend to be better than 2020 and better than 2019. And then the fourth quarter, as usual, with very strong cash generation. And as Mr. Tronchetti, we think that we will be able to stay in the higher part of our guidance range.

Gianluca Bertuzzo – Intermonte SIM Spa Analyst

I have a couple of questions. I noticed in your presentation, you build a new product for North America, dedicated to the SUV pickup segment of the market. I was wondering what is your presence in the pickup segment at the moment. Are you playing in this segment? Or is it a segment in which you are under exposed at the moment?
Second question is on the level of competition, given that volumes are still below 2019 levels. If I'm not wrong, in 2019, the industry was in an overcapacity situation. I was wondering what the drivers behind this positive pricing environment are. Supply chain challenges that reduce the prices of imported products, tariffs, inventories or what else?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Before giving the floor to Mr. Casaluci, I want to underline that our strategy in terms of competitiveness is based on leveraging on technology and specialties. That's why we are leading in the prestige market and that's why we are getting, step-by-step, a larger market share in the high-end electric. Moreover, in specialties, there is no overcapacity because specialties are products on demand, where we offer a portfolio that includes noise cancelling systems, seal-inside, run flat and electric, now we introduced products with specific qualities and environmental features (ex. FCS-certified for Pirelli P-zero tyre), lightweight for high weight products. We have our own strategy and ~60% of our sales in the high value segment are now from specialties where there is no overcapacity because, as I already mentioned, the offer is on-demand. Now Mr. Casaluci for the other questions.

Andrea Casaluci – General Manager Operations

Thank you. So back to North America. For Pirelli, North America represents most probably one of the biggest opportunity we have because we are still small in a big and fast growing market. And so we will continue investing in new products, reducing the life cycle of actual products and renewing the range. You currently mentioned this Scorpion ALL SEASON PLUS 3 for crossover SUVs and pickups. We also entered in important pickups of North American producers like the Ram 1500 or the Ford F-150. We are addressing this segment where historically we were not present as we would like to be. So that we started a new customer base and product portfolio enlargement for the U.S.

Philipp Koenig – Goldman Sachs Analyst

My first question is also on the bridge of the savings from COVID last year. If you could just clarify if there are any further reversals that are yet to be expected in the second half of the year because you obviously booked a few savings also in the second half last year? And my second question is on capacity. You mentioned in your presentation that capacity is running already back at 90%. And you also just mentioned that one of your main growth avenues could be the North American market. At the moment, you only have one plant in the U.S. and another one in Mexico, so I was just wondering what your capacity strategy is and if there's any potential for you to expand further capacity in the region?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

One first answer about Mexico and then Mr. Casaluci will provide all the other information. While we continue to grow in Mexico, is very efficient factory. So the investment in Mexico are part of our plan. The growth that we see looking forward is Mexico and China and the investments we are making in Romania. Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Yes. We will support our growth in North America, as Mr. Tronchetti said, with the investment in Mexico, Moreover, we will support the growth of North America also with production from Brazil. So more or less 1/3 of our growth will be supported by North American factories, Mexico and U.S., in Rome, Georgia, 1/3 from South America and 1/3 is coming from imported mainly of prestige high-end tires from Europe.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Mr. Bocchio on other costs.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes. On the COVID cost, actually, as you saw in the bridge, the first half we already registered negative EUR 10 million out of the foreseen minus EUR 30 million in 2021 COVID actions reversal impact. In particular, minus EUR 55 million were related to discretionary costs linked to activities canceled in 2020 in order to counterbalance the impact of the pandemic. And the positive of EUR 45 million of benefits coming from higher saturations of our plants, in particular during second quarter. On a full year basis, we confirm net COVID impacts equal to around minus EUR 30 million, a substantial revert back of the 2020 COVID positive net impact of plus EUR 32 million. In particular, around minus EUR 80 million out of the 2020 EUR 110 million gross cost savings, will revert back as 2021 costs, in particular almost all the benefits gained in manufacturing and product cost together with 50% of the SG&A. And the positive of EUR 50 million will be accounted as volume rebound, considering the production recovery and furlough not contributing anymore. Hence, overall, the net COVID actions will equal to minus EUR 30 million for the full year.

Operator

Mr.Tronchetti Provera, there are no more questions registered at this time, back to you for any closing remarks you may have.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So thank you, Ladies and Gentlemen. This will conclude today's program.