Pirelli & C. S.p.A. FY 2021 preliminary unaudited results conference call transcript

February 23rd, 2022

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening, Ladies and Gentlemen, and welcome to our preliminary FY 2021 conference call.

2021 was a year of economic recovery, especially for our Industry, despite the prolonged COVID emergency, the semi-conductor crisis, and growing inflationary tensions.

Pirelli closed the year with results exceeding our targets and among the best in the Industry, thanks to the implementation of our Industrial Plan and our strong reactivity to the external context.

The Macroeconomic scenario we foresee for 2022 is positive but characterized by growing volatility, as highlighted by the recent events in the Russia -Ukraine crisis, which will have an impact on the prices of oil and energy.

Let me dwell for a few minutes on the impact of such a crisis on the industry and on the actions which we have already taken in Pirelli:
- The incidence of energy costs on sales in the Tyre Industry is ~3% ,compared to much higher values in other sectors (e.g. Construction, Steel, Food and Chemicals);
- Still referring to the incidence of energy costs on sales, if we compare Pirelli to our main peers, we position ourselves amongst the best, by virtue of a manufacturing footprint which benefits from a high exposure to low cost countries (Pirelli 83% vs 47% Peers' average).
- The increase of oil and energy prices will be reabsorbed by efficiencies and price increases. In particular, demand elasticity to price is much lower in High Value than in Standard; it's worth remembering, for example, that in 2011, in the face of a peak in natural rubber prices ($4,500 / ton), Pirelli reached a price/mix increase 1.3 times higher than the headwind.

For the Tyre Industry, the demand outlook is positive:
- High Value confirms as the fastest growing segments (4 times the Standard segment), supported by an improved car parc mix

In this scenario, Pirelli will go forward with the implementation of its Industrial Plan:
- seizing market opportunities in the segments with the highest value and growth (≥19" and Electric) and at the same time
- putting in place all the actions needed to counter the volatility of the external context. In particular, concerning the potential impact of oil and energy on the Russia Ukraine crisis, we are implementing a dynamic mitigation plan, with commercial and technical countermeasures

In 2022 we will pursue revenue growth, profitability improvement, and deleverage, with a ratio close to 2 times the adjusted EBITDA.

Pirelli closed the year with results above targets, after two upward revisions in 2021.
- the progressive upgrade of the Sales guidance has been mainly driven by:

- a strengthening of High Value, with a share gain in Car ≥18” across geographies (+8pp the outperformance vs the market, against our target of +4pp at the end of March), and above all
- the improvement in the price/mix (+6pp vs. March target, +2pp vs. November), due to a solid price discipline and a strong mix improvement

— the adjusted EBIT in absolute terms improved against March and November targets, through a sound commercial performance and the effectiveness of internal levers; in 2021, Pirelli was among the few players who countered the inflation of all production costs with price/mix and efficiencies

— a solid cash generation reflects the structural improvements in the working capital; more specifically on Inventories, we are benefitting from:
- the strong integration with our clients - which provides us with high visibility into trade stock and demand, and
- the flexibility of our manufacturing footprint

which allow us to react rapidly to market fluctuations and optimize Group' stock

— Return On Investments was above our targets, 17.6%, reflecting an improvement in operations performance

In 2021, our commitment to Sustainability continued.

— first of all, safety: in line with our approach “Towards zero accident at work”, our accident frequency index further decreased in 2021 as a consequence of our focus on prevention, training and digitisation

— our Eco & Safety product roadmap is to improve:
- rolling resistance “with no compromise on safety” sees the growth to 49% (vs. 39% in 2020) of the new labeled IP codes in class A or B rolling resistance, according to the European labelling classification
- confirms 87% of the new products falling into the highest Wet Grip A and B safety classes

both KPIs are fully on track to our 2025 targets

— materials innovation is a major means to reduce environmental impact. In 2021, we issued in the market products made with 28% renewable materials, a significant improvement against 23% in 2020. Our objective is to reach, through our technologies, over 43% renewable components and 8% recycled in 2025. As Mr. Casaluci will detail you later, we have already devised a tyre with 94% of materials coming from non-fossil sources.

Finally, our path towards de-carbonization:

— in 2021, as much as 62% of the electricity used by Pirelli worldwide came from renewable sources, 10 more percentage points than in 2020; 100% of electric energy purchased in Europe already today is renewable

— absolute CO_2 emissions in our plants went down by 31% vs. 2015, reaching 4 years in advance the target approved by the Science Based Target Initiative, which set a 25% cut by 2025 vs. 2015

— in line with the Science Based target, we also reduced the emissions of the supply chain: -6% compared with 2018, base year for the target

Besides, we are proudly:

- the first and only Tyre Player awarded with the “3 stars environmental accreditation” of FIA
- the Company that produced the first tyre ever certified by Forest Stewardship Council for natural rubber and rayon
- and that entered a multi-year partnership with BMW and Birdlife for the sustainability of natural rubber, placing the improvement in quality of life of indigenous communities at the centre, together with the protection of forests and endangered animals

Once again, in 2021, Pirelli has been leading in relevant ESG indexes and initiatives, like the “Global Gold Class” award of S&P Global, the inclusion in the Climate A list of CDP, obtaining an “A” score in the CDP Supplier Engagement Rating Leaderboard and Ecovadis platinum, among others.

Thank you for your attention and I leave the floor over to Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Thank you Mr. Tronchetti and good evening to all of you.

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

In FY 2021, the Global Car tyre demand increased by +8%, the recovery was more sustained in the ≥18" segment (+15% year over year) already exceeding pre-COVID levels (+5% vs. FY 2019).

Pirelli outperformed the market both in the total Car segment with volumes at +16% and in ≥18" where the outperformance is even more relevant with a +23%.

Deepening the High Value market we are able to see how Pirelli grew on both channels:

- O.E. growth (Pirelli volumes +21% vs market +8%) was supported by:
  - the exposure to Premium and Prestige which was less impacted than lower end vehicles by the chip shortage
  - an over performance in all High Value regions and in particular in North America and Asia Pacific, where the consolidation of the client portfolio is going forward as previously forecasted, and
  - finally due to also our significant exposure to growth in the Electric, a strategic segment for Pirelli future development
- in the Replacement (Pirelli volumes +25% vs market +20%) we gained market share in all main regions due to our "pull-through" High Value volumes and a furtherly improved product offer with specific regional lines

The growth was higher than the market (+3pp) even in Car ≤17" due to a strong rebound in South American volumes.

In the fourth quarter, the negative market trend (total Car -4% YoY) was mainly related to O.E. (-13% YoY). This channel is still facing, as we previously said, supply shocks and semiconductor shortage. Replacement demand (-2%) was instead affected by an increasingly volatile macro scenario

In the fourth quarter Pirelli beat the ≥18" market in both channels:

- Replacement saw a solid growth, reporting +13% YoY (was +10% in 3Q) and outperforming the market by 3pp, with a share gain in Asia Pacific, North America and in the European Winter segment
- the -5% in O.E., attributable to the automotive problems already discussed, was 6pp better than the market, due to our well known exposure to Premium and Prestige car-makers

Our underperformance was only in the Standard segment (-12% vs. -7% of the market), where we are reducing our exposure, in line with our strategy, after the strong growth recorded in 1H.

The 2021 results follow the full implementation of the «key programs» of our Industrial Plan, as described in this slide.

In our Commercial Program, We:

- strengthened our position in the High Value with an outperformance versus the market, definitely higher than expected; and

- increased our exposure to the ≥19" (66% of the High Value volumes, +3pp YoY) and new technologies, with an EV volume growth ~6 times bigger than in 2020

In our Innovation Program, We:
- achieved ~310 technical homologations, concentrated in the ≥19” segment (~85%) and Specialties (~30%); and
- developed our product portfolio with 6 lines especially conceived for the Replacement channel, with the target of meeting the needs of our consumers in the Regions (All-Seasons, Winter, push-lines)

In our Competitiveness Program, we continue the Phase 2 of our Efficiency Plan.

In the Operations Program, We completed the plant reorganization, which I am going to discuss later on.

Our Commercial Program has brought a robust High Value strengthening, with a 23% growth in the Car ≥18” segment compared to +15% in the Market.

In greater detail:
- >75% of the growth reported for the Car ≥18” segment comes from the ≥19” segment, while ~60% from Specialties

In the Replacement ≥18”, a consolidated growth has been reported, both in:
- «Pull» volumes, based on the advantage from past homologations (~90% of the world “Pull” growth); and
- in «Push» volumes, especially in Europe and the US (>85% of the world growth), through the introduction of new lines exclusively conceived for this channel

O.E. ≥18” recorded a uniform increase of our market share in all the Regions, with EV fitments accounting for ~30% of the O.E. growth for the whole year.

The Pirelli Innovation Plan unfolds in line with the Plan roadmap.

- in 2021, a closer cooperation with major Premium and Prestige brands was reported, and
  - 310 homologations were granted of which, ~85% in the ≥19” segment; and
  - an increasing focus on EVs also through new partnerships with emerging EV car makers
- More product offerings through the introduction of 6 new lines in the Regions that meet customers’ requirements

The Innovation Program is in line with Pirelli Eco and Safety approach

- considerable investments in R&D on materials, compounds, tread structures and designs make our products reach top performances in terms of braking power on wet and dry surfaces as well as improving environmental performance

- more specifically, on the Rolling Resistance, as already illustrated by Mr. Tronchetti, we improved our performance by 10 percentage points vs. 2020, while maintaining over 87% of all our new products with the two top-grade labels A and B, in compliance with European standards

- the positive impact from our new products is also reported in terms of our sales, which we monitor through our "Eco and Safety Performance Revenues" (sales percentage value from products that are included into the first three labelling classes, both in terms of Rolling Resistance and Wet Grip) and that increased by 5 percentage points in 2021

The reduction in terms of environmental impact also includes Materials.

In 2021, Pirelli fitted the Volvo Recharging Concept with 94% of non-fossil materials, like silica from rice husks, bio resins and recycled carbon black. This opens up the way to introducing these materials also in the Standard products.

RHA ash silica was introduced on several production plants and several product lines. This is a material that comes from the external shell of rice grains and is a waste from the Food Industry. It sets a pattern in terms of circular economy as well as provides remarkable CO2 savings: 90% compared to a typical silica production.

Increasing attention is being paid to a further element in the development of new products: Tyre Wear particles, generated by the combined abrasion of both tyres and road surface.

- Pirelli, while promoting a proactive engagement of various stakeholders in the Tyre Industry and Institutions, has also intensified its R&D efforts (research on materials, virtualization, and tests in real driving conditions) to develop increasingly environmentally-friendly products; and
- the new product lines launched in 2021, based on this approach, have improved their wear and tear rate up to 30% compared with the previous generations of products

The Competitiveness Program achieved gross efficiencies worth €155 million, €70 million net from inflation (€80 million FY target), which increased by €10 million in the last quarter, due to increased logistic and energy costs.

In the fourth quarter, gross benefits were worth €45 million, in line with the Plan, and such as to more than offset (~1.5 times) the strong inflationary impact compared to the previous quarters, bringing Net Efficiencies to ~€10 million.

To give you further details as to each FY 2021 project:

- when it comes to Product cost, which is worth ~35% of gross efficiencies, we have continued the implementation of a new approach to modular design and worked to achieve more efficiencies in material purchases
- as to Manufacturing, which accounts for ~ 30% of the gross benefits gained, we have continued to work on increasing flexibility, digitization and sustainability, as planned. In the fourth quarter, Manufacturing reported a considerable increase of the inflation rate and, more specifically, of energy costs.
- as far as SG&A are concerned, which are accounting for ~15% of the gross efficiencies, we resorted to further efficiencies ranging from our distribution network redesign to inventory optimization. In this last quarter, a considerable increase in the rate of inflation was also reported in this area, mainly due to international freight forwarding costs.
- finally, when it comes to Organization, which accounts for ~20% of the efficiencies, we continued our digitization efforts in our processes and upskilling programs for our staff

Let us now go through the progress made in our Operations.

At the end of 2021, we ended the reorganization process of the major plants of our Group, with:
- the closing of the Gravatai plant, and the transfer of its High Value Moto capacity to Campinas
- the Bollate plant was converted from Car Standard to Premium Velo production, and from 2022, the plant will produce tyres «made in Italy» for bicycles; and
- the conversion of the Burton plant into semi-finished products

Through these actions, our Car capacity at the end of 2021 was of:
- 73 million tyres
- 83% of the capacity in low-cost countries; and
- 71% of the total Car capacity is High Value

Consistently with our Plan targets, the Car segment total saturation returns to 90%, with the High Value segment close to full saturation.

Our production arrangements can now count on:
- 15 plants for Car tyres, with a clear-cut mission
- local for local supply policy
- an increasingly «green» approach, in line with our Plan targets

I wish to thank you all, and leave the floor to Fabio Bocchio.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Thank you Andrea, and good evening to you all.

Pirelli closes the year 2021 with Revenues worth €5.3 billion, a growth of +23.9% year-over-year, +24.8% without taking the Exchange Rate impact into account (-0.9%), the latter related to the depreciation of the US Dollar as well as the main Emerging Market currencies.

Let's go through the commercial drivers in detail:

- Volumes contributed by €675 million (+15.7%); a solid growth in the High Value (+20.2%), which is confirmed to be at pre-COVID levels
- Price-mix reported a strong increase (+€390 million, or +9.1%), supported by:
    - Price increases in the Replacement channel on both segments
    - Improved Product Mix, with increasing demand for bigger rim sizes and products with higher technological content

In the 4Q, Revenues growth was worth 11.9%, or +9% excluding Forex impact.

The Volume trend of -7.3% reflects the slowdown of the global Car tyre demand (-5% the market)

- mainly in the O.E. channel (-13%), due to semi-conductor shortage; while
- demand in the Replacement channel (-2%) discounts the volatility of the macro-economic scenario

In this context, Pirelli High Value volumes remained flat compared to 2020, while the Standard volumes recorded a -13.4% decline, in line with our strategy to reduce exposure to this segment.

Price/mix progressively improved quarter after quarter, reaching a record +16.3% in the 4Q, benefiting from:

- full impact of price increases from the second quarter
- improvement in terms of
    - Product Mix, mainly supported by the migration from Standard to High Value
    - Channel Mix driven by a better trend on the Replacement channel, and finally
    - Regional Mix, with a better performance in the High Value Regions

The Exchange Rate impact was also positive, with a +2.9%, thanks to appreciation of the US Dollar as well as the Chinese Yuan.

Let us now discuss Pirelli profitability.

Adjusted EBIT in 2021 was worth €816 million, with a 15.3% margin, in line with our yearly target.
The solid contribution of our internal levers (volumes, price/mix, efficiencies) has more than offset the negative external scenario (raw materials, inflation and exchange rate impact).

More specifically, the profitability improvement during the year reflects:

- a sound Volume contribution (+€267 million)
- a strong upside in Price/Mix (+€283 million) which has more than offset the Raw Material (-€212 million) and Exchange Rate impacts (-€12 million)

- the Phase 2 of our Competitiveness Plan, which has generated Gross Efficiencies worth €155 million (~3% of the Revenues), or €70 million net from Inflation (-€85 million); inflation was higher than the assumptions made in the early part of the year and mainly due to an increased cost of transports during the last quarter, net efficiencies covered by:
  - the “reversal impact” of the COVID Plan (-€31 million), and
  - Other cost increases (-€39 million).

A short comment on «Other Costs», including:
- R&D and Marketing in the High Value segment (-€32 million),
- a positive impact mainly from stock replenishment (+€44 million), coherent with the recovery of the business
- provisions (-€51 million) for short and long-term Management Incentives

The impact of these provisions in 2021 is:
- 1/3 related to short-term Incentives which were cancelled in 2020 due to COVID emergency, while provisions in 2021 reflect the strong performance improvement of the Group on all targets
- as to the remaining 2/3 related to Long-term Incentives:
  - I wish to remind you that 2021 is the first year we made provisions for the two LTI Plans: the 2020-22 Plan and the “3-year rolling” Plan firstly introduced in 2021 (related to the 2021-2023 period)
  - the provisions related to the 2020-22 Plan also reflect the adjustments related to 2020 for above-target performance, in particular on the cumulative Net Cash Flow

  In 2022, provisions will be normalised with a positive impact on the adj. EBIT bridge, while the other items within «Other Costs» will be negligible.

In the fourth quarter, the adjusted EBIT was worth €217 million, basically in line with the 2020 level. The Price/Mix offset 1.4 times the Raw Materials and Exchange Rate impacts, while the lower volumes (-€43 million) are related to the drop of Standard described previously.

The adjusted EBIT margin for the period was 16.0% (18.3% in 4Q’20), and discounted:
- the “reversal impact” of COVID actions (-€8 million)
- higher Inflation costs (-€10 million)

Both approximately equal to 1 margin point.

Let us move to the Net Income dynamics.

Net Income strongly increased by about +€279 million in 2021 versus 2020. The trend takes into account:
- the already mentioned improvement in the operating performance
- lower restructuring and non-recurring costs

Results from Equity participations was positive by €4 million, mainly as we recorded better results in our JVs in China and Indonesia.

Net financial charges were slightly improving YoY, mainly impacted by:
- higher charges on central debt, impacted mainly by the COVID pandemic which caused a temporary increase in the margin of the major credit line of the Group
- which were more than compensated for by benefits from financial management at local level

The €101 million increase in tax charges relates to the higher operating results we just discussed, as tax rate is stable at 26%.

Net Income adjusted, i.e. excluding all the one-offs and non-recurring items, is positive for €469 million in 2021.

In 2021, the Net Cash Flow Before Dividends was €431 million (~€390 ÷ ~€410 million, the November target), mainly supported by:

- the Operating Performance improvement already mentioned
- less absorption of the Working Capital / other, with:
  - Trade payables trend benefiting from the business recovery; and
  - a careful Inventories management (20.5% of Revenues at the end of 2021): finished products 15.7% of revenues, and stable YoY, as well as stock of raw materials worth 3.3% of the revenues (+0.8pp YoY), with the target of easing potential risks connected to the supply chain, in an extremely volatile macro-economic situation which is characterized by an uncertain scenario of the transportation industry

Capital Expenditure was worth €346 million, and was primarily related to High Value, and the constant improvement of Mix and Quality in all plants.

The Net Financial Position is negative by -€2.9 billion, with a leverage 2.4 times the Adjusted EBITDA at the end of 2021, definitely improving versus the ≤2.6x the November guidance.

Pirelli's Gross Debt stands at €5.3 billion, with a Net Financial Position of €2.9 billion, thanks to a €2.4 billion financial assets. Our liquidity margin totals €2.7 billion.

Please note that on February, 21st, Pirelli signed an agreement with a large pool of international banks for the opening of a new 5-year ESG Facility of €1.6 billion, of which €600 million as Term Loan and €1 billion Revolving. These credit lines replace the bank loans due in June 2022 and worth a similar amount, although with a slightly different mix as our financial flexibility has now increased.

Our cost of debt increases by 44 basis points compared with 31 December 2020, reaching 2.38%, mainly due to the cost increase of some bank lines, whose margin is parametrised to the Group's leverage, which was temporarily impacted negatively by COVID pandemic.

Now I leave the floor back to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you Mr. Bocchio.

The outlook for 2022 remains positive, with the global GDP expected to grow +4.4% YoY, basically in line with the estimates in the Industrial Plan.

However, volatility remains high: the COVID emergency, although easing at the moment, is still looming. At the same time, there are growing geopolitical tensions and a tightening of fiscal policies of the last few years, both in Europe and the US.

Unlike in the past, inflation has risen in 2H 2021, due to the reopening of world economies and a generalised increase in production factors. Its impact is significant in the US and Europe, where it went up to 4.2% and 3.0%, respectively. It should be stressed that over 50% of inflation in Europe is attributable to the increase in energy prices, under further pressure by way of the last days' events.

Always due to inflation, in 2022, we expect a generalised increase in the major input costs, although offset by the price/mix and efficiencies.

Raw Materials are mainly impacted by oil price driven by the recovery of demand which is due to go back to pre-COVID levels in 2022. Supply is expected to be lagging due to the limited investments made in the last few years and a policy in the major oil producers focused on maximising prices. Let me remind you that Pirelli has price indexing clauses with OEMs for over 65% of Original Equipment production.

Energy is always the cost item where we expect the highest increase.

The current intensification of the Russia-Ukraine crisis is leading to an increase in oil and energy prices, which requires the rapid implementation of mitigation actions on tyre pricing and efficiencies.
For example,

- in our plants, we are already reducing our consumption and accelerating the use of renewable sources
- we have implemented hedging contracts to protect ourselves from excessive price fluctuations

As for shipping, in 2022, the same criticalities as in 2H 2021 are going to stay, especially on long sea routes. Pirelli appears to be less affected than many other players due to our local-for-local production, which is close to 85%, except for the North American market which is served by our plants in Mexico and Europe.

Finally, the increase in the cost of labour is going to be limited in 2022, with most of blue collar contracts being already negotiated.

Let us now go through our forecasts for the Car Tyre market in 2022. Demand is expected to grow by ~+3%.

As we already forecasted in our Industrial Plan presented in 2021:

- Total Car tyre market should be back to 2019 levels only by 2023
- Car ≥18" is confirmed as the most resilient segment and growing the most

After reaching 2019 levels already in 2021, High Value is expected to grow by ~ +8% year on year, ~4 times the levels of Car ≤17", more than the Plan estimates.

Let us move to the next slide to go into more depth in the segment dynamics.

Also in the high-end of the market, a more decisive growth is expected in the Original Equipment channel, with a ramp-up of Car production, especially in the second half of the year.

Positive also the trend in the Replacement channel, due to the restocking at dealer level and the positive impact of growth in new registrations of the last few years.

Now, I would like to give you more colour on the segments specifically targeted by Pirelli: Car ≥19" and the Electric.

The ≥19" segment is expected to grow double-digit in 2022. It will account for almost half of the ≥18" compartment, due to an improvement in the mix of both Car production and Car parc.

As already clarified during the Plan presentation in 2021, the Electric is proving to be the fastest growing market segment: ~27 million tyres between the Replacement and Original Equipment channel, and a year on year increase close to 40%.
This good trend discounts the greater penetration of the Electric in the total Car production, as well as in Premium and Prestige, supported by an increase in the demand from consumers and Government incentives.

In this scenario, Pirelli will continue implementing its Industrial Plan "key programs".

In the Innovation program:
- we confirm our focus on High Value, which at the end of 2022 will account for 73% of the Group's revenues
- our exposure to the Standard segment is decreasing, in line with our objective of reaching the landing point of ~25 million pcs in 2025
- we expect a more selective approach in the Original Equipment, with a focus of the higher rim sizes (≥19") and Specialties, particularly in the Electric

In the Innovation program, we continue with
- the expansion of our homologation portfolio in the fastest growing segments, and
- the renewal of products, with the launch of 10 new Regional lines, strengthening our local-for-local strategy
- We confirm our Competitiveness program, with gross benefits of €150 million; inflation, definitely higher than what forecasted in the Industrial Plan will be offset by efficiencies and price increases
- finally, in the Operations program, we foresee, in line with our Plan, a further increase in High Value capacity, which at the end of 2022 will account for 72% of total Car capacity

In light of described so far, Pirelli expectation for 2022 are:
- Revenues between ~€5.6 and €5.7 billion, with

- Group's volumes between ~+1.5% and ~+2.5%; High Value volumes are expected to be between ~+6% and ~+7%, while Standard volumes are expected to drop by ~-3% ÷ ~-4%, in line with our strategy of progressively reducing the exposure to this segment
- price/mix improvement between ~+5.5% and ~+6.5%, supported by further price increases and a more favourable mix, mainly Product and Region
- Forex impact between ~-2% and ~-1.5%, with volatility of the currencies of emerging countries concentrated in the second half of the year

— adjusted EBIT margin between ~16% and ~16.5%, reflecting the above mentioned dynamics, and more precisely:
- positive contribution from volumes
- price/mix will more than compensate for exchange rates and the growing input costs, like raw materials and inflation. The latter will only be partially covered by the gross efficiencies coming from Wave 2 of the Competitiveness program
- basically neutral the impact of D&A and other costs

— Investments of ~€390 million, equal to ~7% of revenues
— Net Cash Flow before dividends expected between ~€450 and ~€480 million, due to the improved operating performance and an efficient management of the working capital
— Net Financial Position equal to ~€2.6 billion, with a leverage at or below 2 times the adjusted EBITDA
— Return On Investments at or above 19%

Finally, with reference to the Russian-Ukrainian crisis, we developed a first sensitivity by assuming that current oil and energy price may last from March until the end of the year.

In such critical context, we have also considered impacts on local operations related to flow from and to Russia both in terms of raw materials and finished products.

Factoring those hypotesis and mitigation actions, the impact on Adjusted EBIT and Cash Flow should bring us to the floor of 2022 guidance.

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

Questions & Answers

Giulio Pescatore – Exane BNP Paribas Analyst

I guess we have to start with Russia. So I was just wondering if you were willing to share your thoughts on the current situation. And can you remind us on the exposure of Pirelli to the market in terms of sales and production. What are the direct impacts on local operations that you're assuming at the floor of your guidance, as you just explained?

And then still on Russia, does Tacticum have a 5.6% stake? which is kind of indirectly related to Russia. So do you see any risk for that shareholder potentially being forced to sell because of sanctions?

And then lastly, just a quick question on price and mix. Are you willing to share how much of the 16%, which, by the way, was an incredible result in 4Q. How much of that was driven by price and how much was mix?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

For the first part of your question, Russia accounts for ~3% of our Group revenues and below 4% of our adj. EBIT. So the impact we foresee is not directly material on Russia operation and half of our sales are directly in Russia. What we see is indirect effect and the impact on oil price and energy, so we can have some logistic issues, but we don't see material impact locally.
And for the second question, price mix, I'll leave the floor to Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Thank you, Mr. Tronchetti. Out of the 16% of price/mix improvement in 4Q 2021, I would say ~30% is coming price and ~70% is coming from mix. The very positive performance on mix has been supported by all the main operative drivers like the channel mix, the region mix and, of course, the usual micro mix inside the product segment. On top of that, as we presented the standard in the last quarter decreased. And so the weight of the standard and the total sale was below the average of the full year.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

For the second part of your question related to Tacticum. They recently announced that their Pirelli stake dropped below the 3% threshold. So there is no impact on our shareholder structure.

Monica Bosio – Intesa San Paolo Analyst

I hope you can hear me. My first question is on the current weight of your EV tyres on total revenues. You just gave us volumes impacted, but I was wondering if you can share with us the weight on revenues. And the second is still related to the EV tyres. EV market is running faster than initial expectations. For the time being, it's only Original Equipment, but can we expect some impact on the aftermarket segment already in 2022, 2023?

Or should we wait until 2024 to see a material impact as a pull-through effect on the aftermarket?

And the third one is on the standard tyres. Can you just update us on the operating margin on the Standard tyres at the end of 2021. And if you have some expectation for the current year? And if we should expect some restructuring on the back of the reduction in standard also in 2022?

Andrea Casaluci – General Manager Operations

Yes. Thank you for the question. So I will start from the electric vehicle. In 2022, we do expect that in the Original Equipment channel at electric vehicle, we start to have a significant and meaningful impact. In terms of volume, we target roughly a bit more than 10% of the total sales will come from the EV while as far as the net sales is concerned, it is a bit higher, closer to the 12%.

In the Replacement channel, the impact is still very low, I would say, ~2% on the total sales inside the High Value channels. And as you correctly said, the first significant impact on the Replacement channel due to the pull-through of the regional equipment will start to be meaningful from 2023, but we need to wait until 2025 to see a first material impact on the total result of the company.

In 2022 we target to reach more than 2 million EV tyres on the Original Equipment.

As far as the standard profitability is concerned, at the end of 2021, we reached the target of the double digit which is what we expect for the entire 2022. So more than 10% of return on sales with a total volume on standard that is targeting ~25.6 million tyres in 2022. It means that we are fully on track with our target of 25 million within the Industrial Plan time horizon.

Monica Bosio – Intesa San Paolo Analyst

Okay. And sorry, do you expect some restructuring related to the further reduction?

Andrea Casaluci – General Manager Operations

No, we don't have. We finalized all our project of restructuring. We should see the opposite reduction of the cost related to restructuring we still have in 2021.

Martino De Ambroggi – Equita SIM Analyst

The first question is just a very broad question because you reminded that in 2011, you were able to react to skyrocketing raw material costs. If the figures I have in front of me are correct, in that period, you were able to improve margins both in absolute and as a percentage of sales. I clearly understand it was 10 years ago, but what are the main differences and the base similarities versus the current environment? Maybe more unpredictable, but I remember also that period was quite unpredictable. So that's my first general question.

The second is on the free cash flow guidance because in the press release, you write and your guidance embed efficient management of working capital. Could you elaborate a bit on this and trying to quantify it? And related to this question, what was the factoring at the end of the year? And what's your assumption in the free cash flow for the current year?

And very last, sorry, if I missed it, but I didn't see the split between Standard, High Value profitability. So I was wondering if the Standard tyre was able to approach or achieve 10% return on sales? And what is the profitability for High Value?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you. So for the first part of your question, in 2011, the natural rubber grew because of lack of capacity and strong demand, lack of capacity that needed to be restored through new investment in new plantations and there was also a speculation. Today's raw materials increase is also related to a growth in demand that is sound, average, like it was sound in 2011. So the difference is on energy; 2 extraordinary elements are impacting on the input costs: real growth in demand and international geopolitical crisis.

But in both cases, we see that the environment is sound. So was sound in 2011 and is sound today. The stock level as it was in 2011 in the trade are still below average. So there is no visible channel risk today. And so we expect we can have a protection of prices.

And let's say that in 2011, there was also a much lower penetration of the High Value segment that is, as I mentioned before, more protected because the consumer are less, let's say, sensible to the price increase compared to the standard. And on the standard segment, raw materials weight is higher than the weight on High Value tyre.

So considering all these factors, we should be in a better position today than in 2011 because the weight of the High Value on total sales is more than double compared to 2011. So that's why we expect we can cover with the price increase and with efficiencies, the raw mat and inflation impact. Also due to the extraordinary element that is the energy and oil price.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

We'll get a question on the cash flow target and working capital. So our target for 2022 Net Cash Flow in the range €450 million to €480 million relies upon, first of all, obviously, a very sound operating performance. Second point is related to the CapEx that is absolutely in line with what we were foreseeing in our Industrial Plan presented last year. Restructuring cash out strongly reducing year-on-year, 2022 will be more or less 50% compared to 2021, as already foreseen in the Industrial Plan and an efficient management of the working capital with still a positive impact on cash. Specifically speaking about the working capital, we think that the improvement that we reached in 2021 is really structural with particular reference to the inventories.

I wanted to highlight that the strong integration with our clients that has been established along the last few years provide us high visibility on the trade stock and on the demand and the flexibility of our manufacturing footprint allow us to react rapidly to market fluctuation and optimize the group inventories.

For 2022, in particular, we forecast an increase of the stocking units, obviously, given the increase of the sales in volume, but keeping the same inventory efficiency, meaning the same impact on the top line and an increase in the unit value, obviously due to the inflation.

Based on this, we expect 2022 inventories to increase in absolute value, but remaining stable year-on-year in terms of incidence on sales. The higher value of inventories will be more than compensated, more than offset by the expected increase in trade payables. Stable weight on sales is also expected for receivables and payables with the DSO and DPO in line with the pre-COVID levels.

And we don't foresee any change in our policy regarding factoring. So pretty in line in 2022 compared to 2021.

Martino De Ambroggi – Equita SIM Analyst

And those are 2021 versus 2020?

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes. Actually, there was a slight decrease in our operation in 2021 compared to 2020.

Andrea Casaluci – General Manager Operations

Yes. The last question was the profitability of the 2 segments. Standard we already said, is ~10% and High Value is ~19%.

Martino De Ambroggi – Equita SIM Analyst

Is it improvable, the Standard?

Andrea Casaluci – General Manager Operations

Yes, we are in the direction of improving year after year. So the total profitability of the company is improving both for the higher weight of the high value and the profitability of the Standard itself.

Sascha Gommel – Jefferies Analyst

The first one would be on your CapEx program again. Can you explain a bit the split between maintenance and growth CapEx? And then related to the CapEx question, we hear a lot of your competitors in Europe but also in the U.S. stepping up the investment programs as well and volume growth seems to be quite muted in 2022. Is there a risk that we're coming into an overcapacity situation in tyres again?

And then my second question is on your margin guidance, 16% to 16.5%. I think your midterm plan had 16% to 17% for 2022. I was just wondering given that your top line is better and your price/mix is offsetting not only raw mats, but also other cost inflation. What's the reason that you become a bit more cautious on your margin?

Andrea Casaluci – General Manager Operations

Yes. So as far as CapEx is concerned, we can consider the €390 million, so ~7% on sales of the total CapEx. ~20% will be devoted to High Value capacity, mainly China, Mexico. And this is to prepare the growth of the coming years because in 2021, we are already well balanced with more than 90% of overall saturation.

And no, there is not under saturation of the capacity at all in this moment in the industry. On the contrary, there is a shortage of availability mainly due to the very good demand on the Replacement channel coming from North America and the United States, both High Value markets where we are overexposed.

Then more or less 40% of the CapEx, which is the vast majority, as always, Pirelli is dedicated to technological upgrade and quality and productivity improvement, ~7% in digitization, the digital transformation of the company. And the remaining part, ~30% is maintenance and base load.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Regarding the profitability, so we have a growth in volumes that is higher than expected and the recovery even faster. And we see an average profitability slightly below the plan, but we keep the targets for our 2025 plan. So the trend you see is a trend of growth when 2021 was better than expected. And I think in this environment, these numbers are reflecting our objectives considering also the top line growth.

Christoph Laskawi – Deutsche Bank Analyst

The first one will be on the price rounds that you're targeting. Have you already implemented price hikes across the regions for 2Q? And are you planning to grow quarter-by-quarter like your competitors? So essentially 4 hikes in 2022?

And then sort of following up to that, do you see a risk of trade downs by customers more into Tier 2, Tier 3 brands when Premium moves up constantly throughout the year? And in case freight rates are normalizing more into 2H'22, do you expect pressure on market share from imports, especially in Europe and the U.S.

And last question from my end will be on the inventories across the regions. If you could comment on those, please.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Before leaving the floor to Mr. Casaluci, what we see we don't see any trading down of the Premium. We see a Premiumization of the market related to the electric vehicle that today is affecting the Original Equipment and in the future will affect the Replacement in a positive way. The market itself, as I said before, is sound, considering the stock in transparency, our stock and the stock of the trade and the demand we have. And we see that all the logistic issues are creating an environment where the costs are going up as also the importers from Asia to Europe and U.S. they have to revise their price up because there is obviously an impact.

We have a lower impact because we are more local-for-local. In 2H, there should be also an effect on the recovery of the volumes in the Original Equipment that volume-wise, could keep the market sound also in the pricing for the replacement market. Please, Mr. Casaluci.

Andrea Casaluci – General Manager Operations

Thank you. As far as price increase is concerned, we have already announced all around the world, price increase. In Europe is 3.5% of price increase, in United States is up to 10%, in China is a 3% avg. price increase. These already announced price increases all around the world, together with the favourable exit speed from 2021 will assure the price performance that is embedded in our guidance of a price/mix 5.5% to 6.5%. And I would say that more or less 70% of this price/mix increase is related to fuel price.

Clearly, we are following on a daily basis, the development of the market demand or end of the inflation environment. And we are ready to announce further price increase where and when necessary.

As far as stock is concerned, the level of stock in the trade in U.S. and Europe is still below the average. So we see opportunities of good demand, even if we are entering most probably in a restocking phase, the stock in the trade is below what we consider a normal level while in China has been normalized into what we consider a healthy environment with the trade stock at the normal level since 2H 2021.

Gabriel Adler – Citi Analyst

Just two quick questions left for me. In 2022, should we expect the drop-through on price/mix to be much higher because there's more of a weighting towards price. Is that the right way to think about the drop-through for 2022 price/mix?

And the second question is just a follow-up on the EV tyres point. Could you just confirm what your current market share is in the EV tyre market relative to your market share for the total market? I appreciate you gave a target for 2025, but a comment on where we are today would also be very helpful.

Andrea Casaluci – General Manager Operations

So I will start from the last question. Our market share in the electric vehicle today, it makes sense to talk about market share in the Original Equipment channel that already started. So our target within 2025 was to reach in the Premium segment of the EV a market share 1.5x higher than the one on ICE.

And we have to say that we will reach this target 3 years in advance because in 2022 numbers, we already have embedded a market share in EV Premium and Prestige segment that is 1.5x our market share in ICE. To give you consistent numbers, if we have a 20% of share in the ICE in the Premium segment, in the EV Premium segment in 2022 we are targeting a 30% market share.

While if we talk about Prestige segment, as you know, we already have 50% of share in this segment, and we target to confirm the same share in EV and we are fully on track with this target.

The other question was related to price/mix. As I mentioned before, price/mix in our guidance is in the range of 5.5% and 6.5% with a midpoint of 6%. And out of this 6%, we can easily consider a 70% at least related to price and we don't see any kind of risk on this target. On the contrary, we will follow the inflationary environment, and we will evaluate if announced further price increase or not in the coming weeks. Thank you.

Philipp Konig – Goldman Sachs Analyst

My first one is on the volume guidance. So you're mentioning that you're expecting your High Value volumes to grow between 6% and 7%, but you're sort of expecting the market for ≥18” to grow above that. Can you just explain why your High Value guidance is just sitting slightly below that?

And my second is just getting back to the Net Cash Flow guidance of €450 million to €480 million. If we go a year back to the Industrial Plan, you were guiding for cash flow of ~€440 million at the midpoint with the same amount of CapEx, but obviously a much lower adjusted EBIT in absolute terms. So has there anything changed otherwise on the cash flow if we think about today against the plan a year ago.

Andrea Casaluci – General Manager Operations

Okay. I will answer about the pace of growth of the High Value in 2022, you are right. We have a total growth that is more or less in line with the market with very different behaviour between Original Equipment and Replacement.

We target to gain market share in the Replacement in the ≥18” in all the markets and regions, which is the core of our business model, and we will over perform the market of at least 3 percentage points.

While we target decrease of market share in the regional equipment, mainly or, I would say, concentrated only in Europe, where we are in the phase of execute our selective approach with the carmakers with a clear target to grow in the electric vehicle both in traditional partners and carmakers in Premium and Prestige and in the newcomers and to reduce our presence in the Synergic segment and also in the lower end of the Premium segment, where we do consider the integrated profitability is no more at the level we want to reach. At the same time, we still plan to grow, thanks to a customer enlargement in the regional equipment in Asia and in North America.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Okay. So regarding the cash flow, I think it's the opposite of what you said. So the midpoint of the guidance was €440 million in the plan and is now €465 million, and the CapEx remains at €390 million. So that is in line with a better cash flow in line with the investment and with better cash flow.

Thomas Besson – Kepler Cheuvreux Analyst

I have 2 quick questions, please. First, on Forex. I'm wondering if you could explain us how you get to the -1.5% to -2%, please as current spot rates suggest more something positive for 1H. So are you assuming a sharp deterioration in 2H of currencies? That's the first question.

The second: looking at the exit price/mix level, I'm a bit surprised that you're only assuming 6% midpoint. Is it reasonable to think that the overall elements of your revenue guidance may be a bit conservative? Thank you very much.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

I will take the question about the FX. And I will say, yes, you're right, meaning we do expect deterioration mainly concentrated in the second part of the year, so in the second half of the year. And our forecast about the Forex that is between minus 2% and minus 1.5% comes mainly from the currencies of the Latin American countries and the Turkish Lira. Obviously, Turkish Lira, we are already seeing in these days, the impact coming from the country, but we expect higher volatility from Latin America for the second part of the year.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Relative to the price mix. Obviously, the second part of the year will be a comparison with last year 2021. And as you have seen, there has been a 16.3% increase in 4Q. So let's say, there is an opportunity, but the comparison base is quite challenging.

Michael Shawn Jacks – Bank of America Analyst

It sounds like you're still factoring in a positive mix impact for 2022 despite OEM volumes coming back. How should we think about the negative channel mix implications of a recovering OEM market? Are you able to quantify the estimated impact on price/mix? And I would imagine this would be more weighted to the second half of the year?

And then my second question is just focusing in on cost inflation. Can you please give us a sense for what you're factoring in for the various cost inflation categories in euro terms? Is it fair to assume that raw mat inflation would be roughly the same the first half of this year as it was in the second half?

And then if you could give us some sort of steer on what you're expecting from the combination of wages, transport and energy prices in euro terms.

Andrea Casaluci – General Manager Operations

Yes. Channel mix. So if you look at the market, we would expect a negative price mix because of the recovery of the regional equipment due to the shortage that affected the 2021 and that is expected to recover even not full recovery during 2022 mainly in 2H.

But as I said before, at Pirelli we are implementing a more selective approach in the channel, mainly in Europe. As a consequence, we do expect a neutral impact of the channel mix during 2022 with similar speed between 1H and 2H.

Fabio Bocchio – Senior Vice President Strategic Planning & Controlling

Yes. On the inflation, we foresee an overall environment, obviously, that will have much more inflation in 2022 compared to 2021. Given a few details about it. I would say that on raw materials, we see 2022 reasonably similar to the ongoing situation of 2021.

So we already foresee this increase in raw mat with the latest increase even in brent that will hit us in the COGS in the next few months. So the picture on raw materials will be 2022 similar to 2021.

We are seeing impact coming from international transportation and we are taking into account this impact in the guidance that we released.

And obviously, the impact from energy that has been starting from 4Q 2021, and will be hitting fully 2022. And even this assumption, obviously, it is already included in our 2022 guidance having in mind that we still see a lot of volatility on the market. So obviously, there is always the possibility to go up and down.

We have included in our numbers some inflation related to the labour cost that is slightly higher than in 2021.

Michael Shawn Jacks – Bank of America Analyst

So is it fair then to assume that in absolute terms, the cost impact from other OpEx inflation is going to be roughly similar then to what we're going to see in raw materials?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

What we can see to simplify things is that we see a raw mat and inflation headwind close to 7% on sales which will be offset through price increase and efficiencies.

Operator

Mr. Tronchetti Provera, there are no more questions registered at this time. The floor is back to you for the closing.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you, ladies and gentlemen. So this concludes our today program, and I wish all of you a very good evening.