

Pirelli & C

H1 2013 Conference Call

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Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

SLIDE 3: KEY MESSAGES

Good evening Ladies and Gentlemen and welcome to this conference call on Pirelli's 1H2013 results

This first half reporting season is drawing to an end. Yet, I believe we may say that the Tyre Industry, although in a critical macroeconomic situation in Europe and experiencing a slowdown in some Emerging Markets, has so far confirmed its value strategy with profitability and cash generation as its top priorities.

In this context, Pirelli is the best performer in terms of Revenue drivers for the first half of 2013.

- Total volumes of +6.3% with two underlying performance drivers:
 - A) A higher exposure to Emerging Markets, posting a double-digit volume growth (+16,9%)
 - B) A focus on the Premium segment which is proving an exceptional growth driver in the Emerging Markets (+28% in 1H'13 yoy) and started recovering in the second quarter in Europe, with a good performance in July
- A +2.5% Price/mix, driven by Emerging Markets, since in Europe the mix improvement offsets the price reduction, in a market where prices are stabilizing vs. the first few months of 2013

Concerning price, it is worthwhile pointing out that the Industry shifted on customers part of the tailwind resulting from lower raw material costs, with a fiercer competition also on other marketing and product innovation levers.

Through our analysis of the competition scenario, we decided to accelerate investments for our future growth since new Premium car registrations are increasing globally and therefore we must be ready to make the most of the opportunities offered by the Replacement market when demand rebounds.

We believe that a crisis is just a moment of discontinuity, that can be turned into new opportunities.

In 2008/2009, we were the first Tyre Company in the Industry to shut down high-cost non-Premium capacity and install Premium capacity in low-cost countries, bearing the investment peak throughout the last two years and accomplishing today the most competitive production network: 80% in the Car and 100% in the Truck!

Now, what we need to do is a fast implementation of innovative solutions in our distribution network through channel expansion, new Premium products, enhanced Brand consideration in the Emerging Markets where we are new entrants (specifically China and Russia), to create a selling proposition for future matching of products in the future, Brand, services and a higher loyalty rate. Please, bear in mind that in the top Premium range the loyalty rate can reach as much as 80%!

As for the Truck Business, in this first half of the year, we have reached a record profitability, that allows us to upgrade our FY13 Ebit target.

The drivers are:

- the production footprint, where we nearly completed the delocalization process. This will result into a recurrent economic benefit, which can amount to as much as approximately +20 mln euro, when fully operational;
- the product mix, with a strong development of the 01 series and the double-A label;
- volume growth, especially in LatAm, where we have improved our market share and achieved full saturation of our plants.

If we combine all these business drivers, we are confident that at the end of this year our profitability will be stable vs. last year. We shall also benefit from having started large investments in the commercial area and an optimized management of the working capital. This will eventually allow us to generate cash and start writing the Second Chapter of our Equity Story, which we are going to tell you on November 6 in London, where we shall present our new Industrial Plan.

SLIDE 5: KEY FINANCIAL RESULTS

Let us go through the results of the second quarter of 2013, which show a Revenue increase of 8.8% in spite of a 5% negative impact of foreign exchange rates.

This significant improvement vs. the first quarter of 2013 is connected to:

- A stabilization of market fundamentals in Europe, with improving volumes and pricing developing in line with our expectations;
- Strong growth in the Industrial business, because of a rising demand and an easy comparison base; and
- Continued solid performance in the Emerging Markets, in particular in the Premium segment

These factors more than compensated for a lower-than-expected level of sales in Russia.

Profitability has been growing year on year due to the positive trend of Revenue drivers and efficiency gains. It includes, however, additional investments in future Premium growth.

This means:

- stronger commercial and marketing expenses to sustain our Brand and our new products and increase proximity to consumers, and
- the ramp-up of our Premium plants in Mexico and Russia.

In addition, Profitability was impacted by Forex and the slowdown of demand in Europe and Russia.

In the remainder of my presentation, I shall discuss Net Income in detail.

Continued investments with a focus on Premium and the payment of dividends resulted in a slight increase in Net Debt over the second quarter of 2013.

Net Cash Flow before dividends amounted to 107 million euro, achieved through careful management of Net Working Capital.

SLIDE 6: H1 2013 PERFORMANCE BY REGION

On a regional basis, our results show:

- An acceleration of growth in Emerging Markets, accounting for 57% of total sales and approximately 65% of the Ebit in the first half of 2013
- Outperformance in the North American market, although still faced with demand uncertainty, where we improved our market share not only in the Premium segment
- Stabilizing results in Europe, where second quarter 2013 tyre revenues were flat year-on-year versus -15% in Q1, and the Premium segment returned to growth
- A slowdown in Russia, as we will detail in the following slide.

Specifically on Premium, sales growth turned positive in H1 2013 through a sequential improvement in demand which we captured because of our distinctive geographical reach, continued product innovation and capacity ramp-up.

Positive signs came out of Europe, where we seized important opportunities in the OE channel, continued to improve our product mix and to develop value-added sales channels.

In this region, however, demand fundamentals have not yet recovered and the early data on our winter market confirm our initial cautious view.

Turning to the most dynamic markets, Premium sales in Asia Pacific continued to grow profitably, helped by improved availability of locally sourced products and the successful extension of our Cinturato P1 range.

A similar positive trend is shown in South America. We continue to drive the development of the Premium market in the region, gaining market share in Brazil, especially in the Replacement channel. Pricing continued to be supportive, and our network of single-brand shops helped us deliver higher-mix products to end customers.

Lastly, the overall North American market slowed down in the first 6 months of 2013 even though the Premium segment proved resilient. We expect an improvement in our Nafta performance in the second half of the year also through our new products coming on stream, such as Pzero Nero GT and Scorpion Verde AS+, and a dedicated care to Tier-1 customers.

SLIDE 7 RUSSIAN JV

Now, specifically on our JV in Russia.

The Russian market is going through a phase of contraction sensibly changing our outlook from early 2013.

New car registrations, which were deemed to be moderately growing in our budget, in line with AEB forecasts, posted a -6% YTD, with a worsening trend since the beginning of this year. Our new full-year forecast is now -4 to -5%, with imported brands and foreign local production in a better position than Russian brands.

This proves that the Premiumisation process keeps on.

The same trend reversal occurs in the Tyre market where we are revising our estimates.

The performance YTD is -2% and in the second half of this year we forecast its further worsening, due to the mentioned negative trend in car registrations as well as the general market overstocking.

It should be noted that most of the market contraction will occur in the A-brand segment, while all major players are resorting to B-brands in the current contingencies.

The economic slowdown is not confined to the Automotive Business, but extends to the whole Russian economy, as recently proved by the reduction of approximately one point in the estimates of their GDP made by the International Monetary Fund.

Such unfavorable scenario has a major impact: the sub-saturation of our plants. This causes a “sub-optimization” of industrial costs, which made us opt for a stronger push on sales of our second brands that of course have a lower margin than the Pirelli brand.

Yet again, this sub-saturation makes it possible for us to accelerate the industrialization process of the new Premium lines, specifically in our Voronezh plant, whose results exceeded our planned target in the first six months and allowed us to review our full year target for both plants to more than 110 new industrializations.

In spite of the changes to the market scenario, Pirelli continues to pursue its plan for a stronger commercial position.

At the end of June 2013, the number of Pirelli’s Premium branded stores reached 600, in line with our target.

Also, our shelf presence continued to improve, as measured on a pool of more than 300 stores in all major cities in the country.

Our considerable advertising spending during the first six months has further allowed us to enhance our brand consideration in our target segment of Premium car owners.

All this translated into a tangible outcome with an increased market share both in the Standard and particularly in the Premium segments.

In summary, we stick to our long-term value strategy, with a short-term revision of our targets in terms of Revenues and Profitability, as we shall see later.

SLIDE 8 PIRELLI NET INCOME H1 2013 VS H1 2012

Pirelli closed the first half of this year with a Net Result of 150 mln euro.

The year-on-year trend discounts the following factors:

- A lower operating result in the first quarter;
- The impact of RCS and Mediobanca evaluation;
- Higher financial charges (21 million euro) from the increased average gross debt and a greater exposure to currencies in Emerging Countries. In 2013, a cost of debt reduction is expected in line with the 6.3% target, through a different mix of currencies and a reduction of gross debt;
- The one-off impact connected to a different year on year exchange rate dynamics and financial earnings by Prelios (7 mln euro) booked in the first six months of 2012.

In the first half of 2013, the tax rate was 40.4%, due to both the impact of devaluation (4 percentage points) and start-up costs in Mexico and Russia, affecting the net result of those countries and consolidated earnings before taxes. Based on this trend, the full year tax rate for 2013 is expected to be approximately 37%.

SLIDE 9 PIRELLI DEBT STRUCTURE AS OF JUNE 30, 2013

At the end of the Second Quarter of 2013, Pirelli's Gross Debt is worth approximately 2.6 billion euro, out of which more than 75% maturing in 2015 or later. At the same time a sound liquidity margin of 1.1 billion covers debt maturities throughout 2015.

Pirelli's Euro Medium-Term Note programme announced back in December last year has now been signed and officially established. Therefore, our financing policy gains further flexibility through the ease of access to the debt capital markets which already contribute 30% of our debt structure.

Under favourable circumstances, we could take into consideration accessing the market during 2013, as an anticipation of a 2014 refinancing exercise.

The cost of debt is 6.4%, decreasing from 6.5% of the first quarter and in line with the trend for the remainder of 2013, when the cost of debt is expected to come down to 6.3%

Now, I give the floor to Mr. Sala.

SLIDE 10: PIRELLI H1 2013 NET FINANCIAL POSITION

Thank you Mr. Tronchetti. Let us now take a closer look at our Net Financial Position.

Net Cash Flow before dividends amounted to 107 million euro in the second quarter of 2013 – up strongly versus the previous year.

This is due to the trend of Net Working Capital, which includes a reduction in inventories now worth 17.5% of sales, lower than 19.9% at the end of June 2012.

Investments totaled 84.3 million euro, or 1.2x depreciation, and were mostly directed to our Consumer Business.

Approximately one third of our investments was devoted to Premium capacity expansion in Mexico, Romania and China, whereas another third to improving mix and quality of existing capacity to better meet Premium demand.

The cumulative 164 million euro investments as of June 2013 account for approximately 40% of our yearly target, same run rate as last year.

The 52.4 million euro increase of Net Financial Position we recorded in the second quarter of 2013 is therefore mainly attributable to the payment of dividends, worth approximately 160 million euro.

SLIDE 12: KEY TYRE RESULTS

The second quarter Tyre business results show a clear improvement of top-line drivers, which resulted in:

- A Revenue increase by 8.9%, after a negative impact of Foreign Exchange worth 5%, and
- 207 million euro in profitability, growing 3.8% year over year and accounting for 13.1% of sales after restructuring costs

Volume growth was:

- strong in the Consumer Business, as demand continued to be supportive in Emerging Markets while showing signs of stabilization in Europe, and
- an impressive 20.6% in the Industrial Business, with buoyant end-markets especially in South America.

Overall, our geographic footprint and regional leadership positions allowed for an 8.8% volume growth.

Price/Mix improved by 5.1% year on year in the second quarter of 2013.

This includes a negative channel component: the weight of OE sales grew as compared with the second quarter of 2012 as a reflection of increased activity with Premium automakers.

Product mix was however very positive and Premium volumes were the chief contributor to price/mix growth.

This is due to:

- a return to growth in Europe, and
- the performance of Emerging Markets, with acceleration in MEA (+16% year over year) and Russia (+68%) and on-going strength in Asia (+44%) and South America (+26%)

Premium Sales in Nafta were stable as compared with the previous year, outperforming the market which slightly contracted in the first two quarters of 2013.

SLIDE 13 : PIRELLI TYRE OPERATING PERFORMANCE

The operating result of the second quarter of 2013 amounted to 207.2 million euro (+3.8% yoy) with a margin of 13.1%, improved as against 12.2% of the first quarter of this year.

The year on year profitability trend reflects the meaningful improvement of the top-line drivers as well as the continuation of our efficiency program.

Sustained volume growth – mainly in the Truck Business and Emerging Markets – translated into an EBIT enhancement worth 28 €mln.

The price/mix contribution was positive: +20.2 € mln in the 2Q vs. -19.6 mln € in the 1Q 2013, due to a Premium Segment acceleration – with a recovery of European sales – and price increases in the Emerging Markets to counter exchange rate volatility.

The impact of efficiencies is in line with the first quarter of 2013 and amounts to +12.8 mln €, made in the following areas:

- labour, productivity and scale;
- raw materials, by a reduction of product weight and waste;
- industrial production, entirely moved to low-cost countries and producing its initial benefits.

We confirm our target of 70 million euro efficiency gain for the full year.

All the above assets, together with lower raw material costs (31.2 mln €), offset:

- higher production costs (37.2 mln €), in line with inflation in the Emerging Markets;
- investments to support growth in the Premium segment worth approximately 20.2 mln euro, of which 12.3 mln related to higher commercial and marketing costs, and 8 mln euro as start-up costs in Mexico and Russia and conversion costs for the Settimo Torinese plant;
- higher plant sub-saturation (7.5 mln €) due to weaker demand in Europe and Russia;
- higher amortization, negative exchange rate impact and other costs.

SLIDE 14 : INVESTMENTS TO FOSTER PREMIUM GROWTH

In line with our strategy to make our Premium position stronger, we intensified our marketing efforts using all the different levers.

In order to be closer to our Premium customers, we are boosting our Retail network by opening new stores in our target markets such as China, Russia, Brazil and Europe.

More specifically, in China we expanded our presence with almost 400 new stores located in the crucial areas for Premium. Now, we total almost 1,800. Our 2014 objective is more than 3,000 stores.

We already talked about Russia.

In Brazil, where we have the widest distribution network of single-brand stores, we are developing a successful affiliation program targeting high-mix independent dealers (UHP specialists). 90 new stores were added in the 1st half.

In Europe, we are strengthening our network by improving the mix and privileging high-value stores. We are about to open our first flagship store in Frankfurt, specifically for Premium Customers with an innovative layout and service offering located in the area with the highest Premium potential.

A new advertising campaign called “Iris” was launched globally with the purpose of raising brand consideration with our top customers, highlighting our very strong partnerships with our Premium OEMs. The remaining 30% of our extra marketing spend helped us

- launch new products,
- further expand our digital advertising projects, and
- launch further promotions and co-marketing projects in key markets, such as in Russia with Rosfnet, in Italy with Eni, and in the US.

SLIDE 15: PIRELLI INNOVATION CAPABILITY

We have already touched upon the launch of new products in the first half of this year.

I now invite you to concentrate on our product innovation capability.

In the Car Business, our leading positioning in the Premium high-end is based on an unmatched number of products in our range, and a wide portfolio of OE homologations. We supplied more than 400 items to our Premium and Prestige OEM partners just in the first half of this year.

Our portfolio is being continuously expanded and renewed and here you can see just a few prestigious homologations granted to Pirelli in 2013, like the 900 horse power McLaren P1.

As a testimony of our commitment to quality, the Volkswagen Group just recognized us as Global Champions among their suppliers, adding one more milestone to our partnership which goes way beyond Europe encompassing operations in Latin America, Mexico, China, Russia and the US.

Besides working on the products, our R&D also focuses on innovative technologies, such as our very recent Pirelli Noise Cancelling System, developed jointly with Audi: a special sound-absorbing material fitted inside the tyre that reduces noise inside the car by more than 50%.

Pirelli technological state-of-the-art level of quality not only characterizes our Car, but also our Truck Business, which can rely on cutting-edge products, especially in the new '01' Platform.

This new '01' Platform includes the right product for all applications, also for the winter season, and has been further reinforced with our latest "ST-01", specifically engineered for semi-trailers.

The "ST-01 Neverending" was also awarded a double-A label.

In its Truck Business, Pirelli matches top-quality Tyres with new revolutionary technologies. Our "cyber" sensor, which can be applied inside the tyre, allows the real time measurement of pressure and temperature and thus completes the service range Pirelli offers to commercial fleets, helping them to optimize their management costs.

SLIDE 16: PIRELLI CONSUMER BUSINESS PERFORMANCE

Let us now review the performance of our Consumer business, which accounted for 72% of total sales in the Second Quarter of 2013.

Revenues rebounded – up 10.3% before a 4.7% negative exchange rate impact – due to still buoyant Emerging Markets and the improvements in Europe: together, these accounted for a 4.6% volume increase, of which 12.9% in the Premium segment and 0.9% in Non Premium.

Worth noting is the performance of our Car Business in Asia Pacific and Latin America, which posted a combined increase of revenues of almost 20% year-on-year in the second quarter and improved from the already good results of the first quarter of 2013.

Our sales in Russia and North America continued to be dented by anemic Consumer Tyre demand in the Replacement Channel, but our focus on Premium allowed us to outperform the market in both regions.

Premium was the main contributor to the acceleration of price/mix improvement in the second quarter of 2013, +5.7% yoy. Premium volumes were up 12.9%, or approximately three times faster than overall consumer volumes, with Emerging Markets continuing in their strong momentum, Europe returning to growth and stable volumes in North America.

Country mix also improved for the second quarter in a row, due to a normalized consolidation perimeter of our Russian assets.

Quarterly profitability reached 144.2 million euro after restructuring costs, or 12.7% of sales.

Now, if we look at the profitability of the first six months of 2013, consumer Ebit margin was down 3.2 percentage points before restructuring costs.

Premium accounted for half of this Ebit margin reduction, as we invested in:

- the OE channel, and
- marketing levers to build a sustainable base for future growth.

We also booked:

- start-up cost of our high mix facilities in Mexico and transformation of Settimo Torinese plant, and
- incremental expenses versus our initial estimates for Russia start-up.

The remaining 1.6 percentage point difference in Ebit margin in non-Premium sales includes:

- slowdown costs due to lower factory utilization, and
- the impact of weaker volumes and hardly any mix compensation, mostly in the European market.

SLIDE 17: PIRELLI INDUSTRIAL BUSINESS PERFORMANCE

The Industrial Business continued to deliver strong results in the second quarter of 2013, posting

- a revenue increase of 18.2%, even after a negative foreign exchange impact of 6%, and
- record profitability at 14% Ebit margin after restructuring costs.

The volume driver was particularly significant, with a 20.6% yearly increase mainly due to the growth in South America and Middle-East Africa.

It is important to highlight, however, that the comparison base is exceptionally favorable given that the second quarter of 2012 was characterized by:

- negative market volumes

on top of which we had two specific headwinds, worth alone a 7% volume drop:

- a production stoppage in our Egypt plant in June, and
- import constraints in Argentina.

Adding further to top-line growth, firm pricing and increasing acceptance of our new products meant a +3.6% growth in price/mix.

The positive development of volume and price/mix produced a 2.1 percentage points increase in profitability, also sustained by:

- lower raw material costs, and
- benefits from the recent improvement of our cost base, now 100% located in low-cost countries.

And now back to you Mr. Tronchetti

SLIDE 19: 2013 OUTLOOK BY REGION

Thank you Mr. Sala.

Let us now go through our assumptions for the global Tyre Market as well as our regional revenue and profitability targets for 2013, highlighting the main differences with what we shared during the last conference call.

In Europe, we see mild signs of recovery, but for the full year our view remains unchanged, somewhat negative in the mid-single digit range year-over-year.

The slow starting of the winter season is confirmed, and this leads us to revise our forecast on the Premium that, although resilient, will likely remain flat year-over-year.

Our guidance for the Region, however, remains unaffected.

In North America, we confirm our previous assumptions, whereas the scenario in Russia is worsening, as we already commented earlier.

This has an impact on our guidance: we forecast Revenues upward in the high-single digit range, with a slightly negative profitability, paying for the cost of the slowdown in the Voronezh plant in the short term.

In the medium, though, we confirm our value strategy and continue the industrial and commercial investments that we have already described in detail.

Apart from Russia, the rest of Emerging Markets maintains our expectations of a robust market growth everywhere, with a Premium segment on the surge. This positive scenario and our good performance in the first half lead us to improve our Revenue guidance for the full year.

We see both in South America and Asia Pacific a top line growth in the double digit range, up from the high-single digit of last quarter, whereas in the Middle East and India our estimate for a flat performance now turns into a low single-digit growth.

SLIDE 20 PIRELLI 2013 TARGETS UPDATE

The market outlook we just discussed led us to confirm our 2013 full year targets, now based on a slightly different set of drivers.

Revenues are expected to grow by more than 4% as compared with 2012, within the previous target range.

Volumes are now expected to grow faster, given the development of Emerging Markets, South America and Asia Pacific, which more than compensate for the sales slowdown we expect in Russia.

Premium growth is confirmed above 13% in volumes, albeit with a higher weight of OE sales as an investment in future growth in the Replacement channel.

This trend has a negative impact on the Consumer Business mix worth approximately 1 percentage point, or 0.5 percent in terms of overall Tyre mix.

The recent devaluation of South American currencies made us revise our Forex assumptions for the year, from -4% to -6%. This has a 60 million euro negative impact on Ebit, 20 million euro more than the previous guidance.

As a result of the above, Ebit is now expected at the floor of the previous guidance range, approximately 810 million euro.

We also expect a higher positive impact of raw materials, +15 million euro, which will counterbalance higher industrialization and start-up costs in Russia and rising inflation in Emerging Markets.

Our Capex guidance is confirmed at 400 million euro, and we still expect cash flow generation before dividends to be above 200 million euro.

Finally, our Net financial Position target is confirmed at below 1.2 billion euro, before the impact of Prelios credit reclassification.

SLIDE 21 CONSUMER AND INDUSTRIAL TARGETS

Let us now review our targets by business.

In Consumer we confirm our 2013 Revenue target of about 4.6 billion euro as a result of:

- Volume growth between 4.5% and 5.5%, with Premium growing more than 13%
- Price/mix between 3.5% and 4.5% given the higher weight of Premium OE as compared with the previous guidance
- -5% Foreign exchange impact

Increased investments on Premium have a short-term impact on profitability, which we expect at above 13% Ebit margin

In the Industrial Business we confirm our Revenue target of about 1.7 billion euro.

- Volumes are expected to grow by 9%, or twice as fast as in the previous guidance
- Price/mix will grow between 3% and 4%, given a different country mix
- Foreign exchange impact will account for an 8% reduction in sales

The new mix of Revenue drivers and a higher Raw Material tailwind led us to revise the Profitability level of this Business upwards.

We now expect an Ebit margin in excess of 13%, a level which we consider sustainable in the medium-term considering:

- A continuously improving business positioning: wider product and service portfolio
- Best in class cost structure, with production entirely based in low-cost countries.

SLIDE 22- 2013 MAIN PROFITABILITY DRIVERS

This Chart details the main changes in our Profitability drivers.

Ebit is expected at approximately 810 mln euro, the floor of the previous guidance.

The new revenues drivers have a net zero impact on Ebit with the exception of 20 mln euro lower profitability due to a heavier forex impact.

Efficiency target is confirmed and the higher Raw Material tailwind and lower marketing expenses compensate for:

- Higher input costs due to labour and inflation increase in Emerging Markets, and
- Higher industrial costs in Russia

SLIDE 23 - 2013 RAW MATERIAL GUIDANCE

Finally the assumptions behind our revised raw material guidance.

The advantage we expect in Natural Rubber and Butadiene is largely eroded by foreign exchange whose negative is almost double.

This concludes the presentation and we are now ready to take your questions.

Questions and Answers

Massimo Vecchio - Mediobanca - Analyst

Good afternoon to everybody. You detailed quite a lot your view on Brazil, which is quite optimistic. My question is don't you fear that the government may try to raise the interest rates because inflation is going up and the currency is devaluating? In this case probably the growth will slow down. I would like to know your view on that because you are clearly very exposed and knowledgeable of the area. Thank you.

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Thank you for your questions. The fact is that the government already did it and the other fact is that the government confirmed incentives for the automotive industry that were to be stopped in May. And so we do believe that even in an environment that is not as bullish as it used to be in the first months of the year, there will be still growth compared to last year. And in our accounts, we take into account all of this.

Stephan Puetter - Goldman Sachs - Analyst

Good afternoon and thank you very much for taking my questions. The first one is just on the cost inflation maybe looking out a little bit into 2014. If I add up all the numbers on slide 22, it basically suggests you have had cost inflation/a negative impact of the slowdown this year of EUR260 million, which is quite a sizable number. How much of this should we expect to repeat next year or could we have a materially lower number?

Then secondly, if you could just share a little bit your thoughts on what the price mix was in the second quarter, if we split it out in the individual components. And also when I look out for the full year, you basically guide for price mix to be up 3.5% to 4% on the revenue line. Is it probably fair to assume that the net effect of a better mix and a negative pricing to the EBIT is roughly zero? Is that probably a fair assumption? Thank you very much.

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Thank you. If you look to the price mix, we expect to have an effect that will be around 3.9, that's what we have in our estimates for the full year. Volumes, as we mentioned before, should be around 4.3% and mix will be worth around 4.5% and price 0.5%. The exchange rate should be around 5.9%.

So these are the effects we expect to have in the next quarters and that takes into account also the inflation impact that you have mentioned. I tried to synthesize the answers.

Stephan Puetter - Goldman Sachs - Analyst

Okay, just to repeat so the mix for the full year should be plus 4.5% and price minus 0.5%. Did I get that correctly?

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Yes, that's right, that's right.

Stephan Puetter - Goldman Sachs - Analyst

Okay, perfect. On the cost inflation when we add up the 260 basically on slide 22, the other input costs, marketing, industrial costs, depreciation, I guess a lot of this is more related to this year, so for next year presumably your cost inflation should come down quite materially. Is that a fair assumption?

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

It is a good assumption. Now Mr. Sala will provide you the details on the answer.

Maurizio Sala - Pirelli & Co. SpA - Head of Group Planning and Control

For the time being, considering what we expressed in page 22, what is recurring in terms of inflation is what we are putting other input costs, because in this case we are talking about inflation that are affecting our activities in particular in the South American countries, but also in Turkey, also in Egypt.

And in this case, the level of inflation year by year will be in the region of EUR120 million, EUR130 million, slightly higher than the previous year because also our activities in the emerging markets is growing. You may account that 57% of our sales currently are in the emerging markets different versus what we had some years ago.

Then when we talk about industrial cost, this part for sure is an impact in this year and in the next year we will have less of these one-off events and therefore all concerned marketing commercial costs is too early to talk about with the new investment that we will do next year.

Stephan Puetter - Goldman Sachs - Analyst

Okay, that's very clear. Thank you very much.

Martino De Ambroggi - Equita - Analyst

Thank you. Good evening, everybody. I have a question on Russia. I know you are going to present a new business plan in November but just to have an idea if you are going to change the medium-term targets considering the weaker than expected performance?

Always on Russia, I understand it's partly due to the unfavorable trend of volumes on the market but is there any other main issue that has to be addressed? In your presentation you talked about new startup costs or additional investments.

Third and last on Russia, you are also mentioning you are going to buy another stake, the minorities. What is the amount in terms of cash and is it already included in your debt target for the full year? Thank you.

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

So starting with the last question, we already have EUR11 million of costs that are already in our cash this year.

So back to the first question, the business plan stays as we presented it two years ago, so we confirmed the targets for next year. We have a delay of one year, already mentioned it during the last conference call we had. And we are confident that the implementation of the project we are making also on commercial side where we make some changes, we provide us more strength in the market. We can underline the factories are improving well and the mix of products that will be produced in Russia by year-end, we re-size that we will have a mix in the market that will be very competitive, so we are confident that we can stick to the targets.

Martino De Ambroggi - Equita - Analyst

Okay, in terms of startup costs that you have to add, so there is no additional cost from this year or there is some additional cost also going forward?

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

No, we don't see any additional cost if now the acceleration of the industrialization we are making, so we have approximately EUR10 million of higher cost for industrialization. The real difference is the results that is affecting our EBIT this year, but we expect to recover next year.

Martino De Ambroggi - Equita - Analyst

Okay, thank you. If I may, just a follow up on pricing in Europe, if you have any comment on the trend going forward specifically on the premium segment? Thank you.

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

I leave the floor to Mr. Pirondini.

Andrea Pirondini - Pirelli & Co. SpA - Chief Commercial Officer

Okay, so good evening to everybody. As far as the European market is concerned, we had a tough first quarter. The market continued to go down as we saw and we were expecting a rebound in the second quarter. The second quarter confirmed these expectations in most of the markets especially in Central Europe. We had the recovery of the volumes because of peculiar weather conditions that delayed part of the summer demand.

Now I think it is important to look ahead into the second half and I am little bit more optimistic than I was three months ago because I see some fundamentals moving in the positive direction, although we all know that in Central Europe there is an issue of destocking of certain wholesalers and this is an industry issue.

While we start to see some slight positives in the fundamentals, today came out the news of a positive number for the car registrations in the German market, although it is a minor positive. We hope this is a tendency towards a stabilization of the system.

Martino De Ambroggi - Equita - Analyst

Thank you very much.

Niels Fehre - HSBC - Analyst

Good afternoon, I have three questions if I may. The first one is on Russia as you mentioned here, that the market is overstocked in summer and winter tires. Maybe you can give us some more details if you see that over stocking also in the premium segment or is it something you face only in the standard segment?

Also how your Japanese competitors are reacting to these -- to the situation in the market and what are the other tire makers doing? So do you face any pricing pressure in the Russian markets at current?

The second question is on your industrial tire margin, which was at 14%, I think the highest ever margin you achieved in that division. You mentioned in the presentation that you have improved your footprint, so I am just wondering is that higher margin something we have to expect for the future as being sustainable because you have a better footprint or how much of this higher-margin is coming from better raw material costs? If you can just tell us if it's sustainable or not.

And the third question is on slide number 10, where you mention in the second quarter a positive effect on your net debt from ForEx and others of around EUR30 million. Maybe if you can just explain that because I thought your FX effect was negative in the second quarter. So I'm wondering why it's helping here your net debt to come down a bit. Thanks very much

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Starting from Brazil, then I leave the floor to Mr. Pirondini, Brazil and rest of the industrial business, we consider these results as part of two main factors. One is the 100% of production we have now in the low-cost countries having shut down the production in Italy. We will profit at full steam of more than EUR20 million EBIT margin improvement thanks to the localization of the production.

The second element where we see we can keep going with these good results is related to our position in Latin America that has been strengthened also thanks to the fact that we bought the distribution network and we are positioning the market with our monobrand distribution that is stronger and stronger.

So these two elements are very positive and we can consider it a structure. Some concerns still remains on Egypt where for the time being it's doing well. And so we could have negative -- it doesn't depend from us some turbulence. But for the time being we didn't see anything happening And then all in all what is really the best news we have from industrial products is the 01 success and the older line of 01 has been successfully tested in Europe, in Latin America, and the development of this product could confirm the profitability we have now plus the success of the cyber tire for the fleet. We started with Brazil and now we are going on in Europe, Middle East, and in China.

So these are the structural elements whereby we are confident that they can continue to successfully develop our strategy in the industrial side.

Now I leave the floor to Mr. Pirondini.

Andrea Pirondini - Pirelli & Co. SpA - Chief Commercial Officer

Thanks, I go back to the first part of your question. You were asking about the overstock situation in winter. I was talking about Central Europe, but you're right, there is a similar situation in Russia. So Russia has also relatively high stock of winter this year. This is part of the classic trend, cyclical trend of seasonal markets.

Typical in these situations, there is a higher pressure at selling level in terms of prices but what we have seen in Russia is not different from what we've seen overall at the European level with the realignment of the prices more or less in line with the tailwinds, with the advantages we had at the raw material levels. So I don't see a particularly dramatic situation in that respect in Russia.

What we are doing at Pirelli, we are launching new products. We are launching a new product at top-level, the ICE zero this year in the market. We have a very good rating for this and we have good expectations in this respect. Also we are entering in the area of B brands with a reinforcement of our lineup. What we are seeing in Russia, we are expecting also certain growth of B brands this year

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Now Mr. Sala about the debt.

Maurizio Sala - Pirelli & Co. SpA - Head of Group Planning and Control

Talking about the impact of the ForEx in net debt, two different trends in the first quarter, in the second quarter. In the second quarter, this was a benefit coming from the exchange rate because there was a devaluation of the Brazilian real, of the Mexican pesos, of the Russian rubles, and the

pound Egyptian in which we have position at debt. So in this case, the devaluation of local position in-depth that reminds us that there was a positive improvement in the second quarter.

In this first quarter, there was a negative improvement because in some countries in which we had the liquidity for instance Venezuela, there was a devaluation so in this case, we had the impact negative coming from the devaluation of the liquidity in Venezuela and the devaluation of the debt that we have in Mexico due to the revaluation of the Mexican pesos.

Cumulative, the impact is EUR20 million negative of ForEx in net financial position versus the position of December 2012.

Niels Fehre - HSBC - Analyst

Okay, very clear. Thanks

Giuseppe Puglisi - Intermonte Securities SIM - Analyst

Good afternoon, everybody. Giuseppe Puglisi, Intermonte. A few questions. The first, can you please give some more color about your inventories in the different macro areas? So LatAm, Europe, and so on.

Second question, we got Egypt, are you taking into account the possibility to exit from Egypt in case of further turmoil? If yes, what is the Plan B?

Third question regards the fact that you said that in Europe you are seeing some good possibilities in the early trend. Can you please give us more color about it? Thank you.

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Thank you. The stocks, what I can give you as a figure is that we have 2% less than last year-on-year so the improvement is global. And when you look to the working capital, you see what has been the outcome or the action that you have taken.

Egypt, no, we don't have any reason to leave the Egyptian market because it is also a good basis for the export. Turbulences can happen. We build factories not for the next months but for the next decades, so we are there. We stay. We feel comfortable and in case there is something, we will have some trouble, but it's nothing that is affecting our results, if not for a low single-digit effect. It is marginal, but can be very profitable, has been and will be profitable.

And in Europe original equipment, we increased our balance between replacement and original equipment of approximately 4 points in the first months of this year. And then in the next months, we will rebalance a bit if the forecasted volumes remains as is, so we are a bit flexible in that area.

Giuseppe Puglisi - Intermonte Securities SIM - Analyst

If I may, just a quick follow-up. Are you investing in both a full capacity utilization in Brazil, in LatAm and do you plan to speed up investment in that area?

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

As you know, we have also a bulk of opportunities thanks to the growth of the production in Mexico and so we can balance -- so we feel comfortable.

Giuseppe Puglisi - Intermonte Securities SIM - Analyst

Okay, thank you.

Marco Tronchetti Provera - Pirelli & Co. SpA - Chairman and CEO

Thank you. So I believe there are no more questions and I'd like to thank you all for your attention. Enjoy your summer and have a nice evening. Thank you.

Conference Call. Operator

That will conclude today's conference call. Thank you for your participation. Ladies and judgment, you may now disconnect.