

# Pirelli & C. S.p.A. 3Q / 9M 2018 results conference call transcript

*November 14, 2018*

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

Good afternoon, Ladies and Gentlemen, and thank you for joining our conference call today.

In a very volatile market environment, Pirelli delivered prominent results, being the only Tier 1 player to improve profitability both in the nine months and in the third quarter. And here is why:

- › our High Value strategy is proving resilient, and our programs and results in this area are on track
- › we are cutting costs, with a short-term crash program to deal with the LatAm crisis, and with additional actions in 2019 - thanks to the benefit related to the patent box, as we already announced- to continue to support the double digit reduction in Standard and the High Value strategy.

Let me briefly recall the two key factors which explain “why our Strategy is unique”:

1. the first reason is our choice of Positioning

We have positioned ourselves in the High Value Market.

This segment has a very healthy growth, in the past but also in the future.

Prestige and Premium Car Parc is growing. And importantly, the ≥18” tyre market is growing 10% this year, ten times more than the ≤17” market.

The High Value market is also protected by technological and complexity barriers.

Customer Demand is calling for an increasing number of Car Models per Brand, and within those, an increasing number of fitments and rim sizes.

All this compounded with a higher number of technical requirements and the superior sophistication demanded by Prestige and Premium OEM’s.

This trend is even more marked for Electric vehicles. Here tyres have to meet additional technical requirements such as High Load Capacity and Aerodynamics.

2. the second factor behind our unique Strategy is our distinctive business model: the model is built on the integration of many components, but let me just recall 5 of them:
  - › first, we collaborate with very demanding OEMs to their vehicle development, and today we detain the largest portfolio of Marked Tyres’ Homologations
  - › second, through our collaboration with OEM’s, the homologation portfolio and our own market insight, we have an early visibility on Tyre Replacement demand for the years to come...
  - › third, this visibility allows us to secure a robust pull-through replacement demand
  - › fourth, as growing variety in product offering can create complexity costs, we have implemented new Flow processes in our Plants, which support mass customization

- › finally, we control the High Value Consumer Experience at Retail level, by growing our coverage through Car Dealers and Pirelli Retail

Having recalled our strategy pillars, let me turn to our results in the first Nine months.

As mentioned, in High Value, we are fully on track with the guidance:

- › in the “≥18”, our volumes grew faster than the global market
- › we keep on strengthening our strategic levers at a rapid pace:
  - We added 260 new High Value homologations, 45% of which in Specialties
  - We doubled our available homologated fitments on Electric Vehicles compared to previous year
  - Our High Value capacity grew by 2.6 million pcs, reaching almost 60% of total capacity
  - We have improved our control over the last mile, channelling 55% of our sales through Car Dealers, Pirelli Retail and Tier 1 customers (versus 51% in FY 2017).
- › Our High Value Revenues experienced a double digit organic growth, with an EBIT margin of around 25%
- › In the Standard business, we have taken Cost Measures to respond to a deteriorating LatAm environment and accelerated the reduction of our exposure to Standard.
- › In particular, we are implementing our crash program to cut costs by €50 million by the end of the year, of which €30 million “recurring”, that are producing a structural cost basis reduction in 2019. Of the €50 million cost reduction, 40% are affecting LatAm while the remaining 60% the other regions and the Headquarters. These actions mainly concern labour, plant overheads, marketing budget and advertising, purchasing negotiations.
- › Thanks to the benefit related to the patent box, as we already announced, additional cost cutting actions, in line with what we have done in 2018, will be implemented in 2019 to continue to support the double digit reduction in standard and the High Value strategy.

Getting into more detail, in the first nine months, we recorded a sound organic growth of revenues, +4.4%, supported by a further strengthening of our positioning in the High Value segment, which now accounts for more than 64% of sales.

In the face of a deteriorating scenario in LatAm, we proved the resilience of our business model and our responsiveness to headwinds by posting a significant profitability increase with an EBIT margin of 18.7%.

Our solid operating performance combined with

- › a strong reduction in the cost of debt, and
- › the patent box benefits

boosted our Net Income that grew 90% versus the first nine months of 2017, reaching 9.6% of sales.

Following the agreement with the Italian Tax Office, signed on October 15th, 2018, the benefit relating to the 2015-2017 period and the expected benefit for 2018 is reflected in the estimated FY tax rate, which is the base of the calculation of the tax charge for the first nine months 2018.

Finally, Net Debt reflects the usual seasonality of the working capital, which absorbs cash in the first nine months and returns it in the last quarter of the year.

Mister Sala will add some more colour to that.

Let's talk about regions now, starting from High Value Regions which account for 80% of the Group Sales and 93% of High Value revenues.

In Europe, we reinforced our leadership in High Value, with a market share gain in Car tyres  $\geq 18$ " both in the O.E. and Replacement channel.

The new emissions test on CO2 modified the O.E. business seasonality with sales concentrating in the first half of the year and a contraction in the third quarter. The negative WLTP impact is progressively easing and Pirelli, thanks to its exposure to Prestige and Premium Car makers, is expecting a lower impact for the fourth quarter.

In the Replacement channel, our positive performance is the result of the pull-through effect and a more pervasive presence in the car dealer channel.

In the Standard segment, we keep on restricting our exposure to the less profitable products.

The Mix improvement and efficiency gains drove the profitability enhancement to the "High -Teens" range.

In NAFTA, we keep growing High Value Sales, especially in the Replacement channel, driven by the success of our Regional All-Season products and the increase in coverage with our Retail distribution network.

In the OE business, we keep on expanding our homologation portfolio adding new partnerships with local car makers.

Profitability went back to the Twenties range as a result of the mix improvement and a stronger Dollar.

APac seized the opportunities offered by the High Value segment confirming the highest growth and profitability among all regions.

We recorded a 25% organic growth in High Value sales as a result of:

- › a strong performance in the O.E. channel, consistent in all quarters, consolidating our leadership and expanding our client base to local and innovative car makers; and
- › An improved positioning in the Replacement channel through a robust pull-through effect and a wider distribution network

Standard Regions account for 21% of our Sales and just 7% of our High Value revenues.

The macroeconomic environment in Latin America is challenging: GDP growth is slowing down and currencies are highly volatile.

The tyre market is weakening: in the first nine months, the Replacement market was down 6%, -11% just in the third quarter. The trend was even worse in Brazil where the Replacement market reached -17% in 3Q.

In this context, we keep focusing on mix improvement. However, the weak market demand did not allow us to implement the price increase we had planned.

We promptly reacted to the market weakness by implementing a crash program on costs.

This manoeuvre allowed us to contain the impact of lower sales on the EBIT. We ended the first nine months with:

- › revenues down 4% year over year in organic terms, and
- › a profitability in the mid-single digit range, declining by more than 1 percentage point year over year.

In MEAI our performance discounts the exchange rate volatility (mainly related to the Turkish Lira) and the macroeconomic slowdown in the Region.

In this scenario, cost cutting actions and local price increases, particularly in Turkey<sup>1</sup>, were activated to protect our profitability.

Finally, in Russia & CIS, our focus on the most profitable segments allowed us to grow both sales and profitability, with an EBIT margin in the High-Teens range.

Let's discuss the way we expect to close 2018.

- › We confirm our operating profitability target leveraging on both High Value and actions to counter the deteriorating scenario in South America
- › Our performance in High Value confirms its robustness with a 13% growth in volumes
- › In addition, we are accelerating the reduction of exposure to Standard with a 12% volume drop (-9% in our August guidance)
- › This will result in a 2% decrease in total volumes ("flat" the previous indication)
- › Price/Mix is expected to post a solid +6.5%, although in the low range of our guidance, because prices could not be increased in Brazil in the third quarter. The price manoeuvre planned would have produced a price/mix improvement of at least 7%
- › Hence, organic top line growth is due to reach ~4.5%
- › High Value will account for ~64% of total revenues and more than 83% of our profitability
- › Adjusted EBIT, before start-up costs is confirmed to be above €1 billion. The increased volatility of exchange rates, lower volumes and the performance of the business in South America will be offset by:
  - higher efficiencies exceeding input costs by ~€20 million (a zero balance the previous indication)
  - a cost cutting crash program worth €50 million, out of which €30 million are recurring
  - a lower raw material headwind (from €60 to €50 million)
- › Through the net efficiencies and the recurring cost reduction we are structurally lowering our 2019 cost base by ~€50 million.
- › Adjusted EBIT is confirmed to be of ~€1 billion, net of €40 million start-up costs
- › Our leverage is expected to reach ~2.35x Net Debt over adjusted EBITDA, discounting the impact of South America;
- › CapEx is in line with the previous guidance

And now I leave the floor to Mr. Sala for a detailed review of the first nine months results.

## Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

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

In the first nine months of 2018, we recorded an organic growth of more than 4%.

- › In High Value, we posted a 12% volume growth. Within this segment, the performance was more pronounced in Car tyres  $\geq 18''$ , with a volume growth of 16.5% compared with the 10.5% of the market
- › In the Standard - where the market is slowing down, especially in Latin America - we reduced our exposure with volumes declining by  $\sim -11\%$ .
- › We keep boosting the price/mix (+6.2% in the first nine months) by also
  - improving mix, in both the High Value and the Standard segments, and
  - increasing prices in emerging markets, to compensate for the volatility of exchange rates in those countries

While we were successful in implementing price increases in Turkey and in Argentina, the difficult market environment prevented us from increasing prices in Brazil in the third quarter. Had we been able to implement it, this price manoeuvre would have brought our group price/mix to a +6.7% improvement both in the third quarter and in the first nine months.

Finally the negative FX impact (-6.6% in the period) reflects the volatility of the Emerging Markets currencies, mainly the Brazilian Real, the Russian Ruble, the Argentinian Peso and the Turkish Lira versus the Euro.

If we factor-in the impact of Forex and the new IFRS 15 accounting standards, Pirelli Group Sales decreased by  $\sim 3\%$ .

Let us now look at the drivers behind the €60 million increase in adjusted EBIT from the first nine months of 2017 to the same period of 2018, which brought our adjusted EBIT margin to 17.8%, almost 2 percentage points more year over year.

The profitability improvement in the first nine months was the result of our internal levers, namely price/mix, efficiencies and the crash program.

- › Price/mix improvement more than compensates for raw materials and forex headwinds, as well as D&A and other costs;
- › Industrial efficiencies programs were accelerated and more than offset costs inflation. These programs involved industrial and product activities: from the optimization of raw material costs and product simplification, to productivity improvement through a greater digitalization of processes;
- › A crash program (for  $\sim \text{€}20$  million) was implemented in the third quarter to deal with LatAm crisis by cutting marketing and advertising expenses, as well as G&A, both locally and globally.

These internal levers (price/mix, efficiencies and the crash program) are the main drivers of the EBIT growth also in the last quarter of the year, allowing us to reach our targets.

Net income, before discontinued operations, was almost twice that of the same period of 2017.

This result mainly reflected:

- › the improvement in the operating performance just discussed,

- › A better financial profile, with financial charges which are about half those in the same period of 2017, and
- › lower taxes following the benefit recognition related to the Patent Box. Tax rate for the first nine months stands at around 15%, stable compared to the same period of 2017 which benefitted mainly from the one-off booking of deferred tax assets on tax losses

The tax rate for the full year 2018 is expected to be in the range of 15% to 18%. As above mentioned, the Patent Box benefit is expected to cover the additional cost cutting actions with no significant impact on net income.

Said benefit will have a positive impact on the cash flow starting from 2020 mainly due to the availability of other tax attributes, i.e. tax losses carried forward and ACE (Italian Allowance for Corporate Equity) carried forward.

The average consolidated tax rate for the 2018-2020 period is expected to range between 26 and 28%, in line with the average tax rate for 2017-2020 Industrial plan (<30%).

Excluding all the one-offs and non-recurring items, Net Income adjusted amounted to €404 million in the first nine months of 2018 vs. €258 million in the same period of 2017.

We closed the first nine months with a Net Debt of ~€4 billion.

The Operating cash flow was negative for €634 million, impacted by:

- › investments of €297 million, mainly devoted to increase the High Value capacity in Europe and NAFTA, the conversion of Standard capacity into High Value in Brazil, and the constant improvement of mix and quality in all factories;
- › absorption of working capital in the first nine months of the year for €1,245 million. The performance of working capital discounts:
  - an increase in inventories as a result of the slowdown in the Replacement market in LatAm and actions to increase sales in the US from Brazilian sources, on the one hand, and, on the other, the improvement of the level of service in High Value
  - the reduction of commercial debts which continued in the third quarter
  - the growth of commercial credits, linked to the seasonality of the winter business, the receipts of which are cashed in the fourth quarter

As usual, the working capital trend is expected to reverse in the last quarter of the year due to cash generation deriving from

- › the receipt of commercial credits in conjunction with the Winter sell-out
- › the containment of inventories thanks to the reduction of Standard production capacity, and
- › the increase of commercial debts, also due to the usual weight of investments in the last quarter of the year.

All of these will bring us to a cash flow generation slightly below €1 billion in the last quarter of the year, reaching a Net Financial Position over Adjusted EBITDA ratio of 2.35 times; 2.3 times if we exclude the LatAm impact.

Pirelli's Gross Debt amounted to €4.8 billion at the end of September 2018, with an average life of 2.8 years, as more than 80% of it is now due beyond 2019.

The cost of debt on annual basis (last Twelve Month) is down to 3.51% from the 5.52% of September 2017. This result is mainly due to:

- › interest rate reduction in Brazil (from ~11.75% to ~6.8%)
- › a more favourable year-over-year comparison because 9M 2017 results included €61 million of fee wash-down relating to our previous credit line reimbursed ahead of time in June 2017
- › lower level and cheaper cost of debt thanks to the capital injection made by Marco Polo in June 2017 and the refinancing of our main bank lines last year; indeed such refinancing allows to maintain interest expenses unaffected by the current volatile market scenario in Europe while leaving room for reduction in accordance with our deleveraging profile

Finally, please note that the above-mentioned 3.51% cost of debt is already adjusted for the accounting effects from the re-pricing of our main bank facilities occurred in January. This re-pricing produced a one-off benefit of ~€30 million, bringing the nominal cost of debt down to 3.05%. This benefit is being amortized during the life of the facilities.

I now leave the floor to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Thank you, Mr Sala. This ends our presentation. We may now open the Q&A session.

## Questions & Answers

### Martino De Ambroggi – Equita Sim Analyst

Good evening everybody. The first question is on the drop through of the price/mix, because in the previous call, in my notes, I have that the 2H was expected ~72%÷73%. Is it entirely due, the lower drop-through we saw in 3Q, to the delay in price increase in Brazil or is there any other justification for this difference?

### Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

Due to the not increase of price in Brazil and also to the lower growth of the High Value volumes in 3Q resulting from the reduction of the market in the O.E. in Europe. In any case the drop-through was 63% on price/mix in 3Q, in line with 1H. For the last quarter of the year we expect a drop through on price/mix that will be in the region of 70%, thanks to a higher weight of High Value and Winter tyre, and also a positive contribution coming from channel mix. You may remember that in the last quarter of the year, Replacement is usually higher than O.E. And also, price increase in emerging markets should also contribute positively.

### Martino De Ambroggi – Equita Sim Analyst

Okay. Thank you. And the second is on the price increases that you announced today in the US, just to have overview if what is the environment, not only in the US, just to understand if you are a follower, what else in this area? Apart from Brazil, you already discussed what the scenario in Asia and in Europe is.

### Andrea Casaluci – General Manager Operations

Good evening, Andrea Casaluci speaking. So, if we talk about the High Value Regions, Europe, mainly China and the US, the situation is on price stability for the time being in Europe as well as in China, while in the US, as we announced yesterday, we are going to apply a price list increase of up to 6%. Which is a scenario more or less shared with the main players of the market. While if we talk about Emerging Markets, we started to apply the price increase following the devaluation of the Argentinian Pesos and the Turkish Lira, we also applied a price without reaching the target we had in Brazil, and we continue to do it in the last quarter of the year.

### Martino De Ambroggi – Equita Sim Analyst

Ok, that may be the last on the cost cutting measure. This is the second quarter in a row you are cutting costs. Without having evidence of non-recurring costs in the P&L. When you announced the Patent Box benefit you also talked about the matching of this benefit with the cost, but could you elaborate just to understand what are the referring to and when we should expect eventually non-recurring costs and with cash and or non-cash impact. Thank you.

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



So, what we have done has been mainly in Brazil to cut cost. We started in 3Q, as we announced in August and we increased from €20 to €50 million the cost cutting, of which €30 million are recurring, and that is what is producing a structural reduction of cost basis in 2019. 40% of this €50 million are affecting LatAm, while the remaining 60% is in the other regions and headquarters. These actions are mainly related to labour, plant overheads, marketing budget, advertising, and purchasing negotiation. Through recurring cost reduction (€30 million) and the net efficiency gain (€20 million) we are structurally lowering our 2019 cost basis as I mentioned before in my presentation, and so the cost base will be ~€50 million below what was in the plan before. We will have additional actions, thanks to the €50 million of restructuring costs, we announce we are using an extra action to reduce cost, to keep the shape of reduction of Standard, double-digit next year, and to continue the High Value strategy.

Martino De Ambroggi – Equita Sim Analyst

OK, but in terms of non-recurring costs with or without cash-out?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No cash-out.

Kai Mueller – Bank of America Merrill Lynch Analyst

Thank you very much for taking the question. Maybe just on the cost cutting, actually, to come back to the point. You mentioned the €50 million cutting; how deep does that go in terms of how much this impact your possible growth profile for the next years?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

This €30 million are structural and so this is for the cost cutting. And so, we reduced, as I was saying before, our cost basis for next year by €50 million.

Kai Mueller – Bank of America Merrill Lynch Analyst

And then maybe to think about next year, obviously your Standard volumes have been now a lot lower than what we've been seeing before, you had single-digit declines, now it's double-digit. How do we need to think about next year? Will you continue on the path of accelerated declines or we see at some point also a recovery of those Standard volumes again?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No, we expect to continue the trend. That's why I mention that the €50 million of restructuring cost will be dedicated to reduce our cost basis, so the reduction of Standard, double-digit, requires reduction of fixed cost, obviously, and so what we are now going to implement with the €50 million is an extra reduction of fixed cost in order to continue the trend of profitability, thanks to growth of High Value.

Kai Mueller – Bank of America Merrill Lynch Analyst

Ok. And then to come back to the question earlier on your price increases of up to 6%. You said it's in line with other peers, some of the other peers, I have heard, were more like 1 or 2%. How much do you believe of these up to 6% can stick and we could see?

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

The answer is it depends on the trend of raw materials. Obviously now we have to cover part of the increase of oil price that has been affecting the last few months and now is a bit less pronounced, but it really depends on the trend for the next months. The largest part of analysts they expect to have an oil price increase in the coming months, so we are ready thanks to this announcement to align immediately the prices to the cost, to the input cost increase.

### Monica Bosio – Banca IMI Intesa Sanpaolo Analyst

Good afternoon everyone. If just to check on the volume side, Pirelli is going to cut Standard tyres at a double-digit rate, even in 2019? Is it correct?

And if it is correct, can I ask you what are you expecting in terms of total volume growth, should we expect a flat trend for volumes in 2019? Or the growth in High Value will manage to offset the rest, in terms of volumes?

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

So, volumes in the  $\geq 18$ " in the High Value we continue a growth a double-digit growth. This is in the market already, it doesn't depend only on O.E., so this is what is already in a market, talking about  $\geq 18$ " while we have the pull-through effect. I remind you that Pirelli has a pull-through effect of 80%, and we target to do even better. So, thanks to this the Car, the existing car parc makes us in a position to grow double-digit in the Replacement. In the O.E. we don't see any sign of weakness, but in case it will be weaker, people will change the tyres if they don't buy a new car, so in any scenario  $\geq 18$ " marked tyres, we see a double-digit growth considering both O.E. and Replacement volumes. So, volume-wise, a double-digit growth in  $\geq 18$ ". The top line will not grow much. That will depend on the exchange rate scenario, on raw materials, but the fact is that our profitability do not depend on the top line itself. Our profitability depends on the growth on  $\geq 18$ " on High Value and we expect a double-digit growth in that area. The Standard reduction will not affect, if not positively, our profitability, because the programs we have of cost cutting (mainly fixed cost) is obviously offsetting the effect of reduction of Standard. So, all in all, we see an increase in profitability even in an environment where volumes will not grow. The important thing is a double-digit growth in the High Value. And that is already in the market.

### Gaetan Toulemonde – Deutsche Bank Analyst

Good evening, Gaetan Toulemonde speaking, just a few questions. The first one: is it possible to get an order of magnitude between O.E. and Replacement on  $\geq 18$ " rough idea, the breakdown of that volume?

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

~75% Replacement and ~25% O.E. on Group, on Car  $\geq 18$ " ~55% Replacement and ~45% O.E. The car parc is growing fast in China, so that growth of the car parc with  $\geq 18$ " is providing a continuous growth of the ratio in favour of the Replacement looking forward.

### Gaetan Toulemonde – Deutsche Bank Analyst

Okay. Second question: you just talked about China, I'm positively surprised that you are not affected by any kind of slow-down by the Chinese situation right now, because you are growing at double-digit. Is still the same in 4Q? You don't see a slowdown as some others are feeling the pain?

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

We don't see any slowdown in the O.E. The Replacement market continue to be strong, both are strong. What is interesting is that the car parc is growing. It is a new car parc, so the number of cars in the market grew in the last few years, homologated with Pirelli tyres in a way that we see a double-digit growth for the next years even if there will be a slowdown on the O.E., because the car parc is a new car parc and the peak of sales on Replacement happens after 6 years that one new vehicle is launched, so we have visibility for the next years and we see that the double-digit growth will happen in  $\geq 18$ ", even in an environment where the O.E. could slow down. It's not the case now, it continues to grow, and it continues to grow double-digit.

### Gaetan Toulemonde – Deutsche Bank Analyst

Ok, that's clear. Two other very small questions. Raw material: what kind of increase do you expect for 2019 order of magnitude, are we talking about low single digit growth, is that what we're talking about or not?

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

We do not expect a double-digit growth of raw material for the next months. We see an economy that is not so bullish, except the trend of the O.E. that could sometimes go in different directions, we don't see a double-digit growth.

### Gaetan Toulemonde – Deutsche Bank Analyst

Okay, last question from me. On the financial charge I have been very surprised about the number in 3Q. Can you give us an idea about what could be the run rate of financial charges for next year, as an order of magnitude?

### Francesco Tanzi – Senior Vice President and Chief Executive Officer

Good evening, Francesco Tanzi speaking. For what is concerning 2019, we expect to have a cost of debt below what we have basically given during the IPO plan that we are below 5%. As you remember, for this year we indicated cost of debt below 4% on a consolidated basis, and we believe that we will stick to the target of having the cost below 5%.

## Gaetan Toulemonde – Deutsche Bank Analyst

Ok, can you help me to get the number in absolute terms? It's easier for me.

## Francesco Tanzi – Senior Vice President and Chief Executive Officer

We are talking about financial charges below €200 million, on a yearly basis.

## Thomas Besson – Kepler Cheuvreux

I'd like to come back to the minimum effect of the O.E. decline on your business. Both Europe and APac had a decline in production, which was relatively meaningful in 3Q and should, again, be relatively meaningful in 4Q. Could you explain how your volumes notably in APac go up so much in a context of declining production? Including foremost of the Premium OEMs? Could you detail if you have new contracts or if you are gaining market share or what's driving your growth?

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

As you know, if we compare us to our competitors, we will have to keep in mind that we don't play the Standard game, so we are only in the High Value in APac. If I look at the main OEMs that are our clients, their growth is still double-digit. Mercedes announced a 13% increase, Audi a 11% increase, BMW a 10% increase... We have also some new Asian customers in China. We are entering in new homologations, so we see this precise segment of the market totally different from the average Standard market. So you cannot compare our business model to our competitors.

## Thomas Besson – Kepler Cheuvreux

So can you please explain what Asian Premium customers you are getting?

## Andrea Casaluci – General Manager Operations

Yes, apart from the traditional ones, the big German car makers that Mr. Tronchetti mentioned before, we started working with Hyundai, in the high-end of their product range, the Genesis platform. We are also developing local relationship with the Chinese players but focusing always only in the High Value and the high-end range of their product portfolio, like Dongfeng for example. And we are focusing mainly on the electric vehicle, always in the High Value segment, working both the traditional car makers and with some interesting newcomers into the automotive sector.

## Thomas Besson – Kepler Cheuvreux

I have a last question, please, for Mr. Sala. On the EBIT bridge, you have a positive D&A also for €5 million in 3Q, while traditionally it's a negative line, and -€33 million in 9M. Can you explain why you manage to get a positive figure there and what we should expect for the full year on this line of business?

## Maurizio Sala – Executive Vice President and Chief Planning & Control Officer

For what concerns depreciation and other costs, there was the usual trend in 3Q of the increase of depreciation, also the increase of the costs that we are continuously following for the growth of the High Value in the High Value Regions, but in 3Q we start with the crash program action on costs and so you can see that on the chart 13 that we reduce cost in terms of cost cutting by €21 million. As it was said before, we work at 360 degrees on all categories of costs, in order to make the costs flexible starting from the factories to the reduction of the Standard. So, working on labour cost, working on all the overheads cost of the factories, then working on the market advertising budget and then working on G&A. So, the effects of this happened in 3Q. In 4Q 2018 we will have another positive effect for €30 million. This action will be for the full year €50 million more vs. the beginning of the year and €30 million more vs. what we forecasted in August, because already in August we gave a guidance that we wanted to work on €20 million of cost reduction. Beside this, we are working also to increase efficiencies because our guidance at the beginning of the year was to have efficiencies of €50 million, in line with input cost of €50 million, so to have a balance from inflation and efficiencies. Currently we are working to increase efficiency from €50 million to €70 million, so to have a positive balance of €20 million. And this is a trend that we already had in 3Q, where the efficiencies were €24 million vs. input costs that were €14 million.

### Andrea Belloni – Mediobanca Analyst

Good evening. It will be just a couple of questions on my side. The first one is about Patent Box: can you give us just the impact of the Patent box in term of net cash? Do you expect Patent Box to have a full impact on 2018 or are you planning to have a kind of partial impact also next year? And my second question is about the restructuring process to be put in place for the Standard production capacity: how much do you plan to invest in this restructuring process in 2019?

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

First of all, Patent Box cash-in will be in 2020. We will capitalise also the 2018, so when you ask how much will be spent on restructuring cost, we say today that it is €50 million. And there could be some additional opportunities coming from the future effect of the Patent Box, so we are just analysing all the opportunities we have to continue this process of reduction, as I mentioned before, double-digit, of Standard and cutting the fixed cost related and we have an opportunity to do it without an effect on our cash flow, thanks to the positive effect of the Patent Box.

### Henning Cosman – HSBC Analyst

I would like to understand the weight between Standard and High Value a bit better, and as more recently was still volume-wise 60% Standard / 40 % High Value? Is that still a good base to calculate going forward? So, if I apply that, I obviously still get negative overall volumes for 2018 or 2019 rather. So, I wanted to understand what the mixed contribution then should be. Is it then fair to assume a similar mix as we've seen in 2018?

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

No, we drive towards 50% / 50%, already this year on Car.

### Henning Cosman – HSBC Analyst

OK and then on a 50% / 50% base if we going forward double-digit Standard decline and double-digit High Value increase, what's the mix we should think of next year then?

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

No, we will be close to 50% this year. Next year the Standard will be lower than 50%. And price/mix ~5%.

### Henning Cosman – HSBC Analyst

Second question on the tax rate, as I can clarify, you said 15% to 18% for 2018 and 26% to 28% for the whole average of 2018 to 2020, so closer to 30% for 2019 and 2020, is that right?

### Francesco Tanzi – Senior Vice President and Chief Executive Officer

If we're talking about this year, we have addressed before, with the speech of Mr. Sala, the tax rate we are expecting is between 15% and 18%. If we are talking about the future, when we have announced the signing of the agreement for the Patent Box, we have also announced the level of the tax rate that are expected for the next couple of years, which is between 26% and 28%, very much in line with what we have announced during the IPO plan that were below 30%. So, 26% to 28% in each of the years 2019 and 2020.

### Henning Cosman – HSBC Analyst

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### Henning Cosman – HSBC Analyst

Yes, understood. Final question again on the drop-through of Standard volumes. Did I understand you correctly that you said that the reduction in Standard doesn't really have a big effect on profitability? One, because cost savings mainly coming through Standard and two, because the drop-through in Standard is not very high anyway? Is that really the way to think about it?

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

Yes, it's correct.

### Christian Dirpes – Berenberg Analyst

Hi, thank you for taking my questions. Just two from my side. First on the price/mix. The 5.5% achieved in the quarter, how much of that was there just to offset the effects weakness? Then my second question: can you give a bit extra detail maybe on why the year-over-year growth in ≥18” tyres has decelerated so much sequentially. Because if I'm looking at 2Q you achieved 18% year-over-year growth in 3Q was 500 basis points lower, at 13%. So, maybe you should give a bit some details behind this deceleration.

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

The only effect has been on the O.E., because of the WPTL was down in 3Q. In 4Q we will have a better price/mix related also to the Winter season and the fact on O.E. is over on WPTL. So, we see looking forward a positive trend both on price/mix and also on the Winter season because we have had a good beginning of the seasonality.

### Christian Dirpes – Berenberg Analyst

Sorry, in the price/mix of 5.5% for this quarter you don't have a figure of how much was kind of a response to the Turkish Lira or like other FX weakness that we have seen so far. Just for this quarter.

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

The effect on price/mix is net of the forex, so when we mention 5.5% is net of forex, so it is the effect of price and mix in euros, to simplify things. Obviously it includes both the price increase in Emerging Markets and the devaluation of currencies, so this is the net effect in euros.

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

Ladies and Gentlemen, this will conclude today's call. Thank you for your attendance.