

Pirelli & C. S.p.A. FY 2020 prel. unaudited results conference call transcript

March 10, 2021

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Good evening Ladies and Gentlemen.

We are closing a year which unfortunately shall remain in history because of the millions of lives lost and the fall of GDP. This severe crisis accelerates structural changes which will change our lifestyle and economy.

When faced with this emergency:

- Pirelli responded at once with an Action Plan to protect the interests of all our Stakeholders
- Our High Value market position proved once more our stronger resilience and helped us contain the impact of the health crisis

The results are in line with our November indication and especially with our Top Line, Cash Generation and Debt targets are noticeably in line with our April indication, when, at the beginning of this crisis, we were the only Tyre Company to provide an outlook.

Our yearly performance improved with a significant High Value market share gain in the 4Q and a 18.3% profitability, higher than last year, and among the highest of the industry

2020 was a year of great and deep change also in the way we work, as well as an opportunity to accelerate our programs on innovation, efficiencies, sustainability and growth in our key areas, such as China.

At the end of March, we will go through these Programs within our New Industrial Plan.

In 2020 We have implemented a number of preventive measures to protect as best as we could the health of our employees, their families and communities.

- we quickly and efficiently implemented remote working policies which were adopted by our staff on average for 60% of their working time during the year, thereby limiting the danger of contagion
- our production plants remained in operation for ~85% of the year, thereby guaranteeing business continuity to our partners, and
- over 3,000 employees were involved in Upskilling programs

In 2020, we strengthened our integration with our clients, through:

- a careful management of our product range and production scheduling, to guarantee a high level of service, allowing a good result in terms of sales in 4Q, in spite of the almost 3M pieces of finished product stock reduction throughout the year
- a stronger level of integration with our Tier 1 clients and partners ensuring a correct balance of the working capital along the entire chain, and
- a higher level of integration with O.E. clients, who together with Tier 1 clients represent ~60% of our volumes, managed with planned orders and ad-hoc supply chains
- with Strategic Suppliers, partnering with us on critical materials and specialities, we have designed a Protection Program to guarantee stock levels and payment terms so as not to cause financial hardships

- we activated different supply chains and strengthened local for local supplies, guaranteeing the continuity of our purchases also in the most critical times
- we have concurrently reduced by ~3% days payable, to allow our major partners a more sustainable economic process

Eventually:

- the impact of the crisis on Cash Generation was softened through cost reduction and a careful Working Capital management
- our financial structure was strengthened through diversification of funding and extending of maturities, with a liquidity margin covering our dates until the first six months of 2024
- Successful Convertible Bond placement worth €500 million, zero coupon and 2025 maturity:
 - high demand from both Italian and foreign institutional investors, which witnesses the market's trust of our corporate outlook; and
 - this Bond will also allow us to preserve our cash generation, given the non interest-bearing nature of the bonds

Moving to slide number 5. Pirelli integrates sustainability values into its strategy, with a growing commitment with all our Stakeholders.

Consumers are looking for increasingly more sustainable products all along their lifecycle and, following these lines:

- In 2020 Pirelli revenues from "Eco & Safety" tyres keep growing (from 55.8% in 2019 to 58% in 2020 out of the total sales); and
- The average Rolling Resistance of our tyres decreases more than one percentage point in 2019

As to manufacturing processes and green value chain:

- Renewable electric energy use increased and is now 52% of the total for the Group, more than +10pp versus 2019; and
- CO₂ absolute emissions are down by 23% YoY, and this was supported by the temporary shutdown of our production plants; net from all Covid impacts, we would have anyhow reached the yearly target which forecasted a ~-2% reduction of CO₂ emissions

Furthermore:

- Pirelli was confirmed worldwide Sustainability Leader in Automobiles & Components by the Dow Jones Sustainability (World and Europe) indexes as well as global leader in the fight against climate change and is on the A list drafted by CDP (ex Carbon Disclosure Project)
- Pirelli is the only "Auto Components" company to be awarded the "Gold Class Distinction" in the Sustainability Yearbook 2021 and the only one in the sector included in the United Nations Global Compact Lead Companies.

Let's now go through the 2020 Car Tyre demand trend as well as Pirelli's operating performance.

- the High Value market confirmed its distinctive nature and resiliency during this crisis, with a decline which was limited to -10% YoY versus -17% of the Standard
- after a slow start in 1Q this year, mainly impacted by trade de-stocking measures in the EU and US, Pirelli has accelerated and gained market share in the second semester of the year on High Value as Mr. Casaluci will explain to you
- on the one hand, we see demand improving, mainly driven by a better O.E. in APac and North America, while maintaining a cautious view for Europe, given the recently introduced restrictive measures to cope with the COVID-19 emergency
- on the other hand, we are expecting a more volatile Forex environment, following the appreciation of the Euro against all major currencies in 2H'20

Let's move to slide 7.

FY'20 results are in line with the early November indication. I believe it is important to highlight that if we compared with the guidance we gave in April – we were the only ones in our industry – we have reached Top Line and Cash Flow targets, through a tactical use of our internal levers.

Therefore, overall, we have achieved:

- €4.3 billion sales, despite the strong exchange rate volatility, with a better volume contribution in 2H and a lesser price/mix contribution due to channel mix as Mr. Casaluci will tell you in a few minutes
- €208 million worth of «structural» Cash Generation through a careful management of the Working Capital, benefitting from a strong stock reduction
- €3.3 billion of Net Debt

Profitability of €501 million is in line with our November guidance and is less €130 million versus our April target as a result of:

- commercial variables compensating exchange rate volatility
- higher impact of raw materials, due to higher exchange rate devaluation of our production sources
- higher other costs, mainly connected to:
 - stock reduction and with no impact on cash
 - less royalties and revenues from Prometeon following the fees renegotiation, only for 2020, due to pandemic effects

Let's talk about the 2021 outlook. The car tyre market is expected to have a high-single-digit growth, partly rebounding versus the 2020 decline (-15%). 2019 levels will only be recovered in 2023.

The H.V. segment is different: the ≥18" market segment is expected to exceed the 2019 levels already in 2021 in both Channels.

- the O.E. will have double-digit growth, with a marked rebound in 1H, following the decline of over 30% in the past year
- also the Replacement Channel is expected to have a double-digit growth in all High Value Regions, with a particularly strong trend in APac

Segmentation is increasingly going towards higher sizes: in H.V., ≥19" segment is growing at an even faster yearly pace, ~+2pp versus ≥18"

The recovery in 2021 is an opportunity for Pirelli, with the following priorities:

- strengthening our leadership on the H.V., also thanks to a pull-through demand on ≥19" Car tyres which is growing strongly (+21% vs. +12% of ≥18"), driven by our «Top end» homologation portfolio of over 2,100 items in ≥19" (2/3 of the total) which grew also over the past few years; volume growth on ≥18" Car tyres will be more balanced between O.E. and Repl., versus 2020
- renew our product range for our Replacement Channel, with 7 «push» product launches, supporting gains in new volume growth areas and pricing positioning
- further strengthen our position in China, also by resorting to our on-line channel
- continue with the implementation of the second wave of our "Cost Competitiveness" Plan (Wave 1 = €110 million net achieved; wave 2 = €180 million net)
- investing (7% on sales) to improve the mix, quality & technology and digitization

Moving to slide number 10. Targets for 2021 are:

- revenues between ~€4.7 and €4.8 billion, with:
 - a «double-digit» volume growth, thanks to H.V. over performance and Standard sales rebound, given the strong reduction recorded in 2020 (-21.4%)

- a positive price/mix supported by an improvement of the product mix (H.V. vs. Standard and micro-mix)
- exchange rates negative, specifically because of the Euro appreciation versus the US Dollar
- adj. EBIT margin between >14% and ~15%.
 - price/mix will offset the increased cost of materials, mainly Natural Rubber and Butadiene
 - net efficiencies in the Competitiveness Plan are in line with the second wave benefit
 - COVID plan, tactically launched in 2020 to protect profitability - with a net benefit of €30 million - will reverse into a negative effect of the same amount in 2021
- solid Net Cash generation, between €300 and €340 million before dividends, supported by the operating performance and by an efficient management of the working capital
- investments are ~7% of sales

2021 indication will be further detailed in the Investor Day presentation on March 31. We are accelerating our plans for 2021-2025, also focusing our management team to achieve our new goals.

With this in mind, we are pleased to welcome Mr. Fabio Bocchio, as our Chief Planning and Controlling Officer. Mr. Bocchio is re-joining the Company, after gaining further International experience with other multinationals.

I want to thank Mrs. Valeria Leone, who will get back 100% of her time to Investor Relations, Competitive and Business Insight, where years ago she guided the re-introduction of Pirelli in the Velo business, and now is focusing on Micro-mobility Solutions.

Now I will leave the floor to Mr. Casaluci.

Andrea Casaluci – General Manager Operations

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

Let's move to the market dynamics of 2020 and of the last quarter, with the relative performance of Pirelli. Car Tyre demand recorded a -15% decrease in 2020, due to the COVID crisis and the mobility restrictions enforced in all major countries to fight the pandemic, with an improvement in the last quarter of the year (-0.8%, -6% in 3Q, -35% in 2Q).

- Original Equipment was the only channel to go back to 2019 levels in 4Q, supported, among other things, by a recovery in the Premium and Prestige car production where the growth rate was double digit. Over the whole year, demand went down -18% compared with the previous year
- on the contrary, the Replacement channel had to bear the brunt of a mild winter season in Europe and a global demand down by -1% compared with 4Q'19. On review of the trend in the full year, the Car Replacement market shows a -15% drop compared with 2019.

Despite the crisis, the Car $\geq 18"$ segment once again showed its resilience: -10% year on year, 7 points higher than the Car $\leq 17"$. The outperformance appears even more clearly when we focus on the Replacement channel: -7% in 2020, +9 points compared with the Car $\leq 17"$.

In this context, Pirelli managed to gain market share in the $\geq 18"$ (-8% compared with -10% of the market). And I am going to comment these dynamics shortly.

In the Standard, although Pirelli grew more than the market in South America, supported by an import reduction in the Region, we keep on pruning the less profitable products to decrease our exposure.

Moving to slide number 13.

Let us focus on the top of the range:

- in the Original Equipment, the market share increase (-6% Pirelli vs. -13% market) was steady throughout the year, supported by our leadership in the Premium segment in China and by an expansion of our customer base, especially through our new projects in APac, and North America. The very good performance in O.E. will allow us to further extend our pull-through Replacement market in perspective
- the early part of the year was characterised by a trade policy aimed at protecting our distribution partners in Europe and North America. To this purpose we decided to reduce trade inventories although this resulted in a loss of share. In the second part of the year, we re-balanced the trend through:
 - a sustained growth in China, due to a higher pervasiveness online and in the Car Dealer channel
 - gains in the EU share, where the expansion of our Summer and All-Season product portfolio bore its fruit

The good performance of last year reflects the implementation of our 3 major programs: Commercial Development, Cost Competitiveness and Technology-Based Innovation.

In the Commercial Development:

- the sales network was strengthened with ~500 new points of sales, compared with the previous year. In addition, a growth was recorded in the weight of the volumes sold through our priority channel.
- the online business kept on developing: in China, where Pirelli is the market leader in terms of value, the year closed with a substantial increment of our sales through the online channel, ~+50% YoY; in the US, through the launch of an innovative solution integrated with our major Tier 1 partners

- inventory reduction was completed in the first 9 months of last year, while between October and December, given the good trend of demand, we kept a high service level to our partners as a priority. This was made possible also due to a higher degree of agility developed in the last few months to better manage demand volatility in the supply chain.
- lastly, we progressed in our growth of the High Value business, where we increased our market share in the very top segment of the market, that is to say the segment ≥ 19 ".

Moving to slide number 15.

Cost Reduction plan was in line with May-20 expectations, registering €142 million of efficiencies net of inflation and slowdown. In particular:

- Competitiveness Program delivered ~€110 million net of inflation (or €160 million gross), while
- COVID Actions generated approximately €32 million net of slowdown (or €110 million gross)

From October to December, the demand recovery allowed an higher saturation of our plants and a null quarterly impact of slowdown, with a correspondent lower level of COVID actions on manufacturing.

At the end of 4Q overall net benefits were consistent with our forecasts at €58 million, with a major contribution from SG&A, product range optimization and organization.

In 2021:

- confirmed to deliver almost half of the second wave Competitiveness net benefits '21-'22 presented in February 2020
- partially dented by COVID action reversal linked to activities that were kept on-hold during 2020

As for technological innovation:

- We launched in the global market the new Cinturato P7 flagship product, designed for the Premium Segment with many innovative features, already achieving ~90 homologations
- strong emphasis on marked tyres and technologies like – Run-Flat, PNCS, Seal inside, ELECT – that account for ~80% of the homologations developed in the year (423 in total). We keep on focusing on electric vehicles (~30% of our overall technical homologations) where, in the last quarter, we achieved homologations for Prestige, Premium and Upper Synergic vehicles
- thanks to the improvements in our development simulation tools, we are speeding up innovation, preparing a portfolio of new product launches that goes beyond old plan expectations
- in conclusion, at the end of the year, we had different activities going on in preparation for the numerous launches due in 2021. Among these, I would like to mention the recent announcement of the integration of Pirelli Cyber system as Original Equipment in McLaren Artura. It is the first time ever that a system of "sensorized" tyres is designed and integrated with the electronics of the vehicle.

Thank you for your attention. I now leave the floor to Mrs. Leone

Valeria Leone – Executive Vice President Investor Relations, Competitive & Business Insight and Micromobility Solutions

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

Let's review our full year 2020 results in detail, starting from slide 18.

Pirelli closed 2020 with revenues of €4.3 billion, exceeding the indication we gave at the beginning of November, as the trend in demand and Pirelli sales proved to be better than expected.

In terms of drivers:

- we recorded a volume decline by -15%, 2 percentage points better than our November guidance:
 - on the High Value, the drop was more contained (-9%) and better than expected (-11% our November indication), thanks to a stronger performance on Car ≥18" in 4Q (+12.6%), especially in the O.E. channel (+19,1%), as Mr. Casaluci has already explained;
 - on Standard (-21% vs. -25% our November indication), we keep on pruning the less profitable products, while improving our performance across regions in 4Q, especially in LatAm
- price/mix closed at +1.2%, where the difference with our November guidance is related to different channel mix in 4Q with higher sales of Original Equipment than in Replacement
- Forex was in line with November expectations (-5.1%), discounting the weakness of the US dollar and of the major Emerging Markets currencies

Moving to slide 19, I wish to describe price/mix dynamics in the course of 2020, especially mix trend that was affected by the strong volatility of demand.

- in 1Q, the price/mix (-1.3%) discounted:
- the strong exposure of Pirelli to China, the first country to be impacted by the pandemic, and where Pirelli is the leader in the Car ≥18". We remind you the Pirelli in this market has an average sales price which is higher than the global one
- a trade policy aimed at safeguarding the distribution chain, by reducing inventories at the European and North American dealers, which brought the performance in Replacements below that of O.E.
- in 2Q and 3Q, the price/mix (+3.3% and +2.3%, respectively) benefitted from the recovery of demand in China, the first country to get out of the crisis, and from the channel mix improvement, especially in Replacements in Europe, where inventory reduction was completed in April.
- finally, in 4Q – as already mentioned – the price/mix trend (+0.6%) discounts again an extraordinary component: the demand rebound in Original Equipment, with the production of Premium and Prestige cars growing by +11% YoY

The price/mix trend may be affected by volatility also in the various quarters of 2021, due to the comparison basis.

Let's have a look to slide 20. Pirelli closed 2020 with an adjusted EBIT of €501 million and a profitability of 11.6%, in line with our targets.

Efficiencies and the COVID cost-cutting program, together with the price/mix contributed to limit the impacts of both:

- the external scenario (volumes, raw materials, exchange rates), and
- the increase of amortizations (-€30 million, slightly above 2019 due to FX) and of other costs (-€117 million, of which €55 million non-monetary). The latter includes:
 - costs linked to the transformation process (digitalization -€20 million),
 - provisions for the Long-Term Incentive plan for the management (-€13 million),

- a lesser contribution from Prometeon in terms of royalties and services provided (-€22 million) and sales of raw mat, semi-finished.
- other costs (-€62 million), mainly of a non-monetary nature and linked to inventory reduction (-€34 million)

In 4Q, the profitability trend improved, with an adjusted EBIT margin of 18.3% (18.1% in 4Q'19), driven by cost reduction programs (€58 million net benefits in 4Q, 41% of FY figure), and among the highest in the Industry.

Let us move to Slide 21

Net Income in 2020 was €43 million, from €458 million in 2019. Trend in 2020 discounts:

- the delta EBIT for -€416 million;
- an increase of restructuring and non-recurring of ~€108 million
- more specifically, restructuring and non-recurring costs in 2020 were equal to €168 million and composed by:
 - restructuring expenses (€71 million), related to
 - the rationalization of structures
 - write-off and restructuring costs, the latter related to Brazil and Bollate
 - non-recurring items (€37M) in line with 2019 level, mainly related to UK pension fund and retention plan
 - Direct COVID-19 costs (€60 million), including: personal protection material, donations for COVID-19, the impact of unusable semi-finished products because of plant closures, and non-discretionary costs for sponsorships for events that were cancelled or reduced in visibility

Moving to slide 22.

In 2020 Net Cash Flow before dividends and before convertible bond impact was €208 million, better than the November Guidance of €190 million, and includes the payment of sanctions of €34 million regarding the cables' cartel, imposed by the EU Tribunal.

This is the result of a structural improvement of working capital management:

- inventories reached at the end of the year a 19.4% weight on Sales (20.5% at the end of FY'19) thanks to the already mentioned reduction of 3 million pieces of finished product stocks
- trade receivables trend was in line with the usual seasonality of the business, with a strong cash generation in the last quarter of the year; receivables reached at the end of the year a 13.9% weight on Sales (12.2% at the end of FY'19)
- trade payables weight on sales decreased YoY (from 30.3% of 2019 year-end to 29.5% in 2020) reflecting both the lower level of activities and the lower days of payables (-3% YoY)

More in details, the Net Cash Flow in 4Q was positive €953 million, improving from the €973 million in 4Q'19, supported by:

- operating performance improving quarter on quarter, confirming the recovery of the business
- the positive seasonality of working capital in the last quarter of the year
- lower investments

At the end of December, the Net Financial Position was negative €3,258 million, or €3.3 billion excluding the positive effect of the convertible bond, in line with the FY target, improving from the €3.5 billion of 2019.

Moving to slide 23

As of December 2020, our Gross Debt stands at €6.0 billion, while our Net Financial Position lands at €3.3 billion.

Thanks to its cautious financial policy, Pirelli faced 2020 pandemic situation maintaining a sound liquidity margin throughout the year. At the end of 2020, a €3 billion liquidity margin covers upcoming financial debt maturities until 1H'24, when sole borrower extension option on our main committed bank lines is considered.

Year end liquidity includes as usual last quarter's free cash flow generation as well as the issuance of a €500 million convertible bond which allows the Group to optimize its debt profile extending maturities, preserving the cash generated from the business due to the zero coupon.

As far as our debt maturity profile is concerned, in January and February 2021 we have applied part of the available cash to early reimburse €82 million of the Schuldschein financing - originally due in July 2021 - and €756 million out of the €1.6 billion bank loan due in June 2022. This smooths down our debt maturity profile and contributes to optimize our net financial charges.

Coming to our cost of debt, in 2020 we have managed to reduce our cost of debt by 0.89 percentage points to 1.94% mainly thanks to:

- previous year's deleverage which positively impacted the margins of our committed bank lines until November 2020
- reduced exposure to high-yield currencies coupled with the general decreasing trend of interest rates

Now I leave the floor back to Mr. Tronchetti.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

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

Questions & Answers

Martino De Ambroggi – Equita SIM Analyst

The first question is on the price/mix. First of all, some of your competitors revised upwards prices twice. I suppose you will follow or you are going to do the same. So this is the first part of the question.

The second is on the price/mix trend. It's clear, for the full year, you expect the price/mix offsetting raw mat. But could you elaborate on what is the trend of price/mix in absolute value for 2021?

Andrea Casaluci – General Manager Operations

So to answer the first question, you are right. There are movement in the market on the direction of the price increase. This is true for basically all the markets around the world for the time being, as it has been already announced by the major Tier 1 players, including Pirelli, and we are at the second announcement of price list increase, both in Europe and in the U.S. So the outlook for the price is positive as far as the beginning of 2021 is concerned.

Regarding the trend of the price/mix, we will give you more details during the presentation of the Industrial Plan on March 31st. But we can confirm that the price/mix will compensate all the negative impact of the raw material. And we expect, compared to 2020, two different improvements: one it is price, as already mentioned; and the second is a more rebalanced channel mix compared to what we saw in 2020.

Thank you.

Martino De Ambroggi – Equita SIM Analyst

The second question is on the drop-through of volumes. Okay, 2020 was a strange year. But in 4Q, the drop-through was quite low. So I don't want to suggest the answer, but this is the question for 2021.

And the last, if I do my calculation in a right way, you are stating High Value, had 18% return on Sales while profitability in Standard was negative by 4%, roughly. How will evolve the profitability on Standard in 2021?

Andrea Casaluci – General Manager Operations

First question, the drop-through of 1Q has been negatively affected by the channel mix. As Mrs. Leone explained before, we had a higher weight compared on the average sales of the Original Equipment. We do expect to go back to the normal level of drop-through of volume in the coming future, so ~40%÷45%.

If we talk about Standard, yes, we do expect recovering Standard volumes, following the trend of the market. We never target to gain market share in Standard, but to continue our selective approach, protecting profitability. We did a good job in the last 1.5 years to improve the profitability of Standard supported by the right sizing of our Standard capacity, the phase out of the second brands and of the low end of our product range, and also price discipline. So we do expect to improve significantly the profitability of the Standard and keeping on our strategy of pruning the less profitable segment.

Thank you.

Martino De Ambroggi – Equita SIM Analyst

So going forward in this segment, pricing is not under pressure?

Andrea Casaluci – General Manager Operations

In the Standard segment, there is always higher pressure on prices. That's the reason why we are progressively reducing our exposure to the segment. But considering our exit strategy, we don't follow the pricing pressure dynamics. And so being selective, we keep on maintaining our price trend, which was from neutral to positive also in 2020. And we focus on the more profitable products, such as the 17" with technologies or seasonal products (e.g. Winter segment), marked tyres in the Standard and so on.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Sorry, I just add 1 point on Standard. We have better sources also for the Standard. So we are upgrading our mix in the Standard. And we will be concentrating our Brazilian production in 1 factory, from the 2 factories where we produce Standard. And we moved our production of Standard from Italy to Russia. So that makes us confident that Standard will continue to improve the average profitability.

Gabriel Adler – Citi Analyst

It's Gabriel Adler at Citi. I have 3 questions. My first is on the net efficiencies in 2021. Could you please clarify your comments around that efficiencies, specifically the impact of one-offs this year that are going to reverse in the bridge? If we think about the €90 million net efficiency target for 2021, how much of this do you expect to be offset by one-off reversals and other costs this year?

Valeria Leone – Executive Vice President Investor Relations, Competitive & Business Insight and Micromobility Solutions

For what regards efficiencies in 2021, you have to split between the COVID actions and the Competitiveness Plan. For what regards Competitiveness, we confirmed the whole plan for 2021-22 period. So as Mr. Casaluci said before, we should have more or less €85 million of net positive effect in 2021.

For what regards COVID actions, I remind you that in 2020, we had a positive net effect of ~€30 million. In 2021, this impact will revert back. So because we will have 65% of 2020 efficiency that will revert back, so we will add €73 million on €110 million. But on the other hand, we will have the opposite effect due to volume rebound equal to more or less €45 million, considering the production recovery, still below the old plan. So net-net the positive effect of 2020, will revert back in 2021.

Gabriel Adler – Citi Analyst

My second question was just coming back to price/mix. I know that you commented there that we will have better pricing environment, and we should also have better channel mix. So if we look at slide 19 in the presentation, in 2Q this year, we have favourable channel mix, favourable regional mix and global product mix. On top of that, we should have good pricing. Is it therefore fair to assume that in 2021, you could see price/mix ahead of what we did in 2Q of this year?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

If we expect for 2021 a better price/mix, the answer is yes.

Gabriel Adler – Citi Analyst

And then the final question is on recent trends. Maybe you could comment on how trends have developed in 1Q, specifically, if you have already continued to see growth of volumes ahead of the market? And have you already seen an improvement in that price/mix we just talked about?

Andrea Casaluci – General Manager Operations

Yes. So about 1Q'21 we have some preliminary information. We don't have the clear picture of the entire quarter. But we see, as expected, a rebound of the demand both in the regional equipment and in the replacement, I would say, ~10%. And it is mainly driven by Asia Pacific because of the more favourable comparison with last year. And so we see from 30% to 40% of growth in this region, mainly driven by China.

There is also a good sign of demand with a single-digit, mid-single digit growth in Europe and North America because there is a positive trend of re-stocking of the trade based on positive expectations on the sell-out, and also based on the announced price increase. And so there is positive signals from the Replacement channel.

While in Europe and North America, opposite to what is happening in China, growth is less than expected, mainly due to the semiconductor shortage in the supply chain, which is affecting the car registrations.

Thank you.

George Galliers – Goldman Sachs Analyst

The first question, I just wanted to quickly follow-up on the prior question around the price/mix for this year. I believe you confirmed it would be higher than the 2Q, 3.3%. Is that correct?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

The question was, if we expect for 2021 a better price/mix, the answer is yes. More details will be given during the presentation of our Plan at the end of March.

George Galliers – Goldman Sachs Analyst

Okay. And then the second question I had is if I look at your margin guidance for this year, it's ~300 basis points lower at the midpoint than what you achieved in 2019. And that despite the fact that your expectations are for the High Value market to be higher in 2021 than it was in 2019.

And obviously, we also have some benefits from your Competitiveness Plan.

So I think when we compare the margin expectation for this year versus 2019, what are the big headwinds?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

As you can see from the top line, we expect not to work at full capacity in 2021. So we expect a strong recovery of volumes, but not so strong to reach the level of 2019. Let's say we have in the High Value a full recovery compared to 2019. But overall, including all the Standard, we are not back to the Group volumes of 2019. That's why there is some obvious cautiousness.

George Galliers – Goldman Sachs Analyst

Understood. So it's the fixed cost absorption on the Standard tyre volume?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

We will provide more details end of March.

Monica Bosio – Intesa San Paolo Analyst

I have 3 questions. The first is on the regional mix this time. Can you comment a little bit on the evolution of the regional mix in 2021? I can imagine it should improve also on the back of the market share gains in China. And on this last topic, can you just please give us some more detailed figure on the Pirelli market share in China in the last quarter of the year.

And still on China, can we assume that the profitability of the online channel in China is better than the rest of the online channel also in other countries?

And then the last question is on the semiconductor shortage. It seems that you have not any impact from the semiconductor shortage, but I would like to be sure if you see an increase in volatility in the volume market due to this issue.

Andrea Casaluci – General Manager Operations

So region mix, first. Yes, you are right. We had a positive effect of the region mix in 2H'20 because of the rebound of China. And considering the speed of growth of China expected for 2021, we confirm a positive region mix. Let's consider that our pace of growth in North America and China, which are affecting positively the region mix, are always higher than the pace of growth in the other regions. So normally, in our price/mix, there is always reflected a positive impact of the region mix.

But you are right, in 2021, we expect this effect to be a bit better than 2020.

Market share in 4Q'20 in China has been extremely positive. We were able to gain market share during all the quarters of the year in China, both in the Replacement and in the Original Equipment. But to give you a rough indication, we gained ~1.5 percentage point of market share, both in the Replacement and in the Original Equipment in 4Q in China.

About the semiconductor shortage, we were affected compared to our initial expectation of a stronger rebound of the Original Equipment in January and February. Nevertheless, we don't see a major issue, at least so far for 2Q, as we do expect a recovery during the year.

Channel mix in 1Q will be positive because of the impact of the semiconductor, as we said before. Sorry, I forgot the first...

Monica Bosio – Intesa San Paolo Analyst

Yes, on the profitability of the online commercial strategy in China versus Pirelli online commercial strategy in other regions. So I'm just wondering if the margins of the online channel in China is better than the rest of Pirelli in the other areas.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

The online in China is in line with the profitability of the market in China. It is handled very professionally

and our people are doing a great job, thanks to the involvement of the trade. And we do not have conflicting channels.

Andrea Casaluci – General Manager Operations

If I may add a comment. As Mr. Tronchetti was saying, in China the e-commerce is growing so fast that today it represents the average of the market behaviour. While in the other markets, following your question, is still more concentrating in the lower end.

That's the reason why we are following the growth of the channel, with a high profitability, in line with the average of the country.

Michael Jacks – Bank of America Analyst

I have two, if I may. The first one on your revenue guidance, applying high-single-digit market growth, a positive regional mix, as you just mentioned, and assuming a ~+3% price/mix and perhaps a little bit of negative Forex, it implies that you haven't really priced in anything for market outperformance in 2021. Is that a fair observation, firstly?

And then my second question relates to Standard tyres. It sounds like we expect the underperformance relative to the market in Standard tyres to level off in 2021. So can we expect this to be the case now going forward? Or do you expect some more underperformance in the future?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

On Standard, we expected our position to stabilize looking forward. In the overall market, we expect the High Value to go back to the numbers of 2019 but not the Standard segment.

Michael Jacks – Bank of America Analyst

And then just on the first question, is it fair my comments around you're not including any expectations for market share gains in 2021 in your guidance. Is my math correct? Or is there another dynamic that I'm missing?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No. You're right. We expect on the high end, on the ≥ 18 ", to grow in market share.

Thomas Besson – Kepler Cheuvreux Analyst

I have a few questions, please. Firstly, I'd like to come back to your Slide 13, where you show both market and Pirelli's performance in the ≥ 18 " market. First, I'd like to understand whether the very sharp performance in O.E. remains a voluntary strategy from Pirelli to continue to build up presence in different channels and eventually get some pull-through? And if that's the case, I would like to understand why we don't see that pull-through effect because clearly, your relative performance is much better in O.E., but weaker in Replacements, apart from 2H.

And I'd like to understand what we should expect in 2021. Should we expect that you continue to outperform in O.E., but that you are talking about in Replacement or that eventually, you slowdown in O.E. and you replaced your accelerating replacements. So it's maybe a long question.

Andrea Casaluci – General Manager Operations

So the good performance in ≥ 18 " in Original Equipment was mainly driven by 2 factors. First is the enlargement of our homologation portfolio in the traditional carmakers, so the Premium and Prestige that are our historical partners, both in Europe and in China. Second is our program of customer base enlargement that we started already at the end of 2019, and that is now delivering interesting results, not because we are changing our strategy but because there are a lot of Synergic OEMs producing Premium models. And so today, we are able to deliver our technologies and our brand to very important partners in North America, in China and in S. Korea that were not partnering with us in the past. I can make some examples like Ford, Tesla, Hyundai. So extremely important carmakers that are more and more producing Premium models. And this is a result of our business model enlarging in this segment.

We expect an over-performance of the market also in 2021, maybe less than what we saw in 2020. But of course, we plan to gain market share also in 2021 in Original Equipment in ≥ 18 ".

Thomas Besson – Kepler Cheuvreux Analyst

Okay. But do you expect to do better than the market in Replacements, finally in 2021? Or are you also expecting to lose share in the market like in 2020?

Andrea Casaluci – General Manager Operations

Yes, of course, both in Original Equipment, in Replacement, we plan to gain market share in ≥ 18 ". Of course, Replacement is our main target. But as I mentioned before, also in the Original Equipment, we expect to over-perform the market in 2021.

Thomas Besson – Kepler Cheuvreux Analyst

Perfect. Second question, please, I'd like to come back to your CapEx guidance and talk about CapEx versus depreciation in 2021. So you clearly underspent in 2020, but moving sharply to 7% of CapEx on Sales is a bit higher than what I was assuming. So it's more than €300 million, so more than doubling CapEx. While you said you would not be operating at full capacity in 2021. Could you explain what you intend to focus your CapEx on?

And where CapEx is expected to stand versus depreciation in 2021, please?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

No. We underlined that we have in our budget to invest 7% of revenues in 2021. And after reducing investments in 2020, we plan to spend 7% of revenues, to improve mix and quality and technology. And then there is also investment in digitalization.

Thomas Besson – Kepler Cheuvreux Analyst

Okay. Last question, please. Could you confirm what you expect for non-recurring items in 2021? In your 2020 results, you had, if I'm correct, €168 million of non-recurring items & restructuring costs. What should we expect for 2021?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

There will be a difference, not higher expenses, but we will provide you information in detail in end of March. Anyhow, it will be lower.

Giulio Pescatore – Exane BNP Paribas Analyst

The first one is going back to the topic of High Value market share and growth. And I was just wondering, what is allowing you to gain market share in that segment? Is that technology, is that being more aggressive on pricing? And who is losing market share, if you gain market share?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

On ≥ 19 ”?

Giulio Pescatore – Exane BNP Paribas Analyst

Yes. In the High Value, yes.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

Okay. I think that when we look to the market, we see that there is a move upward from the 18” to the ≥ 19 ”. In the last few years we have been focusing on the ≥ 19 ”. And the growth of this segment made it possible for us to have an over-performance.

Also, electric is helping. It is becoming quite an important segment. It's ~40% now of our new portfolio of homologation. And so I think these are the 2 main reasons why we increased our market share.

Giulio Pescatore – Exane BNP Paribas Analyst

Okay. And following up on that, can you remind us on what is the typical conversion rate? So from O.E. to Replacement in the High Value and in the Prestige, in particular segment, is that different from Standard, I assume?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

In High Value, we have 80%, and we have 90% pull-through the Prestige.

Giulio Pescatore – Exane BNP Paribas Analyst

Okay. And just the last one. On a slide you showed about the new technology partnership with McLaren. I mean it's interesting in itself, but I just wanted to understand, is it also an opportunity for you? I mean, are these type of programs only a niche with very high-end car makers? Or can we expect something more scalable to take place in the coming years?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

For sure, we have been working on it for 20 years. Now we are inside the car with the Original Equipment. And we have numbers of other projects.

And obviously, we see the evolution of technology and the industrialization of that technology that we have achieved will allow us to enter into larger O.E. contracts. And we expect in the coming years that this will be one of the drivers of our technological growth.

And so I think that we are naturally focused on technology. And this is the evolution of technology. So we have to combine the information we get from the only point that touches the ground with the electronics of the cars. We are working on it. We have the first industrial results because we are inside the performance car, but we are working with others, and we strongly believe it will be part of our future.

Gianluca Bertuzzo - Intermonte SIM Analyst

First one is a clarification on price/mix. You previously mentioned that you expect drop-through to go to 40% to 45%, right? Second one is on non-recurring costs. Can you maybe provide us some colour on the delta between the €130 million guidance provided at the end of the 3Q and the final result of €168 million?

Last question is more general, it is on consolidation. At the end of February, we saw the acquisition of Cooper by Goodyear. Can you elaborate on the potential impact on Pirelli's business from this move?

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

First of all, I answer to your second question, then I leave the floor to Mr. Casaluci and Mrs. Leone for the first question. It's a local transaction that is not affecting the market. It's good news in our mind because it's strengthening two companies, combining them with synergies. And there is also a synergy they can have in China. So good for them, good for the Tyre Industry. And I think it is a value-accretive move, good for the market.

Andrea Casaluci – General Manager Operations

Okay. I answer to the drop-through question. The drop-through, I mentioned before, 42% is related to volume. While if we talk about price/mix, the drop-through goes at ~55%. Thank you.

Valeria Leone – Executive Vice President Investor Relations, Competitive & Business Insight and Micromobility Solutions

As far as for the non-recurring costs, I think it is useful to remind that in 2020, we recorded €168 million of non-recurring & restructuring costs, after which perhaps it is useful for you that I repeat, the €71 million were related to restructuring, €37 million were related to one-off, non-recurring and other costs and €60 million were COVID direct costs.

In 2021, we are factoring more or less €120 million, mostly related for ~75% to the ongoing restructuring programs, with a cash-out just a little bit higher than what we had in 2020. Because we have to include the payments of restructuring provision accounted in previous years.

Operator

Gentlemen, there are no questions registered at this time.

Marco Tronchetti Provera – Executive Vice Chairman and Chief Executive Officer

So thank you. Thank you. Thank you, everybody, and have a good evening.