

Pirelli & C

Keeps Growing Thanks to Premium Resilience

Pirelli & C - Key estimates and data					
Y/E December		2010A	2011E	2012E	2013E
Revenues	EUR M	4,848.43	5,770.65	6,618.85	7,193.95
EBITDA	EUR M	629.03	836.10	1,087.66	1,254.11
EBIT	EUR M	407.83	583.90	737.16	895.71
Net income	EUR M	21.33	315.77	400.34	500.65
Dividend ord.	EUR	0.17	0.22	0.32	0.42
Adj. EPS	EUR	0.57	0.71	0.88	1.09
EV/EBITDA	x	5.58	4.55	3.84	3.40
Adj. P/E	x	11.32	9.10	7.27	5.87

A: actual; E: estimates; Source: Company data and Intesa Sanpaolo Research

- The new Business Plan.** On 9 November in London, Pirelli disclosed its 2012-14 business plan that envisages a 10% revenues CAGR to EUR 7.7Bn and a 15-16% EBIT margin by the end of 2014. Over 2015, the group points to an operating profitability above 16%. Overall the plan takes into account a moderate volume growth (+3% CAGR), the contribution of the Russian JV (+2%) and a still significant boost in group price mix (+5% CAGR 2011-14.). The driver behind this significant growth at the top line level and the impressive targeted improvement in operating profitability relies in the combination of two strategies: 1) a continuous leverage on the Premium segment, which should support improvements in the consumer segment; 2) a regional strategy for trucks & special vehicles; 3) the implementation of an efficiency plan for roughly EUR 250M; and 4) a sharp increase in capacity in order to meet the future demand in premium and emerging markets. Despite the boost in the capex plan to EUR 2.4Bn (2011-14), Pirelli targets a superior cash generation (EUR 3.2Bn), which could drive the 2015 NFP below EUR 600M (with a net debt/EBITDA ratio at 0.4x) after the expected peaks in 2012 (NFP below EUR 1Bn) and 2013 (NFP below EUR 1.1Bn).
- Outlook.** While we concur that the group long term targets might look aggressive, we also believe that they are not fully out of reach. We believe that strong group track record achieved so far, along with the fact that Pirelli's market share in the premium segment is still relatively small, leaves room for a significant improvement and we believe that Pirelli will progressively reduce its gap with the main premium player Nokian. We also appreciate the group caution on the 2012 outlook and the Industrial segment trend. Thanks to the group's focus on the premium segment and exposure to the truck segment, mainly in emerging countries, we view Pirelli's next year targets as achievable. We also appreciate the group's 2012 contingency plan: Pirelli's high flexibility in tightening 20% of its capex plan and containing labour costs, together with a likely softening of the commodities should guarantee the maintenance of an 11% operating profitability, i.e. the bottom of the group EBIT margin target range.
- Estimates and valuation.** Given the strong group track record to date, we raised our 2012-14 projections for the group. For 2012, we positioned in the middle of the guidance range (EBIT margin for 2011-12 between 11-12%). While 2012 is expected to be characterised by a slowdown of the market, we believe that group profitability might also be supported by a definitely lower pressure by raw materials. Despite the stock outperformance during the last 3 months, our new estimates suggest there is still an unexpressed value in Pirelli Tyre, for which we improved our equity valuation to EUR 4.2Bn **bringing our SOP to EUR 9.32/share**. We view EUR 7.40/share as a potential floor valuation in case Pirelli has to face its so called contingency plan.
- Key risks.** The main risks to our SOP value are: 1) a severe downturn of the reference market and sector overcapacity; 2) bad execution of the implementation of Russian initiatives; 3) price war amongst players in case of recession; and 4) lack of working capital control.

23 November 2011

NO RATING

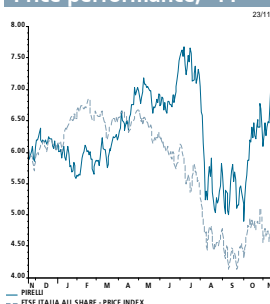
SOP: EUR 9.32
(from EUR 7.40)

Auto & Components
Company Update

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Price performance, -1Y



Source: Thomson Reuters

Data priced on 22.11.2011

SOP (€)	9.32
SOP upside (%)	45.25
Market price (€)	6.42
52-week range (€)	7.7/4.9
Market cap (€M)	3,054.25
No. of shares (M)	475.74
Free float (%)	49.14
Major shareholder (%)	M Tronchetti Provera, 25.5
Reuters	PECI.MI
Bloomberg	PC IM
FTSE It All Shares	15056

Performance %			
	Absolute	Rel. to FTSE All Sh	
-1M	0.0	-1M	11.0
-3M	26.1	-3M	30.2
-12M	5.9	-12M	34.3

Source: Intesa Sanpaolo Research estimates and Thomson Reuters

The Business Plan at a Glance

After having beaten the profitability targets for the second consecutive year, a year ahead of time, on 9 November in London, Pirelli disclosed its 2012-14 business plan and group outlook on 2015.

While fine-tuning downward its 2011 revenue target due to a higher than expected slowdown in volumes mainly in the truck segment, only partially offset by a better pricing mix trend, the company targets a 10% revenues CAGR to EUR 7.7Bn and a 15-16% EBIT margin trend for 2011-14. Over 2015 the group points to an operating profitability above 16%. Overall the plan takes into account a moderate volume growth (+3% CAGR), the contribution of the Russian JV (+2%) and a still significant boost in group price mix (+5% CAGR 2011-14). With tyres now representing 99% of group revenues, Pirelli Group and Pirelli Tyre targets are broadly aligned.

The 2012-14 targets

Pirelli targets 2012-14			
€/bn	2011E	2012E	2014E
Total Revenues	<5.8	~6.7	~7.7
		YoY	CAGR 11-14
Growth rate		16%	10%
o/w Russia JV		6%	2%
o/w volumes	~ +3%	2%	3%
o/w Premium	23%	20%	17%
o/w price/mix	~+18%	8%	5%
EBITDA*%	~14%	15% 16%	19% 20%
EBIT*%	~ 10%	11% 12%	~ 15% ~ 16%
o/w Russia		mid single digit	14% 15%
(€/bn)	2011	2012	2014
Holding Costs & LTI provisions	<20	Including Tyre following the new organization	
Minor Business & other non-recurring items	~ -35	< -20	< -10

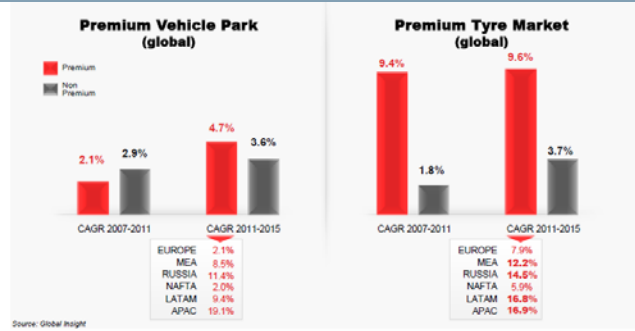
*After continuous restructuring

Source: Company data

The driver behind this significant growth at the top line level and the impressive targeted improvement in operating profitability is once again the expansion of the Premium segment, which should support the improvements in the consumer segment, particularly in Europe. As previously mentioned, demand in the European premium segment is expected to grow at a compound annual rate of 7.9% (9.6% globally thanks to the APAC area), and should play an important role in the achievement of these targets. At the end of the plan in Europe, thanks also to the winter tyre contribution, roughly 80% of revenues should come from the premium segment (expected to grow by 7.9% at a European level). Globally, the weighting of the premium segment in Pirelli's Car business should stand at 60% in terms of revenues and 81% in terms of EBIT by 2015. The Group's continuous efforts in the premium segment also represent the bulk of Pirelli's expansion strategy in the motorcycle segment, where the company targets increasing its revenues by 10% on a compound annual growth rate (2011-2014) and where operating profitability is already at 17% and, despite a momentary slowdown due to start up costs for the new Chinese factory, should further improve to 17.5% by the end of 2014. We also highlight that Pirelli's business plan does not yet take into account, unless on the investment side, the potential positive impact of group new manufacturing activities in Indonesia in the motorcycle tyre segment that once on stream, might further enhance Pirelli motorcycle tyre revenues by roughly EUR 100M contributing to a further improvement in profitability thanks to lower cost sourcing from Indonesia.

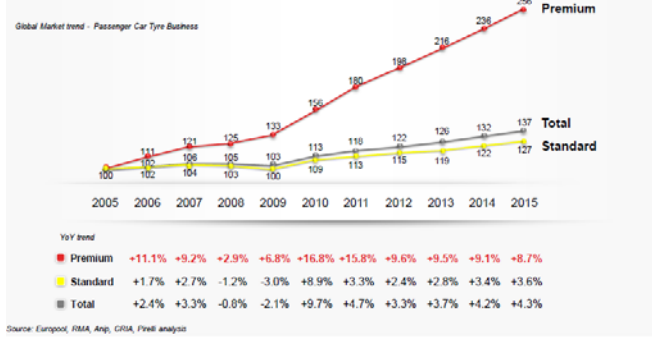
Leveraging on premium tyres

Premium Tyres continue to grow above the standards



Source: Company data

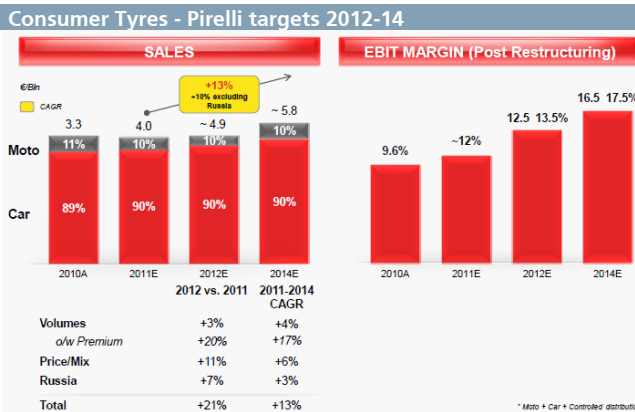
Premium tyres: a growing segment even during market downturn



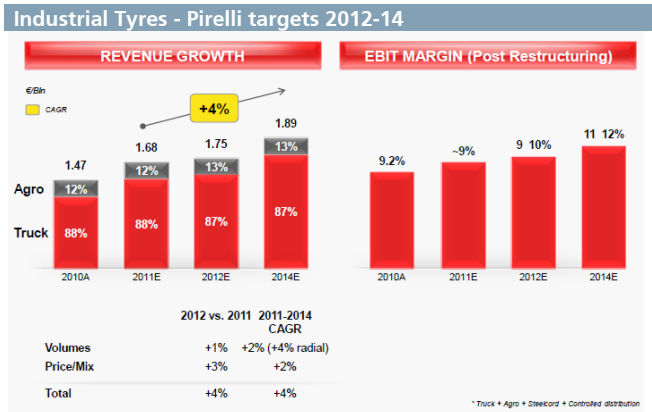
Source: Company data

As for Consumer (i.e. cars and motorcycles), the group targets a 13% CAGR in revenues, mainly driven by the contribution of premium tyres to the division, 4% by volumes and a 6% rise in the price mix. On the back of the abovementioned actions for both cars and in motorcycles, Pirelli consumer division is expected to record a very significant improvement in its operating profitability, seen at 16.5-17.5% as early as 2014.

Aggressive targets in Consumer BU



Source: Company data



Source: Company data

Group targets for the Industrial division appear less ambitious and also take into account a slowdown by the truck division in 2012: as for trucks, the driver behind the improvement in group profitability will mainly rely on the still healthy demand of emerging countries and Pirelli's manufacturing footprint, which is highly skewed towards fast growing and low labour cost countries.

More prudent in the Industrial BU

Alongside the expansion in the premium segment, Pirelli plans roughly EUR 250M of efficiency gains. A strong progression in group fundamentals is expected to be driven by a sharp increase in capacity in order to meet the future demand in premium and emerging markets. In this context, the group increased its 2011-14 capex plan from EUR 1.9Bn to EUR 2.4Bn including Russia and also the newly-announced initiatives in Argentina, for radial truck tyres, and in Indonesia, for the motorcycle segment. Despite the hike in capex between 2011 and 2015, Pirelli targets a superior cash generation (EUR 3.2Bn) which could drive the 2015 NFP below EUR 600M (with a net debt/EBITDA ratio at 0.4x) after the expected peaks in 2012 (roughly EUR 1Bn) and 2013 (below EUR 1.1Bn). Cumulative dividends are expected in the region of EUR 800M, implying a 40% payout ratio.

Efficiency plan and further boost in capex

Updated capex plan

	Old Plan 2011-2015	New Plan 2011-2015				
€Bn						
2011E	> 0.5	< 0.6				
Cumulated Capex (w/o Russia)	>1.9	<2.2				
Russia (*)	(*)	~0,2				
Premium Capacity Growth (Mln pcs)	+22,5	+24				
Russia	+3,5	+8				
Total Premium Capacity Growth (Mln pcs)	+26	+32				
Investments by destination (w/o Russia)						
Mix (mature plants)	12%	16% ▲				
Quality (mature plants)	7%	10% ▲				
Capacity	56%	53% ▼				
Others**	25%	21% ▼				
New Plan						
Year End Capacity (m/npes)	2010A	2011E	2014	2014/2011	2015	2015/2011
Consumer*** w/o Russia	56	60	71	+18%	74	+23%
Russia	-	-	10		10	
Industrial	5.8	6	6.4	+7%	6.8	13%

(*) In Old Plan Russia is assumed to have a JV partnership (in 2013 financial investments only) with 2015 purchase (all data consolidated)
 (**) Logistics, IT, Maintenance, Health Safety Environment, others
 (***) In Consumer Capacity is included Motorradial only

Source: Company data

The Group's premium strategy in the car and motorcycle segments together with the implementation of a regional strategy in truck and special vehicles, should enable the company to reach a significant operating profitability improvement across all Pirelli's main geographical markets. In the following table we show Pirelli's objectives by geographical area: as we can see, while South America is expected to maintain its high level of profitability, the boost for the improvement in group operating profitability will come from: 1) Europe, thanks to the higher weighting of premium tyres; 2) Russia, where the group aims to be a leading player in the winter segment; and 3) Asia where the group has recently established a new production capacity in order to meet the OE demand of the main German car makers (i.e. the players mostly positioned in the premium segment), which directly manufacture in Asia.

Significant operating profitability improvement across all Pirelli's main geographical markets

Pirelli targets by geographical area	2011	2012	2013	2014
Europe				
Revenues	2200	<2400	<2500	2600
EBIT%		from low to high teen		
Russia				
Revenues	0	300	NA	>500
EBIT%	0	mid single digit		14-15%
NAFTA				
Revenues	580	660	NA	710
EBIT%		from low one digit to add by 2013		
South America				
Revenues	1960	2180		2500
EBIT%		mid teen across the years		
MEA				
Revenues	530	560	NA	600
EBIT%		mid teen across the years		
Asia				
Revenues	370	490	NA	690
EBIT%		from low one digit to double digit by 2013		

NA: not available; Source: Company data

Pirelli has also outlined a 'contingency plan', which envisages a 10% slowdown in volumes for Original Equipment, a 20% volume market decrease in the truck sector or a sell out drop of more than 10%. Should this scenario materialise, Pirelli plans to act on its investments (with a flexibility of 20% compared to the figures indicated in the plan), on labour costs and on the efficiency plan. Thanks to these actions the group is confident of meeting the low end of its 2012 EBIT margin range, i.e. 11%.

The contingency plan

The group is factoring in a slowdown scenario for 2012, but not a crisis one. The 2012 guidance envisages a 16% rise in revenues to EUR 6.7Bn, split as follows: +6% from Russia, +2% from volumes (with premium volumes up by 20%), +8% from price/mix. In this context and taking into account that almost half (EUR 120M) of the efficiency plan will be implemented next year, the group targets an EBIT margin of 11-12%. In Consumer, revenues are seen at EUR 4.9Bn with an EBIT margin of 12.5-13.5%, while for Industrial, which is suffering from a slowdown in volumes, especially in Europe, the operating profitability has been revised downwards to 9-10% in front of EUR 1.79Bn of expected sales. The company does not expect significant headwinds from raw materials in 2012, while the forex impact is seen negative at EUR 140M.

Short-term targets

Our View and New Earnings Outlook

Overall, we view the business plan presentation as impressive, confirming Pirelli's ongoing efforts to become a leading player in the premium segment.

We admit that Pirelli's long-term EBIT margin targets might look optimistic, as they rely on an impressive market share growth in the premium tyre segment, particularly winter tyres, both in Russia and in Europe where we estimate the group enjoys a market share of roughly 7.6%. Although being ambitious, we do not believe that the group targets are out of reach, as given the small group market share in premium segments, Pirelli has room to grow and a recovery in operating profitability could be significant if the volume and pricing scenarios remain healthy. As for the long-term targets, however, we would not exclude that the group could be subject to some execution risks, especially regarding its initiative in Russia, where the group has to realign the JV manufacturing process and equipment to their standards.

Strong track record reinforces business plan credibility

As for 2012 targets (revenues of EUR 6.7Bn and EBIT between EUR 737M and EUR 804M) they are higher than our estimates (by 4.8% for revenues and between 6.1% and 15.7% for EBIT). Including the Russian JV (so far not included in our model) our old estimates pointed, in fact, to 2012 revenues of around EUR 6.5Bn and an aggregate EBIT (i.e. including Russia) of EUR 694M, implying an EBIT margin of 10.9%.

While fine-tuning our 2011E estimates in order to be more in line with group indications after the 9M release, we upgrade our earnings outlook for 2012E-15E. In the following table we show the main changes for Pirelli Tyre and the entire group: in detail we upgrade our projections for Pirelli Tyre EBIT by 12.6% and 29.3%. While remaining somewhat cautious on 2012, which should be characterised by a slowdown of the end market, we projected a significant improvement in Pirelli Tyre profitability over the long term. Given the strong group track record and its strategy focused on the premium segment, we believe the group has good chances to partially fill its gap with pure premium tyres such as Nokian.

Significant upward revision for Pirelli Tyre

Pirelli Tyre - main changes in estimates										
EUR M	Old (*)					New				
	2011E	2012E	2013E	2014E	2015E	2011E	2012E	2013E	2014E	2015E
Net revenues	5807.29	6094.04	6330.43	6457.04	6586.18	5708.55	6555.54	7129.30	7675.18	7956.62
Raw materials	2510.8	2633.8	2736.0	2790.7	2846.5	2432.7	2793.1	3037.3	3269.8	3389.6
External Services & Others	1495.4	1569.3	1630.1	1662.7	1696.0	1470.0	1688.1	1835.9	1976.4	2048.9
Value Added	1,801.11	1,890.95	1,964.30	2,003.59	2,043.66	1,805.88	2,074.35	2,256.13	2,428.93	2,518.12
Labour Cost	924.2	978.3	1001.5	1021.5	1042.0	915.3	959.4	982.2	1001.9	1021.9
EBITDA pre restructuring	876.9	912.7	962.8	982.0	1001.7	890.6	1114.9	1273.9	1427.0	1496.2
Other items & write down	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0
EBITDA Reported	856.9	892.7	942.8	962.0	981.7	870.6	1094.9	1253.9	1407.0	1476.2
EBITDA%	14.8	14.6	14.9	14.9	14.9	15.3	16.7	17.6	18.3	18.6
Depreciation	220.0	220.0	240.0	227.5	227.5	240.0	337.5	345.0	300.0	240.0
Non recurring items (write down)	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0
EBIT	636.87	672.69	702.79	734.55	754.19	630.57	757.41	908.88	1,107.04	1,236.19
EBIT%	11.0	11.0	11.1	11.4	11.5	11.0	11.6	12.7	14.4	15.5
Pre-tax	552.17	588.41	626.13	683.07	724.49	545.87	650.83	802.32	1,033.21	1,205.95
Taxes	201.5	203.0	206.6	225.4	239.1	196.5	234.3	288.8	372.0	434.1
Minorities	20.50	21.84	23.24	25.36	26.90	20.27	24.16	29.79	38.36	44.77
Net Attributable Income	330.13	363.56	396.26	432.30	458.51	329.09	392.37	483.70	622.89	727.04
Tax rate %	36.5	34.5	33.0	33.0	33.0	36.0	36.0	36.0	36.0	36.0
Capex	550.0	400.0	400.0	350.0	350.0	600.0	675.0	575.0	500.0	400.0
NFP	814.5	801.8	742.5	566.8	298.1	868.8	1217.5	1287.9	1166.3	665.7

Source: Intesa Sanpaolo Research estimates (*) Official figures excluding Russia

We also show our main estimates for the Pirelli Tyre BU. As for Consumer, we also highlighted our projections for the Russian JV that as for long term targets appear now more aligned to group business plan indications.

Pirelli tyres Consumer BU					
	2011E	2012E	2013E	2014E	2015E
Consumer revenues	4048	4822	5314	5772	6010
Car	3,625	4,044	4,363	4,665	4,819
Moto	424	484	526	587	642
Russia		294	425	520	549
Consumer EBIT	485	605	734	898	984
Car	413	510	600	719	774
Moto	72	80	89	103	114
Russia	0	16	44	76	95
Consumer EBIT margin %	12.0	12.6	13.8	15.6	16.4
Car %	11.4	12.6	13.8	15.4	16.1
Moto %	17.0	16.5	17.0	17.5	17.8
Russia %	NM	5.3	10.3	14.7	17.3

Source: Intesa Sanpaolo Research estimates

Pirelli Tyres Industrial BU					
	2011E	2012E	2013E	2014E	2015E
Industrial Revenues	1,660	1,733	1,815	1,904	1,946
Industrial EBIT	146	152	175	209	252
Industrial EBIT mgn %	8.8	8.8	9.6	11.0	13.0

Source: Intesa Sanpaolo Research estimates

We also show below our estimates at the consolidated level bearing in mind that minor businesses should progressively reduce their operative losses.

Pirelli Group - Income statement									
EUR M	Old			New					
	2011E	2012E	2013E	2011E	2012E	2013E	2014E	2015E	
Net Revenues	5,869.4	6,197.3	6,465.1	5,770.6	6,618.9	7,193.9	7,741.3	8,024.3	
-of which Tyres	5,807.29	6,094.04	6,330.43	5,708.55	6,555.54	7,129.30	7,675.18	7,956.62	
EBITDA reported	821.6	877.7	953.6	836.1	1,087.7	1,254.1	1,412.6	1,486.7	
(depreciation)	-232.2	-233.0	-253.4	-252.2	-350.5	-358.4	-314.5	-255.5	
EBIT pre restructuring	609.4	664.7	720.2	603.9	757.2	915.7	1,118.1	1,251.2	
-of which Tyres	656.9	692.7	722.8	650.6	777.4	928.9	1,127.0	1,256.2	
EBIT% pre restructuring	10.4	10.7	11.1	10.5	11.4	12.7	14.4	15.6	
-EBIT % Tyres	11.3	11.4	11.4	11.4	11.9	13.0	14.7	15.8	
Restructuring Charges	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	
EBIT Reported	589.4	644.7	700.2	583.9	737.2	895.7	1,098.1	1,231.2	
-of which Tyres	636.87	672.69	702.79	630.57	757.41	908.88	1,107.04	1,236.19	
EBIT reported%	10.0	10.4	10.8	10.1	11.1	12.5	14.2	15.3	
-EBIT% Tyres %	11.0	11.0	11.1	11.0	11.6	12.7	14.4	15.5	
Financial Charges	-90.8	-92.3	-85.6	-90.8	-114.6	-115.5	-81.4	-36.8	
Income from equity participations	0.3	0.3	1.3	0.3	0.3	0.3	0.3	0.3	
Pre-tax profit / (loss)	498.8	552.7	615.9	493.4	622.9	780.5	1,017.0	1,194.6	
Taxes	-182.6	-188.3	-202.7	-177.6	-222.5	-279.9	-365.7	-430.4	
Minorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Discontinued Operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net Attributable profit / (loss)	316.2	364.4	413.2	315.8	400.3	500.6	651.3	764.3	
Debt (Cash)	696	683	642	750	1123	1205	1087	582	
-of which Pirelli Tyre	815	802	743	869	1217	1288	1166	666	
-of which Corporate	-119	-119	-101	-119	-95	-83	-79	-84	

Source: Intesa Sanpaolo Research estimates

Valuation

Pirelli's defensive features within the automotive sector are well reflected by the stock performance to date. While the stock has far outperformed the market, our updated SOP analysis **would still suggest a fair value of EUR 9.32/share**, i.e. 45% above current prices.

Upgrading Pirelli Tyre equity value

As for our SOP analysis we take into account the potential equity value of Pirelli Tyre derived as an average of the traditional peers analysis, the DCF and the valuation of Pirelli's car Premium Tyres (roughly 51% and 80% of car tyres revenues and EBIT in 2012 including Russia) on the basis of its most direct peers Nokian. On average we derive an equity value for Pirelli Tyre of EUR 4.2Bn.

Pirelli Sum of the Parts 2012						
Pirelli SOP	Stake (%)	No Sh (000)	Price (EUR)	Equity Value (EUR M)	% Weight	Comments
Pirelli Tyres	100.0	-	-	4,204.1	96.8	2011 Peer comparison and DCF
Pirelli Ambiente/Pirelli Ecotechnology Holding Costs				22.0	0.5	Book value
RCS	5.18	37.8	0.6	-84.70	-2.0	Capitalised costs
Mediobanca ord	1.81	15.0	4.7	24.4	0.6	Market cap
Treasury	0.16	0.8	6.4	70.7	1.6	Market cap
				4.9	0.1	Treasury at market price
Total Pirelli main assets				4,241	97.7	
Other Pirelli assets				100.00	2.3	Book value
Total Gross assets				4,341	100.0	
Pirelli Corporate net debt 12(Cash)				-94.8		
Total Net Assets				4436.3		
Pirelli & C Total Market Value				3054.3		
Pirelli SOP per share				9.32		
Current Price per share				6.40		

Source: Intesa Sanpaolo Research estimates

Pirelli Equity valuation	
EUR M	
Equity Value on P/E12 peers (Michelin and Continental)	2293.9
Equity Value on EV 12 peers (Michelin and Continental)	2184.7
Equity value on EV12 with premium consumer valorised at Nokian multiples	4084.5
Equity value from DCF 2011-15	8253.3
Total Average Equity valuation Pirelli Tyres	4204.1

Pirelli Tyre peers	EV/sales			EV/EBITDA			EV/EBIT			P/E		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Michelin	0.47	0.44	0.41	3.38	3.15	2.84	5.16	4.95	4.34	5.95	5.75	5.28
Continental AG	0.55	0.50	0.43	3.87	3.51	3.12	6.16	5.74	4.70	6.45	5.94	5.11
Goodyear Tire & Rubber Co.	0.25	0.24	0.23	2.95	2.79	2.50	4.64	4.26	3.77	6.17	4.88	4.20
Bridgestone Corp.	0.58	0.54	0.48	4.87	4.15	3.41	8.88	6.98	5.68	11.41	8.94	7.73
Yokohama Rubber Co. Ltd.	0.56	0.46	0.44	5.74	4.29	3.74	11.53	8.38	7.15	11.61	7.77	6.78
Sumitomo Rubber Industries Ltd.	0.65	0.61	0.56	5.42	4.70	4.03	9.73	7.60	6.58	11.09	7.81	7.22
Hankook Tire Manufacturing Co. Ltd.	1.20	1.11	1.00	7.62	6.21	5.65	12.98	9.67	8.62	15.03	10.52	9.38
Nokian Renkaat Oyj	2.05	1.87	1.60	6.41	6.17	5.33	7.61	7.53	6.36	9.75	9.70	8.52
Yokohama Rubber Co. Ltd.	0.56	0.46	0.44	5.74	4.29	3.74	11.53	8.38	7.15	11.61	7.77	6.78
Average most direct peers (Michelin and Continental)	0.51	0.47	0.42	3.62	3.33	2.98	5.66	5.34	4.52	6.20	5.85	5.20
Average all	0.79	0.72	0.64	5.03	4.37	3.83	8.33	6.89	5.90	9.68	7.67	6.78

Source: FactSet price 18/11/11

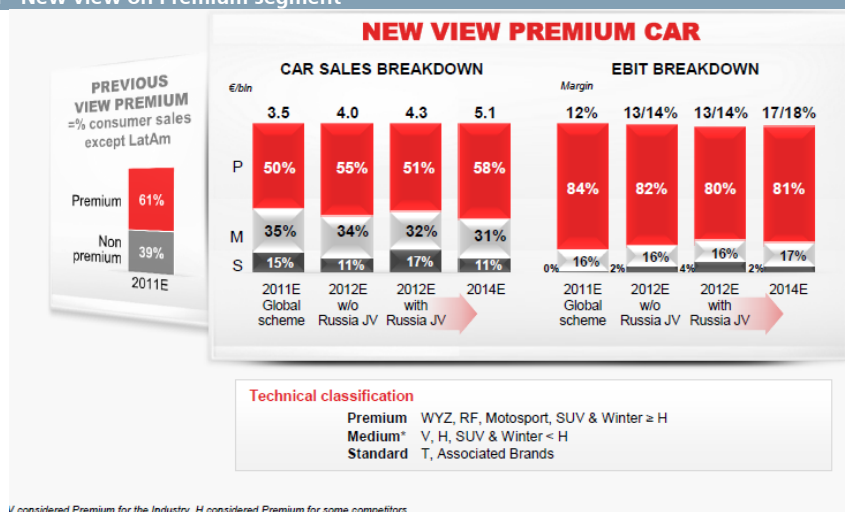
The hidden value of premium tyres

As for our peer valuation, while we already report above the sector peers multiple, we also highlight the potential equity value of Pirelli Tyres if, instead of applying a simple peers comparison with European leading players (Michelin and Continental), we extrapolate the hidden value of Pirelli premium tyres. We highlight that, according to the company, the business plan has provided a rather precise definition of its premium segment, Pirelli premium tyres should account for 51% of Pirelli car revenues and roughly 80% of car tyres EBIT, including the Russian initiatives.

Pirelli - Tyre equity value valorising the premium segment								
	Sales 12	EBITDA 12	EBIT 12	EV/sales12	EV/EBITDA 12	EV/EBIT12	EV	Peers
Total sales Tyres 2011	6,556	1,095	757					
- of which consumer (Car and Moto)	4,822	853	605					
- of which only car consumer (Including Russia)	4,338	751	505					
-premium tyres in car consumer including Russia (respectively 51% and 80% of car revenues and EBITDA/EBIT)	2212.4	601.1	404.3	1.9	6.2	7.5	3633.3	Nokian
- Other Consumer non premium and industrial	4343.2	493.9	353.1	0.5	3.3	5.3	1857.3	Michelin and Continental
Net Debt 2012E							-1217	
Pension Funds 2012 E							-159	
Minorities (P/E12E)							-30	
Total Pirelli Tyre equity value							4084	

Source: Intesa Sanpaolo Research estimates

Pirelli - New view on Premium segment



Source: Company data

The DCF models factor in the full Business Plan implementation

Lastly, we show below our DCF analysis, that takes into account the entire business plan time horizon, and suggests a highly generous Equity value for Pirelli Tyres.

Pirelli Tyres DCF					
	2011E	2012E	2013E	2014E	2015E
Sales	5,708.5	6,555.5	7,129.3	7,675.2	7,956.6
Growth %	19.6	14.8	8.8	7.7	3.7
EBIT	630.6	757.4	908.9	1,107.0	1,236.2
Margin %	11.0	11.6	12.7	14.4	15.5
Depreciation and amortization	240.0	337.5	345.0	300.0	240.0
EBITDA	870.6	1,094.9	1,253.9	1,407.0	1,476.2
Cash flow from operations	643.6	822.2	926.7	1,008.5	1,031.2
Capex	600.0	675.0	575.0	500.0	400.0
Decrease (increase) in working capital	88.0	79.5	53.9	51.3	26.4
% Working capital on Sales	9.4	9.4	9.4	9.4	9.4
Other changes in cash (c)	0.0	0.0	0.0	0.0	0.0
Free cash flow	-44.4	67.7	297.8	457.2	604.7
Discount factor	0.93	0.86	0.79	0.74	0.68
Discounted cashflow	-41.1	58.1	236.6	336.4	412.0

Source: Intesa Sanpaolo Research estimates

WACC assumption	
Risk free rate %	4.8
Equity risk premium %	5.8
Beta x	1.0
Tax rate (Long term) %	36.0
Cost of debt %	5.6
Cost of equity %	9.7
Debt/capital employed ratio %	42
Equity/capital employed ratio %	58
G %	2.5
WACC %	7.98

Source: FactSet and Intesa Sanpaolo Research estimates

DCF result	
Terminal value	11,321.3
NPV 11-15E	1,002.0
NPV Terminal	8,537.4
Total	9,539.4
Cash (Debt)10E	-1,109.9
Pension funds 10 projected	-159.0
Minorities (P/E)	-16.7
Equity	8,253.7

Source: Intesa Sanpaolo Research estimates

Given the current uncertainties on the European and, above all, the Italian situation and taking into account the fact that 2015 is still a long way off, we do not expect the market consensus to promptly align with the group's targets. We could not exclude a certain stock volatility for a while as with the rest of the market. However we believe that should the situation stabilise, consensus could significantly move upwards.

A floor valuation

We believe that Pirelli group targets in case of a contingency plan deserve a thought apart. First of all we highlight Pirelli's defensive features which come from: 1) the group's strong positioning in the premium car tyres segment; 2) Pirelli's high exposure to emerging trucks tyre markets.

The above features, in case of a contingency plan, should enable the company to record better performances than the market. We assumed that in case of a 10% drop in car OE volumes and a 20% contraction in the truck business, Pirelli's slowdown in car volumes would stand at -5%, while for truck tyres the volumes slowdown should be limited to -10%. We maintained the rest of our assumptions for price mix and Russia.

Is the market ready for a re-rating?

What about a floor valuation?

Pirelli – Simulation on contingency plan			
Consumer	2012-11 Delta Revenues	2012-11 Delta EBIT	Contingency
Vol.	-202		-25.5
price mix	385		48.5
Russia	294		16
Total	476		38.5
Industrial			
Volumes	-166.0		-14.9
Price mix	33		3.0
Total	-133		-11.9

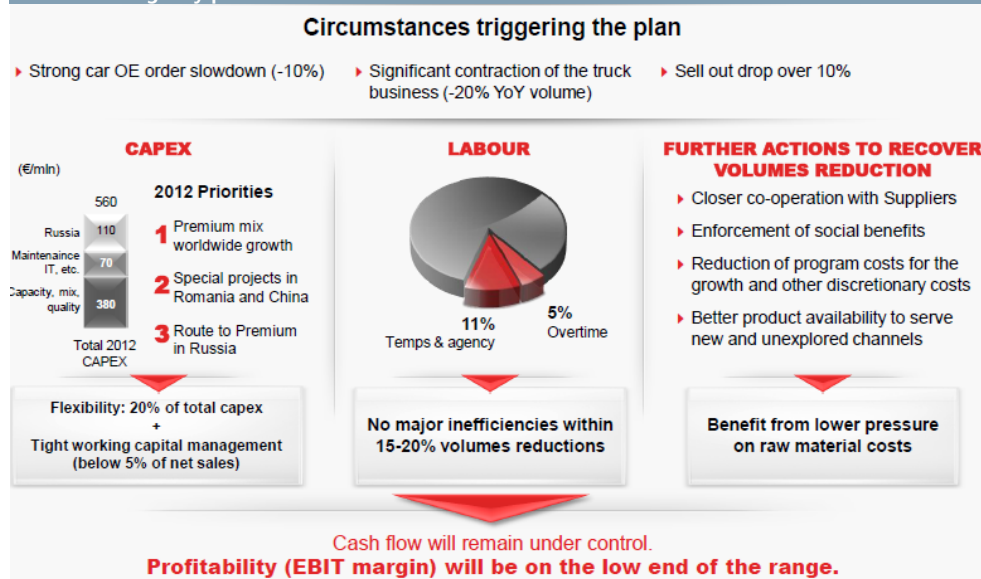
Source: Intesa Sanpaolo Research estimates

Taking into account the abovementioned assumptions, in case of a contingency plan, we estimate total revenues at EUR 6,052M and an EBIT margin between 10.9-11% for Pirelli Tyres. These values are somewhat aligned with our previous estimates (see September Auto sector report), according which we derived a value per share of EUR 7.40. On the back of these considerations we would consider this level as a floor valuation for Pirelli in case of a significant recession of the OE car and truck markets.

Pirelli – Tyre revenues in case of Contingency plan 2012				
	Revenues 2012 Contingency plan	EBIT 2012 Contingency plan	EBIT% 2012 mg Contingency plan	SOP/share EUR
Pirelli Tyre consumer 2012 Contingency plan	4525	523.5	11.6	
Pirelli Tyre Industrial 2012 Contingency plan	1527	134.1	8.8	
Total Pirelli Tyre revenues 2012 Contingency plan	6052	658	10.9	
Previous IMI official estimates	6094	672	11	7.40

Source: Intesa Sanpaolo Research estimates

Pirelli Contingency plan



Source: Company data

Pirelli & C - Key figures						
Sector	Auto & Components	Mkt price EUR/Share	Ordinary		Rating	
REUTERS CODE	PECI.MI	Target price EUR/Share	6.42		NO RATING	
Values per share (EUR)	2009A	2010A	2011E	2012E	2013E	
No. ordinary shares (M)	5,233.14	475.74	475.74	475.74	475.74	475.74
No. NC saving/preferred shares (M)	134.76	0.01	0.01	0.01	0.01	0.01
Total no. of shares (M)	5,367.91	475.75	475.75	475.75	475.75	475.75
Adj. EPS	0.02	0.57	0.71	0.88	1.09	1.09
CFPS	0.04	0.51	1.19	1.58	1.81	1.81
BVPS	0.41	4.18	4.68	5.30	6.04	6.04
Dividend Ord	0.01	0.17	0.22	0.32	0.42	0.42
Dividend SAV Nc	0.04	0.18	0.23	0.33	0.43	0.43
Income statement (EUR M)	2009A	2010A	2011E	2012E	2013E	
Sales	4,462.20	4,848.43	5,770.65	6,618.85	7,193.95	7,193.95
EBITDA	428.50	629.03	836.10	1,087.66	1,254.11	1,254.11
EBIT	217.40	407.83	583.90	737.16	895.71	895.71
Pre-tax income	75.30	141.63	493.37	622.87	780.52	780.52
Net income	22.70	21.33	315.77	400.34	500.65	500.65
Adj. net income	102.30	269.83	335.77	420.34	520.65	520.65
Cash flow (EUR M)	2009A	2010A	2011E	2012E	2013E	
Net income before minorities	-22.60	4.23	315.77	400.34	500.65	500.65
Depreciation and provisions	211.10	221.20	252.20	350.50	358.40	358.40
Change in working capital	473.49	74.80	-64.58	-12.39	-21.41	-21.41
Operating cash flow	661.99	300.23	503.38	738.45	837.64	837.64
Capital expenditure	-237.00	-425.00	-600.00	-575.00	-525.00	-525.00
Other (uses of Funds)	355.85	-57.20	-92.00	-312.00	-265.00	-265.00
Free cash flow	780.84	-181.97	-188.62	-148.55	47.64	47.64
Dividends and equity changes	-	-81.35	-78.50	-104.67	-152.24	-152.24
Net cash flow	780.84	-263.32	-267.11	-253.22	-104.60	-104.60
Balance sheet (EUR M)	2009A	2010A	2011E	2012E	2013E	
Net capital employed	3,023.38	2,483.48	3,014.86	3,683.75	4,113.81	4,113.81
of which associates	-	-	-	-	-	-
Net debt/-cash	529.40	455.50	750.06	1,123.28	1,204.93	1,204.93
Minorities	319.60	37.20	37.20	37.20	37.20	37.20
Net equity	2,174.38	1,990.78	2,227.60	2,523.27	2,871.68	2,871.68
Market cap	33,596.77	3,054.25	3,054.25	3,054.25	3,054.25	3,054.25
Minorities value	-	-	-	-	-	-
Enterprise value (*)	34,126.17	3,509.75	3,804.31	4,177.53	4,259.19	4,259.19
Stock market ratios (x)	2009A	2010A	2011E	2012E	2013E	
Adj. P/E	328.41	11.32	9.10	7.27	5.87	5.87
P/CEPS	143.70	12.59	5.38	4.07	3.56	3.56
P/BVPS	15.45	1.53	1.37	1.21	1.06	1.06
Dividend yield (% ord)	0.23	2.57	3.43	4.98	6.54	6.54
EV/sales	7.65	0.72	0.66	0.63	0.59	0.59
EV/EBITDA	79.64	5.58	4.55	3.84	3.40	3.40
EV/EBIT	156.97	8.61	6.52	5.67	4.76	4.76
EV/CE	11.29	1.41	1.26	1.13	1.04	1.04
D/EBITDA	1.24	0.72	0.90	1.03	0.96	0.96
D/EBIT	2.44	1.12	1.28	1.52	1.35	1.35
Profitability & financial ratios (%)	2009A	2010A	2011E	2012E	2013E	
EBITDA margin	9.60	12.97	14.49	16.43	17.43	17.43
EBIT margin	4.87	8.41	10.12	11.14	12.45	12.45
Tax rate	130.01	97.01	36.00	35.73	35.86	35.86
Net income margin	0.51	0.44	5.47	6.05	6.96	6.96
ROE	1.04	1.07	14.18	15.87	17.43	17.43
Debt/equity ratio	0.21	0.22	0.33	0.44	0.41	0.41
Growth (%)		2010A	2011E	2012E	2013E	
Sales		8.66	19.02	14.70	8.69	8.69
EBITDA		46.80	32.92	30.09	15.30	15.30
EBIT		87.59	43.17	26.25	21.51	21.51
Pre-tax income		88.09	248.34	26.25	25.31	25.31
Net income		-6.03	1,380.13	26.78	25.06	25.06
Adj. net income		163.76	24.43	25.19	23.86	23.86

(*) EV = Mkt cap+ Net Debt + Minorities Value - Associates A: actual; E: estimates; Source: Company data and Intesa Sanpaolo Research

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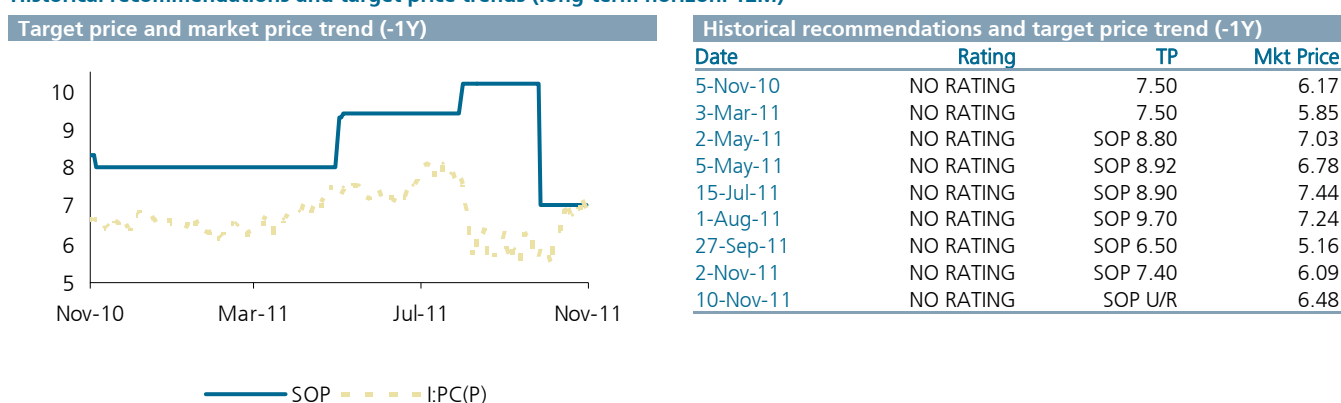
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Equity rating key (short-term horizon: 3M)

Equity rating key (short-term horizon: 3M)	
Short-term rating	Definition
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