

Pirelli & C. (PC-IT)

Hold

Down to hold, factoring in a more conservative scenario

Last (€)	7.16
Valuation Range (€)	7.6-8.0
Market Cap.(€m)	3445
Av. Daily Vol.(m sh)	4,680
Free Float	48,6%
YTD	12%

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- We downgraded Pirelli from Buy to Hold following an estimates revision that is factoring in a more conservative '12 scenario.
- We reduced our '12 estimates on sales, EBIT and net profit by 3%, 7% and 11% respectively. The 4Q'11 negative tyre market watch led us to downward revise our assumptions about the volumes trend, mainly in Europe and Lat.Am concerning both OEM and replacement.
- We now expect a '12 sales growth at +10% vs company guidance at +16%, Consensus at +12%. We are factoring in:
 - Price/mix effect +5% vs +8% guided by the Co.
 - Volumes effect -1% vs +2% guided by the Co
 - Russia consolidation +6%, in line with the Co.
- On the EBIT and net profit we are now set at 8% and 15% respectively below Consensus. '12 Net debt is now expected at above €1bn from €750m expected in '11, factoring in both the capex in Russia at €422m and the dividend distribution.
- We set a new valuation range at €7.6-8.0 from €9.0-9.4 (-13%). Pirelli is trading at 6.5-10.1x on EV/EBIT and PE on our new '12 estimates. Main peers are below: Conti at 6.3-7.6x, Michelin at 5.7-7.3x, Goodyear at 4.3-5.5x and Bridgestone at 6.4-8.2x.

	Sales (€m)	EBITDA (€m)	vs. Cons	Net Profit (€m)	EPS(old) (€)	EPS(new) (€)	vs.Cons	P/E(x)	EV/EBITDA (x)	DPS(€)	DIV Yield
2009	4067	469		23		0,25		27,7	7,8	0,16	2,3%
2010	4848	636		22		0,50		13,8	5,8	0,17	2,5%
2011E	5750	814	-2%	331	0,64	0,68	3%	10,2	4,5	0,22	3,2%
2012E	6318	909	-8%	338	0,78	0,69	-14%	10,1	4,0	0,31	4,5%
2013E	6866	1095	-5%	440	1,01	0,90	-9%	7,7	3,3	0,44	6,4%

Est 3 Yr Sales CAGR: 12% Shares Outstanding (m): 487

Est 3 Yr EPS CAGR: 22% Mkt Cap (€m): 3445

Share price performance	YTD	1 month	3 months	12 months
Absolute	9.99%	8.82%	11.8%	25.64%
Relative to FTSE MIB	40.08%	42.72%	51.29%	74.02%
Relative to Stoxx Europe 600	18.99%	20.12%	17.27%	38.03%

PC-IT: Summarised P&L Account and key ratios

€m	2008	2009	2010	2011E	2012E	2013E
Sales	4660	4067	4848	5750	6318	6866
EBITDA	262	469	636	814	909	1095
Depreciation & Amort.	219	219	228	231	242	251
EBIT	43	250	408	583	667	844
Net Interest Cost	80	70	66	88	122	136
Associates	-366	-12	23	4	4	4
Impairment & Other	0	0	1	0	0	0
Discontinued operations	63	-100	-224	0	0	0
PBT	-340	68	142	499	549	712
Taxes	73	90	137	185	211	272
Minorities	65	45	18	18	0	0
Net Profit	-348	23	22	331	338	440
EPS	-0,84	0,25	0,50	0,68	0,69	0,90
Sales growth	-3%	-13%	19%	19%	10%	9%
EBITDA growth	na	79%	36%	28%	12%	20%
Net Profit growth	nm	-107%	-4%	1405%	2%	30%
EBITDA margin	6%	12%	13%	14%	14%	16%
EBIT margin	1%	6%	8%	10%	11%	12%
Net Pr. Margin	-7%	1%	0%	6%	5%	6%
Interest Cover (1) (x)	0,5	3,6	6,2	6,6	5,5	6,2

PC-IT: Summarised Balance Sheet and key ratios

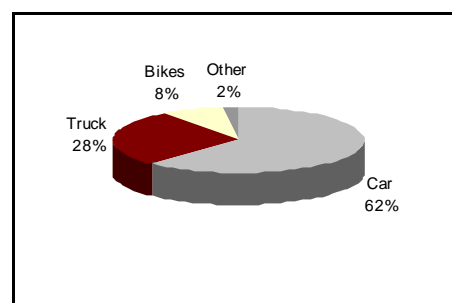
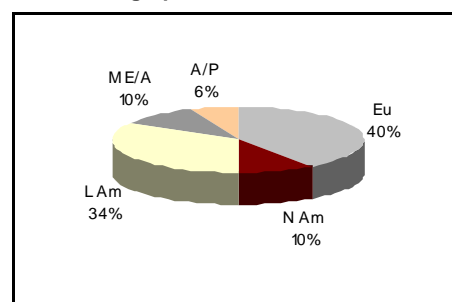
€m	2008	2009	2010	2011E	2012E	2013E
Fixed assets	1636	1757	1991	2340	2880	3109
Goodwill	1008	1018	834	834	834	834
Inventories	921	679	692	821	916	1009
Trade Receivables	788	736	677	802	903	995
Cash + S/T Inv. + other	1887	1868	866	1271	933	774
Total Assets	6240	6058	5060	6068	6466	6721
Sharehold. Equity	2374	2495	2028	2261	2490	2777
L-T Financial Debt	1378	1506	895	1395	1395	1250
S-T Financial Debt	736	319	248	248	248	200
Trade Payables	1109	988	1066	1265	1390	1510
Provisions + Other	643	750	823	899	943	984
Total Liabilities	6240	6058	5060	6068	6466	6721
Net Debt	1028	529	458	780	1078	1014
WACC	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%
Net Debt/Equity	43,3%	21,2%	22,6%	34,5%	43,3%	36,5%
ROCE (2)	1,2%	-1,9%	0,5%	9,4%	9,9%	12,3%
ROE	-14,7%	0,9%	1,1%	14,6%	13,6%	15,8%
ROCE/WACC (x)	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!

PC-IT: Simplified Cash Flow Statement and key ratios

€m	2008	2009	2010	2011E	2012E	2013E
Net Profit	-348	23	22	331	338	440
+ Depreciation & Amort.	219	219	228	231	242	251
+/- Other	0	0	0	0	0	0
= Operating CF	-129	242	250	562	580	691
- Chg in Working Capital	-402	-587	-149	152	41	-5
- CAPEX of which	208	193	305	635	727	480
Expansionary CPX	0	0	0	0	0	0
- Dividends	168	2	85	81	109	152
= FCF	-103	634	9	-306	-297	64
FCF Yld (M.Cp)	-4,2%	41,9%	0,4%	-10,0%	-8,8%	1,9%
FCF Yld (EV)	-3,3%	37,9%	0,3%	-8,3%	-6,9%	1,5%
FCF (3)	-103	634	9	-306	-297	64
FCF Yld (M.Cp)	1,8%	50,8%	9,1%	4,5%	6,3%	11,8%
FCF Yld (EV)	1,4%	46,0%	7,9%	3,8%	4,9%	9,4%

PC-IT: EV Valuations

€m	2011E	2012E	2013E
+ Mkt Cap	3061	3061	3061
+ Net Debt	780	1078	1014
- Non-core assets	208	153	153
+/- Other	27	346	343
= EV	3660	4332	4265
EV/Sales (x)	0,6	0,7	0,6
EV/EBITDA (x)	4,5	4,8	3,9
EV/EBIT (x)	6,3	6,5	5,1
EV/IC (x)	1,2	1,2	1,1

PC-IT: Divisional Sales Breakdown**PC-IT: Geographical Sales Breakdown****Debt Structure (€m)**

Total Debt in the B.Sheet	
Short Term	248
Long Term: maturing in	895
24 months	
36 months	
more than 36 months	895
Cost Range	5.0-5.5%
Rating (Moody's)	
Short term	
Long term	
Estimated Off B/S Liabilities	0

PC-IT: Share Information

Outstanding no. shares (m)	487
Market Cap (€ m)	3061
Avg daily volume (m sh, last 3 m)	4,680
Free float %	48,6%
Major shareholders	
Camfin	25,5%
Generali	5,5%
Edizione	4,8%
Allianz	4,5%
Management shares option scheme	
% of Capital	0,3%
Nearest to vest	0%

(1) calculated as EBIT/Int. expenses (2) calculated as ROCE after taxes (*) Source: company data and Fidentis estimates

1. Financials: weakening market conditions

- We have revised down our '12 estimates factoring in 1) lower volumes trend and 2) lower price/mix effect. We lowered by 3%, 7% and 11% our estimates on '12 sales, EBIT and net profit
- On '12 P/L estimates we are now set below both Company guidance and Consensus.
- The weak 4Q'11 trend of the tyre market watch underpins our idea that '12 could be tougher than expected mainly in terms of volumes

'12 Estimates downward revised on a weaker volumes trend: '12 EBIT revision at -7%

We have decided to fine-tune the '11 figures and revise down our '12 estimates.

On '11, we kept sales and margins unchanged, since the company recently confirmed to have reached the level guided during the recent business plan. We just fine-tuned

- **net profit expectations**, to consider a lower tax rate and
- **Net debt**, factoring in slightly larger capex

On '12, we cut our estimates by 3%, 7% and 11% at sales, EBIT and Net profit level

Figure 1: Fidentiis new/old estimates

€m	11 old est	11 new est	% change	12 old est	12 new est	% change
Sales	5,750	5,750	0%	6,490	6,318	-3%
growth	121%	19%		13%	10%	-3.0%
- price/mix	77.0%	17.8%		6.0%	4.9%	-1.1%
- volumes	44.0%	2.8%		1.0%	-0.9%	-1.9%
- forex	0.0%	-1.3%		0.0%	0.0%	0.0%
- Russia	0.0%	0.0%		6.0%	6.0%	0.0%
EBIT	583	583	0%	719	667	-7%
Margin	10.1%	10.1%		11.1%	10.6%	
Net profit	313	331	6%	379	338	-11%
Group Net debt	759	780	3%	772	1,078	40%

Source: Fidentiis estimates

Our new '12 estimates are now factoring in a '12 sales at +10%, vs Company guidance at +16% and Consensus set at +12%. The main differences concern:

- **volumes**, which we expect to have negative impact in the range of -1% vs Pirelli guidance of 2% growth and. We forecast a negative performance to be reported mainly in Europe for both Passenger and Truck divisions
- **price/mix**, expected at +5% vs Company indications in the range of +8%.

We keep for Russia the same 6% growth impact predicted by Pirelli.

Figure 2: '11-'12E Pirelli guidance vs Fidentiis, Consensus estimates

	2011				2012			
	Fidentiis	Pirelli	Consensus	Fid vs Cons	Fidentiis	Pirelli	Consensus	Fid vs Cons
Sales	5,750	<5800	5751	0%	6,318	6700	6427	-2%
growth	19%	21%	19%		10%	16%	12%	
- price/mix	17.8%	18%			5%	8%		
- volumes	2.8%	3%			-1%	2%		
- forex	-1.3%				0%	0%		
- Russia	0.0%	0%			6%	6%		
EBIT	583	625	590	-1%	667	737-804	725	-8%
Margin	10.1%	10.0%	10.3%		10.6%	11-12%	11.3%	
Net profit	331	n.a.	320	4%	338	n.a.	397	-15%
Group Net debt	780	750	770	1%	1,078	1000	964	12%

Source: Fidentiis estimates, Factset, Company Guidance

Our estimates revision follows the release of a disappointing **4Q'11 tyre market watch**, with a worsening performance reported in December. As highlighted in the table below the **replacement, representing 74% of Pirelli sales, was particularly weak in December**, with a negative performance for the whole Truck division and for the Passenger car in Europe (-17%) and NAFTA (-8%).

Figure 3: 4Q'11 Tyre market watch

	Oct	Nov	Dec	Q4'11
Passenger				
Europe				
OEM	8%	3%	-9%	1%
Replacement	3%	-1%	-17%	-4%
Nafta				
OEM	9%	17%	16%	14%
Replacement	-5%	1%	-8%	-4%
Mercosur				
OEM	-8%	-9%	-7%	-8%
Replacement	-4%	3%	9%	3%
Truck				
Europe				
OEM	8%	5%	-8%	2%
Replacement	-11%	-20%	-25%	-18%
Nafta				
OEM	60%	43%	44%	49%
Replacement	-6%	-5%	-11%	-7%
Mercosur				
OEM	18%	17%	28%	21%
Replacement	-3%	-8%	-17%	-9%

Source: Pirelli

2. New valuation range at €7.6-8.0, Down to Hold

- We set a new valuation range at €7.6-8.0, from €9.0-9.4, based on a FCF yield model
- We downgrade from Buy to Hold. A downward revision of the '12 Company guidance could be a negative catalyst.

Valuation range at €7.6-8.0

We based our valuation on a '12 FCF yield model which leads to a valuation range at €7.6-8.0 from the previous €9.0-9.4 (-15%).

Figure 4: Free Cash Flow Yield Valuation

	2011	2012E	2013E
EBIT	582.6	667.1	843.6
+ Depreciation/Amortisation	231.5	241.5	251.5
- Maintenance capex (according to Fidentiis)	250.0	250.0	250.0
Adjusted EBIT	564.1	658.6	845.1
- Taxes (normalised tax rate)	209.4	253.3	323.2
Adjusted cash flow after tax	354.8	405.3	521.9
Return on the investment	8.9%	8.6%	8.6%
Fair EV	3983	4729	6041
- Net debt (cash)	780.4	1077.9	1013.6
+ Financial assets (JV)	207.9	152.9	152.9
- Minorities	0.0	0.0	0.0
Fair market cap.	3410	3804	5180
Number of shares (million)	487.2	487.2	487.2
Fair value per share	7.0	7.8	10.6
Current value per share		7.3	7.3
premium (-) / discount (+) in %		7%	45%

Source: Fidentiis calculation

We downgrade Pirelli from Buy to Hold in light of:

- Its **strong performance**, +49% from the bottom of September, +12% year-to-date
- The potential **downward revision of the consensus** guidance.
- a **demanding valuation**, if compared with the main peers.

Pirelli is trading at 6.5-10.1x on EV/EBIT and PE on our new '12 estimates. Main peers are below: Conti at 6.3-7.6x, Michelin at 5.7-7.3x, Goodyear at 4.3-5.5x and Bridgestone at 6.4-8.2x.

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HOLD: 12-month valuation is 0-10% higher than the current market price.

SELL: 12-month valuation is lower than the current market price.

Current market price is the reference price of the day prior to the publication of the report.

Recommendation history and valuation trends – Pirelli & C. spa

Date of publication	Recommendation	Valuation range (EUR)
23 February 2011	BUY	7.2-7.4
9 March 2011	BUY	7.9-8.1
2 May 2011	BUY	7.9-8.1
5 May 2011	BUY	8.3-8.5
10/11/2011	BUY	9.0-9.4
26/11/2011	HOLD	7.6-8.0

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Rating allocation

	BUY	HOLD	SELL
As a percentage of total	47%	35%	18%

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