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Price
EUR6.29

Target
EUR7.80

Previous
Buy

Buy

Aggressive plan, but 2012 seems feasible

Pirelli's new industrial plan for 2013-14 looks aggressive to us, although feasible for 2012, as it assumes a doubling of EBIT in 2014 versus 2011 with Europe and the consumer premium market the growth drivers, despite the current macro weaknesses.

Italy | Automobiles & parts

Pirelli & C.

COMPANY UPDATE

24 November 2011

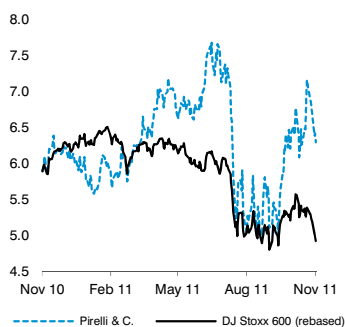
Reuters PECI.MI
Bloomberg PC IM
Index DJ Stoxx 600

Latest financials

Market cap (EURbn)	3.0
Free float	74%
Shares outstanding (m)	488
Daily trade volume ('000)	5,134
YTD abs. performance	4%
52-week high (EUR)	7.7
52-week low (EUR)	4.9
Enterprise value (EURm)	4,463
Net debt (EURm)	728

(EUR)	2011E	2012E	2013E
Sales	5,706.4	6,424.9	6,824.8
EBITDA	825.4	1,015.5	1,111.3
EBIT	617.1	727.5	818.2
Pretax profit	533.8	644.6	748.9
Net profit (adj)	343.7	393.7	454.3
EPS (adj)	0.70	0.81	0.93
DPS	0.27	0.31	0.36
P/E	8.9	7.8	6.8
EV/sales	0.8	0.7	0.7
EV/EBITDA	5.4	4.6	4.1
EV/EBIT	7.2	6.5	5.6
Net div. yield	4.3%	5.0%	5.8%

Financial year end: 31 December



In brief

- > New industrial plan: EBIT to double in 2014 versus 2011
- > Consumer premium market and Europe the growth drivers
- > Our opinion: aggressive plan for 2013-14, feasible for 2012
- > Buy, EUR7.8 TP confirmed

In detail

New industrial plan: EBIT to double in 2014 versus 2011

Pirelli presented a new industrial plan which foresees revenues in 2012 at EUR6.7bn, +17.5% YOY and EBIT between EUR737m and EUR804m with a margin of 11-12% (11% in 2011). In 2014, revenues should increase to EUR7.7bn (+10.5% CAGR 2011-14) and the EBIT margin should rise to 15-16% with a 23-25% CAGR. Net debt should be below the EUR1bn mark in 2012 and should remain broadly stable at EUR1bn in 2014 after EUR0.5bn of dividends and EUR2.2bn of capex.

Consumer premium market and Europe the growth drivers

At the basis of the plan is Pirelli's aim to become a global premium leader, as the segment is less cyclical and more profitable than the average automotive industry. The consumer business should therefore increase its weight in revenues to 75% (from 70% in 2011) and in EBIT to 82% (76%) thanks to the launch of new products, a higher weight of winter tyres, efficiencies mainly coming from innovations in raw materials, processes optimisation and the allocation of capacity expansion to low-cost plants. Europe will be the key beneficiary with its weight in EBIT increasing to over 50% in 2014 versus 30% in 2010.

Our opinion: aggressive plan for 2013-14, feasible for 2012

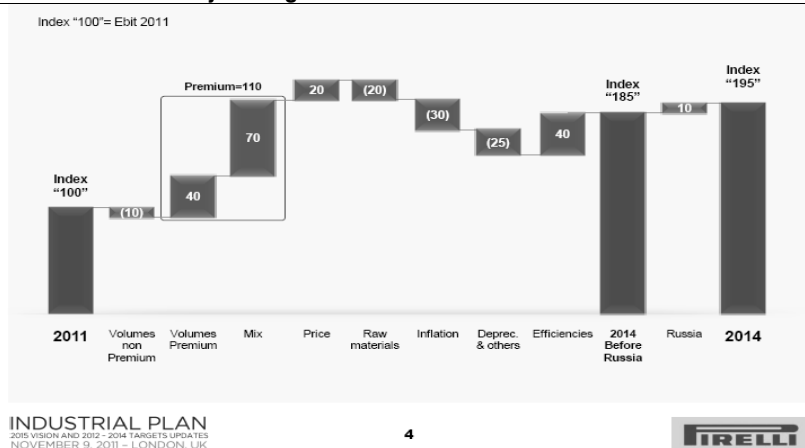
We consider the plan aggressive for 2013-14, while it seems quite feasible for 2012. Our estimates for 2012 are slightly below company targets (-4% for revenues and -12% when considering the upper-end EBIT target), but are in line in terms of debt (we expect EUR948m vs. the <EUR1bn target). We are however more cautious on 2014 (-8% for revenues and -26% vs. the median EBIT target), as we are more cautious on the global macro scenario, especially in Europe, as the demand slowdown combined with the capacity increase of the industry could force Pirelli to lower prices, therefore reducing the price/mix effect which is key to the plan's delivery (Chart 1). We are however more cautious on investments as we believe Pirelli could decide to delay part of them if demand slows further.

Table 1: Pirelli: company targets vs. Kepler Capital Markets estimates

(EURm)	Company targets							Kepler CM Estimates				
	FY 11	FY 12		FY 14		CAGR 2011-14		FY 11E	FY 12E	FY 13E	FY 14E	CAGR 2011-14E
Net revenues	5700	6700	6700	7700	7700	10.5%	10.5%	5706	6425	6825	7093	7.5%
Consumer	3500	4891	4891	5775	5775	18.2%	18.2%	3977	4663	4981	5214	9.4%
Industrial	2200	1809	1809	1925	1925	-4.4%	-4.4%	1729	1762	1844	1879	2.8%
Weight												
Consumer	70%	73%	73%	75%	75%			70%	73%	73%	74%	
Industrial	30%	27%	27%	25%	25%			30%	27%	27%	26%	
EBIT	627	737	804	1155	1232	22.6%	25.3%	597	707	798	881	13.9%
Margin	11.0%	11.0%	12.0%	15.0%	16.0%			10.5%	11.0%	11.7%	12.4%	
Consumer	477	582	635	947	1010	25.7%	28.5%	457	584	685	776	19.3%
Margin	13.6%	11.9%	13.0%	16.4%	17.5%			11.5%	12.5%	13.8%	14.9%	
Industrial	150	155	169	208	222	11.4%	13.8%	140	123	113	106	-9.0%
Margin	6.8%	8.6%	9.3%	10.8%	11.5%			8.1%	7.0%	6.1%	5.6%	
Weight												
Consumer	76%	79%	79%	82%	82.0%			76%	83%	86%	88%	
Industrial	24%	21%	21%	18%	18%			24%	17%	14%	12%	
Net debt	750	<1000	<1100	1000		10.1%		728	948	811	583	-7.1%
Cumulative capex 2012-15		2200						1889				
Dividends 2011-14		500						464				

Source: Company data, Kepler Capital Markets

Chart 1: Pirelli 2011-14 EBIT tyre bridge



Source: Company data

Russia: the possible positive surprise

We believe the plan is conservative regarding the contribution from the Russian business, as Pirelli expects revenues of around EUR300m in 2012 increasing to EUR500m in 2014 with a mid-single-digit EBIT margin in 2012, increasing to 14-15% in 2014 despite the market being mainly focused on winter tyres, with competitors reaching a 20% margin. Furthermore, Russia could be an interesting opportunity in terms of innovation for the development and access to alternative raw materials.

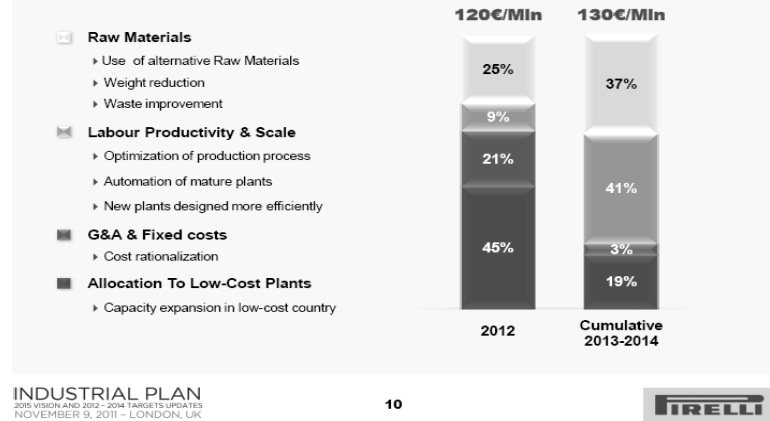
Raw material prices assumed to remain stable over the plan period

Targets include a EUR140m headwind on raw materials for 2012 (already fully offset by price increases) and mainly due to the negative forex effect. In particular, the plan's targets assume natural rubber at USD4,300/tonne, Brent at USD105/barrel and Butadiene EU at EUR2,100/tonne. For 2013-14, raw materials are expected to be stable.

EUR250m of efficiencies over 2012-14

EBIT growth should be sustained by EUR250m of efficiencies over 2012-14, of which EUR120m already in 2012 (Chart 2). The main drivers for the efficiencies are innovations on raw materials (EUR75m), a greater scale reach (EUR65m), G&A and fixed costs reduction (EUR30m) and the allocation of production to low-cost plants (EUR80m). Again we are more conservative on the possibility of reaching these efficiencies, especially for the 2013-14 period as, should the market slow further, Pirelli may not be able to attain the expected scale reach and may have to deal with an overcapacity issue instead.

Chart 2: Pirelli: efficiency plan



Source: Company data

BUY, EUR7.8 TP confirmed

We confirm our EUR7.8 target price which implies a fair EV/EBIT of 7.3x and 6.5x in 2011-12E. We reiterate our Buy rating and EUR7.8 target price as: 1) Pirelli is following a clear strategy towards the premium segment, with scalable investments; 2) the recent raw material price declines should be supportive for H1 2012 results; 3) at current prices, Pirelli is discounting flat revenues over the next three years with an EBIT margin of about 11%, without cutting investments. We instead assume Pirelli can stabilise its tyre margins above 12% and below the 15-16% targeted by the company.

Table 2: Pirelli valuation (EURm)

	Stake owned	Method	Enterprise Value - Total	NFP	Total Equity	Equity value Pirelli stake	Equity per share (EUR)	Weight on Equity
Pirelli Tyre	100%	DCF	4479	-923	3557	3557	7.29	94%
Listed participations		market value				237		
Unlisted participations		book value				119	0.24	3%
Total participations						106	0.22	3%
						225	0.46	6%
Parent NFP (year end 2011)				195		195	0.40	5%
Consolidated NFP (year end 2011)				-728				
Pension funds and capitalised costs						-92	-0.19	-2%
Corporate costs						-88	-0.18	-2%
Total Equity Value						3796	7.8	100%
Outstanding Shares (m)						488		
Target price (EUR)							7.8	

Source: Kepler Capital Markets

Key financials

Pirelli & C.

Rating	Buy	Market cap	EUR3,050m	Bloomberg	PC IM	Laura Pennino		
Target price	EUR7.80	EV	EUR4,463m	Reuters	PECLMI	laura.pennino@keplercm.com		
Price	EUR6.30	Float	74%			+39 02 8550 7210		

31 December

	2006	2007	2008	2009	2010	2011E	2012E	2013E
Income statement (EURm)								
Sales	4,841.2	5,208.9	4,660.2	4,067.5	4,848.4	5,706.4	6,424.9	6,824.8
Change (%)	na	7.6%	-10.5%	-12.7%	19.2%	17.7%	12.6%	6.2%
EBITDA adjusted	632.0	585.6	253.0	470.8	630.5	825.4	1,015.5	1,111.3
Change (%)	na	-7.3%	-56.8%	86.1%	33.9%	30.9%	23.0%	9.4%
EBITDA margin (%)	13.1%	11.2%	5.4%	11.6%	13.0%	14.5%	15.8%	16.3%
EBIT adjusted	445.1	373.2	188.0	297.0	432.5	617.1	727.5	818.2
Change (%)	na	-16.2%	-49.6%	58.0%	45.6%	42.7%	17.9%	12.5%
EBIT margin (%)	9.2%	7.2%	4.0%	7.3%	8.9%	10.8%	11.3%	12.0%
Net financial	533.8	-141.4	-80.0	-85.4	-65.8	-83.3	-82.9	-69.3
Extraordinary result	603.1	-6.3	-144.8	-29.1	-23.2	-20.0	-20.0	-20.0
Associates	113.9	198.5	-366.5	-11.6	23.4	0.0	0.1	0.1
Pretax profit	950.4	225.5	-36.8	182.5	343.5	513.8	624.6	728.9
Reported net earnings	-1,266.0	-34.0	19.0	-8.1	-17.7	330.7	380.7	441.2
Adjusted net earnings (group)	174.3	247.5	1.0	46.1	244.6	343.7	393.7	454.3
Change (%)	+chg	42.0%	-99.6%	4561.4%	430.0%	40.5%	14.6%	15.4%
Cash flow statement (EURm)								
Net earnings	-1,147.4	125.1	-46.0	-8.1	-17.7	330.7	395.7	467.2
D&A	215.3	218.7	209.8	202.9	221.2	228.3	308.0	313.1
Change in TWC	486.5	-786.5	-190.9	368.4	61.3	-37.8	-62.7	-64.6
Others	62.7	-721.8	151.7	129.5	104.3	-106.0	26.2	27.6
Operating cash flow	1,587.2	-1,197.7	61.1	829.9	592.9	415.3	667.3	743.2
Operating CF margin (%)	32.8%	-23.0%	1.3%	20.4%	12.2%	7.3%	10.4%	10.9%
Capex	-296.1	-441.7	-378.2	-227.8	-438.6	-551.1	-587.4	-453.8
Free cash flow	1,291.1	-1,639.3	-317.1	602.1	154.3	-135.9	79.8	289.5
Change in liquid funds	960.1	1,834.6	-1,709.0	180.6	-574.9	-111.4	-220.2	136.3
Balance sheet (EURm)								
Intangible assets	516.4	672.5	1,046.1	1,047.5	848.8	1,007.7	1,030.1	1,041.4
Property, plant & equipment	1,574.6	1,650.5	1,598.0	1,727.4	1,977.1	2,296.8	2,693.0	2,808.3
Financial assets	6,356.6	882.3	238.4	228.1	338.2	370.5	398.4	400.8
Cash and cash equivalents	960.1	2,794.7	1,085.7	1,266.3	691.4	580.0	359.8	496.1
Current and other assets	2,134.0	2,218.5	2,089.3	1,680.0	1,609.1	2,020.1	2,346.4	2,557.7
Total shareholders' equity	4,686.6	4,630.1	2,374.4	2,494.7	2,028.0	2,277.6	2,540.3	2,854.4
Pension provisions	415.9	349.1	366.5	451.9	481.7	505.8	531.1	557.7
Financial liabilities	2,939.7	1,666.8	2,113.9	1,795.1	1,147.0	1,307.6	1,307.6	1,307.6
Other liabilities & provisions	3,128.2	1,572.6	1,202.7	1,207.6	1,807.8	2,182.0	2,446.5	2,594.0
Net debt	1,979.5	-1,128.0	1,028.2	528.8	455.6	727.6	947.8	811.5
Trade working capital	-658.8	127.7	318.6	-49.8	-111.1	-73.4	-10.7	53.9
Capital employed	13,149.8	7,090.6	7,085.7	6,478.0	5,920.2	7,000.6	7,773.3	8,125.2
Ratios								
Capex/D&A (%)	137.5%	202.0%	180.3%	112.3%	198.3%	241.4%	190.7%	144.9%
ROE (%)	na	6.7%	0.0%	2.1%	11.7%	16.2%	16.7%	17.3%
ROCE (%)	na	3.7%	2.7%	4.4%	7.0%	9.6%	9.8%	10.3%
Net debt/EBITDA (%)	313.2%	-192.6%	406.4%	112.3%	72.3%	88.1%	93.3%	73.0%
Net debt/equity (%)	42.2%	-24.4%	43.3%	21.2%	22.5%	31.9%	37.3%	28.4%
Per share (EUR)								
EPS adjusted	0.03	0.05	0.00	0.01	0.50	0.70	0.81	0.93
EPS reported	-0.22	0.03	-0.06	0.00	0.01	0.68	0.78	0.90
CFPS	2.72	-3.36	-0.65	1.24	0.32	-0.28	0.16	0.59
BVPS	9.87	9.49	4.87	5.12	4.16	4.67	5.21	5.85
DPS	0.03	0.17	0.00	0.01	0.17	0.27	0.31	0.36
Year-end number of shares (m)	5,088.4	5,230.5	5,230.5	5,230.5	475.7	475.7	475.7	475.7
Valuation								
P/E	243.9	200.1	28,509.8	385.5	10.5	8.9	7.8	6.8
P/BV	0.8	1.0	1.1	0.6	1.3	1.3	1.2	1.1
P/CF	3.0	na	na	2.7	16.7	na	38.5	10.6
Dividend yield	0.4%	1.9%	0.0%	0.4%	3.1%	4.3%	5.0%	5.8%
FCF yield	27.6%	-27.4%	-11.3%	32.4%	5.9%	-4.4%	2.6%	9.2%
EV/sales	1.3	0.7	0.9	0.7	0.8	0.8	0.7	0.7
EV/EBITDA	10.2	6.7	16.4	5.9	5.9	5.4	4.6	4.1
EV/EBIT	14.5	10.4	22.1	9.4	8.6	7.2	6.5	5.6
EV/capital employed	na	0.4	0.6	0.4	0.6	0.7	0.6	0.6

Research ratings and important disclosures

Disclosure checklist - Potential conflict of interests

Stock	ISIN	Disclosure (See Below)	Currency	Price
Pirelli & C.	IT0000072725	nothing to disclose	EUR	6.30

Source: Factset closing prices of 23/11/2011

Stock prices: Prices are taken as of the previous day's close (to the date of this report) on the home market unless otherwise stated.

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We did not disclose the rating to the issuer before its publication and dissemination.

Rating ratio Kepler Capital Markets Q3 2011

Rating breakdown	A	B
Buy	65.0%	0.0%
Hold	20.0%	0.0%
Reduce	14.0%	0.0%
Not Rated/Under Review/Accept Offer	1.0%	0.0%
Total	100.0%	0.0%

Source: Kepler Capital Markets

A: % of all research recommendations

B: % of issuers to which Investment Banking Services are supplied

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