

**Pirelli 9M Results Conference Call
Milan, November 12, 2012**

Good evening, Ladies and Gentlemen. Welcome and thank you for attending our conference call on Pirelli Nine Months 2012 results approved today by the Board of Directors.

Slide 3: Key messages

The Key Messages we shall be focusing on during this hour of work together are:

- Solid 9 month results, deriving from our value strategy and a continued progress in our efficiency program.
- A mixed market outlook in which we can count on the balanced geographical coverage. Europe is still a cause for concern and, at this stage, we do not see any signs of recovery.

In this environment we stand by our strategy of not forsaking value for volume and protecting our profitability with continued actions on our cost structure.

Premium strategy: In 2012, the acceleration of our focus on Premium consists in the activation of relevant processes:

- Under the industrial profile, a reduction of 4 million Standard pieces in Europe, of which 50% are already being reconverted to Premium
- Under the commercial aspect, a higher selectivity in all channels, both in retail and in wholesale. The consumer journey is getting more and more sophisticated, and besides products, service is becoming extremely important, too

In Russia, we are on track with our start-up plan, both from the industrial and the commercial point of view. Moreover, we are still refocusing on Premium products, in line with our worldwide Premium strategy and, as you'll see in a moment, with the evolution of the Russian market.

Slide 4: Market outlook update

Let's have a look at our view of the market on a regional basis.

As you all know, Europe is experiencing a harsh crisis, which is worse than what we expected. In this context of market deterioration and confirmed double-digit overall reduction, the Premium segment confirms its resilience once again and, despite not showing any increase it remains almost stable at previous year level. However, the picture varies depending on the different European regions.

In **North Western Europe** the market has been affected by the crisis, but even if the Premium segment is performing better than in the overall market, our growth is bound to remain in the second half of the mid single-digit range.

Central Europe, which has also been impacted by the crisis, has been quite resilient. In this region we have revised our growth estimate for the second half of the year moving from about 10% to single-digit.

In this core European region, we have already launched a new retail-centric program based on:

- The geo-location of the Premium car park
- A stronger presence with car dealers and Premium retailers
- The implementation of our soft and hard franchising programmes

Now we need to extend this more selective approach to wholesalers, with a more careful choice of our partners, based on stronger agreements and on more collaboration on customers they serve.

There is a risk of losing some limited volumes at first, but this manoeuvre, boosted by the strengthening of our peripheral and field sales structures, will ultimately reinforce our control of the Premium market.

Southern Europe still shows a very negative picture, with all indicators on the low, including the performance of the Premium segment. In this scenario, we are updating our outlook for the second half to a double-digit reduction.

Other Regions register only minor changes in the overall market landscape, and also our volume forecasts remain unchanged.

Looking in particular at the Premium segment, in **Nafta** we keep on selectively focusing on Premium OEMs and on "Tier 1" partners, a strategy that proved to be very effective and allowed us to confirm a 25% Premium growth.

In **LatAm**, the scenario is moderately positive and the Premium segment continues its solid expansion. Leveraging on our reinforced equity retail structure, we are strengthening our leadership position, maintaining our growth expectation of over 50%.

APAC is confirmed to be one of the major contributors to Pirelli growth, in spite of the signs of slowdown coming from China. Our strong focus on Premium channels, thanks to an effective geo-marketing approach, the selective support of local Premium OEMs, and the success of our recently launched Cinturato P1 will enable us to grow at a level above 30%, with the Premium segment growing twice as fast.

Finally, **Middle East and Africa** remain largely immune from the crisis that hit mature markets; in this Region we concentrated on top-end segments and, in the Premium segment, we confirm our expectation to grow by well over 50%.

Slide 5: Change VS November 2011 Industrial Plan

Given the deep recession that hit Southern Europe (suffices to think that the current 2012 GDP estimate for Italy dropped to -2.3%), and the resulting slowdown in Western and Central Europe, we promptly decided to tackle all possible issues, since we believe that strong moments of discontinuities can, in fact, be exploited to create new opportunities.

During the 2008-2009 crisis, we cut our production capacity by about 11 million pieces in the standard segment in high-cost countries (mostly Italy and Spain) to accelerate delocalization to low-cost countries, thus benefiting, already in 2010 and 2011, from cumulative savings for 150 million Euro. Now, in 2012, we are coping with the economic crisis with the same spirit to rapidly abandon the standard segment and accelerate our focus on Premium which keeps having stable prices and showing its resilience by growing at least 3 times more than the non-Premium segment.

Compared to the plan presented last November, we therefore significantly reduced our sales volume forecasts.

- In the Car business by almost 4.9 million of which 4.5 million are non-Premium products. Matching these volumes we are cutting our capacity in Europe by approx. 4 million pieces, of which 50% will be progressively eliminated and the remaining 50% converted into Premium capacity. Obviously, the resulting benefits will be enjoyed in the next two years, while in 2012, we are discounting the costs entailed by the slowdown, the reconversion and the restructuring actions.
- In the Moto business, our volume forecasts were cut, compared to the plan, by approx. 3 million of which 400k Premium pieces due to the European crisis and 2.6 million non-Premium pieces mostly concentrated in LatAm.
- On the whole, in 2012 the consumer volume reduction amounts to -4.5/-5.0% (+3% in the industrial plan) equal to -510 million in revenues.
- In the Truck business, due to both the strike in Egypt (-1.5 pp volume growth) and to residual import licences in Argentina, we reduced volumes by approx. 550K pieces, equal to a volume reduction of 6.5/7.0% (+1% in the industrial plan) or -140 million Euro in revenues.

Therefore, adding consumer and industrial volume cuts, net of the positive trend coming from the price mix, compared with the Plan, sales dropped by 490 million Euro and the EBIT by 67 million Euro.

In 2012, the cost of this strategy for Premium amounts to 65 million Euro in total, of which 50 € mln just in the consumer segment.

We can bring forward this fast focusing plan and, at the same time, balance the impact on the EBIT described above, amounting to approx. 130 million Euro, by using internal levers, with savings of 45 million Euro (I will comment upon in the next slide), as well as external levers, for over 85 million Euro, related to lower raw materials headwind.

Therefore, we can guarantee an Ebit of around 800 million Euro, despite the highly uncertain economic scenario while accelerating investments in the future!

Slide 6: 2012 enhanced Efficiency Plan

Starting from an initial 2012 efficiency plan worth 120 mil Euro, we are now foreseeing approx. 155 mil Euro the majority of which coming from production capacity allocation to low cost countries and G&A. At the end of the first nine months we had already reached 71% of the target.

In the third quarter, we strongly pushed on G&A efficiency by rationalizing processes and structures and by maintaining only those high value-added costs characterized by a proven positive impact on the overall results.

In 4Q we intend to implement this very selective approach for all G&A costs, and to reduce production to keep inventory levels under control, especially in some high-cost plants, thus favouring efficiency in the allocation mix.

Slide 7: Pirelli 2012 Targets update

Given the scenario we just commented upon, we aim at closing 2012 with approx. 6.15 billion Euro revenues recording a 9% growth and approximately 800 million Euro of EBIT.

Given the weak European demand and our standard production reduction programme, the first nine months trend leads us to foresee a 5 to 5.5% volume decrease in 2012.

The Premium segment is expected to grow between 17% and 18%, confirming the growing appeal of high-tech products among our customers.

The Price Mix is expected to grow by over 11%, in line with our previous indications.

In Russia, our Premium-focused strategy led us to review our low-value standard production output. We expect revenues of about 200 million Euro and a low single-digit profitability.

We expect a negative Net Financial Position of equal to or greater than 1.2 billion Euro after dividends distribution. This change in the guidance reflects the outlook for sales and operating activities in Europe which will lead to inventory levels optimization within the first quarter of 2013.

Investments are confirmed to be just below the 500 million Euro threshold.

Slide 10: Russia – Healthy Premium market confirmed

Let's now look at the development of our Russian set-up.

Once again, we confirm the overall positive outlook we communicated in the previous quarters; the Russian economy is still going through a positive phase, with GDP expected to increase by about 4% in 2012 .

Let's now have a quick look at the Car and Tyre Markets where the picture remains basically positive with no major variations:

- Registrations posted a positive trend in the first nine months of 2012, with a 14% growth YOY. The last Quarter will likely post a slowdown, since it will compare to a strong 4Q in 2011, and as of September 1st a new "scrapage fee" has been introduced on new cars being purchased . However, the year-to-date trend leads us to improve our growth forecast from 6 to 9% on a full year basis. Most importantly, growth is mainly to be found in foreign local production, while imported brands are stable and Russian brands are declining about 7%. These trends will lead to the improvement of the overall car park and of the Tyre market.
- coming to the car Tyre replacement market , our estimate is confirmed, with a 4% growth in volumes leading to over 37 million units. The growth is concentrated on the high-end mix - A and B brands – and, in particular, on the winter segment that counts for about 60% of the A and B brands. Also the mix is improving, as shown by the average price of the A segment going from 79€ to approximately 85€. As a consequence, the overall market value is growing by 14%, reaching a close-to-2 billion Euro overall value.

Therefore, we have every reason to believe that the Car and Tyre Premium markets outlook is a sound one.

Slide 11: Russia – Healthy Premium market confirmed

In this scenario, we keep working strictly in line with our plans, in both the industrial and the commercial side.

Starting from our factories , we already put in place 40% of the overall investment planned: the new mixing rooms have been completed in both plants and will be ready for production by the end of 1Q 2013, the indoor testing structures and laboratories and the IT backbone have been set up.

Therefore, if we take into consideration Voronezh "late incorporation" in March , we can confirm we will reach the capacity of 8.2 million pieces/year.

We already industrialized 28 Pirelli products, currently regularly being produced and partially exported to Nordics and Canada. This witnesses the complete compliance of Russian production with the top-quality standards of Pirelli brand.

In this overall positive picture, our main objective is to expedite industrial conversion moving from legacy brands to Premium products, in line with our strategy and with the market trend. With this choice, our plants were temporarily underutilized and currently only two thirds of the capacity is being exploited leading to the reduction in sales we already hinted at before.

By strengthening our commercial activities in line with our plans,

- we achieved 85% of our target in terms of retail presence (800 Points of Sale at year end)
- we are well above target with Pirelli qualified premium stores: in 480 points of sale Pirelli is given clear visibility, and we are already operational in 20 major cities in the country
- we are also improving our network auditing program, now extended to over 300 Points of Sale, which lead to a growing Pirelli footprint and shelf presence
- On top of it, we are continuing our strong investment in communication to strengthen brand awareness, and our new advertising campaign featuring Russian F1 driver Vitaly Petrov is now on-air.

All these pervasive efforts are giving a very positive return on sales: Premium volumes are growing 56% year over year , winter sales are increasing 70% in value and, overall, our volumes have increased more than three times faster the pace of the high-end mix market, represented by A and B brands.

I think we have touched upon the most relevant aspects of our Business in Russia.

Slide 13: Pirelli Key Financial Results

Our results show our ability to proactively address the challenges of the industry and grow profitably in an ever changing scenario.

Positive momentum continued in the high-end of the market, with our focused efforts in this segment delivering a 19% increase in Premium revenues in the third quarter, thanks to substantially above-market results in the most dynamic regional markets such as Latin America, Nafta and Asia Pacific.

Our value strategy, executed with a firm price policy and mix improvement, led to a strong increase in price/mix, among the best in the industry (+8.6%).

This, combined with improved efficiency and a leaner cost structure, produced a profitability increase by one and a half percentage points year over year in the quarter.

Below the operating results line, earnings were affected by valuation changes in our equity holdings, mainly RCS.

As for tax rate, the cumulative result in September was 35.5%, in line with our FY 2012 target of approximately 36%.

Our Net Financial Position at 1.87 billion euro is the result of a season-related cash-absorbing third quarter and it incorporates initial benefits deriving from inventory reduction.

Slide 14: 9 month 2012 performance by Region

Let us now review our performance on a regional basis.

Sales growth was sustained by Asia Pacific and North America, up in the double-digits, and a healthy trend in our largest market, Latin America.

The Premium segment continued to perform strongly, posting a growth 3 times higher than the overall market, hence contributing to the Ebit margin gain in the period.

Sales in **Europe** discount the difficult economic environment in the Region, which showed no signs of improvement over the last few months. Although the slowdown remains particularly evident in the southern countries, it is no longer accurate to say that it is confined to the periphery of Europe.

Notwithstanding the fragile market conditions, profitability in the Region improved thanks to positive development of Premium sales and efficiency gains.

Performance in the **Nafta** Region keeps being very positive, with continued market share gains in the Premium segment, where Tier-one clients and UHP specialists are being supported with tailored services, such as delivery and claim management services.

Profitability improved substantially yoy, thanks to highly visible Premium domestic car models fitting our Tyres and to our role of Development Partner with foreign Premium car manufacturers.

In **Latin America**, revenue growth accelerated in the third quarter, helped by the ongoing structural shift upward of the market in favor of top-of-the-range high-tech products and by Government subsidies for the automotive industry. This was evident in the Consumer business, with Premium sales doubling year-on-year, as well as in the Truck business, where we are outperforming the market and gaining market share especially in the All-steel segment.

Mix improvement supported profitability in the Region, up year over year.

Successful product launches and increased visibility, gained through our involvement in Formula 1 with 7 races in the Region, clearly benefited our results in Asia Pacific.

Premium sales continued to grow supported by targeted development in retail outlets and the Replacement Channel benefited from our Original Equipment production.

Profitability increased also in the Middle-East and Africa Regions, where Premium Car sales growth shows no signs of slowdown and truck volumes decline is compensated by a positive price mix.

Slide 13: Pirelli Key Financial Results

Net income improved by 57 million euro to 308 million euro.

Our commitment to value significantly improved our operating performance year on year.

As of September 2012, Ebit grew by 31% year over year, adding 142 million euro as a result of :

- Price mix improvement, which allowed us to offset the increased cost of raw materials, inflation, volume reduction, production slowdown and industrialization by more than 43 million euro
- 109 million euro efficiency improvement, despite the current slowdown
- 13.7 million euro reduction of losses in non-tyre businesses.

Changes in valuation of our equity holdings resulted in a burden of 29 million euro as of September 2012; this is largely the result of our 5% stake in RCS, a media company, which is consolidated with the equity method. Due to its results the negative impact is equal to 22.6 million euro.

Financial and fiscal charges are in line with our guidance. Current cost of debt stands at 5.5% and our tax rate is around 36%.

Slide 16: Pirelli 9M'12 Net Financial Position

In the third quarter, net debt increased by 166 million euro, in line with the business seasonality.

Operating cash flow was negative by 67 million euro

- with Ebit compensating cash absorption by working capital,
- while investments were approximately twice the depreciation. Capex was mainly devoted to our Route to Premium project.

Specifically on Working Capital, the increase in receivables recorded in 3Q was due to:

- the business seasonality: Winter Tyres sale will cash-in in 4Q
- the higher price mix - which proves our commitment to value – and
- a larger consolidation perimeter.

Payables trend reflects our production adjustments and lower purchases in response to current market trends.

Inventories have already started to come down, with a benefit of 47 million euro.

In light of the revised 2012 sales target and the corresponding level of production activity, we envisage our Net Financial position to reach an amount equal to or above 1.2 billion euro at year end.

The change reflects revised expectations on working capital with the targeted inventory reduction of 200 million, of which 130 million within the year end and the rest in 1Q 2013.

Slide 17: Pirelli Net Debt Structure as of September 30, 2012

Pirelli gross debt amounts to 2.7 bln euro, of which more than 65% maturing beyond 2014 with an average cost of 5.5% which is due to remain stable for the year.

Although well balanced among different sources (33% committed lines, 19% bond, 48% other borrowings), Pirelli has just taken a further step towards a higher diversification of funding.

We recently priced a 150 million US dollars multitranche private transaction, with an average 10-year maturity, opening a new market for Pirelli, at a cost lower than 5% in euro. This transaction will contribute to:

- refinance existing debt,
- extend our maturities and
- increase our financial flexibility.

Finally, Pirelli Board has just approved a Euro Medium-Term Note program which marks a breakthrough in our financing policy giving us ease of access to capital markets also in case of persistent high volatility.

This program allows us to

- quickly take advantage of future windows of opportunities by dramatically reducing our time-to-market, and
- preserve complete flexibility to execute transactions with various currencies, maturities and amounts.

Before said refinancing program, available committed lines and cash allow us to cover maturities until 2014.

Now I leave the floor to Mr. Sala who will cover tyre results.

Slide 19: Key tyre results

MR SALA: Thank you mr. Tronchetti and thank you all. Let's go to slide number 19.

In 3Q 2012, the Tyre Business posted a

- mid-single-digit improvement of revenues and
- as much as a 16% growth in profitability

Topline growth underlines Pirelli value strategy allowing us to maintain a firm pricing policy -despite current market conditions – while seizing growth opportunities across markets and segments.

Growth originated mainly from Asia Pacific and Nafta, that in the third quarter posted a revenue increase of 25% and 23%, respectively; in addition, growth in LatAm picked up and is at +9%.

Premium volumes continue to outgrow the market, recording a 12.5% increase yoy and sustaining the price/mix trend which improved by 8.6%.

Quality growth allowed us to achieve a 199 million euro operating profit in the quarter, or 12.9% of sales.

Ebit margin net of restructuring costs is up 1.2 percentage points yoy; this is despite the strong winter sell-in trend we experienced in 2011 which created a difficult comparison base.

Slide 20 Pirelli Tyre Operating Performance

Let us now focus on the profitability drivers of the quarter.

The Ebit increase of 27 million euro was mostly due to a better price mix (83€ mln) that more than offset volume contraction, the raising of input costs and the negative effects of production slowdown.

Efficiencies helped the operating result with a gain of 48 € mln, reaching 71% of FY target, achieved through

- continued allocation of production to low-cost plants
- labour productivity improvements in mature economies
- fixed cost reduction, and
- lower raw material use and waste reduction

Slide 21 – Consumer business: key market trends

Let's review briefly what happened in the consumer market in the Third Quarter.

- The European market trend was in line with the first two quarters of the year, with the OE channel deteriorating following the poor trend in car registrations. Premium trend showed again its resilience against the market in the Third Quarter.
- The North American market trend continued to be vibrant in the OE channel despite the slower pace of growth compared with the Second Quarter, while the Replacement channel showed a slight contraction yoy, with Premium sales still positive.
- In Mercosur, the OE and Replacement channels followed opposing trends with a slight growth in OE, benefiting from government support to the local industry, and a contraction in Replacement.

Slide 22 Consumer business: Pirelli performance

The Consumer Segment sales went up 9.0% yoy in the Third Quarter of 2012, sustained by another strong +19% increase in Premium sales; +24% is the cumulative figure for the first nine months of the year.

Prices holding well in all Regions and a clear mix improvement led to a price mix increase of 9.6%.

A non-Premium sales decrease proves our continuous effort in focusing on Premium products and partly explain the reduction in overall volumes.

Profitability remained high with an Ebit margin of 13.6% after restructuring costs, an improvement of 1 percentage points.

Slide 23 Industrial business: key market trends

In the Third Quarter, the Industrial market across Regions continued to be weak with the Original Equipment channel still negatively affected by the macroeconomic scenario. In Mercosur, the weakness of OE is heightened by the comparison with 2011, when sales benefited from government incentives which were not renewed in 2012.

In the third quarter, the Replacement channel continued its downturn trend. Europe was helped by an easier comparison base, whereas Mercosur volumes were stable yoy.

Slide 24 Industrial business: Pirelli performance

The Industrial segment is the most affected by the current economic scenario, due to its cyclicity. Nevertheless, in the third quarter, sale variation can be explained almost entirely through the effect of exchange rates that produced a negative impact adding to 3%.

The price mix, positive by 6%, offset the volume reduction almost totally.

In the third quarter, profitability proved to be definitely growing, with an 11.1% margin (+1.4pp vs. 3Q 2011), thanks to a price mix improvement and a tailwind from raw material cost, especially natural rubber.

Slide 25: A Walk Through 4Q 2012

Finally, I want to accompany you through the dynamics of the current quarter.

Our expectations on profitability in the 4Q, of approximately €210 mln, are based on:

- efficiencies, €45 mln, almost 30% of our 2012 target, deriving from internal measures already taken over the course of 2012;
- a price mix similar to that of 3Q through a solid pricing policy and a mix improvement
- positive contribution from raw material costs (tailwind of €40 mln)
- substantial volume stability compared with the last quarter of 2011, when a 4% reduction was recorded

Moving to cash flow, we are targeting a Net Financial position equal to or slightly above €1.2 billion.

The change in the guidance reflects the current market scenario that led us to review our expectations in terms of sales and production levels, with an impact mostly on working capital and timing of inventory reduction.

We are expecting to achieve a further 80 mln € inventory reduction in 4Q bringing the total reduction vs. June to 130 mln €. The remaining 70 million euro reduction will be completed in the first quarter of 2013.

In addition, in the 4Q, the working capital, net of inventories, will be reduced by over 550 million euro. This is in line with the seasonal trend of the working capital: in 4Q 2011, for example, the net working capital excluding inventories was down by almost 500 million euro. This year we will also benefit from additional winter collections coming from highly seasonal markets such as Russia and Nordics.

Slide 26: 2012 Cash flow update vs. Industrial Plan

I would like to conclude by showing you how our cash flow profile is expected to evolve compared with what we said last November 2011.

The improvement in the operating result is expected to be in the top range of the target.

A worsening of the market led us to expedite our Premium strategy with an Ebit margin expected to reach around 13%.

We seized the opportunity of reinforcing our position in such new markets as Nordics, due to their relevance in the Winter and Premium segments. We acquired the Däckia chain for 70 million euro, using part of the resources initially set aside for fixed assets.

The main cash flow variation is due to the delay in the inventory reduction in Europe where we settled for a sound pricing policy.

We expect to close 2012 with a sound Net Debt/Ebitda ratio of 1.1X after dividends, where our initial target was around 1x before dividends.

I thank you for your attention, especially at this late time of the day, and give the floor back to Mr. Tronchetti.

Marco Tronchetti Provera - Pirelli & C. S.p.A. - Chairman and CEO

Thank you, Mr. Sala. We are now available to take your questions.

QUESTIONS AND ANSWERS

Monica Bosio - Banca Imi Equity Research - Analyst

Good evening, everyone. I would have two questions.

The first one is on the dealer network. Can you please give us a flavor on the dealer network situation for the time being, especially, obviously, for the winter tires? This could be very useful. I understood that winter tires would be down by 15% in 2012, but I'm just trying to have an idea on what's going on for 2013.

And the second question is more general. Maybe it's too early to ask, but I'm just trying. For the current year, we see a volume reduction in the region of 5.5% in terms of volumes, with premium up by 17%. Maybe it's really too early, but would you see a reasonable slight trend in volumes for the next year? And, more specifically, what are you expecting for premium? Should we assume a double-digit growth for premium, maybe lower than 2012, or a stability?

And a third question, are you maybe planning a deceleration in Capex for the next year?

Thank you.

Marco Tronchetti Provera

Thank you. First of all, dealer network. We see that the dealer network has a trend to be normal within 24, 30 months. Last year we had all channels that were fulfilled by quantity. We increased our market share in the winter -- talking about winter tires -- and now we see that the winter tire market for the sell-in will be lower. We already underlined it many times. And looking forward to next year, the situation will be better. Could be far better, or could be better.

It will be far better if there will be a second seasonality in December, if we will see a lot of snow in Central Europe, then it means that the situation for next year will see the dealer network having need to be fulfilled, because we'll have too-low stocks.

In any case, we expect to have a better year next year than this year. The beginning of the sell-in has been good, thanks to the sell-out in Central Europe, thanks to the snow that we had 15 days ago. I think that next year should be better because stocks are going down.

Going to the second question, we expect next year the growth in premium to continue in all regions. And we cannot forecast a change in Europe, because we don't see, yet, the light in the European economy.

But if we look to the stocks, we expect next year not to be worse than this year. This year was a difficult one because of stocks of dealers. They have been able to de-stock summer. They are now de-stocking winter, so I think that next year in terms of volumes should not be worse than this year, as far as what we can see today, and talking only about Europe.

China is doing a bit better. Other regions are expected to be better.

Anyhow, back to the question on premium, we expect volume in premium to continue to grow and the two digit growth is expected, also, for next year.

Next year, we expect to have Capex a bit lower than this year thanks also to the reshape of our existing capacity. We cut more than 4 million tire capacity in the standard business, and we are replacing 2 million of them with 2 million premium tires thanks to the changes inside the factories.

So, we expect to spend more to reshape than to add new capacity. The switch from standard to premium is becoming effective, and so the need of investments for next year should be a bit lower.

Philip Watkins - Citi - Analyst

Good evening.

Yes, on the price mix, it's 8.5%, if I'm not mistaken, for Q4. I'm just wondering what sort of the split between price and mix changes into Q4? I mean, the reason why I ask is it sounds -- it's quite a high amount compared to what peers are saying and I'm just wondering how that changes?

And secondly, just on inventory, I don't know if you can give any more granularity as you did last quarter about how it's composed, how much is winter, how much summer, how much premium and non-premium?

And then thirdly, just a very broad question. When I look at your cash flow and I compare it to some of your peers, and I mean, for the operating cash flow, net operating cash flow, it is lower than many of your peers so far year to date, and I'm wondering if you can -- why you think that is?

Thank you.

Marco Tronchetti Provera

Thank you. Starting with the last question, the cash flow is related to the slowdown, mostly, and to the reduction of stocks that will be more effective in the last quarter. We had only €47 million reduction of stocks in the third quarter, and we expect to be in line with the plan by year end.

So, this is one of the reasons, and this is also related to the decision we took to cut the standard production, and to change, to switch to premium some capacity in the European factories. This is the main reason for cash flow.

We also have a reduction in the input costs, which meant that the balance between credit and debts has been in favor of the debts instead of in favor of the credits, because we reduced the spending on raw materials. This is an effect that year end will be more or less rebalanced.

These are the main reasons why.

Price mix, it is mix. It's not price, any more. It has been price at the beginning of the year. There has been no price increase last year September, and so we expect to continue the same trend, also, in the fourth quarter, so this 8.5 is expected to continue until year end.

Philip Watkins - Citi - Analyst

Thank you. And then, so the mix element of Q3, it's obviously increasing into Q4, the mix element of this price mix?

Marco Tronchetti Provera

We continue the trend. So, we will have in the fourth quarter, 8.6. If you look to figures, the expectation we have is to continue.

Philip Watkins - Citi - Analyst

Thank you, but what was the mix element in Q3?

Marco Tronchetti Provera

Third quarter it has been partly the Summer, the queue of the Summer, and the beginning of the Winter. So, we cut in the standard capacity, if you look to our figures, you see that this 17% of increasing in the premium is creating this effect on mix.

Then there is the mix source, we reduced the capacity in factories that are in high cost in Europe and we increased the capacity where the cost of labor and where the mix is better.

Philip Watkins - Citi - Analyst

On the inventory, the inventory question, where you able to give a bit more granularity there?

Marco Tronchetti Provera

We reduced €47 million starting in the third quarter. We are reducing another €80 million in 4Q and we'll go down to the normal beginning of the first quarter next year.

So, we will have, more or less, €130 million in 2H, and then the target we have is €200 million and will be reached beginning of next year.

Philip Watkins - Citi - Analyst

Thanks. And I guess it's mostly non-premium in this inventory?

Marco Tronchetti Provera

By far the largest part is non-premium.

Martino De Ambroggi - Equita SIM - Analyst

Good evening, everybody. Two questions on raw materials.

First is on the full-year 2012, because in your updated guidance, you are always forecasting a strong impact from Forex, so I was wondering what is the amount year to date of the Forex impact, just to have an idea what is the impact you expect in Q4?

And still on raw materials, all other things being equal, what is the impact that we should expect in the first half? I don't know if you can split between first and second quarters, next year?

And my second question is on the Russia, because this is the second time you are reducing the revenue expectation, but how do you believe to recover to be on track with your 2014 targets if they are confirmed?

And the last question is on premium volumes. If I look at your speed, plus 13.5% year to date, plus 12.5% in Q3, this means that you have very strong acceleration in Q4 to achieve the plus 17%, 18% you had for the full year, so well in excess of 20%. We already discussed it in the previous quarter, but could you try to give a bit more -- higher visibility on this item, please?

Marco Tronchetti Provera

So, I give the floor to Mr. Sala, but before I will give the answer about Russia.

We expect to have, in Russia, more or less, €350 million total next year. This year we expect €200 million. The capacity we have is 1.7 in Voronezh and 6.5 Kirov.

So, total capacity in Russia 2012, 8.2 million. Out of this capacity, we saturate around 60%, equal to close to 5 million, out of which 70% of the capacity of Kirov was saturated and 40% of Voronezh. Voronezh is in the process of being reshaped. It will be a brand-new factory, and we decided to accelerate the premiumization, because, as I mentioned, we are covering the territory quite well with the point of sales that we have in the last few months in our network, that are now around 800.

And so we believe and we are confident that next year we will go full speed in Voronezh, and we'll be able to sell Pirelli-branded tires produced in Russia for more than 1.2, 1.3 million pieces, compared to the fact that this year, we produced 450,000 pieces in Russia with Pirelli brand, equal to 9% of the saturation of the capacity in Russia and 5% of the total.

So, with this environment, we decided to accelerate, as we did in the rest of the world. We accelerated the process of premiumization, even in Russia, considering that the loss in volumes is a very low loss in fixed cost exposure. So, this maneuver is cost us, all in all, around €50 million in Europe, including this approximately €15 million in Russia.

So, the problem of premiumization acceleration, taking into account the slowdown and the fact that in Russia, also, we were building our network and we didn't want to do any action with our, let's say, standard tire that could hurt our brand with prices, so we reduced the capacity, and we confirm that for next year we will have all the weapons in order to reach the €350 million and with a profitability that will be two digits.

That's what we see month after month, but I hope that soon we will have the opportunity to show the new factory in Voronezh, even to investors, which is quite an interesting experiment we are making very successfully.

Going to guidance on raw material, or Forex related to raw materials, the foreign account was about, let me check, €185 million, the guidance in 2012. Year end, the fourth quarter, we expect to have an effect of €70 million in Forex. So, this is rebalanced. So, that is why we are confident the target year end will be achieved.

The other question was?

Martino De Ambroggi - Equita SIM - Analyst

First half on the next year?

Maurizio Sala - Group Planning and Control Department

The request was concerning what will be the raw material for 2013. It's too early now to say for the full year what will be the raw material cost for 2013, for sure. What we know already is that considering that the current purchasing price are for the last quarter 5 to 6 points lower than the average of 2012, and considering natural rubber are 20% lower than the average, the first quarter 2013 will have an important benefit versus the corresponding period of 2012.

Then raw materials cost trend for 2013 full year will depend on the commodities movement and the industry movement, but what we know now is that the first quarter will probably be positive.

Martino De Ambroggi - Equita SIM - Analyst

Yes, I was referring, especially, to the first half. So, am I right in assuming more than €50 million in Q1?

Maurizio Sala - Group Planning and Control Department

In the region of €40 million, €50 million.

Martino De Ambroggi - Equita SIM - Analyst

Just Q1?

Maurizio Sala - Group Planning and Control Department

First quarter, yes.

Martino De Ambroggi - Equita SIM - Analyst

Okay, thank you. And there is only the premium volume missing.

Marco Tronchetti Provera

Yes, we expect in last quarter, considering that last year fourth quarter was low, we expect to have over 25% in fourth quarter. Because the summer season was very bad in sales for us. So, we consider that fourth quarter will be good.

Martino De Ambroggi - Equita SIM - Analyst

Okay. If I may, just one Russia follow-up. Are you still confident in the €500 million target in 2014 for sales?

Marco Tronchetti Provera

If the trend of the market stays as is, we don't see major issues in achieving the targets.

Martino De Ambroggi - Equita SIM - Analyst

Okay, thank you.

Marco Tronchetti Provera

Now there is a question coming from the web. The question is, "Can you please help me in understanding how do you plan to reduce debt by €650 million in quarter four, without hampering fourth quarter production?"

So, our financial position is €1.87 billion, more than €80 million will be the inventories reduction, thanks to additional production cuts in fourth quarter, worth minus €130 million in second half, and more than €550 million operating working capital reduction, net of inventories. This variation is coherent with fourth quarter '11. It was almost €500 million, through winter season cash-in, that is always cash-in, year end, including Dackia and Russia, and we are seeking to reduce payment terms policy and usually our customers fall in line with our policy.

And the other reduction -- the other part of the reduction will come from increasing payables, fourth quarter Capex, due to the seasonality and the start of purchasing increased linked to 2013 production schedule, so the fourth quarter will be definitely providing us room to reduce, even for that reason, the working capital.

Now, we are ready to have the other questions.

Stephan Puetter - Goldman Sachs & Co. - Analyst

Good afternoon and thank you very much for taking my questions.

The first one is coming back to the price mix, but now moving more towards the EBIT line. So, if I got this correctly, in the third quarter the 8.6% price-mix benefit was basically 100%, nearly 100%, mix, and the drop-through to the P&L was €83 million, so roughly 66%.

You're guiding to an 8.5% benefit in the fourth quarter. Is there any reason why the drop-through on this should be considerably lower? I.e., should we sort of expect something like the €77 million benefit to the EBIT on something like €117 million, benefit to the revenues?

And my second would just be if you could give us the latest update on what's happening at Prelios and how you sort of see your loan evolving?

And then, the third question is a little bit of housekeeping, if you can maybe give us a bit of guidance on what you expect for the other businesses for the full year?

Thank you very much.

Maurizio Sala - Group Planning and Control Department

So, concerning price mix, the third quarter was positive by 8.6%, including an element still coming from price. This is representing a higher value of impact of the price-mix effect in the sales on the EBIT. The last quarter will represent an EBIT, a price-mix effect, positive, by higher than 8.5%, only dedicated to mix.

Two of the most important reasons of this good element in the fourth quarter, the first one is coming from the fact that the premium volumes in the fourth quarter, as it was discussed before, will be higher than the trend of the first nine months. The first nine months registered plus 13.5% of premium volumes, and the full year will be plus 17%, plus 18%. So, in the fourth quarter we will have better benefit coming from the mix, thanks to the increase of volume premium in many regions, in particular for the growth in Asia-Pacific, in the NAFTA region, in the EMEA region.

Second is coming from the fact that when we talk about industrial versus the prior guidance in which the price-mix effect was plus 5%, 6% 'til the end of the year, the current guidance is 6%, and this was positive already in the third quarter, which was more positive than in the second quarter.

This, coming from the fact that we have a good resilience on price for all concerning data and we are benefiting on the mix from the new launches on the market of the new product like the truck Series 01, which is now doing a very strong positive benefit in terms of mix.

Marco Tronchetti Provera

About the second question about Prelios, I first want to let you know that the Committee For related Parties, core-related parties, gave the mandate to Mr. Tanzi to follow this transaction and I think that Mr. Tanzi can provide you any information about this. Mr. Tanzi, please.

Francesco Tanzi - SVP Administration and Finance

Thank you. With reference to our previous financial credit, which accounts for €160 million, nominal amount, as of today, we note that the form of defined financial agreements with other creditors, the Company, and the new investor.

Therefore, Pirelli is not in a position to anticipate an impact on our balance sheet or profit and loss account with respect to the aforementioned credit. Our aim is, in any case, to preserve its value in the context of the possible future new capital structure of Prelios.

Stephan Puetter - Goldman Sachs & Co. - Analyst

And then the question on the other business?

Marco Tronchetti Provera

So, the EBIT is negative €20 million in our businesses, the minor businesses. We expect one of these businesses, Feelpure, to be in 2013 out of our perimeter. There are negotiations going on, and we are quite convinced that, at least half of what we have this year in terms of effects or negative EBIT will be offset next year.

The other business that the P Zero fashion and we consider this as an advertising campaign that we have that is very, very well appreciated. The cost should go down compared to this year. So, we expect the negative impact next year, all in all, will be less than half the effect we have this year from both activities.

Stephan Puetter - Goldman Sachs & Co. - Analyst

And then, sorry, just finally to ask on the fourth quarter, so the run rate in the fourth quarter should be - is very similar to what we've seen for Q1 to Q3? So, something in the range of, let's say, €6 million to €8 million losses?

Marco Tronchetti Provera

Last quarter will be, still, a bit negative. We do not expect major impact.

Stephan Puetter - Goldman Sachs & Co. - Analyst

Okay. Thank you very much. Very clear.

Marco Tronchetti Provera

Because last year we made -- because you can have the comparison date that is last year where we made in the last quarter a heavy restructuring. There will be no heavy restructuring in the fourth quarter. There will be only the EBIT loss that is in line with what we have seen in these quarters.

Giuseppe Puglisi - Intermonte SIM - Analyst

Good afternoon to everybody. Giuseppe Puglisi from Intermonte. Two questions.

The first, about your capacity, what part is premium and what part is standard today?

And the second question is regarding inventories. May you please compare the actual situation in inventories with respect to the end of 2008, the total inventories in the market are higher or lower?

And then, please, a quick follow-up.

Marco Tronchetti Provera

Starting with the last question. The capacity -- you mean the stocks in the dealerships?

Giuseppe Puglisi - Intermonte SIM - Analyst

Yes, right. We have better or worse situation with respect to the end of 2008 that there was --?

Marco Tronchetti Provera

We feel in the dealership the stock being better than last year, definitely, in winter tires, because the slowdown we have this year in Europe is more than two digits. That's the fact, it's more than 10%. And so we expect next seasonality to be better.

Giuseppe Puglisi - Intermonte SIM - Analyst

And so we are in a better situation with respect to the end of 2008 when we had the bottom of the previous crisis? Is this right?

Marco Tronchetti Provera

Yes, you are right because end of 2008, there was a shock in the market. So the market stopped, also, in original equipment. So, the huge volumes that were in stock were related mostly to the original equipment.

We had a slowdown in the car manufacturers in the last year, I mean, and there is not such a shock, so the stock that was in inventories, both on the industry and on the dealership, all in all, this year will be better than in 2008.

We have to consider not only the stock of the dealers, but also the stocks of the tire manufacturers. All in all, we consider that the situation is better than in 2008.

Giuseppe Puglisi - Intermonte SIM - Analyst

Okay.

Marco Tronchetti Provera

Then, going to premium capacity, excluding Russia, we have in 2012, end of 2012, we will have, more or less, a capacity of 26.5 million. If we consider the management plan of 2013, which is not in place, but in line with the guidance we gave in our industrial plan, the capacity will go up to 29.5 million.

Giuseppe Puglisi - Intermonte SIM - Analyst

Okay, so with respect to the last, your last business plan, we can assume a higher weight, a stronger weight of premium with respect to standard, and, consequently, a higher margin for the Pirelli Group with respect to the previous guidance? Is this correct?

Marco Tronchetti Provera

Yes. It is absolutely in line with what we did until now and what we have in mind to do. So, accelerating reduction of standard, as you can see, we offset the volume decrease with a higher profitability, keeping compared to the industrial plan, our result in the top range of the expected EBIT we had in the plan.

And we continue the same way. So, in 2013 we continue and we will start with a lower level of standard and, you are right, thinking that what should happen as we maneuver is to have an improvement on percentage of EBIT.

Giuseppe Puglisi - Intermonte SIM - Analyst

Thank you. If I may, just a quick follow-up. In 2013, assuming zero growth in terms of volume, and zero growth in terms of price, can you give us an indication of what will be the mix, just to try to model what can be the next year in terms of revenues?

Marco Tronchetti Provera

We are targeting, as you see, an improvement in 2012 compared to the target we used to have. So, we will continue with the same plan. It's too early to say any precise figure, because by February next we will have our revised plan, and so that will be the right time to give you all the figures.

In any case, the trend is the one you underlined.

Olsten Earl - Marshall Wace - Analyst

Hi, good evening. It's okay. All of my questions have been asked already. Thank you.

Philippe Barrier - Société Générale - Analyst

Yes, good evening. Philippe Barrier, Société Générale. Two questions, if I may.

First question is regarding the impact of the labeling. Actually, do you think that the dealers could have higher inventories due to labeling, which started in first of November? Do you think that it will have some impact in terms of sell-through or in inventories?

And on topic, what is your view regarding the competitors, which may which may pose, for instance, AA, for some tyres and what -- do you think the regulation is tough enough? What's your view on the labeling impact? And broadly will it be positive for the sector, or negative?

And the second question is regarding the pricing at the end of the year. Given the very low level of rubber price at this time, do you see some pressure on tires, outside the standard tires, of course, but also the premium tires? Do you see some changing behavior of competitors regarding the pricing at the end of 2012?

Thank you.

Marco Tronchetti Provera

Thank you. Labeling, it's happening in a way that is comparable to what happened in Japan. So, at the beginning, there is a destocking of the non-labeled tires, and then everything goes back to normal, with one advantage, or two advantages.

One is for the ultra-high-end and high-end tires, because that makes evidence to consumers that tires are not only round and black, there is something technologically linked to their safety and to the environment. So, the perception of the value of the tires, thanks to labeling, improves, and the dealers have other issues that can be given to consumers to let them understand why they have to buy Pirelli or Michelin or whatever. But this creates value, the real value, that today a tire has.

One example is the original equipment. Dealers now start talking more and more with consumers about the fact that they have to replace tires with the same tires that have promulgated because they are safer, because they have been approved by car manufacturers, and that is the effect of labeling.

We are checking the attitude of consumers in Europe within the distribution channels, and what we have as an analysis that comes from the check we make is that consumers are asking more about tires, and then the dealers are telling more about tires, that it's not only prices, it's worth for the high end. This is less evident for the standard tires.

So, all in all, I consider that for the industry it's good and for a player like us that is concentrated on premium, it's even better.

Then, year end. On premium, we wanted the market to be aware that we don't have pressure on prices on the high end. So, the fact is that there is a policy on everywhere in the world in the high end not to play on prices. Play on prices is short for standard business where you compete with Koreans, with second and third brands.

In the premium, there are few players and there are two different categories. The tier one players, five, have their price more or less in line, and then there is a discount, of course, from 15% to 25% for the second tier. But, prices in the high end are sticking and there is, as far as we can see, no effect on prices in any region.

Philippe Barrier - Société Générale - Analyst

Okay, thank you. Just the very last question, if I may, just on -- going back on Prelios loan, do you think that there is some risk to have a write-off on this loan, or actually, given the commitment or the agreement with the different parties, there is no risk in the near future to see some write-off on this amount?

Francesco Tanzi - SVP Administration and Finance

The value of the credit or the financial credit that we have in our balance sheet is €160 million amount, in terms of nominal, plus around €10 million of interest. And that, as of now, as I mentioned to you before, there is no reason for us to reduce this value in our balance sheet, because we are not aware of the global picture of the situation versus the new coming capital structure of Prelios, which will be negotiated in the next weeks, jointly with the new investor, and the creditors.

As of today, we are anticipating a major element of impairment in our credit to the situation that we know today.

Niels Fehre - HSBC - Analyst

On your industrial tire margin, again, I see that it has been down in Q3 again versus Q2. Can you give me some more feedback on that one? Because your price mix was, again, better than in Q2, and, also, your volume drop was less than in Q2, and I would have assumed some positive tailwind, already, from raw materials. So, can you elaborate why your margin is, again, down by 130 basis points, roughly, versus Q2 margins in the business?

Maurizio Sala - Group Planning and Control Department

In Q3 we accelerated the action for the stock reduction. The slowdown effect was €25 million negative in the first nine months, out of which €14 million only was in the third quarter. And this represented a negative element of the result in the third quarter, with the speedup, also, or the acceleration of this test for the transition to the Premium strategy.

Then, third quarter 2011 had a strong comparison base, because it was a very strong quarter in terms of sell-in for the winter sales in Europe, in particular in Central Europe. This year, the sell-in activity in Europe were more cautious. There was caution from the point of view of the customer to pre-buy winter in certain countries by having stocks coming from last season, in particular in Italy and in Germany.

So, these are the two most important elements that are representing the reduction of the EBIT margin.

Niels Fehre - HSBC - Analyst

But I'm talking about the industrial margin, right? Industrial tire margin, right?

Maurizio Sala - Group Planning and Control Department

Industrial margin? Industrial margin improved in the third quarter.

Niels Fehre - HSBC - Analyst

No, versus the second quarter. Versus the second quarter, I think it has been down, right?

Maurizio Sala - Group Planning and Control Department

No, yes. Okay --

Niels Fehre - HSBC - Analyst

Right? The volumes being slightly better and the price mix improving? So, yes, and a positive tailwind, probably, from raw materials?

Maurizio Sala - Group Planning and Control Department

Okay. You are moving about moving from 11.9% versus 11.1%.

Niels Fehre - HSBC - Analyst

Yes.

Maurizio Sala - Group Planning and Control Department

Okay, there was a certain reduction of the margin coming from the fact that in the third quarter we had the effect coming from the strike in Egypt that finished the effect in the 25 of July, which determined a lower level of stock-in volume, so we needed to re-build up, let me say, the activity, and so we have this delay coming from this effect. This was the most important element that affected the third quarter result.

But, in any case, we are still talking about an EBIT margin which is 11.1%, so higher than 11%, and we grew the target for the end of the year, nine months cumulative margin is 10.5%, and the current guidance for the full-year EBIT margin is plus, then, 11%.

So, we are not having any major variances versus this trend.

Niels Fehre - HSBC - Analyst

Okay. And the inventory problem you have, that is only from consumer tires, right? Or is that also partly from industrial tires?

Marco Tronchetti Provera

I already mentioned the issue of volumes in the consumer standard business, where we have still stocks that are higher.

Niels Fehre - HSBC - Analyst

Okay, so only consumer. Okay. That's all I wanted to know. And it's only Europe, right? It's only Europe?

Marco Tronchetti Provera

This is global, but the largest part, by far the largest part, is Europe. I consider it is only Europe.

Massimo Vecchio - Mediobanca - Analyst

Yes, good evening. My first question is on the premium volumes, which have been reduced from plus 20% to plus 17%, I think. Can you detail which geographic area is, basically, driving this reduction?

And my other question is on the price mix. Am I right in assuming a price reduction in 2013, mostly due to lower raw materials prices?

Thanks.

Marco Tronchetti Provera

What we expect, starting with the last question, for 2013 is there will be a price reduction that will come mostly on the truck business, if raw materials stay where they are, but that will be mostly in Europe and US. We do not expect major impacts in other regions, and for us, the most important region is Brazil for the truck. Brazil was already affected by a reduction, even if the nominal prices stay where they are, because of the weakness of the reais. So, we don't expect in Brazil, effects on prices. So, even in the truck business.

Then, in premium, we had, in Europe, a double-digit reduction in Southern Europe. And so, that is the only reason why we reduced our forecast. And I mentioned at the beginning of my presentation, 400,000 pieces of premium. This is Europe, and this is why we are not reaching the target of 20, and it will be within 17%, 18%.

That's all.

Edoardo Spina - Morgan Stanley - Analyst

Yes. Good evening. Thank you. I have two questions, but they're quick.

One is on the mix effect for next year. I understand you don't want to give a detailed number. I just wanted to ask, in order to manage my expectations for next year, do you think, say 4% to 5% growth in mix would be a reasonable assumption?

And the second question is on China. I wanted to ask if, for the data you have so far, people in China drive more or less than the Europeans, to have an understanding about the replacement cycle in China?

Marco Tronchetti Provera

So, your forecast of 4%, 5%, I think it's close to the reality. So, we expect in our target for premium in the price mix, we put 6% in our average growth rate between 2011, 2014. And saying at 5%, having had 8.5%, I think that is in line with the average growth rate, 4% or 5%. So, we can confirm it.

Then going to Chinese way of driving, they have less mileage, and so everyone that goes to China sees this immediately. The fact is, that these premium cars are a different gadget. In premium cars, they like to have them in the garage, but then, if they keep them in the garage, after two years, the dealer calls him and says, it's time to change your tires. So, every driver with a premium car likes to have new tires.

Ad there is also a push on the dealership side to remind them there is a continuous evolution of product, and this will change.

Michele Baldelli - Exane BNP Paribas - Analyst

I have just one question concerning the difference between sell-in and sell-out, if you can provide us this statistic for the first nine months about the difference, what has been sell-in and sell-out in Europe? I was referring to Europe. What is the difference between the two?

And then the second question, what has been, for you, the volume growth of the premium tires in October, if you can provide this data?

Thanks.

Marco Tronchetti Provera

Good news for October, mix was good for the stocks, at year end, the sell-out of winter should be higher than the sell-in and the summer sell-out has been in the first half of the year more or less balanced. Then, depends on when you look to this phenomenon, then you have to go and check each single company, how it behaved the year before. Because the policy of a tire company has to be analyzed in a range of three years, because markets are going up and down, sell-in could be better one year and the year after lower.

Average, I can tell you that in two years it is balanced. So, the excess of winter tires that were in the sell-in last year will have sold by year end, and we expect in 2013 more balance between stocks.

Just to give in nine months sell-in and sell-out in Europe have been sell-in minus 12%, and sell-out has been minus 10% in terms of volumes. So, that is a big number, including everything.

But to have a clear picture of the market, you should include, also, the original equipment, because the volumes in the market are also related on how it develops, the original equipment. I can tell you that for the high end 2012 has been a good year for the original equipment, which will be good for replacement 18 months from now, average, because there will be more premium in the market.

For the standard business, 2012 in Europe has been not a very good year as you can see on any official figure.