J.P.Morgan

Europe Equity Research
11 September 2023

Pirelli

Top tyre pick. Reiterate OW with a raised PT of €6.5

Overweight

PIRC.MI, PIRC IM
Price (08 Sep 23):€4.70

▲**Price Target (Dec-24):€6.50**
Prior (Dec-24):€5.80

Pirelli has delivered strong earnings growth in the first half of 2023 despite a worsening tyre market outlook (especially in Europe) and transactional FX headwinds. We see that investors have been on the sidelines following the Golden Power Procedure and organisational changes at Pirelli, but we think this presents a buying opportunity in the medium term. In an uncertain macroeconomic environment, Pirelli provides a relative "safe" haven and is the most compelling tyre stock to own with a High Value (HV)/Specialty focus and earnings growth. We see strong upside from current levels, given Pirelli's growth outlook, strong position in EVs and China, three upcoming catalysts and key valuation support. On earnings estimates (adj. Ebit), we are 5% ahead of consensus expectations for the next 3 years. We remain OW with a raised PT of €6.5 (€5.8), based on our earnings forecasts.

- **A strong, underappreciated HV Replacement (RT) Cycle ahead:** HV tyre demand (OE+RT) should grow by a HSD % CAGR over the next 3-4 years (2023-26/27e), in our view. This should be driven by a double-digit growth in HV RT tyres (growing car parc for >18" tyres globally and pull-through from HV OE shipments) and supported by a low-to-mid single digit % growth in HV OE tyres (with underlying market growth and Pirelli's high market share in EV tyres). Overall, we expect HV sales for Pirelli to grow by €1.0-1.5bn by 2027.
- **Green Transition enhancing competitive barriers**. The current penetration of HV tyres in the car parc is 20%/35%/<10% in EU/NA and China respectively. The current penetration of BEVs in the car parc is <3%. Tier 1 tyremakers have a dominant position in Specialty tyres (run flat, seal inside, noise cancelling, cyber tyres). As the market moves towards bigger rim sizes (>18" tyres) and EV tyres, the demands from a tyre (and the technological edge of Tier 1s) will increase, in our view. These tyres need to have lower weight and an advanced rubber compound for better performance and longer life. Lower rolling resistance and lower tyre noise are key differentiators for EV tyres. Safety, comfort, performance and technology will lead to higher pricing power and margin benefits (details in the note).
- **Profit drivers**: 1) Room for profitable growth in HV RT (primarily in NA and China); 2) Market share opportunities in Europe (with Nokian losing share) and Russia; 3) Arguably the only sub-sector where China is still an earnings driver (through BEV OE tyres and a growing car parc); 4) Stabilization of Standard tyres in profitable niche and margin improvement.
- **Revisiting medium-term targets**: Overall, we expect Pirelli to guide for €500-€800m sales growth till 2025 and margins of >16%. We expect FCF of ~€585m by 2025 and the leverage ratio to fall to 0.9x. Our 2025 estimates are 6% ahead of company collected consensus. By 2027, we expect overall group revenues of ~€8bn and a 17-18% adj. Ebit margin target in the medium term.
- **Catalysts: 1)** JPM call with management (13 Sep); **2)** 3Q 2023 results (9 Nov): RT market returning to growth. Continued price discipline and resilient product mix. **3)** Mid-term update: 2025 Plan to be updated by the end of 2023.

European Autos & Auto Parts

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Key Changes (FYE Dec)

	Prev	Cur
Revenue - 24E (€ mn)	6,870	6,956
Adj. EBIT - 24E (€ mn)	1,066	1,103

Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	17	23	28	40	17
Growth	32	34	8		
Momentum	47	36	30	56	70
Quality	61	70	75	80	86
Low Vol	51	38	38	28	30
ESGQ	48	31	73	2	-

Contents

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

See page 18 for analyst certification and important disclosures, including non-US analyst disclosures.

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Price Performance

	YTD	1m	3m	12m
Abs	15.0%	1.6%	3.3%	25.1%
Rel	2.1%	6.4%	8.2%	9.2%

Company Data

Shares O/S (mn)	1,000
52-week range (€)	5.06-3.22
Market cap ($ mn)	5,031.55
Exchange rate	0.93
Free float(%)	38.4%
3M - Avg daily vol (mn)	2.04
3M - Avg daily val ($ mn)	10.1
Volatility (90 Day)	22
Index	STOXX Europe 600 Automobiles & Parts
BBG BUY|HOLD|SELL	14|5|0

Key Metrics (FYE Dec)

€ in millions	FY22A	FY23E	FY24E	FY25E
Financial Estimates				
Revenue	6,616	6,606	6,956	7,352
Adj. EBITDA	1,373	1,460	1,549	1,653
Adj. EBIT	978	1,015	1,103	1,208
Adj. net income	415	397	472	534
Net margin	6.3%	6.0%	6.8%	7.3%
Adj. EPS	0.42	0.40	0.47	0.53
BBG EPS	0.55	0.50	0.56	0.62
Cashflow from operations	1,009	958	1,006	1,064
FCFF	611	472	508	585
Margins and Growth				
Revenue growth	24.1%	(0.1%)	5.3%	5.7%
EBITDA margin	20.8%	22.1%	22.3%	22.5%
EBITDA growth	13.4%	6.3%	6.1%	6.7%
EBIT margin	14.8%	15.4%	15.9%	16.4%
Adj. EPS growth	37.2%	(4.4%)	19.0%	13.1%
Ratios				
Adj. tax rate	28.8%	37.1%	35.4%	34.6%
Interest cover	6.8	6.6	7.2	7.2
Industrial Net Debt/Equity	0.5	0.4	0.3	0.2
Industrial Net Debt/EBITDA	1.8	1.5	1.2	0.9
ROCE	7.0%	6.5%	7.1%	7.6%
ROE	8.1%	7.3%	8.3%	8.8%
Valuation				
FCFF yield	13.0%	10.0%	10.8%	12.4%
Industrial Dividend yield	3.6%	3.5%	3.4%	4.0%
Industrial EV/EBITDA	5.3	5.1	4.4	3.9
Industrial EV/Sales	1.1	1.1	1.0	0.9
Industrial P/E	8.5	9.8	8.6	7.7

Summary Investment Thesis and Valuation

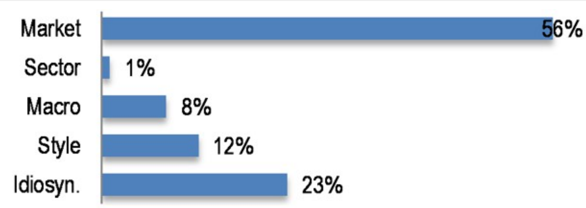
Investment Thesis

Pirelli has delivered strong earnings growth in the first half of 2023 despite a worsening tyre market outlook (especially in Europe) and transactional FX headwinds. We see that investors have been on the sidelines following the Golden Power Procedure and organisational changes at Pirelli, but we think this presents a buying opportunity in the medium term. In an uncertain macroeconomic environment, Pirelli provides a safe haven and is the most compelling tyre stock to own with a High Value (HV)/Specialty focus and earnings growth. We see strong upside from current levels, given Pirelli's growth outlook, strong position in EVs and China,three upcoming catalysts and key valuation support.

Valuation

We value Pirelli on a 1.2x EV/Sales (24e) multiple. On our price target Pirelli would trade on ~8x EV/adj. Ebit and ~12x P/E.

Performance Drivers



Factors	6M Corr	1Y Corr
Market: MSCI Europe ex UK	0.86	0.78
Sect: Cons Discretionary	0.14	0.22
Ind: Automobiles & Comp	0.36	0.41
Macro:		
Eurozone Exports	0.05	0.18
Eurozone CPI	0.19	0.14
Markit Eurozone Comp PMI	0.17	0.12
Quant Styles:		
DivYld	0.01	0.52
Value	0.12	0.51
Growth	-0.59	-0.46

Source: J.P. Morgan Quantitative and Derivatives Strategy for Performance Drivers; company data, Bloomberg Finance L.P. and J.P. Morgan estimates for all other tables. Note: Price history may not be complete or exact.

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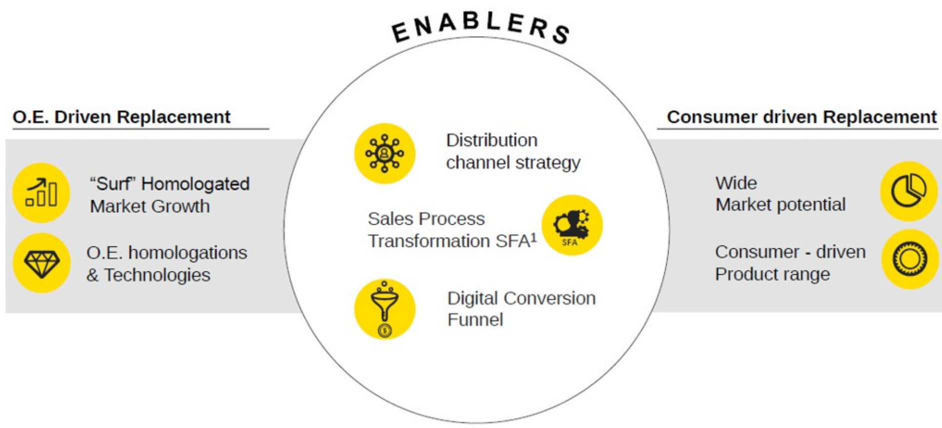
Investment thesis - High Value focussed Specialties Tyre Leader

1. A strong, underappreciated High Value Replacement Cycle Ahead

High value tyre demand (OE+RT) should grow by a high single digit percentage CAGR over the next 3-4 years (2023-26/27e), in our view. This should be driven by a double-digit growth in HV RT tyres (growing car parc for >18" tyres globally and pull-through from HV OE shipments) and supported by a low-to-mid single digit % growth in HV OE tyres (with underlying market growth and Pirelli's high market share in EV tyres). Overall, we expect HV sales for Pirelli to grow by €1.0-1.5bn by 2027.

Figure 1: High Value growth drivers



Source: Company data.

- **O.E. Driven HV Replacement pull-through**: Pirelli has had a strong push in the High Value OE market in the last few years, growing stronger than the market - primarily focussing on share wins in North America and APAC. O.E driven pull-through into Replacement remains the most profitable channel for tyremakers. Based on high loyalty rates of 85-90%, we expect high-single-digit growth in HV RT volumes (from OE pull-through alone) over the next three years. As shown in the chart below, Pirelli has grown its HV OE volumes at a 9% CAGR between 2015 and 2022 (vs the market CAGR of 5%).

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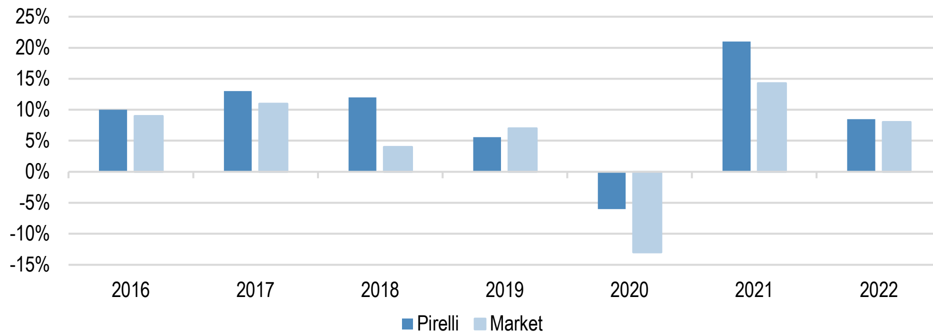
Figure 2: O.E. Driven HV Replacement pull-through

High Value y/y sales development: Pirelli vs the market.

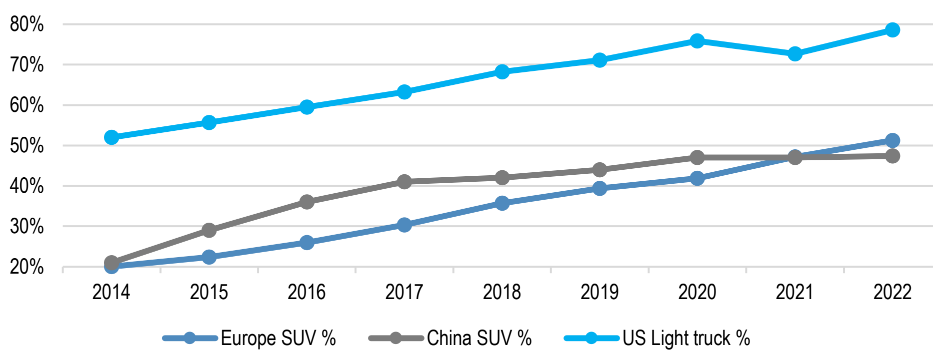


Source: J.P. Morgan.

- **Widening market potential**: the market potential for bigger rim size tyres has widened considerably over the last 7 years. As shown below, the SUV portion of sales in 3 key regions (Europe, NA and China) globally has increased by 20 to 30% in the last 7 years. As the car parc rolls over, with a 4-7 year lag, the market for bigger rim size tyres will grow substantially. This also open up opportunities for Pirelli to win new customers and gain market share from other brands, given its strong brand identity.
- **Consumer-driven Replacement**: consumers buy bigger rims and tyres for two main reasons - performance and aesthetic. The second one is easy to explain - bigger wheels just look “better” on a car. For performance, a bigger wheel has wider contact patches and has a higher influence on grip and handling. This is where the technological edge of Tier 1 tyremakers shines through. If bought for better performance, buying the “right” tyre becomes important - as the weight of the tyre and the high-performance rubber compound are crucial for tyre performance. As the market moves to bigger rim sizes, Pirelli is favourably positioned to gain share in the Replacement market.

Figure 3: Key trends in new car sales

Growing share of higher rim sizes in new car sales



Source: J.P. Morgan.

- **Wide range of specialties**: Specialty tyres are a key validation of the technological edge and innovation at Pirelli. Pirelli is a clear leader in O.E marked items and has a strong future homologation pipeline as well. These tyres have strong pricing power

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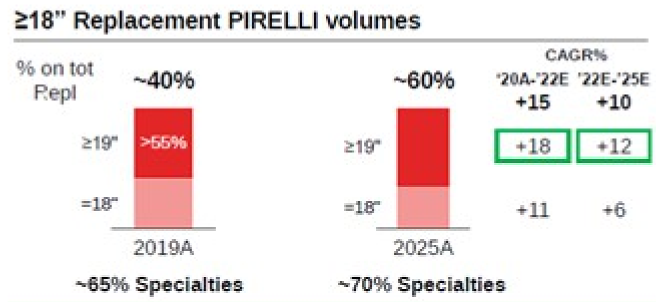
(up +20% pricing in replacement) and a strong loyalty with high replacement pull-through rates. At the last CMD in 2021, Pirelli had guided to ~70% of >18” RT volumes to be specialties in 2025.

Figure 4: Focus on Specialty tyres

Source: Company data.

Figure 5: Specialty tyres have stronger pricing power



Source: Company data.

2. Green Transition spurring innovation and enhancing Competitive Barriers

EV tyres are a competitive edge for Pirelli as they need to be technologically advanced to meet the higher load requirement (higher weight of batteries in an EV); lower rolling resistance is better for EV range and a lower tyre noise is good for ride comfort - a key complain for EV passengers. The demand for higher performance features creates a higher competitive barrier compared to rest of the business. **Overall, we see three value drivers with EV tyres**: **1) BEV launches focused on faster growing market segments** like SUVs and crossovers: as OEMs move towards higher rim sizes as standard fitting, it would increase product mix and profitability within both the HV and Standard segments for Pirelli. **2) Longer wheelbase in BEVs** makes OEMs opt for bigger rim sizes for aesthetic purposes. **3) More technology, higher performance requirements** drive higher pricing and margins and possibly a faster replacement cycle.

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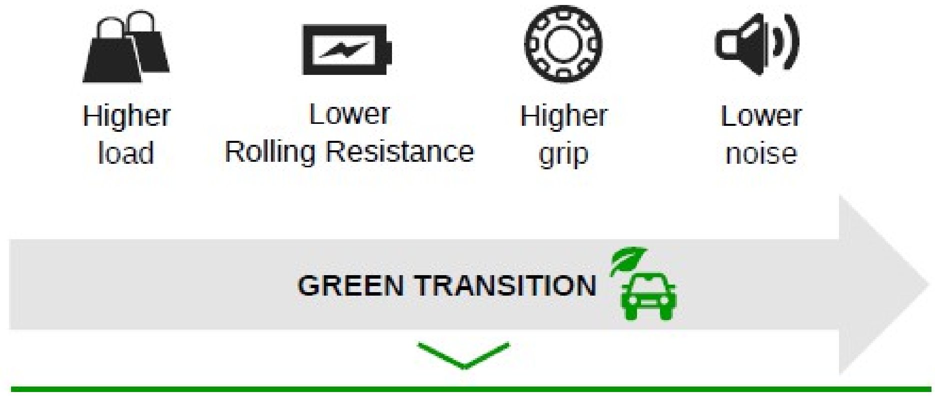
Figure 6: EV Speciality Tyres - higher competitive barriers

Tyre for EVs are technologically challenging



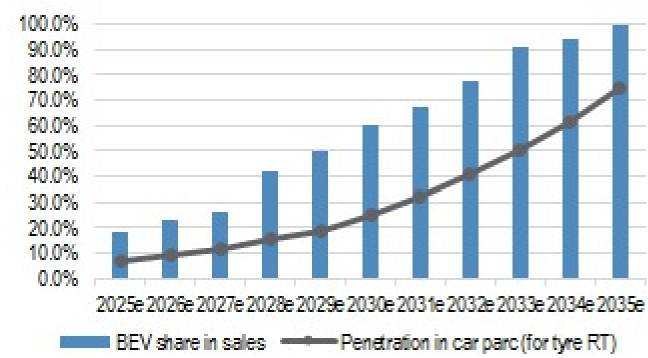
Source: Company data.

- **EV tyres are a structural margin driver for Pirelli - 1% margin boost at Group level by 2025 and 2% margin boost by 2030**. Pirelli has previously talked about a 10-15% pricing premium to a normal tyre. Current contribution to incremental margins is minimal as BEVs account for 10-15% share of new car sales in key markets and BEVs in the car parc are <3%. With the lag in the RT cycle, we expect to see a meaningful margin accretion only by 2024/2025 - when we expect ~1% margin benefit. At this point, BEVs should make for ~20% of new car sales and ~7% of the relevant car parc for Tier 1 tyre makers. By the end of the decade, we expect a 2% margin improvement for the Pirelli group (JPM estimates). At this point, we expect 60% of new cars sales to be BEVs and BEVs to form 25% of the relevant car parc (shown in Figure 8 below).

Figure 7: BEV penetration in key markets for Pirelli: Europe, NA and China (2017-2025)

Source: J.P. Morgan estimates.

Figure 8: BEV penetration in key markets for Pirelli: Europe, NA, and China (2025-2035)



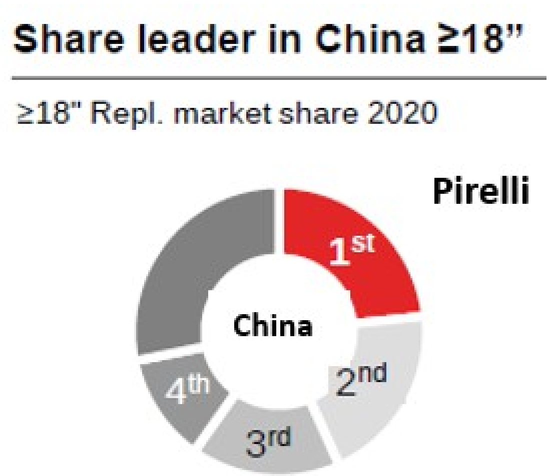
Source: J.P. Morgan estimates.

3. China - a long lasting growth opportunity

With frequent pandemic related shutdowns and overall restrictions on mobility, overall replacement (RT) tyre demand has been sluggish in China in the last few years. Between 2017 and 2022, we saw overall RT volumes declining at a 3% CAGR - with absolute levels down 15% vs. 2017. Till July 2023, we have seen the market rebound by 15% and we expect similar growth rates for the rest of the year. Despite the overall slowdown in economic activity, we expect continued growth in China RT volumes in 2024 and assume a growth rate of +3%.

In the medium to long term, we see continued growth opportunities for Pirelli as the High Value OE market continues to grow (based on higher share of SUVs and EVs) and a strong replacement pull-through of >18” tyres in a growing car parc. Pirelli is the market leader in this space and has a market share of ~25%.

Figure 9: Pirelli - leader in High value tyres



Source: Company data.

Figure 10: Pirelli - online channels in China

Partnering with top 3 platforms Tuhu, JD.com and Alibaba

Source: Company data.

4. Profit Bridge Drivers

- **Volumes**: we expect tyre volumes for Pirelli overall to grow at a 3-3.5% CAGR between 2023 and 2026/27. This should be driven by a high single digit percentage CAGR in the High Value business. The Standard Tyre business has been cut by >40% in terms of volumes since the time of the IPO. We don’t expect further volume reductions and expect Pirelli to focus on stabilisation in a profitable niche and achieving 12% Ebit margins.
- **Product-mix evolution**: Historically, Group price-mix has been driven by improving product mix within Standard tyres and greater focus on HV tyres (segment mix, i.e., growth difference between HV and Standard tyres). In the last 8 years, on average, Pirelli has delivered a product mix of ~5%. Going forward, we expect mix to be driven by >19” tyres, EV tyres and growing presence in North America and China. Also, the rising share of crossovers/SUVs in new car sales over the last 5 years should help in the replacement cycle. The relatively higher growth in HV compared to Standard will also contribute to mix. With a stronger-than-expected rebound in HV RT tyre market, new HV OE contracts and improving Standard tyre profitability, we conservatively expect product mix to be >2% between 2023 and 2025. Below we also show an estimate of product mix development within the 2 segments: High-value and Standard. We do this by looking at revenue change and volume change across the divisions in isolation. We then subtract group pricing and FX to come to the product mix estimate. Over the last 4 years, mix within the High value segment has averaged +2%; mix within the Standard segment has averaged +7%.

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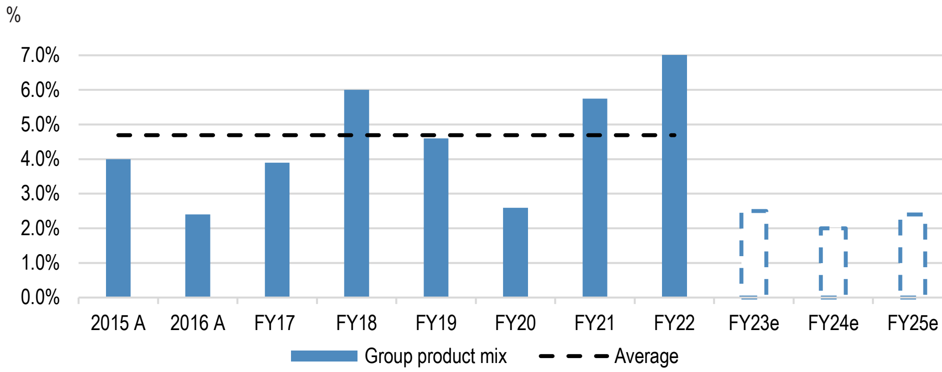
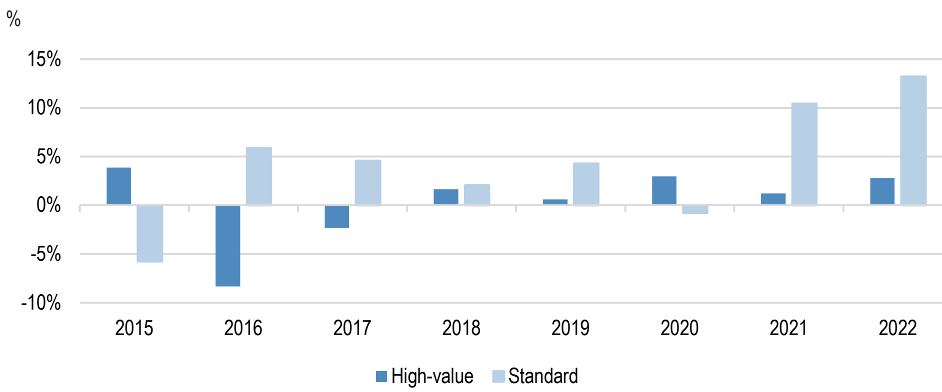
Figure 11: Group product mix evolution



Source: J.P. Morgan estimates, Company data.

Figure 12: Micro mix estimate within the 2 segments



Source: J.P. Morgan estimates.

- **Pricing vs inflation**: We have seen stronger and better pricing vs inflation by Pirelli since 2021. Absolute pricing alone is expected to offset inflationary pressures in 2023 - with volume/product mix contributing to profit growth. A key question that is frequently asked is on the sustainability of this trend going into 2024. Energy, labour, and land transport is expected to be a 3-4% cost headwind and all competitors (especially importers) don't face the same inflation pressures – especially with sea freight costs coming down dramatically. As a starting point, we would flag that Pirelli is less exposed to down-trading and competition from cheaper imports as Pirelli a premium brand know for safety, performance, and high quality. Also, while sea freight has come down dramatically, higher land freight eats into some of those benefits.

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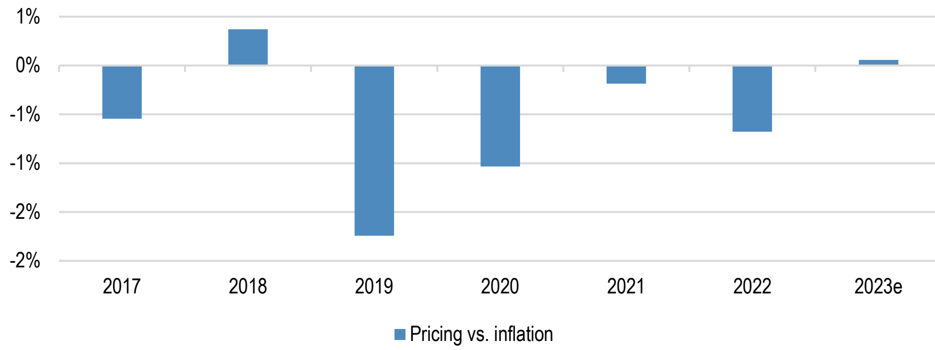
Figure 13: Pirelli: Pricing and Cost savings vs. inflation

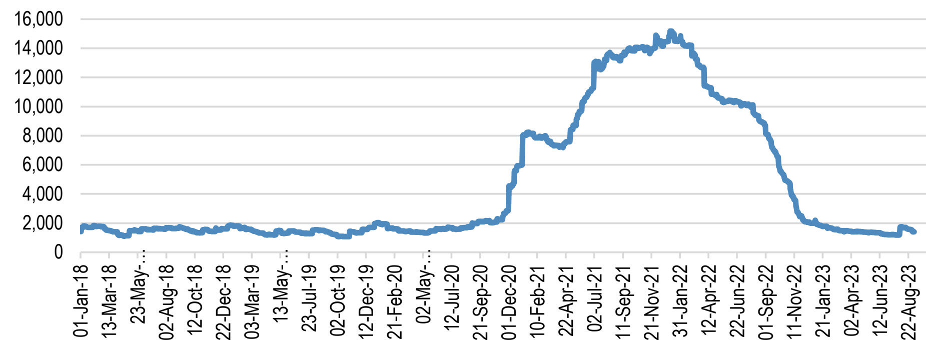
As a % of sales



Source: J.P. Morgan estimates, Company data.

Figure 14: Shipping Index - Far East to North Europe

Short-term freight rate for a 40' container, $



Source: J.P. Morgan estimates, Bloomberg Finance L.P.

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Revisiting medium-term targets and what was said at the last CMD (2021)

Within Pirelli's Industrial Plan, the 2023-2025 focus was on building on key leadership positions, by seizing growth in High Value (with shifting focus towards >19" tires, specialties, EV tires and China) and reaping the benefits of improving commercial actions (product mix) while keeping pricing discipline. The 2023-2025 (3-year) focus plan aimed for €750m revenue growth at the mid-point, of which ~90% was driven by the High Value segment. In terms of margins, the focus was to hit 16-17% margins in 2022 and improve margins to 19-20% by 2025. However, margins in 2021 and 2022 came in close to 15% levels. Below, we take a shot at the new 2025 targets that will be updated by Pirelli by the end of 2023 - reflecting the current inflationary environment.

Overall, we expect Pirelli to guide for €500-€800m sales growth till 2025 and margins of >16%. This should be mainly driven by a strong pull-through on HV replacement, targeted HV OE growth and continued growth in China, EV tyres and Specialties. Our 2025 estimates are currently at the mid-point of the growth range and assumes a ~30% drop-through to profits. We are currently 6% ahead of 2025 consensus estimates (company collected). Finally, we expect FCF of ~€585m by 2025 and the leverage ratio to fall to 0.9x.

We also think that this growth should continue into 2027. We expect overall group revenues to reach ~€8bn and Pirelli to target 17-18% adj. Ebit margins in the medium term. Overall Group adj. Ebit of >€1.3bn by 2027, would be >35% higher than the previous peak in 2018.

Table 1: Pirelli - JPM vs consensus - Medium-term targets

€ in million, %

	2022 A	2025 JPMe	2025 Cons.	% diff.	Bridge 2022A -25 JPMe	2027 JPMe
Sales	6,616	7,352	7,188	2%	737	7,967
Ebit	978	1,208	1,138	6%	230	1,361
Ebit margin %	14.8%	16.4%	15.8%		31.2%	17.1%
FCF	531	585	571	2%		
Net Debt	2,553	1,502	1,601	-6%	-1,051	
ND / Ebitda (x)	1.8x	0.9x	1.0x			

Source: J.P. Morgan estimates, Company collected consensus.

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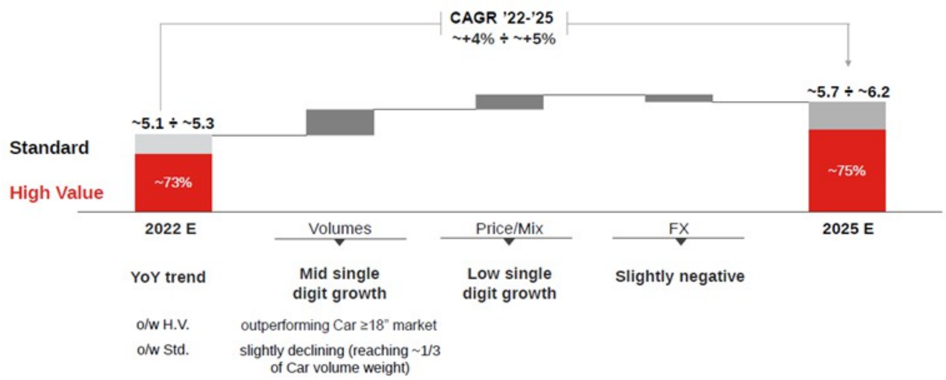
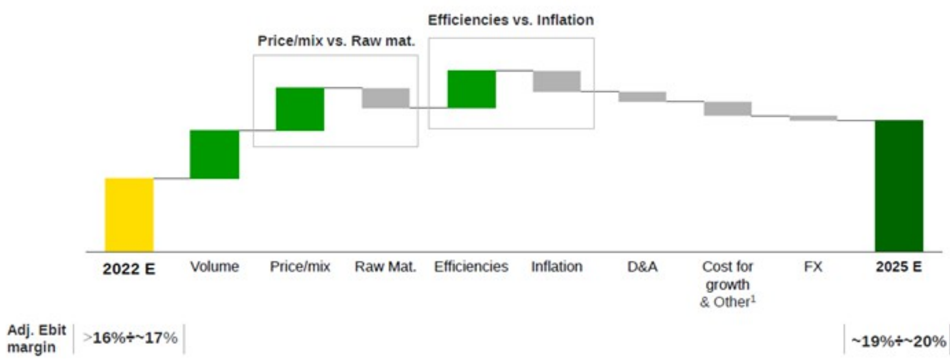
Figure 15: 2022e-2025 Revenue trend Company expectations (at the 2021 CMD)



Source: Company data.

Figure 16: 2022e-2025 Adj. Ebit trend company expectations (at the 2021 CMD)



Source: Company data.

Snippets from the 1H 2023 results

Pirelli reported Q2 revenues of €1.74bn , up 9% y/y organically and Adj. EBIT of €269m at 15.5% margins (1H margin of 15.1%). Adj. Ebit came in 4% higher than consensus expectations in Q2 - mainly on a better price-mix in the quarter (>10%). Importantly, Pirelli upgraded their 2023 margin target to 14.5-15% (vs. 14-14.5% earlier) despite a weak volume environment and higher than anticipated transactional FX headwinds. The underlying earnings look strong as price increases continue to stick and product mix within the 2 segments (micro mix) is healthy. In Q2, price/mix and efficiencies covered inflation and FX headwinds by >1.3x (vs. 1.25x in Q1 and 1.1x in 2022). High value demand (>6% y/y) again proved resilient vs. a weak Standard market (-0.5%). Pirelli continued to win market share in high value RT (particularly in Americas).

- **Key takeaways: 1)** Market outlook: more cautious market outlook (2% YoY), while High Value resilience confirmed (+6pp vs. Standard). **2)Pricing**: see “full” price discipline and are not looking to cut prices at the end of the year. **3)In Car ≥18” Replacement** Pirelli outperformed (Pirelli volumes grew +2.9% (market +0.8%), with an increase in market shares in North America. **4) Total plant saturation** stood at 95% in high value. However, Pirelli has the option to convert 10% standard capacity to high value.
- **2023 outlook was upgraded**. Adjusted Ebit Margin was revised upwards to between ~14.5% and <15% (previous estimate >14% and ~14.5%) thanks to the improvement of price mix (~+7% and ~+8% compared with prior indication ~+4.5% / ~+5.5%). Revenues estimated between €6.5-6.7bn (vs. previous estimate of €6.6-6.8bn) on lower volumes and FX. Net cash flow of €440-470m was confirmed.

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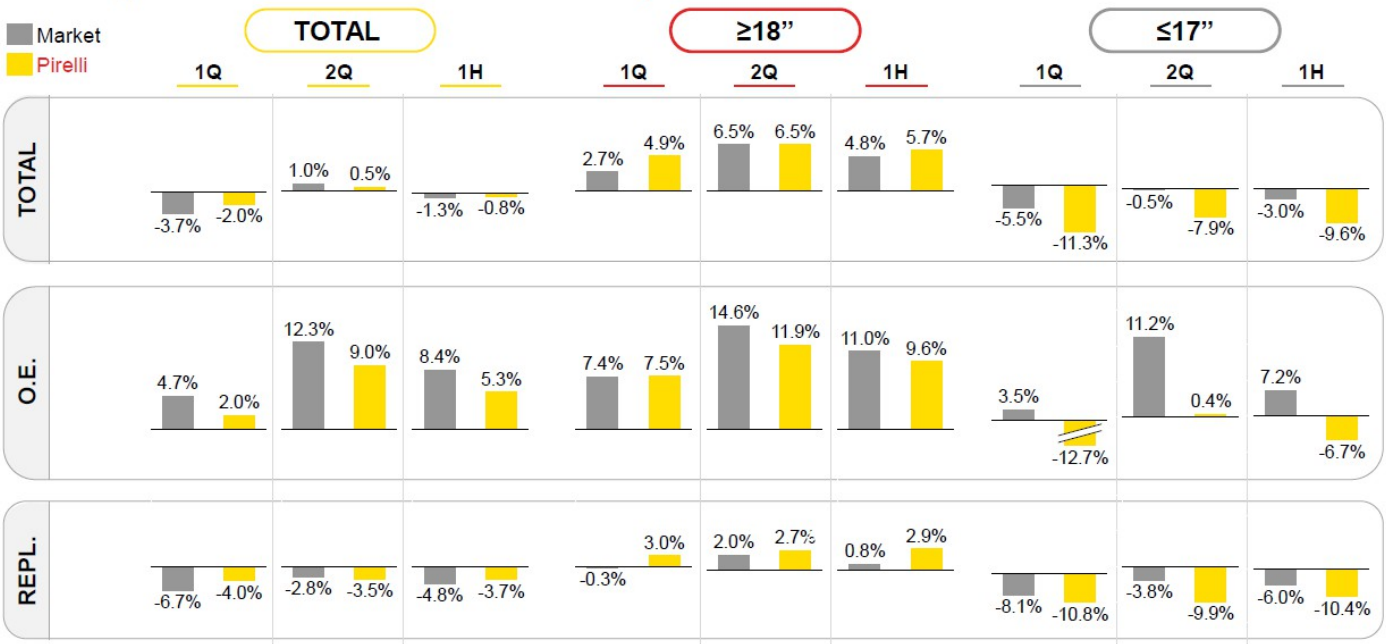
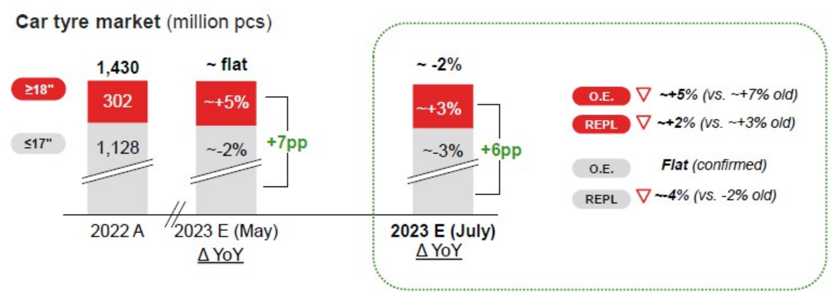
Figure 17: 2Q/1H'23 Car Tyre volumes: Pirelli vs. Market



Source: Company data.

Figure 18: 2023 Global Car Tyre Market Outlook



Main highlights by segment / channel

- **O.E. ≥18"**: a more cautious view on China recovery post pandemic
- **Repl. ≥18":** Softer demand trend in EU (following the trends in 1H but improving YoY in 2H) and China
- **Car ≤17":** demand trend on OE and Replacement reflecting a weak economic environment (South America and EU)

Source: Company data.

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Figure 19: FY 2023 targets: Stronger Price/mix driving to Ebit margin upgrade

€ billion	2022 A	2023 E	
		TARGET @11 May '23	TARGET @27 July '23
Net Sales	**6.62**	**~6.6 ÷ ~6.8**	**~6.5 ÷ ~6.7**
adj. EBIT margin	**14.8%**	**>14%÷ ~14.5%**	**~14.5%÷ <15%**
CapEx *(% of Sales)*	**0.40** *(6.0%)*	**~0.40** *(~6%)*	**confirmed**
Net Cash Flow bef. Dividends	**0.52**	**~0.44 ÷ ~0.47**	**confirmed**
Net Financial Position NFP / adj. EBITDA	**2.55** *1.8x*	**~2.35** *~1.65x ÷ ~1.7x*	**confirmed**

- **Vol.: ~-2% ÷ -1%** (old: flat / ~+1%)
- **Price/mix: ~+7% ÷ ~+8%** (old: ~+4.5% ÷ ~+5.5%)
- **Forex: ~-7% ÷ ~-6%** (old~-4.5% ÷ ~-3.5%)

Source: Company data.

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Financials and Valuation

Improving financial profile: After a few difficult years, we think Pirelli can create value for shareholders in the next few years, on the back of 5-6% organic growth (volume and mix) in the business and improving margins in HV and Standard tires. Overall, we expect a 3-4% volume growth over the next two years and ~2% product mix. Combined with efficiency enhancement programs, this should lead to a quicker margin recovery (vs. market expectations) and an improved cash conversion profile.

Table 2: Pirelli: full-year financials

€ in million, %

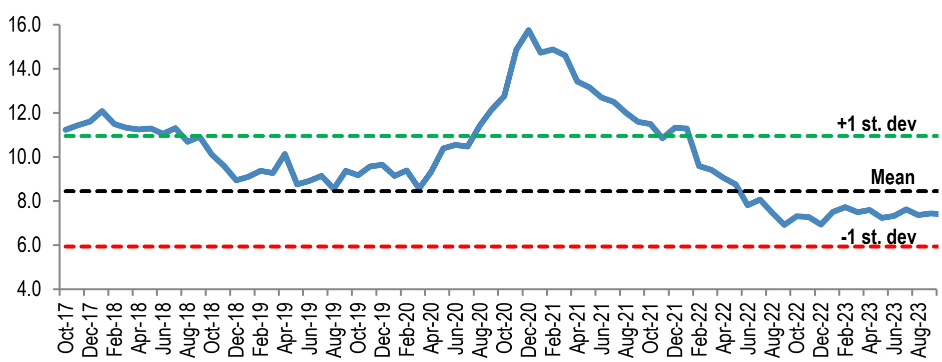
	FY22	FY23e	FY24e	FY25e	FY23 Cons	FY24 Cons	FY25 Cons	FY23 % diff	FY24 % diff	FY25 % diff
Group Sales	6,616	6,606	6,956	7,352	6,697	6,908	7,188	-1%	1%	2%
Group Adj. EBIT	978	1,015	1,103	1,208	981	1,052	1,138	3%	5%	6%
% EBIT Margin	**14.8%**	**15.4%**	**15.9%**	**16.4%**	**14.6%**	**15.2%**	**15.8%**			
Net Income	530	480	548	612						
Net Debt	2,553	2,247	1,898	1,502	2,307	1,955	1,601	-3%	-3%	-6%
Net Debt/ Adj. EBITDA	1.8x	1.5x	1.2x	0.9x						
FCF	531	472	508	585	450	540	571	5%	-6%	2%

Source: J.P. Morgan estimates, Company collected consensus.

Valuation: Below we look at the EV/Ebit chart for Pirelli since 2017. On average Pirelli has traded on 8.5x EV/Ebit (excluding outliers in 2020 and 2021) over this period. The stock currently trades on 7.4x FY23 Ebit - at a 12% discount to its historical average. In an uncertain macroeconomic environment, Pirelli provides a safe haven and is the most compelling tyre stock to own with a High Value (HV)/Specialty focus and earnings growth. Current market dynamics and the green transition enhances competitive barriers and the technological edge of Tier 1s. Bigger rim sized tyres, EV tyres and specialties place higher demands from tyres. These tyres need to have lower weight and an advanced rubber compound for better performance and longer life. Lower rolling resistance and lower tyre noise are key differentiators for EV tyres. Safety, comfort, performance and technology will lead to higher pricing power and margin benefits. In summary, we see strong upside from current levels, given Pirelli's growth outlook, strong position in EVs and China and 3 upcoming catalysts. We value Pirelli on a ~8x EV/Ebit (24e) and 1.2x EV/Sales multiple and this implies a FCF yield of ~9% over the next 3 years (vs. current yield of 12% - where Pirelli is trading like an ex-growth stock).

Figure 20: EV/Ebit trading chart

(x)



Source: J.P. Morgan estimates, Bloomberg Finance L.P.

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Investment Thesis, Valuation and Risks

Pirelli *(Overweight; Price Target: €6.50)*

Investment Thesis

Pirelli has delivered strong earnings growth in the first half of 2023 despite a worsening tyre market outlook (especially in Europe) and transactional FX headwinds. We see that investors have been on the sidelines following the Golden Power Procedure and organisational changes at Pirelli, but we think this presents a buying opportunity in the medium term. In an uncertain macroeconomic environment, Pirelli provides a safe haven and is the most compelling tyre stock to own with a High Value (HV)/Specialty focus and earnings growth. We see strong upside from current levels, given Pirelli's growth outlook, strong position in EVs and China, three upcoming catalysts and key valuation support.

Valuation

We value Pirelli on a 1.2x EV/Sales (24e) multiple. On our price target Pirelli would trade on ~8x EV/adj. Ebit and ~12x P/E.

Risks to Rating and Price Target

Downside risks: 1) weaker-than-expected developments in the HV segment and loss of market share to key competitors. 2) High pricing pressure from OEMs or in the RT channel. 3) Relatively lower ability to pass on price increases going into 2024. 4) higher-than-anticipated capex needs to support the growth in HV tyres.

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Pirelli: Summary of Financials

Group P&L (EUR m)	FY21	FY22	FY23E	FY24E
Revenues	5,331	6,616	6,606	6,956
% change Y/Y	23.9%	24.1%	(0.1%)	5.3%
Cost of Sales	(1,821)	(2,107)	(1,983)	(2,059)
EBITDA	1,211	1,373	1,460	1,549
EBIT	857	1,019	1,056	1,144
% Ebit	15.3%	14.8%	15.4%	15.9%
Net financial result	(144)	(202)	(220)	(215)
Pretax Income	436	596	641	745
Net Income	303	415	397	472
Adj. EPS	0.30	0.42	0.40	0.47
Industrial Cash flow (EUR m)	**FY21**	**FY22**	**FY23E**	**FY24E**
Net income	311	390	418	496
Depreciation & amortization	517	544	559	559
Working capital	(8)	4	(19)	(49)
Other change in operating cash flow	(93)	70	0	0
Operating cash flow	727	1,009	958	1,006
Net capex	(346)	(398)	(486)	(498)
Free cash flow	381	611	472	508
Financing cash flow	(202)	(265)	(166)	(159)
Currency	0	0	(40)	0
Net change in cash	179	347	266	349
Net industrial debt (cash)	3,394	3,201	2,855	2,426
Industrial multiples	**FY21**	**FY22**	**FY23E**	**FY24E**
Industrial EV/Sales	1.5	1.1	1.1	1.0
Industrial EV/Ebitda	6.8	5.3	5.1	4.4
Industrial EV/Ebit	10.1	7.4	7.4	6.2
Industrial P/E	10.8	8.5	9.8	8.6
Industrial Dividend yield	1.6%	3.6%	3.5%	3.4%
Industrial Net debt to Ebitda	2.3	1.8	1.5	1.2

Group Balance sheet (EUR m)	FY21	FY22	FY23E	FY24E
Intangibles	5,486	5,383	5,409	5,437
PP&E	3,289	3,400	3,221	3,052
Investments	-	-	-	-
Non-current receivables from sales financing	363	231	231	231
Leased assets	-	-	-	-
Other	380	381	381	381
Total non current assets	9,598	9,475	9,323	9,181
Inventories	1,092	1,458	1,453	1,530
Trade receivables	1,130	1,378	1,377	1,410
Receivables from sales financing	-	-	-	-
Cash and cash equivalents	1,885	1,290	1,555	1,905
Other	178	297	297	297
Total current assets	4,285	4,422	4,683	5,142
Total assets	**13,883**	**13,898**	**14,005**	**14,324**
Equity	5,043	5,454	5,666	6,003
Long term liabilities	3,789	3,690	3,610	3,530
Pension provisions	221	181	181	181
Other non current liabilities	92	87	87	87
Total non current liabilities	5,217	5,102	5,022	4,942
Short term financial liabilities	1,489	800	800	800
Trade payables	1,626	1,973	1,949	2,010
Other current liabilities	508	568	568	568
Total current liabilities	3,624	3,342	3,318	3,379
Total Liabilities and Equity	**13,883**	**13,898**	**14,005**	**14,324**

Source: Company reports and J.P. Morgan estimates.

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Pirelli (PIRC.MI, PIRC IM) Price Chart

Date	Rating	Price (€)	Price Target (€)
23-Oct-20	N	3.78	4.1
05-Jan-21	UW	4.36	4
05-May-21	UW	4.60	4.4
09-Aug-21	N	5.45	5.6
05-Jan-22	OW	6.18	7.5
29-Apr-22	OW	4.75	6.2
03-Nov-22	OW	3.76	5.3
22-Feb-23	OW	4.82	5.8

Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Nov 13, 2017. All share prices are as of market close on the previous business day.

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IB clients**	67%	64%	53%

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