EthiFinance Ratings

PIRELLI & C. SPA

860340157 CORPORATE

BBB ISSUER RATING
Long term

OUTLOOK
Stable

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RATING ACTION AND RATIONALE

- EthiFinance Ratings affirms Pirelli & C S.p.A.'s long-term corporate rating at BBB, maintaining its Stable outlook.
- The rating affirmation results from some improvement in the financial risk profile from BBB+ in FY22 to A- in FY23 thanks primarily to significant deleveraging during the past year. Pirelli reported marginal top-line growth of 0.5% for FY23, primarily driven by a price/mix effect of 8.6% (vs 19.7% in FY22), fully offsetting the negative impact from both volumes (-1.8%) and FX headwinds (-6.3%). Amid this low top-line growth, Pirelli's EBITDA margin, which is higher compared with peers, has remained steady and above our expectations at 20.5% vs 20.2% in FY22 (vs 18.5% expected). We expect this margin to improve slightly to reach 20.9% by 2026.
- The tyre market has experienced some softness in growth in the standard segment, which represented 25% of FY23 sales. Pirelli is poised to decrease its exposure to this segment in the coming years as its focus will be on the premium/prestige (being the market leader with a 50% market share) and electric vehicles (EV) segments. The latter, which have helped to mitigate the negative impact of the underperforming standard (<17") tyre segment through its OEM strong performance, will be the key driver for future growth in both OEM and the aftermarket, as the tyres maker is working with the new EV players (NIO, Sokon, BYD) and has achieved between 8% and 9% of its FY23 sales by selling them around 5.4m tyres. Our adjusted net leverage ratio has improved above our expectations, from 2.4x at end-2022 to 2.1x at end-2023 (vs 2.3x expected). This improvement is mainly attributed to a reduction of €0.44bn in adjusted net debt thanks to strong cash generation. We forecast this ratio to further improve to 1.3x by end-2026, factoring in a dividend payout ratio of 50% from FY25 onwards, in line with the management's deleveraging strategy.
- However, our ratings are constrained by the tyre industry's risk profile, which remains at BB owing to low demand growth in the standard segment. The rating is also constrained by the interest coverage ratio, which decreased from 9.7x in FY22 to 6.6x in FY23 due to higher interest rates. We expect this ratio to improve from 2025 onwards to reach 9.3x by 2026 on the back of interest rates normalization.
- According to our methodology, the auto component industry has medium-to-high ESG risks (sector heatmap score between 3.5 and 4), slightly constraining our industry assessment. Its impact on the climate is primarily tied to OEMs, but with a lighter production process generating low GHG emissions. The industry uses a lot of resources, mainly raw materials, thereby generating a significant amount of waste and pollution. In FY23, Pirelli's CO2 emissions and energy consumption slightly decreased in absolute value, achieving a 0.3% reduction in its scope 1 and 2 emissions. In addition, from a 2018 baseline, the company has reduced its CO2 emissions by 18% and aims for carbon neutrality by 2030. Pirelli's carbon and energy intensity efficiency in the past years is a key factor contributing to our positive ESG assessment of the company with a score ranging between 0 and 1, thereby offsetting the negative impact from our industry ESG assessment. Nevertheless, it is to be noted that the emissions by product ratio have deteriorated as the volumes were down by 1.8% in FY23. Consequently, should volumes increase in the next few years, in the absence of an improvement in the emissions by product, our ESG score could deteriorate, thereby constraining our rating.

ISSUER DESCRIPTION

Pirelli, based in Milan, is one of the world's largest tyre manufacturers. The company is the only one in the industry that specializes exclusively in the consumer segment, comprising tyres for cars, motorcycles, and bicycles. The company is listed on Euronext Milan and had a market capitalization of c.€6.1bn as of May 23, 2024.

Pirelli's customers include both premium (BMW, Audi and Mercedes) and prestige (Bentley, Ferrari, Lamborghini, Maserati, and Porsche) car makers. The group has c.32,000 employees spread across 18 industrial sites located in 12 different countries; its products are distributed globally through 19,500 distributors and specialized resellers and 300 Pirelli points of sale. For FY23, Pirelli reported revenues of €6.65bn and EBITDA of €1.36bn. The EthiFinance Ratings-adjusted net leverage ratio was 2.1x at end-2023.

LIQUIDITY

We assess Pirelli's liquidity profile to be 'Superior' as the company can repay all its upcoming debt without refinancing for more than two years.

MAIN FINANCIAL FIGURES AND FORECASTS

Main financial figures. €m	2022	2023	2024E	2025E	2026E	23vs22
Turnover	6 616	6 650	6 733	6 915	7 114	*0.5%*
Adj EBITDA (1)	1 336	1 366	1 390	1 435	1 484	*2.3%*
EBITDA Margin (1)	20.2%	20.5%	20.6%	20.7%	20.9%	*0.4pp*
EBIT	719	729	744	777	809	*1.4%*
EBIT Margin	10.9%	11.0%	11.1%	11.2%	11.4%	*0.1pp*
Interest expenses	(137)	(208)	(222)	(199)	(159)	*-51.7%*
Total Assets	13 898	13 531	13 892	13 311	13 666	*-2.6%*
Equity (Adjusted)	5 454	5 620	5 872	6 135	6 431	*3.0%*
Total Adjusted Debt (2)	4 726	4 193	4 274	3 366	3 367	*-11.3%*
Net Adjusted Debt (2)	3 149	2 848	2 566	2 242	1 889	*-9.6%*
Equity/TAD (2)	115.4%	134.0%	137.4%	182.3%	191.0%	*18.6pp*
NAD/EBITDA (1)(2)	2.4x	2.1x	1.8x	1.6x	1.3x	*-0.3x*
Funds From Operations	989	940	1 052	1 105	1 174	*-4.9%*
FFO/NAD (2)	31.4%	33.0%	41.0%	49.3%	62.2%	*1.6pp*
EBITDA/Interest (1)	9.7x	6.6x	6.3x	7.2x	9.3x	*-3.2x*

(1) Adj EBITDA includes non-recurring expenses and other adjustments related to the usual Opex

(2) Net debt adjustments : The adjusted net debt is inclusive of pension benefits, equity components of convertible bonds and other financial assets

CREDIT RATING

CREDIT RATING	
Business Risk Profile	***BBB-***
Industry Risk Assessment	*BB*
Industry 's ESG	***Negative***
Competitive Positioning	*BBB*
Governance	*BBB-*
Financial Risk Profile	***A-***
Cash flow and leverage	*BBB*
Solvency	*A-*
Company's ESG	***Positive***
Anchor Rating	***BBB***
Modifiers	-
Final Rating	***BBB***

RATING SENSITIVITY

- **Long-term rating positive factors (↑)**

We could upgrade our rating should Pirelli's credit metrics improve further on a sustainable basis. Specifically, a potential catalyst for such upgrade would be an EthiFinance Ratings adjusted net leverage ratio below 1.5x and/or an interest coverage ratio above 9.0x, on a sustainable basis. Also, an upgrade is subject to stable prospects for the whole tyre industry, which is closely tied to the trend in global automotive production.

- **Long-term rating negative factors (↓)**

We may consider lowering our long-term rating in the event of a significant deterioration in Pirelli's credit metrics, such as an EthiFinance adjusted net leverage ratio exceeding 2.5x and/or an interest coverage ratio falling below 5.0x. Additionally, a less cautious financial strategy pursued by the company, such as significant debt-financed M&A, could constitute another potential catalyst for a rating downgrade.

Sources of information

The credit rating issued in this report is unsolicited. The credit rating is based exclusively on public information, being the main sources the following:

1. Annual Audit Report.
2. Corporate Governance Report.
3. Corporate Website.
4. Information published in the Official Bulletins.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, EthiFinance Ratings assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Level of the rated entity participation in the rating process

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies. Principal methodology used in this research are :
  - Corporate Rating Methodology - Long Term : https://files.qivalio.net/documents/methodologies/CRA 190 V3 Corporate%20Methodology 2023-10-06.pdf
- The rating scale used in this report is available at https://www.ethifinance.com/en/ratings/ratingScale.
- EthiFinance Ratings publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.
- The issued credit rating has been notified to the rated entity, and has not been modified since.

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