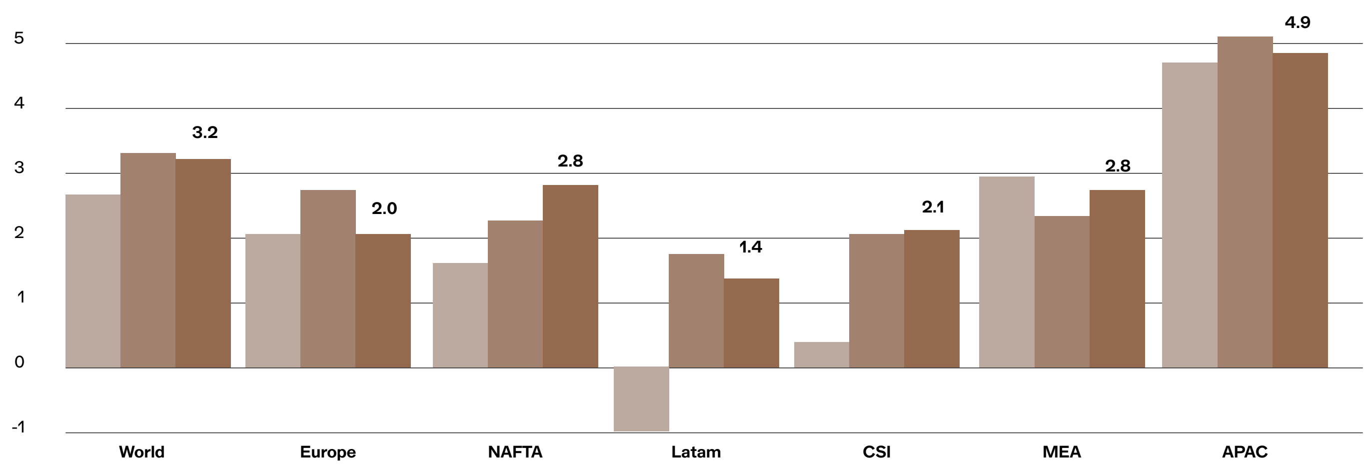
DIRECTORS' REPORT ON OPERATIONS AT DECEMBER 31, 2018

Macroeconomic and market scenario

MACROECONOMIC PERFORMANCE

In 2018 global GDP growth stood at +3.2%, a slight decrease compared to +3.3% for 2017.

GLOBAL GDP GROWTH (ANNUAL CHANGE IN %)



2016 2017 2018

Source: IHS Markit, January 2019: growth rate shown for 2018 are estimates.

Europe recorded an increase of +2.0% for 2018 compared to its peak in 2017 (+2.7%). The slowdown was mainly due to uncertainties on international trade and on the political situation of some European Union countries, also in view of the upcoming European elections, as well as the so far uncertain deal regarding the exit from the EU of the United Kingdom.

It was vice versa for the US economy where GDP growth strengthened in 2018 to +2.9% compared to +2.2% for 2017, also thanks to the fiscal stimulus introduced by the government and to its positive effects on consumption, investment and employment (the unemployment rate decreased further to 3.9% from 4.4% for 2017). The inflationary effects of growth (a consumer price index of +2.4%) pushed the US Federal Reserve to progressively increase the benchmark rate from 1.5% at the beginning of the year to 2.5% in December 2018.

The performance of emerging markets was mixed. The Brazilian economy (+1.3% GDP growth in 2018) was impacted by the transport workers' strike in May and by the fall in vehicle exports during the second half of the year linked to the collapse of demand in Argentina. The contraction of the economies of Argentina and Turkey was particularly accentuated, both of which were hit by currency crises. There was recovery instead for Russia's economy and for those of the CIS (Commonwealth of Independent States) member states, sustained by oil prices, which more than offset the tightening of sanctions by the United States.

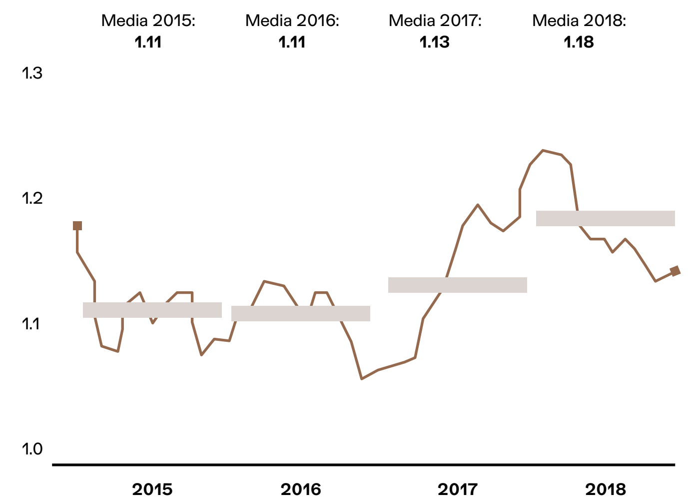
Growth of the Chinese economy was +6.6% in 2018 (+6.7% for 2017) despite measures to reduce the use of credit and trade tensions with the United States, thanks to the fiscal stimulus measures introduced by the government.

On the currency front, the performance of the Euro vs USD exchange rate for 2018 reflected the growth differential of the two economies and the rise in US interest rates compared to the substantial stability of interest rates as set by the ECB. Against the US Dollar, the European currency rose from an average 1.23 in the first quarter of 2018 to 1.14 in the fourth quarter, recording an average of 1.18 dollars per euro for the year (+4.6% compared to the average of 1.13 in 2017).

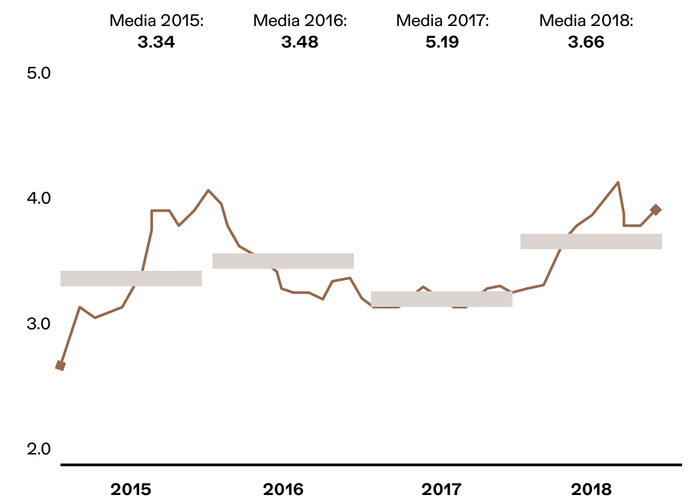
The US Dollar also strengthened against the currencies of emerging markets. The Brazilian Real went from an average of 3.19 against the US Dollar in 2017, to an average of 3.66 for 2018, a depreciation of 13.0%. The Russian currency averaged 62.60 Roubles per USD during 2018 with a depreciation of 7.0%, compared to an average exchange rate of 58.30 Roubles per USD in 2017.

The Chinese currency weakened from 6.36 Renminbi per USD for the first quarter of 2018 to 6.92 for the fourth, resulting in an average for the year of 6.62 per USD, an appreciation of 2.0% compared to the average of 6.75 in 2017.

EXCHANGE RATE: USD PER EURO



EXCHANGE RATE: BRAZILIAN REAL PER USD



Source: European Central Bank monthly data at December 31, 2018.

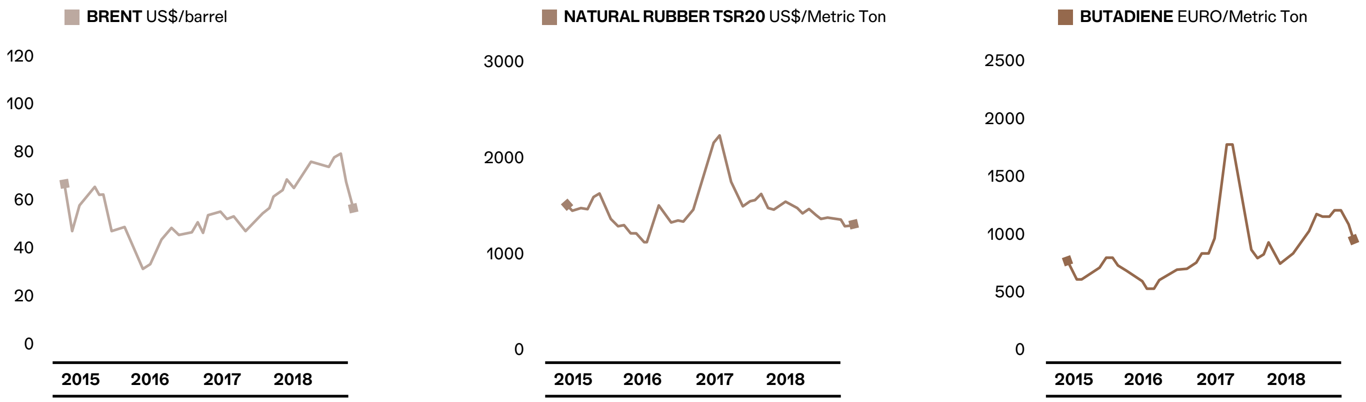
RAW MATERIALS

The year 2018 was characterised by increases in the price of energy resources and butadiene, and a decrease in the price of natural rubber.

Brent recorded an average price for the year of USD 72 per barrel, +31% compared to the average price for 2017. This performance reflected the increase in the price of Brent during the first ten months of 2018 (which culminated in an average price of USD 81 per barrel in October), offset by a gradual reduction in price during the last part of the year (to an average of USD 58 per barrel in December). The price rise for 2018 was mainly influenced by an agreement between the main oil producing countries which limited the production of oil, and also by fears tied to US sanctions against Iran. During the last part of the year, the increase in crude oil production in the US, and the slowdown in global economic growth impacted oil's performance.

The price of natural rubber followed a trend of gradual decline during 2018, moving from an average of USD 1,467 dollars per tonne for the first quarter to USD 1,266 per tonne in the fourth quarter, with an average annual price of USD 1,365 per tonne, down -17.0% compared to 2017.

PRICES OF RAW MATERIALS



Source: IHS Markit

The average price of butadiene, the main raw material for the production of synthetic rubber, stood at euro 1,011 per tonne for 2018, a decline of -9.0% compared to the average price for 2017. As with the price of oil, butadiene prices increased during 2018 to reach a peak in October (averaging Euro 1,175 per tonne for the month) to then return below Euro 1,000 per tonne in December, influenced by the fall in the price of crude oil and by the slowdown in the global economy.

AUTOMOTIVE MARKETS

The global car market consolidated itself at a level of 93.9 million units sold in 2018 according to IHS Markit, a fall of -0.3% compared to the previous year when registrations reached an all-time high. Growth in emerging market such as South America (+7.0%), Russia (+13.6%) and the stability of the car market in Europe (+0.8%) during 2018 was counterbalanced by the contraction of the car market in APAC (-1.5%), in the Middle East/Africa (-2.5%) and in North America (-0.7%).

There was a positive performance by car sales in the Premium and Prestige segments (+0.8%) which reached a 12.6% share of all vehicles sold. This trend, which translates into the continued improvement of the Premium and Prestige share of the overall car parc, was sustained in particular by APAC (+3.5%) and by North America (+3.4%). Europe confirmed its position as the region with the highest share of Premium and Prestige sales (20%).

Thanks to growth of +3.6%, the car parc reached 1.38 billion automobiles (compared to 1.33 billion units in 2017, revised upwards due to an increase in the number of countries included) with the Premium and Prestige segment share of the car parc at 10.4% (10.3% in 2017) equal to 144 million vehicles in circulation (137 million for 2017). Europe, NAFTA and APAC represented 92% of the Premium and Prestige car parc.

TYRE MARKETS

Regarding the development of demand in the Car tyre market, a positive trend was seen in the New Premium segment (car or light truck tyres with a rim diameter of ≥18inches), with growth of +10% during 2018, compared to a contraction in the segment for tyres with a lower rim diameter (-1.0%). The New Premium segment attained a 15% share of the total market (14% in 2017).

In **Europe**, sales of New Premium Car tyres recorded growth of +8.5% for 2018, with a -0.4% performance for the segment for tyres with a rim diameter of ≤17 inches. In the Original Equipment channel, New Premium sales grew by +2.1% compared to a decrease in sales recorded for non-New Premium segment tyres (-4.7%). Both segments were impacted during the second half of 2018 by delays in the introduction of new C02 emission control procedures for new cars. In the Replacement channel, New Premium sales recorded a growth of +14.3% compared to +0.7% for tyres ≤17 inches.

In **NAFTA,** sales for car New Premium tyres rose +10.2% (+12.9% for the Replacement channel, +5.3% for the Original Equipment channel) compared to a -0.6% decline registered for the non-New Premium segment (+0.5% on the Replacement channel, -5.4% on the Original Equipment channel).

In **APAC**, sales of New Premium Car tyres equalled +10.4% (+10.9% for the Replacement channel, +10.1% for the Original Equipment channel) compared to a -1.8% decline in sales for the non-New Premium segment (+0.2% for the Replacement channel, -4.9% for the Original Equipment channel).

The decline continued for markets in **Latin America**, with a further contraction of -6.8% for the total market (Original Equipment + Replacement); -8.7% for the Replacement channel while Original Equipment grew by +2.8%.

The market in **Russia** recovered with growth at +11.7%, with the Replacement channel at +11.0% and Original Equipment at +15.9%.

Significant events of 2018

On **January 11, 2018** Pirelli sold, through an operation reserved for *"qualified investors"* in Italy, and institutional investors abroad, the entire investment directly held in Mediobanca S.p.A. - which corresponded to approximately 1.8% of the relative share capital - with a total net collection of euro 152.8 million.

On **January 22, 2018**, as part of the EMTN (Euro Medium Term Note) program approved at the end of 2017, Pirelli placed a bond loan with international institutional investors for a nominal amount of euro 600 million, with a five-year duration at a fixed rate. The effective yield at maturity is equal to 1.479%. The securities were listed on the Luxembourg Stock Exchange. Furthermore, during the first weeks of January 2018, Pirelli initiated an operation to change the financial conditions of the Group's main bank credit facility - involving a total notional amount of euro 4.2 billion, which included a revolving credit facility for the amount of euro 700 million - which allowed for the reduction of the applied interest margin by 30 basis points.

On **March 6, 2018** at the Geneva Motor Show, Pirelli presented the Cyber Car technology, the new system for Original Equipment which thanks to a sensor, allows for the interaction between tyre and car.

On **March 15, 2018** Pirelli placed a Floating Rate Note to the value of euro 200 million with maturity in September 2020. The Floating Rate Note issue - intended exclusively for institutional investors – has allowed for the repayment of the existing debt by the same amount, thereby further optimising the company's financial structure by reducing the cost of debt.

On **March 20, 2018** the euro 600 million bond loan maturing in November 2019 was repaid in advance by the subsidiary Pirelli International Plc. The loan was reimbursed at a price of euro 1,031.15 by way of a Make-Whole Amount for each bond with a value of euro 1,000, to which euro 5.85 was added as interest accrued up until the date of the reimbursement.

On **May 14, 2018**, the Pirelli Board of Directors, upon the proposal of the Executive Vice Chairman and CEO, Marco Tronchetti Provera, approved the development of an organisational structure aimed at consolidating the implementation of the integrated business model. The new organisation model provides that all staff functions and as well as the regions, continue to report to the Executive Vice Chairman and CEO as regards institutional issues and overall coordination. In addition, the General Operations Department entrusted to Andrea Casaluci, will also report to the Executive Vice Chairman and CEO. It is a department which assembles staff functions which already previously reported to Marco Tronchetti Provera, or report directly such as the Technology area entrusted to the Executive Vice President of Technology, Maurizio Boiocchi, and the Digital function, entrusted to Pier Paolo Tamma.

On **May 15, 2018,** the Shareholders' Meeting of Pirelli & C. S.p.A. approved the Financial Statements for 2017, (as approved by the Board of Directors on February 26, 2018) as well as the increase to the number of members of the Board of Directors to 15, and - upon the proposal by a group of institutional investors - appointed a new Director, Giovanni Lo Storto, who has joined the Audit, Risks, Sustainability and Corporate Governance Committee and the Remuneration Committee. Giovanni Lo Storto has declared that he possesses the requisites to qualify as an Independent Director pursuant to the Finance Consolidation Act and the self-regulatory Code of Conduct for listed companies. With this appointment, the Pirelli Board of Directors is composed of a majority (8 out of 15 members) of Independent Directors. Furthermore, the Shareholders' Meeting appointed the new Board of Statutory Auditors for the financial years 2018-2020, which is composed of Francesco Fallacara (Chairman); Antonella Carù, Fabio Artoni, Luca Nicodemi and Alberto Villani (effective statutory auditors) and Franca Brusco, Elenio Bidoggia and Giovanna Oddo (Alternate Auditors). The fee was set at euro 50,000 for the Statutory Auditors and euro 75,000 for the Chairman of the Board of Statutory Auditors. The Shareholders also authorised the Board of Directors to stipulate a new D&O (Directors & Officers Liability Insurance Policy), expressed a favourable opinion on the Remuneration Policy, and approved for the section related to Total Shareholder Return, the adoption of the

2018-2020 three-year monetary Long Term Incentives (*"LTI Plan"*), the latter intended for the entire management sector correlates with the 2018-2020 objectives contained in the 2017-2020 Industrial Plan.

On **June 22, 2018**, the Pirelli Board of Directors extended the expiry date (from January 31 to December 31, 2019) and increased the amount of the previous Board's authorisation for bond loans from euro 1.0 billion to euro 1.8 billion, of which euro 800 million was placed during the first quarter of 2018.

On **26 July 2018**, Pirelli & C.S.p.A. finalised a *"Schuldschein"* loan for a total euro 525 million. The loan, guaranteed by Pirelli Tyre and granted by primary market participants, consists of one tranche for the amount of euro 82 million with three-year maturity, another for euro 423 million with a five-year maturity, and another for euro 20 million with a seven-year maturity. The operation has allowed for the repayment of the existing debt, and thus further optimising the debt structure and debt cost.

On **August 7, 2018** the Pirelli Board of Directors - as regards the *"Pirelli & C. S.p.A. 600,000,000 euro 1.375 per cent Guaranteed Notes due 25 January 2023"* (ISIN: XS1757843146) issued by Pirelli & C.S.p.A as part of the euro 2.0 billion EMTN (Euro Medium Term Note) program listed on the Luxembourg Stock Exchange - resolved to proceed with the partial purchase of these bonds. **On December 19, 2018** Pirelli repurchased bonds for a total value of euro 47 million out of a total of euro 50 million as part of the mandate conferred to Goldman Sachs International to proceed with the partial repurchase of the bond.

On **August 7, 2018**, the Pirelli Board of Directors, upon the proposal of the Executive Vice Chairman and CEO, Marco Tronchetti Provera, proceeded to co-opt Ning Gaoning for his appointment as Chairman of the Board of Directors, replacing Ren Jianxin, who resigned on July 30, 2018. Ning Gaoning - who declared that he did not possess the requisites to qualify as independent pursuant to the Finance Consolidation Act and the self-regulatory Code of Conduct - was qualified by the Board in his role as non-executive Director and has been assigned the legal representation of the Company pursuant to the Articles of Association. The Board also appointed the new Director as a member of the Nominations and Successions Committee.

On **August 13, 2018** Pirelli announced that it had signed an agreement with the Luna Rossa Challenge to create a partnership aimed at developing a multi-year project that will bring about Luna Rossa's participation in the next edition of the America's Cup, scheduled for New Zealand during the course of 2021. Pirelli and Prada will be the co-title sponsors for the vessel.

On **August 28, 2018** Pirelli announced that it had joined the United Nations *"Road Safety Trust Fund"* and - with the aim of supporting the Fund by having a significant impact on global road safety - provided an initial contribution of USD 600,000 (2018-2019).

On **September 7, 2018** Pirelli announced that it had sold its Car tyre factory in Guacara, Venezuela, together with all the assets held in that country. The operation, which follows the de-consolidation of accounting on December 31, 2015, had no financial impact on the Group. The agreement, which provides for the continuity of employment, was reached with a consortium of South American entrepreneurs, and the company Sommers International as buyer.

On **October 9, 2018** the closing was completed for the purchase by Pirelli Tyre S.p.A. of a 49.0% stake in the Joint Venture which, through the company Jining Shenzhou Tyre Co., owns a new Consumer tyre manufacturing plant in China. The investment, - which had already been announced on **August 1, 2018** along with the announcement of the preliminary agreement – was for approximately euro 65 million. Pirelli Tyre S.p.A. will have the right, to be exercised during the period between January 1, 2021 and December 31, 2025, to increase its participation up to 70%.

On **October 15, 2018** Pirelli signed the preliminary agreement with the *Agenzia delle Entrate* (the Italian Tax Office) for access to the tax relief concessions of the Patent Box, with reference to the 2015-2019 fiscal years. The tax benefit for the three year period 2015-2017 was equal to approximately euro 54 million to which is added the benefit for the 2018 financial year estimated at euro 35 million. As per the proposal by CEO, Marco Tronchetti Provera, the Board of Directors allocated the resources of the Patent Box to the reduction of costs, which will be implemented during the 2019 financial year in order to continue the double-digit reduction of exposure on the Standard segment, as well as the High Value strategy.

On **18 December 2018** Pirelli & C. S.p.A. announced that it had been admitted - together with the subsidiary Pirelli Tyre S.p.A. - to the *Regime di Adempimento Collaborativo* (Collaborative Compliance Scheme), a new initiative for dialogue with the Italian Tax Office based on a relationship of transparency which allows the Company to further increase its level of certainty on the relevant tax issues. The admission comes at the end of the positive outcome of the assessment conducted by the Italian Tax Office on the *"Tax Control Framework"* of the company, which is the system for the detection, management, control and mitigation of tax risk.

Group performance and results

In this document, in addition to the financial measures as provided for by the International Financial Reporting Standards (IFRS), alternative performance indicators derived from IFRS were also used in order to allow for a better assessment of the of the Group's operating and financial performance.
Reference should be made to the paragraph *"Alternative Performance Indicators"* for a more detailed description of these indicators.

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As a result of the assignment in March 2017 by Pirelli & C. S.p.A. to the parent company Marco Polo International Holding Italy S.p.A., of the TP Industrial Holding S.p.A. shares, the company into which almost all of Pirelli's Industrial assets had been merged, in continuity with the 2017 financial year some residual activities in China and Argentina relative to the Industrial business, qualified as *"Discontinued operations"*. The results for the financial year for *"Discontinued operations"* were classified to the Income Statement as a single item, *"Net income (loss) related to discontinued operations"*. The separation process for Argentina was completed during the month of June 2018, while for China completion was completed during the fourth quarter of 2018.

* * *

The Directors' Report on Operations at December 31, 2018 has been prepared by applying the new accounting standards IFRS 15 - Revenues from Contracts with Customers, and IFRS 9 - Financial Instruments, which came into force as of January 1, 2018.
The main impacts deriving from their application were as follows:

- IFRS 15 - Revenues from Contracts with Customers: as a result of the application of this accounting standard, some amounts previously accounted for under costs and mainly related to variable considerations payable to indirect customers, and mainly linked to the achievement of sales targets, have been recorded as a reduction to revenues or other revenues, with insignificant impact. The restatement of these amounts did not alter the operating income or equity of the Group at the date of the transition (January 1, 2018);
- IFRS 9 - Financial Instruments: following the application of this standard, the Group's equity, at the date of the transition (January 1, 2018) decreased by euro 1,023 thousand, due to effect of the new model of impairment applied to financial receivables.

The Group has adopted the two principles retrospectively, taking into account the combined effects deriving from their first application to equity as of January 1, 2018. The comparative data for 2017 has not been subjected to restatement.

During the course of the third quarter of 2018, the inflation rate accumulated over the past three years in Argentina exceeded 100%. This, together with other characteristics of the country's economy led the Group to adopt, the accounting standard IAS 29 - Financial Reporting in Hyper-inflationary Economies - for the Argentine subsidiary Pirelli Neumaticos SAIC, as of July 1, 2018. As a result, the data for non-monetary assets and liabilities present in the financial statements has been re-evaluated to eliminate the distortionary effects due to the loss of purchasing power of the local currency. The inflation rate used for the purposes of implementing hyperinflation accounting corresponds to the consumer price index. The financial statements have been translated into Euro by applying the period-end exchange rates to the items of both the Statement of Financial Position and the Income Statement.

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The 2018 financial year results confirmed the resilience of the business model which is focused on the High Value segment, with an operating performance consistent with the targets for the financial year:

- Revenues which amounted to euro 5,194.5 million, (the 2018 target had been approximately euro 5.2 billion) with an organic growth of +3.7%, characterised by the strengthening of the leadership position in the high-end products range in all regions: an organic growth of +10.3% for High Value revenues, which represented approximately 64.0% of total sales;
- the EBIT *adjusted* equalled euro 955.0 million, (the 2018 target had been approximately euro 1 billion) with a growth of +9.0% compared to 2017 with a margin of 18.4% (+2.0 % on an annual basis). This improvement was supported by internal levers (price/mix, efficiencies, costs rationalisation) which more than offset the impacts of the external scenario (exchange rate volatility, increase in the cost of production factors) and the contraction in Standard segment sales;
- EBIT *adjusted without start-up costs* amounted to euro 1002,7 million (higher than euro 1 billion the target), a growth of +8.2%, thanks to the High Value segment which achieved a share of more than 83.0% of the EBIT;
- The net income (loss) related to continuing operations (Consumer) stood at euro 448.8 million, a growth of +70.5% compared to euro 263.3 million for 2017.
- The net financial (liquidity)/debt position, negative to the amount of euro 3,180.1 million, was an improvement of to the amount of euro 858.2 million compared to September 30, 2018 (due to the usual seasonality of

working capital) and to the amount of euro 38.4 million compared to December 31, 2017. The net financial position at the end of 2018 included approximately euro 140 million in financial investments advanced to the Joint Venture in China, as well as the impact of the slowdown/restructuring in Brazil which should foresee recovery by 2020. Consequently the net financial (liquidity)/debt position / EBITDA *adjusted without start-up costs* ratio stood at 2.49x (2.7x in 2017, the 2018 target had been 2.35x).

The main actions underlying these results can be summarised as follows:

- → **strengthening of the High Value segment** which represented 63.7% of revenues (up by +6.2% compared to 57.5% for 2017). High Value volumes recorded a growth of +11.0%, with an improvement in the market share for the Car New Premium segment (Pirelli sales volumes were up by +14.3% for Car tyres ≥18" compared to the +10.0% growth of the market). Of particular note was the growing demand for Specialties tyres with ≥18" rim diameters (*Run-flat, Pirelli Noise Cancelling System, Seal-Inside*) due to the continuous expansion of the homologations portfolio for these technologies (for 2018 approximately 46.0% of the 421 new High Value homologations were represented by Specialties); Volume growth for the High Value segment was more contained in respect of the target of ~+13% and was impacted by the contraction of the European Original Equipment market during the second quarter (-4.9% for the third quarter and -8.7% for the fourth quarter), following the introduction of the new CO2 emissions tests (WLTP) as of September 1st.;
- → **reduction of exposure on the Standard segment** with a -14.0% contraction in volumes driven by the progressive exit from products with a lower rim diameter and lower profitability, in context of the general slowdown of the Standard market. The increased contraction compared to the target of -12% was attributable to the deterioration of the market for the Standard segment in LatAm (-7.1% for 2018, -14.6% for the fourth quarter). The combination of High Value and Standard segment performances resulted in an overall change in volumes of -3.1%;(the target for 2018 was -2.0%);
- → **improvement in the price/mix component**: +6.8% for 2018 (the target for 2018 was +6.5%) due to the increasing proportion of the high end range, the progressive improvement of the product mix and channels, and the price increases put in place in emerging countries to offset the volatility of exchange rates;
- → **the acceleration of the efficiencies program as of the third quarter** (euro 70 million for the entire financial year, 1.3% of revenues) which more than offset costs inflation (euro -48 million). These programs involved industrial and product activities: from the optimisation of raw material costs and product simplification, to productivity improvement, thanks to the increasing digitalisation of processes.
- → **rapid implementation of costs recovery actions** (approximately euro 50 million mainly for marketing budgets and advertising costs, consultancy fees, and general and administrative expenses) in response to the worsening of market trends for the Standard segment in emerging countries, particularly in South America.

As regards the more specific programs, of note were:

- → **the strengthening of the partnership** with Prestige and Premium car manufacturers: 421 new High Value homologations during 2018, with a portfolio increasingly oriented towards new technologies which reached more than 2,480 high-end range homologations. During 2018, Pirelli intensified its collaborative relationships for the electric car with the major global Premium and Prestige car manufacturers and with the most innovative Chinese brands. These partnerships allow for the strengthening of Pirelli's positioning on the Replacement channel, generating a loyalty rate of over 80%;
- → **expansion of the High Value productive capacity mainly in Europe and NAFTA** and the conversion of the Standard segment capacity into High Value in Brazil, predisposing the processes and organisation of manufacturing plants to handle the growing complexity and ever-increasing rim diameters. During 2018, High Value capacity reached a 60.0% share of production, with an increase in the High Value capacity of 3 million units, of which 37.0% was due to conversion;
- → **increased distribution coverage mainly in Europe, NAFTA, and APAC** with a greater presence on the car dealer, retail client and Pirelli Tier 1 channels, where Pirelli exercises greater control and records higher sales. The volume share of these channels rose from 51.0% of volumes for 2017 to 57.0% for 2018;
- → the **development of business programs which intercept new end-customer needs** (such as Cyber and Velo), also through the collaboration with the Premium and Prestige Original Equipment channels. There was the continuation of projects for the **digital transformation of the Company, while the conversion of Aeolus brand production into Pirelli brand** production was completed in the manufacturing plant in Jiaozuo for the Car sector acquired from Aeolus. These activities were reflected in the sustainment of start-up costs of approximately euro 47.7 million during the 2018 financial year (euro 50.2 million for 2017).

The **Group's consolidated Financial Statements** are summarised as follows:

(In millions of euro)

	12/31/2018	12/31/2017
Net sales	**5,194.5**	**5,352.3**
EBITDA adjusted without start-up costs (°)	**1,279.1**	**1,175.1**
% of net sales	24.6%	22.0%
EBITDA adjusted (°°)	**1,234.7**	**1,137.7**
% of net sales	23.8%	21.3%
EBITDA	**1,097.4**	**1,044.5**
% of net sales	21.1%	19.5%
EBIT adjusted without start-up costs (°)	**1,002.7**	**926.6**
% of net sales	19.3%	17.3%
EBIT adjusted (°°°)	**955.0**	**876.4**
% of net sales	18.4%	16.4%
EBIT	**703.1**	**673.6**
% of net sales	13.5%	12.6%
Net income (loss) from equity investments	(5.0)	(6.9)
Financial income/(expenses)	(196.3)	(362.6)
Net income (loss) before tax	**501.8**	**304.1**
Tax expenses	(53.0)	(40.8)
Tax rate %	(10.6%)	(13.4%)
Net income (loss) related to continuing operations (Consumer)	**448.8**	**263.3**
Eanings/(loss) per share related to continuing operations (in euro per share)	0.44	0.31
Net income (loss) related to continuing operations (Consumer) adjusted	576.3	386.8
Net income (loss) related to discontinued operations (Industrial)	(6.4)	(87.6)
Total net income (loss)	**442.4**	**175.7**
Net income attributable to the Parent Company	431.6	176.4
Fixed assets related to continuing operations	**9,017.8**	**9,121.0**
Inventories	1,128.5	940.7
Trade receivables	628.0	652.5
Trade payables	(1,604.7)	(1,673.6)
Operating working capital related to continuing operations	**151.8**	**(80.4)**
% of net sales	2.9%	(1.5%)
Other receivables/other payables	34.3	(42.2)
Net working capital related to continuing operations	**186.1**	**(122.6)**
% of net sales	3.6%	(2.3%)
Net invested capital held for sale	**10.7**	**60.7**
Net invested capital	**9,214.6**	**9,059.1**
Equity	**4,550.9**	**4,177.0**
Provisions	1,483.6	1.663.6
Net financial (liquidity)/debt position	**3,180.1**	**3,218.5**
Equity attributable to the Parent Company	4,468.1	4,116.7
Investments in property. plant and equipment and intangible assets	463.4	489.4
Research and development expenses	219.0	221.5
% of net sales	4.2%	4.1%
Research and development expenses - High Value	202.9	199.9
% on sales High Value	6.1%	6.5%
Employees (headcount at end of period)	31,489	30,189
Industrial sites (number)	19	19

(°) Start-up costs refer to contribution to EBITDA and EBIT (amounting to euro 44.4 millions (euro 37.4 millions in 2017) and euro 47.7 millions (euro 50.2 millions in 2017) respectively) of the Cyber and Velo activities, the costs for the conversion of Aeolus brand Car products, and costs sustained for the digital transformation of the Group.
(°°) Adjustments refer to non recurring and restructuring expenses amounting to euro 91.5 millions (euro 93.2 millions in 2017), expenses relating to the retention plan approved by the Board of Directors on February 26, 2018 amounting to euro 13.3 millions and 2018 costs (i) relating to renegotiation of commercial agreements and royalties amounting to euro 14.2 millions and (ii) not pertinent to normal business operations amounting to euro 18.3 millions.
(°°°) Adjustments refer to amortization of intangible assets recognised as a consequence of Business Combinations amounting to euro 114.6 millions (109.6 millions in 2017) which are sumed to adjustments included in EBITDA adjusted.

For a better understanding of the Group's performance, the following **quarterly performance** information is provided.

(In millions of euro)

	1 Q		2 Q		3 Q		4 Q		TOTAL	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Net sales	**1,310.3**	1,339.3	**1,320.0**	1,346.0	**1,294.9**	1,353.2	**1,269.3**	1,313.8	**5,194.5**	5,352.3
yoy	-2.2%		-1.9%		-4.3%		-3.4%		-2.9%	
*organic yoy **	5.7%		5.3%		2.5%		1.0%		3.7%	
EBITDA adjusted without start-up costs	**298.0**	281.7	**310.3**	285.1	**328.0**	298.9	**342.8**	309.4	**1,279.1**	1,175.1
% of net sales	22.7%	21.0%	23.5%	21.2%	25.3%	22.1%	27.0%	23.5%	24.6%	22.0%
EBITDA adjusted	**288.1**	270.4	**299.8**	276.0	**319.8**	289.9	**327.0**	301.4	**1,234.7**	1,137.7
% of net sales	22.0%	20.2%	22.7%	20.5%	24.7%	21.4%	25.8%	22.9%	23.8%	21.3%
EBITDA	**282.4**	260.3	**290.4**	240.4	**312.2**	315.4	**212.4**	228.4	**1,097.4**	1,044.5
% of net sales	21.6%	19.4%	22.0%	17.9%	24.1%	23.3%	16.7%	17.4%	21.1%	19.5%
EBIT adjusted and without start-up costs	**229.4**	219.5	**243.9**	223.5	**258.8**	238.2	**270.6**	245.4	**1,002.7**	926.6
% of net sales	17.5%	16.4%	18.5%	16.6%	20.0%	17.6%	21.3%	18.7%	19.3%	17.3%
EBIT adjusted	**218.4**	205.0	**231.7**	211.2	**250.0**	226.0	**254.9**	234.2	**955.0**	876.4
% of net sales	16.7%	15.3%	17.6%	15.7%	19.3%	16.7%	20.1%	17.8%	18.4%	16.4%
EBIT	**184.0**	168.7	**193.7**	149.5	**213.7**	222.9	**111.7**	132.5	**703.1**	673.6
% of net sales	14.0%	12.6%	14.7%	11.1%	16.5%	16.5%	8.8%	10.1%	13.5%	12.6%

* before exchange rate effect, high inflation accounting in Argentina and adoption effect of new accounting standard IFRS 15

Net sales amounted to euro 5,194.5 million and recorded an organic growth of +3.7% compared to the previous financial year. The change in revenues equalled -2.9%, including the combined effect of exchange rates and the application of hyperinflation accounting in Argentina (a total of -5.9%), and the impact deriving from the application of the new accounting standard IFRS 15 (-0.7%).

High Value revenues for 2018 which amounted to euro 3,309.9 million, represented an organic growth of +10.3% (+7.5% including the negative exchange rate effect of -2.8%), which accounted for a 63.7% share of the total turnover (+6.2 p.p. compared to 2017).

(In millions of euro)

	2018	% of total	2017	% of total	Variation y/y	Variation y/y organic
High Value	3.309,9	63.7%	3,079.2	57.5%	7.5%	10.3%
Standard	1.884,6	36.3%	2,273.1	42.5%	-17.1%	-5.4%
Total net sales	**5.194,5**	**100.0%**	**5,352.3**	**100.0%**	**-2.9%**	**3.7%**

The following table shows the market **drivers for the net sales performance:**

	1 Q	2 Q	3 Q	4 Q	Cumulative 2018
Volume	-1.5%	-0.9%	-3.0%	-7.1%	-3.1%
Price/mix	7.2%	6.2%	5.5%	8.1%	6.8%
Change on a like-for-like basis	**5.7%**	**5.3%**	**2.5%**	**1.0%**	**3.7%**
Translation effect/High inflation Argentina	-7.3%	-6.6%	-6.1%	-3.4%	-5.9%
Adoption of new accounting standard IFRS 15	-0.6%	-0.6%	-0.7%	-1.0%	-0.7%
Total change	**-2.2%**	**-1.9%**	**-4.3%**	**-3.4%**	**-2.9%**

The performance for sales volumes for the 2018 financial year (-3.1%) reflected the differing trends between the High Value and Standard segments.

High Value volumes grew sharply: up by +11.0% during 2018 with an improvement in market share in all the main geographic regions. There was sustained growth for Car tyres with ≥18" rim diameters (+14.3% compared to the +10.0% growth of the market) thanks to:

→ strong demand in Europe, APAC and North America;
→ the growing demand for Pirelli Specialties with ≥18" rim diameters (*Run-flat, Pirelli Noise Cancelling System, Seal-Inside*).

The differential between the growth trend of the High Value segment and that of Car tyres ≥18" was attributable to the lower demand for ≤17" *Specialties*, in favour of those with higher rim diameters, and to the performance of the Premium motorcycle market (+1.8% for 2018 compared to +8.1% for 2017).

Volume growth for the high-end range during the fourth quarter was more contained (+7.2% for High Value volumes, +7.6% for Car tyres ≥18"), with an extremely positive performance in the Replacement channel, which recorded a growth of +15.6% for Car tyres ≥18", while the Original Equipment channel suffered an overall contraction of -1.2%, impacted in particular by the downturn in the European market following the introduction of the new CO_2 emissions tests (WLTP) as of September 1, 2018. These tests led to a different seasonality for the Original Equipment channel, with demand in Europe concentrated in the first half-year, and a market contraction as of the third quarter, continuing also into the fourth quarter.

There was an opposite trend on the Standard segment which recorded a contraction of -14.0% during 2018 and of -22.6% for the fourth quarter. This trend was impacted:

→ the fall in demand for Standard products in mature markets for the first quarter (Europe and NAFTA -5.7%);
→ market contractions in emerging countries, particularly in LatAm (-7.1% for the market in 2018 and -14.6% for the fourth quarter);
→ by Pirelli's decision to accelerate the reduction in volumes of lower profitability products.

Improvement of the price/mix: +6.8% for the entire 2018 financial year supported by the growing share of the High Value segment, by the improvement of the mix in the High Value Standard segment, and by the increase in prices in emerging markets to counter exchange rate volatility. The price/mix for the fourth quarter was higher (+8.1%), and mainly reflected the improvement in the product mix, the higher sales on the Replacement channel and the implementation of the price increases in the emerging markets.

The exchange rate effect was negative mainly for the currencies of emerging countries: -5.9% for the entire financial year, and -3.4% for the fourth quarter.

The apportionment of **net sales by geographic region** was composed as follows:

	2018				2017
	euro\mln	%	yoy	Organic Yoy*	%
Europa	2,234,2	43.1%	-0.2%	1.4%	41.7%
Nafta	1,004.1	19.3%	2.1%	7.6%	18.4%
Asia\Pacific (APAC)	890.2	17.1%	10.4%	13.3%	15.1%
South America	691.9	13.3%	-24.4%	-3.1%	17.1%
Middle East\Africa\India (MEAI)	207.1	4.0%	-16.8%	-6.6%	4.7%
Russia and CIS	167.0	3.2%	4.6%	15.5%	3.0%
Total	**5,194.5**	**100.0%**	**-2.9%**	**3.7%**	**100.0%**

* before exchange rate effect, high inflation accounting in Argentina and adoption effect of new accounting standard IFRS 15

Europe (43.1% of sales) closed the 2018 financial year with an organic growth in revenues of +1.4%, (-0.2% including the impact of both the exchange rate effect at -0.4%, and the impact deriving from the adoption of the new accounting standard IFRS 15 of -1.2%). The strengthening of the High Value segment continued, with an organic growth of +7.0%, which in the second half-year was impacted by a contraction in the Original Equipment market (-5.0% for the third quarter and -5.0% for the fourth quarter) following the introduction of the new WLTP CO_2 emissions tests, and the weakness of the Premium motorcycle market (-2.4% for 2018 compared to +3.3% for 2017). In this context, Pirelli improved its market share on the Car tyre ≥18" rim diameter market both on the Original Equipment channel, thanks to the expansion of the homologation portfolio with the Premium and Prestige producers, and on the Replacement channel, thanks to the pull-through effect.

The Standard segment recorded a negative performance with an organic contraction in revenues of -8.9%, due to:

- → the accelerated reduction of exposure to less profitable products in the presence of an unfavourable market situation, particularly during the first quarter (-5.7%);
- → the contraction in sales for 17" rim diameters on the Original Equipment channel in favour of higher rim diameters;

Profitability (Ebit *margin adjusted*) in the high-teens range increased by more than +1 p.p. compared to the previous financial year (mid-teens), mostly due to the continued improvement of the mix and to costs efficiencies.

NAFTA (19.3% of sales) recorded an organic growth in revenues of +7.6% (+2.1% including the negative exchange rate effect of -4.5% and the impact deriving from the new accounting standard IFRS 15 (negative at -1.0%), driven by the High Value segment (an organic growth of +9.3%) and in particular by the growth sustained on the Replacement channel thanks to the introduction of *All-Season* products. Profitability (Ebit *margin adjusted*) improved by more than +1 p.p. and was again at twenties level, thanks to the increased share of the high-end range and to the progressive strengthening of the US Dollar.

APAC (17.1% of sales) was the region with the highest growth and profitability (an EBIT *margin adjusted* in the twenties range), which was a decisive improvement compared to the previous financial year. Revenues recorded an organic grew of +13.3% (growth of +10.4% including the negative exchange rate effect of -2.9%), driven by the High Value segment (an organic growth in revenues of +21.0%), thanks to:

- → increased exposure on the Original Equipment channel which counted new supplies and homologations with European and local brands;
- → increased market share for the Replacement channel thanks to the pull-through effect and an ever wider commercial presence which counted over 4,500 points of sale.

Sales on the Standard segment contracted with an organic change of -8.0%, with a fall in sales for ≤17" rim diameters, in context of the weakness of the market for that segment.

South America (13.3% of sales) recorded an organic change in revenues of -3.1% (-24.4% including the exchange rate effect and the adoption of inflation accounting in Argentina totalling a negative -21.1%, and a negative impact of -0.2% deriving from the application of the new IFRS 15), mainly due to the drop in volumes of -14.8% as a result of:

- → the weakness of the market (-6.8% for the total car market in 2018, -14.4% for the fourth quarter with a -15.5% contraction on the Replacement channel and -9.1% in the Original Equipment market);
- → the continuing focus on the mix, with the progressive reduction of sales of less profitable Standard segment products with lower rim diameters;
- → the destination of a portion of production for export to North America in view of the growing demand for High Value Pirelli products and the progressive growth of the mix recorded by the Brazilian factories;

A trend of marked improvement for the price/mix (+11.7% for the financial year, +23.8% for the fourth quarter), thanks to the increase on prices in Brazil which occurred in fourth quarter, and to the strong improvement of the product mix.

Profitability (Ebit *margin adjusted*) was in the high-single-digits range, representing a decrease compared to 2017. This trend was impacted by:

- → the aforementioned contraction in volumes;
- → the impact of the application, as of the third quarter of 2018, of high inflation accounting in Argentina;
- → the increased cost of raw materials rendered more expensive by unfavourable exchange rates.

These impacts were partly offset by the improvement in the mix, by higher efficiencies and costs structure actions (actions on purchases, advertising and marketing budgets, consultancy, travel expenses and other general expenses) for approximately euro 20 million in response to the difficult external environment.

MEAI (4.0% of sales) recorded a negative organic change in revenues of -6.6% (negative at -16.8% including the exchange rate effect) due to the reduction in volumes mainly on the Standard segment of lower and less profitable rim diameters, in an unfavourable market; profitability (Ebit *margin adjusted*) in the low-teens range had recorded a contraction compared to 2017, impacted by the impairment of exchange rates particularly in Turkey.

In **Russia** (3.2% of sales) the strategy of focusing on the more profitable segments plus the recovery of the market impacted favourably on the results for 2018, with an organic growth in revenues of +15.5% (a growth of +4.6% including the negative exchange rate effect of -10.9%) with significant improvement in profitability (an EBIT *margin adjusted* in the high-teens range, compared to the low-teens range for 2017).

EBIT *adjusted without start-up costs* amounted to euro 1,002.7 million, representing a growth of +8.2% and euro 76.1 million in absolute values compared to the previous financial year (euro 926.6 million). The EBIT *margin adjusted* without start-up costs stood at 19.3%, a growth of +2 p.p. compared to 2017. Start-up costs which equalled euro 47.7 million (euro 50.2 million the previous financial year) were relative to

- → the Cyber business which continued the development of the *Cyber Car* and *Cyber Tyre Development Kit* technologies, dedicated to Original Equipment Premium and Prestige customers, those dedicated to the world fleet (*Cyber Fleet*), and new consumer solutions to be launched in 2019;
- → the *Velo* business, whose range has been expanded with the introduction of new Road Racing products (*Cinturato Velo*) and a line of products dedicated entirely to electric bikes (*Cycl-e*). the growing success of the business, which is expected to break-even in 2019, and saw confirmation in the collaborations for the Original Equipment channel launched with Premium bicycle manufacturers in the course of 2018 (e.g., Pinarello);
- → the conversion of Aeolus brand production into Pirelli brand production in the manufacturing plant in Jiaozuo for the Car sector which was completed in 2018;
- → the digital transformation of the Company which, following the positive results of the activities already under way, was intensified to support the long-term efficiency program and to deal with the growing complexity of the business. The greater resources allocated to this activity led to an increase in start-up costs by euro 8 million compared to the financial year target of euro 40 million.

EBIT *adjusted* equalled euro 955.0 million, representing an annual growth of +9.0% and euro +78.6 million in absolute values compared to the previous financial year (euro 876.4 million), with a margin of 18.4%, an improvement of +2 p.p. compared to 2017. The improvement in the results was attributable to the effect of internal levers (price mix, efficiencies and the costs reduction program) which more than offset the impacts linked to the deterioration of the external scenario (raw materials, exchange rate effect and inflation) and the contraction in sales volumes on the Standard segment.

In more detail:

- → the improvement in the price/mix (euro 239 million) more than offset the impact deriving from the

- increase in raw materials prices (euro -52 million), exchange rate volatility (euro -43 million), as well as the aforementioned decline in sales volumes (euro -68 million);
- a positive balance of euro 22 million, between industrial efficiencies (euro 70 million, 1.3% of revenues) and costs inflation (euro -48 million);
- the cost reduction plan of euro 50 million, launched during the second half-year of 2018 to counter the decline in sales on the Standard segment especially in Brazil, contributed in reducing the increase in amortisation and depreciation and other costs linked to the development of the High Value segment (euro -71 million);
- start-up costs were slightly less (an impact of euro +2.5 million on the EBIT, which went from euro -50.2 million euro for 2017 to euro -47.7 million for 2018).

(In millions of euro)

	1 Q	2 Q	3 Q	4 Q	Total
2017 EBIT Adjusted	**205.0**	**211.2**	**226.0**	**234.2**	**876.4**
- Internal levers:					
Volumes	(8.0)	(4.5)	(16.5)	(39.3)	(68.3)
Price/mix	62.7	50.1	47.0	78.9	238.7
Amortisation, depreciation and other costs	(21.4)	(15.9)	4.8	11.7	(20.8)
Start-up costs	3.5	0.1	3.4	(4.5)	2.5
Efficiencies	9.0	10.0	23.6	27.5	70.1
- External levers:					
Cost of production factors (commodities)	(13.8)	2.3	(12.7)	(27.8)	(52.0)
Cost of production factors (labour/energy/others)	(11.4)	(11.9)	(14.1)	(10.9)	(48.3)
Foreign currency translation	(7.2)	(9.7)	(11.5)	(14.9)	(43.3)
Total change	**13.4**	**20.5**	**24.0**	**20.7**	**78.6**
2018 EBIT adjusted	**218.4**	**231.7**	**250.0**	**254.9**	**955.0**

The **EBIT** which amounted to euro 703.1 million (compared to euro 673.6 million for 2017) included:

- the amortisation of intangible fixed assets identified during the Purchase Price Allocation of euro 114.6 million (euro 109.6 million for 2017).
- non-recurring and restructuring expenses to the amount of euro 91.5 million (euro 93.2 million for 2017), for which further details are provided below;
- costs not pertinent to normal business operations to the amount of euro 18.3 million;
- costs for the renegotiation of commercial agreements and royalties to the amount of euro 14.2 million, of which euro 9 million was attributable to the extraordinary reshaping of the technology license agreement granted to the Aeolus Tyre Co. Ltd, a related party to the Group;
- expenses relative to the retention plan approved by the Board of Directors on February 26, 2018 to the amount of euro 13.3 million.

In particular, the non-recurring and restructuring expenses included:

- restructuring costs totalling euro 67.5 million of which euro 47.3 million in costs attributable to rationalisation measures for the structures of the Standard business launched at the end of 2018, and which will continue throughout the 2019-2020 two year period in addition to euro 20.2 million mainly due to the impairment of tangible and intangible fixed assets, consistent with the reduction in the Standard segment capacity;
- non-recurring costs of euro 24 million, mainly attributable to the adjustment of the value of pension funds in the UK following a change in the method for calculating the Guaranteed Minimum Payment (euro 14.4 million).

The impact on the net income of non-recurring and restructuring expenses was substantially offset by the benefits of the Patent Box (euro 89 million for the 2015-2018 four-year period).

The **net income from equity investments** was negative at euro -5 million (a loss of euro -6.9 million for 2017), and comprised:

- the pro-rata share of the loss attributable to the Indonesian Joint Venture PT Evoluzione Tyres (euro -10.4 million) evaluated using the equity method;
- a positive net income (euro 3.7 million) deriving from the positive change in fair value recorded by Mediobanca shares up until the date of disposal (January 11, 2018);
- dividends received during the financial year to the amount of euro 4.2 million.

Net financial expenses which fell by euro 166.3 million (from euro 362.6 million for 2017 to euro 196.3 million for 2018) mainly reflected:

- lower interest by approximately euro 84.9 million, for the most part due to the lower cost of the main bank credit facility signed in June 2017 compared to the old bank loan, as well as the reduction of debt thanks also to the share capital increase by Marco Polo of approximately euro 1.2 billion which took place in June 2017;
- the favourable comparison between the (not-yet-amortised) wash down of fees of euro 61.2 million included for 2017, and the amount of euro 3.6 million for 2018, respectively relative to the old bank loan which was repaid in advance in June 2017, and to the bond placed by Pirelli International Plc (for the amount of euro 600 million, with a fixed coupon of 1.75% and original maturity in November 2019) which was repaid early in March 2018;
- the almost neutral balance between the positive effect deriving from the repricing of the Group's main bank credit facility which occurred in January 2018, and the expenses arising from the early extinction of the bond placed by Pirelli International Plc (for the amount of euro 600 million with a fixed coupon of 1.75% and original maturity in November 2019) carried out in March 2018 through the exercise of the so-called make-whole option;
- lower interest on local product lines, due to a mix of interest rate cuts, and the reduction of indebtedness in countries with a high interest rate.

The cost of debt on an annual basis (last 12 months) stood at 3.37%, (2.95% net of repricing impacts), compared to 5.36% at December 31, 2017.

Tax expenses for 2018 amounted to euro 53 million against pre-tax earnings of euro 501.8 million with a tax rate which stood at 10.6%. The tax rate for 2018 was positively impacted by the benefit derived from the application of the concessions of the Patent Box tax relief scheme in accordance with the preliminary agreement signed on October 15, 2018 with the Italian Tax Office. This benefit, which equalled approximately euro 89 million (euro 54 million for the three-year 2015-2017 period and euro 35 million in estimated benefits for 2018), substantially offset non-recurring and restructuring expenses.

The **net income related to continuing operations (Consumer)** amounted to euro 448.8 million compared to earnings of euro 263.3 million for 2017, a growth of +70.5%.

The **net income related to continuing operations (Consumer)** ***adjusted*** amounted to euro 576.3 million compared to euro 386.8 million for 2017.

The following table shows the calculation of the net income (loss) related to continuing operations (Consumer) *adjusted*:

(In millions of euro)

	2018	2017
Net income (loss) related to continuing operations	**448.8**	**263.3**
Amortisation of intangible assets included in PPA	114.6	109.6
Non-recurring and restructuring expenses	91.5	93.2
Expenses relating to renegotiation of commercial agreements and royalties	14.2	-
Expenses not pertinent to normal business operations	18.3	-
Retention plan	13.3	-
Net financial expenses	2.1	61.2
Tax	(126.5)	(140.5)
Net income (loss) related to continuing operations adjusted	**576.3**	**386.8**

The net income (loss) related to discontinued operations which included the financial data for 2018 of some residual Industrial activities in China and Argentina, was negative to the total amount of euro 6.4 million, and whose separation has for the most part been completed.

The **total net income** was positive to the amount of euro 442.4 million compared to the positive amount of euro 175.7 million for the previous financial year.

The **net income attributable to the Parent Company** amounted to euro 431.6 million compared to the positive result of euro 176.4 million for 2017.

Equity went from euro 4,177.0 million at December 31, 2017 to euro 4,550.9 million at December 31, 2018.

Equity attributable to the Parent Company at December 31, 2018 equalled euro 4,468.1 million compared to euro 4,116.7 million at December 31, 2017.

This change is shown in the table below:

(In millions of euro)

	Group	Non-controlling interests	Total
Equity at 12/31/2017	**4,116.7**	**60.3**	**4,177.0**
Adoption of new accounting standard IFRS9	(1.0)	-	(1.0)
Translation differences	(82.3)	0.9	(81.4)
Net income (loss)	431.6	10.8	442.4
Actuarial gains/(losses) on employee benefits	28.7	-	28.7
Dividends paid	-	(8.4)	(8.4)
Transacions with minorities	(36.3)	19.0	(17.3)
High inflation accounting Argentina	26.2	-	26.2
Other	(15.5)	0.2	(15.3)
Total changes	**351.4**	**22.5**	**373.9**
Equity at 12/31/2018	**4,468.1**	**82.8**	**4,550.9**

The reconciliation statement for the equity attributable to the Parent Company and the consolidated equity attributable to the Shareholders of the Parent Company is shown below:

(In millions of euro)

	Share Capital	Treasury reserves	Net income (loss)	TOTAL
Equity of Pirelli & C. S.p.A. at 12/31/2018	**1,904.4**	**2,325.9**	**262.4**	**4,492.7**
Net income (loss) of consolidated companies (before consolidation adjustments)	-	-	434.4	434.4
Share capital and reserves of consolidated companies (before consolidation adjustments)	-	4,108.6	-	4,108.6
Consolidation adjustments:				
- carrying amount of equity investments in consolidated companies	-	(4,570.9)	-	(4,570.9)
- intercompany dividends	-	281.3	(281.3)	-
- others	-	(12.8)	16.1	3.3
Consolidated equity of Group at 12/31/2018	**1,904.4**	**2,132.1**	**431.6**	**4,468.1**

The **net financial (liquidity)/debt position** was negative to the amount of euro 3,180.1 million compared to euro 3,218.5 million at December 31, 2017. It was composed as follows:

(In millions of euro)

	12/31/2018	12/31/2017
Current borrowings from banks and other financial institutions	800.1	559.2
Current derivative financial instruments	53.5	11.2
Non-Current borrowings from banks and other financial institutions	3,929.1	3,897.1
Non-Current derivative financial instruments	13.8	55.0
Total gross debt	**4,796.5**	**4,522.5**
Cash and cash equivalents	(1,326.9)	(1,118.5)
Securities held for trading	-	(33.0)
Other financial assets at fair value through Income Statement	(27.2)	-
Current financial receivables and other assets**	(27.4)	(36.5)
Current derivative financial instruments	(91.2)	(21.4)
Net financial debt *	**3,323.8**	**3,313.1**
Non-Current derivative financial instruments	(20.1)	-
Non-current financial receivables and other assets**	(123.6)	(94.6)
Total net financial (liquidity)/debt position	**3,180.1**	**3,218.5**

* Pursuant to Consob Notice of July 28, 2006 and in compliance and in compliance with ESMA/2013/319 Recommendations
** The amount of "financial receivables and other assets" is reported net of the relative impairment amounting to euro 6,1 million.

The **structure of the gross financial debt**, which amounted to euro 4,796.5 million, was as follows:

(In millions of euro)

	12/31/2018	Maturity date				
		2019	2020	2021	2022	2023 and beyond
Use of unsecured financing ("Facilities")	2,643.9	-	939.5	-	1,704.4	-
Bond EURIBOR +0,70% - 2018/2020	199.6	-	199.6	-	-	-
Bond 1,375% - 2018/2023	546.6	-	-	-	-	546.6
Schuldschein	523.4	-	-	81.8	-	441.6
EIB loans	10.0	10.0	-	-	-	-
ISP short term borrowing	200.0	200.0	-	-	-	-
Other loans	673.0	643.7	7.9	2.7	16.7	2.0
Total gross debt	**4,796.5**	**853.7**	**1,147.0**	**84.5**	**1,721.1**	**990.2**
		17.8%	*23.9%*	*1.8%*	*35.9%*	*20.6%*

At December 31, 2018, the Group had a liquidity margin equal to euro 2,054.1 million composed of euro 700.0 million in the form of non-utilised committed credit facilities, and euro 1,326.9 million in cash, in addition to financial assets carried at fair value recognised in the Income Statement to the amount of euro 27.2 million.

The performance for **cash flows for the financial year** was as follows:

(In millions of euro)

	2018					2017
	1 Q	2 Q	3 Q	4 Q	Total	Total
EBIT adjusted	218.4	231.7	250.0	254.9	955.0	876.4
Amortisation and depreciation (excluding PPA amortization)	69.7	68.1	69.8	72.1	279.7	261.3
Investments in property, plant and equipment and intangible assets	(85.3)	(93.9)	(117.5)	(166.7)	(463.4)	(489.4)
Change in working capital/other	(928.8)	(68.9)	(247.4)	856.9	(388.2)	123.8
Operating net cash flow	**(726.0)**	**137.0**	**(45.1)**	**1,017.2**	**383.1**	**772.1**
Financial income/(expenses)	(55.2)	(62.8)	(20.8)	(57.5)	(196.3)	(362.6)
Taxes paid	(31.1)	(36.2)	(33.8)	(17.9)	(119.0)	(135.5)
Financial (investments) / disinvestments	155.0	0.2	-	-	155.2	23.2
Caçula purchase from Brasilian controlled distribution	-	-	-	(1.4)	(1.4)	-
Acquisition of non-controlling interests	(18.5)	-	-	-	(18.5)	(15.4)
Cash Out for non-recurring and restructuring expenses/other	(38.2)	(11.9)	(4.6)	(17.3)	(72.0)	(63.8)
Other dividends paid	-	-	(8.4)	-	(8.4)	(12.9)
Acquisition of JV China	-	-	-	(65.2)	(65.2)	-
Minorities	-	-	-	-	-	(5.5)
Differences from foreign currency translation/other	(11.7)	6.4	(18.7)	14.8	(9.2)	0.7
Net cash flow before extraordinary transactions	**(725.7)**	**32.7**	**(131.4)**	**872.7**	**48.3**	**200.3**
Industrial reorganization	5.3	(10.3)	9.6	(14.5)	(9.9)	304.6
Share capital increase subscribed by Marco Polo	-	-	-	-	-	1,189.4
Net cash flow	**(720.4)**	**22.4**	**(121.8)**	**858.2**	**38.4**	**1,694.3**

More specifically, the **operating net cash flow** for 2018 was positive to the amount of euro 383.1 million (compared to euro 772.1 million for 2017).

The operating cash flow was impacted by:

- investments of euro 463.4 million (euro 489.4 million for 2017) which were primarily aimed at increasing the capacity of the High Value segment in Europe and the NAFTA area, at the strategic conversion of the capacity of the Standard segment into High-Value in Brazil, and to the continuous improvement of the quality and mix of all manufacturing plants.
- the change in working and other capital (euro -388.2 million in cash absorption in 2018).

The performance of working and other capital was mainly impacted by:

- the realignment of factoring at historic levels compared to those of 2017;
- the increase in inventories, mainly attributable to the Standard segment, even after the strong slowdown in sales in LatAm. The level of inventories at the end of 2018 was equal to 21.7% of sales; the Company has launched a plan to normalise this phenomenon, to realign inventories to a level below 20.0% of revenues for 2019;
- the temporary renegotiation of the terms of collection for some dealers in Brazil, given the difficult macroeconomic environment, which will continue for the course of the 2019 financial year;
- the usual financing of pension fund deficits.

Total cash flow, was positive to the amount of euro 38.4 million, and mainly included:

- cash outflow relative to the balance of financial income and expenses (euro 196.3 million) and tax expenses (euro 119 million);
- restructuring expenses to the amount of euro 21 million and non-recurring expenses to the amount of euro 50 million (of which euro 31 million was for advisory costs and fees relative to the IPO process which took place in 2017);
- the impact of transactions on equity investments which occurred during the financial year, including the disposal of the investment in Mediobanca (euro +152.8 million), the acquisition of 49.0% of the new JV in China (euro -65.2 million) and the completion of the strengthening of the distribution chain in Brazil (euro -19.9 million).

Research and development activities

The research and development activities carried out by Pirelli constitute a central phase for the development of new products. The Research and Development department - which dedicates strong attention to technological innovations - counts approximately 1,932 personnel (equal to 6.1% of the Group's human resources) between the Milan headquarters and the 12 technology centres located in various geographical areas, and which allow for a direct relationship with the major car manufacturers. Pirelli's model for research and development, implemented in accordance with the *"Open Innovation"* model, is carried out through a series of collaborations with partners who are external to the Group - such as suppliers, universities and car manufacturers - in order to pre-empt technological innovations for the sector and to direct research and development activities towards meeting the needs of the end consumer.

Research and development expenses for the 2018 financial year totalled euro 219.0 million, (equal to 4.2% of sales) of which euro 202.9 million was destined for High Value activities (equal to 6.1% of High Value revenues).

Pirelli also continued to develop their *CYBER™* technologies which, thanks to the sensor technology inside the tyre, will contribute in making information available from time to time in order to increase the safety or performance of vehicles. At the Geneva Motor Show, Pirelli presented their 2018 *CYBER CAR™*, the new system for Original Equipment which allows for the interaction between tyre and car. Pirelli also completely renewed their *Cyber Fleet*, the system for the monitoring and management of fleet tyres, presented at the 67th edition of the IAA Commercial Vehicles Motor Show in Hannover in 2018.

PRODUCT INNOVATION

In order to develop new products specifically designed to meet the needs and technical specifications of customers, Pirelli has established long-lasting relationships with major Prestige and Premium car manufacturers. The development of the product together with these car manufacturers is geared towards producing tyres that match the dynamic characteristics and electronics of the car (the so called perfect fit). Pirelli is the absolute leader of the Prestige segment with a market share which in excess that of 50% on the Original Equipment channel, and is also the leader in supplying to brands such as Aston Martin, Bentley, Ferrari, Porsche, and Maserati, and is the sole supplier to Lamborghini, McLaren and Pagani Automobili. With Premium, instead, there was further proof of the privileged relationship with companies such as Alfa Romeo, Audi, BMW, Mercedes, Jaguar and Land Rover. In addition, in 2018 Pirelli was honoured by the Ford Motor Company with the Gold World Excellence Award.

Pirelli's strong presence is proven by a portfolio of approximately 3,100 homologations, of which, approximately 2480 are High Value (80.0%), and more than 770 are linked to specialties. In particular, Pirelli can count on a portfolio of over 500 homologations for *Run Flat* products, a technology that allows you to drive with a perforated tyre long enough to reach the nearest tyre supplier for a replacement. Amongst the brands that have chosen to homologate their vehicles with Pirelli *Run Flat* are Alfa Romeo, BMW, Cadillac, Dodge, Jeep, Mercedes and Mini. Pirelli *Run Flat* technology is available on *P Zero, Cinturato, Scorpion* and *Scorpion Winter, Winter Sottozero 3* and *Winter Sottozero Serie II* tyres. It is a range that is able to satisfy 97% of rim diameters from 18" and upwards. Also during 2018, homologations for Pirelli tyres with PNCS technology (Pirelli Noise Cancelling System) doubled compared to the previous financial year, exceeding 150 (there were 78 at the end of 2017). This technology, which reduces the noise perceived within the vehicle by up to 25%, is increasingly requested by car manufacturers, especially in the Premium and Prestige segments, in order to offer greater comfort to car occupants.

During 2018, the Pirelli Scorpion Winter tyre received prestigious awards from German magazines *Auto Bild Allrad, Off Road* and *Auto Zeitung*. Designed specifically to maximize the safety and performance of modern SUVs and CUVs, especially from the Premium range, since its launch in 2012, the *Scorpion Winter* tyre has confirmed itself as the leader in its category. Available with the main Specialties, the Pirelli *Scorpion Winter* tyre is chosen by many manufacturers and has already registered 131 homologations of which 110 are marked on 46 different car models. In addition, as confirmation of the relevance of its characteristics, it has won homologations for new electric vehicles, as well as for the sportiest versions of SUVs on the market, including Alfa Romeo Stelvio Quadrifoglio and Lamborghini Urus.

In 2018 Pirelli achieved a new record lap time at the Nürburgring-Nordschleife circuit for the eighth consecutive year. A result obtained thanks to the *P Zero Trofeo R* fitted to the Lamborghini Aventador SVJ. During the course of the financial year, Pirelli returned to making tyres for vintage cars, by creating a new tyre for the *Collezione* family: the *Stella Bianca*. The Stelvio Corsa, designed specifically for the 1962 Ferrari 250 GTO, was also presented. Thanks to the most up-to-date and advanced technologies, Pirelli *Collezione* tyres offer improved grip and better adherence on wet surfaces, guaranteeing reliability and high levels of safety, without losing the original style.

In the world of motorcycles - by taking advantage of the experience gained in fifteen years as the Official Tyre Supplier for all classes of the FIM World Superbike Championship - Pirelli has put the best technologies and patents developed to date to good use in designing the *DIABLO ROSSO™ CORSA II*, the new tyre derived from racing technology but designed for use on the road and on the track, to meet the requirements of increasingly more powerful motorcycles. Presented by Pirelli to the international press at the beginning of April 2018 in South Africa, the *DIABLO ROSSO™ CORSA II* emerged the victor in comparative performance reviews for hypersport tyres organised by the prestigious German magazines *MOTORRAD* and *PS Das Sport-Motorrad Magazin*, and the Italian online magazine *Red-live.it.*

The collaboration between Pirelli and MV Agusta, has generated the latest limited edition jewel by MV Agusta and Pirelli Design, the *Dragster 800 RR PIRELLI*, whose world premiere came about at the inauguration of the new *P Zero™ World of Monte Carlo* store and which is fitted with the *DIABLO™ Supercorsa SP*. Pirelli The tank and windshield are made of a rubber specially formulated by Pirelli Research and Development technicians to ensure superior resistance to scratches and other impacts.

Pirelli was selected by Yamaha as the tyre supplier also for the fifth edition of the *Yamaha VR46 Master Camp*, the track training sessions organised by Yamaha Motor's Iwata Factory in Japan together with Valentino Rossi's VR46 Riders Academy.

In May Pirelli signed a collaboration agreement with *Consorzio Ente Autodromo Pergusa* for the modernisation of the historic Sicilian track which will bolster experimentation and development activities at the site.

In the *Velo* world, Pirelli announced its partnership with the prestigious Italian bicycle manufacturer Pinarello, which means that Pirelli will supply its *P Zero™ Velo* for 100% of the Pinarello Dogma F10 series, Pinarello's flagship model. A Pirelli tyre knows how to offer optimal performance, balanced on all fronts, for rolling resistance, wet grip, dry grip, handling, puncture resistance and durability, proving itself capable of meeting the high-performance needs of the Dogma F10. The 2018 year also saw the launch of, the *Cinturato™ Velo* product line, a reinforced tyre, thanks to the new (patent pending) *Armor Tech™* technology created specific for cycling, which can be used with and without an inner tube, and offers extreme reliability in all, even the most adverse road conditions.

NEW MATERIALS

The Group is active in the development of new polymers in order to improve the characteristics of tyres in terms of rolling resistance, low temperature performance, mileage and road grip. In addition, the Group's business focuses on the development of other non-polymeric materials, such as; high dispersion silica for wet grip, rolling resistance and mileage; biomaterials such as lignin and plasticisers/resins of vegetable origin; nano-fillers for more stable compounds, lighter structures and linings with elevated waterproof qualities; new silica surfactants to ensure performance stability and processability and; vulcanisers and stabilisers that allow for the development of tyres with low environmental impact and high performance. The Group has entered into cooperation agreements with various international and national institutions and universities. These agreements – which include numerous research projects with the University of Milano-Bicocca, as part of the Consortium for Advanced Materials Research (CORIMAV), and through the Silvio Tronchetti Provera Foundation - allow for the development of innovative materials and solutions which are fundamental to the development of tyres with reduced environmental impact and high performance. The Joint Labs agreement between Pirelli, and the Politecnico di Milano, established in 2011 for research and training in the tyre sector, is aimed at the development of innovative materials and technologies for sustainable and increasingly safe mobility. The most recent phase of the agreement, with a three year (2017-2020) duration, focuses on two main areas of research: the area for designing innovative materials and the area for product and Cyber development.

PROCESS AND PRODUCTIVITY INNOVATION

In order to allow for the effective management of the diverse ranges of products in the factories, the Group has launched the *"Smart Manufacturing"* program based on Big Data analytics techniques which flank the consolidated Lean Manufacturing programs, to improve production and maintenance processes, machine productivity and product quality, also from a predictive perspective, despite a significant reduction in the size of production batches. During 2018, of note was the involvement of the Feira de Santana, State of Bahia, (Brazil) factory in the Smart Manufacturing and Flexible Factory program, which has already led to its transformation into a real 4.0 factory, a technology hub for the production of High Value tyres in South America, as was already under way also for the Campinas plant in the state of Sao Paolo. By being at the vanguard of processes and product development, the Bahia hub, in this way contributes to the goal of constant improvement in production efficiency in the Pirelli world. Its digitalisation process has brought Smart Manufacturing to the factory, allowing it to improve its results with the use of Big Data and the ability to intervene faster in solving problems. Also, the digitalisation of information and the intersection of collected data not only enables machinery to provide feedback on the performance of an ongoing process, but to also anticipate the results (feed forward) as well as any potential problem on the basis of historical data (machine learning). The use of cloud computing, open source tools and online programs that analyse data to make future predictions, in fact, are the other essential elements which address the complexity and speed of the manufacturing world, and which make the Bahia factory one of Pirelli's most technologically advanced manufacturing locations.

COMMITTENT TO MOTORSPORTS

Pirelli has extended its presence in F1 as the Global Tyre Partner until 2023. The new agreement foresees for the introduction of the new 18" tyres in 2021. Their involvment in the Formula 1™® World Championship has allowed Pirelli to develop new simulation models which allow for the further reduction of the time it takes to launch a product on the market, and to improve the quality of road product design, rendering them better performing and compliant with the highest of requirements. The *P Zero™* 2019 range comes in only three colours (even if they comprise more compounds), the same used for racing Championships. The three colours are white, yellow and red and correspond to hard, medium and soft tyres respectively. The *Cinturato* will have the same colours as for 2018, being intermediate (green) and for extreme wet (blue). The idea behind this change was to make the tyres more easily recognisable, even at television level, while also clearly indicating which specific compounds are used in each race.
Pirelli is now engaged in over 460 championships across all five continents. The different programs range from open competitions, in some cases with over 20 manufacturers represented, to the single-brand trophies of world brand such as the Ferrari Challenge and the Lamborghini Super Trofeo. In order to understand the enormous commitment of Pirelli to Motorsport, just think that all these events translate into 1,170 races per year, all over the world, which employ approximately 1,000 people between engineers, track technicians and other personnel dedicated to Research and Development. In the European two wheel Championships which foresees the participation of several tyre producers, Pirelli on average fits 70% of the motorcycles deployed on the paddock, thereby confirming the appreciation demonstrated by motorcycle riders around the world for the Pirelli brand. Thanks to its involvement in the FIM Superbike World Championship, Pirelli has during the course of the season developed new increased sizes for the *DIABLO™ Superbike*. As for the engraved product *DIABLO™ Supercorsa* which is used in all the other classes of World Championship racing, Pirelli has worked all season to develop the new product, now in its third generation. Finally, in the field of cycling, in 2018

Pirelli and Mitchelton-Scott, a World Tour professional team ranked second in the UCI ranking, announced a technology partnership. During the 2018 Tour de France, the Australian team exclusively fitted their Scott bicycles with Pirelli *P ZERO™ Velo* tyres.

Parent company highlights

The table below shows a summary of the main Income Statement and Statement of Financial Position figures.

(In millions of euro)

	12/31/2018	12/31/2017
Operating Income (loss)	5.6	(50.9)
Financial income/(expenses)	(32.8)	(123.4)
Net income (loss) from equity investments	284.9	204.4
Income taxes	4.7	140.8
Net profit/(loss)	**262.4**	**170.9**
Financial assets	4,641.7	4,803.1
Net Equity	**4,492.7**	**4,238.4**
Net financial position	1,913.8	2,363.0

Operating income was positive to the amount of euro 5.6 million compared to the loss of the previous financial year equal to euro 50.9 million. The improvement was mainly attributable to advisory costs and fees incurred to the amount of euro 62 million relative to the IPO process which took place in 2017.

The reduction in **financial expenses** was mainly attributable to the following factors:

- → the favourable comparison compared to the previous financial year, which included euro 42 million in the not-yet-amortised wash down of fees relative to the bank loan that was repaid in advance in June 2017;
- → the positive effect deriving from the repricing of the Group's main bank credit facility which occurred in January 2018 to the amount of euro 12.4 million;
- → the lower cost of debt.

The net income from equity investments **mainly includes the dividends of** Pirelli Tyre S.p.A. (euro 270 million compared to euro 200 million for 2017).

For 2018 **taxes** were positive to the amount of euro 4.7 million compared to the positive amount of euro 140.8 million for the previous financial year. The significant change was mainly attributable to the detection during the 2017 financial year of deferred tax assets on tax losses carried forward, surplus interest payables which had not been deducted, and the ACE tax concession (Economic Growth Aid).

The following is a summary of the values of the main **financial assets:**

(In millions of euro)

		12/31/2018	12/31/2017
	Equity investments in subsidiaries		
	- Pirelli Tyre S.p.A.	4,523.8	4,521.8
	- Pirelli Ltda	9.7	9.7
	- Pirelli & C. Ambiente S.r.l.	-	2.0
	- Pirelli UK Ltd.	21.9	21.9
	- Pirelli Group Reinsurance Company S.A.	6.3	6.3
	- Pirelli Servizi Amministrazione e Tesoreria S.p.A.	3.2	3.2
	- Other companies	3.4	3.4
A	**Total equity investments in subsidiaries**	**4,568.3**	**4,568.3**
	Equity investments in associates and other financial assets		
	- Eurostazioni S.p.A. - Roma	6.3	6.3
	- Fenice S.r.l.	-	2.5
	- Focus Investments S.p.A.	-	1.4
	- Mediobanca S.p.A. - Milano	-	149.0
	- RCS Mediagroup S.p.A. - Milano	28.4	30.2
	- Fin. Priv Srl	15.6	19.9
	- Fondo Comune di Investimento Immobiliare Anastasia	15.6	15.3
	- Istituto Europeo di Oncologia S.r.l.	7.0	6.6
	- Other companies	0.5	3.6
B	**Total equity investments in associates and other financial assets at fair value through other comprehensive income**	**73.4**	**234.8**
A+B	**Total financial assets**	**4,641.7**	**4,803.1**

Equity increased from euro 4,238.4 million to euro 4,492.7 million:

(In millions of euro)

Equity at 12/31/2017	**4,238.4**
Net income (loss) for the financial year	262.4
Gains/(losses) recognised directly in Equity	(8.1)
Equity at 12/31/2018	**4,492.7**

The table below shows the **composition of equity** at December 31, 2018 and the comparison with the previous financial year:

(In millions of euro)

	12/31/2018	12/31/2017
Share capital	1,904.4	1,904.4
Legal reserve	380.9	380.9
Reserve premium	630.4	630.4
Concentration reserve	12.4	12.4
Other reserves	92.5	92.5
IAS Reserve	13.0	29.4
Reserve for cash flow hedges and relative tax effects	(7.7)	(5.4)
Retained earnings	181.5	-
Merger Reserves	1,022.9	1,022.9
Net income (loss) for the financial year	262.4	170.9
Total Equity	**4,492.7**	**4,238.4**

Risk factors and uncertainty

The volatility of the macroeconomic environment, the instability of the financial markets, the complexity of management processes and the continuous legislative and regulatory changes demands the capacity to protect and maximise the tangible and intangible sources of value that characterise the corporate business model. Pirelli has adopted a proactive risk governance model, which through the systematic identification, analysis and assessment of risk areas is able to provide the Board of Directors and Management with the instruments needed to anticipate and manage the effects of these risks. The Pirelli Risk Model systematically assesses three categories of risk:

1. **External risks**
   These are risks which occur outside the sphere of influence of the company. This category includes risks related to macroeconomic trends, to the evolution of demand, to competitor strategies, to technological innovation, to the introduction of new regulations, and to country-specific risks (financial, security related, political and environmental risks) as well as the impacts linked to climate change.
2. **Strategic Risks**
   These are risks which are typical for a specific business sector of which the proper management is a source of competitive advantage, or on the contrary, the cause for the failure to achieve financial objectives. This category includes risks linked to markets, to product innovation and development, to human resources, to raw material costs, to production processes, and to financial risks and risks connected to merger and acquisition operations.
3. **Operational Risks**
   These are risks generated by the organisation and by corporate processes, whose occurrence do not necessarily result in any kind of competitive advantage. These types of risks include Information Technology, Business Interruption, Legal & Compliance, Health, Safety & Environment, and Security related risks.

At cross roads to the aforesaid risks are **corporate social responsibility risks, environmental and business ethics risks.**

These are risks associated with the non-compliance with local and international regulations, best practices and corporate policies regarding the respect for human and labour rights, and environmental and business ethics, and can be generated by the organisation either as part of the relative value chain or as part of the supply chain. These risks in turn can lead to reputational risks. Reputational risks are linked to actions or events that could cause a negative perception of the company on the part of its major stakeholders. The main areas of risk in this category are, in addition to the aforementioned risks related to corporate social-environmental responsibility and business ethics, also to those risks inherent to leadership, and the quality and level of product innovation.

EXTERNAL RISKS

RISKS ASSOCIATED WITH GENERAL ECONOMIC CONDITIONS AND CHANGING DEMAND IN THE MEDIUM TERM

Pirelli expects a weakening of the world economy during 2019. These expectations are based on a possible slowdown in international trade, being weighed down a possible exacerbation of United States and China tensions and the uncertainty surrounding Brexit. To this is added a possible deceleration of the American economy, mainly caused by a more restrictive monetary policy and the lesser benefits deriving from recent fiscal policies, together with a weakening of the growth prospects of the Eurozone. The high degree of political uncertainty caused by the growing tensions between key European Union countries will in fact have a detrimental effect on investments and, more generally, on the confidence of businesses and consumers. Regarding the emerging market space, the progressive normalisation of US monetary policy will continue to represent a significant risk both in terms of exchange rate volatility and the cost of sovereign and corporate debt issued in foreign currencies.

COUNTRY RISK

Where appropriate, Pirelli has adopted a local-for-local strategy, creating a productive presence in rapidly developing countries in order to respond to the local demand with competitive industrial and logistical costs. This strategy is aimed at increasing the competitiveness of the Group, as well as allowing the Group to overcome potential protectionist measures (customs barriers or other measures such as technical prerequisites, product certification, and administrative costs relative to import procedures, etc.) In context of this strategy, Pirelli operates in countries (Argentina, Brazil, Mexico and Russia) where the general economic and political situation and tax regimes may prove unstable in the future. Elements of uncertainty persisted with the growing tension between China and the United States and, more generally, on the medium-long term equilibrium of the current international trade agreements, which could lead to an alteration of the normal market dynamics and, more generally, of business operating conditions. The Group constantly monitors the evolution of risks (political, economic/financial and security related) relative to the countries in which it operates in order to continue to adopt timely (and if possible advance) measures to mitigate the potential impacts of any changes arising at local level. Moreover, in situations of under-utilisation of the capacity of some factories, the reallocation of production between Group plants is possible.

RISKS TIED TO A HARD BREXIT

The Group has pro-actively activated a working group whose goals were to assess potential critical areas, in the case of a hard Brexit, both in terms of macroeconomic (amongst other FX volatilities and duties) as well as operational risks - mainly due to possible delays in the supply of raw materials and/or finished products - and to carry out mitigation strategies aimed at reducing possible negative impact. Although the most likely scenario continues to point to the orderly withdrawal of the United Kingdom from the EU, the fact that the British government failed, at least as at the date of the drafting of the budget - to ratify the *"withdrawal agreement"* with the European Union, which would allow both parties to enter a transitional period until the end of 2020, has undoubtedly increased the odds of a hard Brexit.

RISKS RELATED TO CHANGES IN DEMAND IN THE LONG TERM

Over the last few decades, certain social and technological trends have emerged that might potentially have a material impact in the medium-long term on the automotive sector, and indirectly on the tyre market. On the one hand, these are represented by the growing phenomena of urbanisation (according to the latest United Nation estimates, approximately 70% of the global population will live in urban areas by 2050) and on the other hand, by changes in the values and behaviour of younger generations (increase in the average age when a driver's license is obtained, loss of importance of owning a car, increased use of various types of car sharing). Added to these factors is the increasing spread of information technologies which increasingly encourages the use of e-commerce and/or telecommuting along with frequent regulatory interventions, both in the mature as well as emerging economies, aimed at limiting the presence of polluting vehicles within and near metropolitan areas. These dynamics may give rise to a change in automotive sector demand (from changes to vehicle dimensions/engines which take different types of fuel/power supply, to the possible resizing of the car in accordance with the transportation preferences of citizens), with a potential impact on the dynamics of the tyre sector. Pirelli constantly monitors the evolutionary trends in automotive sector demand both by participating in national and international conferences on the topic, and by working on specific projects together with other major players in the world of mobility such as the SiMPlify project sponsored by the World Business Council for Sustainable Development (WBCSD) which has been active since 2013. The principal aim of such projects is in fact to study the possible long-term evolution of urban mobility and to promote solutions that might improve the social, environmental and financial well-being of the urban population.

RISKS RELATED TO CLIMATE CHANGE

In accordance with what emerged from the last *Climate Change Risk Assessment* of the Group, there are no significant risks in relation to production processes or the markets where Pirelli operates over the short to medium-term horizon. On the other hand, as regards a medium-long term scenario, the tyre sector could be subject to a number of risks both of a physical nature (extreme weather events), as well as of a regulatory nature. Pirelli monitors these elements of uncertainty through sensitivity and risk assessment analysis. Opportunities related to climate change were highlighted in terms of growth in the sales of Pirelli Green Performance products, which feature tyres with a lower environmental impact during their life cycle.

RISKS RELATED TO PRICE TRENDS AND THE AVAILABILITY OF RAW MATERIALS

Natural rubber, synthetic rubber and raw materials related to oil (in particular chemicals and carbon black) will continue to be a factor of uncertainty within the Group's cost structure, given the strong volatility recorded in recent years and their impact on the cost of the finished product.
For the main raw materials purchased by the Group, possible price scenarios are constantly simulated in relation to the historical volatility and/or the best information available on the market (e.g. forward prices). On the basis of the different scenarios, any increases in sales prices and/or the different internal actions, for the recovery of cost efficiencies (use of alternative raw materials, reduction of the weight of the product, improvement of the processing quality and reduction of the levels of waste), which are necessary to guarantee the expected levels of profitability are identified.

RISKS LINKED TO THE COMPETITIVE POSITIONING OF THE GROUP AND TO THE COMPETITIVE DYNAMICS OF THE SECTOR

The market in which the Group operates is characterised by the presence of numerous operators, some of which have significant financial and industrial resources with brands that enjoy a significant level of international or local notoriety. To date, Pirelli is the only player in the tyre industry that focuses entirely on the consumer market on a global scale, with a single brand positioned in the segment of interest for manufacturers and users of Prestige and Premium vehicles. The intensification of the level of competition in the sector in which the Group operates could, in the medium-long term, impact on its income, equity and financial situation. The high barriers to entry - both technological and productive - provide structural mitigation to the potential tightening of the competitive arena in the Group's segment of reference. To this is also be added the uniqueness of the Pirelli's strategy which rests - amongst other things - on a wide homologation-based parc focused on the Prestige and Premium segments and an ever increasing capacity focused on the High Value segment.

STRATEGIC RISKS

EXCHANGE RATE RISK

The diverse geographical distribution of Pirelli's productive and commercial activities entails the exposure to exchange rate risks such as transaction risk and translation risk.

Transaction risk is generated by transactions of a commercial and financial nature carried out by individual companies in currencies other than the functional currency, due to fluctuations in exchange rates between the time when the commercial/financial relationship originates and the time when the transaction is settled (collection/payment).

The Group's policy is to minimise the impact of transaction risk linked to volatility, and for this reason the Group's procedures provide that the Operating Units are responsible for collecting all the relevant information pertaining to positions subject to transaction risk (mainly represented by receivables and payables in foreign currency). Coverage is then provided in the form of forward contracts which are entered into where possible with the Group's Treasury.

The positions subject to exchange rate risk are mainly represented by receivables and payables in foreign currency. The Group's Treasury is responsible for hedging the resulting net position for each currency and, in accordance with the established guidelines and restrictions, it in turn provides for the closure of all risk positions by trading derivative hedging contracts on the market, typically forward contracts.

Furthermore, as part of the one year and three year planning process, the Group formulates exchange rate forecasts on the basis of the best available information on the market. Any fluctuation in an exchange rate between the time of planning and the time when a commercial or financial transaction originates, results in a translation risk on future transactions. From time to time the Group assesses the opportunity to engage in currency hedging on future transactions for which it typically makes use of either forward buy or sell operations, or optional operations such as risk reversal (for example, zero cost collars).

Pirelli owns controlling interests in companies that prepare their Financial Statements in currencies other than the Euro which is the currency used to prepare the consolidated Financial Statements. This exposes the Group to currency translation risk, due to the conversion into Euro of the assets and liabilities of subsidiaries operating in other currencies. The main exposures to currency translation risk are constantly monitored and at present it has been decided not to adopt specific hedging policies for these exposures.

LIQUIDITY RISK

The principal instruments used by the Group to manage the risk of insufficient available financial resources to meet the financial and commercial obligations within the terms and deadlines established, are its one year and three year financial plans and its treasury plans, in order to allow for the complete and correct detection and measurement of incoming and outgoing cash flows. The differences between the plans and the final data are constantly analysed.

The Group has implemented a centralised system for the management of collections and payments in compliance with various local currency and tax regulations. Banking relationships are negotiated and managed centrally, in order to ensure coverage for short and medium-term financial needs at the lowest possible cost. Even the procurement of medium and long-term resources on the capital market is optimised through centralised management.

The prudent management of the aforementioned risk requires the maintenance of an adequate level of cash or cash equivalents and/or highly liquid short-term securities, plus the availability of funds obtainable through an adequate amount of committed credit facilities and/or recourse to the capital market.

In addition to the available portion of the committed credit facility (*Revolving Credit Facility*) for a total euro 700 million which at December 31, 2018 resulted as being completely unused, the Pirelli Group has resorted to the capital market to diversify both products and maturities in order to seize the best opportunities available from time to time.

INTEREST RATE RISK

Interest rate risk is represented by exposure to the variability of the fair value or of the future cash flows of financial assets or liabilities due to changes in market interest rates.

The group assesses, on the basis of the market circumstances, whether to enter into derivative contracts, typically interest rate swaps and cross currency interest rate swaps, for hedging purposes for which hedge accounting is activated when the conditions set forth in the IFRS 39 are met.

PRICE RISK ASSOCIATED WITH FINANCIAL ASSETS

The Group was exposed to price risk only regarding the volatility of financial assets such as listed and unlisted stock securities and bonds, which represented 0.7% of the total assets of the Group. Derivatives are not normally set up to limit the volatility of these assets.

CREDIT RISK

Credit risk represents the Group's exposure to potential losses resulting from the non-fulfilment of the commercial and financial obligations undertaken by counterparties. As regards these commercial counterparties, in order to limit this risk, Pirelli has implemented procedures to evaluate customer potential and financial creditworthiness, to monitor expected collection flows and to take credit recovery action if and when necessary. The aim of these procedures is to define customer credit limits, whereby in the event that those limits are exceeded, the rule to withhold further supplies is activated. In some cases customers are asked to provide guarantees. These mainly consist of bank guarantees issued by parties of the highest credit or personal standing. Less frequently, mortgage guarantees may be requested.

Other instruments used for commercial credit risk management is the taking out of insurance policies. As of January 2012, the company signed a master agreement which expired in December 2018, with a leading insurance company for worldwide coverage for credit risk mainly related to sales on the Replacement channel (with an approximate 75% acceptance rate at December 2018).

Insurance coverage has been extended to also cover the two year 2019-2020 period. At December 31, 2018, the amount of trade receivables remained essentially consistent with that at closing the previous financial year. The Group operates only with highly rated financial counterparties for the management of its temporary cash surpluses or for trading in derivative instruments. Pirelli does not hold public debt instruments from any European country, and constantly monitors its net credit exposure to the banking system, and does not show significant concentrations of credit risk.

RISKS ASSOCIATED WITH HUMAN RESOURCES

The Group is exposed to the risk of loss of resources in key positions or in possession of *"critical know how"*. To address this risk, the Group adopts remuneration policies periodically updated also based on changes in the general macroeconomic scenario as well as on the basis of salary benchmarks. Also planned are long-term incentive plans and specific non-competition agreements (also with retention effect) designed amongst other things, to fit the risk profiles of the activities related to the business.

Finally, specific management policies have been adopted to motivate and retain talent.

OPERATIONAL RISKS

RISKS RELATED TO ENVIRONMENTAL ISSUES

The activities and products of the Pirelli Group are subject to numerous environmental laws that vary between the countries where the Group operates. These regulations have in common their tendency to evolve in an ever more restrictive manner, also due to the growing concern of the international community over the issue of environmental sustainability. Pirelli expects the gradual introduction of ever stricter laws in relation to the various environmental aspects on which companies may impact (atmospheric emissions, waste generation, impacts on soil and water use, etc.), by virtue of which the Group expects to have to continue to make investments and/or incur costs that may be significant.

EMPLOYEE HEALTH AND SAFETY RISKS

In carrying out its activities the Pirelli Group incurs expenses and costs for the measures necessary to ensure full compliance with the obligations pursuant to regulations regarding health and safety in the workplace. Particularly in Italy the law relating to health and safety in the workplace (Legislative Decree No. 81/08) and subsequent amendments, (Legislative Decree No.106/09) have introduced new obligations that have impacted on the management of activities at Pirelli sites, and on the models for allocating liabilities.

Failure to comply with current health and safety regulations entails criminal and/or civil penalties at the expense of those responsible, and in some cases, the penalties for the violation of regulations are borne by the Companies themselves in accordance with a European model of objective liability for companies incorporated in Italy (Legislative Decree No. 231/01).

DEFECTIVE PRODUCT RISK

As with all manufacturers of goods for sale to the public, Pirelli is subject to potential liability claims related to any alleged defects of the materials sold or may be required to launch recall campaigns for products. Although in recent years there have been no significant cases and such events are however covered from an insurance point of view, any occurrence could have a negative impact on the reputation of the Pirelli brand. For this reason, the tyres manufactured by Pirelli are subjected to careful quality analysis before being placed on the market. The entire production process is subject to specific quality assurance procedures aimed at safety, as well as at constantly elevated performance.

LITIGATION RISKS

In carrying out its activities, Pirelli may become involved in legal, fiscal, trade or labour law disputes. The Group adopts the necessary measures to prevent and mitigate any penalties that may result from such proceedings.

RISKS RELATED TO INFORMATION SYSTEMS AND NETWORK INFRASTRUCTURE

The supporting role of ICT (Information and communication technology) systems for business processes, their evolution and development, and for the Group's operating activities was also confirmed during the course of the 2018 financial year as being fundamental to the achieving of results. Pirelli has mainly worked towards the prevention and mitigation of risks connected to possible system malfunctions through high reliability solutions for the protection of the corporate information assets, through the enhancement of the security systems against unauthorised access, as well as of the business data management solutions. At the application level Pirelli has intervened in terms of system adaptation to both comply with local regulations (the Electronic Invoicing in Italy and Hungary, and Electronic Payments in Mexico) and to ensure the most recently released updates (Upgrade of Payroll Italy and SAP systems). Particular attention has been paid to the renewal of infrastructural componentry characterised by technological obsolescence which could entail a greater risk of breakdowns and incidents which could impact on the Group's activities. In particular:

- Network Security solutions were optimised, as regards both internet access and interaction with the rest of the Pirelli network, in public Clouds (Azure, AWS and AliCloud), in order to improve system protection and governance.
- The Virtual Private Clouds (VPC) required for the business in the Azure and AliCloud environment were implemented in compliance with the Group's security policies.
- The work continued to bring the Server and Client environments into compliance through the constant and progressive updating of the operating systems in order to reduce their vulnerabilities.
- The new Disaster Recovery solution was activated, which substantially reduces recovery times and limits any loss of data to a minimum.
- The infrastructures for saving corporate data resident on user PCs and on central systems were optimised to reduce the risk of information loss.
- The work continued on the segregation of the factory networks within the various locations of the Group, and with the implementation of protective solutions to the level of individual machinery.

BUSINESS INTERRUPTION RISKS

The territorial fragmentation of the operating activities of the Group and their interconnection, expose it to risk scenarios that could cause the interruption of business operations for more or less prolonged periods, with the consequent impact on the operational capabilities and results of the Group itself.

Risk scenarios related to natural events or accidents (fires, floods, earthquakes, etc.), to wilful misconduct (vandalism, sabotage, etc.), to breakdowns of the auxiliary plants or to the interruption of the supply of utilities can, in fact, cause significant property damage, and the reduction and/or interruption of production, particularly if the event concerns high volume or specific product (high-end) production sites. Pirelli monitors their vulnerability to catastrophic natural events (in particular flood, hurricane and earthquake) with estimates of any potential damage (based on the given probability of occurrence) for all the Group's production sites. The analyses confirm the adequate monitoring of business interruption risks, thanks to a complex series of security measures, systems of prevention of harmful events and the mitigation of potential impacts on the business, also in light of the current business continuity plans as well as the insurance policies in place to cover property damage and any business interruptions which the Group's production facilities might suffer (the Group's insurance coverage may however not be sufficient in compensating all potential losses and liabilities in case of catastrophic events). Even Pirelli's supply chain is subject to regular assessment concerning the potential risk of business interruption in the qualification phase of new Tier-1 raw materials suppliers.

RISKS RELATIVE TO THE FINANCIAL REPORTING PROCESS

Pirelli has also implemented a specific and articulated system of risk management and internal control, supported by a dedicated information technology application, with regard to the process of preparing the half-year, annual, separate and consolidated Financial Statements, in order to safeguard the company's assets, compliance with laws and regulations, the efficiency and effectiveness of corporate operations, as well as the reliability, accuracy and timeliness of financial reporting.

In particular, the process of preparing financial reports takes place through the appropriate administrative and accounting procedures that have been drawn up in accordance with criteria established by the Internal Control - Integrated Framework issued by the Committee of Sponsoring Organisations of the Tradeway Commission.

The administrative/accounting procedures for the preparation of Financial Statements and all other financial reports are prepared under the responsibility of the Chief Financial Officer, who periodically attests to (in any case, regarding the Financial Statements/consolidated Financial Statements) their adequacy and effective application.

In order to enable the attestation by the Chief Financial Officer, the companies and the relevant processes that feed and generate the data for the Income Statement, the Statement of Financial Position or the Financial Statements have been mapped out. The identification of companies that belong to the Group and the relevant processes is carried out annually on the basis of quantitative and qualitative criteria. The quantitative criterion involves the identification of the Group companies which, in relation to the selected processes, represent an aggregate value which exceeds a certain threshold of materiality.

The qualitative criteria involve the examination of processes and companies which, in the opinion of the Chief Executive Officer may present potential areas of risk despite not falling within the aforesaid quantitative parameters.

For each selected process, the risk/control objectives associated with the preparation of the Financial Statements and any related disclosures, as well as to the effectiveness/efficiency of the internal control system in general, have been identified.

For each control objective, specific verification procedures have been implemented and specific responsibilities have been assigned.

A supervisory system has been implemented on the controls carried out by way of a mechanism of chain attestations. Any problems that emerge within the evaluation process are subject to action plans whose implementation is verified in subsequent closings.

The quarterly issue of a declaration of the reliability and accuracy of the data supplied for the purposes of preparing the Group's consolidated Financial Statements is also ultimately provided by the Chief Executive Officer and the Chief Financial Officer of each subsidiary.

In the lead up to the dates of the Board of Directors' Meeting which approve the consolidated data at June 30 and December 31st, the results of the verification procedures are discussed by the Chief Financial Officer of the Group companies and the Chief Financial Officer.

The Internal Audit Department performs regular audits aimed at verifying the adequacy of the design and effectiveness of the controls aimed at the subsidiaries, as well as the sampling procedures, selected on the basis of materiality criteria.

REPUTATIONAL RISK AND CORPORATE SOCIAL-ENVIRONMENTAL RESPONSIBILITY

REPUTATIONAL RISKS

Pirelli has developed an ad hoc digital tool for the identification, measurement and management of reputational risk, which is measured in terms of the probability of occurrence and impact on reputation. Reputational risk is understood as a current or prospective risk that might result in a loss in gains and affect the propensity to buy due to a negative perception of the Company by one or more stakeholders. While on the one hand, reputational risk is construed as a possible consequence of the occurrence of an adverse event related to one of the three aforementioned macro-risk families, on the other hand it is managed as an independent event precisely because its scope depends on the expectations of the stakeholders concerned, as well as the impact of the negative event. The chosen methodology has led to the identification of a specific set of reputational risks. This mapping emerges from the analysis of a series of internal and external drivers including: negative events with an impact on reputation which have occurred in the sector worldwide over the last ten years; interviews with external Key Opinion Leaders on sector trends, aspects of mobility and sustainability; interviews with internal Key Opinion Leaders with particular reference to the analysis of the probability of the occurrence of the risks identified.

The risk events identified were then subjected to the qualitative-quantitative assessments of a sample representative of the general public in the three key Pirelli countries, which led to the definition of the governance and management structures and the preparation of mitigation and/or crisis management plans.

RISKS RELATIVE TO CORPORATE SOCIAL AND ENVIRONMENTAL RESPONSIBILITY, BUSINESS ETHICS, AND THIRD-PARTY AUDITS.

Risk management at Pirelli is enterprise-wide and includes the identification, analysis and monitoring of environmental, social, economic/financial and business ethics risks that are directly or indirectly attributable to the company, through Pirelli affiliates or from within relations with them, such as the sustainability of the supply chain.

Before entering a specific market, ad hoc assessments are carried out in order to assess any political, financial, environmental and social risks, including those connected with human and labour rights.

Together with the ongoing monitoring of the application of Pirelli's internal requirements regarding financial, social (particularly regarding human and labour rights), environmental and business ethics on Group sites, which occurs through periodic audits performed by the Internal Audit Function, Pirelli has adopted an ESG (environmental and social governance) risk mitigation strategy also with respect to its own supply chain, which is periodically audited by specialised third party companies. In both cases, where non-compliances are found, it is envisaged that a re-compliance plan is conceived whose implementation is promptly monitored by the auditing body.

Outlook for 2019

(In millions of euro)

	2018	2019
Revenues	5,194.5	~+4%/+6%
Weight of High Value on revenues	*64%*	*~67%*
Volumes	-3.10%	0/+1%
Volumes High Value	*+11%*	*~+11%*
Volumes Standard	*-14%*	*-10%/-9%*
Price/Mix	+6.8%	+5%/+5.5%
Forex	-5.9%	-1%/-0.5%
Ebit margin adjusted	18.4%	~19%
Start-up costs	48	~40
Net financial position/Ebitda Adjusted without start-up costs	2.49X	~2.1X
CapEx	463	~430

The outlook data for 2019 reflects the strategy of focusing on the High Value segment and the acceleration of the reduction of exposure to the Standard segment. The data also already takes into account the marginal effect of the reshaping of some of the terms of the license agreements with the Prometeon Tyre Group and Aeolus.

The forecasts for 2019 are for:

- revenues to increase by between +4.0% and +6.0% compared to the euro 5,194.5 million recorded for 2018, supported by the strengthening of the High Value segment (a 67.0% share of revenues compared to 64.0% in 2018) and by the continuous improvement of the price/mix (+5.0%/+ 5.5%);
- High Value volumes to increase by approximately +11.0%, plus further acceleration of the reduction of exposure to the Standard segment (volumes -10.0/-9.0%);
- total volumes: between 0.0% and +1.0% compared to 2018;
- an exchange rate effect of approximately -1.0%/-0.5%;
- growth in profitability with an EBIT *margin adjusted* of approximately 19.0% (18.4% for 2018) supported by the improvement in internal levers (price/mix, costs efficiencies);
- a High Value segment share of approximately 85.0% of the EBIT *adjusted without start-up costs* (approximately 83.0% for 2018).
- *start-up costs* of approximately euro 40 million (euro 47.7 million for 2018) destined to strengthen the Company's digital transformation program, the continuous development of Cyber solutions and the start-up of new Joint Venture production activities in China;
- reduced indebtedness with a ratio, between the net financial position and the EBITDA *adjusted without start-up costs* of approximately 2.1x[8] compared to 2.49x at the end of 2018;
- investments equal to approximately euro 430 million, consistent with the 2018 figure.

Pirelli has confirmed its *"less than 2 times"* 2020 target for the ratio between the net financial position and the EBITDA *adjusted* forecast by the Industrial plan presented during the IPO. The other forecasts contained in these Financial Statements will be updated - and are therefore to be considered obsolete - by the fourth quarter of the financial year with the presentation of a new plan with a time span of up until 2022 and which reflects, the new economic scenario, the continuation of a more accelerated reduction of Standard volumes, compared to the original plan whose impacts will be mainly offset by the tax relief benefits of the Patent Box, and the strengthening of transformation programs (decomplexity, cost containment and digital transformation) in order to support the greater development of the High Value segment.

8 Excluding the impact of the new accounting standard IFRS 16

Significant events subsequent to the end of the financial year

No significant events occurred since the end of the year.

Alternative performance indicators

This document, in addition to the financial measures as provided for by the International Financial Reporting Standards (IFRS), also includes measures derived from the latter even though not provided for by the IFRS (Non-GAAP Measures). These measures are presented in order to allow for a better assessment of the results of Group operations and should not be considered as alternatives to those required by the IFRS.

In particular, the Non-GAAP Measures used were as follows:

- **EBITDA:** is equal to the EBIT excluding the depreciation and amortisation of property, plant and equipment and intangible assets. The EBITDA is used to measure the ability to generate earnings from operations, excluding the impact of investments;
- **EBITDA *adjusted*:** is an alternative measure to the EBITDA from which are excluded, the non-recurring and restructuring expenses, the expenses relative to the retention plan approved by the Board of Directors on February 26, 2018; and for the 2018 financial year only, costs relative to the renegotiation of commercial agreements and royalties, and costs not pertinent to normal business operations;
- **EBITDA *adjusted without start-up costs*:** is equal to the EBITDA *adjusted* but excludes the contribution to the EBITDA (*start-up costs*) of the Cyber and Velo activities, the costs for the conversion of Aeolus brand car products, and costs sustained for the digital transformation of the Group. The EBITDA *adjusted without start-up costs* is an alternative measure to the EBITDA *adjusted* but which excludes start-up costs;
- **EBITDA *margin*:** is calculated by dividing the EBITDA by revenues from sales and services (net sales). This measure is used to evaluate operational efficiency, excluding the impacts arising from investment activities;

- **EBITDA *margin adjusted*:** is calculated by dividing the EBITDA adjusted by revenues from sales and services (net sales). This measure is used to evaluate operational efficiency, excluding the impacts arising from investments, the operating costs attributable to non-recurring and restructuring expenses, the expenses relative to the retention plan approved by the Board of Directors on February 26, 2018 and, for the 2018 financial year only, costs relative to the renegotiation of commercial agreements and royalties, and costs not pertinent to normal business operations;
- **EBITDA *margin adjusted without start-up costs*:** is calculated by dividing the EBITDA *adjusted without start-up costs* by revenues from sales and services (net sales). This is an alternative measure to the EBITDA *margin adjusted* but which excludes start-up costs;
- **EBIT:** is an intermediate measure, which is derived from the net income (loss) but which excludes the net income (loss) from discontinued operations, taxes, financial income, financial expenses and the net income (loss) from equity investments. The EBIT is used to measure the ability to generate earnings from operations, including the impact arising from investment activities;
- **EBIT *adjusted*:** is an alternative measure to the EBIT from which are excluded the depreciation and amortisation of property, plant and equipment and assets recognised as a consequence of Business Combination, the non-recurring and restructuring expenses, the expenses relative to the retention plan approved by the Board of Directors on February 26, 2018 and, for the 2018 financial year only, costs relative to the renegotiation of commercial agreements and royalties, and costs not related to the normal operational management of the business.
- **EBIT *adjusted without start-up costs*:** is equal to the EBIT *adjusted* but excludes the contribution to the EBIT (*start-up costs*) of the Cyber and Velo activities, the costs for the conversion of Aeolus brand Car products, and costs sustained for the digital transformation of the Group. The EBIT *adjusted without start-up costs* is an alternative measure to the EBIT *adjusted* but which excludes start-up costs;
- **EBIT *margin*:** is calculated by dividing the EBIT by revenues from sales and services (net sales). This measure is used to evaluate operational efficiency;
- **EBIT *margin adjusted*:** is calculated by dividing the EBIT *adjusted* by revenues from sales and services (net sales). This measure is used to evaluate operational efficiency, but excludes the amortisation of intangible assets relative to assets recognised as a consequence of Business Combinations, the operating costs attributable to non-recurring and restructuring expenses, the expenses relative to the retention plan approved by the Board of Directors on February 26, 2018 and, for the 2018 financial year only, costs relative to the renegotiation of commercial agreements and royalties, and costs not related to the normal operational management of the business;
- **EBIT *margin adjusted* without start-up costs:** is calculated by dividing the EBIT *adjusted without start-up* costs by revenues from sales and services (net sales). This is an measure to the *EBIT margin adjusted* but which excludes start-up costs;
- **Net income (loss) related to continuing operations (Consumer) *adjusted*:** is calculated by excluding the following items from the net income (loss) from continuing operations;
  - the amortisation of intangible assets relative to assets recognised as a consequence of Business Combinations, the operating costs attributable to non-recurring and restructuring expenses, the expenses relative to the retention plan approved by the Board of Directors on February 26, 2018; and, for the 2018 financial year only, costs relative to the renegotiation of commercial agreements and royalties, and costs not related to the normal operational management of the business;
  - non-recurring income/costs recognised under financial income and expenses;
  - non-recurring income/costs recognised as a tax item, as well as the tax impact relative to the adjustments referred to in the previous points.

  This is used to measure net profitability, excluding the impact of the items referred to in the previous points.

- **Fixed Assets related to continuing operations:** this measure is constituted of the sum of the items, *"Property, plant and equipment"*, *"Intangible assets"*, *"Investments in associates and joint ventures"* and *"Other financial assets carried at fair value recognised under other items in the Statement of Comprehensive Income", and "Other financial assets carried at fair value recognised in the Income Statement"* (*"Other financial assets"* with reference to comparative data at December 31, 2017). Fixed assets related to continuing operations represents non-current assets included in the net invested capital;
- **Net Operating working capital related to continuing operations:** this measure is constituted by the sum of *"Inventory"*, *"Trade receivables"* and *"Trade payables"*; This measure is used to measure the financial equilibrium of commercial activities.
- **Net working capital related to continuing operations:** this measure consists of the net operating working capital and other receivables and payables not included in the *"Net financial liquidity/(debt) position"*. The measure represents short-term assets and liabilities included in the "*Net invested capital*", and is used to measure short-term financial equilibrium;
- **Net invested capital assets available for sale:** this measure is constituted by the difference between *"Assets available for sale"* and *Liabilities available for sale"*. Net invested capital assets available for sale is used to measure net assets relative to assets available for sale;
- **Net invested capital:** this measure is constituted by the sum of (i) fixed assets related to continuing operations, (ii) net working capital related to continuing operations, and (iii) net invested capital assets available for sale. Net invested capital is used to represent the investment of financial resources;
- **Average net invested capital:** this measure consists of the average between the net invested capital at the beginning and at the end of the period, excluding investments in associated companies and Joint Ventures, *"Other financial assets at carried fair value recognised in the Statement of Comprehensive Income"*, and *"Other non-current financial assets carried at fair value recognised in the Income Statement"* (other financial assets refer to the comparative data at December 31, 2017) and the intangible assets relative to assets recognised as a consequence of Business Combinations. This measure is used to calculate the ROI;
- **Provisions:** this measure is constituted by the sum of *"Provisions for liabilities and charges (current and non-current)"*, *"Employee benefit obligations (current and non-current)"* and *"Provisions for deferred taxes*. The item provisions represents the total amount of liabilities due to obligations of a probable but not certain nature;
- **ROI:** is calculated as the ratio between the EBIT *adjusted* and the average net invested capital. ROI is used as to measure the profitability of invested capital;
- **Net financial debt:** calculated pursuant to CONSOB Communication No. 6064293 of July 28, 2006 and in compliance with Recommendations ESMA/2013/319. Net financial debt represents the debt position towards banks and financial institutions net of cash and cash equivalents, other current financial assets carried at fair value recognised in the Income Statement (or "*Securities held for trading"* with reference to comparative figures at December 31, 2017) and "*Current financial receivables"* (included in "*Other receivables"*) and current derivative financial instruments included in the item *"Net financial position"* (included under *"Current assets as derivative financial instruments");*
- **Total net financial (liquidity) debt position**: is calculated as net financial debt less *"Non-current financial receivables"* (included in the non-current assets line item *"Other receivables"*) and *"Non-current derivative financial instruments included in net financial position"* (included under non-current assets as *"Derivative financial instruments"*). Total net financial (liquidity)/ debt position is an alternative measure to net financial debt that includes long-term financial assets;
- **Total net financial (liquidity) debt position/EBITDA *adjusted without start-up costs;*** calculated as the ratio between the Total net financial (liquidity) debt position and the EBITDA *adjusted without start-up costs*. This is used to measure the sustainability of the debt;
- **CapEx (Capital Expenditures) or Investments in property, plant & equipment and intangible assets:** calculated as the sum of (i) investments (increases) in intangible assets and (ii) investments (increases) in property, plant and equipment. This measure represents the total amount of investments in tangible and intangible assets;
- **Impact of amortisation and depreciation on investments:** calculated by dividing the investments (increases) of tangible assets with amortization for the period. The ratio of investments to amortisation is used to measure the ability to maintain or restore the amounts for tangible fixed assets.

Other information

ROLE OF THE BOARD OF DIRECTORS

The Board of Directors is responsible for the strategic guidance and supervision of the overall business activities, has the power to address the administration as a whole, and is empowered in the undertaking of the most important financial/strategic decisions and decisions which have a structural impact on operations, or are functional decisions, as well as to exercise the control and direction of Pirelli.

The Chairman is endowed with the legal representation of the Company including in the legal proceedings of the Company, as well as all other powers attributable to the Chairman in accordance with the Articles of Association.

To the Executive Vice Chairman and CEO are exclusively delegated powers for the ordinary management of the Company and the Group, as well as the power to propose business and industrial plans and budgets to the Board of Directors, as well as any resolutions concerning any strategic industrial partnerships and joint ventures of which Pirelli is a part.

The Board has internally instituted the following Committees with advisory tasks:

- Audit, Risks, Sustainability and Corporate Governance Committee
- Remuneration Committee
- Committee for Related Party Transactions
- Nominations and Successions Committee
- Strategies Committee

For more details reference should be made to the section of this present Report titled *"Report on Corporate Governance and Ownership Structure"*, included in the Financial Statements and published in the Governance section of the Company's website (*www.pirelli.com*).

INFORMATION ON THE SHARE CAPITAL AND OWNERSHIP STRUCTURE

The information referred to in Article 123 bis of Legislative Decree 24 February 1998 n. 58 are reported in the specific section of this present Report titled *"Report on Corporate Governance and Ownership Structure"*, included in the Financial Statements as well as published in the Governance section of the Company's website (*www.pirelli.com).*

DEROGATION OF THE PUBLICATION OF INFORMATION

The Board of Directors, taking into account the simplification of regulatory requirements introduced by CONSOB in the Issuer's Regulation No. 11971/99, resolved to exercise the power to derogate, pursuant to the provisions of Article 70, paragraph 8, and of Article 71, paragraph 1-*bis* of the aforesaid Regulation, the obligations to publish the disclosure documents required at the time of significant mergers, de-mergers, capital increase by contributions in kind, acquisitions and disposals.

FOREIGN SUBSIDIARIES NOT BELONGING TO THE EUROPEAN UNION (NON-EU COMPANIES)

Pirelli & C. S.p.A. directly or indirectly controls some companies based in countries which do not belong to the European Community (Extra-EU Companies) which hold particular significance pursuant to Article 15 of CONSOB Regulation No. 20249 of December 28th 2017 concerning markets.

With reference to the data at December 31, 2018, the Extra-EU Companies controlled, directly or indirectly, by Pirelli & C. S.p.A. which are of relevance pursuant to Article 15 of the Markets Regulation are:

Limited Liability Company Pirelli Tyre Russia (Russia); Pirelli Pneus Ltda (Brazil); Pirelli Comercial de Pneus Brasil Ltda (Brazil); Comercial e Importadora de Pneus Ltda. (Brasile); Pirelli Tire LLC (USA); Pirelli Tyre Co. Ltd (China); Pirelli Otomobil Lastikleri A.S. (Turkey); Pirelli Neumaticos S.A.I.C. (Argentina); Pirelli Neumaticos S.A. de C.V. (Mexico).

Also under the same regulations, the Company has put in place a specific and appropriate *"Group Operating Regulation"* which ensures immediate, constant and full compliance with the provisions contained in the aforementioned CONSOB regulation. In particular, the competent corporate departments ensure a timely and periodical identification and publication of the relevant non-EU companies under the Market Regulation, and - with the necessary and appropriate collaboration of the companies involved - guarantee the collection of data and information and the verification of the circumstances referred to in the aforesaid Article 15, ensuring the availability of the information and data provided by the subsidiaries in the event of a request by CONSOB. In addition, it also provides for a regular flow of information in order to ensure to the Board of Statutory Auditors that the Company carries out the required and appropriate verifications. Finally, the above *"Operating Regulation"*, consistently with the regulatory provisions, governs the provision to the public of the financial statements (the Statement of Financial Position and Income Statement) of the relevant non-EU companies which are subject to the preparation of the consolidated Financial Statements of Pirelli & C. S.p.A.

It shall therefore be noted that the Company is fully compliant with the provisions of Article 15 of the aforementioned CONSOB Regulation No. 20249 of December 28, 2017 and the subsistence of the conditions required by the same.

RELATED-PARTY TRANSACTIONS

As part of the new listing process initiated and completed in 2017, the Company's Board of Directors, again approved the Procedure for Related Party Transactions (***"OPC Procedure"***). Subsequently, following the renewal of the administrative body and the constitution of the Committee for Related Party Transactions (***"OPC Committee"***), the OPC Procedure was adopted, without any modification, and, following the unanimous favourable opinion expressed by the members of the OPC Committee, also by the Board of Directors currently in office.

The OPC Procedure can be consulted, together with the other corporate governance procedures, in the section of the website at *www.pirelli.com* dedicated to corporate governance.

For more details on the procedure for Related Party Transactions (OPC Procedure), reference is made to the sections named Directors' Interests and Related Party Transactions included in the Annual Report on Corporate Governance and Ownership Structure contained in the Financial Statements and group of documents.

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Pursuant to Article 5 paragraph 8 of CONSOB Regulation No. 17221 of March 12, 2010 on Related Party Transactions, and the subsequent CONSOB Resolution No. 17389 of June 23, 2010, it should be noted that during the 2018 financial year, that no transaction of significant importance as defined by article 3 paragraph 1, letter a) of the aforementioned Regulation was submitted to the Board of Directors of Pirelli & C. S.p.A. for approval.

Furthermore, there were no Related Party Transactions -

or changes or developments in the transactions described in the previous Financial Statements - that significantly affected the financial position or income of the Group for the 2018 financial year.

On February 14, 2019, the Company's Board of Directors approved the reshaping of some of the terms of the existing license agreements with the Prometeon Tyre Group S.r.l. and the Aeolus Tyre Co., Ltd. For a description of the aforementioned remodulations and the financial effects of the same (attributable in part to the 2018 financial year) reference should be made to the sections of the 2018 Financial Statements indicated below, as well as to the Disclosure Documents on transactions published (on a prudent and voluntary basis) by the Company on February 20, 2019.

The information on related party transactions that is required pursuant to CONSOB Communication No. DEM/6064293 of July 28, 2006 is presented in the Financial Statements, and in the Note entitled *"Related Party Transactions"* in the annual Financial Statements at December 31, 2018.

Related party transactions, are neither unusual nor exceptional, but are part of the ordinary course of business for the Group companies and are carried out in the interest of the individual companies. Such transactions, when not settled under standard conditions, or dictated by specific regulatory conditions, are in any case regulated by conditions consistent with those of the market. Furthermore, their execution was carried out in compliance with the OPC Procedure.

EXCEPTIONAL AND/OR UNUSUAL OPERATIONS

Pursuant to CONSOB Communication No. 6064293 of July 28, 2006, it is hereby specified that during the course of the 2018 financial year that no exceptional and/or unusual transactions as defined in the aforesaid Notice were carried out by the Company.

COMPLIANCE WITH THE REGULATIONS ON THE PROTECTION OF PERSONAL DATA

Following the entry into force of EU Regulation 2016/679 and amendments to Legislative Decree No. 196/2003 (introduced by Legislative Decree No. 101/2018), it should be noted that the Company has started and completed, with the support of the competent functions, all the activities necessary to meet the new requisites of the law, including, amongst others, the preparation of the registry of data processing operations. The Company has also appointed a Data Protection Officer (*"DPO")* in the person of lawyer Alberto Bastanzio, whose contact details were duly communicated to the Guarantor for the Protection of Personal Data July 25, 2018. The DPO can be contacted, other than at the registered office of the Company, also at the following e-mail address: *dpo_pirelli@pirelli.com*.

The activities carried out by the DPO during the relevant reporting period are described in detail in the *"Annual Report of the DPO"* available at the registered office of the Company, to which reference should be made for further details.

The Board of Directors
Milan, February 26, 2019