Euler Hermes Economic Research

Euler Hermes Italy

Industry Report

Textile & Clothing in Italy: Bronze medal on the international fashion podium, but facing obstacles

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Executive summary

- Demand for clothing has collapsed, dragging the whole T&C (textile and clothing) industry down: in Q1 2014, one in four business foreclosures was a clothing store.
- 'Italy-made' fashion is facing rough competition from low-cost countries: value added has deteriorated by 22% over the last 15 years.
- Despite the threats, the Italian T&C retains its appeal: Italy is the 3rd strongest global performer, behind China and India, with EUR 45 bn of estimated T&C exports in 2015.

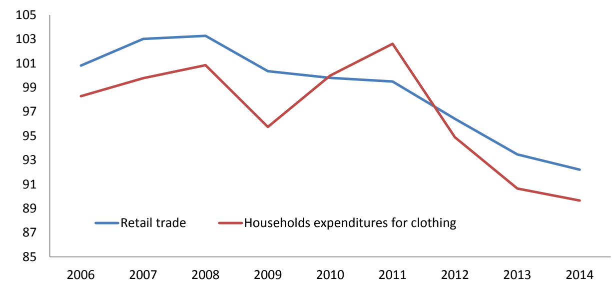
Strong rooted organizational ties: A challenge for the future

Historically, the success of Italy's T&C activity stemmed from its organization of production in industrial districts. The sector counts nearly 50 000 companies and over 410 000 employees. A large number of companies are concentrated within each of the different steps of the supply chain, each contributing their specific skills and equipment. Yesterday's strength, the organization of production in industrial clusters and giving minor importance to a company's individual profitability, is today's threat to the longevity of Italy's T&C.

Households' expenses for clothing have slumped by 11% since 2008, dragging down the sector

Retail trade has declined by 10% since having reached its top level in 2008. This is correlated to the unstable consumption of households, which collapsed over the same period. Unsurprisingly, the total annual household expenses for clothing and related items has fallen by € 8 billion.

Chart 1: Retail Clothing and Household T&C expenditures (Index: 2010=100)



Sources: IHS Global Insight, Euler Hermes

The increased tax burden on businesses and the simultaneous reduction in household disposable income have led to a severe hemorrhage of the business environment. On Q1 2014, almost one in four business foreclosures was a clothing store. Worse, the number of companies is diminishing; closings outnumber new enterprises (a negative net balance of 2,342 units over the period. Lombardy is the unfortunate leader, counting the largest number of foreclosures. The figures compel the entire industry, from manufacturing to distribution, to rethink their business model.

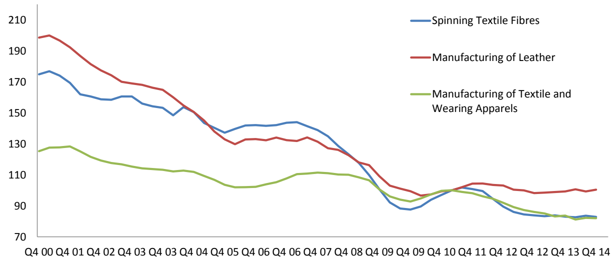
Distributors impelled to adjust to declining production and demand

Upstream, manufacturing of T&C plummeted by a third since 2000, with even worse trends for specific segment of activities such as fibers, which halved over the same period.
Downstream, in 2012 for the first time, the share of products sold on sale or promotion exceeded 50% of turnover. Among the distribution channels, the smallest actors (independent retailers) are the first to lose ground while outlets and e-commerce grab market shares. The latter has an indisputably bright future but Italy is a traditional market with reluctance towards new distribution channels. Italians were 15 million of digital buyers, a quarter of the population, while half of Germans made on-line purchase in 2013. However, on-line T&C turnover is expected to rise from EUR 6 bn to EUR 10 bn by 2018.

Local manufacturers cannot compete

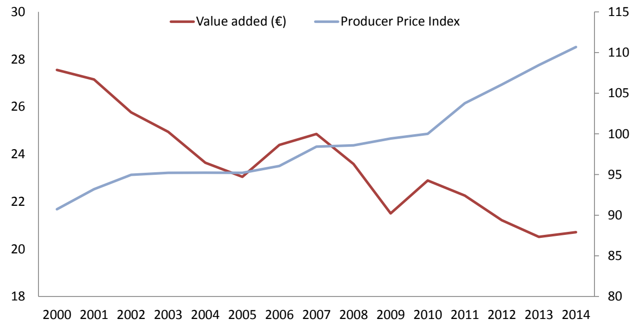
The top three import partners China, France and Romania each have their respective specialties, cheap clothing and fabrics, high-end garments and luggage, and footwear and shirts. Simultaneously to the erosion of manufacturing volumes, T&C value-added has deteriorated by 22%, while output prices were raised by the same proportion. Competitiveness was lost due to the heavy weight of fixed investment (notably renewal) and labor/safety regulation costs; constraints to which Asian and East European competitors are hardly exposed. The fall in investment in Italy (3.5% annual decline since 2000) has made little room for innovation and sufficient productivity upgrades (in order to preserve profitability). Furthermore, foreign buyers and competitors have made use of Italian technology to nibble market share. This phenomenon also raises intellectual property concerns. In Italy, counterfeiting has caused most of the 7 000 companies closure in 5 years, worth an estimated EUR 6 bn or 0.45% of GDP. Italy leads Europe in the quantity of counterfeited goods seized with 10 million units. Two third of products seized by Italian authorities originate from China.
Competition is even being undermined from the inside, with large factories in Prato, the capital of Italian textiles, making use of unregulated workers to cut costs. These companies operate on the outside of the law, often opening and

Chart 2 : Multi-gear T&C manufacturing sector (Index: 2010=100)



Source: IHS Global Insight, Euler Hermes

Chart 3 : PPI and value-added for T&C manufacturing (Left scale: EUR mn - Right scale: Index: 2010=100)



Sources: Oxford Economics, Euler Hermes

Chart 4 : Evolution of investments (EUR mn)

Sources: Oxford Economics, Euler Hermes

shutting down to avoid tax and regulation scrutiny.
Unable to compete in the core market, fashion companies have no choice but to go into designing, engineering in order to create original, profitable products, while low value-added products are outsourced to countries with lower production costs, contributing to the decline of domestic manufacturing. The Italian government has launched a tax credit incentive program running from 2014-2016 to promote Research & Development, especially in textiles. The program will grant a tax credit for 50% of the increased R&D expenses over the three-year period, with a minimum EUR 50 k and maximum EUR 2.5 mn eligible expense per annum. This program risks further encouraging textile engineering to the detriment of domestic manufacturing.

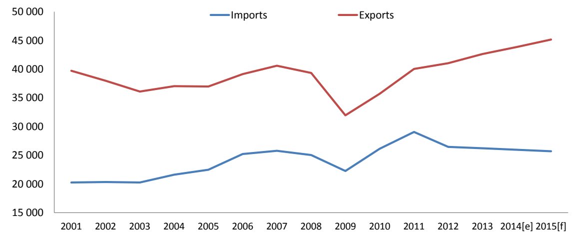
Despite the threats, the Italian T&C retains its appeal

Italy is the 3rd largest world exporter of textiles, behind China and India. It benefits from a structurally positive trade balance. T&C exports surged by 38% between 2009 and 2013 - with a 100% increase for leather articles and even 170% for artificial furs. We estimate the market to reach EUR 45 bn in 2015, attaining a surplus of nearly EUR 20 mn.

The Italian know-how in textile machinery

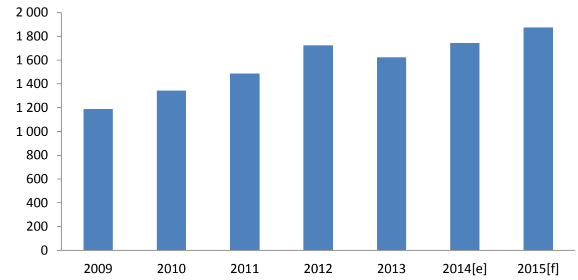
Italy is the 2nd largest European producer of textile machinery, behind Germany. Despite the challenging economic environment, entrepreneurs in textile machinery have made productivity and innovation a high priority to preserve the competitive advantage. Scaling back until 2009, investments have grown by 4.6% annually for the last 5 years. Textile machinery orders were up 6% in Q2 2014 after a slight draw back on Q1. The same trend was observed the for producer prices. After a tough 2013 and early 2014, prices are increasing again and this trend should continue in 2015. This momentum is fueled by foreign demand, the domestic market being distressed (-9% in Q2 2014), with 79% of production value exported, of which 50% to Asia. However, Italy has already targeted new growth drivers, specifically the USA and Turkey with sales up 46% and 24%, as the (historical) Asian market is saturated (sales -3% in Q2 2014). Euler Hermes estimates exports to reach EUR 1.7 bn in 2014, and EUR 2 bn in 2015.

Chart 5 : Italian textile and clothing external trade (EUR mn)



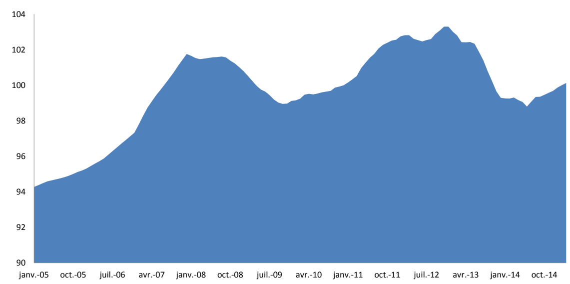
Sources: ITC, Euler Hermes

Chart 6: Italian textile machinery exports (EUR mn)



Source: ITC, Euler Hermes

Chart 7: Producer Price Index textile machinery (moving average, Index: 2010=100)



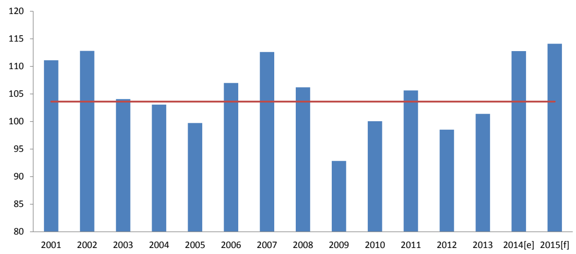
Sources: IHS Global Insight, Euler Hermes

Success factors for Italian T&C companies

Despite its depressed domestic T&C market, in the first semester of 2014 Italian fabrics production (excluding knitted) outperformed the global upstream textile production (+7.6% and +4.8% respectively). Order books in 2014 for T&C manufacturing are 8.1% higher than the long-term average, driven by foreign demand. Euler Hermes expects producer prices to increase by a further 2.2% in 2015, while value-added is stopping its declining trend.

This performance is driven by the high end sector, made possible by worldwide recognition of the innovative aspect and quality of 'made-in-Italy' products. Within the luxury sector, the top ten Italian brands controlled 20% of world market with an output value of EUR 40 bn in 2010. This very same group registered revenues of EUR 20 bn in 2013 with an Ebitda of 23%. Companies' sizes are often smaller than their reputation would suggest. Indeed, most high-end Italian brands are traditionally managed, and sometimes still headed by their founders. The typically closed environment has eluded the succession financing and transition issues which, despite current success, it will have to address. This change could bring the opportunity to further expand.

Chart 8: Industrial orders for T&C manufacturing (Index: 2010=100)



Sources: IHS Global Insight, Euler Hermes

Chart 9: Top 10 Italian brands performances

Brand	Sales 2013 (EUR bn)	Var. % 13/12	% EBITDA
PRADA	3,6	8,8	31,9
GUCCI	3,6	-2,1	35,8
GIORGIO ARMANI	2,2	4,5	n.d.
CALZEDONIA / Intimissimi	1,7	10,8	16,3
GRUPPO COIN	1,7	0,6	n.d.
BENETTON GROUP	1,6	-10	n.d.
ONLY THE BRAVE / Diesel	1,6	4,2	8,3
ERMENEGILDO ZEGNA GROUP	1,3	0,7	20,2
SALVATORE FERRAGAMO	1,3	9,1	20,7
BOTTEGA VENETA	1,0	7,5	34
TOP 10	**19,4**	**3,4**	**23,9**

Source: Pambianco, 2014