INDUSTRIALS WITHSTAND INFLATION IN 2022

The nominal turnover of the 2,150 Italian industrials and service sector companies grew by 30.9% in 2022; an increase in real terms of 0.6%

The total workforce increased (by 1.7%), but its purchasing power was cut (by 22%)

Italian Manufacturing

The real growth was 1.3%, driven by the fashion, electronics and pharmaceuticals/cosmetics sectors

The sector's EBIT margin was resilient in the face of inflation: at 6% in 2022, vs 5.3% pre-Covid

Estimates for 2023 sales are positive: nominal growth of 6% is expected, but inflation could erode this

Milan, 21 September 2023

The Mediobanca Research Area has presented the new edition of its annual survey of Financial Aggregates for large and medium-size Italian companies operating in the manufacturing and services sectors, which covers the ten years from 2013 to 2022. In particular, a total of **2,150 Italian companies** have been analysed, representing 48% of the total industrial turnover. The survey also represents 49% of the manufacturing turnover, 46% of that generated from retail distribution, and 38% of the sales generated by the transport sector. Non-Italian companies make up 52% of the firms which employ more than 250 staff in Italy, and 90% of the manufacturing firms alone. All Italian companies with more than **500 staff** and approximately **20% of the medium-size manufacturing companies** are included in the survey.

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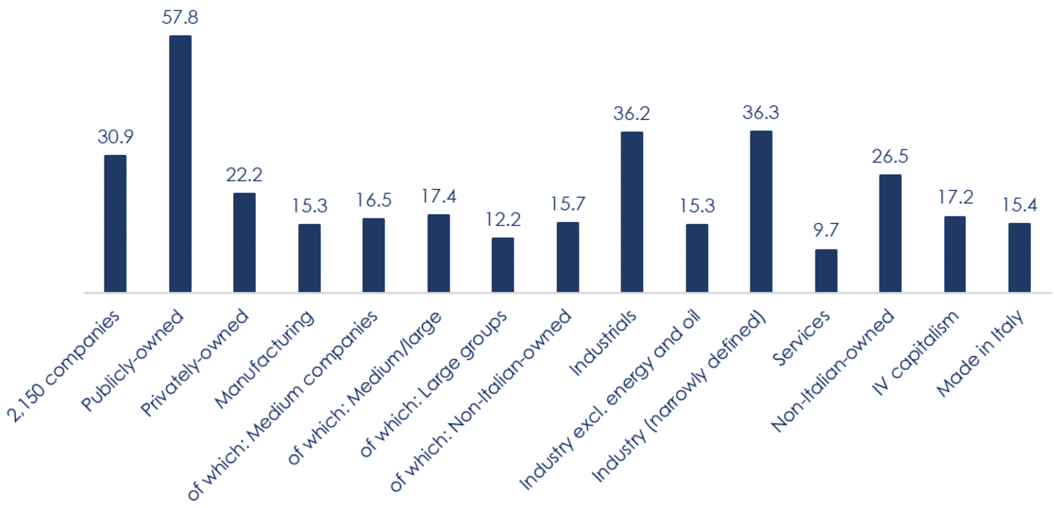
INFLATION BOOSTS COMPANIES' REVENUES

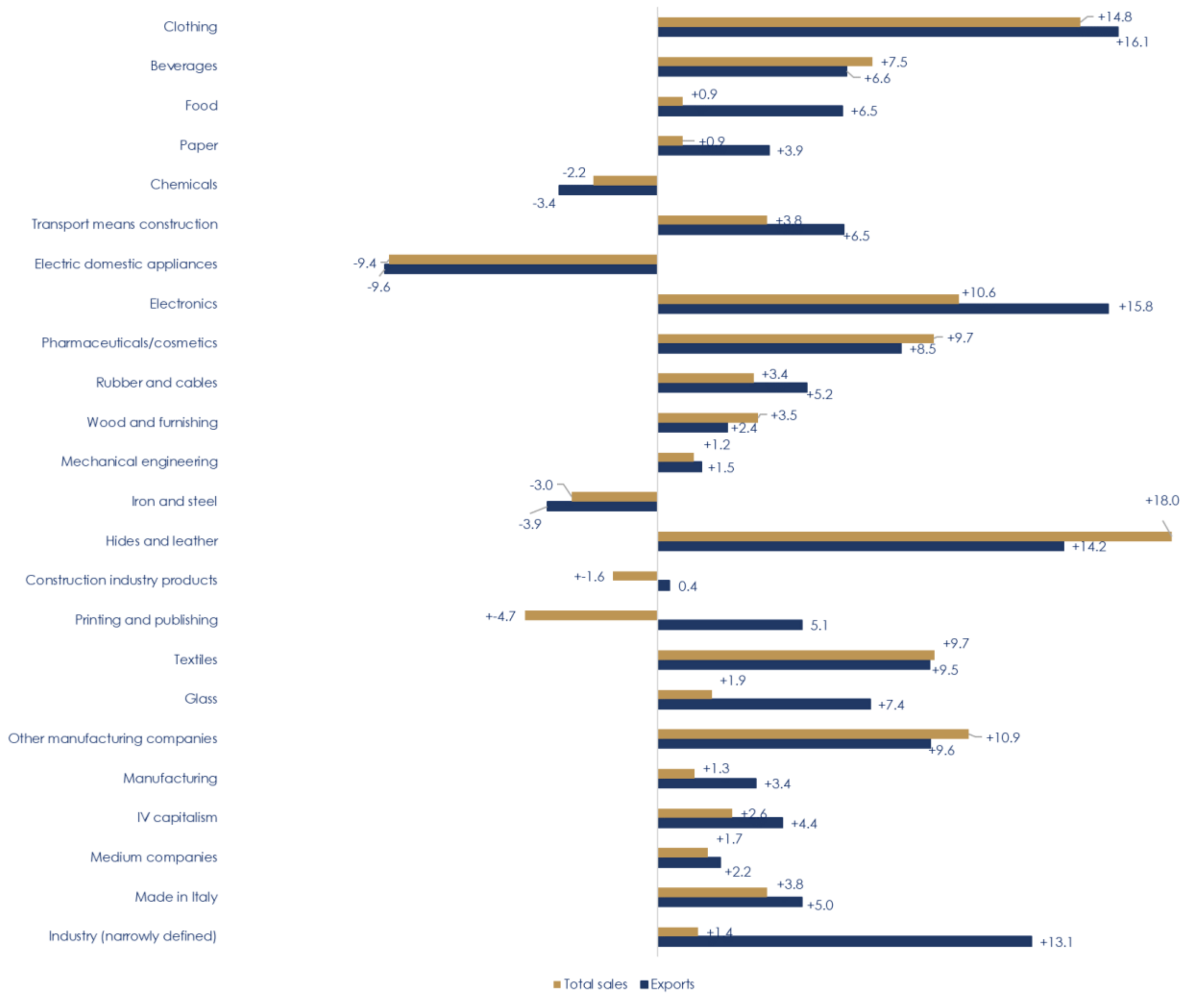
The turnover reported by the 2,150 companies in 2022 reflects an **annual nominal increase** of 30.9%, exceeding €1,000bn in absolute terms. For 2022 the industrials saw sales rise by 36.2%, but net of the oil & gas and energy companies, the increase would have been 15.3%.

Nominal percentage change in 2022 sales for the main aggregates



The presence of publicly-owned companies in the energy sector drove the growth in these companies' sales (up 57.8%), more than double the growth posted by the private sector companies (up 22.2%). Within the manufacturing industry aggregate (which reported growth of 15.3%), the so-called **"fourth capitalism"**, consisting of medium-size and medium-large firms, in general owned by Italian families, demonstrated an **increased capability to pass on rising input costs to sales prices** than the larger firms (nominal turnover up 17.2%, as opposed to 12.2%). By contrast, the trend in nominal turnover for the tertiary sector companies appears to be more modest (up 9.7%), the aggregate consisting mainly of retail distribution (up 7.9%), telecommunications (down 0.3%), transport (up 20.5%), and radio and TV broadcasting (down 7.3%).

Real percentage change in 2022 sales by sector



Many of the changes were driven by inflation: factoring in the change in production prices, the **real growth in sales** posted by the 2,150 firms stood at 0.6%. The **industrials defined narrowly** reported a 1.4% increase, and the **manufacturing industrials** 1.3%. In the latter aggregate, the food companies saw their nominal sales grow by 16.3% but, net of average specific inflation of 15.3%, posted real growth of just 0.9%. The change is entirely attributable to the international market, where sales grew by 6.5%, as the domestic market posted a reduction of 0.6%. The beverages sector performed better, with nominal growth in revenues of 13.8%, which reduces to 7.5% net of inflation (with exports up 6.6%).

The **fashion sector**, meanwhile, performed impressively, with nominal increases of above 20% in all its segments, which continue to be profitable even accounting for inflation: the real increase in sales for the hides and leather segment was 18%, that for clothing 14.8%, and for textiles 9.7%. The most dynamic sectors also include **electronics** – which recorded real turnover growth of 10.6% (on nominal growth of 15.7%), which rises to 15.8% on international markets (or 25.7% without factoring in inflation) – and **pharmaceuticals/cosmetics**, which posted nominal growth of 12.2% and real growth of 9.7% total (exports up 8.5% also in real terms).

As is well known, the shock to the energy industry had a fundamental role on the trend in inflation. Indeed, it was the **energy sectors** that encountered the greatest difficulties in preserving the growth in real terms, despite posting material increases in turnover: the iron and steel sector reported a 3% reduction in real terms (despite posting 19.7% growth in nominal terms), the chemicals sector lost 2.2% of its real value (even though turnover increased by 20.3% in nominal terms), while construction industry products dropped by 1.6% (despite nominal growth of 18.9%). The paper sector fared better, with growth in both nominal terms (up 25.9%) and in real terms (up 0.9%), as did rubber and cables (with nominal growth of 18.4% vs 3.4% net of inflation).

Within the manufacturing production aggregate, an impressive performance in real terms was delivered by the **made in Italy companies** (total sales up 3.8%, exports up 5%), confirming the growing reputation that Italian products continue to have on international markets especially.

In 2022, the 2,150 companies reported a 1.7% increase in their **workforces**, with some segments performing better than others: in particular the "fourth capitalism" (up 2.4%), and also, once again, the made in Italy companies (up 2.6%). The aggregate average per capita labour cost was up 2%. However, the workforce is also the most penalized component in terms of **purchasing power**, having lost an estimated 22% in 2022.

MARGINS: MANUFACTURING INDUSTRY HAS MANAGED INFLATION EFFECTIVELY AND ABSORBED ITS IMPACT

Between 2021 and 2022, the 2,150 companies posted extremely positive performances in terms of the change in their main earnings margins: **value added** rose by 7.7%, which, when reduced using the GDP price deflator, decreases to 4.6%. Proceeding to look at the individual earnings items for the aggregate, it becomes clear that certain **margins reflect higher increases**: the EBIT margin increased by 21.9%, gross profit before one-off items rose by 9.6%, and net profit was up 26.2%. ROI increased from 6.5% to 6.9%, and ROE from 6.4% to 7.7%.

Nonetheless, if we extend the analysis to consider a broader time horizon, the impressive performance in terms of **profitability** starts to diminish: the EBIT margin decreases from 5.6% in the 2015-19 period (pre-Covid) to 4.7% in 2022, in line with the trend reflected by ROI (down from 7.8% to 6.9%), whereas ROE reported an increase, albeit minor, from 7.4% to 7.7%. A significant distinction is evident between public and sector companies. Those owned by the government, which too delivered material growth in their nominal turnover, saw their profitability levels weaken significantly: the EBIT margin decreased from 7% to 3.4%, ROI declined from 7.4% to 4.6%, while ROE reduced from 8.3% to 6.8%. Conversely, the privately-owned companies, both Italian and international, reported increases in all margins: their EBIT margin rose from 5.2% to 5.3%, ROI from 8% to 8.4%, and ROE by even more, from 7% to 8.2%.

Manufacturing industry showed the best **capability in terms of managing the costs of inflation**, absorbing the impact and managing to report significant growth in profitability even compared to the five-year period prior to Covid: analysis of this segment shows that the EBIT margin rose from 5.3% to 6% (an increase of 13.2%), and ROE from 8.2% to 11.2% (a rise of 36.6%). In this connection, the improvements made by the family-owned medium and medium-large firms stand out (EBIT margin up 6.3% and ROE up 12.1%), and also those posted by the made in Italy companies (up 4.3% and 14.3% respectively). Meanwhile, the service sector companies' performances reflect the opposite trend, with the EBIT margin and ROI basically halving – from 6.7% to 3.5% in the case of the former, and from 6.3% to 3.4% in the case of the latter, and net profitability levels (ROE) entering negative territory at minus 0.4% in 2022.

Average profitability levels in 2015-19 and 2022 for the principal aggregates

	Ebit margin		ROI		ROE	
	Average 2015-19	2022	Average 2015-19	2022	Average 2015-19	2022
			As %			
2,150 companies	*5.6*	*4.7*	*7.8*	*6.9*	*7.4*	*7.7*
Publicly-owned	*7.0*	*3.4*	*7.4*	*4.6*	*8.3*	*6.8*
Privately-owned	*5.2*	*5.3*	*8.0*	*8.4*	*7.0*	*8.2*
Service sector	*6.7*	*3.5*	*6.3*	*3.4*	*4.9*	*-0.4*
Retail distribution (food)	*2.4*	*1.9*	*5.8*	*4.6*	*5.8*	*4.9*
Retail distribution (non-food)	*3.4*	*3.7*	*11.0*	*10.4*	*6.0*	*10.6*
Radio/TV broadcasting	*-0.8*	*-9.6*	*0.9*	*-10.4*	*-0.9*	*-18.5*
Telecommunications	*11.4*	*2.1*	*5.1*	*0.9*	–	*-7.4*
Transport	*4.5*	*7.3*	*4.7*	*8.6*	*5.9*	*16.6*
Manufacturing	*5.3*	*6.0*	*8.9*	*9.6*	*8.2*	*11.2*
Clothing	*6.3*	*7.9*	*9.9*	*8.4*	*7.9*	*8.0*
Food and beverages	*5.1*	*3.6*	*8.1*	*6.4*	*8.3*	*7.3*
Paper	*5.6*	*6.0*	*9.1*	*9.0*	*9.2*	*16.9*
Chemicals	*6.2*	*3.8*	*10.9*	*7.5*	*9.4*	*9.3*
Transport means construction	*1.2*	*3.3*	*4.5*	*8.7*	*1.0*	*11.8*
Electric domestic appliances	*1.2*	*1.8*	*4.5*	*4.1*	*5.3*	*-4.1*
Electronics	*3.3*	*6.5*	*6.7*	*9.9*	*8.5*	*10.4*
Pharmaceuticals/cosmetics	*10.2*	*9.6*	*14.5*	*11.0*	*16.1*	*11.1*
Rubber and cables	*6.5*	*6.1*	*13.5*	*15.8*	*15.8*	*23.4*
Systems	*1.5*	*0.5*	*3.3*	*1.8*	*-4.2*	*-2.1*
Wood and furnishing	*7.0*	*9.2*	*9.8*	*13.5*	*10.6*	*14.9*
Mechanical engineering	*7.0*	*6.5*	*10.2*	*8.7*	*9.8*	*8.4*
Iron and steel	*3.8*	*6.4*	*7.1*	*13.5*	*7.4*	*18.8*
Hides and leather	*11.9*	*16.3*	*18.1*	*21.9*	*21.4*	*22.9*
Construction industry products	*3.5*	*6.9*	*6.1*	*7.8*	*4.4*	*11.2*
Printing and publishing	*3.6*	*4.6*	*5.9*	*6.1*	*0.6*	*9.8*
Textiles	*6.5*	*5.3*	*7.9*	*5.2*	*8.7*	*7.1*
Glass	*9.6*	*13.5*	*10.7*	*12.8*	*9.6*	*18.4*
Made in Italy	*7.0*	*7.3*	*9.8*	*9.5*	*9.8*	*11.2*

Analysis by sector shows that the fashion industry posted significant growth in real turnover for 2022 with profitability growing on average, the only exception being the textiles segment. As for the energy sectors, the results appear somewhat uneven. The **iron and steel** and **glass** sectors bucked the trend in reporting improved performances for all the indicators observed. In other words, inflation does not appear to have had a uniform effect on the manufacturing companies' results for 2022. The price increases do not appear to have been triggered automatically in general, but are conditioned by the positioning that the companies have in terms of the quality profile of their products, their place in the global value change, their bargaining power versus clients, their distinctiveness versus their competitors, and also, last but not least, their capability to reshape their cost structures in order to maintain their profit margins. Certainly inflation does not appear to have impacted negatively on margins, which in fact improved for a significant number of sectors in 2022, even compared to the pre-Covid period.

The manufacturing industrials continue to face the uncertainties of the economic downturn with caution, seeing growth in total sales and exports for 2023 (up 6%). These changes could, however, be significantly reduced in real terms because of inflation, which is difficult to quantify in view of the current price trends.

VERTICAL COMPETITION IN THE FOOD INDUSTRY

The food industry was inflationary pressures in 2022, a situation which led to discussions between the various players in the supply chain (from the branded goods industry to retail distribution) regarding **price adjustment policies.** Whereas the food industry's turnover increased by 0.9% in real terms (despite domestic sales declining by 0.6%), and the beverages industry reported a 7.5% increase in total sales, it is worth noting that the food retail distribution segment posted a 7.3% increase in sales. This figure, net of the 8.4% inflation in food and household and personal care item prices, translates to a 1% reduction in real terms. Furthermore, the food retail distribution segment saw its performance diminish compared to the pre-Covid period, as shown by all the profitability indicators: the EBIT margin dipped below the 2% level (21% lower than its pre-Covid performances), and ROI and ROE both to below 5%. The food and beverages industry as a whole, too, despite reflecting profitability levels that are structurally superior to those of the food distribution segment, still saw its margins cut (the EBIT margin reduced from a pre-Covid average of 5.1% to 3.6% in 2022, translating to a reduction of 29%).

INVESTMENTS AND FINANCIAL STRUCTURE: FOCUS ON MANUFACTURING INDUSTRY

In 2022 **material investments**, expressed at constant prices based on 2013 cash values, reflected a slight increase versus 2021 (up 0.3%) reaching values which in absolute terms constitute a **record high for the ten-year period**. This is the result of the growth in manufacturing investments (up 4.3%), reflecting the substantial increases reported by the medium-large firms (11.2%) and the productions attributable to the made in Italy chain (up 10.4%). The service sector companies saw their investments decrease by 4.6%, in line with their earnings performances.

The overall financial structure of the 2,150 companies analysed in the Financial Aggregates report remained solid in 2022, reflecting a debt/equity ratio of 81.6%, in line with the average levels at which the system stabilized during the 2015-19 period (82.8%). The **manufacturing industry segment** posted an even more balanced debt/equity ratio of 46.2% in 2022 (compared with an average of 52.9% in 2015-19). This strengthening of the financial solidity was also helped by the higher cash and liquid assets, which increased from 21.9% of borrowings in 2015-19 to 23.1% in 2022, a trend that was even more marked for manufacturing industry (up from 30.1% to 33.2%). This improvement in the companies' financial solidity also enabled the first effects of the rise in interest rates to be managed adequately.

RECORD INFLATION AS IN 1980: SIMILARITIES AND DIFFERENCES WITH 2022

To find a year in which inflation had an impact comparable to that seen in 2022, we have to go back as far as 1980. A **comparison between the P&L accounts and balance sheets** between the 1979-80 two-year period (available in the Mediobanca Research Area) and those for 2021-22 has been compiled, with all the required caveats. The analysis between the two periods enabled certain similarities to be noted, but also some important differences.

The **increase in turnover recorded** in 1979-80 was 31.6%, similar to the levels for 2021-22, when the increase was 30.9%. Costs for acquiring services and raw materials also reflected a similar trend: with an increase of 38.8% in the early 1980s, compared with a rise of 36.7% in 2022.

Among the differences, one that catches the eye is the percentage of **purchasing costs**, which in 1980 was 83.1%, but which for 2022 rose to 90.6%. The weight of **labour costs** also changed, virtually halving from 18.2% of turnover in 1980 to just 8.4% in 2022. This is attributable to certain phenomena that have affected industry in the last forty years, notably the progression made in terms of technology, automation, the change in the composition of the different sectors, and the trend towards servitization.

The comparison also took into account the **automatic inflation recovery mechanisms** in force in 1980, which triggered a 16.9% increase in labour costs in that period (against a 0.8% reduction in headcount). In 2022 the increase in the same item was just 3.5%, driven by a 1.7% rise in the number of employees.

The year 1980 was also marked by an explosion in **borrowings** (up 43.5%), absorbing as much as 6.5% of the companies' turnover: a figure which barely compares with the 1% reported in 2022, despite substantial growth in the same item (up 19.8%). Another substantial difference involves the bottom line, which in 1980 reflected a major loss (more than Lit. 2,000bn), but in 2022 was strongly in profit (€37bn).

If we look at the company's **financial structure**, it appears far more solid in 2022 than in 1980: the debt/equity ratio in 2022 stood at around 81.6%, compared with 194.7% over forty years ago, and the cost of debt was 2.5% (far lower than the 18.3% in 1980). Cash and liquid assets in 2022 accounted for 7.2% of the total assets in 2022, compared with 2.8% in 1980. By contrast, the mix in terms of funding maturities was aligned for the two years: one-third short-term, two-thirds medium-/long-term.

In conclusion, the Italian firms covered by the survey have financial profiles today that appear far better suited to tackling inflation than they did in 1980s.