# A bundle of funds

Scores of private equity funds have been steadily investing in traditional and specialised tanneries in recent years. Andrea Guolo gauges the response of leading tanners to the phenomenon, with a mind to ascertain where the economic boost could take the industry.

Italian tanneries stimulate the appetite of private equity funds, which only discovered the leather business in 2017, overcoming the distrust of an unknown world. It was last year when Pasubio, the second-largest Italian tanning company – in terms of revenues – and a leader in automotive leather supplying, was bought by CVC Capital Partners for an estimated €285 million.

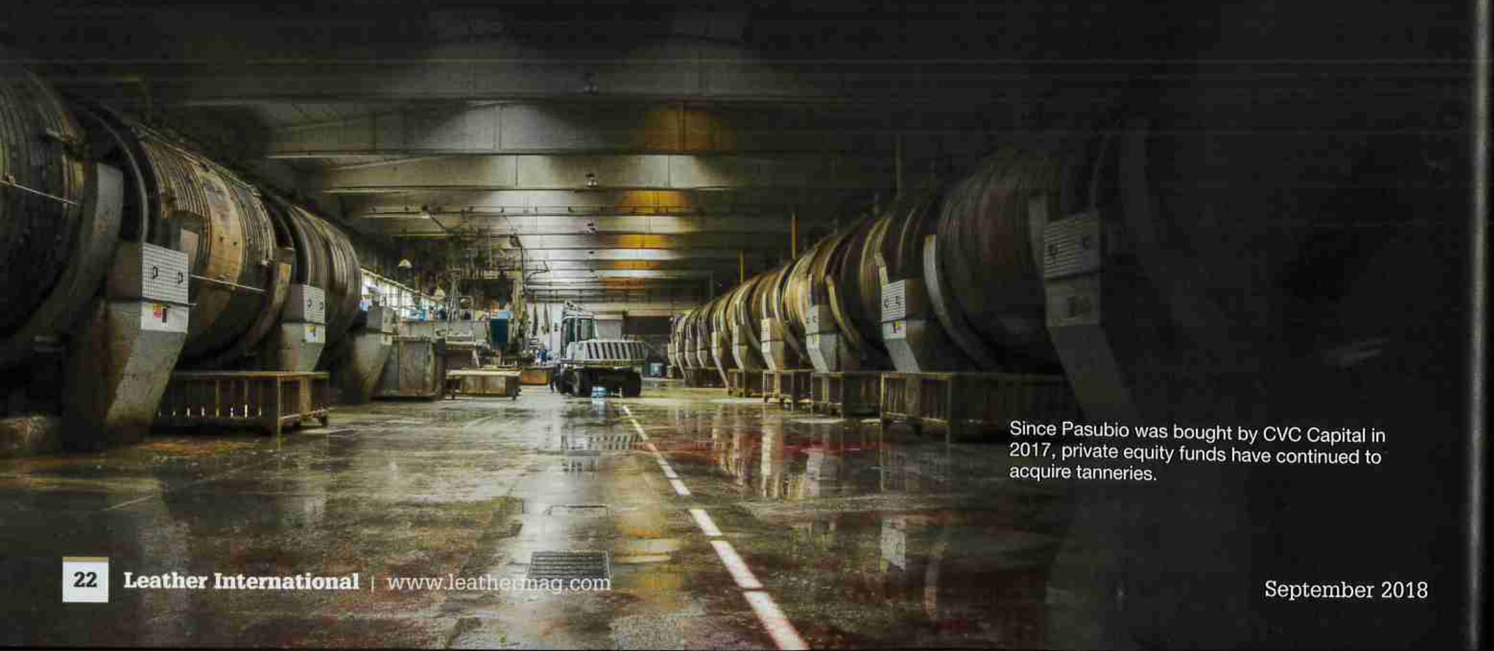
In March of this year, it was announced that via the Arcadia Small Cap fund, Arcadia was able to acquire Chiorino Technology. Chiorino is a much smaller company with a turnover of €30 million at the end of 2017, and specialises in products destined for the fashion and leather goods industry. However, the third operation is in some ways the most important because it concerns Rino Mastrotto Group, a multinational leather company. Additionally, it also includes the Swedish Elmo tannery, as well as facilities in Latin America. The group was founded and is chaired by UNIC and former Cotance president Rino Mastrotto.

In June 2018, it was reported that the group, which is based in Trissino, close to Arzignano tanning cluster in Italy, is being sold and the investment bank Banca IMI will be running the sale. There are currently at least five funds interested in the acquisition, on the basis of an estimated price of €300 million, based on the group's €250-million revenue in 2017 and a margin of under 10% of turnover the year before.

At press time, no details have arisen as to the closing time of the deal or which business will be the buyer. The private equity funds rumoured to be interested are Alpha, Ardian, KKR, NB Renaissance Partners and CVC Capital.

## The allure of tanning

So, why are private equity funds interested in the tanning sector, and why right now? According to Emanuela Pettenò, a partner in PwC's Transaction Services group, this appetite is being stimulated by the current and expected annual growth rate in the leather supply chain. "The tanning business has a turnover estimated at \$45 billion, of which around \$20 billion is from China and more than \$5 billion concerns Italian tannery. Over the next five years, average growth of 6% is expected each year, with a total expected turnover of \$58 billion by 2022," she explains. ››



Since Pasubio was bought by CVC Capital in 2017, private equity funds have continued to acquire tanneries.

Pettenò adds, "In particular, forecasts for the luxury destinations are up 7%, the automotive sector is up 5% and home furnishings is likely to increase by 4%. In addition to potential growth, the funds also evaluate the possible aggregations in a sector where there is no shortage of possibilities for concentration. Keep in mind that the first international tanning player, Eagle Ottawa, operates a dozen tanneries or groups with revenues of €50–200 million."

These companies, in the near future, could incorporate other smaller ones for reasons related to commercial strategies or cost optimisation, as Italian tanneries are family-owned, and removed from the world of investment funds. It must be said that there is a lot of money to invest in the financial community, so investors are looking for opportunities that, due to size and characteristics, are quite similar to the uniqueness and familial etiquette of the country's tanneries.

"Tanning has never been as sexy as it is today for private equity funds," says Alessio Candi, area manager for M&A finance at Pambianco Strategie d'Impresa, a consultant that assists fashion, luxury and design companies with implementing development strategies. "The opportunities to make a good investment and concentrate various realities within a single holding company take other considerations: whether the tanneries have interesting numbers, high positioning and good margins, in the case of the specialisation acquired. And then there is a critical aspect taking place, that of the generational change that has pushed family properties to evaluate possible selling operations."

### Downsides to consider

The pros have been covered, but what are the cons of private equity investment?

To Candi, the negatives are "the environmental issues, and being a B2B and unbranded industry. They are therefore more subject to cyclical phases and they're particularly exposed to the risk of revenue fluctuations. Furthermore, since a private equity fund invests for a short amount of time, it is necessary to understand the risks linked to the exit phase. In other words, who can buy the tannery in the next four or five years?" Besides the risks, he also assesses what type of companies will be the most attractive to financial investors. He adds that "specialisation is rewarding, because a specialised company has higher margins and operates in a niche area", with barriers that prevent entry to outsiders.

Like Pasubio, the sale of Rino Mastrotto Group will be another major deal for the industry.

### Mutual benefit

According to the Italian Private Equity, Venture Capital and Private Debt Association (AIFI), if being unbranded posed a problem in the past, it is no longer the source of any issues.

"Many companies in which the funds invest do not have well-known brands," states Alessia Muzio, director of the AIFI's research office. "However, they are excellent in their reference market. If this were not the case, we would only have operations for 'famous' companies; private equity works very well on SMEs, allowing them to grow thanks to the injection of capital, and managers that bring and allow the realisation of more ambitious industrial plans."

In recent years, the number of transactions by private equity funds in the fashion and luxury sectors totalled €569 million in 2015, €465 million in 2016 and €544 million in 2017, according to the AIFI. "Certainly, if in recent months there have been good operations in the tanning sector, it means that we have good companies that now need to invest in growth," Muzio adds. "But this is a matter that applies to many others that are able to produce, sell internationally and have repercussions on the Italian economy. It's remarkable, in terms of jobs and investments in the territory."

Given all these conditions, and the absence of problems arising from the restrictions of international trade, the coming months could see additional transactions from private equity funds.

Antonio Dosa, associate partner at PwC for M&A, is a long-time observer of tanning sector developments. "The most interesting cases could concern tanneries included in the Italian top ten by turnover, but we do not underestimate the possibility of intervention on the part of medium-sized funds, which could make an argument for tanning SMEs or the possibility of merging small tanneries into more structured groups," he says. "The funds have turned the spotlight because tanning is an Italian excellence, and represents a strategic supplier of the fashion, furniture and automotive groups. Tanneries that are grappling with a process of internationalisation that greatly complicates their business model and market approach need to open up capital."

As for the potential opportunities, Pettenò warns, "There are good reasons to invest in a specialised player, but if a fund is already present in a certain field of business – for example, in the automotive sector – it will almost certainly invest in a tannery that is less or not exposed to the same business, just for diversifying risks." She adds, "The other aspects to take into consideration are the size, the share of foreign sales and the marginality that, if it was low, could be considered to be even more attractive, as it would result in a lower disbursement today and a more satisfactory exit in a few years." ■