

A vibrant green aurora borealis (northern lights) display dominates the sky, with bright, flowing curtains of light. Below the lights, a dark silhouette of a forest line is visible, and the aurora's glow is reflected on the surface of a calm body of water in the foreground.

PARADIGM **DRIFT**

PREDICTIONS 2024



REUTERS
BREAKINGVIEWS

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RIVAL NARRATIVES WILL BATTLE FOR SUPREMACY IN 2024

INTRODUCTION BY PETER THAL LARSEN, GLOBAL EDITOR

As inflation peaks, war rages and trade conflicts harden, new ways of thinking about how and why the world has changed are emerging. The lessons drawn by voters, central banks, tech titans and bureaucrats will shape economies, companies and markets for years to come.

It has been more than six decades since Thomas Kuhn first coined the term “paradigm shift”. Yet the process the American historian described, where accumulating contradictions in and violations of old theories lead to them being painfully overthrown, remains relevant today. As 2024 gets underway, the consequences of an inflationary overshoot, heightening trade conflict and war pose a challenge to established ways of thinking about the world. That leaves fields from central banking to technology, industrial policy, and energy in an uncomfortable state of flux. The lessons their practitioners draw in the coming 12 months will influence economies, companies and markets for years to come.

Kuhn’s thinking, laid out in the seminal “The Structure of Scientific Revolutions”, focused on the messy, confrontational process by which scientific theory changes to accommodate disquieting discoveries. While the concept of paradigm shifts has been widely applied – to the point of misuse – in other fields, it seems appropriate when considering the many uncertainties in confronting today’s changed world.

This is the backdrop against which Breakingviews columnists have embarked on their annual attempt to guide readers through the trends that will shape the

year ahead. As with previous editions, the goal is not forecasting accuracy, but to offer a new way of thinking about the forces with which companies and people will grapple. Last year’s effort produced some hits, as China and the West squabbled over metals and inflation challenged conscious consumers, as well as some misses: Microsoft did not buy Netflix; the United Arab Emirates is still a member of OPEC.

Any attempt to peer into the future starts with acknowledging the range of paradigms vying for supremacy. These include rival political ideologies, which will clash in looming elections in the United States, the United Kingdom, India, Indonesia, and other democracies in the coming 12 months. They will do so as political leaders increasingly frame the contests as existential decisions, the outcome of which they may not deem legitimate. Indeed, former U.S. President Donald Trump has embarked on the 2024 presidential campaign with many supporters still refusing to accept that he lost the last one.

Central banks may seem bastions of stability by comparison. Yet U.S. Federal Reserve boss Jerome Powell and his opposite number at the European Central Bank, Christine Lagarde, are grappling with deep uncertainties. After rapidly hiking interest rates in response to an inflationary spike many policymakers believed was temporary, the theoretical foundations of monetary policy are once again up for grabs. The risks of another mistake are high, potentially putting central banks in the political firing line.

**THE RISKS OF ANOTHER MISTAKE
ARE HIGH, POTENTIALLY PUTTING
CENTRAL BANKS IN THE POLITICAL
FIRING LINE**



The new reality of higher interest rates raises doubts about the sustainability of sovereign debt, pressuring political leaders to re-examine commitments on spending and taxation. That does not mean, however, that they will retreat to laissez-faire passivity. Bureaucrats are ever more willing to meddle in cross-border trade, wield financial sanctions, block mergers, and lure businesses with tax breaks and subsidies. Companies may respond by luring more of them into the executive suite.

That might dampen corporate animal spirits. Nevertheless, after correctly anticipating subdued deal volumes in 2023, our columnists have a hunch mergers and acquisitions are set for a revival. European banks, Hong Kong tycoon Li Ka-shing, and the British oil giant BP are among those that have good reasons to consider corporate activity in the coming year.

Meanwhile, the arrival of self-teaching systems powered by generative artificial intelligence threatens consequences far beyond the technology industry. Clever chatbots could enhance productivity – while destroying jobs. The race for AI supremacy will spark a scramble for reliable data, while governments will struggle to produce appropriate regulations to govern the potential spread of dangerous misinformation. Young people may simply respond by spending less time online.

All these new narratives are not only in competition with old ideas; at times they are also in conflict with each other. The U.S. push to get drivers out of gas-guzzling vehicles and into battery-powered rides, for example, may be incompatible with becoming less dependent on China. And green innovations that previously seemed dead ends, like biofuels, could stage a comeback.

**UNEXPECTED EVENTS WILL
HAVE THE POTENTIAL TO
DERAIL EVEN THE MOST
COMPELLING PARADIGMS**

The global pandemic and war in Ukraine have taught the world about the potential for nasty surprises. Even the most perceptive decision-makers can still be caught off-guard. “The Middle East is quieter today than it has been in decades,” Jake Sullivan, President Joe Biden’s national security adviser, declared in late September, barely a week before combatants from Hamas attacked Israel, killing around 1,200 people and sparking Israel’s deadly invasion of Gaza. As in previous years, unexpected events will have the potential to derail even the most compelling paradigms.

First published January 2024



CHAPTER 1

LOOKING AHEAD

JAY POWELL COULD LAND ON THE BALLOT IN 2024

BY JOHN FOLEY

Central banks' fight against inflation may produce slower growth, joblessness and recession in the U.S., Europe and the UK, just as elections loom. The Fed chief and peers argue their mandate is to slay high prices, not to appease voters. They shouldn't assume it will always be so.

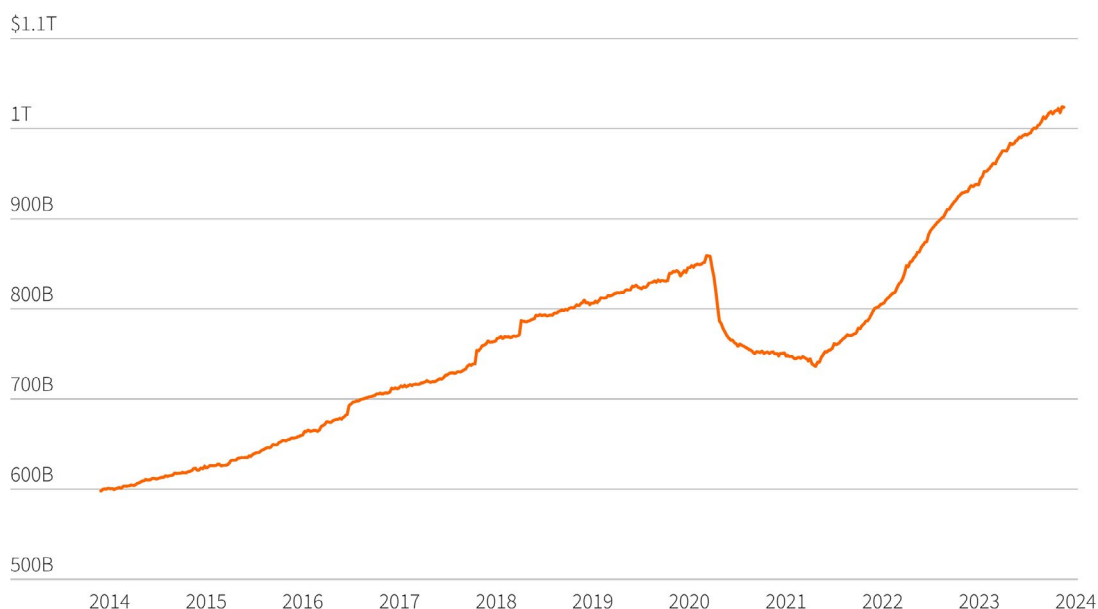
CONFLICTS OF INTEREST

Central bank independence has an irresistible appeal. When monetary policy is insulated from government, vote-seeking politicians can't interfere to get a short-term economic fillip. As elections loom in 2024 in countries like the U.S. and the UK, that logic may come in for a stress test.

Start with the United States. There, President Joe Biden is likely to go up in November against Donald Trump, who, while president, suggested Federal Reserve Chair Jay Powell was an American "enemy" for not slashing interest rates. Trump's attack didn't go far. Within a few months Covid-19 had hit, leading the Fed to slash rates to zero anyway. Powell is good at politics, too: his confirmation to a second term in 2022 won the support of 80 out of the 99 senators who voted.

This time, though, the Fed is unusually exposed to mud-slinging. It messed up on inflation, delaying interest-rate hikes too long and then slamming on the brakes. The coming year may bring a so-called soft landing, where inflation and rates both ease gently. But if instead prices keep rising too fast and rates stay high, millions of Americans – who currently sit on a record \$1 trillion of credit-card debt – will suffer.

US CREDIT CARD LENDING HAS SURPASSED ITS PRE-COVID TREND



Note: Credit card loans held by US commercial banks

Source: Federal Reserve | J. Foley | Breakingviews | Dec. 4, 2023

THE FED IS UNUSUALLY EXPOSED TO MUD-SLINGING

The problem is that the Fed has also crept into areas that – in the United States at least – are political hot potatoes. One is Powell's experiment with "inclusive" monetary policy to maximise employment for all Americans rather than mainly white ones. Another is climate change: big U.S. banks are being put through dry-run climate stress tests, which provoked howls from some conservative lawmakers. Big banks are cynically stoking the fire, claiming that loathed new capital regulations could make prices of everything from plane tickets to mortgages more expensive.

It's not just the U.S. where elections will bring anxiety. Bank of England Governor Andrew Bailey also got inflation wrong – the rate of price increases in the UK hit 11% in October 2022. Prime Minister Rishi Sunak has refrained from criticising the central bank, but Parliament's upper chamber recommended in November that its mandate be "pruned".

As for European Central Bank President Christine Lagarde, she doesn't answer to any one country – although the ECB's upper echelons are replete with often-squabbling representatives from national central banks. But with elections in Belgium, Austria, Portugal and the European Parliament, among others, recession risk and durably high interest rates could make Lagarde a target for discontent.

Some things should give the central bankers – or at least central banks – comfort. Reversing the trend towards independence will be hard and require onerous lawmaking. Whoever takes the White House can, in any case, nominate a new Fed chief in 2026. Besides, preserving an autonomous central bank gives lawmakers on both sides someone else to blame if things go wrong on their watch. Political hopefuls may have harsh words for Powell and peers, but they know when they're on to a good thing.

First published January 2024



U.S. Federal Reserve Chairman Jerome Powell addresses a press conference in Washington, U.S., Sept. 20, 2023. REUTERS/Evelyn Hockstein

BACKLOGGED M&A PIPELINE WILL BURST

BY JEFFREY GOLDFARB

Even normally chipper bankers are wary as merger activity heads for a second straight drop from its \$5.7 trillion peak in 2021. And yet stabilizing capital costs, bulging cash reserves and adjusting valuation mindsets should help spark enough pressure to ignite a deals resurgence.

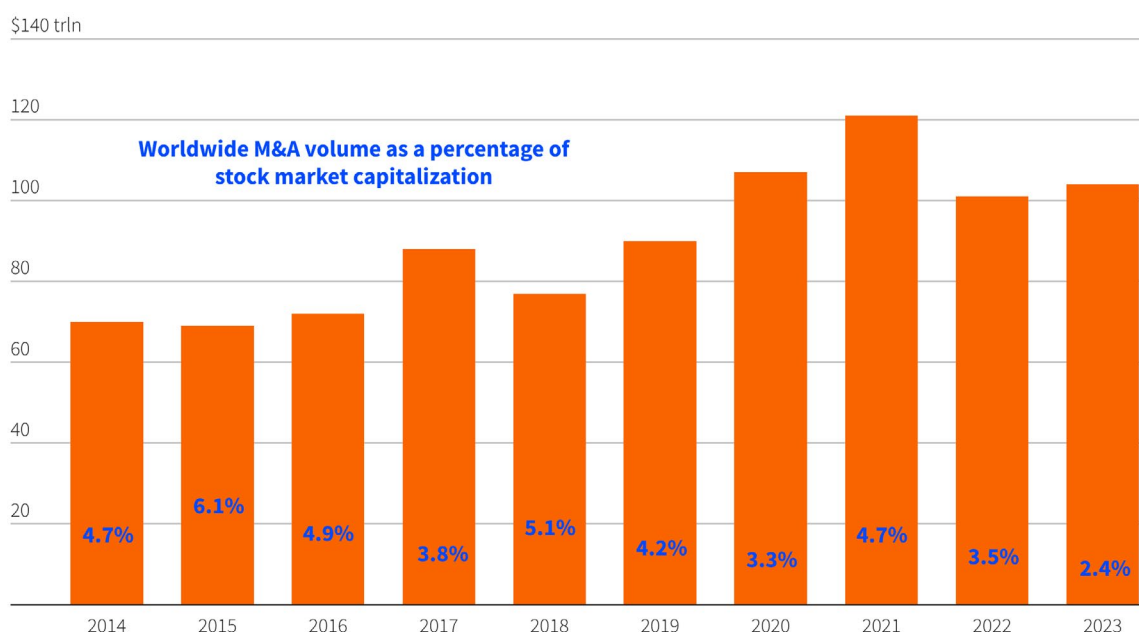
JOINING FORCES

Investment bankers ordered back to the office in 2023 could just as easily have twiddled their thumbs at home. In 2024, however, they should be able to start accumulating frequent-flyer miles again, as a growing list of deals sketched on paper finally get put into action.

The slowdown in M&A activity has darkened the mood of usually chipper financial advisers. Even mega-mergers unveiled by oil giants Exxon Mobil and Chevron in the fourth quarter, worth a combined \$113 billion, haven't boosted spirits much. Globally, companies notched \$2.6 trillion of deals by the end of November, putting volume on track for the lowest full-year total since 2014 and well below 2021's \$5.7 trillion peak.

It's no wonder deal consiglieri have been uncharacteristically cautious. Jim Esposito, the co-head of global banking and markets at Goldman Sachs, recently told Reuters he expects M&A to be a "little bit less robust" over the medium term. Subdued CEO confidence levels back him up.

MERGERS-TO-MARKET-CAP IS AT A DECADE LOW



Note: Percentages shown are not positioned to exact scale

Sources: SIFMA, LSEG | A. F. Alias and J. Goldfarb | Breakingviews | Dec. 7, 2023

At a certain point, however, pressure simply squeezes too hard. In the 40 years LSEG has kept records, the value of mergers and acquisitions has never dropped three years in a row. Moreover, deal volume from 2014 to 2022 averaged 4.5% of worldwide listed equity value without ever dipping below 3%; in 2023, it was 2.4%. A reversion to the mean would yield some \$4.7 trillion of deals.

A REVERSION TO THE MEAN WOULD YIELD SOME \$4.7 TRILLION OF DEALS

More practically, with the U.S. Federal Reserve ending its cycle of rapidly raising interest rates, capital is easier to come by and its cost easier to assess. A coinciding recovery in public stock valuations makes equity a more valuable currency with which to shop. And dealmakers have had time to adjust to the new normal of aggressive trustbusting, both in terms of its legal limitations and

the expense involved. Microsoft's ability to overcome regulatory opposition to owning Activision Blizzard, for one, may embolden other hesitant acquirers to dust off shelved strategies.

This stability should help narrow the previously yawning gap in valuation perspectives held by sellers and buyers. An abundance of cash doesn't hurt either. Members of the S&P 500 Index – excluding those in finance, utilities, property and transportation – were sitting on some \$1.8 trillion of it, the same as at the end of 2021, according to S&P Dow Jones Indices. The clock is also ticking for buyout firms and their record \$2.5 trillion of firepower.

There's also some strategic urgency to spend. Governments pursuing decarbonization and supply-chain restructuring should ignite investor enthusiasm in those trending areas. Striking deals in 2024 will require extra courage and creativity, but there's no shortage of inspiration.

First published December 2023



A man in a suit talks on the phone as he walks on Wall Street, in New York City, U.S., May 3, 2018. REUTERS/Brendan McDermid

CHINA'S HUAWEI COULD BE THE **SURPRISE IPO OF 2024**

BY CHAN KA SING

Ren Zhengfei has long insisted the telecoms giant and chip designer he founded will never go public, but the company is now central to Beijing's technology ambitions, which require heavy funding. A Huawei listing would also breathe life into China's ailing stock market.

NEVER SAY NEVER

Huawei's CEO Ren Zhengfei always insisted that the telecoms giant he founded will never become a publicly traded company and that it would instead focus on working for the bigger ideals of society. An initial public offering could be on the horizon if China's national interest is at stake, however.

To achieve the goal of building a "great modern socialist country", President Xi Jinping has repeatedly stressed the importance of innovation and technological self-sufficiency. Huawei can help Beijing deliver on both fronts. The smartphone it released in September was a surprisingly sophisticated product from a company subject to American sanctions. The device is full of Chinese-made components and is powered by an advanced semiconductor believed to be made by Shanghai's Semiconductor Manufacturing International Corp (SMIC).

Yet investing in research and development in the face of U.S. restrictions is taking its toll. Huawei's operating profit margin has shrunk from over 10% in 2018 to less than 7% in 2022, when annual net profit fell to just \$5.1 billion. On the same 25 times trailing earnings multiple as iPhone maker Apple, Huawei would be worth \$128 billion.

HUAWEI COULD BE ONE OF CHINA'S MOST VALUABLE COMPANIES

● Market capitalisation



Note: Data for largest mainland China-headquartered listed companies as of Dec. 4, 2023

Source: LSEG | Chan K. S. | Breakingviews | Dec. 4, 2023

INVESTING IN RESEARCH AND DEVELOPMENT IN THE FACE OF U.S. RESTRICTIONS IS TAKING ITS TOLL

The company could be worth much more than that, though. Ni Guangnan, ex-chief technology officer at Lenovo and longtime proponent of China developing its own processing chips, opined in 2019 that Huawei could be worth \$1.3 trillion. He didn't provide a detailed explanation, but Apple's market capitalisation had just topped \$1 trillion.

Chinese investors could help Huawei's stock soar. They are renowned for their enthusiasm in chasing hot offerings. SMIC was worth less than \$6 billion upon its delisting from New York in 2019. After floating its shares in Shanghai a

year later, it was worth about \$30 billion by December 2023. A Huawei IPO might receive a similarly euphoric reception and inject life into China's stock market if mom-and-pop traders believe the company will receive state backing and win market share from global rivals.

In a letter to staff in 2021, Ren said that Huawei's businesses could "gradually enter the market in the future". Handset maker Honor, a sub-brand Huawei sold to a consortium led by a Shenzhen state firm in 2020, in November articulated a plan to go public. The same month Huawei said it will move core technologies in its smart car unit to a joint venture owned 40% by automaker Chongqing Changan Automobile. Huawei is busy remaking itself and pushing boundaries. An IPO would fit the bill too.

First published December 2023



A man checks Huawei's Mate 60 series smartphones displayed at a Huawei store in Shanghai, China, Sept. 8, 2023. REUTERS/Aly Song

BIG COMPANIES WILL RAID GOVERNMENT FOR FUTURE CEOS

BY PETER THAL LARSEN

There's a long history of businesspeople going into politics. Now sanctions and subsidies are showing boardrooms the value of diplomatic skills. Lazard CEO Peter Orszag and Legal & General Chairman John Kingman worked in government. Others will follow through the revolving door.

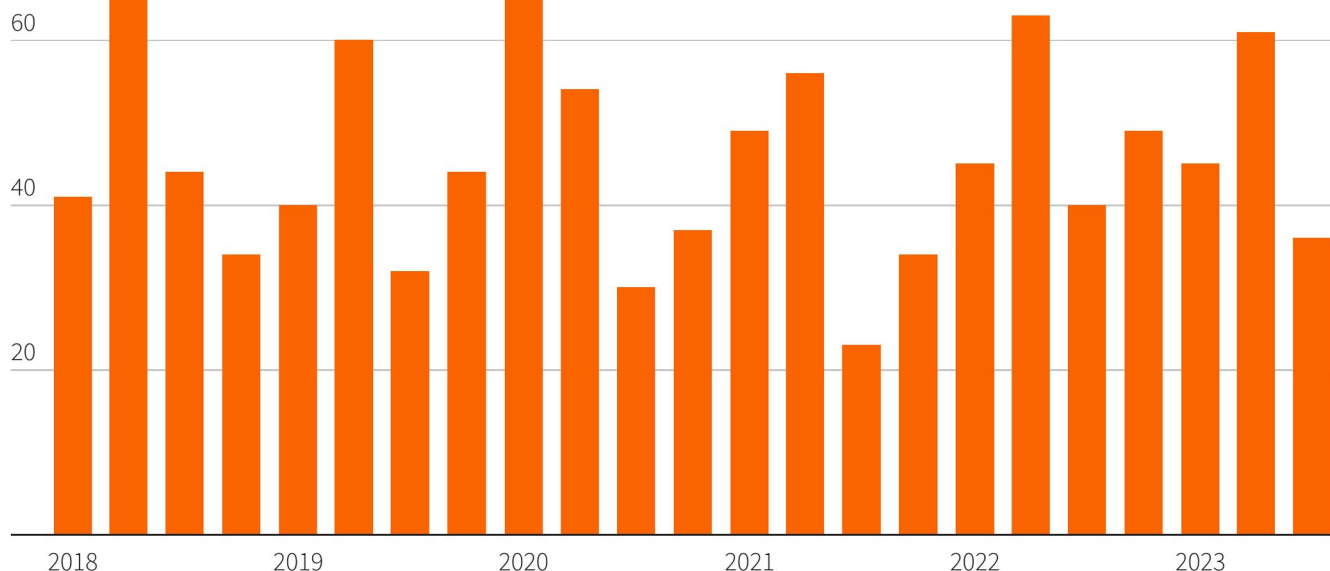
REVOLVING SCORE

Big companies will seek out CEOs with government experience in 2024. As states play a larger role in determining the fate of businesses, boardrooms are waking up to the value of diplomatic skills. Yet relatively few occupants of the corner office have first-hand knowledge of government. That will change.

UNTIL NOW, THE REVOLVING DOOR BETWEEN BUSINESS AND POLITICS HAS SPUN MOSTLY IN ONE DIRECTION

Until now, the revolving door between business and politics has spun mostly in one direction, propelling corporate executives into public office. In 2006, Hank Paulson left the top job at Goldman Sachs to become U.S. Treasury Secretary. His two predecessors in the administration of President George W. Bush also previously ran large companies. Former Standard Chartered boss Mervyn Davies became a UK trade minister in 2009; HSBC Chairman Stephen Green made a similar switch a year later. The former CEO of Air New Zealand, Christopher Luxon, is now the Antipodean nation's prime minister.

GLOBAL CEO TURNOVER HAS REMAINED BROADLY STABLE



Note: Outgoing CEOs from 1,822 global companies

Source: Russell Reynolds Associates | P. Thal Larsen | Breakingviews | Dec. 4, 2023

These days, however, governments are more likely to shape corporate fates. War has disrupted supply chains. Financial sanctions and trade restrictions, such as those the U.S. imposed on sales of semiconductors to China, can place large customers and entire markets off-limits at the stroke of a bureaucratic pen. CEOs surveyed by KPMG in mid-2023 flagged geopolitics and political uncertainty as the biggest risks to growth.

On the plus side, subsidies and tax breaks such as those unleashed by President Joe Biden have turbocharged investment in chips and electric vehicles. CEOs who can navigate government decision-making stand a better chance of avoiding pitfalls and pocketing these windfalls. Meanwhile, corporate leaders are under increasing pressure to stake out public positions on social and political issues, from abortion to the conflict in Gaza. This requires executives capable of communicating with large audiences.

Many companies recruit retired officials to help steer them through the bureaucratic maze, or seek support from lobbying firms and geopolitical advisory outfits. Yet senior leaders with direct experience of the workings of government are also rising to high corporate office. Peter Orszag, who recently took charge of Lazard, was director

of the U.S. Office of Management and Budget before moving into investment banking. In Britain, several officials who helped rescue the banking system in 2008 now hold senior private sector roles. John Kingman, formerly a high-ranking UK civil servant, is chairman of insurer Legal & General; Shriti Vadera, who served in Prime Minister Gordon Brown's government, chairs Prudential.

In some countries it's more common for leaders to move between ministries and management roles. Thierry Breton, currently the European Union's Internal Market Commissioner, served as French finance minister in between stints running France Telecom and consulting firm Atos. Donald Rumsfeld, who was U.S. Defense Secretary in the 1970s, subsequently worked as CEO and chairman of several large companies before returning to the Department of Defense in 2001.

Yet making the switch from actual politics to office politics remains tricky. Former officials who attempt the transition have to quickly master corporate skills, from setting strategy to financial planning. Even so, as governments exert more power, leaders with a detailed grasp of politics are becoming more valuable. Big companies will hire more of them in 2024.

First published December 2023



Peter Orszag, CEO of Lazard, speaks at the ReutersNEXT Newsmaker event in New York City, U.S., Nov. 9, 2023. REUTERS/Brendan McDermid

SAUDI'S BEST FOREIGN INVESTMENT WILL BE IN GAZA

BY GEORGE HAY



Saudi Arabia's Crown Prince Mohammed bin Salman speaks with the Fox News channel, in an interview aired Sept. 21, 2023, in Neom, Saudi Arabia. Saudi Press Agency/Handout via REUTERS

The kingdom is known for flashy punts on Western sports and blue chips. But its real need is foreign cash to help diversify away from oil. If Crown Prince Mohammed bin Salman were to use Saudi money to help Palestinians rebuild post-war, U.S. goodwill may prompt an FDI spike.

FORTUNES OF WAR

The war in Gaza leaves Mohammed bin Salman with a choice. In 2024, Saudi Arabia's crown prince could keep using the kingdom's \$700 billion Public Investment Fund to buy Western corporate and sporting trinkets. A more far-sighted policy would see him help finance the reconstruction of Palestine.

A few months into the war, that might sound implausible. The bloody invasion of Gaza that followed Hamas' murder of around 1,200 people in Israel on Oct. 7 had as of early December killed over 14,000 Palestinians. A November summit of Arab and Islamic leaders, chaired by MbS in Riyadh, castigated Israel for "war crimes". Prime Minister Benjamin Netanyahu said in early November he wanted Israel to control a post-war Gaza, increasing the risk that a weakened Hamas or a different extremist group maintains the support of significant numbers of Palestinians. If Donald Trump gets re-elected as U.S. president in 2024, his zealous support for Israel could polarise the situation further.

Yet it's possible to imagine a better scenario. If Israel ditches Netanyahu's discredited far-right administration, a more moderate government might reopen Palestinian

peace talks. Gulf states, the Carnegie Endowment for International Peace theorises, could promote a new version of the 2002 Arab Peace Initiative. The first incarnation saw major Arab states offer peace and normalised relations with Israel in return for measures that included the establishment of a sovereign Palestinian state. In 2024 Palestinians could be offered, among other things, financing and diplomatic assistance to recover.

It's unclear who would lead a post-war Palestine, so such an outcome is fraught with difficulties. But it would suit MbS, who was already pursuing normalisation talks with Israel before Oct. 7. His Vision 2030 scheme to pivot Saudi's economy away from oil requires \$100 billion of foreign direct investment inflows annually by 2030, but in 2022 the kingdom only managed \$33 billion, even after overhauling its FDI methodology. Securing what's needed requires a quieter Middle East, not a war-torn one.

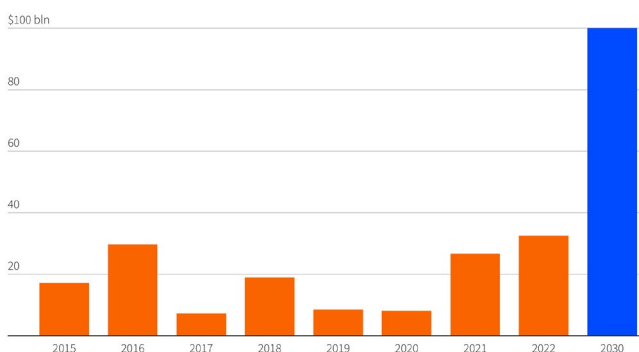
SECURING WHAT'S NEEDED REQUIRES A QUIETER MIDDLE EAST, NOT A WAR-TORN ONE

Despite the \$120 billion in extra net oil export revenues Saudi received in 2022 relative to 2021, Riyadh doesn't have limitless resources to throw at Gaza. The kingdom may run budget deficits until 2026, Capital Economics flags. If oil prices slump, big diversification projects like MbS's flagship Red Sea city Neom might face capital spending cuts.

Yet one key reason why FDI inflows into Saudi have stuttered is foreign investors' misgivings about MbS himself following the murder of journalist Jamal Khashoggi by Saudi agents in 2018. If the Saudi leader were to host a major Arab peace conference in Riyadh and offer billions of dollars in scarce resources in reconstruction aid, he could build a more positive reputation. Western leaders and investors might see him more as a statesman and less as a loose cannon.

That would still be a risky use of Saudi resources. But plenty of PIF punts, like its \$45 billion bet on the SoftBank Vision Fund, went wrong without yielding any political benefits. If U.S. and European investors became more sanguine about heading to Riyadh, it could be the best investment MbS ever made.

SAUDI FDI FLOWS LAG THE KINGDOM'S 2030 GOAL



Note: All figures in USD. Saudi Arabia Foreign Direct Investment data updated in November 2023. Previous 2022 FDI inflow figure was \$7.9 bln

Source: Saudi Arabia Ministry of Investment | G. Hay | Breakingviews | Nov. 28, 2023

First published December 2023

AHMEDABAD WILL BE INDIA'S NEXT SILICON VALLEY

BY PRANAV KIRAN

So will Mysuru, Jaipur and Coimbatore. Global firms are leaning on employees in India to execute more complex tasks. They'll find a cheaper, reliable workforce beyond the country's traditional tech hubs. The rise of AI will see more cities become the workplaces of the world.

BANGALORED

Global firms are realising that white-collar jobs can be done from anywhere, so they're doubling down on India, where labour costs are a fraction of what they are in the West. They will build a cheap and reliable workforce outside the traditional technology hubs of Bengaluru and Hyderabad. As a result, India will have many Silicon Valleys.

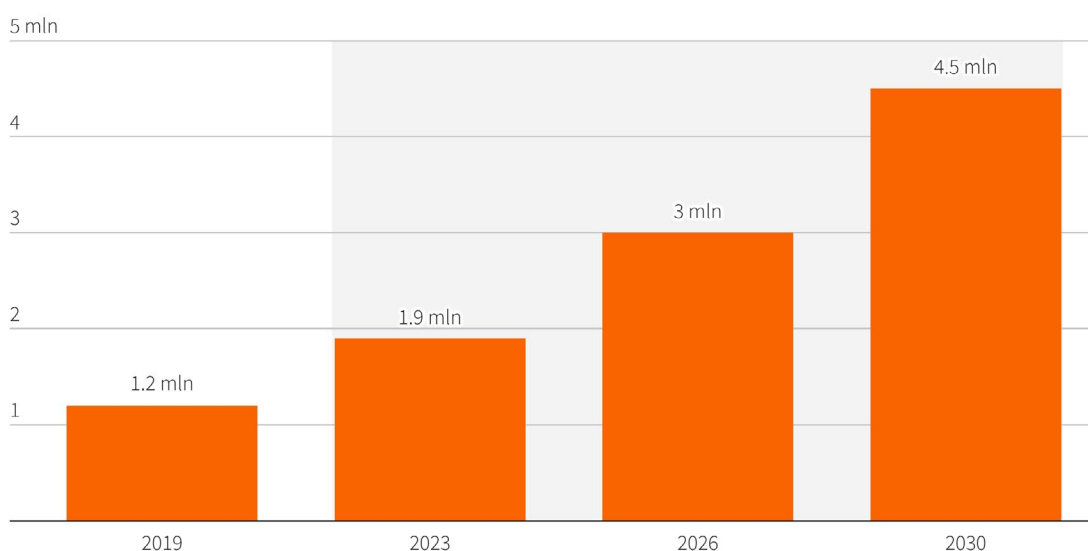
Fortune 500 companies from Walmart to Germany's Bosch are just as likely to consider India when hiring artificial intelligence experts as they are for back-office roles. Increasingly, firms are leaning on employees in the country to execute more complex engineering and research tasks.

For instance, engineers at Boeing's hub in Bengaluru used machine learning to help upgrade wire designs on aircraft including the Chinook helicopter to cut down on design time. The company is investing \$200 million in a new office near the city's airport. Such global capability centres (GCCs) will employ about 4.5 million workers in India by 2030, more than double the current number, EY estimates.

**CENTRES LIKE BENGALURU ARE
PLAGUED WITH INFRASTRUCTURE
PROBLEMS AND ARE GETTING
PRICIER TO OPERATE IN**

GLOBAL FIRMS ARE GROWING THEIR INDIA WORKFORCES

● Headcount of global capability centres



Note: Figures for 2023-2030 are estimates

Source: EY - Future of GCCs in India | P. Kiran | Breakingviews | Dec. 4, 2023

However, centres like Bengaluru are plagued with infrastructure problems and are getting pricier to operate in. Currently, a third of all staff at India's GCCs are based in just the one city, according to research from consulting firm Zinnov. These employees also tend not to stick around in their jobs for very long.

Record demand by global companies for cloud services during the pandemic coincided with high-paying venture capital-funded startups poaching workers. Attrition at India's top three IT services firms including Tata Consultancy Services soared to an average of over 22% in financial year 2022, for example. That makes places like Ahmedabad, Coimbatore, Mysuru and Jaipur more attractive as emerging hubs. Talent and real estate costs for companies can be about 30% and 50% cheaper, respectively, according to Deloitte.

While cities like Austin and Miami in the United States have struggled to replicate the success of Silicon Valley, India won't face the same problem. Nearly 75% of the country's top 100 engineering schools, like the alma maters of Microsoft and Alphabet bosses Satya Nadella and Sundar Pichai, are in smaller towns anyway. Indian workers are young and willing to move, so companies can build offices in far-flung places and the talent will follow.

Firms are creating positions at a rapid pace – more than 200,000 roles in India for data scientists and AI experts remained unfilled as of August 2022. As global companies leverage technology to usher in the next wave of productivity, they could also find themselves spreading out across the South Asian nation.

First published December 2023



A man uses JioDive, a smartphone-based virtual reality headset, at the 2023 India Mobile Congress at Pragati Maidan in New Delhi, India, Oct. 27, 2023. REUTERS/Anushree Fadnavis

AUSSIE TYCOON WILL BLAZE **NEW GREEN** ACTIVIST TRAIL

BY ANTONY CURRIE

Atlassian co-CEO Mike Cannon-Brookes has already used some of his billions to tackle climate change, like battling the country's top carbon emitter. Quitting the software firm would make him more effective. Other wealthy moguls may then join him in the activist trenches.

GREEN FINGERS

Billionaire Mike Cannon-Brookes may put more of his money where his mouth is during 2024. The co-CEO of enterprise software company Atlassian has been no slouch at talking up the need to tackle climate change and has already devoted some of his wealth to the cause. But he would become even more effective by stepping down from the role he has held for some two decades.

THE 44-YEAR-OLD AUSTRALIAN HAS CHANNELLED OR PLEDGED AT LEAST A\$2.5 BILLION (\$1.7 BILLION) TO FIGHTING GLOBAL WARMING

So far the 44-year-old Australian has channelled or pledged at least A\$2.5 billion (\$1.7 billion) to fighting global warming, much of it via his personal investment vehicle, Grok Ventures, run by Jeremy Kwong-Law. While that in some respects is akin to what fellow tech magnates like Bill Gates and Jeff Bezos do, Cannon-Brookes is more willing to get into the trenches.

In 2022 he took the limelight when Grok teamed up with Brookfield Asset Management in a \$4 billion joint take-private bid for AGL Energy, Australia's biggest carbon emitter. When that failed, he bought a roughly

ATLASSIAN RECOVERY IS CANNON-BROOKES' ACTIVIST FUND



Source: LSEG | A. Currie | Breakingviews | Nov. 29, 2023

10% stake – worth some A\$700 million (\$460 million) as of November – foiled the company’s plan to separate its power generation and retailing businesses, and helped get four new board members elected. He also played a prominent role as Grok bested Fortescue founder and fellow tycoon Andrew Forrest to win control of Sun Cable, a struggling startup aiming to build 20 gigawatts of solar farms.

Such star-power influence can only go so far if the activist investor has a day job, though. AGL’s own energy transition, for example, is proceeding slowly. Cannon-Brookes would have more sway being inside on the board than being outside calling it one of the “most toxic companies on the planet”, as he did in August.

Granted, he has said he wants to stay at Atlassian, which has its own issues including slowing growth. But overhauling the top ranks after more than 20 years could help, and its stock rose some 60% in the year since its November 2022 low. That has pushed up the value of his roughly 20% stake, held almost entirely in supervoting shares, to some A\$10 billion, giving him more firepower to take on other corporate climate laggards, should he choose to take up activism full-time. That might convince other billionaire benefactors – like Gates, Bezos, or long-serving bosses like Salesforce’s Marc Benioff – to spend more time alongside him in the green activist trenches.

First published January 2024



Mike Cannon-Brookes, co-founder of software firm Atlassian, gestures during a Reuters interview in central Sydney, Australia, June 5, 2013. REUTERS/Daniel Munoz

GEN ALPHA WILL TIRE OF LIVING ONLINE

BY ANITA RAMASWAMY

As kids born in the 2010s age into the digital world, their fatigue from being forced online will prompt a backlash similar to Gen Z. Both will become smarter about the implicit agreement of trading services for data – and make life more difficult for companies from Alphabet to OpenAI.

SCREENED OUT

For all the changes that technology has brought about, one thing will stay the same in 2024. Generation Alpha, kids born in the 2010s, are going to want to be “different” from their parents. For them, that means spending less time online. For companies counting on their data, that means life is about to get harder.

GENERATION ALPHA, KIDS BORN IN THE 2010S, ARE GOING TO WANT TO BE “DIFFERENT” FROM THEIR PARENTS

Members of the youngest generation may have a role model in their slightly older peers when it comes to pushing back against an all-enveloping digital world. Globally, the amount of time people spent on social media declined year-over-year in 2023 for the first time since the consumer research firm GWI started tracking it in 2012, according to its latest survey of over 950,000 internet users. Gen Zers, born between 1997 and 2007, are at the forefront of the shift. One-third of those surveyed said they were actively trying to limit their usage of such platforms, seeking out hobbies and friendships in the physical world instead.

In addition to cutting down screen time, the internet’s next generation will look to get more out of what they put in. Those who have slowly been lulled into increased online usage have been willing to accept the implicit agreement that underpinned the rise of social media, wherein companies offered services like email and messaging to users at no cost in exchange for the ability to collect data about them and sell it to advertisers. Younger generations are going to become more aggressive about demanding a change.

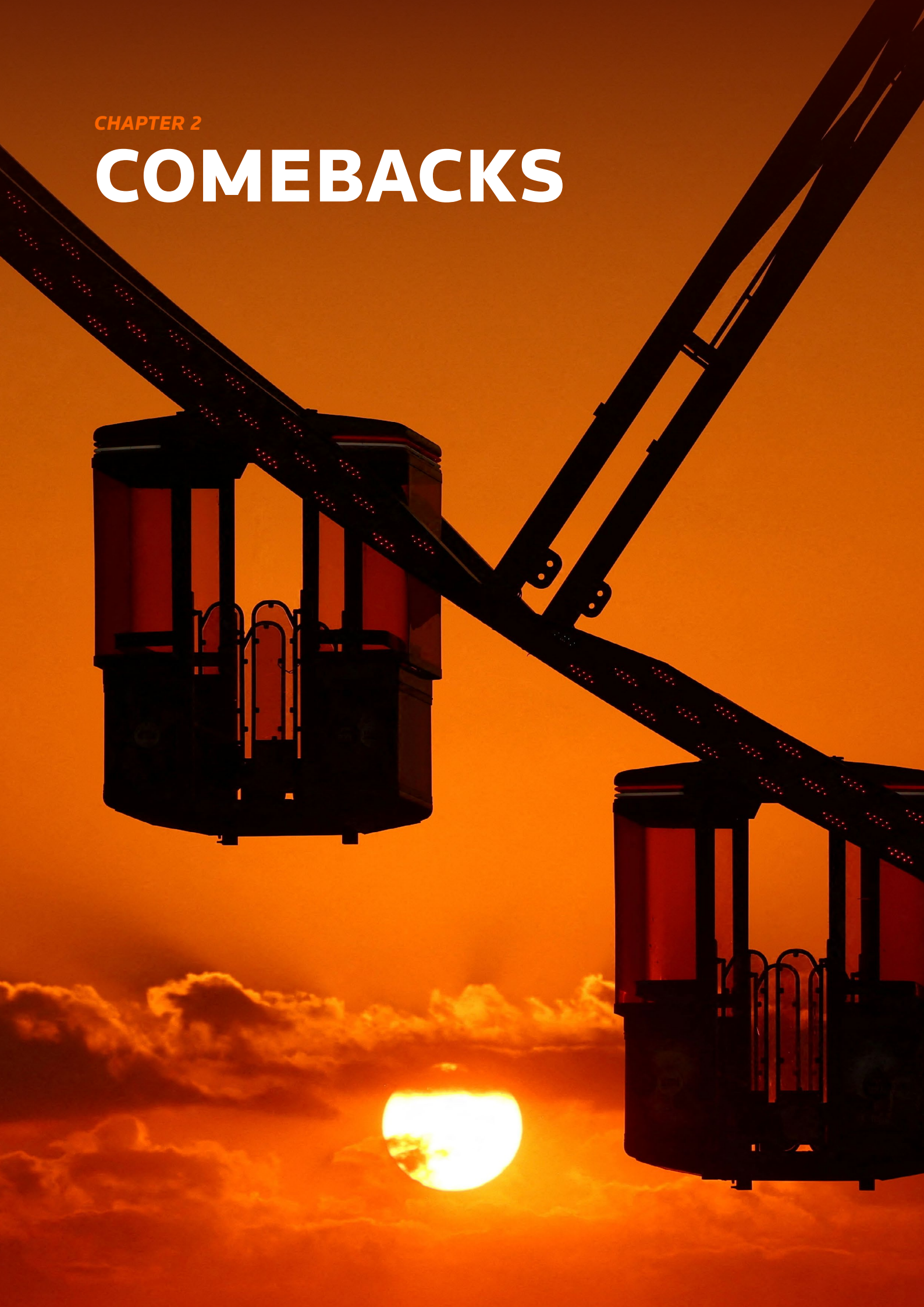
The rise of generative AI tools trained to mimic human behavior will only accelerate the backlash. Tech firms such as Alphabet and OpenAI are facing lawsuits from authors and artists who say the companies improperly scraped their intellectual property from the web to train AI models. Startups like Caden and Datacy claim to help reshape this relationship by allowing users to peddle their valuable data directly to firms. Tech giants are on notice. Instagram parent Meta Platforms and social media site X both rolled out new tools in 2023 to facilitate payments to content creators who post on their platforms.

If companies don’t pay up, Gen Alpha kids will make use of tools to withhold their personal information. TikTok influencer Coco Moe, who herself has over 1 million followers, reckons that virtual avatars will become popular among young users seeking to mask their identities on social media sites. Some parents, too, are growing wary. Meta boss Mark Zuckerberg, for example, hides his kids’ faces when posting photos of them publicly. As their generation grows up, they’re likely to do as Zuckerberg does, not as his company hopes.

First published December 2023

CHAPTER 2

COMEBACKS



MEGA-BANK M&A GOES FROM IMPOSSIBLE TO IMAGINABLE

BY LIAM PROUD

After 2008, CEOs saw investment-bank deals as risky while regulators saw them as dangerous. UBS will prove otherwise if it safely and profitably absorbs Credit Suisse. Imitators will not get the same sweet deal, but targets like SocGen and Barclays at least come cheap.

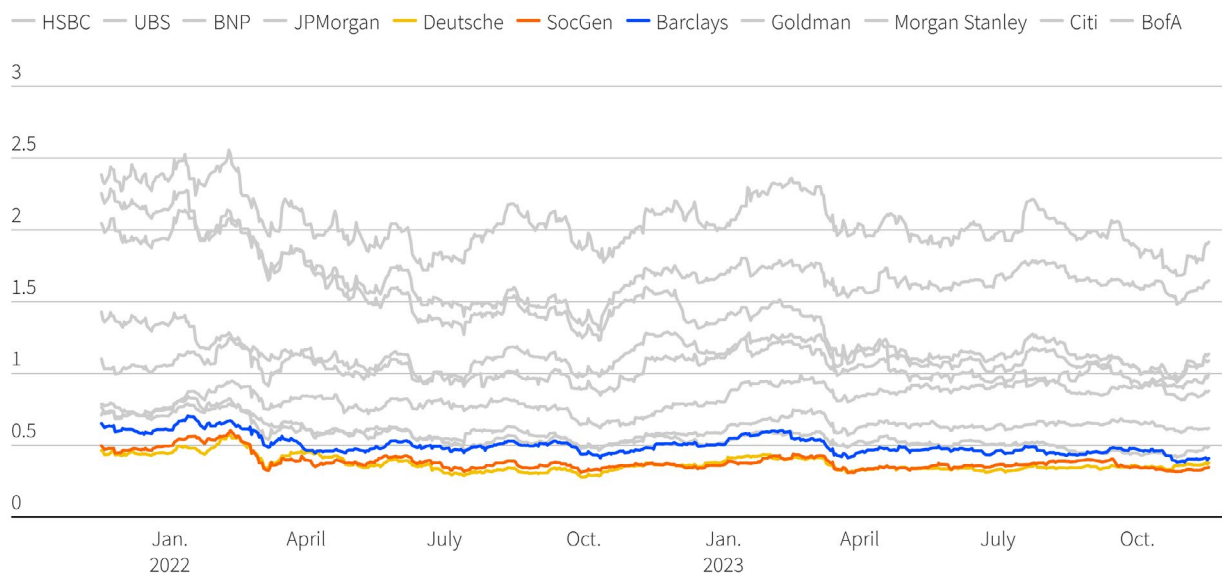
TWINKLE IN THE EYE

Big bank mergers are no longer taboo. Ever since the 2008 crisis bosses have considered consolidation between large lenders unworkable, while regulators deemed it undesirable. UBS Chief Executive Sergio Ermotti may change that if he safely and profitably absorbs local rival Credit Suisse.

Big bank M&A is tainted by painful memories of hubristic transactions, culminating in the \$100 billion breakup of Dutch lender ABN Amro in 2007 by Royal Bank of Scotland, Banco Santander of Spain, and Belgium's Fortis. That deal contributed to the collapse of two consortium members the following year and taught a generation of bank CEOs that buying a rival meant treading on financial landmines. Regulators, meanwhile, introduced rules penalising the largest and most complicated lenders. For the 30 global systemically important banks, mergers would mean holding even more capital.

THE IMPLOSION OF CREDIT SUISSE AND ITS SUBSEQUENT STATE-ORCHESTRATED RESCUE BY UBS CHALLENGES THE RECEIVED WISDOM

EUROPEAN INVESTMENT BANKS' LOW PRICE TO BOOK VALUE



Note: Share price divided by analysts' average forecast for tangible book value per share in 12 months' time
Source: LSEG Datastream, Breakingviews calculations | L. Proud | Breakingviews | Nov. 17, 2023

The implosion of Credit Suisse and its subsequent state-orchestrated rescue by UBS challenges the received wisdom. Start with regulators. Swiss watchdog FINMA for years watched as the Zurich-based lender limped from one crisis to another, while its shares traded at a big discount to book value. Investors and customers eventually lost faith. The lesson is that well-capitalised but unloved banks can fall out of favour fast. With hindsight, Swiss authorities may have preferred an earlier and more orderly merger.

That experience will shape the thinking of supervisors responsible for lowly valued European lenders like Société Générale and Barclays. There is no reason to think either of those institutions will run into trouble soon. Yet investors are sending a pessimistic signal about their long-term prospects. A takeover by a more profitable rival might avoid a potential Credit Suisse-style headache.

UBS's Ermotti is setting a promising standard for would-be imitators by planning cuts equivalent to a quarter of the two banks' combined adjusted total costs in 2022.

After deducting tax at 24% and applying a 10% discount rate, the net present value of those savings is \$76 billion, before factoring in one-off costs like severance payments. That is close to UBS's market value as of November.

Admittedly, an M&A copycat would not get the same sweet terms. UBS paid just \$3.7 billion for its local rival while regulators also wiped out funky debt securities worth \$17 billion. But SocGen and Barclays are hardly expensive. The French bank is valued at one-third of forecast tangible book value for 2024, potentially appealing to local rival BNP Paribas or long-term suitor UniCredit. Barclays, which trades at two-fifths of expected book value, could be attractive for Santander, which could wring out cost savings in Britain while boosting its Wall Street presence.

None of those deals are likely. But as memories of 2008 recede and UBS safely swallows Credit Suisse, they are more imaginable by the day.

First published December 2023



The logos of Swiss banks UBS and Credit Suisse are seen in Zurich, Switzerland, March 20, 2023. REUTERS/Denis Balibouse

BIOFUELS COMEBACK WILL GIVE WEST A RARE ENERGY WIN

BY LISA JUCCA



Corn is loaded into a truck to be transported for ethanol production in Kelley, Iowa, U.S., Jan. 21, 2020. REUTERS/Shannon Stapleton

Propellants from plant waste and animal fats have lost out amid an e-mobility push. Yet the difficulty of using electricity for planes and ships, and the rise of non-edible crops as feedstock, will offset food supply fears. Western groups like BP, Total and Eni will benefit.

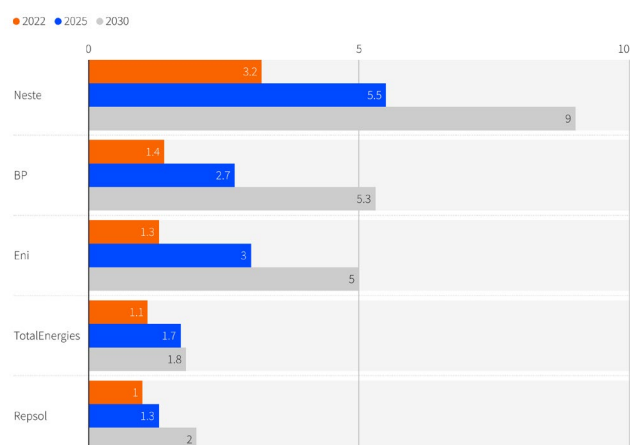
BACK WITH A VENGEANCE

A global drive to replace combustion engines with electric cars has threatened to undermine biofuels. In 2024, planes and ships will open a new avenue for propellants made from food and plant waste. That could offer a lifeline to fossil-fuel majors such as BP, TotalEnergies and Eni – and benefit the West.

BIODIESEL CAN REDUCE CARBON DIOXIDE EMISSIONS BY 75% COMPARED TO ITS FOSSIL-FUEL EQUIVALENT

Biofuels, derived from plant material or animal waste, can help fight global warming. Biodiesel can reduce carbon dioxide emissions by 75% compared to its fossil-fuel equivalent, the U.S. Department of Energy says. Oil players like Finnish pioneer Neste have been focusing on biofuels as a way to put their refining skills to a less polluting use.

EUROPEAN PLAYERS WILL BULK UP ON BIOFUELS



Note: Expected annual production of biofuels measured in capacity (millions of metric tons per annum)
Source: Bernstein | L. Jucca | Breakingviews | Nov. 24, 2023

That said, biofuels took a blow in March 2023 when European Union states decided not to spare them from a planned 2035 ban on combustion engine cars, amid concerns for the global food supply chain. Buses and commercial vehicles are also taking the e-route, particularly in China, where more than 95% of heavy-duty trucks produced in 2021 were equipped with lithium batteries.

Yet propelling large ships and airplanes requires so much power that electric batteries are impractical. That hands biofuels a new life. Using sustainable aviation fuel (SAF) made from waste and able to withstand extreme low temperatures looks the only clean energy option for aircraft: hydrogen and ammonia are either potentially explosive or poisonous. Using non-edible feedstock such as castor beans, rather than maize or sugar cane, should help alleviate food security concerns.

At about 200 million euros, the market for SAF is currently almost non-existent. Yet global regulation will force a radical uptake. The EU's ReFuelEU Aviation initiative, approved in October, requires sustainable fuel to constitute 70% of airline propellant by 2050, while the U.S. envisages 100% by then. Hence the global market could hit 50 billion euros by 2030 and 500 billion euros by 2050, SFS Ireland reckons.

This paves the way for an acceleration in biofuel demand that will benefit players with expertise. India, which chaired the G20 in 2023 and aspires to become a sustainable fuel refining hub, has launched a 19-country-strong Global Biofuel Alliance to accelerate the use of low-emission fuels. But Europe looks a more obvious winner: it contributed 60% of global production in 2022. Italy's Eni, the world's No. 3 producer, forecasts global demand to grow to 45 million metric tons per year by 2030, from about 10 million metric tons at the end of 2022.

Hoarding enough feedstock to keep up with rising demand, without compromising the food supply chain, will remain a challenge. Analysts reckon global production will probably be a third less than Eni assumes. Still, that could keep margins high and improve the prospect that biofuel businesses can be spun off and listed at decent valuations.

One relative laggard, in contrast to its breakneck electric mobility growth, is China. While Beijing announced some pilot biofuel projects in November, consumption is relatively scarce. In 2024 Western groups have a chance to jump at a green technology the People's Republic has yet to dominate.

First published December 2023

TOYOTA WILL ENGINEER A HALF-ELECTRIC RENAISSANCE

BY KATRINA HAMLIN

The world's largest carmaker is playing catchup with electric upstarts like Tesla and China's BYD, just as global demand for EVs slows. But boss Koji Sato will capitalise on the Japanese giant's edge in hybrid vehicles as the tech enjoys a sudden renaissance.

U-TURN

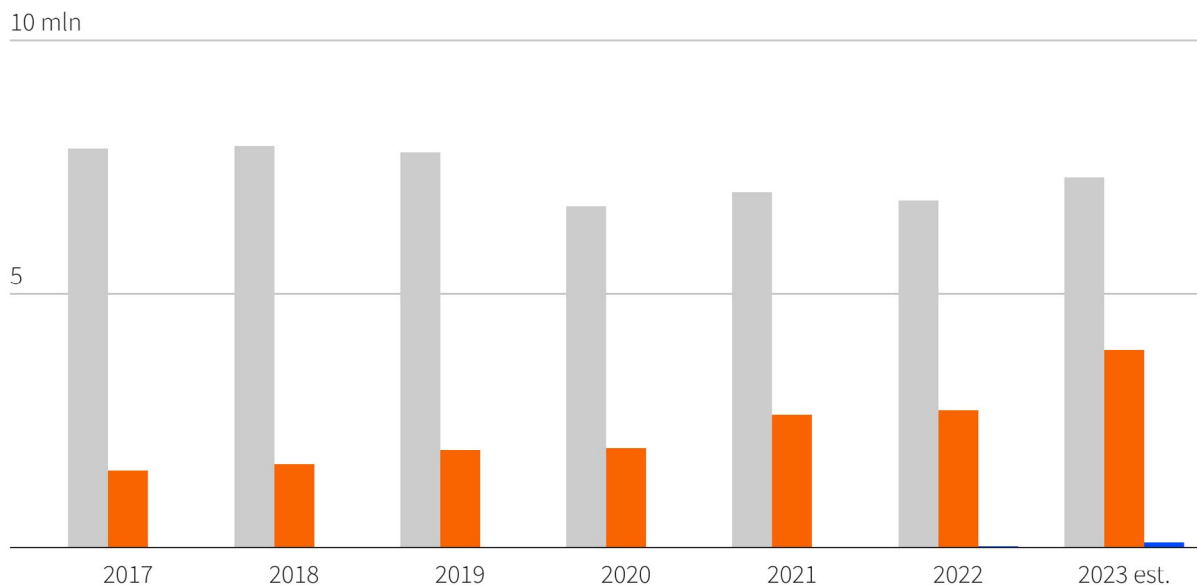
The world's largest automaker will pull back into the fast lane. Toyota Motor risked being left behind in an electric-vehicle revolution, and new boss Koji Sato has vowed to catch up. But in 2024, his greatest asset will be the company's lead in battery-gas hybrids.

TOYOTA, WHOSE SALES NEARED 9 MILLION VEHICLES IN THE YEAR ENDING IN MARCH 2023, SOLD ZERO PURE BATTERY-POWERED CARS AS RECENTLY AS 2019

Toyota, whose sales neared 9 million vehicles in the year ending in March 2023, sold zero pure battery-powered cars as recently as 2019. Competitors seized the opportunity in electric-friendly markets. Tesla displaced Toyota as California's bestseller in 2023. In China, Toyota's first mass-produced EV, the bZ4X, was met with a cool reception as local marques like BYD gained fans.

TOYOTA'S HYBRID SALES ARE PICKING UP SPEED

● Internal combustion engine sales ● Hybrid and fuel-cell vehicle sales ● Electric car sales



Note: 2023 estimate annualises sales (millions of units) for January to October

Source: Toyota | K. Hamlin | Breakingviews | Nov. 29, 2023

With Tesla's once-\$1 trillion valuation overshadowing Toyota, whose market capitalisation is around a quarter of that figure, and seemingly unanimous agreement that the future was all-electric, Sato went to work on a turnaround. Since taking the wheel in April, he has unveiled an electric roadmap that includes research into new technologies and revamping Toyota's manufacturing.

There has been progress. Toyota's pure-electric sales look set to quadruple in 2023 from 2022, albeit from a low base. And in October, the company announced a "technological breakthrough" in solid-state batteries, promising vastly longer range and quicker charging.

Sato's masterplan will take time: next-generation models only hit the tarmac in 2026. But rivals' pace has slowed, along with demand. Global electric-vehicle sales were just shy of 10 million in the first nine months of 2023, per Canalys, suggesting a roughly 30% increase for the full year. That's down from triple-digit gains in 2021. General Motors and Ford Motor have scaled back or deferred EV investment plans, while declining prices and growth have sapped Tesla's operating profit margin.

Meanwhile, Toyota has a mature technology it can exploit in the form of hybrid vehicles. The company pioneered this combination of battery motor and gas engine with the Prius in 1997. The idea is enjoying a renaissance in the U.S. and China, and analysts at Nomura reckon higher oil prices will accelerate adoption in 2024.

Toyota's hybrid sales grew by a third to power record operating profit in the quarter ended in September. Those ever-deep pockets are helping to keep Sato's electric dreams on track. Days after GM and Ford announced cutbacks, Toyota said it would spend an extra \$8 billion on a new factory in North Carolina.

Riding these successes, shares gained more than 40% in Sato's first six months on the job. Still, Toyota's valuation multiple of 9 times expected 2024 earnings paled next to BYD's 14 or Tesla's sky-high 65 times forecast earnings as of November, per Visible Alpha. Taking the middle lane between gas and electric, it can close the gap.

First published December 2023



Toyota CEO Koji Sato holds a briefing during a press day of the 2023 Japan Mobility Show at Tokyo Big Sight in Tokyo, Japan, Oct. 25, 2023. REUTERS/Issei Kato

CONVERTIBLES WILL BE 2024'S HOT FINANCIAL MODEL

BY JEFFREY GOLDFARB

Hybrid bonds, which fueled hedge fund billionaire Ken Griffin's rise, sputtered after a \$370 billion Covid-era boom. Refinancing needs are revving them back up as interest-cost savings lure new issuers like Duke Energy. New features should tempt investors to ride off with them again.

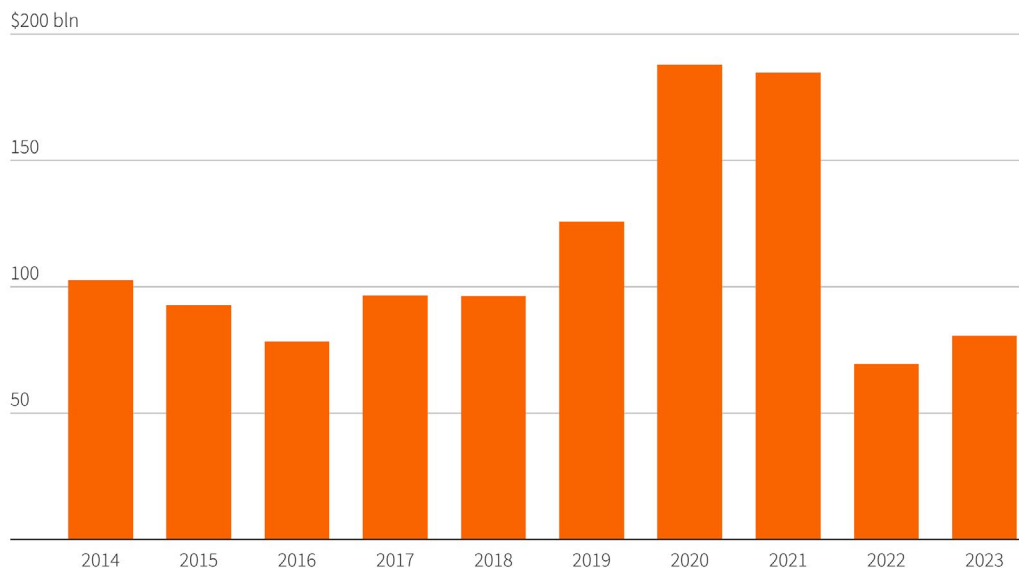
HYBRID POWER

Now is a good time to take a spin in a new convertible. Refinancing needs and higher interest rates will refuel the crossbred bonds that once helped springboard Citadel founder Ken Griffin from Harvard student to billionaire hedge fund manager. And new features should tempt investors to ride off with them again.

Convertible notes that provide steady income, but which can turn into shares at pre-agreed prices, sputtered after a \$370 billion pandemic-era boom in 2020 and 2021. Roaring stocks ultimately made the equity piece more alluring, even enabling dozens to be sold bearing zero interest. Emblematic of the crop was a \$1 billion issuance from Covid-hyped fitness company Peloton Interactive that required a 60% rise in its stock price to convert.

The theoretically optimized hybrid of loss-protected debt and equity-like upside crashed into stark reality, however. In 2022, the S&P 500 Index dropped by some 20%. Now, more than \$200 billion of these securities are set to mature by 2025, reckon BNP Paribas analysts, with many of the associated stocks well below their conversion prices. Peloton's has fallen more than 90% since borrowing the funds.

CONVERTIBLE BOND ISSUANCE COOLED DOWN POST-PANDEMIC



Note: 2023 data is through Nov. 16

Source: LSEG | J. Goldfarb | Breakingviews | Nov. 16, 2023

**DESPITE THE MANY LEMONS
CLUNKING AROUND THE
MARKET, FRESH MODELS
ARE BEING ENGINEERED**

Despite the many lemons clunking around the market, fresh models are being engineered. Benchmark U.S. interest rates have reached a two-decade high, making it more expensive to borrow. The lower coupons paid by convertible bonds and the delay in any equity dilution should be attractive under the circumstances. By mid-November 2023, issuance had jumped 34% from the same span a year earlier versus a 65% decline in leveraged loans and a mere 4% bump for investment-grade debt, according to LSEG.

Stronger issuers than fledgling and unprofitable technology companies also should help kick things into higher gear. Duke Energy, which carries an investment-grade rating, sold its first convertible bond in 2023, using some of the money to pay off short-term funding it typically favors.

The appeal of Griffin's hallmark trade is also rising for fund managers. It can be a fairly simple proposition: Buy the bonds and sell short the underlying equity. If the stock falls, the bond's downside is protected, while the short reaps a profit. If the price goes up, the bond's will too, flipping the result. These swings supply the core of the profit.

Higher rates provide a helpful twist: Invest cash proceeds from the short in safe, higher-yielding Treasury bills and add it to the bond income. These benefits also can be amplified by introducing leverage and other derivatives, albeit with additional risk. Those extra features will make convertibles 2024's hot financial model.

First published January 2024



A man carries an umbrella as he passes the New York Stock Exchange in New York, U.S., Oct. 16, 2014. REUTERS/Brendan McDermid

SWISS PHARMA MEGA-DEAL HAS HEALTHY PROGNOSIS

BY AIMEE DONNELLAN



The Swiss national flag flies in front of a building of drugmaker Novartis in Basel, Switzerland, Jan. 29, 2014. REUTERS/Arnd Wiegmann

In 2001 Novartis took a stake in Roche, yet a deal never happened. Over two decades later, the mooted acquirer is the stronger of the two and could gain from vast synergies and more heft in oncology. Making the \$440 billion union a reality means overcoming family pride, and antitrust issues.

SWISS ROLL

A \$440 billion Swiss drug deal may finally have the right formula. Back in 2001, Novartis took a stake in Roche, sparking speculation of a possible merger that never panned out. The companies' divergent fortunes, however, mean that the logic of a combination is now more convincing.

For decades, Switzerland's largest drugmakers have been close rivals and potential partners. Back in 2001, Swiss activist investor Martin Ebner, who was behind the merger that created banking giant UBS, offered his 20% voting stake in Roche to its cross-town rival, having grown frustrated with the group's management. Roche's outperformance in subsequent years meant the purchase worked out very well for \$220 billion Novartis, which pocketed a 381% total shareholder return by the time it sold the stake in 2021, according to LSEG data.

The tables now appear to be turning. Novartis's share price was up 17% between January and November 2023, thanks to success in its innovative treatments like arthritis medicine Cosentyx. Meanwhile Roche, worth under \$220 billion in late November, has had a torrid couple

of years given failed drug trials including a treatment for Alzheimer's. These disappointments, along with a relatively sparse pipeline, have seen Roche lose over 40% of its market capitalisation between its peak in 2022 and late November. Newish CEO Thomas Schinecker is setting his sights on restoring the group's pipeline, but that will be costly and take years.

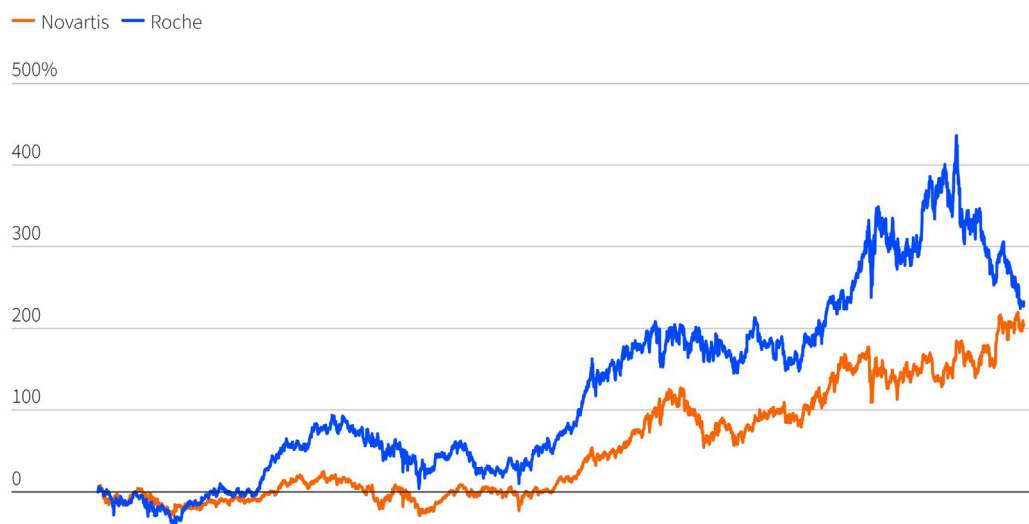
Some Roche shareholders might prefer an exit. Selling to peer Novartis would allow them to pocket a premium, and a share of synergies from any combination. It would be a big bite for Novartis CEO Vas Narasimhan: a deal with even a 30% premium would value Roche at over \$280 billion. But the rewards would be large too. Assume synergies equivalent to 10% of sales, and the earnings uplift could total \$12.5 billion, worth a whopping \$100 billion once taxed and capitalised. Moreover, buying Roche would make Novartis a leader in oncology with \$22 billion of annual revenues in cancer treatments.

GETTING SUCH A LARGE DEAL OVER THE LINE WILL FACE TWO SIGNIFICANT CHALLENGES

Getting such a large deal over the line will face two significant challenges. Antitrust watchdogs may want some disposals, especially in areas like oncology and neurology. And the Roche family, which controls 65% of the voting rights of the company, would need to be willing to loosen its grip. But with the company's share price ailing, even radical treatments may start to appeal.

First published December 2023

NOVARTIS AND ROCHE'S TOTAL SHAREHOLDER RETURNS SINCE 2001



Source: LSEG | A. Donnellan | Breakingviews | Dec. 1, 2023

DISNEY'S 2024 LIFELINE LEADS TO TIM COOK

BY JENNIFER SABA



Kansas City Chiefs' Patrick Mahomes is seen in action with Philadelphia Eagles' Jordan Davis during Super Bowl LVII at the State Farm Stadium in Glendale, Arizona, U.S., Feb. 12, 2023. REUTERS/Brian Snyder

Boss Bob Iger is seeking a partner for sports network ESPN. Tim Cook's Apple would be a nice co-owner. The brands are aligned, the executives have a history with movie studio Pixar, and the iPhone maker is getting deeper into sports.

MATCH UP

Walt Disney and Apple have a history together. A future partnership could be in the cards too. Disney Chief Executive Bob Iger is seeking a team-mate for sports network ESPN. Apple head Tim Cook is expanding into soccer and baseball coverage for its streaming service. In 2024, Iger could look to Cook for a deal.

Disney is casting around for a minority partner to invest in sports cable network ESPN. It's part of a wider effort undertaken by Iger, who is under pressure from activists including Nelson Peltz, to re-evaluate the \$170 billion entertainment company's broadcast portfolio, which includes other networks like ABC and FX.

Apple is a logical place to start. One of Iger's hallmark deals was to buy Apple co-founder Steve Jobs' animation studio Pixar for \$7.4 billion in 2006. The all-stock transaction made Jobs the largest shareholder in the Magic Kingdom, earning him a seat on Disney's board. Cook in turn recruited Iger to Apple's board in 2011, where he served until 2019.

Disney owns 80% of ESPN while Hearst, the publisher of Elle magazine and the Houston Chronicle newspaper, has the other 20%. The network has roughly 71 million subscribers through basic cable packages, as of September. But drumming up viewers is getting harder as eyeballs are fixed on streaming.

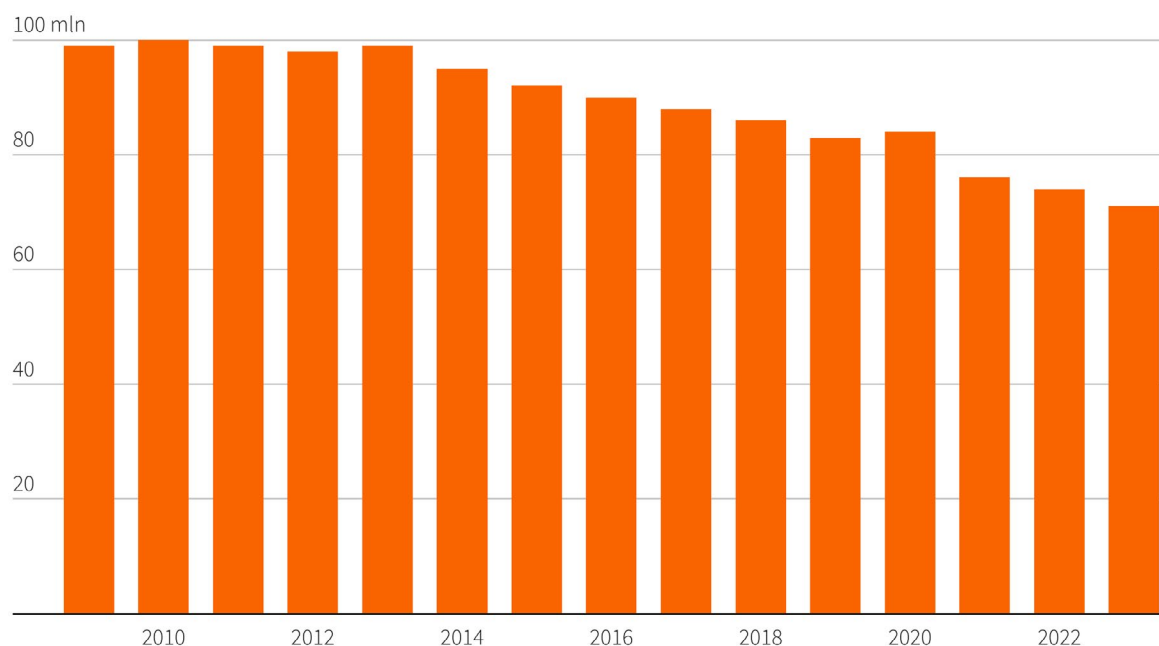
DISNEY NEEDS MONEY AND APPLE NEEDS CONTENT

Both Disney and the \$3 trillion technology giant have invested heavily in their respective streaming businesses, but they are in different stages. Disney needs money and Apple needs content, so a deal could work. Cook has bought rights to Major League Soccer and Major League Baseball. Having ESPN as its main outlet would be a punch up. Plus, Apple could seed the sports network on iPhones and through Apple TV to juice customer acquisitions.

Meantime Iger could get a cash infusion. ESPN generated approximately \$3 billion in EBITDA for the year ending September. On a multiple of 10 times, ESPN has an enterprise value of \$30 billion. With \$162 billion in cash on Apple's balance sheet, Cook could easily swing the investment and provide a lifeline to a familiar friend.

First published December 2023

ESPN HAS BEEN LOSING SUBSCRIBERS FOR A DECADE



Note: Number of subscribers to Disney's ESPN channel. For the year ended Sept. 30, 2023

Source: Walt Disney | J. Saba | Breakingviews | Dec. 1, 2023

MICROSOFT WILL FINALLY MAKE ITS MARK IN MOBILE

BY JENNIFER SABA

The software giant has famously tripped itself up in smartphones for years, but boss Satya Nadella is primed to play catchup. His Activision and OpenAI deals pave the way with “Candy Crush”, Xbox and ChatGPT. Bruising app wars at Apple and Google may exact a high price, however.

GAME ON

Microsoft is finally answering the call on mobile. After missing out on much of the boom, the software goliath is in prime position to make up for lost time. Boss Satya Nadella’s two latest deals provide a useful boost, but engaging in app wars also carries great risk.

Buying “Call of Duty” maker Activision Blizzard affords Microsoft as much opportunity in smartphones as it does to upgrade its Xbox division. One of the company’s most valuable assets, and a big contributor to its \$3.5 billion of 2022 mobile revenue, is “Candy Crush Saga”. Released in 2012, the addictive tile-matching video game, which has been downloaded some 5 billion times, keeps topping the charts more than a decade later, according to research outfit Sensor Tower.

Artificial intelligence gives Microsoft another way to dial in to the market. Its \$10 billion capital injection into ChatGPT owner OpenAI should help Nadella expand further beyond its primary business customers. The chatbot racked up more than 100 million users within two months of its release, making it the fastest rollout UBS analysts had seen in two decades of following the industry.

MICROSOFT’S ACTIVISION DEAL LANDED IT TWO OF THE TOP 10 US MOBILE GAMES

Name	Publisher name	2022 revenue
Candy Crush Saga	Activision Blizzard	\$721 mln
Roblox	Roblox Corporation	\$591 mln
Coin Master	Moon Active	\$374 mln
Royal Match	Dream Games	\$343 mln
Pokémon GO	Niantic	\$327 mln
Evony: The King's Return	Top Games	\$315 mln
Clash of Clans	Supercell	\$303 mln
Homescapes	Playrix	\$274 mln
Bingo Blitz – BINGO Games	Playtika	\$263 mln
Call of Duty: Mobile	Activision Blizzard	\$243 mln

Source: Sensor Tower | J. Saba | Breakingviews | Dec. 1, 2023

Together, these two investments increase Microsoft's ability to gauge consumer behavior, using data collected from in-app purchases and cloud gaming subscriptions. It also ratchets up the competition with other technology titans fiercely competing to match or surpass human intelligence.

Nadella's growing mobile clout already has emboldened him to talk with partners about starting Microsoft's own gaming app store. The company previously staked some ground by testifying for "Fortnite" parent Epic Games in its ongoing lawsuit against Apple and Google, which alleges that monopoly power enables them to force developers to use proprietary payment systems that take a 30% cut of purchases.

The European Commission, meanwhile, recently targeted six tech "gatekeepers", which could lead to third-party workarounds of the two operating-system goliaths. With Microsoft's branding power, its own Xbox shop would be

an attractive alternative and threaten the fees Apple and Google collect. Gaming accounted for an estimated 20%, or \$17 billion, of Apple's services revenue for the year ending September 2023, according to Jefferies analysts.

NADELLA MAY YET HAVE THE LAST LAUGH

Throwing its weight around in mobile will invite more regulatory scrutiny of Microsoft, after largely avoiding the spotlight in the 25 years since it was a defendant in a landmark U.S. antitrust case. Increased market power should also reverse another piece of history in a more beneficial way. When asked about the newly released iPhone a dozen years ago, Microsoft's then-boss Steve Ballmer cackled about its prospects. Nadella may yet have the last laugh.

First published December 2023



Microsoft CEO Satya Nadella speaks during a Reuters Newsmaker event in Manhattan, New York, U.S., Sept. 27, 2017. REUTERS/Shannon Stapleton

STANCHART M&A THEORY WILL FINALLY BECOME REALITY

BY ANSHUMAN DAGA

For years, the bank run by Bill Winters was cheap but dysfunctional. Now, it's producing significantly higher returns on tangible equity but the valuation remains low. If that persists in 2024, it will be hard for suitors like First Abu Dhabi Bank to resist launching a bid.

THROUGH THE WINTER

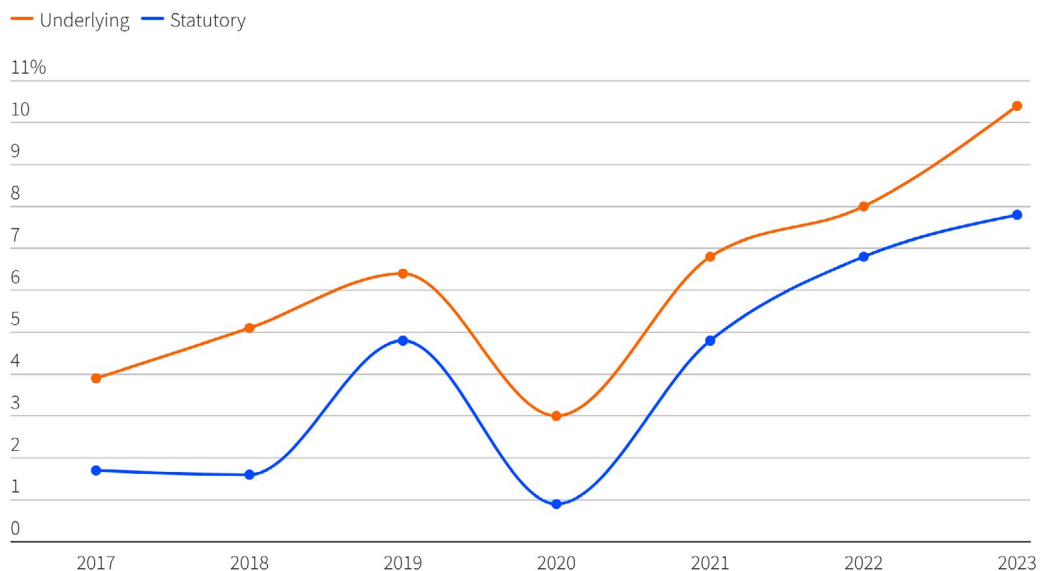
Things are finally going well for Bill Winters' Standard Chartered. After a long period of anaemic performance, the Asia-focused lender generated a 10.4% underlying return on tangible equity in the first nine months of 2023, excluding a one-off impairment charge. But you wouldn't know it from the share price. If that disconnect persists in 2024, long-running takeover theory may get real.

The London-listed lender has been the subject of M&A rumours for decades, with mooted suitors including Barclays, ANZ, and even the state-owned Chinese banking behemoths. First Abu Dhabi Bank (FAB) in early 2023 said it had studied a possible offer but was no longer doing so.

THERE ARE GOOD REASONS WHY A BID HAS NEVER MATERIALISED

There are good reasons why a bid has never materialised. Start with StanChart's global sprawl, which includes wholesale and retail-banking businesses and spans 50 countries in Asia, Africa, the Middle East and elsewhere. Very few possible acquirers would have an interest in bulking up in all those markets at the same time. The vast global footprint also means there are dozens of regulators and governments who could potentially make a takeover tricky.

STANDARD CHARTERED'S RISING RETURN ON TANGIBLE EQUITY



Note: 2023 figure is for the first nine months of the year. Chart uses most recent restated figures where available

Source: Company reports | A. Daga | Breakingviews | Nov. 24, 2023

What's changed, however, is that StanChart's long-standing discount now jars with the performance that Winters is churning out. Throughout much of 2023, the bank's share price bounced around between 0.5 times and 0.6 times analysts' average forecast for its tangible book value in 12 months' time, LSEG data show. Historically, a low multiple was justified by low returns. But if the London-headquartered lender's recent performance is sustainable, there shouldn't really be a discount to book value at all. The upshot is that StanChart now looks attractively cheap, rather than deservedly so.

That could tempt FAB to take another look in 2024. A takeover would fit nicely with Gulf states' ever more expansive corporate ambitions. Trade corridors are growing between the Middle East and Asia.

A combination of the United Arab Emirates' biggest bank and StanChart could form the financial backbone of these flows. Offering to divest businesses could ease regulators' fears. It also helps that the 18% of StanChart owned by Temasek for more than a decade looks increasingly like a non-core holding. In theory, a would-be acquirer could sew up roughly one-fifth of the shares in one go by getting the Singapore state investor to tender.

Any bidder would have to be confident that U.S. authorities would allow the enlarged entity to keep StanChart's dollar-clearing licence, which would be a bigger gamble for FAB than for Western lenders. Still, the gap between the bank's valuation and its recent performance makes for an alluring financial combination, and boosts the chance that someone will finally pounce.

First published December 2023



Standard Chartered CEO Bill Winters speaks during the Global Financial Leaders' Investment Summit in Hong Kong, China, Nov. 2, 2022. REUTERS/Tyrone Siu

A tall, bare tree silhouette stands against a dark, misty background. The tree's branches are intricate and spread out, reaching towards the top of the frame. The overall atmosphere is somber and quiet, with a gradient of dark blues and greys in the sky and a dark, indistinct ground.

CHAPTER 3

FALLING FLAT

POLLS MAY IMPERIL EMERGING ASIA'S POLICY STABILITY

BY UNA GALANI AND ANSHUMAN DAGA

India and Indonesia have had a decade of relative predictability under leaders Narendra Modi and Joko Widodo. Elections in 2024 could upend that and undermine the lofty valuations of local stock markets. Global investors, and 1.7 billion people, should temper expectations.

ALL CHANGE

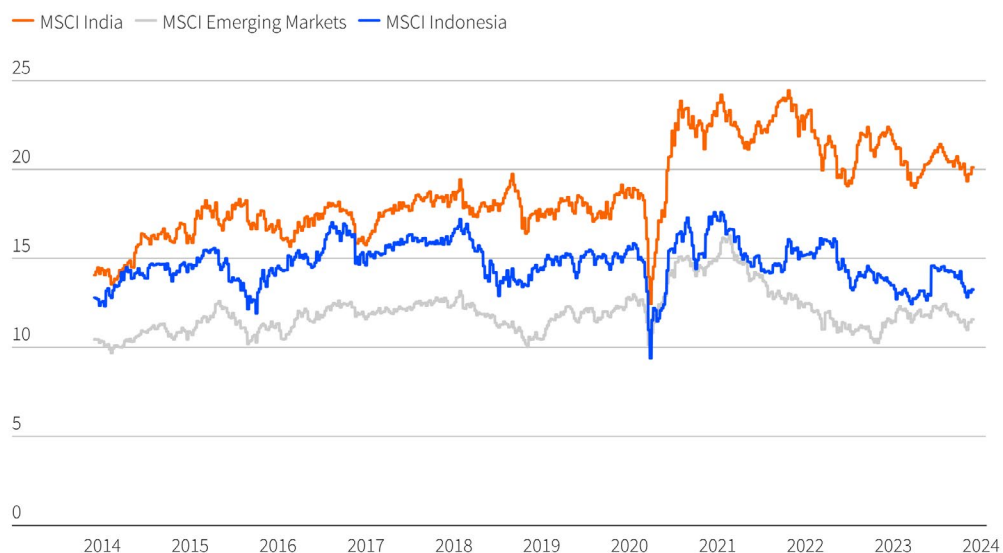
A predictable, business-friendly environment is a rare find in emerging markets. India and Indonesia have enjoyed this elusive commodity, more or less, for roughly a decade under leaders Narendra Modi and Joko Widodo, respectively. With elections coming up, the political stability governing some \$4.7 trillion worth of GDP will come under question.

VOTERS AMONG THE 1.7 BILLION PEOPLE IN THE TWO ASIAN BEHEMOTHS WILL GO TO THE POLLS IN 2024

Voters among the 1.7 billion people in the two Asian behemoths will go to the polls in 2024. The results will be watched closely by foreign executives and investors who are trying to reduce their dependence on China and cut risks in their supply chains. Together India and Indonesia account for almost 18% of the MSCI Emerging Markets Index, more than double the level 10 years ago. Chinese CEOs are also looking hard at these countries as domestic growth slows and labour costs rise.

A change of president is guaranteed in Jakarta. Jokowi, as he is popularly known, has reached his term limit and cannot stand for re-election. But his son is the running mate of Defence Minister Prabowo Subianto, a two-time presidential loser who is chasing the top job again.

INDIA AND INDONESIA ARE EXPENSIVE MARKETS



Note: Forward price-to-earnings ratios

Source: LSEG | U. Galani | Breakingviews | Nov. 30, 2023

That joint ticket is both favourite and controversial: Jakarta suffered some of the worst civil unrest in years in 2019 after Prabowo initially refused to concede defeat following elections that handed Jokowi a second term.

Jokowi's successor will have big shoes to fill. Foreign direct investment into Indonesia, at \$45 billion, is at a 20-year high and the government's industrial policy is embedding nickel-rich Indonesia into the global supply chain for electric vehicles. Chinese companies now dominate the country's smelting capacity, however. At least one presidential candidate, Jakarta Governor Anies Baswedan, might be inclined to pivot Southeast Asia's largest economy towards the United States, though he is not a frontrunner in the race.

Modi remains firm favourite to win in India and results released in December from state polls suggest robust support for his ruling party. Yet the country could see the return of a messy coalition government if his Bharatiya Janata Party is unable to win an outright majority for a

third consecutive term. Policymaking could get bogged down in petty squabbles in this scenario, as it was before he came to power in 2014, even though politicians across the divide broadly agree on the economic path forward. Corruption could soar too. Annual foreign direct investment into India has already fallen back down to 2018 levels and any sign of political upheaval could scare off companies waiting on the sidelines to invest.

The world has obsessed about geopolitics for some time. As the focus also zeroes in on domestic politics, both countries' markets are priced to perfection and assume some continuation of the status quo. The MSCI India Index was near a record high as of Dec. 3, trading at 20 times earnings, while the MSCI Indonesia Index was at 13 times, above the wider emerging market benchmark's 12 times forward valuation. That leaves plenty of room for disappointment.

First published December 2023



India's Prime Minister Narendra Modi (L) talks to Indonesia's President Joko Widodo (R) prior to a photo session during the 20th ASEAN-India Summit as part of the 43rd ASEAN summit in Jakarta on Sept. 7, 2023. Adek Berry/Pool via REUTERS

ARTIFICIAL INTELLIGENCE WILL EMBARK ON A DATA DASH

BY KAREN KWOK

Text and photos produced by professionals are key to training and improving AI models. But accessing this information is getting harder and more expensive. AI firms will have little choice but to pay for data, pushing up already-high costs – and delivering a windfall to publishers.

THE IMITATION GAME

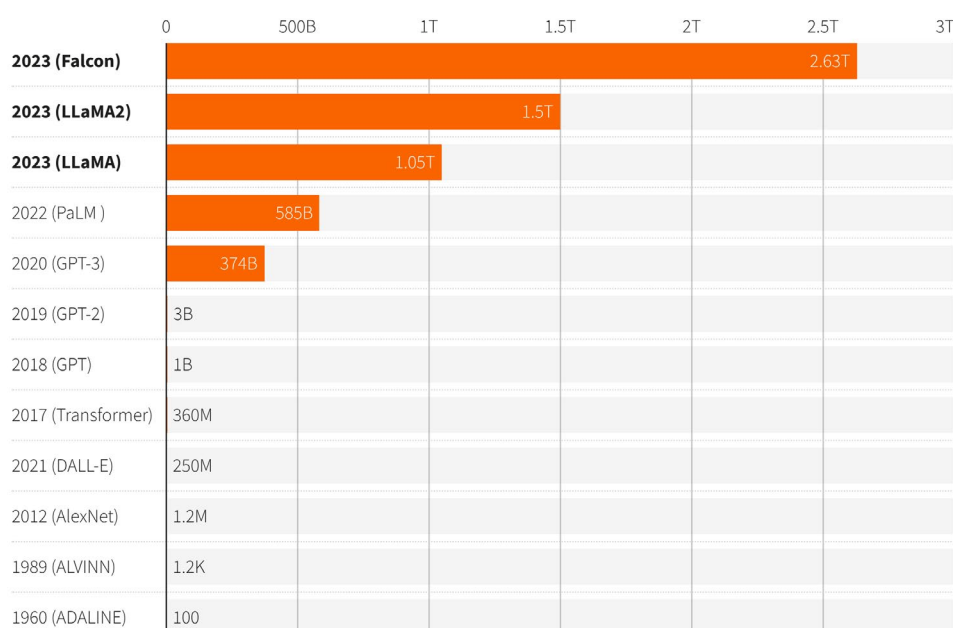
The artificial intelligence race is turning into a dash for data. The most cutting-edge AI models can already achieve high scores in the U.S. bar exam and write human-like text. To keep improving their abilities, software needs to train itself on more sophisticated types of information, such as pictures and scientific papers. But these data are less available and more expensive.

The sophistication of AI software depends in large part on the quality of the datasets on which it trains. Social media posts are easy to find on the internet but can reflect bias or prejudice, while pictures tend to be blurry. Using such data may lead to racist and misogynistic output, as Microsoft experienced when it trained an AI model using Twitter posts.

This is why AI companies are looking for more reliable sources, such as scientific papers and books written by professional authors. These are harder to find. Researchers from Epoch, who sort data into high and low quality, estimate there are as many as 17 trillion high-quality words freely available on the internet, compared with up to 71 quadrillion low-quality ones. If AI models keep swallowing information at the current rate, they could run out of superior data before 2026.

AI MODELS ARE SUCKING UP EVER MORE DATA

● Number of datapoints required to train artificial intelligence models



Source: BofA Global Research, Our World in Data, Epoch, Parameter, Compute and Data Trends in Machine Learning, DeepMind: Training Compute-Optimal Large Language Models | K. Kwok | Breakingviews | Dec. 5, 2023

THERE ARE AS MANY AS 17 TRILLION HIGH-QUALITY WORDS FREELY AVAILABLE ON THE INTERNET, COMPARED WITH UP TO 71 QUADRILLION LOW-QUALITY ONES

One option is for developers to use AI to generate fresh data for specific models. Several projects are already using so-called synthetic content, often sourced from data-generating services such as Mostly AI. American Express creates such data to help it detect uncommon fraud patterns, while Alphabet's Waymo uses made-up scenarios to help train its self-driving software. Research group Gartner expects 60% of AI data will be synthetic in 2024, up from just 1% in 2021.

However, AI models are still hungry for real-world information held by large publishers and offline repositories. This could be a windfall for groups like

RELX, owner of The Lancet and the LexisNexis legal database. Shares in the company, which builds AI software in-house and sells it to customers and was worth over \$70 billion in early December, are up more than 30% in the past year. News Corp, which publishes the Wall Street Journal and the Times, is negotiating content deals with AI developers which it says will bring in "significant revenue".

Such deals will be an additional cost for AI companies, which already spend the equivalent of 15% of their revenue sorting and cleaning data, venture capital firm Andreessen Horowitz estimates. Royalty payments will eat into profit margins thinned by expensive computing power and rising cloud storage costs. But companies such as OpenAI, creator of the ChatGPT chatbot, don't have much choice. Warner Music Group, Getty Images and many other creators are suing AI companies for unauthorised use of their content. One way or another, AI companies will have to pay up for their data dash.

First published December 2023



"Desdemona", an AI-powered robot, stands on stage and answers questions from visitors during the IFA international consumer technology fair in Berlin, Germany, Sept. 1, 2023. REUTERS/Lisi Niesner

CHINA'S AUTOMAKERS WILL DEFY THE GREAT UNCOUPLING

BY JONATHAN GUILFORD

There are industries, like microchips, where American trade warriors can cleave friendly supply chains from China. Cars aren't one of them. Despite \$80 billion of announced investments, lagging tech holds U.S. champions back. In 2024, that will prove the limits of protectionism.

MY WAY OR THE HIGHWAY

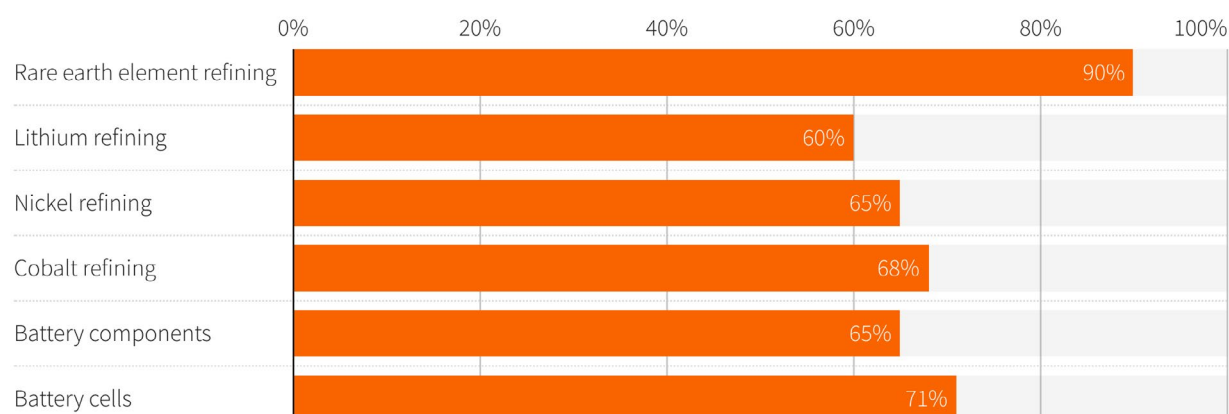
It has become a truism that China and the United States are engaged in a great uncoupling. In strategically sensitive areas, from microchips to telecoms equipment, a wedge has already been driven between the two superpowers. But car companies – and specifically electric vehicles – could sketch out the limits of American protectionism.

Detroit-based automakers General Motors and Ford Motor still agree, despite their production difficulties, that electric cars are the future. They're racing to catch Elon Musk's Tesla, the U.S. company that proved battery-powered rides can catch on. The Inflation Reduction Act, passed in 2022, promises billions of dollars in subsidies, and companies have announced \$80 billion of electrification investments since its passage.

Protecting all-American marques is part of the plan. The IRA focuses too, though, on supporting domestic manufacturing of batteries, electric cars' most crucial component. The cost of letting China dominate the market is high. Batteries won't just power cars, but will also be key in propping up the electric grid, since energy from renewable sources must be stored somehow until needed.

CHINA HAS A FORMIDABLE LEAD

CHINA'S TOWERING MARKET SHARE IN BATTERY PRODUCTION



Note: China's global share of production in each category

Source: Goldman Sachs | J. Guilford | Breakingviews | Dec. 1, 2023

The trouble is that China has a formidable lead, which stretches from refining raw materials through to final production. The country accounts for roughly three-quarters of global battery cell supply, according to Benchmark Mineral Intelligence, and has a cost advantage to boot. Chinese nickel-manganese-cobalt cells, the most popular for cars, were 15%, or \$18.30 per kilowatt-hour of energy capacity, cheaper than Uncle Sam's home-made equivalents in August, Benchmark reckons.

Biden's \$35 per kilowatt-hour subsidy for U.S.-made battery cells closes the gap. But Chinese costs are falling rapidly – and, more importantly, the People's Republic leads in the next wave of battery tech. Tesla, GM and Ford are adopting lower-cost lithium-phosphate batteries for their cheaper models, over 90% of which come from

China. Ford had to license the technology from Chinese firm CATL, raising the possibility that U.S. subsidies will flow to its partner. Chinese suppliers are already developing sodium-ion batteries, another upcoming technology, too.

Even for finished cars, there may be routes into the United States: Members of Congress have raised concerns about Chinese automakers establishing operations in Mexico, where fewer import barriers exist. When it comes to chips or cell towers, Washington has an advantage to press. On the road, though, it risks being left behind. That makes the pursuit of decoupling seem a little less logical.

First published December 2023



A Li L7 electric SUV by Li Auto is displayed at the Auto Shanghai show, in Shanghai, China, April 18, 2023. REUTERS/Aly Song

DEFLATION WILL HELP BIG GROCERS GOBBLE UP MINNOWS

BY AIMEE DONNELLAN



A shopper walks next to a photographic depiction of tomatoes on a Tesco supermarket in London, Britain, Feb. 26, 2023. REUTERS/Toby Melville

Supermarkets like Walmart and Tesco are expecting goods prices to finally fall. That will help larger chains to cut shoppers' bills by putting pressure on suppliers such as Unilever. Smaller rivals may find it harder and end up losing customers, making them ripe for takeovers.

PRICING POWER

Big supermarket chains may be unlikely winners from deflation. Walmart and Tesco are expecting prices to fall in 2024 as they pile pressure on suppliers like Unilever. Even more competition will make it harder for minnows to retain market share. That could set up a new wave of consolidation.

FOR GROCERS, RISING PRICES CAUSED TWO PROBLEMS

Walmart is bracing for falling prices. In November, CEO Doug McMillon said key grocery items like fish, eggs and chicken, as well as pantry items, could start to get cheaper. Deflation would represent an about-turn for a sector that has faced soaring inflation across Europe and the United States over the past couple of years. For grocers, rising prices caused two problems. It prompted customers to rein in spending, and it also left supermarkets vulnerable to accusations of "greedflation" – taking advantage of inflation to boost profit margins. Conversely, falling prices ought to encourage consumers to fill up their trolleys and more customers to come to the stores.

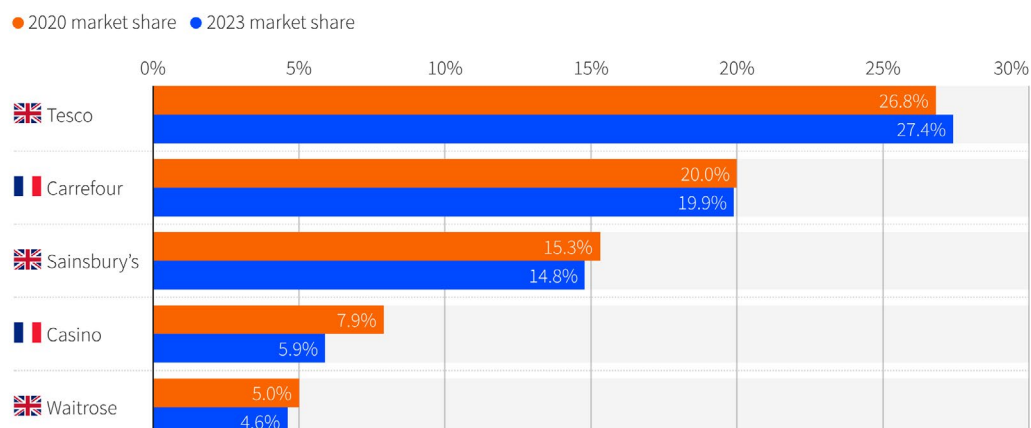
This will put the biggest grocers in a more powerful position. As wholesale prices ease, the likes of Tesco, which has over 27% of the UK market, French giant Carrefour and the United States' largest retailer Walmart will be able to pass on savings more quickly to customers. Ahold Delhaize CEO Frans Muller told a Breakingviews podcast in September that this was already happening. He noted that negotiations with suppliers were becoming easier because grocers produce a lot of private label items, so they have a more accurate reading on what goods cost.

If the giants bring their pricing power to bear, they might crush, or gobble up, smaller players. In Britain, Waitrose, which generates around 6 billion pounds of revenue, is a prime example of a chain that could be sold to a larger rival, not least because its troubled parent company John Lewis is looking for 2 billion pounds from an investor to help fund its turnaround. Even larger supermarkets like Sainsbury's, which generates around 30 billion pounds of sales, could be a target if Tesco starts passing on wholesale price falls to consumers and it struggles to compete.

Since May, valuations of supermarket chains, small and large, are coming down as investors worry about deflation's impact on revenues and margins. But the larger grocers will be better equipped to respond by cutting prices and taking a bigger share of the market. If smaller rivals' valuations keep coming down, they will soon find themselves in the bargain basement.

First published December 2023

SMALLER GROCERS HAVE ALREADY BEEN SHRINKING POST-PANDEMIC, WHILE LARGER RIVALS HAVE HELD STEADY OR GROWN



Note: Grocers' market share in home market

Source: Kantar Worldpanel | A. Donnellan | Breakingviews | Nov. 30, 2023

EU TECH RULES WILL CREATE CLICKS, NOT COMPETITION

BY REBECCA CHRISTIE

Brussels wants to force Google, Meta and Apple to open up app stores, messaging networks and search engines. The U.S. giants will have to let startups compete and offer consumers more opt-outs. It's likely to result in lawsuits and hassle for users rather than rivals for Big Tech.

TACKLING TECH

European Union watchdogs are so frustrated with Big Tech dominance they have turned their traditional approach to regulation on its head. Rather than trying to prove that existing practices shortchange users, new digital rules require market-leading companies to simply open up their systems. But by focusing on competition among providers instead of whether consumers benefit, the EU's main result may just be more frustrating clicks.

Alphabet, Meta Platforms, Apple, Amazon.com, ByteDance and Microsoft are the first targets of the Digital Markets Act, a 2022 law that requires so-called gatekeeper services to open up their "walled gardens". The EU in September identified 22 products at the six companies, including Google Search, social networks like Facebook and TikTok, and browsers like Chrome and Safari.

The designations also include the Google Android, Windows PC and Apple iOS operating systems, and intermediaries like Amazon Marketplace. Designated firms have until March to show that they are doing the necessary work so that third-party developers have access to their platforms and so that consumers aren't shoehorned into too many defaults. ByteDance, Meta and Apple already have filed appeals.

But opening the door doesn't guarantee anyone will walk through it. If startups don't materialise, or if consumers are reluctant to switch away from familiar brands or pay new subscription fees, the EU will end up adding paperwork and annoying layers of "choice screens" rather than creating more competition.

BRUSSELS' APPROACH REGULATES ACCESS, NOT OUTCOMES

Brussels' approach regulates access, not outcomes. In designing the new rules, the EU has fallen back on a definition of competition that focuses on the number of businesses rather than what might be best for customers. This framework would consider it a win if previously free services like Facebook and Instagram start charging fees, because then companies would no longer have free rein to scoop up and monopolise customer data.

But consumers may not place the same importance as regulators on breaking up the market, especially if it carries extra costs. Instead, they may resent creeping subscription charges that start out as optional but eventually become unavoidable for day-to-day use.



And they may rue the time it takes to click through “choose your default” boxes rather than enjoying benefits of switching search engines or app stores.

It’s certainly possible that more competition will drive costs down in certain areas. If, for example, search engines were to keep a smaller portion of advertising-driven online purchase revenues, retailers might lower their prices. Antitrust litigation in the U.S. has shown that in 2021 Google paid \$26 billion to Apple, Samsung and others to keep its search engine dominant on phones and web browsers – money that could change hands if customers were better able to pick their own defaults.

But a risk is that the EU ends up ignoring the lessons of its most popular regulations, like one that lowered the cost of cross-border cellphone roaming, and doubles down on rules that emphasise policy outcomes over citizen experiences. The General Data Protection Regulation is a cautionary tale.

GDPR is generally supported in Europe for its voter-friendly commitment to the “right to be forgotten”, which gives consumers the power to scrub their data from certain search engines. In the rest of the world,

however, it’s mostly known for the endless “cookie” consent screens that require consumers to accept, reject or customise data tracking code for websites they visit.

Users in Europe have largely accepted this as the price of privacy, but there has not been worldwide buy-in. Some non-EU websites have just made their pages inaccessible within the 27-country single market, while most others have added those click boxes for all their users worldwide. Very few consumers have the capacity, or time, to make meaningful decisions.

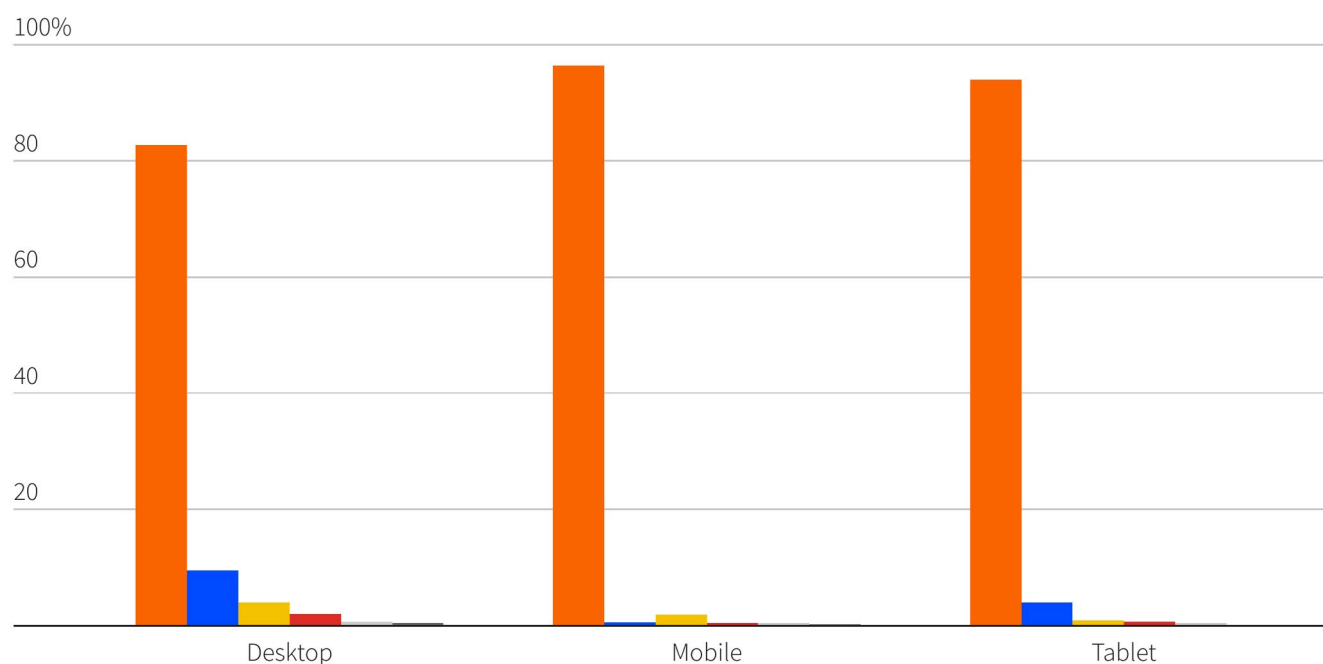
In any case, legal fees may eclipse marketplace changes in 2024, as the big companies roll out challenges to new rules and requirements. This means the European Commission will either have to collaborate with the firms in enforcing its new rules, potentially watering down their impact, or brace itself for a decade of litigation against companies with some of the deepest pockets on the planet.

The stakes may make the whole exercise worthwhile. But to gain public trust, the Commission will have to start paying attention to public prices.

First published December 2023

SEARCH ENGINE MARKET SHARE IN EUROPE

● Google ● Bing ● Yandex ● Yahoo ● DuckDuckGo ● Ecosia



Note: Data as of October 2023

Source: Statcounter Global Stats | R. Christie | Breakingviews | Nov. 21, 2023



AMAZON'S SPACE DREAMS DESERVE TO BE GROUNDED

BY ROBERT CYRAN

The tech giant's \$10 billion internet-in-the-sky venture is years late and thousands of satellites short in rivaling SpaceX. It may appeal to founder Jeff Bezos and his rocket-maker Blue Origin. But Amazon risks a costly re-run of prior telecoms booms that led to painful busts.

FAILURE TO LAUNCH

Amazon.com's Project Kuiper is a misguided technological marvel. The plan to build a sky-spanning network beaming down internet service from space, dreamed up when founder Jeff Bezos still ran the company, took a step forward with the launch of two prototype satellites, which are operating as expected. But with costs set to top \$10 billion and rival SpaceX's Starlink well ahead, current chief Andy Jassy would be best served by grounding the venture.

The promise of global satellite broadband has drawn tech billionaires from Bezos to Microsoft's Bill Gates, who backed Teledesic before it went belly-up in the 2000s, to SpaceX honcho Elon Musk. It's a huge endeavor. To offer sufficiently speedy connections, satellites must be close to Earth. That necessitates thousands to ensure one is always overhead, hence the recent explosion in the number being shot into orbit. Starlink has over 5,000.

Kuiper aims for 3,200, even as Musk plans further expansion. Each new satellite increases coverage, making it easier to find a connection. That allows for simpler and cheaper terminals – the devices customers use to log on – even as service improves. SpaceX says its terminals' cost fell from \$1,300 each to under \$599 since 2021.

Such first-mover advantages are why building a communications network to compete with one already in place is a recipe for incinerating cash. During the dot-com era telecoms boom, entrepreneurs borrowed heavily to build millions of miles of fiber-optic cables and overlapping local systems. Poor returns drove a wave of bankruptcies, including the once-\$47 billion Global Crossing.

Of course, Kuiper isn't an existential bet for Amazon, which is worth well over \$1 trillion. But \$10 billion-plus in earmarked spending jars with Jassy's cost-cutting drive. Bezos-founded rocket-maker Blue Origin is in line for \$2.7 billion of that sum, which drew a shareholder lawsuit accusing Amazon of a conflict of interest.

Since low-orbit satellites need replacing every five years or so, the spending won't stop there. Worse, competition will be fierce: Eutelsat Communications' OneWeb has already begun putting its network into orbit; China alone plans networks comprising 25,000 satellites.

A FLOATING GRAVEYARD OF UNUSED SATELLITES POSES A POTENTIAL HAZARD

That could lead to massive overcapacity, as the fiber boom did. While those cables enabled a flourishing online economy years later, though, a floating graveyard of unused satellites poses a potential hazard. A recent U.S. government report warned that space junk from currently planned networks could start regularly falling back to Earth by 2035. Facing an uncertain payoff and the possibility that its efforts will burn up on re-entry, Amazon's best move is bowing out of a futile space race.

First published October 2023

DEAR CHANCELLOR: INFLATION WILL FALL... WHEN IT FALLS

BY FRANCESCO GUERRERA

Bank of England Governor Andrew Bailey has to write to the UK finance minister when consumer price growth is above or below 2%. Yet it's clear mere central bankers can't influence the behaviour of people or firms. Breakingviews imagines a letter in 2024 which says as much.

BAILEY'S DREAM

Dear Jeremy,
Here we go again. As required by the Bank of England's Monetary Policy Committee rules, I have to write to you on BoE-noteheaded paper to explain why inflation is so much higher than our 2% target. And what we, at the central bank, are doing about it. I'm afraid it's not good news.

This is the 10th letter I have had to write to a UK finance minister explaining why consumer price increases are running much faster than we would like. Clearly that's not great, since as BoE boss I basically have one job: to not let inflation run wild. On the other hand, you are the third Chancellor of the Exchequer I am corresponding with in just over two years, so things aren't exactly stable at Number 11 Downing Street either.

The fact is that inflation has consistently been well above our 2% target. Oops.

WHY HAS INFLATION MOVED AWAY FROM THE 2% TARGET?

Here, I could waffle on a bit about "external cost pressures" – the inflationary effects of the pandemic and Russia's invasion of Ukraine. Then I could bore you about "internal cost pressures", rising wages, and the price of services like hotels and airfares.

What I wouldn't say is exactly why inflation remains so high. Nor when it will fall back to 2%. That's because, in a very real sense, we don't have a clue.

Don't get me wrong: our PhD-laden staff produce lots of forecasts. We now say that inflation will fall to 1.9% in late 2025. But our track record is less than stellar. You might remember that in September 2021, I wrote to Rishi Sunak, your pre-predecessor, confidently stating that "current elevated global cost pressures will prove transitory". The CPI index was 3.2% then. It peaked at 11.1% in October 2022. Oops again.

Predicting is of course very difficult, especially if it's about the future. (H/T Danish physicist Niels Bohr – I did say I would bore you.) Even so, we at the BoE are self-evidently useless at it. Our projections missed the actual inflation



numbers by an average of 6 percentage points between December 2021 and March 2023, according to those know-it-alls at Breakingviews.

There's some good news. I have asked Ben Bernanke to review our forecasting models. He knows a thing or two about predictions. He used to run the U.S. Federal Reserve and has won a Nobel Prize. On the other hand, in May 2007 he said the subprime crisis "will be limited". Oops yet again.

THE POLICY ACTION THE COMMITTEE IS TAKING IN RESPONSE

Well Jeremy, we are both doing too much and not enough. My fancy-dan predecessor Mark Carney may have called me a "big sexy turtle" in honour of my excessively "considered" decision-making. He can talk: he hardly raised rates at all during his seven-year tenure. I've hiked them 14 times to a 15-year high of 5.25%.

Trouble is, that might end up crashing an already fragile economy. We expect growth of just 0.5% in 2023 and a big fat zero in 2024. That may not be what you want to hear given how badly the Conservative Party is faring in the polls ahead of an election expected by the end of 2024. Soz.

**THESE DRACONIAN MEASURES
MAY NOT BE ENOUGH TO QUELL
PRICE GROWTH**

Better or worse still, depending on how dark your sense of humour is, these draconian measures may not be enough to quell price growth. Sure, inflation has more than halved since its peak and we do publicly claim we will not rest until it is back to 2% again – because, well, we need to project authority and we can't really do anything else. But the reality is that we don't have the right tools to fight this kind of price pressure. Our only weapon, short-term rates, is fairly good at dampening demand by making money more expensive. But even that is achieved after what Milton Friedman called "long and variable lags". No, me neither...

The problem, Jeremy, is that the bulk of the inflationary spiral was caused by supply-chain shocks – spikes in the prices of raw materials, energy and food due to the pandemic and the war. Thankfully, those pressures are now abating, but other inflation drivers are still elevated – "core" inflation excluding energy, food, alcohol and tobacco was 5.7% in October 2023. That, in turn, is fuelling workers' demands for higher wages – up by an annual 7.7% in the three months to September 2023 – to pay for the higher cost of being alive.

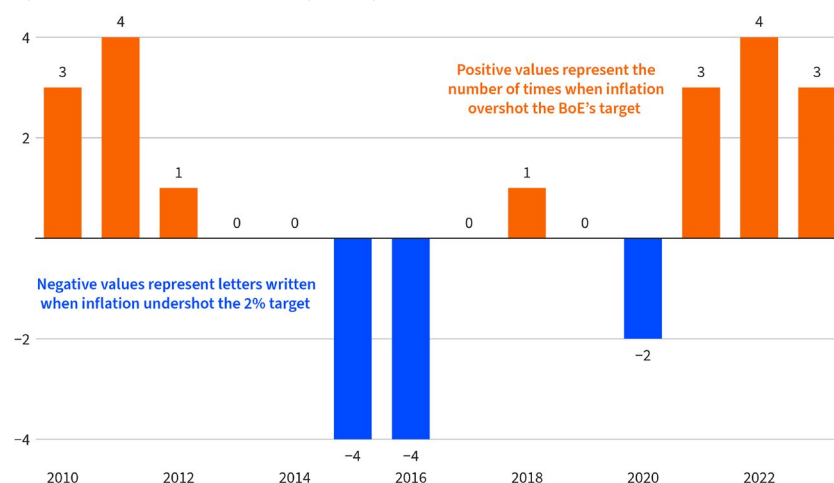
In conclusion, Chancellor, inflation looks likely to fall further from here. I just don't know how fast and when. What I can tell you, though, is that there is not too much we can do about any of the current supply-chain shocks using our only meaningful tool: good old interest rates. Unfortunately.

Yours sincerely,

Andrew Bailey, AKA Notorious B.S.T.

THE BANK OF ENGLAND REPEATEDLY MISSED ITS 2% INFLATION TARGET

Numbers of letters by the BoE to the UK Treasury to explain inflation misses



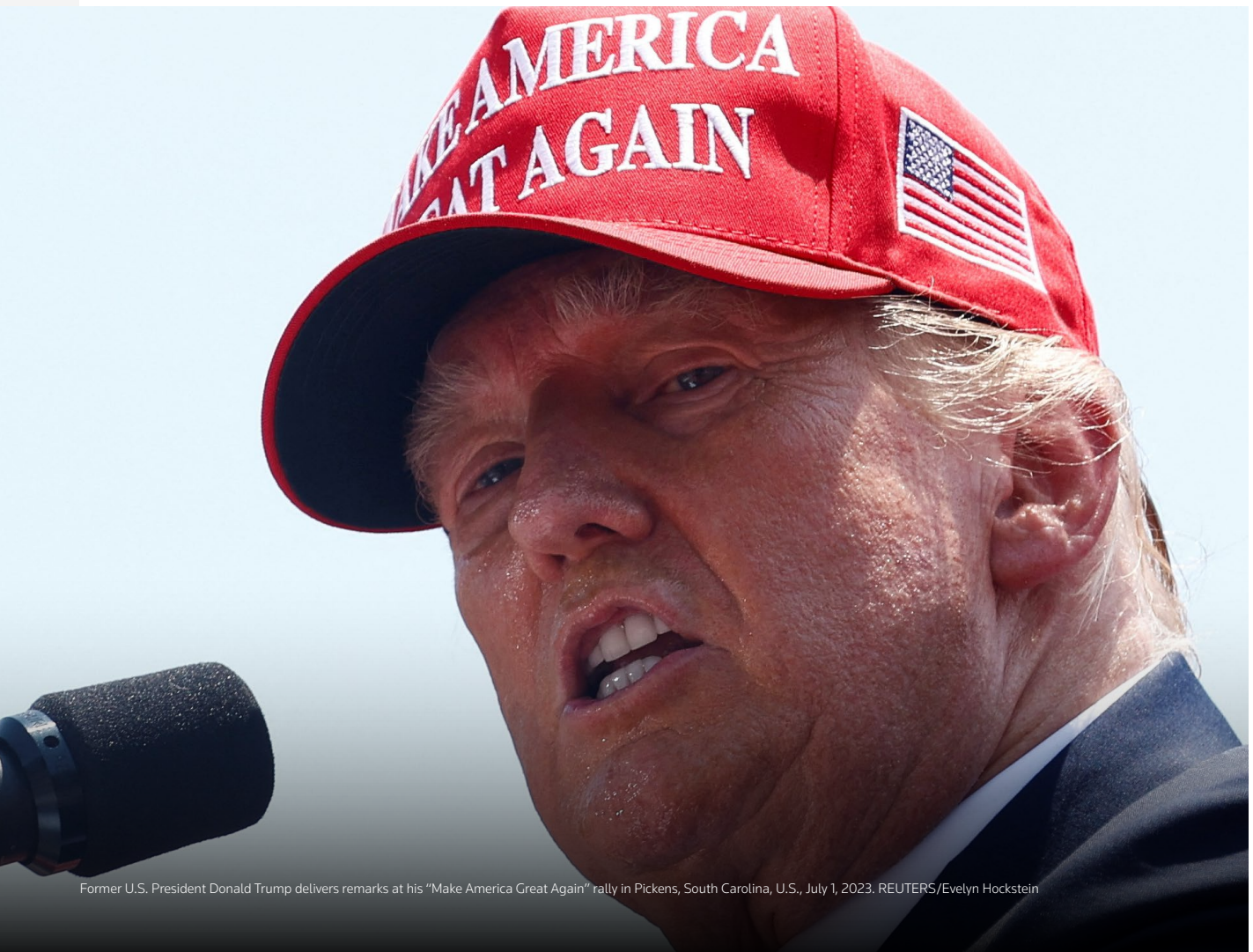


CHAPTER 4

BACKLASH

THE UNITED STATES WILL GO **FROM MAGA TO MAWA**

BY LAUREN SILVA LAUGHLIN



Former U.S. President Donald Trump delivers remarks at his "Make America Great Again" rally in Pickens, South Carolina, U.S., July 1, 2023. REUTERS/Evelyn Hockstein

“Make America Worse Again” won’t be a campaign slogan, but it’s a vibe. Joe Biden’s policies brought jobs onshore, helped the energy transition, and delayed a downturn. But 2024 will bring infighting that worsens the nation’s financial standing and an electoral test of democracy.

DIVIDED IT FALLS

The United States is in for a rocky year that could end with a political rupture. While record numbers of people are working and traveling and the air is getting cleaner, President Joe Biden has failed to change the trajectory of the country’s middle class. The coming year will bring Republican Party infighting that worsens the nation’s financial standing and an election that will test its democracy. “Make America Worse Again” will not be a campaign slogan, but in 2024, it will be a vibe.

The United States is reaching the end of a second consecutive presidential term that sacrificed the government’s balance sheet in an attempt to make citizens’ lives easier. Biden’s sweeping bills to boost chipmaking and renewable power will create thousands of new jobs even as unemployment hovers around record

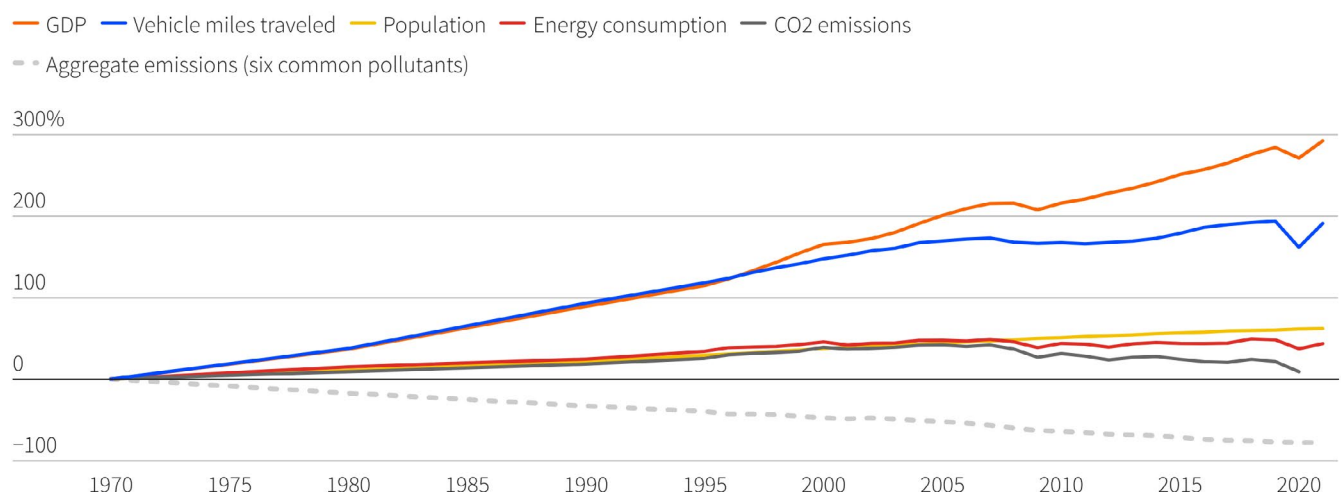
lows. People are still spending pandemic handouts enacted under former President Donald Trump. The number of travelers going through checkpoints at U.S. airports is hitting records, according to the Transportation Security Administration. With greenhouse gas emissions falling, Americans are, by some measures, better off than they were four years ago.

But generous spending has so far failed to reverse some long-standing trends. Despite a post-Covid recovery, the average American’s life expectancy at birth was 77.5 years in 2022, lower than in 2017, when Trump took office, according to data from the National Center for Health Statistics.

Meantime, rich Americans have continued to get richer during Biden’s administration. The top 0.1% of the population held \$18.6 trillion at the end of the second quarter of 2023, up almost 20% from the fourth quarter of 2020 according to Federal Reserve data. The wealth held by the bottom 50% also grew, perhaps reflecting rising wages. The trouble is that inflation also hurts those on lower incomes more, according to the Dallas Federal Reserve.

RICH AMERICANS HAVE CONTINUED TO GET RICHER

AS THE UNITED STATES GROWS, EMISSIONS DECLINE



Note: Six common pollutants refer to PM2.5 and PM10, SO2, NOx, VOCs, CO and Pb
Source: Environmental Protection Agency | L. Silva Laughlin | Breakingviews | Dec. 1, 2023

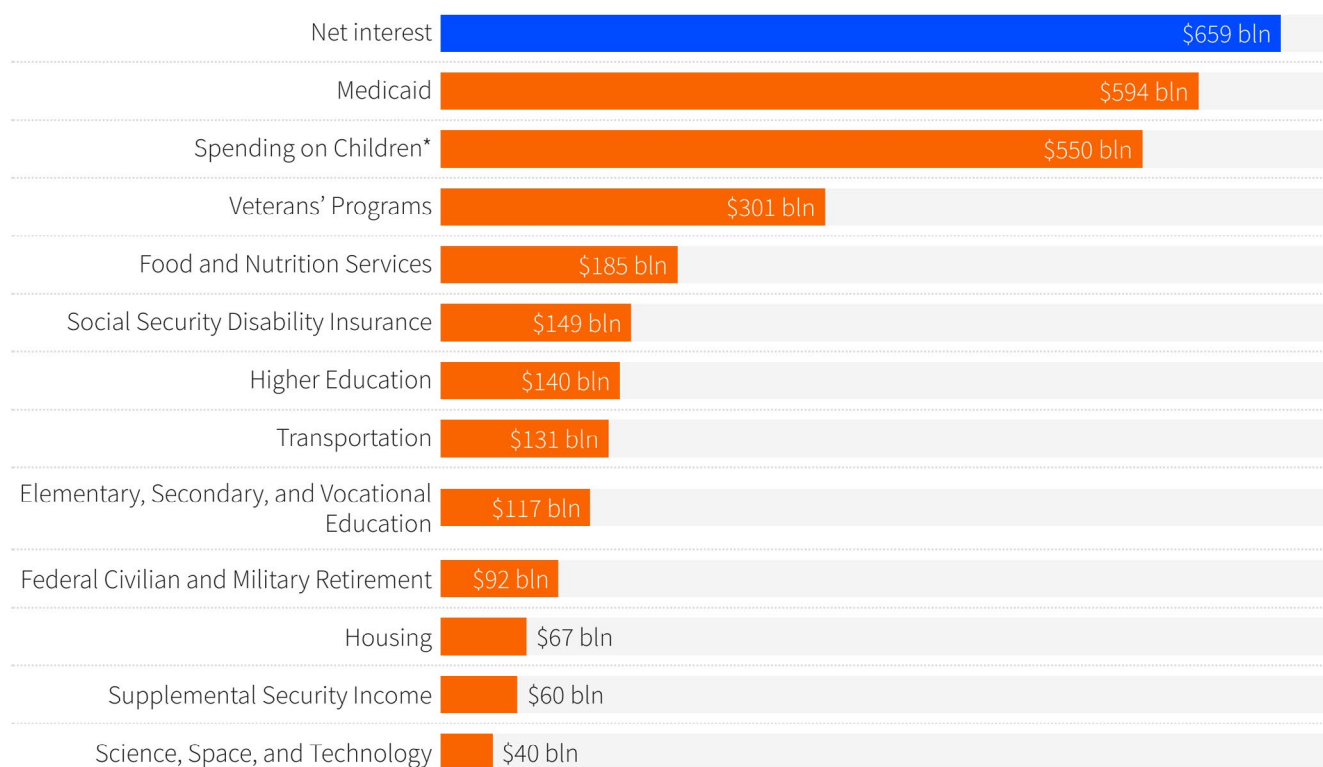
The country's shorter-term trajectory suggests little improvement. While the pace of inflation, a consequence of big spending started by Trump and further enacted by Biden, has slowed, other consequences linger. Soon, servicing the U.S. national debt will cost more per year than funding the country's military. As the election season approaches, political bickering will make it even more difficult for U.S. legislators to pass a permanent budget. It's not a stretch to think that the country will default on its debt in 2024.

If current polls prove accurate, the 81-year-old Biden will face Trump in a replay of 2020's close contest that culminated in the former real estate developer's supporters storming the nation's Capitol. Criminal charges against Trump have made no visible dent in his popularity with supporters, though Republican heavyweights including members of the influential Koch empire have endorsed one of his rivals. Peter Thiel, the tech billionaire who backed Trump in 2016, has declined the opportunity to support him again. Yet Trump has shown before he can defy the grip that party leaders typically maintain over election candidates.

The November budget agreement shows Republicans in the House of Representatives are willing to join forces with their political adversaries to fight the more extreme wing of their own party. But the unpredictable American public will choose the president. If Trump is on a ticket, he will win, according to recent predictions by FiveThirtyEight, which showed Biden's favorability rating is lower than his predecessor's. It's impossible to predict the outcome of an election a year in advance. What seems more certain, however, is that the process will Make America Worse Again.

First published December 2023

NET INTEREST PAYMENTS EXCEEDED MANY OTHER PROGRAMS IN 2023



Note: *This includes spending on parts of the Child Tax Credit, K-12 education, school lunches, and other programs for children as well as parts of spending on Medicaid, SNAP, and other programs
Source: US Committee for a Responsible Budget | A. F. Alias | Breakingviews | Dec. 8, 2023

KIM KARDASHIAN WILL BE KICKED OFF INSTAGRAM

BY LAUREN SILVA LAUGHLIN

The influencer is worth \$1.7 billion, which could climb with her shapewear brand's IPO. That's value that doesn't flow to the owners of platforms sustaining content creators' fame, like Elon Musk or Mark Zuckerberg. The best way for them to pull some back: suspend her privileges.

WINNING FRIENDS, INFLUENCING PEOPLE

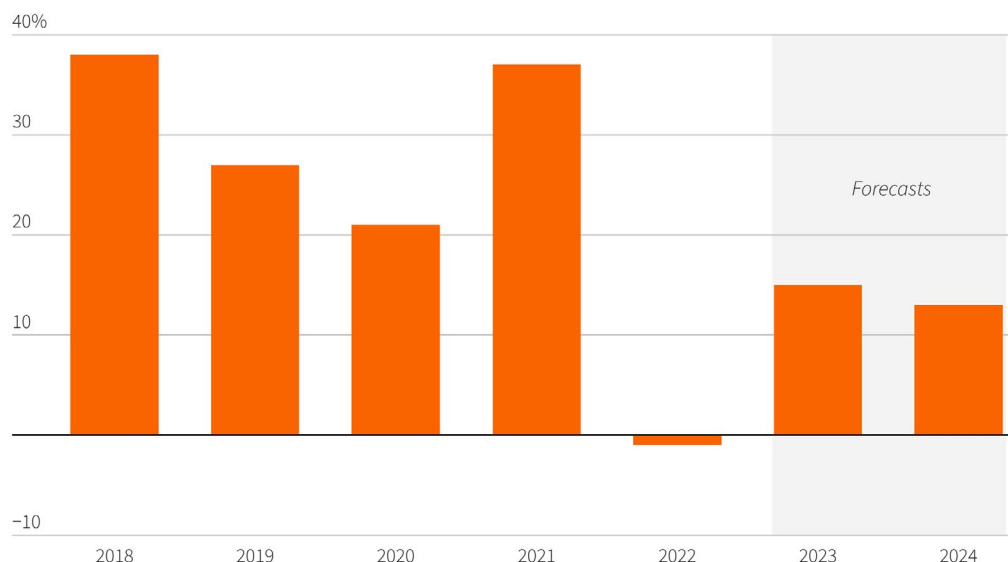
Kim Kardashian knows how to milk free publicity. The reality-star-cum-influencer has used the likes of Instagram to help flog shapewear from her company Skims, among other things, and she isn't alone. The photo-sharing network has more than 10 million influencers tapping into a \$21 billion marketing economy, according to McKinsey. In 2024, social media firms grappling with slowing growth will want a cut of these side hustles. They'll negotiate by revoking stars' privileges.

THE PHOTO-SHARING NETWORK HAS MORE THAN 10 MILLION INFLUENCERS

Kardashian, who clocks more than 360 million followers on Instagram, capitalized on her fame to co-launch private equity firm SKKY Partners in 2023. It's not her first investing foray, having launched Skims, worth \$4 billion, in 2019. Other influencers are also generating value that Instagram parent Meta Platforms and its peers don't get to touch. Though starting from a low base, payments made directly to individual online stars have grown more quickly than advertising revenue at Instagram, Facebook, Alphabet-owned YouTube and Snap, according to market research outfit Insider Intelligence.

The platforms have reason to want a piece. Though it's recovered from 2022's complete stall, Meta's ad revenue is projected to grow at half the rate it was in the years prior, analysts polled by LSEG reckon. Snap is going through its own slowdown.

META PLATFORMS' ADVERTISING GROWTH HAS SLOWED



Note: Year-over-year growth in advertising revenue

Source: LSEG | L. Silva Laughlin | Breakingviews | Dec. 3, 2023

They have one point of leverage to pry back the lucre slipping through their grasp: the reach they offer to influencers. They're already making some moves. At X, formerly known as Twitter, owner Elon Musk has pushed changes that reward paying to boost a profile, showing various metrics illuminating the effects. In 2023, Instagram tweaked its app to make certain posts less visible. Though neither has been particularly successful, these companies can try to flex their star-making power, potentially enabling them to extract rents from off-platform activities like Kardashian's.

Influencers might argue that their content creates the community on these platforms. Indeed, Kardashian's pull is so powerful that her complaints helped force

Instagram to backpedal on app changes in 2022. Still, there's a symbiosis between created content and distribution mechanisms. Both need to get paid.

Instagram is best placed to force the issue, being by far the most popular platform for influencer marketers, Insider Intelligence's data show. What's on offer is potentially bigger than McKinsey suggests, as Skims' upcoming public offering might prove. Influencers won't want to share the wealth. But Meta boss Mark Zuckerberg can remind them how much they have to lose with the biggest power play of all: kicking them off the platforms that sustain their fame.

First published December 2023



Kim Kardashian poses on the red carpet as she arrives for the Time Magazine 100 gala celebrating their list of the 100 Most Influential People in the world in New York City, New York, U.S., April 26, 2023. REUTERS/Andrew Kelly

GOLDMAN'S PARTNERSHIP IS TOO MUCH OF A GOOD THING

BY JOHN FOLEY

The arcane and elite 420-member group bolsters the bank's cachet, but sometimes exerts power that's out of sync with other shareholders. Boss David Solomon already answers to his board, clients and 45,000 other employees. He would do well to cut the inner circle down to size.

SPARRING PARTNERS

The hallowed Goldman Sachs partnership is an undeniable part of the Wall Street firm's cachet. For more than 150 years, the elite club has helped attract top-notch financiers. It is also too much of a good thing.

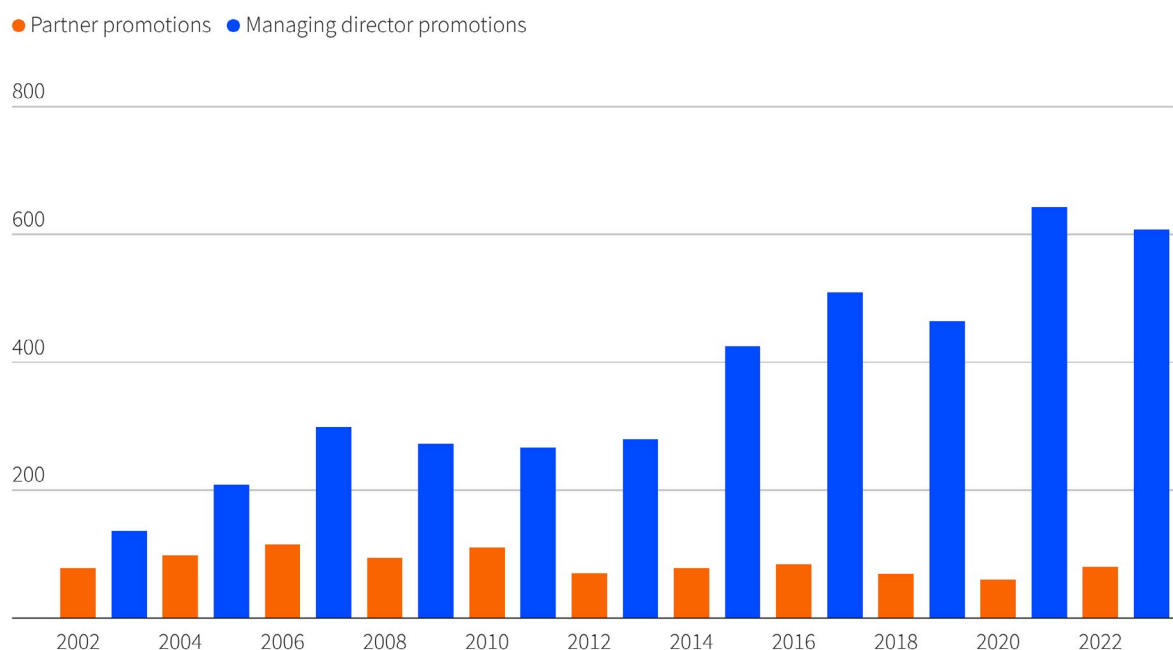
PARTNERS ANSWER TO DAVID SOLOMON, GOLDMAN'S CEO. BUT HE ANSWERS TO THEM, TOO

Goldman partners stopped being partners in the strictest, firm-owning sense when the U.S. investment bank went public in 1999. Their collective shareholding has fallen from about 60% to roughly 5%. Instead, the designation now describes about 420 senior employees who benefit from higher pay, exclusive investment opportunities and the expectation of being heard by top executives.

Partners answer to David Solomon, Goldman's CEO. But he answers to them, too, because they're on the front lines carrying out his plans. The friction became real in 2023 as Goldman's consumer banking project produced growing losses. High-status insiders griped that the division was a drain, and that savings accounts and credit cards were too déclassé for the platinum-plated institution.

Outsiders had little obvious reason to complain. The bank's shareholder returns have, over five years, matched those of chief rival Morgan Stanley. Goldman tops the rankings of M&A and equities trading.

GOLDMAN'S PARTNERSHIP HAS BECOME INCREASINGLY ELITE



Note: New partners and managing directors are named in alternating years

Source: Company filings | J. Foley | Breakingviews | Dec. 5, 2023

Its earnings are volatile, but mostly because of global markets and investment banking, in which more than half the current partners work. Their concerns ultimately won out, however: Solomon has, piece by piece, dismantled his once-prized retail business.

It's a good example of how partners sometimes clash with other constituencies. At worst, a cadre of long-tenured employees – plus the 750 or so retired partners Goldman carefully cultivates – could create an unhelpful brake on new ideas or organisational change. If Morgan Stanley housed a similar star chamber, Chief Executive James Gorman might have struggled to pivot so decisively into wealth management, the division responsible for his bank's premium valuation multiple.

The Goldman partnership faces existential questions either way. Its numbers have barely changed over the past decade even as the bank's overall headcount increased 40%. Promotions to the sub-partner managing director level, meanwhile, have soared. If the partnership's biennial intake doesn't expand, it risks appearing unattainable. Make it bigger, and the balance of power skews further the wrong way.

One way to square the inner circle would be to slowly phase out the partnership, while keeping its perks: that is, appoint ever-fewer new partners, but extend the first-class benefits to high-performing managing directors. Doing so would be in the interest of other shareholders, too. For them, the sense of privilege and loyalty the partnership engenders is an asset; its clout is a liability.

First published December 2023



Goldman Sachs CEO David Solomon speaks at the company's headquarters in New York City, U.S., Nov. 14, 2023. REUTERS/Brendan McDermid

BLOCKCHAIN'S REBIRTH WILL PASS UNITED STATES BY

BY ANITA RAMASWAMY

Regulators are cracking down on digital asset firms while Congress dithers over passing rules to govern them. Financial hubs like London, faster to set guidelines, will capture the value created not just by crypto, but by potentially powerful distributed ledger technology.

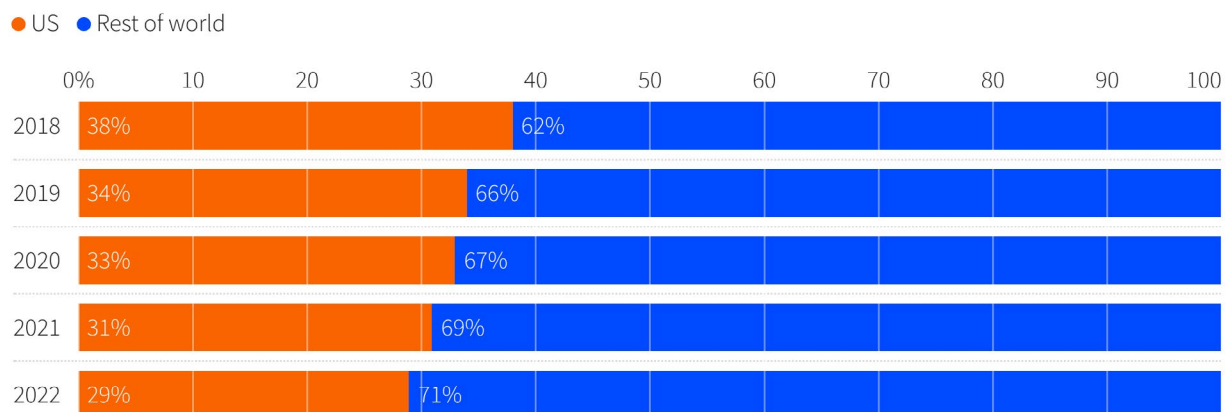
CRYPTO SPRING

After a brutal cryptocurrency downturn wiped out over \$1 trillion of investors' wealth since 2021, new hope is starting to emerge. But if the United States continues to promote a crypto exodus, the recovery of digital assets and their underlying blockchain technology might pass the world's biggest economy by.

True, crypto and blockchain aren't the same, and most cryptocurrencies might prove largely worthless. But digital tokens and the technology underpinning them are inextricably linked, in part because there is big overlap between developers of both. The United States' sluggish approach to crypto rule-making is starting to drive innovators away.

A big reason for that is that lawmakers elsewhere are feathering the digital economy's nest. A new European Union law setting guidelines for digital asset firms is due to take effect in 2024, and the UK plans to bolster its own legislation soon. Decision makers in Washington, though, are merely muddling along, and as a result the United States is losing ground: Data compiled by Electric Capital show that the share of blockchain developers based in the country has fallen each year since 2018.

BLOCKCHAIN DEVELOPERS LOOK TO BE ABANDONING THE US



Note: Data represents the % share in each region of the total number of individual blockchain developers based on their self-reported location

Source: Electric Capital | A. Ramaswamy | Breakingviews | Dec. 4, 2023

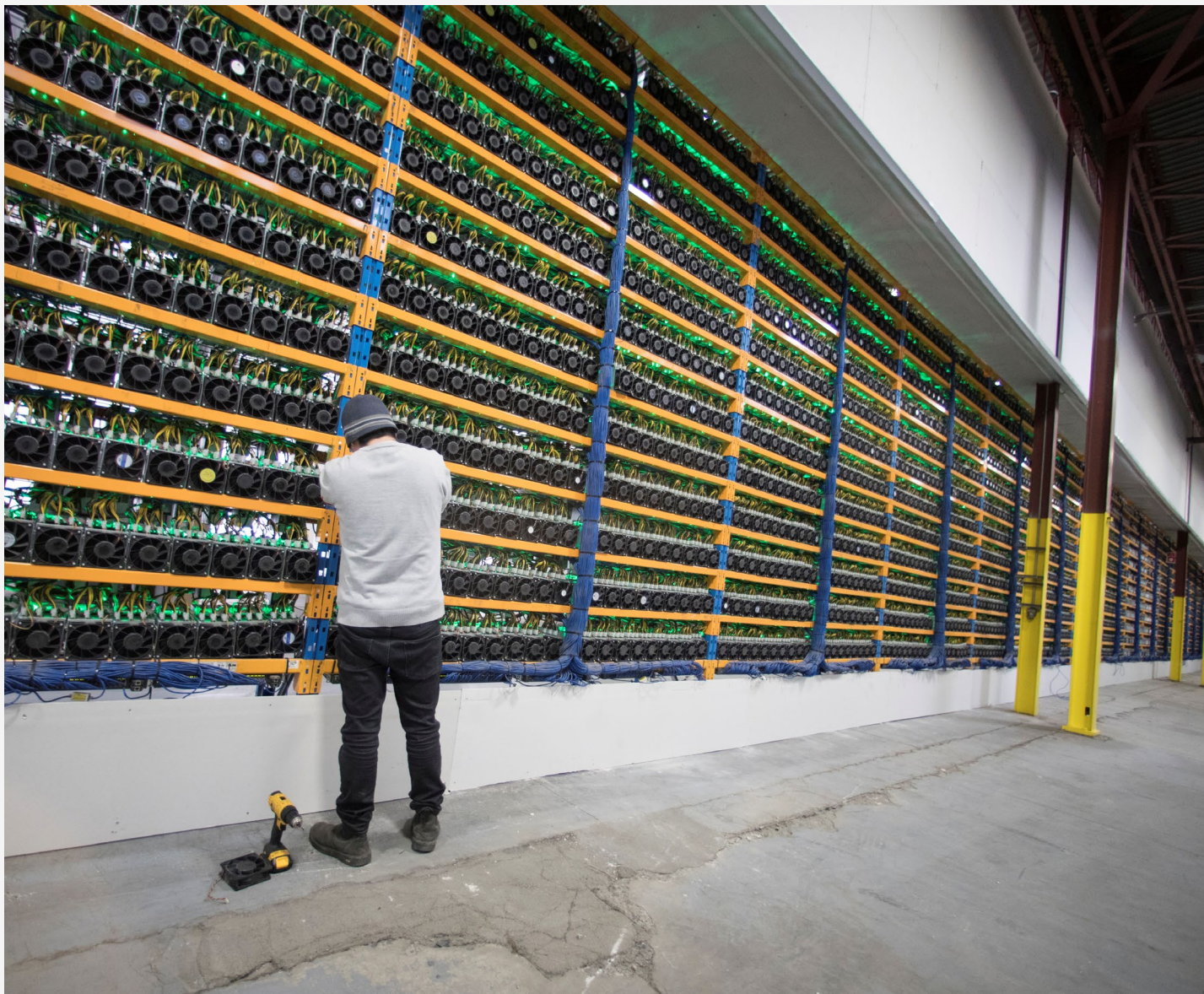
Despite recent high-profile blowups, U.S. companies are still investing in blockchain. Financial services firm Franklin Templeton in April put a money-market fund on a digital ledger to speed up the settlement process and lower costs, while Walt Disney in November unveiled plans for a blockchain-powered collectibles marketplace. Hopes that U.S. authorities might approve the first bitcoin exchange-traded fund have helped rekindle enthusiasm, too. In the last week of November, digital asset investment products saw their largest inflows since 2021, according to investment firm CoinShares.

**THE U.S. ECONOMY MAY MISS
OUT ON EVEN BIGGER, YET-TO-BE-
IMAGINED ADVANCES**

The big risk is that if Uncle Sam loses the loyalty of bitcoin and blockchain developers, the U.S. economy may miss out on even bigger, yet-to-be-imagined advances. History shows other examples of new technologies turbocharging older ones. Take graphics processing units. The recent explosion of super-powerful artificial intelligence models that run on those units, which themselves aren't new, has helped chipmaker Nvidia's stock price more than double in the past year.

Worryingly for the U.S., crypto firms are already beginning to spread their bets. Venture capital firm Andreessen Horowitz itself opened its first non-U.S. office in London in 2023 to focus on digital assets. If innovators keep rushing for the exits, American influence over potentially valuable emerging technologies could sneak away too.

First published December 2023



A worker checks fans on miners at a cryptocurrency farming operation in Farnham, Quebec, Canada, Feb. 2, 2018. REUTERS/Christinne Muschi

GREEN BACKLASH WILL SPREAD TO EUROPEAN PARLIAMENT

BY LISA JUCCA

Pro-environment parties risk losing clout in June's pan-EU vote. That will reinforce a strengthening bond between conservatives and far-right forces wary of the industrial and social cost of the clean transition. The EU's ambitious Green Deal will get a paler hue.

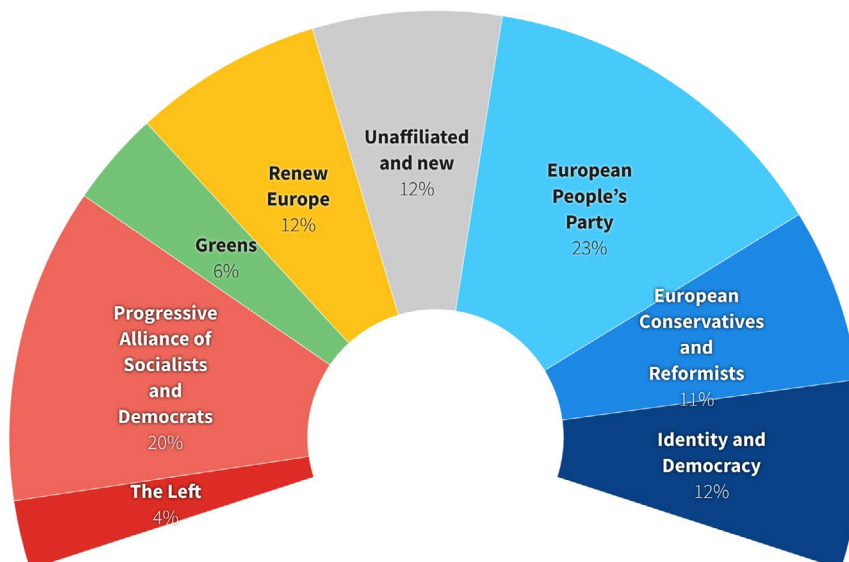
GREEN CROSSROADS

The European Union's green backlash will spread to its parliament in 2024. The growing electoral success of nationalist parties across the continent risks undermining pro-environment forces in the next European Parliament vote in June. That will reinforce a strengthening bond between conservatives and far-right politicians wary of the industrial and social cost of the clean transition, and may water down the EU's ambitious Green Deal.

European Commission President Ursula von der Leyen has kicked off a raft of initiatives designed to ensure the 27-nation bloc achieves net zero carbon emissions by 2050 by heavily reducing or offsetting all greenhouse gases. The policies support renewable energy, reduce waste, promote efficient buildings, boost organic farming, and foster clean mobility. The European Parliament, which co-adopts EU laws together with the bloc's member states, has traditionally been an enthusiastic proponent of green policies.

Yet the recent electoral success of far-right parties in Italy, the Netherlands and elsewhere suggests priorities are shifting. If traditionally pro-environment socialist and green lawmakers lose ground in the vote, the European Parliament's environmental focus may blur.

WHAT THE NEXT EU PARLIAMENT MAY LOOK LIKE



Note: European Parliament seat projections following 2024 vote
Source: Politico's polls of polls | L. Jucca | Breakingviews | Dec. 4, 2023

Cracks are already appearing. In November EU lawmakers torpedoed a bill to curb the use of pesticides in farming, a pillar of the Commission's green strategy, as conservative and right-wing lawmakers responded to lobbying from the agricultural industry. On the same day, the chamber also watered down targets for reducing and reusing packaging to cut waste.

OPINION POLLS SUGGEST RADICAL LAWMAKERS WILL INCREASE IN NUMBERS

Opinion polls suggest radical lawmakers will increase in numbers but probably remain a minority in the European Parliament. The Identity and Democracy group, which includes Marine Le Pen's National Rally in France and the Dutch Freedom Party led by Geert Wilders, is on track to capture 12% of the seats, according to Breakingviews calculations based on opinion polls available on Dec. 4, 2023, closely followed by the European Conservatives and Reformists, including Italian Prime Minister Giorgia

Meloni's Brothers of Italy. Throw in Hungarian Prime Minister Viktor Orbán's Fidesz and a few others and the anti-environmental parliamentarians may at best win 190 seats, or 26% of the total, up from around 22% now. Besides, nationalist parties tend to struggle to present a united front in Europe as their domestic interests often clash. Witness the disagreement between Italy and Hungary on a failed EU immigration deal.

Still, concerns that the EU's plan for a fast climate transition may leave behind many low-income workers and impose heavy costs on citizens may resonate more widely. The conservative European People's Party, projected to be the largest force in the EU Parliament, is concerned about the additional burden that new green legislation will impose on traditionally important European industries such as car-making, fossil fuel energy and chemicals.

After the next European Parliament election, the continent's green policies may get a paler hue.

First published January 2024



European Commission President Ursula von der Leyen delivers the State of the European Union address to the European Parliament, in Strasbourg, France, Sept. 13, 2023. REUTERS/Yves Herman

SOCCER WILL INCH TOWARDS **FINANCIAL RATIONALITY**

BY STREISAND NETO



Manchester City's Julian Alvarez celebrates with Erling Haaland during Manchester City vs. RB Leipzig at the Etihad Stadium, Manchester, Britain, Nov. 28, 2023. REUTERS/Molly Darlington

TV income is stagnating or shrinking in the big European leagues, and regulatory limits on clubs' spending will soon bite. Chelsea, Man United and others must either do a much better job at monetising their vast global fanbases, or finally clamp down on player salaries.

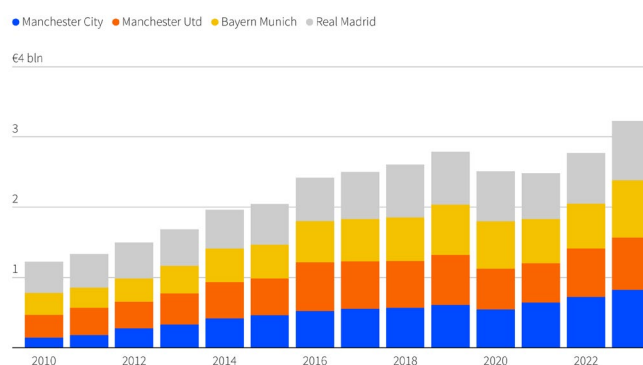
PARKING THE BUS

Soccer's financial free-for-all may be ending. After years of lavish spending, European giants like Erling Haaland's Manchester City and Jude Bellingham's Real Madrid now face the prospect of stagnant TV-rights income and closer regulatory scrutiny. The clubs must either do a much better job at wringing cash from their far-flung fanbases, or finally clamp down on player transfers and salaries.

CLUBS IN ENGLAND'S PREMIER LEAGUE, FOR EXAMPLE, SPENT 2.4 BILLION POUNDS (\$3 BILLION) BUYING PLAYERS IN THE SUMMER OF 2023

The past decade or so in European soccer was characterised by ever-spiralling costs. Clubs in England's Premier League, for example, spent 2.4 billion pounds (\$3 billion) buying players in the summer of 2023. That's almost quadruple the equivalent figure from 2013, according to Deloitte's numbers. Salaries soared too. The wage bill at Saudi Arabia-owned Newcastle United, whose stars include Bruno Guimarães, was equivalent to 95% of revenue in the financial year to June 2022.

SOCCER CLUBS' SLOWING REVENUE GROWTH RATES



Note: Financial year to June. Real Madrid excludes player transfers. UK clubs converted to euros at average financial-year exchange rates

Source: Company reports, Breakingviews calculations | L. Proud | Breakingviews | Nov. 23, 2023

Leaner times may be ahead. The growth in broadcast-deal income has slowed in Europe. Telecoms and pay-TV groups, who used to fight tooth and nail for the rights to screen games, have put a stop to ever-spiralling auction prices, and streaming giants like Amazon.com haven't fully picked up the slack. The Premier League's latest TV-rights package, announced in early December and worth 6.7 billion pounds over four years, saw live rights value grow just 4% compared to the previous process, far below the rate of inflation.

Globally, TV money is still rising. But big clubs' top lines have nonetheless slowed in recent years, partly because of the pandemic. The aggregate revenues of Manchester City, Manchester United, Germany's Bayern Munich and Spain's Real Madrid rose at a 10% compound annual rate between 2010 and 2019. Since 2019, annual growth has dipped to 4%.

And football authorities are finally getting serious in their attempts to enforce financial discipline. The Union of European Football Associations, which runs the sport in Europe, is for the first time imposing a cost cap in the current sporting season. Its new rules roughly state that clubs' spending on player transfers, wages and fees for intermediaries like agents cannot exceed 90% of the sum of total revenue and player-trading profits. That maximum ratio will fall to 80% next season and 70% the year after that. Consultancy Football Benchmark calculated that the average percentage for 20 of Europe's biggest clubs was 86% in 2021, suggesting that many teams were miles away from complying with the future harsher rules.

To get sporting costs below the 70% threshold by 2025, big-spending clubs will have to change their ways now. That's because major player contracts typically span several years, as do amortisation charges for transfer fees. One option is to keep costs the same but boost the top line. European soccer executives often bemoan the fact that they have millions of fans in Asia, North America and elsewhere but no obvious way to get money out of them. Fixing that would help, but may take a while.

That means many clubs will have to turn to cuts instead. Letting more expensive older players leave, potentially to the big-spending Saudi league, could help. So would using more local talent, rather than signing pricey foreign stars. However they do it, the end result will have to be the same: a more defensive financial performance from Europe's top soccer teams.

First published December 2023

"POLLUTER PAYS"

DOCTRINE WILL TAKE ON NEW MEANING

BY LISA JUCCA

Carbon-intensive throwaway fashion and ubiquitous plastic waste are dirtying the globe. That may change as governments start to crack down on discarded textiles and polymer-based items. Companies and their investors face a costlier journey to a more sustainable world.

WASTE NO MORE

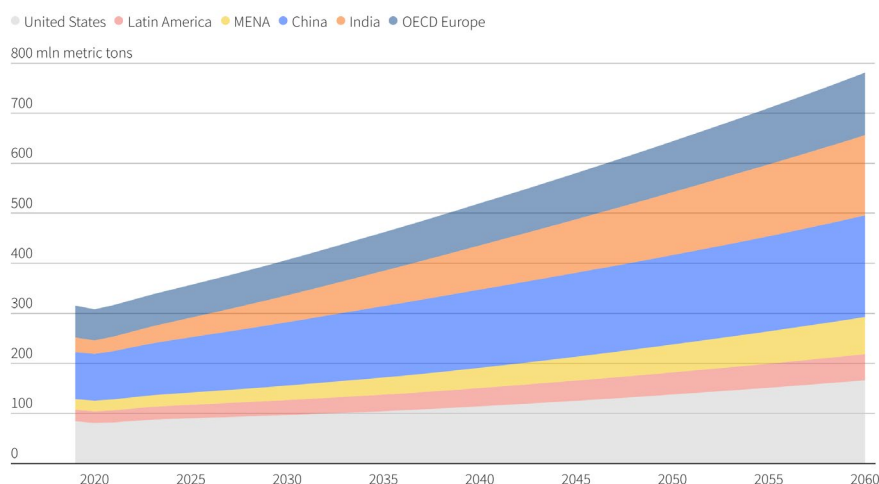
Companies will learn the hard way that polluting the world has a cost. Ten years after the deadly Rana Plaza factory-building collapse that killed more than 1,000 underpaid textile workers in Bangladesh, cheap polyester clothes from Shein, Boohoo or Primark continue to fill our wardrobes before hitting the landfill. Meanwhile, more than 350 million metric tons of Coca-Cola bottles, Mars wrappers and other plastic items are discarded each year. This may change as a crackdown on fossil fuel-based waste takes shape in 2024.

MORE THAN 350 MILLION METRIC TONS OF COCA-COLA BOTTLES, MARS WRAPPERS AND OTHER PLASTIC ITEMS ARE DISCARDED EACH YEAR

Plastic, a range of wonderfully versatile and resistant materials derived from petroleum, has become ubiquitous in sectors ranging from food products to fashion. Its success is linked to the fact that it's seemingly cheaper than more sustainable alternatives. For example, containers in biodegradable plastics, like those produced by CJ Biomaterials, owned by Korean food and biotech company CJ CheilJedang, can be three to five times more expensive than those made of fossil fuel-based virgin plastics. Polyester yarn tends to cost less, and last longer, than natural fabric.

Yet the environmental cost of regular plastic is 10 times higher once waste management, greenhouse gas emissions and the damage to the ecosystem are factored in.

GLOBAL PLASTIC CONSUMPTION IS EXPLODING



Source: OECD | L. Jucca | Breakingviews | Nov. 24, 2023

The additional economic burden, which the World Wildlife Fund calculated at over \$3 trillion per year in 2019 against a market cost of \$370 billion for all plastics produced that year, is currently borne by governments and consumers rather than companies.

Plastic polluters will soon have to start to pay their fair share. California is currently discussing a bill that would require textile companies to design, fund and implement the collecting, sorting and recycling of the garments they produce. The European Union proposed in July that fashion companies either collect a gradually increasing percentage of clothes, linen or shoes or pay a fee towards the cost of managing waste. That seems sensible given that 85% of discarded shirts and dresses end up in landfills.

The approach, known as extended producer responsibility, is also at the centre of discussions around a United Nations treaty to end plastic pollution, to be finalised in 2024. To be effective, however, the “polluter pays” doctrine has to impose sufficiently high financial

contributions to deter overproduction. In France, where a scheme of this kind has been in place since 2007, the fee has averaged just 0.16 euros per garment, says Bloomberg. Targets to reduce the use of virgin plastic, which has increased by 11% globally since 2018, are also sorely needed, although oil-producing countries including Saudi Arabia and Russia are against legally binding caps.

Investors have yet to grasp the potential negative impact of a rise in waste management costs for companies. Shares in Zara owner Inditex and H&M rallied around 50% from the start of January to Dec. 1, 2023, while those in bottler Coca-Cola HBC were up 8%. Meanwhile, deals in the packaging segment, which accounts for 40% of global plastic waste, have been booming.

Yet the financial challenge of addressing climate change while also cleaning up the planet is so huge that many governments around the world are starting to act. Global corporate titans had better get ready to pay up.

First published January 2024



Clothes with discount labels are displayed at a department store in Paris, France, Jan. 12, 2022. REUTERS/Sarah Meyssonier

U.S. DEFENSE MINNOWS WILL STORM THE BARRICADES

BY JONATHAN GUILFORD

Even as conflict in Ukraine leads American arms makers to boost production, the political mood is turning against giants like Lockheed Martin. With half the \$415 billion handed to American defense contractors not receiving a competitive bid, newcomers will make battlefield gains.

STRATEGIC SHIFT

U.S. defense giants are due to cede territory on the battleground. After decades of Pentagon-backed consolidation, political pressure and the challenge of arming Ukraine are forcing a hard look at reduced competition. That means less latitude for big firms to gobble up rivals, and more government money directed to newcomers.

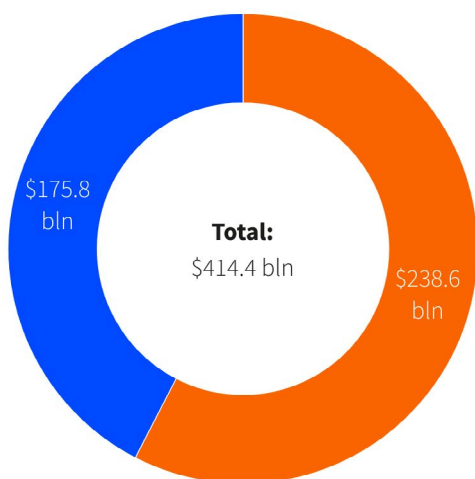
AMERICAN MILITARY SPENDING REACHED \$877 BILLION IN 2022

Rising global conflict and global rearmament are swelling defense budgets. Total American military spending reached \$877 billion in 2022, up 40% from the prior decade's lows. Defense agencies obligated some \$415 billion to contractors that year. Since Russian President Vladimir Putin invaded in early 2022, the U.S. has provided millions of artillery rounds and thousands of missiles to Ukraine, according to the State Department.

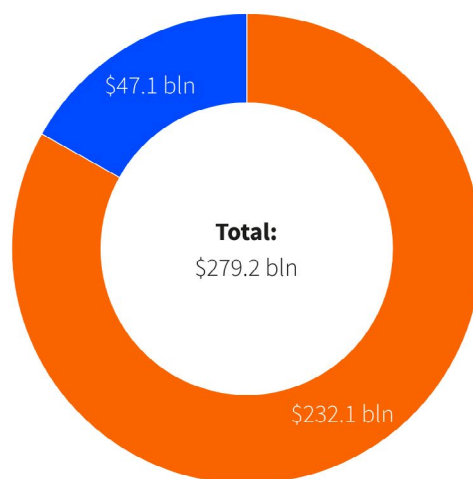
This might seem an opportunity for the biggest U.S. defense contractors to cash in. Instead, current and former government officials have criticized a consolidated, margin-conscious industry for making supply chains more fragile and being slow to boost production to replenish stockpiles.

US DEFENSE CONTRACTS ARE LESS COMPETITIVE

● Competed contract value ● Non-competed contract value



Defense agencies



Civilian agencies

Note: Fiscal year 2022 figures

Source: Government Accountability Office | J. Guilford | Breakingviews | Dec. 6, 2023

It's a change of strategy from the U.S. government's post-Cold War stance. In a 1993 meeting – since dubbed the “last supper” – Pentagon officials warned defense industry leaders that, after the Soviet Union's collapse, they could only support a dwindling number of suppliers. The message: consolidate.

Since then a wave of mergers, from the 1994 tie-up of Lockheed and Martin Marietta to 2019's combination of Raytheon and United Technologies, has reduced competition. The number of prime defense contractors capable of handling the most complicated projects has fallen from 51 to five. Data from the Baroni Center for Government Contracting show that the share of dollars awarded through a competitive process has been on the decline. According to the Government Accountability Office, the competition rate for defense contracts in 2022 was 58%, versus 84% for work awarded by civilian agencies.

That complaisance won't last. Politicians like Senator Elizabeth Warren are pressuring defense agencies. The GAO in October issued recommendations for overhauling defense deal oversight by identifying which acquirers should come in for scrutiny and monitoring the effects of concluded tie-ups. And the DOD, spurred by an executive order from President Joe Biden, in 2022 penned a report warning that consolidation and decreased competition in areas like rockets can drive up costs and hamper procurement.

This official onslaught seems to have made the industry's prime contractors more cautious. The five companies – Lockheed Martin, RTX, General Dynamics, Boeing and Northrop Grumman – spent only \$89 million on acquisitions in 2023, according to Dealogic, the lowest outlay in a decade aside from pandemic-scarred 2020.

More importantly, there are tentative signs the government is willing to shift money to upstarts like autonomous weapon-maker Anduril or 3D-printed rocket developer Ursa Major Technologies. The largest defense companies' share of awards edged down in 2022, according to the Center for Strategic and International Studies, while small contractors won over \$80 billion. Spending buckets that largely pay out to non-traditional vendors have grown. And after tech firm Palantir Technologies and Elon Musk's SpaceX sued over the government's contracting practices, the field seems to be opening to upstarts.

Investor money is flowing accordingly, with venture capital firms sinking roughly \$27 billion into the defense industry in the year to November 2023, up from \$1.9 billion a decade ago, according to PitchBook. Despite a defense spending boom, the industry's giants will remain pinned down.

First published December 2023

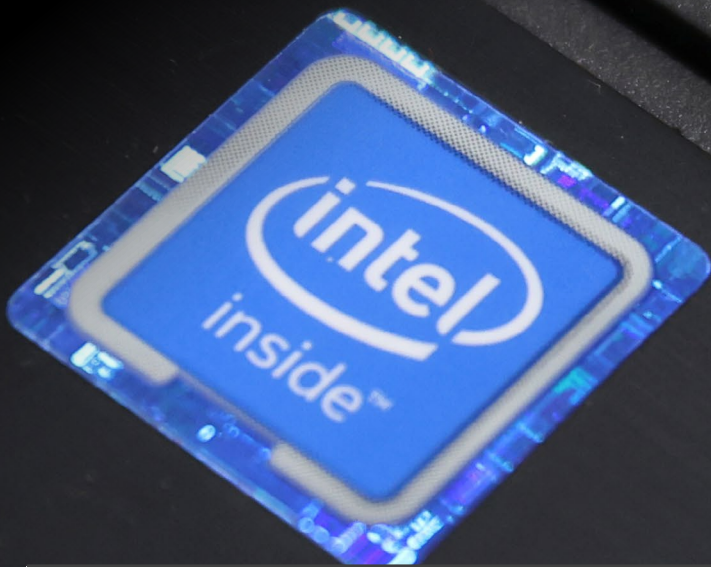


A U.S. navy crew member works on an F-35B fighter jet on the deck of U.S. Amphibious Assault Ship USS Makin Island, anchored at a naval base in Busan, South Korea, March 23, 2023. REUTERS/Kim Hong-Ji



CHAPTER 5

PICKING UP THE PIECES



FIXING INTEL ENDS WITH TAKING IT APART

BY ROBERT CYRAN

The chip giant faces the existential challenge of regaining its lost lead in manufacturing. Doing so could double its market value to \$300 billion, but maintaining an edge requires ever more spending, fed by serving outside customers. The best way to do that: split Intel in two.

FIX AND SPLIT

Intel will have to get out of its own way. The U.S. semiconductor giant is unusual in both designing and building its own chips under one roof. But now that its manufacturing technology has fallen behind, it's dragging down both sides of the business. Boss Pat Gelsinger has vowed to regain Intel's edge. The best way to do so for the long term is to split the company in two.

Chipmaking requires putting ever more capital and technological expertise to work. Intel's next-generation manufacturing facility in Arizona will cost \$30 billion, about eight times more than new sites cost two decades ago after adjusting for inflation.

Back when the company's manufacturing led the world, this spending paid off handsomely, giving its chips an insurmountable edge. In recent years, though, Intel has been overtaken technologically by stand-alone manufacturer TSMC. Rival chip designers, now able to access cutting-edge facilities, have taken share. With demand falling, Intel's factories are running below full capacity. Its expected 2023 operating margin of only 8%, according to LSEG data, is down from over 30% in the company's heyday. TSMC's margin is expected to be over 40%.

Intel's fix is straightforward and difficult: regain its technological crown, which Gelsinger plans to do by 2025, by introducing multiple generations of chips in rapid fire.

The gains would be substantial. Analysts put Intel's 2024 revenue at \$59 billion. If it grew 10% annually from there, roughly how fast the top end of the market grows, sales would top \$70 billion in 2026. If a technological comeback propels Intel to an earnings margin and valuation multiple of 14 times earnings typical of its heyday, its valuation would double to \$300 billion.

INTEL NO LONGER HAS NECESSARY PRODUCTION VOLUME ITSELF TO MAKE FACTORIES ECONOMICAL

Success isn't a given. TSMC's lead may compound as the spending required to catch up increases further and further. Intel no longer has necessary production volume itself to make factories economical. So Gelsinger wants to mimic his rival, offering to manufacture chips for others to defray the cost of new plants.

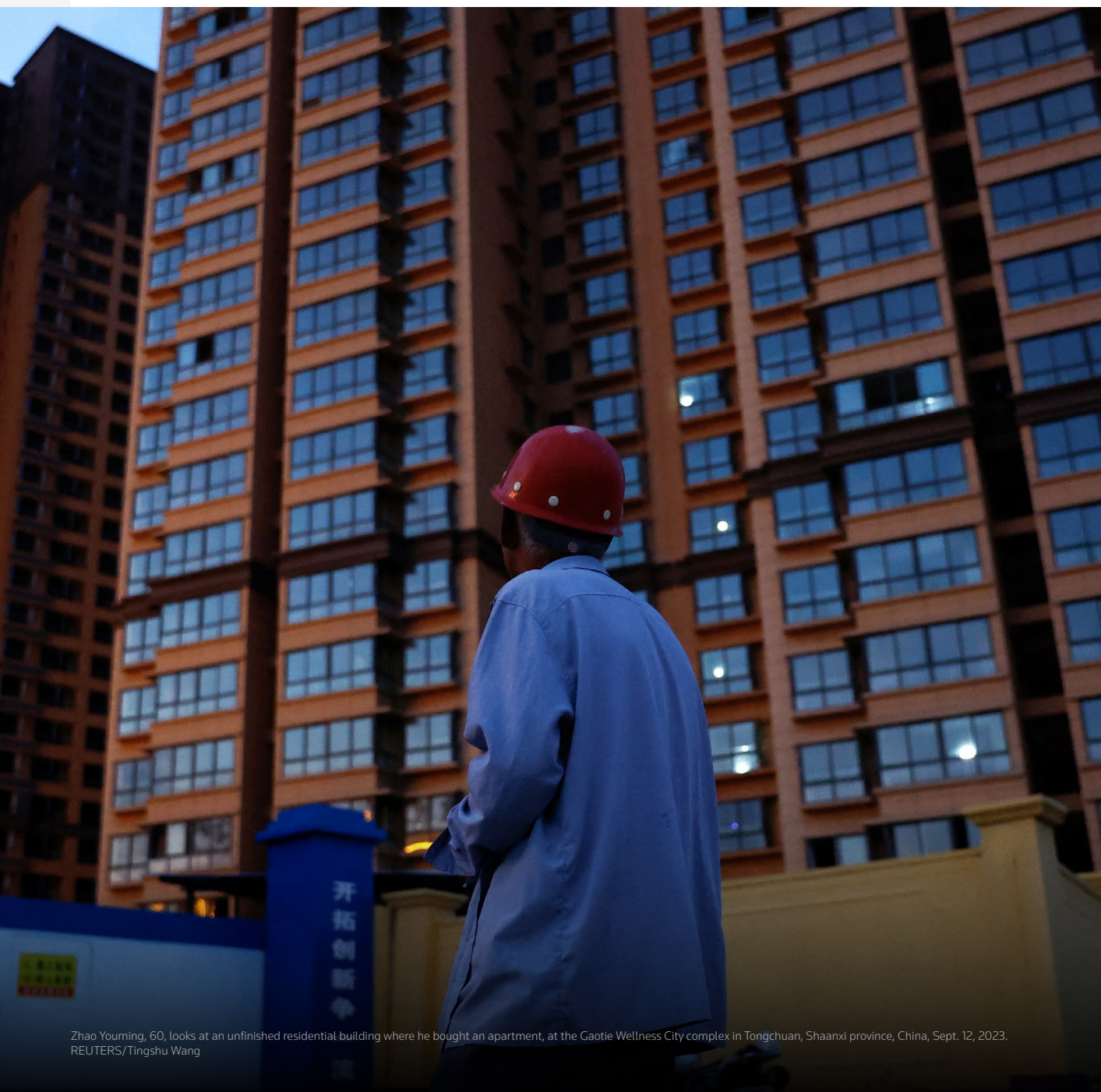
Snag is, Intel's manufacturing arm will always have a reason to prioritize its own chips to support its design business. That conflict of interest means other semiconductor firms may be wary of signing up at sufficient scale.

Beginning in 2024, Intel will report manufacturing results separately. An eventual full split would generate more value if it brings more customers to Intel's plants. After all, TSMC only manufactures chips, and its market capitalization is three times as large as Intel's. Gelsinger's plan to fix Intel should end with breaking it up.

First published September 2023

BEIJING WILL BUILD SAFETY NET AROUND HOUSING HOLE

BY CHAN KA SING



Zhao Youming, 60, looks at an unfinished residential building where he bought an apartment, at the Gaotie Wellness City complex in Tongchuan, Shaanxi province, China, Sept. 12, 2023. REUTERS/Tingshu Wang

China's debt-stricken developers have left 20 million homes unfinished. Local governments can turn the crisis into an opportunity by taking on stalled projects and converting them into public housing. State firms will increase their presence in the property market in the process.

UNFINISHED REVOLUTION

Everyone knows China has a big problem: major developers are crippled by debts and have left millions of residential units unfinished. Few remember that the People's Republic has long strived for the socialist ideal of providing homes for all. In 2024, Beijing is likely to usher in more drastic policies to use the property market crisis to achieve its ultimate housing policy.

China has one of the world's highest home ownership rates. More than 90% of urban households, defined as those with residence permits, or "hukou", own their homes. The ratio is even higher in rural regions, where villagers typically build their houses on collectively owned land.

OFFICIAL DATA SUGGEST THERE WERE NEARLY 300 MILLION "MIGRANT WORKERS"

Nonetheless the Chinese population is extremely mobile. Official data suggest there were nearly 300 million "migrant workers", those who work and live far from their home towns, and more than 60% of them live in rental housing on an average monthly income of 4,615 yuan (\$650), 40% below the nationwide average.

Runaway home prices in recent years have also made it difficult for people with "hukou" in large cities to purchase their own properties. This has instilled a sense of insecurity, especially among younger people, contributing to broader problems such as a dwindling birth rate and high youth unemployment. More and more young adults are becoming "full-time children" who live with, and off, their parents.

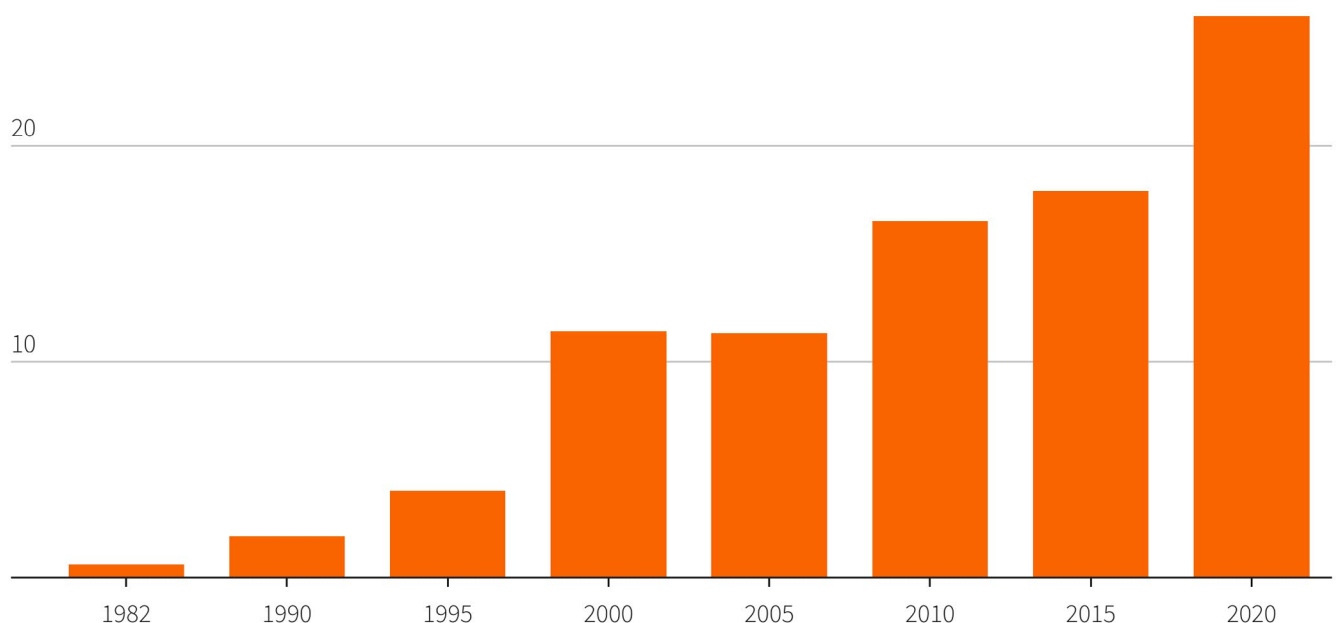
In August, the State Council published an all-encompassing directive calling for nationwide efforts for a "new development model" of the real estate market, with the provision of cheaper, subsidised homes being one of the key policy drives.

CHINA'S POPULATION IS INCREASINGLY MOBILE

30%

20

10



Note: Percentage of people living away from their home towns

Source: National Bureau of Statistics | Chan K. S. | Breakingviews | Nov. 23, 2023

The opportunity, so to speak, is the current property crisis. Nearly all major private builders, including giant ones such as Evergrande and Country Garden, have defaulted on their massive debts, leaving the construction of a large number of residential projects delayed or stalled. There isn't an official tally of unfinished homes. In October, Nomura analysts put the figure at about 20 million units nationwide, saying it would cost \$440 billion to complete them all.

Most local governments rely heavily on land sale income, so in the past they had little incentive to build an extensive housing safety net. The glut of uncompleted homes, however, offers them a much cheaper option to take on an important political duty. They could acquire stalled projects, especially those in more remote locations, below the price at which they sold the land. The injection of government funds could relieve some of the financial pressures faced by distressed builders.

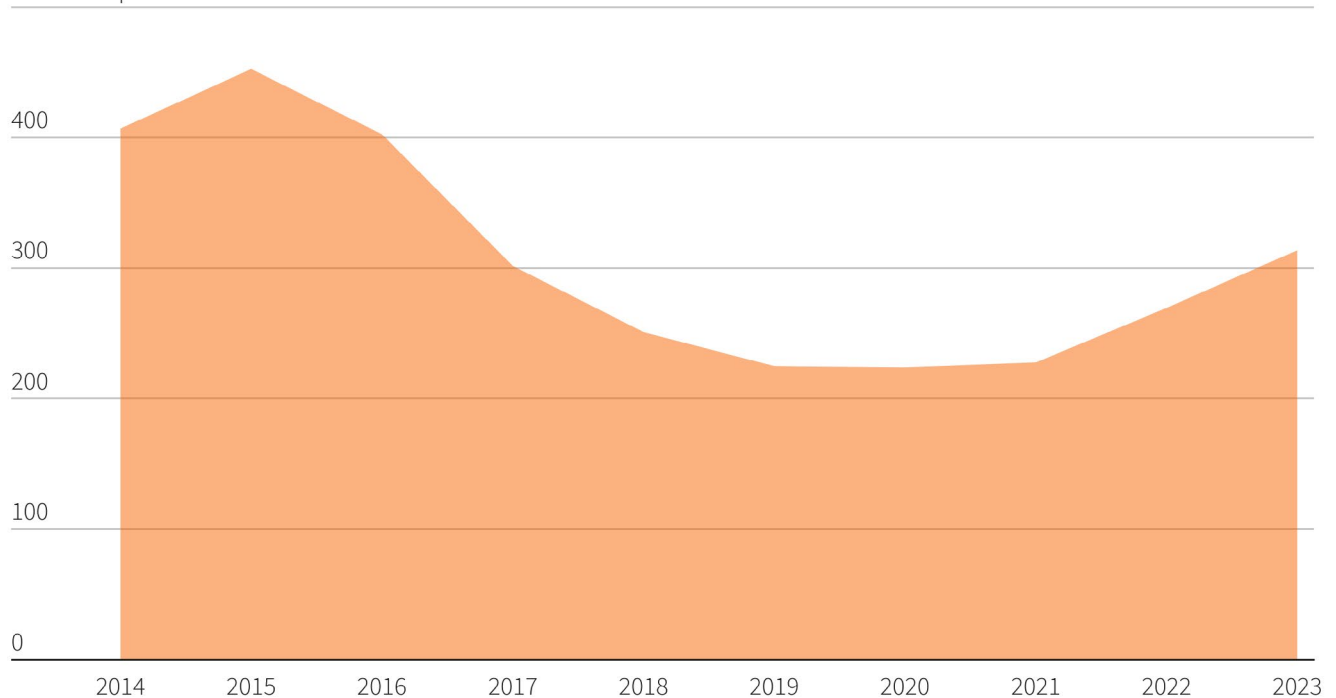
There are signs that Beijing is already steering state banks to stump up more liquidity to support the new drive, with talks that the central government is planning to inject 1 trillion yuan in phases into urban renewal projects and public housing programmes. This may still not be enough, although state-owned property firms, especially those with a regional focus, could also weigh in.

Beijing will have to be comfortable with more property exposure for state banks, as well as the rising presence of the state in the real estate market. But the risks associated with the moves may be acceptable as long as they move China closer to the ideal society that President Xi Jinping envisions.

First published December 2023

CHINA'S UNSOLD RESIDENTIAL PROPERTIES ARE ON THE RISE

500 mln square metres



Note: 2023 figures are from January to October

Source: National Bureau of Statistics | Chan K. S. | Breakingviews | Nov. 23, 2023

SONY ACTIVISION RIPOSTE WILL INVOLVE MOBILE GAMING

BY OLIVER TASLIC

Microsoft's \$69 billion Activision deal threatens its Japanese rival's console dominance. But it also establishes a bridgehead for the U.S. firm in the \$90 billion mobile gaming space. Recent mobile weakness and an expected return to growth mean 2024 is a good time for Sony to plug in too.

RULES OF THUMB

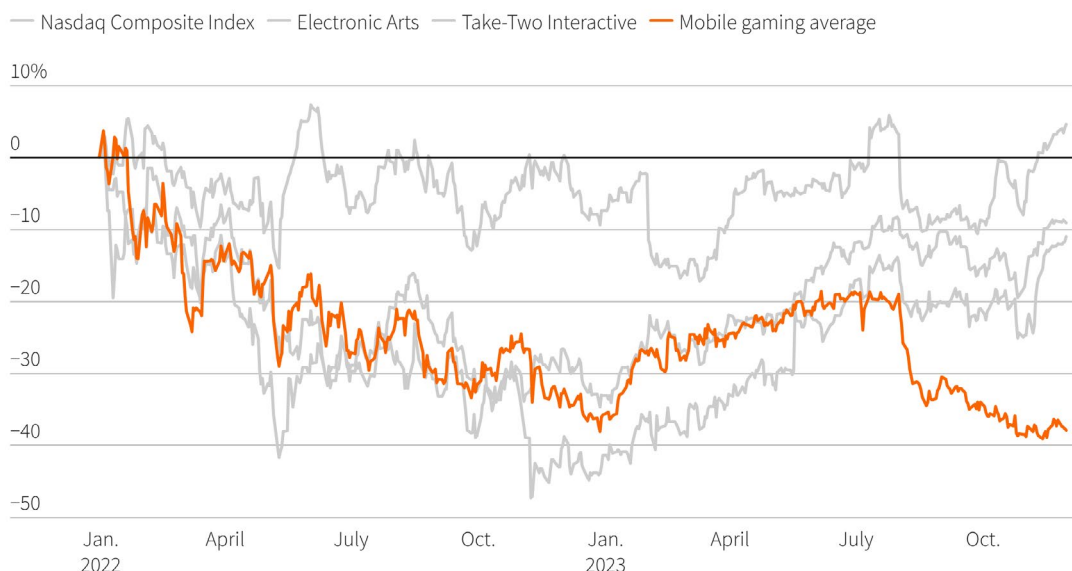
The object of Nintendo's 1980s video game "Duck Hunt" is to pick off targets just as they rise above the horizon. The bird-blasting title could offer a template for a Sony mobile gaming acquisition in 2024.

Sony is well known as the maker of the PlayStation, which commands almost half the near-\$60 billion market for console gaming, according to Ampere

Analysis. Its mobile operations are more modest: the Japanese group announced a PlayStation Studios Mobile Division as recently as 2022. Compare that to Microsoft. The software giant has shot from mobile obscurity to superstardom with its \$69 billion deal for Activision Blizzard, owner of "Candy Crush", which recently passed \$20 billion in lifetime revenue.

It's a huge market to aim for. Overall, the mobile segment of gaming, which includes the likes of "Subway Surfers", raked in about \$90 billion in 2023, Newzoo reckons. That's almost as much as console and PC games combined. But the last two years have been tough. Privacy changes on Apple's iPhone have made it harder for game makers to target new players with ads, while the casual nature of mobile gamers has made them more likely to switch off amid a cost-of-living crisis. Shares in a basket of mobile gaming companies fell 38%, on average, between the beginning of 2022 and late November 2023. That compares to a 9% fall for the Nasdaq Composite Index.

MOBILE GROUPS HAVE UNDERPERFORMED MORE DIVERSIFIED PEERS



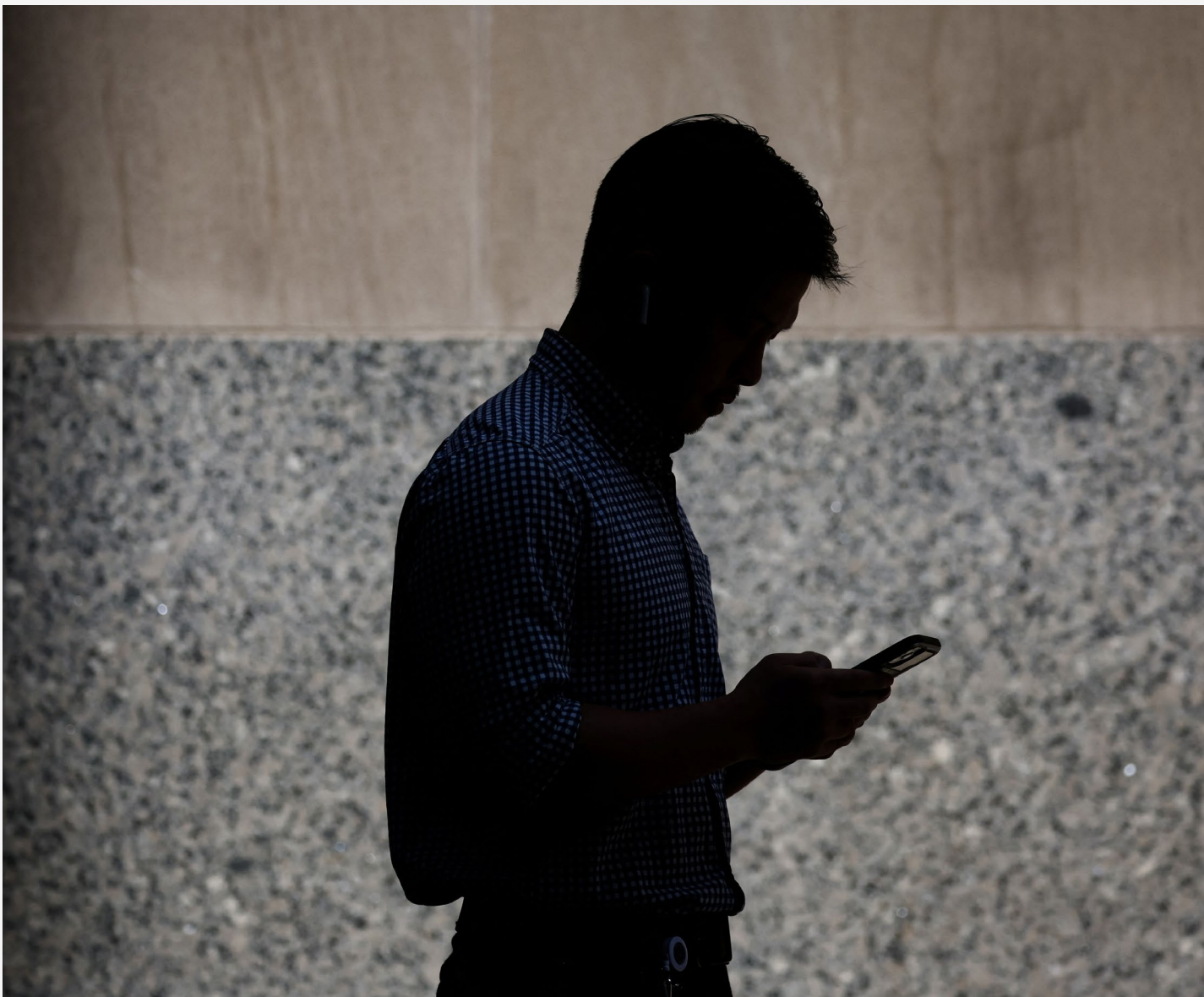
Rebased share price performance. Dec. 31, 2021 = 0. Mobile gaming firms comprise Roblox, Playtika, Huuuge, PlayStudios, Stillfront and GungHo
Source: LSEG Datastream, Breakingviews calculations | O. Taslic | Breakingviews | Dec. 1, 2023

That could make for some enticing targets as the industry bounces back. TD Cowen analysts said in November that they expected U.S. mobile game in-app purchases to jump 5.8% in 2024 and 6.7% in 2025. Sweden's Stillfront, which was worth around \$600 million in early December and owns over a dozen mobile studios, could be one target. Tokyo-listed GungHo, the \$1 billion-plus maker of "Puzzles and Dragons", is another option. A truly mammoth play would be for Roblox, whose eponymous game had 56 million daily active users in 2022, three-quarters of whom were on mobile. Placing a premium on Roblox's \$20 billion-plus enterprise value puts it well beyond Sony's \$11 billion of cash. But it could also pay in shares, and the Japanese group's low leverage ratio could give it the option of raising debt as part of a deal – Morningstar analysts predict that net debt will only be half of EBITDA in 2024.

MOBILE GAMING ALSO HAS LOWER BARRIERS TO ENTRY THAN CONSOLES

Mobile gaming's future looks relatively bright. Ongoing lawsuits and EU legislation are attempting to chip away at the 30% cut that Apple and Google take of in-game purchases, potentially boosting the future profitability of those that make the actual games. Mobile gaming also has lower barriers to entry than consoles, meaning it tends to grow faster, especially in the developing world. The sector's valuation dip in 2022 and 2023 could offer Sony an opportunity to plug in.

First published December 2023



A worker uses his phone in the shade in New York City, U.S., July 5, 2023. REUTERS/Brendan McDermid

BP AND EQUINOR WILL FIND COMMON GROUND

BY YAWEN CHEN

The British oil major is undervalued against peers and is in a leadership vacuum. That makes it vulnerable to a takeover as U.S. mega-mergers shake up the sector. Daring to tie up with Norwegian ally Equinor offers a powerful hedge and a springboard.

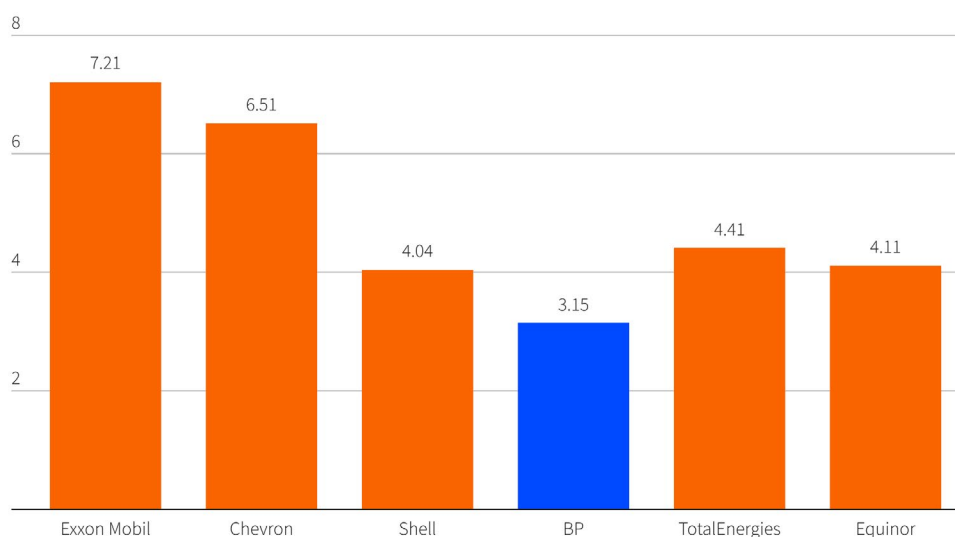
BETTER TOGETHER

Mega-mergers have strengthened U.S. oil majors Exxon Mobil and Chevron and revived talks of more cross-border M&A. One player looks potentially vulnerable: Britain's BP, worth around \$100 billion at the end of November. Its valuation is depressed and the abrupt departure of former CEO Bernard Looney has created a leadership void. Daring to merge with similarly sized Norwegian ally Equinor may allow BP's next boss to both protect and strengthen the UK group.

BP'S PARTICULARLY CHEAP VALUATION AND FRAGMENTED OWNERSHIP COULD TURN IT INTO A HOSTILE TAKEOVER TARGET

European energy companies were trading at a nearly 50% discount to U.S. rivals on a price to cash flow basis in November. But BP's particularly cheap valuation and fragmented ownership could turn it into a hostile takeover target. Its market valuation slipped to just 3 times its cash flow for the next 12 months, well below the 4 times fetched by Equinor, larger British rival Shell and French competitor TotalEnergies, LSEG data show. Also, Equinor had over \$10 billion in net cash at the end of September, while these two rivals held more debt than cash.

BP'S LOW VALUATION LEAVES IT EXPOSED



Note: Price to next 12 months' cash flow

Source: LSEG | Y. Chen | Breakingviews | Nov. 27, 2023

Working on a defence strategy by capitalising on existing business ties would make sense. In 2020 BP became a green partner to Equinor through the \$1.1 billion acquisition of a 50% stake in its U.S. offshore wind projects. The duo has also stood out as planning to spend more than rivals on low-carbon assets: BP has pledged to invest between \$7 billion and \$9 billion a year by 2030 in businesses including electric-vehicle charging, biofuels and hydrogen. That would be equivalent to half of its projected annual capital expenditure, up from 30% in 2022. At over 50%, Equinor's non-oil spending target is similar. TotalEnergies, in comparison, expects to devote only about a third of its capital to low-carbon ventures. Finally, BP Chairman Helge Lund, who led Statoil – before it was renamed Equinor – for a decade until 2014, provides the UK group with a strong Norwegian connection.

A merger would bring financial benefits. Shell's purchase of BG Group led to annual pre-tax savings of \$4.5 billion, or 1.5% of their 2015 revenue. On that basis, a tie-up of BP and Equinor could generate synergies worth \$4.8 billion a year on combined 2024 revenue of \$317 billion, per LSEG forecasts. Through BP, Equinor would gain a bigger international footprint and greater exposure to the lucrative liquefied natural gas segment and green industries in the U.S. and Asia. This would help the

Norwegian major to diversify away from gas pipeline exports to Europe, which are set to shrink. Equinor would also take on BP's much larger oil trading arm.

BP, meanwhile, would be in a stronger position to keep investors happy. The UK company has pledged to return 60% of its surplus cash flow to shareholders. Equinor's high-margin Norwegian oil and gas operations could boost payouts and provide capital for green investments.

There's one major hurdle. The Norwegian state, which owns 70% of Equinor, may be reluctant to lose majority control. Yet a transaction in which the Scandinavian group offered a 30% premium through shares and some \$10 billion in cash would see Oslo remain the top shareholder with around a third of the enlarged company, Breakingviews calculates. That would give Norway enough heft to control the board and block unwanted strategic moves. Elsewhere in Europe, the Italian and Finnish states hold 32% and 36% respectively in national champions Eni and Neste. Paris cut its stake in TotalEnergies to less than 1% in the 1990s.

If Lund can make a strong case at home, a \$200 billion-plus European energy major with a shared climate vision could become a reality.

First published December 2023



A BP gas station is seen in Zurich, Switzerland, March 11, 2022. REUTERS/Arnd Wiegmann

OZEMPIC OVERSHOOT WILL PLUMP UP BARGAIN-HUNTERS

BY ROBERT CYRAN

New weight-loss drugs are highly effective, but investors risk overestimating how fast change will occur and how many people will take the therapies indefinitely. Some companies regarded as victims, such as Zimmer Biomet, may even benefit. Contrarian investors may profit in 2024.

STILL ROUND, STILL AROUND

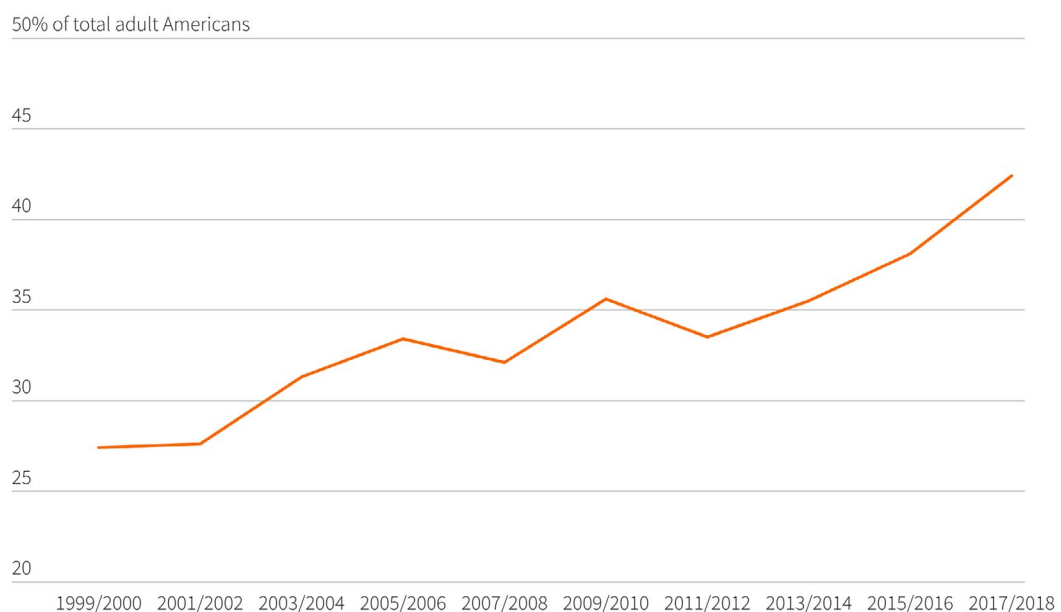
Weight-loss drug excitement went overboard in 2023. Novo Nordisk's Wegovy – which is known as Ozempic when used to treat diabetes – and Eli Lilly's Zepbound are the first effective treatments for obesity. The flip side for investors is that businesses peddling everything from fast food to medical services may see demand shrink. Yet markets have overestimated how quickly change will occur. That will create an opportunity for bargain-hunters.

So-called GLP-1 drugs, originally developed to treat diabetes but subsequently discovered to cause weight loss, have met a rapturous reception from users and investors. But few people currently take them. Over 40% of adult Americans are obese, according to the U.S. Centers for Disease Control, implying more than 100 million potential users for the drugs. Novo Nordisk said in November that fewer than 1 million Americans were taking Wegovy.

SALES OF WEIGHT-LOSS DRUGS MIGHT REACH \$77 BILLION BY 2030

This number will grow. Morgan Stanley analysts estimate sales of weight-loss drugs might reach \$77 billion by 2030, with over \$50 billion of that in the United States, making these treatments the biggest-selling drugs ever. That's still under 15 million Americans, though, and some of those patients may struggle to stay on the drugs and keep weight off.

THE PROPORTION OF OBESE AMERICANS HAS EXPANDED RAPIDLY



Given past rates of growth, it's therefore likely that the total number of obese Americans in 2030 will still be higher than today. Given the harsh side effects, and the likelihood that some insurers and governments will balk at the high cost of spending several thousand dollars per year on treatment for each patient, investors will conclude obesity will not be cured any time soon.

Now consider the selloff in stocks of companies that make products ranging from snacks to fast food and medical services. Most declined in 2023. Food giant Kraft Heinz dropped 17% in the first 11 months of the year, even as the S&P 500 Index rose by a fifth. Yum Brands, the operator of KFC and Taco Bell, was also down. Resmed, which makes devices for sleep apnea, which predominantly affects obese people, lost more than a quarter of its value. At the same time, however, analysts increased their estimates of 2025 revenue for all three companies.

GLP-1 drugs may even benefit some of the casualties of the 2023 selloff. Zimmer Biomet, a medical device maker worth \$24 billion in early December, saw its stock fall about 10% because two-thirds of revenue comes from selling hip and knee implants. Smaller rival Smith & Nephew was also out of favor. That reaction may seem logical, because overweight people are four times as likely to develop arthritis in their knees.

However, joint replacement won't dry up any time soon. Arthritis damage is cumulative, worsening over time, so even people who are no longer obese will still be candidates for knee surgery. The number of patients may even grow, as orthopedic surgeons generally won't operate on morbidly obese patients. Selective stock-pickers will find the Ozempic overshoot creates opportunities to plump up their portfolios.

First published December 2023



Kim Gradwell, who has diabetes, uses an Ozempic injection needle at her home in Dudley, North Tyneside, Britain, Oct. 31, 2023. REUTERS/Lee Smithw

THE LI CLAN WILL DEAL THEIR WAY OUT OF VALUE TRAP

BY UNA GALANI



Hong Kong tycoon Li Ka-shing waves goodbye to journalists after announcing his retirement as chairman of CK Hutchison at a news conference in Hong Kong, China, March 16, 2018. REUTERS/Bobby Yip

The Hong Kong-based empire founded by Li Ka-shing is unloved by investors. Despite his son Victor's efforts to boost value, the \$20 billion CK Hutchison trades at a big discount to its net assets. With 80% of revenue outside Greater China, it makes sense to explore a sale or breakup.

KEEP THE FAITH

Li Ka-shing, Asia's original tycoon, converted to shareholder religion nearly a decade ago when he carved up his Hong Kong-based empire. Though investors supported the deal, they have rapidly lost faith in the company as Sino-American tensions rise. Solving the value conundrum will be a top priority for his son Victor Li in 2024.

The elder Li split his empire in two in 2015 with one part, CK Hutchison, including its global ports, telecoms, retail and energy businesses and the other, later renamed CK Asset, holding its China-focused property portfolio.

Yet the move has failed to unlock any hidden value. CK Hutchison has delivered a negative 29% return to shareholders since announcing the split, trailing the negative 5% of Hong Kong's benchmark Hang Seng Index. The company's \$20 billion market capitalisation is now a 70% discount to its book value, compared to par in 2016, LSEG estimates show. It trades at a paltry 5 times expected 2024 earnings.

The executive team led by Victor Li has hardly been sitting still. CK Hutchison has struck telecoms mergers in the United Kingdom, Indonesia and Australia, and rejigged

its energy assets in Canada. Shareholders are unmoved, though. Meanwhile, Singaporean sovereign fund Temasek has appeared restless to unlock some of the \$10 billion it has invested in CK Hutchison's AS Watson retail business and the conglomerate's port subsidiaries.

The company's Hong Kong listing is part of the problem: global investors are out of love with Greater China equities. Indeed, some interpreted Li's 2015 rejig as signalling a lack of confidence in the Asian hub. Shareholders are also nervous about the waning influence of Hong Kong's tycoons as China tightens its grip on the city.

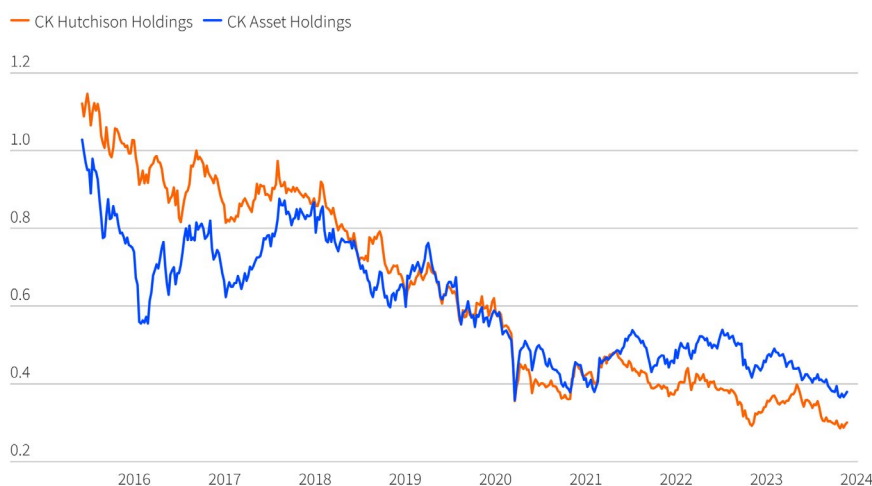
SHAREHOLDERS ARE ALSO NERVOUS ABOUT THE WANING INFLUENCE OF HONG KONG'S TYCOONS

One option would be for CK Hutchison to shift its primary listing to another exchange in Europe or the United States. The group generates 80% of its revenue outside of Greater China. Yet turning its back on Hong Kong would risk a broader backlash.

An alternative would be for the Li clan to use their 30% shareholding in CK Hutchison to take it private with the help of a private equity group before breaking it up. The company has shown it's willing to surrender control, accepting a junior position in a merger of its Three mobile telecoms unit in the United Kingdom with rival Vodafone. It will take more bold dealmaking to unlock value at the parent company.

First published December 2023

LI KA-SHING'S EMPIRE IS HEAVILY DISCOUNTED



Note: Price-to-book value

Source: LSEG | U. Galani | Breakingviews | Nov. 27, 2023

GREEN INVESTORS WILL LEARN **THE ART OF STOCKPICKING**

BY GEORGE HAY



A wind turbine is shrouded in fog at the Low Carbon Energy Generation Park on the Keele University campus in Keele, Staffordshire, Britain, Nov. 11, 2023. REUTERS/Carl Recine

Wind and solar stocks had a torrid 2023, as stars like Orsted crashed. But renewables investment is strong, input cost inflation is abating and rates may have peaked. Investors able to pick developers in the right sector, or suppliers in the right regions, may find bargains.

GREEN LIGHT

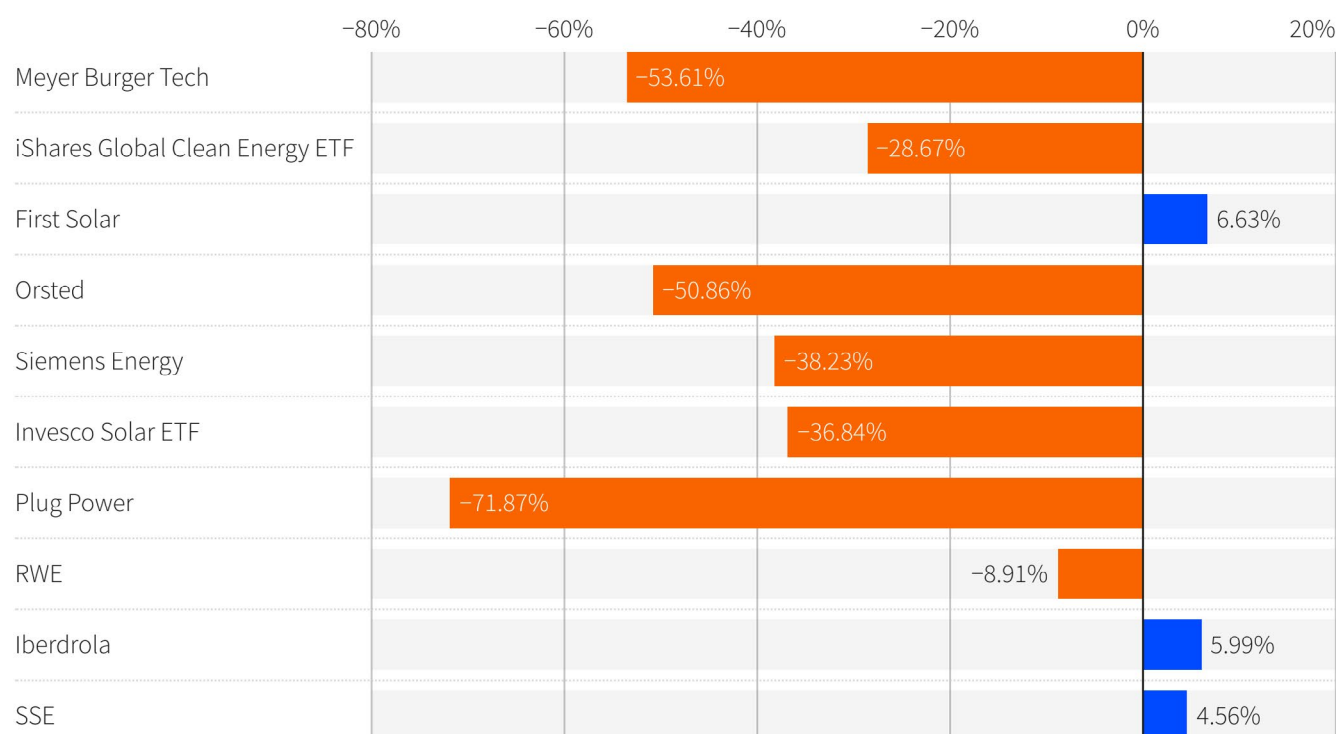
Renewable energy companies had a tough old 2023. After years of robust valuations and cheaper power costs, green stars like Danish offshore wind developer Orsted crashed to earth. Despite the threat posed by Donald Trump's possible re-election as U.S. president, discerning investors should experience a rebound.

On the face of it, clean energy is a sector to swerve. Power prices' failure to keep pace with soaring input costs meant shares in Orsted and wind turbine maker Siemens Energy fell over 50% between June and the end of November, prompting billions of dollars of writedowns and state support.

As of end-November the MAC Global Index of solar companies had fallen almost 40% in 2023 and the iShares Clean Energy ETF had slumped nearly 30%, even as benchmark European and U.S. indexes both rose. Quarterly inflows into global sustainable funds fell from over \$180 billion globally in early 2021 to \$14 billion in the third quarter of 2023, with funds in the U.S. recording actual outflows.

In 2024, the scope for Trump to gut \$369 billion of clean energy support from the U.S. Inflation Reduction Act adds another risk. Yet the long-term trajectory of green capital demand is up. The International Energy Agency thinks clean energy investment will exceed \$1.7 trillion in 2023, against fossil fuels' \$1 trillion. Solar and wind capacity needs to rise threefold by 2030 to cap global warming at 1.5 degrees Celsius above pre-industrial levels. Equipment cost inflation may have peaked, Bernstein analysts reckon, and the UK government recently joined Portugal and India in hiking renewable subsidies to make project economics stack up.

MANY RENEWABLE STOCKS FELL SHARPLY IN 2023



Note: Rebased to zero. Invesco Solar ETF aims to track the MAC Global Solar Energy Index

Source: LSEG | A. F. Alias | Breakingviews | Nov. 23, 2023

Moreover, the single biggest driver of wind and solar valuations is that their long duration creates a strong inverse correlation with interest rates. Anyone who thinks borrowing costs have peaked should therefore be buying green stocks. Capital Economics reckons that if 10-year U.S. Treasury yields fall to the analyst's 3.75% forecast level by the end of 2024, stocks in renewable players might outperform wider energy equities by 50% in the same period.

INVESTORS NEED TO DO MORE THAN JUST CHECK THEIR TARGET IS GREEN

What's clear is that investors need to do more than just check their target is green. Breakneck manufacturing of cut-price Chinese solar panels risks exacerbating a supply glut, hurting Western manufacturers like Switzerland's Meyer Burger Technology, who are vulnerable to falling prices and lack protective tariffs. Solar developers, on the other hand, might gain if the price of kit falls.

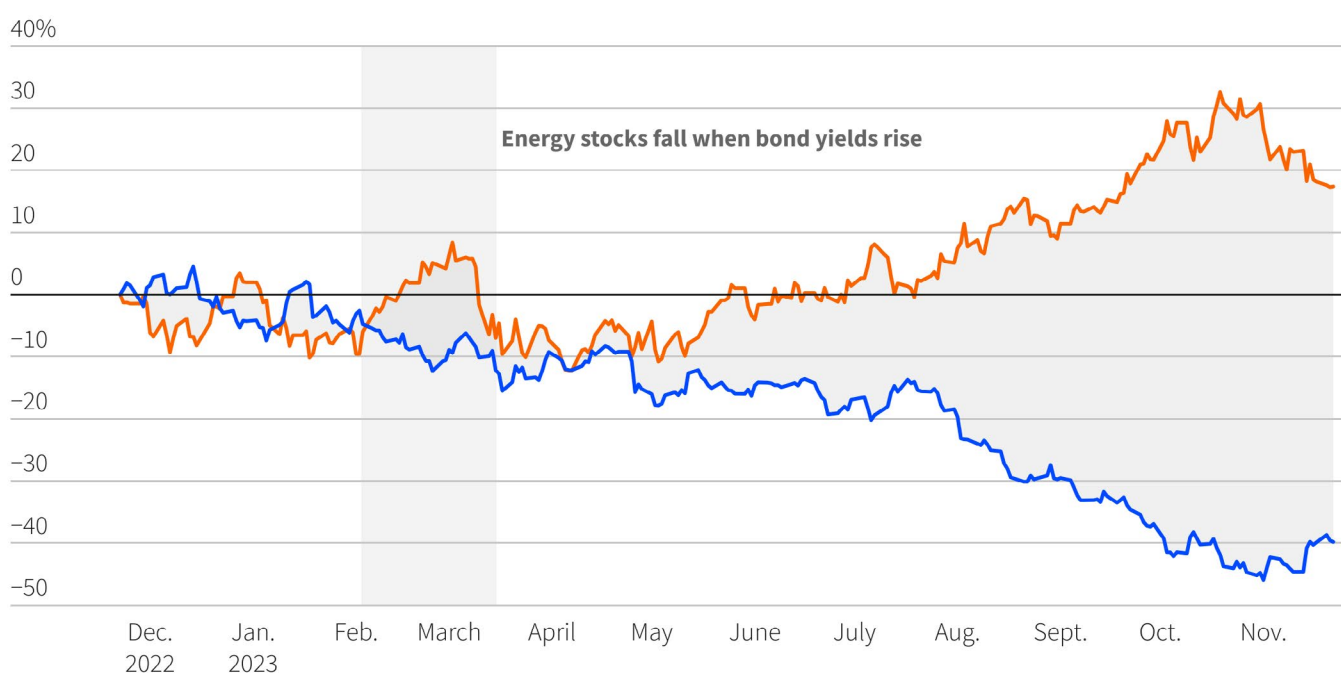
Offshore wind's high capital costs will continue to make it a dicier bet than onshore solar and wind. The regulated network arms of diversified utilities like Spain's Iberdrola, Italy's Enel and Britain's SSE give them a hedge against unpleasant surprises.

After reaching absurdly inflated levels in 2021, green assets are relatively cheap. LSEG data as of the end of November suggested Iberdrola, Enel and SSE were trading below their long-term average multiples of forecast EBITDA. Recent results by Iberdrola and Germany's RWE suggest Orsted's problems may be idiosyncratic. That implies a handy entry point.

First published December 2023

GREEN STOCKS HAVE HAD A CLOSE INVERSE LINK TO BOND YIELDS OF LATE

— MSCI Global Alternative Energy Index — US 10-year Treasury yield



Note: Rebased to zero

Source: LSEG | A. F. Alias | Breakingviews | Nov. 23, 2023

STELLANTIS WILL CRUISE WITH GM AND FORD

BY NEIL UNMACK

The maker of Jeeps and Opels run by Carlos Tavares is one of Europe's lowest-valued carmakers. Yet it generates much of its income in the U.S., and boasts industry-leading profit margins. Keeping a single New York listing could see its valuation match Detroit rivals.

CHANGING LANES

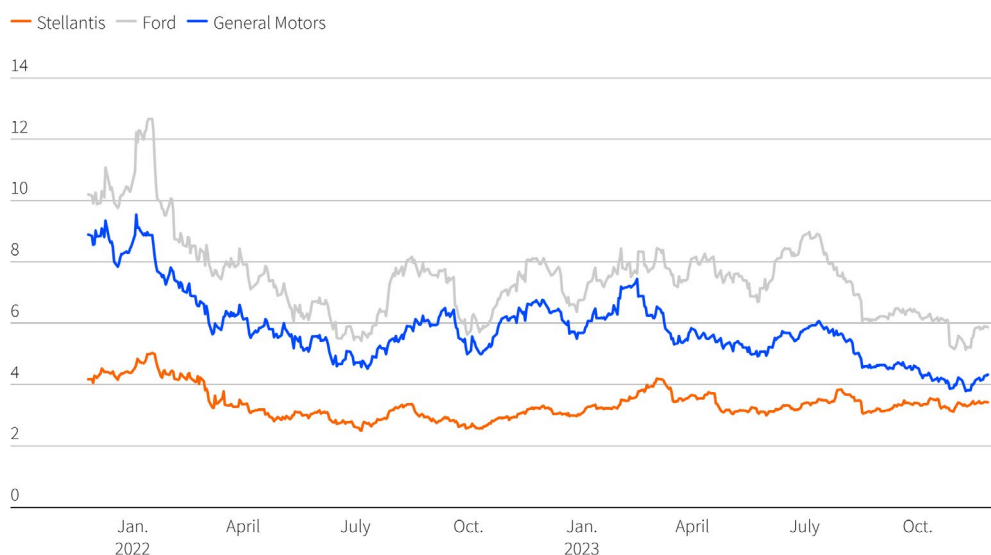
Stellantis will cruise alongside General Motors and Ford Motor. The group run by Carlos Tavares is one of Europe's lowest-valued carmakers. Yet it makes most of its money in the U.S., and boasts industry-leading profit margins. Keeping a main listing in New York could see its valuation match Detroit-based rivals.

TAVARES HAS REASON TO FEEL A LITTLE MIFFED

Tavares has reason to feel a little miffed. Shares in the roughly 60 billion euro carmaker forged from the union of Fiat Chrysler Automobiles and Peugeot were trading at just over 3.4 times its earnings for the next year in late November, according to LSEG. That's marginally above rival Volkswagen, even though Stellantis is less exposed to the highly competitive China market and is much more profitable.

Yet arguably the German automaker isn't the right peer for Stellantis anyway. True, both have their headquarters in Europe, with Tavares' group based in the Netherlands and listed in Milan and Paris. Yet Stellantis, thanks to Fiat's purchase of Chrysler under former boss Sergio Marchionne, has a large U.S. operation, with stateside revenues outstripping those in Europe by over 50% in the third quarter of 2023. Stellantis will make nearly two-thirds of its operating profit in North and South America in 2024, Visible Alpha data show.

STELLANTIS' EARNINGS MULTIPLE LAGS RIVALS



Note: Share price divided by 12-month forward earnings per share

Source: LSEG | N. Unmack | Breakingviews | Nov. 28, 2023

Put Stellantis alongside its U.S. competitors, and it looks even cheaper. Ford and General Motors are valued on average at 5 times their forward earnings. Yet Tavares' group is more profitable than either: in 2024 it will convert some 11% of its revenue into operating profit, nearly double the equivalent metric for the two U.S. players. Barclays analysts reckon Stellantis' electric-vehicle division is second only to Tesla in terms of profitability among Western EV players. If the European carmaker traded on the average 5 times earnings multiple of Ford and GM, its shares would be worth nearly 50% more.

One solution would be to focus on a single U.S. listing. Stellantis shares already trade in New York, although they mostly change hands in Europe, RBC analysts reckon. If it qualified for the S&P 500 Index, the leading U.S. stock market index, Stellantis would immediately

attract more American investors. Tavares would hardly be the first CEO to make the move: Milan-listed trucks and tractors maker CNH Industrial, whose main shareholder Exor is also Stellantis' biggest owner, has chosen to retain a single listing in New York from Jan. 2.

There are downsides to such a move. European politicians would resist bitterly any step that could pave the way for moving Stellantis' headquarters to the U.S. And some of the prospective additional value might disappear once accounting changes linked to R&D are factored in. John Elkann, CEO of Exor, said in late November that there were no current plans to have a single U.S. listing. For Tavares, spending more time talking to American investors may be an easier way to boost his company's stock. Still, if Stellantis' valuation discount persists, pressure for more radical solutions will step up a gear.

First published December 2023



Stellantis CEO Carlos Tavares speaks during a keynote address at CES 2023, an annual consumer electronics trade show, in Las Vegas, Nevada, U.S., Jan. 5, 2023. REUTERS/Steve Marcus

ALTICE'S BEST HOPE WILL BE A MIDDLE EAST LIFELINE

BY PAMELA BARBAGLIA

Telecoms tycoon Patrick Drahi is dismantling his empire to cope with a \$60 billion debt wall. Attracting new investors may be tricky given low growth and a corruption scandal. Luckily Gulf states like the UAE and Saudi Arabia are flush with cash and keen to grab Western assets.

LAST TANGO IN PARIS

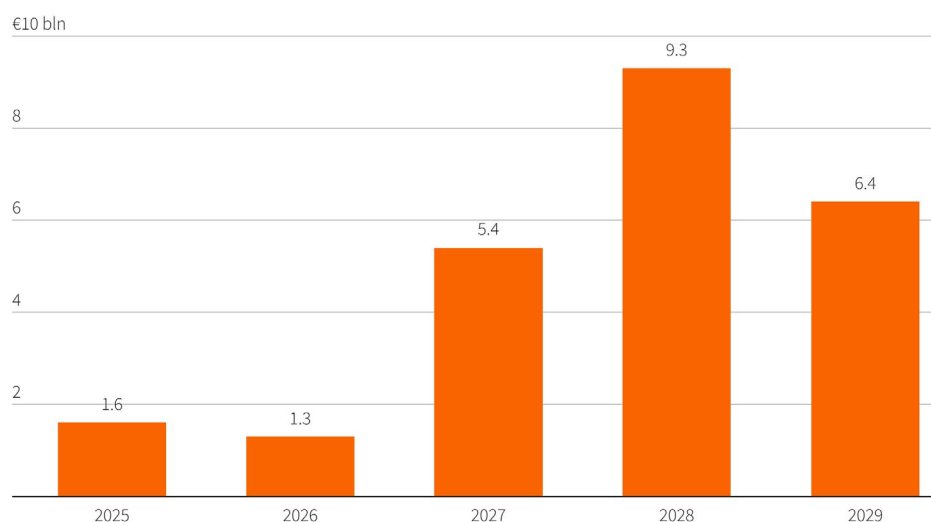
Franco-Israeli billionaire Patrick Drahi is facing a harsh reversal of fortune. A \$60 billion debt wall is threatening to bring down the telecoms empire he built in an era of low interest rates. With soaring debt costs and a corruption probe, the Altice tycoon needs help to stay afloat. Gulf investors may be his best lifeline.

Born in Morocco, the 60-year-old son of two maths teachers has built a telecoms group spanning the United States, Europe, the Caribbean and Israel, now split into three separately funded units. The main problem lies in

France, where Drahi has 24 billion euros of borrowing coming due by 2029. The business, France's second-largest telecoms operator, had debt equivalent to 6 times trailing EBITDA in the third quarter of 2023, well above its 4.5 times target. Fierce competition saw revenue fall 1.7% in the nine months to the end of September. Some Altice France bonds maturing in 2027 were yielding 35% in late November, according to LSEG data, a sign of investor concern over its debt.

Drahi's fix is to sell assets from his empire, which is now privately held with the exception of the listed U.S. business. First on the block is Portugal, housed within the Altice International group, the third leg outside France and the United States. Altice Portugal has a price tag of more than 7 billion euros, according to a Bloomberg report. But given telecoms peers like Vodafone and Deutsche Telekom are worth on average 5 to 6 times EBITDA including debt, a valuation range of 5 billion euros to 6 billion euros looks more likely. Drahi may also sell Altice International's advertising business, worth some 1.5 billion euros, bankers say.

ALTICE FRANCE'S €24 BLN DEBT WALL



Note: Includes bonds and bank borrowings

Source: Altice France's nine-month earnings report to Sept. 30, 2023 | P. Barbaglia | Breakingviews | Nov. 24, 2023

This fire sale may not be enough. Altice International has debt equivalent to 5 times 2022 EBITDA, and so its own creditors may be wary of seeing too much cash leak out of the business to rescue France. Drahi may therefore need to raise equity for France directly. A 4 billion euro cash call would cut debt to around 5 times EBITDA, according to Breakingviews calculations.

Drahi would need to find a deep-pocketed anchor investor. Middle Eastern companies could fit the bill: both Abu Dhabi's e& and Saudi Arabia's STC have recently built stakes in Europe's debt-laden telecoms groups. He would also have to secure the approval of the French government, given any deal would see new investors take a large stake in a key part of French infrastructure. It helps that President Emmanuel Macron has been courting Gulf investors, and plans to appoint an ambassador to manage relationships with sovereign funds in the region.

DRAHI WILL NEED TO SCOUR EVERY CORNER OF THE GLOBE FOR HELP

An investment in Altice France would be a tough pitch. A corruption scandal in Portugal may not be cleared up for years. And new investors would still own a stake in a relatively indebted, slow-growing group. The hope is that France may one day gain from consolidation: rivals Xavier Niel's Free, Orange and Bouygues Telecom are all considering strategic options. To fix Altice, Drahi will need to scour every corner of the globe for help.

First published December 2023



Altice founder Patrick Drahi attends the inauguration of the Altice Campus in Paris, France, Oct. 9, 2018. REUTERS/Philippe Wojazer

RESTAURANT DEALS WILL BE BACK ON THE MENU IN 2024

BY SHARON LAM



With the pandemic receding, U.S. spending on dining out has topped \$1.3 trillion. Inflation has eaten into any exuberance, but as costs moderate and restaurants recoup margins, dealmaking will return, giving long-held investments like Panera a shot at cashing out.

FEEDING FRENZY

Restaurant operators will prove tasty morsels for acquirers in 2024. Consumer spending on dining out has recovered from the pandemic, while the worst of its inflationary after-effects are receding. That means eager sellers, like private equity owners stuck in investments during a deal rout, will finally get to serve up some sales or public listings.

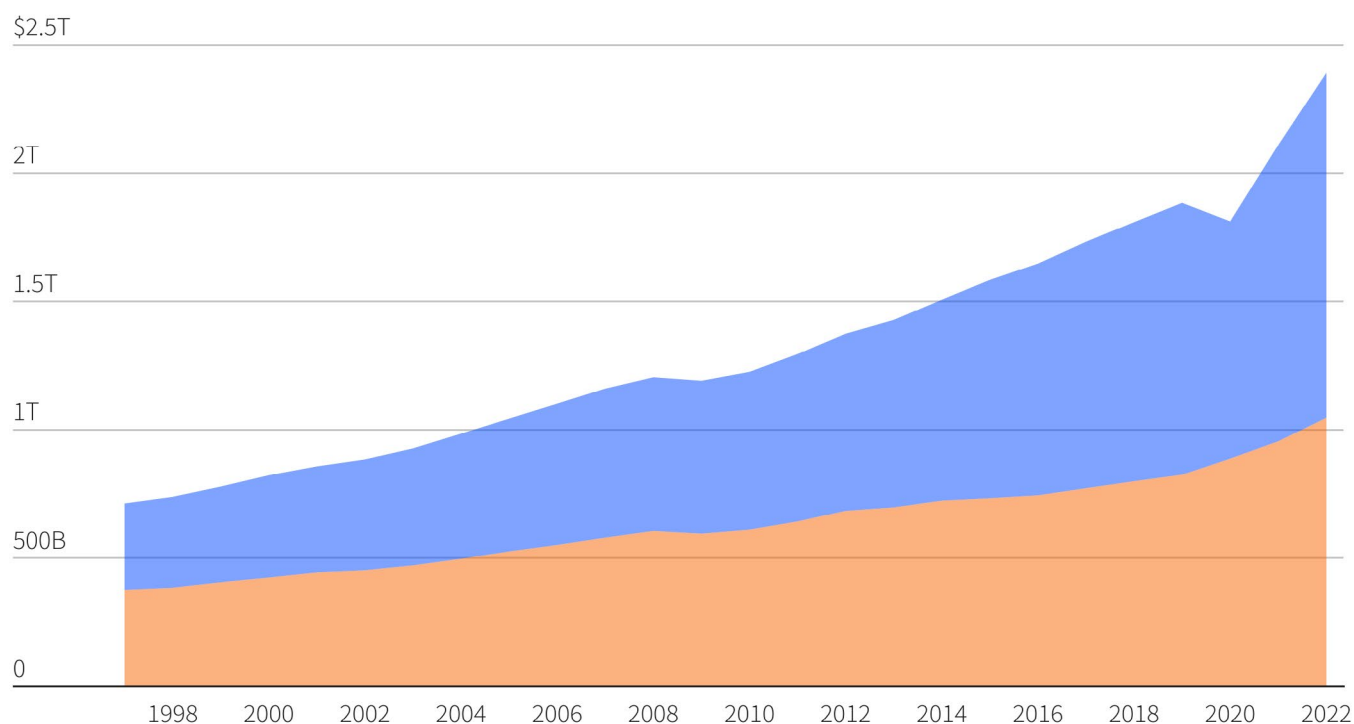
RESTAURANT SALES ROSE FOR EIGHT CONSECUTIVE MONTHS

Home cooks have hung up their aprons. Spending on food away from home rose 16% year-on-year to about \$1.3 trillion in 2022, U.S. Department of Agriculture data show. Restaurant sales rose for eight consecutive months through October 2023, according to a national trade group. Yet the soaring cost of ingredients, tougher access to capital and labor shortages restrained investors' appetites.

That is now unwinding. After food and labor costs rose by as much as 27% in the wake of Covid-19, according to Morningstar, there is now some relief, with prices paid to producers for various food categories falling consistently through 2023 and wage inflation tumbling to less than half its peak. And despite sluggish foot-traffic growth this year, restaurateurs have held on to some pricing power, especially in fast food, where McDonald's has boasted higher prices as its restaurants' profitability largely recovered from 2022's downturn.

US FOOD-AT-HOME VS. FOOD-AWAY-FROM-HOME SPENDING

● Total food-at-home ● Total food-away-from-home



Source: US Department of Agriculture | S. Lam | Breakingviews | Nov. 30, 2023

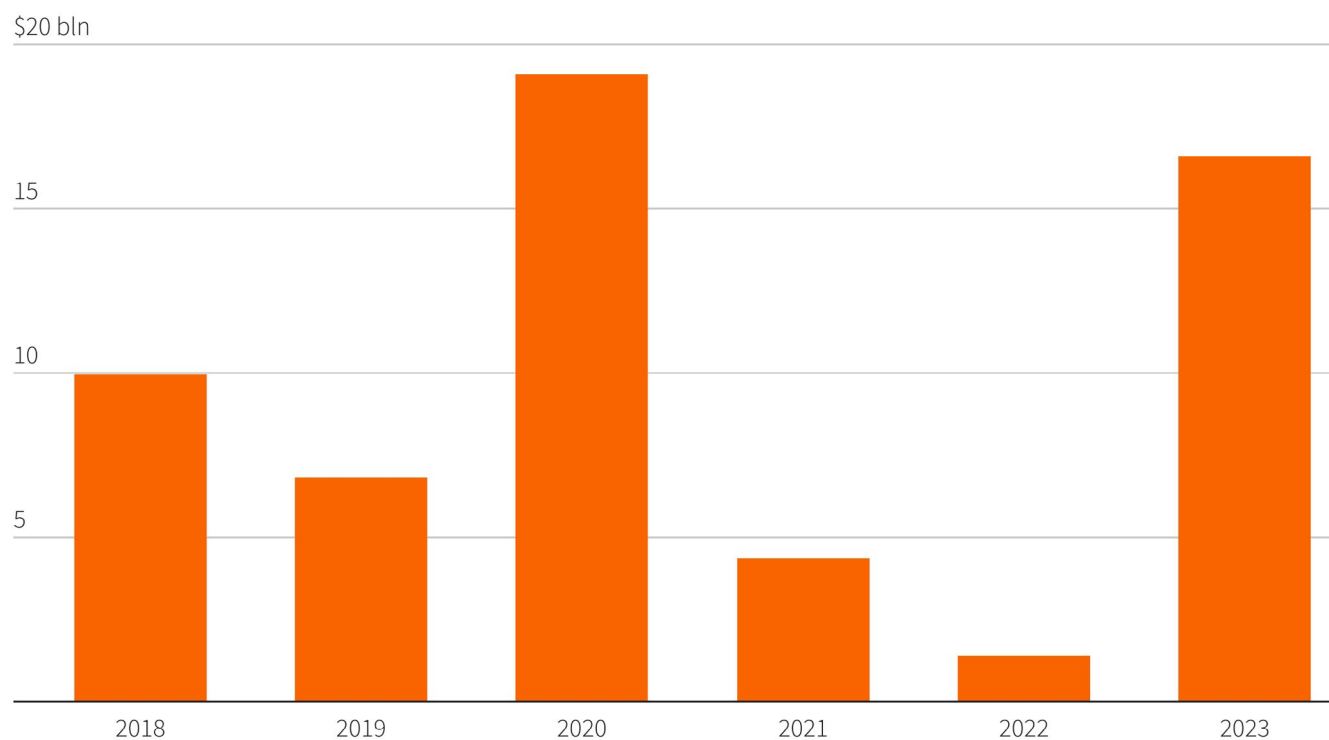
Taken together, these ingredients could form the perfect concoction for a resurgence in deals. Things are already heating up. While 2022 proved a dud, with a mere \$1.4 billion in transactions, 2023 notched 12 times that figure by September, according to Dealogic data. Sandwich chain Subway finally found a long-sought \$9.6 billion sale to Roark Capital in August.

It's a hopeful sign for others stuck in long-held investments. Various private equity firms have rolled up a slew of restaurant brands, like Brentwood Associates' 2013 deal for Lazy Dog Restaurant & Bar, or JAB's 2017 take-private of Panera Bread for \$7.5 billion.

With interest rates topping out and markets recovering, acquirers – such as fellow buyout shops sitting on dry powder – could look to clean their plates. Or they could join the long list of companies preparing to test investors' enthusiasm for public offerings. Panera, for instance, has filed confidentially for an IPO. That should finally give restaurant owners something to feast on in 2024.

First published December 2023

US RESTAURANT M&A DEAL VOLUME



Note: Value of deals targeting full- and limited-service US restaurants to Q3 2023

Source: Dealogic | S. Lam | Breakingviews | Dec. 4 2023

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ACKNOWLEDGEMENTS

PRODUCTION BY Oliver Taslic and Katrina Hamlin

DESIGN BY Bond and Coyne Associates

COVER AND CONTENTS PAGE IMAGE

The Aurora Borealis (Northern Lights) is seen over the sky near Rovaniemi in Lapland, Finland, Oct. 7, 2018. REUTERS/Alexander Kuznetsov

CHAPTER TITLE IMAGES

LOOKING AHEAD

A sailor takes bearings from a compass on the bridge deck of Japanese helicopter carrier Kaga during a joint naval drill with Indonesian patrol boat Kurau in the Indian Ocean, Indonesia, Sept. 22, 2018. REUTERS/Kim Kyung-Hoon

COMEBACKS

A Ferris wheel is seen during sunset in Brussels, Belgium, June 2, 2023. REUTERS/Yves Herman

FALLING FLAT

A tree is pictured at sunrise in the village of Rio Pardo next to the Bom Futuro National Forest, in the district of Porto Velho, Rondonia State, Brazil, Sept. 2, 2015. REUTERS/Nacho Doce

BACKLASH

A steel worker of Thyssenkrupp stands amid sparks of raw iron coming from a blast furnace at a steel factory in Duisburg, Germany, Nov. 14, 2022. REUTERS/Wolfgang Rattay

PICKING UP THE PIECES

Participants wearing historical costumes ride their high-wheel bicycles during the annual penny farthing race in Prague, Czech Republic, Nov. 5, 2022. REUTERS/David W Cerny



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