

**BREAKINGVIEWS 2022**  
PREDICTIONS AND PRESCRIPTIONS

# A WORLD IN TRANSITION

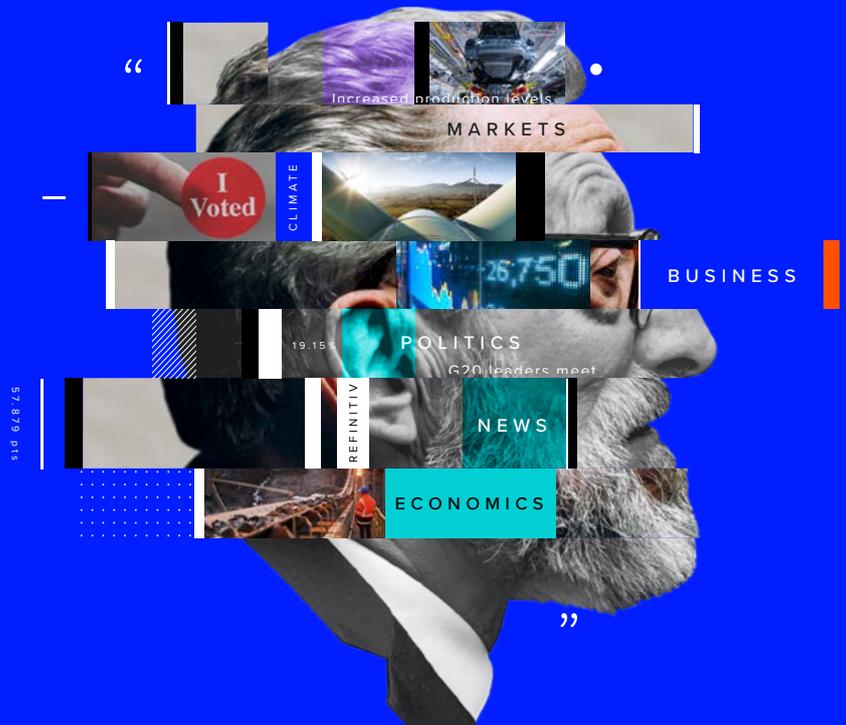
**THE MEGA SHIFTS SHAPING FINANCE,  
BUSINESS AND ECONOMIES**



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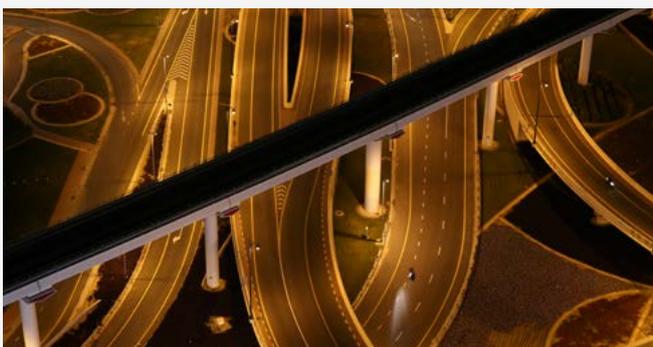
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# BIG TRANSITIONS ARE BETTER EMBRACED THAN RESISTED

**INTRODUCTION BY ROB COX, GLOBAL EDITOR**

The dictionary defines transition as “a change from one state or condition to another.” That sums up the world as 2022 arrives. Whether it is the move away from an economic system reliant upon hydrocarbons, vanquishing the Covid-19 plague or central banks ending the free-money era, extraordinary shifts are occurring across the planet that will shape markets, corporate finance, politics and economies well beyond the coming year. These are the themes that inform Reuters Breakingviews’ annual book of predictions and prescriptions: “A World in Transition”.

**THE EXTRAORDINARY ACTIONS  
REQUIRED TO DRIVE THESE  
EPOCHAL TRENDS ARE BEING  
TAKEN NOW**

The extraordinary actions required to drive these epochal trends are being taken now, even if it will be years or even decades before achievements can be meaningfully measured. Inevitable transitions, like the one toward renewable energy, are better embraced than resisted. Investors and entrepreneurs who can adapt to change and its concomitant upheaval will reap the greatest rewards. But they must be prepared to make sacrifices along the way. Without social inclusion, these transformations may lead to violence.

Efforts by governments and companies to reduce carbon emissions and reach net zero by 2050 or sooner to limit planetary frying to 1.5 degrees Celsius above pre-industrial levels will continue to dominate the financial and business landscape in 2022. Switching away from coal, gas and oil is a priority. But every sector, including heavy industries like steel and cement, transportation, agriculture and banking, will soon need to make huge commitments to meet the lofty ambitions of the next generation. Our columnists explore all of these.

At the same time, inflation is less quiescent than in the past couple of decades. Central banks will have to start pulling away the punchbowl, which has broad implications for the cost of capital (it goes up!) and the price of money. Speaking of which, money itself will go through a transformational period as the Federal Reserve, the European Central Bank and other monetary authorities try to keep up with the emerging dynamics of crypto and digital currencies.

A third year of the pandemic, with the persistent threat of new, more virulent strains, continues to dramatically accelerate the shift to digital everything. The winners and losers of this transition will become more evident in 2022. Quasi-monopolies – like Amazon.com in delivery and web-services; Meta, the company formerly known as Facebook, and Alphabet in advertising; and Microsoft in workflow – were given extraordinary boosts by state-mandated shutdowns. Governments face a make-or-break year to regulate these multi-trillion-dollar behemoths. Microsoft under Satya Nadella is our pick to manage these headwinds best.



And even as people trickle back to offices, post-pandemic dynamics in communications, training, travel and social interaction are permanently reshaping the workplace and productivity. This has implications for the nature of labour, property, urban planning and beyond. It also poses new challenges to leaders, none of whom were trained at Harvard Business School or INSEAD to run sprawling organisations of employees working individually from home. That's why we're predicting high CEO turnover, robot investment bankers and a return to offshore jobs.

The increasingly chilly war between the United States and China will dominate international trade and geopolitics. The kerfuffle over U.S. nuclear-submarine sales to Australia and America's shambolic retreat from Afghanistan offered glimpses into the fractious nature of the Western alliance. With Xi Jinping set for a third term (if not life) as China's president, U.S. President Joe Biden has a chance to reach détente of some sort to cooperate on climate change, the pandemic and other priorities. But with Biden's own party facing a trouncing in November's congressional elections, his hands may be tied. On the plus side, European leadership will have a chance to consolidate as French President Emmanuel Macron likely

wins a second term in May, Germany welcomes a new chancellor after 16 years with Angela Merkel at the helm, and Italy chooses its next president.

### **SUCCESS WILL REQUIRE EXTRAORDINARY SOCIAL INCLUSION**

Success will require extraordinary social inclusion. Governments, companies and taxpayers (especially the richest) have to proactively prepare for the sacrifices that are needed to prevent the earth from scorching, while delivering greater equity, financial inclusion and social justice. Failure to do so will lead to civil unrest or worse. In addition to being terrible for business, that would torpedo more existential goals like limiting global warming, whose deleterious effects will be disproportionately borne by the world's poor. Here's hoping the business world and financial markets help guide the way to a fairer, greener and more just society in the year ahead.

*First published January 2022*

A landscape of charred trees, likely after a fire. The background is filled with dark, skeletal trees. In the foreground, a single, taller, charred tree stands prominently, its branches covered in small, dark, cone-like structures. To the right, a cluster of bright green, leafy branches is visible, providing a stark contrast to the dark background.

*CHAPTER 1*

# ECOLOGY

# CLIMATE-CHANGE MONEY WILL FLOW FREELY TO PLAN B

**BY GEORGE HAY**

COP26's so-so outcome makes damaging temperature rises more likely. At some point, optimal portfolios may require guns and canned food. Until then investors will lean towards shares in Syngenta, Veolia and other companies that aid adaptation to global warming not just mitigation.

## **ADAPT OR DIE**

Sustainable investing is pivoting to Plan B. Billed as humanity's last chance to avert disastrous climate change by committing states to halve global emissions by 2030, Glasgow's United Nations COP26 global shindig ultimately managed nothing of the sort. In 2022 that will focus money minds on what happens when temperatures rise.

The stereotypical climate-change investment thus far has been buying shares in a renewable energy maven like Denmark's \$52 billion Orsted, which mitigates carbon emissions and slows down warming. COP26 had a new focus on adaptation, which covers what to do when higher temperatures materialise. Rich countries agreed to double annual transfers to developing countries to \$40 billion for battling rising sea levels, droughts, and more violent storms.

The actual opportunity is much larger. Bank of America reckons the overall climate adaptation market will double to \$2 trillion per year within the next five years. The UN's Global Commission on Adaptation says a \$1.8 trillion investment by 2030 in early warning systems, resilient infrastructure, dryland agricultural crop production, mangroves, and water resource management would yield more than \$7 trillion of benefits in avoided costs from climate change effects.

To see how this would work in detail, consider the global chemicals sector. Switzerland's Syngenta, whose Chinese owner is mulling a \$60 billion listing, spends \$2 billion a year on research and development helping farmers maintain yields hit by planetary warming. That includes drought-resistant cabbage and corn with deeper roots, fungicides to stop flood-ravaged crops going mouldy, and grain variants that shorten the time to fatten beef. Its \$50 billion German rival Bayer is a potential winner too.

Who else is in the mix? Big engineers like Canada's \$16 billion WSP Global will be constantly engaged helping municipalities redesign infrastructure to guard against flooding. France's Veolia is well-placed to scoop up desalination contracts to render saltwater in drought-afflicted areas drinkable. And there are racier ways to hedge against climate change.

## **THERE ARE RACIER WAYS TO HEDGE AGAINST CLIMATE CHANGE**

Microsoft and Swiss Re have invested in so-called direct air capture to suck carbon from the air. Even wacky ideas like solar geoengineering to dim the sun will gain traction. Miserabilists, meanwhile, can always try \$1 billion U.S. gunmaker Smith & Wesson, or an appropriate proxy for canned food. But they can achieve the same result by taking a more sober punt on adaptation.

*First published December 2021*



# ESG ACRONYM IS DUE FOR A SPIN OFF OF ITS INITIALS

BY ROB COX

Lumping environmental sustainability, social justice and corporate governance into a single bucket is a clumsy way to address three complex and distantly related challenges. Savvy executives and investors want to separate them. E, S and G will be more valuable after a breakup.

## ACRONYMIC BREAKUP

General Electric's doing it. So is Toshiba. And Johnson & Johnson. Breakups are all the rage and rightly so: The individual parts of sprawling corporations can be better managed on their own and are arguably worth more separately than the whole. But the biggest breakup of 2022 won't be company specific. It's time to spin off the letters in ESG.

The initialism stands for environmental, social and governance, and it first surfaced in a 2005 United Nations report. At the time it was a handy way for do-gooders to push the investor community to invest in solving communal problems they ignored in pursuit of the bottom line. It seems to have worked. Today more than \$17 trillion of U.S. assets under management are dedicated to ESG-related strategies, according to the Forum for Sustainable and Responsible Investment, and growing at nearly 20% a year.

**LUMPING THE ISSUES  
TOGETHER UNNECESSARILY  
COMPLICATED FUND MANAGERS'  
DECISION-MAKING**

However, lumping the issues together unnecessarily complicated fund managers' decision-making. For example, nearly 60% of investors polled by Natixis Investment Managers believe they have a responsibility to help solve social issues. But a larger majority – 78% – said it's primarily the responsibility of governments.

Companies that do well in carbon emissions or "E", may fail on board diversity measures. Alternatively, they may prioritise shareholder returns at the expense of sustainability or better maternity leave and call it good governance. Aggregating ESG measurement lets executives mask failures in one domain by outperforming on another. Unlike corporate debt ratings, ESG scores vary widely depending on who is doing the measuring.

Many investors are prioritising climate change, an area where financial investments can have direct, measurable impact, and one devoid of country-specific cultural values packed into social justice measures. But corporations that are sincerely committed to attacking all three problems are avoiding a blanket approach regardless.

"E, S and G are not natural bedfellows – and we don't use that language," Alan Jope, Unilever's chief told Breakingviews. "We shouldn't look too closely at the label, but at the actions that sit underneath it."

As 2022 kicks off, with more corporate breakups undoubtedly in the offing, it is time to give the E, the S and the G their own independence too.

*First published December 2021*

# CLIMATE M&A WILL SHIFT FROM RISK TO OPPORTUNITY

**BY ANTONY CURRIE**



Defensive and green-signalling plays dominate ESG-touted deals, like BHP's coal sales and Santos' Oil Search swoop. SPACs are active, too. Next will be more ambitious, impactful tie-ups, from banks upping their skills to firms like Autodesk and Ecolab being predator or prey.

### GREEN DEALS

Climate-change dealmaking is about to get a lot more legit. Green-tinged transactions more than tripled in value in 2021 to \$164 billion by early December, per Refinitiv, though there's no standard definition for what merits the colour. There has, though, been a dearth in genuinely environmentally useful tie-ups. Expect more to emerge.

### SOME TRANSACTIONS CLAIMING A CLIMATE RATIONALE ARE JUST ECOLOGICAL VIRTUE-SIGNALLING

Some transactions claiming a climate rationale are just ecological virtue-signalling. Santos boss Kevin Gallagher argues his firm's recent \$6 billion embrace of Oil Search will help to "successfully navigate the transition to a lower carbon future", yet he'll increase fossil-gas drilling more than 45% to get there.

Special-purpose acquisition companies, meanwhile, dominate the eco-friendly deals list, topped by multi-billion-dollar swoops for electric-vehicle makers Polestar and Lucid. These, though, are more capital-raising public listings – albeit by the SPAC door – than mergers.

Climate-risk avoidance has been the biggest driver for the past two years, like the \$50 billion creation of carmaker Stellantis. Ditto BHP's \$16 billion oil-and-gas sale to Woodside Petroleum and offloading of coal assets, or Anglo American's Thungela Resources coal miner spinoff. These mitigate corporate exposures. They don't tackle overall greenhouse-gas emissions.

That'll be the next big M&A thing. It may involve, for instance, upstart electric-vehicle makers like Lucid, Polestar or Rivian Automotive combining. Equally, smaller players such as Nikola, valued at \$4 billion in mid-December, could make tasty morsels for lagging behemoths like Toyota Motor or Nissan Motor.

Large environmental companies like \$66 billion Ecolab and \$22 billion Xylem have a history of making bolt-on acquisitions. They're potential prey as well as predator for conglomerates like Danaher and Honeywell International. Software could be in the mix too: \$61 billion Autodesk in February bought H2O data-infrastructure specialist Innovyze for \$1 billion. Such capabilities could interest green-preening tech giants like Microsoft or Alphabet.

Financial institutions need environmental data, too. Some 450 joined the Glasgow Financial Alliance for Net Zero, but few have all the resources to assess client portfolios in detail. Figuring out, say, how to finance retrofitting a fleet of CO<sub>2</sub>-belching container ships will earn more than a credit facility. Plenty will ape Moody's, which paid \$2 billion for climate-analytics company RMS. Targets may include newbies Aquantix and geospatial specialists like Kayrros. It's time to seize opportunities, not just offload risks.

*First published December 2021*

# CONSUMER GIANTS WILL BE IN “PLASTIVIST” CROSSHAIRS

BY DASHA AFANASIEVA

Expected to double by 2030, plastic pollution will create financial risks for companies like Coca-Cola and PepsiCo as countries introduce more single-use bans and taxes. Emboldened by the defeat of Exxon over reducing its carbon footprint, activists will target consumer giants.

## PET HATES

PepsiCo and Unilever will have new reasons to confront plastic waste in 2022. Bans on single-use items or landfill taxes pose an increasing financial risk to companies not taking the problem seriously. Activist shareholders will mould the worst offenders into shape.

The United Nations expects plastic pollution to double by 2030. Much of that is packaging. Campaign group Break Free From Plastic in October named Coca-Cola and PepsiCo as the worst plastic polluters for the fourth consecutive year, despite both vowing to use at least 50% recycled material in their plastic packaging by 2030. Unilever, which promises to collect and process more plastic packaging than it sells by 2025, came in at number three.

## GOVERNMENTS ARE GETTING WISE TO CORPORATE HEEL-DRAGGING

Governments are getting wise to corporate heel-dragging. Unilever replacing plastic mustard sachets in Britain or Nestlé ditching plastic KitKat wrappers in Japan won't fend off tougher government responses forever. Some are looking to introduce a levy on companies to compensate for the environmental cost of plastic packaging, either via recycling or landfill.

In Belgium, one country leading the charge, the “extended producer responsibility fee” is 200 euros per tonne for the transparent PET-type plastics widely used in drinks bottles. Applying that to Coca-Cola's nearly 3 million tonnes of annual plastic waste would result in a charge of nearly 600 million euros, around 7% of its 2020 operating profit. Other harder and more fiddly items, like screw-tops, carry stiffer penalties.

Taxes and bans are not the only threat. If consumers could get their hands on the same product but without plastic packaging – be it shampoo or a fizzy drink – many would quickly switch. Take PepsiCo's SodaStream: if the syphons produced fizzy drinks as tasty as that from the bottle, they could start grabbing market share.

Most consumer goods companies still score well on environmental and social metrics. But investors are getting wiser to the link between sustainability and the bottom line, as shown in June by little-known fund Engine No. 1's successful campaign against U.S. oil giant Exxon Mobil. Even hard-nosed activists like Nelson Peltz, who may be eyeing an assault on Unilever, see plastic as a problem. In a previous campaign, the New York billionaire pushed Procter & Gamble to develop packaging made from materials like bamboo. In 2022, plastivism will tear off its wrapper.

*First published December 2021*



# FORGET COP26. THE WORLD NEEDS COPPER 26.

BY GEORGE HAY

The climate shindig is all about cutting demand for fossil fuels. The required flipside is a 2020s surge in production of metals for all those extra wind turbines and electric cars. Stay tuned for a separate forum in which governments and miners thrash out how that might happen.

## HEAVY METAL

COP26 has a blind spot. The prime ministers and corporate bigwigs who gathered in Glasgow want to cut demand for the fossil fuels that constitute most of the world's greenhouse gas emissions. To make that happen without crashing the economy, there has to be lots more of the metals underpinning a greener society.

Along with phasing out coal and reducing deforestation, COP26 needs to champion electric vehicles and spur investment in renewable energy. That means more wind turbines, solar panels, energy storage and charge points. That in turn means more aluminium, cobalt, copper, lithium and nickel.

Consultant Wood Mackenzie has run the numbers. Limiting global warming to 2 degrees Celsius above pre-industrial levels implies 19 million tonnes of additional annual copper production by 2030, a 60% increase. Aluminium supply needs to jump 30%, nickel 50%, and lithium and cobalt 140% and 150% respectively. Limiting warming to 1.5 degrees Celsius implies an even greater supply hike.

Normally this would be an epic green light for miners to get digging. After an iron ore boom, giants like BHP and

Rio Tinto are awash with cash. But the gap between the investment that's needed over the next 15 years and what's signed off is almost \$2 trillion, Wood Mackenzie says.

**THE GAP BETWEEN THE INVESTMENT THAT'S NEEDED OVER THE NEXT 15 YEARS AND WHAT'S SIGNED OFF IS ALMOST \$2 TRILLION**

As big a problem is red tape. On average, it takes over 16 years to go from discovering reserves to producing metal, according to the International Energy Agency. Meeting the elevated demand will also mean venturing into trickier jurisdictions like Democratic Republic of Congo, where most western investors have feared to tread. That said, labour disputes and environmental or social rows can erupt anywhere, as Rio's Juukan Gorge debacle in Australia proved.

That's where politicians can help. Western governments have lists of critical materials. If they are so important, European nations and the United States can use their heft to strike agreements with mining jurisdictions like DRC. These could lay down rules of engagement to stop companies being hit with sudden taxes or expropriation, while also committing them to strict social and environmental principles.

This wouldn't change the geopolitical headache created by China's control of 60% of rare-earth production and its hefty sway over cobalt. But at the very least, Western powers need to start talking about the issue. Step forward, COPPER 26.

*First published Nov. 5, 2021*



CHAPTER 2

# WHEELS



# COMBUSTION ENGINES ARE CARMAKERS' TOXIC ASSETS

BY NEIL UNMACK

The likes of Volkswagen and GM are shifting to battery vehicles while petrol-powered rides die out. Engine units are a drag on valuations, like lenders' ropey assets after the 2008 crisis. Hiving them off into a "bad bank" would please investors and generate much-needed savings.

## CRISIS TRICKS

Internal combustion engines may be the toxic assets of the electric-vehicle revolution. Volkswagen, Ford Motor and other industry veterans are rapidly shifting to battery-powered rides, while demand for automobiles that burn fossil fuels is dying. After the 2008 financial crisis, banks cleaned themselves up by shifting dud loans into so-called bad banks. Carmakers could do something similar.

Setting up bad banks helped lenders limit their exposure to questionable assets and present a healthier image to shareholders. Carmakers' combustion engine divisions aren't quite as toxic: for one, they're still profitable. But their days are numbered. In Europe, over three-quarters of new cars will be electric by 2030, according to Jefferies analysts. Spinning off gas-guzzling divisions could limit exposure to shrinking assets and highlight the value of Tesla-like electric businesses.

Take Volkswagen. Assume electric vehicles bring in a fifth of the German carmaker's sales by 2025, producing revenue of 55 billion euros, according to calculations based on Refinitiv data. Put that on a conservative multiple

of 3 times – roughly a third of Elon Musk's group's equivalent valuation in early December – and the business would be worth around 160 billion euros today. That's about the same as VW's entire worth, including debt.

Carmakers could unlock further value by teaming up. Assume two rivals pool their fossil-fuel units and sell a chunk of the combination to a financial investor. The new entity could cut costs, helping it to maintain profitability even as sales of combustion engines shrink. And by retaining only a minority stake the carmakers would no longer have to fully consolidate the legacy business in their accounts.

Volvo Cars provides a prototype. The \$24 billion Swedish carmaker, which recently listed in Stockholm, has transferred its fossil-fuel operations to a new group controlled by Chinese parent Zhejiang Geely, allowing it to deconsolidate the business while locking in a supply of engines for hybrid models.

**AS THE GREEN REVOLUTION  
ACCELERATES, AUTOMAKERS WILL  
HAVE TO CONSIDER EVER MORE  
RADICAL REPAIRS**

Mimicking that arrangement won't be easy. Bigger carmakers face less pressure to explore risky spinoffs, which could involve high costs and a loss of control over what remains a key part of their product. Still, as the green revolution accelerates, automakers will have to consider ever more radical repairs. They could do worse than following the banking industry's lead.

*First published December 2021*

# MAMMOTH RE-ENGINEERING PROJECT BEGINS: GERMANY

**BY LIAM PROUD**

Its manufacturing-led, carbon intensive economy is ill-suited to the 21st century. Chancellor Olaf Scholz and firms like Volkswagen will spend more on green and digital investment. The trick will be to plough on despite short-term supply chain problems and rising labour costs.

## TEUTONIC MAKEOVER

Germany is turning over a new leaf. Its new chancellor, Olaf Scholz, wants a greener and more digital economy, and so do corporate titans like Volkswagen and Siemens. Their combined efforts will launch a complete revamp of Europe's biggest economy.

Failure to do so would spell decline for German companies and jobs losses for their workers, but the task is a mammoth one. The country is more dependent on making things and shipping them abroad than other major European economies. Exports of goods account for more than a third of its GDP, twice the proportion for France or Britain. Meanwhile German manufacturing contributes 18% to economic output, twice as much as is the case for the other two major European industrial nations. The reliance on fossil fuel-intensive heavy industry partly explains why Germany's carbon emissions per head of population were 87% above the comparable figure for France and 59% above Britain's in 2018.

Vast public and private investment will be required to retool such an economy. Take cleaning up the car industry. VW's capital expenditure bill will surpass 20 billion euros in 2022, according to the Refinitiv median estimate, compared with an annual average of 13 billion euros between 2018 and 2020. Building a local plant to produce battery cells could cost at least the same again, which means Chief Executive Herbert Diess will probably need the government's help. Scholz will have to find a way of squaring that with his own restrictive budget pledges.

**THE COUNTRY NEEDS TO ATTRACT TECH-SAVVY WORKERS FROM OVERSEAS AS ITS POPULATION AGES**

Germany's digital infrastructure could also use a jolt. Fewer than one in 10 households are connected to full-fibre broadband, but state-backed Deutsche Telekom can help fix that. And the country needs to attract tech-savvy workers from overseas as its population ages. Scholz can help by relaxing rules for work permits for skilled labour while large companies like Siemens do their bit by retraining existing employees.

The desire to deliver all this will have to be strong to overcome some short-term hurdles. A global supply chain crisis is pushing up producer prices. Meanwhile, Scholz's plan to increase the minimum wage to 12 euros per hour and labour shortages will push up wage costs. All this will eat into companies' profit margins. But there won't be any long-term gains without some short-term pain.

*First published December 2021*



# NIO'S EUROPEAN ROAD-TRIP WILL EARN BRAGGING RIGHTS

BY KATRINA HAMLIN

The Chinese electric-car maker will win foreign fans with a marketing splurge. While it may take years to grab a big share of the \$120 bln global market for battery-powered rides, even modest success abroad can put it ahead of rivals, boosting its sales and stock in 2022.

## WILD WEST

Chinese electric-car maker Nio will burnish its brand with an expedition to Europe. William Li's roughly \$60 billion marque can deploy extravagant marketing and services to win foreign fans. Though it may take years to snag significant share, in 2022 even modest overseas sales will lift its stock.

Li first outlined his plans for foreign conquest in March. Six months later, he'd set up shop in Norway, where battery-powered cars already outsell traditional gas guzzlers. Li wants to move into tougher terrain, entering a further five European countries in the year ahead.

The grand tour won't come cheap. Nio is following a roadmap devised for China, where it built its brand from scratch. That means opening flashy "Nio Houses" – exclusive, conspicuous clubs-cum-showrooms at prestigious addresses. Renting such premises in cities like Berlin could cost as much as 2 million euros a year, estate agents estimate. Fiddly after-sales services like on-demand battery delivery will also jack up costs.

But cracking Europe is critical for Nio and rivals like Xpeng and WM Motor. In 2020, when consumers spent \$120 billion on electric cars, according to the International Energy Agency, the region accounted for almost half of vehicles sold. Meanwhile, the domestic market is becoming increasingly crowded as hundreds of local startups vie with titans such as Volkswagen and Tesla eyeing a piece of the People's Republic. In response, larger Chinese brands are driving in the opposite direction. Long term, Nio reckons half its sales will come from outside China.

## CRACKING EUROPE IS CRITICAL FOR NIO AND RIVALS LIKE XPENG AND WM MOTOR

Tesla's early days in China provide an interesting lesson. In 2015, a year after arriving, it reported \$300 million of Chinese revenue. Though that was barely 8% of Tesla's top line, it laid the foundations for Musk's marque to become the world bestseller. Nio can sell 11,000 units in Europe to achieve a similar outcome from its first foreign forays, assuming the top line is similar to Refinitiv's forecasts for 2022. Such early success would put Nio far ahead of most rival Chinese companies, too.

Hype around Nio's domestic prospects has already boosted its valuation tenfold in the three years since its \$7 billion New York listing. Even a modest overseas road trip will push the shares into overdrive.

*First published January 2022*

# BOOZE TO BATTERIES WILL MEASURE CHINA'S TRANSITION

BY YAWEN CHEN

Distiller Kweichow Moutai overtook lender ICBC as the country's biggest company by market cap in 2020. President Xi Jinping's policy upheaval, along with rapidly changing investor attitudes, augur a new champ for 2022. Look for CATL to ride the electric-vehicle craze to the top.

## ACID TEST

Xi Jinping isn't going anywhere, but there will be a new Chinese corporate leader. Rapidly changing policy initiatives and investor attitudes threaten the reign of distiller Kweichow Moutai as the biggest mainland-listed company by market capitalisation. Look for battery maker Contemporary Amperex Technology, or CATL, to epitomise the economic transition by charging into the top spot.

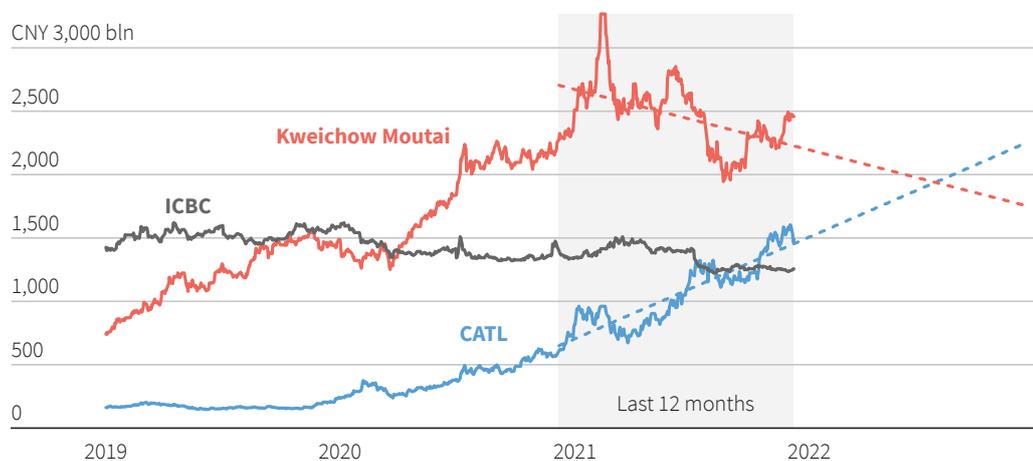
Moutai overtook state-controlled Industrial and Commercial Bank of China in early 2020. Even after a slide in the baijiu producer's stock price in 2021, its equity was worth some \$420 billion as of mid-December, more than enough to retain the crown and a weighty spot among domestic and international indexes.

The lofty position, obtained by selling booze for lavish state and business dinners, hardly squares with Xi's common prosperity drive and a cooling economy. Moutai also has been curiously allocating capital to government projects.

In the meantime, \$240 billion CATL is trending in the other direction. Xi's push for a greener economy prompted a target for electric vehicles to account for a fifth of Chinese car sales by 2025. The goal could be reached as early as 2022, suggesting explosive demand.

## A-LIST BATTLE

CATL could overtake Kweichow Moutai as China's most valuable listed company



Source: Refinitiv Datastream

Yawen Chen & Vincent Flasseur | Breakingviews - Predictions 2022

Boss Robin Zeng is adeptly navigating the situation. CATL's revenue more than doubled in the first three quarters of 2021 from the previous year. With little debt and some \$7 billion of additional equity being raised, the company should be able to keep expanding production and developing fresh technology.

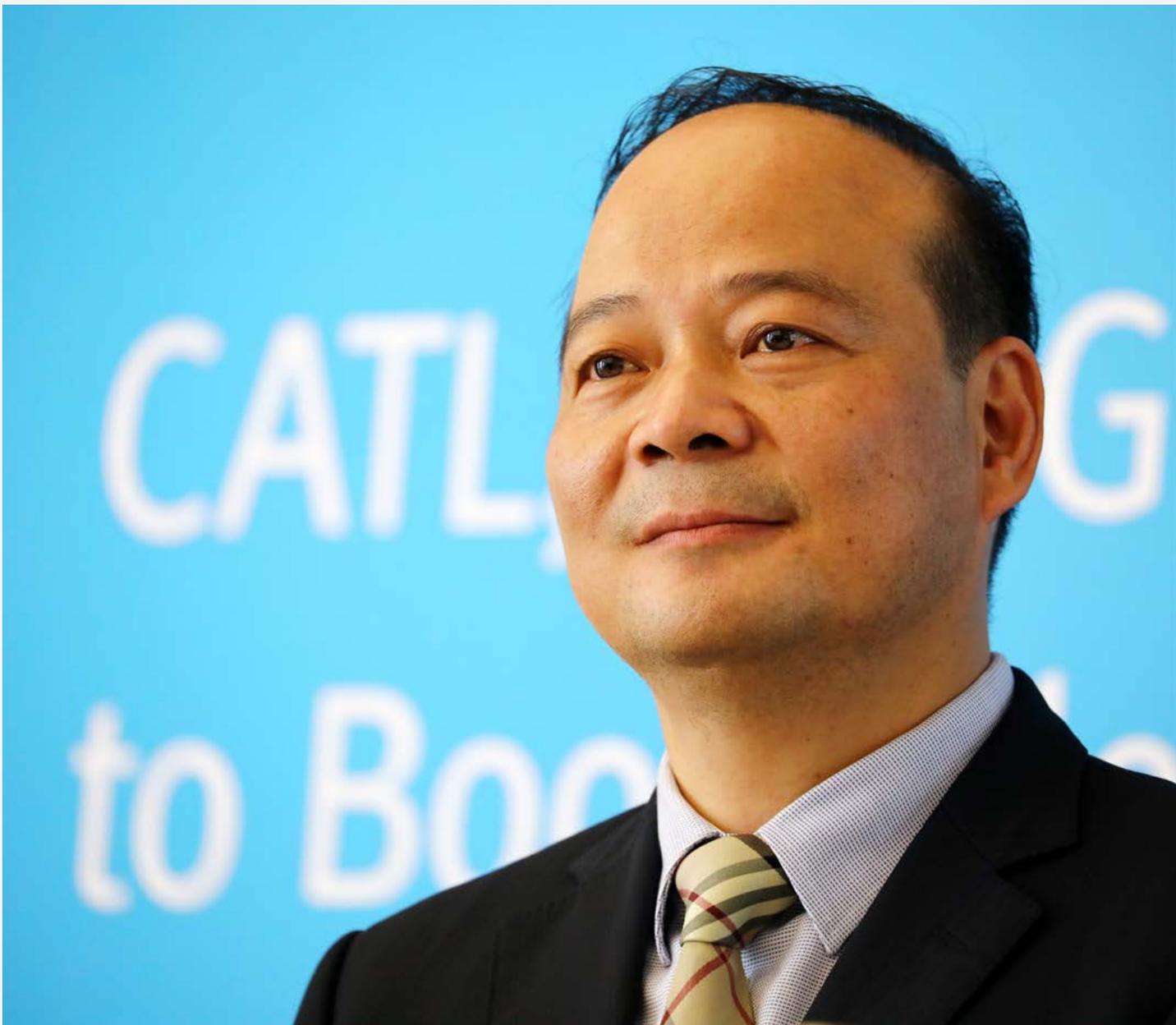
**CATL'S REVENUE MORE THAN DOUBLED IN THE FIRST THREE QUARTERS OF 2021**

CATL is already richly valued at 80 times its \$3 billion of expected 2022 earnings per Refinitiv. And yet smaller rivals such as BYD and Gotion High Tech fetch over

100 times, as do electric-car makers such as Tesla, to which CATL is a major supplier. If some of that extra exuberance rubs off and CATL grows its bottom line a little more than the anticipated 70%, it could easily be worth more than \$300 billion.

On the flip side, Moutai's mounting challenges stand to disappoint growth expectations and hurt its 44 times forward valuation multiple. Even a 20% dip would still leave a healthy premium to peers Diageo and Pernod Ricard. By the end of 2022, it'll be time to toast CATL as China's new equity leader.

*First published January 2022*



Chinese battery maker CATL's Chief Executive Robin Zeng attends a news conference in Berlin, Germany, July 9, 2018. REUTERS/Hannibal Hanschke



# BIG MEAT

## WILL CHANNEL VW-TESLA IN ALT-PROTEIN WAR

BY KAREN KWOK

Elon Musk stole a march on automakers, forcing them to play catchup on electric cars. A similar dynamic could play out in real and plant-based meat. The likes of Impossible Foods have a Tesla-like lead, but old hands like Tyson and JBS can use M&A to play tortoise to their hare.

### MEAT THE FUTURE

Elon Musk successfully forced Volkswagen to embrace the electric vehicle big time. In 2022, Brazil's \$15 billion meat giant JBS and \$31 billion U.S. rival Tyson Foods could end up trailing Tesla's alternative protein equivalents, Beyond Meat and Impossible Foods. Yet just as VW aims to overtake Tesla's production by 2025, there's a way for incumbents to win.

Making meat the old-fashioned way emits over 40% of annual global methane production and wastes too much land, water and time. To make the food system

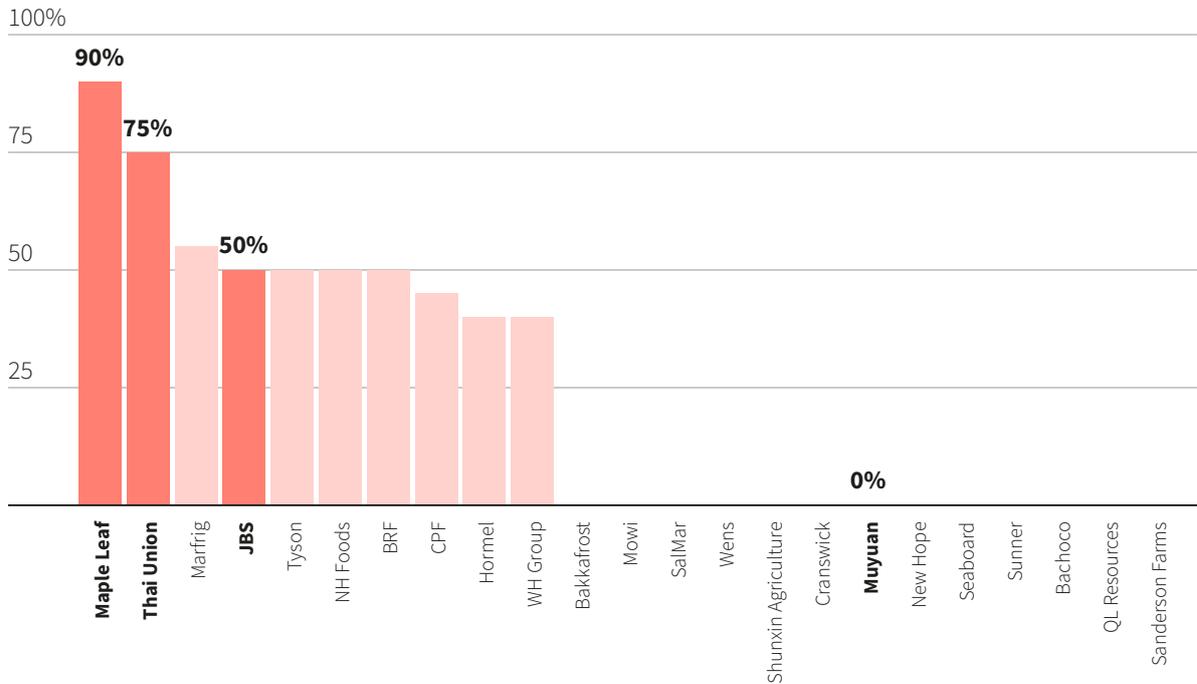
more sustainable, technologies that imitate meat are flourishing. The \$4 billion Beyond Meat and Impossible Foods, which may seek a public listing in 2022, have both launched plant-based burgers at major restaurant chains such as McDonald's.

Doing nothing is unwise. Big traditional producers face more costs: carbon taxes could cost beef companies up to 55% of current average EBITDA by 2050, according to research group FAIRR. And more governments are subsidising the alternative protein sector, which Credit Suisse estimates could reach \$555 billion of sales by 2050 and account for 25% of the global meat market, up from 5% in 2030. Meanwhile, apart from plant-based meat, there are funding gaps in technologies that create slaughter-free meat grown from animal cells. This so-called "lab-grown" cultivated meat could reach \$25 billion of sales by 2030, according to McKinsey.

**MAKING MEAT THE OLD-FASHIONED  
WAY EMITS OVER 40% OF ANNUAL  
GLOBAL METHANE PRODUCTION**

**SLOW-COOKED**

Focus on alternative protein for 52 traditional meat and fish producers



Note: Farm Animal Investment Risk and Return (FAIRR), a provider of research charting the investment risks around factory farming, grades companies' focus on alternative proteins by looking at their investments in related R&D and acquisitions. The higher the percentage, the greater the focus.

Source: FAIRR  
 Karen Kwok & Vincent Flasseur | Breakingviews - Predictions 2022

As yet, traditional players are only getting involved in a piecemeal fashion. JBS has recently bought a Spanish cultivated meat startup, while \$3 billion Asia-based Thai Union has backed insect-protein firms. But no one has yet committed to serious top-line targets. Aside from Toronto-listed \$3 billion player Maple Leaf Foods, 51 traditional meat and fish producers have yet to disclose their alternative protein sales, according to FAIRR. Chinese meat producers like \$40 billion Muyuan Foods have zero exposure.

That may change in 2022. Valid targets include hot startups in cultivated meat, fermentation or even insect protein. Temasek-backed Eat Just was last valued at \$1.2 billion and has regulatory approval to sell cultivated chicken in Singapore. DSM-owned Meatable and Leonardo DiCaprio-endorsed Mosa Meat and Aleph Farms could be in the mix. Meanwhile, upstarts with considerable scale like UK-based Meatless Farm, which supplies pea protein to Pret A Manger and over 20 countries, are good alternatives. So is France's Insect, which sells buffalo mealworm protein that's mixed in faux meat. Big Meat, in other words, has multiple ways to beef up.

First published December 2021



*CHAPTER 3*

# DIGITAL

# MICROSOFT AND SATYA NADELLA TO BE TECH STANDOUTS

BY RICHARD BEALES

The \$2.5 trln software giant has outpaced most Silicon Valley peers over several years. A slowdown might seem inevitable. But the company's CEO since 2014 is poised to deliver again. That could make him the most successful second-generation tech boss ever in market value terms.

## HOW TO EXCEL

Microsoft is the oldest of the current crop of technology Goliaths. Yet despite roots in the bell-bottom days of 1975, the \$2.5 trillion software maker has been a recent Big Tech standout in terms of share-price performance. Boss Satya Nadella is poised to deliver again. That could make him the most successful second-generation chief executive ever, measured by value created.

Nadella took over in 2014 from Steve Ballmer, an early employee of founder Bill Gates. Microsoft's market worth has grown by \$2.2 trillion, from little more than \$300 billion then. So far, Tim Cook at Apple has presided over a slightly larger increase in market value since officially taking over from Steve Jobs in 2011. But Nadella, who started from a smaller base and has had less time, is breathing down Cook's neck. Sundar Pichai, first at Google and then at parent Alphabet, is far behind.

And Microsoft is on a roll. The so-called FAANG stocks – Meta Platforms (formerly Facebook), Apple, Amazon.com, Netflix and Alphabet – are a favorite yardstick for investors. Stacked against them, the total return on Microsoft stock over the year to Dec. 8 is second only to Alphabet, and over three and five years it's second only to Apple.

## GATES' MIDDLE-AGED COMPANY STILL HAS PLENTY OF ENERGY LEFT

Gates' middle-aged company still has plenty of energy left, too. In a November report, analysts at Deutsche Bank pointed to the "crown jewel" known as Azure, Microsoft's cloud-computing business. Amazon Web Services used to dominate the public cloud. It had a 65% market share in 2017, versus 20% for Azure and just 15% for Google's offering. By 2020, Microsoft had raised its share to 30%, almost entirely at Amazon's expense, according to Deutsche.

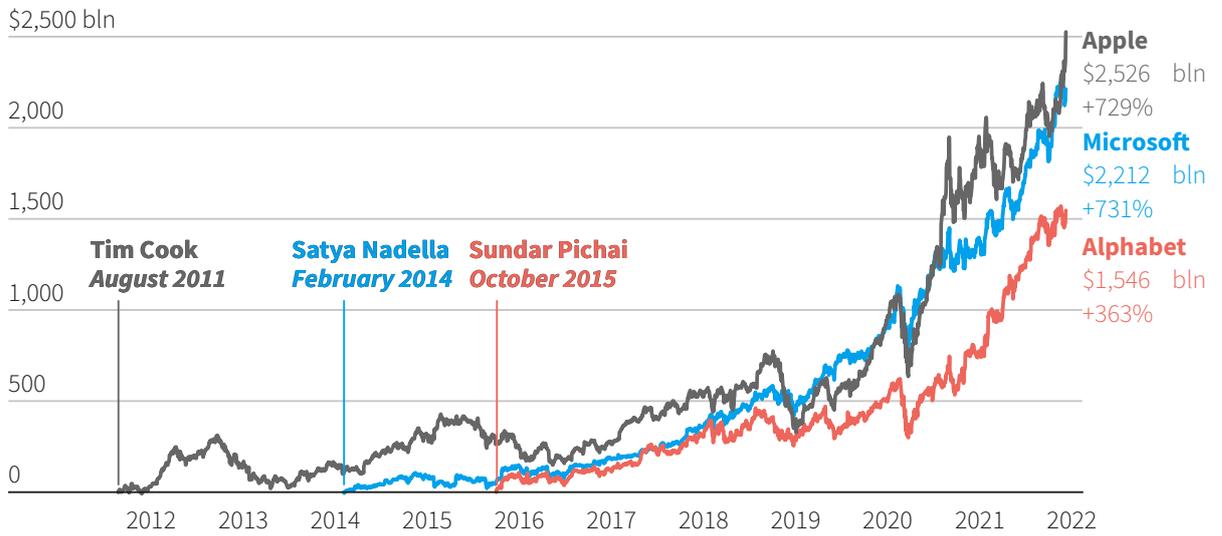
Microsoft has traditional strengths with business customers and the resources to come from behind. That happened with the company's Teams product after Slack Technologies developed the market for workplace-chat software – and it could happen again with the idea of the so-called metaverse, beloved of Meta boss Mark Zuckerberg.

Between cloud computing, productivity, collaboration and even gaming, Microsoft's activities mesh with powerful, global digital trends. Deutsche's number-crunchers picked a target stock price that's more than 15% above the company's early December trading price. That could add another \$400 billion or so to Nadella's value-creation tally, and take him past Cook.

*First published December 2021*

### SUPER SUBS

Market value gains under second-generation tech CEOs



Source: Refinitiv Datastream

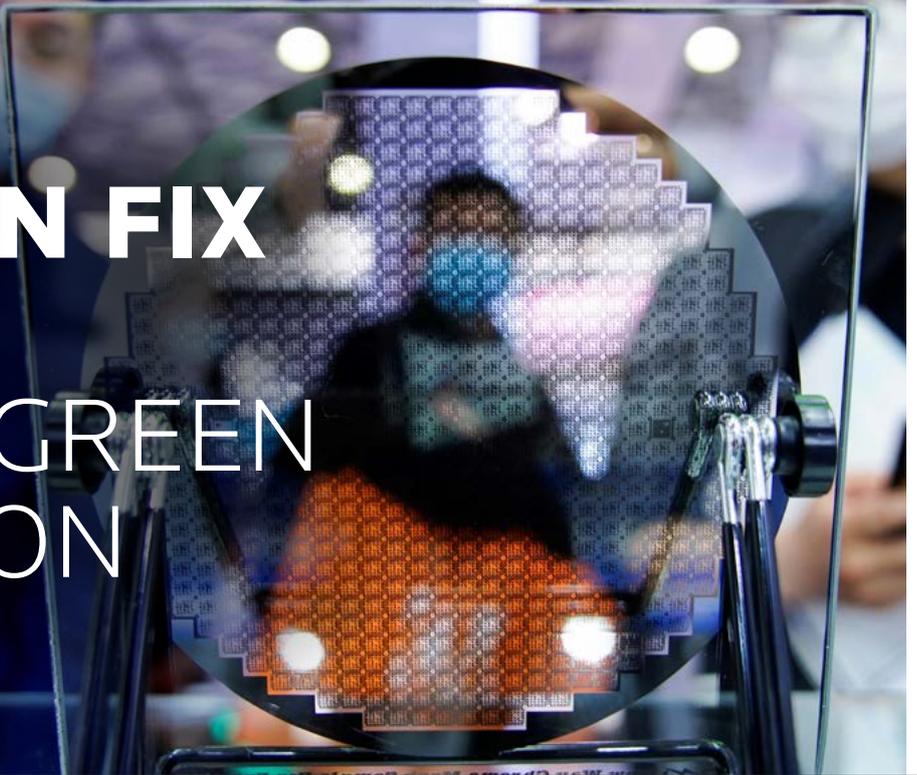
Richard Beales & Vincent Flasseur | Breakingviews - Predictions 2022



Microsoft's Chief Executive Satya Nadella speaks at the Viva Tech startup and technology summit in Paris, France, May 24, 2018. REUTERS/Charles Platiau

# TSMC CAN FIX TAIWAN'S STALLED GREEN TRANSITION

BY ROBYN MAK



Referendums on a nuclear power plant and a fossil-gas terminal spotlight the island's 20% renewables target. Bureaucracy and red tape, though, have held up wind and solar projects. The local chipmaking champion's voracious appetite for cleaner power offers a much-needed spark.

## GREEN POWER

After conquering semiconductors, Taiwan Semiconductor Manufacturing, the world's biggest chipmaker, has a new challenge: kickstarting Taiwan's stalled green transition. Bureaucracy and red tape have marred the island's renewable-energy goals. The company's voracious appetite for cleaner power will offer a much-needed spark.

Referendums on whether to restart a nuclear power plant and whether to change the location of a planned \$2 billion liquid fossil gas terminal highlight how politically contentious the island's energy issues are. President Tsai Ing-wen has pledged to phase out nuclear power and is hoping gas-fired plants will supply half of the \$600 billion economy's electricity needs by 2025. At the same time, she has promised to increase the share of renewable sources to 20%, from 5.4% in 2020.

On paper that's doable, but in practice it looks out of reach. Covid-19 disruptions held up wind and solar projects, but lengthy and complex approval processes are also to blame. Offshore wind developers, for instance, must obtain

consent letters from at least eight different authorities as well as approval from the environmental watchdog even to be eligible to bid for projects. Those that make it to the second round must also detail how they can meet local procurement requirements, often onerous criteria given how new the industry is in Taiwan. According to one 2021 estimate, unfinished wind and solar projects totalled \$83 billion, among the highest in Asia.

TSMC is in a unique position. The local behemoth, whose market capitalisation equates to roughly 90% of Taiwan's GDP, accounts for roughly 5% of the island's electricity usage, Greenpeace estimates. In 2020, its energy consumption topped 16,900 gigawatt hours – up 18% thanks to water- and electricity-guzzling factories that churn out most of the world's bleeding-edge chips.

**IN 2020, TAIWAN'S ENERGY  
CONSUMPTION TOPPED 16,900  
GIGAWATT HOURS – UP 18%**

The company, though, wants a greener look – and customers like Apple, as well as investors, are pushing for one, too. In 2020, it missed its water-reduction target but exceeded a 7% renewable-energy goal. As part of a plan to reach 25% by 2030 and eventually 100% two decades later, TSMC signed a 20-year power purchasing agreement with Danish offshore wind developer Orsted – the world's largest corporate renewables deal. The chipmaker's rising political clout means it can push for better rules. Taiwan's green transition depends on it.

*First published December 2021*

# ANT WILL BE BEST AMONG CHINA'S **BAD** BUNCH

**BY YAWEN CHEN**

After a brutal year for tech, ByteDance, Ant and Didi will spearhead the sector's recovery. A shaky ad market looms for the restructured TikTok owner, however, while the ride-hailing company faces rising driver costs. Jack Ma's fintech outfit has the clearest path ahead.

## **BAD NEWS**

A new Chinese technology trinity is set to rise. Following in the footsteps of Baidu, Alibaba and Tencent are ByteDance, Ant and Didi Global. After a brutal year for the entire sector, the path back through new rules and a slowing economy looks tough, but Ant, Jack Ma's financial services marketplace, will lead the uphill march.

**ANT, JACK MA'S FINANCIAL SERVICES MARKETPLACE, WILL LEAD THE UPHILL MARCH**

All three have taken significant hits. Didi, the ride-hailing company, lost half its market capitalisation in a few short months after a New York initial public offering in June, and in December it started the process of delisting its shares amid pressure from Beijing. Privately held stakes in TikTok-owner ByteDance, once pegged at \$400 billion, have been changing hands for less. And Ant backer Warburg Pincus recently slashed its valuation by 15%.

Relocating to the Hong Kong bourse should put Didi back into Beijing's good graces. Likewise, Ant is restructuring its entire payments-to-lending business and brought in new state backers to satisfy officials.

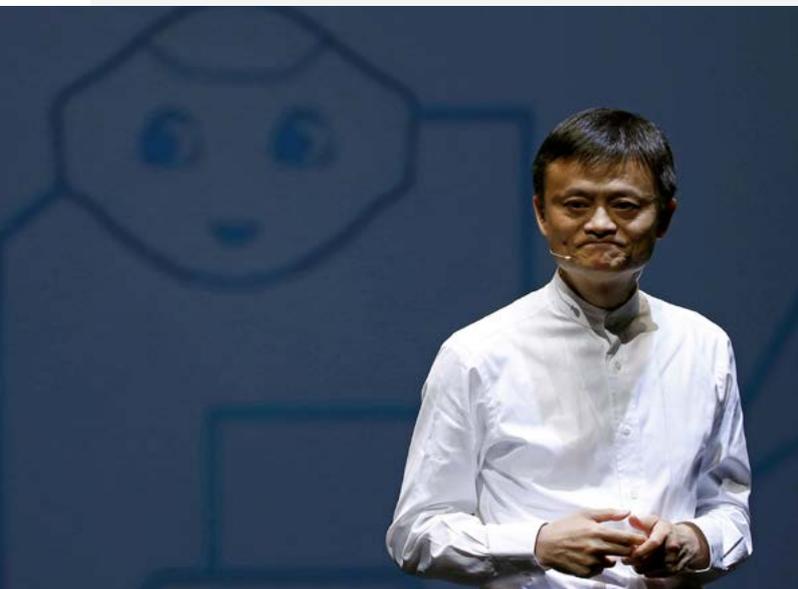
Reviving growth will be less straightforward. Didi faces a raft of new rules aimed at protecting China's gig economy workers. Those range from providing social insurance to a cap on how much they can siphon from driver fees. That will push up costs at the unprofitable company.

For ByteDance, an online advertising slowdown looms large. Efforts to diversify into video games and education have led to layoffs. Cybersecurity authorities also are preparing restrictions on how algorithms can be used to reel in viewers. Douyin, the Chinese version of TikTok and ByteDance's main money-spinner, has started to let users opt out of personalised recommendations.

Ant has the clearest path ahead. Its fast-growing credit business was curbed, but the company retains its payments dominance. And in a sign that regulatory pressure may be easing, its consumer finance division in June secured an important licence in micro-lending, insurance, fixed income securities and more, putting a vital part of its operation back on track.

What's more, the central bank in November accepted the application of a personal credit-scoring business 35%-owned by the company. Such progress might even pave the way for a long-delayed IPO and puts Ant in position to be the best of the BAD bunch.

*First published December 2021*



# INDIA'S TECH BUBBLE WILL BURST

BY UNA GALANI

Investors will continue to afford banks and consumer firms dizzying valuations but will increasingly give their money-losing digital brethren a shorter leash. Some mix of rampant competition, slowing user growth and rising data charges will crash the party for the startup crew.

## PROGRAMMED TO POP

India's newly listed startups are set to discover their limits. Buyers of stocks in the giant emerging market will increasingly give money-losing digital companies a short leash on dizzying valuations. Some mix of rampant competition and higher mobile data tariffs will crash the party.

A pandemic-induced flood of easy money and mom-and-pop investors have lifted stocks around the world, but Indian tech companies hit extremes in 2021. One97 Communications' financial super-app Paytm, Falguni Nayar's online beauty retailer Nykaa, and food delivery giant Zomato fetch more than 30 times sales as of Dec. 8, per Refinitiv, after listing their enterprises in Mumbai.

Peers elsewhere point to rich valuations in India as a benchmark to insist their businesses are cheap. Other companies, including ride-hailing giant Ola Mobility, budget lodging chain Oyo Hotels & Homes, and Delhivery are eyeing debuts. All three are backed by SoftBank, the Japanese investor arguably most responsible for bidding up private company share prices.

Newcomers will find it harder to maintain premium valuations than traditional consumer-facing giants like Indian lender HDFC Bank and Hindustan Unilever; both are richly rewarded for their healthy margins, consistently trading on close to 4 times trailing book value and over 60 times earnings, respectively, per Refinitiv.

## ONE OBSTACLE IS THE SHEER RAFT OF NEWCOMERS JOSTLING FOR USERS

One obstacle is the sheer raft of newcomers jostling for users. Although there's plenty of room to grow online, India's fierce competitive landscape contrasts with China, where Alibaba and its affiliates dominate in e-commerce and payments, or Southeast Asia where all-singing super-apps like Grab and GoTo dominate in ride-hailing, delivery and digital financial services. Just-profitable Nykaa competes with Walmart's Flipkart, Amazon.com and Goldman Sachs-backed Purple for example.

Maintaining the current growth rates will become costlier as onboarding customers and merchants in far-flung towns can be a painstaking process requiring boots on the ground. A difficult regulatory environment, which bans charges for basic retail money transfers, is one reason adoption of digital payments by customers is slowing.

And while rising tariffs for using mobile data on Bharti Airtel and Vodafone Idea's networks will hurt video streaming and online gaming the most, higher subscription charges of up to one quarter will prompt customers in the value-conscious market to think twice before spending hours browsing for products online. India's tech story is strong, but its valuation bubble is poised to deflate.

*First published December 2021*

# ZUCKERBERG HAS METAVERSE RIVALS WHO MEAN BUSINESS

BY OLIVER TASLIC

Meta Platforms and Epic Games are trumpeting visions of an immersive, 3D internet. But even ignoring the technological challenges, consumers' appetite for full-on virtual socialising is uncertain. The corporate world is a more manageable target – and that is Microsoft's domain.

## FOR META OR WORSE

Many successful consumer technologies began life with a narrow focus. Think 1980s executives wielding bulky cellphones or scientists sharing research on Tim Berners-Lee's newfangled World Wide Web. If the metaverse goes the same way, Microsoft – rather than chief proponent Meta Platforms – will be in pole position.

The metaverse refers to a more immersive version of the current internet: pulling on a virtual-reality headset, meeting friends at an entirely digital theatre, and watching a movie together, for example. Among its cheerleaders are "Fortnite" maker Epic Games and Mark Zuckerberg's Meta – formerly Facebook – which is looking to capitalise on its VR unit.

But regular punters' appetite for the metaverse is uncertain. To many people, existing video games like those available on the Roblox platform are already part of it. But the next step, VR headsets, remain pricey, not to mention heavy: Meta's Quest 2 costs \$300 and weighs half a kilogram. Meanwhile, subtler augmented-reality glasses are still nascent.

Then there's the unproven appeal of virtual experiences. Eventbrite, which helps people organise concerts, cooking classes and such, saw sales collapse by two-thirds in 2020, despite the number of events on its platform falling by just 2%. It's not clear that giving 2D online gigs an extra virtual dimension would have made much difference.

By contrast, corporations look a more fruitful target. The latest wave of Covid-19 has shuttered borders again, and finance chiefs are looking to keep a grip on expenses. Meta's Horizon Workrooms software already allows for VR meetings. Yet although Microsoft boss Satya Nadella isn't thumping the tub like Zuckerberg, that kind of customer is the software giant's domain.

Slack Technologies' experience shows how quickly Microsoft can catch up. By bundling its Teams product with existing subscriptions, users rapidly came from a standing start in 2016 to overtake former workplace-chat leader Slack within about three years. Slack agreed to sell itself to Salesforce.com for \$28 billion in December 2020. Metaverse-wise, Nadella's firm has partnered with Accenture to build "the Nth floor", a virtual office the consultancy's employees can beam into.

**HIS ENTHUSIASM MAY HELP ARCH-RIVALS MORE THAN IT HELPS HIS OWN BUSINESS**

"If this is the future you want to see, I hope you'll join us," said Zuckerberg. At least at first, his enthusiasm may help arch-rivals more than it helps his own business.

*First published December 2021*



# LIVE NOW, PAY LATER

## IS FINTECH'S LATEST EXTENSION

BY KAREN KWOK

Instalment financing, rebranded as “buy now, pay later,” has been the hot consumer financial innovation powering groups like Klarna and Afterpay. Look for the next iteration to entice consumers beyond shopping and leisure, including doctor’s visits, utilities and even taxes.

### DOWN THE ROAD

Buy now, pay later is taking its millennial attitude up a notch. To keep consumers hooked on this newfangled instalment financing, companies from Sweden’s \$46 billion Klarna to Australia’s Afterpay, soon to be part of Block, are extending their services beyond shopping to recurring payments like doctor visits and taxes. That adds to the risk of debt piling up. Call it “live now, look out later.”

BNPL took off at e-commerce sites where younger people purchase smaller-ticket items – say an outfit for a Friday night – without paying in full. Shoppers set pay-off dates for the loan without compound interest payments. It became one of the hottest trends in consumer finance.

A Momentive poll in August showed 20% of Americans used such services over the previous year. In 2020, when shopping went mostly online thanks to Covid-19, lending volume in the United States alone rose 10-fold to \$39 billion annually, according to Mercator.

But the pandemic boost could be short-lived. Morgan Stanley analysts expect growth of gross merchandise value in Europe

to slow from about 90% in the year to June to 22% annually up to 2024. Competition is heating up as PayPal and banks jump in. There are also fears that as millennials age and become more financially secure they will move to credit cards, which provide higher loan balances and perquisites.

### THE PANDEMIC BOOST COULD BE SHORT-LIVED

To stay competitive, pay-later providers are going beyond their comfort zones in fashion and beauty. Featherpay is facilitating healthcare providers to offer longer-term instalment options. Wisetack is helping consumers pay for home and auto repairs. Klarna acquired Inspirock, a travel planning app.

Goldman Sachs-backed Zilch, worth some \$2 billion, is charging UK consumers a fixed fee of about 2 pounds to pay anywhere – not just one retailer’s website. Customers can use the virtual Zilch card for groceries, utility bills, even taxes. Klarna, Affirm and Zip are offering similar features. Afterpay is providing instalment options as a form of subscription payments.

The business model hasn’t been tested by a financial downturn where consumer defaults rise. With interest rates still close to zero, for now there’s limited financing cost in providing goods virtually for free. But that won’t last. As money becomes more expensive, pay-later providers jockey to offer more products and credit losses go up, shareholders need to brace for a bumpier ride ahead.

*First published December 2021*

CHAPTER 4

# MONEY



# INFLATION GENIE

## IS GOING TO LINGER IN 2022

**BY SWAHA PATTANAIAK**



Visitors watch the 10th Cape Town International Kite Festival in Cape Town, South Africa, on Sept. 18, 2005. REUTERS/Mike Hutchings

Consumer prices will rise at a less hectic pace in 2022. But they'll still overshoot targets that Fed Chair Jay Powell and his peers aim to hit. Policymakers are less apt to hit the brakes on stimulus than in years past. Also, businesses and workers are behaving differently.

### WISHING WELL

Fairy-tale genies sometimes resist attempts to shove them back into bottles. Global inflation will display a similar tendency in the coming year because of the changing behaviour of policymakers, businesses, and workers.

Central bankers undershot their 2% inflation targets for years and have been circumspect about slamming the brakes on monetary stimulus even though overshoots have become the norm. And fiscal austerity is less of a fetish than a decade ago, with finance ministers less apt to embrace the policy despite much higher debt burdens. Both groups of policymakers want to ensure economies recover properly from Covid-19 shocks. But that means price pressures will endure for longer.

True, inflation is practically guaranteed to fall in the coming year, albeit later than Federal Reserve Chair Jerome Powell and his global peers had anticipated.

**INFLATION WILL CONTINUE TO SURPASS CENTRAL BANKERS' TARGETS WELL INTO THE COMING YEAR**

Its four-decade high of 6.8% in the United States and 4.9% record peak in the euro zone are partly a result of comparisons with depressed 2020 prices. Shortages of goods will also ease up as demand cools and supply-chain disruptions are gradually fixed. Even so, inflation will continue to surpass central bankers' targets well into the coming year.

There's a big backlog of orders. And businesses, scarred by supply shocks, may well shift from a "just-in-time" to a "just-in-case" approach by holding more inventories. Walmart, for example, said in November that U.S. inventories were up 11.5% before its busy festive season. Companies could also be readier to pay more for parts made locally or whose delivery is guaranteed and seek to pass extra costs to customers.

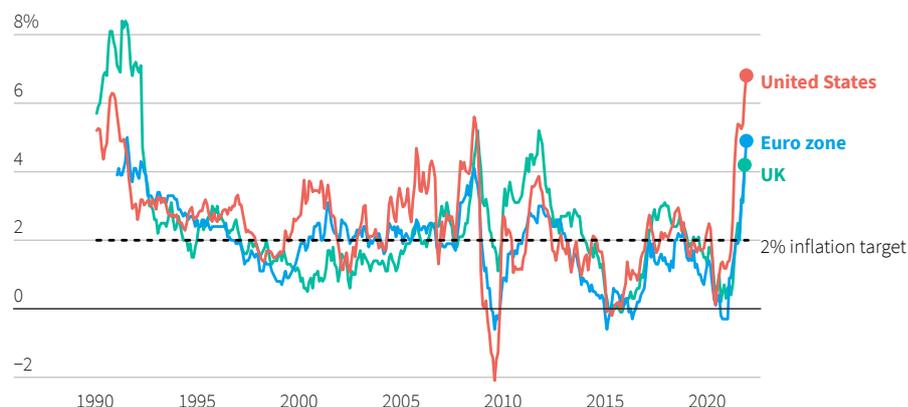
The longer high inflation persists, the more likely workers are to push for bigger wage rises. They certainly have more leverage to do so than in the past given post-pandemic labour shortages. In the United States, for example, the number of people quitting and the so-called quits rate both hit record highs in September. Euro zone unemployment has been more stable through the pandemic, but some sectors nevertheless face staff shortages as labour force participation rates take time to rebound.

Central bankers are biding their time in the hope that wage inflation won't be either too hot or too cold. But that's another fairy tale altogether.

*First published Dec. 10, 2021*

### INFLATION OVERSHOOTS

Headline inflation rates



Source: Refinitiv Datastream

Vincent Flasseur | Breakingviews - Predictions 2022

# THE CULT OF REVENUE IS FLYING IN THIN AIR

BY ROBERT CYRAN

Top-line growth is the surest way to create wealth. But Wall Street has taken a good idea too far. The price-to-sales ratio for tech IPOs is at a 20-year high, even as profitability is dangerously distant. The coming year may sort the durable Amazons from the hyped-up WeWorks.

## THE WEWORK OF...

Top-line growth is the surest way to create wealth. But Wall Street has taken the idea too far lately by ignoring the importance of profit and cash flow.

## REVENUE GROWTH ACCOUNTS FOR THE MAJORITY OF WEALTH CREATION OVER A DECADE

Among top-performing stocks, revenue growth accounts for the majority of wealth creation over a decade, according to consultancy BCG. Take Microsoft, with a \$2.5 trillion market value. Over 20 years, revenue grew nearly sevenfold. Net margin improved slightly, so earnings grew by a factor of eight. Investors reckon the company is worth something over 30 times estimated earnings, about what they paid two decades ago. Microsoft's stock is worth 10 times as much, as of mid-December, largely because revenue grew.

Unlike Microsoft, Amazon.com took years to become profitable in an accounting sense. But like Bill Gates' firm, it threw off cash early, so it didn't need additional capital to grow. Sales growth is one key ingredient, but profit and/or cash flow is another.

Contrast that with WeWork. The office-sharing startup was valued at \$47 billion based on revenue doubling annually prior to a failed 2019 initial public offering. But the company wasn't profitable and couldn't fund itself. When investors got tired of injecting capital, WeWork's valuation plummeted. It was worth \$6 billion in early December.

That lesson seems to have been forgotten. The median enterprise value-to-sales ratio for technology-sector IPOs in the first 10 months of 2021 was 15, according to Jay Ritter at the University of Florida. The only time it has been higher in 40 years was prior to the dot-com crash in the early 2000s. Already-listed e-commerce firm Shopify is valued at around 30 times estimated revenue, according to Refinitiv data for December. Five years ago, it was valued at just 6 times.

This creep has spread to less established firms, including some with almost no revenue, let alone profit, like Rivian Automotive, an electric-truck maker with a market capitalization above \$100 billion.

Shopify, like the growing Amazon, can bankroll its own expansion. But many firms with huge valuations are unlikely to do that for many years. Rivian's valuation, for example, is based on the promise of uninterrupted future growth combined with a second promise that sufficient profit will eventually materialize. In buoyant markets investors forgive such optimism. But any blows to confidence in 2022, whether economic, pandemic, political or otherwise, should sort the durable Amazon.coms from the hyped-up WeWorks.

*First published December 2021*

# TOSHIBA CLEARS WAY FOR JAPAN'S NEXT BIG BUYOUT

BY JEFFREY GOLDFARB

The \$18 bln conglomerate plans to split, but a takeover bid betrayed private equity's voracious appetite in the country. A few dozen chunky companies suit the LBO financial model, per a Breakingviews analysis. Closer inspection suggests a tempting target among them is Ricoh.

## FINE PRINT

The leveraged buyout will be big in Japan. A takeover approach for Toshiba betrayed private equity's growing appetite in the country. Breakingviews found a few dozen chunky companies that make suitable candidates, in theory. One that stands out among them is Ricoh.

**BUYOUT SHOPS ARE STOCKPILING MONEY IN THE LAND OF THE RISING SUN**

Buyout shops are stockpiling money in the Land of the Rising Sun, where cheap borrowing and corporate resistance to change prevail. Dry powder available to Japan-dedicated funds, which accounted for an unusually high 7% of capital raised in the region in 2020, surpassed \$60 billion, per research outfit Preqin, more than twice as much as five years ago.

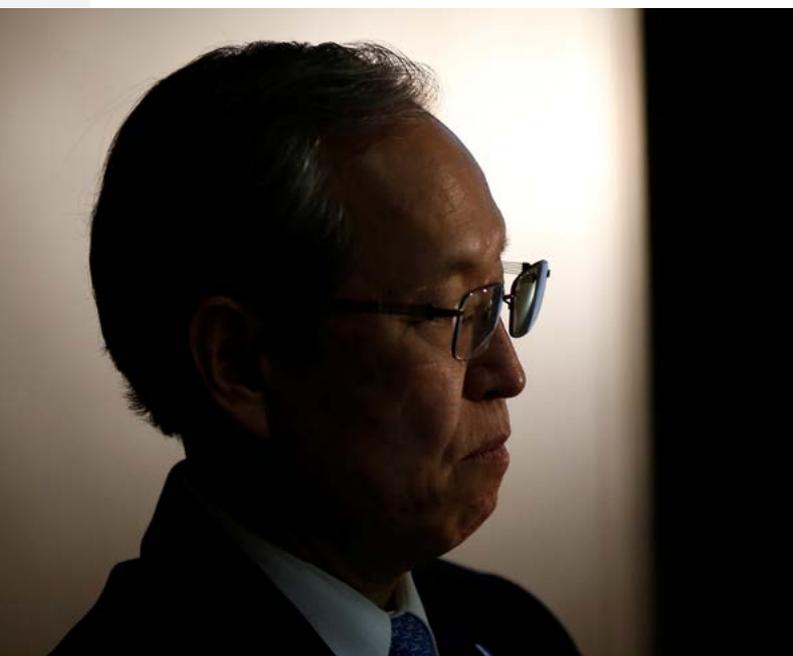
Sizeable deals are uncommon, though. The Bain-led \$18 billion acquisition of Toshiba's memory-chip business four years ago was Japan's biggest ever. Second on the list is a property manager taken private in 2007 for about \$4 billion. CVC's \$20 billion offer for Toshiba in 2021 heralds a fresh chance for something hefty.

A crude Breakingviews screen of Refinitiv data for Japanese enterprises with market caps between \$5 billion and \$20 billion, ample EBITDA and low debt spat out a variety of prospects. Many of them could use a shakeup, but look too domestically entrenched for private equity to successfully make their case.

Copier and printer maker Ricoh is different. Although it already has implemented a restructuring to become more of a services provider, new owners could sharpen and accelerate the transition behind closed doors. The nearly \$7 billion company isn't getting much credit for its changes. After investors were initially energised by a strategic update unveiled in March by Chief Executive Yoshinori "Jake" Yamashita, the stock price retreated. Its total shareholder return has been just 4% annually on average over the past five years, less than half that of Japan's benchmark index.

Ricoh generates more than half its sales overseas and nearly two-thirds of its employees are abroad, adding to the appeal for an international private equity firm. Yamashita's extended stints in the U.S. and British divisions also might help make him more receptive to an entreaty. And the company's biggest shareholder happens to be the same pushy investor, Effissimo, rattling Toshiba's cage. All that suggests Ricoh could be a tempting target as buyout barons supersize their yen for Japan.

*First published December 2021*





# VULTURE FUNDS WILL HAVE TO LEARN HOW TO FLY AGAIN

**BY NEIL UNMACK**

Distressed debt investors are looking like the pterodactyls of finance. Defaults are low, thanks to rock-bottom interest rates. Specialists like Oaktree can push into more opaque assets like private credit or far-flung places. But new risks will favour the bigger predators.

## LEAN SCAVENGERS

Vulture funds will need to stretch their wings. Corporate defaults are falling, despite the surprising endurance of the pandemic. Investors that specialise in buying distressed debt like Oaktree Capital Management will have to look beyond the mainstay of public debt markets.

The last two decades have been a golden era for financial crises, yet life is getting harder for funds who take control of troubled companies by buying their bonds or loans. Covid-19 did trigger some big failures, like rental car company Hertz. But default rates, which reached nearly 14% in 2009, peaked at around half that level in 2021, Moody's Investors Service data shows.

**THE LAST TWO DECADES  
HAVE BEEN A GOLDEN ERA  
FOR FINANCIAL CRISES**

It's part of a longer-term trend. High government debt levels mean central banks need to keep interest rates low, helping even shaky companies raise funds. Barring severe

shutdowns from new coronavirus variants, 2022 may be even more stress-free. The proportion of U.S. loans trading below 80% of face value, an indicator of likely default, was just 1.12% in November, according to an index tracked by Leveraged Commentary & Data.

Yet the business of managing distressed debt funds is far from dead. The sector raised some \$40 billion of capital in the first 11 months of 2021, Preqin reckons. That's on top of the \$100 billion of so-called dry powder that was waiting to be deployed earlier in 2021. Oaktree, founded a quarter century ago by Howard Marks, just raised \$16 billion for a credit opportunities fund.

The Chinese property crash could be an opportunity. Dollar-denominated high-yield bonds from the country yielded nearly 25% in early December, according to an ICE Bank of America Asia index. And managers will also need to seek out higher returns by lending in the \$1 trillion private credit market, where loans aren't widely traded.

New markets bring fresh challenges. Valuing Chinese debt is tricky given uncertainty over how offshore creditors will be treated. And returns in private debt may shrink as more money pours in. Experienced managers may still thrive.

But distressed debt funds on aggregate generated a 13% return in the 12 months after Covid emerged, according to Preqin, less than half the return after the 2008 crisis. With 2022 looking leaner, investors in vulture funds may find future pickings equally hard to come by.

*First published December 2021*

# MACAU WATCHDOGS WILL DOUBLE DOWN ON DIGITAL YUAN

**BY KATRINA HAMLIN**

As casino operators prepare bids for new licenses in the \$37 bln gambling hub, investors fear regulators will tighten their grip on Sands, Wynn and MGM. One clever way to start would be by forcing them to adopt China's new virtual currency.

## CRYPTIC PRONOUNCEMENT

China will gamble on the digital yuan. As Macau's casino owners prepare to bid for new licenses in the city for the first time in two decades, regulators will be sure to use the opportunity to squeeze more out of them in 2022. Expect them to force operators in the offshore gaming hub to become test beds for the digital yuan.

As current concessions for the \$37 billion market expire, companies like Sands China and Wynn Macau will be eager to prove themselves team players. Regulators are already flexing their muscles. A government consultation paper on the rebidding process pitched ideas like appointing government agents to supervise daily operations.

The average high roller lost over \$27,000 on each visit to the tables in Macau, Bernstein analysts estimate. It has been a haunt of corrupt officials and businessmen too. In December, junket operator Suncity's boss Alvin Chan was implicated in an investigation into illegal gaming. Suncity facilitated bets for wealthy VIPs, a market segment worth around \$8 billion in gaming revenue the year before Covid-19 struck. Just one month earlier, central bank governor Yi Gang suggested China's newly developed cryptocurrency could be useful for fighting crime and resolving complex cross-border payments problems, including money-laundering. Macau might have been on his mind.

**CENTRAL BANK GOVERNOR  
YI GANG SUGGESTED CHINA'S NEWLY  
DEVELOPED CRYPTOCURRENCY COULD  
BE USEFUL FOR FIGHTING CRIME**

Migrating the gaming hub to digital payments would complement Beijing's desire for greater oversight of cash flows and customers. Situated outside Chinese capital controls, Macau is also an ideal place to test the technology before rolling it out more widely on the mainland. Others are already considering the concept of cashless casinos using traceable funds. Australia's Star Entertainment, for example, says it is exploring digital payments to assuage its watchdogs.

VIP favorites like Galaxy Entertainment and Wynn Macau might once have worried that big spenders would shy away from such scrutiny. However, high rollers no longer rule income statements. The mass market now accounts for two-thirds of gaming revenue and almost 90% of earnings according to official data and Breakingviews estimates.

The technology is here: Testing is already underway, and pilots have already seen Chinese consumers splurge some \$10 billion worth of digital yuan. While watchdogs have much to win, and operators have less to lose, 2022 will be the year the new currency comes to casinos.

*First published January 2022*



# FINANCIAL PRODUCTS WE'D RATHER NOT SEE IN 2022

**BY RICHARD BEALES**

Breakingviews is readying a new metaverse-based buy-now-pay-later digital-asset trading platform. Here are a few of the shiny new opportunities that could pop up in the coming year, from a melding of SPACs with NFTs to a new crypto-churn account.

## CAVEAT EMPTOR

In a merger of buzzwords from 2021, Breakingviews is readying a new metaverse-based buy-now-pay-later digital-asset trading platform. If that's too much to swallow, here are a few other improbable – if, sadly, not impossible – financial product innovations that could rear their heads in the coming year.

First, how about combining blank-check companies with non-fungible tokens? NFTs are digital certificates that share technology with cryptocurrencies but are unique rather than interchangeable. They can be used, among other things, to authenticate ownership of digital assets. They are also all the rage, perhaps explaining why movie-theater chain AMC Entertainment, whose stock

surged over 1,000% in 2021 through mid-December on the back of social-media interest, is offering an NFT to self-identified shareholders of the company.

Public offerings of special-purpose acquisition companies, which raise cash to buy other businesses, hit a record pace early in 2021 but have since run into investor indigestion and skepticism. They typically hand out warrants when they issue shares as a carrot to invest. Adding AMC-like NFTs as well – tradeable, crypto-powered proof that “I own this SPAC” – could be just the ticket to reinvigorate the market.

Another headline-grabber in the past year was Robinhood Markets, the stock and crypto trading platform that went public in July. One controversy that has helped tank its shares since then is its revenue model, dominated by so-called payment for order flow, or PFOF. This means market makers pay Robinhood to direct stock transactions their way for execution.

How could trading firms replace that revenue? Newbie cryptocurrency dabblers who don't want to lose sleep at night might fancy an account in which their dollars are turned into bitcoin or ether each morning and back into dollars each afternoon. They'd collect the inexorable – right? – daily gains on the cryptocurrency, while the brokerage could rake in fees on those exchanges and avoid the taint of PFOF.

A third idea for a handy financial product in 2022 is what might be called the Tech Triple 12 ETF. Cathie Wood's ARK Investment Management's actively managed technology exchange-traded funds made waves in 2021. Passive ETFs, too, can be tailored tightly for specific stock characteristics. In exchange for a fee, this one would bet only on tech companies with a market worth above \$3 trillion. By the time you read this, one company may qualify.

*First published January 2022*





CHAPTER 5

# POLITICS

# XI'S 2022 GDP TARGET WILL BE MOMENT OF TRUTH

BY PETE SWEENEY

One of the Chinese president's signature policy initiatives was to curb property-related risks. That implies slower but higher quality growth: 4% or so in 2022. Outside advisers are pushing for more. The final economic decision will signal the extent of Xi Jinping's power.

## SLOW-GROWING PAINS

China is preparing to set its most important GDP target since the global financial crisis. The country faces an unprecedented swathe of economic challenges, implying a significant downward revision to growth goals from the "above 6%" for 2021 to something that signals sustained pressure on bad debt. What President Xi Jinping chooses will measure his power to drag China onto a less wasteful development path.

The Chinese Communist Party has every reason to downgrade expectations as flattering comparisons to earlier Covid-19 damage fade. Beyond the threat from new variants, authorities in Beijing have initiated a broad campaign to curb financial risk in the property sector, which contributes between a quarter and a third of the country's economic activity. They have their work cut out ensuring a sector shaken by China Evergrande and others doesn't collapse, including seeing that \$2.5 trillion of pre-sold properties are completed to fend off a crash in consumer confidence.

## THE CHINESE COMMUNIST PARTY HAS EVERY REASON TO DOWNGRADE EXPECTATIONS

Retail sales, domestic tourism and the services sector have lagged under lockdown, but their malaise was offset somewhat by export demand for medical supplies and e-commerce. As trading partners normalise, however, that is unlikely to be sustained. As for productivity gains, they have been dragging on China's economic growth, not contributing. Prioritising state enterprises exacerbates the latter trend.

After just 4.9% expansion in the third quarter, a 2022 slowdown is widely expected. It could get ugly. Xi is trying to keep investors convinced that "flood-like stimulus" is not imminent, which means refraining from big interest-rate cuts while digesting loan and bond defaults. That implies growth closer to 4%, well short of the 5.5% or so that government advisers are pushing.

A more conservative target would indicate Xi is serious about reshaping the \$15 trillion economy. The danger is that bureaucrats freeze up, as they did during a 2015 anti-corruption campaign. It also would strain local government finances. The alternative, though, is re-warming investment in housing and infrastructure, which would keep output imbalanced, further stretch China's debt-to-GDP ratio and encourage investors to discount tough deleveraging talk. If Xi can force the system to stay on its credit diet, however painful, it will be the strongest sign yet of his clout.

*First published December 2021*

# BRACE FOR A \$600 BLN CHINESE ESCAPE FROM NEW YORK

**BY JENNIFER HUGHES**

Mainland-based companies with U.S. listings face regulatory fire from both Beijing and Washington. Retreats are accelerating, as ride-hailing outfit Didi joins the exodus mere months after its \$4 bln IPO. Hong Kong offers one clear route, but there will be a wave of buyouts too.

## THE GREAT ESCAPE

The party's over for Chinese companies in New York. They're being squeezed by lawmakers in both Beijing and Washington over data protection, accounting oversight plus other crackdowns and political spats. New U.S. rules that would usher out lingerers won't apply for two years but waiting until the last minute only will make leaving harder.

New American laws will force companies to delist if their audit papers can't be reviewed by U.S. bean-counter watchdogs. Assume no change in China's reluctance to clear the way, and some 270 enterprises are in danger of getting the boot in 2024.

Beijing's own recent efforts to control corporate funding options and tighten security over consumer information also have spooked overseas investors. Nasdaq's Golden Dragon index of U.S.-listed Chinese stocks fell roughly a third from the start of 2021 through early December while mainland-listed blue-chip counterparts were broadly flat. The ability to fetch higher valuation multiples had been one key Manhattan attraction.

Even if the current pressures ease, U.S.-Sino tensions will persist. Nearly two dozen companies, worth some \$800 billion, have sought a dual listing in Hong Kong. Another 100 or so with a total market capitalisation of about \$400 billion, led by e-commerce outfit Pinduoduo, meet the Asian hub's standards, Bank of America analysts reckon. It's easy to see half that combined sum relocating its centre of trading in 2022. Indexers including MSCI and FTSE already use the Hong Kong price for Alibaba and others.

## AS THE QUEUE GROWS, SO DOES THE DANGER OF INVESTOR FATIGUE

As the queue grows, so does the danger of investor fatigue and valuation discounts. Similarly, buyouts could be complicated by higher borrowing costs or pushy shareholders. Asian private equity firm PAG recently teamed up with hedge fund Oasis to make an offer for online marketer iClick Interactive Asia that will at least force its controlling owner to lift any bid. Some 150 companies worth a combined \$40 billion probably will need to be acquired before seeking another listing venue.

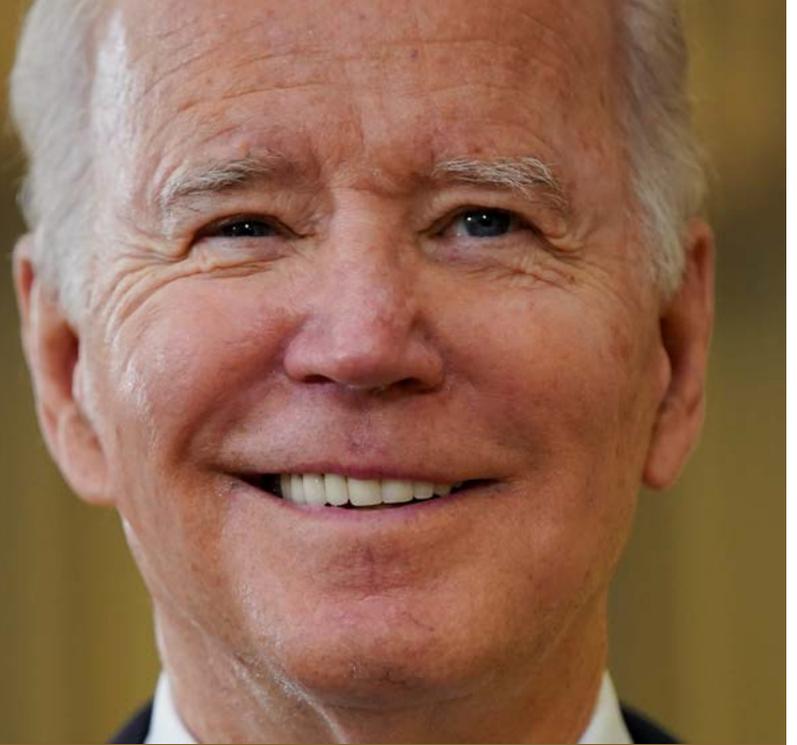
The bottom line is that U.S.-listed Chinese companies will spend much of 2022 scrambling to replenish capital. The race will be on before escape routes get crowded. Didi Global is already hailing a \$32 billion ride home. Others will have to rush to beat the traffic.

*First published December 2021*



# BIDEN AND BUSINESS ARE MIDTERM ELECTION PAIR TRADE

BY GINA CHON



The U.S. president handed corporate chiefs a good year – his moves to help the economy helped them too. If his power wanes after 2022's Congressional elections, Biden will struggle to wield the stick meant to follow the carrot. A weaker White House means a stronger hand for CEOs.

## DO NOTHING

If President Joe Biden's stock falls in 2022, that of America's corporate bosses is likely to rise. Midterm elections in November are likely to punish the governing Democratic Party and will probably hand rival Republicans at least one chamber of Congress. With Washington in gridlock, companies will get a reprieve from the commander-in-chief's more aggressive ideas.

Biden handed company executives a good year in 2021. He pushed a \$2 trillion stimulus package in March, which boosted consumer demand and corporate profit. The S&P 500 Index gained around 40% between Biden's inauguration in January and early December. America's richest 1% slightly increased its share of national wealth in 2021, according to the Federal Reserve.

In so far as companies and wealthy individuals benefited from all of this, the carrot was supposed to be followed by a stick. Take regulation, for example. Corporate mergers, which often enrich executives but result in job cuts, are meeting more opposition from a newly staffed Federal Trade Commission. Wall Street is bracing for a harsher head of supervision at the Federal Reserve than the outgoing Randal Quarles.

The midterm elections, though, are likely to put a stop on further action. Republicans control about 60% of the country's state legislatures. They need to flip only five seats held by Democrats in the 435-member U.S. House of Representatives to gain control in the lower chamber; they flipped 15 in 2020. Even without a majority, Republicans – plus a couple of moderate Democrats – hollowed out Biden's plan to raise taxes on investment and jack up the levy on corporate income.

A Republican-led House would likely target Democrats rather than companies – including possibly investigating the Biden administration's handling of the withdrawal from Afghanistan. If Democrats retain the Senate, they can summon chief executives to hearings, but those tend to cause only temporary discomfort. More substantive changes in antitrust law, like requiring big technology firms to divest of certain businesses, would probably get stuck; tax increases will be off the menu.

## EVEN WITHOUT CONGRESS BEHIND HIM, THE PRESIDENT CAN THROW GRIT INTO CORPORATE WHEELS

Even without Congress behind him, the president can throw grit into corporate wheels. Regulators he appoints, or at least those who obtain Senate approval like FTC Chair Lina Khan and Environmental Protection Agency Administrator Michael Regan, will still be in place. But companies gained from Biden's first-year actions, and they'll gain more from the forced inaction that follows.

*First published December 2021*

# QATAR'S WORLD CUP WILL PAY GULF-WIDE DIVIDENDS

BY GEORGE HAY

After an awful lead-in, expectations for soccer's showcase event in 2022 are low. Even so, the tiny emirate's status will likely benefit. Provided Covid-19 is under control, the jamboree should also boost a regional economic recovery that has lagged other parts of the globe.

## GOLDEN GOAL

Qatar's World Cup has suffered an awful lead-in. Since the tiny emirate successfully pitched for soccer's quadrennial showcase event in 2010, it has grappled with accusations of corrupt bidding and exploiting migrant workers. Shifting the competition to November 2022 to avoid Qatar's unbearable summer has further lowered expectations. Yet the jamboree could still be a success for the region.

## THE JAMBOREE COULD STILL BE A SUCCESS FOR THE REGION

Back in 2010 Qatar argued the World Cup could benefit the whole Gulf. As recently as 12 months ago, that sounded fanciful. Qatar was in the fourth year of

a blockade spearheaded by Mohammed bin Salman and Mohamed bin Zayed, de facto heads of fellow Gulf Cooperation Council members Saudi Arabia and the United Arab Emirates. The short hop from Dubai to Doha had become a lengthier round trip via neutral Oman. While the blockade ended in January, Saudi and the UAE have been at odds over trade tariffs and oil policy, and whether multinational companies will locate regional headquarters in Dubai or Riyadh.

Hosting the World Cup won't banish these tensions. But the tournament may rev up the GCC's anaemic post-pandemic recovery. Though the GDP of leading Gulf countries suffered the same 4.9% average contraction as the G7 in 2020, they're set to grow just 2.6% in 2021, half the rate of the largest developed economies, the World Bank reckons. Sales of oil and gas, which bring in over half the state revenue of most GCC members, are still recovering after the 2020 demand slump.

An influx of tourists would therefore be welcome. The World Cup should bring more than 1 million fans to the emirate, equivalent to a third of its population, according to the tournament's chief executive. But it's not clear where they will all stay. Dubai, Abu Dhabi and Bahrain can all benefit by offering alternative bases.

Things could yet go awry. Though Doha is less uptight than Riyadh, inebriated western fans could face brusque treatment. The national teams of two even fiercer enemies, Saudi Arabia and Iran, may face each other on the pitch. And another virulent strain of Covid-19 could see France's Kylian Mbappe and England's Raheem Sterling playing in empty stadiums.

Still, the Gulf's first World Cup seems like more of an opportunity. To wean the GCC's young populations off fossil fuel-enabled state subsidies, their economies need foreign direct investment inflows to aid short-term recovery and longer-term diversification. Despite its unsavoury origins, Qatar 2022 is a handily timed shop window.

*First published December 2021*



# COX: FRENCH FINANCE WILL TAKE AN ELECTORAL PAUSE

BY ROB COX

Parisian executives who want President Emmanuel Macron to win another term will avoid deals that could become political hot potatoes for the former M&A banker. Shopping abroad is chic but domestic takeovers and synergy-squeezers are out for now. After the election, le déluge.

## APRÈS L'ÉLECTION, LE DÉLUGE

It should have been what the French call “une évidence” – a no-brainer. Nearly a year ago, Alimentation Couche-Tard, a Quebec convenience store chain, offered to drop \$20 billion in the land of its founders’ forebears to buy French grocer Carrefour. The Quebecois promised to invest billions of euros in the business and not to fire anybody. Yet Gallic President Emmanuel Macron’s government dismissed the deal with a Jupiterian wave of the hand.

True, the Canadians were clumsy in their approach. They hired Macron’s former employer, top Parisian investment banking firm Rothschild. But Couche-Tard’s due diligence consisted more of walking the aisles of Carrefour and Monoprix supermarkets than briefing Finance Minister Bruno Le Maire. Surprised by the takeover approach, he rejected it outright on cable television.

The episode illustrates the extent to which politics and private enterprise are entangled in the world’s seventh-largest economy. And it explains why Parisian finance will start 2022 relatively placidly but likely end the year with a bang. Macron is fighting for a second term in office. While he is comfortably ahead in the polls as 2021 wraps up, his swift ascent to the presidency five years ago and the fickleness of French voters, who have not given a second term to any president since Jacques Chirac in 2002, mean re-election in April is not a given.

**PARISIAN FINANCE WILL START 2022 RELATIVELY PLACIDLY BUT LIKELY END THE YEAR WITH A BANG**

This will dampen bankers’ ardour for deals before the elections. That’s not just because they fear transactions, especially those involving international acquirers, might face extra scrutiny during this politically febrile period. It’s also because there’s a strong pro-Macron faction among the CAC 40 executive class that wants to avoid doing anything that might boot a former corporate financier from the Élysée Palace.

Macron has been generally good for business and dealmaking. As of late November, French companies had been involved in some 2,900 transactions with a combined value of more than \$252 billion, according to Refinitiv data. At that pace, 2021 may turn out to be, if not greater than the record year of 2006, the most active since 2007, when \$288 billion of transactions were inked.

Granted, Macron has stymied some big deals, including Renault’s merger with Fiat Chrysler Automobiles two years ago. But the current crop of contenders for his job may not be any more accommodating. Éric Zemmour, a former journalist with eurosceptic and hardline anti-migration views, would likely be even more hostile to business and foreign capital than Macron’s leading challenger on the right, Marine Le Pen.

The left is fragmented for now. Meanwhile, Michel Barnier, who led the European Commission’s negotiations with Great Britain over its withdrawal from the European Union, is vying with Valérie Pécresse, head of the Paris regional government, to represent the centre-right. Neither is perceived to be more open to market forces than Macron.

Against this backdrop, sensitive deals will be on hold, at least until after Macron wins the election, and perhaps for longer if his party fails to gain a robust position in the National Assembly. The biggest of these would be a long-expected restructuring of EDF, the giant electric utility in which the state holds an 85% stake. A deal would likely see the company's small stock-market float acquired by the government, and its renewable energy assets separated from its nuclear power business.

Foreign purchases of businesses in industries deemed strategic – a definition France has stretched to include yogurt, supermarkets, cars and beyond – would remain off limits. In late November the finance ministry extended stricter measures on foreign ownership of companies it deems strategically important to the country for another year. Foreign buyers must receive permission to take stakes of more than 10% in listed companies in the health, electronic communications, technology, aerospace, data centres, media and food safety industries.

And private equity buyers, who are seen as temporary owners, will want to avoid assets that touch national interests. That would, for instance, seem to preclude any imminent sale of companies such as Idemia, a security business acquired by Advent International and Bpifrance from Safran in 2016. The company, worth more than \$3 billion, specialises in biometric identification technology, and provides services to the government, including border control. Putting an asset like that into play during an election would be tricky.

Similarly, privatisations, such as of the government's 51% stake in Aéroports de Paris, which Macron wanted to use to start an innovation fund, may have to wait until late 2022, if not beyond. While a referendum to block any sale of the airport operator failed to garner enough signatures in 2020, the company trades at half its pre-pandemic high, making a sale less attractive financially – and potentially easier for opponents to criticise.

Difficult, but not impossible, to pull off in an electoral campaign would be domestic mergers that raise anticompetitive issues. That said, in October Macron declined to renew Isabelle de Silva's mandate as chief antitrust watchdog – a sign many bankers took to mean that he wants to more easily facilitate the creation of domestic and European champions.

Still, the problem is that in-market deals generally mean job cuts, which would hand Macron's opponents ammunition. While not the primary cause for the termination of talks in October between Carrefour and privately owned Auchan, it hovered over the deliberations. A merger would have resulted in a domestic juggernaut with a 30% market share, reduced consumer choice and fewer jobs in the sector.

After the election, a Carrefour combo with Auchan – or even a Couche-Tard redux – may be possible. Even crunchier mergers, such as a long-studied purchase by BNP Paribas of crosstown rival Société Générale, could be on the table. In the meantime, pent-up demand for overseas assets by French heavyweights with clean balance sheets like LVMH, L'Oréal, Kering, Sanofi, TotalEnergies and Schneider Electric may be more palatable politically. Whether their shareholders can stomach the prices they will have to pay abroad is another matter entirely.

*First published Nov. 30, 2021*



# RIYADH WILL FLIP FROM NO-GO TO FOMO FOR BUSINESS

BY GEORGE HAY

Lifestyle reasons mean bosses have long preferred Dubai to the Saudi capital as a Gulf HQ. A mix of the kingdom's financial promise and government strong-arming means that could start to change. The city's social scene is already slowly making it less of a punishment posting.

## SHIFTING SANDS

The Saudi Arabian capital, Riyadh, has long been seen by international bankers and executives as a place to visit for work, before weekending in the UAE's more western-friendly hub, Dubai. That crowd may develop a nagging fear of missing out.

Economically, Saudi dwarfs regional Gulf peers. Its \$700 billion GDP in 2020 was double the UAE's, with three times the population. Its domestic stock market's \$2.6 trillion market capitalisation is over four times those of Abu Dhabi, Dubai and Qatar combined.

There's also loads of work. In the next four years, Saudi wants to raise \$55 billion via privatisations, and that doesn't include further asset or equity sales by \$1.9 trillion oil giant Aramco. Nor does it encompass disposals by the \$450 billion Public Investment Fund, which recently sold down a big chunk of its 70% stake in \$61 billion Saudi Telecom Company. Crown Prince Mohammed bin Salman envisages \$3.2 trillion of public and private investment over the next decade to shift the domestic economy away from oil.

Big western banks are keeping quiet about whether they will follow the 44 multinationals, including Novartis, Unilever and Deloitte, and establish regional headquarters in Riyadh. Part of that is a desire not to offend the UAE, where Dubai harbours fee-generative privatisation plans of its own. Riyadh's relative lack of good schools remains an issue. And it's also only three years since the crown prince faced international condemnation for the murder of Jamal Khashoggi in Istanbul, which U.S. intelligence agencies believe he sanctioned.

One basic reason why JPMorgan, Goldman Sachs and co. may overcome their reluctance is that the Saudi government has made it clear those who don't move by end-2023 will struggle to win the kingdom's business. But fading overseas scepticism is another pull factor. The number of foreign investors registered at the Tadawul has more than doubled from 6% in 2019, and Saudi's foreign direct investment inflows rose during the pandemic.

## EVEN THE FINAL TABOO – DRINKING ALCOHOL – MAY SOON GET A BETTER WORKAROUND

Riyadh may also become less of a social desert. Gigs by Miami rapper Pitbull, World Wrestling Entertainment matches, and Saudi ownership of the Newcastle United football club reduce the cultural distance with the west. More importantly, cafes and restaurants where men and women can mix are now commonplace. One long-term Saudi observer thinks even the final taboo – drinking alcohol – may soon get a better workaround. If so, Dubai's pre-eminence will be sorely tested.

*First published December 2021*



*CHAPTER 6*

# WORK

# BIG QUIT SENDS WORLD'S BACK OFFICE BACK OFFSHORE

BY UNA GALANI

When the pandemic fades, and along with it the stigma of letting people go, the WFH revolution will embolden global employers to move jobs to low-cost centres again. While that should benefit India's IT services providers, they're ironically grappling with similar problems.

## BACK TO FRONT

Remote working has become a happy norm for many information industry workers. Companies from New York to San Francisco to London to Paris are struggling to coax employees back into the office, resorting to handing out ever-more generous incentives from free meals to free transportation.

Employers are on the back foot because the pandemic has led to a huge expansion in demand for tech services as companies accelerate their digital strategies. Revenue growth at industry stalwart Infosys more than doubled to 21% in the September quarter year-on-year from pre-pandemic levels, for example.

One likely solution to the workforce problem will be to shift more jobs offshore, reversing a recent trend where many companies in the United States and Europe focused on on-shoring or near-shoring their techies to please politicians or simply to be closer to the rich-world clients they serve.

## YET OFFSHORING 2.0 WILL BE A FRAUGHT AFFAIR

Yet offshoring 2.0 will be a fraught affair as service providers are grappling with unprecedented levels of attrition in India, the original low-cost hub. Cognizant Technology Solutions lost a stunning 37% of its 300,000-plus India-dominated workforce on an annualised basis in the quarter ending in September. Others like Wipro are reporting 20% attrition.

As in the West, Indian workers are struggling to juggle their jobs as prolonged school closures take a toll. Junior staff who've worked from their towns and villages during the pandemic are quitting simply to avoid moving back into cramped, shared apartments in polluted cities. The talent squeeze is likely to persist even as the pandemic subsides because India's own domestic tech industry is booming, and its 100-plus unicorns are competing for manpower, leaving techies spoiled for choice in jobs.

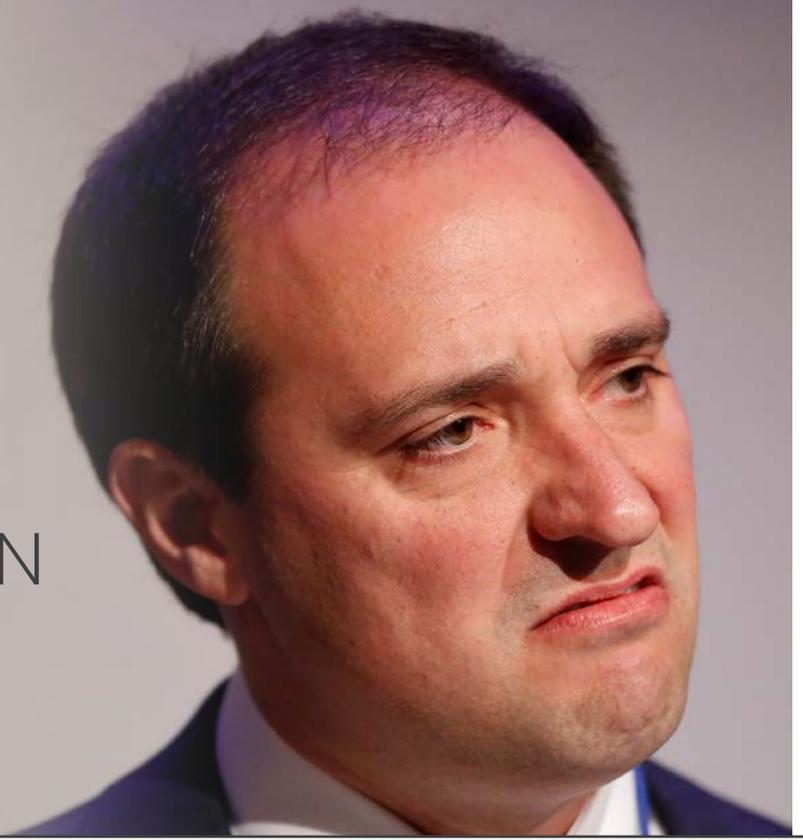
Some global IT services firms are already doubling down outside of India: Blackstone-controlled Mphasis is opening offices from Mexico to Costa Rica. Expect others to ramp up their overseas plans too. But an equal number of companies accustomed to WFH will bet that hiring in India will be less financially painful than keeping jobs elsewhere.

*First published December 2021*



# GREAT CEO RESIGNATION INVITES THE GREAT AGITATION

BY LAUREN SILVA LAUGHLIN



Bosses are retiring at a record clip, leaving companies scrambling for experienced leaders. At the same time, activists are revved up. As companies grapple with restless staff, supply chain challenges and economic uncertainty, investor cage rattlers will ramp up their campaigns.

## GREENER PASTURES

Chief executives are over it. C-suite turnover spiked in the first half of 2021, according to data from recruiter Heidrick & Struggles. With average corporate leaders far older than they were 15 years ago and the job of managing during a pandemic a lot less fun the trend will continue in 2022. The Great CEO Resignation will become an invitation for corporate cage rattlers.

U.S. bosses like American Airlines' Doug Parker and Janus Henderson's Dick Weil are throwing in the towel. Half of Europe's largest banks have replaced CEOs in the past two years. Leaders at some of Asia's biggest firms, including Mizuho Financial's Tatsufumi Sakai and Simon Hu at Ant have recently quit. Some were helped to the door, like the bosses at Barclays and Apollo Global Management. Not even the Las Vegas strip seems to be as much fun: Wynn Resorts' Matt Maddox is cashing in his chips.

Among just over 1,000 large, listed companies, some 76 CEOs in the first half of 2021 left their posts globally, Heidrick tallies, a 23% jump from the previous high of 2018 and almost as many as departed in all of 2020.

The trend will continue. Rank and file are restless. From Wall Street to Silicon Valley, workers are demanding higher pay and better benefits. Leaders are not only consumed with staff retention and the difficulty of managing during a pandemic via Zoom or Teams but struggling with supply-chain headaches and other disruptions related to Covid-19. Zero-Covid policies in Hong Kong and elsewhere make the fun part of the job – flying the company jet to see the troops or customers – nearly impossible.

## FROM WALL STREET TO SILICON VALLEY, WORKERS ARE DEMANDING HIGHER PAY AND BETTER BENEFITS

The average CEO is also eight years older at hire now than in 2005, according to data from Crist Kolder Associates, a headhunter. That leaves an opening for activist investors like Dan Loeb and Bill Ackman. As Morgan Stanley's head of mergers Rob Kindler told Breakingviews at the Reuters Next conference, activists like to muscle into companies when leadership is strained, and boards are distracted.

Uppity investors are ready to roll, too. Firms like Paul Singer's Elliott Management deployed just \$28.5 billion in the first three quarters of 2021, about half the amount they put to work in the same period in 2018 and less than the two subsequent years, research from Lazard's Capital Markets Advisory Group shows. CEOs may be hitting the beach, but that will make remaining executives' jobs far harder.

*First published January 2022*

BANKER PAY SURGE PROMPTS

# RISE OF THE ROBOT ANALYST

BY LIAM PROUD

Junior dealmaker salaries blew past \$100,000 in 2021 as Morgan Stanley, UBS and others vied for talent. That gives banks a reason to use machines rather than twentysomethings for gruntwork. Old-school bosses may resist, but financial incentives to automate will prevail in 2022.

## TERMINAL VALUE

Dealmakers are the Luddites of the banking world. Algorithms have conquered trading floors, but departments that underwrite securities and advise on deals are still stuffed with twentysomethings formatting pitchbooks and copying data from annual reports. A pay surge offers new incentives to automate. Prepare for the rise of the robot investment banker.

Bank bosses like JPMorgan's Jamie Dimon and David Solomon of Goldman Sachs get it. Both banks have set up teams dedicated to modernising their M&A advisory and capital markets businesses. The problem is that old-school rainmakers often mistrust valuation multiples pulled from live databases. Some also prize the process of making analysts spend hours sweating over seemingly trivial details, as it helps to weed out the less committed. An aversion to technology partly explains why the number of mergers, debt and equity bankers has risen by 2% since 2016 to 19,500, according to Coalition Greenwich, even as the number of humans trading shares and bonds has declined.

That will change. Record deal volumes and a tight labour market pushed up pay in 2021. First-year analysts at Morgan Stanley will now earn a \$100,000 base salary, Reuters reported, a \$15,000 rise. Rivals worldwide have followed suit. A poll by London-based recruiter Dartmouth Partners found that second-year analysts on average earned a total of almost 120,000 pounds (\$160,000), a roughly 20% rise.



That changes the calculus for tech-averse senior bankers: higher pay for juniors eats into their bonus pot. It's also harder to justify paying analysts six-figure salaries to perform menial tasks, such as fiddling around with font sizes on PowerPoint presentations.

The logical alternative is to use software that gathers data automatically and pulls it into live pitchbook templates. It could be a stop on the way to a slicker business model. Imagine if companies could issue bonds with the click of a button, or if chief executives could pull up a list of merger targets on a smartphone app.

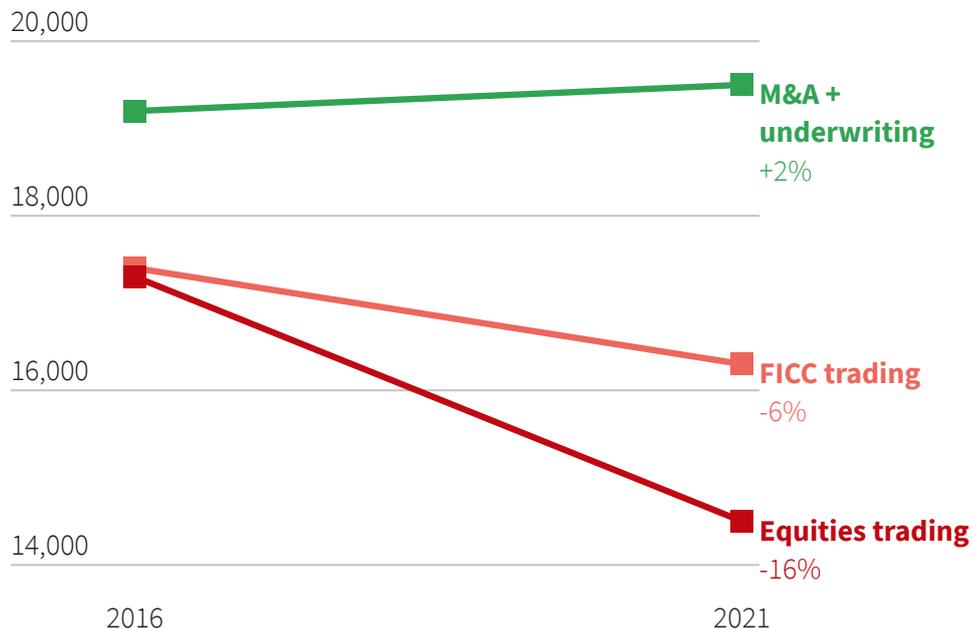
### THE BIGGER QUESTION IS WHETHER ANALYSTS SHOULD WELCOME THEIR ROBOT COUNTERPARTS

Senior bankers will defend the status quo, but the sudden ubiquity of video calls shows entrenched habits can change. The bigger question is whether analysts should welcome their robot counterparts. In theory, automation should mean fewer all-nighters and more time for interesting tasks. However, it may knock some of them out of a job.

First published December 2021

#### DEFYING DISRUPTION

Investment bank headcount by role



Note: Figures refer to total employment during the first half of the calendar year. Headcount is defined as the number of full-time equivalent revenue-generating employees within each division at the 12 largest global investment banks: Bank of America, Barclays, BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JPMorgan, Morgan Stanley, Société Générale, UBS.

Source: Coalition Greenwich

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# MORGAN STANLEY WILL FRAME NEW PORTRAIT AT THE HELM

BY JOHN FOLEY

James Gorman turned in better stock-price performance than most rivals over his CEO tenure. While peers like Goldman Sachs chase traditional banking customers, Gorman has set a course towards fast-growing wealth management. In 2022, he will script a graceful exit.

## ACTS OF SUCCESSION

When's the right time for a Wall Street titan to leave? Probably when the company's fortunes are on a high, and with an oven-ready successor teed up. By that logic, Morgan Stanley's James Gorman will be the first of the long-standing bank chiefs to go.

### MORGAN STANLEY'S JAMES GORMAN WILL BE THE FIRST OF THE LONG-STANDING BANK CHIEFS TO GO

The Australian who has run the New York bank since 2010 has turned in a better performance than most rivals. Every \$1 invested in Morgan Stanley back then is worth over \$4 now, including dividends. That's less than JPMorgan, but beats Goldman Sachs, Citigroup, Wells Fargo or Bank of America. Gorman's peers are all either newish to the job, like Citi's Jane Fraser, or plan to stay on, like BofA's Brian Moynihan or Jamie Dimon at JPMorgan.

Gorman also bet on wealth management while peers focused elsewhere, acquiring brokerage E\*Trade Financial and asset manager Eaton Vance for \$20

billion during the pandemic. Unlike banks with big lending businesses, Morgan Stanley wasn't worried about consumer loan defaults.

Quitting while he's ahead would be another way for the former McKinsey consultant to peel away from the pack – except it's not obvious who'll replace him. Gorman doled out new roles to four potential successors in May, all long-serving senior lieutenants. Only wealth management boss Andy Saperstein and institutional securities head Ted Pick have run Morgan Stanley's major profit engines, though, suggesting a two-horse race.

Since wealth is where Morgan Stanley's future lies – Gorman has said he wants to grow client assets to \$10 trillion, from just over \$6 trillion – Saperstein might seem a shoo-in. Wealth could account for two-thirds of revenue if Gorman hits his target.

Pick has an edge in other ways. He fixed up stock trading after the crisis. The markets arm he oversees has seen its share of the big five trading houses' revenue grow from 13% to 18% over the past decade. While that hasn't been without hiccups – like the \$1 billion in trading losses from hedge fund Archegos in 2021 – Pick was also the highest-paid executive after Gorman according to an April filing, reflecting the fact his division carries more risk than others.

One catch: Pick hasn't previously run brokerage. Then again, Gorman will probably copy his predecessor, John Mack, and stick around as chairman for a spell. There's probably time for another reshuffle before then to fill in some gaps in his successor's résumé.

*First published December 2021*

# NOT ALL MERGER BOUTIQUES WILL BE EQUAL IN 2022

BY LAUREN SILVA LAUGHLIN

The crackdown on big deals will put a crimp on fees for shops that advise large companies, like PJT or Goldman. The most successful ones will be those that focus on transactions worth less than \$1 billion, like Moelis, or big private equity. Houlihan Lokey tops that list.

## MAKING IT SPRINKLE

Houlihan Lokey isn't typically the envy of Wall Street. But in 2022, the mergers shop worth \$7 billion that doles out advice to midstream energy companies and middling dental groups will be. That's thanks to a consolidation crackdown from global antitrust watchdogs that will crimp the ability of companies to do hairy, strategic deals.

## RAINMAKERS ARE GOING TO HAVE TO WORK HARDER FOR LESS

Rainmakers are going to have to work harder for less – partly a consequence of a record-breaking year. The value of corporate marriages announced during the first 11 months of 2021, \$5.2 trillion, was already 45% higher than the value recorded during all of 2020 and more than any annual total since tallying started in 1980, according to Refinitiv.

But competition authorities are making life tough for merger-inclined executives. Recently the UK's Competition and Markets Authority told Facebook owner Meta Platforms to sell popular animated-images group Giphy. Days later

the U.S. Federal Trade Commission said it would sue to block graphics chipmaker Nvidia from buying UK-based semiconductor designer Arm. Large-scale corporate concentration is becoming harder to achieve and will be replaced by smaller deals and buyouts.

Mega-deal consiglieri like Paul Taubman and Aryeh Bourkoff – founders of PJT Partners and LionTree, for Comcast and AT&T, respectively – will need to dig deeper for clients. Firms like Houlihan are well-positioned. In the year through Dec. 6, its average deal size was about \$200 million, 8% the size of a Goldman Sachs transaction and about 12% the size at PJT. And it ranks top of the list – even ahead of Goldman – on advising private equity, by number of deals rather than volume.

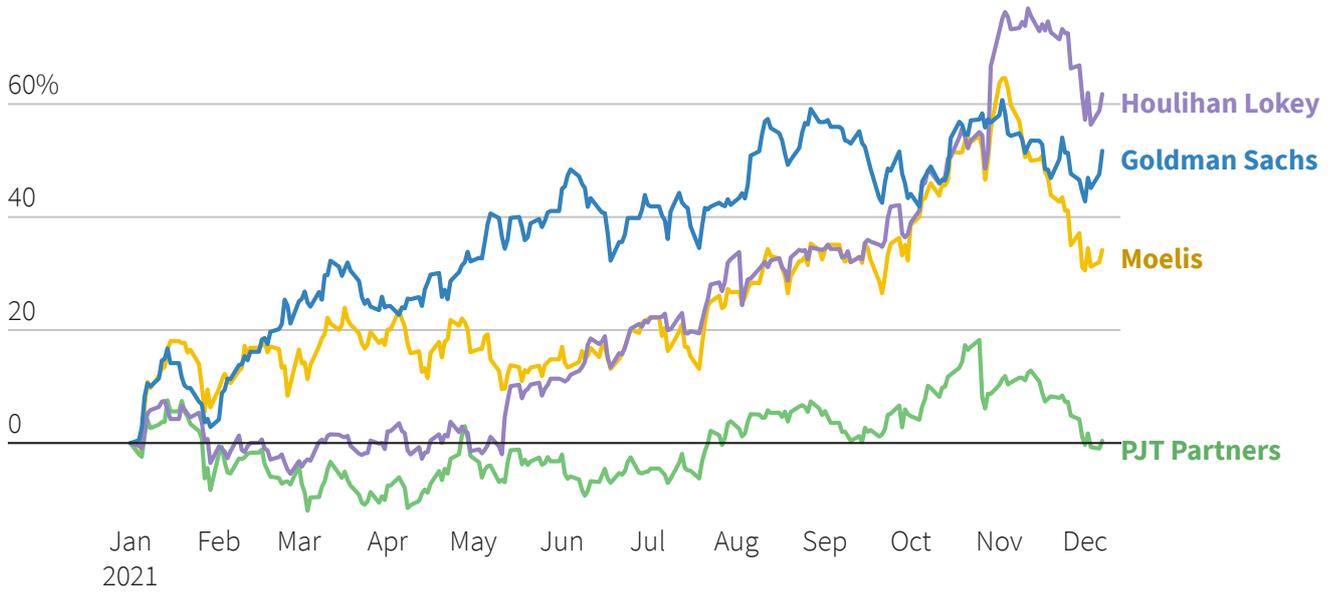
Houlihan required 85% more employees than \$2.6 billion PJT to execute its deals, but they also carried their weight. A Houlihan worker brought in \$1.3 million on average, versus \$1.1 million at PJT, based on Refinitiv estimates for 2021. On that metric, Moelis, worth \$4 billion, is squeezing out the max among boutiques. The firm, with an average deal size of nearly \$650 million, raked in \$1.8 million per head.

The stock market has already rewarded Moelis and Houlihan, with shares up significantly in the past year versus a slight decline at PJT. Plugging away on dental practice deals may be more arduous and less glamorous. In a period when M&A advisers will be duking it out for fees, that only means they'll be prepared.

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### BOUTIQUE BOOST

Year-to-date stock price performance



Source: Refinitiv Datastream  
Vincent Flasser | Breakingviews - Predictions 2022



A woman with an umbrella walks in the rain in the Manhattan borough of New York City, New York, United States, Oct. 26, 2021. REUTERS/Carlo Allegri

# FED WILL HAVE TO PUT INCLUSIVE JOBS ON BACK BURNER

BY GINA CHON

Chair Jerome Powell wanted a labor market recovery to filter through to women and minorities before hiking interest rates. But tighter monetary policy is the surest way to contain inflation, which is at a 31-year high. Price stability will trump the job prospects of these groups.

## HEART STRINGS

Jerome Powell's humane economic instincts are in conflict with cold reality. With inflation at a 31-year high, the Federal Reserve boss won't be able to afford to wait for a labor market recovery to filter through to women and minorities before he starts raising interest rates in the coming year.

There's tension between the U.S. central bank's dual mandate of price stability and maximum employment as Powell defines the latter. For him, the second goal means boosting the employment rates for disadvantaged groups. That's an admirable aim, not least because these were

groups that were hardest hit during the pandemic. The unemployment rate for white men aged 20 and above was 3.6% in October but 8.3% for their Black counterparts.

Powell's dilemma is twofold. First, the overall labor market has recovered quickly. It took eight years after the 2008 financial crisis for the unemployment rate to fall to 4.6% from its peak. This time it took less than two years. Moreover, there were 0.7 unemployed persons for every job opening in September, according to the Labor Department.

Second, inflation has had more staying power than the central bank expected. Powell, who was nominated to a second term in late November, has repeatedly said big price increases are transitory because they were largely linked to Covid-19. But since May, the year-over-year growth in the consumer price index has been at least 5% each month and hit 6.2% in October.

## INFLATION HAS HAD MORE STAYING POWER THAN THE CENTRAL BANK EXPECTED

This combination puts pressure on the Fed to raise interest rates to contain inflation. It's the central bank's most effective tool, as shown by former Fed Chair Paul Volcker during the 1980s. True, supply-chain bottlenecks related to the pandemic have contributed to the price spikes that Powell faces. Raising policy rates is not the ideal response to these disruptions. But such hikes would tamp down inflation by putting the brakes on demand. There are trade-offs, including a possible slowdown in hiring. That would make Powell's inclusive employment goal more elusive.

Putting this ambition on the back burner would mean going back on past pledges. But maintaining it in the face of mounting inflation would be more damaging to the Fed's credibility. Powell may have to choose his head over his heart.

*First published Nov. 23, 2021*



CHAPTER 7

# OTHER SHIFTS



# SHIPPING GIANTS WILL PLOT COURSE FOR LANDBOUND M&A

**BY EDWARD CROPLEY**

Soaring container fees pushed the valuations of seaborne transport companies to record highs. Those trends will reverse in tandem. Still, with sacks of cash on board, ocean-goers like Maersk can buy landlubbing logistics rivals in preparation for the next supply-chain crunch.

## **FULL STEAM ASHORE**

Shipping giants are heading for port, but not in the traditional sense. Companies like Denmark's A.P. Moller-Maersk and Germany's Hapag-Lloyd are riding a record valuation wave thanks to a year of sky-high container rates. Gobbling up land-based logistics rivals would be one use for the cash burning a hole in their pockets. It would also serve as a handy buffer against future supply-chain crunches.

**PANDEMIC UPHEAVAL  
HAS BENEFITTED THE  
SHIPPING INDUSTRY**

Pandemic upheaval has benefitted the shipping industry. Government support, such as cheques mailed out to U.S. households, fuelled a consumer spending spree. Freight rates have soared. In September, a container from China to New York cost \$22,000, eight times its 2019 price. That has boosted shipping firms' bottom lines. Market leader Maersk's EBITDA will nearly treble in 2021 to over \$23 billion, according to analyst estimates compiled by Refinitiv. The firm, which the market valued at \$59 billion in mid-December, is likely to be carrying over \$17 billion of net cash in 2022.

The normal response would be for chief executives like Maersk's Soren Skou to splash out on ever bigger boats. Yet March's blockage of the Suez Canal shows the dangers of excessive bulk. And the arrival of lots of new vessels in three or four years may overwhelm demand for container space, cratering freight prices and shipping company margins.

A smarter move may be to invest in getting containers seamlessly from port to customer. Danish shipping and freight specialist DSV bought the logistics unit of Kuwait's Agility Public Warehousing in April for \$4.1 billion for just such a reason. France's CMA CGM and Maersk both pulled similar moves in December. At \$51 billion, DSV is too big even for Maersk. Switzerland's Kuehne und Nagel, at \$34 billion, would also be a challenge. However, its shares shed 25% in September and October as freight rates eased. If those trends continue, the company could come into play in 2022. U.S. land-transport specialist CH Robinson Worldwide, now worth \$13 billion, would be another option.

Bringing sea and land services under one roof would allow for cost savings. It would also make it easier for operators to plot a course through future supply-chain bottlenecks and charge a premium for speedier delivery. Danish wind turbine giant Vestas Wind Systems, which has struggled to get parts throughout 2021, signed just such a deal with Maersk in November. In 2022, there are a lot of incentives for sailors to step ashore.

*First published December 2021*



# DATA HUNTERS WILL BE BIG PHARMA'S NEXT PREY

BY AIMEE DONNELLAN

Drugmakers such as AstraZeneca spend \$160 bln annually trying to unearth new treatments for diseases like cancer. The winners will be those who can source and analyse data quickly. That makes artificial intelligence experts like Relay Therapeutics and Exscientia targets.

## DATA DIVE

Big Pharma will need to tool up in the data arms race. Drug giants like AstraZeneca are pouring \$160 billion a year into unearthing new treatments. Artificial intelligence could provide a shortcut, by helping discover new treatments and getting them to market sooner. That makes firms like Exscientia, Relay Therapeutic and Recursion Pharmaceuticals hot property.

The pandemic has given a tangible example of the value of machine learning, a kind of computer programme that processes vast amounts of data quickly and spots trends that humans might miss. Technicians at UK-based BenevolentAI realised by running patients' medical history and previous trial results through their algorithms that Baricitinib, an arthritis treatment, might also help Covid-19 sufferers.

Machine learning could help drugmakers develop new remedies, not just rebadge old ones. Take gene therapy, which involves tinkering with patients' DNA to prevent diseases such as cancer. By analysing millions of potential patients' genetic codes and medical history, an artificial intelligence programme could identify those most likely to benefit from a treatment. That could mean faster trials and more efficient drugs.

Time is money in the pharmaceutical industry. It can currently take as long as 10 years to get a drug developed, tested, approved and on the market. That leaves perhaps just another 10 years before patents expire and other drugmakers can copy it. But pharma executives reckon machine-learning tools could get a treatment to market two years earlier, implying 12 years before loss of exclusivity, or 20% more revenue over a drug's life.

## BIG PHARMA IS ALREADY BUSILY BUDDYING UP WITH ARTIFICIAL INTELLIGENCE TECH FIRMS

Big Pharma is already busily buddying up with artificial intelligence tech firms. Pfizer, for example, is working with IBM Watson to develop cancer treatments. Yet companies will increasingly need to bring machine learning technology in-house to fully analyse data and secure proprietary access to the results.

Several machine learning specialists have listed in recent years. And UK group BenevolentAI merged with a Dutch blank-cheque company founded by Michael and Yoel Zaoui. The combined market value of Exscientia, Schrodinger, Relay, Recursion, BenevolentAI and AbCellera Biologics is less than \$16 billion, equivalent to just one-tenth of Big Pharma's annual R&D costs. Given the potential benefits, it's unlikely those companies will stay independent for long.

*First published December 2021*

# CANADA'S WEED LEAD IS GOING TO LINGER IN 2022

**BY SHARON LAM**



Production team member Justyna Cetnar removes dead leaves from cannabis plants in an aquaponics grow operation by licensed marijuana producer Green Relief in Flamborough, Ontario, Canada, Jan. 25, 2019. REUTERS/Carlos Osorio

The country's homegrown outfits are angling for the U.S. market, which could be worth \$40 bln a year by 2026. The high after Ottawa's early legalization of cannabis is fading, however. Canadian players in the pot sector need to act soon to make the most of the remaining buzz.

### GREEN RUSH

Canada often has little choice but to bend to the heftier market forces of its neighbor to the south. The cannabis business was an exception after Ottawa legalized weed in 2018 and gave Canadian companies a lead. They've been angling for a stake in the larger U.S. market. But they need to act soon to make the most of the remaining early legalization buzz.

There were about \$2 billion in cannabis sales in Canada in 2020, according to Bernstein analysts. That pales beside \$17.5 billion in legal sales in the United States, where pot remains illegal at the federal level. Even without a change in that situation, Bernstein expects the American market will be worth some \$40 billion a year by 2026.

The introduction in November by Republicans in Washington's House of Representatives of legislation to decriminalize marijuana is one move that has lit up still higher hopes. But there's already enough at stake to encourage multistate operators – or MSOs – like Green Thumb Industries and Cresco Labs to ramp up production capacity and strengthen their balance sheets.

Meanwhile the high after Canada legalized the business is fading. Unrealistic heady valuations for pot companies have come down; Ontario-based Canopy Growth recently pushed back its profitability expectations; Hexo and others have slashed their workforces.

### THE HIGH AFTER CANADA LEGALIZED THE BUSINESS IS FADING

And they are running out of time. Valuation multiples relative to revenue are still higher for Canada's operators, roughly in line with technology names like Meta Platforms and Netflix, despite the bigger potential upside of legalization to the south and what Bank of Montreal reckons is a more profitable U.S. operating model given MSOs' ability to vertically integrate, among other things. That suggests that even if the feds don't make marijuana fully legal, the differential may not last.

Canadian purveyors with the merger munchies need to find their targets before then. One structure that is being used is a kind of option on federal action. Canopy Growth boss David Klein, for instance, shelled out nearly \$300 million in October for the right to acquire Colorado-based edibles maker Wana if the United States makes pot legal, after striking a similar deal with Acreage. There's risk in committing capital up front, but the moment may pass if Canadian firms don't grab it.

*First published December 2021*

### BUZZKILL

Valuations of Canadian and U.S. pot operators are set to narrow further

*Enterprise value to 12-month forward sales ratio*



Source: Refinitiv Datastream

Sharon Lam & Vincent Flasseur | Breakingviews – Predictions 2022



# sale

## SHOP SPREE WILL STUFF LANDLORDS IN BARGAIN BIN

BY AIMEE DONNELLAN

Ikea and Amazon are among the many retailers opening new locations. In theory, it's a good sign for mall owners like Unibail-Rodamco-Westfield, which trade at steep discounts to their assets. Cheap rents and other freebies, however, mean they're effectively giving away the store.

### WIND OUT OF THE SALES

After a strong run for clicks, bricks will be back on the agenda in 2022. Amazon.com and Ikea are among the many retailers planning to rent or buy new locations. In theory, it's a good sign for embattled landlords. With so much available space, however, their negotiating leverage is weak. As a result, property stocks will be driven deeper into the bargain bin.

For the past decade, shopkeeping titans including Zara owner Inditex and H&M have been rapidly shifting their businesses online. During the pandemic, that trend accelerated with online purchases in the United States soaring to represent a record 20% of total sales in 2020, according to e-commerce research firm Digital Commerce 360. That has pummeled the valuations of mall owners such as Unibail-Rodamco-Westfield, Land Securities and Klépierre, which depend on a steady stream of tenants vying to occupy their stores. The trio trade at an average discount of about 40% to their net asset value.

The provisional end of lockdowns is changing behaviour again. Shoppers are seeking out human interaction, prompting brands to scramble for more physical space. Shoemaker Allbirds, freshly capitalised from its U.S. initial public offering, intends to open hundreds of stores. Ikea recently paid \$500 million for Topshop's former flagship building on Oxford Street. In China and India, some 90% of retailers told commercial real estate services provider CBRE they intend to expand their store portfolios in 2022.

### SHOPPERS ARE SEEKING OUT HUMAN INTERACTION

These evolving trends demand a fresh look at property owners and managers. The trouble is that the volume of empty storefronts leaves them in a weak spot. In Midtown Manhattan retail hubs, for example, the vacancy rate is 30%, according to the Real Estate Board of New York. On London's Oxford Street, it's 14%, more than five times the 15-year average, says real estate consultancy Knight Frank.

Under the circumstances, retailers can demand rock-bottom rents and extra perks. In regional parts of Britain, Legal & General and others are offering new tenants two years of free rent. Mall owners Hammerson and Landsec also have revised leasing terms. Short-term contracts and ones linked to merchant revenue, previously shunned as uneconomic, are on display. It's hard to invest in landlords when they're effectively giving away the store.

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### COVER AND CONTENTS PAGE IMAGE

Aerial view of the Sheikh Zayed Road, following the outbreak of coronavirus disease, in Dubai, United Arab Emirates, March 26, 2020. REUTERS/Satish Kumar

### CHAPTER TITLE IMAGES

#### ECOLOGY

Burned trees are seen on a hillside in Bormes-les-Mimosas, in the Var department, France, July 27, 2017. REUTERS/Jean-Paul Pelissier

#### WHEELS

A combination photo of various car wheels displayed at exhibition stands during a media preview day at the Frankfurt Motor Show, Sept. 10, 2013. REUTERS/Staff

#### DIGITAL

A visitor stands in front of an immersive art installation titled “Machine Hallucinations - Space: Metaverse” by media artist Refik Anadol, at the Digital Art Fair, in Hong Kong, China, Sept. 30, 2021. REUTERS/Tyrone Siu/File Photo

#### MONEY

A visitor to the Bellas Artes Museum walks between two Andy Warhol “Dollar Sign” paintings in Mexico City, Mexico, Aug. 24, 1999. REUTERS

#### POLITICS

Soldiers of People’s Liberation Army are seen before a giant screen as Chinese President Xi Jinping speaks at the military parade marking the 70th founding anniversary of People’s Republic of China, on its National Day in Beijing, China, Oct. 1, 2019. REUTERS/Jason Lee/File Photo/File Photo

#### WORK

Offices and residential buildings are illuminated as the spread of the coronavirus disease continues in Frankfurt, Germany, Jan. 28, 2021. REUTERS/Kai Pfaffenbach

#### OTHER SHIFTS

Businessmen walk across a street in Tokyo, Japan, Sept. 10, 2007. REUTERS/Yuriko Nakao



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