



As the EV industry experiences growing pains, we favor companies with competitive advantages and proven business models, but proper positioning largely depends on time horizon, region, and risk tolerance. (UBS)

# Road to EVs

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**In the US, the recent news flow on the electric vehicle (EV) market has been downbeat. Here EV adoption is less than 10%. As competition intensifies, some US automakers have tempered expectations regarding the pace of their EV transitions.**

While adoption should rise further, the investment opportunity requires more nuance. The pace of the transition will ultimately depend on consumer adoption, the offering of more affordable EVs, and government incentives and/or regulation. This introduces an interesting tradeoff between stoking demand and manufacturer profitability. Against this backdrop, we favor businesses with competitive advantages, and opportunities along the supply chain including semiconductors and select producers of input materials.

## **Is affordability at odds with profitability?**

Outside of range anxiety, EV affordability has always been cited as a key adoption hurdle. Meaningfully higher financing costs have resurfaced this concern, but after years of supply shortages and inflation, EV prices are moving in the other direction. Industry price data through November shows EV prices down 21.1% year over year.<sup>1</sup> EV sales have pushed higher, but competition is fierce and the risk of a “race to the bottom” has emerged. According to KBB’s 3Q report, at least fourteen new EV models have sold in 2023 compared to last year, and many more are expected to follow.<sup>2</sup>

An economic “race to the bottom” occurs when businesses in a competitive industry attempt to undercut one another to gain market share. The price cuts rippling through the industry will likely hit margins, unless automakers can offset them with higher sales volume or lower costs. However, recent price action by some market participants has not appeared to result in a materially positive volume impact. This has caused some collateral damage, as consumers question the timing of a purchase in anticipation of further price cuts, but also question the resale value. This dynamic also means it’s not a straightforward positive correlation between consumer adoption rates and auto stock price performance. Aggressive

competition will be especially painful for companies unable to break even or differentiate with superior product, and therefore an industry shakeout could eventually occur.

### Will supportive policy support performance?

Global policy initiatives have aided the EV transition in recent years, but the question becomes how long supportive policy lasts. The Inflation Reduction Act (IRA) expanded consumer tax credits in the US, but with a significant amount of fine print attached. Qualifying for the tax credit is tied to restrictions regarding “foreign entities of concern” (FEOC), but leased EVs can circumvent this requirement, causing some to voice concern over loopholes.

Potential repeal of the consumer tax credit will add to concerns over consumer affordability, and IRA spending cut threats add headline risk in an election year. Separate policies aimed at building out charging stations are a positive for long-term adoption rates, but we are cautious on pure-play charging companies that are operating in a highly fragmented market.

### How are we positioned?

As the EV industry experiences growing pains, we favor companies with competitive advantages and proven business models, but proper positioning largely depends on time horizon, region, and risk tolerance. Falling rates should help support valuations, but consumer demand will be a key determining factor. As penetration rates increase, it becomes incrementally harder to convert the next, more wary, consumer. If consumer demand holds strong, sales volumes should help offset price decline. If it starts to wane, the race to the bottom will accelerate, somewhat limited by the ability and willingness to sell product below its cost.

The investable market for EVs is broader than automakers themselves. Enabling technologies like semiconductors have recently fared better, emphasizing the case for supply chain diversification. Semiconductors are a top export in the United States, and like other critical infrastructure sectors, are significant to national security. This should allow for the related spending plans to be viewed more favorably if spending cut rhetoric heats up in 2024, which supports our tactical preference for global semiconductors and US infrastructure spending beneficiaries.

Looking beyond a tactical horizon, we still believe supply chain diversification is prudent, as higher semi content and high voltage components will be required for electrification more broadly. Passenger vehicles are just a small subset of transport innovation. Larger commercial fleets are still being electrified, and urban mobility is supporting growth in other modes of electrified transport, adding to the case for *Smart Mobility* more broadly.

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Read the full blog [Road to EVs](#) 15 December 2023.

<sup>1</sup> Kelly Blue Book, Cox Automotive, <https://www.coxautoinc.com/market-insights/kbb-atp-november-2023/>

<sup>2</sup> Kelly Blue Book, Cox Automotive, <https://www.coxautoinc.com/wp-content/uploads/2023/10/Q3-2023-Kelley-Blue-Book-Electric-Vehicle-Sales-Report.pdf>

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