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Harbour Navigator

Investment implications of electric vehicle momentum

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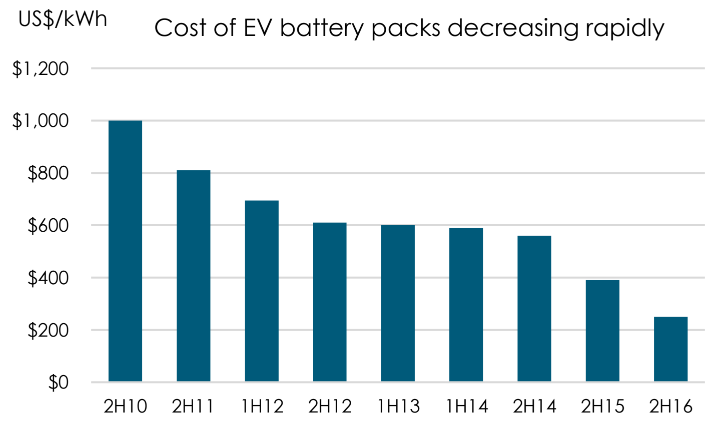
It has been hard to miss recent headlines relating to the progress of electric vehicles (EVs) and the phasing out of the internal combustion engine (ICE) that powers the majority of today's cars.

In May, Daimler announced the funding of its first European battery plant for its future Mercedes EVs. Last week, Volvo announced that all its new-model cars will have an electric drivetrain by 2019; a mix of hybrids and pure EVs. More recently, France announced that they will ban the sale of petrol and diesel cars by 2040. These are just a handful of examples of recent headlines suggesting strong momentum in the EV race.

What is not widely reported in the headlines – yet – is that most major car manufacturers have made similar decisions, and are dedicating significant resources towards their own EV strategies. Bringing cost competitive EVs to market (to eventually phase out the ICEs) is widely expected among most market participants and analysts. However there are differing opinions on the likely timing of the EV roll-out, and the potential implications of this for traditional businesses such as petrol retailers, refiners, power generators, lines companies etc.

Whilst we do not pretend to have the final answer, based on our research we believe that technology is moving faster than consensus expectations. We see battery manufacturing costs bring rapidly driven down, which will make EVs cost-compatible for the mass market sooner than expected. This is in part a function of scale, know-how and increased competition in the battery manufacturing industry. Regulation is likely to accelerate this transition.



Source: Bloomberg Energy Finance

This is a topic we have been monitoring for a long time and it is a polarising theme for investors. The uncertain nature of the EV disruption makes it incredibly hard to decide on an appropriate terminal value for companies, such as Z Energy, the NZ Refining Company and Caltex (Australia). Short-term cashflows and dividends may look solid, but uncertainty about the longer-term is significant. Given the forward-looking nature of markets, there is a chance that affected companies could sell off as market participants learn more about the potential future cash-flows and dividends.

A lot of our time is spent looking at how to best position portfolios, to both protect against losses (should equity markets start pricing in the inevitable shift to EVs), but also how to potentially be part of funding what could be a very long, secular growth industry. At present, we have established in portfolios some limited exposure to battery materials.

Harbour will continue to monitor any further developments that could challenge or support our base-case that the EV revolution is accelerating faster rather than slower.

Harbour Asset Management

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