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WILL EUROPEAN AUTOMOTIVE SUPPLIERS FIND THEIR WAY?

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KEY POINTS:

- The European car market is shrinking, unlike China
- 70% of the market is controlled by Asians, and most of the thirty European gigafactory projects (plants producing batteries for electric vehicles) have been designed and built with the help of Chinese and Korean companies
- However, China does not have all the automotive know-how. Complex and heavy parts (such as engines, transmissions, chassis and seats) are mastered by Europeans

On November 21st, 2024, Northvolt, an electric vehicle battery manufacturer, said to be Europe's future of energy, filed for Chapter 11 bankruptcy. This downfall raises questions about Europe's strategy for the automotive industry. Reflecting this downturn, European automotive suppliers have reported a net loss of 56,000 jobs between 2020 and 2024[1] while BYD (a Chinese car manufacturer) expanded its workforce by 415,000 employees between 2021 and 2023[2] and increased its vehicle sales by 6.5x, establishing itself as the global leader in the electric vehicle segment. The European automotive industry appears to be struggling under strict regulations with limited financial support, especially when compared to the significant aid provided under the U.S. Inflation Reduction Act or the strong backing of Chinese manufacturers by their government...

... adding to these challenges is low consumer demand across Europe for expensive electric vehicles, further hindering the sector's growth.

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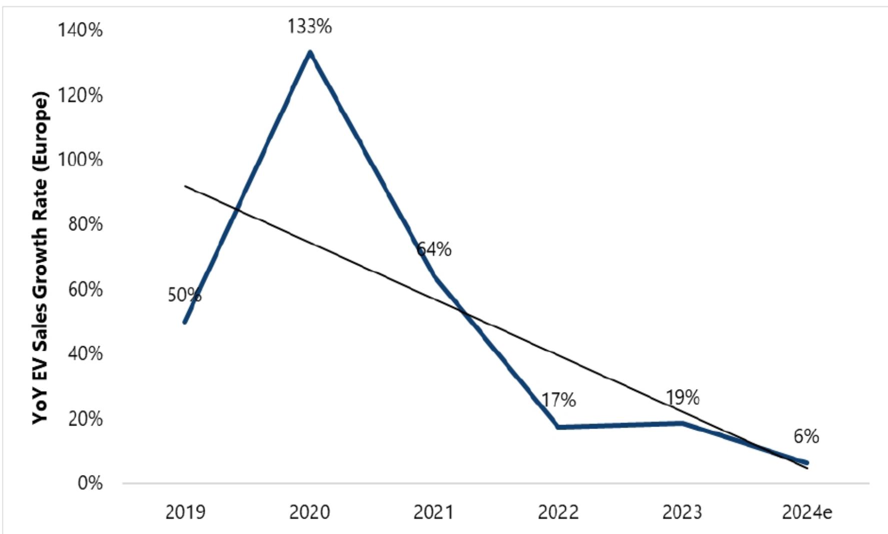
Growth rate of electric vehicle sales in Europe (published November 27, 2024)



Source: IEA, Jefferies

1) Published on 22.10.2024, Press Release: Worst job losses in the automotive supply industry since the pandemic, CLEPA
2) BYD, rapport annuel 2021 et 2023

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The failure of Northvolt: A symbol of aborted European ambitions

Founded in 2017 to compete with Asian battery giants (CATL, LG, etc.), the Swedish start-up is a symbol of Europe's ambitions in the energy transition. Quickly, Northvolt secured significant funding, raising €15 billion in debt and capital from Volkswagen (a 21% shareholder), BMW (2.8%), major financialinstitutions (mainly Goldman Sachs) and, to a lesser extent, public funds. By the end of 2022, Northvolt had an impressive order book of $55 billion, reflecting a strong commitment from automakers.

Unfortunately, Northvolt's management, driven by overly ambitious goals, attempted to build eight high-tech factories in eight locations across two continents. However, a shortage of skilled labor, knowledgeable in these advanced technologies, and insufficient expertise in essential machine tools resulted in the inaugural factory producing only 1% of its original target. This led to client order cancellations, including BMW, and a massive cash burn, leaving the start-up with $5.8 billion in debt and only $30 million in liquidity[3] at 2024 year-end. Thanks to its revised development plan, Northvolt still has a couple of months left to secure new financing.

Thanks to other industry players (Verkor, ACC, PowerCo, etc.), Europe has managed to increase its share of the global battery market from 3% to 17% since 2017, achieving annual revenues of €81 billion in 2023 after allocating more than €6 billion of the European Union (EU) budget to support cross border battery projects and innovation[4]. However, the market remains dominated by Asian players who control 70% of it. Additionally, most of Europe's thirty gigafactory projects (factories producing batteries for electric vehicle) have been designed and built with the help of Chinese and Korean companies. For example, CATL and Stellantis have announced plans to co-construct a lithium battery factory in Spain, further expanding China's manufacturing footprint on European soil.

The European automotive industry is therefore slow to undergo an industrial transformation to withstand the aggressive tactics of Chinese players, who have been cut off from the US market due to geopolitical restrictions. On top of this, the "mountain" of CO2 regulations looms over automakers, with penalties that could reach billions of euros.

The number of vehicles sold in Europe (including the UK) shrank to 13.4 million units in 2024[5] down 17% vs. 2018. European production outside the UK also fell sharply by 18.5% to 12.2 million units in 2023[6]. These lower volumes have placed significant pressure on the cost structure of automotive equipment suppliers. In addition, production costs have risen due to inflation in energy prices, logistics costs and wages. More importantly, according to Jim Fairley, CEO of Ford Motors, manufacturing an electric vehicle requires 40% less labor than producing a thermal vehicle[7]. As a result, automakers in Europe have announced capacity reductions (Volkswagen, Ford).

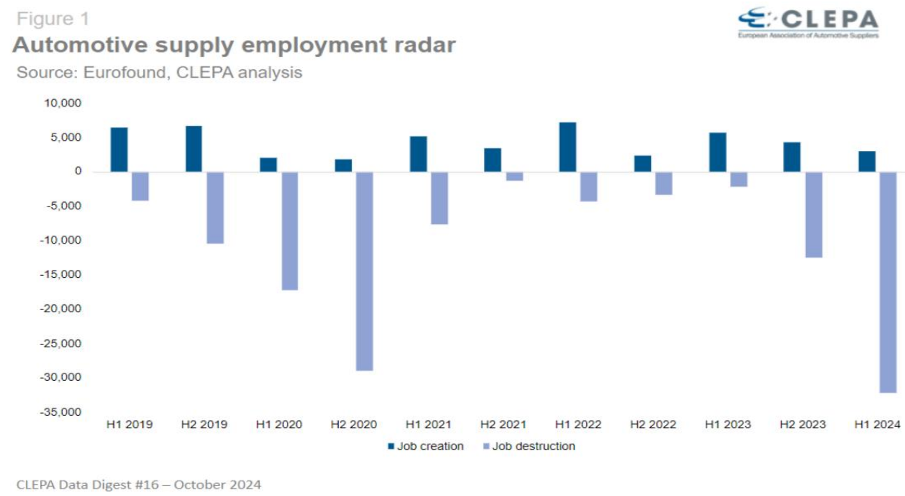
In addition, the EU's climate change goals add further pressure. Starting in 2025, the average CO2 emissions of new cars must be reduced by 15% compared to 2021 levels, with a target reduction of 37.5% by 2030. For the entire automotive market to be aligned, the market share of electric vehicles in Europe would have to reach at least 28% by 2025 (compared to 21% in the first half of 2024[8]). Manufacturers must comply with these targets or face financial sanctions which could amount to a total of €15 billion.

A declining market and regulatory pressures imply a significant restructuring of the industrial sector. The European Association of Automotive Suppliers[9] says that around 56,000 net jobs have been lost since 2020. Additionally, further job cuts (32,000) were announced in the first half of 2024 alone.

It is only a matter of time before European automakers start sourcing components from Chinese suppliers. The combination of short authorization processes, footprints in low-cost countries (Eastern Europe, Morocco), a presence throughout the value chain (from batteries to finished cars), aggressive business strategies and a strong ability to absorb losses in the short term explain why Chinese supplier costs are 20% to 30 %[10] lower than those of Western suppliers. Against this backdrop, new entrants are very well placed to gain market share in Europe over the next three to five years.

3) Northvolt Bankruptcy: Lessons and What Next, Jefferies, 27 November 2024
4) The Northvolt dilemma: can European EVs avoid relying on Asian batteries? Financial Times, 25 November 2024
5) Selon les estimations de Moody's, Automotive – Global, Outlook to negative on weaker sales, significant margin contraction, 16 October 2024
6) ACEA Pocket Guide 2024-2025, data not yet available
7) Financial Times, Ford to cut 4,000 jobs in Europe , 20 November 2024
8) Barclays European Autos, Auto Parts EU 2025 CO2 targets unpacking the big gap, Barclays, 23 September 2024
9) Published on 22.10.2024, Press Release: Worst job losses in the automotive supply industry since the pandemic, CLEPA
10) BNP Paribas Exane July 2024 Auto Suppliers/Expert access feedback: Chinese suppliers at the gates of Europe

«The game is not entirely over for European suppliers, as it is unlikely that new entrants will compete fiercely across all product categories.»



Is there a way out?

The game is not entirely over for European suppliers, as it is unlikely that new entrants will compete fiercely across all product categories. Chinese suppliers have a clear competitive advantage in electronics and software, positioning themselves as leaders in entertainment applications and autonomous driving. However, in the case of complex and heavy parts (such as powertrains, transmission, chassis, seats), Chinese manufacturers are not at the forefront of technological innovation. Instead, European suppliers have built extensive expertise and a long-standing reputation for high standards of quality and reliability.

At the same time, automakers have entered into negotiations to amend the European regulation that sets a CO_2 emissions reduction target for fleets sold by the end of 2025. They are also encouraging consumers with efforts to reduce the prices of new vehicles. Furthermore, some governments are beginning to increase their consumer subsidy programs. While Europe's environmental path toward carbon neutrality by 2050 is both clear and ambitious, its industrial policy suffers from a lack of proper structure, leading to a negative environmental impact.

Investing entails risks, particularly the risk of capital loss. It is not intended to promote direct investment.