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MARKETSHEARD ON THE STREET

BMW and Volkswagen Are Spending Whatever it Takes To Rival Tesla

Germany's car makers are investing ever more money into electric vehicles. Better brands have higher chances of making satisfactory financial returns.

BMW wants 15% of the total number of vehicles it sells this year to be all-electric, compared with 9% last year.
PHOTO: KRISZTIAN BOCSI/BLOOMBERG NEWS

By Stephen Wilmot Follow
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Making electric-vehicle investments pay off is a challenge for all auto makers, but it is easier if you can charge luxury prices.

Bayerische Motoren Werke, better known as BMW BMW **-0.19%** ▼ , closed the financial reporting season for the German car industry Wednesday with a glitzy annual conference for press and investors. It had already disclosed a record profit for last year, but its outlook was new, including a target for 15% of its sales volumes to be from all-electric vehicles this year, up from about 9% in 2022.

BMW has a complex history with EVs. It was an early adopter with the i3 a decade ago, but as Tesla grew, its German rival stepped back, emphasizing the value of "electrified" plug-in hybrids and flexible production lines that could work with multiple technologies. At its annual conference two years ago it shifted again, announcing the Neue Klasse, a new generation of EVs to be built on a dedicated production platform starting in 2025.

The flip-flopping is likely the result of BMW's early experience, when it must have discovered how hard it is to make EVs add up financially, combined with a culture of financial prudence. Unlike Volkswagen VOW **-3.21%** ▼ , which went all in on EVs after its 2015 diesel scandal, BMW was never going to throw money at a new technology without a lot of hesitation.

But now it is spending: Last year, capital expenditures amounted to a record 7.8 billion euros, equivalent to $8.37 billion and 5.5% of revenue. And they will grow: The company said Wednesday that it expects to invest 5.5% to 6% of revenue this year as it prepares its production network for the Neue Klasse. Research and development will cost another 4% to 5%, bringing total investments to 9.5% to 11% of revenue.

Compared with Volkswagen, though, BMW still appears thrifty. Germany's largest auto maker by sales headlined its annual conference on Tuesday with a pledge to invest €180 billion into capital expenditures and research and development over the five years through 2027, two-thirds of it in electric and digital technologies. Its last planning round through 2026 earmarked €159 billion. It expects this year to mark the peak, with investments amounting to 14.5% of revenue—about €46 billion at the midpoint of its guidance.
The spending is necessary for regulatory and competitive reasons. Governments across the world are taking car makers down the path of EVs with carrots, such as the U.S. tax credits, and sticks, such as European Union fines for carbon emissions above falling thresholds. Meanwhile, Tesla has shown that there is a way to make EVs profitable if you cut the existing industrial model to the bone, though its approach is in many ways unrepeatable and possibly unsustainable.

However, the necessity of EV investments doesn't mean they will make satisfactory financial returns. This is a quandary for car makers, and a key reason why many investors are parked on the sector's sidelines. Among the few favored stocks are top-end brands Ferrari and Porsche, which have the pricing power to make consumers pay for their investments. Porsche's car business made a return on investment of 24.9% last year, despite a big increase in its asset base.

Investors distinguish between Porsche's shares, which fetch 19 times forward earnings, and Volkswagen's, on about 4 times, even though the latter company still owns 75% of the former. There is room for debate about the German companies that lie between, BMW and Mercedes-Benz. They are valued like volume manufacturers on 6 to 7 times earnings, but Mercedes-Benz's profitability last year was more like Porsche's. Both companies are growing faster at the top end, where BMW also owns Rolls-Royce.

Gargantuan EV investments will pay the planet and consumers a better return than shareholders, but prestige brands are the industry's best line of defense.

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