Should BlackRock continue its position in Nikola? – An Analysis

Introduction

With its 4% stake, BlackRock Inc. (NYSE:BLK) is one of the leading institutional shareholders in Nikola Corporation (NYSE:NKLA), an American electric vehicle manufacturer[1]. This memo intends to offer BlackRock a thorough examination of Nikola in order to better understand its strategic goals and make competent investment decisions.

Nikola, based in Phoenix, Arizona, focuses on the development and commercialization of zero-emission heavy-duty battery-electric and hydrogen fuel cell vehicles, alongside other energy solutions. The company was founded in 2014 and went public in 2020. After an initially successful launch, with a valuation higher than that of Ford, the company has been embroiled in scandals.

In September 2020, prominent activist short selling firm Hindenburg Research accused Nikola of being "an intricate fraud" perpetrated largely by former CEO Trevor Milton[2]. He was later charged with three counts of criminal fraud and two counts of securities fraud. Prosecutors accused him of "lying about 'nearly all aspects of the business'"[3]. Publicly traded stock price as of July 8, 2023 is around US$1.4, as compared to lifetime high of over $65 in mid-2020.

BlackRock aims to always abide its principles[4]. They guide how the company interacts with each other, their clients, the communities in which BlackRock operates, and all of their other stakeholders. This memo argues that continued investment in Nikola in its current state would be a betrayal of their principles. BlackRock needs to either divest its stake or persuade the management of Nikola to make major changes in the way they operate. Anything less will not feasible.

General Assessment and Strategic Problems

Nikola appears to be beset by a number of strategic problems. First and foremost, amongst them is the lack of management credibility and extremely bad corporate governance.

Nikola's management has perpetuated fraud, engaged in deceptive practices and exaggerated its technological capabilities. Even though the former CEO Milton has resigned from the company, he remains a major shareholder with his 20% stake in the company. The new management has not been able to refocus the company towards profitability either, and the general instability around the company makes it hard for them to do so.

This lack of good management leads into the other major problems the company faces. The company is unable to effectively execute its production plans and deliver on its promises within a reasonable timeframe. Production rates are falling while competitors move full speed

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[1] https://www.wsj.com/articles/nikola-production-declines-after-fire-at-headquarters-1ea296aa
[2] https://hindenburgresearch.com/nikola/
[3] https://www.nytimes.com/2021/07/29/business/nikola-trevor-milton-fraud.html
[4] https://www.blackrock.com/corporate/about-us/mission-and-principles

ahead, and the company is unable to raise desperately needed capital due to their bad reputation. A plan for increasing outstanding shares to raise capital was rejected by shareholders. The company is struggling with high costs, and the recent pause of manufacturing has added to their backlog. In fact, the company now has less in cash holdings than what it spends in one quarter. While companies in developing technology industries often struggle with profitability initially, Nikola is in a uniquely bad situation.

In addition, the company also seems to lack a clear focus, as is evident from their multiple failed partnerships. In 2020, a high-profile and potentially very valuable partnership with General Motors was terminated. Another partnership with RepublicServices, the second largest waste disposal agency in the United States, fell through as well. Nikola then proceeded to acquire the battery company Romeo Power in 2022, which it has now divested of. They also got out of a joint venture with the European automaker Iveco Group.

The company is flailing around without a coherent vision of what exactly it intends to do. While Nikola has now redirected its focus to hydrogen fuel cell based trucks for the North American market, past performance doesn't give much reason to be confident of the management being capable of executing these plans.

External Analysis and Industry Dynamics

Despite all the problems Nikola faces, the industry it belongs is poised for a bright future. The global push for clean energy and decarbonization has created significant opportunities for electric vehicle companies like Nikola. In the United States in particular, the Biden administration has enacted regulations and policies favoring clean energy which Nikola can capitalize on. BlackRock's significant investment in Nikola too was motivated by its ESG potential. Other institutional investors are similarly motivated and geared up for huge investments in the clean energy vehicle industry. Nonetheless, this is a very competitive industry with well-established players like Tesla and Rivian, who are titans in this industry and do not face the major challenges Nikola does, which adds pressure to the company.

In order to get a comprehensive and holistic understanding of Nikola's external environment, a Porter's Five Forces analysis would be very useful. This would highlight the challenges and opportunities Nikola faces, helping to inform decision-making and identifying areas for potential solutions to their strategic problems.

Porter's Five Forces

1. Threat of New Entrants:
   This is a moderate threat. While the industry has significant growth potential, high capital costs, advanced technology, and supply chain complexity remain barriers to entry that limit the entry of new competitors. However, as the clean energy vehicle market becomes larger, already established players with huge capital reserves are going to enter the market, posing a major threat. This is already happening with companies like Toyota, Ford, General Motors etc seeking to enter the EV industry.
2. Bargaining Power of Suppliers:

This is a significant threat as EVs rely on advanced and specialized technologies that suppliers excel in producing, giving them an upper hand. Nikola relies on various suppliers for components like batteries, motors, and EV-related technologies. They did try to circumvent this by purchasing a battery manufacturer Romeo Power, but that did not work out as previously mentioned. Additionally, the availability of critical materials like lithium for batteries is limited and expensive, which impacts the company's cost structure. However, the EV supplier industry itself faces a threat of new entrants and that may lower their bargaining power in the future.

3. Bargaining Power of Buyers:
   Buyers have good bargaining power in the EV industry and their power is only going to get higher. Companies like Tesla and Rivian offer customers a wide range of options, including trucks (which was Nikola's main differentiator) and traditional automakers are entering the market as well. Nikola faces major challenges in this area, with their declining production rates and inability to meet deadlines, as customers will not stick to an unreliable company when so many different reliable options exist.
4. Threat of Substitute Products:
   The threat of substitute products in the EV industry is moderate, but for Nikola this may become another major problem. The company has tried to differentiate itself by offering unique EV trucks, but Tesla, in fact, appears to be ahead of them. Nikola is relying heavily on its hydrogen-based technologies to differentiate itself, and while that is a promising market, Nikola's ability to actually capture it remains in question.
5. Competitive Rivalry:
   The competitive rivalry in the EV industry is high, as mentioned earlier. Nikola faces competition from players like Tesla, Rivian and Lucid Motors, in addition to traditional automakers now entering the industry.

Another valuable framework to further understand the broad industry environment is PESTEL.

1. Political Factors: With a worldwide political emphasis on producing green technologies, policies and regulations promoting clean energy and emission reductions create favorable conditions for companies like Nikola. The Biden administration has set ambitious goals, such as achieving net-zero emissions by 2050 and transitioning the federal government's vehicle fleet to electric vehicles. Also proposed are significant investments in infrastructure, including the development of electric vehicle charging networks, making it easier for consumers to adopt electric vehicles.
2. Economic Factors: Factors like economic growth, disposable income, and consumer confidence influence purchasing and investment decisions. Should a recession be around the corner, as many analysts predict, Nikola will face major challenges to raise capital and make sales, something it already struggles with.
3. Social Factors: These are favorable to Nikola as well. Increasing environmental consciousness and a shift towards sustainability among consumers influences the acceptance and demand for EVs. Preferences for clean transportation, and a desire for reduced carbon footprints drive EV adoption as well. This combined with a government push presents major opportunities.

4. Technological Factors: Technological innovations are of course critical in a developing industry. Developments in battery technology, charging infrastructure, autonomous driving, and connectivity all influence Nikola's outcomes. A major fork road in the industry is the electric/hydrogen rivalry. As Nikola has decided to focus on hydrogen, it has to remain abreast of research and development in hydrogen fuel and build broad coalitions to push for the embrace of hydrogen-based technologies over electric.
5. Environmental Factors: This is self-evidently a driving factor for Nikola. Their focus on electric and hydrogen fuel cell technology aligns with the growing environmental concerns and moves towards zero emissions, positioning the company well.
6. Legal Factors: Regulations related to safety, emissions, intellectual property, and trade keep evolving and Nikola has to comply with them. Stringent emission regulations open up new markets for Nikola as well.

Internal Analysis

Nikola experienced a decline in production, falling to 33 units in the quarter ending on June 30, compared to 63 units in the previous quarter. However, deliveries rose to 66 trucks through retail channels, up from 33 in the previous quarter, and 45 through wholesale, up from 31. The company still has a backlog of 140 orders. Nikola has been facing high costs and recently announced layoffs of about 10% of its workforce, as part of its efforts to reduce cash expenditure. The company's shares have lost nearly three-quarters of their value in the past 12 months.

While revenue for the company is still growing, up to US$50 million in FY22[5]. In the latest quarter, the company made $11M in revenues. The problem lies in the fact that their costs for generating these sales were around $44M. The company has around $206M in cash, while their quarterly operating costs are around $240M. To say that these financials are unsustainable is an understatement[6].

The core competency of Nikola lies in their innovative hydrogen-based technologies, and their ESG potential. This is one area that they have an edge over their rivals. Hydrogen based fuel cells are more energy efficient and produce zero emissions. They are also very expensive and need critical infrastructure that is not yet built. Nikola has recently refocused all its efforts towards becoming a pioneer in the hydrogen EV market in North America. To this end, they divested their shares in Iveco, which gives them a much-needed capital infusion of $35M. The recent $41M grant they secured from the California Transport Commission will also prove helpful[7]. They also entered into a deal with Voltera to build 50 more fuel stations, in addition to their longstanding partnership with Bosch[8].

While clarifying their focus to hydrogen is a good plan, battery electric vehicles have a huge head-start in the clean energy vehicle market. And even if hydrogen technologies prove to be

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[5] https://www.sec.gov/ix?doc=/Archives/edgar/data/1731289/000173128923000013/nkla-20221231.htm
[6] https://www.nikolamotor.com/investor-events/
[7] https://www.prnewswire.com/news-releases/nikola-secures-41-9-million-grant-accelerating-zero-emissions-infrastructure-for-heavy-duty-hydrogen-fuel-cell-electric-trucks-in-california-301870507.html
[8] https://www.nikolamotor.com/press_releases/nikola-corporation-reports-first-quarter-2023-results/

the future, established players like Toyota are ready to enter that market. Nikola will have to move fast without faltering if seeks to realize these gains. This will only be possible under very competent management.

The internal dynamics of Nikola can be summarized with the VRIO framework – the company has valuable resources in terms of technological know-how, these resources and capabilities are rare, but they are not inimitable, as their main rivals Tesla and Rivian are burrowing their way into clean energy trucks, and Toyota is developing hydrogen-based capabilities. As to being well organized, Nikola faces serious management problems and is not in any good position to leverage its valuable and rare capabilities.

Diagnostics
The internal and external dynamics of Nikola can be synthesized in a SWOT analysis.

- Strengths:

1. Innovative Technology: Nikola's hydrogen fuel cell technologies are a strong suit and can position the company as a leader in the zero-emission transportation industry.
2. ESG potential: The company has gained significant attention due to its ESG potential, which has helped in attracting investors and strategic partnerships.

- Weaknesses:

1. Bad Management and Bad Reputation: Unstable and fraudulent management make it hard for the company to realize its potential and stick to any strategic plan. The company's legal challenges of fraud, misrepresentations, and deceptive practices, which have damaged its reputation and investor confidence.
2. Limited Production and Revenue: Nikola fails to generate substantial revenue and is unable to execute production efficiently.
3. Volatile Partnerships: Nikola lacks a coherent plan for its alliances. They enter into and leave alliances and deals constantly which makes it hard to execute any plan.

- Opportunities:

1. Industry growth potential: Increasing consumer demand for clean transportation present a lot of opportunities for Nikola.
2. Government Initiatives: Government regulations and infrastructure development for hydrogen fuel cell and electric vehicles can benefit Nikola.

- Threats:

1. Intense Competition: The industry is highly competitive, with established automakers, and new companies investing heavily in similar technologies.
2. Supply Chain Disruption: Nikola is vulnerable to supply chain risks, as it depends on a complicated global supply chain for essential components like as batteries and hydrogen infrastructure.
3. Technological Advancements: This is a rapidly advancing industry and Nikola has to keep up with market changes together with shifting consumer tastes to remain competitive.

Recommendations for Nikola
Nikola's shift in focus to the North American market and their singular focus on hydrogen technologies reflects a strategic adjustment to internal and external factors. The company still needs to streamline production, engage in cost control, and to strengthen partnerships in order to align strategies to the environment appropriately. In addition, Nikola has to become more transparent and communicate honestly with stakeholders, providing regular updates efforts to address challenges. The corporate culture has to change if the company wants to survive.

Recommendations for BlackRock
BlackRock's first principle is their fiduciary duty to their clients. In order to remain true to that duty, BlackRock needs to reconsider its position in Nikola. The company's long-term prospects remain very uncertain. Even if the company manages to solve its challenges, it is unlikely to ever regain the value it had when it launched.

BlackRock, along with other institutional investors could pursue a campaign to pressurize the management to engage in a major restructuring of the company, but it will be complicated task. BlackRock has already sold substantial holdings in Nikola, and is now down to a 4% stake from the 9.4% stake it initially had[9]. The best course of action might be to simply divest all of BlackRock's holdings in Nikola, or at least to reduce them further.

While Nikola's core technology does have potential, the company doesn't have the time, capital and human resources to tackle the significant obstacles in faces. BlackRock cannot act as a policeman to Nikola when there are so many better alternatives available to invest in.

[9] https://fintel.io/so/us/nkla/blackrock