

## PACCAR Inc

# Cycle concerns exist but can't ignore stronger EPS power: upgrade to Neutral

Rating Change: NEUTRAL | PO: 97.00 USD | Price: 95.38 USD

## Upgrade to Neutral

We upgrade our PCAR rating to Neutral from Underperform. While we expect the truck production cycle to be in a downturn in 2024, this is largely captured in expectations. Consensus forecasts earnings down 15% in 2024, one of the largest declines in our coverage. We see evidence that this downturn is likely contained to one year (spot freight rates bottoming, BofA trucker survey inflecting, EPA 2027 around the corner), underpinning a higher multiple. We still see risks to the cycle (used truck market is deteriorating, Europe) yet PCAR's earnings power is stronger than we appreciated.

## Trucks: downturn in 2024 yet captured in expectations

ACT expects NA truck production to fall 20% to 272k units in '24 – closer to normalized levels – following the ramp in production ('21: 264k, +23%, '22 315k, +19%, '23e: 339k, +8%). The good news is this downturn is reflected in consensus (2024 EPS down 15% YoY). The upside risk is if spot freight rates recover, the downturn is likely a one year event. The EPA27 change is likely to drive a pre-buy (i.e., new models post regulatory change could be ~\$25k more expensive), underpinning a certain level units in 2025-26.

## (Much) stronger earnings power than realized

PCAR is earning significantly higher gross margin on a nearly similar truck deliveries cycle over cycle: 2023e: ~19%, 204k units vs 2019: ~15%, 199k units. While we attribute some of this to unique supply/demand factors (i.e., strong pricing), we believe a large part is tied to PCAR's execution - focus on growing high margin parts business (25.1% of pretax profit vs 14% in 2012) and market share gains (exhibit 3). Additionally, we wonder if the industry is a bit more pricing focused following consolidation in recent years.

## Neutral: cycle concerns, not completely out of the woods

We update our estimates (2024e \$7.75 vs \$7.00) to reflect stronger execution in a downcycle. Our estimates are above consensus (\$7.59). We raise our PO to \$97 (\$84) based on 12.5x 2024e (vs 12x prior) as we believe a slightly higher multiple is warranted given the stronger earnings power vs prior cycles. While we are more confident on the depth of the truck downturn, cyclical risks remain: used truck values are falling YoY, used inventories are rising YoY, and Europe is still uncertain (26% of PCAR).

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	3.56	5.75	9.18	7.75	8.25
EPS Change (YoY)	43.0%	61.5%	59.7%	-15.6%	6.5%
Consensus EPS (Bloomberg)			8.90	7.61	8.22
DPS	0.89	0.93	1.04	1.14	1.26
Valuation (Dec)					
P/E	26.8x	16.6x	10.4x	12.3x	11.6x
Dividend Yield	0.9%	1.0%	1.1%	1.2%	1.3%
EV / EBITDA*	21.2x	13.2x	7.9x	9.2x	8.6x
Free Cash Flow Yield*	2.2%	4.3%	6.6%	5.7%	5.9%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 6.

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Timestamp: 19 January 2024 06:00AM EST

19 January 2024

## Equity

### Key Changes

(US\$)	Previous	Current
Inv. Opinion	B-3-7	B-2-7
Inv. Rating	UNDERPERFORM	NEUTRAL
Price Obj.	84.00	97.00
2023E Rev (m)	33,386.7	33,404.0
2024E Rev (m)	29,494.1	30,778.3
2025E Rev (m)	32,596.6	32,998.8
2023E EPS	9.00	9.18
2024E EPS	7.00	7.75
2025E EPS	7.75	8.25

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## Stock Data

Price	95.38 USD
Price Objective	97.00 USD
Date Established	19-Jan-2024
Investment Opinion	B-2-7
52-Week Range	62.67 USD - 98.20 USD
Mrkt Val (mn) / Shares Out (mn)	50,017 USD / 524.4
Free Float	98.2%
Average Daily Value (mn)	219.38 USD
BofA Ticker / Exchange	PCAR / NAS
Bloomberg / Reuters	PCAR US / PCAR.OQ
ROE (2023E)	51.8%
Net Dbt to Eqty (Dec-2022A)	-51.0%
ESGMeter <sup>TM</sup>	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

# iQprofile<sup>SM</sup> PACCAR Inc

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	16.4%	24.7%	38.4%	29.4%	28.2%
Return on Equity	25.4%	36.0%	51.8%	38.9%	36.2%
Operating Margin	8.5%	11.3%	16.0%	14.7%	14.8%
Free Cash Flow	1,113	2,162	3,304	2,856	2,968

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.2x	1.0x	1.2x	1.3x	1.3x
Asset Replacement Ratio	4.0x	2.6x	6.2x	5.7x	6.1x
Tax Rate	22.1%	21.8%	22.0%	22.0%	22.0%
Net Debt-to-Equity Ratio	-41.6%	-51.0%	-49.2%	-51.6%	-53.6%
Interest Cover	NA	NA	NA	NA	NA

## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	21,835	27,314	33,404	30,778	32,999
% Change	27.3%	25.1%	22.3%	-7.9%	7.2%
Gross Profit	2,737	4,023	6,404	5,731	6,260
% Change	31.7%	47.0%	59.2%	-10.5%	9.2%
EBITDA	2,136	3,422	5,754	4,922	5,286
% Change	34.0%	60.2%	68.1%	-14.5%	7.4%
Net Interest & Other Income	526	759	825	695	670
<b>Net Income (Adjusted)</b>	<b>1,862</b>	<b>3,012</b>	<b>4,816</b>	<b>4,065</b>	<b>4,329</b>
<b>% Change</b>	<b>43.4%</b>	<b>61.7%</b>	<b>59.9%</b>	<b>-15.6%</b>	<b>6.5%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	1,862	3,012	4,816	4,065	4,329
Depreciation & Amortization	270	332	405	405	405
Change in Working Capital	(352)	(547)	(112)	(6)	9
Deferred Taxation Charge	(213)	(208)	0	0	0
Other Adjustments, Net	619	438	700	700	700
Capital Expenditure	(1,074)	(866)	(2,505)	(2,308)	(2,475)
<b>Free Cash Flow</b>	<b>1,113</b>	<b>2,162</b>	<b>3,304</b>	<b>2,856</b>	<b>2,968</b>
<b>% Change</b>	<b>-41.4%</b>	<b>94.2%</b>	<b>52.8%</b>	<b>-13.5%</b>	<b>3.9%</b>
Share / Issue Repurchase	(2)	(2)	0	0	0
Cost of Dividends Paid	(708)	(1,005)	(2,225)	(949)	(1,009)
Change in Debt	(236)	906	0	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	3,254	4,545	4,773	5,780	6,839
Trade Receivables	1,575	1,920	2,348	2,163	2,319
Other Current Assets	4,268	4,495	5,045	5,061	5,421
Property, Plant & Equipment	3,398	3,468	3,713	4,008	4,303
Other Non-Current Assets	1,595	1,668	1,668	1,668	1,668
<b>Total Assets</b>	<b>14,091</b>	<b>16,096</b>	<b>17,547</b>	<b>18,680</b>	<b>20,550</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	4,452	5,486	6,153	5,778	6,103
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	1,817	1,699	1,699	1,699	1,699
<b>Total Liabilities</b>	<b>6,269</b>	<b>7,186</b>	<b>7,852</b>	<b>7,478</b>	<b>7,802</b>
<b>Total Equity</b>	<b>7,822</b>	<b>8,910</b>	<b>9,695</b>	<b>11,203</b>	<b>12,748</b>
<b>Total Equity &amp; Liabilities</b>	<b>14,091</b>	<b>16,096</b>	<b>17,547</b>	<b>18,680</b>	<b>20,550</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Sector

Truck/Bus Manufacturers

## Company Description

PACCAR (PCAR), fifth-largest manufacturer of medium and heavy trucks worldwide and third-largest in North America, is recognized for its premium brands, above-average profitability and high returns. PACCAR's three businesses are: 1) Trucks (which designs, manufactures and markets medium and heavy trucks and related after-market parts), 2) Financial Services (which leases and finances PACCAR's trucks and related equipment), and 3) Other.

## Investment Rationale

We rate PACCAR Neutral. PACCAR has a strong long-term track record of growing earnings and FCF, taking market share with superior products, and improving returns. We expect the truck production cycle to be in a downturn in 2024 and risks remain (used values, inventories, Europe). That said, PCAR is delivering higher gross margin on nearly similar truck deliveries - demonstrating cycle over cycle improvement.

## Stock Data

Average Daily Volume 2,264,295

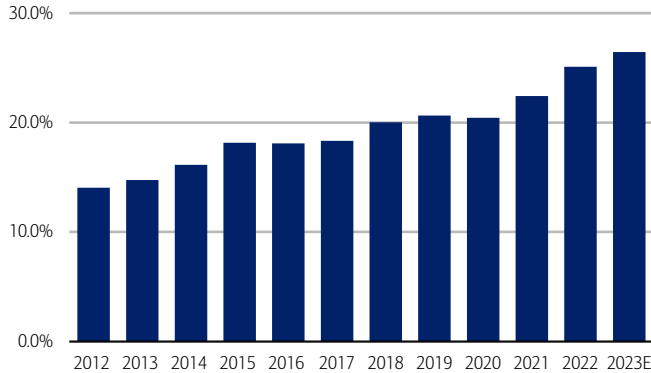
## Quarterly Earnings Estimates

	2022	2023
Q1	1.15A	2.25A
Q2	1.38A	2.33A
Q3	1.47A	2.34A
Q4	1.76A	2.26E

# Key charts

## Exhibit 1: PCAR pretax parts profit

Parts is a bigger portion of profit for PCAR

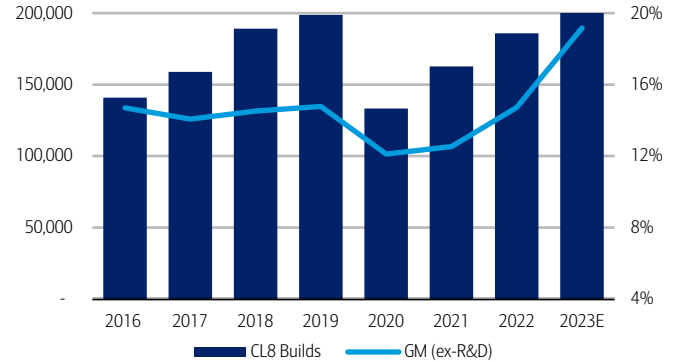


Source: Company Filings

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## Exhibit 2: PCAR truck deliveries vs Gross Margin (ex- R&D)

Truck deliveries are recovering yet gross margins are higher

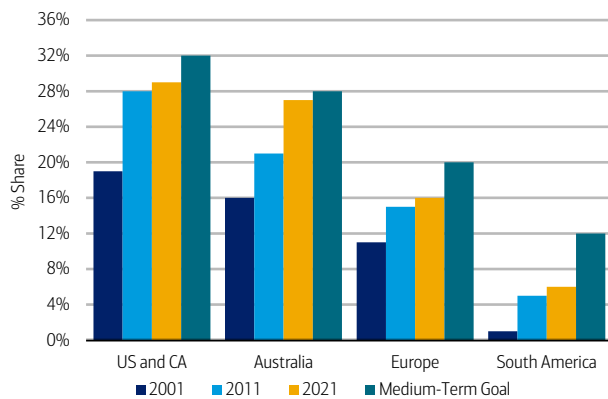


Source: Company Filings

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## Exhibit 3: PCAR Heavy Duty Market Share

PCAR has been increasing their market share across all geographies

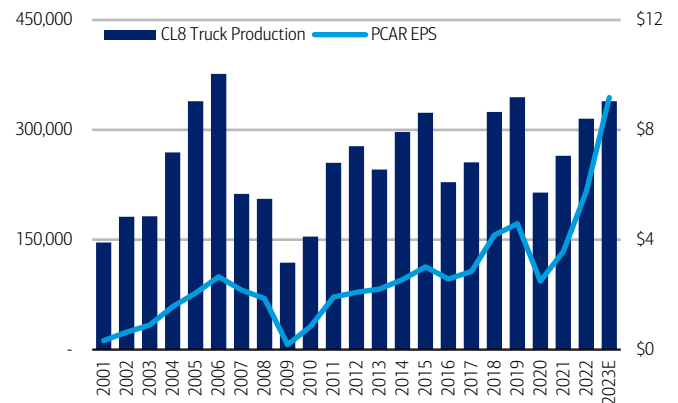


Source: PACCAR Investor Day 2022 Presentation

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## Exhibit 4: CL8 Annual truck production vs PCAR EPS

PCAR is earning more through the cycle

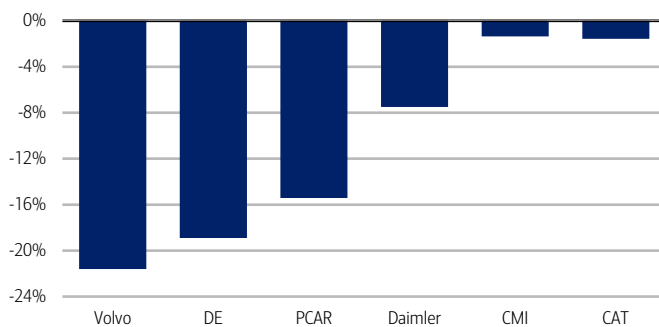


Source: ACT, Company Filings

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## Exhibit 5: 2024 Adj EPS Growth YoY (Consensus)

Consensus forecasts ~15% EPS decline next year for PCAR

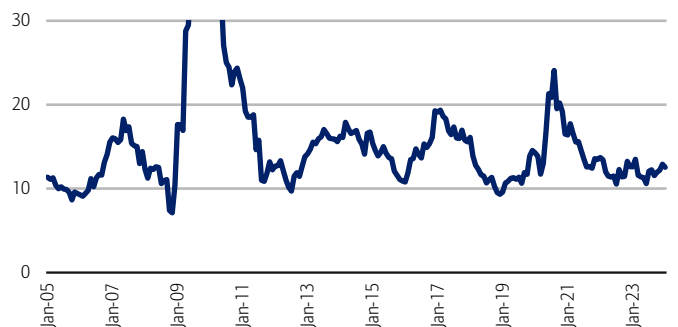


Source: Bloomberg

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## Exhibit 6: PCAR fwd P/E

PCAR 12-month forward PE is approaching mid cycle territory

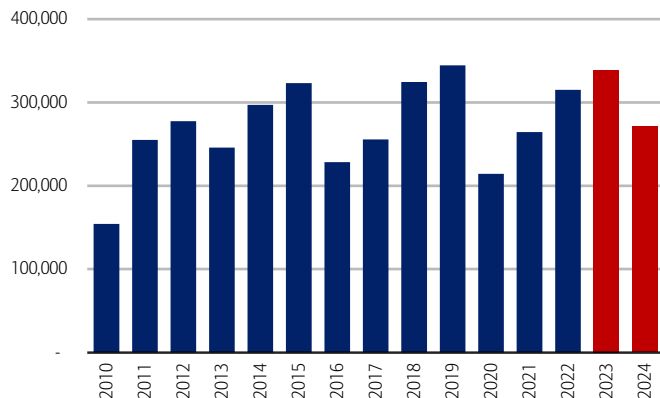


Source: Company Filings, Bloomberg

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**Exhibit 7: CL8 Truck Production**

ACT expects truck production to decline 20% YoY in 2024

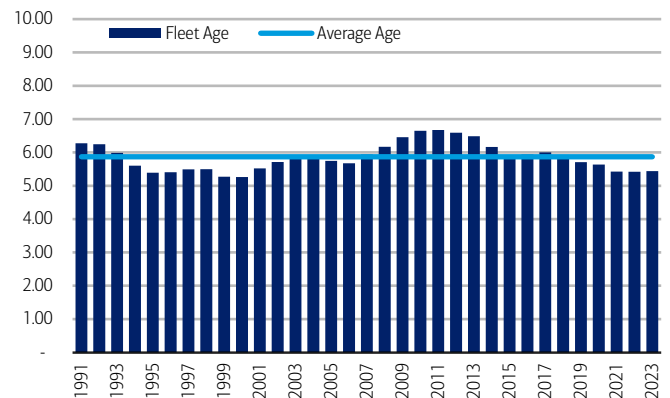


Source: ACT

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**Exhibit 8: NA CL8 Average Truck Fleet Age**

NA CL8 Truck fleet is normalizing after years of robust orders/production

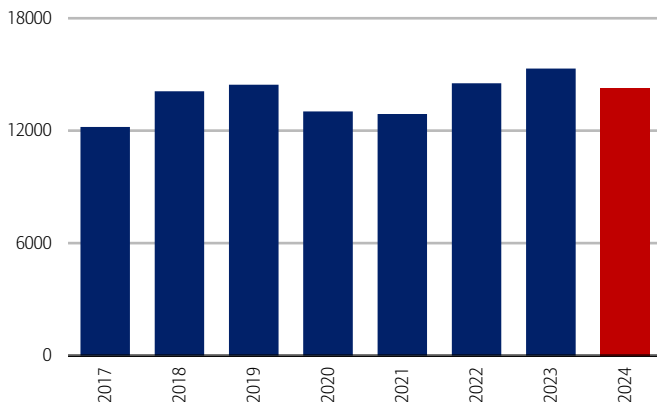


Source: ACT

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**Exhibit 9: Trucker Capex**

Trucker capex is expected to be down in 2024

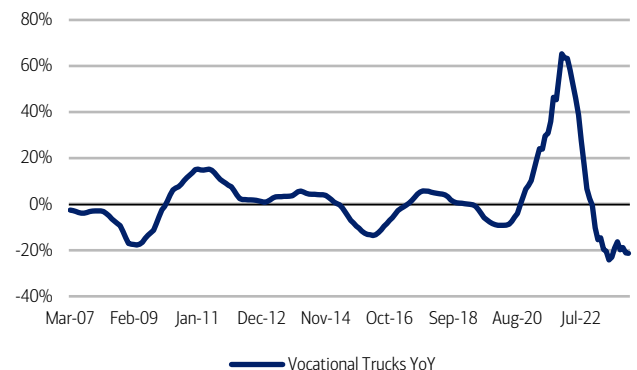


Source: Company Filings (includes: J.B. Hunt, Werner, Arcbest, Knight-Swift, FedEx, UPS)

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**Exhibit 10: Used Vocational Trucks YoY**

Used truck prices have been falling

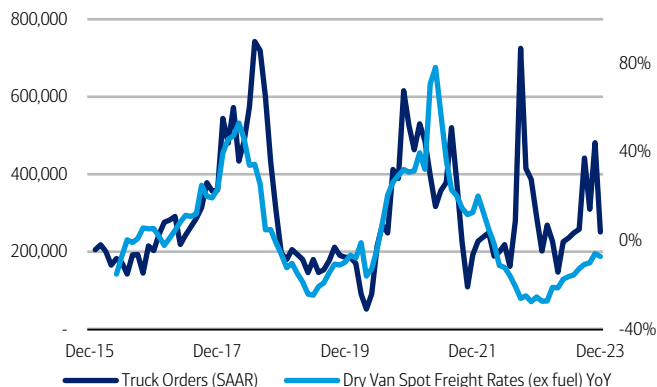


Source: RB Global

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**Exhibit 11: Heavy Duty truck orders (SAAR) vs Spot Freight Rates YoY**

Order rates running ahead of spot freight rates

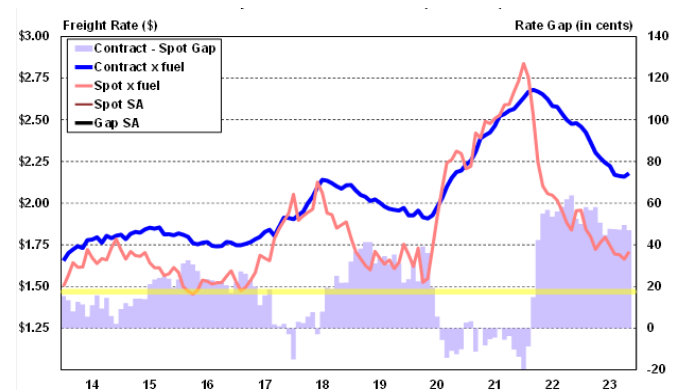


Source: Bloomberg, ACT

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**Exhibit 12: DAT Trendlines Spot Rates: Aggregate Revenue per Mile**

Spot rates have been trending down with a wide spread vs contract



Source: DAT Solutions, ACT Research Co. ©2023

Source: ACT

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## Price objective basis & risk

### PACCAR Inc (PCAR)

Our \$97 price objective is based on 12.5x 2024E EPS. Our 2024E EPS estimate assumes a peak class 8 SAAR of 335k in 2023 and a return to more replacement demand levels by 2024. PACCAR valuation range is typically 10-20x earnings over the cycle, with the lower end of the range (10x) typically applied to peak. We think the higher multiple is warranted in 2024 as we are one year removed from peak and closer to mid-cycle. We do not believe the higher end of the valuation range is appropriate given depressed spot freight rates and concerns on the cycle.

Upside risks to our price objective are 1) faster than expected recovery in used truck pricing, 2) better than expected incremental margins, 3) sector M&A, 4) more robust scenario in Europe than we are forecasting.

Downside risks to our price objective are: 1) Continued COVID-19 driven demand declines including the potential for another wave, 2) steeper than expected decline in Class 8 orders, 3) European truck registrations decelerate at a faster than expected pace, 4) renewed pressure in used truck prices.

## Analyst Certification

I, Michael Feniger, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	AECOM	ACM	ACM US	Michael Feniger
	Blue Bird Corp	BLBD	BLBD US	Sherif El-Sabbahy
	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Knife River Corp	KNF	KNF US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
<b>NEUTRAL</b>				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Fluor	FLR	FLR US	Michael Feniger
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger



**US - Machinery Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger
<b>UNDERPERFORM</b>				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger
	Terex Corp.	TEX	TEX US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethod<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

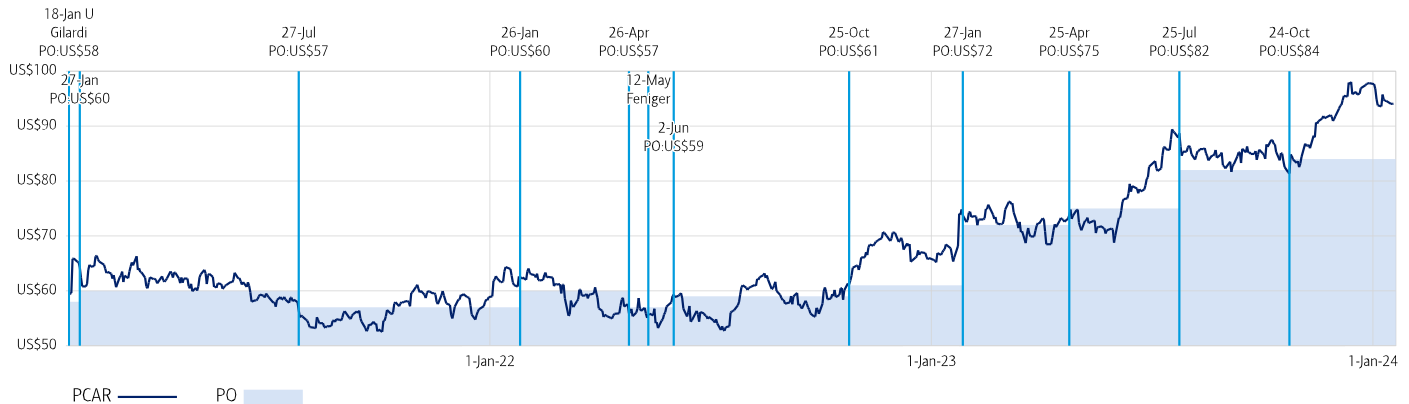
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# Disclosures

## Important Disclosures

### PACCAR Inc (PCAR) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Autos Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	67	55.83%	Buy	39	58.21%
Hold	30	25.00%	Hold	15	50.00%
Sell	23	19.17%	Sell	12	52.17%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

**INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

Price Charts for the securities referenced in this research report are available on the [Price Charts website](#), or call 1-800-MERRILL to have them mailed.

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