

PACCAR Inc

Strong finish – can we start to look through to 2025 already?

Reiterate Rating: NEUTRAL | PO: 102.00 USD | Price: 97.09 USD

Positive merits: bit too early to look pending downturn

PCAR capped off an impressive '23 with a strong Q4. Last week, we upgraded PCAR to Neutral as we feel the '24 truck production downturn is captured in cons. The debate near-term is around the sustainability of PCAR's margin profile as the truck market faces a production decline. In our view, the bigger story for PCAR (and Machinery as a whole) in '24 is who can ultimately grow earnings in '25? There is some merit for PCAR: EPA2027 likely pulls forward some units, spot freight rates recover in '24. That said, we believe it might be a bit too early to 'look through' a downturn that is just starting to materialize (ACT sees biggest production declines in 2H, trucker capex down, early trucker commentary hints at a normalized fleet age, used values still soft). Neutral.

Delivering the goods: rebasing margin on similar units

PCAR reported a strong Q4 (adj EPS \$2.70, up 53% YoY) – please see page 2 for more details. The bright spot was another strong gross margin quarter: 19.4%, +350bps YoY vs BofAe 19%), capping off a record year (19.3%, +450bps YoY). While the Q1 guide of 18.5-19% let some air out of the momentum (down QoQ), PCAR's EPS power is notable. PCAR reported a gross margin of 19.4% in Q4 on 51.1k units compared to 5 years ago (Q418) of 14.2% on 50.4k units. While some of this is higher contribution of parts, even truck pretax profit margin is notably higher vs a similar unit figure (14.3% vs 9.2%).

Early trucker commentary hints at pending downturn

ACT expects truck production to decline 20% in 2024, with the biggest portion of the decline in the 2H. We are sensing truckers are pulling back: BofA's analysis on trucker capex suggests a decline in 2024, public trucker JB Hunt highlighted they cleared out older equipment and feel the fleet is refreshed into 2024, spot freight rates remain weak (bottoming, but soft). Another area for concern is our recent used equipment call – highlighting rising inventories and widening spread in the used pricing market. Our concern is if this caps the pricing upside following a few years of strong growth.

Neutral: Raising estimates and PO

We raise our 2024 estimates 1% to \$7.85 on the back of a strong Q4 result. We raise our PO to \$102 based on 13x 2024e EPS, as we believe a slightly higher multiple is warranted (vs 12.5x) given the improved margin performance. We reiterate our Neutral rating on a more balanced risk/reward: strong execution yet some cycle caution.

| Estimates (Dec) (US\$) | 2022A | 2023A | 2024E | 2025E | 2026E |
|---------------------------|-------|-------|--------|-------|-------|
| EPS | 5.75 | 9.61 | 7.85 | 8.50 | 9.00 |
| GAAP EPS | 5.75 | 8.76 | 7.85 | 8.50 | 9.00 |
| EPS Change (YoY) | 61.5% | 67.1% | -18.3% | 8.3% | 5.9% |
| Consensus EPS (Bloomberg) | | | 7.60 | 8.22 | 8.87 |
| DPS | 0.93 | 1.04 | 1.14 | 1.26 | 1.38 |
| Valuation (Dec) | | | | | |
| P/E | 16.9x | 10.1x | 12.4x | 11.4x | 10.8x |
| GAAP P/E | 16.9x | 11.1x | 12.4x | 11.4x | 10.8x |
| Dividend Yield | 1.0% | 1.1% | 1.2% | 1.3% | 1.4% |
| EV / EBITDA* | 13.5x | 8.0x | 9.2x | 8.5x | 8.0x |
| Free Cash Flow Yield* | 4.2% | 6.1% | 5.8% | 6.1% | 6.3% |

* For full definitions of *IQmethod*SM measures, see page 5.

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Timestamp: 23 January 2024 04:33PM EST

23 January 2024

Equity

Key Changes

| (US\$) | Previous | Current |
|---------------|----------|----------|
| Price Obj. | 97.00 | 102.00 |
| 2024E Rev (m) | 30,778.3 | 30,476.8 |
| 2025E Rev (m) | 32,998.8 | 33,321.9 |
| 2026E Rev (m) | NA | 36,033.4 |
| 2024E EPS | 7.75 | 7.85 |
| 2025E EPS | 8.25 | 8.50 |
| 2026E EPS | NA | 9.00 |

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Stock Data

| | |
|---------------------------------|-----------------------|
| Price | 97.09 USD |
| Price Objective | 102.00 USD |
| Date Established | 23-Jan-2024 |
| Investment Opinion | B-2-7 |
| 52-Week Range | 63.88 USD - 98.20 USD |
| Mrkt Val (mn) / Shares Out (mn) | 50,914 USD / 524.4 |
| Free Float | 98.2% |
| Average Daily Value (mn) | 224.27 USD |
| BofA Ticker / Exchange | PCAR / NAS |
| Bloomberg / Reuters | PCAR US / PCAR.OQ |
| ROE (2024E) | 42.9% |
| Net Dbt to Eqty (Dec-2023A) | -48.2% |
| ESGMeter™ | 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".

PCAR: Paccar

Cons: Consensus

iQprofileSM PACCAR Inc

iQmethodSM – Bus Performance*

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|----------------------------|-------|-------|-------|-------|-------|
| Return on Capital Employed | 24.7% | 40.2% | 32.2% | 34.3% | 35.6% |
| Return on Equity | 36.0% | 54.9% | 42.9% | 45.0% | 46.2% |
| Operating Margin | 11.3% | 16.2% | 15.1% | 15.1% | 14.9% |
| Free Cash Flow | 2,162 | 3,101 | 2,973 | 3,116 | 3,184 |

iQmethodSM – Quality of Earnings*

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|--------------------------|--------|--------|--------|--------|--------|
| Cash Realization Ratio | 1.0x | 1.1x | 1.3x | 1.3x | 1.2x |
| Asset Replacement Ratio | 2.6x | 6.0x | 5.2x | 5.7x | 6.1x |
| Tax Rate | 21.8% | 20.1% | 22.0% | 22.0% | 22.0% |
| Net Debt-to-Equity Ratio | -51.0% | -48.2% | -44.8% | -42.1% | -39.7% |
| Interest Cover | NA | NA | NA | NA | NA |

Income Statement Data (Dec)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|------------------------------|--------------|--------------|---------------|--------------|--------------|
| Sales | 27,314 | 33,316 | 30,477 | 33,322 | 36,033 |
| % Change | 25.1% | 22.0% | -8.5% | 9.3% | 8.1% |
| Gross Profit | 4,023 | 6,421 | 5,669 | 6,321 | 6,846 |
| % Change | 47.0% | 59.6% | -11.7% | 11.5% | 8.3% |
| EBITDA | 3,422 | 5,821 | 5,030 | 5,465 | 5,802 |
| % Change | 60.2% | 70.1% | -13.6% | 8.7% | 6.2% |
| Net Interest & Other Income | 759 | 912 | 695 | 695 | 695 |
| Net Income (Adjusted) | 3,012 | 5,047 | 4,122 | 4,462 | 4,724 |
| % Change | 61.7% | 67.6% | -18.3% | 8.2% | 5.9% |

Free Cash Flow Data (Dec)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|--|--------------|--------------|--------------|--------------|--------------|
| Net Income from Cont Operations (GAAP) | 3,012 | 5,494 | 4,122 | 4,462 | 4,724 |
| Depreciation & Amortization | 332 | 415 | 440 | 440 | 440 |
| Change in Working Capital | (547) | (116) | (4) | 14 | 22 |
| Deferred Taxation Charge | (208) | 0 | 0 | 0 | 0 |
| Other Adjustments, Net | 438 | (193) | 700 | 700 | 700 |
| Capital Expenditure | (866) | (2,499) | (2,286) | (2,499) | (2,703) |
| Free Cash Flow | 2,162 | 3,101 | 2,973 | 3,116 | 3,184 |
| % Change | 94.2% | 43.5% | -4.1% | 4.8% | 2.2% |
| Share / Issue Repurchase | (2) | 0 | 0 | 0 | 0 |
| Cost of Dividends Paid | (1,005) | (2,226) | (2,279) | (2,339) | (2,405) |
| Change in Debt | 906 | 0 | 0 | 0 | 0 |

Balance Sheet Data (Dec)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & Equivalents | 4,545 | 4,570 | 4,363 | 4,240 | 4,119 |
| Trade Receivables | 1,920 | 2,342 | 2,142 | 2,342 | 2,533 |
| Other Current Assets | 4,495 | 5,035 | 5,038 | 5,445 | 5,852 |
| Property, Plant & Equipment | 3,468 | 3,703 | 3,963 | 4,223 | 4,483 |
| Other Non-Current Assets | 1,668 | 1,668 | 1,668 | 1,668 | 1,668 |
| Total Assets | 16,096 | 17,318 | 17,175 | 17,919 | 18,655 |
| Short-Term Debt | 0 | 0 | 0 | 0 | 0 |
| Other Current Liabilities | 5,486 | 6,132 | 5,732 | 6,153 | 6,572 |
| Long-Term Debt | 0 | 0 | 0 | 0 | 0 |
| Other Non-Current Liabilities | 1,699 | 1,699 | 1,699 | 1,699 | 1,699 |
| Total Liabilities | 7,186 | 7,832 | 7,432 | 7,852 | 8,271 |
| Total Equity | 8,910 | 9,486 | 9,743 | 10,067 | 10,383 |
| Total Equity & Liabilities | 16,096 | 17,318 | 17,175 | 17,919 | 18,655 |

* For full definitions of iQmethodSM measures, see page 5.

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 2,309,890

Quarterly Earnings Estimates

| | 2023 | 2024 |
|----|-------|-------|
| Q1 | 2.25A | 2.13E |
| Q2 | 2.33A | 2.07E |
| Q3 | 2.34A | 1.81E |
| Q4 | 2.70A | 1.84E |

4Q23 Results

Segment breakdown: Trucks

Truck deliveries in 4Q23 of 51.1k units decreased 1% YoY and were slightly above PCAR's guide of 48-51k units. Truck margin of 14.3% beat BofAe of 13.1% (+430bps YoY). PCAR maintained 2024 HDT industry retail sales estimates in both US+Canada and Europe at 260k-300k units (vs 2023 US+CA: 297k units and EU: 343k units). This implies a -6% decreased for US+CA and -18% decrease for EU on a YoY basis at the midpoint. ACT forecasts CL8 NA production to be ~271k units in 2024, down 20% YoY.

Segment breakdown: Parts strength to continue in 2024

PCAR's 4Q23 parts pre-tax margin of 26.9% beat BofA estimates of 26.5% (+100bps YoY). PCAR parts set new records for revenues and profits in 2023 with annual revenue up 11% to \$6.4bn and pre-tax profit up 18% to \$1.7bn. Parts gross margins increased to 31.9% (vs 30.4% in 2022). PCAR expects parts sales to growth to be +3 to 5% in 1Q24 and +4 to 8% for FY24.

Changing some elements of the guide

PCAR raised 2024 capex outlook to \$700-750mn (from \$675-725mn) and lowered R&D outlook to \$460-500mn (from \$470-520mn).



Price objective basis & risk

PACCAR Inc (PCAR)

Our \$102 price objective is based on 13x 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 |
|-------------------|------------------------------|-------------|------------------|-------------------|
| BUY | | | | |
| | 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 |
| NEUTRAL | | | | |
| | 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 |
| | RB Global, Inc | RBA | RBA US | Michael Feniger |
| | Waste Management | WM | WM US | Michael Feniger |

US - Machinery Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|---------------------|------------------------------------|-------------|------------------|-------------------|
| UNDERPERFORM | | | | |
| | 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 |

iQmethodSM 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 & 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

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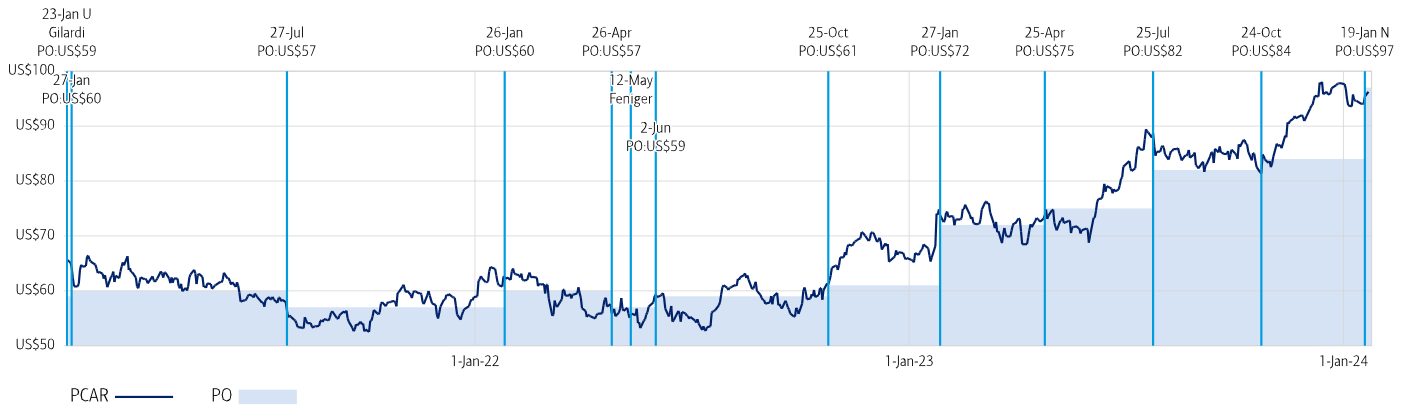
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PACCAR Inc (PCAR) Price Chart



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

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | 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 ^{R1} | 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% |

^{R1} 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.

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

^{R2} 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.

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