Bloomberg Intelligence

Truck Market to Hit Accelerator in 2018

BI Machinery, Global Dashboard

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1. Truck-Order Strength Paves Way to Highest Production Since 2015

(Bloomberg Intelligence) -- The North America heavy-truck market is poised to accelerate in 2018 to its highest level since the cycle peaked in 2015. Recent order strength could pave the way for a 25% year-over-year increase in Class 8 truck production to 313,000 units in 2018, about 13% above consensus. Even if orders moderate to around replacement levels, unit production could still exceed 300,000. Improving demand, firmer used-truck prices and tighter capacity are likely to drive new equipment purchases.

Table of Contents

Companies Impacted: Daimler, Paccar, Volvo and Navistar are the largest heavy-truck producers in North America, accounting for almost all of the market. (11/16/17)

Topics

Production Forecast

Heavy-Truck Production May Jump 25% in 2018, Trouncing Forecasts

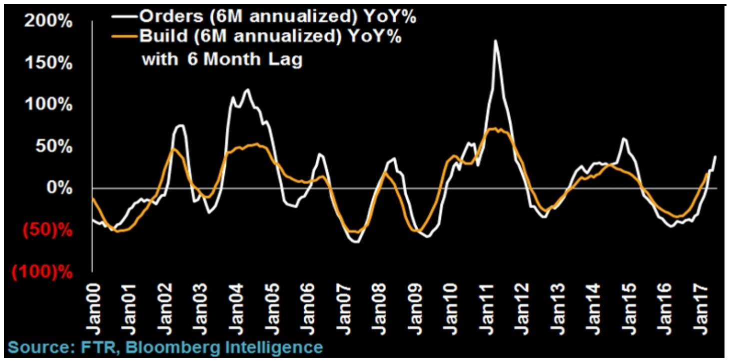
North American Class 8 production could surge more than 25% in 2018 vs. 2017 to 313,000 units, about 13% above consensus of 277,000. With heavy-truck orders running at a 261,000 annualized pace in the past six months, the industry should surpass build-rate expectations in 2018. (11/16/17)

2. Heavy-Truck Output Underestimated by Industry

Recent order trends and a Bloomberg Intelligence model put North American heavy-truck production well above 2018 estimates. Output may rise 25% to 313,000 units, exceeding company and third-party forecasts. Class 8 orders are running at a 261,000 annualized rate over the past six months, supporting higher 2018 build rates, after production is poised to rise almost 12% in 2017. FTR Intelligence projects Class 8 factory shipments will increase about 21% to 300,000 units in 2018 and remain elevated (285,000) in 2019.

Methodology: BI's production estimate applies a six-month annualized order-growth percentage to daily build rates with a six-month lag, which have the highest correlation. Based on these order trends, 2018 heavy-truck production equates to about 313,000 units. (11/16/17)

Heavy-Truck Orders vs. Build (6-Month Annualized)

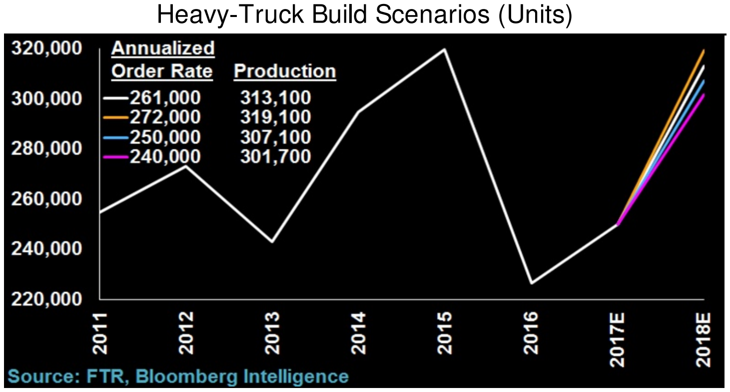


3. Build Should Top 300,000, Even If Orders Drop

Assuming North American heavy-truck orders continue at a 261,000-unit annualized rate, production could exceed 313,000 in 2018, the highest since the cycle peaked in 2015. Even if orders moderate to a 240,000 rate -- below replacement levels -- production should still surpass 300,000 units. Class 8 orders will likely need to accelerate and sustain a 272,000 annualized rate in 2018 for production to rise above 319,000 units and top the 2015 peak.

Daimler is the leader in the North American heavy-truck market with a 39.7% market share in 2016, according to Ward's. Paccar accounted for 29% of the Class 8 market, followed by Volvo at 17.5% and Navistar at 12.4%. (11/16/17)

Heavy-Truck Build Scenarios (Units)



4. Producer, Supplier Outlooks Too Conservative

Sustained order strength is likely to prompt truck producers and suppliers to increase their conservative 2018 outlooks throughout the year. While FTR Intelligence forecasts 2018 Class 8 factory shipments will increase 21% to 300,000 units, parts supplier WABCO projects production that's flat to up a modest 5%. Paccar expects U.S. and Canada heavy-truck retail sales to rise about 12% to 235,000 units. Volvo projects an 11% increase to 260,000 units. (11/16/17)

North American 2018 Heavy-Truck Industry Outlook

	2017E	2018E	y/y%
Paccar (U.S. & Canada)	210,000	235,000	11.9%
Volvo	235,000	260,000	10.6%
WABCO	+2-6%	+0-5%	2.5%
CVGI	245,000		
Dana	250,000		
Cummins[1]	218,000		
Eaton	250,000		
Navistar[2]	205,000		
Meritor[3]	237,000	270,000	13.9%
FTR	248,100	300,000	20.9%
Average			12.0%

[1] Class 8 group 2 production
[2] Fiscal year ending Oct 31, 2017
[3] Fiscal year ending Sep 30, 2017
Source: FTR, Company data, Bloomberg Intelligence

Order Seasonality

North American Heavy-Truck Order Strength May Persist Through 1Q

A strengthening economy and tighter capacity may keep heavy-truck orders at elevated levels through 1Q as customers look to reserve 2018 build slots. Historically, 4Q and 1Q are the strongest order periods of the year, accounting for almost 55% of annual orders. (11/16/17)

5. Orders Could Remain Elevated Through March

Heavy-truck orders could remain elevated as customers seek to reserve build slots amid a strengthening market and tighter capacity. Sustained order strength in 4Q, historically the strongest period of the year (more than 27% of annual orders), portends higher 1H build rates. December through March typically represents some of the highest order months. Heavy-truck orders surged 168% in October and are at a 313,900 annualized run rate over the past three months.

Companies Impacted: Truck producers Paccar and Volvo and drivetrain and braking systems supplier Meritor expect the North American heavy-truck market to increase double-digits in 2018. (11/16/17)

Percent of Annual Class 8 Truck Orders

	Month	Quarter
January	9.0%	
February	8.9%	
March	9.0%	26.9%
April	8.5%	
May	8.1%	
June	7.7%	24.2%
July	7.0%	
August	7.1%	
September	7.2%	21.4%
October	9.1%	
November	8.8%	
December	9.6%	27.5%

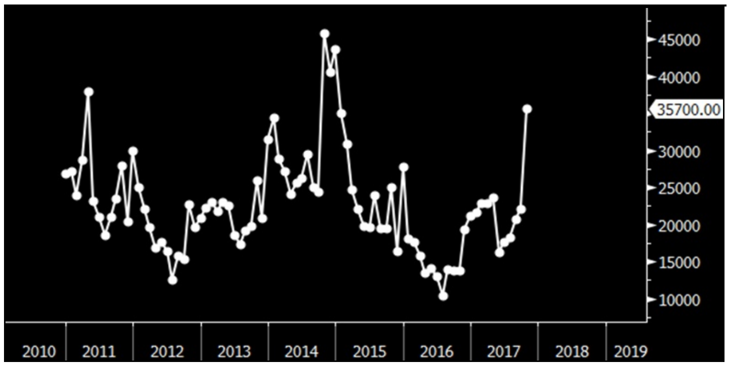
Source: FTR

6. Preliminary Truck Orders Surge 62% As Fall Order-Season Starts

Contributing Analysts Karen Ubelhart (Industrials) & April Kim (Industrials)

October preliminary North American heavy-truck orders surged 62% sequentially to 35,700 units, according to FTR, the highest in almost three years. This well-exceeds the five-year average October sequential increase of 42%, as nearly all OEMs posted gains. Orders surged 159% year-over-year as truck demand recovers with a stronger economy. Recent trends, including robust PMI and higher freight rates, indicate sustained strength as fleets need to add trucks. The North America market is set for robust 2018 sales. (11/02/17)

North America Preliminary Truck Orders



Truck Fundamentals

Truck Fundamentals Strengthen, Driving Higher Production in 2018

Industry fundamentals continue to strengthen, supporting higher 2018 build rates for heavy trucks. Firming used-truck prices, a solid freight environment and tight capacity should drive demand for new equipment. (11/16/17)

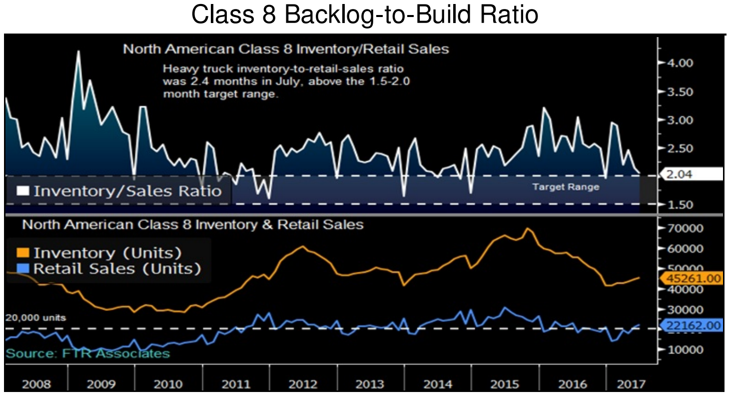
7. Class 8 Backlog-to-Build Ratio Holds Steady on Higher Output

Contributing Analysts Karen Ubelhart (Industrials) & April Kim (Industrials)

The North American Class 8 truck backlog-to-build ratio, which measures the time between orders and delivery, was 3.9 months in September, in-line with August's 3.8, as companies rapidly increase production rates. Backlog fell 0.8% sequentially, reflecting higher build rates. Daily builds rose 10% from the prior month and 37% from a year ago. After falling through much of 2016, backlog-to-build was five to six months in 1H, which led to higher production.

Companies Impacted: Volvo, Paccar, Daimler and Navistar are the largest heavy-truck makers in the North American market. (10/20/17)

Class 8 Backlog-to-Build Ratio



8. Truck-Order Cancellations 7.4% in September, Should Remain Low

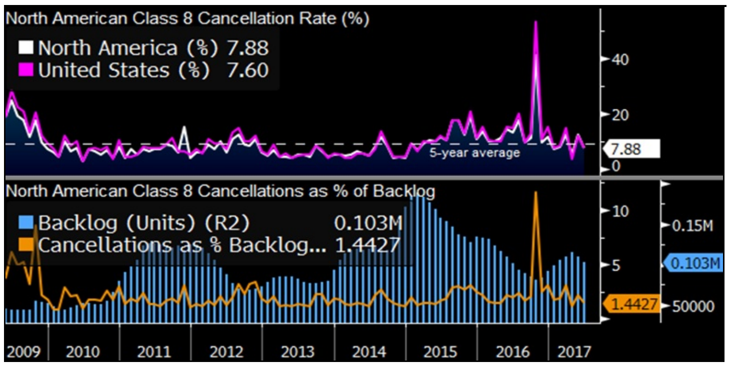
Contributing Analysts Karen Ubelhart (Industrials) & April Kim (Industrials)

September's North America Class 8 truck-order cancellation rate was 7.4%, similar to August's 8.5%. For much of

2016, cancellations topped 10%, the level above which builders typically cut production, but have returned to more normal levels. Cancellations should remain low as truck capacity tightens. Orders are running above replacement demand in 2017 after sliding 35% in 2016, and are accelerating coming out of seasonally slow months. The robust PMI index, which truck orders track, supports higher purchases.

The North American heavy-truck market is dominated by four manufacturers: Navistar, Volvo, Paccar and Daimler. (10/20/17)

Class 8 Truck Cancellations (% of New Orders)



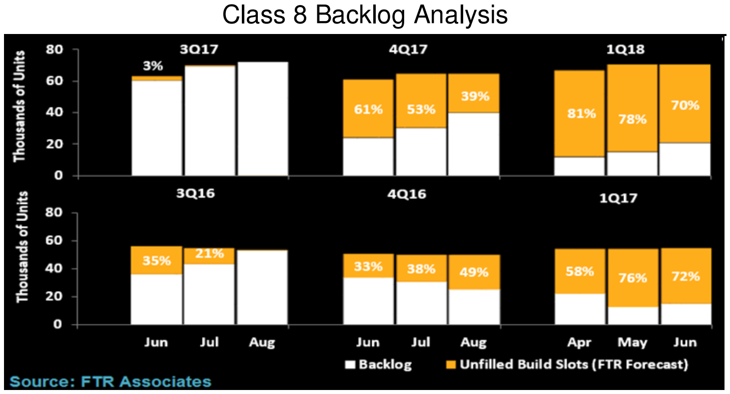
9. Heavy-Truck Slots Should Fill Quickly for Remainder of the Year

Contributing Analysts Karen Ubelhart (Industrials) & April Kim (Industrials)

Heavy truck fabrication, or build slots, have been filling more slowly than in 2016 as producers raise production capacity amid an order rebound, yet August has shown a reversal in trends. After a challenging 2016, 4Q slots are 39% unfilled as of August vs. 49% unfilled in August 2016. FTR data suggests that open slots for the rest of the year should fill quickly, creating momentum into 2018. In August, 1Q18 slots were 70% unfilled vs. 72% in 2016 for 1Q17, even with 29% more available.

Companies Impacted: Volvo, Paccar, Daimler and Navistar are among the largest truck makers with a presence in North America. Engine manufacturers are represented by Cummins, and parts manufacturers include Meritor and Commercial Vehicle Group. (10/20/17)

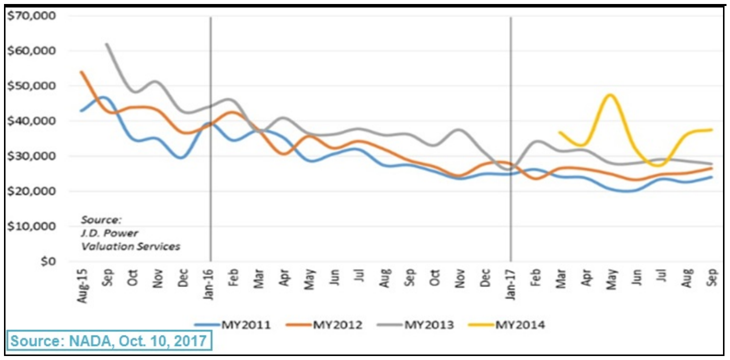
Class 8 Backlog Analysis



10. Firmer Used-Truck Pricing Good News for 2018

In an encouraging sign for 2018, used-truck pricing remains relatively strong. Auction prices for model-year 2011-13 trucks increased 2.6% sequentially in September as volume was up modestly, according to the National Automobile Dealers Association. Used-truck prices are an important component for new truck sales as trade-in values can influence purchase decisions. Firming used-truck prices, an improved demand environment and tighter capacity bode well for new truck sales in 2018. (11/16/17)

Average Selling Price: No-Reserve Auction



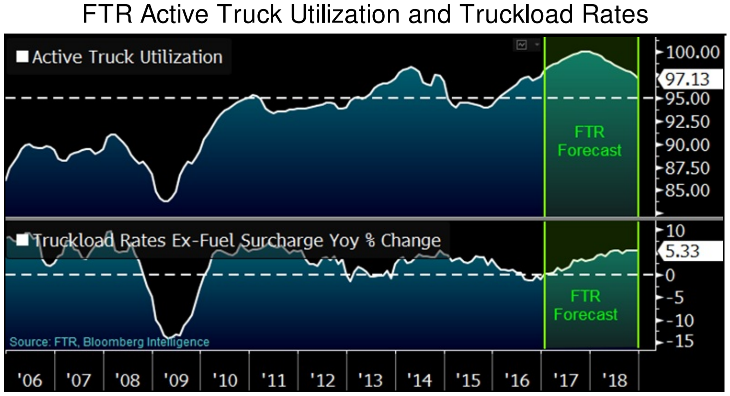
11. Tighter Trucking Markets Yields Higher Rates

Contributing Analysts Lee A Klaskow (Transportation)

Truck utilization rates should stay elevated in 2018 following the implementation of electronic logging devices on Dec. 18. FTR estimates utilization rates will average 98.5%, down from 99.3% in 2017, but well above the 10-year average of 94%. The tighter market should result in contractual truckload rates rising by mid-single digits in 2018. FTR is forecasting rates to increase 4.9% in 2018. Shippers would rather pay higher rates to ensure available capacity ahead of the uncertainty from ELDs.

Companies Impacted: Driver availability may restrain fleet expansion and keep upward pressure on rates. Higher rates are needed to for trucking companies like J.B. Hunt, Heartland Express, Schneider National, Werner Enterprises and USA Truck to mitigate the rising costs to attract and retain drivers. (11/16/17)

FTR Active Truck Utilization and Truckload Rates



Company Implications

Improved Heavy-Truck Output Could Add $1 Billion to Paccar Sales

A scenario where North American heavy-truck production increases 25% to 313,000 units could add $1 billion to Paccar's revenue and push its 2018 sales past $20 billion, 5% above estimates. Meritor's Ebitda could improve to almost $430 million, 9% above its guidance midpoint. (11/16/17)

12. Truck Acceleration Lifts Paccar Sales, Margin

A 25% increase in North American heavy-truck production to 313,000 units, above forecasts of 277,000, could add more than $1 billion to Paccar's 2018 revenue and 40 bps to its pretax margin (10.7%). Assuming Paccar's U.S. and Canada truck sales advance 25%, based on recent order trends and a Bloomberg Intelligence model, and European revenue declines 3% (consistent with management's industry forecast), truck and parts revenue may increase 13% in 2018 to $20.1 billion.

Paccar is the second-largest North American heavy-truck producer, with a 29% market share in 2016, trailing only Daimler at almost 40%, according to Ward's. (11/16/17)

Paccar Scenario Analysis

	2015	2016	2017E Consensus	2018E Consensus	2018E
Inputs:					
Deliveries y/y	8%	(9)%	12%		
U.S. & Canada	8%	(22)%	17%	12%	25%
Europe	20%	12%	7%	(3)%	(3)%
Other	(14)%	3%	7%	7%	7%
Parts Sales	(1)%	(2)%	9%	5%	5%
PACCAR					
Net sales (Truck, Parts & Other)	**$ 17,942.8**	**$ 15,846.6**	**$ 17,766.7**	**$ 18,971.3**	**$ 20,099.9**
Truck sales	14,782.5	12,767.3	14,405.8	15,431.[illegible]	16,559.9
U.S. & Canada	9,774.3	7,363.5	8,615.3	9,64[illegible].1	10,777.7
Europe	3,472.1	3,863.0	[illegible]	[illegible]3.2	4,013.2
Other	1,536.1	1,540.8	[illegible]	[illegible]9.0	1,769.0
Parts	3,060.1	3,005.7	[illegible]	[illegible]0.0	3,440.0
Other	100.2	73.6	[illegible]	[illegible].0	100.0
Gross profit	2,650.7	2,328.9	2,558.4	2,781.[illegible]	2,946.6
Gross margin	14.8%	14.7%	14.4%	14.7%	14.7%
SG&A	445.9	440.8	445.9	492.8	522.2
SG&A/sales	2.5%	2.8%	2.5%	2.6%	2.6%
R&D	239.8	247.2	265.0	285.0	265.0
EBT	1,952.7	1,629.3	1,834.9	1,991.8	2,147.2
EBT margin	10.9%	10.3%	10.3%	10.5%	10.7%

Click to change assumptions

Source: PACCAR, Bloomberg Intelligence

13. Meritor Ebitda to Rise on Heavy-Truck Gains

In a scenario where North American heavy-truck production rises to 313,000 units, in-line with recent order trends, Meritor's Ebitda could improve to about $430 million, 9% above its guidance midpoint. Assuming an incremental margin consistent with Meritor's 15-20% historical range, Ebitda margin would widen to 11.3%, 40 bps above management's forecast. A 313,000-unit heavy-truck market could add $172 million to Meritor's revenue, boosting sales toward $3.8 billion.

Meritor is a leading supplier of drivetrain systems and components, including axles and brakes for commercial vehicles. Volvo, Daimler and Navistar account for about 50% of Meritor's sales and represent almost 70% of the North American heavy-truck market. (11/16/17)

Meritor Class 8 Scenario Analysis

Class 8 Industry Scenario[1]	FY2018 Revenue	Revenue Impact	YoY% Growth	% Chg vs. Guidance		EBITDA Incremental/Decremental Margin @ 10%	@ 15%	@ 20%	@ 25%	@ 30%
320,000	$ 3,850.0	$200.0	20.4%	5.5%		$ 397	$ 422	$ 448	$ 473	$ 498
313,000	$ 3,822.0	$172.0	19.5%	4.7%		$ 395	$ 418	$ 442	$ 466	$ 490
310,000	$ 3,810.0	$160.0	19.1%	4.4%		$ 393	$ 416	$ 440	$ 463	$ 486
300,000	$ 3,770.0	$120.0	17.8%	3.3%		$ 389	$ 410	$ 432	$ 453	$ 474
290,000	$ 3,730.0	$80.0	16.6%	2.2%		$ 385	$ 404	$ 424	$ 443	$ 462
280,000	$ 3,690.0	$40.0	15.3%	1.1%		$ 381	$ 398	$ 416	$ 433	$ 450
270,000	$ 3,650.0	$0.0	14.1%	0.0%	Guidance[3]	$ 377	$ 392	$ 408	$ 423	$ 438
260,000	$ 3,610.0	($40.0)	12.8%	(1.1)%		$ 373	$ 386	$ 400	$ 413	$ 426
250,000	$ 3,570.0	($80.0)	11.6%	(2.2)%		$ 369	$ 380	$ 392	$ 403	$ 414
240,000	$ 3,530.0	($120.0)	10.3%	(3.3)%		$ 365	$ 374	$ 384	$ 393	$ 402
230,000	$ 3,490.0	($160.0)	9.1%	(4.4)%		$ 361	$ 368	$ 376	$ 383	$ 390

Source: Bloomberg Intelligence, company data

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