PACCAR Inc. (PCAR) CEO Preston Feight on Q3 2019 Results - Earnings Call Transcript

Oct. 22, 2019 4:43 PM ET1 comment
by: SA Transcripts

Q3: 10-22-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.75 beats by $0.11 | Revenue of $6B (10.84% Y/Y) beats by $30.12M

Earning Call Audio

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00:00 -49:23

PACCAR Inc. (NASDAQ:PCAR) Q3 2019 Earnings Conference Call October 22, 2019 12:00 PM ET

Company Participants

Ken Hastings - Director of IR

Preston Feight - CEO

Harrie Schippers - President & CFO

Michael Barkley - SVP & Controller

Conference Call Participants

Joel Tiss - BMO

Stephen Volkmann - Jefferies

Andrew Casey - Wells Fargo Securities

Ann Duignan - JPMorgan

Erin Welcenbach - Baird

Benjamin Burud - Goldman Sachs

Timothy Thein - Citigroup

Ross Gilardi - Bank of America

Jamie Cook - Credit Suisse

Courtney Yakavonis - Morgan Stanley

Adam Uhlman - Cleveland Research

David Raso - Evercore ISI

Jeff Kauffman - Loop Capital Markets

Joe O'Dea - Vertical Research

Neil Frohnapple - Buckingham Research

Robert Salmon - Wolfe Research

Shawn Kim - Gabelli Funds

Operator

Good morning and welcome to PACCAR's Third Quarter 2019 Earnings Conference Call. [Operator Instructions]

I would now like to introduce, Mr. Ken Hastings, PACCAR's Director of Investor Relations. Mr. Hastings, please go ahead.

Ken Hastings

Good morning. We would like to welcome those listening by phone and those on the webcast. My name is Ken Hastings, PACCAR's, Director of Investor Relations, and joining me this morning are Preston Feight, Chief Executive Officer; Harrie Schippers, President and Chief Financial Officer; and Michael Barkley, Senior Vice President and Controller.

As with prior conference calls, we ask that any members of the media on the line participate in a listen-only mode. Certain information presented today will be forward-looking and involve risks and uncertainties, including general economic and competitive conditions that may affect expected results. For additional information, please see our SEC filings and the Investor Relations page of paccar.com.

I would now like to introduce Preston Feight.

Preston Feight

Good morning.

Harrie Schippers and I will provide you an update on PACCAR's excellent third quarter results and business highlights. To begin, I'm proud of our employees around the world who provide our customers the highest quality trucks, powertrains, and transportation solutions.

In the third quarter PACCAR achieved sales and financial services revenues of $6.4 billion and net income of $608 million, resulting in a strong 9.5% after-tax return on revenues. PACCAR net income increased 11% compared to the third quarter of last year. PACCAR achieved robust truck, parts, and other gross margins of 14.9% in the third quarter, and also for the year to date.

Through the first nine months of the year, our team achieved record revenue and earnings. PACCAR delivered 49,300 trucks during the third quarter, compared to 52,200 in the second quarter. This reflects fewer billing days in Europe, due to DAF's regular summer shutdown, which was partially offset by higher deliveries in North America.

In the fourth quarter, deliveries will be lower by 6% to 8% compared to the third quarter, due to fewer production days in North America and lower daily build rates in North America and Europe. Fourth quarter truck, parts and other gross margins are estimated to be in the range of 14% to 14.5%.

PACCAR declared third quarter dividends of $0.32 per share and year-to-date dividends of $0.96 per share. Year-to-date dividends were 19% higher than dividends declared in the same period last year. We repurchased 833,000 shares of stock during the third quarter, and there is $431 million remaining in the current $500 million Board of Directors' authorization.

PACCAR continues to create a full lineup of innovative truck models and technologies. Kenworth, Peterbilt and DAF have introduced a range of electric powertrain vehicles in the last two years, that customers are field testing in a variety of applications. PACCAR is well positioned to supply the industry with a complete set of powertrain technologies, including battery electric, fuel cell and diesel engines.

This year, PACCAR has opened two global software research and development centers in the U.S. and Europe that are accelerating the development of embedded vehicle software, and PACCAR connected vehicle solutions for our customers.

The PACCAR Innovation Center in the Silicon Valley, which we opened in 2017, complements PACCAR's extensive R&D efforts, and is focused on the development of PACCAR level 2 and 4 autonomous trucks. PACCAR will showcase many of our innovative products and technologies at the North American Commercial Vehicle Show in Atlanta next week, and at the CES Technology Show in Las Vegas in January. We hope to see you there.

We are pleased to share that Kenworth, Peterbilt and PACCAR parts were each recognized as top employers for women at the Women in Trucking Annual Conference. We were honored for excellent work environment and company culture, that supports gender diversity.

Harrie Schippers will now provide an update on PACCAR's truck segment, PACCAR Parts, Financial Services and investment priorities for next year.

Harrie Schippers

Thanks Preston.

Our 2019 forecast, for Europe's greater than 16-tonne truck market, to be in a range of 310,000 to 320,000 units, reflecting continued modest economic growth and strong truck demand. Next year, the Eurozone and U.K. economies are expected to grow about 1%. We expect 2020 to be another good year, with the European above 16-tonne truck market in a range of 260,000 to 290,000 vehicles.

The U.S. economy is growing 2.3% this year, with 50-year low unemployment, and strong consumer spending. Freight tonnage has grown 4.2% year-to-date. In the U.S. and Canada Class 8 industry retail sales continue to grow in 2019, following the strong orders and production over the last two years.

We estimate 2019, U.S. and Canadian Class 8 industry retail sales to be in the range of 310,000 to 320,000 trucks. We expect 2020 to be another good economy, and estimate the U.S. and Canadian Class 8 truck markets to be in the range of 230,000 to 260,000 trucks, in line with normal replacement demand.

The South American above 16-tonne truck market should be in the range of 95,000 to 105,000 trucks this year, and slightly higher in 2020. In Brazil, the above 16-tonne truck segment is projected to be in a range of 65,000 to 75,000 vehicles this year and slightly higher next year. PACCAR Parts business generated strong quarterly revenues of $1 billion.

Quarterly pre-tax income was $207 million, 10% higher than the third quarter last year. Consistent investments in parts distribution capacity, customer focus programs such as fleet services and TRP Stores, and a growing number of PACCAR trucks and engines in operations, drove these results.

Since 2013, DAF, Kenworth and Peterbilt dealers have opened nearly 200 TRP retail stores on six continents. The stores provide high quality TRP branded, aftermarket products and services to owners of all makes of trucks, trailers, buses and engines. PACCAR Parts is constructing two new distribution centers, that will open next year.

A 250,000 square foot facility in Las Vegas, which will make efficient use of solar power and 160,000 square foot facility in Ponta Grossa, Brasil. We expect part sales to grow by 4% to 6% next year.

PACCAR Financial Services earned third quarter pre-tax income of $67 million. The portfolio was a record $15.6 billion this quarter, and performed well, with low past dues. In the third quarter, industry used truck inventory increased, and used truck pricing declined. Kenworth and Peterbilt truck resale values commanded 10% to 15% premium in the market.

We estimate 2019 capital spending to be in the range of $675 million to $725 million, and R&D expenses to be $325 million to $335 million. In 2020, we're planning for capital investments of $625 million to $675 million, and R&D expenses of $320 million to $350 million. These investments will continue to enhance PACCAR's truck, powertrains and transportation solutions.

Thank you. We'd be pleased to answer your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Joel Tiss with BMO. Your line is now open.

Joel Tiss

Wow, I'm not used to be in first. How is it going guys? Wow, first time for everything, I guess. So I just wondered if you could give us any sense of production levels for 2020, after mentioning, kind of -- we got a sense where the industry is going to be, and then mentioning that inventories for the industry are up a little bit? And I just wondered if you could give us any sense of where your production -- where you're thinking for 2020?

Preston Feight

Sure, as we've watched the industry normalize, if you look at inventory, we really think that right now, it's not in that shape at all for us. We just have 2.4 months of inventory retail sales sitting out there, so that's a nice level. In good shape. We've already adjusted our backlog to be -- we have 36% of the backlog in the industry. So that's in good shape.

And then as we look forward and think about build rates, we took adjustments into the -- end of the third quarter there, both North America and Europe to get them right for the markets, so that we feel like we've got a reasonable build going into 2020.

Joel Tiss

And can you give us any sense about the parts, margins, I could see and we can all see in 2019, the margins are up a little bit, profits growing faster than revenues. You gave us a revenue number for next year, is there enough momentum in the business and the new parts distribution centers to be able to do that again in 2020, you think?

Preston Feight

I think the guidance we gave on the 4% to 6% growth, and I think margins would likely be comparable to what we saw this year.

Harrie Schippers

In the 27% to 28% range, that's what we typically see for parts.

Operator

Our next question comes from Stephen Volkmann with Jefferies. Your line is now open.

Stephen Volkmann

I'm not used to Joel being first either.

Preston Feight

Good morning.

Stephen Volkmann

But maybe I'll pile on to his question a little bit. So Preston, just thank you for the comments around sort of production expectations. Is it your expectation at this point, that the production declines that you've kind of baked in for -- here in the second half of 2019, will be enough, and that you'll be able to sort of keep stable through 2020, is that the way, the plan is laid out?

Preston Feight

I think we'll watch what happens in 2020. I don't think it's going to be an even year, every month will be different. I mean every quarter will be different. So we'll make sure that we adjust build rate appropriate to the orders we have. Right now we have reasonable backlog in the first quarter, especially in North America. So we feel like we've got ourselves about right and we'll watch as the year comes along, what we need to do, whether it's go up or down in build rate.

Stephen Volkmann

Okay, understood. And can we talk, maybe this is a Harrie question, just a little bit about the decremental margins since -- I guess it will be decremental next year. You've done a good job holding your incrementals kind of in the mid-teens, with an occasional high teens kind of number. I'm just curious as you have sort of more vertically integrated a little bit with your engine growth in the U.S. and all these parts distribution centers, etcetera. Do you think your decremental margin will also be in that kind of mid-teens level, or is there a reason to think it could be higher, because of the additional investment?

Harrie Schippers

I think we've -- historically we've seen incremental and decremental margins in the 15% to 20% range and I would expect that to be similar for next year.

Operator

Our next question comes from Andy Casey with Wells Fargo Securities. Your line is now open.

Andrew Casey

A couple of questions. First on the Financial Services and this is kind of picking at it, but SG&A and provision for losses on receivables were up a little bit sequentially and year-over-year, what was driving that change, and was it due to any specific region?

Preston Feight

What we saw in Financial Services, we've had really a low credit losses. We've had low past dues. The portfolio continues to perform really well. In fact, we're pretty pleased with that portfolio. The only headwind we've had in Financial Services was used trucks.

Andrew Casey

And then, I just want to make sure I have this right, if I compare the truck segment performance to Q3 '18, you had a pretty beneficial gross spread between the 12% revenue increase, and the 3% volume growth. And I recall Q3 last year had some timing issues related to buyback contracts and stuff like that. Was that the difference in the revenue growth and the volume growth really driven by comps and pricing, or was there something else that occurred in the quarter?

Preston Feight

Yes, if you just think about what this quarter was about, we did have reasonable pricing influence, that more than offset costs. So I think those are the things that drove our stronger margin performance for the quarter. I don't know if I've gone back in terms of kind of a bridge to the 3Q of '18 numbers and what was going on back in there. We did have fewer operating lease deferrals in Q3 of '19 versus Q3 of 2018, and therefore, that that helped our revenue a bit.

Andrew Casey

And then on the used truck market in North America, you mentioned inventories are growing I think, have you started to see the price trends kind of gradually decline? Are we starting to see more double digit?

Preston Feight

So if you think about used trucks, one of the things that has been nice for PACCAR, is we've made investments over the past few years to grow our used truck capability. We created a new used truck center in Los Angeles. We're in the middle of creating one in

Denton, Texas, it will open in the fourth quarter. Obviously PACCAR's used trucks provide a premium value in the marketplace.

So that's a nice thing for our customers, and really have a 10% to 15% premium over our competitors. And actually sometimes, more than that compared to some of the competitors. But we have seen the used truck market in general, go into that double digit level of declines on that 10% to 15% decline, and that's already been kind of dealt with through this quarter.

Operator

Our next question comes from Ann Duignan with JPMorgan. Your line is now open.

Ann Duignan

Yes, our data that we analyze and publish shows that while you do garner a premium in the used market, you're seeing these prices are down year-over-year just like everybody else's. So thank you for confirming that. My question is around the month of inventory at your dealer, it has been, you know 2.4 months, but that's based on a trailing 12 month -- trailing sales, which are at a peak. So isn't it inevitable, that as we go into next year, those months of supply at the dealers are going to expand, and you're going to have to cut production. So could you just talk about that, and why you wouldn't have to under-produce retail sales going into next year, despite the fact that you got higher backlog?

Preston Feight

Well, I think -- maybe that's a little bit less than I would think about it. And I think we feel like the inventory, while you admit it, while you acknowledge is trailing run rate. We still do talk to our dealers all the time and our customers all the time, and we see that there will be good demand for the products, as we look forward.

So I would say that, the last quarter's order intake has been lower, but as we get into the fourth quarter and we're meeting with customers, talking about what next year's buying pattern is going to be, I expect people will be buying trucks, and I think that indeed the occasional market seems to continue to be very solid throughout the country, throughout

Canada. So I would expect that our inventory is okay. As far as adjustments go to production, like we said earlier, I think we make those adjustments up and down, as the market demands it.

Ann Duignan

Yes, that's for sure. And then just based on your guide's history. I know the truck cycles over the long term and a lot of them have been manmade. But if we're going into a decline in 2020, for whatever reason, have we ever seen a cycle that's on a one year decline, or should we be bracing for a couple of years and then back to normal again. Just your perspective on that from your years of experience will be beneficial. Thanks.

Preston Feight

Yes, that's a tough thing to forecast out what kind of a decline rate there would be. And if it might last longer than a year. I think we probably look at this and say, there are still strong economic fundamentals in the U.S. and Canada right now. GDP is positive, tonne miles are high.

I think, we think there is normalizing of the market estimate of 230,000 to 260,000 is just -- kind of feels like where things are happening too. As far as it being beyond next year. No idea if it's just a pause in the economy, and that it will reaccelerate, or if it will slow down for more than a year.

Operator

Our next question comes from David Leiker with Baird. Your line is now open.

Erin Welcenbach

This is Erin Welcenbach on for David. So my question for you is, just how firm does the backlog look from an industry perspective, and when would you expect order activity to pickup this year, if at all?

Preston Feight

Sure. Well, I think that we've already done a good job of looking into our backlog and working with our customers, just to make sure that we had real backlog, and that if there were cancellations, we took them. If there were different scheduling needs, we've addressed them. I can't speak for the total industry, but I feel like -- we feel like our backlog is in a reasonable shape right now.

Erin Welcenbach

And then my second question is just, maybe if you can provide some additional color on your thoughts for Europe, and any regional variances you would expect next year, given your outlook for double digit declines in sales.

Preston Feight

One of the things we've seen in Europe has been -- that the U.K. has done quite nicely for us this year. So in spite of all the news around it, and maybe that will continue. We also are the leading brand of tractors throughout Europe. And as we watch Europe really expand East -- continue to expand east in development, our DAF premium products do a great job throughout all of Europe, and we have market leadership in countries like Poland and we are strong in Hungary and Romania and those kinds of countries. So as the total market of Europe matures, DAF does very well, enables us to grow share there.

Operator

Our next question comes from Jerry Revich with Goldman Sachs. Your line is now open.

Benjamin Burud

This is Ben Burud on for Jerry. Just wanted to spend a few more minutes on Europe. So the second quarter of production adjustments in a row it seems, and it seems to be the main driver of deliveries, only increasing 3% year-over-year in the quarter. I believe your guide three months ago was 5% to 7%. So can you just spend a little more time on what drove the softness there, if that's continuing? And if you guys like to flex production over there, on a quarterly basis or if there is second production adjustment, what was more of a surprise, any color there would be helpful. Thank you.

Preston Feight

Sure. I think I think your comments are reasonably accurate, as we did take the adjustments to Europe, to where -- a point where it matched the market demand. And we've seen that we've held onto our market share gains with our build rates. So we're setting at like 16.4%, which is near historic highs for us, in market share.

So we think we have it balanced about right now. And Europe was probably a little sooner coming down than maybe we thought it might be, and that's why we made the necessary adjustments, and it feels like we're setting the right levels.

Benjamin Burud

And then, can you give us an update on how you're thinking about dealer location growth next year, for the TRP locations? Are you still thinking of adding 50 new locations per year, and any expected increase in Kenworth and Peterbilt dealers in 2020?

Preston Feight

Yes. We have -- I mean I'll start by just saying, we have the best dealer network in the industry, and I mean spent a lot of time with them. They're fantastic business partners. We see significant investments from them in North America and in Europe.

So it's one way to think about this, is that they're constantly renewing their facilities, and adding service bays and shop capability, to make sure our customers maximize their uptime. And so we'll watch next year that they'll continue to make those investments into new facilities, with lots of great plans around adding locations.

And we'll see some location growth in North America. What I'd expect more in Europe, is it will be -- the continuing development of replacement locations and improved service bay capability or more service bay capability. And to your point of, TRP Stores, we will be adding TRP Stores in 2020 as well, probably much along the lines as we have, in this year.

Operator

Our next question comes from Tim Thein with Citigroup. Your line is now open.

Timothy Thein

First question, just on a -- from a mix standpoint, this revenue per truck that -- call it 10% or almost 10% year-over-year growth, was that just all that contribution from North America being a bigger part of the deliveries, or is there kind of underlying content growth or mix story that's also contributing?

Preston Feight

No, you've got it about right. It's mostly contribution from North America.

Timothy Thein

Okay.

Harrie Schippers

Pricing improvement, right?

Preston Feight

Yes.

Timothy Thein

Right, okay. And then just back on the Financial Services and the pre-tax profits; in terms of the increase, I know that we have limited disclosure here in the release. But the increase in that interest and other line, how much of that is a change in terms of higher depreciation, that we will potentially be sustained going forward, versus maybe impairments or losses on used, that are presumably more one-time in nature? And the spirit of the question is just, should we assume a kind of a similar run rate in terms of a -- from a profitability perspective in the third quarter, or were there some kind of one timer's within that line? Thank you.

Preston Feight

So as far as the continuing to profitability, we think the strong profits we had in the third quarter will continue going forward and for the detail of your question, I will let Michael want to address that one.

Michael T. Barkley

Yes. We did have some impairments that were taken, and we also adjusted our depreciation to reflect expected future impairments. And so that run rate will continue going forward. And as Preston indicated, will be reflected at a similar pace in coming quarters.

Operator

Our next question comes from Ross Gilardi with Bank of America. Your line is now open.

Ross Gilardi

I'm just trying to understand gross margins in a more draconian scenario than what you're forecasting for next year. I mean, I think if you go back in gross margins ex R&D in more of a garden-variety downturn have been around 12% to 13%. But you've got to go back like seven or eight years to see it. I'm just wondering, how do you think gross margins look in the next downturn, whenever it comes, in relation to that 12% to 13%, given the way the company has evolved over the last decade, particularly with the growth in the Parts business?

Preston Feight

I think one of the great strengths of PACCAR, is that we are always looking at operational efficiency gains, not just in one year, but over the course of time. We're always thinking about cost control.

So as we head into markets like the normalized market we're facing, we've already been aggressively thinking about cost control, and I think that's enabled us to deliver the solid gross margins we had this quarter, and even the quarterly gross margins we predict for next quarter in 14% to 14.5%. So I think that we are always managing the business efficiently for the benefit of our customers, and we think that 14% to 14.5% that we deliver next quarter will be pretty solid.

Ross Gilardi

Yes, I mean, I realize that. I wasn't asking about next quarter. I'm not asking you for it to forecast when the next trough is. I'm just saying, when eventually it does come, what do you think your gross margins would look like with -- in comparison to what prior downturns looked like? I mean, I imagine you're -- it has been very difficult to stay in the 14% to 14.5% range, if Class 8 build -- goes to sub 200,000 number.

Preston Feight

Well, that's kind of hypothetical to us. Just to think where it might go down to and how we might react in those circumstances. But you can imagine, that we will always be focused on cost control, and we have a long, long history of all different markets back through the recession of 2009, and we still continue with profitability and we'll continue to do a good job in those, even if those circumstances were to return, which we don't predict.

Ross Gilardi

How quickly can you reduce SG&A, as Class 8 production normalizes, and what will be the source of the savings? And just how should we think about SG&A into next year, as we revert back to replacement level demand? I mean if we model it at 2.3% of sales or so for this year, does it stay at that ratio in 2020, as production normalizes, or do we see it -- the ratio move higher?

Preston Feight

Yes, I think what we're always looking for in those in SG&A, and in our spending is to make sure that we are developing the right products and services for customers looking into the future. And so as we shared, we think the level of spending for us on R&D and capital our capital come down a little bit. R&D is roughly flat, and I think in SG&A, we will apply rigorous disciplines, to make sure that the costs are appropriately controlled.

Ross Gilardi

And is that just from flexing the workforce, or what are the other -- is that the main source of savings, if -- when you get to that point?

Preston Feight

Workforce is one, contracts is another, licensing agreements, work we do, those kinds of things, all get looked at. We really don't think of things in terms of a lot of fixed pricing.

Harrie Schippers

We go through our overhead budgeting process every year, as a zero based budgeting process, and we review all necessary spending in detail and make sure that we're keeping our organization as lean as possible.

Ross Gilardi

And then can you just remind us the percentage of your European deliveries that come from the U.K.? I seem to remember, it's around 20%, is that in the right ballpark? And can you remind us what portion of Leyland's capacity sold to the U.K. market versus the European Union? I mean on that note, could you shift production out of the U.K. to DAF in the Netherlands to serve Europe, if we did go through a hard Brexit?

Preston Feight

So I as we think about the U.K. one of the beautiful things for us is, we have great production capacity in the U.K. We also have it in Eindhoven, and so we were able to flex depending on what Brexit might or might not be appropriately for the market, so we can build the trucks we need in the U.K., in U.K., and we can build all the trucks, the CFXs we need for the continent, we can build on the continent as well. So that gives us good flexibility, and I think Harrie, you were looking at the number...

Harrie Schippers

The U.K. typically is between 15% and 20% of our European production.

Ross Gilardi

So most of the existing production, at least for a year like this year, would just be -- would be for the U.K. market out of the U.K. factory?

Preston Feight

Yes, that's -- we can use it for both, and we have enough there to support the U.K. and we have enough capacity in Europe to support Europe.

Harrie Schippers

And being the only truck manufacturer that has a factory in the U.K., that could give us a very nice advantage.

Operator

Our next question comes from Jamie Cook from Credit Suisse. Your line is now open.

Jamie Cook

I guess one question, as you're thinking about the commentary that you made about decrementals of the 15% to 20% or so, are there any variances or differences as we think about where the weakness is coming from, are the decrementals dissimilar and the U.S. and Europe are not so much anymore with being more vertically integrated the U.S. now. And then I guess my second question regards to -- relates to sort of price costs. Obviously pricing has been pretty strong for you guys this year, and the downturn that you guys are forecasting, do you think you can hold sort of price in that material cost could potentially be a tailwind for you? Thank you.

Preston Feight

Yes, I think it will be -- your second part of question is quite possibly true, and we'll continue to manage price to best of our ability in the market, and we are always aggressively looking at our cost structure. And, as you mentioned, that could be a bit of a tailwind for us, in terms of what happens next year, as in 2019, suppliers are running at full capacity, some inefficiencies in their ships. So maybe there's some upside in that.

Jamie Cook

And just the first part, difference U.S. versus Europe in terms of impact on margins?

Preston Feight

Yes, they're very similar, very similar.

Operator

Our next question comes from Courtney Yakavonis with Morgan Stanley. Your line is now open.

Courtney Yakavonis

I just wanted to go back to the clarification on the comments on your build rate being appropriate for the orders you have right now in the backlog for the first quarter. So is your assumption then that -- at the beginning of 2020, that we should return to that kind of replacement rate of 20,000 orders a month? Or is your current build rate kind of assuming, that we remain at this sub-15,000 orders, and the backlog can fill in the rest. And then also just wanted to make sure that the comment was, that the September build rate is the right assumption we should have, going forward?

Preston Feight

Well, we've made adjustments in the first parts of October for our build rates, so this is coming at that. So we think we've got that set up right. When I think about our backlog and build rates for next year, we still have quite a healthy backlog, and so there could be a little bit of a more time for the normalization to that quarter intake of 20,000 per month, as you put the number out there.

But orders are definitely starting to pick up. It's a very normal part of the cycle to have late summer be quiet, and then as people are putting their capital budgets into place, then to see the fourth quarter be a time of ordering, and we're seeing that right now. So whether it's going to be exactly at level this month or it will take a month or two to normalize out, it should normalize out.

Courtney Yakavonis

But it sounds like before the beginning of the year, you do expect that return. And then just on CapEx and R&D, you gave us guidance for 2020 and I think there's a bit of a step-down in CapEx versus '19 but still an elevated level, relative to what's historically seen out of you guys. So is that kind of the right run rate that we should be thinking about, the investments that you're -- that the business kind of needs at this point, or a lot of those one-time in nature? And then kind of same question on R&D, which is expecting to pick up, and especially in light of concerns about decrementals next year. Are there any buckets in R&D that potentially could be factored in as well.

Preston Feight

Sure. For both of them as far as -- whether they're one-time or continuous run rates, what we do is, we always look at the portfolio of projects and opportunities that are going to bring value, and we invest in those. We build the business for the long haul. Don't think about the quarterly cycle as much as we do, is making the right level of investments, and we have -- that's how we've arrived at the number, and the guidance number, at $625 million to $675 million in CapEx.

And the same approach is on R&D, which is not a lot of really good projects out there right now, that have great ROIs for our customers. And so we're looking at those and always evaluating whether they should be done and whether you can bring the right value and the portfolio we have is, it's a fantastic portfolio, both for factory improvements, and one of the ones we mentioned, is the Chillicothe new paint facility, which will improve efficiencies and quality, just as an example.

And as we look at the R&D spending kinds of projects on powertrains, and we mentioned electric vehicles and autonomous vehicles and more aerodynamic truck models, improvements, all of those are things that we look at and say, hey, if we can do this, and it's going to make our already best in class trucks even better, then we're going to do them.

Courtney Yakavonis

And then just lastly, I think last quarter you called out some customer mix headwinds. Obviously, we saw an improvement in margins this quarter, part of that was just stockings from the headwinds from last quarter. But were there any customer mix changes this quarter that we should be thinking about, kind of for the remainder of the year?

Preston Feight

So I think we already kind of talked about North America being a positive for us in the quarter. And I think that's really the only minor thing that was -- I would say it was a contributor. But overall, good pricing, good cost control and a stronger North American mix.

Operator

Our next question comes from Adam Uhlman with Cleveland Research. Your line is now open.

Adam Uhlman

I wanted to start with a clarification of the fourth quarter production being down 6% to 8% sequentially. Could you break that out between your plans for North America and Europe?

Preston Feight

So I think they're fairly comparable without running exact numbers. They are both roughly in the same ranges in the quarterly, look at how they how they moved about high-single digits in North America, and it was a series of smaller steps through Europe, that did the same thing.

Adam Uhlman

And then, I'm wondering what your view is on medium-duty truck markets next year in North America and then also your thoughts on Europe as well?

Preston Feight

So for the medium-duty market in North America, I think we're seeing, it's around 100,000 in North America and right around 50,000 in Europe for next year. So, comparable numbers for this year.

Adam Uhlman

And then just back to Europe. I'm wondering if you would be willing to share with us, the magnitude of the order declines that you did see in that region, and do you get the sense that order rates are bottoming out now, if we start to see a leveling out of that pace of decline, or is that maybe still too early?

Preston Feight

It what we're really trying to look at, is what's going on with the cycle and what's going on with the timing of the calendar year, and in fact of recent, we've seen an improving order intake in Europe, actually it's matching up to our build, so that's been a nice balancing point. And hopefully that will be what continues.

Adam Uhlman

Is there any particular region or part of the continent that saw a nice improvement?

Preston Feight

Got to believe it has something to do with providing great trucks to our customers, and I think that really is a big part of it at the end of the day, because I think that we've been able to get to our record market shares in Europe and hold on to that share because people are experiencing our fantastic trucks and want some more of those.

Operator

Our next question comes from David Raso with Evercore ISI. Your line is now open.

David Raso

I was impressed with the parts outlook for next year. Can you give us a little more comfort on your visibility to project that kind of parts growth for next year? I know you have some help from the aging of the engines, hitting a sweet spot. But can you help us get a little more comfort with that stronger growth?

Preston Feight

Yes, sure. I think that strong growth is a result of, as you said the engines. It's also this investment in TRP that we're doing. Our team there does a fantastic job in e-commerce and in reaching out to our customers through new ways that are meeting their needs. So we're able to just kind of keep taking more and more of the market.

These investments in our PDCs that we mentioned, both in Ponta Grossa in Brazil and in Las Vegas, allow us to get parts to the customers more quickly in those regions, which makes us a more desirable provider. And really frankly in partnership with our dealerships, who are fully committed to growing their parts business, because it's good for them, good for our customers and good for us, it's one of those real opportunities for win-win-win.

David Raso

Are there any metrics of any kind though that you for backlog of some kind or some parts -- percent of the parts business that has some sort of annual contract?

Preston Feight

Yes. Parts don't really work out that kind of a long backlog, it's much more of a...

David Raso

I appreciate that. But just any anything you're looking at, that might give us some more comfort on the number?

Preston Feight

Well, I think the comfort should come from the historically strong performance and then the reasons that we just talked about, which are just a lot of great products, growing relation of PACCAR products in Europe and North America over the past several years and that has also contributed to that growth and will continue to contribute to that growth, and some strong markets that we have a large part of trucks out there.

David Raso

And last, the European business, the leasing of trucks, can you help us a little bit, well you said there was less of it in this quarter, sort of, what are you seeing on that front for the mix going into next year?

Preston Feight

Missed the first part of your question on this side, can you say it again David?

David Raso

For the European business, the mix of businesses where there are some buyback guarantees and the leasing of the business, how you represent to the revenues, it impacted the price per unit delivery this quarter. Can you just help us take us through your thoughts on '20, on the mix for that into next year?

Preston Feight

I think it's probably going to run a lot like this '19 has gone. Those adjustments were more '19 to '18 than they were looking forward. So we're at a pretty stable rate of optional and fixed rate GRVs.

Operator

Our next question comes from Jeff Kauffman with Loop Capital Markets. Your line is now open.

Jeff Kauffman

A lot of my questions have been answered. I wanted to focus a little bit on tax rate, if that's okay. It looks like the tax rate outlook had come down a little bit, and maybe I'm not thinking about it right, I would have thought more North American exposure would have driven it higher? Am I wrong, does it drive it lower, and is that kind of a lower level of taxes that we should be thinking about for the rest of this year?

Harrie Schippers

The tax rate normally -- you should think about is a 23% level. We benefited in Q3 from higher R&D credits than originally anticipated. So those are our final returns.

Jeff Kauffman

So should I carry that through to the end of the year, or is it more of a third quarter thing?

Harrie Schippers

Well, I think you should think in terms of 23% for Q4 and for 2020.

David Raso

And as I look to -- okay. You said for 2020. That's my question, all my others have been answered. Thank you.

Operator

Our next question comes from Joe O'Dea with Vertical Research. Your line is now open.

Joe O'Dea

In U.S. and Canada, it looks like Class 6, 7 growth was pretty healthy in the quarter, and better than the market, and so curious, whether that's just sort of time...

Preston Feight

Joe, are you still there?

Ken Hastings

Lindsay, are you there?

Operator

Yes, I am showing that Joe is still connected.

Preston Feight

Well, I guess, we'll just -- we aren't hearing from you, we will just kind of try to extrapolate your question a little bit.

Ken Hastings

Or we could move on and maybe Joe can rejoin.

Operator

Our next question comes from Neil Frohnapple with Buckingham Research. Your line is now open.

Neil Frohnapple

I believe PACCAR's market share historically tends to be counter-cyclical. I mean is there any reason to think that your market share wouldn't be higher in 2020, and your production wouldn't outperform the industry? I guess I'm just asking the production question a little differently.

Preston Feight

Sure. I think, the trucks are performing exceptionally well in the field. I think our customers are experiencing that we're delivering the best fuel economy, and the lowest operating cost of any brand. So we do think that should drive our market share up, and looking forward to that happening, and working every day to make sure that does happen.

Neil Frohnapple

And then just going back to the parts sales growth outlook for next year, 4% to 6%. I'm presuming that the lower outlook, I guess relative to the 8% part segment CAGR that you talked about at the Investor Day, is more due to just fleets pulling back on spending and purchasing obviously a lot less trucks next year. So I guess, at what point do you think that growth rate can start to reaccelerate, in order for you guys to hit those long-term targets?

Preston Feight

Yes, I think that the 4% to 6% number is a nice steady growth rate in a market that's declining, as depending on what happens. And again, I think that there's a lot of things working right to it, as far as when it come back up. We'll keep our eyes on that, and watching for every opportunity to grow it.

Operator

Our next question comes from Robert Salmon with Wolfe Research. Your line is now open.

Robert Salmon

Could you give a little clarification on the used truck outlook, it sounded like in the third quarter, it was down 10% to 15%, is that what you guys are contemplating looking out, or are you contemplating kind of a similar absolute level of used truck sales, from a price perspective?

Preston Feight

Yes, I think that down amount that we've seen, maybe that will continue. It's obviously difficult to forecast entirely where it will stay settled out to. But...

Harrie Schippers

It could stay around for the next couple of quarters.

Preston Feight

And I think you know the thing we're looking at is just that there is -- there is still a really healthy demand out there for day cabs specifically, and although values are down, we have the advantage of PACCAR of having a mix of trucks. We are not very uniform in our truck distribution. A lot of day cabs, a lot of pickup and delivery, a lot of vocational trucks, and some sleeper trucks as well.

So I think our ability to move those trucks should at least perform to the market and probably outperform, and again, we'll keep getting the premium for those trucks.

Robert Salmon

And as I look at the gross margin outlook for the fourth quarter, can you give an update on what the price cost spread was in the third quarter? And then, looking out to the fourth quarter, if there are any sort of different assumptions you have built in there, just to get a sense of what sort of decrementals you guys are kind of thinking about in production, versus a different price cost mix?

Preston Feight

And so, in the third quarter, we saw a price of roughly 3% and cost of 1.5%. And I think in the fourth quarter, I think there will be more pricing pressure, but there could be some opportunity on costs, that we're evaluating right now.

Robert Salmon

And would you expect the cost opportunity to kind of continue, should it step up in 2020, relative to your experience in the fourth quarter? Or are you kind of thinking about something similar?

Preston Feight

I think it might be hard to guess out to what is going to be in 2020 right now.

Operator

[Operator Instructions] Our next question comes from Shawn Kim with Gabelli Funds. Your line is now open.

Shawn Kim

Just wanted to follow up on the parts business. I think at your Investor Day, you mentioned -- you guys expect to have 450,000 MX engines in service by 2024. But I guess, said another way, I mean is that the right way to look about your total addressable market for the parts business in the mid 2020s? So if -- I think the active U.S. Class 8 population is about 2.2 million trucks. I guess, out of that 2.2 million figure, what's the opportunity for you guys long-term regarding servicing those trucks on the road?

Preston Feight

So I think about it in a couple of different ways. One is, that you mentioned is, the growing MX park that's out there, we did add capacity to our Columbus engine plant, and increase our build rates of MX engines. In fact, in the second -- in the first half, I think we were 39%

MX, and in the third quarter we were 45%, so we saw some growth there and do see some continued upside for MX engines, as people get to realize the benefits of that great engine.

And then I think it's not just about our park of vehicles for Kenworth and Peterbilt and DAF for the engine. I think our team does a great job of also capturing into the all-mix business with the TRP brands, where 50% of those customers are new to PACCAR, which creates a great opportunity for growth for us as well.

And I think we're always looking at opportunities to grow, not just the parts business itself, but provide increased levels of service for our customers, and that comes through higher degrees of connectivity of the trucks, where we understand better what's going on. So all of those point to opportunities to keep growing the parts business over time.

Operator

There are no other questions in queue at this time. Are there any additional remarks from the company?

Ken Hastings

Yes. We'd like to thank everyone for joining the call and thank you, operator.

Operator

Ladies and gentlemen, this concludes PACCAR's earnings call. Thank you for participating. You may now disconnect.