PACCAR Inc. (PCAR)

Updated October 24th, 2019 by Eli Inkrot

Key Metrics

Current Price:	$75	**5 Year CAGR Estimate:**	8.9%	**Volatility Percentile:**	55.6%
Fair Value Price:	$88	**5 Year Growth Estimate:**	2.0%	**Momentum Percentile:**	86.0%
% Fair Value:	85%	**5 Year Valuation Multiple Estimate:**	3.3%	**Growth Percentile:**	10.4%
Dividend Yield:	4.4%	**5 Year Price Target**	$98	**Valuation Percentile:**	84.3%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	60.3%

Overview & Current Events

In 1905, William Pigott, Sr. founded Seattle Car Mfg. Co, focusing on railway and logging equipment, which would later become Pacific Car and Foundry Company and eventually PACCAR Inc. Today PACCAR designs and manufactures light, medium and heavy-duty trucks under the Kenworth (U.S., Canada, Mexico & Australia), Peterbilt (U.S. & Canada) and DAF (Netherlands, Belgium, Brazil & UK) nameplates. In addition, the company provides financial services, information technology, and distributes truck parts related to its principle business. PACCAR, a $26 billion market cap business with 28,000 employees, generates $23 billion in revenue and earnings of $2.2 billion on an annual basis.

On October 22nd, 2019 PACCAR released Q3 2019 results for the period ending September 30th, 2019. For the quarter PACCAR generated $6.37 billion in sales, which was an 11% increase compared to the $5.76 billion reported in Q3 2018. This result was driven by a 12.4% increase in truck sales. Net income totaled $607.9 million ($1.75 per share) compared to $545.3 million ($1.55 per share) in the year ago period. PACCAR delivered 49,300 trucks in the quarter.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.23	$1.25	$2.86	$3.12	$3.30	$3.82	$4.51	$3.85	$4.26	$6.24	***$6.80***	***$7.51***
DPS	$0.54	$0.69	$1.30	$1.58	$1.70	$1.86	$2.32	$1.56	$2.19	$3.16	***$3.28***	***$3.62***
Shares[1]	364	365	357	353	354	355	351	351	352	347	***347***	***345***

Note that PACCAR has an irregular dividend schedule in that the company pays a regular, four quarter dividend throughout the year but then supplements this with a special dividend towards the end of the year. The company has followed this practice for every year in the last two decades except for 2009. This method makes sense from a business prospective - only paying what you can afford or feel comfortable with instead of arbitrarily trying to bump up the payout regardless of performance or opportunities available - but you don't see it occur in practice very often.

PACCAR operates in a needed industry: roughly 70% of total U.S. freight is hauled by truck, and the company currently supplies about a third of the heavy duty market in the U.S., Canada, and Mexico. When economic times are good, the business is well positioned to capture its fair share of business. Moreover, the company's focus on owner-operators instead of large customers with pricing power has proven to be an advantage thus far. Further, the company's brands command a premium. Of course that is not to suggest that the company does not face risks, especially as it relates to growth. The business is largely cyclical, depending a great deal on general economic progress and the movement of goods. Moreover, there are new threats on the horizon such as disruption via autonomous vehicles, which could impact owner-operators in a disproportionate way. We are cautious when lesser times arrive, forecasting 2% growth.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	35.8	16.0	13.5	16.1	16.6	13.3	14.5	15.9	10.5	***11.1***	***13.0***
Avg. Yld.	1.6%	1.5%	2.8%	3.8%	3.2%	2.9%	3.9%	2.8%	3.2%	4.8%	***4.4%***	***3.7%***

[1] In millions.

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Absent the most recent recession, shares of PACCAR have traded hands with an average P/E ratio of about 14 or 15 times earnings. While earnings-per-share have risen dramatically as of late, we do not anticipate significant growth from this point (indeed, some analysts are even projecting negative growth). As such, we are more comfortable with a slightly lower starting earnings multiple, which still could mean solid gains from valuation expansion.

The 4%+ dividend yield won't show up on a typical finance website due to PACCAR paying a special dividend each year. We are comfortable including it, as it has been nearly as consistent (granted at varying levels) as the regular dividend. (The regular dividend sits at $0.32 per quarter, or an annual yield of roughly 1.7%, but this year's special dividend amounted to $2.00 per share.) The company targets a 45% to 55% payout ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	55%	45%	51%	52%	49%	51%	41%	51%	51%	***48%***	***48%***

PACCAR currently enjoys a competitive advantage in offering a premium product to owner-operators. This has served the company exceptionally well in the past. Moving forward this advantage is less certain, as PACCAR will face economic cyclicality and the possibility of consolidation via autonomous vehicles. Both of which could hit its core customer.

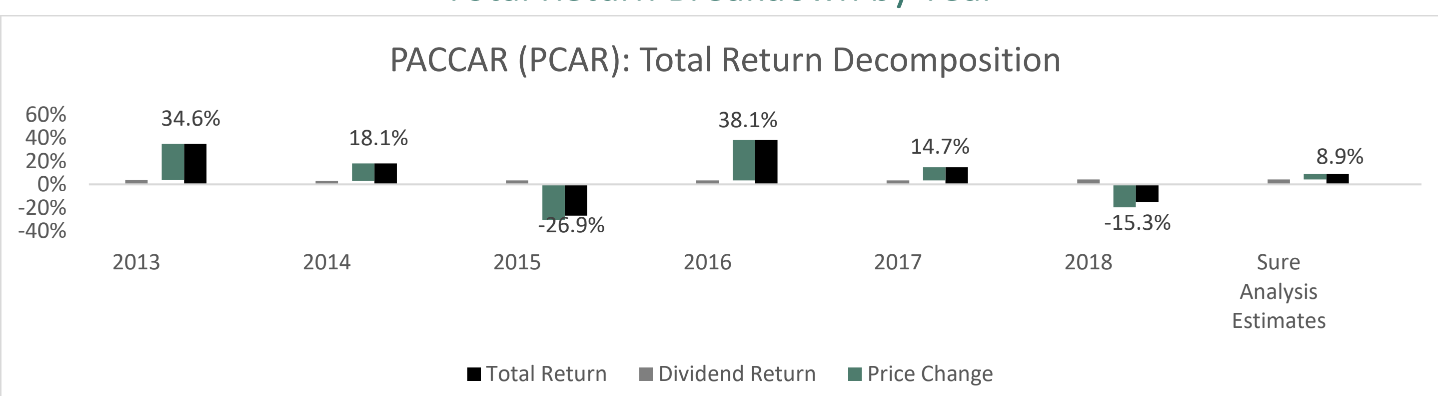
The company's last recession performance – generating earnings of $2.78, $0.23, $1.25 and $2.86 in 2008 through 2011 – is noteworthy. It shows just how far earnings can fall during lesser times, but also gives you some insight into the resilience of the business. Also noteworthy is PACCAR's record of 80 consecutive years of net profit (the last recession was close) and paying a dividend every year since 1941 (although the lumpiness should still be considered).

PACCAR breaks its balance sheet down into two parts: Trucks, Parts & Other and Financial Services. The Trucks, Parts & Other segment held $4.6 billion in cash and securities and $12.2 billion in total assets against $5.6 billion in total liabilities, with a debt-free industrial business. The Financial Services segment held $15.6 billion in assets against $12.2 billion in liabilities. Collectively, the business has its financial house in order.

Final Thoughts & Recommendation

Shares are up 4% since our last update. PACCAR faces two main risks: poor performance during recessions and autonomous (or otherwise) vehicle disruption. Still, the company has proven to be a quality firm over a business cycle, has a conservative financial stance and a premium product. We see 8.9% total return potential from a 2% growth rate, an above average 4.4% dividend yield and a moderate valuation tailwind. To that last point, it should be underscored that an investment thesis for PACCAR is somewhat valuation dependent, as we do not have particularly robust growth expectations. Collectively we believe the business is sound, but continue to rate shares as a hold at today's price.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	7585	10293	16355	17051	17124	18997	19115	17033	19456	23496
Gross Profit	1101	1430	2356	2466	2496	2793	3121	2753	2986	3656
Gross Margin	14.5%	13.9%	14.4%	14.5%	14.6%	14.7%	16.3%	16.2%	15.3%	15.6%
SG&A Exp.	435	482	547	572	560	561	542	540	555	645
D&A Exp.	652	623	674	701	811	918	907	993	1108	1054
Operating Profit	-80	649	1479	1596	1672	2001	2328	1947	2144	2689
Operating Margin	-1.1%	6.3%	9.0%	9.4%	9.8%	10.5%	12.2%	11.4%	11.0%	11.4%
Net Profit	112	458	1042	1112	1171	1359	1604	522	1675	2195
Net Margin	1.5%	4.4%	6.4%	6.5%	6.8%	7.2%	8.4%	3.1%	8.6%	9.3%
Free Cash Flow	402	668	-55	-284	503	586	831	336	869	1040
Income Tax	63	203	465	517	524	659	733	609	498	615

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	14569	14234	17173	18628	20726	20619	21110	20639	23440	25482
Cash & Equivalents	1912	2041	2107	1272	1750	1738	2016	1916	2365	N/A
Accounts Receivable	555	610	8238	9200	9832	10090	10183	9700	10825	1314
Inventories	632	534	710	782	814	926	797	728	928	1185
Goodwill & Int. Ass.	9465	8876	11808	12781	14091	13866	14169	13861	15390	16890
Total Liabilities	N/A	707	1462	1148	1397	1552	1287	1334	1621	5711
Accounts Payable	6073	5276	6655	7880	8424	8231	8592	8475	8879	0
Long-Term Debt	5104	5358	5364	5847	6634	6753	6940	6778	8051	8593
Shareholder's Equity										
D/E Ratio	1.19	0.98	1.24	1.35	1.27	1.22	1.24	1.25	1.10	0

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.7%	3.2%	6.6%	6.2%	6.0%	6.6%	7.7%	2.5%	7.6%	9.0%
Return on Equity	2.2%	8.7%	19.4%	19.8%	18.8%	20.3%	23.4%	7.6%	22.6%	26.4%
ROIC	1.0%	4.2%	9.2%	8.6%	8.1%	9.0%	10.5%	3.4%	10.4%	17.2%
Shares Out.	364	365	357	353	354	355	351	351	352	352
Revenue/Share	20.79	28.11	44.88	47.92	48.21	53.35	53.75	48.42	55.13	66.79
FCF/Share	1.10	1.82	-0.15	-0.80	1.42	1.65	2.34	0.95	2.46	2.96

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.