PACCAR Inc. (PCAR)

Updated July 22nd, 2020 by Eli Inkrot

Key Metrics

Current Price:	$86	**5 Year CAGR Estimate:**	0.8%	**Market Cap:**	$29.8 B
Fair Value Price:	$49	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	08/10/20
% Fair Value:	176%	**5 Year Valuation Multiple Estimate:**	-10.6%	**Dividend Payment Date:**	09/01/20
Dividend Yield:	1.5%	**5 Year Price Target**	$79	**Years Of Dividend Growth:**	10
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	14.3%

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 $30 billion market cap business with 28,000 employees, generated $24 billion in revenue and earnings of $2.4 billion last year.

On July 21st, 2020 PACCAR released Q2 2020 results for the period ending June 30th, 2020. For the quarter PACCAR generated $3.06 billion in sales compared to $6.63 billion in Q2 2019, as the company closed its factories for five weeks amid the COVID-19 pandemic. Truck sales were down -64% and Part sales were down -20%, while the Financial Services segment was flat. Net income equaled $147.7 million ($0.43 per share) compared to $619.7 million ($1.78 per share) in the year ago period. PACCAR delivered 18,100 trucks during the quarter compared to 52,300 in Q2 2019.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.25	$2.86	$3.12	$3.30	$3.82	$4.51	$3.85	$4.26	$6.24	$6.87	***$3.50***	***$5.64***
DPS	$0.69	$1.30	$1.58	$1.70	$1.86	$2.32	$1.56	$2.19	$3.16	$3.28	***$1.28***	***$2.82***
Shares[1]	365	357	353	354	355	351	351	352	347	348	***347***	***345***

PACCAR has an irregular dividend schedule: paying four regular quarterly dividends throughout the year and then supplementing this with a special dividend at yearend. 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 instead of arbitrarily trying to bump up the payout - but you don't see it occur in practice very often. With that in mind, we are not yet forecasting a special dividend this year due to the coronavirus uncertainty.

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 closing facilities in the past and the potential for this to occur again. The business is largely cyclical already - depending a great deal on general economic progress – and the crisis has exacerbated this inherent risk. We have greatly reducing our earnings estimate for this year. As a result, intermediate-term growth is pegged at a robust 10% annually, but this is coming off a much lower base and still implies reduced earnings expectations five years out.

[1] In millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	35.8	16.0	13.5	16.1	16.6	13.3	14.5	15.9	10.5	10.3	***24.6***	***14.0***
Avg. Yld.	1.5%	2.8%	3.8%	3.2%	2.9%	3.9%	2.8%	3.2%	4.8%	5.1%	***1.5%***	***3.8%***

Absent the most recent recession, shares of PACCAR have traded hands with an average P/E ratio of about 14 times earnings. While earnings-per-share had risen dramatically through 2019, we expect a significantly down year for 2020 and are more comfortable with the average earnings multiple. With shares trading near 25 times our reduced earnings expectation, this implies a significant valuation headwind, which is somewhat offset by an artificially high growth rate.

PACCAR pays a special dividend every year, but we are not currently including that in this year's forecast. If conditions improved this could be back on the table again, but we are not yet ready to make that leap considering the liquidity requirements that could be necessary during a recession. The company targets a 45% to 55% payout ratio, which we expect to continue in a normalized environment.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	55%	45%	51%	52%	49%	51%	41%	51%	51%	48%	***37%***	***50%***

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.

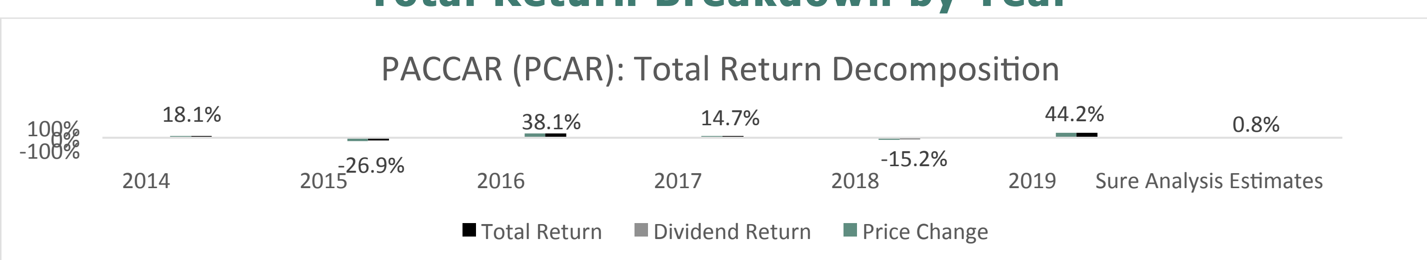
The company's last recession performance – generating earnings of $2.78, $0.23, $1.25 and $2.86 in 2008 through 2011 – is noteworthy. It shows just how far earnings can fall during lesser times, but also gives you some insight into the resilience of the business. Also noteworthy is PACCAR's record of 81 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 $4.2 billion in cash and securities and $11.4 billion in total assets against $5.0 billion in total liabilities. The Financial Services segment held $15.0 billion in assets against $11.7 billion in liabilities.

Final Thoughts & Recommendation

Shares are up a significant 30% since our last update, while earnings expectations have remained the same. 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. However, total return potential comes in at 0.8% per annum, stemming from a 10% growth rate and 1.5% dividend yield offset by a meaningful valuation headwind. We believe the business is sound but will face short-term challenges and may generate much lower profits this year. Due to the much higher valuation, shares earn a sell rating.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours

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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue ($B)	10	16	17	17	19	19	17	19	23	26
Gross Profit	1,430	2,356	2,466	2,496	2,793	3,121	2,737	2,950	3,656	4,015
Gross Margin	13.9%	14.4%	14.5%	14.6%	14.7%	16.3%	16.1%	15.2%	15.6%	15.7%
SG&A Exp.	482	547	572	560	561	542	543	572	645	699
D&A Exp.	623	674	701	811	918	907	993	1,108	1,054	1,077
Operating Profit	649	1,479	1,596	1,672	2,001	2,328	1,929	2,092	2,689	2,975
Operating Margin	6.3%	9.0%	9.4%	9.8%	10.5%	12.2%	11.3%	10.8%	11.4%	11.6%
Net Profit	458	1,042	1,112	1,171	1,359	1,604	522	1,675	2,195	2,388
Net Margin	4.4%	6.4%	6.5%	6.8%	7.2%	8.4%	3.1%	8.6%	9.3%	9.3%
Free Cash Flow	668	(55)	(284)	503	586	831	336	869	1,040	890
Income Tax	203	465	517	524	659	733	609	498	615	711

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	14,234	17,173	18,628	20,726	20,619	21,110	20,639	23,440	25,482	28,361
Cash & Equivalents	2,041	2,107	1,272	1,750	1,738	2,016	1,916	2,365	3,436	
Accts Receivable	610	8,238	9,200	9,832	10,090	10,183	9,700	10,825	12,155	1,306
Inventories	534	710	782	814	926	797	728	928	1,185	1,153
Total Liabilities	8,876	11,808	12,781	14,091	13,866	14,169	13,861	15,390	16,890	18,655
Accounts Payable	707	1,462	1,148	1,397	1,552	1,287	1,334	1,621	1,828	6,013
Long-Term Debt	5,276	6,655	7,880	8,424	8,231	8,592	8,475	8,879	9,951	-
Sh. Equity	5,358	5,364	5,847	6,634	6,753	6,940	6,778	8,051	8,593	9,706
D/E Ratio	0.98	1.24	1.35	1.27	1.22	1.24	1.25	1.10	1.16	-

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	3.2%	6.6%	6.2%	6.0%	6.6%	7.7%	2.5%	7.6%	9.0%	8.9%
Return on Equity	8.7%	19.4%	19.8%	18.8%	20.3%	23.4%	7.6%	22.6%	26.4%	26.1%
ROIC	4.2%	9.2%	8.6%	8.1%	9.0%	10.5%	3.4%	10.4%	12.4%	16.9%
Shares Out.	365	357	353	354	355	351	351	352	347	348
Revenue/Share	28.11	44.88	47.92	48.21	53.35	53.75	48.42	55.13	66.79	73.67
FCF/Share	1.82	(0.15)	(0.80)	1.42	1.65	2.34	0.95	2.46	2.96	2.56

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