LONG IDEAS 2/6/25

Front Seat to Profitability

We first made PACCAR Inc. (PCAR: $108/share) a Long Idea in July 2020. Since our original report PCAR has outperformed the market by 9%, gaining 95% compared to an 85% gain for the S&P 500. Even after this outperformance, we see more potential upside in PCAR.

PCAR offers favorable Risk/Reward based on the company's:

- industry leadership,
- long history of growing market share and profits,
- diversified business model,
- quality corporate governance that link executive pay to ROIC, and
- cheap stock valuation.

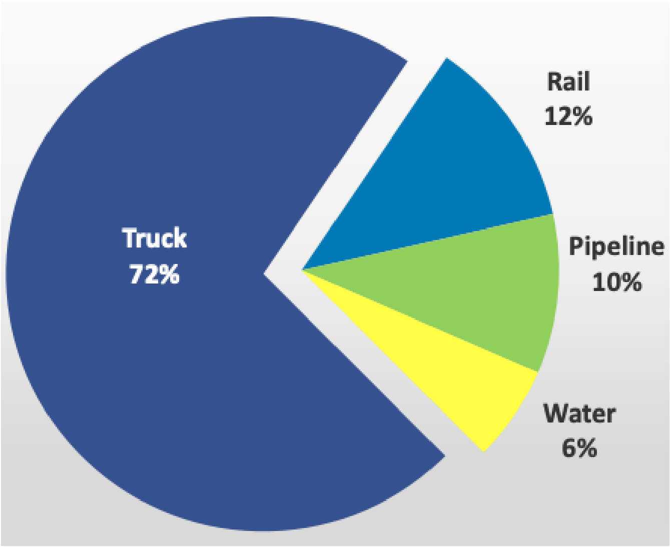
What's Working

Trucking Is Still the King of Freight

Trucking moves the U.S. economy. Trucking has been the dominant mode of freight transportation since the latter half of the 20th century because of its flexibility, cost-effectiveness, and accessibility.

In 2024, 72% of U.S. freight was moved by trucks, compared to 12% by rail, 10% by pipeline, and 6% by water ways. See Figure 1. According to PACCAR, a total of 39 million commercial trucks, including 4 million heavy-duty trucks, move that freight.

Figure 1: U.S. Freight by Transportation Method in 2024



Sources: PACCAR 4Q24 earnings presentation

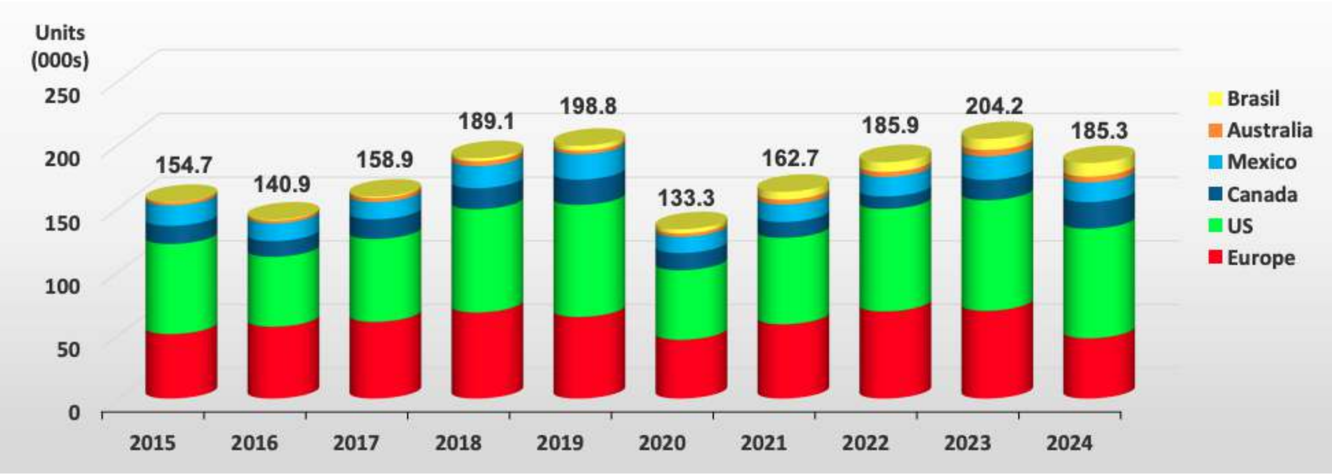
Production Is Trending Up in the Long-Term in a Growing Industry

Long-term demand for freight transportation remains strong. According to the American Trucking Associations, total truck tonnage in the U.S. will rise from an estimated 11.3 billion tons in 2024 to 14.0 billion tons in 2035. Over the same period, trucking industry revenues are estimated to grow from $906 billion to $1.5 trillion, which would grow the truck share of the freight market to 77% from 72% in 2024.

As one of the largest medium and heavy truck manufacturers in the world, PACCAR is well-positioned to benefit from this tail wind.

Although production was down from its all-time high in 2023, it's trending up in the long-term. PACCAR increased its truck production from 155 thousand trucks in 2015 to 185 thousand trucks in 2024. See Figure 2.

Figure 2: Trucks Produced by PACCAR: 2015 - 2024

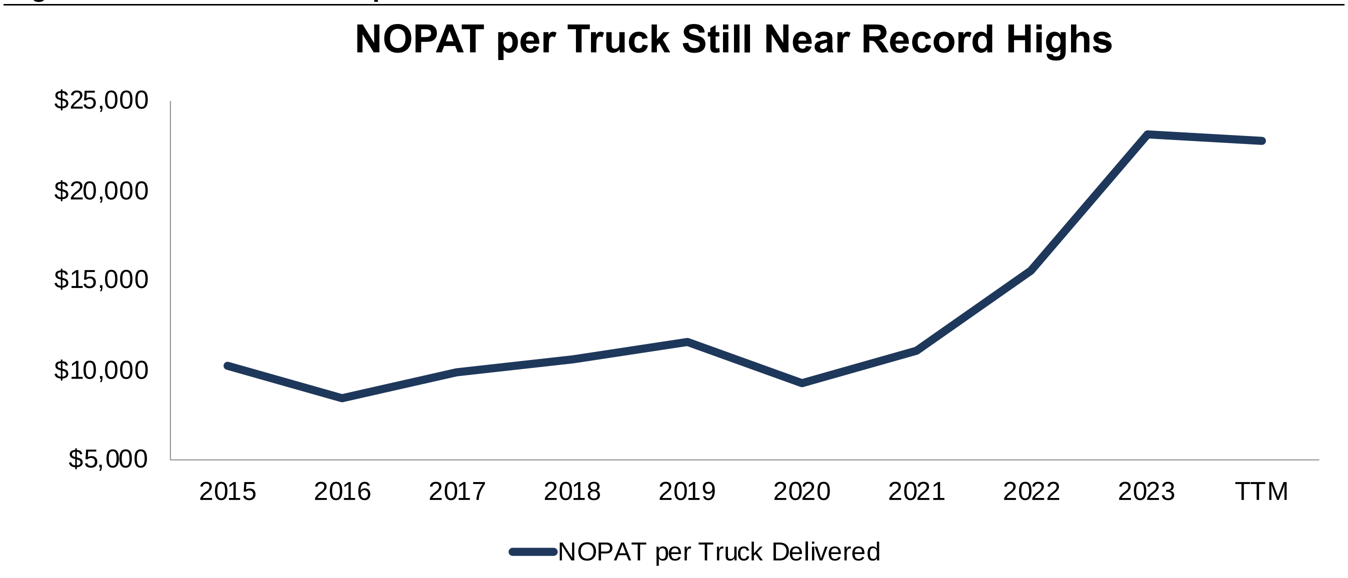


Sources: [PACCAR 4Q24 earnings presentation]

Increasing Profits per Truck

Not only is the number of trucks that PACCAR manufactures increasing, but the company is also making more profit per truck sold. PACCAR's NOPAT per truck, which is calculated by dividing its NOPAT by total truck unit sales, increased from $10,270 in 2015 to $22,791 in the TTM. See Figure 3.

Figure 3: PACCAR's NOPAT per Truck: 2015 – TTM



Sources: New Constructs, LLC and company filings

Parts Business Is Growing, Too

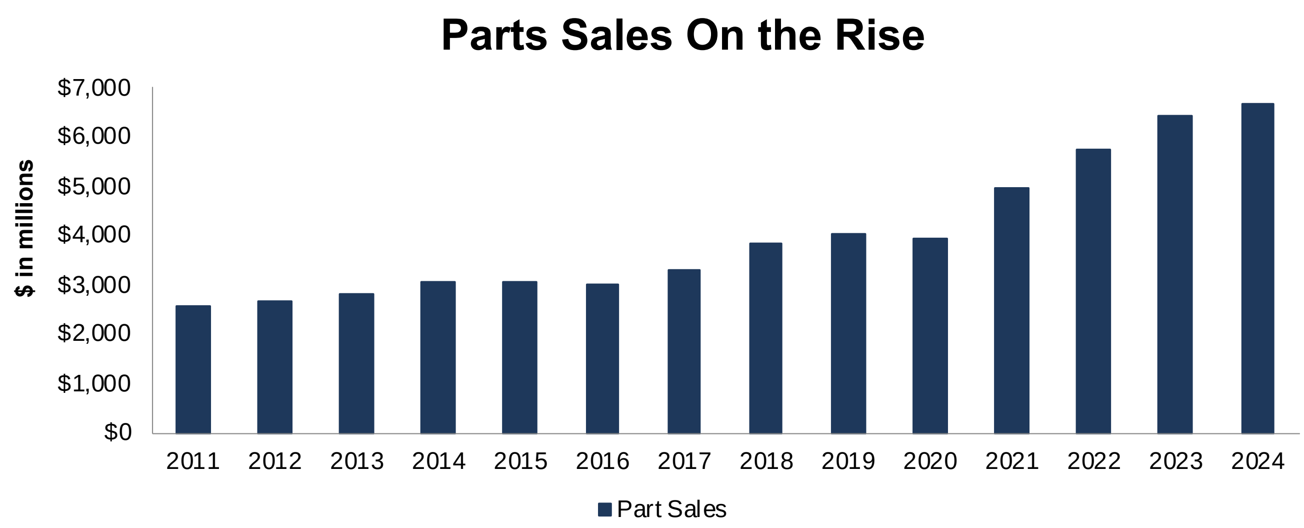
Aftermarket parts made up 20% of the company's revenue in 2024.

The company's parts segment has seen particularly strong growth in recent years. 2024 was a record year for PACCAR's parts segment, as it achieved record sales of $6.7 billion and record reported pretax profits of $1.7 billion.

Over the last two decades, PACCAR Parts sales grew 8% compounded annually. This growth was driven mainly by the increasing number of PACCAR branded trucks on the road, geographic expansion, and global market share growth. Additionally, PACCAR has grown the number of TRP (PACCAR's private label of aftermarket parts) locations, from 76 locations in 2016 to 353 locations in 2024, which helps boost parts sales.

PACCAR's parts segment is also becoming a larger part of the company's overall business. PACCAR's parts sales as a percentage of total revenue increased from 16% in 2011 to 20% in 2024.

Figure 4: PACCAR's Parts Sales: 2005 – 2024



Sources: New Constructs, LLC and company filings

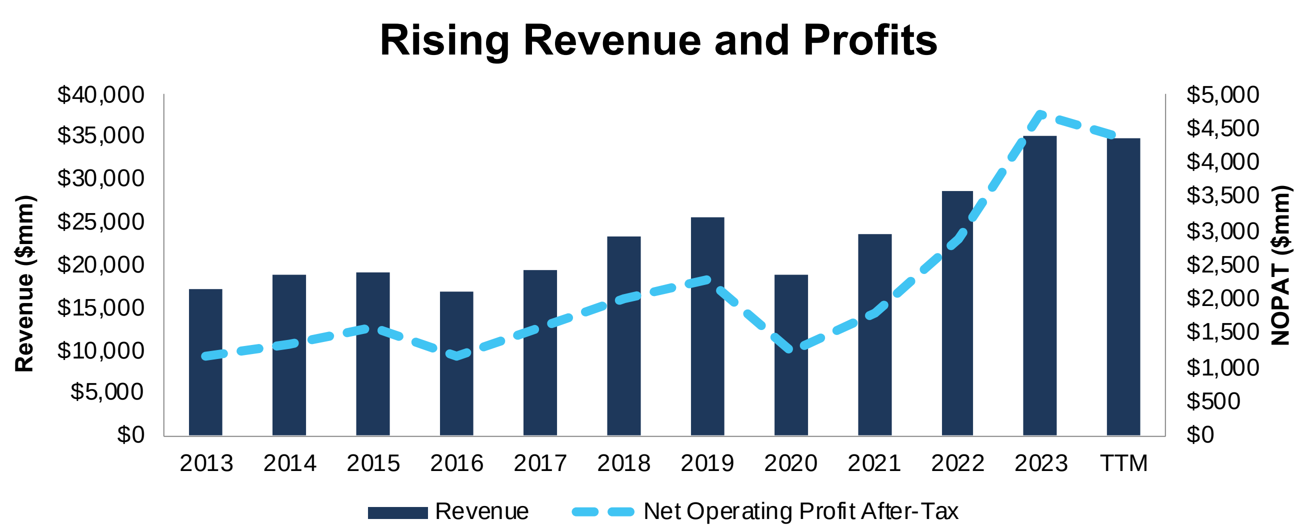
Growing Revenue and Profits

PACCAR has steadily grown its revenue and increased its margins over the past two decades. The company grew revenue and NOPAT by 7% and 11% compounded annually, respectively, over the last two decades.

More recently, PACCAR grew revenue and NOPAT by 7% and 13% compounded annually, respectively, over the last decade. See Figure 5.

PACCAR's NOPAT margin improved from 8% in 2013 to 13% in the TTM, while invested capital turns increased from 2.3 to 2.6 over the same time. Rising NOPAT margins and invested capital turns drive the company's ROIC from 16% in 2013 to 33% in the TTM.

Figure 5: PACCAR's Revenue and NOPAT: 2013 - TTM



Sources: New Constructs, LLC and company filings

Executive Compensation Aligns with Shareholders' Interests

We applaud companies that design executive compensation plans to align executives' interests with those of shareholders. PACCAR frequently emphasizes the importance of return on invested capital (ROIC) in its earnings calls and investor presentations. The company also uses ROIC to incentivize its management team.

PACCAR's long-term incentive compensation includes both equity and cash-based awards. The cash portion of this long-term compensation is paid out based on the three-year change in return on capital (similar to ROIC), net income, and return on sales compared to peer companies.

PACCAR's executive compensation plan gives us more trust in the management team to make investor-friendly decisions than we can have in companies that fail to align executive interests with those of shareholders.

Best-In-Class Profitability

An emphasis on ROIC in the company culture drives better profitability. Per Figure 6, PACCAR generates the highest ROIC amongst its peers, which include Caterpillar Inc. (CAT), Deere & Company (DE), Cummins Inc. (CMI), Honeywell International (HON), and more. The company boasts strong operational (margins) and balance sheet (invested capital turns) efficiencies to drive its high ROIC.

Figure 6: PACCAR's Profitability Vs. Peers: TTM

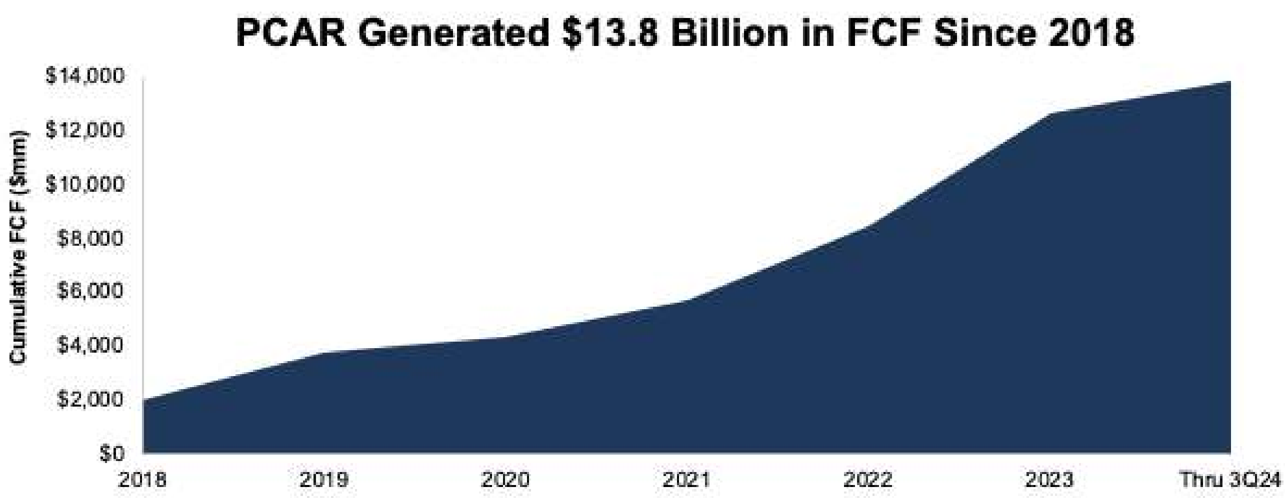
Ticker	Company	NOPAT Margin	Invested Capital Turns	ROIC
PCAR	**PACCAR Inc.**	**13%**	**2.6**	**33%**
CAT	Caterpillar Inc.	16%	1.5	24%
DE	Deere & Company	15%	1.5	22%
CMI	Cummins Inc.	9%	1.5	13%
HON	Honeywell International	17%	0.6	11%
OSK	Oshkosh Corporation	8%	1.3	10%
AGCO	AGCO Corporation	7%	1.2	8%

Sources: New Constructs, LLC and company filings

Strong Free Cash Flow

PACCAR has generated a cumulative $13.8 billion in FCF since 2018, which equals 28% of its enterprise value. PACCAR's large and rising FCF shows the company's ability to expand margins while also growing market share. See Figure 7.

Figure 7: PACCAR's Free Cash Flow: 2018 Through 3Q24



Sources: New Constructs, LLC and company filings

Attractive Dividends

PACCAR has been increasing its regular cash dividend steadily since the company began paying regular dividends in 2003. Since 2018, the company has paid $8.5 billion (15% of market cap) in cumulative special and regular dividends and has increased its quarterly dividend from $0.17/share in February 2018 to $0.33/share in February 2025. The company's current regular dividend, when annualized, provides a 1.2% yield. If the company were to continue to pay a special dividend equal to 2024 levels ($3.00/share in 2024) in 2025, the total dividend yield at the current price would be 3.9%.

PACCAR also returns capital to shareholders through share repurchases, though at much lower levels. In December 2018, the company's board of directors approved the repurchase of up to $500 million of its outstanding common stock with no expiration date. Since then, PACCAR repurchased $110 million of its stock, there were no repurchases made under the current authorization in the first nine months of 2024. $390 million worth of shares remain under the current repurchase authorization.

What's Not Working

Slowdown Could Continue in 2025

In its 4Q24 earnings presentation, PACCAR forecasted that in the >16 tonnage truck category, market size will slightly decrease both in the U.S. and Canada, as well as in Europe over the next year.

ACT Research, a commercial vehicle and freight forecasting provider, expects slower freight growth in 2025 due to "stabilized retail inventory levels and slower replenishment cycles."

Ebbs and flows in the trucking industry are nothing new, however. And importantly, PACCAR has proven its ability to generate profits throughout all cycles. PACCAR has never generated a negative NOPAT in the history of our model, which dates back to 1998. Perhaps even more impressive, the company has generated a negative FCF only twice in the history of our model, back in 2008 and again in 2001.

Best of all, for long-term investors, the drop in 2025 is more than priced into the current stock price.

Shares Have 34%+ Upside at Current Price

At its current price, PACCAR's price-to-economic book value (PEBV) ratio is 0.9. This ratio means the market expects the company's NOPAT to permanently decline 10% from TTM levels. This expectation seems overly pessimistic considering PACCAR has grown NOPAT by 13% compounded annually over the past 10 years and 11% compounded annually over the last 20 years.

Below, we use our reverse discounted cash flow (DCF) model to quantify the cash flow expectations for different stock price scenarios for PCAR.

In the first scenario, we quantify the expectations baked into the current price. We assume:

- NOPAT margin immediately falls to 8% (below five-year average of 10%), and
- revenue grows 5% compounded annually from 2024 to 2033 (compared to 7% compound annual growth over the past 10 and 20 years).

In this scenario, PACCAR's NOPAT would fall 1% compounded annually through 2033, and the stock would be worth $109/share today – equal to the current price. As noted above, PACCAR has grown NOPAT 13% compounded annually over the last decade and 11% over the last two decades.

Shares Could Go 34%+ Higher at Consensus Growth

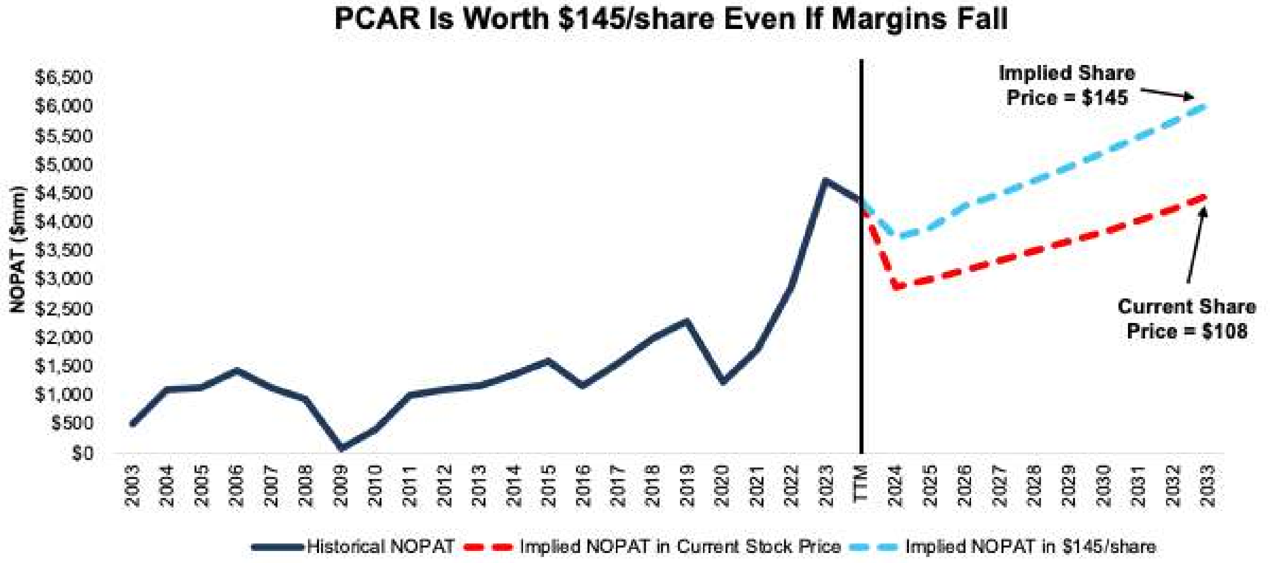
If we assume PACCAR's:

- NOPAT margin is falls to 11% (below TTM margin of 13%) from 2024 to 2033,
- revenue grows at consensus estimates in 2025 (4%), and 2026 (10%) and
- revenue grows 5% each year thereafter through 2033, then

PCAR would be worth at least $145/share today – a 34% upside to the current price. In this scenario, PACCAR's NOPAT grows just 3% compounded annually over the next decade.

Should PACCAR grow profits more in line with historical levels, the stock has even more upside. Figure 8 compares PACCAR's historical NOPAT to the NOPAT implied in each of the above DCF scenarios.

Figure 8: PACCAR's Historical and Implied NOPAT: DCF Valuation Scenarios



Sources: New Constructs, LLC and company filings.

This article was originally published on [February 6, 2025](#).

Disclosure: Hakan Salt owns PCAR. David Trainer, Kyle Guske II, and Hakan Salt receive no compensation to write about any specific stock, sector, style, or theme.

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It's Official: We Deliver the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

In The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

Ernst & Young features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Harvard Business School. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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