

PACCAR INC
Form 10-Q
August 03, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2018

Commission File No. 001-14817

PACCAR Inc

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	91-0351110 (I.R.S. Employer Identification No.)
---	--

777 - 106th Ave. N.E., Bellevue, WA 98004 (Address of principal executive offices) (Zip Code)
--

(425) 468-7400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Edgar Filing: PACCAR INC - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$1 par value — 350,543,255 shares as of July 31, 2018

PACCAR Inc – Form 10-Q

INDEX

	Page
PART I. <u>FINANCIAL INFORMATION:</u>	
ITEM 1. <u>FINANCIAL STATEMENTS:</u>	
<u>Consolidated Statements of Comprehensive Income –</u>	
<u>Three and Six Months Ended June 30, 2018 and 2017 (Unaudited)</u>	3
<u>Consolidated Balance Sheets –</u>	
<u>June 30, 2018 (Unaudited) and December 31, 2017</u>	4
<u>Condensed Consolidated Statements of Cash Flows –</u>	
<u>Six Months Ended June 30, 2018 and 2017 (Unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	7
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND</u>	
<u>RESULTS OF OPERATIONS</u>	31
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	47
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	47
PART II. <u>OTHER INFORMATION:</u>	47
ITEM 1. <u>LEGAL PROCEEDINGS</u>	47
ITEM	
1A. <u>RISK FACTORS</u>	47
ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	47
ITEM 6. <u>EXHIBITS</u>	48
<u>INDEX TO EXHIBITS</u>	48
<u>SIGNATURE</u>	51

PACCAR Inc – Form 10-Q

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Comprehensive Income (Unaudited)

(Millions Except Per Share Amounts)

	Three Months		Six Months Ended	
	Ended June 30 2018	2017	June 30 2018	2017
TRUCK, PARTS AND OTHER:				
Net sales and revenues	\$5,467.2	\$4,397.9	\$10,789.0	\$8,333.6
Cost of sales and revenues	4,647.3	3,764.0	9,182.8	7,154.9
Research and development	76.7	66.1	152.7	127.1
Selling, general and administrative	127.0	111.8	264.1	226.3
Interest and other (income), net	(16.4)	(11.9)	(35.1)	(25.9)
	4,834.6	3,930.0	9,564.5	7,482.4
Truck, Parts and Other Income Before Income Taxes	632.6	467.9	1,224.5	851.2
FINANCIAL SERVICES:				
Interest and fees	121.6	104.2	237.3	206.4
Operating lease, rental and other revenues	216.4	202.1	432.9	402.1
Revenues	338.0	306.3	670.2	608.5
Interest and other borrowing expenses	45.7	37.4	87.0	71.5
Depreciation and other expenses	185.5	172.8	371.9	352.5
Selling, general and administrative	29.8	26.9	60.9	52.6
Provision for losses on receivables	4.6	6.8	10.5	12.7
	265.6	243.9	530.3	489.3
Financial Services Income Before Income Taxes	72.4	62.4	139.9	119.2
Investment income	14.6	8.7	24.6	16.8
Total Income Before Income Taxes	719.6	539.0	1,389.0	987.2
Income taxes	160.0	166.0	317.3	303.9
Net Income	\$559.6	\$373.0	\$1,071.7	\$683.3
Net Income Per Share				
Basic	\$1.59	\$1.06	\$3.04	\$1.94
Diluted	\$1.59	\$1.06	\$3.04	\$1.94
Weighted Average Number of Common Shares Outstanding				
Basic	351.7	351.8	352.1	351.7
Diluted	352.5	352.7	353.0	352.7

Edgar Filing: PACCAR INC - Form 10-Q

Dividends declared per share	\$.28	\$.25	\$.53	\$.49
Comprehensive Income	\$384.2	\$505.8	\$971.6	\$886.2

See Notes to Consolidated Financial Statements.

- 3 -

PACCAR Inc – Form 10-Q

Consolidated Balance Sheets (Millions)

	June 30 2018 (Unaudited)	December 31 2017*
ASSETS		
TRUCK, PARTS AND OTHER:		
Current Assets		
Cash and cash equivalents	\$ 2,411.5	\$ 2,254.8
Trade and other receivables, net	1,546.9	1,127.9
Marketable debt securities	1,033.3	1,367.1
Inventories, net	1,258.5	928.4
Other current assets	492.9	404.4
Total Truck, Parts and Other Current Assets	6,743.1	6,082.6
Equipment on operating leases, net	711.0	1,265.7
Property, plant and equipment, net	2,397.4	2,464.4
Other noncurrent assets, net	673.4	425.2
Total Truck, Parts and Other Assets	10,524.9	10,237.9
FINANCIAL SERVICES:		
Cash and cash equivalents	95.3	109.9
Finance and other receivables, net	10,185.5	9,697.1
Equipment on operating leases, net	2,781.4	2,876.3
Other assets	568.7	519.0
Total Financial Services Assets	13,630.9	13,202.3
	\$ 24,155.8	\$ 23,440.2

*The December 31, 2017 consolidated balance sheet has been derived from audited financial statements. See Notes to Consolidated Financial Statements.

PACCAR Inc – Form 10-Q

Consolidated Balance Sheets (Millions)

	June 30 2018 (Unaudited)	December 31 2017*
LIABILITIES AND STOCKHOLDERS' EQUITY		
TRUCK, PARTS AND OTHER:		
Current Liabilities		
Accounts payable, accrued expenses and other	\$ 3,096.0	\$ 2,569.5
Dividend payable		422.1
Total Truck, Parts and Other Current Liabilities	3,096.0	2,991.6
Residual value guarantees and deferred revenues	758.2	1,339.0
Other liabilities	1,115.3	939.8
Total Truck, Parts and Other Liabilities	4,969.5	5,270.4
FINANCIAL SERVICES:		
Accounts payable, accrued expenses and other	517.1	466.2
Commercial paper and bank loans	3,130.6	2,933.9
Term notes	6,077.1	5,945.5
Deferred taxes and other liabilities	682.1	773.7
Total Financial Services Liabilities	10,406.9	10,119.3
STOCKHOLDERS' EQUITY:		
Preferred stock, no par value - authorized 1.0 million shares, none issued		
Common stock, \$1 par value - authorized 1.2 billion shares, issued 352.2 and 351.8 million shares	352.2	351.8
Additional paid-in capital	143.8	123.2
Treasury stock, at cost - 1.5 million and nil shares	(94.2)	
Retained earnings	9,271.3	8,369.1
Accumulated other comprehensive loss	(893.7)	(793.6)
Total Stockholders' Equity	8,779.4	8,050.5
	\$ 24,155.8	\$ 23,440.2

*The December 31, 2017 consolidated balance sheet has been derived from audited financial statements. See Notes to Consolidated Financial Statements.

PACCAR Inc – Form 10-Q

Condensed Consolidated Statements of Cash Flows (Unaudited)

(Millions)

	Six Months Ended June 30	
	2018	2017
OPERATING ACTIVITIES:		
Net income	\$1,071.7	\$683.3
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and amortization:		
Property, plant and equipment	179.8	151.5
Equipment on operating leases and other	362.0	376.7
Provision for losses on financial services receivables	10.5	12.7
Other, net	(2.7)	(8.8)
Pension contributions	(80.7)	(10.4)
Change in operating assets and liabilities:		
Trade and other receivables	(518.7)	(425.2)
Wholesale receivables on new trucks	(234.5)	(176.0)
Sales-type finance leases and dealer direct loans on new trucks	38.5	105.8
Inventories	(388.5)	(126.8)
Accounts payable and accrued expenses	661.4	422.2
Income taxes, warranty and other	99.7	180.2
Net Cash Provided by Operating Activities	1,198.5	1,185.2
INVESTING ACTIVITIES:		
Originations of retail loans and direct financing leases	(1,930.1)	(1,347.5)
Collections on retail loans and direct financing leases	1,464.9	1,324.0
Net decrease in wholesale receivables on used equipment	15.3	1.6
Purchases of marketable debt securities	(252.3)	(435.3)
Proceeds from sales and maturities of marketable debt securities	569.2	359.0
Payments for property, plant and equipment	(221.6)	(188.3)
Acquisitions of equipment for operating leases	(697.0)	(728.0)
Proceeds from asset disposals	308.3	244.2
Other, net	(1.9)	
Net Cash Used in Investing Activities	(745.2)	(770.3)
FINANCING ACTIVITIES:		
Payments of cash dividends	(608.5)	(382.5)
Purchases of treasury stock	(94.2)	
Proceeds from stock compensation transactions	10.9	18.8
Net increase in commercial paper and short-term bank loans	230.1	336.9
Proceeds from term debt	1,327.7	959.8
Payments on term debt	(1,144.6)	(1,440.8)
Net Cash Used in Financing Activities	(278.6)	(507.8)

Edgar Filing: PACCAR INC - Form 10-Q

Effect of exchange rate changes on cash	(32.6)	57.0
Net Increase (Decrease) in Cash and Cash Equivalents	142.1	(35.9)
Cash and cash equivalents at beginning of period	2,364.7	1,915.7
Cash and cash equivalents at end of period	\$2,506.8	\$1,879.8

See Notes to Consolidated Financial Statements.

- 6 -

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE A - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10 Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. For further information, refer to the consolidated financial statements and footnotes included in PACCAR Inc's (PACCAR or the Company) Annual Report on Form 10 K for the year ended December 31, 2017.

Earnings per Share: Basic earnings per common share are computed by dividing earnings by the weighted average number of common shares outstanding, plus the effect of any participating securities. Diluted earnings per common share are computed assuming that all potentially dilutive securities are converted into common shares under the treasury stock method. The dilutive and antidilutive options are shown separately in the table below.

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2018	2017	2018	2017
Additional shares	779,300	933,300	897,300	1,013,700
Antidilutive options	1,175,100	616,800	1,173,700	649,300

New Accounting Pronouncements

New Revenue Standard

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, including subsequently issued ASUs to clarify the implementation guidance in ASU 2014-09. Under the new revenue recognition model, a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The Company adopted this ASU for outstanding contracts on a modified retrospective basis on January 1, 2018.

The most significant effect of the standard relates to certain trucks sold in Europe that are subject to a residual value guarantee (RVG) and were accounted for as an operating lease in the Truck, Parts and Other section of the Company's Consolidated Balance Sheets. Prior to the adoption of ASU 2014-09, these sales were recognized on a straight-line basis over the guarantee period. Under the new standard, revenues are recognized upon transfer of control for certain

of these RVG contracts that allow customers the option to return their truck and for which there is no economic incentive to do so. The estimate of customers' economic incentive to return the truck is based on an analysis of historical guaranteed buyback value and estimated market value. A return asset and liability is recognized for estimated returns. Return rates are estimated by using a historical weighted average return rate over a four-year period. Also as required by the new standard, the Company recognized an asset for the value of expected returned aftermarket parts which had previously been netted with the related liabilities.

The cumulative effect of the changes made to the Company's Consolidated Balance Sheet on January 1, 2018 for the adoption of ASU 2014-09 was as follows:

	BALANCE AT	CHANGE	BALANCE AT
	DECEMBER 31, 2017	DUE TO NEW STANDARD	JANUARY 1, 2018
Consolidated Balance Sheets			
TRUCK, PARTS AND OTHER:			
Other current assets	\$ 404.4	\$ 100.0	\$ 504.4
Equipment on operating assets, net	1,265.7	(668.8)	596.9
Other noncurrent assets, net	425.2	115.0	540.2
Accounts payable, accrued expenses and other	2,569.5	103.1	2,672.6
Residual value guarantees and deferred revenue	1,339.0	(703.8)	635.2
Other liabilities	939.8	129.8	1,069.6
STOCKHOLDERS' EQUITY:			
Retained earnings	8,369.1	17.1	8,386.2

- 7 -

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

The following reconciles pro forma amounts as they would have been reported under the prior standard to current reporting:

	PRO FORMA		
	UNDER PRIOR	EFFECTS OF	CURRENTLY
Three Months Ended June 30, 2018	STANDARD	NEW STANDARD	REPORTED
Consolidated Statements of Comprehensive Income			
TRUCK, PARTS AND OTHER:			
Net sales and revenues	\$ 5,453.1	\$ 14.1	\$ 5,467.2
Cost of sales and revenues	4,636.0	11.3	4,647.3
Truck, Parts and Other Income Before Income Taxes	629.8	2.8	632.6
Total Income Before Income Taxes	716.8	2.8	719.6
Income taxes	159.3	.7	160.0
Net income	557.5	2.1	559.6
Comprehensive Income	383.4	.8	384.2

	PRO FORMA		
	UNDER PRIOR	EFFECTS OF	CURRENTLY
Six Months Ended June 30, 2018	STANDARD	NEW STANDARD	REPORTED
Consolidated Statements of Comprehensive Income			
TRUCK, PARTS AND OTHER:			
Net sales and revenues	\$ 10,767.3	\$ 21.7	\$ 10,789.0
Cost of sales and revenues	9,168.3	14.5	9,182.8
Truck, Parts and Other Income Before Income Taxes	1,217.3	7.2	1,224.5
Total Income Before Income Taxes	1,381.8	7.2	1,389.0
Income taxes	315.5	1.8	317.3

Net income	1,066.3	5.4	1,071.7
Comprehensive Income	966.9	4.7	971.6

	PRO FORMA	UNDER PRIOR	EFFECTS OF	CURRENTLY
At June 30, 2018	STANDARD	NEW STANDARD	REPORTED	
Consolidated Balance Sheets				
TRUCK, PARTS AND OTHER:				
Other current assets	\$ 383.9	\$ 109.0		\$ 492.9
Equipment on operating leases, net	1,426.3	(715.3)	711.0
Other noncurrent assets, net	543.5	129.9		673.4
Accounts payable, accrued expenses and other	2,983.9	112.1		3,096.0
Residual value guarantees and deferred revenue	1,513.8	(755.6)	758.2
Other liabilities	970.0	145.3		1,115.3
STOCKHOLDERS' EQUITY:				
Total stockholders' equity	8,757.6	21.8		8,779.4

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

New Pension Standard

In March 2017, FASB issued ASU 2017-07 Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The amendment disaggregates the service cost component from non-service cost components of pension expense and prescribes where to present the various components of pension cost on the income statement. This ASU also allows only the service cost component to be eligible for capitalization, when applicable (e.g. as a cost of manufactured inventory or self-constructed assets). The Company adopted this ASU in January 2018 and accordingly applied the income statement presentation of service and non-service components of pension expense retrospectively and the capitalization of service cost prospectively. Adoption of this ASU had no impact on net income. The retrospective application of this ASU had the following effects on the Consolidated Statement of Comprehensive Income:

	PREVIOUSLY REPORTED	EFFECTS OF NEW STANDARD	CURRENTLY REPORTED
Three Months Ended June 30, 2017			
Consolidated Statements of Comprehensive Income			
TRUCK, PARTS AND OTHER:			
Cost of sales and revenues	\$ 3,755.2	\$ 8.8	\$ 3,764.0
Selling, general and administrative	107.8	4.0	111.8
Interest and other (income), net	1.5	(13.4)	(11.9)
Truck, Parts and Other Income Before Income Taxes	467.3	.6	467.9
FINANCIAL SERVICES:			
Selling, general and administrative	26.3	.6	26.9
Financial Services Income Before Income Taxes	63.0	(.6)	62.4

	PREVIOUSLY REPORTED	EFFECTS OF NEW STANDARD	CURRENTLY REPORTED
Six Months Ended June 30, 2017			
Consolidated Statements of Comprehensive Income			
TRUCK, PARTS AND OTHER:			
Cost of sales and revenues	\$ 7,137.4	\$ 17.5	\$ 7,154.9
Selling, general and administrative	219.1	7.2	226.3
Interest and other (income), net	(.1)	(25.8)	(25.9)
Truck, Parts and Other Income Before Income Taxes	850.1	1.1	851.2
FINANCIAL SERVICES:			
Selling, general and administrative	51.5	1.1	52.6
Financial Services Income Before Income Taxes	120.3	(1.1)	119.2

Other Standards

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02 Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendment requires a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for the difference between the historical corporate income tax rate and the newly enacted income tax rate resulting from the Tax Cuts and Jobs Act. This ASU is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods and early adoption is permitted. Upon adoption, the Company estimates Retained earnings will increase and AOCI will decrease approximately \$30 million with no impact to Stockholders' Equity. The Company expects to early adopt this ASU in the fourth quarter of 2018.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendment in this ASU requires entities having financial assets measured at amortized cost to estimate credit reserves under an expected credit loss model rather than the current incurred loss model. Under this new model, expected credit losses will be based on relevant information about past events, including historical experience, current conditions and reasonable and supportable forecasts that affect collectability. The ASU is effective for annual periods beginning after December 15, 2019 and interim periods within those annual periods. Early adoption is permitted, but not earlier than annual and interim periods beginning after December 15, 2018. This amendment should be applied on a modified retrospective basis with a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact on its consolidated financial statements.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), including subsequently issued ASUs to clarify the implementation guidance in ASU 2016-02. Under the new lease standard, lessees will recognize a right-of-use asset and a lease liability for virtually all leases (other than short-term leases). Lessor accounting is largely unchanged. The ASU is effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods. Early adoption is permitted. This ASU requires leases to be recognized and measured at the beginning of the earliest period presented using a modified retrospective approach with optional practical expedients. The Company is currently evaluating the impact on its consolidated financial statements.

In addition to adopting the ASUs discussed above, the Company adopted the following standards effective January 1, 2018, none of which had a material impact on the Company's consolidated financial statements.

STANDARD DESCRIPTION

2016-01 * Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.

2016-15 * Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.

2017-12 ** Derivative and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.

*The Company adopted on the effective date of January 1, 2018.

**The Company early adopted in 2018.

The FASB also issued the following standard, which is not expected to have a material impact on the Company's consolidated financial statements.

STANDARD	DESCRIPTION	EFFECTIVE DATE
2018-07 *	Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting.	January 1, 2019

*The Company will adopt on the effective date.

NOTE B – Sales and Revenues

The Company enters into sales contracts with customers associated with purchases of the Company's products and services including trucks, parts, product support, and other related services. Generally, the Company recognizes revenue for the amount of consideration it will receive for delivering a product or service to a customer. Revenue is recognized when the customer obtains control of the product or receives benefits of the service. The Company

excludes sales taxes, value added taxes and other related taxes assessed by government agencies from revenue. There are no significant financing components included in product or services revenue since, generally customers pay shortly after the products or services are transferred. In the Truck and Parts segment, when the Company grants extended payment terms on selected receivables and charges interest, interest income is recognized when earned.

The following table disaggregates Truck, Parts and Other revenues by major sources:

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Truck		
Truck sales	\$4,274.7	\$8,449.1
Revenues from extended warranties, operating leases and other	193.1	371.7
	4,467.8	8,820.8
Parts		
Parts sales	942.5	1,854.6
Revenues from dealer services and other	25.5	53.3
	968.0	1,907.9
Winch sales and other	31.4	60.3
Truck, Parts and Other sales and revenues	\$5,467.2	\$10,789.0

The Company recognizes truck and parts sales as revenue when control of the products is transferred to customers which generally occurs upon shipment, except for certain truck sales which are subject to a residual value guarantee by the Company. The standard payment term for trucks and aftermarket parts is typically within 30 days, but the Company may grant extended payment terms on selected receivables. The Company recognizes revenue for the invoice amount adjusted for estimated sales incentives and returns. Sales incentives and returns are estimated based on historical experience and are adjusted to current period revenue when the most

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

likely amount of consideration the Company expects to receive changes or becomes fixed. Truck and part sales include a standard product warranty which is included in cost of sales. The Company has elected to treat delivery services as a fulfillment activity with revenues recognized when the customer obtains control of the product. Delivery revenue is included in revenues and the related costs are included in cost of sales. As a practical expedient, the Company is not disclosing truck order backlog, as a significant majority of the backlog has a duration of less than one year.

Truck sales with RVGs that allow customers the option to return their truck are accounted for as a sale when the customer does not have an economic incentive to return the truck to the Company, or as an operating lease when the customer does have an economic incentive to return the truck. The estimate of customers' economic incentive to return the trucks is based on an analysis of historical guaranteed buyback value and estimated market value. When truck sales with RVGs are accounted for as a sale, revenue is recognized when the truck is transferred to the customer less an amount for expected returns. Expected return rates are estimated by using a historical weighted average return rate over a four-year period. The estimated value of the returned truck assets and the related return liabilities at June 30, 2018 were \$193.2 and \$201.4, respectively.

Revenues from extended warranties, operating leases and other includes optional extended warranty and repair and maintenance service contracts which can be purchased for periods generally ranging up to five years. The Company defers revenue based on stand-alone observable selling prices when it receives payments in advance and recognizes the revenue on a straight-line basis over the warranty or repair and maintenance contract periods. See Footnote F, Product Support Liabilities, in the Notes to the Consolidated Financial Statements for further information. Also included are truck sales with an RVG accounted for as an operating lease. A liability is created for the residual value obligation with the remainder of the proceeds recorded as deferred revenue. The deferred revenue is recognized on a straight-line basis over the guarantee period, which typically ranges from three to five years. Deferred revenue related to trucks sold with a residual value guarantee was \$758.1 at June 30, 2018. The Company expects to recognize approximately \$130.0 of the remaining deferred revenue in 2018, \$252.6 in 2019, \$231.6 in 2020, \$81.6 in 2021, \$45.6 in 2022 and \$16.7 thereafter.

Aftermarket parts sales allow for returns which are estimated at the time of sale based on historical data. The estimated value of the returned goods asset was \$45.7 and the related return liability was \$95.2 at June 30, 2018. The Company decreased parts sales by \$3.6 in the second quarter of 2018 due to changes in the reserve balance. Parts dealer services and other revenues are recognized as services are performed.

Revenue from winch sales and other is primarily derived from the industrial winch business. Winch sales are recognized when the product is transferred to a customer. Also within this category are other revenues not attributable to a reportable segment.

NOTE C - Investments in Marketable Debt Securities

The Company's investments in marketable debt securities are classified as available-for-sale. These investments are stated at fair value with any unrealized gains or losses, net of tax, included as a component of accumulated other comprehensive income (loss) (AOCI).

The Company utilizes third-party pricing services for all of its marketable debt security valuations. The Company reviews the pricing methodology used by the third party pricing services, including the manner employed to collect market information. On a quarterly basis, the Company also performs review and validation procedures on the pricing information received from the third party providers. These procedures help ensure that the fair value information used by the Company is determined in accordance with applicable accounting guidance.

The Company evaluates its investment in marketable debt securities at the end of each reporting period to determine if a decline in fair value is other-than-temporary. Realized losses are recognized upon management's determination that a decline in fair value is other-than-temporary. The determination of other-than-temporary impairment is a subjective process, requiring the use of judgments and assumptions regarding the amount and timing of recovery. The Company reviews and evaluates its investments at least quarterly to identify investments that have indications of other-than-temporary impairments. It is reasonably possible that a change in estimate could occur in the near term relating to other-than-temporary impairment. Accordingly, the Company considers several factors when evaluating debt securities for other-than-temporary impairment, including whether the decline in fair value of the security is due to increased default risk for the specific issuer or market interest-rate risk.

In assessing default risk, the Company considers the collectability of principal and interest payments by monitoring changes to issuers' credit ratings, specific credit events associated with individual issuers as well as the credit ratings of any financial guarantor, and the extent and duration to which amortized cost exceeds fair value.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

In assessing market interest rate risk, including benchmark interest rates and credit spreads, the Company considers its intent for selling the securities and whether it is more likely than not the Company will be able to hold these securities until the recovery of any unrealized losses.

Marketable debt securities at June 30, 2018 and December 31, 2017 consisted of the following:

At June 30, 2018	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
U.S. tax-exempt securities	\$ 468.8	\$.1	\$ 1.7	\$467.2
U.S. corporate securities	84.2	.1	.4	83.9
U.S. government and agency securities	59.2		.5	58.7
Non-U.S. corporate securities	255.7	.4	2.0	254.1
Non-U.S. government securities	49.6	.2	.1	49.7
Other debt securities	120.9		1.2	119.7
	\$ 1,038.4	\$.8	\$ 5.9	\$1,033.3

At December 31, 2017	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
U.S. tax-exempt securities	\$ 537.9		\$ 2.4	\$535.5
U.S. corporate securities	89.7	\$.2	.2	89.7
U.S. government and agency securities	48.9		.2	48.7
Non-U.S. corporate securities	459.4	1.3	1.4	459.3
Non-U.S. government securities	91.5	.3	.1	91.7
Other debt securities	142.8	.1	.7	142.2
	\$ 1,370.2	\$ 1.9	\$ 5.0	\$1,367.1

The cost of marketable debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Amortization, accretion, interest and dividend income and realized gains and losses are included in investment income. The cost of securities sold is based on the specific identification method. Gross realized gains were \$.9 and \$.9 and gross realized losses were \$.5 and \$.3 for the six months periods ended June 30, 2018 and 2017, respectively.

Marketable debt securities with continuous unrealized losses and their related fair values were as follows:

	June 30, 2018		December 31, 2017	
	LESS	TWELVE MONTHS	LESS	TWELVE MONTHS
	THAN	GREATER	THAN	GREATER
	TWELVE MONTHS	TWELVE MONTHS	TWELVE MONTHS	TWELVE MONTHS
Fair value	\$ 710.3	\$ 82.4	\$ 908.5	\$ 18.4

Unrealized losses	4.7	1.2	4.8	.2
-------------------	-----	-----	-----	----

For the investment securities in gross unrealized loss positions identified above, the Company does not intend to sell the investment securities. It is more likely than not that the Company will not be required to sell the investment securities before recovery of the unrealized losses, and the Company expects that the contractual principal and interest will be received on the investment securities. As a result, the Company recognized no other-than-temporary impairments during the periods presented.

Contractual maturities on marketable debt securities at June 30, 2018 were as follows:

Maturities:	AMORTIZED COST	FAIR VALUE
Within one year	\$ 292.0	\$291.7
One to five years	730.5	725.7
Six to ten years	.2	.2
More than ten years	15.7	15.7
	\$ 1,038.4	\$1,033.3

- 12 -

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE D - Inventories

Inventories are stated at the lower of cost or market. Cost of inventories in the U.S. is determined principally by the last in, first-out (LIFO) method. Cost of all other inventories is determined principally by the first-in, first-out (FIFO) method.

Inventories include the following:

	June 30 2018	December 31 2017
Finished products	\$590.6	\$ 515.7
Work in process and raw materials	846.0	586.2
	1,436.6	1,101.9
Less LIFO reserve	(178.1)	(173.5)
	\$1,258.5	\$ 928.4

Under the LIFO method of accounting (used for approximately 45% of June 30, 2018 inventories), an actual valuation can be made only at the end of each year based on year-end inventory levels and costs. Accordingly, interim valuations are based on management's estimates of those year-end amounts.

NOTE E - Finance and Other Receivables

Finance and other receivables include the following:

	June 30 2018	December 31 2017
Loans	\$4,436.1	\$ 4,147.8
Direct financing leases	3,285.5	3,211.7
Sales-type finance leases	712.5	781.1
Dealer wholesale financing	2,069.7	1,880.6
Operating lease receivables and other	157.8	161.1
Unearned interest: Finance leases	(363.4)	(368.0)
	\$10,298.2	\$ 9,814.3
Less allowance for losses:		
Loans and leases	(102.7)	(101.9)
Dealer wholesale financing	(6.2)	(6.0)
Operating lease receivables and other	(3.8)	(9.3)

\$10,185.5 \$ 9,697.1

Recognition of interest income and rental revenue is suspended (put on non-accrual status) when the receivable becomes more than 90 days past the contractual due date or earlier if some other event causes the Company to determine that collection is not probable. Accordingly, no finance receivables more than 90 days past due were accruing interest at June 30, 2018 or December 31, 2017. Recognition is resumed if the receivable becomes current by the payment of all amounts due under the terms of the existing contract and collection of remaining amounts is considered probable (if not contractually modified) or if the customer makes scheduled payments for three months and collection of remaining amounts is considered probable (if contractually modified). Payments received while the finance receivable is on non-accrual status are applied to interest and principal in accordance with the contractual terms.

Allowance for Credit Losses

The Company continuously monitors the payment performance of its finance receivables. For large retail finance customers and dealers with wholesale financing, the Company regularly reviews their financial statements and makes site visits and phone contact as appropriate. If the Company becomes aware of circumstances that could cause those customers or dealers to face financial difficulty, whether or not they are past due, the customers are placed on a watch list.

- 13 -

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

The Company modifies loans and finance leases in the normal course of its Financial Services operations. The Company may modify loans and finance leases for commercial reasons or for credit reasons. Modifications for commercial reasons are changes to contract terms for customers that are not considered to be in financial difficulty. Insignificant delays are modifications extending terms up to three months for customers experiencing some short-term financial stress, but not considered to be in financial difficulty. Modifications for credit reasons are changes to contract terms for customers considered to be in financial difficulty. The Company's modifications typically result in granting more time to pay the contractual amounts owed and charging a fee and interest for the term of the modification.

When considering whether to modify customer accounts for credit reasons, the Company evaluates the creditworthiness of the customers and modifies those accounts that the Company considers likely to perform under the modified terms. When the Company modifies loans and finance leases for credit reasons and grants a concession, the modifications are classified as troubled debt restructurings (TDR). The Company does not typically grant credit modifications for customers that do not meet minimum underwriting standards since the Company normally repossesses the financed equipment in these circumstances. When such modifications do occur, they are considered TDRs.

On average, modifications extended contractual terms by approximately five months in 2018 and 2017 and did not have a significant effect on the weighted average term or interest rate of the total portfolio at June 30, 2018 and December 31, 2017.

The Company has developed a systematic methodology for determining the allowance for credit losses for its two portfolio segments, retail and wholesale. The retail segment consists of retail loans and direct and sales-type finance leases, net of unearned interest. The wholesale segment consists of truck inventory financing loans to dealers that are collateralized by trucks and other collateral. The wholesale segment generally has less risk than the retail segment. Wholesale receivables generally are shorter in duration than retail receivables, and the Company requires periodic reporting of the wholesale dealer's financial condition, conducts periodic audits of the trucks being financed and in many cases, obtains guarantees or other security such as dealership assets. In determining the allowance for credit losses, retail loans and finance leases are evaluated together since they relate to a similar customer base, their contractual terms require regular payment of principal and interest, generally over 36 to 60 months, and they are secured by the same type of collateral. The allowance for credit losses consists of both specific and general reserves.

The Company individually evaluates certain finance receivables for impairment. Finance receivables that are evaluated individually for impairment consist of all wholesale accounts and certain large retail accounts with past due balances or otherwise determined to be at a higher risk of loss. A finance receivable is impaired if it is considered probable the Company will be unable to collect all contractual interest and principal payments as scheduled. In addition, all retail loans and leases which have been classified as TDRs and all customer accounts over 90 days past due are considered impaired. Generally, impaired accounts are on non-accrual status. Impaired accounts classified as TDRs which have been performing for 90 consecutive days are placed on accrual status if it is deemed probable that the Company will collect all principal and interest payments.

Impaired receivables are generally considered collateral dependent. Large balance retail and all wholesale impaired receivables are individually evaluated to determine the appropriate reserve for losses. The determination of reserves for large balance impaired receivables considers the fair value of the associated collateral. When the underlying collateral fair value exceeds the Company's recorded investment, no reserve is recorded. Small balance impaired receivables with similar risk characteristics are evaluated as a separate pool to determine the appropriate reserve for losses using the historical loss information discussed below.

The Company evaluates finance receivables that are not individually impaired on a collective basis and determines the general allowance for credit losses for both retail and wholesale receivables based on historical loss information, using past due account data and current market conditions. Information used includes assumptions regarding the likelihood of collecting current and past due accounts, repossession rates, the recovery rate on the underlying collateral based on used truck values and other pledged collateral or recourse. The Company has developed a range of loss estimates for each of its country portfolios based on historical experience, taking into account loss frequency and severity in both strong and weak truck market conditions. A projection is made of the range of estimated credit losses inherent in the portfolio from which an amount is determined as probable based on current market conditions and other factors impacting the creditworthiness of the Company's borrowers and their ability to repay. After determining the appropriate level of the allowance for credit losses, a provision for losses on finance receivables is charged to income as necessary to reflect management's estimate of incurred credit losses, net of recoveries, inherent in the portfolio.

In determining the fair value of the collateral, the Company uses a pricing matrix and categorizes the fair value as Level 2 in the hierarchy of fair value measurement. The pricing matrix is reviewed quarterly and updated as appropriate. The pricing matrix considers the make, model and year of the equipment as well as recent sales prices of comparable equipment sold individually, which is the lowest unit of account, through wholesale channels to the Company's dealers (principal market). The fair value of the collateral also considers the overall condition of the equipment.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Accounts are charged-off against the allowance for credit losses when, in the judgment of management, they are considered uncollectible, which generally occurs upon repossession of the collateral. Typically the timing between the repossession and charge-off is not significant. In cases where repossession is delayed (e.g., for legal proceedings), the Company records a partial charge-off. The charge-off is determined by comparing the fair value of the collateral, less cost to sell, to the recorded investment.

For the following credit quality disclosures, finance receivables are classified into two portfolio segments, wholesale and retail. The retail portfolio is further segmented into dealer retail and customer retail. The dealer wholesale segment consists of truck inventory financing to PACCAR dealers. The dealer retail segment consists of loans and leases to participating dealers and franchises that use the proceeds to fund customers' acquisition of commercial vehicles and related equipment. The customer retail segment consists of loans and leases directly to customers for the acquisition of commercial vehicles and related equipment. Customer retail receivables are further segregated between fleet and owner/operator classes. The fleet class consists of customer retail accounts operating more than five trucks. All other customer retail accounts are considered owner/operator. These two classes have similar measurement attributes, risk characteristics and common methods to monitor and assess credit risk.

The allowance for credit losses is summarized as follows:

	2018					
	DEALER		CUSTOMER		TOTAL	
	WHOLESALE	RETAIL	WHOLESALE	RETAIL		OTHER*
Balance at January 1	\$6.0	\$ 9.4	\$ 92.5		\$ 9.3	\$ 117.2
Provision for losses	.2	(.1)	10.0		.4	10.5
Charge-offs			(12.1)		(6.2)	(18.3)
Recoveries			4.7		.3	5.0
Currency translation and other		(.1)	(1.6)			(1.7)
Balance at June 30	\$6.2	\$ 9.2	\$ 93.5		\$ 3.8	\$ 112.7

	2017					
	DEALER		CUSTOMER		TOTAL	
	WHOLESALE	RETAIL	WHOLESALE	RETAIL		OTHER*
Balance at January 1	\$5.5	\$ 9.6	\$ 87.5		\$ 8.6	\$ 111.2
Provision for losses		(.7)	12.8		.6	12.7
Charge-offs			(11.5)		(.5)	(12.0)
Recoveries			2.2		.1	2.3
Currency translation and other	.4	.2	3.8		.4	4.8
Balance at June 30	\$5.9	\$ 9.1	\$ 94.8		\$ 9.2	\$ 119.0

*Operating leases and other trade receivables.

Information regarding finance receivables evaluated and determined individually and collectively is as follows:

At June 30, 2018	DEALER WHOLESALE	RETAIL	CUSTOMER RETAIL	TOTAL
Recorded investment for impaired finance				
receivables evaluated individually	\$.1	\$ 3.0	\$ 44.8	\$ 47.9
Allowance for impaired finance receivables				
determined individually	.1		6.1	6.2
Recorded investment for finance receivables				
evaluated collectively	2,069.6	1,357.6	6,665.3	10,092.5
Allowance for finance receivables				
determined collectively	6.1	9.2	87.4	102.7

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

At December 31, 2017	DEALER WHOLESALE	RETAIL	CUSTOMER RETAIL	TOTAL
Recorded investment for impaired finance				
receivables evaluated individually	\$.1	\$4.0	\$ 50.8	\$54.9
Allowance for impaired finance receivables				
determined individually	.1		6.6	6.7
Recorded investment for finance receivables				
evaluated collectively	1,880.5	1,354.7	6,363.1	9,598.3
Allowance for finance receivables				
determined collectively	5.9	9.4	85.9	101.2

The recorded investment for finance receivables that are on non-accrual status is as follows:

	June 30 2018	December 31 2017
Dealer:		
Wholesale	\$.1	\$.1
Customer retail:		
Fleet	36.5	44.4
Owner/operator	7.3	6.0
	\$ 43.9	\$ 50.5

Impaired Loans

Impaired loans are summarized below. The impaired loans with a specific reserve represent the unpaid principal balance. The recorded investment of impaired loans as of June 30, 2018 and December 31, 2017 was not significantly different than the unpaid principal balance.

At June 30, 2018	DEALER WHOLESALE	RETAIL	CUSTOMER RETAIL OWNER/ FLEET OPERATOR	TOTAL
Impaired loans with a specific reserve	\$.1		\$20.0 \$ 2.7	\$ 22.8
Associated allowance	(.1)		(3.1) (.6)	(3.8)

Edgar Filing: PACCAR INC - Form 10-Q

			\$ 16.9	\$ 2.1	\$ 19.0
Impaired loans with no specific reserve	\$ 3.0		8.8	.1	11.9
Net carrying amount of impaired loans	\$ 3.0		\$ 25.7	\$ 2.2	\$ 30.9
Average recorded investment*	\$.1	\$ 3.8	\$ 32.8	\$ 2.0	\$ 38.7

*Represents the average during the 12 months ended June 30, 2018.

	DEALER		CUSTOMER RETAIL		
At December 31, 2017	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	TOTAL
Impaired loans with a specific reserve	\$.1		\$ 18.8	\$ 1.0	\$ 19.9
Associated allowance	(.1)		(3.0)	(.2)	(3.3)
			\$ 15.8	\$.8	\$ 16.6
Impaired loans with no specific reserve	\$ 3.9		13.1	.2	17.2
Net carrying amount of impaired loans	\$ 3.9		\$ 28.9	\$ 1.0	\$ 33.8
Average recorded investment*	\$.9	\$ 3.8	\$ 30.7	\$ 2.2	\$ 37.6

*Represents the average during the 12 months ended June 30, 2017.

- 16 -

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

During the period the loans above were considered impaired, interest income recognized on a cash basis was as follows:

	Three Months Ended June 30 2018		Six Months Ended June 30 2017	
Interest income recognized:				
Customer retail - fleet	\$.5	\$.3	\$ 1.0	\$.6

Credit Quality

The Company's customers are principally concentrated in the transportation industry in North America, Europe and Australia. The Company's portfolio assets are diversified over a large number of customers and dealers with no single customer or dealer balances representing over 5% of the total portfolio assets. The Company retains as collateral a security interest in the related equipment.

At the inception of each contract, the Company considers the credit risk based on a variety of credit quality factors including prior payment experience, customer financial information, credit-rating agency ratings, loan-to-value ratios and other internal metrics. On an ongoing basis, the Company monitors credit quality based on past due status and collection experience as there is a meaningful correlation between the past due status of customers and the risk of loss.

The Company has three credit quality indicators: performing, watch and at-risk. Performing accounts pay in accordance with the contractual terms and are not considered high-risk. Watch accounts include accounts 31 to 90 days past due and large accounts that are performing but are considered to be high risk. Watch accounts are not impaired. At-risk accounts are accounts that are impaired, including TDRs, accounts over 90 days past due and other accounts on non-accrual status. The tables below summarize the Company's finance receivables by credit quality indicator and portfolio class.

	DEALER		CUSTOMER RETAIL		
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	TOTAL
At June 30, 2018					
Performing	\$2,064.8	\$1,357.6	\$5,520.9	\$1,049.0	\$9,992.3
Watch	4.8		90.0	5.4	100.2
At-risk	.1	3.0	37.3	7.5	47.9
	\$2,069.7	\$1,360.6	\$5,648.2	\$1,061.9	\$10,140.4

Edgar Filing: PACCAR INC - Form 10-Q

At December 31, 2017	DEALER		CUSTOMER RETAIL		TOTAL
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	
Performing	\$1,874.5	\$1,354.7	\$5,290.3	\$1,005.2	\$9,524.7
Watch	6.0		62.9	4.7	73.6
At-risk	.1	4.0	44.7	6.1	54.9
	\$1,880.6	\$1,358.7	\$5,397.9	\$1,016.0	\$9,653.2

The tables below summarize the Company's finance receivables by aging category. In determining past due status, the Company considers the entire contractual account balance past due when any installment is over 30 days past due. Substantially all customer accounts that were greater than 30 days past due prior to credit modification became current upon modification for aging purposes.

At June 30, 2018	DEALER		CUSTOMER RETAIL		TOTAL
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	
Current and up to 30 days past due	\$2,069.4	\$1,360.6	\$5,621.9	\$1,050.6	\$10,102.5
31 – 60 days past due	.2		12.4	4.5	17.1
Greater than 60 days past due	.1		13.9	6.8	20.8
	\$2,069.7	\$1,360.6	\$5,648.2	\$1,061.9	\$10,140.4

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

At December 31, 2017	DEALER		CUSTOMER RETAIL		TOTAL
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	
Current and up to 30 days past due	\$ 1,880.5	\$ 1,358.7	\$ 5,365.7	\$ 1,007.4	\$ 9,612.3
31 – 60 days past due			14.7	4.0	18.7
Greater than 60 days past due	.1		17.5	4.6	22.2
	\$ 1,880.6	\$ 1,358.7	\$ 5,397.9	\$ 1,016.0	\$ 9,653.2

Troubled Debt Restructurings

The balance of TDRs was \$27.3 and \$37.9 at June 30, 2018 and December 31, 2017, respectively. At modification date, the pre-modification and post-modification recorded investment balances for finance receivables modified during the period by portfolio class are as follows:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	RECORDED INVESTMENT		RECORDED INVESTMENT	
	PRE-MODIFICATION	POST-MODIFICATION	PRE-MODIFICATION	POST-MODIFICATION
Fleet	\$ 7.7	\$ 7.7	\$ 7.9	\$ 7.9
Owner/operator	.2	.2	.4	.4
	\$ 7.9	\$ 7.9	\$ 8.3	\$ 8.3

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	RECORDED INVESTMENT		RECORDED INVESTMENT	
	PRE-MODIFICATION	POST-MODIFICATION	PRE-MODIFICATION	POST-MODIFICATION
Fleet	\$ 7.8	\$ 7.8	\$ 16.6	\$ 16.6
Owner/operator	.2	.3	.4	.4
	\$ 8.0	\$ 8.1	\$ 17.0	\$ 17.0

The effect on the allowance for credit losses from such modifications was not significant at June 30, 2018 and 2017.

TDRs modified during the previous twelve months that subsequently defaulted (i.e., became more than 30 days past due) during the period by portfolio class are as follows:

	Six Months Ended June 30, 2018	2017
Fleet	\$.8	\$ 1.0

Owner/operator	.1
	\$.8 \$ 1.1

There were nil and \$.4 of finance receivables modified as TDRs during the previous twelve months that subsequently defaulted and were charged off in the six months ended June 30, 2018 and 2017, respectively.

Repossessions

When the Company determines a customer is not likely to meet its contractual commitments, the Company repossesses the vehicles which serve as collateral for the loans, finance leases and equipment under operating leases. The Company records the vehicles as used truck inventory included in Financial Services Other assets on the Consolidated Balance Sheets. The balance of repossessed inventory at June 30, 2018 and December 31, 2017 was \$20.9 and \$13.1, respectively. Proceeds from the sales of repossessed assets were \$35.2 and \$29.2 for the six months ended June 30, 2018 and 2017, respectively. These amounts are included in Proceeds from asset disposals in the Condensed Consolidated Statements of Cash Flows. Write-downs of repossessed equipment on operating leases are recorded as impairments and included in Financial Services Depreciation and other expenses on the Consolidated Statements of Comprehensive Income.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE F - Product Support Liabilities

Product support liabilities include estimated future payments related to product warranties and deferred revenues on optional extended warranties and repair and maintenance (R&M) contracts. The Company generally offers one year warranties covering most of its vehicles and related aftermarket parts. For vehicles equipped with engines manufactured by PACCAR, the Company generally offers two year warranties on the engine. Specific terms and conditions vary depending on the product and the country of sale. Optional extended warranty and R&M contracts can be purchased for periods which generally range up to five years. Warranty expenses and reserves are estimated and recorded at the time products or contracts are sold based on historical data regarding the source, frequency and cost of claims, net of any recoveries. The Company periodically assesses the adequacy of its recorded liabilities and adjusts them as appropriate to reflect actual experience. Revenue from extended warranty and R&M contracts is deferred and recognized to income generally on a straight-line basis over the contract period. Warranty and R&M costs on these contracts are recognized as incurred.

Changes in product support liabilities are summarized as follows:

WARRANTY RESERVES	2018	2017
Balance at January 1	\$298.8	\$282.1
Cost accruals	156.0	102.7
Payments	(144.2)	(121.6)
Change in estimates for pre-existing warranties	19.9	2.6
Currency translation and other	(1.2)	8.6
Balance at June 30	\$329.3	\$274.4

DEFERRED REVENUES ON EXTENDED WARRANTIES AND R&M CONTRACTS	2018	2017
Balance at January 1	\$653.9	\$573.5
Deferred revenues	223.4	176.7
Revenues recognized	(187.6)	(152.9)
Currency translation	(9.4)	22.8
Balance at June 30	\$680.3	\$620.1

The Company expects to recognize approximately \$125.1 of the remaining deferred revenue on extended warranties and R&M contracts in 2018, \$223.0 in 2019, \$174.4 in 2020, \$94.2 in 2021, \$43.7 in 2022 and \$19.9 thereafter.

NOTE G - Stockholders' Equity

Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
Net income	\$559.6	\$373.0	\$1,071.7	\$683.3
Other comprehensive income (loss) (OCI):				
Unrealized gains (losses) on derivative contracts	6.8	11.6	2.7	(2.0)
Tax effect	(2.0)	(3.1)	(.4)	.9
	4.8	8.5	2.3	(1.1)
Unrealized gains (losses) on marketable debt securities	.5	(.5)	(2.1)	2.9
Tax effect	(.1)	.1	.5	(1.2)
	.4	(.4)	(1.6)	1.7
Pension plans	21.3	(1.4)	23.9	2.5
Tax effect	(5.2)		(5.8)	(1.3)
	16.1	(1.4)	18.1	1.2
Foreign currency translation (losses) gains	(196.7)	126.1	(118.9)	201.1
Net other comprehensive (loss) income	(175.4)	132.8	(100.1)	202.9
Comprehensive income	\$384.2	\$505.8	\$971.6	\$886.2

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Accumulated Other Comprehensive Income (Loss)

The components of AOCI and the changes in AOCI, net of tax, included in the Consolidated Balance Sheets consisted of the following:

	MARKETABLE		FOREIGN		TOTAL
	DERIVATIVE	DEBT	PENSION	CURRENCY	
	CONTRACTS	SECURITIES	PLANS	TRANSLATION	
Three Months Ended June 30, 2018					
Balance at April 1, 2018	\$ (1.3)	\$ (3.8)	\$ (373.6)	\$ (339.6)	\$ (718.3)
Recorded into AOCI	77.6	.4	8.2	(196.7)	(110.5)
Reclassified out of AOCI	(72.8)		7.9		(64.9)
Net other comprehensive income (loss)	4.8	.4	16.1	(196.7)	(175.4)
Balance at June 30, 2018	\$ 3.5	\$ (3.4)	\$ (357.5)	\$ (536.3)	\$ (893.7)

	MARKETABLE		FOREIGN		TOTAL
	DERIVATIVE	DEBT	PENSION	CURRENCY	
	CONTRACTS	SECURITIES	PLANS	TRANSLATION	
Three Months Ended June 30, 2017					
Balance at April 1, 2017	\$ (13.9)	\$ 1.8	\$ (411.5)	\$ (634.4)	\$ (1,058.0)
Recorded into AOCI	(28.2)	(.3)	(5.7)	126.1	91.9
Reclassified out of AOCI	36.7	(.1)	4.3		40.9
Net other comprehensive income (loss)	8.5	(.4)	(1.4)	126.1	132.8
Balance at June 30, 2017	\$ (5.4)	\$ 1.4	\$ (412.9)	\$ (508.3)	\$ (925.2)

	MARKETABLE		FOREIGN		TOTAL
	DERIVATIVE	DEBT	PENSION	CURRENCY	
	CONTRACTS	SECURITIES	PLANS	TRANSLATION	
Six Months Ended June 30, 2018					
Balance at January 1, 2018	\$ 1.2	\$ (1.8)	\$ (375.6)	\$ (417.4)	\$ (793.6)
Recorded into AOCI	65.8	(1.3)	4.0	(118.9)	(50.4)
Reclassified out of AOCI	(63.5)	(.3)	14.1		(49.7)
Net other comprehensive income (loss)	2.3	(1.6)	18.1	(118.9)	(100.1)
Balance at June 30, 2018	\$ 3.5	\$ (3.4)	\$ (357.5)	\$ (536.3)	\$ (893.7)

Six Months Ended June 30, 2017	DERIVATIVE	MARKETABLE	PENSION	FOREIGN	TOTAL
--------------------------------	------------	------------	---------	---------	-------

Edgar Filing: PACCAR INC - Form 10-Q

	CONTRACTS	DEBT	PLANS	CURRENCY	
	SECURITIES		TRANSLATION		
Balance at January 1, 2017	\$ (4.3)	\$ (.3)	\$ (414.1)	\$ (709.4)	\$(1,128.1)
Recorded into AOCI	(74.1)	2.0	(7.8)	201.1	121.2
Reclassified out of AOCI	73.0	(.3)	9.0		81.7
Net other comprehensive (loss) income	(1.1)	1.7	1.2	201.1	202.9
Balance at June 30, 2017	\$ (5.4)	\$ 1.4	\$ (412.9)	\$ (508.3)	\$(925.2)

- 20 -

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Reclassifications out of AOCI during the three months ended June 30, 2018 and 2017 are as follows:

AOCI COMPONENTS	LINE ITEM IN THE CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME	Three Months Ended	
		June 30 2018	2017
Unrealized (gains) and losses on derivative contracts:			
Truck, Parts and Other			
Foreign-exchange contracts	Net sales and revenues	\$(2.8)	\$12.1
	Cost of sales and revenues	(2.5)	(1.3)
	Interest and other (income), net	.3	.6
Financial Services			
Interest-rate contracts	Interest and other borrowing expenses	(92.1)	40.0
	Pre-tax expense (reduction) increase	(97.1)	51.4
	Tax expense (benefit)	24.3	(14.7)
	After-tax expense (reduction) increase	(72.8)	36.7
Unrealized gains on marketable debt securities:			
Marketable debt securities	Investment income		(.1)
	Tax expense		
	After-tax income increase		(.1)
Pension plans:			
Truck, Parts and Other			
Actuarial loss	Interest and other (income), net	10.1	5.9
Prior service costs	Interest and other (income), net	.3	.3
	Pre-tax expense increase	10.4	6.2
	Tax benefit	(2.5)	(1.9)
	After-tax expense increase	7.9	4.3
Total reclassifications out of AOCI		\$(64.9)	\$40.9

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Reclassifications out of AOCI during the six months ended June 30, 2018 and 2017 are as follows:

AOCI COMPONENTS	LINE ITEM IN THE CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME	Six Months Ended	
		June 30 2018	2017
Unrealized losses and (gains) on derivative contracts:			
Truck, Parts and Other			
Foreign-exchange contracts	Net sales and revenues	\$1.8	\$16.3
	Cost of sales and revenues	(3.6)	(1.2)
	Interest and other (income), net	(.7)	.6
Financial Services			
Interest-rate contracts	Interest and other borrowing expenses	(82.8)	85.8
	Pre-tax expense (reduction) increase	(85.3)	101.5
	Tax expense (benefit)	21.8	(28.5)
	After-tax expense (reduction) increase	(63.5)	73.0
Unrealized gains on marketable debt securities:			
Marketable debt securities	Investment income	(.4)	(.4)
	Tax expense	.1	.1
	After-tax income increase	(.3)	(.3)
Pension plans:			
Truck, Parts and Other			
Actuarial loss	Interest and other (income), net	17.8	12.6
Prior service costs			
	Interest and other (income), net	.7	.6
	Pre-tax expense increase	18.5	13.2
	Tax benefit	(4.4)	(4.2)
	After-tax expense increase	14.1	9.0
Total reclassifications out of AOCI		(49.7)	81.7

Stock Compensation Plans

Stock-based compensation expense was \$2.0 and \$9.0 for the three months and six months ended June 30, 2018, respectively, and \$1.9 and \$9.0 for the three months and six months ended June 30, 2017, respectively.

During the first half of 2018, the Company issued 377,361 common shares under deferred and stock compensation arrangements.

Other Capital Stock Changes

During the first half of 2018, the Company purchased 1,467,454 treasury shares, of which 1,454,746 shares were repurchased pursuant to the \$300 million common stock repurchase plan approved on September 23, 2015. The Company also acquired 12,708 shares under the Company's Long-Term Incentive Plan.

NOTE H - Income Taxes

The effective tax rate for the second quarter of 2018 was 22.2% compared to 30.8% in the second quarter of 2017. The effective tax rate for the first half of 2018 was 22.8% compared to 30.8% in the same period of 2017. The difference in 2018 tax rates compared to 2017 was primarily due to the U.S. federal income tax legislation enacted on December 22, 2017, which lowered the U.S. statutory income tax rate from 35.0% to 21.0%.

NOTE I - Segment Information

PACCAR operates in three principal segments: Truck, Parts and Financial Services. The Company evaluates the performance of its Truck and Parts segments based on operating profits, which excludes investment income, other income and expense and income taxes. The Financial Services segment's performance is evaluated based on income before income taxes. The accounting policies of the reportable segments are the same as those applied in the consolidated financial statements as described in Note A of the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Truck and Parts

The Truck segment includes the design and manufacture of high-quality, light-, medium- and heavy-duty commercial trucks and the Parts segment includes the distribution of aftermarket parts for trucks and related commercial vehicles, both of which are sold through the same network of independent dealers. These segments derive a large proportion of their revenues and operating profits from operations in North America and Europe. The Truck segment incurs substantial costs to design, manufacture and sell trucks to its customers. The sale of new trucks provides the Parts segment with the basis for parts sales that may continue over the life of the truck, but are generally concentrated in the first five years after truck delivery. To reflect the benefit the Parts segment receives from costs incurred by the Truck segment, certain expenses are allocated from the Truck segment to the Parts segment. The expenses allocated are based on a percentage of the average annual expenses for factory overhead, engineering, research and development and selling, general and administrative (SG&A) expenses for the preceding five years. The allocation is based on the ratio of the average parts direct margin dollars (net sales less material and labor costs) to the total truck and parts direct margin dollars for the previous five years. The Company believes such expenses have been allocated on a reasonable basis. Truck segment assets related to the indirect expense allocation are not allocated to the Parts segment.

Financial Services

The Financial Services segment derives its earnings primarily from financing or leasing of PACCAR products and services provided to truck customers and dealers. Revenues are primarily generated from operations in North America and Europe.

Other

Included in Other is the Company's industrial winch manufacturing business. Also within this category are other sales, income and expense not attributable to a reportable segment, including a portion of corporate expenses.

	Three Months		Six Months Ended	
	Ended		June 30	
	June 30	2017	June 30	2017
	2018	2017	2018	2017
Net sales and revenues:				
Truck	\$4,678.6	\$3,768.9	\$9,214.7	\$7,066.2
Less intersegment	(210.8)	(215.3)	(393.9)	(382.5)
External customers	4,467.8	3,553.6	8,820.8	6,683.7
Parts	983.1	835.2	1,936.6	1,634.3
Less intersegment	(15.1)	(12.1)	(28.7)	(24.5)
External customers	968.0	823.1	1,907.9	1,609.8
Other	31.4	21.2	60.3	40.1
	5,467.2	4,397.9	10,789.0	8,333.6
Financial Services	338.0	306.3	670.2	608.5
	\$5,805.2	\$4,704.2	\$11,459.2	\$8,942.1

Edgar Filing: PACCAR INC - Form 10-Q

Income before income taxes:

Truck	\$434.0	\$312.7	\$829.2	\$543.9
Parts	194.5	151.2	386.3	302.0
Other	4.1	4.0	9.0	5.3
	632.6	467.9	1,224.5	851.2
Financial Services	72.4	62.4	139.9	119.2
Investment income	14.6	8.7	24.6	16.8
	\$719.6	\$539.0	\$1,389.0	\$987.2

Depreciation and amortization:

Truck	\$106.0	\$111.0	\$213.3	\$218.1
Parts	2.2	2.0	4.4	3.9
Other	4.4	4.2	8.9	8.0
	112.6	117.2	226.6	230.0
Financial Services	155.7	151.8	315.2	298.2
	\$268.3	\$269.0	\$541.8	\$528.2

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE J - Derivative Financial Instruments

As part of its risk management strategy, the Company enters into derivative contracts to hedge against interest rates and foreign currency risk. Certain derivative instruments designated as either cash flow hedges or fair value hedges are subject to hedge accounting. Derivative instruments that are not subject to hedge accounting are held as derivatives not designated as hedging instruments. The Company's policies prohibit the use of derivatives for speculation or trading. At the inception of each hedge relationship, the Company documents its risk management objectives, procedures and accounting treatment. All of the Company's interest-rate and certain foreign-exchange contracts are transacted under International Swaps and Derivatives Association (ISDA) master agreements. Each agreement permits the net settlement of amounts owed in the event of default and certain other termination events. For derivative financial instruments, the Company has elected not to offset derivative positions in the balance sheet with the same counterparty under the same agreements and is not required to post or receive collateral.

Exposure limits and minimum credit ratings are used to minimize the risks of counterparty default. The Company's maximum exposure to potential default of its swap counterparties is limited to the asset position of its swap portfolio. The asset position of the Company's swap portfolio is \$60.5 at June 30, 2018.

The Company uses regression analysis to assess effectiveness of interest-rate contracts at inception and uses quantitative or qualitative analysis to assess subsequent effectiveness on a quarterly basis. For foreign-exchange contracts, the Company performs quarterly assessments to ensure that critical terms continue to match. All components of the derivative instrument's gain or loss are included in the assessment of hedge effectiveness. Hedge accounting is discontinued prospectively when the Company determines that a derivative financial instrument has ceased to be a highly effective hedge. Cash flows from derivative instruments are included in Operating activities in the Consolidated Statements of Cash Flows.

Interest-Rate Contracts: The Company enters into various interest-rate contracts, including interest-rate swaps and cross currency interest-rate swaps. Interest-rate swaps involve the exchange of fixed for floating rate or floating for fixed rate interest payments based on the contractual notional amounts in a single currency. Cross currency interest-rate swaps involve the exchange of notional amounts and interest payments in different currencies. The Company is exposed to interest-rate and exchange-rate risk caused by market volatility as a result of its borrowing activities. The objective of these contracts is to mitigate the fluctuations on earnings, cash flows and fair value of borrowings. Net amounts paid or received are reflected as adjustments to interest expense.

At June 30, 2018, the notional amount of the Company's interest-rate contracts was \$2,991.8. Notional maturities for all interest-rate contracts are \$405.7 for the remainder of 2018, \$919.0 for 2019, \$429.6 for 2020, \$910.9 for 2021, \$165.1 for 2022, \$80.4 for 2023 and \$81.1 thereafter.

Foreign-Exchange Contracts: The Company enters into foreign-exchange contracts to hedge certain anticipated transactions and assets and liabilities denominated in foreign currencies, particularly the Canadian dollar, the euro, the British pound, the Australian dollar, the Brazilian real and the Mexican peso. The objective is to reduce fluctuations in earnings and cash flows associated with changes in foreign currency exchange rates. At June 30, 2018, the notional amount of the outstanding foreign-exchange contracts was \$640.4. Foreign-exchange contracts mature within one year.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

The following table presents the balance sheet classification, fair value, gross and pro forma net amounts of derivative financial instruments:

	June 30, 2018		December 31, 2017	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
Derivatives designated under hedge accounting:				
Interest-rate contracts:				
Financial Services:				
Other assets	\$60.5		\$53.3	
Deferred taxes and other liabilities		\$ 28.4		\$ 98.3
Foreign-exchange contracts:				
Truck, Parts and Other:				
Other current assets	7.3		3.8	
Accounts payable, accrued expenses and other		.9		1.9
	\$67.8	\$ 29.3	\$57.1	\$ 100.2
Derivatives not designated as hedging instruments:				
Interest-rate contracts:				
Financial Services:				
Deferred taxes and other liabilities				
Foreign-exchange contracts:				
Truck, Parts and Other:				
Other current assets	\$.2		\$.6	
Accounts payable, accrued expenses and other		\$.9		\$.6
Financial Services:				
Other assets	2.5		.1	
Deferred taxes and other liabilities		.1		2.2
	\$2.7	\$ 1.0	\$.7	\$ 2.8
Gross amounts recognized in Balance Sheets	\$70.5	\$ 30.3	\$57.8	\$ 103.0
Less amounts not offset in financial instruments:				
Truck, Parts and Other:				
Foreign-exchange contracts	(1.5)	(1.5)	(.4)	(.4)
Financial Services:				
Interest-rate contracts	(4.5)	(4.5)	(8.7)	(8.7)
Pro forma net amount	\$64.5	\$ 24.3	\$48.7	\$ 93.9

Fair Value Hedges

Changes in the fair value of derivatives designated as fair value hedges are recorded in earnings together with the changes in fair value of the hedged item attributable to the risk being hedged. As of June 30, 2018, the following amounts were recorded on the Consolidated Balance Sheets related to cumulative basis adjustments for fair value

hedges:

Hedged Balance Sheet Line Item	Carrying Amount of the Hedged Liabilities	Cumulative Basis Amount Included in the Carrying Amount
Medium-term notes	\$ 230.2	\$ (4.8)

The above table excludes the cumulative basis adjustments on discontinued hedge relationships of (\$1.9) million as of June 30, 2018.

Cash Flow Hedges

Substantially all of the Company's interest-rate contracts and some foreign-exchange contracts have been designated as cash flow hedges. The fixed interest earned on finance receivables will offset the amount recognized in interest expense, resulting in a stable interest margin consistent with the Company's risk management strategy. Changes in the fair value of derivatives designated as cash flow hedges are recorded in AOCI. Amounts in AOCI are reclassified into net income in the same period in which the hedged transaction affects earnings. The maximum length of time over which the Company is hedging its exposure to the variability in future cash flows is 10.0 years.

- 25 -

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

The following table presents the pre-tax effects of derivative instruments recognized in other comprehensive income (loss) (OCI):

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	INTEREST- RATE EXCHANGE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE EXCHANGE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Gain recognized in OCI:				
Truck, Parts and Other	\$ 10.8		\$ 6.4	
Financial Services	\$93.1		\$ 81.6	
	\$93.1	\$ 10.8	\$ 81.6	\$ 6.4

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	INTEREST- RATE EXCHANGE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE EXCHANGE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Loss recognized in OCI:				
Truck, Parts and Other	\$ (1.7)		\$ (20.4)	
Financial Services	\$(38.1)		\$(83.1)	
	\$(38.1)	\$ (1.7)	\$(83.1)	\$ (20.4)

The following table presents the location and amount of expense (income) on fair value hedges recognized in the Consolidated Statements of Comprehensive Income. The loss (gain) on fair value hedges for foreign-exchange contracts was nil for the three months and six months ended June 30, 2018 and 2017. The amounts related to interest-rate contracts were as follows:

	Three Months Ended June 30 2018		Six Months Ended June 30 2017	
Financial Services:				
Interest and other borrowing expenses:				
Derivatives	\$.3	\$(.7)	\$ 1.1	\$.6
Hedged term notes	.2	.9	(.2)	(.4)
	\$.5	\$.2	\$.9	\$.2

The following presents the amount of loss (gain) from cash flow hedges reclassified from AOCI into income:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Truck, Parts and Other:				
Net sales and revenues	\$ (2.8)		\$ 1.8	
Cost of sales and revenues	(2.5)		(3.6)	
Interest and other (income), net	.3		(.7)	
Financial Services:				
Interest and other borrowing expenses	\$(92.1)		\$(82.8)	
	\$(92.1)	\$ (5.0)	\$(82.8)	\$ (2.5)

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Truck, Parts and Other:				
Net sales and revenues		\$ 12.1		\$ 16.3
Cost of sales and revenues		(1.3)		(1.2)
Interest and other (income), net		.6		.6
Financial Services:				
Interest and other borrowing expenses	\$ 40.0		\$ 85.8	
	\$ 40.0	\$ 11.4	\$ 85.8	\$ 15.7

The amount of gain recorded in AOCI at June 30, 2018 that is estimated to be reclassified into earnings in the following 12 months if interest rates and exchange rates remain unchanged is approximately \$8.0, net of taxes.

Derivatives Not Designated As Hedging Instruments

For other risk management purposes, the Company enters into derivative instruments that do not qualify for hedge accounting. These derivative instruments are used to mitigate the risk of market volatility arising from borrowings and foreign currency denominated transactions. Changes in the fair value of derivatives not designated as hedging instruments are recorded in earnings in the period in which the change occurs.

For the three and six months ended June 30, 2018 and 2017 the expense (income) recognized in earnings related to derivatives not designated as hedging instruments was as follows:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Truck, Parts and Other:				
Cost of sales and revenues				\$ 1.2
Interest and other (income), net		\$.3		3.7
Financial Services:				
Interest and other borrowing expenses		(8.9)		(8.4)
Selling, general and administrative		(.7)		.5
Total		\$ (9.3)		\$ (3.0)

Three Months Ended Six Months Ended

Edgar Filing: PACCAR INC - Form 10-Q

	June 30, 2017		June 30, 2017	
	INTEREST- RATE EXCHANGE CONTRACTS		INTEREST- RATE EXCHANGE CONTRACTS	
Truck, Parts and Other:				
Cost of sales and revenues	\$.1	\$.7
Interest and other (income), net		.7		4.2
Financial Services:				
Interest and other borrowing expenses	\$(.1)	11.4	\$(.1)	44.6
Selling, general and administrative		(2.3)		(13.1)
Total	\$(.1)	\$ 9.9	\$(.1)	\$ 36.4

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

NOTE K - Fair Value Measurements

Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Inputs to valuation techniques used to measure fair value are either observable or unobservable. These inputs have been categorized into the fair value hierarchy described below.

Level 1 – Valuations are based on quoted prices that the Company has the ability to obtain in actively traded markets for identical assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market or exchange traded market, valuation of these instruments does not require a significant degree of judgment.

Level 2 – Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuations are based on model-based techniques for which some or all of the assumptions are obtained from indirect market information that is significant to the overall fair value measurement and which require a significant degree of management judgment.

There were no transfers of assets or liabilities between Level 1 and Level 2 of the fair value hierarchy during the six months ended June 30, 2018. The Company's policy is to recognize transfers between levels at the end of the reporting period.

The Company uses the following methods and assumptions to measure fair value for assets and liabilities subject to recurring fair value measurements.

Marketable Securities: The Company's marketable debt securities consist of municipal bonds, government obligations, investment-grade corporate obligations, commercial paper, asset-backed securities and term deposits. The fair value of U.S. government obligations is determined using the market approach and is based on quoted prices in active markets and are categorized as Level 1.

The fair value of U.S. government agency obligations, non-U.S. government bonds, municipal bonds, corporate bonds, asset-backed securities, commercial paper and term deposits is determined using the market approach and is primarily based on matrix pricing as a practical expedient which does not rely exclusively on quoted prices for a specific security. Significant inputs used to determine fair value include interest rates, yield curves, credit rating of the security and other observable market information and are categorized as Level 2.

Derivative Financial Instruments: The Company's derivative contracts consist of interest-rate swaps, cross currency swaps and foreign currency exchange contracts. These derivative contracts are traded over the counter, and their fair value is determined using industry standard valuation models, which are based on the income approach (i.e. discounted cash flows). The significant observable inputs into the valuation models include interest rates, yield curves, currency exchange rates, credit default swap spreads and forward rates and are categorized as Level 2.

PACCAR Inc – Form 10-Q

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Assets and Liabilities Subject to Recurring Fair Value Measurement

The Company's assets and liabilities subject to recurring fair value measurements are either Level 1 or Level 2 as follows:

At June 30, 2018	LEVEL 1	LEVEL 2	TOTAL
Assets:			
Marketable debt securities			
U.S. tax-exempt securities		\$467.2	\$467.2
U.S. corporate securities		83.9	83.9
U.S. government and agency securities	\$ 58.7		58.7
Non-U.S. corporate securities		254.1	254.1
Non-U.S. government securities		49.7	49.7
Other debt securities		119.7	119.7
Total marketable debt securities	\$ 58.7	\$974.6	\$1,033.3
Derivatives			
Cross currency swaps		\$49.5	\$49.5
Interest-rate swaps		11.0	11.0
Foreign-exchange contracts		10.0	10.0
Total derivative assets		\$70.5	\$70.5
Liabilities:			
Derivatives			
Cross currency swaps		\$22.1	\$22.1
Interest-rate swaps		6.3	6.3
Foreign-exchange contracts		1.9	1.9
Total derivative liabilities		\$30.3	\$30.3

At December 31, 2017	LEVEL 1	LEVEL 2	TOTAL
Assets:			
Marketable debt securities			
U.S. tax-exempt securities		\$535.5	\$535.5
U.S. corporate securities		89.7	89.7
U.S. government and agency securities	\$ 48.7		48.7
Non-U.S. corporate securities		459.3	459.3
Non-U.S. government securities		91.7	91.7
Other debt securities		142.2	142.2
Total marketable debt securities	\$ 48.7	\$1,318.4	\$1,367.1
Derivatives			
Cross currency swaps		\$44.2	\$44.2

Edgar Filing: PACCAR INC - Form 10-Q

Interest-rate swaps	9.1	9.1
Foreign-exchange contracts	4.5	4.5
Total derivative assets	\$57.8	\$57.8
Liabilities:		
Derivatives		
Cross currency swaps	\$93.0	\$93.0
Interest-rate swaps	5.3	5.3
Foreign-exchange contracts	4.7	4.7
Total derivative liabilities	\$103.0	\$103.0

Fair Value Disclosure of Other Financial Instruments

For financial instruments that are not recognized at fair value, the Company uses the following methods and assumptions to determine the fair value. These instruments are categorized as Level 2, except cash which is categorized as Level 1 and fixed rate loans which are categorized as Level 3.

- 29 -

Notes to Consolidated Financial Statements (Unaudited) (Millions, Except Share Amounts)

Cash and Cash Equivalents: Carrying amounts approximate fair value.

Financial Services Net Receivables: For floating-rate loans, wholesale financings, and operating lease and other trade receivables, carrying values approximate fair values. For fixed rate loans, fair values are estimated using the income approach by discounting cash flows to their present value based on assumptions regarding the credit and market risks to approximate current rates for comparable loans. Finance lease receivables and related allowance for credit losses have been excluded from the accompanying table.

Debt: The carrying amounts of financial services commercial paper, variable rate bank loans and variable rate term notes approximate fair value. For fixed rate debt, fair values are estimated using the income approach by discounting cash flows to their present value based on current rates for comparable debt.

The Company's estimate of fair value for fixed rate loans and debt that are not carried at fair value was as follows:

	June 30, 2018		December 31, 2017	
	CARRYING	FAIR	CARRYING	FAIR
	AMOUNT	VALUE	AMOUNT	VALUE
Assets:				
Financial Services fixed rate loans	\$4,058.1	\$4,049.4	\$3,793.8	\$3,804.8
Liabilities:				
Financial Services fixed rate debt	4,943.9	4,891.2	5,397.6	5,387.0

NOTE L - Employee Benefit Plans

The Company has several defined benefit pension plans, which cover a majority of its employees. The following information details the components of net pension expense for the Company's defined benefit plans:

	Three Months		Six Months	
	Ended		Ended	
	June 30		June 30	
	2018	2017	2018	2017
Service cost	\$26.0	\$22.2	\$54.7	\$46.0
Interest on projected benefit obligation	21.7	20.0	43.0	40.4
Expected return on assets	(44.5)	(39.6)	(89.3)	(79.4)
Amortization of prior service costs	.3	.3	.7	.6
Recognized actuarial loss	10.1	5.9	17.8	12.6
Net pension expense	\$13.6	\$8.8	\$26.9	\$20.2

The components of net pension expense other than service cost are included in Interest and other (income), net on the Consolidated Statements of Comprehensive Income.

During the three and six months ended June 30, 2018 the Company contributed \$5.1 and \$80.7 to its pension plans, respectively, and \$5.5 and \$10.4 for the three and six months ended June 30, 2017, respectively.

NOTE M – Commitments and Contingencies

On July 19, 2016, the European Commission (EC) concluded its investigation of all major European truck manufacturers and reached a settlement with DAF. Following the settlement, claims and lawsuits have been filed against the Company, DAF and certain DAF subsidiaries and other truck manufacturers. Others may bring EC related claims and lawsuits against the Company or its subsidiaries. While the Company believes it has meritorious defenses, such claims and lawsuits will likely take a significant period of time to resolve. An adverse outcome of such proceedings could have a material impact on the Company's results of operations.

The Company and its subsidiaries are parties to various other lawsuits incidental to the ordinary course of business. Management believes that the disposition of such lawsuits will not materially affect the Company's business or financial condition.

PACCAR Inc – Form 10-Q

ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
 2. OPERATIONS
 OVERVIEW:

PACCAR is a global technology company whose Truck segment includes the design and manufacture of high-quality light-, medium- and heavy-duty commercial trucks. In North America, trucks are sold under the Kenworth and Peterbilt nameplates, in Europe, under the DAF nameplate and in Australia and South America, under the Kenworth and DAF nameplates. The Parts segment includes the distribution of aftermarket parts for trucks and related commercial vehicles. The Company's Financial Services segment derives its earnings primarily from financing or leasing PACCAR products in North America, Europe and Australia. The Company's Other business includes the manufacturing and marketing of industrial winches.

Second Quarter Highlights:

Worldwide net sales and revenues were a quarterly record \$5.81 billion in 2018 compared to \$4.70 billion in 2017 due to record revenues in the Truck, Parts and Financial Services segments.

Truck sales were \$4.47 billion in 2018 compared to \$3.55 billion in 2017 primarily due to higher truck deliveries in the U.S. and Canada, Europe and Australia and favorable currency translation effects.

Parts sales were \$968.0 million in 2018 compared to \$823.1 million in 2017 reflecting higher demand in all markets.

Financial Services revenues were \$338.0 million in 2018 compared to \$306.3 million in 2017. The increase was primarily the result of higher average earning asset balances and higher interest rates.

Net income was \$559.6 million (\$1.59 per diluted share) in 2018 compared to \$373.0 million (\$1.06 per diluted share) in 2017 reflecting record Truck and Parts pre-tax income. In addition, net income increased in the second quarter due to a lower effective tax rate (22.2% in 2018 compared to 30.8% in 2017) under the new U.S. tax law.

Capital investments were \$101.7 million in 2018 compared to \$87.1 million in 2017.

Research and development (R&D) expenses were \$76.7 million in 2018 compared to \$66.1 million in 2017.

First Six Months Highlights:

Worldwide net sales and revenues were a record \$11.46 billion in 2018 compared to \$8.94 billion in 2017 due to record revenues in the Truck, Parts and Financial Services segments.

Truck sales were \$8.82 billion in 2018 compared to \$6.68 billion in 2017 primarily due to higher truck deliveries in the U.S. and Canada, Europe and Australia, and favorable currency translation effects.

Parts sales were \$1.91 billion in 2018 compared to \$1.61 billion in 2017, reflecting higher demand in all markets.

Financial Services revenues were \$670.2 million in 2018 compared to \$608.5 million in 2017. The increase was primarily due to higher average earning asset balances and higher interest rates.

Net income was a record \$1.07 billion (\$3.04 per diluted share) in 2018 compared to \$683.3 million (\$1.94 per diluted share) in 2017. Net income growth was due to record Truck and Parts pre-tax income and increased Financial Services results. In addition, net income increased in the first six months due to a lower effective tax rate (22.8% in 2018 compared to 30.8% in 2017) under the new U.S. tax law.

Capital investments were \$167.7 million in 2018 compared to \$159.8 million in 2017.

R&D expenses were \$152.7 million in 2018 compared to \$127.1 million in 2017.

In the first quarter of 2018, Peterbilt launched its new Model 579 UltraLoft, which offers customers a high-roof, integrated cab and sleeper that enhances driver comfort and operational efficiency. The UltraLoft dimensions represent an 18 percent increase in interior space giving drivers best-in-class living quarters. The Model 579 UltraLoft is an excellent tractor for long-haul routes, team driving, and driver training.

DAF has developed the DAF CF Electric truck for up to 40 tonne distribution applications within urban areas. The fully electric vehicle includes a 285 horsepower electric motor powered by a 170 kWh lithium-ion battery pack, providing a range of approximately 60 miles. The DAF CF Electric truck is designed for high-volume distribution applications in which customers desire zero-emissions and ultra-low noise.

- 31 -

PACCAR Inc – Form 10-Q

The Kenworth T680 Zero Emission Cargo Transport (ZECT) and the Kenworth Hybrid Electric Cargo Transport (HECT) trucks will be in field trials this year at the Ports of Los Angeles and Long Beach. The ZECT uses a hydrogen fuel cell that combines hydrogen gas and air to produce electricity. The HECT incorporates a parallel hybrid propulsion system that uses a compressed natural gas-powered engine and lithium-ion batteries.

Peterbilt has created a battery electric Model 520 equipped with a 400 horsepower electric drive system, 350 kWh of energy storage and regenerative braking. The truck's 80-mile range and quiet operation is an excellent solution for residential neighborhood refuse operations.

PACCAR Parts continues to add global parts distribution capacity to deliver industry-leading availability, and support the growth of PACCAR MX engine parts sales and the global fleet service program. A new \$35 million 160,000 square-foot distribution center in Toronto, Canada is under construction and is expected to open in the fourth quarter of 2018.

The PACCAR Financial Services (PFS) group of companies has operations covering four continents and 24 countries. The global breadth of PFS and its rigorous credit application process support a portfolio of loans and leases with record total assets of \$13.63 billion. PFS issued \$1.30 billion in medium-term notes during the first six months of 2018 to support portfolio growth.

Truck Outlook

Truck industry retail sales in the U.S. and Canada in 2018 are expected to be 265,000 to 285,000 units compared to 218,400 in 2017. In Europe, the 2018 truck industry registrations for over 16-tonne vehicles are expected to be 300,000 to 320,000 units compared to 306,100 truck registrations in 2017. In South America, heavy-duty truck industry sales in 2018 are estimated to be 75,000 to 85,000 units compared to 68,700 in 2017.

Parts Outlook

In 2018, PACCAR Parts sales are expected to grow 13-15% compared to 2017 sales.

Financial Services Outlook

Based on the truck market outlook, average earning assets in 2018 are expected to increase 6-9% compared to 2017. Current strong levels of freight tonnage, freight rates and fleet utilization are contributing to customers' profitability and cash flow. If current freight transportation conditions decline due to weaker economic conditions, then past due accounts, truck repossessions and credit losses would likely increase from the current low levels and new business volume would likely decline.

Capital Spending and R&D Outlook

Capital investments in 2018 are expected to be \$425 to \$475 million and R&D is expected to be \$300 to \$320 million. The Company is investing in enhanced aerodynamic truck designs, integrated powertrains including electric, hybrid, and hydrogen fuel cell technologies, advanced driver assistance systems and truck connectivity, and expanded manufacturing and parts distribution facilities.

See the Forward-Looking Statements section of Management's Discussion and Analysis for factors that may affect these outlooks.

- 32 -

PACCAR Inc – Form 10-Q

RESULTS OF OPERATIONS:

The Company's results of operations for the three and six months ended June 30, 2018 and 2017 are presented below. The balances for 2017 have been restated to reflect the adoption of the ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Pension Benefit. Refer to Note A in the Notes to Consolidated Financial Statements for additional details.

(\$ in millions, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30	2017	June 30	2017
Net sales and revenues:				
Truck	\$4,467.8	\$3,553.6	\$8,820.8	\$6,683.7
Parts	968.0	823.1	1,907.9	1,609.8
Other	31.4	21.2	60.3	40.1
Truck, Parts and Other	5,467.2	4,397.9	10,789.0	8,333.6
Financial Services	338.0	306.3	670.2	608.5
	\$5,805.2	\$4,704.2	\$11,459.2	\$8,942.1
Income before income taxes:				
Truck	\$434.0	\$312.7	\$829.2	\$543.9
Parts	194.5	151.2	386.3	302.0
Other	4.1	4.0	9.0	5.3
Truck, Parts and Other	632.6	467.9	1,224.5	851.2
Financial Services	72.4	62.4	139.9	119.2
Investment income	14.6	8.7	24.6	16.8
Income taxes	(160.0)	(166.0)	(317.3)	(303.9)
Net income	\$559.6	\$373.0	\$1,071.7	\$683.3
Diluted earnings per share	\$1.59	\$1.06	\$3.04	\$1.94
After-tax return on revenues	9.6	% 7.9	% 9.4	% 7.6

The following provides an analysis of the results of operations for the Company's three reportable segments - Truck, Parts and Financial Services. Where possible, the Company has quantified the impact of factors identified in the following discussion and analysis. In cases where it is not possible to quantify the impact of factors, the Company lists them in estimated order of importance. Factors for which the Company is unable to specifically quantify the impact include market demand, fuel prices, freight tonnage and economic conditions affecting the Company's results of operations.

2018 Compared to 2017:

Truck

The Company's Truck segment accounted for 77% of revenues in the second quarter and first six months of 2018 compared to 76% and 75% in the second quarter and first six months of 2017, respectively.

The Company's new truck deliveries are summarized below:

	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2018	2017	% CHANGE	2018	2017	% CHANGE
U.S. and Canada	25,900	21,200	22	50,100	38,200	31
Europe	15,800	13,800	14	31,500	28,100	12
Mexico, South America, Australia and other	4,700	4,400	7	9,300	8,100	15
Total units	46,400	39,400	18	90,900	74,400	22

In the first six months of 2018, industry retail sales in the heavy-duty market in the U.S. and Canada increased to 126,500 units from 96,000 units in the same period of 2017. The Company's heavy-duty truck retail market share was 29.4% in the first half of 2018 compared to 29.6% in the first half of 2017. The medium-duty market was 51,700 units in the first half of 2018 compared to 44,500 units in the same period of 2017. The Company's medium-duty market share was 15.0% in the first half of 2018 compared to 15.9% in 2017.

PACCAR Inc – Form 10-Q

The over 16 tonne truck market in Europe in the first six months of 2018 was 163,600 units compared to 157,000 units in the first six months of 2017. DAF EU market share was 16.5% in the first six months of 2018 compared to 15.2% in the same period of 2017. The 6 to 16 tonne market in the first six months of 2018 was 25,200 units compared to 26,300 units in the first six months of 2017. DAF market share in the 6 to 16-tonne market in the first six months of 2018 was 9.3% compared to 10.8% in the same period of 2017.

The Company's worldwide truck net sales and revenues are summarized below:

(\$ in millions)	Three Months Ended June 30			Six Months Ended June 30		
	2018	2017	% CHANGE	2018	2017	% CHANGE
Truck net sales and revenues:						
U.S. and Canada	\$2,792.2	\$2,181.7	28	\$5,406.9	\$3,986.3	36
Europe	1,181.9	962.4	23	2,447.9	1,934.8	27
Mexico, South America, Australia and other	493.7	409.5	21	966.0	762.6	27
	\$4,467.8	\$3,553.6	26	\$8,820.8	\$6,683.7	32
Truck income before income taxes	\$434.0	\$312.7	39	\$829.2	\$543.9	52
Pre-tax return on revenues	9.7	% 8.8	%	9.4	% 8.1	%

The Company's worldwide truck net sales and revenues in the second quarter increased to a record \$4.47 billion in 2018 from \$3.55 billion in 2017, and the first half worldwide truck net sales and revenues were a record \$8.82 billion in 2018 compared to \$6.68 billion in 2017. The increase in both periods was primarily due to higher truck deliveries in the U.S. and Canada, Europe and Australia, and favorable currency translation effects.

For the second quarter and first half of 2018, Truck segment income before taxes and pretax return on revenues reflect the impact of record truck unit deliveries, higher margins, and favorable currency translation effects.

The major factors for the changes in net sales and revenues, cost of sales and revenues and gross margin between the three months ended June 30, 2018 and 2017 for the Truck segment are as follows:

(\$ in millions)	NET SALES AND REVENUES	COST OF SALES AND REVENUES	GROSS MARGIN
Three Months Ended June 30, 2017	\$ 3,553.6	\$ 3,141.1	\$ 412.5
Increase (decrease)			
Truck sales volume	715.2	586.9	128.3
Average truck sales prices	107.8		107.8
Average per truck material, labor and other direct costs		87.1	(87.1)
Factory overhead and other indirect costs		28.9	(28.9)
Extended warranties, operating leases and other	2.1	(.7)	2.8

Edgar Filing: PACCAR INC - Form 10-Q

Currency translation	89.1	78.0	11.1
Total increase	914.2	780.2	134.0
Three Months Ended June 30, 2018	\$ 4,467.8	\$ 3,921.3	\$ 546.5

Truck sales volume primarily reflects higher unit deliveries in the U.S. and Canada (\$523.9 million sales and \$423.2 million cost of sales) and in Europe (\$133.9 million sales and \$112.4 million cost of sales).

Average truck sales prices increased sales by \$107.8 million, primarily due to higher price realization in North America.

Average cost per truck increased cost of sales by \$87.1 million reflecting higher material costs.

Factory overhead and other indirect costs increased \$28.9 million primarily due to higher salaries and related expenses (\$17.6 million) and higher maintenance costs (\$12.0 million) to support higher truck production.

The currency translation effect on sales and cost of sales primarily reflects an increase in the value of the euro relative to the U.S. dollar.

Truck gross margin was 12.2% in the second quarter of 2018 compared to 11.6% in the same period of 2017 due to the factors noted above.

- 34 -

PACCAR Inc – Form 10-Q

The major factors for the changes in net sales and revenues, cost of sales and revenues and gross margin between the six months ended June 30, 2018 and 2017 for the Truck segment are as follows:

(\$ in millions)	NET SALES AND REVENUES	COST OF SALES AND REVENUES	GROSS MARGIN
Six Months Ended June 30, 2017	\$ 6,683.7	\$ 5,945.0	\$ 738.7
Increase (decrease)			
Truck sales volume	1,697.1	1,391.4	305.7
Average truck sales prices	167.7		167.7
Average per truck material, labor and other direct costs		126.0	(126.0)
Factory overhead and other indirect costs		54.5	(54.5)
Extended warranties, operating leases and other	(7.6)	(10.7)	3.1
Currency translation	279.9	250.7	29.2
Total increase	2,137.1	1,811.9	325.2
Six Months Ended June 30, 2018	\$ 8,820.8	\$ 7,756.9	\$ 1,063.9

Truck sales volume primarily reflects higher unit deliveries in the U.S. and Canada (\$1,270.0 million sales and \$1,031.3 million cost of sales) and in Europe (\$259.9 million sales and \$213.0 million cost of sales).

Average truck sales prices increased sales by \$167.7 million, primarily due to higher price realization in North America.

Average cost per truck increased cost of sales by \$126.0 million reflecting higher material costs.

Factory overhead and other indirect costs increased \$54.5 million primarily due to higher salaries and related expenses (\$29.0 million) and higher maintenance costs (\$22.7 million) to support increased truck production.

Extended warranties, operating leases and other decreased revenues by \$7.6 million and cost of sales by \$10.7 million primarily due to lower revenue and associated costs from operating leases.

The currency translation effect on sales and cost of sales primarily reflects an increase in the value of the euro relative to the U.S. dollar.

Truck gross margin was 12.1% in the first six months of 2018 compared to 11.1% in the same period of 2017 due to the factors noted above.

Truck SG&A for the second quarter of 2018 increased to \$60.7 million from \$50.6 million in the second quarter of 2017. The increase was primarily due to higher professional fees (\$4.4 million), higher labor related costs (\$3.7 million), and currency translation effects (\$2.1 million). For the first six months, Truck SG&A increased to \$123.9 million in 2018 from \$103.8 million in 2017 primarily due to higher professional fees (\$8.5 million), higher labor related costs (\$6.1 million) and currency translation effects (\$6.3 million).

As a percentage of sales, Truck SG&A decreased to 1.36% in the second quarter of 2018 from 1.42% in the second quarter of 2017 and to 1.4% in the first half of 2018 from 1.6% in the same period of 2017 reflecting higher sales volume.

Parts

Edgar Filing: PACCAR INC - Form 10-Q

The Company's Parts segment accounted for 17% of revenues in the second quarter of 2018 and 2017, and for the first half, the Parts segment accounted for 17% of revenues in 2018 compared to 18% in 2017.

(\$ in millions)	Three Months Ended			Six Months Ended		
	June 30 2018	2017	% CHANGE	June 30 2018	2017	% CHANGE
Parts net sales and revenues:						
U.S. and Canada	\$639.9	\$545.1	17	\$1,256.1	\$1,062.6	18
Europe	233.2	191.5	22	469.6	382.2	23
Mexico, South America, Australia and other	94.9	86.5	10	182.2	165.0	10
	\$968.0	\$823.1	18	\$1,907.9	\$1,609.8	19
Parts income before income taxes	\$194.5	\$151.2	29	\$386.3	\$302.0	28
Pre-tax return on revenues	20.1 %	18.4 %		20.2 %	18.8 %	

- 35 -

PACCAR Inc – Form 10-Q

The Company's worldwide parts net sales and revenues for the second quarter increased to a record \$968.0 million in 2018 from \$823.1 million in 2017. For the first six months, worldwide parts net sales and revenues increased to a record \$1.91 billion in 2018 from \$1.61 billion in 2017. The increase in both periods was primarily due to higher aftermarket demand and successful marketing programs in all markets, as well as favorable currency translation effects.

For the second quarter and first half of 2018, the increase in Parts segment income before income taxes and pre-tax return on revenues was primarily due to higher sales volume.

The major factors for the changes in net sales, cost of sales and gross margin between the three months ended June 30, 2018 and 2017 for the Parts segment are as follows:

	NET	COST	GROSS
	SALES	SALES	MARGIN
(\$ in millions)		OF	
Three Months Ended June 30, 2017	\$ 823.1	\$ 604.9	\$ 218.2
Increase (decrease)			
Aftermarket parts volume	104.2	61.9	42.3
Average aftermarket parts sales prices	23.0		23.0
Average aftermarket parts direct costs		20.1	(20.1)
Warehouse and other indirect costs		3.6	(3.6)
Currency translation	17.7	11.1	6.6
Total increase	144.9	96.7	48.2
Three Months Ended June 30, 2018	\$ 968.0	\$ 701.6	\$ 266.4

▲Aftermarket parts sales volume increased by \$104.2 million and related cost of sales increased by \$61.9 million due to higher demand in all markets.

▲Average aftermarket parts sales prices increased sales by \$23.0 million primarily due to higher price realization in the U.S. and Canada and Europe.

▲Average aftermarket parts direct costs increased \$20.1 million due to higher material costs.

▲Warehouse and other indirect costs increased \$3.6 million primarily due to higher salaries and related expenses and higher maintenance costs.

▲The currency translation effect on sales and cost of sales reflects an increase in the value of the euro relative to the U.S. dollar.

▲Parts gross margins in the second quarter of 2018 increased to 27.5% from 26.5% in the second quarter of 2017 due to the factors noted above.

PACCAR Inc – Form 10-Q

The major factors for the changes in net sales and revenues, cost of sales and revenues and gross margin between the six months ended June 30, 2018 and 2017 for the Parts segment are as follows:

	NET	COST	GROSS
	SALES	SALES	MARGIN
(\$ in millions)		OF	
Six Months Ended June 30, 2017	\$ 1,609.8	\$ 1,175.7	\$ 434.1
Increase (decrease)			
Aftermarket parts volume	201.2	124.6	76.6
Average aftermarket parts sales prices	45.4		45.4
Average aftermarket parts direct costs		36.7	(36.7)
Warehouse and other indirect costs		8.6	(8.6)
Currency translation	51.5	33.3	18.2
Total increase	298.1	203.2	94.9
Six Months Ended June 30, 2018	\$ 1,907.9	\$ 1,378.9	\$ 529.0

▲Aftermarket parts sales volume increased by \$201.2 million and related cost of sales increased by \$124.6 million due to higher demand in all markets.

▲Average aftermarket parts sales prices increased sales by \$45.4 million primarily due to higher price realization in the U.S. and Canada and Europe.

▲Average aftermarket parts direct costs increased \$36.7 million due to higher material costs.

▲Warehouse and other indirect costs increased \$8.6 million primarily due to higher salaries and related expenses and higher maintenance costs.

▲The currency translation effect on sales and cost of sales reflects an increase in the value of the euro relative to the U.S. dollar.

▲Parts gross margins in the first half of 2018 increased to 27.7% from 27.0% in the first half of 2017 due to the factors noted above.

Parts SG&A expense increased in the second quarter to \$52.0 million in 2018 from \$49.0 million in 2017, primarily due to the effects of currency translation (\$2.1 million). For the first six months, Parts SG&A increased to \$103.5 million in 2018 compared to \$96.8 million in 2017 primarily due to the effects of currency translation (\$5.5 million).

As a percentage of sales, Parts SG&A decreased to 5.4% in the second quarter and first half of 2018 from 6.0% in the second quarter and first half of 2017. The decrease for both periods was primarily due to higher net sales.

PACCAR Inc – Form 10-Q

Financial Services

The Company's Financial Services segment accounted for 6% of revenues in the second quarter and first six months of 2018 compared to 7% in the second quarter and first six months of 2017.

(\$ in millions)	Three Months Ended June 30			Six Months Ended June 30		
	2018	2017	% CHANGE	2018	2017	% CHANGE
New loan and lease volume:						
U.S. and Canada	\$841.9	\$617.1	36	\$1,461.6	\$1,020.8	43
Europe	343.0	263.7	30	646.4	504.1	28
Mexico, Australia and other	220.8	219.4	1	398.4	376.5	6
	\$1,405.7	\$1,100.2	28	\$2,506.4	\$1,901.4	32
New loan and lease volume by product:						
Loans and finance leases	\$1,132.4	\$834.2	36	\$2,033.8	\$1,433.8	42
Equipment on operating lease	273.3	266.0	3	472.6	467.6	1
	\$1,405.7	\$1,100.2	28	\$2,506.4	\$1,901.4	32
New loan and lease unit volume:						
Loans and finance leases	12,760	8,190	56	21,090	14,880	42
Equipment on operating lease	2,580	2,590		4,430	4,730	(6)
	15,340	10,780	42	25,520	19,610	30
Average earning assets:						
U.S. and Canada	\$7,700.5	\$7,210.8	7	\$7,619.0	\$7,233.6	5
Europe	3,331.7	2,805.6	19	3,363.9	2,755.1	22
Mexico, Australia and other	1,722.5	1,591.4	8	1,730.0	1,533.9	13
	\$12,754.7	\$11,607.8	10	\$12,712.9	\$11,522.6	10
Average earning assets by product:						
Loans and finance leases	\$7,959.1	\$7,303.9	9	\$7,919.8	\$7,282.8	9
Dealer wholesale financing	1,800.5	1,463.1	23	1,767.6	1,442.3	23
Equipment on lease and other	2,995.1	2,840.8	5	3,025.5	2,797.5	8
	\$12,754.7	\$11,607.8	10	\$12,712.9	\$11,522.6	10
Revenues:						
U.S. and Canada	\$190.5	\$175.9	8	\$376.6	\$356.8	6
Europe	87.5	73.4	19	174.6	143.5	22
Mexico, Australia and other	60.0	57.0	5	119.0	108.2	10
	\$338.0	\$306.3	10	\$670.2	\$608.5	10
Revenue by product:						
Loans and finance leases	\$104.6	\$91.4	14	\$204.5	\$181.5	13
Dealer wholesale financing	17.0	12.8	33	32.8	24.9	32
Equipment on lease and other	216.4	202.1	7	432.9	402.1	8
	\$338.0	\$306.3	10	\$670.2	\$608.5	10
Income before income taxes	\$72.4	\$62.4	16	\$139.9	\$119.2	17

For the second quarter, new loan and lease volume was \$1,405.7 million in 2018 compared to \$1,100.2 million in 2017 and for the first half was \$2,506.4 million in 2018 compared to \$1,901.4 million in 2017 reflecting higher truck deliveries in all markets.

In the second quarter of 2018, PFS finance market share on new PACCAR truck sales was 24.6% compared to 24.7% in the second quarter of 2017. In the first six months of 2018, PFS finance market share on new PACCAR truck sales was 23.6% compared to 24.2% in the first six months of 2017.

In the second quarter of 2018, PFS revenues increased to a record \$338.0 million from \$306.3 million in 2017, and in the first six months of 2018, PFS revenues increased to \$670.2 million from \$608.5 million in 2017. The increase for both periods was primarily due to revenue on higher average earning assets and higher portfolio yields reflecting higher market interest rates in North America. The effects of currency translation increased PFS revenues by \$6.1 million and \$21.6 million in the second quarter and first half of 2018, respectively.

PACCAR Inc – Form 10-Q

PFS income before income taxes increased to \$72.4 million in the second quarter of 2018 from \$62.4 million in the second quarter of 2017. In the first six months of 2018, PFS income before income taxes increased to \$139.9 million from \$119.2 million in 2017. The increase for both periods was primarily due to higher average earning asset balances and the effects of translating stronger foreign currencies to the U.S. dollar, partially offset by higher borrowing rates. The impact of currency translation increased PFS income before income taxes by \$.9 million and \$3.9 million for the second quarter and first half of 2018, respectively.

Included in Financial Services “Other Assets” on the Company’s Consolidated Balance Sheets are used trucks held for sale, net of impairments, of \$231.4 million at June 30, 2018 and \$221.7 million at December 31, 2017. These trucks are primarily units returned from matured operating leases in the ordinary course of business, and also include trucks acquired from repossessions or through acquisitions of used trucks in trades related to new truck sales.

The Company recognized losses on used trucks, excluding repossessions, of \$10.5 million in the second quarter of 2018 compared to \$10.0 million in the second quarter 2017 including losses on multiple unit transactions of \$6.0 million in 2018 compared to \$7.1 million in the second quarter of 2017. Used truck losses related to repossessions, which are recognized as credit losses, were nil and \$1.4 million for the second quarter of 2018 and 2017, respectively.

The Company recognized losses on used trucks, excluding repossessions, of \$20.0 million in the first half of 2018 compared to \$22.9 million in the first half of 2017 including losses on multiple unit transactions of \$12.7 million in the first half of 2018 compared to \$15.6 million in the first half of 2017. Used truck losses related to repossessions, which are recognized as credit losses, were \$.3 million and \$3.1 million in the first half of 2018 and 2017, respectively.

The major factors for the changes in interest and fees, interest and other borrowing expenses and finance margin between the three months ended June 30, 2018 and 2017 are outlined below:

	INTEREST AND OTHER		
	INTEREST	BORROWING	FINANCE
(\$ in millions)	AND FEES	EXPENSES	MARGIN
Three Months Ended June 30, 2017	\$ 104.2	\$ 37.4	\$ 66.8
Increase (decrease)			
Average finance receivables	9.9		9.9
Average debt balances		2.5	(2.5)
Yields	7.3		7.3
Borrowing rates		6.1	(6.1)
Currency translation	.2	(.3)	.5
Total increase	17.4	8.3	9.1
Three Months Ended June 30, 2018	\$ 121.6	\$ 45.7	\$ 75.9

• Average finance receivables increased \$775.8 million (excluding foreign exchange effects) in the second quarter of 2018 as a result of retail portfolio new business volume exceeding collections and higher dealer wholesale balances.

• Average debt balances increased \$487.6 million (excluding foreign exchange effects) in the second quarter of 2018. The higher average debt balances reflect funding for a higher average earnings asset portfolio, which includes loans, finance leases, wholesale and equipment on operating lease.

• Higher portfolio yields (5.1% in 2018 compared to 4.8% in 2017) increased interest and fees by \$7.3 million. The higher portfolio yields were primarily due to higher market rates in North America.

• Higher borrowing rates (2.0% in 2018 compared to 1.8% in 2017) were primarily due to higher debt market rates in North America.

• The currency translation effects reflect an increase in the value of foreign currencies relative to the U.S. dollar, primarily the euro.

PACCAR Inc – Form 10-Q

The major factors for the changes in interest and fees, interest and other borrowing expenses and finance margin between the six months ended June 30, 2018 and 2017 are outlined below:

	INTEREST AND OTHER		
	INTEREST	BORROWING	FINANCE
(\$ in millions)	AND FEES	EXPENSES	MARGIN
Six Months Ended June 30, 2017	\$ 206.4	\$ 71.5	\$ 134.9
Increase (decrease)			
Average finance receivables	16.5		16.5
Average debt balances		4.3	(4.3)
Yields	9.6		9.6
Borrowing rates		10.2	(10.2)
Currency translation	4.8	1.0	3.8
Total increase	30.9	15.5	15.4
Six Months Ended June 30, 2018	\$ 237.3	\$ 87.0	\$ 150.3

▲Average finance receivables increased \$664.4 million (excluding foreign exchange effects) in the first six months of 2018 as a result of retail portfolio new business volume exceeding collections and higher dealer wholesale balances.

▲Average debt balances increased \$446.8 million (excluding foreign exchange effects) in the first six months of 2018. The higher average debt balances reflect funding for a higher average earnings asset portfolio, which includes loans, finance leases, wholesale and equipment on operating lease.

♣Higher portfolio yields (5.0% in 2018 compared to 4.8% in 2017) increased interest and fees by \$9.6 million. The higher portfolio yields primarily due to higher market rates in North America.

♣Higher borrowing rates (2.0% in 2018 compared to 1.7% in 2017) were primarily due to higher debt market rates in North America.

♣The currency translation effects reflect an increase in the value of foreign currencies relative to the U.S. dollar, primarily the euro.

The following table summarizes operating lease, rental and other revenues and depreciation and other expenses:

	Three Months		Six Months	
	Ended		Ended	
	June 30		June 30	
(\$ in millions)	2018	2017	2018	2017
Operating lease and rental revenues	\$206.7	\$193.7	\$413.3	\$376.4
Used truck sales and other	9.7	8.4	19.6	25.7
Operating lease, rental and other revenues	\$216.4	\$202.1	\$432.9	\$402.1
Depreciation of operating lease equipment	\$149.0	\$144.5	\$300.3	\$285.1
Vehicle operating expenses	29.7	22.7	57.9	46.7
Cost of used truck sales and other	6.8	5.6	13.7	20.7
Depreciation and other expenses	\$185.5	\$172.8	\$371.9	\$352.5

PACCAR Inc – Form 10-Q

The major factors for the changes in operating lease, rental and other revenues, depreciation and other expenses and lease margin between the three months ended June 30, 2018 and 2017 are outlined below:

	OPERATING		
	LEASE, RENTAL	DEPRECIATION	
	AND OTHER	AND OTHER	LEASE
(\$ in millions)	REVENUES	EXPENSES	MARGIN
Three Months Ended June 30, 2017	\$ 202.1	\$ 172.8	\$ 29.3
Increase (decrease)			
Used truck sales	1.0	1.2	(.2)
Results on returned lease assets		1.6	(1.6)
Average operating lease assets	4.5	4.5	
Revenue and cost per asset	3.4	.9	2.5
Currency translation and other	5.4	4.5	.9
Total increase	14.3	12.7	1.6
Three Months Ended June 30, 2018	\$ 216.4	\$ 185.5	\$ 30.9

▲ A higher sales volume of used trucks received on trade increased operating lease, rental and other revenues by \$1.0 million and increased depreciation and other expenses by \$1.2 million.

■ Results on returned lease assets increased depreciation and other expenses by \$1.6 million primarily due to higher losses on sales of returned lease units.

▲ Average operating lease assets increased \$71.2 million (excluding foreign exchange effects), which increased revenues and related depreciation and other expenses by \$4.5 million.

■ Revenue per asset increased \$3.4 million primarily due to higher rental income and higher fee income. Cost per asset increased \$.9 million due to higher depreciation expense and vehicle operating expenses, partially offset by lower impairments.

■ The currency translation effects reflect an increase in the value of foreign currencies relative to the U.S. dollar, primarily the euro.

The major factors for the changes in operating lease, rental and other revenues, depreciation and other expenses and lease margin between the six months ended June 30, 2018 and 2017 are outlined below:

	OPERATING		
	LEASE, RENTAL	DEPRECIATION	
	AND OTHER	AND OTHER	LEASE
(\$ in millions)	REVENUES	EXPENSES	MARGIN
Six Months Ended June 30, 2017	\$ 402.1	\$ 352.5	\$ 49.6

(Decrease) increase			
Used truck sales	(7.4)	(6.7)	(.7)
Results on returned lease assets		(3.5)	3.5
Average operating lease assets	14.3	13.2	1.1
Revenue and cost per asset	6.6	2.9	3.7
Currency translation and other	17.3	13.5	3.8
Total increase	30.8	19.4	11.4
Six Months Ended June 30, 2018	\$ 432.9	\$ 371.9	\$ 61.0

▲ A lower sales volume of used trucks received on trade decreased operating lease, rental and other revenues by \$7.4 million and decreased depreciation and other expenses by \$6.7 million.

◆ Results on returned lease assets decreased depreciation and other expenses by \$3.5 million primarily due to lower losses on sales of returned lease units.

▲ Average operating lease assets increased \$116.1 million (excluding foreign exchange effects), which increased revenues by \$14.3 million and related depreciation and other expenses by \$13.2 million.

◆ Revenue per asset increased \$6.6 million primarily due to higher rental income and higher fee income. Cost per asset increased \$2.9 million due to higher depreciation expense and vehicle operating expenses.

◆ The currency translation effects reflect an increase in the value of foreign currencies relative to the U.S. dollar, primarily the euro.

PACCAR Inc – Form 10-Q

The following table summarizes the provision for losses on receivables and net charge-offs:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	PROVISION FOR		PROVISION FOR	
	LOSSES ON NET		LOSSES ON NET	
(\$ in millions)	RECEIVABLES	CHARGE-OFFS	RECEIVABLES	CHARGE-OFFS
U.S. and Canada	\$ 3.3	\$ 3.1	\$ 5.1	\$ 4.8
Europe	(.6)	6.9	1.9	7.1
Mexico, Australia and other	1.9	.6	3.5	1.4
	\$ 4.6	\$ 10.6	\$ 10.5	\$ 13.3

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	PROVISION FOR		PROVISION FOR	
	LOSSES ON NET		LOSSES ON NET	
(\$ in millions)	RECEIVABLES	CHARGE-OFFS	RECEIVABLES	CHARGE-OFFS
U.S. and Canada	\$ 4.6	\$ 3.5	\$ 8.3	\$ 8.1
Europe	.8	.5	1.4	.7
Mexico, Australia and other	1.4	.3	3.0	.9
	\$ 6.8	\$ 4.3	\$ 12.7	\$ 9.7

The provision for losses on receivables was \$4.6 million for the second quarter of 2018 compared to \$6.8 million in 2017. For the first half of 2018, the provision for losses on receivables was \$10.5 million compared to \$12.7 million in 2017 reflecting continued good portfolio performance.

The Company modifies loans and finance leases as a normal part of its Financial Services operations. The Company may modify loans and finance leases for commercial reasons or for credit reasons. Modifications for commercial reasons are changes to contract terms for customers that are not considered to be in financial difficulty. Insignificant delays are modifications extending terms up to three months for customers experiencing some short-term financial stress, but not considered to be in financial difficulty. Modifications for credit reasons are changes to contract terms for customers considered to be in financial difficulty. The Company's modifications typically result in granting more time to pay the contractual amounts owed and charging a fee and interest for the term of the modification. When considering whether to modify customer accounts for credit reasons, the Company evaluates the creditworthiness of the customers and modifies those accounts that the Company considers likely to perform under the modified terms. When the Company modifies loans and finance leases for credit reasons and grants a concession, the modifications are classified as troubled debt restructurings (TDR).

The post-modification balance of accounts modified during the six months ended June 30, 2018 and 2017 are summarized below:

(\$ in millions) Six Months Ended June 30,	2018			2017		
	RECORDED OF TOTAL			RECORDED OF TOTAL		
	INVESTMENT	PORTFOLIO*		INVESTMENT	PORTFOLIO*	
Commercial	\$ 97.1	2.4	%	\$ 105.4	2.8	%
Insignificant delay	27.8	.7	%	46.0	1.2	%
Credit – no concession	41.9	1.0	%	37.4	1.0	%
Credit – TDR	8.3	.2	%	17.0	.5	%
	\$ 175.1	4.3	%	\$ 205.8	5.5	%

*Recorded investment immediately after modification as a percentage of ending retail portfolio, on an annualized basis.

During the first six months of 2018, total modification activity decreased compared to the first six months of 2017, due to lower modifications for commercial reasons, insignificant delays and credit – TDRs, partially offset by higher credit – no concession modifications. The decrease in modifications for commercial reasons primarily reflects lower volumes of refinancing. The decrease in modifications for insignificant delay reflects fewer fleet customers requesting payment relief for up to three months. Credit – TDR modifications decreased to \$8.3 in 2018 from \$17.0 in 2017 mainly due to contract modifications for two fleet customers in 2017. The increase in modifications for credit – no concession is primarily due to the contract modification of one fleet customer in Europe.

PACCAR Inc – Form 10-Q

The following table summarizes the Company's 30+ days past due accounts:

	June 30	December	June 30		June 30	
	2018	31	2017		2017	
Percentage of retail loan and lease accounts 30+ days past due:						
U.S. and Canada	.2	%	.4	%	.2	%
Europe	.4	%	.3	%	.9	%
Mexico, Australia and other	1.8	%	1.5	%	2.3	%
Worldwide	.5	%	.5	%	.6	%

Accounts 30+ days past due were .5% at June 30, 2018 compared to .5% at December 31, 2017, as lower past due accounts in the U.S. and Canada were offset by higher past dues in Europe and Mexico. The Company continues to focus on maintaining low past due balances.

When the Company modifies a 30+ days past due account, the customer is then generally considered current under the revised contractual terms. The Company modified \$7.5 million of accounts worldwide during the second quarter of 2018, \$.6 million during the fourth quarter of 2017 and \$10.5 million during the second quarter of 2017 that were 30+ days past due and became current at the time of modification. Had these accounts not been modified and continued to not make payments, the pro forma percentage of retail loan and lease accounts 30+ days past due would have been as follows:

	June 30	December	June 30		June 30	
	2018	31	2017		2017	
Pro forma percentage of retail loan and lease accounts 30+ days past due:						
U.S. and Canada	.2	%	.4	%	.2	%
Europe	.4	%	.3	%	.9	%
Mexico, Australia and other	2.2	%	1.5	%	3.1	%
Worldwide	.6	%	.5	%	.8	%

Modifications of accounts in prior quarters that were more than 30 days past due at the time of modification are included in past dues if they were not performing under the modified terms at June 30, 2018, December 31, 2017 and June 30, 2017. The effect on the allowance for credit losses from such modifications was not significant at June 30, 2018, December 31, 2017 and June 30, 2017.

The Company's annualized pre-tax return on average assets for Financial Services was 2.1% for both the second quarter and the first half of 2018, compared to 2.0% for the same periods in 2017.

Other

Other includes the winch business as well as sales, income and expenses not attributable to a reportable segment, and a portion of corporate expense. Other sales represent less than 1% of consolidated net sales and revenues for both the second quarter and first half of 2018 and 2017. Other SG&A increased to \$14.3 million for the second quarter of 2018 from \$12.2 million for the second quarter of 2017 primarily due to higher compensation costs. Other SG&A increased to \$36.7 million for the first half of 2018 from \$25.7 million in 2017 primarily due to higher compensation costs and higher professional fees.

For the second quarter, other income before tax was \$4.1 million in 2018 compared to \$4.0 million in 2017. For the first six months, other income before tax was \$9.0 million in 2018 compared to \$5.3 million in 2017 primarily due to improved results in the winch business.

Investment income for the second quarter increased to \$14.6 million in 2018 from \$8.7 million in 2017. For the first six months, investment income increased to \$24.6 million in 2018 from \$16.8 million in 2017. The higher investment income in the second quarter and first six months of 2018 was primarily due to higher average portfolio balances and higher yields on U.S. investments due to higher market interest rates.

PACCAR Inc – Form 10-Q

Income Taxes

The effective tax rate for the second quarter of 2018 was 22.2% compared to 30.8% for the second quarter of 2017. The effective tax rate for the first half of 2018 was 22.8% compared to 30.8% in the same period of 2017. The difference in 2018 tax rates compared to 2017 was primarily due to the U.S. federal income tax legislation enacted on December 22, 2017 which lowered the U.S. statutory income tax rate from 35.0% to 21.0%.

(\$ in millions)	Three Months Ended		Six Months Ended	
	June 30 2018	June 30 2017	June 30 2018	June 30 2017
Domestic income before taxes	\$451.6	\$351.8	\$872.5	\$610.9
Foreign income before taxes	268.0	187.2	516.5	376.3
Total income before taxes	\$719.6	\$539.0	\$1,389.0	\$987.2
Domestic pre-tax return on revenues	13.9 %	13.2 %	13.8 %	12.4 %
Foreign pre-tax return on revenues	10.5 %	9.2 %	10.0 %	9.4 %
Total pre-tax return on revenues	12.4 %	11.5 %	12.1 %	11.0 %

For the second quarter and first half of 2018, both domestic and foreign income before income taxes improved primarily due to higher revenues from truck, parts and finance operations. Domestic and foreign pre-tax return on revenues for the second quarter and first half of 2018 increased primarily due to improved truck and parts results.

LIQUIDITY AND CAPITAL RESOURCES:

(\$ in millions)	June 30	December 31
	2018	2017
Cash and cash equivalents	\$2,506.8	\$2,364.7
Marketable debt securities	1,033.3	1,367.1
	\$3,540.1	\$3,731.8

The Company's total cash and marketable debt securities at June 30, 2018 decreased \$191.7 million from the balances at December 31, 2017, primarily due to a decrease in marketable debt securities, partially offset by an increase in cash and cash equivalents.

The change in cash and cash equivalents is summarized below:

(\$ in millions)	2018	2017
Six Months Ended June 30,		

Edgar Filing: PACCAR INC - Form 10-Q

Operating activities:		
Net income	\$1,071.7	\$683.3
Net income items not affecting cash	549.6	532.1
Changes in operating assets and liabilities, net	(422.8)	(30.2)
Net cash provided by operating activities	1,198.5	1,185.2
Net cash used in investing activities	(745.2)	(770.3)
Net cash used in financing activities	(278.6)	(507.8)
Effect of exchange rate changes on cash	(32.6)	57.0
Net increase (decrease) in cash and cash equivalents	142.1	(35.9)
Cash and cash equivalents at beginning of period	2,364.7	1,915.7
Cash and cash equivalents at end of period	\$2,506.8	\$1,879.8

Operating activities: Cash provided by operations increased by \$13.3 million to \$1,198.5 million in the first half of 2018 from \$1,185.2 million in 2017. Higher operating cash flows reflect higher net income of \$388.4 million and higher cash inflows of \$239.2 million from accounts payable and accrued expenses as purchases of goods and services exceeded payments. These inflows were offset by \$261.7 million in net purchases of inventories, decreased cash inflows of \$93.5 million from accounts receivables as cash receipts were lower than sales in 2018 and a decrease of \$80.5 million in other liabilities, mainly related to settlement of matured interest rate contracts and income tax payments. Additionally, there was a higher cash usage for pension contributions of \$70.3 million, a higher volume of new business exceeding collection for dealer direct loans of \$47.1 million and a higher increase in wholesale receivables on new trucks of \$58.5 million.

PACCAR Inc – Form 10-Q

Investing activities: Cash used in investing activities decreased by \$25.1 million to \$745.2 million in the first half of 2018 from \$770.3 million in 2017. Lower net cash used in investing activities reflects \$393.2 million from marketable debt securities as there was \$316.9 million in net proceeds from sales of marketable securities in the first half of 2018 versus \$76.3 million in net purchases of marketable debt securities in 2017. In addition, there were higher proceeds from asset disposals of \$64.1 million. These inflows were offset by higher net originations from retail loans and direct financing leases of \$441.7 million.

Financing activities: Cash used in financing activities decreased by \$229.2 million to \$278.6 million for the first half of 2018 from \$507.8 million in 2017. The Company paid \$608.5 million in dividends in the first half of 2018 compared to \$382.5 million in 2017 due to a higher special dividend paid in January 2018. In the first half of 2018, the Company repurchased 1.5 million shares of common stock for \$94.2 million. There were no stock repurchases in 2017. In the first half of 2018, the Company issued \$1.33 billion of term debt, repaid term debt of \$1.14 billion and increased its outstanding commercial paper and short-term bank loans by \$230.1 million. In the first half of 2017, the Company issued \$959.8 million of term debt, repaid term debt of \$1.44 billion and increased its outstanding commercial paper and short-term bank loans by \$336.9 million. This resulted in cash provided by borrowing activities of \$413.2 million in the first half of 2018, \$557.3 million higher than the cash used in borrowing activities of \$144.1 million in 2017.

Credit Lines and Other

The Company has line of credit arrangements of \$3.50 billion, of which \$3.25 billion were unused at June 30, 2018. Included in these arrangements are \$3.0 billion of syndicated bank facilities, of which \$1.0 billion expires in June 2019, \$1.0 billion expires in June 2022 and \$1.0 billion expires in June 2023. The Company intends to replace these credit facilities on or before expiration with facilities of similar amounts and duration. These credit facilities are maintained primarily to provide backup liquidity for commercial paper borrowings and maturing medium-term notes. There were no borrowings under the syndicated bank facilities for the six months ended June 30, 2018.

As of June 30, 2018, the Company has completed the repurchase of \$300.0 million of the Company's common stock under the authorization approved in September 2015. On July 9, 2018, the Company's Board of Directors approved another plan to repurchase up to \$300.0 million of PACCAR's outstanding common stock.

Truck, Parts and Other

The Company provides funding for working capital, capital expenditures, R&D, dividends, stock repurchases and other business initiatives and commitments primarily from cash provided by operations. Management expects this method of funding to continue in the future.

Investments for property, plant and equipment in the first half of 2018 were \$159.6 million compared to \$157.4 million for the same period of 2017. Over the past decade, the Company's combined investments in worldwide capital projects and R&D totaled \$6.04 billion, and have significantly increased the operating capacity and efficiency of its facilities and enhanced the quality and operating efficiency of the Company's premium products.

In 2018, capital investments are expected to be \$425 to \$475 million and R&D is expected to be \$300 to \$320 million. The Company is investing in PACCAR's enhanced aerodynamic truck designs, integrated powertrains including electric, hybrid, hydrogen fuel cell technologies, advanced driver assistance and truck connectivity, and expanded manufacturing and parts distribution facilities.

The Company conducts business in certain countries which have been experiencing or may experience significant financial stress, fiscal or political strain and are subject to the corresponding potential for default. The Company routinely monitors its financial exposure to global financial conditions, global counterparties and operating environments. As of June 30, 2018, the Company's exposures in such countries were insignificant.

Financial Services

The Company funds its financial services activities primarily from collections on existing finance receivables and borrowings in the capital markets. The primary sources of borrowings in the capital markets are commercial paper and medium-term notes issued in the public markets and, to a lesser extent, bank loans. An additional source of funds is loans from other PACCAR companies.

The Company issues commercial paper for a portion of its funding in its Financial Services segment. Some of this commercial paper is converted to fixed interest rate debt through the use of interest-rate swaps, which are used to manage interest-rate risk.

In November 2015, the Company's U.S. finance subsidiary, PACCAR Financial Corp. (PFC), filed a shelf registration under the Securities Act of 1933. The total amount of medium-term notes outstanding for PFC as of June 30, 2018 was \$4.60 billion. The registration expires in November 2018 and does not limit the principal amount of debt securities that may be issued during that period. PFC intends to renew the registration prior to its expiration.

PACCAR Inc – Form 10-Q

As of June 30, 2018, the Company's European finance subsidiary, PACCAR Financial Europe, had €1.33 billion available for issuance under a €2.50 billion medium-term note program listed on the Professional Securities Market of the London Stock Exchange. This program replaced an expiring program in the second quarter of 2018 and is renewable annually through the filing of new listing particulars.

In April 2016, PACCAR Financial Mexico registered a 10.00 billion peso medium-term note and commercial paper program with the Comision Nacional Bancaria y de Valores. The registration expires in April 2021 and limits the amount of commercial paper (up to one year) to 5.00 billion pesos. At June 30, 2018, 6.80 billion pesos were available for issuance.

In the event of a future significant disruption in the financial markets, the Company may not be able to issue replacement commercial paper. As a result, the Company is exposed to liquidity risk from the shorter maturity of short-term borrowings paid to lenders compared to the longer timing of receivable collections from customers. The Company believes its cash balances and investments, collections on existing finance receivables, syndicated bank lines and current investment-grade credit ratings of A+/A1 will continue to provide it with sufficient resources and access to capital markets at competitive interest rates and therefore contribute to the Company maintaining its liquidity and financial stability. A decrease in these credit ratings could negatively impact the Company's ability to access capital markets at competitive interest rates and the Company's ability to maintain liquidity and financial stability. PACCAR believes its Financial Services companies will be able to continue funding receivables, servicing debt and paying dividends through internally generated funds, access to public and private debt markets and lines of credit.

FORWARD-LOOKING STATEMENTS:

This report contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements relating to future results of operations or financial position and any other statement that does not relate to any historical or current fact. Such statements are based on currently available operating, financial and other information and are subject to risks and uncertainties that may affect actual results. Risks and uncertainties include, but are not limited to: a significant decline in industry sales; competitive pressures; reduced market share; reduced availability of or higher prices for fuel; increased safety, emissions or other regulations or tariffs resulting in higher costs and/or sales restrictions; currency or commodity price fluctuations; lower used truck prices; insufficient or under-utilization of manufacturing capacity; supplier interruptions; insufficient liquidity in the capital markets; fluctuations in interest rates; changes in the levels of the Financial Services segment new business volume due to unit fluctuations in new PACCAR truck sales or reduced market shares; changes affecting the profitability of truck owners and operators; price changes impacting truck sales prices and residual values; insufficient supplier capacity or access to raw materials; labor disruptions; shortages of commercial truck drivers; increased warranty costs; litigation, including EC-related claims; or legislative and governmental regulations. A more detailed description of these and other risks is included under the heading Part 1, Item 1A, "Risk Factors" in the Company's Annual Report on Form 10 K for the year ended December 31, 2017.

PACCAR Inc – Form 10-Q

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in the Company's market risk during the six months ended June 30, 2018. For additional information, refer to Item 7A as presented in the 2017 Annual Report on Form 10 K.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Principal Executive Officer and Principal Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the period covered by this report. Based on that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

There have been no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

For Items 3, 4 and 5, there was no reportable information for the six months ended June 30, 2018.

ITEM 1.LEGAL PROCEEDINGS

On July 19, 2016, the European Commission (EC) concluded its investigation of all major European truck manufacturers and reached a settlement with DAF. Following the settlement, claims and lawsuits have been filed against the Company, DAF and certain DAF subsidiaries and other truck manufacturers. Others may bring EC related claims and lawsuits against the Company or its subsidiaries. While the Company believes it has meritorious defenses, such claims and lawsuits will likely take a significant period of time to resolve. An adverse outcome of such proceedings could have a material impact on the Company's results of operations.

The Company and its subsidiaries are parties to various other lawsuits incidental to the ordinary course of business. Management believes that the disposition of such lawsuits will not materially affect the Company's business or financial condition.

ITEM 1A.RISK FACTORS

For information regarding risk factors, refer to Part I, Item 1A as presented in the 2017 Annual Report on Form 10-K. There have been no material changes in the Company's risk factors during the six months ended June 30, 2018.

ITEM 2.UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

For Items 2(a) and (b), there was no reportable information for the six months ended June 30, 2018.

(c) Issuer purchases of equity securities.

As of June 30, 2018, the Company completed the repurchase of \$300.0 million of the Company's common stock under the authorization approved on September 23, 2015. The following are details of repurchases made under the plan for the second quarter of 2018:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Maximum Dollar Value that May Yet be Purchased Under This Plan
April 1-30, 2018	50,000	\$ 64.30	\$73,995,787
May 1-31, 2018	1,100,000	64.07	3,519,722
June 1-30, 2018	55,812	63.04	
Total	1,205,812	\$ 64.03	

On July 9, 2018, the Company's Board of Directors approved another plan to repurchase up to \$300.0 million of PACCAR's outstanding common stock.

PACCAR Inc – Form 10-Q

ITEM 6. EXHIBITS

Any exhibits filed herewith are listed in the accompanying index to exhibits.

INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Form	Date of First Filing	Exhibit Number	File Number
(3) (i)	Articles of Incorporation: <u>Amended and Restated Certificate of Incorporation of PACCAR Inc</u>	8-K	May 4, 2016	3(i)	001-14817
(ii)	Bylaws: <u>Fifth Amended and Restated Bylaws of PACCAR Inc</u>	10-K	February 21, 2018	3(ii)	001-14817
(4)	Instruments defining the rights of security holders, including indentures**:				
(a)	<u>Indenture for Senior Debt Securities dated as of November 20, 2009 between PACCAR Financial Corp. and The Bank of New York Mellon Trust Company, N.A.</u>	S-3	November 20, 2009	4.1	333-163273
(b)	Forms of Medium-Term Note, Series N (PACCAR Financial Corp.)	S-3	November 7, 2012	<u>4.2</u> and <u>4.3</u>	333-184808
(c)	Forms of Medium-Term Note, Series O (PACCAR Financial Corp.)	S-3	November 5, 2015	<u>4.2</u> and <u>4.3</u>	333-207838
(d)	<u>Form of InterNotes, Series C (PACCAR Financial Corp.)</u>	S-3	November 5, 2015	4.4	333-207838
(e)	<u>Terms and Conditions of the Notes applicable to the €1,500,000,000 Medium Term Note Programme of PACCAR Financial Europe B.V. set forth in the Base Prospectus dated May 9, 2014</u>	10-Q	November 6, 2014	4(h)	001-14817
(f)	<u>Terms and Conditions of the Notes applicable to the €2,500,000,000 Medium Term Note Programme of</u>	10-K	February 21, 2017	4(i)	001-14817

PACCAR Financial Europe B.V. set forth in the Listing Particulars dated May 9, 2016

- | | | | | | |
|-----|--|------|----------------|------|-----------|
| (g) | <u>Terms and Conditions of the Notes applicable to the €2,500,000,000 Medium Term Note Programme of PACCAR Financial Europe B.V. set forth in the Listing Particulars dated May 10, 2017</u> | 10-Q | August 4, 2017 | 4(h) | 001-14817 |
| (h) | <u>Terms and Conditions of the Notes applicable to the €2,500,000,000 Medium Term Note Programme of PACCAR Financial Europe B.V. set forth in the Listing Particulars dated May 9, 2018*</u> | | | | |

** Pursuant to the Instructions to Exhibits, certain instruments defining the rights of holders of long-term debt securities of the Company and its wholly owned subsidiaries are not filed because the total amount of securities authorized under any such instrument does not exceed 10 percent of the Company's total assets. The Company will file copies of such instruments upon request of the Commission.

(10) Material Contracts:

- | | | | | | |
|-----|--|------|-------------------|-------|-----------|
| (a) | <u>PACCAR Inc Amended and Restated Supplemental Retirement Plan</u> | 10-K | February 27, 2009 | 10(a) | 001-14817 |
| (b) | <u>Amended and Restated Deferred Compensation Plan</u> | 10-Q | May 5, 2012 | 10(b) | 001-14817 |
| (c) | <u>Deferred Incentive Compensation Plan (Amended and Restated as of December 31, 2004)</u> | 10-K | February 27, 2006 | 10(b) | 001-14817 |

PACCAR Inc – Form 10-Q

Exhibit Number	Exhibit Description	Form	Date of First Filing	Exhibit Number	File Number
(d)	<u>Second Amended and Restated PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors</u>	DEF14A	March 14, 2014	Appendix A	001-14817
(e)	<u>PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Restricted Stock Agreement for Non-Employee Directors</u>	10-K	February 27, 2009	10(e)	001-14817
(f)	<u>PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Deferred Restricted Stock Unit Agreement for Non-Employee Directors</u>	8-K	December 10, 2007	99.3	001-14817
(g)	<u>Amendment to Compensatory Arrangement with Non-Employee Directors</u>	10-K	February 26, 2015	10(g)	001-14817
(h)	<u>PACCAR Inc Senior Executive Yearly Incentive Compensation Plan (effective 01/01/16)</u>	10-Q	August 6, 2015	10(i)	001-14817
(i)	<u>PACCAR Inc Long Term Incentive Plan</u>	8-K	September 19, 2016	10(j)	001-14817
(j)	<u>PACCAR Inc Long Term Incentive Plan, Nonstatutory Stock Option Agreement and Form of Option Grant Agreement</u>	8-K	January 25, 2005	99.1	001-14817
(k)	<u>Amendment One to PACCAR Inc Long Term Incentive Plan, Nonstatutory Stock Option Agreement and Form of Option Grant Agreement</u>	10-Q	August 7, 2013	10(k)	001-14817
(l)	<u>PACCAR Inc Long Term Incentive Plan, 2014 Form of Nonstatutory Stock Option Agreement</u>	10-Q	August 7, 2013	10(l)	001-14817
(m)	<u>PACCAR Inc Long Term Incentive Plan, 2016 Restricted Stock Award Agreement</u>	10-Q	August 6, 2015	10(q)	001-14817
(n)	<u>PACCAR Inc Savings Investment Plan, Amendment and Restatement effective September 1, 2016</u>	10-Q	November 4, 2016	10(q)	001-14817
(o)		8-K		10.1	001-14817

Edgar Filing: PACCAR INC - Form 10-Q

				<u>Memorandum of Understanding, dated as of May 11, 2007, by and among PACCAR Engine Company, the State of Mississippi and certain state and local supporting governmental entities</u>	May 16, 2007		
(p)		10-Q		<u>Letter Waiver Dated as of July 22, 2008 amending the Memorandum of Understanding, dated as of May 11, 2007, by and among PACCAR Engine Company, the State of Mississippi and certain state and local supporting governmental entities</u>	October 27, 2008	10(o)	001-14817
(q)		10-Q		<u>Second Amendment to Memorandum of Understanding dated as of September 26, 2013, by and among PACCAR Engine Company, the Mississippi Development Authority and the Mississippi Major Economic Impact Authority</u>	November 7, 2013	10(u)	001-14817
(r)		10-K		<u>Second Amended and Restated PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Amended Deferred Restricted Stock Unit Grant Agreement</u>	February 26, 2015	10(t)	001-14817
(s)		10-K		<u>Second Amended and Restated PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Amended Restricted Stock Grant Agreement</u>	February 26, 2015	10(u)	001-14817

PACCAR Inc – Form 10-Q

Exhibit Number	Exhibit Description	Date of First Form Filing	Exhibit Number	File Number
(31)	Rule 13a-14(a)/15d-14(a) Certifications:			
	(a) <u>Certification of Principal Executive Officer*</u>			
	(b) <u>Certification of Principal Financial Officer*</u>			
(32)	Section 1350 Certifications:			
	<u>Certification pursuant to rule 13a-14(b) and section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. section 1350)*</u>			
(101.INS)	XBRL Instance Document*			
(101.SCH)	XBRL Taxonomy Extension Schema Document*			
(101.CAL)	XBRL Taxonomy Extension Calculation Linkbase Document*			
(101.DEF)	XBRL Taxonomy Extension Definition Linkbase Document*			
(101.LAB)	XBRL Taxonomy Extension Label Linkbase Document*			
(101.PRE)	XBRL Taxonomy Extension Presentation Linkbase Document*			

* filed herewith

PACCAR Inc – Form 10-Q

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PACCAR Inc
(Registrant)

Date August 3, 2018 By/s/ M. T. Barkley
M. T. Barkley
Senior Vice President and Controller
(Authorized Officer and Chief Accounting Officer)