
**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)

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

91-0351110
(I.R.S. Employer Identification No.)

98004
(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

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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Comprehensive Income (Unaudited)
(Millions Except Per Share Amounts)

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2018	2017	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)
	<u>4,834.6</u>	<u>3,930.0</u>	<u>9,564.5</u>	<u>7,482.4</u>
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
	<u>265.6</u>	<u>243.9</u>	<u>530.3</u>	<u>489.3</u>
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	<u>\$ 1.59</u>	<u>\$ 1.06</u>	<u>\$ 3.04</u>	<u>\$ 1.94</u>
Weighted Average Number of Common Shares Outstanding				
Basic	351.7	351.8	352.1	351.7
Diluted	<u>352.5</u>	<u>352.7</u>	<u>353.0</u>	<u>352.7</u>
Dividends declared per share	<u>\$.28</u>	<u>\$.25</u>	<u>\$.53</u>	<u>\$.49</u>
Comprehensive Income	\$ 384.2	\$ 505.8	\$ 971.6	\$ 886.2

See Notes to Consolidated Financial Statements.

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.

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.

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)
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	<u>\$ 2,506.8</u>	<u>\$ 1,879.8</u>

See Notes to Consolidated Financial Statements.

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 June 30		Six Months Ended 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 DECEMBER 31, 2017	CHANGE DUE TO NEW STANDARD	BALANCE AT 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

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:

Three Months Ended June 30, 2018	PRO FORMA UNDER PRIOR STANDARD	EFFECTS OF NEW STANDARD	CURRENTLY 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
Six Months Ended June 30, 2018	PRO FORMA UNDER PRIOR STANDARD	EFFECTS OF NEW STANDARD	CURRENTLY 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
At June 30, 2018	PRO FORMA UNDER PRIOR STANDARD	EFFECTS OF NEW STANDARD	CURRENTLY 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

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:

Three Months Ended June 30, 2017	PREVIOUSLY REPORTED	EFFECTS OF NEW STANDARD	CURRENTLY REPORTED
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

Six Months Ended June 30, 2017	PREVIOUSLY REPORTED	EFFECTS OF NEW STANDARD	CURRENTLY REPORTED
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.

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 *	<i>Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.</i>
2016-15 *	<i>Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.</i>
2017-12 **	<i>Derivative and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.</i>

* 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 *	<i>Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting.</i>	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
<i>Truck</i>		
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
<i>Parts</i>		
Parts sales	942.5	1,854.6
Revenues from dealer services and other	25.5	53.3
	968.0	1,907.9
<i>Winch sales and other</i>	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

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.

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
	<u>\$ 1,038.4</u>	<u>\$.8</u>	<u>\$ 5.9</u>	<u>\$ 1,033.3</u>

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
	<u>\$ 1,370.2</u>	<u>\$ 1.9</u>	<u>\$ 5.0</u>	<u>\$ 1,367.1</u>

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 THAN TWELVE MONTHS	TWELVE MONTHS OR GREATER	LESS THAN TWELVE MONTHS	TWELVE MONTHS OR GREATER
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
	<u>\$ 1,038.4</u>	<u>\$ 1,033.3</u>

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
	<u>1,436.6</u>	<u>1,101.9</u>
Less LIFO reserve	(178.1)	(173.5)
	<u>\$ 1,258.5</u>	<u>\$ 928.4</u>

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)
	<u>\$ 10,298.2</u>	<u>\$ 9,814.3</u>
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)
	<u>\$ 10,185.5</u>	<u>\$ 9,697.1</u>

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.

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.

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	OTHER*	TOTAL
	WHOLESALE	RETAIL	RETAIL		
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	OTHER*	TOTAL
	WHOLESALE	RETAIL	RETAIL		
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		CUSTOMER	TOTAL
	WHOLESALE	RETAIL	RETAIL	
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

Notes to Consolidated Financial Statements (Unaudited)

(Millions, Except Share Amounts)

At December 31, 2017	DEALER		CUSTOMER	TOTAL
	WHOLESALE	RETAIL	RETAIL	
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
	<u>\$ 43.9</u>	<u>\$ 50.5</u>

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		CUSTOMER RETAIL		TOTAL
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	
Impaired loans with a specific reserve	\$.1		\$ 20.0	\$ 2.7	\$ 22.8
Associated allowance	(.1)		(3.1)	(.6)	(3.8)
			\$ 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		<u>\$ 3.0</u>	<u>\$ 25.7</u>	<u>\$ 2.2</u>	<u>\$ 30.9</u>
Average recorded investment*	<u>\$.1</u>	<u>\$ 3.8</u>	<u>\$ 32.8</u>	<u>\$ 2.0</u>	<u>\$ 38.7</u>

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

At December 31, 2017	DEALER		CUSTOMER RETAIL		TOTAL
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	
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		<u>\$ 3.9</u>	<u>\$ 28.9</u>	<u>\$ 1.0</u>	<u>\$ 33.8</u>
Average recorded investment*	<u>\$.9</u>	<u>\$ 3.8</u>	<u>\$ 30.7</u>	<u>\$ 2.2</u>	<u>\$ 37.6</u>

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

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

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	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.

At June 30, 2018	DEALER		CUSTOMER RETAIL		TOTAL
	WHOLESALE	RETAIL	FLEET	OWNER/ OPERATOR	
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
	<u>\$ 2,069.7</u>	<u>\$ 1,360.6</u>	<u>\$ 5,648.2</u>	<u>\$ 1,061.9</u>	<u>\$ 10,140.4</u>

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
	<u>\$ 1,880.6</u>	<u>\$ 1,358.7</u>	<u>\$ 5,397.9</u>	<u>\$ 1,016.0</u>	<u>\$ 9,653.2</u>

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
	<u>\$ 2,069.7</u>	<u>\$ 1,360.6</u>	<u>\$ 5,648.2</u>	<u>\$ 1,061.9</u>	<u>\$ 10,140.4</u>

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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
	<u>\$ 1,880.6</u>	<u>\$ 1,358.7</u>	<u>\$ 5,397.9</u>	<u>\$ 1,016.0</u>	<u>\$ 9,653.2</u>

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
	<u>\$ 7.9</u>	<u>\$ 7.9</u>	<u>\$ 8.3</u>	<u>\$ 8.3</u>

	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
	<u>\$ 8.0</u>	<u>\$ 8.1</u>	<u>\$ 17.0</u>	<u>\$ 17.0</u>

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
	<u>\$.8</u>	<u>\$ 1.1</u>

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.

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	<u>\$ 329.3</u>	<u>\$ 274.4</u>
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	<u>\$ 680.3</u>	<u>\$ 620.1</u>

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		Six Months Ended	
	June 30		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
	<u>4.8</u>	<u>8.5</u>	<u>2.3</u>	<u>(1.1)</u>
Unrealized gains (losses) on marketable debt securities	.5	(.5)	(2.1)	2.9
Tax effect	(.1)	.1	.5	(1.2)
	<u>.4</u>	<u>(.4)</u>	<u>(1.6)</u>	<u>1.7</u>
Pension plans	21.3	(1.4)	23.9	2.5
Tax effect	(5.2)		(5.8)	(1.3)
	<u>16.1</u>	<u>(1.4)</u>	<u>18.1</u>	<u>1.2</u>
Foreign currency translation (losses) gains	(196.7)	126.1	(118.9)	201.1
Net other comprehensive (loss) income	<u>(175.4)</u>	<u>132.8</u>	<u>(100.1)</u>	<u>202.9</u>
Comprehensive income	<u>\$ 384.2</u>	<u>\$ 505.8</u>	<u>\$ 971.6</u>	<u>\$ 886.2</u>

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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:

<u>Three Months Ended June 30, 2018</u>	DERIVATIVE CONTRACTS	MARKETABLE DEBT SECURITIES	PENSION PLANS	FOREIGN CURRENCY TRANSLATION	TOTAL
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	<u>\$ 3.5</u>	<u>\$ (3.4)</u>	<u>\$ (357.5)</u>	<u>\$ (536.3)</u>	<u>\$ (893.7)</u>

<u>Three Months Ended June 30, 2017</u>	DERIVATIVE CONTRACTS	MARKETABLE DEBT SECURITIES	PENSION PLANS	FOREIGN CURRENCY TRANSLATION	TOTAL
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	<u>\$ (5.4)</u>	<u>\$ 1.4</u>	<u>\$ (412.9)</u>	<u>\$ (508.3)</u>	<u>\$ (925.2)</u>

<u>Six Months Ended June 30, 2018</u>	DERIVATIVE CONTRACTS	MARKETABLE DEBT SECURITIES	PENSION PLANS	FOREIGN CURRENCY TRANSLATION	TOTAL
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	<u>\$ 3.5</u>	<u>\$ (3.4)</u>	<u>\$ (357.5)</u>	<u>\$ (536.3)</u>	<u>\$ (893.7)</u>

<u>Six Months Ended June 30, 2017</u>	DERIVATIVE CONTRACTS	MARKETABLE DEBT SECURITIES	PENSION PLANS	FOREIGN CURRENCY TRANSLATION	TOTAL
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	<u>\$ (5.4)</u>	<u>\$ 1.4</u>	<u>\$ (412.9)</u>	<u>\$ (508.3)</u>	<u>\$ (925.2)</u>

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:			
<i>Truck, Parts and Other</i>			
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
<i>Financial Services</i>			
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:			
<i>Truck, Parts and Other</i>			
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

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:			
<i>Truck, Parts and Other</i>			
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
<i>Financial Services</i>			
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:			
<i>Truck, Parts and Other</i>			
Actuarial loss	Interest and other (income), net	17.8	12.6
<i>Financial Services</i>			
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.

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 Ended		Six Months Ended	
	June 30		June 30	
	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
	<u>\$ 5,805.2</u>	<u>\$ 4,704.2</u>	<u>\$ 11,459.2</u>	<u>\$ 8,942.1</u>
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
	<u>\$ 719.6</u>	<u>\$ 539.0</u>	<u>\$ 1,389.0</u>	<u>\$ 987.2</u>
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
	<u>\$ 268.3</u>	<u>\$ 269.0</u>	<u>\$ 541.8</u>	<u>\$ 528.2</u>

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.

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:				
<i>Interest-rate contracts:</i>				
Financial Services:				
Other assets	\$ 60.5		\$ 53.3	
Deferred taxes and other liabilities		\$ 28.4		\$ 98.3
<i>Foreign-exchange contracts:</i>				
Truck, Parts and Other:				
Other current assets	7.3		3.8	
Accounts payable, accrued expenses and other		.9		1.9
	<u>\$ 67.8</u>	<u>\$ 29.3</u>	<u>\$ 57.1</u>	<u>\$ 100.2</u>
Derivatives not designated as hedging instruments:				
<i>Interest-rate contracts:</i>				
Financial Services:				
Deferred taxes and other liabilities				
<i>Foreign-exchange contracts:</i>				
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
	<u>\$ 2.7</u>	<u>\$ 1.0</u>	<u>\$.7</u>	<u>\$ 2.8</u>
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	<u>\$ 64.5</u>	<u>\$ 24.3</u>	<u>\$ 48.7</u>	<u>\$ 93.9</u>

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.

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 CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Gain recognized in OCI:				
Truck, Parts and Other		\$ 10.8		\$ 6.4
Financial Services	\$ 93.1		\$ 81.6	
	<u>\$ 93.1</u>	<u>\$ 10.8</u>	<u>\$ 81.6</u>	<u>\$ 6.4</u>
	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS
Loss recognized in OCI:				
Truck, Parts and Other		\$ (1.7)		\$ (20.4)
Financial Services	\$ (38.1)		\$ (83.1)	
	<u>\$ (38.1)</u>	<u>\$ (1.7)</u>	<u>\$ (83.1)</u>	<u>\$ (20.4)</u>

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

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)	
	<u>\$ (92.1)</u>	<u>\$ (5.0)</u>	<u>\$ (82.8)</u>	<u>\$ (2.5)</u>

Notes to Consolidated Financial Statements (Unaudited)

(Millions, Except Share Amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2017		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	
	<u>\$ 40.0</u>	<u>\$ 11.4</u>	<u>\$ 85.8</u>	<u>\$ 15.7</u>

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		Six Months Ended	
	June 30, 2018		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		<u>\$ (9.3)</u>		<u>\$ (3.0)</u>

	Three Months Ended		Six Months Ended	
	June 30, 2017		June 30, 2017	
	INTEREST- RATE CONTRACTS	FOREIGN- EXCHANGE CONTRACTS	INTEREST- RATE CONTRACTS	FOREIGN- 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	<u>\$ (.1)</u>	<u>\$ 9.9</u>	<u>\$ (.1)</u>	<u>\$ 36.4</u>

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.

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	<u>\$ 58.7</u>	<u>\$ 974.6</u>	<u>\$ 1,033.3</u>
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		<u>\$ 70.5</u>	<u>\$ 70.5</u>
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		<u>\$ 30.3</u>	<u>\$ 30.3</u>
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	<u>\$ 48.7</u>	<u>\$ 1,318.4</u>	<u>\$ 1,367.1</u>
Derivatives			
Cross currency swaps		\$ 44.2	\$ 44.2
Interest-rate swaps		9.1	9.1
Foreign-exchange contracts		4.5	4.5
Total derivative assets		<u>\$ 57.8</u>	<u>\$ 57.8</u>
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		<u>\$ 103.0</u>	<u>\$ 103.0</u>

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.

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 AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
<i>Assets:</i>				
Financial Services fixed rate loans	\$ 4,058.1	\$ 4,049.4	\$ 3,793.8	\$ 3,804.8
<i>Liabilities:</i>				
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 Ended June 30		Six Months Ended 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.

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

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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.

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		June 30	
	2018	2017	2018	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
	<u>\$ 5,805.2</u>	<u>\$ 4,704.2</u>	<u>\$ 11,459.2</u>	<u>\$ 8,942.1</u>
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	<u>46,400</u>	<u>39,400</u>	<u>18</u>	<u>90,900</u>	<u>74,400</u>	<u>22</u>

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.

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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
	<u>\$ 4,467.8</u>	<u>\$ 3,553.6</u>	<u>26</u>	<u>\$ 8,820.8</u>	<u>\$ 6,683.7</u>	<u>32</u>
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
Currency translation	89.1	78.0	11.1
Total increase	<u>914.2</u>	<u>780.2</u>	<u>134.0</u>
Three Months Ended June 30, 2018	<u>\$ 4,467.8</u>	<u>\$ 3,921.3</u>	<u>\$ 546.5</u>

- 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.

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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

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 June 30			Six Months Ended June 30		
	2018	2017	% CHANGE	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%	

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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:

(\$ in millions)	NET SALES	COST OF SALES	GROSS MARGIN
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.

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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:

(\$ in millions)	NET SALES	COST OF SALES	GROSS MARGIN
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.

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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
	<u>\$ 1,405.7</u>	<u>\$ 1,100.2</u>	<u>28</u>	<u>\$ 2,506.4</u>	<u>\$ 1,901.4</u>	<u>32</u>
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
	<u>\$ 1,405.7</u>	<u>\$ 1,100.2</u>	<u>28</u>	<u>\$ 2,506.4</u>	<u>\$ 1,901.4</u>	<u>32</u>
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	(6)	4,430	4,730	(6)
	<u>15,340</u>	<u>10,780</u>	<u>42</u>	<u>25,520</u>	<u>19,610</u>	<u>30</u>
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
	<u>\$12,754.7</u>	<u>\$11,607.8</u>	<u>10</u>	<u>\$12,712.9</u>	<u>\$11,522.6</u>	<u>10</u>
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
	<u>\$12,754.7</u>	<u>\$11,607.8</u>	<u>10</u>	<u>\$12,712.9</u>	<u>\$11,522.6</u>	<u>10</u>
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
	<u>\$ 338.0</u>	<u>\$ 306.3</u>	<u>10</u>	<u>\$ 670.2</u>	<u>\$ 608.5</u>	<u>10</u>
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
	<u>\$ 338.0</u>	<u>\$ 306.3</u>	<u>10</u>	<u>\$ 670.2</u>	<u>\$ 608.5</u>	<u>10</u>
Income before income taxes	<u>\$ 72.4</u>	<u>\$ 62.4</u>	<u>16</u>	<u>\$ 139.9</u>	<u>\$ 119.2</u>	<u>17</u>

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.

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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:

(\$ in millions)	INTEREST AND FEES	INTEREST AND OTHER BORROWING EXPENSES	FINANCE 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	<u>17.4</u>	<u>8.3</u>	<u>9.1</u>
Three Months Ended June 30, 2018	<u>\$ 121.6</u>	<u>\$ 45.7</u>	<u>\$ 75.9</u>

- 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.

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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:

(\$ in millions)	INTEREST AND FEES	INTEREST AND OTHER BORROWING EXPENSES	FINANCE 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:

(\$ in millions)	Three Months Ended June 30		Six Months Ended June 30	
	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

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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:

(\$ in millions)	OPERATING LEASE, RENTAL AND OTHER REVENUES	DEPRECIATION AND OTHER EXPENSES	LEASE 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:

(\$ in millions)	OPERATING LEASE, RENTAL AND OTHER REVENUES	DEPRECIATION AND OTHER EXPENSES	LEASE 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.

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

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

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

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 INVESTMENT	% OF TOTAL PORTFOLIO*	RECORDED INVESTMENT	% OF TOTAL 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%
	<u>\$ 175.1</u>	<u>4.3%</u>	<u>\$ 205.8</u>	<u>5.5%</u>

* 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.

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

	June 30 2018	December 31 2017	June 30 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 2018	December 31 2017	June 30 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.

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 June 30		Six Months Ended June 30	
	2018	2017	2018	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 2018	December 31 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,		
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.

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.

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.

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.

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: Amended and Restated Certificate of Incorporation of PACCAR Inc	8-K	May 4, 2016	3(i)	001-14817
(ii)	Bylaws: Fifth Amended and Restated Bylaws of PACCAR Inc	10-K	February 21, 2018	3(ii)	001-14817
(4)	Instruments defining the rights of security holders, including indentures**:				
(a)	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.	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	4.2 and 4.3	333-184808
(c)	Forms of Medium-Term Note, Series O (PACCAR Financial Corp.)	S-3	November 5, 2015	4.2 and 4.3	333-207838
(d)	Form of InterNotes, Series C (PACCAR Financial Corp.)	S-3	November 5, 2015	4.4	333-207838
(e)	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	10-Q	November 6, 2014	4(h)	001-14817
(f)	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, 2016	10-K	February 21, 2017	4(i)	001-14817
(g)	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	10-Q	August 4, 2017	4(h)	001-14817
(h)	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*				
**	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)	PACCAR Inc Amended and Restated Supplemental Retirement Plan	10-K	February 27, 2009	10(a)	001-14817
(b)	Amended and Restated Deferred Compensation Plan	10-Q	May 5, 2012	10(b)	001-14817
(c)	Deferred Incentive Compensation Plan (Amended and Restated as of December 31, 2004)	10-K	February 27, 2006	10(b)	001-14817

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Exhibit Number	Exhibit Description	Form	Date of First Filing	Exhibit Number	File Number
(d)	Second Amended and Restated PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors	DEF14A	March 14, 2014	Appendix A	001-14817
(e)	PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Restricted Stock Agreement for Non-Employee Directors	10-K	February 27, 2009	10(e)	001-14817
(f)	PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Deferred Restricted Stock Unit Agreement for Non-Employee Directors	8-K	December 10, 2007	99.3	001-14817
(g)	Amendment to Compensatory Arrangement with Non-Employee Directors	10-K	February 26, 2015	10(g)	001-14817
(h)	PACCAR Inc Senior Executive Yearly Incentive Compensation Plan (effective 01/01/16)	10-Q	August 6, 2015	10(i)	001-14817
(i)	PACCAR Inc Long Term Incentive Plan	8-K	September 19, 2016	10(j)	001-14817
(j)	PACCAR Inc Long Term Incentive Plan, Nonstatutory Stock Option Agreement and Form of Option Grant Agreement	8-K	January 25, 2005	99.1	001-14817
(k)	Amendment One to PACCAR Inc Long Term Incentive Plan, Nonstatutory Stock Option Agreement and Form of Option Grant Agreement	10-Q	August 7, 2013	10(k)	001-14817
(l)	PACCAR Inc Long Term Incentive Plan, 2014 Form of Nonstatutory Stock Option Agreement	10-Q	August 7, 2013	10(l)	001-14817
(m)	PACCAR Inc Long Term Incentive Plan, 2016 Restricted Stock Award Agreement	10-Q	August 6, 2015	10(q)	001-14817
(n)	PACCAR Inc Savings Investment Plan, Amendment and Restatement effective September 1, 2016	10-Q	November 4, 2016	10(q)	001-14817
(o)	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	8-K	May 16, 2007	10.1	001-14817
(p)	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	10-Q	October 27, 2008	10(o)	001-14817
(q)	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	10-Q	November 7, 2013	10(u)	001-14817
(r)	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	10-K	February 26, 2015	10(t)	001-14817
(s)	Second Amended and Restated PACCAR Inc Restricted Stock and Deferred Compensation Plan for Non-Employee Directors, Form of Amended Restricted Stock Grant Agreement	10-K	February 26, 2015	10(u)	001-14817

PACCAR Inc – Form 10-Q

<u>Exhibit Number</u>	<u>Exhibit Description</u>	<u>Form</u>	<u>Date of First Filing</u>	<u>Exhibit Number</u>	<u>File Number</u>
(31)	Rule 13a-14(a)/15d-14(a) Certifications:				
	(a) Certification of Principal Executive Officer*				
	(b) Certification of Principal Financial Officer*				
(32)	Section 1350 Certifications:				
	Certification pursuant to rule 13a-14(b) and section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. section 1350)*				
(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

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)

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the terms and conditions which, as completed by the relevant Pricing Supplement, will be endorsed on each Note in definitive form issued under the Programme. The terms and conditions applicable to any Note in global form will differ from those terms and conditions which would apply to the Note were it in definitive form to the extent described under "Summary of Provisions Relating to the Notes while in Global Form" below. All capitalized terms that are not defined in the terms and conditions shall have the meanings given to them in the relevant Pricing Supplement. References in the terms and conditions to "Notes" are to the Notes of one Series only, not to all Notes that may be issued under the Programme.

1. Introduction

- (a) *Programme*: PACCAR Financial Europe B.V., a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) incorporated under the laws of The Netherlands, having its corporate seat at Eindhoven (the "**Issuer**") has established a Euro Medium Term Note Programme (the "**Programme**") for the issuance of up to €2,500,000,000 in aggregate principal amount of notes (the "**Notes**").
- (b) *Pricing Supplement*: Notes issued under the Programme are issued in series (each a "**Series**") and each Series may comprise one or more tranches (each a "**Tranche**") of Notes. Each Tranche is the subject of a Pricing Supplement (the "**Pricing Supplement**") which completes these Conditions. The terms and conditions applicable to any particular Tranche of Notes are these Conditions as completed by the relevant Pricing Supplement.
- (c) *Agency Agreement*: The Notes are the subject of and issued pursuant to an amended and restated agency agreement dated 11 May 2015 (the "**Agency Agreement**") between the Issuer and Citibank, N.A., London Branch as fiscal agent (the "**Fiscal Agent**," which expression includes any successor fiscal agent appointed from time to time in connection with the Notes) and the paying agents named therein (together with the Fiscal Agent, the "Paying Agents," which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes) and with the benefit of a deed of covenant executed by the Issuer dated 11 May 2015 (the "**Deed of Covenant**") in relation to the Notes.
- (d) *The Notes*: All subsequent references in these Conditions to "**Notes**" are to the Notes that are the subject of the relevant Pricing Supplement. Copies of the relevant Pricing Supplement are available during normal business hours at the Specified Office of the Fiscal Agent or at the office of the Paying Agent in London, the initial Specified Offices of which are set out below.
- (e) *Summaries*: Certain provisions of these Conditions are summaries of the Agency Agreement and are subject to their detailed provisions. The holders of the Notes (the "**Noteholders**") and the holders of the related interest coupons, if any, (the "**Couponholders**" and the "**Coupons**," respectively) are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them. Copies of the Agency Agreement and the Deed of Covenant are available for inspection during normal business hours at the Specified Offices of each of the Paying Agents, the initial Specified Offices of which are set out below.

2. Interpretation

- (a) *Definitions*: In these Conditions the following expressions have the following meanings:

"**Accrual Yield**" means the amount as specified in the relevant Pricing Supplement;

"**Additional Business Centre(s)**" means the city or cities specified as such in the relevant Pricing Supplement;

"**Additional Financial Centre(s)**" means the city or cities specified as such in the relevant Pricing Supplement;

"**Adjustment Spread**" means either a spread (which may be positive or negative), or the formula or methodology for calculating a spread, in either case, which the Issuer, following consultation with the Independent Adviser and acting in good faith, determines is required to be applied to the Successor Rate or the Alternative Rate (as the case may be) to reduce or eliminate, to the extent reasonably practicable in the circumstances, any economic prejudice or benefit (as the case may be) to Noteholders and Couponholders as a result of the replacement of the Original Reference Rate with the Successor Rate or the Alternative Rate (as the case may be) and is the spread, formula or methodology which:

- (i) in the case of a Successor Rate, is formally recommended in relation to the replacement of the Original Reference Rate with the Successor Rate by any Relevant Nominating Body; or
- (ii) (if no such recommendation has been made, or in the case of an Alternative Rate) the Issuer determines, following consultation with the Independent Adviser and acting in good faith, is recognised or acknowledged as being in

customary usage in international debt capital markets transactions which reference the Original Reference Rate, where such rate has been replaced by the Successor Rate or the Alternative Rate (as the case may be); or

- (iii) (if the Issuer determines that no such customary market usage is recognised or acknowledged) the Issuer, in its discretion, following consultation with the Independent Adviser and acting in good faith, determines to be appropriate;

"Alternative Rate" means an alternative to the Reference Rate which the Issuer determines in accordance with Condition 7(e)(ii) has replaced the Original Reference Rate in customary market usage in the international debt capital markets for the purposes of determining rates of interest (or the relevant component part thereof) for the same interest period and in the same Specified Currency as the Notes or, if the Independent Adviser determines there is no such rate, such other rate as the Issuer determines (following consultation with the Independent Adviser and acting in good faith) is most comparable to the relevant Reference Rate;

"Benchmark Amendments" has the meaning given to it in Condition 7(e)(iv);

"Benchmark Event" means:

- (i) the Original Reference Rate ceasing to be published for a period of at least 5 Business Days or ceasing to exist; or
- (ii) a public statement by the administrator of the Original Reference Rate that it will, by a specified date within the following six months, cease publishing the Original Reference Rate permanently or indefinitely (in circumstances where no successor administrator has been appointed that will continue publication of the Original Reference Rate); or
- (iii) a public statement by the supervisor of the administrator of the Original Reference Rate that the Original Reference Rate has been or will, by a specified date within the following six months, be permanently or indefinitely discontinued; or
- (iv) a public statement by the supervisor of the administrator of the Original Reference Rate that means the Original Reference Rate will be prohibited from being used or that its use will be subject to restrictions or adverse consequences, in each case within the following six months; or
- (v) it has become unlawful for any Paying Agent, Calculation Agent, the Issuer or other party to calculate any payments due to be made to any Noteholder using the Original Reference Rate;

"Business Day" means:

- (i) in relation to any sum payable in euro, a TARGET Settlement Day and a day on which commercial banks and foreign exchange markets settle payments generally in each (if any) Additional Business Centre; and
- (ii) in relation to any sum payable in a currency other than euro, a day on which commercial banks and foreign exchange markets settle payments generally in London, in the Principal Financial Centre of the relevant currency and in each (if any) Additional Business Centre;

"Business Day Convention" means, in relation to any particular date, the business day convention specified in the relevant Pricing Supplement and, if so specified in the relevant Pricing Supplement, may have different meanings in relation to different dates and, in this context, the following expressions shall have the following meanings:

- (i) **"Following Business Day Convention"** means that the relevant date shall be postponed to the first following day that is a Business Day;
- (ii) **"Modified Following Business Day Convention"** or **"Modified Business Day Convention"** means that the relevant date shall be postponed to the first following day that is a Business Day unless that day falls in the next calendar month in which case that date will be the first preceding day that is a Business Day;
- (iii) **"Preceding Business Day Convention"** means that the relevant date shall be brought forward to the first preceding day that is a Business Day;
- (iv) **"FRN Convention," "Floating Rate Convention"** or **"Eurodollar Convention"** means that each relevant date shall be the date which numerically corresponds to the preceding such date in the calendar month which is the number of months specified in the relevant Pricing Supplement as the Specified Period after the calendar month in which the preceding such date occurred provided, however, that:

- (A) if there is no such numerically corresponding day in the calendar month in which any such date should occur, then such date will be the last day which is a Business Day in that calendar month;
 - (B) if any such date would otherwise fall on a day which is not a Business Day, then such date will be the first following day which is a Business Day unless that day falls in the next calendar month, in which case it will be the first preceding day which is a Business Day; and
 - (C) if the preceding such date occurred on the last day in a calendar month which was a Business Day, then all subsequent such dates will be the last day which is a Business Day in the calendar month which is the specified number of months after the calendar month in which the preceding such date occurred; and
- (v) "**No Adjustment**" means that the relevant date shall not be adjusted in accordance with any Business Day Convention;

"**Calculation Agent**" means the Fiscal Agent or such other Person specified in the relevant Pricing Supplement as the party responsible for calculating the Rate(s) of Interest and Interest Amount(s) and/or such other amount(s) as may be specified in the relevant Pricing Supplement;

"**Calculation Amount**" means the amount specified in the relevant Pricing Supplement;

"**Consolidated Assets**" means the aggregate amount of assets (less applicable reserves for depreciation, amortization, unearned finance charges, allowance for credit losses and other properly deductible items) after deducting therefrom all goodwill, trade names, trademarks, patents, organization expenses and other like intangibles, all as set forth on the most recent balance sheet of the Issuer and its Subsidiaries and computed in accordance with generally accepted accounting principles;

"**Coupon Sheet**" means, in respect of a Note, a coupon sheet relating to the Note;

"**Day Count Fraction**" means, in respect of the calculation of an amount for any period of time (the "**Calculation Period**"), such day count fraction as may be specified in these Conditions or the relevant Pricing Supplement and:

- (i) if "**Actual/Actual (ICMA)**" is so specified, means:
 - (a) where the Calculation Period is equal to or shorter than the Regular Period during which it falls, the actual number of days in the Calculation Period divided by the product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year; and
 - (b) where the Calculation Period is longer than one Regular Period, the sum of:
 - (A) the actual number of days in such Calculation Period falling in the Regular Period in which it begins divided by the product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year; and
 - (B) the actual number of days in such Calculation Period falling in the next Regular Period divided by the product of (a) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year;
- (ii) if "**Actual/365**" or "**Actual/Actual (ISDA)**" is so specified, means the actual number of days in the Calculation Period divided by 365 (or, if any portion of the Calculation Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Calculation Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Calculation Period falling in a non-leap year divided by 365);
- (iii) if "**Actual/365 (Fixed)**" is so specified, means the actual number of days in the Calculation Period divided by 365;
- (iv) if "**Sterling/FRN**" is so specified, means the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;
- (v) if "**Actual/360**" is so specified, means the actual number of days in the Calculation Period divided by 360;
- (vi) if "**30/360**" is so specified, means the number of days in the Calculation Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (i) the last day of the Calculation Period is the 31st day of a month but the first day of the Calculation Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day

month, or (ii) the last day of the Calculation Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month)); and

- (vii) if "**30E/360**" or "**Eurobond Basis**" is so specified means, the number of days in the Calculation Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Calculation Period unless, in the case of the final Calculation Period, the date of final maturity is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month);

"**Early Redemption Amount (Tax)**" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Pricing Supplement;

"**Early Termination Amount**" means, in respect of any Note, its principal amount or such other amount as may be specified in the Pricing Supplement and/or determined in accordance with these Conditions;

"**EURIBOR**" means, in respect of any specified currency and any specified period, the interest rate benchmark known as the Euro zone interbank offered rate which is calculated and published by a designated distributor (currently Thomson Reuters) in accordance with the requirements from time to time of the European Banking Federation (or any other person which takes over administration for that rate) based on estimated interbank borrowing rates for a number of designated currencies and maturities which are provided, in respect of each such currency, by a panel of contributor banks (details of historic EURIBOR rates can be obtained from the designated distributor);

"**Extraordinary Resolution**" has the meaning given in the Agency Agreement;

"**Final Redemption Amount**" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Pricing Supplement;

"**First Interest Payment Date**" means the date specified in the relevant Pricing Supplement;

"**Fixed Coupon Amount**" means the amount specified in the relevant Pricing Supplement;

"**Indebtedness**" means any mortgage, indenture or instrument under which there may be issued or by which there may be secured or evidenced any indebtedness for money borrowed by the Issuer;

"**Independent Adviser**" means an independent financial institution of international repute or an independent financial adviser with appropriate expertise appointed by the Issuer under Condition 7(e)(i);

"**Interest Amount**" means, in relation to a Note and an Interest Period, the amount of interest payable in respect of that Note for that Interest Period;

"**Interest Commencement Date**" means the Issue Date of the Notes or such other date as may be specified as the Interest Commencement Date in the relevant Pricing Supplement;

"**Interest Determination Date**" means the date specified in the relevant Pricing Supplement;

"**Interest Payment Date**" means the First Interest Payment Date and any other date or dates specified as such in the relevant Pricing Supplement and, if a Business Day Convention is specified in the relevant Pricing Supplement:

- (i) as the same may be adjusted in accordance with the relevant Business Day Convention; or
- (ii) if the Business Day Convention is the FRN Convention, Floating Rate Convention or Eurodollar Convention and an interval of a number of calendar months is specified in the relevant Pricing Supplement as being the Specified Period, each of such dates as may occur in accordance with the FRN Convention, Floating Rate Convention or Eurodollar Convention at such Specified Period of calendar months following the Interest Commencement Date (in the case of the First Interest Payment Date) or the previous Interest Payment Date (in any other case);

"**Interest Period**" means each period beginning on (and including) the Interest Commencement Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date;

"**ISDA Definitions**" means the 2006 ISDA Definitions (as amended and updated as at the date of issue of the first Tranche of the Notes of the relevant Series (as specified in the relevant Pricing Supplement) as published by the International Swaps and Derivatives Association, Inc.) or, if so specified in the relevant Pricing Supplement, the 2000 ISDA Definitions (as amended and updated as at the date of issue of the first Tranche of the Notes of the relevant Series (as specified in the relevant Pricing Supplement) as published by the International Swaps and Derivatives Association, Inc.);

"Issue Date" means the date specified in the relevant Pricing Supplement;

"LIBOR" means, in respect of any specified currency and any specified period, the interest rate benchmark known as the London interbank offered rate which is calculated and published by a designated distributor (currently Thomson Reuters) in accordance with the requirements from time to time of ICE Benchmark Administration Limited (or any other person which takes over the administration of that rate) based on estimated interbank borrowing rates for a number of designated currencies and maturities which are provided, in respect of each such currency, by a panel of contributor banks (details of historic LIBOR rates can be obtained from the designated distributor);

"Liens" means any interest in Property securing an obligation owed to, or a claim by, a Person other than the owner of the Property, including but not limited to a security interest arising from a mortgage, encumbrance, pledge, conditional sale or trust receipt, or a lease, consignment or bailment for security purposes. For the purposes of this definition, a Person shall be deemed to be the owner of any Property which it has or holds subject to a conditional sale arrangement, financing lease or other arrangement pursuant to which title to the Property has been retained by or is vested in some other Person for security purposes;

"Margin" means the margin specified in the relevant Pricing Supplement;

"Maturity Date" means the date specified in the relevant Pricing Supplement;

"Maximum Redemption Amount" means the amount specified in the relevant Pricing Supplement;

"Minimum Redemption Amount" means the amount specified in the relevant Pricing Supplement;

"Optional Redemption Amount (Call)" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Pricing Supplement;

"Optional Redemption Amount (Put)" means, in respect of any Note, its principal amount or such other amount as may be specified in the relevant Pricing Supplement;

"Optional Redemption Date (Call)" means the date specified in the relevant Pricing Supplement;

"Optional Redemption Date (Put)" means the date specified in the relevant Pricing Supplement;

"Original Reference Rate" means the originally-specified Reference Rate used to determine the Rate of Interest (or any component part thereof) on the Notes;

"Participating Member State" means a Member State of the European Union that adopts the euro as its lawful currency in accordance with the Treaty;

"Payment Business Day" means:

- (i) if the currency of payment is euro, any day which is:
 - (A) a day on which banks in the relevant place of presentation are open for presentation and payment of bearer debt securities and for dealings in foreign currencies; and
 - (B) in the case of payment by transfer to an account, a TARGET Settlement Day and a day on which dealings in foreign currencies may be carried on in each (if any) Additional Financial Centre; or
- (ii) if the currency of payment is not euro, any day which is:
 - (A) a day on which banks in the relevant place of presentation are open for presentation and payment of bearer debt securities and for dealings in foreign currencies; and
 - (B) in the case of payment by transfer to an account, a day on which dealings in foreign currencies may be carried on in the Principal Financial Centre of the currency of payment and in each (if any) Additional Financial Centre;

"Person" means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having separate legal personality;

"Principal Financial Centre" means, in relation to any currency, the principal financial centre for that currency *provided, however, that* in relation to euro, it means the principal financial centre of such Member State of the European Union as is selected (in the case of a payment) by the payee or (in the case of a calculation) by the Calculation Agent;

"Property" means any kind of property or asset, whether real, personal or mixed, tangible or intangible;

"Put Option Notice" means a notice that must be delivered to a Paying Agent by any Noteholder wanting to exercise a right to redeem a Note at the option of the Noteholder;

"Put Option Receipt" means a receipt issued by a Paying Agent to a depositing Noteholder upon deposit of a Note with such Paying Agent by any Noteholder wanting to exercise a right to redeem a Note at the option of the Noteholder;

"Rate of Interest" means the rate or rates (expressed as a percentage per annum) of interest payable in respect of the Notes specified in the relevant Pricing Supplement and/or calculated or determined in accordance with the provisions of these Conditions;

"Redemption Amount" means, as appropriate, the Final Redemption Amount, the Early Redemption Amount (Tax), the Optional Redemption Amount (Call), the Optional Redemption Amount (Put), the Early Termination Amount or such other amount in the nature of a redemption amount as may be specified in the relevant Pricing Supplement;

"Reference Banks" means the reference banks specified in the relevant Pricing Supplement or, if none, four major banks selected by the Calculation Agent in the market that is most closely connected with the Reference Rate;

"Reference Price" means the reference price specified in the relevant Pricing Supplement;

"Reference Rate" means EURIBOR or LIBOR as specified in the relevant Pricing Supplement in respect of the currency and period specified in the relevant Pricing Supplement;

"Regular Period" means:

- (i) in the case of Notes where interest is scheduled to be paid only by means of regular payments, each period from and including the Interest Commencement Date to but excluding the First Interest Payment Date and each successive period from and including one Interest Payment Date to but excluding the next Interest Payment Date;
- (ii) in the case of Notes where, apart from the first Interest Period, interest is scheduled to be paid only by means of regular payments, each period from and including a Regular Date falling in any year to but excluding the next Regular Date, where **"Regular Date"** means the day and month (but not the year) on which any Interest Payment Date falls; and
- (iii) in the case of Notes where, apart from one Interest Period other than the first Interest Period, interest is scheduled to be paid only by means of regular payments, each period from and including a Regular Date falling in any year to but excluding the next Regular Date, where **"Regular Date"** means the day and month (but not the year) on which any Interest Payment Date falls other than the Interest Payment Date falling at the end of the irregular Interest Period;

"Relevant Date" means, in relation to any payment, whichever is the later of (a) the date on which the payment in question first becomes due and (b) if the full amount payable has not been received in the Principal Financial Centre of the currency of payment by the Fiscal Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders;

"Relevant Financial Centre" means the relevant financial centre specified in the relevant Pricing Supplement;

"Relevant Nominating Body" means, in respect of a Reference Rate:

- (i) the central bank for the currency to which the Reference Rate relates, or any central bank or other supervisory authority which is responsible for supervising the administrator of the Reference Rate; or
- (ii) any working group or committee sponsored by, chaired or co-chaired by or constituted at the request of (a) the central bank for the currency to which the Reference Rate relates, (b) any central bank or other supervisory authority which is responsible for supervising the administrator of the Reference Rate, (c) a group of the aforementioned central banks or other supervisory authorities or (d) the Financial Stability Board or any part thereof;

"Relevant Screen Page" means the page, section or other part of a particular information service (including, without limitation, the Reuter Money 3000 Service) specified as the Relevant Screen Page in the relevant Pricing Supplement, or such other page, section or other part as may replace it on that information service or such other information service, in each case, as may be nominated by the Person providing or sponsoring the information appearing there for the purpose of displaying rates or prices comparable to the Reference Rate;

"Relevant Time" means the time specified in the relevant Pricing Supplement;

"Reserved Matter" means any proposal

- (i) to change any date fixed for payment of principal or interest in respect of the Notes, to reduce the amount of principal or interest payable on any date in respect of the Notes, to alter the method of calculating the amount of any payment in respect of the Notes or the date for any such payment;
- (ii) to effect the exchange or substitution of the Notes for, or the conversion of the Notes into, shares bonds or other obligations or securities of the Issuer or any other Person or body corporate formed or to be formed;
- (iii) to change the currency in which amounts due in respect of the Notes are payable;
- (iv) to change the quorum required at any Meeting or the majority required to pass an Extraordinary Resolution; or
- (v) to amend this definition;

"Restricted Debt" when used with respect to the Issuer or any Subsidiary of the Issuer, means any present or future indebtedness for money borrowed evidenced by any note, bond, debenture or other evidence of indebtedness for money borrowed which is, or is capable of being, listed, quoted or traded on any stock exchange or in any securities market (including, without limitation, any over-the counter market), for which the Issuer or such Subsidiary of the Issuer is liable, directly or indirectly, absolutely or contingently. Restricted Debt shall not include any indebtedness for the payment, redemption or satisfaction of which money (or other Property permitted under the instrument creating or evidencing such indebtedness) in the necessary amount shall have been deposited in trust with a trustee or proper depository at or before the maturity or redemption date thereof. For the purposes of this definition, "indebtedness for money borrowed" shall include, without limitation, obligations created or arising under any conditional sale, financing lease, or other title retention agreement and obligations to pay for Property;

"Specified Currency" means the currency specified in the relevant Pricing Supplement;

"Specified Denomination(s)" means the denomination(s) specified in the relevant Pricing Supplement;

"Specified Office" has the meaning given in the Agency Agreement;

"Specified Period" means the period specified in the relevant Pricing Supplement;

"Subsidiary" means, in relation to any Person (the **"first Person"**) at any particular time, any other Person (the **"second Person"**):

- (i) whose affairs and policies the first Person controls or has the power to control, whether by ownership of share capital, contract, the power to appoint or remove members of the governing body of the second Person or otherwise; or
- (ii) whose financial statements are, in accordance with applicable law and generally accepted accounting principles, consolidated with those of the first Person;

"Successor Rate" means a successor to or replacement of the Original Reference Rate which is formally recommended by any Relevant Nominating Body;

"Talon" means a talon for further Coupons;

"TARGET2" means the Trans-European Automated Real-Time Gross Settlement Express Transfer payment system which utilizes a single shared platform and which was launched on 19 November 2007;

"TARGET Settlement Day" means any day on which TARGET2 is open for the settlement of payments in euro;

"Treaty" means the Treaty on the Functioning of the European Union, as amended; and

"Zero Coupon Note" means a Note specified as such in the relevant Pricing Supplement.

(b) *Interpretation:* In these Conditions:

- (i) if the Notes are Zero Coupon Notes, references to Coupons and Couponholders are not applicable;
- (ii) if Talons are specified in the relevant Pricing Supplement as being attached to the Notes at the time of issue, references to Coupons shall be deemed to include references to Talons;

- (iii) if Talons are not specified in the relevant Pricing Supplement as being attached to the Notes at the time of issue, references to Talons are not applicable;
- (iv) any reference to principal shall be deemed to include the Redemption Amount, any additional amounts in respect of principal which may be payable under Condition 11 (*Taxation*), any premium payable in respect of a Note and any other amount in the nature of principal payable pursuant to these Conditions;
- (v) any reference to interest shall be deemed to include any additional amounts in respect of interest which may be payable under Condition 11 (*Taxation*) and any other amount in the nature of interest payable pursuant to these Conditions;
- (vi) references to Notes being "outstanding" shall be construed in accordance with the Agency Agreement;
- (vii) if an expression is stated in Condition 2(a) to have a meaning as specified in the relevant Pricing Supplement, but the relevant Pricing Supplement does not so specify or specifies that such expression is "not applicable" then such expression is not applicable to the Notes; and
- (viii) any reference to the Agency Agreement shall be construed as a reference to the Agency Agreement as amended and/or supplemented up to and including the Issue Date of the Notes.

3. **Form, Denomination and Title**

The Notes are in bearer form in the Specified Denomination(s) with Coupons and, if specified in the relevant Pricing Supplement, Talons attached at the time of issue. In the case of a Series of Notes with more than one Specified Denomination, Notes of one Specified Denomination will not be exchangeable for Notes of another Specified Denomination. The minimum Specified Denomination shall be €1,000 (or its equivalent in any other currency as at the date of issue of the relevant Notes). Title to the Notes and the Coupons will pass by delivery. The holder of any Note or Coupon shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no Person shall be liable for so treating such holder. No Person shall have any right to enforce any term or condition of any Note under the *Contracts (Rights of Third Parties) Act 1999*.

4. **Status of Notes**

The Notes constitute direct, general, unconditional, unsubordinated and (without prejudice to the provisions of Condition 5 (*Negative Pledge*)) unsecured obligations of the Issuer which will at all times rank *pari passu* among themselves and at least *pari passu* with all other present and future unsecured and unsubordinated obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application and subject to Condition 5 (*Negative Pledge*).

5. **Negative Pledge**

After the date hereof, the Issuer will not itself, and will not permit any Subsidiary of the Issuer to, create, incur or suffer to exist, any Lien on any Property of the Issuer or any Subsidiary of the Issuer securing any Restricted Debt, without effectively providing that the Notes (together with, if the Issuer shall so determine, any other indebtedness of the Issuer or such Subsidiary then existing or thereafter created) shall be secured equally and rateably with (or, at the option of the Issuer, prior to) such secured Restricted Debt, so long as such secured Restricted Debt shall be so secured, unless, after giving effect thereto, the aggregate amount of all Restricted Debt of the Issuer and its Subsidiaries secured by Liens on Property of the Issuer and its Subsidiaries would not exceed 15 per cent. of Consolidated Assets; *provided, however, that this Condition 5 shall not apply to, and there shall be excluded from Restricted Debt secured by Liens in any computation under this Condition 5, Restricted Debt secured only by:*

- (i) Liens on Property of, or on any shares of capital stock of, any corporation existing at the time such corporation becomes a Subsidiary of the Issuer;
- (ii) Liens in favour of the Issuer or any Subsidiary of the Issuer or Liens securing any indebtedness of a Subsidiary to the Issuer or of the Issuer or a Subsidiary to a Subsidiary of the Issuer;
- (iii) Liens in favour of any governmental body (or surety for any governmental body) to secure progress, advance or other payments pursuant to any contract or provision of any statute or rule of court;
- (iv) Liens of any other creditors on Property repossessed in the ordinary course of business which comprises collateral security for defaulted indebtedness or additional Liens created on any such Property for the purpose of protecting the interest of the Issuer therein;

- (v) A banker's Lien or other right of offset in favour of any lender or other holder of Restricted Debt on money deposited with such lender or holder in the ordinary course of business;
- (vi) Liens on Property and rentals therefrom existing at the time of acquisition thereof, or to secure the payment of all or any part of the purchase price thereof or construction thereon or to secure any Restricted Debt incurred prior to, at the time of, or within 180 days after the later of the acquisition of such Property or the completion of construction for the purpose of financing all or any part of the purchase price thereof or construction thereon; or
- (vii) Any extension, renewal or replacement (or successive extensions, renewals or replacements), as a whole or in part, of any Lien referred to in the foregoing clauses (i) through (vi), inclusive; *provided, however, that* such extension, renewal or replacement Lien shall be limited to all or part of the same Property that secured the Lien extended, renewed or replaced (plus improvements on such Property).

For purposes of this Condition 5 an "acquisition" of Property shall include any transaction or Series of transactions by which the Issuer or a Subsidiary of the Issuer acquires, directly or indirectly, an interest, or an additional interest (to the extent thereof), in such Property, including without limitation an acquisition through merger or consolidation with, or an acquisition of an interest in, a Person owning an interest in such Property.

6. **Fixed Rate Note Provisions**

- (a) *Application:* This Condition 6 (*Fixed Rate Note Provisions*) is applicable to the Notes only if the Fixed Rate Note Provisions are specified in the relevant Pricing Supplement as being applicable.
- (b) *Accrual of interest:* The Notes bear interest from the Interest Commencement Date at the Rate of Interest payable in arrear on each Interest Payment Date, subject as provided in Condition 10 (*Payments*). Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition 6 (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).
- (c) *Fixed Coupon Amount:* The amount of interest payable in respect of each Note for any Interest Period shall be the relevant Fixed Coupon Amount and, if the Notes are in more than one Specified Denomination, shall be the relevant Fixed Coupon Amount in respect of the relevant Specified Denomination.
- (d) *Calculation of interest amount:* The amount of interest payable in respect of each Note for any period for which a Fixed Coupon Amount is not specified shall be calculated by applying the Rate of Interest to the Calculation Amount, multiplying the product by the relevant Day Count Fraction and rounding the resulting figure to the nearest sub-unit of the Specified Currency (half a sub-unit being rounded upwards) and multiplying such rounded figure by a fraction equal to the Specified Denomination of such Note divided by the Calculation Amount. For this purpose a "**sub-unit**" means, in the case of any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, in the case of euro, means one cent.

7. **Floating Rate Note Provisions and Benchmark Replacement**

- (a) *Application:* This Condition 7 (*Floating Rate Note Provisions and Benchmark Replacement*) is applicable to the Notes only if the Floating Rate Note Provisions are specified in the relevant Pricing Supplement as being applicable.
- (b) *Accrual of interest:* The Notes bear interest from the Interest Commencement Date at the Rate of Interest payable in arrear on each Interest Payment Date, subject as provided in Condition 10 (*Payments*). Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).
- (c) *Screen Rate Determination:* If Screen Rate Determination is specified in the relevant Pricing Supplement as the manner in which the Rate(s) of Interest is/are to be determined, the Rate of Interest applicable to the Notes for each Interest Period will be determined by the Calculation Agent on the following basis:

- (i) if the Reference Rate is a composite quotation or customarily supplied by one entity, the Calculation Agent will determine the Reference Rate which appears on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date;
- (ii) if Linear Interpolation is specified as applicable in respect of an Interest Period in the applicable Pricing Supplement, the Rate of Interest for such Interest Period shall be calculated by the Calculation Agent by straight-line linear interpolation by reference to two rates which appear on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date, where:
 - (A) one rate shall be determined as if the relevant Interest Period were the period of time for which rates are available next shorter than the length of the relevant Interest Period; and
 - (B) the other rate shall be determined as if the relevant Interest Period were the period of time for which rates are available next longer than the length of the relevant Interest Period;

provided, however, that if no rate is available for a period of time next shorter or, as the case may be, next longer than the length of the relevant Interest Period, then the Calculation Agent shall determine such rate at such time and by reference to such sources as it determines appropriate;

- (iii) in any other case, the Calculation Agent will determine the arithmetic mean of the Reference Rates which appear on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date;
- (iv) unless the Calculation Agent has been notified pursuant to Condition 7(e)(v) (*Benchmark Discontinuation – Notices, etc.*), if, in the case of (i) above, such rate does not appear on that page or, in the case of (ii) above, fewer than two such rates appear on that page or if, in either case, the Relevant Screen Page is unavailable, the Calculation Agent will:
 - (A) request the principal Relevant Financial Centre office of each the Reference Banks to provide a quotation of the Reference Rate at approximately the Relevant Time on the Interest Determination Date to prime banks in the Relevant Financial Centre interbank market in an amount that is representative for a single transaction in that market at that time; and
 - (B) determine the arithmetic mean of such quotations; and
- (v) unless the Calculation Agent has been notified pursuant to Condition 7(e)(v) (*Benchmark Discontinuation – Notices, etc.*), if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean of the rates (being the nearest to the Reference Rate, as determined by the Calculation Agent) quoted by major banks in the Principal Financial Centre of the Specified Currency, selected by the Calculation Agent, at approximately 11.00 a.m. (local time in the Principal Financial Centre of the Specified Currency) on the first day of the relevant Interest Period for loans in the Specified Currency to leading European banks for a period equal to the relevant Interest Period and in an amount that is representative for a single transaction in that market at that time,

and the Rate of Interest for such Interest Period shall be the sum of the Margin and the rate or (as the case may be) the arithmetic mean so determined; *provided, however, that* if the Calculation Agent is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Interest Period, the Rate of Interest applicable to the Notes during such Interest Period will be the sum of the Margin and the rate or (as the case may be) the arithmetic mean last determined in relation to the Notes in respect of a preceding Interest Period.

- (d) *ISDA Determination:* If ISDA Determination is specified in the relevant Pricing Supplement as the manner in which the Rate(s) of Interest is/are to be determined, the Rate of Interest applicable to the Notes for each Interest Period will be the sum of the Margin and the relevant ISDA Rate where "ISDA Rate" in relation to any Interest Period means a rate equal to the Floating Rate (as defined in the ISDA Definitions) that would be determined by the Calculation Agent under an interest rate swap transaction if the Calculation Agent were acting as Calculation Agent for that interest rate swap transaction under the terms of an agreement incorporating the ISDA Definitions and under which:
 - (i) the Floating Rate Option (as defined in the ISDA Definitions) is as specified in the relevant Pricing Supplement;
 - (ii) the Designated Maturity (as defined in the ISDA Definitions) is a period specified in the relevant Pricing Supplement;
 - (iii) the relevant Reset Date (as defined in the ISDA Definitions) is either (A) if the relevant Floating Rate Option is based on LIBOR for a currency, the first day of that Interest Period or (B) in any other case, as specified in the relevant Pricing Supplement; and

- (iv) if Linear Interpolation is specified as applicable in respect of an Interest Period in the applicable Pricing Supplement, the Rate of Interest for such Interest Period shall be calculated by the Calculation Agent by straight-line linear interpolation by reference to two rates based on the relevant Floating Rate Option, where:
- (A) one rate shall be determined as if the Designated Maturity were the period of time for which rates are available next shorter than the length of the relevant Interest Period; and
 - (B) the other rate shall be determined as if the Designated Maturity were the period of time for which rates are available next longer than the length of the relevant Interest Period

provided, however, that if there is no rate available for a period of time next shorter than the length of the relevant Interest Period or, as the case may be, next longer than the length of the relevant Interest Period, then the Calculation Agent shall determine such rate at such time and by reference to such sources as it determines appropriate.

(e) ***Benchmark Discontinuation:***

(i) *Independent Adviser*

If a Benchmark Event occurs in relation to an Original Reference Rate when any Rate of Interest (or any component part thereof) remains to be determined by reference to such Original Reference Rate, then the Issuer shall use its reasonable endeavours to appoint and consult with an Independent Adviser, as soon as reasonably practicable, with a view to the Issuer determining a Successor Rate, failing which an Alternative Rate (in accordance with Condition 7(e)(ii)) and, in either case, an Adjustment Spread if any (in accordance with Condition 7(e)(iii)) and any Benchmark Amendments (in accordance with Condition 7(e)(iv)).

An Independent Adviser appointed pursuant to this Condition 7(e) shall act in good faith as an expert and (in the absence of bad faith or fraud) shall have no liability whatsoever to the Issuer, the Paying Agents, the Calculation Agent, the Noteholders or the Couponholders for any determination made by it or for any advice given to the Issuer in connection with any determination made by the Issuer, pursuant to this Condition 7(e).

(ii) *Successor Rate or Alternative Rate*

If the Issuer, following consultation with the Independent Adviser and acting in good faith, determines that:

- (A) there is a Successor Rate, then such Successor Rate shall (subject to adjustment as provided in Condition 7(e)(iii)) subsequently be used in place of the Original Reference Rate to determine the Rate of Interest (or the relevant component part thereof) for all future payments of interest on the Notes (subject to the operation of this Condition 7(e)); or
- (B) there is no Successor Rate but that there is an Alternative Rate, then such Alternative Rate shall (subject to adjustment as provided in Condition 7(e)(iii)) subsequently be used in place of the Original Reference Rate to determine the Rate of Interest (or the relevant component part thereof) for all future payments of interest on the Notes (subject to the operation of this Condition 7(e)).

(iii) *Adjustment Spread*

If the Issuer, following consultation with the Independent Adviser and acting in good faith, determines (x) that an Adjustment Spread is required to be applied to the Successor Rate or the Alternative Rate (as the case may be) and (y) the quantum of, or a formula or methodology for determining, such Adjustment Spread, then such Adjustment Spread shall be applied to the Successor Rate or the Alternative Rate (as the case may be).

(iv) *Benchmark Amendments*

If any Successor Rate, Alternative Rate or Adjustment Spread is determined in accordance with this Condition 7(e) and the Issuer, following consultation with the Independent Adviser and acting in good faith, determines (i) that amendments to these Conditions are necessary to ensure the proper operation of such Successor Rate, Alternative Rate and/or Adjustment Spread (such amendments, the "**Benchmark Amendments**") and (ii) the terms of the Benchmark Amendments, then the Issuer shall, subject to giving notice thereof in accordance with Condition 7(e)(v), without any requirement for the consent or approval of Noteholders, vary these Conditions to give effect to such Benchmark Amendments with effect from the date specified in such notice.

In connection with any such variation in accordance with this Condition 7(e)(iv), the Issuer shall comply with the rules of any stock exchange on which the Notes are for the time being listed or admitted to trading.

(v) *Notices, etc.*

Any Successor Rate, Alternative Rate, Adjustment Spread and the specific terms of any Benchmark Amendments determined under this Condition 7(e) will be notified promptly by the Issuer to the Calculation Agent, the Paying Agents and, in accordance with Condition 18, the Noteholders. Such notice shall be irrevocable and shall specify the effective date of the Benchmark Amendments, if any.

(vi) *Survival of Original Reference Rate*

Without prejudice to the obligations of the Issuer under Conditions 7(e)(i), (ii), (iii) and (iv), the Original Reference Rate and the fallback provisions provided for in Conditions 7(c)(iv) and (v) will continue to apply unless and until the Calculation Agent has been notified of the Successor Rate or the Alternative Rate (as the case may be), and any Adjustment Spread (if applicable) and Benchmark Amendments, in accordance with Condition 7(e)(v).

- (f) *Maximum or Minimum Rate of Interest:* If any Maximum Rate of Interest or Minimum Rate of Interest is specified in the relevant Pricing Supplement, then the Rate of Interest shall in no event be greater than the maximum or be less than the minimum so specified.
- (g) *Calculation of Interest Amount:* The Calculation Agent will, as soon as practicable after the time at which the Rate of Interest is to be determined in relation to each Interest Period, calculate the Interest Amount payable in respect of each Note for such Interest Period. The Interest Amount will be calculated by applying the Rate of Interest for such Interest Period to the Calculation Amount, multiplying the product by the relevant Day Count Fraction, rounding the resulting figure to the nearest sub-unit of the Specified Currency (half a sub-unit being rounded upwards) and multiplying such rounded figure by a fraction equal to the Specified Denomination of the relevant note divided by the Calculation amount. For this purpose a "**sub-unit**" means, in the case of any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, in the case of euro, means one cent.
- (h) *Publication:* The Calculation Agent will cause each Rate of Interest and Interest Amount determined by it, together with the relevant Interest Payment Date, and any other amount(s) required to be determined by it together with any relevant payment date(s) to be notified to the Paying Agents and the London Stock Exchange as soon as practicable after such determination but (in the case of each Rate of Interest, Interest Amount and Interest Payment Date) in any event not later than the first day of the relevant Interest Period. Notice thereof shall also promptly be given to the Noteholders. The Calculation Agent will be entitled to recalculate any Interest Amount (on the basis of the foregoing provisions) in the event of an extension or shortening of the relevant Interest Period. If the Calculation Amount is less than the minimum Specified Denomination the Calculation Agent shall not be obliged to publish each Interest Amount but instead may publish only the Calculation Amount and the Interest Amount in respect of a Note having the minimum Specified Denomination.
- (i) *Notifications etc.:* All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition by the Calculation Agent will (in the absence of manifest error) be binding on the Issuer, the Paying Agents, the Noteholders and the Couponholders and (subject as aforesaid) no liability to any such Person will attach to the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.

8. **Zero Coupon Note Provisions**

- (a) *Application:* This Condition 8 (*Zero Coupon Note Provisions*) is applicable to the Notes only if the Zero Coupon Note Provisions are specified in the relevant Pricing Supplement as being applicable.
- (b) *Late payment on Zero Coupon Notes:* If the Redemption Amount payable in respect of any Zero Coupon Note is improperly withheld or refused, the Redemption Amount shall thereafter be an amount equal to the sum of:
- (i) the Reference Price; and
 - (ii) the product of the Accrual Yield (compounded annually) being applied to the Reference Price on the basis of the relevant Day Count Fraction from (and including) the Issue Date to (but excluding) whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

9. **Redemption and Purchase**

- (a) *Scheduled redemption:* Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their Final Redemption Amount on the Maturity Date, subject as provided in Condition 10 (*Payments*).

- (b) *Redemption for tax reasons:* The Notes may be redeemed at the option of the Issuer in whole, but not in part:
- (i) at any time (if the Floating Rate Note Provisions are specified in the relevant Pricing Supplement as not being applicable); or
 - (ii) on any Interest Payment Date (if the Floating Rate Note Provisions are specified in the relevant Pricing Supplement as being applicable),

on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable), at their Early Redemption Amount (Tax), together with interest accrued (if any) to the date fixed for redemption, if:

- (A) (x) the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 11 (*Taxation*) as a result of any change in, or amendment to, the laws or regulations of The Netherlands or the United States of America or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after the date of issue of the first Tranche of the Notes; and (y) such obligation cannot be avoided by the Issuer taking reasonable measures available to it; or
- (B) the Issuer shall determine that any payment made outside the United States by the Issuer or any Paying Agents in respect of any Note or Coupon appertaining thereto would, under any present or future laws or regulations of the United States affecting taxation or otherwise, be subject to any certification, information or other reporting requirement of U.S. law or regulation with regard to the nationality, residence or identity of a beneficial owner (other than reporting requirements pursuant to Sections 1471 to 1474 of the Internal Revenue Code, pursuant to any intergovernmental agreement or implementing legislation adopted by another jurisdiction in connection with these provisions of the Internal Revenue Code, or pursuant to any agreement with the U.S. Internal Revenue Service), who is not a U.S. Person, of such instrument or Coupon (other than a requirement that: (x) would not be applicable to a payment made (1) directly to the beneficial owner or (2) to a custodian, nominee or other agent of the beneficial owner; or (y) could be satisfied by the holder, custodian, nominee or other agent certifying that the beneficial owner is not a U.S. Person, provided, however, that in each case referred to in (x)(2) or (y) payment by any such custodian, nominee or agent to the beneficial owner is not otherwise subject to any requirement referred to in this sentence; or (z) would not be applicable to a payment made by at least one paying agent),

provided, however, that no such notice of redemption shall be given earlier than:

- (1) where the Notes may be redeemed at any time, 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts if a payment in respect of the Notes were then due; or
- (2) where the Notes may be redeemed only on an Interest Payment Date, 60 days prior to the Interest Payment Date occurring immediately before the earliest date on which the Issuer would be obliged to pay such additional amounts if a payment in respect of the Notes were then due.

Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Fiscal Agent (A) a certificate signed by two members of the Board of Management of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and (B) (in the case of redemption under Condition 9(b)(A)) an opinion of independent legal advisers of recognized standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment. Upon the expiry of any such notice as is referred to in this Condition 9(b), the Issuer shall be bound to redeem the Notes in accordance with this Condition 9(b).

- (c) *Redemption at the option of the Issuer:* If the Call Option is specified in the relevant Pricing Supplement as being applicable, the Notes may be redeemed at the option of the Issuer in whole or, if so specified in the relevant Pricing Supplement, in part on any Optional Redemption Date (Call) at the relevant Optional Redemption Amount (Call) on the Issuer giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable and shall oblige the Issuer to redeem the Notes or, as the case may be, the Notes specified in such notice on the relevant Optional Redemption Date (Call) at the Optional Redemption Amount (Call) plus accrued interest (if any) to such date).
- (d) *Partial redemption:* If the Notes are to be redeemed in part only on any date in accordance with Condition 9(c) (*Redemption at the option of the Issuer*), the Notes to be redeemed shall be selected by the drawing of lots in such place and in such manner as may be fair and reasonable in the circumstances, taking into account prevailing market practices, subject to compliance with applicable law and the rules of the London Stock Exchange and the notice to Noteholders referred to in Condition 9(c) (*Redemption at the option of the Issuer*) shall specify the serial numbers of the Notes so to be redeemed. If any Maximum

Redemption Amount or Minimum Redemption Amount is specified in the relevant Pricing Supplement, then the Optional Redemption Amount (Call) shall in no event be greater than the maximum or be less than the minimum so specified.

- (e) *Redemption at the option of Noteholders:* If the Put Option is specified in the relevant Pricing Supplement as being applicable, the Issuer shall, at the option of the holder of any Note, redeem such Note on the Optional Redemption Date (Put) specified in the relevant Put Option Notice at the relevant Optional Redemption Amount (Put) together with interest (if any) accrued to such date. In order to exercise the option contained in this Condition 9(e), the holder of a Note must, not less than 30 nor more than 60 days before the relevant Optional Redemption Date (Put), deposit with any Paying Agent such Note together with all unmatured Coupons relating thereto and a duly completed Put Option Notice in the form obtainable from any Paying Agent. The Paying Agent with which a Note is so deposited shall deliver a duly completed Put Option Receipt to the depositing Noteholder. No Note, once deposited with a duly completed Put Option Notice in accordance with this Condition 9(e), may be withdrawn; *provided, however, that* if, prior to the relevant Optional Redemption Date (Put), any such Note becomes immediately due and payable or, upon due presentation of any such Note on the relevant Optional Redemption Date (Put), payment of the redemption moneys is improperly withheld or refused, the relevant Paying Agent shall mail notification thereof to the depositing Noteholder at such address as may have been given by such Noteholder in the relevant Put Option Notice and shall hold such Note at its Specified Office for collection by the depositing Noteholder against surrender of the relevant Put Option Receipt. For so long as any outstanding Note is held by a Paying Agent in accordance with this Condition 9(e), the depositor of such Note and not such Paying Agent shall be deemed to be the holder of such Note for all purposes.
- (f) *No other redemption:* The Issuer shall not be entitled to redeem the Notes otherwise than as provided in paragraphs (a) to (e) above.
- (g) *Early redemption of Zero Coupon Notes:* Unless otherwise specified in the relevant Pricing Supplement, the Redemption Amount payable on redemption of a Zero Coupon Note at any time before the Maturity Date shall be an amount equal to the sum of:
 - (i) the Reference Price; and
 - (ii) the product of the Accrual Yield (compounded annually) being applied to the Reference Price from (and including) the Issue Date to (but excluding) the date fixed for redemption or (as the case may be) the date upon which the Note becomes due and payable.

Where such calculation is to be made for a period which is not a whole number of years, the calculation in respect of the period of less than a full year shall be made on the basis of such Day Count Fraction as may be specified in the Pricing Supplement for the purposes of this Condition 9(g) or, if none is so specified, a Day Count Fraction of 30E/360.

- (h) *Purchase:* The Issuer or any of its Subsidiaries may at any time purchase Notes in the open market or otherwise and at any price, provided that all unmatured Coupons are purchased therewith.
- (i) *Cancellation:* All Notes so redeemed or purchased by the Issuer or any of its Subsidiaries and any unmatured Coupons attached to or surrendered with them shall be cancelled and may not be reissued or resold.

10. **Payments**

- (a) *Principal:* Payments of principal shall be made only against presentation and (provided that payment is made in full) surrender of Notes at the Specified Office of any Paying Agent outside the United States by cheque drawn in the currency in which the payment is due on, or by transfer to an account denominated in that currency (or, if that currency is euro, any other account to which euro may be credited or transferred) and maintained by the payee with, a bank in the Principal Financial Centre of that currency (in the case of a sterling cheque, a town clearing branch of a bank in the City of London). No payments on Notes will be made by mail to an address in the United States of America or by transfer to an account maintained in the United States of America.
- (b) *Interest:* Payments of interest shall, subject to paragraph (h) below, be made only against presentation and (provided that payment is made in full) surrender of the appropriate Coupons at the Specified Office of any Paying Agent outside the United States in the manner described in paragraph (a) above.
- (c) *Payments in The City of New York:* Payments of principal or interest in U.S. dollars may be made at the Specified Office of a Paying Agent in The City of New York if (i) the Issuer has appointed Paying Agents outside the United States with the reasonable expectation that such Paying Agents will be able to make payment of the full amount of the interest on the Notes in U.S. dollars when due, (ii) payment of the full amount of such interest in U.S. dollars at the offices of all such Paying Agents is illegal or effectively precluded by exchange controls or other similar restrictions and (iii) payment is permitted by applicable United States law.

- (d) *Payments subject to fiscal laws:* All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 11 (*Taxation*). No commissions or expenses shall be charged to the Noteholders or Couponholders in respect of such payments.
- (e) *Deductions for unmatured Coupons:* If the relevant Pricing Supplement specifies that the Fixed Rate Note Provisions are applicable and a Note is presented without all unmatured Coupons relating thereto:
- (i) if the aggregate amount of the missing Coupons is less than or equal to the amount of principal due for payment, a sum equal to the aggregate amount of the missing Coupons will be deducted from the amount of principal due for payment; provided, however, that if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of such missing Coupons which the gross amount actually available for payment bears to the amount of principal due for payment;
- (ii) if the aggregate amount of the missing Coupons is greater than the amount of principal due for payment:
- (A) so many of such missing Coupons shall become void (in inverse order of maturity) as will result in the aggregate amount of the remainder of such missing Coupons (the "**Relevant Coupons**") being equal to the amount of principal due for payment; *provided, however, that* where this sub-paragraph would otherwise require a fraction of a missing Coupon to become void, such missing Coupon shall become void in its entirety; and
- (B) a sum equal to the aggregate amount of the Relevant Coupons (or, if less, the amount of principal due for payment) will be deducted from the amount of principal due for payment; *provided, however, that*, if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of the Relevant Coupons (or, as the case may be, the amount of principal due for payment) which the gross amount actually available for payment bears to the amount of principal due for payment.

Each sum of principal so deducted shall be paid in the manner provided in paragraph (a) above against presentation and (provided that payment is made in full) surrender of the relevant missing Coupons.

- (f) *Unmatured Coupons void:* If the relevant Pricing Supplement specifies that this Condition 10(f) is applicable or that the Floating Rate Note Provisions are applicable, on the due date for final redemption of any Note or early redemption of such Note pursuant to Condition 9(b) (*Redemption for tax reasons*), Condition 9(e) (*Redemption at the option of Noteholders*), Condition 9(c) (*Redemption at the option of the Issuer*) or Condition 12 (*Events of Default*), all unmatured Coupons relating thereto (whether or not still attached) shall become void and no payment will be made in respect thereof.
- (g) *Payments on Business Days:* If the due date for payment of any amount in respect of any Note or Coupon is not a Payment Business Day in the place of presentation, the holder shall not be entitled to payment in such place of the amount due until the next succeeding Payment Business Day in such place and shall not be entitled to any further interest or other payment in respect of any such delay.
- (h) *Payments other than in respect of matured Coupons:* Payments of interest other than in respect of matured Coupons shall be made only against presentation of the relevant Notes at the Specified Office of any Paying Agent outside the United States (or in The City of New York if permitted by paragraph (c) above).
- (i) *Partial payments:* If a Paying Agent makes a partial payment in respect of any Note or Coupon presented to it for payment, such Paying Agent will endorse thereon a statement indicating the amount and date of such payment.
- (j) *Exchange of Talons:* On or after the maturity date of the final Coupon which is (or was at the time of issue) part of a Coupon Sheet relating to the Notes, the Talon forming part of such Coupon Sheet may be exchanged at the Specified Office of the Fiscal Agent or at the office of the Paying Agent in London for a further Coupon Sheet (including, if appropriate, a further Talon but excluding any Coupons in respect of which claims have already become void pursuant to Condition 13 (*Prescription*)). Upon the due date for redemption of any Note, any unexchanged Talon relating to such Note shall become void and no Coupon will be delivered in respect of such Talon.

11. **Taxation**

- (a) *Gross up:* All payments of principal and interest in respect of the Notes and the Coupons by or on behalf of the Issuer shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of The Netherlands or the United States of America or any political subdivision therein or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments, or governmental charges is required by law or agreement of the Issuer. In that event, the Issuer shall pay such additional amounts as will result in receipt by the

Noteholders and the Couponholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Note or Coupon presented for payment:

- (i) by or on behalf of a holder which is liable for such taxes, duties, assessments or governmental charges in respect of such Note or Coupon by reason of its having some connection with the jurisdiction by which such taxes, duties, assessments or charges have been imposed, levied, collected, withheld or assessed other than the mere holding of the Note or Coupon; or
 - (ii) more than 30 days after the Relevant Date except to the extent that the holder of such Note or Coupon would have been entitled to such additional amounts on presenting such Note or Coupon for payment on the last day of such period of 30 days; or
 - (iii) where such withholding or deduction would not have been imposed but for the holder's past or present status as a personal holding company, foreign personal holding company or passive foreign investment company with respect to the United States or a corporation that accumulates earnings to avoid U.S. federal income tax; or
 - (iv) where such withholding or deduction would not have been imposed but for the holder's past or present status as a "10 per cent. shareholder" of the obligor of the Note as defined in Section 871(h)(3) of the U.S. Internal Revenue Code or any successor provisions, a controlled foreign corporation related to the obligor of the Note or a bank that has invested in the Note as an extension of credit in the ordinary course of its trade or business; or
 - (v) where such withholding or deduction is required by the rules under Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 (the "**Code**") (or any amended or successor provisions), pursuant to any inter-governmental agreement, or implementing legislation adopted by another jurisdiction in connection with these provisions of the Code, or pursuant to any agreement with the U.S. Internal Revenue Service ("**FATCA withholding**") as a result of a holder, beneficial owner or an intermediary that is not an agent of the Issuer not being entitled to receive payments free of FATCA withholding.
- (b) *Taxing jurisdiction:* If the Issuer becomes subject at any time to any taxing jurisdiction other than The Netherlands references in these Conditions to The Netherlands shall be construed as references to The Netherlands and/or such other jurisdiction.

12. **Events of Default**

If any of the following events occurs and is continuing:

- (a) *Non-payment:* the Issuer fails to pay any amount of principal in respect of the Notes on the due date for payment thereof or fails to pay any amount of interest in respect of the Notes within 14 days of the due date for payment thereof; or
- (b) *Breach of other obligations:* the Issuer defaults in the performance or observance of any of its other obligations under or in respect of the Notes and such default remains unremedied for 30 days after written notice thereof, addressed to the Issuer by any Noteholder has been delivered to the Issuer or to the Specified Office of the Fiscal Agent; or
- (c) *Cross-default of Issuer:* the Issuer defaults under any Indebtedness, whether such Indebtedness now exists or shall hereafter be created, which default shall have resulted in Indebtedness in an aggregate principal amount exceeding €10,000,000 (or its equivalent in any other currency or currencies) (except that such euro amount shall not apply with respect to a default with respect to Notes of any other Series), becoming or being declared due and payable prior to the date on which it would otherwise have become due and payable, without such acceleration having been rescinded or annulled or such Indebtedness having been discharged within a period of 30 days after there shall have been given, by registered or certified mail, to the Issuer by any Noteholder, a written notice specifying such default and requiring the Issuer to cause such acceleration to be rescinded or annulled or such Indebtedness to be discharged and stating that such notice is a "Notice of Default" under this Condition 12(c); or
- (d) *Security enforced:* a secured party or encumbrancer takes possession, or a receiver, manager or other similar officer is appointed, of the whole or a substantial part of the undertaking, assets and revenues of the Issuer or any of its Subsidiaries; or
- (e) *Insolvency etc.:* (i) the Issuer becomes insolvent or admits in writing that it is unable to pay its debts as they fall due, (ii) an administrator (including a *bewindvoerder*) or liquidator (including a *curator*) of the Issuer or the whole or a substantial part of the undertaking, assets and revenues of the Issuer is appointed (or application for any such appointment is made including an application for the Issuer to be declared bankrupt (*failliet*) or to be granted a moratorium of payments (*surseance van betaling*), unless such application is contested by the Issuer and/or discharged or stayed within 90 days or is cancelled or withdrawn within 90 days after the making thereof), (iii) the Issuer takes any action for a readjustment or deferment of any of its obligations or makes a general assignment or an arrangement or composition (*akkoord*) with or for the benefit of its creditors or declares a moratorium in respect of any of its Indebtedness; or

- (f) *Winding up etc.*: an order is made or an effective resolution is passed for the winding up, liquidation or dissolution (*ontbinding en vereffening*) of the Issuer or any of its Subsidiaries (otherwise than, in the case of a Subsidiary of the Issuer, for the purposes of or pursuant to an amalgamation, reorganisation or restructuring whilst solvent); or
- (g) *Attachment etc.*: an executory attachment (*executorial beslag*) or interlocutory attachment (*conservatoir beslag*) is made on all or a substantial part of the assets of the Issuer, or a similar measure under foreign law is made, unless such application is contested by the Issuer and/or discharged or stayed within 90 days, or is cancelled or withdrawn within 90 days after the making thereof; or
- (h) *Enforcement proceedings*: a distress, attachment, execution or other legal process is levied, enforced or sued out on or against the whole or a substantial part of the property, assets or revenues of the Issuer or any of its Subsidiaries and is not discharged or stayed within 90 days,
- (i) *Keep Well Agreement etc. not in force*: the Keep Well Agreement is not (or is claimed by either party thereto not to be) in full force and effect or is modified, amended or terminated in contravention of the provisions thereof, or the Issuer waives, or fails to take all reasonable steps to exercise, any of its rights under the Keep Well Agreement or PACCAR or the Issuer fails to perform or observe any obligation on its part under the Keep Well Agreement so as to affect materially and adversely the interests of any Noteholder or Couponholder;

then any outstanding Notes of a particular Series may by written notice, addressed by any Noteholder, delivered to the Issuer or to the Specified Office of the Fiscal Agent, be declared immediately due and payable, whereupon they shall become immediately due and payable at their Early Termination Amount together with accrued interest (if any) without further action or formality. Upon payment of the Early Termination Amount, all obligations of the Issuer in respect of payment of the principal amount of the Notes of such Series shall terminate.

13. **Prescription**

Claims for principal shall become void unless the relevant Notes are presented for payment within ten years of the appropriate Relevant Date. Claims for interest shall become void unless the relevant Coupons are presented for payment within five years of the appropriate Relevant Date.

14. **Replacement of Notes and Coupons**

If any Note or Coupon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Fiscal Agent, subject to all applicable laws and requirements of the London Stock Exchange, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

15. **Agents**

In acting under the Agency Agreement and in connection with the Notes and the Coupons, the Paying Agents act solely as agents of the Issuer and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders or Couponholders.

The initial Paying Agents and their initial Specified Offices are listed below. The initial Calculation Agent (if any) is specified in the relevant Pricing Supplement. The Issuer reserves the right at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor fiscal agent or Calculation Agent and additional or successor paying agents; *provided, however, that:*

- (a) the Issuer shall at all times maintain a Fiscal Agent; and
- (b) if a Calculation Agent is specified in the relevant Pricing Supplement, the Issuer shall at all times maintain a Calculation Agent; and
- (c) if and for so long as the Notes are admitted to listing and trading on the London Stock Exchange and it requires the appointment of a Paying Agent in any particular place, the Issuer shall maintain a Paying Agent having its Specified Office in the place required by the London Stock Exchange.

In addition, the Issuer shall forthwith appoint a Paying Agent in New York City in respect of any Notes denominated in U.S. dollars in the circumstances described in Condition 10(c).

Notice of any change in any of the Paying Agents or in their Specified Offices shall promptly be given to the Noteholders.

16. **Meetings of Noteholders; Modification and Waiver**

- (a) *Meetings of Noteholders:* The Agency Agreement contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Issuer and shall be convened by them upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more Persons holding or representing one more than half of the aggregate principal amount of the outstanding Notes or, at any adjourned meeting, two or more Persons being or representing Noteholders whatever the principal amount of the Notes held or represented; *provided, however, that* Reserved Matters may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more Persons holding or representing not less than three-quarters or, at any adjourned meeting, one quarter of the aggregate principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders and Couponholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of the holders of not less than 75 per cent. in aggregate principal amount of the outstanding Notes will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

The consent or approval of the Noteholders will not be required for any Benchmark Amendments made pursuant to Condition 7(e) (*Benchmark Discontinuation*).

- (b) *Modification:* The Notes and these Conditions may be amended without the consent of the Noteholders or the Couponholders to correct a manifest error. In addition, the parties to the Agency Agreement may agree to modify any provision thereof, but the Issuer shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature, it is made to correct a manifest error or it is, in the opinion of the Issuer, not materially prejudicial to the interests of the Noteholders.

17. **Further Issues**

The Issuer may from time to time, without the consent of the Noteholders or the Couponholders, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest) so as to form a single series with the Notes.

18. **Notices**

Notices to the Noteholders shall be valid if published in a leading English language daily newspaper published in London (which is expected to be the Financial Times) or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. Any such notice shall be deemed to have been given on the date of first publication. Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Noteholders.

19. **Currency Indemnity**

If any sum due from the Issuer in respect of the Notes or the Coupons or any order or judgment given or made in relation thereto has to be converted from the currency (the "**first currency**") in which the same is payable under these Conditions or such order or judgment into another currency (the "**second currency**") for the purpose of (a) making or filing a claim or proof against the Issuer, (b) obtaining an order or judgment in any court or other tribunal or (c) enforcing any order or judgment given or made in relation to the Notes, the Issuer shall indemnify each Noteholder, on the written demand of such Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Fiscal Agent, against any loss suffered as a result of any discrepancy between (i) the rate of exchange used for such purpose to convert the sum in question from the first currency into the second currency and (ii) the rate or rates of exchange at which such Noteholder may in the ordinary course of business purchase the first currency with the second currency upon receipt of a sum paid to it in satisfaction, in whole or in part, of any such order, judgment, claim or proof.

This indemnity constitutes a separate and independent obligation of the Issuer, shall give rise to a separate and independent cause of action and shall continue in full force and effect despite any other judgment, order, claim or proof for a liquidated amount in respect of any sum due under the Note or Coupon or any other judgment or order.

20. **Rounding**

For the purposes of any calculations referred to in these Conditions, (unless otherwise specified in these Conditions, or the relevant Pricing Supplement), (a) all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, (b) U.S. dollar amounts used in or resulting from such calculations will be

rounded to the nearest cent (with one half cent being rounded up), (c) all Japanese Yen amounts used in or resulting from such calculations will be rounded downwards to the next lower whole Japanese Yen amount, and (d) all amounts denominated in any other currency used in or resulting from such calculations will be rounded to the nearest two decimal places in such currency, with 0.005 being rounded upwards.

21. **Governing Law and Jurisdiction**

- (a) *Governing law:* The Notes and any non-contractual obligations arising out of or in connection with the Notes are governed by English law.
- (b) *English courts:* The courts of England have exclusive jurisdiction to settle any dispute (a "**Dispute**") arising from or connected with the Notes (including a dispute relating to the existence, validity or termination of the Notes or any non-contractual obligation arising out of or in connection with the Notes) or the consequences of their nullity.
- (c) *Appropriate forum:* The Issuer agrees that the courts of England are the most appropriate and convenient courts to settle any Dispute and, accordingly, that it will not argue to the contrary.
- (d) *Rights of the Noteholders to take proceedings outside England:* Condition 21(b) (*English courts*) is for the benefit of the Noteholders only. As a result, nothing in this Condition 21 (*Governing law and jurisdiction*) prevents any Noteholder from taking proceedings relating to a Dispute ("**Proceedings**") in any other courts with jurisdiction. To the extent allowed by law, Noteholders may take concurrent Proceedings in any number of jurisdictions.
- (e) *Process agent:* The Issuer agrees that the documents which start any Proceedings and any other documents required to be served in relation to those Proceedings may be served on it by being delivered to PACCAR Financial PLC at Croston Road, Leyland, Preston, Lancashire PR5 3LZ, United Kingdom or, if different, its registered office for the time being. If such Person is not or ceases to be effectively appointed to accept service of process on behalf of the Issuer, the Issuer shall, on the written demand of any Noteholder addressed and delivered to the Issuer or to the Specified Office of the Fiscal Agent appoint a further Person in England to accept service of process on its behalf and, failing such appointment within 15 days, any Noteholder shall be entitled to appoint such a Person by written notice addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Fiscal Agent. Nothing in this paragraph shall affect the right of any Noteholder to serve process in any other manner permitted by law. This Condition applies to Proceedings in England and to Proceedings elsewhere.

CERTIFICATIONS

I, Ronald E. Armstrong, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PACCAR Inc;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date August 3, 2018

/s/ Ronald E. Armstrong
Ronald E. Armstrong
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, Harrie C.A.M. Schippers, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PACCAR Inc;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date August 3, 2018

/s/ Harrie C.A.M. Schippers
Harrie C.A.M. Schippers
President and Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002 (18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of PACCAR Inc (the "Company") on Form 10-Q for the quarter ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned certify, pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. section 1350), that to the best of our knowledge and belief:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date August 3, 2018

By /s/ Ronald E. Armstrong
Ronald E. Armstrong
Chief Executive Officer
PACCAR Inc
(Principal Executive Officer)

By /s/ Harrie C.A.M. Schippers
Harrie C.A.M. Schippers
President and Chief Financial Officer
PACCAR Inc
(Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.