



SMARTER PERSPECTIVE: TRANSPORTATION

Class 8 Truck Values Remain Strong Amid Supply Chain Constraints but Warrant Close Lender Monitoring

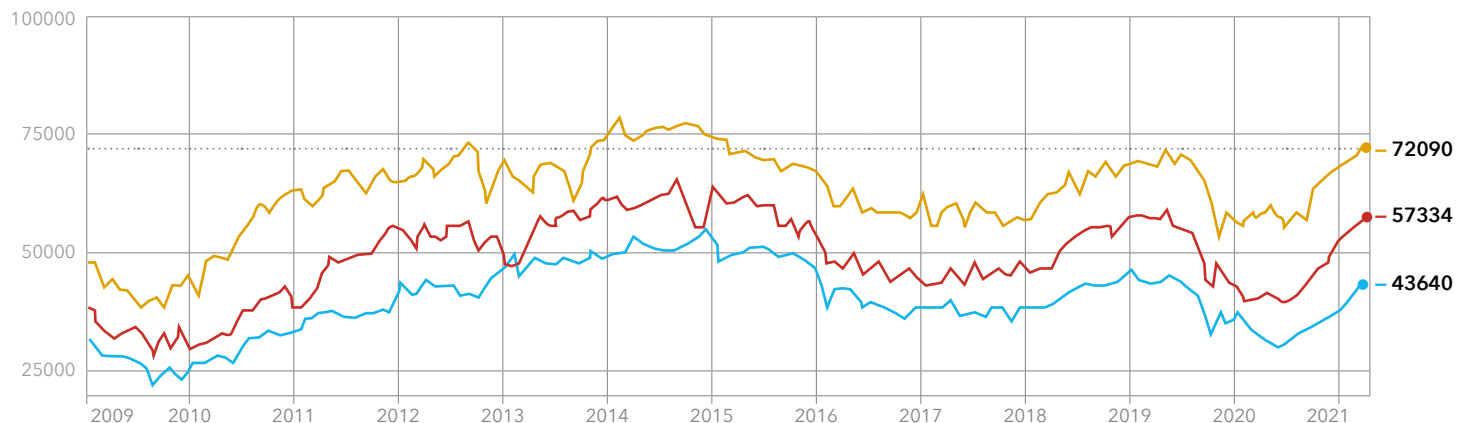
By Bryan Courcier

In this article we take a look at how factors including the current semiconductor chip manufacturing shortage and COVID-19 restrictions, requiring changes in auction practices, have impacted the Class 8 truck market. We also discuss steps lenders can take in the months ahead to ensure limited portfolio exposure when industry production ultimately catches up with demand.

Demand in the trucking industry has continued to rebound notably, as evidenced by freight rates which began increasing dramatically late last summer and have continued to remain strong. This has given trucking operators the added confidence to step up and place orders for new equipment. While only about 217,000 Class 8 trucks were ordered in 2020, forecasts for 2021 indicate that somewhere between 250,000 and 280,000 units will be ordered this year.

Right now, supply rather than demand has become the greatest issue for the industry. According to ACT Research, preliminary used Class 8 volumes (same dealer sales) dropped 6% m/m and 12% y/y in June. As compared with June of 2020, the average used price was 63% higher, with average miles and age lower by 5% and 2%, respectively. The average year-to-date price for 2021 is 38% higher y/y, with average miles and age down 4% and 3%, respectively.

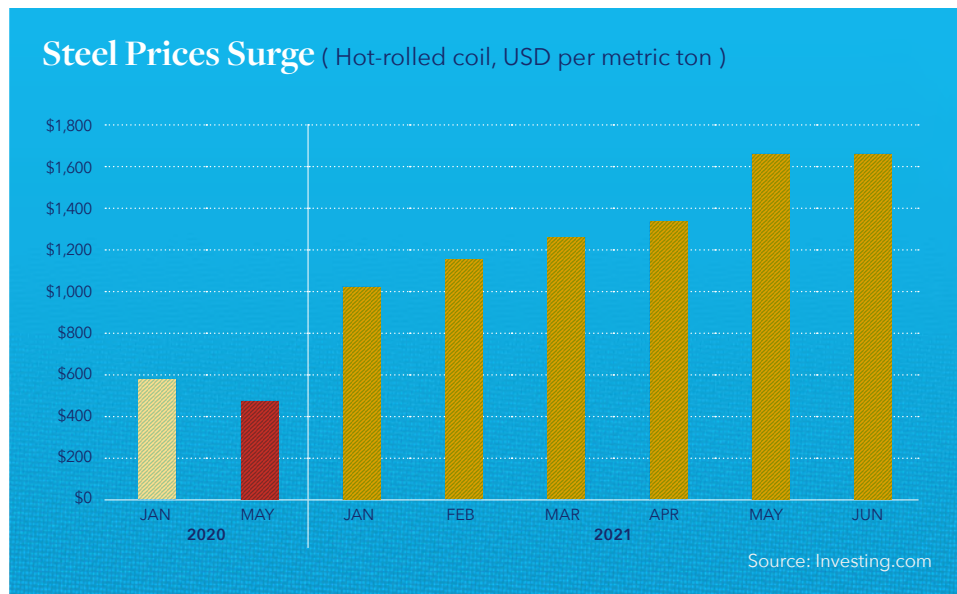
ACT Research 3 Year Old Used Truck Price Index (USA)



The widely reported global shortage of semiconductor chips has notably impacted production across the overall automotive market in 2021. The shortage resulted in large part from semiconductor manufacturers' quick pivot in the face of vehicle assembly plant shutdowns starting in the early stages of the global pandemic. With consumers required to spend the majority of their time in their homes, demand for consumer electronics dramatically increased. While entertainment and home dining fed the overall appetite, one key driver of this growth was the very real need for home office equipment among the new, unanticipated remote workforce. Recognizing these developments, many semiconductor manufacturers quickly shifted their production emphasis away from automotive to fill this gap as a means of sustaining their businesses. When demand for new vehicles ultimately returned sooner than expected, a semiconductor chip supply shortfall occurred. Furthermore, because assembly of these types of chips necessitates extended lead times, the deficit of these essential components grew even deeper as production began to ramp back up. While this shortfall has not resulted in as profound of an effect on heavy truck manufacturing as it has in some other areas of the market, namely consumer vehicles, the impacts are clearly being felt.

To provide some perspective on the importance of these components, on average, 17 different clusters of semiconductor chips are utilized in a typical Class 8 truck. Factors including regulatory compliance, complexity of the vehicles themselves, their size and required breaking power all contribute to the need for this technology. Chip clusters control the function of everything from lights, brakes, dashboard displays and communication systems, to GPS fleet tracking, electronic time-out logging and logistics reporting.

Manufacturers are working with chip suppliers to understand delivery cycles and minimize further negative impact



on their customers. They are adjusting production schedules as needed, scheduling and instituting stop days/ weeks based on anticipated periods of significant supply chain bottleneck. It is worth noting that given continued labor force challenges, it is highly likely that even if semiconductor chips were readily available, vehicle assembly would still be notably slowed. Additionally, with Steel prices setting records nearly every week and copper prices reaching 15-year highs, OEMs are incorporating surcharges on some trucks just to keep pace with the cost of materials.

Even with many truck orders being canceled or postponed by wary fleet operators during the pandemic, those who didn't cancel are now, in many cases, seeing delivery on only between 40-60% of the vehicles in their original orders. As they struggle to catch up, many truck makers are only now beginning to take orders for 2022 and the percentage of those orders which can reasonably be expected to be fulfilled by the end of next year remains in question. On the bright side, Class 8 preliminary orders for June reached 25,700 units, that was an 11% increase over May and a 61% rise as compared with June 2020, according to ACT Research. Without question, this continues to be a seller's market. With

used inventory in extremely high demand, and OEM production still lagging, we believe pricing for Class 8 trucks is unlikely to soften until early/mid 2022.

The pandemic has also required most auction operators to sell vehicles remotely for the past year, which has created significant challenges with buyers experiencing limited time and restrictive processes to review inventory for sale in person. Principal among these has been the need for those conducting auctions to have trained personnel provide an enhanced level of visual and written documentation, while having access to a very limited workforce during the pandemic. These vehicles are heavy duty industrial assets, which at some point before payment require a live inspection to ensure they are as advertised. As a result, we have seen a much higher incidence of collapsed sales, even among those auction houses with the best reputations in the business. While auctioneers have done their level best to photograph and describe the vehicles in great detail, these limitations have been felt by buyers who either didn't see issues in the photos/ videos provided, or believe they were not accurately informed about details of the vehicles they purchased. With COVID restrictions becoming more relaxed, we expect to see more live auctions and fewer collapsed sales in the months ahead.



Those on both ends of these transactions are clearly hoping that recent developments regarding the spread of the Coronavirus Delta Variant do not derail progress in that direction.

The continuation of the ongoing, multi-year driver shortage has also added to challenges created by these supply chain and remote auction issues. The dearth in the influx of new drivers has been exacerbated by the pandemic. While logistics companies have tried to incentivize would-be applicants via bonuses, higher pay and preferred routing, a career on the road and the compensation associated with it have not proven appealing to a younger generation of people searching for employment options that present greater gratification and lifestyle balance.

While some prognosticators have speculated that the industry could mitigate the impacts of the continued driver shortage through an accelerated transition to autonomous trucking vehicles, that technology and the infrastructure that supports it is still too far off – likely 10 or more years – to resolve the current issue. Furthermore, when one stops to consider the potential semiconductor chip processing requirements of a fleet of fully autonomous, artificial intelligence (AI)-guided Class 8 trucks, current supply chain issues pale in comparison. Lance Elliot's March 2, 2021, Forbes article on self-driving cars makes the point nicely, "To have a suitable AI driving system, you need lots of computer chips. For example, there are specialized computer chips for the Machine Learning and Deep Learning aspects of AI capabilities. Also, computer chips are running the AI algorithms for keeping track of the driving scene and planning the actions needed for undertaking the driving task. There are computer chips needed for the sensors that are used by a self-driving car. You've got the video cameras, radar, LIDAR, ultrasonic devices, and the rest of the extensive sensor suite, all of them utilizing various computer chips. Chips, chips, and more chips."

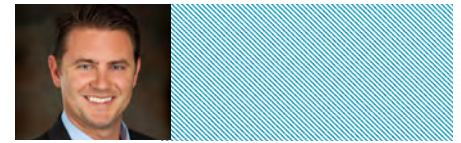
Conclusions

Lenders who may, in the last year, have been hesitant to add current technology-level Class 8 trucks/fleets or investments into their portfolios for fear of autonomous vehicles becoming the standard, can rest easy. Driver-guided vehicles will be the norm for the foreseeable future. That said, in the near term, with trucks remaining in short supply and continuing to increase in value, it is critically important for lenders to maintain a close eye on the recent shifting value of these assets. We are far outside of normal cyclical trending in terms of pricing right now. At some point – likely before the end of 2022 – chip manufacturing and mainframe production will catch up with demand and OEMs will figure out a formula to put volume back into the market. When that occurs, lending into large, older fleets will require a thorough knowledge of those hard assets, as values are likely to drop rather rapidly. With this in mind, Hilco recommends that initial appraisals during the current period include a reasonably sized, on-site fleet sampling to ensure accuracy. These should be supplemented by a desktop appraisal at 6 months, followed by another on-site between 6 and 12 months after that.

Hilco has remained highly active in appraising a wide variety of trucking and transportation assets throughout the pandemic. We can provide perspective and guidance on your distinct portfolio holdings based upon both our knowledge and proprietary data pertaining to the value of these types of assets over the past 30- to 60-days. With this in mind, we encourage you to reach out to our team today. We are here to help.

Hilco Valuation Services is one of the world's largest and most diversified business asset appraisers and valuation advisors. A trusted resource to companies, their lenders and professional services advisors, Hilco Valuation Services provides value opinions across virtually every asset category. Its expertise in transportation, construction, material handling and related asset categories is well established. The company's track record in liquidation

of fleet assets for maximum valuation, based on its understanding of realistic value and real challenges to an actual orderly liquidation process, is equally well known across the industry. Hilco Valuation Services has the ability to affirm asset values via proprietary market data and direct worldwide asset disposition and acquisition experiences. Access to this real-time information, in contrast with the aged data relied upon by others, ensures clients of more reliable valuations, which is crucial when financial and strategic decisions are being made.



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Bryan is responsible for business development, sourcing and relationship management within Hilco's expanding transportation, energy services and heavy equipment sectors in both the valuation and asset acquisition/liquidation practices. Bryan also serves as Chief Operating Officer at two of Hilco's operating companies within the commercial transportation space: H19 Capital headquartered in Indianapolis, IN and H19 Sutton Leasing in Detroit, MI with roughly \$200,000,000 in combined transportation lease portfolio currently under management. He previously served as National Account Manager at Ritchie Bros. Auctioneers, with a focus on insolvency, restructuring and special situations within the construction and heavy equipment industry. Bryan brings to Hilco an extensive knowledge of equipment lending and asset management functions from a valuation, liquidation, banking and finance perspective. He is an active member of the Turnaround Management Association, the Commercial Finance Association and the American Bankruptcy Institute. Contact Bryan at: 720.636.5123 or bcourcier@hilcoglobal.com.