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Global Report

# VOLVO AB

**COMPANIES DISCUSSED:** CAT, DCX, DCX GR, MAN GR, PCAR, SCVB SS, VOLV, VOLVB SS

# Demand Rebounds in Europe

## SOURCES & BACKGROUND

**41 Volvo sales managers and fleet buyers** representing more than €1 billion in 2005 Volvo truck sales/purchases

**United States** 8 Volvo truck dealership sales managers; **Europe** 33 Volvo truck dealership sales managers (7 in Scandinavia, 5 each in France and Germany, 4 in the United Kingdom, 3 each in Spain, Benelux and Poland, 2 in Romania and 1 in Hungary)

**Repeat Sources** 33 (6 in the United States and 27 in Europe) from OTR's October report

**Interviews** End of December, beginning of January

**Averages** Weighted according to sources' 2006 Volvo truck sales; Western European averages weighted according to each country's share of Volvo sales

**Background** Trucks account for roughly two-thirds of Volvo's revenue, and it is the dominant business within the group, bringing the highest margins. Europe accounts for 56% of sales (51% in Western Europe and 5% in Eastern Europe), while North America accounts for roughly 26%. In Western Europe, the United Kingdom is Volvo's most important market, accounting for approximately 15% of sales, followed by Scandinavia with approximately 13%, and Benelux, Germany and France each with approximately 12%.

"It's not all about anticipated orders before the December price increase; there is a genuine pickup of activity."

*– French source*

- Western European VOLV truck orders up 9%-14% during 4Q06 yy, beating all sources' expectations, though slowdown expected in 1Q07 *> page 2*
- U.S. VOLV 4Q06 truck orders down 60%-65% yy, in line with dealers' expectations and based on weak demand for 2007 emission-compliant trucks; unexpectedly high pre-emissions inventory likely to keep 1Q07 orders low *> page 2*
- U.S. VOLV share gains continuing; PCAR still vulnerable on CAT engine concerns *> page 4*
- U.S. VOLV prices higher qq; some discounts given on large 2007 emissions deals, more discounts expected in 2007 *> page 3*

## Executive Summary

All **Volvo AB** Western European dealers said 4Q06 orders were higher than their initial expectations, with demand fueled by a rebound of freight activity and purchases ahead of 4Q06's price hike. Lead times increased for most sources in Scandinavia, France and the United Kingdom, averaging 21 to 26 weeks in January, up four to nine weeks qq. Orders in Eastern European rose an average 9% to 14% yy during 4Q06, slightly above sources' expectations. U.S. 4Q06 orders decreased in line with expectations in OTR's October report. All U.S. sources said 4Q06 inventory was above average, and two-thirds said it had grown qq as a softening freight market unexpectedly kept demand at bay. However, Volvo continued to gain market share against **DaimlerChrysler AG**'s Freightliner and **Paccar Inc.**

## Key Data

**4Q06 Orders Exceeded Sources' Expectations**
(number of sources)

| | U.S. | W. Europe | E. Europe | Total |
|---|---|---|---|---|
| **Better** | 2 | 26 | 4 | 32 |
| **In line** | 5 | 1 | 2 | 8 |
| **Worse** | 1 | - | - | 1 |

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# Euro Demand Beats Expectations

Volvo's European truck orders increased notably in 4Q06 yy. Western European orders rose an average 9% to 14%, beating sources' expectations for the quarter. Eastern European also orders rose 9% to 14% yy, exceeding most sources' expectations as well. An increase of activity occurred in all countries, and sources reported a boost of order taking in front of Volvo's December price increase of 2% to 6%. Increasing lead times for Euro 4- and Euro 5-compliant truck models also played a part in pushing Volvo customers to place early orders.

**Rebound in France and the U.K.**

French and British dealers reported a significant order increase for 4Q06. "Summer had been very quiet. We saw a boost of demand before the price rise and ahead of the London [Low] Emission Zone legislation that will require all trucks circulating in London to meet Euro 4 at least," a British dealer said. A French source said, "It's not all about anticipated orders before the December price increase; there is a genuine pickup of activity."

However, several French and British dealers said many customers still were holding their purchases to see how the new models were doing on the road. Orders in France and Great Britain cover both Euro 4 and Euro 5 trucks, with demand for Euro 5 trucks increasing despite a lack of state incentives. A British source said, "Euro 5 trucks are more expensive than Euro 4, but customers start to think in advance and see the more important residual value of Euro 5-compliant trucks."

**Boost in Germany**

German Volvo dealers equally reported 4Q06 orders beating Q4 expectations. In light of Germany's strong general economic rebound, freight capacity shortages continued to boost Volvo truck orders although the lack of drivers capped growth. "Demand is there and also the will to invest in new trucks, but there is a lack of skilled drivers," said one dealer. All German dealers said they ordered only Euro 5-compliant trucks, directing their commercial strategy away from Euro 4 trucks. A source said, "Forget about the Euro 4; it's of no interest to us and too expensive in comparison with Euro 5 trucks."

**Scandinavia Beats Expectations**

Volvo continued to experience strong market conditions in Scandinavia during 4Q06. "This is another best quarter ever; we can't stop clapping," a Danish dealer said. Another Danish source said, "My orders are up 300% yy thanks to very strong export demand for Euro 5 trucks." One Swedish dealer said, "The market is just rolling on and on, even better than our expectations."

**Spain Shines**

Demand in Spain was equally above all sources' expectations, with orders slightly up on average yy. In OTR's October report, sources had forecast a sharp drop in 4Q06 orders. Good economic conditions let the market grow while state incentives boosted Euro 5 sales. "Large fleets are entitled to state incentives in favor of Euro 5 trucks," said a Volvo dealer.

**Steady Growth in E. Europe**

The fast development of local economies and increasing freight volumes continue to fill Volvo's Eastern European books, beating most dealers' 4Q06 expectations. A Polish source said, "Demand was huge in front of the price increase, but the market is growing fast anyway." Sources in Romania said customers still preferred to buy Euro 4 trucks, whereas Polish sources said they ordered mainly Euro 5 trucks. "Customers are interested in the residual value that Euro 5 trucks will have, and the price difference between Euro 4 and Euro 5 is small anyway," a Polish dealer said.

# U.S. Orders Drop As Expected

U.S. Volvo dealers said 4Q06 truck orders dropped 60% to 65% yy on average, in line with predictions from OTR's October report. With order slots limited to 2007 emissions trucks, customers had little incentive to place orders. Most customers prepurchased trucks in 1H06 to avoid the EPA-mandated engines, and for customers still looking to buy, dealer inventories of pre-emissions trucks was ample. "I do not have a single customer order for the new technology. Everything is for stock," said a Midwestern dealer. Another dealer said, "We're still working off of a lot of inventory." Shortening lead times further eroded customers' sense of urgency. "People know if they order a truck, it's not going to be nine months before they get it. They are holding off until they can see and feel the new emissions trucks," said an Eastern dealer. On the other hand, a California dealer said buyers were showing greater-than-expected interest in emission-compliant trucks to avoid expensive retrofitting that the state may require when emission standards tighten further in 2010.

"Volvo's going to look at their order board and come back with some offers in the next couple of months."

## Prices Rise in U.S., Some Discounts Given

Most U.S. sources said Volvo introduced a model-year increase of 1.5% to 3% in late October on top of the $7,500 to $10,000 emissions charge announced earlier in the year. Volvo restructured its pricing strategy during 4Q06, reducing base truck prices but concurrently limiting the discounts dealers can work with. The net result is that 2007 emissions trucks will still cost more than pre-emissions models, with estimated increases ranging from $6,000 to $12,000. "Bottom line is $10,000 more: $7,500 for the emissions, then they're up another 2%," said one dealer.

**Deals with Discounts**

U.S. sources said Volvo generally held firm on pricing but delivered discounts on some big deals. On an order for a long-time fleet customer, one dealer said, "Volvo came through with some hefty concessions. They still had the typical 1% to 2% increase, but the majority of the emissions charge was offset." Overall, sources said pricing is relatively consistent between manufacturers, but as one said, "We haven't been on enough deals to find out." Sources expect discounts to expand in 2007. "Volvo's going to look at their order board and come back with some offers in the next couple of months," said one dealer.

## U.S. Inventories Grow

All U.S. sources said 4Q06 inventory was above average, and two-thirds said it had grown qq. Dealers stockpiled trucks for last-minute customers, but softening freight unexpectedly kept demand at bay. "I thought there would be nice 4Q06 business ahead of the '07 standards, but the freight isn't there, so why buy," said one source. A source from a multilocation dealership said, "We have so many trucks in one store that you can't even drive through the lot." One dealer said his inventory of dump trucks and other vocational trucks has swelled as the construction market has softened.

**Lead Times Up in W. Europe**

Most Western European dealers, except those in Germany, said lead times increased significantly in 4Q06, rising to 26 weeks for a standard FH model and even to more than 30 weeks in Scandinavia. A Danish source said, "Lead times have doubled every three months the last six months. It is way too much."

Western European sources attributed longer lead times to the demand rebound they are experiencing, but several sources also mentioned delays caused by third-party providers. "Volvo's management blames its providers for the delays," said a source from the Benelux, while a British source said, "We have problems with the French input; this is what causes delay." Dealers said competitors also were suffering from longer lead times.

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# Volvo Continues U.S. Gains, PCAR Vulnerable

U.S. dealers said the scarcity of 4Q06 orders made market share difficult to gauge, with one source speculating that OEM availability of pre-emissions trucks may have driven 4Q06 share shifts more than anything else. Still, sources said they believe Volvo will continue to gain share on fuel efficiency and driver comfort in the long run, benefiting further from the new emission standards. "The only manufacturer that really seems to have it together on this new EPA particulate trap is Volvo, and they have done a good job of presenting that to the public," said one source. Another dealer said the fuel-saving and productivity-enhancing features of Volvo's new I-Shift transmission system will give the company an additional edge when it becomes available in 2007.

**PCAR, Freightliner Losing in U.S.**

In line with OTR's October findings, sources said **DaimlerChrysler AG**'s Freightliner and Paccar's Kenworth and Peterbilt continued to lose share. Freightliner is viewed as weak on quality and resale value, while the Kenworth and Peterbilt brands are seen as vulnerable because of the **Caterpillar Inc.** emissions-compliant engine they will use in 2007. "Caterpillar is having enough problems with their engine that it will get me a foot in the door to fleets I haven't sold to before," said one U.S. dealer. Three-fourths of U.S. sources have ordered Volvo's new models and said they appeal to markets previously underserved by Volvo. "With the advent of the [long-hood, high horsepower] VT 880, we have a lot more interest from owner-operators — the Peterbilt and Kenworth extended-hood guys, the classic Freightliner guys," said one source. Referring to the new VN 730 and VT 830 midroof sleepers, one dealer said, "Now we can compete for the owner-operator who doesn't need a condo, and ours is a step ahead of the others in terms of roominess and comfort."

**MAN Gains in Europe**

Although Volvo's 4Q06 market share was stable or up for most European sources, **MAN AG** and DCX's Mercedes were the main winners, at the expense of **Scania AB**. "The EGR technology chosen by MAN to meet Euro 4 and Euro 5 legislation is quite appealing to customers, and they are less expensive than our Volvo trucks," said a British dealer. "MAN is doing better than Volvo because they have a good product at a much cheaper price," said a Polish dealer. Paccar's DAF got mixed reviews from dealers across Europe. Another Polish dealer said, "DAF is buying market shares, but their product is of lower quality and they offer a very poor service."

Only a few European dealers reported losses for Volvo; all blamed higher prices while some also regretted longer lead times. "The distribution of the new Volvo's FE models has been chaotic. I link our market share loss directly to our delay in selling those trucks," said one British dealer. A German source said, "The problem with the FE and FL models is that they were marketed too early."

"Caterpillar is having enough problems with their engine that it will get me a foot in the door to fleets I haven't sold to before."

# European Growth to Soften in 1Q07

Western European dealers expect 1H07 yy comparisons to be tough because of last year's demand boost ahead of European Union's digital tachograph deadline. One Swedish source said, "Although we have good volumes, we just can't beat 2006." Still, sources remain positive for 1Q07, expecting orders to average flat to up 5% yy. Increased freight activity and a good economic climate are expected to be the main drivers. A German Volvo dealer said, "The economic activity will continue to pull up our activity."

**U.S. Orders Still Weak in Q1**

U.S. sources expect 1Q07 orders to fall an average 57% to 62% yy, citing the same factors that weighed on 4Q06 as well as tough comparisons to 1Q06's pre-

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purchasing activity. "We have enough trucks on the ground to sell through the first quarter or longer," one dealer said. Furthermore, trucks with pre-emissions engines will continue to roll off Volvo's production lines well into 1Q07. "Volvo is booked through March 15 on pre-emissions trucks," said a large Eastern dealer. "Our dealership alone has 250 trucks coming in the first three months."

Most U.S. sources agreed with Volvo's forecast that demand will pick up during 2H07 after a slow first 1H07, but they said selling existing inventory will be key. "Until all the stock is gone in the country, new orders will be off significantly," said one dealer.

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# ADDITIONAL QUOTES

**On Orders ...**

"Despite increasing fuel prices, we can take advantage of the fast-developing national economy." *Polish dealer*

"Clients order early because of longer lead times." *German dealer*

"All economic indicators are green in the country right now." *Polish dealer*

"Lead times have increased by 10 weeks in December to now 24 weeks for a FH model." *French dealer*

**On Demand ...**

"There is a lack of skilled workers on the market, which limits our sales." *German dealer*

"This is the best market ever." *Scandinavian dealer*

"Euro 4 trucks are less expensive, but there is now a tax break for Euro 5 purchases." *Spanish dealer*

**On Market Share ...**

"The new VT model can play havoc on the Paccar group." *U.S. dealer*

"Caterpillar is behind on their engine program; that might shift people to our brand." *U.S. dealer*

"Renault [S.A.]'s trucks sometimes offer better technology than Volvo's, such as with the Magnum's new cab which is better than Volvo's." *French dealer*

**On Pricing ...**

"The rumor is that Volvo is trying to be more aggressive and make more money per truck. They look at Paccar and how much they can make per truck." *U.S. dealer*

"We have to reduce our margins in order to close deals." *German dealer*

"Some competitors offer large discounts on their trucks." *Romanian source*

**On Outlook ...**

"I think Volvo will be down 50% to 60% in the first half of 2007 year to year. Volvo is underestimating the dealers' inventories." *U.S. dealer*

"I don't know how sales will develop in the first half of 2007. We won't have the tachograph deadline or the Euro 4 deadline to boost sales." *French dealer*

"We expect international freight to continue to develop for our customers." *Polish dealer*

"The national market has grown; business should continue to be good." *German dealer*

## > VOLVO AB TALLY

**1. Which trends do you expect to help or hurt Volvo truck sales during the next three to six months? (Some sources gave more than one answer while others did not respond.)**

| POSITIVE | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Strong economy: | 2 | 18 | 3 | 23 |
| Anticipated demand: | - | 7 | - | 7 |
| Other: | 5 | 1 | 1 | 7 |
| **NEGATIVE** | | | | |
| 2007 emissions standards: | 7 | - | - | 7 |
| Lead times: | - | 3 | 2 | 5 |
| High inventory: | 2 | - | - | 2 |
| Softening freight: | 2 | - | - | 2 |
| Other: | 1 | 4 | 2 | 7 |

**2a. Did your Volvo truck orders increase, decrease or remain the same during 4Q06 yy?**

| | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Up more than 100%: | - | 2* | - | 2* |
| Up 41%-50%: | - | 1 | - | 1 |
| Up 31%-40%: | - | 3 | - | 3 |
| Up 21%-30%: | - | - | 1 | 1 |
| Up 11%-20%: | - | 5 | 3 | 8 |
| Up 1%-10%: | - | 9 | 1 | 10 |
| Flat: | 2 | 6 | 1 | 9 |
| Down 1%-10%: | - | 1 | - | 1 |
| Down 41%-50%: | 3 | - | - | 3 |
| Down more than 61%: | 3 | - | - | 3 |
| ***Weighted average:*** | ***Down 60%-65%*** | ***Up 9%-14%*** | ***Up 9%-14%*** | ***Not averaged*** |
| ***3Q06 average:*** | ***Down 52%-57%*** | ***Up 4%-9%*** | ***Up 4%-9%*** | ***Not averaged*** |

** Two sources were not included in the average; one reported an increase of 100%, the other 300%.*

**2b. Was this better, worse than or in line with your initial expectations for 4Q06?**

| | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Better: | 2 | 26 | 4 | 32 |
| In line: | 5 | 1 | 2 | 8 |
| Worse: | 1 | - | - | 1 |

**3. Do you expect your Volvo truck orders to increase, decrease or remain the same during 1Q07 yy?**

| | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Up 91%-100%: | - | 1 | - | 1 |
| Up 11%-20%: | - | 2 | 2 | 4 |
| Up 1%-10%: | - | 8 | 2 | 10 |
| Up: | - | - | 1 | 1 |
| Flat: | 1 | 9 | 1 | 11 |
| Down 1%-10%: | - | 2 | - | 2 |
| Down 11%-20%: | - | 2 | - | 2 |
| Down 31%-40%: | 1 | - | - | 1 |
| Down 41%-50%: | 2 | - | - | 2 |
| Down 51%-60%: | 1 | - | - | 1 |
| Down more than 61%: | 3 | - | - | 3 |
| Don't know: | - | 3 | - | 3 |
| ***Weighted average:*** | ***Down 57%-62%*** | ***Flat-up 5%*** | ***Up 3%-8%*** | ***Not averaged*** |

**4. Are you already ordering Volvo's new models?**

| | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Yes: | 6 | 25 | 5 | 36 |
| No: | 2 | 2 | - | 4 |
| No response: | - | - | 1 | 1 |

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**5. What advantages and disadvantages do the new Volvo models have? (Some sources gave more than one answer while others did not respond.)**

| ADVANTAGES | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Appeal to owner-operators: | 4 | - | - | 4 |
| Quality of the trucks: | - | 4 | - | 4 |
| Technology: | 1 | 2 | - | 3 |
| Driver comfort: | 2 | - | - | 2 |
| Fuel consumption: | - | 2 | - | 2 |
| Other: | 1 | - | - | 1 |
| **DISADVANTAGES** | | | | |
| Price: | 1 | 8 | - | 9 |
| Inadequate suspension: | 2 | - | - | 2 |
| Manual gearbox: | - | 2 | - | 2 |
| No response: | - | 15 | 6 | 21 |

**6. Did Volvo's truck prices increase, decrease or remain the same during 4Q06 qq?**

| | | | | |
|---|---|---|---|---|
| Up 11%-20%: | 1 | - | - | 1 |
| Up 1%-10%: | 3 | 24 | - | 27 |
| Up: | 1 | 3 | 4 | 8 |
| Flat: | 3 | - | 2 | 5 |
| ***Weighted average:*** | ***Flat-up 4%*** | ***Flat-up 5%*** | ***Not averaged*** | ***Not averaged*** |

**7. How long are current lead times for Volvo truck deliveries?**

| | | | | |
|---|---|---|---|---|
| 41-50 weeks: | - | 1 | - | 1 |
| 30-40 weeks: | - | 5 | - | 5 |
| 21-30 weeks: | - | 12 | 3 | 15 |
| 11-20 weeks: | 7 | 9 | 1 | 17 |
| 1-10 weeks: | 1 | - | 2 | 3 |
| ***Weighted average:*** | ***10-15 weeks*** | ***21-26 weeks*** | ***16-21 weeks*** | ***Not averaged*** |
| ***3Q06 average:*** | ***15-19 weeks*** | ***15-19 weeks*** | ***18-22 weeks*** | ***Not averaged*** |

**8. Did lead times for Volvo truck deliveries increase, decrease or remain the same during 4Q06 qq?**

| | | | | |
|---|---|---|---|---|
| Up 21-30 weeks: | - | 1 | - | 1 |
| Up 11-20 weeks: | - | 7 | - | 7 |
| Up 1-10 weeks: | - | 10 | 1 | 11 |
| Flat: | - | 6 | 3 | 9 |
| Down 1-10 weeks: | 1 | 3 | 2 | 6 |
| Down 11-20 weeks: | 7 | - | - | 7 |
| ***Weighted average:*** | ***Down 9-14 weeks*** | ***Up 4-9 weeks*** | ***Slightly down*** | ***Not averaged*** |
| ***3Q06 average:*** | ***Down 3-7 weeks*** | ***Flat*** | ***Up 3-7 weeks*** | ***Not averaged*** |

**9. Are current inventory levels of Volvo trucks above or below average?**

| | | | | |
|---|---|---|---|---|
| Above: | 8 | 1 | 1 | 10 |
| In line: | - | 7 | 2 | 9 |
| Below: | - | 2 | 3 | 5 |
| Not applicable: | - | 17 | - | 17 |

**10. Were inventory levels of Volvo trucks higher, lower or the same during 4Q06 qq?**

| | | | | |
|---|---|---|---|---|
| Higher: | 5 | 1 | 1 | 7 |
| Same: | 2 | 8 | 3 | 13 |
| Lower: | - | 1 | 2 | 3 |
| No response: | 1 | - | - | 1 |
| Not applicable: | - | 17 | - | 17 |

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**11. Which manufacturers gained or lost market share during 4Q06? (Some sources gave more than one answer while others did not respond.)**

| GAINED | U.S. | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|---|
| Volvo: | 6 | 7 | 3 | 16 |
| MAN: | - | 9 | 4 | 13 |
| DCX's Mercedes/Freightliner: | 1 | 9 | - | 10 |
| Paccar (DAF): | - | 5 | - | 5 |
| Fiat S.p.A. (Iveco): | - | 2 | 2 | 4 |
| Renault: | - | 3 | - | 3 |
| Navistar International Corp.: | 2 | - | - | 2 |
| Other: | - | 1 | - | 1 |
| **LOST** | | | | |
| Paccar (Peterbilt, Kenworth): | 5 | 6 | 2 | 13 |
| Scania: | - | 10 | 2 | 12 |
| Mercedes/Freightliner): | 5 | 5 | 1 | 11 |
| Volvo: | 1 | 4 | 2 | 7 |
| Iveco: | - | 4 | - | 4 |
| Navistar: | 2 | - | - | 2 |
| Renault: | - | 2 | - | 2 |
| Other: | 1 | 1 | - | 2 |

## European Dealers

**12. Are customers buying Euro 4- or Euro 5-compliant trucks?**

| | W. EUROPE | E. EUROPE | TOTAL |
|---|---|---|---|
| Yes, both: | 12 | 4 | 16 |
| Yes, Euro 4: | 6 | 1 | 7 |
| Yes, Euro 5: | 9 | 1 | 10 |

**13. Did purchasing patterns change during 4Q06 qq?**

| | | | |
|---|---|---|---|
| More Euro 4: | 1 | 2 | 3 |
| More Euro 5: | 17 | 3 | 20 |
| No change: | 4 | - | 4 |
| No response: | - | 1 | 1 |
| Not applicable: | 5 | - | 5 |

**14. Were Euro 4 engine truck sales above, below or in line with your expectations during 4Q06?**

| | | | |
|---|---|---|---|
| Above: | 6 | 2 | 8 |
| In line: | 13 | 4 | 17 |
| Below: | 8 | - | 8 |

## U.S. Dealers

**15. Is Volvo's estimate of a 40% decline in deliveries during 1H07 optimistic, pessimistic or about right?**

| | |
|---|---|
| Optimistic: | 1 |
| About right: | 5 |
| Don't know: | 2 |

**16. Volvo expects deliveries to pick up in 2H07. Do you agree or disagree?**

| | |
|---|---|
| Agree: | 6 |
| Don't know: | 2 |