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Nimble Wheels? Truck Dealerships Shift with a Shifting Economy

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Nancy Condon: *Welcome to the Federal Bank of Atlanta's* EconSouth Now *podcast. I'm Nancy Condon, associate editor of* EconSouth*. Today, we're joined by Oscar Horton. Oscar is owner and president of Sun State International, a heavy-duty commercial truck dealership based in Tampa and with five locations across West-Central Florida. Oscar is also on the board of directors of the Jacksonville Branch of the Federal Reserve Bank of Atlanta.*

Oscar, thank you for joining us today.

Oscar Horton: Thank you, and thanks for inviting me.

Condon: *Oscar, the trucking industry is still adapting to changes wrought by the recession. Can you talk about some of the ways your own business has adapted to changes?*

Horton: In the Florida market much of the wealth that was generated to drive demand for our products was around home equity, real estate values, the construction of new homes and commercial properties, and also commercial business start-ups. And in the 2008 to 2010 timeframe, the Florida market was really hit severely, and at that point we saw home values take as much as a 50 percent hit in equity. And new truck production nationwide saw a severe drop from its peak of over 400,000 units to something south of 200,000 units a year. We saw major customers filing for bankruptcy.

So, in Florida, the construction market just dried up. Credit also tightened at the same time that all these devastations were taking place in the economy. So we saw, basically, about a 40 percent drop in the demand for new trucks in our dealerships during that timeframe.

We look at our trucks in different segments. We have a heavy-duty truck segment, we have a medium duty, and we have a severe service. And all of those areas were severely impacted during that time. For us, though, we could see it coming. It's an interesting process in the truck market that we can watch the movement of freight in our markets as well as across the country. We can watch what will happen in our service and parts end of the business and start to see that there is a drop-off in customers repairing their units or buying parts to repair the units themselves. And these are sort of leading indicators that the market is starting to turn. So, here at Sun State, we recognized that turn and we started to adjust about that time.

Condon: *That's very interesting. Do you see these adaptations as permanent, or do you think that when the economy is running full steam again your business will revert to its former business model?*

Horton: Well, let me sort of walk you through what we did, and then, I think, we can determine if they will be permanent or not permanent changes. We simply took a look at our income statement as a staff, line by line, and said, "Where can we start to cut costs?" We were building an organization for growth. We had purchased a couple of dealerships since we had acquired the original dealership here, and we had our eyes on other opportunities. So, therefore, we had cost in the system that was designed to grow, and not necessarily just for the immediate profit levels.

So when the 2007–2008 timeframe came, we simply got in a room and said, "What can we do to make sure we remain profitable?" We looked at reducing our truck-and-parts inventory. We carry a little over $3 million worth of parts in our inventory, and that's just like cash sitting on the shelf. So we had to get those down to improve our returns. Our new-truck inventory, we floor planned all of those trucks. You have to understand that we have units here that we sell for more than $100,000 apiece, and International [International Truck & Engine Corporation, the parent company of Sun State] doesn't necessarily sell them to us at $50,000—it's a lot higher number than that—so, therefore, the floor plan cost on each unit out there every month is quite expensive. So we looked at how we could control our inventory and really just have more of a "just-in-time" inventory. We invested money in our computer system so that we could have just-in-time information to have a better line of sight on all of our receivables, who our customers were, and how we will be able to get that money in on time.

We took a 3 to 5 percent salary cut company-wide, and we did that primarily to make sure we didn't have to go through the process of laying anyone off, so [that] our cash was strong enough and our profits were strong enough that we didn't need to just immediately let people go. So we did all of our reductions through attrition. And there were just any number of things like that that we went through, and we kept a running tab. So, therefore, we were able to take somewhere north of $3 million worth of cost out of our system by looking at the things I just told you about.

One of the things that happened is that we employed something called "an employee expense reduction challenge." We said that there are expenses in the system that we know we can't find from my office or the CFO's office. But our technicians and our service writers and our parts salespeople are walking over expenses every day. And we said, if we put together a challenge and if you guys can help us identify other expense areas, we will take 10 percent of those findings and put it in a lottery pool and at the end of the year, we will have a drawing and then someone will win that 10 percent. The bottom line is that we saved something north of $70,000 to $75,000 that year. We gave away about $7,000 of it to an employee in a drawing.

And all of the things that I just described to you, we will keep in our systems. We are not going to give those back. The productivities that we'veve been able to gain because of our investment in capital, equipment, and better computer systems will remain in the system. So at the end of the day, we had about a 25 percent reduction in head count simply by just letting nature take its course and doing the attrition process, and we don't see any need to put that back in the system at the current level that we are operating.

Condon: *So you anticipate that these changes will stick around for a while.*

Horton: They will stick around for a while. Some of them will get back into the system just as we start to grow again, but they will be very closely monitored and make sure that when we put someone in we don't need them for 90 percent productivity—we really need them for about 120 percent productivity, and we'll need someone so...

Condon: *Yeah. So how have other truck dealerships dealt with the economy? Have you seen... Was your model unique?*

Horton: I can only speak really for the International dealerships, and we fared very well. International had started to change its business model in terms of dealerships. There was a point where International might have had 400 to 500 individual dealers, and some of those dealers operated small dealerships that might have $12 million in sales a year, or $20 million. Over the last several years, International has gotten its dealer ranks down to probably in the 200-range, almost half. So, therefore, the ones that remain are larger, they've got more scale, they've got more capital to invest in systems and things just as I told you about. So just about the time the economy was starting to turn, the system was pretty much prepared for that on the International side. We did see a few of the competitors' dealerships move away from the marketplace as the economy turned, but I think, overall, truck dealers, unlike some of the car dealers, have always managed their systems pretty well.

Condon: *That's very interesting. Are you seeing demand for new trucks coming back yet?*

Horton: The answer is "yes." New truck sales are pretty strong these days. What I can't determine is, is the market growing or are we just really selling replacement units? And what I mean is that our trucks—you take, for example, what they call a Class-8 long-haul truck, which is a truck that would load juice in central Florida and drive it to California or New York—these trucks run 120,000 miles or so a year, and the typical owner of trucks like that would like to have a truck that is always under warranty. 500,000 miles plus warranty—in four years or so, and the truck has used up all of its warranty time period, and they typically will want to trade those trucks in and get a new one. So a lot of what we are seeing is what we call "replacement vehicles." They are taking their old ones out, putting new ones in.

Condon: *So from 2008 to now, that's four years, that's the life of a warranty?*

Horton: That's pretty much the life of the warranty based on the miles that they will have on the unit. So they will start to trade those trucks in. They typically buy trucks. A typical customer will have, you know, north of 100 trucks or so in their fleet, so they will try to figure out how to turn about 25 percent of those trucks every year. So we are seeing a strong market in the truck as well as the trailer business. We are also a trailer dealer for Hyundai Translead Trailers, and we are seeing a very strong trailer market these days as well.

Condon: *Do you see any upcoming technological changes that could cause a pre-buy, or a run, on trucks?*

Horton*:* No, I don't think you are going to see much in the way of a pre-buy because the turn cycle is so fast. The customer gets his truck today and even if you see something strong happening in the market, they are going to say, "When does the economic line cross?" And what I mean, [it's] between me going ahead and buying a new truck or driving this one and looking at what I can get out of it until I trade in for another one. And it's those economic balances that they will look at to determine when to buy.

There are so many changes coming in the product itself that if you are talking about a pre-buy, they probably have to pre-buy every year. The technology has really, really, taken off in driving a different type of truck in the market.

When we talk about new technology coming into the marketplace, what we see coming at us in the very near future will be the products around compressed natural gas. You will hear them use the term CNG—CNG stands for "compressed natural gas." There is a version of that called LNG, which would be a liquid natural gas. These are the products of the future. For example, compressed natural gas, when you talk about emissions, which we talked about earlier, there is no concern about the emissions standards anymore. These engines are clean. Also, the cost of compressed natural gas—let's say, for example, today, if diesel fuel is $4 a gallon in the marketplace, compressed natural gas is probably running about $2 to $2.10 per gallon. So there is some real cost savings just in terms of fuel. We'll have a big impact on the environment. And this will be a totally different engine and a different technology than what we understand today in our diesel products.

Condon: *What about the high fuel prices these days. Are they affecting your business? Are you seeing any more demand for fuel-efficient trucks?*

Horton: Well, two things. If you just look at our dealership, we probably—between parts, delivery trucks, and cars for sales guys—we probably have 30, 40 trucks and vehicles on the road, and we have almost traded out our entire old fleet into vehicles that are much more fuel-efficient. We had delivery trucks that were lucky to get 12 miles to the gallon; we have trucks now that will get 22. We had cars that were getting 17 or 18 that are now getting 32. So we made that move internally, just to be able to overcome some of the expenses that go with fuel.

What happens in the truck business, it's a little different. Again, I'll use the example of a long-haul truck. Many of the long-haul truck customers will have a contract with a vendor, and in that contract, there can be formulas that will trigger an increase in the rate if the fuel price goes to a certain point. And typically, they follow the lines of the consumer price index. So that is sort of a built-in protection. The other piece is that weight is a big factor on a long-haul truck. Eighty-thousand pounds would be the maximum weight you can pull over the highways, and that is the weight of the truck and the trailer. A commercial Class-8 tractor five to eight years ago probably weighed somewhere in the area of 19,000 pounds, just the truck itself. That truck today is probably about 16,500 to 17,000 pounds. That means that there is somewhere in the neighborhood of 2,000 additional pounds that you can put on the trailer, which means that there are a few more bottles of water, Coke, beer, whatever it is you are hauling, that can make up for some of that price that you've got in the fuel. Also, a commercial truck today will get you somewhere in the neighborhood of seven to seven-and-a-half miles per gallon.

Now, if you own a car, that is not that impressive, but if you were driving that same truck three years, five years ago, that truck would probably be getting five-and-a-half to six miles per gallon. So you take that difference in the fuel economy that they've got in the vehicles today—fuel is just not the big issue that you would think it would be because the price has gone from $3.50 to $4 or something.

Condon: *Yeah, I wouldn't have guessed that. I would have thought it would be a big issue. Oscar, I just have one more question. Where do you see the trucking industry in, say, one year or in five years? Are you able to get a view?*

Horton: Well, in one year it is going to look pretty similar to what it does today, and the big driver today is around the issue with emissions. The diesel trucks that you see running over the road today are every bit as clean as they have ever been in my career of being involved with diesel technology. But the governmental regulations to make it even cleaner continue to come forward. And every time, we have to figure out how to make that engine a little bit cleaner—it's not as simple as to just putting another filter on it. This will cause major designs in the engine. And whenever you go into those major designs, temporarily, you might have some issues with some of the product as it comes. So in the next year or so, I think most of the manufacturers will be working to just make sure the quality is there. Quality in the construction of the truck and the engine, that's what you are going to see in the short run.

If I look five years down the road, these trucks are just choked with technology these days. Here's an example. We've been testing some trucks that could literally run down I-75 here in Florida, could pass something like you would see as a SunPass, that sensor could read the truck and find out if there's a problem with the truck. That sensor could then notify Sun State International in Tampa, Florida, and say, "I've got a truck. It's in Gainesville, Florida, it will be at your location in two hours—here's the problem with the truck." The reason for that is that when it gets here, we would have the parts, we would have the bay ready, we would pull that truck in and get it back on the road. It's important that the truck runs. I tell people all the time that no one pays $100,000 plus for a truck to drive it to church and show it off to their friends.

Condon: *(laughs)*

Horton: ...This is a business. They are actually going into business and if they are not running, it is no different than me closing Sun State down every Wednesday for some reason and have all of the expenses and none of the revenue coming in. So it's important that we keep that customer on the road. It's that type of technology that you are going to see in leaps and bounds as we go forward in the next few years here.

Condon: *That's really interesting. Well, Oscar, I want to thank you so much for your time and for talking to us today. It was a really fascinating conversation.*

Horton: Well, thank you.

Condon: *Again, we've been speaking today with Oscar Horton, president and owner of Sun State International and a member of the board of directors of the Atlanta Fed's Jacksonville Branch.*

This concludes our EconSouth Now *podcast on the trucking industry. For more information, please see the second quarter 2012 edition of* EconSouth. *On our* *website, www.frbatlanta.org, you can read our article about the trucking industry and the changes it has seen. Thanks for listening, and please return for more podcasts. If you have comments, please send us e-mail at podcast@frbatlanta.org.*