State of the Industry White Paper – July 2020
Analysis and Points of View for Our Industry

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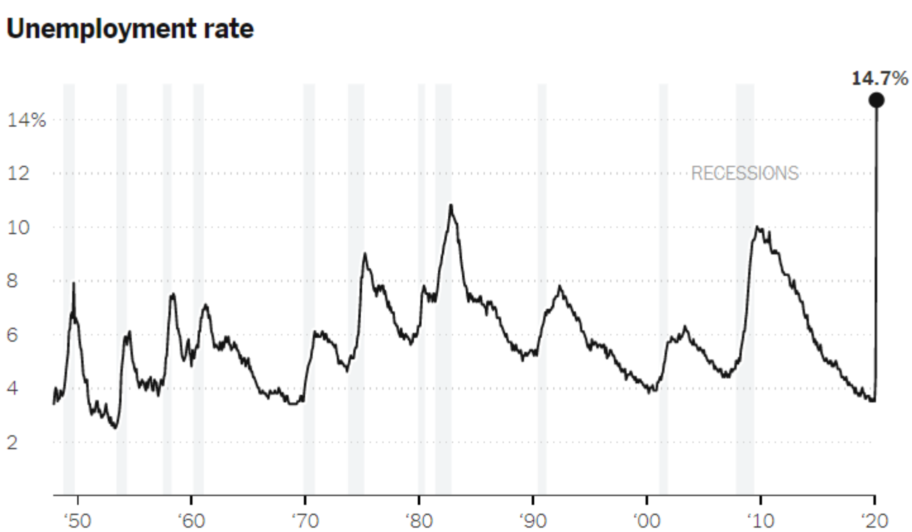
Key Issues:

- Economy: We are in a recession.
- Consumer Spending: But wait, we had a "record" season?
- Recovery: What "shape" will it take and what will drive it?
- Business Owner: What to watch for and how to plan.
- Future Assessment: Cautiously Optimistic!

Economy: We're in a recession – and we need to understand the impact.

Recessions can be hard to predict, but that's not the case this time. The COVID-19 pandemic sweeping the globe has pushed the U.S. economy into recession (already officially confirmed by the National Bureau of Economic Research), with U.S. GDP falling 4.8% in the first quarter. While the drop was sizable, an even more pronounced decline is in store for the second quarter, as broad swaths of the country remain shuttered. The U.S. is feeling the sting of a sharp reduction in consumer spending and the continued cutback in industrial production.

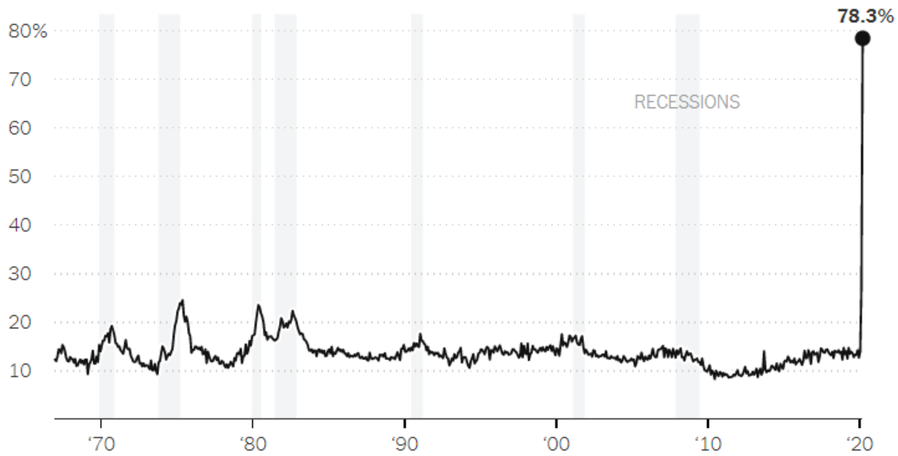
The recession this time is really all about consumer spending (or the lack thereof), which typically accounts for approximately two-thirds of the country's economic engine. With unemployment claims skyrocketing — although many may be temporary — and consumers staying in their homes, a weakening economy is no surprise. The $2.4 trillion stimulus package may help support some levels of consumer activity, but wage stagnation and employment uncertainty are likely to keep many consumers in a frugal mindset.



Source: Department of Labor

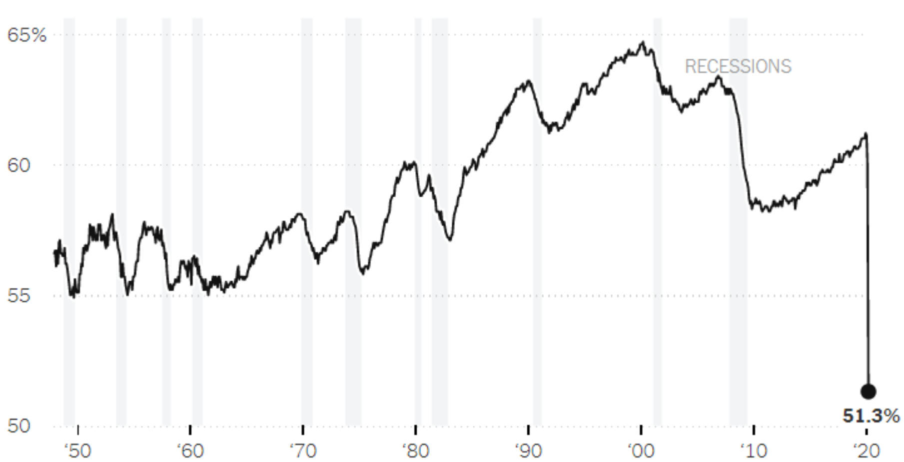
The American economy plunged deeper, losing 20.5 million jobs as the unemployment rate jumped to 14.7 percent, the worst level since the Great Depression. Unlike the Great Recession, the Great Shutdown has accelerated what would normally take months to play out. The one bright spot is that nearly 80 percent of the unemployed said they had been temporarily laid off and expected to return to their jobs in the coming months.

Share of unemployed on temporary layoffs



Source: Department of Labor

Share of the population that is employed



Source: Department of Labor

Point of View: This will be a consumer recession impacted by stubborn unemployment. While this recession is motivated by a pandemic-driven government shut down of the economy – and not by an underlying financial weakness – the effects may be the same. Dropping workers off of payrolls is much easier than the transaction cost of putting workers back on. If the "temporary" furloughs and layoffs result in a quick return to

employment and the trillions of dollars of government stimulus do their job, we may see a relatively mild recession. But neither of those factors can be assured at this time.

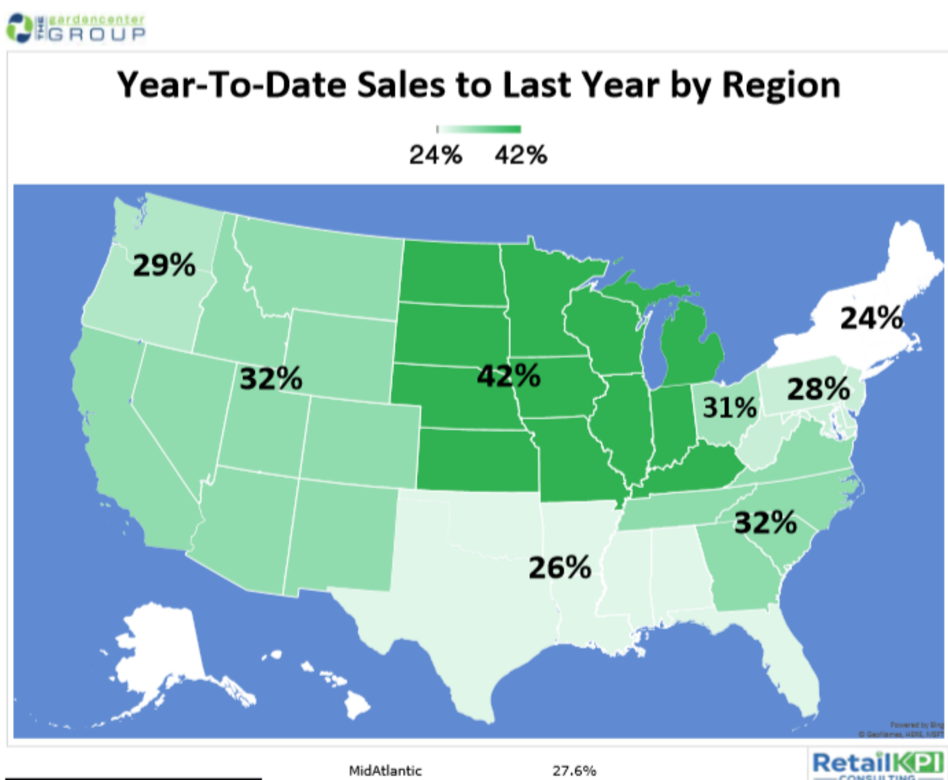
Consumer Spending: "A record year!"

What is driving consumption of horticulture products and is it sustainable? Across the economy, just about anything used at home is seeing a lift (residential cocooning). Home improvement retailers are up 25% on the year. Home appliances, technology, landscaping, bicycles, etc. are all being purchased. Psychologically, our needs have changed from commuting to work to working at home, multi-tasking while caring for the kids. Economically normal expenses for durable goods are way down, allowing more discretionary income and fewer places to spend it. There is little-to-no spending on childcare, gasoline, eating out, routine health care, haircuts, clothes, sporting events, travel, and big ticket items – they were all affected by the shutdown.

How good has it been for retail sales in our industry?

Through June 21st (week 25) the Garden Center Group is reporting (vs Last Year):

- YTD Sales are up +30.4%
- Average Sale YTD is up +14.0%
- Transaction Counts YTD are up +15.3%



MidAtlantic	27.6%
Midwest	41.6%
Mountains West	31.8%
Northeast/Nova Scotia	23.7%
Northwest/British Columl	29.3%
Ohio	30.8%
South	25.9%
Southeast	32.1% .

Questions or Comments?
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Chris Beytes at Ball Publishing (Acres Online, Grower Talks, Green Profit) has been reporting similar numbers all season with all US Regions and Canada reporting strong sales. While the statistical validity of this survey would not meet academic journal standards due to the convenience sampling format of the survey, it does provide anecdotal data about how the season is going. Some of the industry comments Chris captured throughout the season were almost too good to be true!

Examples of these comments from June 14th:

> *Virginia: "We are not open Sunday, but if you compare the Friday and Saturday from last year, we had great days—50% to 100% higher sales!—Ray Shank, Strawberry Acres*
>
> *Oklahoma: "With everyone staying inside, they started looking out at yards that have been neglected for years. Yards look great this year!"—Naomi Starkenbaum, Sanders Nursery*
>
> *New Hampshire: "We never cut back our spring planting. In addition, we leased some extra space on another property and crossed our fingers. Sales have never been this strong at wholesale. Our biggest customers in the Boston area were slow to start due to the governor's shutdown and once they opened, it appears they made up for those short-term losses. Now, what will happen next year?! So, yes, we still have product to sell and we will have product every week. The difference is that our availability gets chewed up every Monday morning!"—Doug Cole, D.S. Cole Growers*
>
> *New Hampshire: "Another Saturday that felt like if it wasn't nailed down, they'd buy it."—Beth Simpson, Rolling Green Nursery*
>
> *California: "About 25% lower than the peak two months ago. Even then, Saturday's sales were higher than any other day during the last five years."—Rigo Hernandez, Green Hills Nursery*
>
> *Kansas: "Still going very strong, even with the hot temperatures."—Kathy Miller, Sedan Floral*
>
> *Virginia (9): "Another super weekend; we did a three-day sale of all odds and ends and overstocks, all promoted on our social media page. Each morning we showed pictures of new plants featured for the day. We had many customers that returned all three days. Some called friends from the sale to tell them to come on in. Many add-on sales, and because most of the items were things we had raised, our profit margin remained at 54%. We got rid of a lot of items we did not need to water and care for thru the summer. Great promotion!"—Mark Landa, Boulevard Flower Gardens*
>
> *North Carolina: "Nice, sunny day. Getting very low on hanging baskets, no geraniums left, no fern hanging baskets left and getting low on annuals. Best day ever for this time of the year. Have restocked on shrubs and roses. Have grown more veggies from seed and perennials from plugs. Still getting new customers and others just now getting out."—Judy Mitchell, Mitchell's Nursery & Greenhouse*
>
> *Iowa: "Good weather, nice and steady traffic. Our state is back open 100%, so we are seeing a return to the Sunday morning church lull and then getting busy after lunch. Perennials and shrubs are all the rage right now! Would still be selling tons of annuals if we weren't sold out of most of them."—Kate Terrell, Wallace's Garden Center*
>
> *Idaho: "Weather was less than ideal—wind mostly. With the state opened up completely now, the floodgates seem to have shut down a bit. Still, we continue to do more than last year each week."—John Crook, Town & Country Gardens*
>
> *Wyoming: "At this point, it is irrelevant if anyone comes in at all. Anything now is just the most awesome frosting on the most amazing cake! Still have annuals, baskets, perennials, shrubs and trees to last through the summer."—Jeff Jones, Great Gardens*

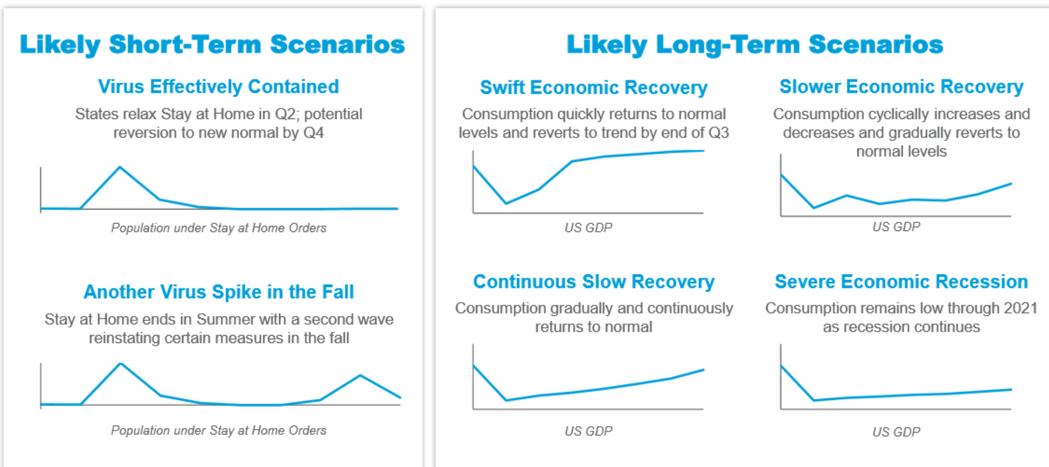
It is important to note, however, that this strong pattern of lawn and garden-related consumption follows the trend of every recession prior to now. There is always a lift in sales associated with consumers staying at home more. An equally documentable fact is that sales of lawn and garden products often decline slightly as the recovery begins and consumers start shifting expenditures back towards durable goods and the other aforementioned items.

Point of View – Recent consumer demand has been driven by psychology as much as economics. While we will likely see some consumers establish new consumption patterns with horticulture products and services, don't expect to see 25% growth next year – and we will likely trend back toward 2019 numbers +/- 10%. The "work from home" and "residential cocooning" phenomena will likely continue for many in our economy,

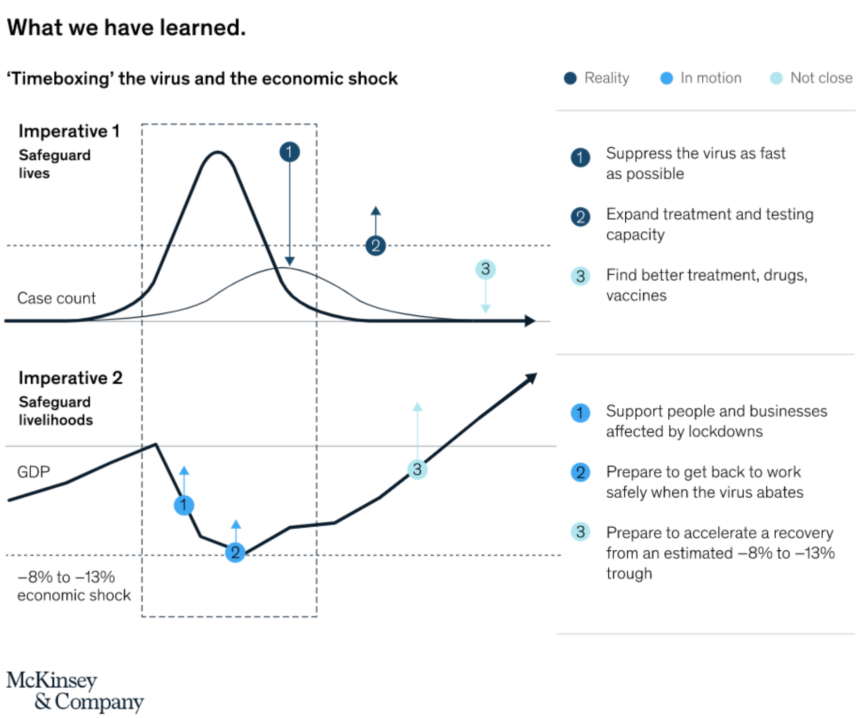
but children back in school, landscapes redone, and a return to "normal" family and social activities may affect the time allocated to yard and garden projects.

Recovery: What "shape" will it take and what will drive it?

Our economy, as indicated by consumer sentiment and the stock market, is showing resilience in the face of continuing economic concerns, public health crisis, social unrest, and political divisiveness. But it's difficult to see how we can count on containing the virus and a swift economic recovery.

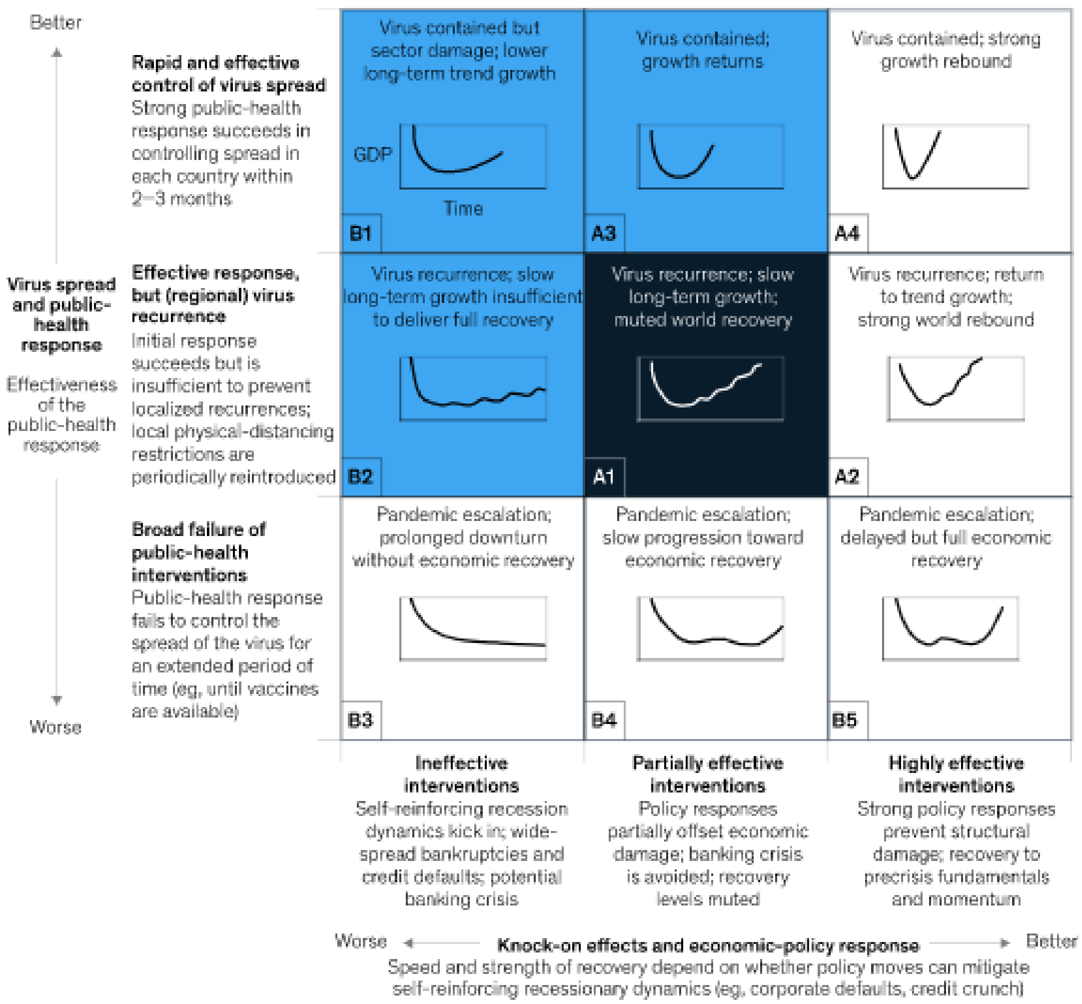


McKinsey & Company recently released a forecast based on several scenarios regarding the recession and the shape of the recovery. These are provided below.

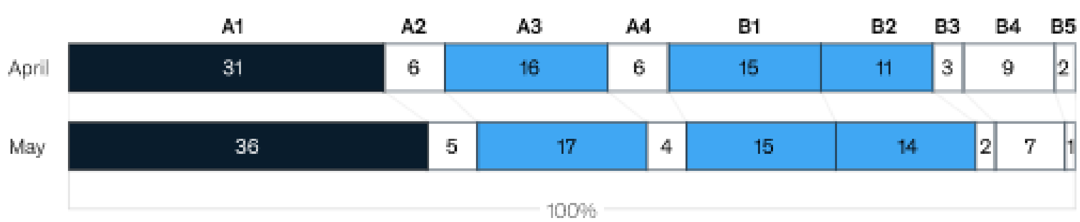


Executive uncertainty about the COVID-19 crisis.

GDP impact of COVID-19 spread, public-health response, and economic policies



Most likely scenario, % of respondents



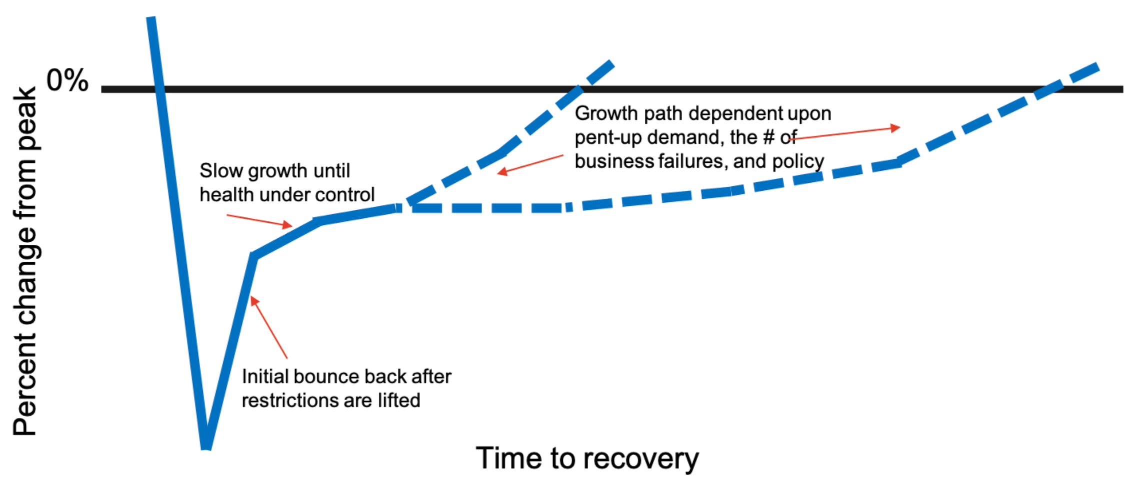
Note: Figures may not sum to 100%, because of rounding.
Source: McKinsey survey of global executives, n = 2,079

McKinsey & Company

In the latest issue of GrowerTalks, Charlie Hall provided his own perspective of the shape of the recovery:

As I write this essay, the US is in the process of reopening from the Great Shutdown brought on by the COVID-19 pandemic, with many hopeful that better times are ahead as the economy wakes up from its forced slumber. Many businesses are resuming limited operations and recalling workers and many consumers have ventured out for the first time in months and begun the process of rebuilding the economy one exchange at a time. But they do so with greater attention to personal space, some wearing masks and gloves, and even subjecting themselves to thermal imaging, antigen testing, and contacts tracing. These and other measures that were taken to flatten the COVID-19 curve will likely have long-lasting effects on consumer interactions and purchasing behavior.

I'm afraid, however, that the economic recovery from this recession will likely be much slower than many want to believe. As more economic data became available throughout spring, I found myself changing my own projections about the "shape" of the recovery almost weekly. I no longer expect the recovery to resemble anything like a "V-shape" or a "U-shape," nor do I expect it necessarily to be an "L-shaped" or "hockey stick" recovery like we saw after the Great Recession. Instead, it will likely be characterized by the initial sharp drop that we have already experienced, followed by a sharp bounce back to a "higher-but-not-back-to-normal" level, and a slightly upward sloping recovery after that, with the steepness of that slope dependent on demand factors, supply chain effects, and policy influences.

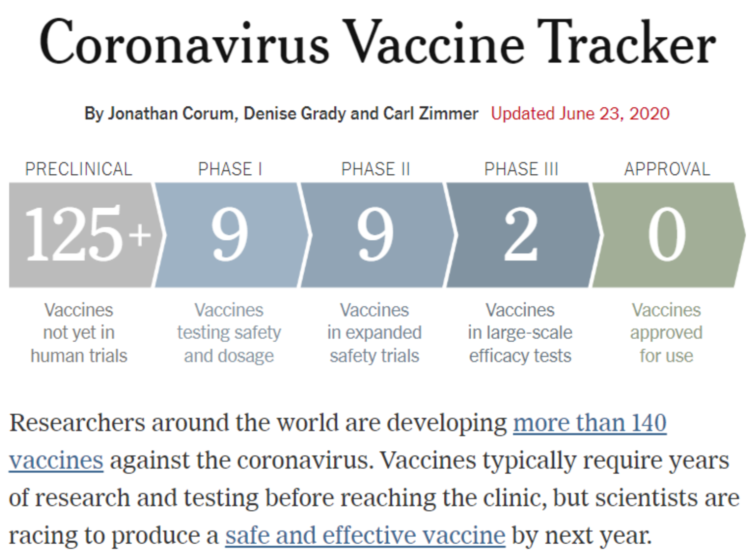


Consensus expectations have now converged on the view that US GDP will not exceed pre-COVID levels until sometime between 4Q 2021 to 2Q 2022. The nonpartisan Congressional Budget Office (CBO) recently released new analyses estimating that US GDP would not recover to its prior peak until 3Q 2022. The CBO now expects the economy to contract at a 37.7% annual rate in 2Q 2020, then projected to rebound at a 21.5% annual rate in 3Q 2020, which would be the strongest quarter ever recorded. That pattern would fit my own projection stated above.

There is obviously a lot of uncertainty surrounding all of this forecast. The drop could be steeper or not as steep. The rebound could be faster or slower. GDP could be far below trend by late 2021 or it may be above trend. However, the general pattern (sharp decline, partial upswing, then gradual recovery) seems the most likely result, with the uncertainty revolving around the length of the gradual recovery stage.

No matter which scenario ultimately emerges, the economic cost of the coronavirus crisis will be unprecedented. Even a moderately favorable scenario could result in a global GDP decline from 2019 of $4 trillion to $5 trillion. The toll on individuals, in lost jobs and income, will be equally severe.

Vaccines and treatments – Intuitively, getting the virus under control will allow our society and economy to get back to normal. While there are several promising efforts on both fronts, there is no quick fix. If a "second wave" of the virus emerges, an effective treatment will be critical. Several treatments are in clinical trials that reduce the symptoms and duration of the virus. Gilead Sciences *remdesivir* is the treatment that has shown the most promise to date.



Housing Starts and Home Sales – A relatively strong recovery in housing starts and home sales bodes well for the 2021 season. Sales in home improvement stores are up 25% YoY and home remodeling projects are strong. In addition, mortgage rates are holding at historically low rates making for a reasonably strong housing market (new and resale).

Builder confidence in the market for newly built single-family homes jumped 21 points to 58 in June, according to the latest NAHB/Wells Fargo Housing Market Index (HMI). Any reading above 50 indicates a positive market.

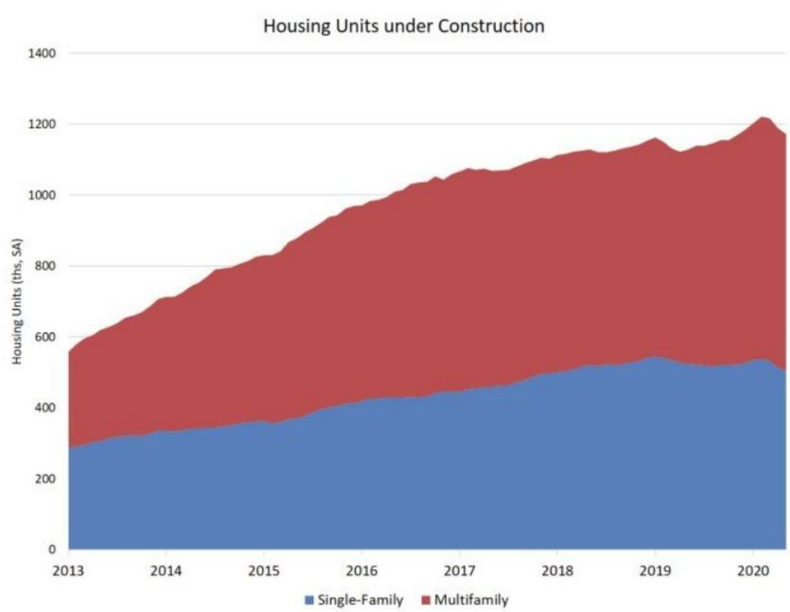
Derived from a monthly survey that NAHB has been conducting for 30 years, the NAHB/Wells Fargo HMI gauges builder perceptions of current single-family home sales and sales expectations for the next six months as "good," "fair" or "poor." The survey also asks builders to rate traffic of prospective buyers as "high to very high," "average" or "low to very low." Scores for each component are then used to calculate a seasonally adjusted index where any number over 50 indicates that more builders view conditions as good than poor.

All the HMI indices posted gains in June. The HMI index gauging current sales conditions jumped 21 points to 63, the component measuring sales expectations in the next six months surged 22 points to 68 and the measure charting traffic of prospective buyers vaulted 22 points to 43. Looking at the monthly average regional HMI scores, the Northeast surged 31 point to 48, the South jumped 20 points to 62, the Midwest posted a 19-point gain to 51 and the West catapulted 22 points to 66. There were 669,000 multifamily units under construction in May, a slight decline from April (675,000). But this total is 10% higher than May of 2019.

Two comments from NAHB representatives support the optimistic outlook for housing:

> *"As the nation reopens, housing is well-positioned to lead the economy forward," said NAHB Chairman Dean Mon. "Inventory is tight, mortgage applications are increasing, interest rates are low, and confidence is rising. And buyer traffic more than doubled in one month even as builders report growing online and phone inquiries stemming from the outbreak."*
>
> *"Housing clearly shows signs of momentum as challenges and opportunities exist in the single-family market," said NAHB Chief Economist Robert Dietz. "Builders report increasing demand for families seeking single-family homes in inner and outer suburbs that feature lower density neighborhoods. At the same time, elevated unemployment and the risk of new, local virus outbreaks remain a risk to the housing market."*

We expect the current undersupply of houses and the pent-up demand brought on by sheltering in place to converge and become an increasingly important economic force. At the same time, housing affordability is improving, mortgage rates are lower, and other forms of debt service remain manageable by historical standards. But we are keeping a watchful eye on housing prices which are slowly creeping up on pre-Great Recession levels.



<u>Elections, taxes and policy</u> – Elections matter and the outcomes in November 2020 will be as impactful to our businesses and industry as any we've seen in recent times. Social issues, economics, public heath, immigration, government assistance, education, foreign affairs, First and Second amendments, and many other issues could be impacted and may impact the shape of the recession recovery curve.

Faced with this historic health and economic challenge, Congress came together to achieve a $2 trillion stimulus package, including a $1,200 onetime payment for most adults and $500 for many children, a radical expansion of the unemployment-insurance system to include gig workers, and a $600-a-week bump to unemployment-insurance payouts. It also created a sweeping small-business rescue plan, covering payroll for companies that kept their employees on the books.

But not everyone will be affected by it equally. “Do-anywhere” office jobs, have remained relatively stable by job and earnings losses thus far. Front-line and service workers have experienced the heaviest employment and earnings losses. Income and job losses for them translate into a loss of demand economy-wide, absent additional federal intervention. The CBO forecasts that every quarter through the end of 2021, American consumers will buy $300 billion to $370 billion less than they would have if the pandemic had never happened.

This steep decline in consumer spending could hasten business failure. The Paycheck Protection Program and other federal initiatives helped businesses through a short, intense disruption, though the economy is expected to remain sluggish for months. Many businesses will fail, if customers fail to return.

On top of that, numerous businesses—airlines, restaurants, live-events businesses, hotels, private schools, oil and gas companies—face severe and stubborn slumps. Students are not willing to pay as much for online learning as in-person instruction. Companies are not financing travel to conferences and sales meetings. Concerts and festivals are not expected to restart until scientists develop a coronavirus vaccine.

There will be a budget crisis facing states and cities. The federal government does not have to balance its ledger year to year, but just about every state and most cities are required to remain in the black. Sales taxes, real-estate-transfer taxes, income taxes, fines and fees—they are all declining, leaving local governments with a budget gap expected to total $1 trillion next year. Without help from Washington, this could result in service cuts and job losses.

These factors will likely weigh heavily on the November elections.

With respect to Congress, it’s nearly certain that the House of Representatives will remain under control of the Democrats. It takes 218 seats, a simple majority, to control the House. Combined polling suggests 223 seats rated safe, likely, or leaning Democratic. Another 19 are rated as tossups.

The Senate is right on the bubble. With one-third of the Senate up for reelection, polling suggests 50 seats to Republicans, and 46 seats for the Democrats, with four battleground races rated as toss-ups (Arizona, Colorado, Maine, and North Carolina). No matter the outcome, the party with the majority will have a razor-thin margin.

And the Presidency? Though a lot can change quickly, polling (June 2020) suggests it is Joe Biden with the edge. The most recent Politico/Morning Consult poll had President Trump’s approval rating dipping to 39%, and disapproval rating at 59%. By contrast, former Vice President Joe Biden had a 46 percent approval rating against 47 percent disapproval.

There are five states -- Arizona, Florida, Michigan, Pennsylvania, Wisconsin -- where Trump won in 2016 by razor-thin margins. Midwest states will be key; if Trump loses one of them, especially Biden's home state of Pennsylvania with 20 electoral votes, the path to 270 electoral votes needed to win becomes difficult.

Implications for Policy: A few thoughts on what a Biden victory might mean for relevant policy issues. Some will depend on to what degree Biden is able to chart a centrist course in the face of a growing and increasingly restive group of progressives well to his left.

Immigration, Visas, and Labor: If Democrats take a bipartisan path on this, we could see real opportunities for immigration and visa reform like we saw in the House last year. That will require appeasing or overcoming labor union opposition.

Tax and Wages: We would expect to be playing defense on most tax issues, though Democrats know they have to deepen their support particularly in the small business community and in rural areas. A national minimum wage increase would seem a virtual certainty.

Regulation: Environmental and labor regulation will likely increase, as Democrats would be looking to bring back some of the regulations the Trump administration rolled back.

Climate Change: A serious focus on climate policy could mean both challenges and potential opportunities for our industry. It is certain to be a priority for the Democrats.

Intangible Effect: Investors and business loathe uncertainty. Would a Biden victory bring a more stable, consistent, predictable presidency?

Regardless of election outcome, we will continue to rely on several key Congressional champions to help achieve our policy goals. Between now and November, our PlantPAC political action arm will be leveraging support for those who in turn support Horticulture.

Point of View: Government stimulus and a relatively strong economy before the pandemic will soften the blow and help the economy recover. But don't expect a "V shaped" recovery. Locking down the economy for two months may have lingering effects for two years. Consumer and business spending will be uneven at best and the full impact of unemployment and business failures won't be known for several months. Containment of the pandemic, vaccine/treatment, government stimulus and the November elections will all impact the rate and shape of the recovery. Keep an eye on housing starts and the outcome of the November elections to help gauge factors aiding an economic recovery.

Business Owner: What to watch for and how to plan

Strong consumer demand this season was a welcome surprise. If a small business owner met or exceeded their 2020 operating plan, that's probably a good place to start for 2021. But expect continued higher operating costs from worker and customer safety requirements. Health care costs – both direct and premiums – will likely climb. Perhaps not in the short term, but in the medium term the influx of government stimulus, strain on the energy sector, business closures and constrained/consolidated supply chains may result in a level of inflation for input materials and services, as demonstrated in the most recent Index of Prices Paid by Growers (available on the AmericanHort Knowledge Center website).

The revenue increases this season reported by both growers and garden retailers were not likely a result of additional production – although some growers may have planned some expansion and made in-season adjustments. But a significant amount of the revenue growth was a result of less product shrink and limited supply chain discounting. Driven by need and potential market constraints, growers and retailers utilized better coordination and supply chain communication to manage shipments and inventories resulting in optimized performance. The industry demonstrated that consumers will pay a fair price for horticulture products and retailers don't need to be timid about the price and value of our products.

COVID-19 not only exposed deficiencies in the US economy, it demonstrated how susceptible business supply chains and healthcare are to a single point of failure. Just as the country's reliance on foreign oil producers in the 1970s helped to spur the creation of domestic energy production, we would expect the issues associated with a "just-in-time" global supply chain to catalyze changes and spark significant domestic supply chain-related investment. The virus will also accelerate the adoption of B2B and B2C e-commerce technologies, remote working, and strategic omnichannel relationships.

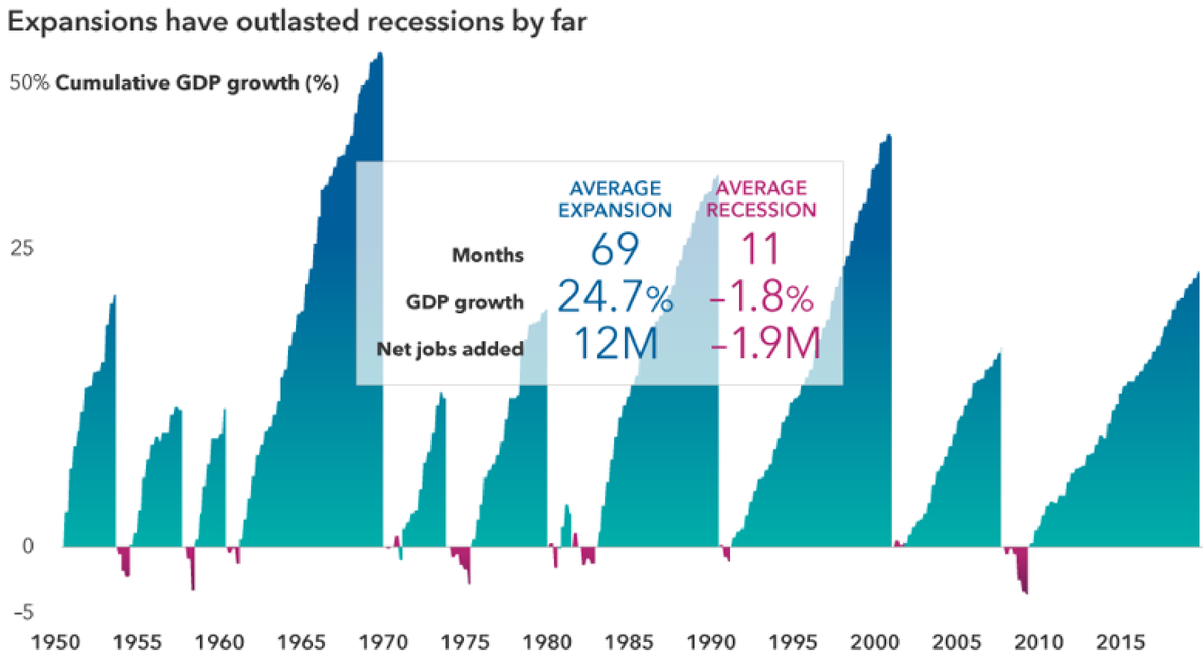
Business owners would be wise to be prepared for a "downside" scenario by carefully managing debt, aggressively managing working capital (inventory, shrink, AR/AP), and keeping a close eye on fixed and variable cost increases. Labor will continue to be an issue. The H2A program seems safe at this time, but our entire industry will be impacted by reduced H2B workers in landscape. Even though unemployment may remain high, don't expect a large pool of workers or lower labor costs.

Although credit requirements will tighten, interest rates will be very attractive for the next year. Now might be a good time for borrowing to implement labor or efficiency projects with relatively safe return economics. Given the uncertain economic environment, borrowing for expansion should be carefully aligned with high probability market opportunities (ex. growth to support expansion of a "big box" contract).

Point of View: Slow and steady wins this race in 2021. Consumers "staying at home" have demonstrated they will buy our industry. A strong economy before the pandemic and government stimulus during, created an economic environment that gave consumers the reason and resources to purchase plants. With high unemployment and a lingering recession, there are no similar guarantees for 2021. While there are no signs that suggest our industry should pull back from the plan entering 2020, extrapolating 2020 final results to 2021 might prove to be a bit aggressive. Strong pricing and revenue growth can be achieved with careful management of product shrink and limiting discounting in season. Moderate growth projections with sound cost and cash management will be necessary for 2021.

<u>Future Assessment:</u>

The good news is that historically recessions generally haven't lasted very long. While this time may be different, looking at 10 cycles since 1950 shows that recessions have ranged from eight to 18 months, with the average lasting about 11 months. For those directly affected by job loss or business closures, that can feel like an eternity. The average expansion increased economic output by 25%, whereas the average recession reduced GDP by less than 2%.



Sources: Capital Group, National Bureau of Economic Research, Refinitiv Datastream. As of 12/31/19. Since NBER announces recession start and end months rather than exact dates, we have used month-end dates as a proxy for calculations of jobs added. Nearest quarter-end values used for GDP growth rates. GDP growth shown on a logarithmic scale.

However, we've not seen an economic environment like this. While it's encouraging that retail sales rose 18 percent in May, and the economy added 2.5 million jobs, there are a few big risks lurking in the shadows.

Lastly, now is the perfect time for firms in the industry to convey a strong value proposition to their customers. That value proposition must not only include the favorable points of differentiation of their respective businesses but must also include value statements about the "why" undergirding the reasons people buy flowers and plants and landscapes to begin with. We find ourselves in the midst of economic turmoil brought by a health crisis. We just happen to produce products that enhance the physiological and psychological health of humans across the world. Four recent articles by Chief Economist Charlie Hall documents these results in detail in HRI's Journal of Environmental Horticulture (available on the HRI website). Any messaging by green industry firms must focus on the "why" and include these benefits. We own our own narrative; it's up to us to emphasize it.