When will this bubble burst?

The Congressional Budget Office (CBO) reported in January that two factors to watch as major potential limits on the economy's growth are labor availability and a slight pickup in interest rates. It also anticipates some drop in consumer spending and investment, as well as a slower rate of growth for the stock market.

"The U.S. labor market is unsustainably tight," says the report, which also sees no remedy in sight.

It's going to be a real sellers' market for labor, CBO says, predicting an increase in wages and compensation as employers compete head-on for good workers. This will eventually affect interest rates (along with several other factors).

As for interest rates rising, the CBO forecasts "increasing upward pressure," which sounds more like a weather report than an economic forecast. Just for good measure, the CBO compares its forecasts to an average of those prepared by 40 to 50 "Blue-chip" private—sector economists.

What's this mean for the next year? LM's take is not to worry too much. Even the somewhat gloomy CBO has

this to say about the next 10 years (through 2009):

▶ Gross domestic product will grow an average of 2.3% per year.

▶ Unemployment rises to only 5.7% after 2001.

▶ Short and long-term interest rates inch up after 2001 (but not too high or too fast).

In other words, expect a little less borrowing power, a little less ROI from the stock market, a few more price rises and continuing difficulty finding labor.


Alan Steiman

"Soft landing scenario" is the way CBO forecasts the future. That sounds a lot better than any "hard landing scenario."

What's limiting growth?

We asked respondents to our survey to list the key factors limiting their growth from 1998 to 1999, as well as services they're planning to drop. Here's what they said:

▶ **Labor availability** was the overwhelming factor limiting their organization's growth, said 43.6% of respondents. This seemed to hit mid-size organizations the worst — 53.6% of small companies ($100,000-$500,00) and 53.6% mid-size ($500,000 to $1 million) companies said labor availability was their major headache. In contrast, only 22.2% of large firms (>$1 million) and 36.4% of the smallest firms (<$100,00) ranked it number one.

Highest geographical need for labor apparently is felt by firms in the Midwest (54.3%), followed by the Northeast (43.2%) and the West (42.1%).

But, putting a lot of bodies on the payroll is not the ultimate goal of any company—being profitable is that goal.

Alan Steiman, owner of Alan Steiman's Landscape Inc., Northboro, MA, says 10 years ago he employed as many as 40 people during peak season, and his company lost money. Now, with 12 employees, it's profitable. And Steiman is content to keep it from growing too large.

▶ **Ability to get good supervisors/foremen** also ranked high overall, with 38.4% reporting this as another limiting factor. Mid-size companies ranked this much higher than other firms — with 58.% noting its importance. Small firms also had problems here, with 42% ranking it important. Only 38.9% of largest firms and 25% of the smallest firms ranked this a limiting factor.

If you're a supervisor, head to the Northeast, where 46.2% of the firms noted this is a problem, followed by the West (41.2%), South (37.1%) and Midwest (30.3%).

▶ **Unfair pricing and low-ball/competition** also ranked as important with 25.4% of the respondents. This situation obviously hurts the smallest firms most, with 33.3% noting a problem, followed by those ranging from $100,000 to $500,000 (25.5%).

Contractors in the Northeast seem to have the most problem with this type of competition, because 30.2% cited it a problem, followed by 23.3% in the South, 23.1% in the West and 21.9% in the Midwest.

Business inhibitors

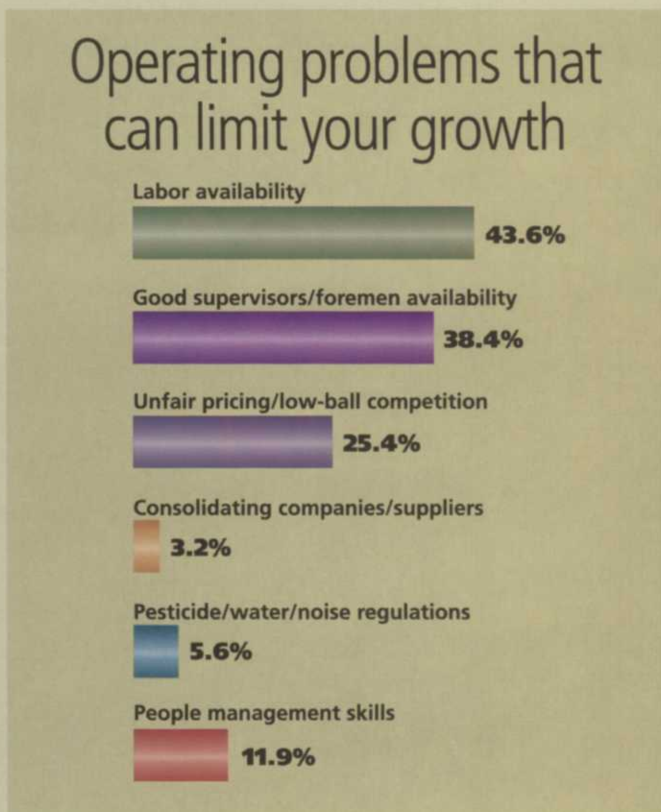
Other factors that clearly inhibited some contractors' business from 1998 to 1999 include bad weather (51.6%), labor quality (51.6%), more competitors (31.7%), plant material availability (18.3%) and their own business management skills (18.3%).

It may be lowball competition or property managers' own pressure to perform at a higher level of profits, but many landscape maintenance budgets remain somewhat tight.

Walfrido Verendia, grounds manager at Pepperdine University, Malibu, CA, sees continuing budget pressure forcing him to try and maintain the landscape with less resources. "Our budget is shrinking and we have to do more with less. This means less color, less manpower and no extras."

Verendia has found some solutions through outsourcing, particularly installation of landscape areas, installation of irrigation equipment, renovation of the soccer fields and renovation of gullies on the property.

Although most contractors we contacted are keenly aware of their competition, they also



see plenty of new opportunities developing from their markets and even from their competitors' moves.

David Daniell of Heads Up Landscape Contractors in Albuquerque, explained: "Our main design/build competitor has dominated his segment of the market by extremely successful marketing and aggressive pricing. However, they are beginning to be victims of their own success, providing opportunities for us."

Survey respondents continue to feel the pinch of lowball competition and "unethical" players. Cathy Clark, Clark Lawn Service, Indianapolis, IN, remarks, "We need more licensing and registry requirements to make the lowballers play on the same field regarding insurance, zoning regulations and tax responsibilities!"

Consolidation drives changes

The effect of consolidation as a factor limiting company growth is not considered very important; in fact 59% considered it to be least important. That isn't to say that there isn't some effect, but most businesses seem confident that they can define a niche or expand on a service.

Dale Amstutz of Northern Lawns, Omaha, NE, sees increased competition as an issue because some of the new smaller businesses are offshoots of consolidated companies.

"People leave and start their own businesses. Some know what they're doing, some don't and some don't know how to bid," he says. "While four to five applications are standard, some businesses are doing them in seven or eight so that comparisons of cost per treatment looks better, even though the actual cost for the season is similar."

Customer turnover is one of the costs of high competition, says Amstutz. "We lose a certain amount each year — but a lot come back." He reports an annual customer retention rate of +85%, with an estimated 2% returning after they've tried someone else. Offering tree care to non-lawn customers is one option he's moving into, with good return.

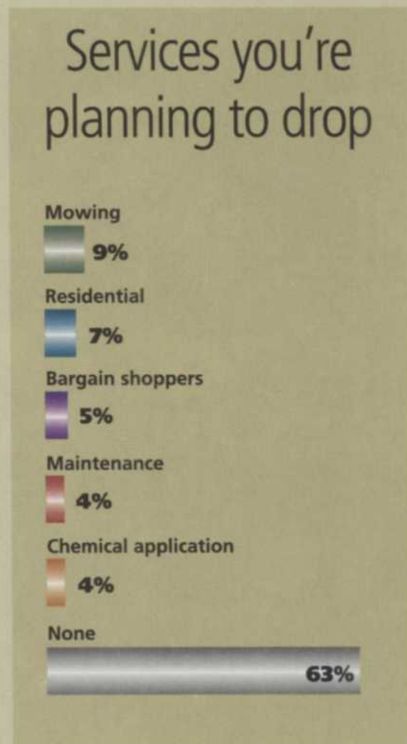
Dale Amstutz

Another new service Amstutz is offering is outdoor structural perimeter pest control. And he's confident — an important characteristic to compete in this business. 'Who does work as good as you do in your market,' we asked? "No one," he stated firmly.

Big isn't better for Scott Carlisle either. He's manager of Valley Landscape & Maintenance, Boise, ID. Referring to his two larger lawn care and maintenance competitors, he says, "This can be a positive for guys like me. They tend to lose the personal touch."

Many industry professionals feel unaffected by the moves of the giant consolidators, since they are not direct competitors or even service the same segments of the market. But they may feel more competition in the future because of consolidation, predicted Stu Mayer, Sunburst Landscape, Cranberry Township, PA. The consolidations "affect a small percent of the total market. A large quantity of middle managers are going to be unemployed or self-employed after (the consolidators') systems are integrated. Look at other industries merging like banking. This will be the next result."

The industry's consolidation may involve giant firms, but even Carlisle feels its effects. Before TruGreen-ChemLawn bought PermaGreen (another local lawn care firm), Carlisle relied on them to do his chemical application work. Now, things are different. "We're starting to do chemical applications. We subcontracted all our chemical work to PermaGreen and (at the time) they didn't do mowing. Now, they're mowing."



Many contractors and grounds managers also feel the effects of supplier consolidation. Verendia explained that supplier consolidation means less service for his grounds management operations. In his case, the supplier also provided field maintenance of irrigation equipment.

Services to drop

While this decision depends more on an individual company's business profile and customer mix, we did see some similarities in services contractors plan to drop for 1999 or 2000 (63.2% plan no drop in services):

▶ Mowing services will be dropped by 8.8%; primarily by companies ranging from $100,000 to $500,000 (12%). Respondents from the Midwest

(13.3%) and Northeast (11.1%) seem to find this more frustrating and plan to drop.

▶ Only 3.7% plan to drop maintenance (highest was companies between $500,000 and $1 million with 7.7%).

▶ Chemical application may be dropped by a small portion of the market also, with 3.7% opting for this.

As for customers, 7.4% of survey respondents plan to drop residential customers from their list, while 5.1% of the contractors will get rid of those pesky bargain shoppers and slow-paying clients.

'What ifs' keep life interesting

Who doesn't wish for a crystal ball, or at least a game plan if things go south? It's not unheard of for dramatic events (economic or otherwise) to turn a market around. But even the experts are not forecasting the possibility of anything dire.

Sure, interest rates may inch up more quickly than expected or foreign events may eventually affect the balance of payments. If the economic boom starts to affect the landscape industry, it won't be without warning. Unemployment claims will jump, construction starts will slow, interest rates will climb and disposable income will get tighter.

As for some quick fallout of the market, that seems unlikely right now. This high-flying cycle is built on unprecedented consumer confidence in their investments and in the system, and that may take quite a while to shake. **LM**

Consumer Confidence Counts

The economy's (and the landscape industry's) growth depends in large part on the confidence that consumers continue to have. Their outlook on investing in stocks, buying and building new homes and their ability to pay for professional landscape services is a key factor to watch. Two studies in particular indicate continuing (but not so strong) growth for professional landscape services.

▶ The Outdoor Power Equipment Institute (OPEI) predicts that fewer commercial intermediate walk mowers will be sold in model year 2000. The sales of commercial riding mowers should remain constant. The OPEI bases its projections on fewer housing starts and sales of existing single-family homes in the coming months, as well as the University of Michigan's continuing studies of consumer confidence.

Their trends show a reduction in the sales of commercial walk-behind mowers, but a 5% jump in sales of commercial riding mowers this year. Then, trends for housing and mower purchases show a slight slowdown going into the year 2000.

COMMERCIAL MOWER PROJECTED SALES

	Model Year 1997	1998	1999	2000
Commercial intermediate walkers	48,300	49,700	48,399	48,300
Commercial riding mowers	52,400	65,100	68,226	68,585

SOURCE: OPEI

▶ The annual Gallup survey of American homeowners using professional landscape and lawn care services also projects growth in some areas and declines in others. Maintenance for landscape and lawns in 1998 showed a hefty 32% increase over services in 1997, and total spending for landscape services jumped $2.2 billion. The big winner in this survey was landscape installation and construction services, which grew an impressive $2.7 billion alone.

But landscape design services dropped off by $100 million and tree care lost even more in revenues — $700 million (leaving the overall total of growth to $2.2 billion). And while the survey showed an amazing 48% increase in the average amount spent per household, it also showed a significant decline in the number of households using these services. Is this statistically meaningful? It may be too soon to make any assumptions, but the drop in some service areas and loss of customers should definitely be watched.

The survey is sponsored by the American Nursery & Landscape Association, the International Society of Arboriculture, the Associated Landscape Contractors of America, the Professional Lawn Care Association of America, the National Arborist Association and the National Gardening Association.

U.S. HOUSEHOLDS USING PROFESSIONAL LANDSCAPE SERVICES (IN MILLIONS)

	1997	1998	Change
Landscape/lawn maintenance	14.3	13.7	- 600,000
Landscape installation/construction	2.0	2.4	+ 400,000
Landscape design	1.1	1.2	+100,000
Tree care	5.6	4.1	-1,500,000
Total	23.0	21.4	-1,600,000

SOURCE: GALLUP SURVEYS