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

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Key Issues:

- Consumer Spending: “What Just Happened?”
- The Split Economy: Employed Consumers and Homeowners.
- Recovery: What to expect and the impact of the election.
- Business Owner: What to watch for and how to plan.
- The best is yet to come.

2020 Soundbites:

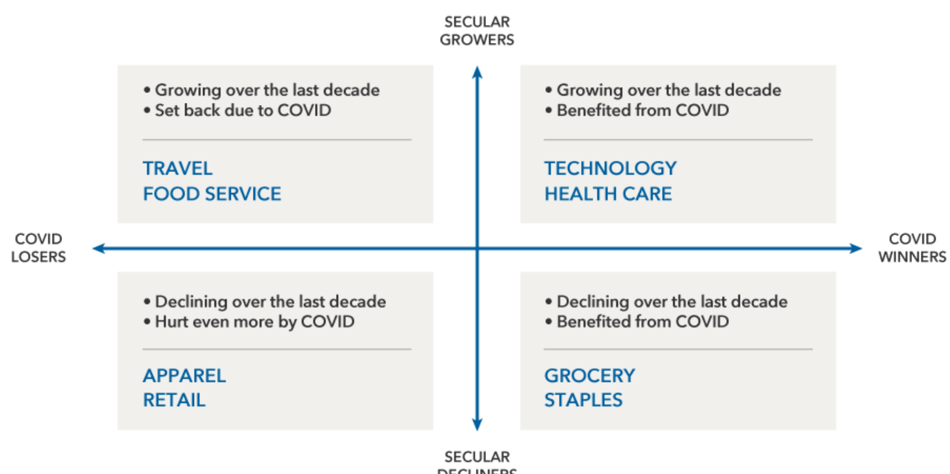
“The virus is the economy.”

“All economic growth forecasts depend on the trajectory of the virus — whether it gets better or worse, whether we can develop an effective vaccine and whether government stimulus measures will continue to help bridge the income gap for workers who have been displaced by this unprecedented downturn.”

Consumer Spending: “What Just Happened?”

Prior to the pandemic, consumers were spending on travel, dining, healthcare, and technology while consumer staples and traditional shopping were flat. One element of the 2020 downturn is how uneven it’s been. For some areas of the U.S. economy, it has reached Depression-era levels: restaurants, hotels, many retailers, airlines and, perhaps the hardest hit of all, thousands of small businesses that have closed and may never come back. But for others, it has been quite literally the best of times: e-commerce, cloud computing, video streaming, and home improvement stores have skyrocketed in the stay-at-home era.

Winners and losers in the COVID economic downturn



Source: Capital Group.

As a general category, “home improvement” is bundled with the “COVID winners” showing a 15% year over year growth at the end of August. With travel and outings curtailed or avoided, home-based activities and projects took center stage with consumers. Home improvement stores benefited from the surge with record sales of appliances, home project essentials, and gardening and landscaping materials.

Sources: Refinitiv Datastream, U.S. Census Bureau. As of 8/31/20. COVID-resilient retail includes e-commerce, health & personal care, grocery, alcohol and home improvement. Top and bottom retail industries do not include those that had not reported 8/31/20 sales growth as of 10/7/20.

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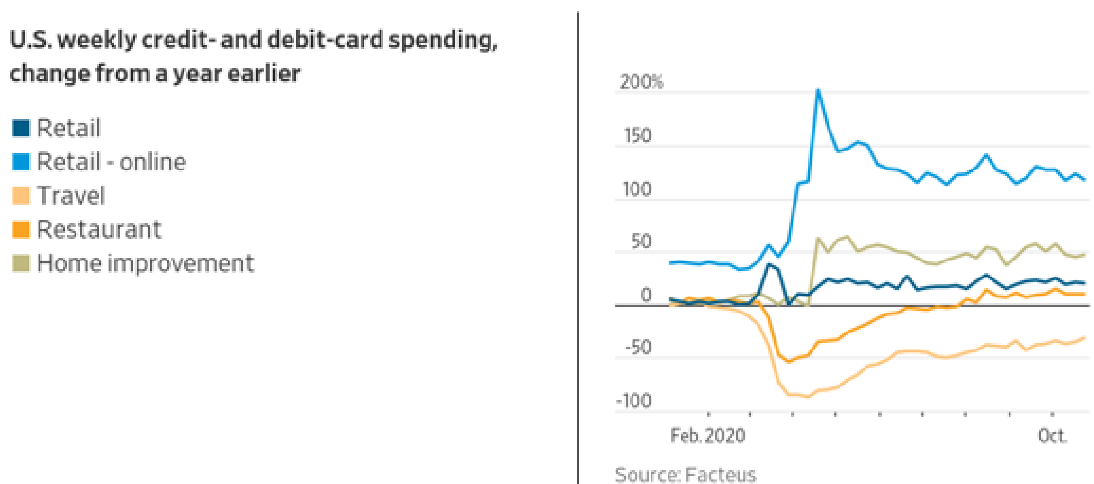
Spending trends became apparent early in the pandemic and the timing corresponds with lockdowns. Travel and restaurant spending collapsed, retail had an early “pantry loading” bump in March, and once it became apparent this “at-home” and “remote-work” situation would last a while, consumers shifted to ecommerce and investing around their home.



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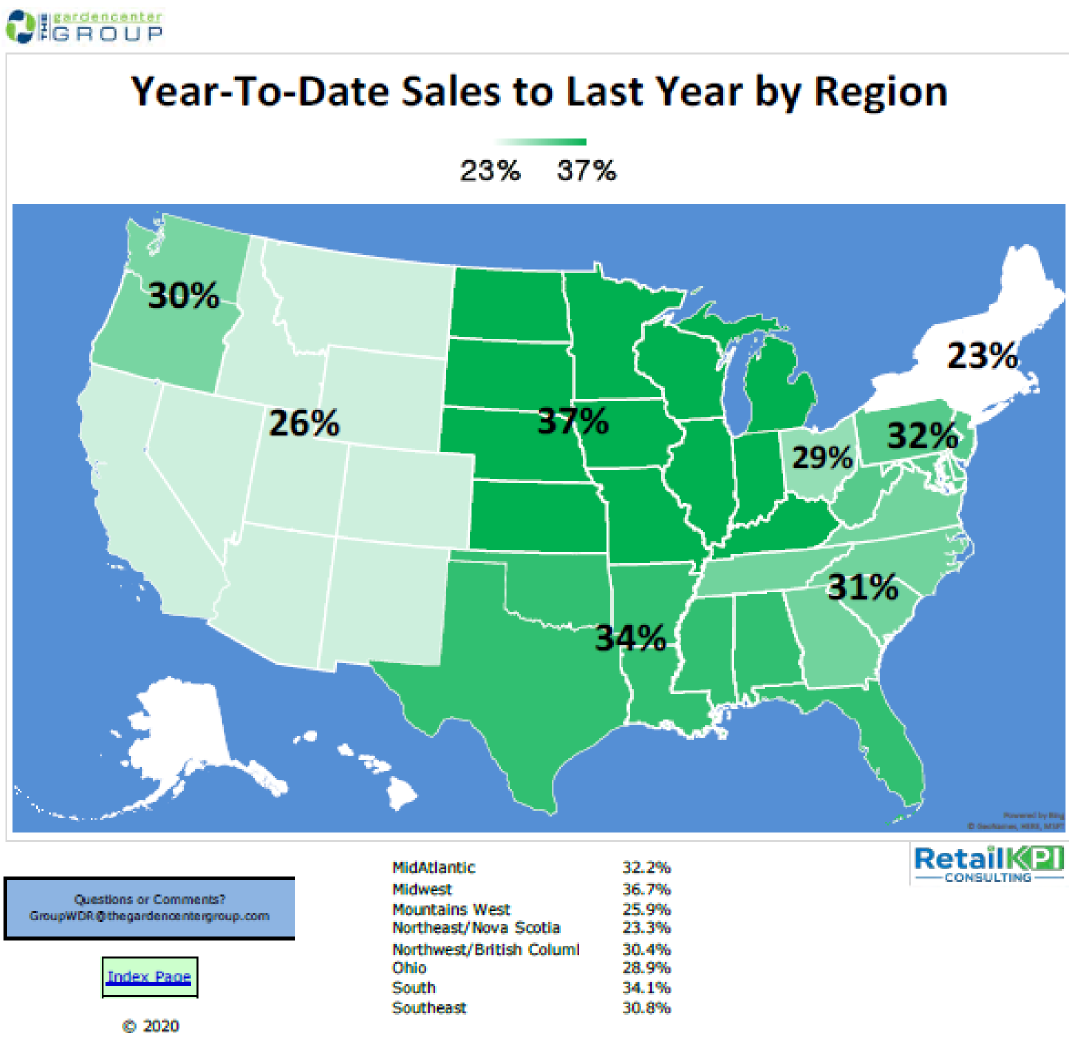
More specific to our industry, the Garden Center Group reported strong year over year revenue growth at Garden Retail across the country during 2020. An October report shows sales growth of 23-37% depending on region. The Wall Street Journal reported that from mid-March to mid-September, Americans spent 60 million fewer hours commuting to and from work each day as lockdown orders to curb the spread of Covid-19 forced many employees to work from home. They estimate that 15%+ of that time – more than nine million hours – was spent on home improvement. While workers in front-line service positions carried the brunt from business closings and unemployment, a large percentage of office workers and many homeowners have fared better with more stable employment and paychecks. The government stimulus payments to individuals and families along with enhanced unemployment benefits also put additional dollars in consumer wallets and contributed to the relative success in our industry.



A closer look at the success enjoyed by our industry indicates gains from both volume and price. Revenue increases this season were not likely a result of additional production as the market adjustments happened as the season was underway (although some growers may have planned some expansion and made in-season adjustments.) Revenue growth was largely a result of less product shrink and limited supply chain discounting. In addition, growers and retailers utilized better coordination and supply chain communication to manage shipments and inventories resulting in optimized performance. It seems that faced with unprecedented uncertainty, our industry rallied to optimal performance.

The bottom line: our 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.

Questions or Comments?
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MidAtlantic	23.2%
Midwest	22.8%
Mountains West	15.0%
Northeast/Nova Scotia	10.9%
Northwest/British Columi	13.3%
Ohio	17.0%
South	27.3%
Southeast	14.6%

Prior to the 2020 season, at AmericanHort we had initiated a study to examine our industry value chain in search of areas in which we might be "leaking" margin. The field-validation work was halted with the COVID-19 lockdowns of consumers across the country. Several key market/consumer hypotheses have been researched and developed that challenge a few of our industry paradigms and practices. Below are some of the preliminary findings. As we move into 2021, we will attempt to validate and further report on our findings and possible ramifications for our industry.

AmericanHort Pricing Study - *Interrupted*

Retail

Big Box retailers don't compete directly with IGCs

Consumers aren't generally "price shoppers" for live plants

Branding alone is not enough, retailers need to provide high quality plants that will justify price premium. However, if successful, this brand recognition can drive yearly purchases

Consumers are not as receptive to the innovation in plants and Retailers do not tend to adapt and introduce a lot of variety

<u>Grower price increases will likely have a strong response from big box retailers and a limited response from landscapers</u>

Landscape

Overall margins are relatively good but there has been a squeeze with the recent consolidations

The market is driven by the economy – consumer and housing

Due to full scope of supply, green-good prices less transparent/sensitive to consumers

Growers still undercharging for the full value of their products

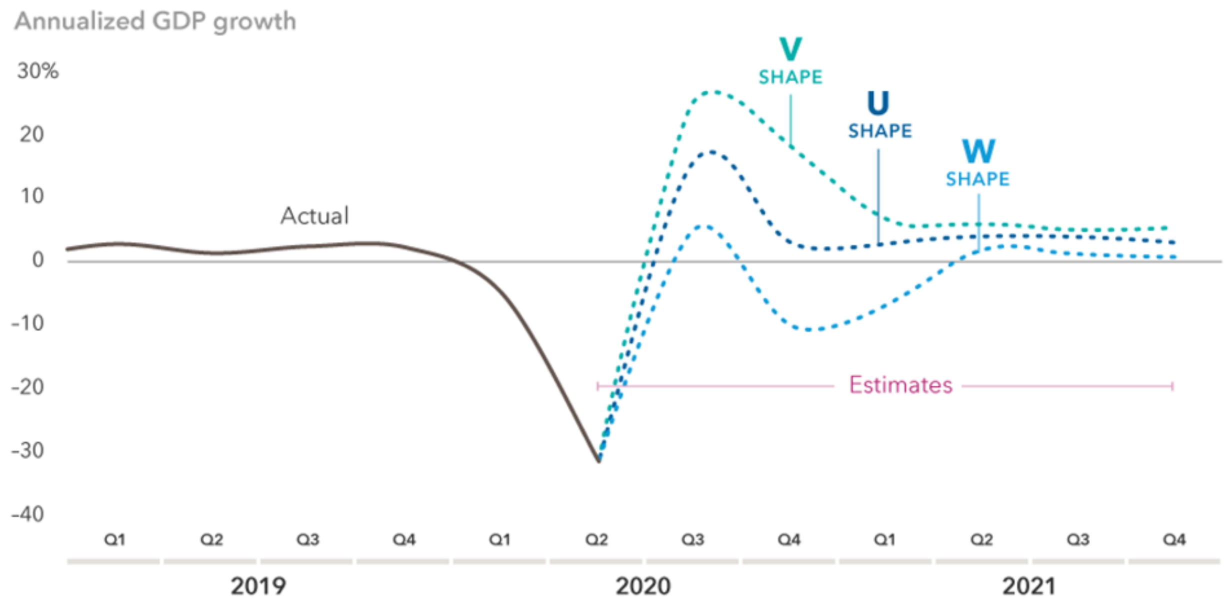
Wholesalers are reluctant to try new products every year from Growers. Wholesalers prefer nonbranded products due to higher margin

The Split Economy: Employed Consumers and Homeowners

The U.S. economy is projected to grow at an annualized rate of roughly 2% to 3% in the year ahead, fueled by pent-up demand from months of sheltering in place, as well as the promise of the pandemic-ending vaccines being distributed throughout the year. Economic growth will likely return to pre-pandemic levels by the middle of 2021 – good news for a nervous consumer economy.

It's often been said of this pandemic, "we're all in the same storm, but not all in the same boat". Due to the high level of uncertainty regarding timing and events and the split economy, different segments of the economy will likely experience different recoveries. Technology, healthcare, and ecommerce are enjoying a "V" shaped recovery, which should continue. Where applicable, our "high touch" green industry should embrace "high tech" solutions for consumers who have become more entrenched in ecommerce shopping. It is estimated that our economy may lose 110,000 small business across the country and many of those are restaurant and service businesses who will suffer the "W" shaped recovery. Reasonable levels of government stimulus and unemployment funding can help those workers and business owners weather the storm to an extent. Our industry will likely experience the middle ground – a "U" shaped recovery – driven by sustained consumer and homeowner spending but substantially more moderate than the jump we enjoyed in 2020. (Some economists group this all together calling it a "K"- shaped" — or moving in two different directions, given the disparity between sectors that have benefited from the pandemic and those that have been crushed by it.)

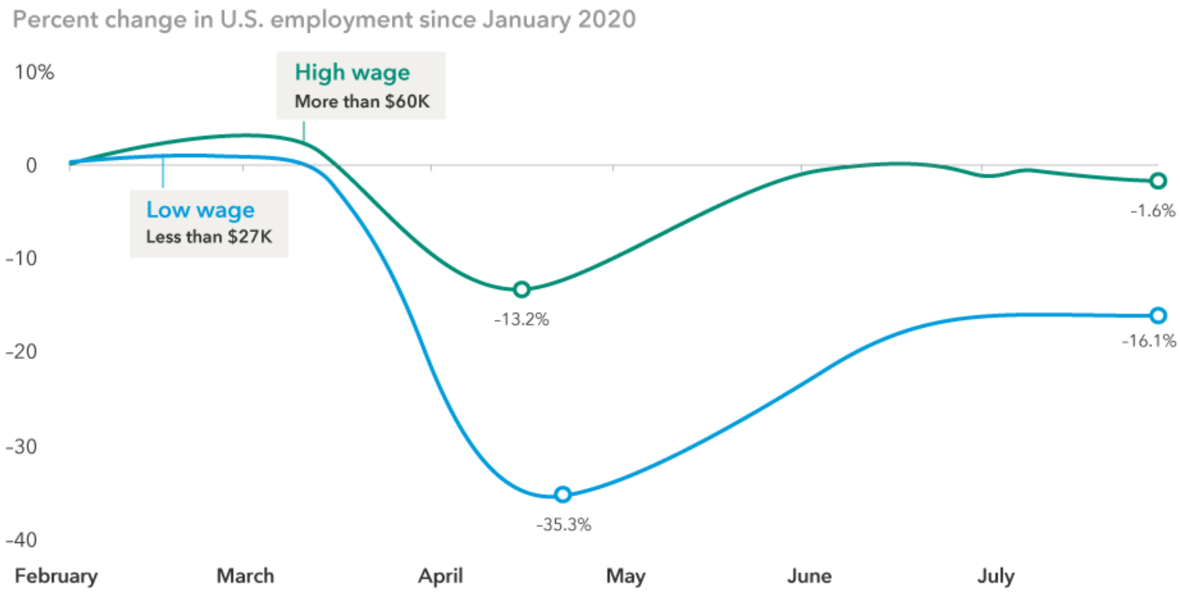
U.S. economy: The road to recovery remains uncertain



The other impact driving the split economy is the unemployment gap between high-wage workers and low-wage workers. From a job loss perspective, the 2020 downturn has been much more severe for workers earning less than $27,000 a year — most of whom cannot work from home — compared to those making $60,000 or more. This disparity, of course, raises societal questions with no easy answers.

The post-pandemic U.S. economy will be very different than the economy we had in February 2020. While more efficient and more dynamic than before, there will be winners and losers. Historically speaking, we have not done a good job of addressing the societal problems that arise from such disparate outcomes. Much of the consumer spending in our industry is driven by homeowners, who often enjoy higher wages and have experienced relatively less unemployment in this economy.

Unemployment levels are uneven among high- and low-wage workers



Source: "The Economic Impacts of COVID-19: Evidence from a New Public Database Built from Private Sector Data," by Raj Chetty, John Friedman, Nathaniel Hendren, Michael Stepner and the Opportunity Insights Team. September 2020. Available at: https://opportunityinsights.org/wp-content/uploads/2020/05/tracker_paper.pdf and https://tracktherecovery.org/. As of 7/28/20. Values in USD.

Will the housing tailwind continue?

During recessions home sales usually take a hit, but have been an unexpected winner during the Covid crisis. Will it continue and provide a tailwind for our industry?

After steep declines during the spring shutdowns, sales of both new and existing single-family homes rebounded and are now well above their pre-crisis levels. The National Association of Realtors (NAR) reported that sales of existing, or previously owned, homes rose by a seasonally adjusted 9.4% in September from August and were up 21% over 2019 levels. Sales would likely be even higher if the inventory of available homes wasn't so low. Housing inventory at the end of September was 1.47 million, down 19.2% from the same month a year ago, according to NAR. In the absence of adequate supply, prices have gone up. According to the NAR, the median existing-home price was $311,800, almost 15% more than in September 2019.

Three main drivers are impacting this trend. The Covid crisis has left millions out of work, but those hit hardest have been lower-paid service workers who often don't have the means to buy a house. Meanwhile, the higher-income earners who generally can afford a house have weathered the downturn much better and show more economic optimism.

Second, the Federal Reserve's response to the recession has been lower interest rates leading to sharp decline in borrowing costs. The average rate on a 30-year fixed mortgage has fallen to 2.8%—its lowest level on record—from 3.7% at the start of the year. That has made it easier for many people to afford a house.

Finally, the pandemic and corresponding work-from-home revolution have motivated many people to move away from urban centers and find locations in the suburbs that make it easier to social distance. There has also been an increase in demand for vacation and second homes.

Lumber and labor costs will further increase housing prices and a lingering consumer recession may slow down the current strong demand. Some will find that working remotely from a vacation spot might not be as easy as expected and post-pandemic cities may rebound and reverse the urban flight.

But the bigger issue is that the crisis may have, in effect, pulled forward a lot of housing activity that would have eventually happened in any case. Couples with children moving to the suburbs isn't a new phenomenon. Many of the people who relocated this year might have otherwise done so over the next few years. So, when the Covid crisis ends, the pool of people ready to move to the suburbs might be smaller.

And regardless of where they now live, the absolute number of people able to make the move to homeownership may be limited as well. Many members of the millennial generation saw early career setbacks following the financial crisis, and now, as they enter their prime earning years, another crisis and recession has arrived.

So far this year the housing market has been exceptionally strong given that the U.S. has experienced an economic recession. Historically low inventories and record-low mortgage rates are currently outweighing economic and employment headwinds and rapid price acceleration. Given this dynamic, the jury is still out on the post-crisis housing outcome and the continued demand for associated landscape products and services.

Recovery: What to expect and the impact of the election.

Most expect a "grinding" recovery throughout 2021. Vaccine distribution logistics, government stimulus, business failures, and job losses will all impact the overall recovery.

In the second quarter of 2020 the U.S. economy contracted by 31.4% on an annual basis, the biggest decline in 70 years. The worst of the downturn occurred from April to June, but the third quarter GDP showed a dramatic bounce back as many U.S. states partially or fully reopened their economies. Since March, our leaders have provided much of the financial stimulus needed to keep the economy "upright". We need to get the virus under control in a manner that lets us return to some sense of normalcy. Now the fiscal stimulus is running out and, if the federal government doesn't act soon, we could be looking at a much more difficult income profile in the months ahead.

<u>So, what's next?</u>

The Bad News-

- Resurgence in the virus, new restrictions from local governments across the country, and expectations for a grim winter ahead have started to take their toll on consumers.
- Conference Board's reading on consumer confidence in November unexpectedly fell, to 96.1 from a reading of 101.4 in October and showed a third straight weekly decline.
- University of Michigan's final look at consumer sentiment in November revealed a cooling of sentiment with the index falling to 76.9 from 81.8 in October. It did rebound back to 81.4 in the two weeks ended Dec. 9.
- Recession driven unemployment will continue to be stubborn

The Good News-

- An inability for Americans to travel and spend on many services at a normal rate is expected to lift “Covid winners” and “Giftable” spending by 9% in November and December.
- Enhanced unemployment benefits and one-time payments from the CARES Act were used not only to bolster spending but create a savings cushion for households that rarely have one.
- Overall, labor markets have continued to recover faster than expected.
- Results from retailers like Target, Walmart, Lowe’s, and Home Depot over the last few weeks outline a healthy appetite for spending and the durability of “better than feared” optimism from consumers.
- All of which leaves the economy where it’s been for months now — both surprisingly strong and seemingly right on the edge of rolling over.

More Potential Good News -

It is highly likely that bipartisan support will result in additional government programs aimed to help households/consumers

- $900 Billion Stimulus Package
- Extended Unemployment Payments – likely support for an additional $300/week
- Vaccines: approvals and distribution lift outlook by summer
- Employment improves with general economy
- Housing starts and sales stay strong in most major markets lifted by low interest rates and suburban flight (supported by some level of continued remote office work)

Elections and Policy

Elections matter, and in the most recent election, American voters participated at record levels. And they displayed an instinctual preference for divided government. There were many “ticket-splitters” who voted for President-elect Joe Biden, while also supporting incumbent GOP Senators, and even some House challengers who flipped seats from blue to red.

The result? A change in the White House, the House will remain under Democratic control, and the Senate - still in play until the January 5 Georgia runoff elections - is likely to remain in Republican hands by a very slim margin. That reality will mean a backstop against legislative excess, a measure of moderation in anything that can get done, and what will be done, legislatively, will require significant bipartisanship. Gridlock or moderation? Time will tell.

Whether he will admit it or not, this setup gives President-elect Biden a measure of cover for some moderation in legislative aspirations as well as Cabinet and other picks that will require Senate confirmation. And bear in mind that Biden is a “creature of the Senate,” having served for decades in the upper chamber and forging relationships on both sides of the aisle. During the Obama administration, when a deal needed to be worked out with the Senate, Biden was typically the point man.

Pent-up progressive frustrations and aspirations may find more of an outlet in the major agencies at the Labor Department, EPA, and elsewhere, and via White House executive actions. It is worth noting that incoming Presidents (including Trump) have been sharply critical of their predecessors' penchant for executive actions, only to double down and take this aspect of governance to a new level. (Trump has issued 192 executive orders to date in his presidency, compared with 147 and 129 in Obama's first and second terms).

Regulatory Roll Backs

A major priority of the Biden administration will be scaling back regulations that were implemented over the past four years. The incoming administration is expected to put a freeze, otherwise known as a "stop order," on all pending regulations on January 21. This means that any regulation which is not final will be put on pause, giving the Biden team time to review each regulation and determine if it should continue or cease altogether. This will apply to executive orders as well.

Environment: There have been plenty of signals that environmental issues will be a major priority for Biden. Expect to see every agency incorporate climate change into its policies. The recently amended Waters of the US (WOTUS) regulation is one to watch, as the regulation determines what streams, wetlands, and other waters get federal protection. The Trump administration placed it as a priority as they saw the Obama interpretation as draconian. It is likely that the Biden administration would propose a new rule, which would not be as broad as the Obama rule, due to the need to pass potential challenges to the now more conservative Supreme Court.

It is uncertain if crop protection tools will be a primary focus but there will be significant pressure to address. Industry groups are hoping that the Biden administration will follow their campaign promises and put science above fiction, as they feel that the science is clearly in favor of usage. Environmental groups have already started to push for revoking the use of glyphosate, dicamba, and atrazine.

Transportation: Transportation will be a focus in the next four years, mainly around auto emissions, fuel efficiency, and incentivizing electric and hybrid vehicles. It is in our opinion that if there were transportation regulations that would be flagged in our focus areas, it would likely be around hours of service in general, as the Trump administration implemented a series of flexibility measures in 2020, as well as the numerous exemptions that are currently in place.

It is comforting that the agricultural commodity definition regulatory clarification will be final before President-elect Biden takes over, as it would have likely gotten caught up in the upcoming regulatory freeze.

Labor Policy, Immigration, and Worker Visas

Workforce development and labor availability are top concerns of horticulture employers, and at the top of the AmericanHort advocacy agenda. We need to advance all options, from better training and apprenticeship programs to investments in automation and mechanization research to workable temporary visa programs and practical solutions for experienced but unauthorized workers in our industry. President-elect Biden's own history on the issue is as a centrist; there is plenty of room for the Biden administration and Congressional Democrats to take a moderate, bipartisan path on the issue.

An early focus for the new Administration will be undoing many of the draconian immigration-related executive orders and other policy actions of the Trump Administration. Measures like restoring work visa and refugee admissions may benefit horticulture employers. President-elect Biden has also articulated support for "early action on comprehensive immigration reform that includes a path to citizenship for 11 million." Past experience suggests that "comprehensive immigration reform" is a better aspirational goal than legislative strategy.

The Democrats' loss of seats in the House, very narrow margins in the Senate, and impacts of the ongoing pandemic suggest that "down the middle" is the only way to resolve the immigration reform riddle. Early signs suggest Congress may take an incremental approach. A few specifics for horticulture:

- The H-2B program is exceptionally important for the landscape sector (and the growers who sell to them); half of the visas each year go to workers in our industry. The Trump Administration's temporary ban on worker admissions is set to expire on December 31. We are working now to ensure that Congress extends the administrative discretion to release more visas when the seasonal caps are hit. Beyond that, we are exploring all realistic legislative avenues to gain visa cap relief, including greater potential flexibility for landscape employers to access the H-2A visa program for some landscape-related work.

- Growers using the H-2A program have mostly been spared the disruption other legal work visa programs have seen especially during the pandemic. And a recent regulatory re-work of the H-2A wage has brought some economic relief to employers. Other program changes are expected by year's end; most, but not all, should be helpful. Still, the near-term forecast is for instability, as these rule changes face legal challenges. They also may be reversed or redone in the Biden administration, though the process could take roughly a year.

- On the legislative front, our best scenario will be for the House to take up the Farm Workforce Modernization Act that passed one year ago and pass it again with no or minimal changes. The House will likely pass other discrete measures such as an immigration status solution for undocumented but essential health care workers, and some version of the DREAM Act providing a pathway to legal residency for young undocumented folks brought to the U.S. as minors. Then, all eyes would turn to the Senate to see what kind of package could garner the bipartisan vote needed to pass. As key pieces of the puzzle, DREAM, Ag, and essential worker bills each have substantial and somewhat overlapping support in the Senate.

Stating the obvious, administrative reforms to programs like H-2A and B are transitory and easily undone in a subsequent administration. Bipartisan legislation is the only realistic way to achieve relative stability. Though never easy, divided government (presuming the Senate remains in the GOP's hands) presents the best environment for negotiating the details.

Going into 2021, we also see several "wildcards" that will influence what is possible legislatively, and when. They include factors such as (1) the trajectory of the Covid-19 pandemic and the real possibility of stubborn high unemployment; and (2) a possible southern "border surge," potentially fueled by policy changes, unrest, or natural disasters like the recent hurricanes that struck Honduras and Nicaragua. The hurricanes destroyed tens of thousands of homes in the region and are said to have set Honduras' economy and infrastructure back 22 years. Expanded TPS for Hondurans could expand the labor pool in some areas and industries.

Also shaping Senate dynamics is the 2022 election cycle. Republicans again find themselves defending more seats (21) in the next election than Democrats (12).

<u>What we're working on:</u>

- Paycheck Protection Program Loans
    - Forgiveness
    - Deductibility of Expenses
- H-2B Caps
- H-2A regulations and costs
- Ag Labor Reform
- Ag Secretary/USDA Program Updates
- Key friends in the new Congress

<u>Other Issues we're monitoring:</u>

- American agriculture is bracing for tougher scrutiny of practices: from environmental protections to workplace safety.
- Biden's campaign pledge to make American agriculture the first in the world to go net-zero with emissions.
    - "Climate Strike Team" - evaluate how to push farmers to cut greenhouse gas emissions. "Agriculture is responsible for 12% of U.S. carbon emissions"
- Taxes: Corporate, Individual, Capital Gains, Deductions/exemptions
- Estate Tax - The Biden tax plan would restore the estate tax rules of 2009.
    - The current top rate of 40% would be replaced by a top rate of 45%.
    - The estate/gift amount not subject to taxes would shrink from today's level of $11.58 million for single beneficiaries (double that for married couples) to $3.5 million and $7 million for couples.
    - Exclusions for the generation-skipping transfer tax and gift tax would also be slashed.
- Real Estate Taxes
- Cash Accounting

Business Owners: What to watch for and how to plan.

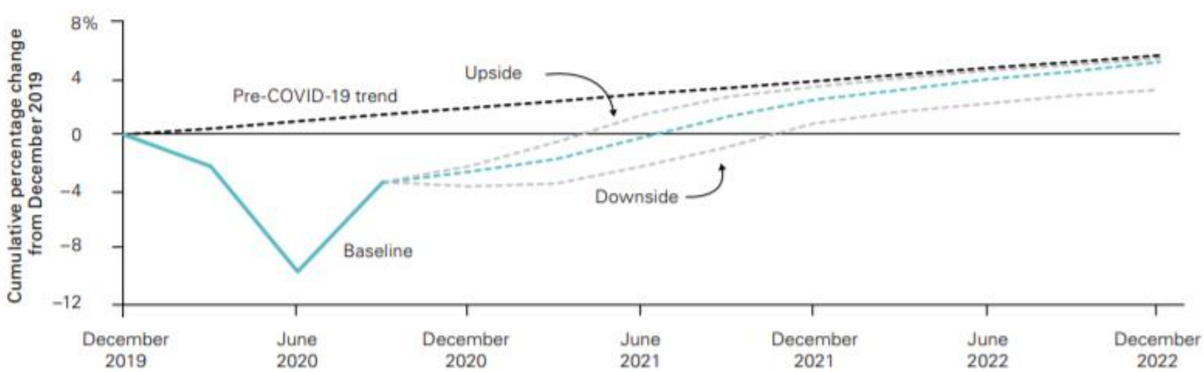
"The virus is the economy"

"All economic growth forecasts depend on the trajectory of the virus — whether it gets better or worse, whether we can develop an effective vaccine and whether government stimulus measures will continue to help bridge the income gap for workers who have been displaced by this unprecedented downturn."

The first doses of the Covid vaccine will be distributed by Christmas and tens of millions of Americans could have protective immunity within eight weeks. As we move into 2021 the vaccine will be easier to get and more than 100 million could have immunity by the end of the first quarter. Many indicators suggest that next summer will be happy and prosperous and we will again gather indoors and outdoors in a slow return to normal. But the tragic toll on our families, communities, and society will leave a lasting imprint on our world.

All of this depends on how efficient and successful the vaccine supply chain and distribution logistics turn out to be, adoption rate of the vaccine by Americans, and overall effectiveness of the various vaccines.

Health outcomes drive next phase of recovery



Most economists are "cautiously optimistic" about 2021, although there are no guarantees regarding quick health outcomes or corresponding economic activity recovery. Vanguard's base case indicates social and business activity normalizing by the second half of the year, but persistent unemployment could provide a drag on the recovery.

Economic scenarios for 2021

	Vanguard assessment of risks		
	Downside risk	Base case	Upside surprise
	10%	60%	30%
Immunity gap	Little progress on infection immunity by end of 2021	Major economies achieve infection immunity by end of 2021	Major economies achieve infection immunity by mid-2021
Reluctance gap	Social and business activity hampered through 2021	Social and business activity normalizes by the second half of 2021	Social and business activity normalizes in the first half of 2021
Economic recovery	Labor market scarring possible given persistently high and long-term unemployment Inflation persistently below target Pre-pandemic level of output not achieved in 2021	Unemployment rate falls through year-end 2021 Inflation moves toward target in 2021 Pre-pandemic level of output reached by end of 2021	Unemployment rate falls and full employment is achieved by end of 2021 Inflation overshoots in 2021 Pre-pandemic level of output reached mid-2021

Note: The odds for each scenario are based on the assessment of members of Vanguard's Global Economics and Capital Markets Outlook Team.
Source: Vanguard, as of November 30, 2020.

We are hopeful that the "at home" consumer spending will carry into our 2021 season and we expect high single digit growth across our industry. With the vaccines being approved and distributed, our outlook changes from uncertainty to risk – and a bit easier to manage and predict. While most in our industry enjoyed the double-digit growth in 2020, don't expect to see a full repeat in the 2021 season. Some business owners are building growth projections off 2020 results and others are going back to 2019. It's important to remember that our economy is slowly climbing out of a very deep hole, and we won't be entirely out for quite a long time.

Consumers will once again be the key. Will they keep spending? Will unemployment levels subside? And will consumers embrace the benefits of plants they've enjoyed while "at home" and continue to buy at 2020 levels.

While we all hope and pray for quick and efficient vaccine distribution and relief from this pandemic, it is important to recognize that economically some of the "Covid-winners" will experience "the vaccine as a headwind". Pent up demand for travel and "away from home" expenditures will climb, taking discretionary dollars from home improvement/landscaping with it.

Business owners need to continue their diligence in managing labor costs, cash (inventory and receivables), and prudent use of short- and long-term debt as the economy recovers. Our industry also needs to capture the pricing, shrink, and supply chain drivers that propelled 2020 growth.

In summary we've learned:

- Our industry proved to be "essential"
- There are clear consumer/economic drivers for our robust 2020
- Strong demand drove smart pricing and supply chain coordination
- Economic recovery will be uneven, but our core consumers should be OK

Q1/2 look good – but not 20% growth

Economic recovery and unemployment will be "stubborn"

Watch cash, debt, and receivables

Thank you all for your continued support of AmericanHort and your investment and management of our industry. ***The best is yet to come***.