The U.S. Residential Service Market

An overview of industry dynamics and indicators for growth

Sample Report • March 2006

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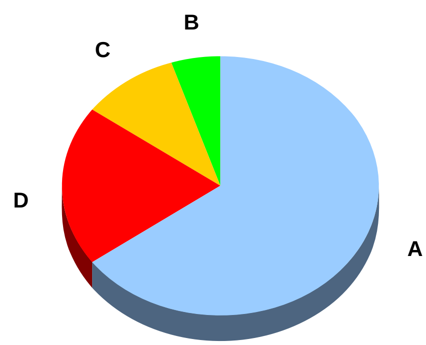
Note: This document is solely intended to serve as an example of a P.K. Data report covering the swimming pool and hot tub industry. Much of its contents portray fictitious representations and, as such, should not be used to make market decisions. Our only intent is simply to demonstrate the scope and style of a typical P.K. Data report.

Introduction

The analysis that follows addresses the dynamics of the U.S. market for professional services. We define these companies as being more or less engaged in the business of providing expert care in the form of cleaning, repair, and specialized services. The term 'more or less' refers to the fact that many service organizations are associated with a developer, contractor, or consultant.

Chart 1: Alignment of firms with retailers and contractors.



Sample data.

We take care to point out that this report is only intended to address the domestic market. The other service sector is a very separate proposition; many firms offering smaller service do not bid on larger work because of the specialized training and certification frequently needed, and also because much larger work is bid-driven.

Service Firms: A Snapshot

Many service firms have a commercial affiliation. Most are of a formal nature, such as operating as a separate profit center. A few are more loosely affiliated. For example, we heard from a number of persons who said that they were developers but also did service work to “take up the slack.”

There are over XXXX specialty firms, either independent or with regional offices, nationwide. The vast majority are small, locally operated enterprises, frequently family-run. On average, each services XX locations a year. Some offer only specialized services while others provide a portfolio of capabilities including repair and renovation.

Over XX% of service companies operate from a single location and nearly XX% have five employees or less. Over half of their customers employ other on-premise services such as pest control and collateral maintenance.

Consolidation

One of the trends affecting the industry is what is known as a “roll-up”. Simply put, a roll-up is an attempt to acquire a number of small firms within the same industry, usually for the purposes of gaining economies of scale. The conventional wisdom is that the profits generated from these efficiencies (such as improved buying power, thus lower cost of goods) can be used to fuel further acquisitions, which induces still further efficiencies, ad infinitum. Roll-ups frequently fail to live up to their billing, however. There are many reasons why, but the two biggest are that many kinds of businesses are not scale-dependent, and also roll-ups die prematurely because early profit-taking by the investors starve the resources of the organization.

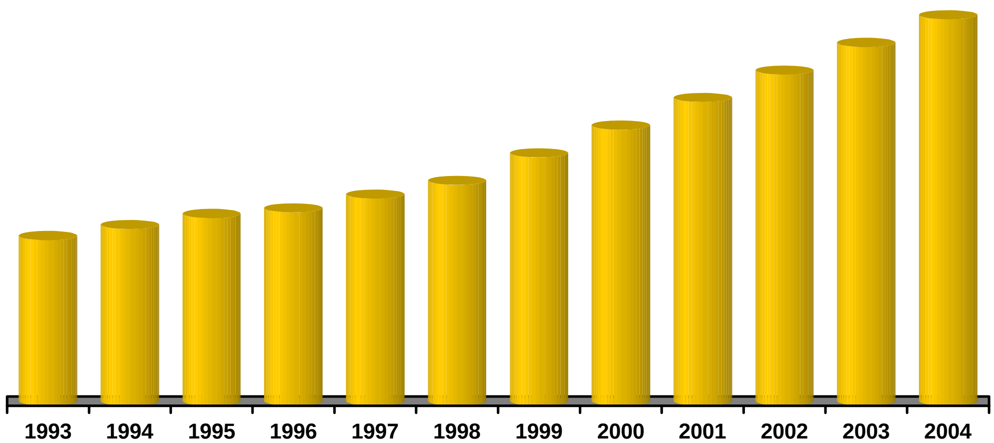
Service companies have made an attractive roll-up target. Few attempts, however, have succeeded. Part of the problem, as just discussed, is that there is little scale benefit. True, consolidation does reap some acquisition cost rewards resulting from increased volume. But forming a buying group mirrors that effect, without the need to disturb equity. Otherwise, a customer is not serviced any better by a five-person company than it is by a company of 5,000. Core staff functions that scale-dependent companies require such as centralized accounting, human resources, and strategic planning are totally transparent to the success of a service firm.

This is not to imply a bias against roll-ups. But any form of consolidation has to have a strategic raison d'etre. If a service firm has a preemptive process, such as a technical advantage or a marketing leverage, then it makes sense to deploy rapidly in order to gain the advantage of first-mover. But most companies today have little to separate themselves other than process quality and cost. Anyone doubting this has only to call twenty such companies in their area and ask why the firm in question is better than their competition. Some combination of "quality and value" will play nineteen of those times.

Market Size

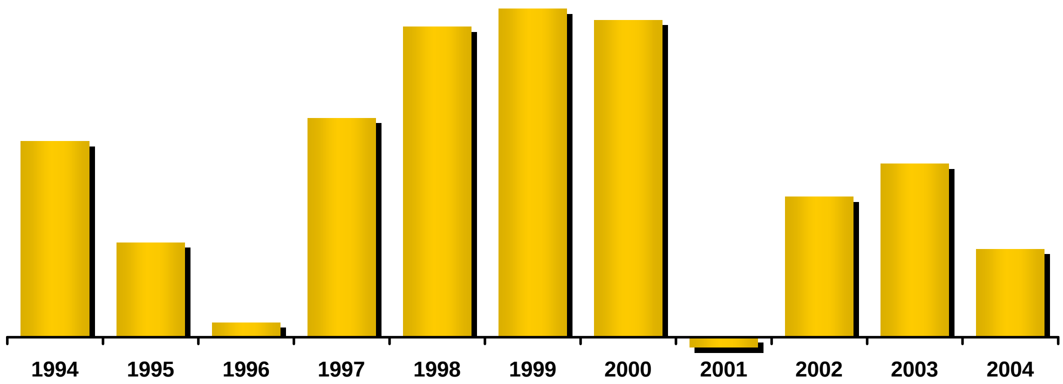
As of the end of 2003, the total value of the U.S. service market was $XXX million. The industry has experienced an average annual growth of XX.X% since 1992.

Chart 2: Annual sales of residential service firms in the U.S., 1993-2004.



Sample data.

Chart 3: Annual growth of sales among service firms, 1994-2004.



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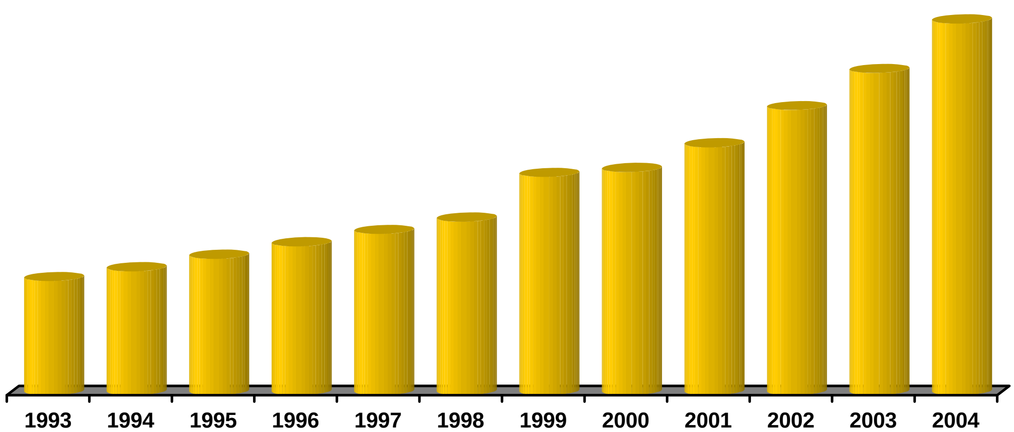
Two factors heavily influencing the growth of the service business is the growth of the residential industry itself and the persistent increase in the percentage of owners who use a service.

In the past decade, the total installed base has increased by some XXX,XXX, or XX%. Comparing that with the growth in the service industry clearly demonstrates that the latter has far outpaced the former.

Chart 4: Installed base of units, 1993-2004.

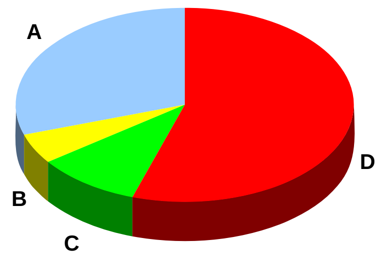


Sample data.

Penetration of Professional Services

Currently, XX.X% of owners use a service to some degree, either for physical maintenance, water maintenance, or both.

Chart 5: Utilization of professional services among owners.

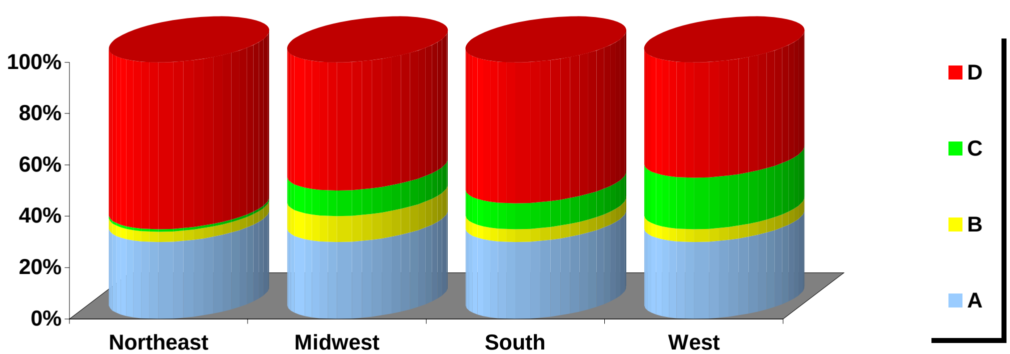


Sample data.

But there is another dimension to service utilization: regular versus occasional usage. Regardless of the services performed, an ever-increasing number of owners are opting to have their maintenance performed on a regularly scheduled basis. The rest are only occasional users, i.e., those who call upon a company to perform needed services such as refurbishing, repair, damage clean up, or issues with the mechanical system.

Perhaps not surprisingly, the North and East tend to be the greatest adherents of outside suppliers. While national penetration is XX.X%, service utilization in the South is XX%; in the West it is XX%.

Chart 6: Utilization of professional service by region.

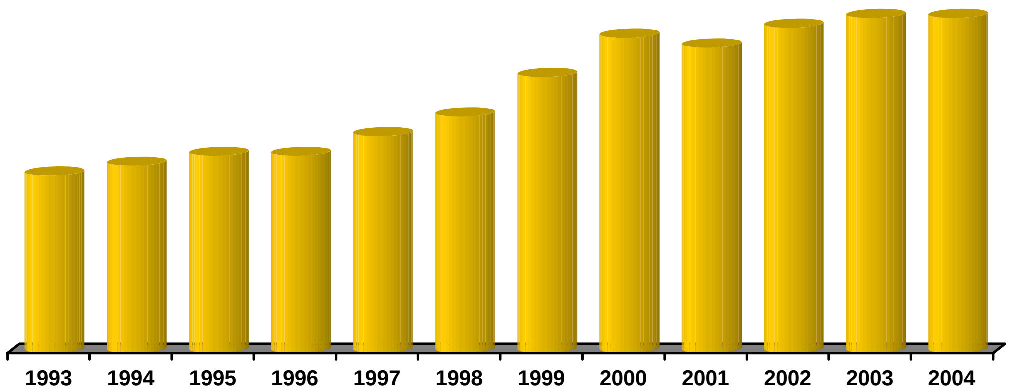


Sample data.

The greatest growth in the service industry has been among regular users of service firms. Since 1992, the percentage of service utilization among owners has increased XXX%.

Regular vs. Occasional Consumers

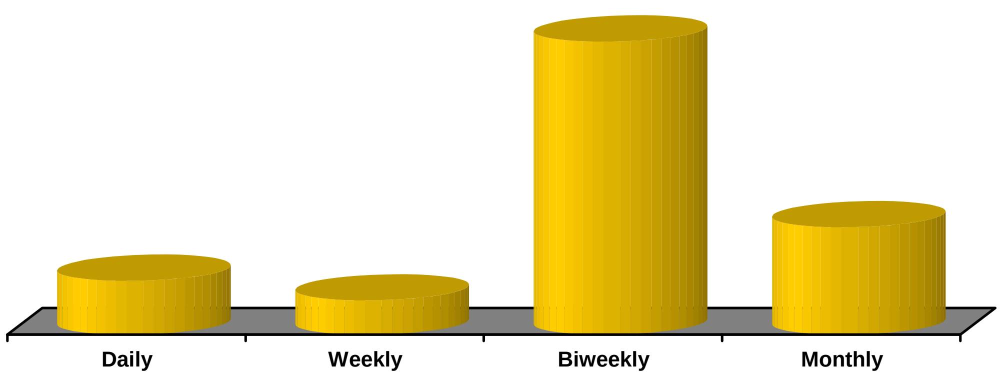
Chart 7: Penetration of regular service users, 1993-2004.



Sample data.

In terms of usage frequency, regular service users generally tend to have weekly service.

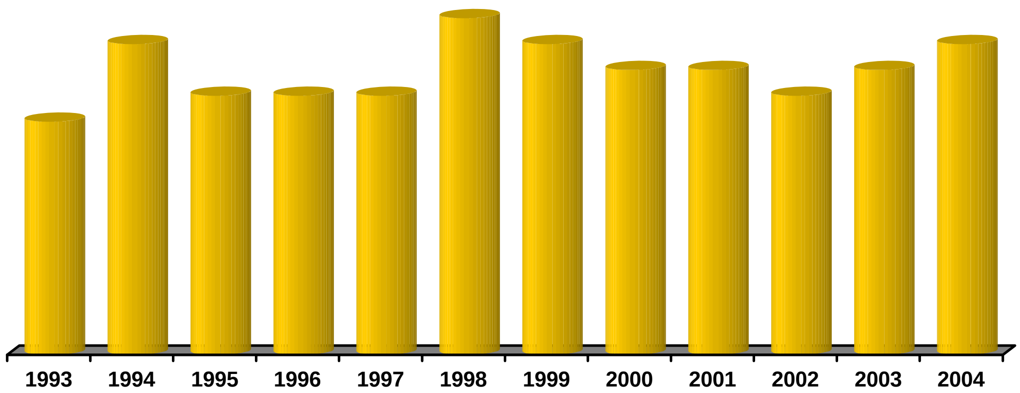
Chart 8: Frequency of service among regular users.



Sample data.

At the present time, occasional users are only XX% of all residential owners. The dollar sales value is less than XX% of the total residential service market.

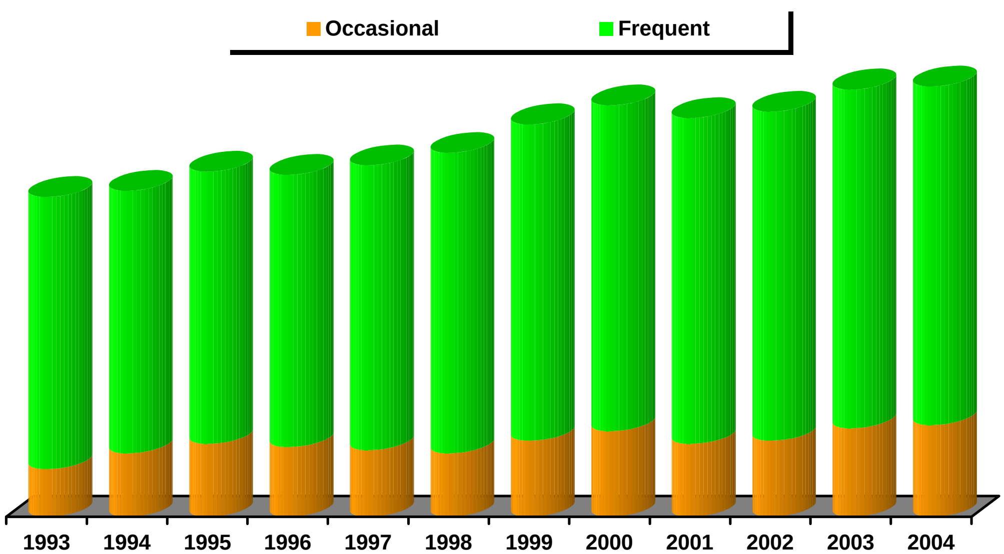
Chart 9: Penetration of occasional service users, 1993-2004.



Sample data.

Growth among this occasional group has been fairly flat. But given that their primary use of a service is for such one-time needs as repair or renovation, there wouldn't be any particular reason for serious growth.

Chart 10: Average annual household service expenditures, 1993-2004.



Sample data.

This chart compares the average annual dollars spent by consumers on their service. Frequent users have increased their annual expenditures by XX% the last decade while occasional users have seen a XX% boost. Most of the service firms we interviewed felt that the increase was probably the result of a diversified services portfolio such as electronics repair and seasonal services rather than simply a sign of inflation.

Yet another contributing factor, we suspect, is the increasing age of residential properties in this country. Even though units have been in use since the reign of the Pharaohs, most experts agree that the U.S. domestic industry didn't really gain traction until the early 1900's. The combination of a revitalized post-war economy and greater efficiencies in manufacturing led to something of a boom. So for all practical purposes, this industry is some 100 years old. We estimate that over half of all residential units in this country are over forty years old. Of that, we estimate a third or so are one particular type. Most of these have a ten-year rated life, at which time the entire assembly needs to be replaced. Other types frequently need attention within that same timeframe. Last year, XXX,000 units—roughly X% of the installed base—entered their tenth year of operation.

Industry Growth

Given the state of both the industry and the service segment over the past ten years, what can we say about the foreseeable future? In order to reasonably estimate the growth of the service industry over the next five years, we need to understand two issues affecting the business: drivers and barriers. We will discuss both in the following narrative.

Drivers of Growth

As we pointed out earlier, the domestic industry is obviously dependent to some extent on the residential business itself. But we have also seen in earlier analysis that the growth of the parent category does not correlate tightly with the growth of the service business. For example, the growth of unit sales over the past five years has been an average of X.X% with a variance of .XX. The average growth of the service business over the same period was X.X% with a variance of XX.X. Obviously they are not totally interconnected. So what else is impacting the service picture?

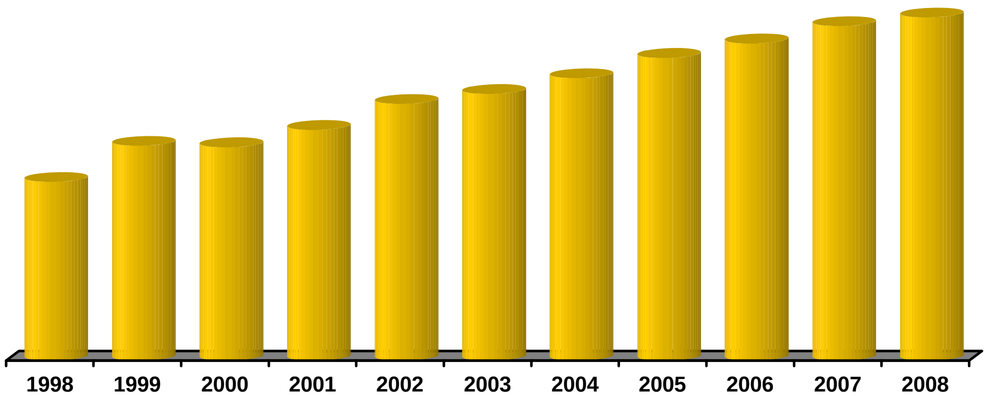
There are a number of fairly minor factors that will always have some effect on the business. For example, there is the aging of the average owner, thus increasing the likely absence of children at home. To a lesser extent, there is also the industry's own "noise level" (collective advertising expenditures). While we track these components, neither seem to have an appreciable impact because the first moves too slowly and the second is always too small to be measured in any meaningful fashion.

The one major player in all of this, of course, is the economy. And, in fact, if you compare certain aspects of the national economy with the change of state in the service business over the past ten years, you will see that they are highly correlated. We have found the most influential drivers are GDP, discretionary income, joblessness, and consumer confidence, somewhat in that order of priority.

How does this help us moving forward? We have evaluated several economic models and have found one that, over time, seems to best fit the realities of the industry. Using that model, we then created a time series extrapolation that correlates the past ten years with the service industry and then regresses the numbers to create a five-year forward horizon.

Industry Forecast

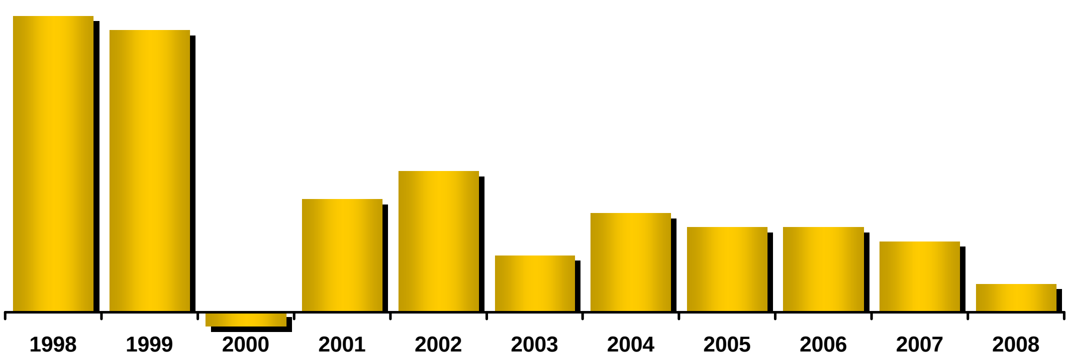
Chart 11: Forecast of annual sales of service firms, 2004-2008.



Sample data.

It's clear from these two exhibits that the days of heady growth within the sector are probably over. This is largely due to the increasing base of service households relative to the overall base of applicable homes.

Chart 12: Forecast of service sales growth, 2003-2008.



Sample data.

Yet that still says there will be reasonable growth in terms of continued penetration of households. Over the past five years, the average annual expenditure for a service has risen by an average of X.X%. If that holds for the next five years it suggests that in 2008 the average annual (regular service) expenditure will be $XXX per household per year. Given that we project annual industry sales in 2008 of $X.XX billion, that would indicate that there will be X.XX million regular service households, a penetration of XX%, as compared with XX% today.

Technology Impacts

One of the trends affecting the residential segment concerns the ever-increasing use of technology. This is particularly noteworthy where maintenance is concerned. Twenty years ago we saw the advent of automatic septic displacement for control of physical debris. That has been followed by a succession of timers, feeders, and alternative devices. Many commentators were predicting that technology would replace the service professional for routine maintenance, thus obviating two-thirds of the industry. These predictions have thus far proven unwarranted. In fact, many of the new technologies have actually helped the service industry. The smarter companies have embraced the new control and monitoring devices by employing them with remote links to reduce the actual number of service calls. Checks can be made from a central location and adjustments made as necessary. Because of the labor intensity of the service industry, that can have a significant impact on profits.

Service companies with fleets of vehicles are also equipping those trucks with global positioning system (GPS) devices. Managers can refer to a computer monitor to see where their trucks are (compared with where they are supposed to be) and even calculate the best routing schemes for servicing their accounts.

The question remains whether technology will ever completely supercede the service technician. Until the fundamental science of sanitization changes, it is hard to imagine any standalone system that could maintain any product without human intervention. There are still too many problems without easy fixes. We also recall that less than X% of owners employ a service for just maintenance. Walls will still need to be brushed, hoses repaired, etc. For that, there will be a continuing need for this industry well into the future.

Survey of Service Firms

During the course of compiling this study, we contacted numerous service companies across the country. The interviews revealed some interesting trends.

Over XX% of respondents said the vast majority of their business consists of weekly or bi-weekly visits. (Several will only accept weekly contracts.) Many say their contracts are based on the service required, i.e., type of unit, level of service required, load, frequency of usage, and use of a cover.

The service firms with whom we spoke averaged nearly twenty years in business. The tenures ranged from three years to forty.

All offered seasonal services, the prices charged for ranged from $XXX each to over $XXX.

Virtually all of the service firms offered equipment repair, but only about XX% will do structural repair.

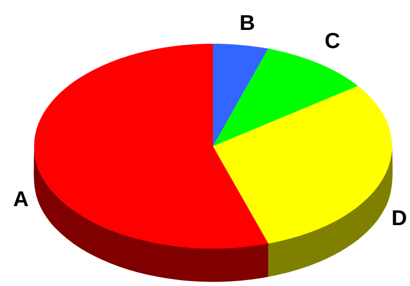
About three-quarters offered assessment inspections. Their usual charge for this service was $XXX-$XXX.

Survey of Service Utilization

In 2003, P.K. Data conducted a national survey of XXX owners of residential units to inquire about their maintenance habits, particularly in the context of utilizing a service. In this section, we present the highlights of that study. In the following section we provide a more in-depth analysis where we compare service usage drivers in order to identify the most meaningful correlations. Much of the information presented in that section is taken from other P.K. Data studies.

Use of a service company

Chart 13: Utilization of professional service firm among owners.

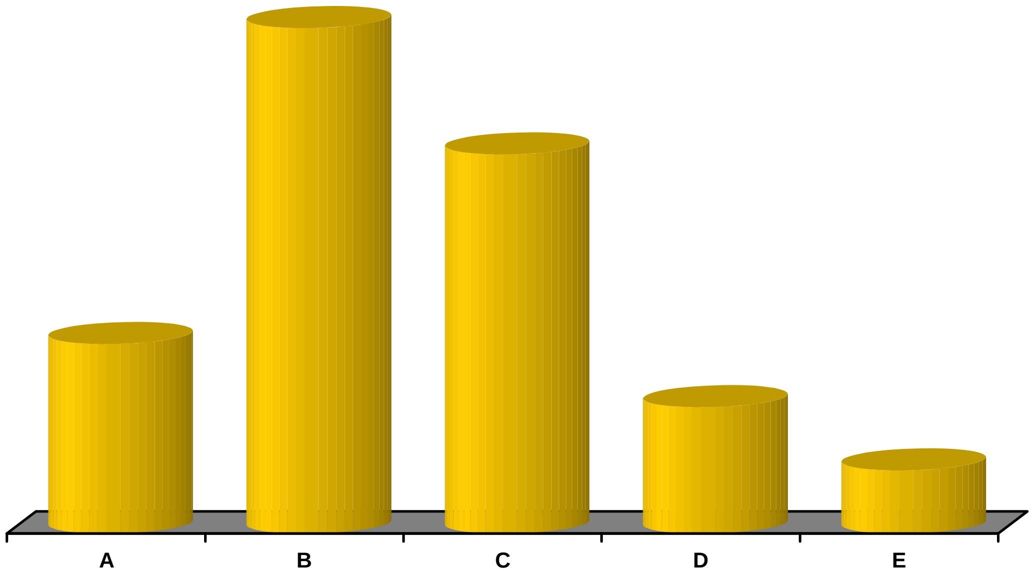


Sample data.

At this point, consumers were asked a series of questions concerning the maintenance of their unit, including the use of a professional service. Nearly XX% of owners rely on a service for some aspect of the maintenance of their unit.

Annual expenditures

Chart 14: Annual self maintenance expenditures.

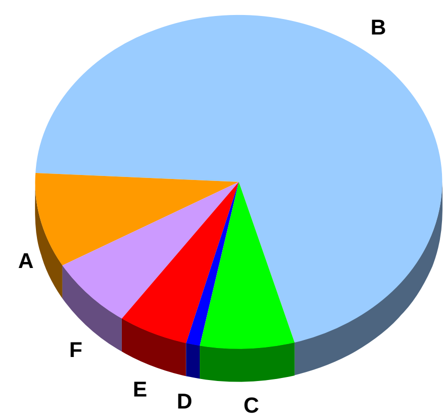


Sample data.

Consumers who do their own chemical care spend an annual average of $XXX on chemicals. Of that, two-thirds spend between $XXX and $XXXX.

Channel selection

Chart 15: Comparison of retail channels preferred by owners.



Sample data.

Another fixture in the residential industry is the continued heavy dependence on specialty stores as a preferred source. Despite the entry of mass merchants, home centers, and even Internet merchants, the specialty channel is still the top player in this sector.

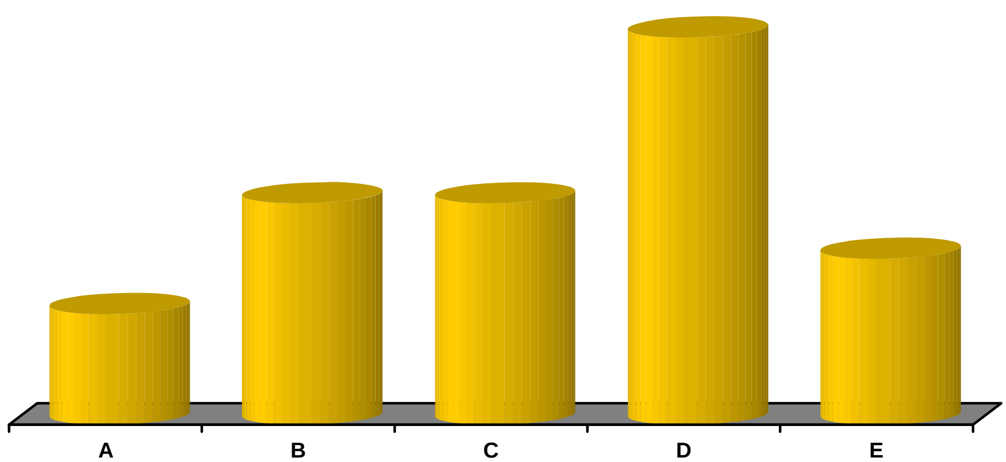
Service use

Frequency of visits

In this portion of the analysis, we take up the question of professional service usage. "No regular schedule" refers to those owners who primarily call a service for repair or special occasional utilization like openings or storm damage cleanup. Net of that group, the national average works out to one visit every eight days.

Annual expenditure

Chart 16: Annual service expenditures by owners.

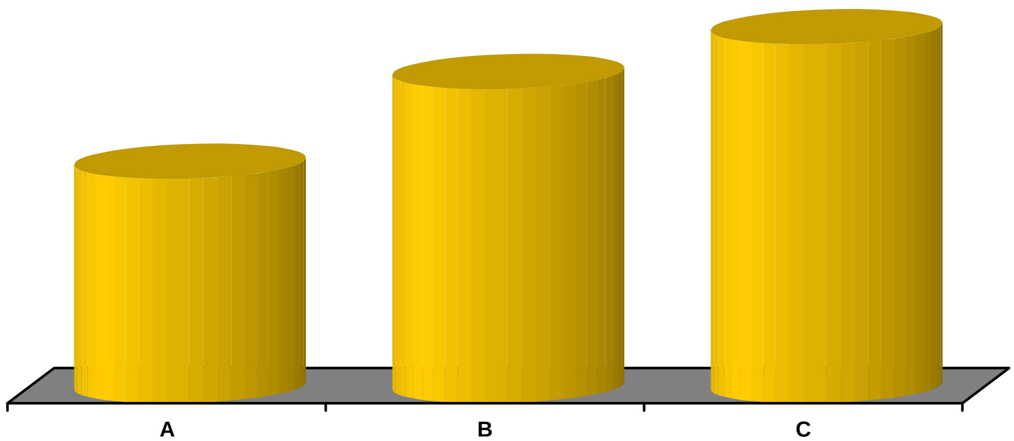


Sample data.

The average annual amount spent by owners on their professional service was nearly $XXX.

Usage Seasonality

Chart 17: Average monthly usage days (seasonal) among owners.



Sample data.

Another key to maintenance is usage per month (during the peak season). Our sample tended to get the most out of their unit; the comparison of maintenance profiles between light users and heavy users is important.

Table of Figures

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About P.K. Data

P.K. Data is a market research firm that has tracked the swimming pool and hot tub industry since 1992. It continuously surveys pool products manufacturers, distributors, builders, retailers, service professionals and, of course, consumers. Its research findings are frequently cited in industry trade journals as well as leading newspapers, magazines, and broadcast media. To date the firm has completed over 300 pool and hot tub studies.

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