BUSINESS LEADERS BLCI CONFIDENCE INDEX®

Colorado
Third Quarter 2005
Volume 3 • Number 3

Business Leaders See Slower, but Solid Growth The 3rd Quarter 2005 Colorado *Business Leaders Confidence Index*® (BLCI) declined by 3.3 points to 58.1. This is the third time the index has declined in the past four quarters; however, the index and each of its six components remain above the neutral point of 50, an indication that the economy should continue in an expansionary mode in the months ahead.

Over the past year the Federal Reserve has raised interest rates at a steady pace in an effort to prevent inflation. In turn, the yield curve, the relationship between long-term and short-term rates, has flattened in recent months. One interpretation of a flatter yield curve is that the economy will grow at a slower rate in the short term. This viewpoint is shared by government and business leaders in Colorado and across the country as evidenced by reductions in projections of real growth for 2006.

Index History

	Q4 2003	Q1 2004	Q2 2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005
INDEX	**58.7**	**66.9**	**64.2**	**66.1**	**63.8**	**61.3**	**61.5**	**58.1**
Expectations for National Economy	65.2	74.3	68.0	71.4	65.2	62.8	62.9	58.5
Expectations for State Economy	61.2	68.2	64.3	68.1	65.7	64.2	62.8	60.2
Industry Sales	59.8	68.7	66.5	68.2	66.1	64.8	65.7	62.1
Industry Profits	57.1	65.5	62.1	65.2	62.7	59.2	59.8	56.4
Industry Hiring Plans	52.6	60.6	61.0	62.1	60.6	58.7	59.7	56.1
Industry Capital Expenditures	56.5	64.0	63.5	61.8	62.7	58.3	57.9	55.3

State Outlook Continues to Outshine National Outlook In addition to expectations for solid, but slower growth, Colorado business leaders also believe the state economy will outperform the national economy in the short term. This has been the case in three of the past four quarters.

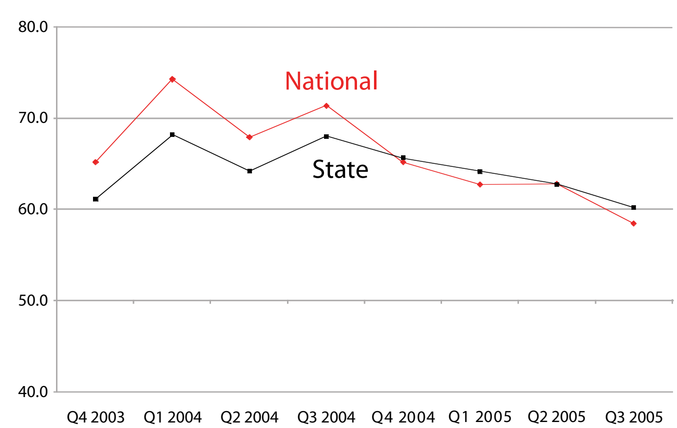
Compared to the second quarter, fewer business leaders anticipate that the national economy will perform "much better" or "somewhat better" in the third quarter. As a result, the national component of the index retreated by 4.4 points to 58.5. Approximately 49% of the respondents expect the national economy to perform better in the third quarter while 37% anticipate no change. Similarly, the state component of the index decreased by 2.5 points to 60.2. About 49% of the panelists believe the state economy will perform better in the third quarter as compared to last quarter while approximately 40% expect it will remain unchanged.

During the past year, an average of 182,000 U.S. jobs have been added each month. It is anticipated that a similar level of growth will occur through the end of the year. The revised projection for 2005 GDP growth, 3.5%, is about a point below the 2004 level, with real growth expected to slip to 3.3% in 2006. Real business investment will not maintain the double-digit growth of 2004, but is expected to show a solid increase of 9.4% in 2005 and 7.9% next year.

Because of Colorado's links to the national economy, the growth in U.S. employment and business investments should bode well for the state. Colorado is on track to meet or slightly exceed the 2005 employment forecast prepared by the Business Research Division, which projected an increase of 43,100 jobs in 2005.

Last year Colorado experienced an employment growth rate of 1.3%, which moved the state up from near the bottom of a state ranking to the 20th position. By comparison, the top-ranked states, Nevada and Arizona, posted employment growth of 5.9% and 3.4%, respectively. A final positive note shows that the 2004 Colorado gross state product increased by 6.1%, up from 3.9% in 2003.

Expectations for National and State Ecomomies

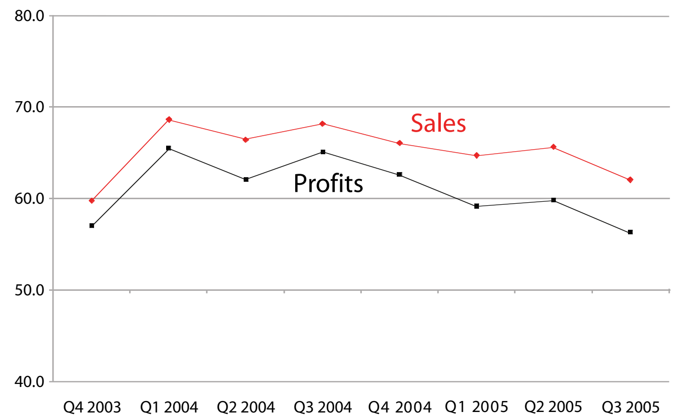


The analysis of the Colorado BLCI is prepared by the Business Research Division, Leeds School of Business, University of Colorado at Boulder.

Gap Remains Between Profits and Sales Although the sales component of the index fell by 3.6 points, to a reading of 62.1, about 59% of the panelists believe that industry sales will increase in the upcoming quarter. Approximately 27% expect sales to remain unchanged. Of greater concern is the decline in the profit component of the index which declined by 3.5 points to 56.4. This suggests that companies are having difficulty controlling expenses. Roughly 44% of the panelists foresee increased profits while about 38% believe they will remain unchanged. This decrease in profit expectations is in line with forecasts that show that nominal pre-tax profits will drop in both 2005 and 2006.

Over the past year, increasing costs for healthcare, fuel, energy, and other inputs have become an issue. Rising costs in these areas have most likely created the gap between sales and profits expectations. In many cases, the volatility of the prices for these goods has made it difficult for companies to react to fluctuations in a timely manner. Accordingly, companies have been forced to absorb cost increases, particularly in the transportation sector. For example, a recent article in the *Rocky Mountain News* stated that annual expenses for Frontier Airlines jump by more than $1.5 million for each penny per gallon increase in fuel.

Sales and Profits Expectations



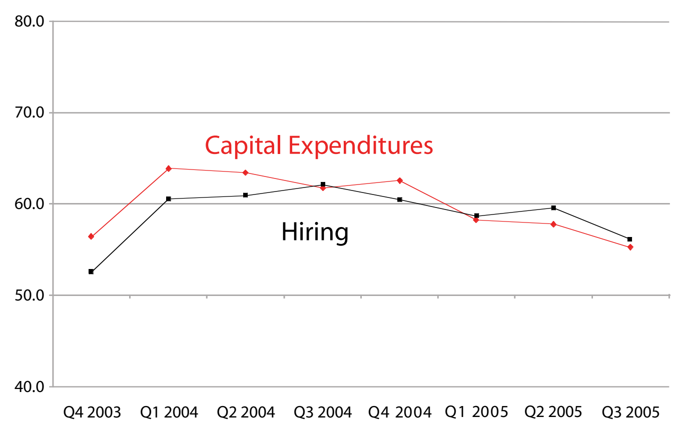
Nationally, employment costs are expected to increase at a rate of about 3.8% through the remainder of the year and rise about 4.0% in 2006 as the unemployment rate continues to drop. Currently, unemployment in Colorado is at 5.0%, which is approximately the same rate as a year ago. There will be minimal wage pressure until the rate drops below 4.5%, with the exception of isolated sectors of the economy that are experiencing above average growth.

Hiring and Capital Spending Moderated But Still Strong Expectations for capital spending declined by 2.6 points, to 55.3, the lowest level in two years. The outlook for hiring fell by 3.6 points, to 56.1. However, the fact that both index components remain above the neutral point of 50 illustrates that companies will continue to make solid investments in labor and capital projects as a means of reaching sales and profit goals.

The anticipated decrease in capital spending is consistent with other national forecasts that show solid but slower growth in the economy as a result of slower real business investment, smaller business inventories, moderate government spending and a reduced rate of personal consumption growth. Approximately 41% of the business leaders foresee moderate or strong increases in capital spending in their industry during the third quarter while another 41% expect no change.

Roughly 39% of the panelists anticipate increases in their industry's work force, whereas about 47% expect no change. Through the first half of this year, Colorado's modest employment growth was driven by increases in the construction, government, professional business services, healthcare and retail sectors. However, such high-paying sectors as manufacturing, air transportation, and telecommunications are either flat or continue to show job losses. Preliminary research conducted by the Business Research Division suggests that the jobs added in the past 18 months have lower wages than the high-paying jobs that were lost during the recent downturn.

Expectations for Capital Expenditures and Hiring



On a more positive note, Colorado is the top-ranked western state in per capita personal income, at $36,083. This is almost $1,000 more than the second and third ranked states of Washington and California.

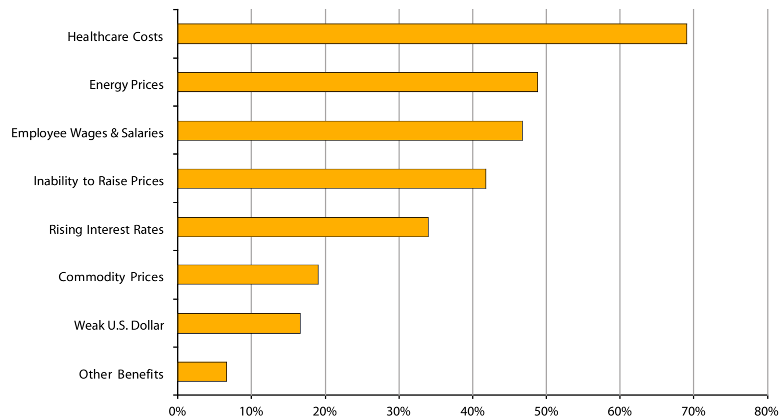
Energy Becomes an Issue in Colorado This quarter's topical question asked Colorado business leaders to select their top three cost concerns for the remainder of the year. From a list of eight items, about 69% of the panelists identified the cost of healthcare benefits as a top concern. Roughly 49% of the business leaders selected energy prices, while 47% chose employee wages and salaries.

Although Colorado is ranked the third-highest royalty-receiving state behind Wyoming and New Mexico, rising energy costs have varying impacts on companies doing business in the state. Less than 1% of the state's employees work for utilities or in the natural resources and mining sector. About 3% of the panelists indicated that increased energy prices positively affect their companies.

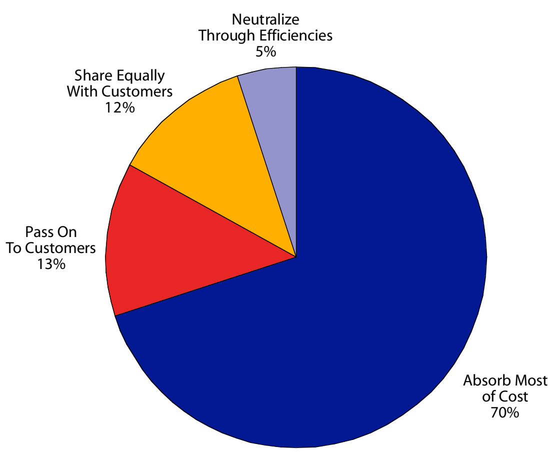
On the other hand, about 44% of business leaders indicated that rising energy prices had a negative impact on their business. These panelists are primarily in the manufacturing, construction, retail and service-providing industries. Their responses were quite passionate about how significantly rising transportation and heating/cooling costs are affecting their bottom line.

About 53% of the panelists indicated that rising energy costs had minimal impact on their business. These respondents are primarily healthcare professionals and providers of financial or other professional services. A portion of the comments from this group acknowledged that rising fuel costs had some impact on their business; however, they largely indicated that the effect was not significant, or they were in a position to make adjustments, such as passing on or sharing costs with their customers.

What are your top three cost concerns in your business for the remainder of 2005?



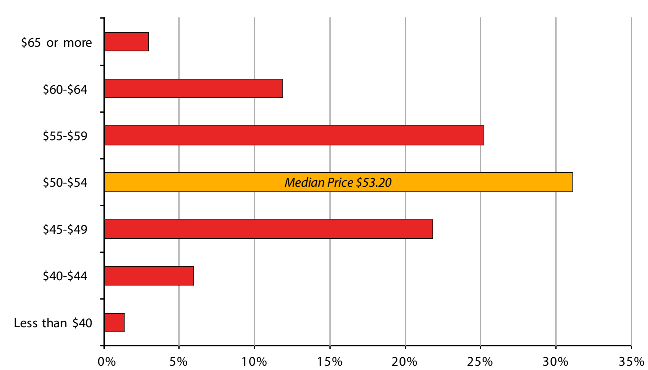
How is your business dealing with higher energy costs?



Over 70% of all business leaders indicated that they have absorbed the increase in fuel costs. This helps explain the previously mentioned gap between expectations for sales and profits. Roughly 13% pass on the entire cost increase, while 12% of the companies try to share the rising costs equally with their customers. The remaining 5% of the panelists indicate they have taken steps to neutralize the impact of the cost increases on their company by improving energy efficiencies.

At the time this survey began, West Texas Intermediate crude oil closed at $51.85 per barrel. It passed $60 per barrel in late June. About 29% of the respondents expect the price of oil at the end of the year to be below $50 per barrel, while approximately 31% anticipate the price to be between $50 and $54. Around 25% expect the year-end price to be in the $55 to $59 range, and the remaining 14% believe the price of oil will be above $60 per barrel at year-end. The overall median price was just above $53 per barrel.

Expected price of oil per barrel at the end of 2005



Compass ON BUSINESS

The BLCI is a Compass on Business initiative created in collaboration with:

Compass Bank

University of Colorado at Boulder
Colorado LEEDS
School of Business

For more details on the Colorado Business Leaders Confidence Index®, visit www.blci.com/colorado

A Look into the BLCI Panelists are asked to choose their responses from a five-point scale. A numerical value ranging from –2 (Strong Decrease/Much Worse) to +2 (Strong Increase/Much Better) is assigned to each of these. A score is then calculated for each question and transformed into a scale that ranges from 0 to 100. Index values above 50 indicate expectations for increases, and index values below 50 indicate expectations for decreases. The BLCI combines these six measures using equal weighting.

Both total panel membership and the number completing the survey continue to expand. Many thanks to all of our panel members for making this survey a useful and reliable indicator. We make no pretense that this survey is representative of all business leaders in Colorado. What we report here are the responses of the panelists who completed our survey. As we continue to grow the size of the panel, we will continue to add analysis for individual industries and sub-state areas. Please join us in early September for our Fourth Quarter 2005 survey at wwww.blci.com/colorado.

The Value and Relevance of Confidence

Using, and learning from, the Business Leaders Confidence Index

- The economic surveys and projections you're most familiar with are based on national data and national trends. The BLCI, on the other hand, expresses the views of Colorado business leaders. Think of the BLCI as "weather report" predicting next quarter's conditions. The more localized the report, the more relevant it is to you.
- There's never enough time to draw upon all the information that, ideally, would contribute to smarter decisions. Too often, we find ourselves in the box of our own experience and our own expectations. The BLCI opens windows into how other executives and business owners like you are thinking. Occasionally you'll come across a general consensus that's quite different from what you would expect. This kind of "reality check" is helpful.
- Hard, cold facts are not the only factors affecting your peers' strategies and decisions. Their feelings and hunches about what to expect in the months ahead also play a surprisingly large role. The BLCI can help you get a better sense of these more subjective but still influential perceptions.
- Long-term projections have their value, but so do more immediate quarterly outlooks. Seeing what both customers and competitors are thinking about industry sales, profits, hiring plans and capital expenditures from quarter to quarter can help you with actions that need to be taken today, not tomorrow.