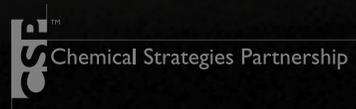


Chemical Management Services

Industry Report 2004

CREATING VALUE THROUGH SERVICE



CMSFORUM
a program of the Chemical Strategies Partnership

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Chemical Strategies Partnership
423 Washington Street, 4th Floor
San Francisco, CA 94111
Ph: 415.421.3405
Fax: 415.421.3304
www.chemicalstrategies.org

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Executive Summary

In 2000, the first-ever report on the state of the newly emerging chemical management services industry was released. At the time, the “chemical management services” (CMS) market had not been distinguished separately from traditional chemical product markets. There appeared to be sufficient growth in the CMS market to warrant a deeper look at this new emerging niche in the chemical industry. Thus, the non-profit organization, Chemical Strategies Partnership, published the *Chemical Management Services Industry Report 2000*. The report provided an overview of the CMS industry’s structure, conduct, and performance.

This report, *Chemical Management Services Industry Report 2004* is an update to the original report and looks at trends and performance since 2000. It is based on responses to a detailed survey by thirteen CMS providers and ten major CMS customers, follow-up interviews, market research, and CSP’s direct experience in the field.

The Market

The CMS market has grown roughly 50% from 2000 to approximately \$1.22 billion (FY1999-2003) and all indicators point to continued steady growth. CMS is consistent with other larger business trends including outsourcing and shifting to service-based business models to realize greater profitability. We estimate the potential U.S. CMS market to be \$17-19.5 billion.

The most notable change in the CMS market from 2000 is the growth in the number of industrial sectors using CMS. CMS is now utilized in eleven sectors with penetration in several sectors above 30% (see Table 1). The automotive industry still leads in the adoption of CMS with about 75-80% of the industry utilizing CMS. However, there has been significant growth in the use of CMS in air transport maintenance (40-50% penetration) and aerospace manufacturing (25-30% penetration).

Table 1. Industry sectors utilizing CMS

<ul style="list-style-type: none"> • Automotive manufacturing (OEM) • Automotive suppliers • Heavy equipment • Aerospace manufacturing • Air transport maintenance • Miscellaneous manufacturing & others 	<ul style="list-style-type: none"> • Electronics • Energy/Utilities • Steel Manufacturing • Food/Beverage • Research/Laboratory
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The CMS market has grown roughly 50% from 2000 to approximately \$1.22 billion (FY1999-2003).

CMS is now utilized in eleven sectors with penetration in several sectors above 30%.

Survey respondents reported net savings of 5%-20% in the first year of implementation.

Industry Structure

The CMS market is served by two distinct provider groups. Approximately 75% of the providers interviewed are considered “product-based” providers. These tend to be large chemical producers who target customers who use (or could use) their products. Over the past ten years, providers have followed their product into the customers’ facilities. Traditionally, these providers have served one of three sectors: automotive, metalworking, or semiconductor. However, we are seeing aggressive activity in new sectors from the product-based providers. In the 2000 survey, CMS providers generally reported that they focused on serving one or two industries. However in 2004, more than half of the providers surveyed serve four or more industries. The aggressive move into new markets may indicate more service expertise being developed among the provider base and thus more success in selling into new markets.

The remaining 25% of CMS providers are service-based, meaning they do not produce chemicals themselves. Instead, they rely on sophisticated service models to target customers with more highly diversified and specialized chemical purchase profiles. They are often more capable of serving industries that are characterized by a higher diversity and lower volume profile of chemical use. Typically, this includes customers in the aerospace, airline maintenance, and electronics industries (excluding semiconductor).

With the growing popularity of CMS and customers who are more educated about the CMS model, there appears to be more of an opportunity for new CMS providers to enter the market now than in 2000. Most notable is activity and interest among environmental and MSDS (Material Safety Data Sheets) information management companies to form alliances with CMS providers to serve new markets characterized by low volume, highly diverse chemical product mix.

Delivering Value to Customers

Customers continue to enjoy significant cost savings and emissions reductions through the implementation of CMS. Survey respondents reported net savings of 5%-20% in the first year of implementation. Over the first three years of the contract, a majority of providers estimate they deliver 6-10% savings per year or more. The majority of savings come from reducing the amount of chemical used, reducing the price of the chemical product, and improving manufacturing processes. Customers are enjoying not only significant cost savings, but also significant environmental benefits from reduced chemical volume, reduced emissions, reduced risk, and better data for reporting.

Many of the CMS contracts cover the entire chemical lifecycle as well as most of the customer’s chemical “footprint” and involve significant investments in on-site staff. Contracts are often modified over their typical lifespan of three to five years to increase the scope of services and the range of products. They are also rather sophisticated, typically including two or three compensation mechanisms – most often a combination of chemical purchase cost pass-through, management fees, and mandated and/or shared cost savings.

CMS Industry Revenue, Profitability and Growth

The growth in the CMS market has translated into strong financial performance for providers and continues to outperform profitability for the chemical industry as a whole. All of the respondents reported revenue growth over the past three years. Approximately 50% of the respondents cited growth greater than 10% per year over the past two years. Based on future projections by CMS providers, we expect future revenue growth to meet or exceed that of the past several years.

Only a few of the providers surveyed divulged information regarding their profit margins. For these respondents, profit margins ranged from 5-25% in 2003. Growth in profit margins since 2000 has been steady at about 5-10% per year and is projected to remain at 5-10% per year through 2006.

The expectations for growth for the CMS industry are in contrast to the traditional chemical industry. Although chemical sales in 2003 for the top 50 companies worldwide increased 15% from the previous year, profit margins fell by 5.5%. The positive profitability growth of CMS is a bright light in the chemical industry where profit margins have dropped steadily since 1997. In addition, since the chemical industry is cyclical in nature, chemical management services can offer steady growth and an opportunity to build stronger relationships with customers.

Outlook

Remarkably, providers reported that their profits are derived primarily from the services sold and savings achieved. This is in contrast to responses in 2000 that placed commodity sales as one of the top profit drivers. The value providers are delivering in services is likely a driver in the expansion of CMS into new industry sectors and providers' enthusiasm to continue pursuing new markets. 62% of providers expect the most growth in CMS opportunities to be with new customers. This is quite different than the outlook in 2000, where 20% of providers felt that growth opportunities were with new customers.

In 2000, a top priority for investment was information management capability and a majority of the providers followed through on these investments. Therefore, in 2004 we see more diversity in expected investments that reflect positioning for a rapidly growing market. Just over 50% indicated that they will invest in information technology, while investments in training, new market segments, and improved chemical and process technologies rated high.

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Challenges and Recommendations

The CMS industry continues to be dynamic, nimble to meet customers' needs, and expanding steadily. Several key areas pose challenges to that growth, but the industry is well positioned to address them in the next several years.

- *International Expansion.* There is significant growth potential for CMS internationally. However, CMS providers are reporting difficulties in expanding the CMS business model into international markets due to informational, cultural, and financial barriers. Therefore, it is no surprise that 75% of providers see the greatest growth potential for CMS in the United States. CMS providers need to develop the right cultural approach to sell CMS in different international markets, but also the logistical infrastructure in those areas to support CMS activity. Governments in Asia and Europe are investing in learning about and promoting the CMS model which offers a window of opportunity for CMS providers.
- *Technological Innovation.* One particular challenge for the future efficacy of CMS is the ability of providers to continuously bring value to their customers and to introduce new technologies, new chemistries, and process efficiency improvements for their customers. CMS providers need to continue tapping a number of resources both internally and externally to serve this need.
- *CMS in Smaller Facilities.* CMS is implemented most often in large industrial facilities, but the potential market for smaller sites is significant. Currently, it is difficult to cost-effectively implement a CMS program at a facility that purchases less than \$1 million in chemicals annually. For continued growth of CMS, strategies for serving the small and medium-sized markets need to be developed.
- *Industry Promotion and Data.* The most compelling information for successfully promoting CMS is good case study data and industry market data. The industry should continue its joint educational efforts through the CMS Forum, continue to aggressively build its membership, and support more industry research activities and case study development.