

## Campbell Brothers (CPB)

**Table 4: Campbell Brothers Corporate History 1863 - 2010**

Year	Event
1863	Company starts business life as a soap maker.
1952	Campbell Brothers lists on the Australian Stock Exchange, growing into a leading diversified services company covering analytical laboratory services, specialty chemicals and distributor of hospitality products.
1998	NPAT exceeds \$10M for first time on revenue of \$175M.
1999	ALS acquires Chemex Laboratory Group for \$8M, with operations in Canada, USA, Mexico and Peru, making ALS the single largest minerals analysis group in the world.
2000	Company sells its soap business to Faulding Healthcare for \$4.6M in December.
2001	Jan – ALS acquires Canada’s leading environmental analysis group Analytical Services Laboratories established in 1982 for \$10M.
2005	NPAT hits \$21.9M on revenues of \$436M.
2005	CEO Bruce Brown retires following 15 years as CEO and 36 years since joining company in 1969.
2005	Greg Kilmister appointed new CEO, General Manager and employee of ALS since 1992 and 1981 respectively.
2005	Company announces 1:5 rights issue at \$9.00 per share, raising \$75M to fund growth initiatives.
2006	Jan – Acquires Enviro-Test Laboratory Group, Canada’s second largest environmental testing group for \$57M, pushing annual North America laboratory revenues to in excess of \$125M and global revenues to \$300M supported by 58 laboratories.
2006	Acquires Swedish based laboratory group Analytica AB for initial cash payment of \$25M.
2006	Acquires two laboratory acquisitions based in Melbourne (Consulchem) and West Africa (Abilab) for \$11M in cash.
2006	Dec – Company sells Home Services Division to Rentokil for \$48M.
2007	Company sells out of listed coal analytical services group CCI Holdings following takeover rejection.
2007	Sep – Enters environmental market acquiring US environmental laboratory group e-Lab Analytical Inc for \$18M.
2007	Company acquires Australian coal services company ACIRL for \$76.8M, employing 400 people and market leader in coal testing with approximately 46% market share.
2007	Company posts NPAT of \$59M on revenues of \$663M, market capitalisation exceeds \$1.5B.
2008	Company shares hit all time high of \$36.36 per share during September 2008.
2009	Company shares hit multi-year low of \$8.29 per share during March 2009.
2009	Company reports record NPAT during 2009 of \$106M on revenues of \$920M.
2009	Takeover of PearlStreet, Australia’s largest non-destructive testing services provider for \$64M in cash.
2009	Company launches 1:6 renounceable rights issue @ \$22 per share to raise \$196.6M.
2010	Group NPAT falls 29% to \$75M, recording its first drop in earnings since 2002.
2010	Company bids for listed mineral testing consultancy group Ammtec, finally gaining approval with cash / scrip offer valuing business at \$148M.
2010	Company employs over 8,000 staff, operating in 200 plus sites in 44 countries. The group’s market capitalisation now sits at \$2.1B, with revenues in excess of \$1.0B.

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**Table 5: Campbell Brothers Financial Snapshot**

\$'M	1995	2000	2005	2006	2007	2008	2009	2010	2011e
Revenue	97.1	271.7	435.6	485.5	611.2	761.0	920.4	825.5	1040
Operating Expenses	89.9	250.3	349.6	432.5	402.5	652.1	756.8	710.2	855.0
EBIT	7.2	21.4	40.9	53.0	83.0	108.9	163.6	115.3	185.0
NPAT	4.7	12.1	21.9	32.7	50.9	76.0	106.2	74.9	126.0
EBIT Margins (%)	7.4	7.9	9.4	10.9	13.6	14.3	17.8	14.0	17.8
Shareholders' Equity	30.5	88.6	151.1	256.7	299.5	338.2	413.1	629.7	675.0
Net Debt / (net cash)	18.4	48.2	73.2	85.7	88.9	191.5	209.6	147.0	127.0
Market Capitalisation	47.0	125.1	366.1	886.4	1,436.0	1,364.5	1,052.6	1,914.5	2,076.4
Enterprise Value	65.4	173.3	439.3	972.1	1,524.9	1,556.0	1,262.2	2,061.5	2,203.4
Buyout (%) **	11.0	12.3	9.3	5.5	5.4	7.0	13.0	5.6	8.4
ROCE (%) *	15.0	15.6	18.2	15.5	21.4	20.6	26.3	14.8	23.1
GOCF / EBITDA (%)	85	44	95	97	85	85	58	93	95
Underlying EPS (¢)	27.2	39.0	53.8	76.8	114.6	147.8	201.9	119.0	198.0
PER	9.9	10.4	16.3	22.6	24.3	17.7	9.8	25.3	16.5
Dividend per share (¢)	16.0	27.0	42.0	50.0	70.0	95.0	100.0	100.0	130.0
Dividend Yield %	5.9	6.7	4.8	2.9	2.5	3.6	5.0	3.3	4.0
Share Price 30 June (\$)	2.70	4.05	8.78	17.38	27.83	26.19	19.86	30.15	32.70
Issued shares (m)	17.4	30.9	41.7	51.0	51.6	52.1	53.0	63.5	63.5

\* ROCE = EBIT / (Shareholders Equity + debt – cash)

\*\* Buyout represents EBIT / EV as a percentage

### History

There are few listed Australian companies that have a history that dates back to the ninetieth century but in the case of Campbell Brothers, its origins can be traced to 1863 when it began life as a soap maker. The foundations were laid by Peter Morrison Campbell and later extended by son's Norman Carlisle and Ronald Clifford in 1910, leading to the formation of private company Campbell Brothers. In 1923 the business separated into three areas, household soap, toilet soap and chemicals, attracting the interests of competitor Kitchen & Son (now Lever & Kitchen) in 1924 with an offer to buy the business for 12,500 pounds. The offer was rejected and led

to the company ultimately listing on the Brisbane stock exchange in 1952, selling shares in lots of 100 shares for 25 pounds.

In 2010 the company celebrated its one hundredth year anniversary and its fifty-eighth year since listing. Today, Campbell Brothers is a vastly different business. While it has maintained some link to its past, the change has become more pronounced in recent years. First time visitors to the group’s website may mistakenly compare the company’s logo to the Australian Coat of Arms, a relic of years gone by.

In 2000, the original soap business was sold to Faulding Healthcare for \$4.6 million, as the business expanded further into industrial chemical operations and consumer products. Today, Campbell Brothers describes itself as an Australian diversified industrial services company with operations around the globe.

**Campbell Brothers Logo**



At the operational level, the business is broken into three areas with the Campbell Chemicals and Rewards Distribution divisions’ small contributors to group profits and revenues while the laboratory testing services subsidiary ALS Laboratory Group remains the prime contributor as illustrated by Graph 1.

**Graph 1: Campbell Brothers divisional contributors**



**Table 6: Divisional Contribution**

\$'M	2003	2004	2005	2006	2007	2008	2009	2010
<b>Revenue</b>								
ALS Laboratory Group	114.4	123.9	159.2	208.9	342.2	468.0	628.8	561.6
Campbell Chemicals	132.1	127.9	124.1	167.1	163.9	152.8	164.3	151.8
Reward Distribution	115.5	141.5	154.1	112.0	135.0	145.7	132.8	117.8
<b>Total</b>	<b>362.0</b>	<b>393.3</b>	<b>437.4</b>	<b>488.0</b>	<b>641.1</b>	<b>766.5</b>	<b>925.9</b>	<b>831.2</b>
<b>Operating Profit</b>								
ALS Laboratory Group	16.3	21.5	35.6	47.3	79.5	112.5	155.8	118.0
Campbell Chemicals	5.9	5.2	6.6	9.5	8.2	9.7	7.9	8.2
Reward Distribution	7.9	9.3	8.3	5.9	5.5	4.6	3.4	3.4
<b>Total</b>	<b>30.1</b>	<b>36.0</b>	<b>50.5</b>	<b>62.7</b>	<b>93.2</b>	<b>126.8</b>	<b>167.1</b>	<b>129.6</b>
<b>Operating Margins %</b>								
ALS Laboratory Group	14.2	17.4	22.4	22.6	23.2	24.0	24.8	21.0
Campbell Chemicals	4.5	4.1	5.3	5.7	5.0	6.3	4.8	5.4
Reward Distribution	6.8	6.6	5.4	5.3	4.1	3.2	2.6	2.9
<b>Total</b>	<b>8.3</b>	<b>9.2</b>	<b>11.5</b>	<b>12.8</b>	<b>14.5</b>	<b>16.5</b>	<b>18.0</b>	<b>15.6</b>

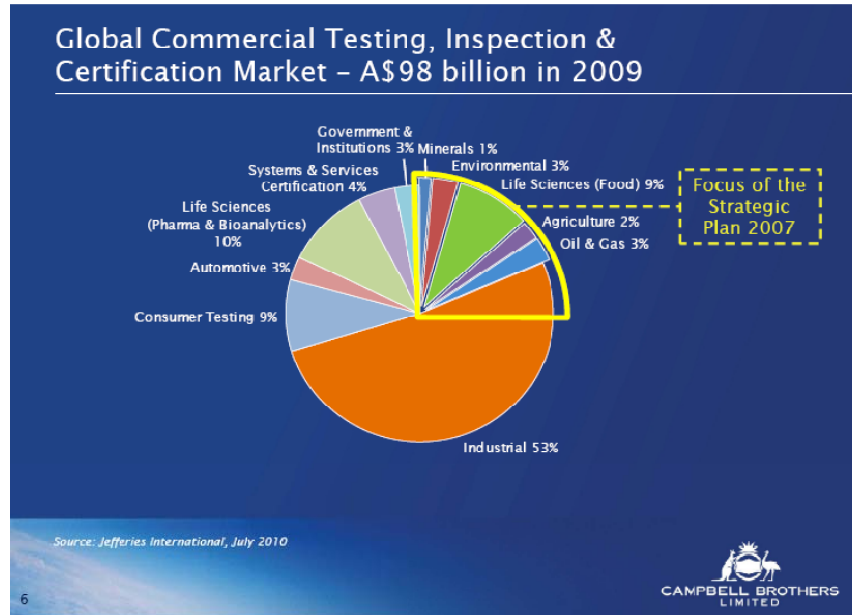
As Table 6 highlights, the mainstay of revenue and profit growth has fallen to the group's analytical laboratory testing division ALS Laboratory. In short, ALS has successfully exploited a market to test and certify product supplies from a raft of customers in key industries including;

- i. minerals - specifically gold, nickel and now coal,
- ii. environmental - surrounding analysis of soil, water and air quality,
- iii. tribology - being the analysis of lubricating oil from mechanical equipment and
- iv. industrial - analysis of assets including plant inspection, power generation and infrastructure assets.

Management identified the laboratory testing market as a key strategic objective for the group earlier this decade. Putting numbers to the opportunity set is a worthwhile exercise but not always a reliable indicator. That said, it is estimated that the global commercial testing, inspection and certification market is worth \$98 billion, of which

Campbell Brothers is currently targeting one quarter of the pie, specifically relating to the testing market as denoted by Graph 2.

**Graph 2: Global Commercial Testing, Inspection & Certification Market**



To date their approach has been to gain a foothold in a given testing field, usually by acquisition and then seek to grow organically.

It is a strategy that has worked very well for another serial acquirer, the QBE Insurance group and one that has so far delivered excellent results for Campbell's. Specifically, the group has added over fifteen acquisitions during the past decade and spent in excess of \$300 million since 2006, a figure that is set to rise by another \$150 million once the current bid for listed Australian mineral testing group Ammtec is completed.

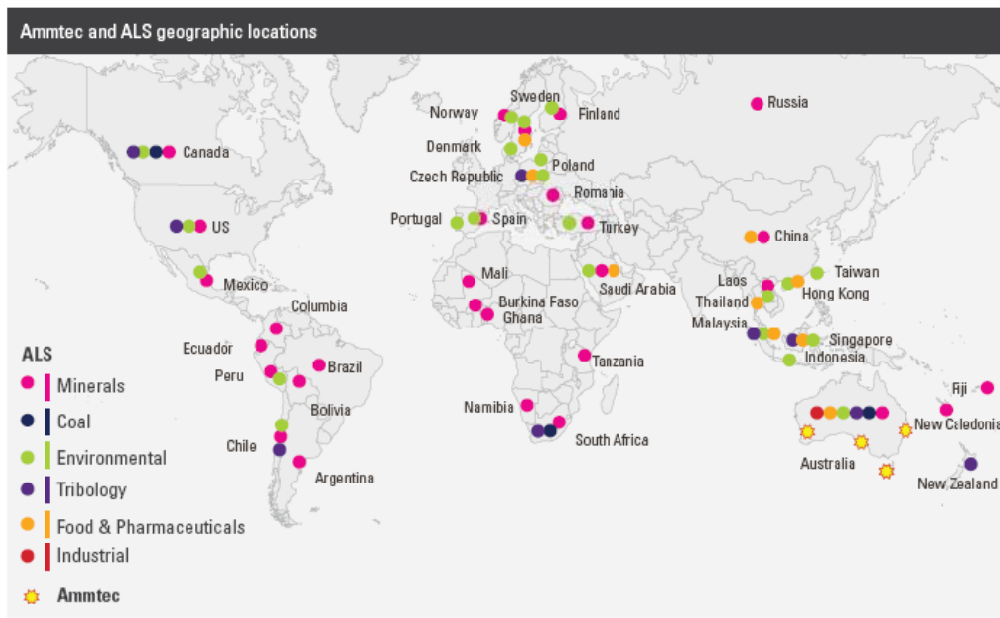
As we noted in our earlier piece, acquisitions can cause considerable pain particularly when the numbers are big. However management have so far avoided many of the pitfalls that beset new owners and have largely paid for the bulk of the acquisitions with cash, thus limiting shareholder dilution as we will discuss a little further on.

At its core the ALS Laboratory service offering is built around the need to test things. For example mineral companies need to test mining samples to confirm their quality or grade and to ensure a specific shipment of product is sent to the right customer.

Similarly, testing for environmental issues ensures standards are maintained while regular plant inspections can pinpoint problems before they emerge. While companies can undertake these services in-house the great bulk of work is carried out by external groups like Campbell Brothers. More importantly, because of the large volume of tests required, providing scale and global coverage becomes an important point of service differentiation.

On this score management is only too happy to point out that the ALS Group is “one of the largest commercial laboratory groups in the world – arguably the most successful commercial analytical laboratory in the world.” With over 160 labs in 42 countries, ALS operates under what is commonly termed a hub and spoke model, whereby a large number of smaller sized labs service larger hub laboratories. And it is a competitive edge that the group has exploited. Where competitors struggle to transfer testing samples internationally, ALS’s information system, dubbed Laboratory Information Management System (LIMS), enables sample tracking and online web-based interaction with clients.

**Graph: 3 ALS global operations**



Source: Campbell Brothers website; Ammtec website

To date, the returns generated on capital invested have justified management’s faith in the industry but to be frank, the tailwind that has been the resources bull market has certainly helped things along. During 2010, ALS suffered a setback to revenue

and earnings as the financial crisis took hold and testing volumes dropped. Profits fell 24% to \$118M on revenues down 11% to \$562M, while margins held up reasonably well at 21%.

To provide some earnings shelter, management has sought to broaden its service offering moving aggressively into a number of new markets with reasonable success as highlighted in Table 7.

**Table 7: ALS Laboratory Group Contribution**

\$'M	2010	2009
<b>Revenue</b>		
ALS Minerals	205.0	310.8
ALS Environmental	245.2	234.9
ALS Coal	61.8	59.2
ALS Tribology	29.8	23.9
ALS Industrial	19.8	0.0
<b>Total ALS</b>	<b>561.6</b>	<b>628.8</b>
<b>Operating Profit</b>		
ALS Minerals	53.3	112.2
ALS Environmental	43.8	28.4
ALS Coal	15.0	13.2
ALS Tribology	4.6	2.1
ALS Industrial	1.3	0.0
<b>Total ALS</b>	<b>118.0</b>	<b>155.9</b>
<b>Margins %</b>		
ALS Minerals	26.0	36.1
ALS Environmental	17.9	12.1
ALS Coal	24.3	22.3
ALS Tribology	15.4	8.8
ALS Industrial	6.6	0.0
<b>Total ALS</b>	<b>21.0</b>	<b>24.8</b>

Of these, ALS Minerals is the division's largest earnings contributor at about 45%, with the bulk of these profits, estimated at 40%, coming from the North American operations followed by Australia and South America. Likewise, ALS Environmental, covering the analysis of soil, water and air quality is split along similar lines although the group's recent Ecowise acquisition in Australia should see the earnings contributions more evenly matched in future years.

ALS Coal is in its infancy, following the 2008 acquisition of ACIRL in Australia and Wittab in South Africa, however the group is already market leader locally and building up scale in both South Africa and Canada. The newer divisions of Tribology and Industrial are small in revenue and profit terms but will benefit from another recent acquisition PearlStreet.

Globally, Campbell Brothers is relatively small compared to its peers (see Table 8) that include the big compliance testing groups SGS, Interlek, Bureau Vertias and smaller oil and gas specialty player Core Labs. Yet despite this, management have successfully positioned the group to dominate in key markets such as Minerals where it has the largest market share and Environmental, where it sits at number two. It is aiming to develop its ALS Coal division into a leading position, having made significant inroads over the past two years.

**Table 8: Global competitive landscape**

Global Players	Listed	Revenue	Operating Profits	Market Cap	EV/EBIT* 2011(e)	Employees	Laboratories
SGS	Switzerland	CHF 4,712 m	CHF821 m	CHF12.6 b	14.0	59,000	1,000
Intertek	United Kingdom	£ 1,237 m	£ 187 m	£ 2.9 b	13.4	26,000	1,000
Bureau Veritas	France	€ 2,648 m	€ 433 m	€ 5.5 b	11.8	39,000	900
Core Labs	United States	\$US 696 m	\$US 187 m	\$US 3.9 b	15.2	4,900	50
Campbell Brothers	Australia	\$A 825 m	\$A 118 m	\$2.1 b	11.9	8,000	200

\* EV/EBIT = Enterprise Value / Group EBIT

### **Management**

And being big doesn't count for much if you have little to show for it. In the case of Campbell's, there is a lot to like and importantly it starts at the very top with management. Former CEO Bruce Brown, an employee of the group for 30 years until his retirement in 2005, certainly deserves a lot of the credit during his 15 year reign as leader. The building blocks of the business were set and maintained during his watch and extended when the baton passed to another long time employee Greg

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Kilmister. He brings continuity to the table as well as a 29 year association with the business including 13 years as General Manager of the all important ALS Laboratory division, until his main appointment in 2005.

### ***Campbell Brothers CEO's Past & Present***



CEO Bruce Brown  
1990 - 2005



CEO Greg Kilmister  
2005 – Present

As noted earlier, the group has spent up big under Kilmister's watch, adding scale and grunt to the testing services division. This has not been without risk but shareholders have been well looked after during the past 15 years as highlighted in Table 5.

### ***Strong financial record***

Since 1995, group revenues and profits have soared, while margins have doubled as the higher earning ALS division surpassed the more sedate chemicals and hospitality operations. Despite the 2010 earnings setback, return on capital employed still stands at a healthy 15% while dividends per share have compounded at 13% per annum. While this is less than the 20% growth recorded in earnings before interest and tax, shareholders have been offered first option to contribute additional capital into the business. The group's issued capital has increased from 17.4 million shares in 1995 to the current 63.5 million and although up, is significantly less than what would have been the case if management had issued shares rather than pay cash for the majority of its acquisitions.

The group's free cash flow pre-acquisitions and before the payment of dividends has been positive and rising since 2003, despite the 2010 set back as shown in Table 9. However, the group's acquisition strategy has impacted the cash flow that remains after the payment of dividends. In this respect the free cash flow post dividend payments has remained largely in the red since 2003, being funded by debt or new equity issues. Obviously, management is confident that the money is being well

spent and while we are prepared to back them in this regard we are mindful of the dangers when a company over commits to such a strategy.

**Table 9: Free Cash Flow**

\$'M	2003	2004	2005	2006	2007	2008	2009	2010
<b>Free Cash Flow</b>								
Net Operating Cash Flow	29.1	26.0	30.2	46.8	58.3	80.7	167.6	100.7
Normal Capital Expenditure	(12.6)	(11.9)	(17.7)	(26.8)	(39.1)	(50.1)	(71.5)	(43.2)
<b>Free Cash Flow (pre acq &amp; divs)</b>	<b>16.5</b>	<b>14.1</b>	<b>12.5</b>	<b>20.0</b>	<b>19.2</b>	<b>30.6</b>	<b>96.1</b>	<b>57.5</b>
Acquisitions & Asset Sales	(8.1)	(12.9)	18.9	(82.0)	(3.5)	(96.3)	(45.2)	(119.1)
<b>Free Cash Flow (pre dividends)</b>	<b>8.4</b>	<b>1.2</b>	<b>31.4</b>	<b>(62.0)</b>	<b>15.7</b>	<b>(65.7)</b>	<b>50.9</b>	<b>(61.6)</b>
Dividends paid	(9.7)	(9.2)	(10.5)	(14.3)	(18.8)	(25.0)	(37.6)	(32.8)
<b>Free Cash Flow (post dividends)</b>	<b>(1.3)</b>	<b>(8.0)</b>	<b>20.9</b>	<b>(76.3)</b>	<b>(3.1)</b>	<b>(90.7)</b>	<b>13.3</b>	<b>(94.4)</b>

Despite these concerns the company has earned the respect of the market with the company's shares often selling at a premium, along with a market capitalisation now topping \$2.1 billion, placing it within reach of the Australian Stock Exchange top 100. Having firmly committed itself to the global laboratory testing market, the company faces a number of headwinds including a business subject to cyclical demand swings and a growing offshore earnings profile. The strong Australian dollar certainly makes life harder in this respect as does the need to sustain increasing levels of testing volumes to cover overheads.

During the past quarter we added Campbell Brothers to the portfolio, making up 2.5% of the Fund's value at an entry price of \$30.94 per share. Based on our entry price, the investment is trading on a prospective PER of 15.6 and a partly franked yield of 4.2%.

In our June 2010 quarterly newsletter we highlighted our investment in Blackmores, noting that there was a lot to like about the business but none more so than the reputation earned over seventy years. In a similar vein, the Campbell Brothers business has morphed over the past century but its reputation earned both in business and from shareholders is clearly deserved. *SFM*