



Testing & Certification

A steady source of disconcerting economic news for months, Europe has been largely overlooked by investors seeking attractive growth opportunities. Baron International Growth Fund, nevertheless, holds significant positions in two European certification and testing companies that have done well and continue, we think, to have favorable prospects.

Both Eurofins Scientific, based in France, and Intertek Group, based in the U.K., are leaders in their fields. Intertek, 2.0% of the Fund as of 2/29/2012, is one of the three major global players in the overall testing and certification industry while Eurofins, 3.3% of the portfolio, is the world-wide leader in food testing. Eurofins also has a presence in environmental and pharmaceutical testing. We first invested in Intertek in June 2009 and in Eurofins in October 2010. Both companies have performed well since our initial investments; both have gained sharply so far this year.

Eurofins and Intertek are benefiting from three significant growth drivers: globalization, regulatory creep, and food-safety concerns. Both companies operate in multiple countries, responding to the needs of manufacturers and retailers to assure the quality of both raw materials and finished goods. For example, paint manufacturers pay for testing and certification that their finished product is lead free. Textile and toy manufacturers also use these services to assure customers of their products' safety.

Growth is especially strong in emerging market countries, which are benefiting from both increased local con-

sumption as well as export-driven manufacturing. Small, local brands that have traditionally competed mainly on price against better-known foreign imports can grow local sales by raising their credibility through testing and certification.

Similarly, the growing world-wide demand for food is creating opportunities for independent food testers to assure that processed and packaged foods are safe and of high quality.

Although some large manufacturers perform testing on their own, many prefer to use third-party providers such as Intertek or Eurofins. The use of third parties does more to raise the credibility and integrity of their products and brands.

Increasing government oversight over imports is also driving demand for testing services. For example, the U.S. Consumer Product Safety Improvement Act contains provisions concerning the quality of consumer goods and more stringent requirements for children's products.

Both Eurofins and Intertek enjoy high barriers to competition, given their substantial investments in laboratories and equipment. They have low customer-churn rates because clients want to avoid disruption and any risk to their reputation. We think that both companies have high-quality management teams.

The testing and certification industry itself is fragmented with numerous small companies serving local markets. There is a tendency for smaller companies to sell out over time as the industry consolidates and as local manufacturers seek new customers by raising their credibility. We believe Eurofins, with a market capitalization of about \$1.6 billion and Intertek, \$ 6.4 billion, are likely acquirers as they expand into new markets. Eurofins is itself considered a possible takeover target, but the company founder and CEO has so far expressed no interest in selling.

Baron International Growth Fund invests primarily in non-U.S. growth companies. In this column, Portfolio Manager Michael Kass examines the companies, industries and events that he believes will influence the Fund in the months to come.

Current and future portfolio holdings are subject to risk. 🏠

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