

Swiss Company Flash

Bank Leu Swiss Equity Research

SGS

New 12-month price target CHF 1'000

SGS's 2005 results were fully in line with our and the market's estimates. We believe investors should focus on the progress made during H2. Compared with H1 organic growth accelerated from 10.1% to 11.3% and operating margin increased from 13.0% to 14.1%. Acquisitions during FY04 contributed positively to the results, operating margin achieved on the acquired businesses was, according to our calculations, 14.5%. We were also positively surprised by the strong cash flows achieved. DSO was once again successfully reduced, CerTIVVA™, the EVA-based model used by SGS, is delivering results. Money inflow from net working capital was CHF 37m.

in CHF m	FY04	FY03	Change	Bk Leu Est.
Revenues	2'885	2'454	17.6%	2'857
- due to volume and prices	10.7%	7.0%		10.8%
- due to currency translation	-1.8%	-4.5%		-2.1%
- due to acquisitions/(disposals)	8.6%	0.1%		7.7%
EBITDA	506	396	27.9%	495
Operating income	391	300	30.5%	396
- Margin	13.6%	12.2%		13.9%
Exceptionals	3	3		0
Goodwill	-16	-10		-18
EBIT	375	293	28.3%	378
Net financial income	6	10		8
Net profit before taxes	384	303	26.9%	386
Taxes	-90	-68		-91
- tax rate	23.4%	22.5%		23.5%
Net profit after taxes	294	235	25.3%	295
Minorities	-15	-8		-13
Net profit	279	227	23.1%	282
Free cash flow	225	168	33.9%	198
Net cash	483	493		380

By segment, organic revenue growth in H2 for the usually rather boring agricultural business turned out to be surprisingly strong (14.4%); strong growth in H2 was also achieved in minerals (20.6%), OGC (13.1%) and consumer testing (26.0%). According to management, the strong momentum achieved in H2 moved into 2005. Moreover, we were also astonished by incredibly strong margins in H2 in TAS (25.8%); management believes that achievement is sustainable. There were also some disappointments in H2; we note automotive with negative growth and a margin decline and certification with nearly flat growth.

Management's tone during the analyst conference was upbeat. The 2005 target (EPS of CHF 45) was confirmed. A new CEO has been appointed; his name will be made public as soon as practicable. Furthermore, Rolf Jeker, Head of TAS, and Mr. Frankie NG, head of consumer testing, both gave upbeat presentations from their divisions.

We have fine-tuned our earnings forecasts and made some minor adjustments. Our bull case was confirmed; we expect newsflow to remain positive. We expect the new CEO to announce his vision for targets beyond 2005 when he is in place. We estimate that EPS of at least CHF 60 should be reachable for 2007 (see our research from 04.01.2005). Applying a PER multiple of 20 times, a multiple that we look on as fair regarding the superior SGS business model and huge growth prospects in the industry, we would expect to see share prices around CHF 1,000 until end of 2005 and CHF 1,200 until the end of 2006. Note that comparable companies in the business service sector (outsourcers) trade, on average, at a 1-year forward PE ratio of 22 times. Calculating with a WACC of 8.3% and a perpetual growth rate of 2.5% we derive a DCF value of CHF 1,083.

As our confidence in the targets has risen, and as we believe the outlook is bright beyond 2005, we have increased our 12-month price target from CHF 950 to CHF 1,000, our rating remains Buy.

January/17 2005, Ronald Wildmann, CEFA

Buy

Bank Leu Long Term Rating

SGSN VX; SGSZn.VX

in CHF	Actual	52WkH	52WkL
Price	810.50	845.00	633.00
New price target (12 mth)			1'000
Market cap (CHF m)			6'340

Per share data

in CHF m	FY04	FY05E	FY06E
EPS	35.7	45.6	54.5
FCF	19.3	28.6	41.5
Dividend	12.00	15.00	18.00
Book value	157	189	227
Valuation	FY04	FY05E	FY06E
P/E	22.7	17.8	14.9
FCF yield	2.4%	3.5%	5.1%
EV/Sales	2.03	1.82	1.59
EV/EBITDA	11.9	9.9	8.2
EV/EBIT	15.6	12.1	9.8
Price/book	5.2	4.3	3.6
Div. Yield	1.5%	1.9%	2.2%

P&L

in CHF m	FY04	FY05E	FY06E
Revenues	2'885	3'224	3'579
EBITDA	490	590	692
Op. Income	391	485	582
Exceptionals	3	0	0
Goodwill	-16	0	0
EBIT	378	485	582
Net fin. inc.	6	5	5
PBT	384	490	587
Taxes	-90	-115	-138
PAT	294	375	449
Minorities	-15	-19	-23
Profit	279	356	426

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