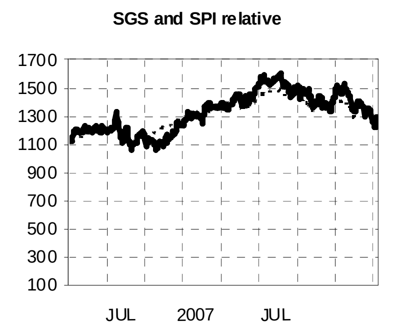
FY 2007 results

Strong FY 07; 2008 targets confirmed; new, aggressive mid-term target ➔ BUY reiterated, unchanged price target of CHF 1,650

BUY

Market cap.	CHF m	9837
Last price	CHF	1291
52 week high	CHF	1628
52 week low	CHF	1199
YTD performance	%	-4.3
Economic value	**CHF**	**1707**
Soft factor ded.	%	0.0
Fair value NZB	**CHF**	**1707**
Div. ranking shs	m	7.6
Symbols		SGSN.VX, SGSN VX



Key figures (CHF)	2006	2007	2008E	2009E	2010E	CAGR 05-10E
Net revenues (m)	3821	4372	4746	5223	5718	11.6
Growth rate (%)	15.5	14.4	8.6	10.1	9.5	
EBITDA (m)	777	908	1'015	1'134	1'260	14.4
Margin (%)	20.3	20.8	21.4	21.7	22.0	
EBIT (m)	605	711	789	886	988	14.5
Margin (%)	15.8	16.3	16.6	17.0	17.3	
Net profit (m)	443	500	577	648	724	14.3
Dividend	20.0	35.0	30.0	34.0	38.0	-5.3

EPS revision	2006	2007	2008E	2009E	2010E	CAGR
EPS new	58.1	65.6	75.7	85.0	95.0	14.0
EPS old			73.1	84.1	94.8	
% change			3.5	1.1	0.2	

Valuation (x)	2006	2007	2008E	2009E	2010E
P / E	20.9	22.2	17.1	15.2	13.6
P / CEPS	20.9	22.2	17.1	15.2	13.6
P / BV	6.0	5.8	4.4	3.7	3.2
EV / EBITDA	13.1	10.9	9.1	7.9	6.8
Dividend yield (%)	1.6	2.4	2.1	2.4	2.7

SGS would be able to certify itself for delivering successful results year-on-year. The group's reported FY 2007 figures were excellent thanks to a strong year-end both for top-line and margin growth. Once again, SGS was able to generate a high cash flow thanks to a decrease in net working capital. On the back of these strong results, the Board has proposed a CHF 25 dividend combined with a CHF 10 special dividend payment. In addition, the group confirmed its 2008 targets (CHF 5bn in sales, 17% margin, EPS of CHF 80). Finally, SGS issued a new mid-term earnings target (EPS of CHF 105 by 2011), which was a positive surprise and a trigger for the stock.

BUY rating maintained, unchanged price target of CHF 1,650

We have slightly adjusted our estimates in view of the FY 2007 results and the management's comments. Based on our new estimates, we derive a new 'fair value NZB' of CHF 1,707 per share (vs. CHF 1,747 previously).

Back in December, we were rather pessimistic about SGS's ability to achieve the 2008 targets. However, in the wake of the FY 2007 results and the rather upbeat outlook given by the management, we now believe that SGS might surprise the market and indeed achieve the targets. To do so, the group needs to rapidly complete several acquisitions amounting to CHF 150m in annual sales. The investment case is intact, in our view. Amid a global economic slowdown in H2 2007, SGS was able to substantially increase its organic growth rate, which is a strong sign of the underlying strength of its different business lines. We continue to believe that SGS has a very attractive profile of both a growth and defensive stock. Our new 'fair value NZB' indicates significant upside in excess of 30%. We are therefore reiterating our BUY rating with an unchanged price target of CHF 1,650 per share.

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- **Strongest organic growth ever and 17% margin in H2 2007:** Amid overall favorable trading conditions, SGS reported a solid fiscal 2007. The group continued to focus on internal investments in expanding service line offerings and geographic coverage. Overall, sales grew by 14.4%. Organic sales growth amounted to 12%, fueled by an exceptional second half with the best organic growth ever, which stood at 12.5%. Six out of ten business units reported organic growth in excess of 10%. The benchmark set by SGS will be hard to beat for Intertek and Bureau Veritas, which will both publish their FY 2007 results in March. Although SGS as usual did not disclose the split between volume growth and price increases, we believe that the pricing environment was definitely not prohibitive for the group, especially in the commodities business divisions.

  Acquisitions net of disposals accounted for CHF 33m of sales at the group level, or a positive impact of 0.8%, while foreign currencies had a positive impact of 1.5%.

  The group's operating profit increased 17.5% to CHF 711m. The operating profit margin improved by 50bp to 16.3%, 20bp above our expectation. The overall increase in operating profit was aided primarily by strong volume growth (operational leverage), an improvement in the business mix toward more upstream services, a favorable geographical mix and by synergies from past acquisitions. The margin expansion was also the result of significant improvements in the Oil, Gas & Chemicals, Agricultural, Consumer Testing, and Governments and Institutions divisions. Two divisions reported a margin contraction (Systems & Services Certification as well as Life Science, which once again reported poor results).

  SGS reported a CHF 21m exceptional charge (compared to our CHF 20m estimate). This one-time item was recorded mainly for workforce reductions related to the ongoing optimization of the group's back-office operations.

  Net income including exceptional items rose 12.9% to CHF 500m. The financial result amounted to CHF 2m, compared to a negative CHF 1m in 2006, mainly thanks to a higher cash position. The tax rate of 24.9% was in line with the prior year. Minority interests of CHF 20m were lower than the CHF 25m for 2006, which can be attributed to the CTS business in China (booming RoHS last year), where SGS operates through SGS CSTC Standards Technical Services (in which SGS holds a 65% stake).

  Cash flow increased 28% to CHF 706m thanks to the group's ongoing discipline with regard to working capital management, which is one of the CFO's top priorities. Net working capital decreased by CHF 12m (vs. NZB projected increase of CHF 28m) as a consequence of a reduction in DSO (days sales outstanding) and a favorable development in accounts payable. This shows that the management's focus on EVA (top management incentivized partly on the basis of EVA) continues to pay off. Moreover, SGS's investments in IT have led to a significant improvement in receivables collection (85% automated).

  Capex amounted to CHF 285m or 6.5% of sales (vs. 6.3% in 2006), at the higher end of the 5% to 7% range stated by the management. Roughly a quarter of the capex (CHF 71m) was allocated to the strong-performing Minerals division in order to expand its lab network (Australia, Canada) and infrastructure. We also noted the CHF 54m investment in

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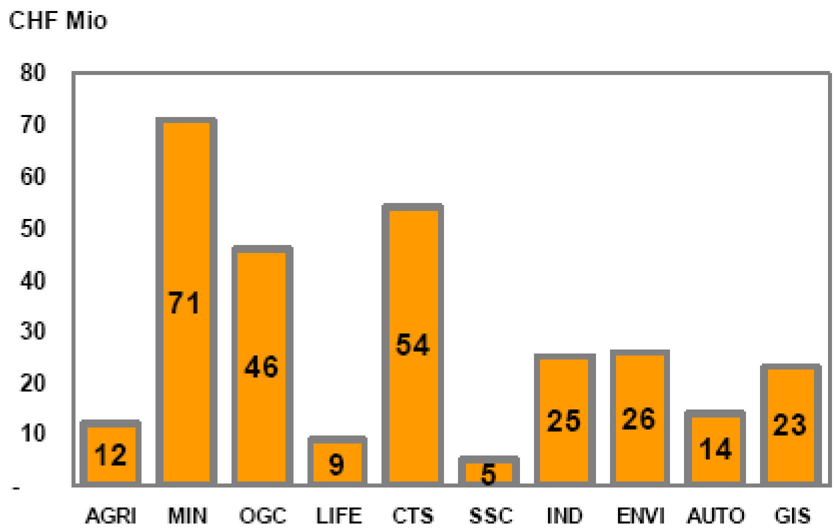
the Consumer Testing division (8.2.% of sales vs. 11.4% in 2006) mainly dedicated to expanding its lab capacity in Latin America, North Africa and the southeast Asia-Pacific region ex-China in order to meet the increased demand there. Once again, the management reiterated that it was allocating the capex to those business opportunities that deliver the highest returns.

Capex



Source: Company data

- **Two new acquisitions, pipeline of 40 to 50 targets:** SGS's acquisition activity last year was rather slow compared to that of Intertek and Bureau Veritas. However, as we stated several times last year, today it appears that SGS has pursued the right strategy, for at least two reasons: first, the group did not overpay for any targets last year; and second, the completed deals were quite excellent and margin-accretive considering the 21% margin achieved by the acquired companies last year. It will be very interesting this year to track the margin development of the competition, which made many expensive acquisitions of companies with sometimes low profitability (Applus would be in that category as well).

  Along with the FY 2007 results, SGS was able to announce two further acquisitions. The first one was Alvey Group, a leading independent provider of comprehensive field research services and GPS soil sampling and testing services to the US agricultural market. Although it is a rather small acquisition (USD 7m in sales), it is highly strategic for the Agricultural Services division because it fits perfectly with the two acquisitions made last year in the USA in that field. The second acquisition was a move to round out the Industrial Services division with the takeover of TACS, a leading provider of transformer insulating oil analytical services in Australia (AUD 2.5m in sales).

  The acquisitions announced last year and yesterday will boost sales by 1.3% (5% per annum was the target set back in 2005). In other words, considering a 10% organic growth rate and a neutral currency impact, SGS this year has to make acquisitions representing sales of roughly CHF 150m. Considering the current pipeline (with a couple of targets

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having annual sales of CHF 200m), we believe that the CHF 5bn sales target is still possible to achieve provided that the targets are either big enough or consolidated early in 2008.

- **Outlook and new NZB estimates:** Although the management does not usually issue any guidance on an annual basis, this year it did confirm an organic growth rate of 10% and EPS of CHF 80 for 2008, which were the targets set at the beginning of the Growth Strategy set back in 2005. The 17% margin target also looks achievable, according to the management. In that context, it is worth mentioning that SGS achieved a margin of 16.9% in the second half of 2007. However, in the event of a larger acquisition with lower margins, the margin target would then be difficult to achieve. The 2008 guidance takes into account an overall slowdown given the economic headwinds seen in the past months, which so far however have not affected SGS's performance. The strategy of the past years of developing and offering more upstream services has significantly reduced SGS's exposure to global trade. In addition, the pricing environment for commodities should remain positive for SGS through the year. In view of this, the 10% organic growth rate is realistic, in our view.

In addition, the group communicated a mid-term EPS target of CHF 105 by 2011. The management explained that it took a bottom-up approach to deriving that number. Each business unit has gone through a strategic review on a four-year basis with in mind new areas of business, replication of solutions in new regions, application of new technologies, etc. The CHF 105 target is the result of the combined strategic plans of the divisions and includes bolt-on acquisitions.

In view of the FY 2007 figures and outlook, we have updated our estimates for the different divisions for 2008 and beyond (details in our financial model). Overall, our adjustments had a slight impact on the key figures: we expect a 10.3% organic growth rate (vs. 10.4%), a negative currency impact of 3.1% (vs. 2.8%) and a positive impact from acquisitions net of divestments of 1.3% (vs. 1.1%). In addition, we now anticipate a 30bp margin improvement to 16.6% (vs. 50bp improvement to 16.6%). All other assumptions for the years thereafter remain largely valid, however with a slight reduction of the top-line growth and the margin development. Overall, our changes lower our EPS forecasts by 3.5% for 2008E, 1.1% for 2009E and 0.2% for 2010E.

New NZB estimates

In CHFm	2007		2008		2009	
	old	new	old	new	old	new
Net revenues	4328	4372	4705	4746	5203	5223
EBIT	697	711	782	789	893	886
Net Profit	485	500	557	577	641	648
EPS (in CHF)	63.6	65.6	73.1	75.7	84.1	85.0

Source: NZB Neue Zürcher Bank estimates

- **Valuation:** On our modified estimates (excluding future acquisitions), we now derive a new 'fair value NZB' – based on EVA®/DCF models – of CHF 1,707 per share (vs. CHF 1,747 previously).

Based on our new estimates, SGS is trading at a P/E 08E of 17.1x (16.1x respectively if the company achieves the CHF 80 target) and an

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EV/EBITDA 08E of 9.1x. This valuation more or less in line with competitors Intertek and Bureau Veritas. We consider a premium of at least 10% versus both competitors justifiable given SGS's superior business mix (lower risk profile), its increasing market share in Consumer Testing and in Oil, Gas and Chemicals Services, its higher operating leverage and its sound financial situation. We currently consider as well the relative low exposure in the US market compared to Intertek and Bureau Veritas as an advantage.

Valuation comparison

Company name	Ticker	CCY	Stock price	Market cap. USD	P/E 2007E x	P/E 2008E x	P/E 2009E x	P/B 2007E x	EV/EBITDA 2007E x	EV/EBITDA 2008E x	EV/EBITDA 2009E x	EV/Sales 2007E x
Intertek	ITRK LN Equity	GBP	891	2755	17.7	16.3	14.0	8.9	12.0	9.3	7.7	2.3
Eurofins Scientific	ERF FP Equity	EUR	68	1388	53.0	33.8	22.3	7.7	18.5	11.8	9.3	2.6
Bureau Veritas	BVI FP	EUR	32	5418	19.2	15.3	13.2	26.7	16.5	10.4	9.3	2.7
Inspicio Plc	INP LN	GBP	223 4	444	32.4	20.5	18.0	2.8	11.2	8.6	10.3	1.2
Average weighted					**24.0**	**18.4**	**14.9**	**3.7**	**15.3**	**10.2**	**8.9**	**2.5**
Average unweighted				**2501**	**30.6**	**21.5**	**16.8**	**11.5**	**14.6**	**10.0**	**9.2**	**2.2**
SGS	**SGSN VX**		**1291.0**	**9203**	**22.2**	**17.1**	**15.2**	**5.8**	**10.9**	**9.1**	**7.9**	**2.3**

Source: NZB Neue Zürcher Bank estimates, JCF

- **Opinion and recommendation:** Back in December, we were rather pessimistic about SGS's capacity to achieve the 2008 targets. However, in the wake of the FY 2007 results and the rather upbeat outlook given by the management, we now believe that SGS might surprise the market and indeed achieve the targets. To do so, the group needs to rapidly complete several acquisitions amounting to CHF 150m in annual sales. The investment case is intact, in our view. Amid a global economic slowdown in H2 2007, SGS was able to substantially increase its organic growth rate, which is a strong sign of the underlying strength of its different business lines. We continue to believe that SGS has a very attractive profile of both a growth and defensive stock. Our new 'fair value NZB' indicates significant upside in excess of 30%. We are therefore reiterating our BUY rating with an unchanged price target of CHF 1,650 per share.

Agenda:

– 17 March 2008 AGM

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