

### Remain Buyers following strong results and reassuring outlook

**■ Excl. TAS - org rev growth +14.3% y/y & margins +80bp y/y**

Although reported organic revenue growth was +10.8% and margin expansion was +20bp, if you were to exclude the TAS division org growth for the remaining 9 divs was +14.3% y/y and margin expansion was +80bp y/y. We felt that SGS managed to reassure investors that margins for those divisions which disappointed in H1 would expand into H2 and the outlook for the rest of the group in H2 is robust.

**■ Almost no changes to EPS estimates**

Our EPS estimates are practically unchanged following the H1 06 results (-2%/+0%/+1% for 06/07/08E). We remain confident regarding the trading outlook and therefore see the recent share price weakness as unjustified and see this as an additional buying opportunity.

**■ M&A still a key theme**

SGS remains completely relaxed about adding roughly 5% of sales p.a. from bolt-on acquisitions p.a. and so we see little risk of them not hitting/exceeding the 2008 CHF80 EPS target. We point out that with Intertek on a c12x 07E PE; 1.6x EV/Sales we believe that although BV could be a better fit for SGS, Intertek in our opinion, could be looking increasingly attractive to SGS (please see details overleaf).

**■ Valuation: Reiterate Buy 1; CHF1470 PT**

With SGS now trading on an undemanding 07E PE of c15x (adjusted for M&A) and with the investment case intact, we reiterate our Buy 1 rating and CHF1470 PT (DCF implied).

Highlights (CHFm)	12/04	12/05	12/06E	12/07E	12/08E
Revenues	2,885	3,308	3,799	4,183	4,562
EBIT (UBS)	391	502	595	684	754
Net income (UBS)	289	371	422	493	544
EPS (UBS, CHF)	38.59	49.46	56.24	65.63	72.50
Net DPS (UBS, CHF)	12.00	50.00	18.00	20.00	22.00

Profitability & Valuation	5-yr hist. av.	12/05	12/06E	12/07E	12/08E
EBIT margin %	9.5	15.2	15.7	16.4	16.5
ROIC (EBIT) %	51.4	71.6	70.3	77.1	83.0
EV/EBITDA x	10.6	11.2	11.3	9.9	8.7
PE (UBS) x	17.3	18.7	19.3	16.6	15.0
Net dividend yield %	1.5	5.4	1.7	1.8	2.0

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of CHF1,088.00 on 19 Jul 2006 08:00 BST

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Industrial Services

**Rating** **Buy 1**  
*Unchanged*

**Price target** CHF1,470.00/US\$11.73  
*Unchanged*

**Price** CHF1,088.00/US\$8.68 (ADR)

RIC: SGSN.VX BBG: SGSN VX

19 July 2006

**Trading data (local/US\$)**

52-wk. range	CHF1,350.00-908.00/US\$10.99-7.03
Market cap.	CHF8.51bn/US\$6.79bn
Shares o/s	7.8m (REG)/782m (ADR)
ADR ratio	100 ADR :1 REG
Free float	62%
Avg. daily volume ('000)	24/OTC
Avg. daily value (CHFm)	28.2

**Balance sheet data 12/06E**

Shareholders' equity	CHF1.29bn
P/BV (UBS)	6.6x
Net cash (debt)	CHF0.28bn

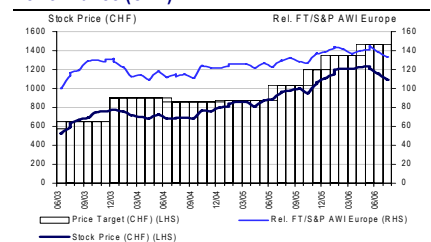
**Forecast returns**

Forecast price appreciation	+35.1%
Forecast dividend yield	1.7%
Forecast stock return	+36.8%
Market return assumption	6.9%
Forecast excess return	+29.9%

**EPS (UBS, CHF)**

	12/06E		12/05 Actual
	UBS	Cons.	
H1E	26.04	-	22.93
H2E	30.34	-	25.86
12/06E	56.24	58.07	
12/07E	65.63	66.54	

**Performance (CHF)**



Source: UBS

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**This report has been prepared by UBS Limited**

**ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5**

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## Overview

With SGS shares trading down -4% yesterday, we believe this was an over-reaction and see the recent share weakness as an additional buying opportunity. We believe the overall investment case is intact and see the valuation (adjusted 0/E PE of c15x) as unjustified. We feel that a comparison to Intertek's valuation (07E PE of c12x), is of limited value as we are of the opinion that both stocks are undervalued and therefore reiterate our Buy 1 ratings on both SGS (CHF1470 PT) and Intertek (955p).

We have detailed below our main take-aways from yesterday's results:

- **Organic growth and margin expansion** - Although reported organic revenue growth for H1 06 was +10.8% and margin expansion was +20bp, if you were to exclude the TAS division - organic growth for the remaining 9 divisions was +14.3% y/y and margin expansion was +80bp y/y. We felt that management were able to reassure investors that the margin contraction in those divisions which disappointed i.e. Life Sciences, Environmental, Industrial and TAS was due to specific factors e.g. restructuring, start-up costs and/or temporary, and that we should see improvements for all these divisions in H2 06. In addition, the outlook for the remaining divisions remains robust with SGS's largest divisions having exceeded expectations at the H1 06 results –e.g. Oil, Gas & Chemicals; Consumer Testing Services; Minerals Services etc.
- **M&A still remains a key theme** and we expect that the additional sales from bolt-on acquisitions to reach 5% p.a.(as a minimum). Given the robust trading outlook and the significant potential for bolt-on acquisitions, we see little risk of them not hitting/exceeding the 2008 CHF80 EPS target. With the H1 06 reporting now over, we expect bolt-on acquisitions to provide the next catalysts for the stock. Although SGS has indicated that it is not in negotiations with Intertek or Wendel (Bureau Veritas) in terms of a large-scale acquisition/merger, we believe that SGS might still be prepared to consider a large-scale deal with either of the 2 larger players if the pricing/terms were favourable. In December 2003, SGS received approval for a 1m conditional share capital increase and an authorised share capital increase of 0.5m shares, in anticipation of a large scale acquisition (we assumed BV) which did not materialise (please refer to our Dec 2003 report titled "Momentum expected to continue" for more details). With a net cash position of CHF0.5bn for FY 07E (UBSe) and the conditional capital, we believe that Intertek, now trading on an undemanding PE of c12x, may well be looking increasingly attractive to SGS. Although we believe Bureau Veritas could be the better fit in terms of higher synergies and also offering new markets, it is uncertain whether Wendel is likely to agree to a potential merger.

**Table 1: Divisional Revenue estimates**

CHFm	H1 05	H2 05	FY 05	H1 06	H2 06E	FY 06E	FY 07E	FY 08E
<b>Agricultural Services</b>	<b>138</b>	<b>157</b>	<b>295</b>	<b>157</b>	<b>169</b>	<b>326</b>	<b>348</b>	<b>373</b>
% change vs. py	10.9%	18.2%	14.7%	13.7%	7.6%	10.5%	7.0%	7.0%
Organic	10.9%	13.3%	12.2%	9.7%	8.4%	9.0%	7.0%	7.0%
<b>Minerals Services</b>	<b>173</b>	<b>221</b>	<b>394</b>	<b>225</b>	<b>247</b>	<b>473</b>	<b>520</b>	<b>562</b>
% change vs. py	14.9%	30.7%	23.2%	30.2%	12.2%	20.1%	10.0%	8.0%
Organic	18.8%	16.4%	17.5%	19.1%	13.6%	16.0%	10.0%	8.0%
<b>Oil, Gas &amp; Chemicals</b>	<b>306</b>	<b>330</b>	<b>636</b>	<b>374</b>	<b>386</b>	<b>760</b>	<b>821</b>	<b>886</b>
% change vs. py	8.2%	12.9%	10.6%	22.4%	16.9%	19.6%	8.0%	8.0%
Organic	8.7%	10.2%	9.5%	13.9%	12.2%	13.0%	8.0%	8.0%
<b>Life Sciences Services</b>	<b>62</b>	<b>63</b>	<b>125</b>	<b>94</b>	<b>99</b>	<b>193</b>	<b>213</b>	<b>235</b>
% change vs. py	21.8%	13.8%	17.7%	51.6%	56.5%	54.1%	10.5%	10.0%
Organic	18.1%	13.3%	15.6%	-1.8%	1.7%	0.0%	10.0%	10.0%
<b>Consumer Testing Services</b>	<b>214</b>	<b>262</b>	<b>476</b>	<b>283</b>	<b>315</b>	<b>598</b>	<b>700</b>	<b>791</b>
% change vs. py	29.3%	34.4%	32.1%	32.3%	20.3%	25.7%	17.0%	13.0%
Organic	25.6%	29.1%	27.5%	28.2%	20.6%	24.0%	17.0%	13.0%
<b>Systems &amp; Services Cert.</b>	<b>127</b>	<b>147</b>	<b>274</b>	<b>151</b>	<b>168</b>	<b>319</b>	<b>348</b>	<b>372</b>
% change vs. py	11.2%	21.3%	16.4%	19.2%	14.1%	16.5%	9.0%	7.0%
Organic	12.6%	17.7%	15.3%	16.1%	14.0%	15.0%	9.0%	7.0%
<b>Industrial Services</b>	<b>209</b>	<b>235</b>	<b>445</b>	<b>240</b>	<b>266</b>	<b>506</b>	<b>557</b>	<b>613</b>
% change vs. py	14.9%	19.2%	17.1%	14.7%	13.1%	13.8%	10.0%	10.0%
Organic	12.1%	13.1%	12.6%	11.8%	12.2%	12.0%	10.0%	10.0%
<b>Environmental Services</b>	<b>111</b>	<b>124</b>	<b>235</b>	<b>125</b>	<b>114</b>	<b>239</b>	<b>258</b>	<b>279</b>
% change vs. py	44.0%	11.5%	12.7%	62.3%	-8.1%	1.7%	8.0%	8.0%
Organic	11.2%	7.0%	9.0%	7.0%	8.9%	8.0%	8.0%	8.0%
<b>Automotive Services</b>	<b>97</b>	<b>103</b>	<b>200</b>	<b>112</b>	<b>110</b>	<b>222</b>	<b>237</b>	<b>254</b>
% change vs. py	9.3%	4.3%	6.7%	14.6%	7.1%	10.8%	7.0%	7.0%
Organic	1.1%	-2.0%	-0.5%	3.4%	4.6%	4.0%	7.0%	7.0%
<b>Trade Assurance Services</b>	<b>120</b>	<b>109</b>	<b>229</b>	<b>83</b>	<b>80</b>	<b>163</b>	<b>180</b>	<b>198</b>
% change vs. py	-10.2%	-10.9%	-10.5%	-30.3%	-26.6%	-28.5%	10.0%	10.0%
Organic	-9.5%	-11.6%	-10.5%	-30.9%	-29.0%	-30.0%	10.0%	10.0%
<b>Total Revenues</b>	<b>1,557</b>	<b>1,751</b>	<b>3,308</b>	<b>1,845</b>	<b>1,954</b>	<b>3,799</b>	<b>4,183</b>	<b>4,562</b>
% change vs. py	<b>12.0%</b>	<b>17.1%</b>	<b>14.7%</b>	<b>18.5%</b>	<b>11.6%</b>	<b>14.8%</b>	<b>10.1%</b>	<b>9.1%</b>
<b>organic</b>	<b>11.1%</b>	<b>11.9%</b>	<b>11.5%</b>	<b>10.8%</b>	<b>9.8%</b>	<b>10.3%</b>	<b>10.1%</b>	<b>9.1%</b>
<b>currency</b>	<b>-1.3%</b>	<b>3.6%</b>	<b>1.2%</b>	<b>3.3%</b>	<b>-0.1%</b>	<b>1.5%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>acquisitions/disposals</b>	<b>2.2%</b>	<b>1.6%</b>	<b>1.9%</b>	<b>4.4%</b>	<b>2.7%</b>	<b>3.5%</b>	<b>0.0%</b>	<b>0.0%</b>

Source: Company data, UBS estimates

**Table 2: Divisional EBITA & EBITA margin estimates**

EBITA by division (CHFm)	H1 05	H2 05	2005	H1 06	H2 06E	2006E	2007E	2008E
Agricultural Services	15.4	18.1	33.5	18.7	21.7	40.4	45.3	48.5
Minerals Services	26.6	36.5	63.1	37.6	42.8	80.4	88.4	95.5
Oil, Gas & Chemical Services	39.7	39.7	79.4	51.9	55.2	107.1	117.4	126.7
Life Sciences	8.8	10.3	19.1	11.4	13.7	25.1	32.0	37.5
Consumer Services	46.4	55.7	102.1	64.6	73.1	137.7	168.1	189.9
Systems & Services Certification	20.4	26.1	46.5	27.7	30.7	58.4	60.9	65.1
Industrial Services	27.5	31.1	58.6	31.5	36.9	68.4	78.0	85.8
Environmental Services	11.1	14.9	26.0	11.3	12.6	23.9	32.3	37.6
Automotive Services	13.2	12.0	25.2	15.3	15.1	30.4	33.2	35.5
Trade Assurance Services	25.9	22.6	48.5	11.4	12.3	23.7	28.8	31.6
<b>Total EBITA</b>	<b>235.0</b>	<b>267.0</b>	<b>502.0</b>	<b>281.4</b>	<b>314.0</b>	<b>595.4</b>	<b>684.2</b>	<b>753.8</b>

EBITA margin by division	H1 05	H2 05	2005	H1 0E	H2 06E	2006E	2007E	2008E
Agricultural Services	11.2%	11.5%	11.4%	11.9%	12.8%	12.4%	13.0%	13.0%
Minerals Services	15.4%	16.5%	16.0%	16.7%	17.3%	17.0%	17.0%	17.0%
Oil, Gas & Chemical Services	13.0%	12.0%	12.5%	13.9%	14.3%	14.1%	14.3%	14.3%
Life Sciences	14.2%	16.3%	15.2%	12.1%	13.8%	13.0%	15.0%	16.0%
Consumer Services	21.7%	21.3%	21.4%	22.8%	23.2%	23.0%	24.0%	24.0%
Systems & Services Certification	16.1%	17.8%	17.0%	18.3%	18.3%	18.3%	17.5%	17.5%
Industrial Services	13.1%	13.2%	13.2%	13.1%	13.8%	13.5%	14.0%	14.0%
Environmental Services	10.0%	12.0%	11.1%	9.0%	11.1%	10.0%	12.5%	13.5%
Automotive Services	13.6%	11.7%	12.6%	13.7%	13.7%	13.7%	14.0%	14.0%
Trade Assurance Services	21.7%	20.7%	21.2%	13.7%	15.3%	14.5%	16.0%	16.0%
<b>Total EBIT-margin</b>	<b>15.1%</b>	<b>15.2%</b>	<b>15.2%</b>	<b>15.3%</b>	<b>16.1%</b>	<b>15.7%</b>	<b>16.4%</b>	<b>16.5%</b>

Source: Company data, UBS estimates

**Table 3: Changes to UBS estimates**

CHFm	New estimates			Old estimates			% change to estimates		
	2006E	2007E	2008E	2006E	2007E	2008E	2006E	2007E	2008E
<b>Revenues</b>	<b>3,799</b>	<b>4,183</b>	<b>4,562</b>	<b>3,753</b>	<b>4,105</b>	<b>4,493</b>	<b>1%</b>	<b>2%</b>	<b>2%</b>
% change	14.9%	10.1%	9.1%	13.4%	9.4%	9.4%			
<b>EBITA</b>	<b>595</b>	<b>684</b>	<b>754</b>	<b>603</b>	<b>674</b>	<b>742</b>	<b>-1%</b>	<b>1%</b>	<b>2%</b>
% EBITA-margin	15.7%	16.4%	16.5%	16.1%	16.4%	16.5%			
<b>Reported net income</b>	<b>443</b>	<b>493</b>	<b>544</b>	<b>438</b>	<b>491</b>	<b>541</b>	<b>1%</b>	<b>0%</b>	<b>1%</b>
% change	19.4%	11.2%	10.5%	18.0%	12.1%	10.3%			
<b>Reported EPS</b>	<b>59.0</b>	<b>65.6</b>	<b>72.5</b>	<b>58.3</b>	<b>65.4</b>	<b>72.1</b>			
<b>UBS adjusted net income</b>	<b>427</b>	<b>493</b>	<b>544</b>	<b>438</b>	<b>491</b>	<b>541</b>	<b>-2%</b>	<b>0%</b>	<b>1%</b>
% change	15.1%	15.3%	10.5%	18.0%	12.1%	10.3%			
<b>UBS adjusted EPS *</b>	<b>56.2</b>	<b>64.8</b>	<b>71.6</b>	<b>57.6</b>	<b>64.6</b>	<b>71.2</b>			

Source: UBS estimates

Note (\*): the EPS estimates in the table are on a fully diluted basis, whereas the EPS estimates are not on a diluted basis.

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## ■ **SGS**

SGS is the largest inspection, testing and certification organisation in the world. The core services offered by SGS (split between 10 divisions) can be divided into three categories: (1) inspection services - SGS inspects and verifies the quantity, weight and quality of traded goods; (2) testing services - SGS tests product quality and performance against various health, safety and regulatory standards; and (3) certification services - SGS certifies that systems or services meet the requirements of standards set by governments, standardisation bodies or by SGS customers.

## ■ **Statement of Risk**

A weakening US dollar should result in downside risk to our estimates given SGS's high US dollar translation exposure of roughly 40%.

## ■ **Analyst Certification**

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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### UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage <sup>1</sup>	IB services <sup>2</sup>
<b>Buy 1</b>	FSR is > 10% above the MRA, higher degree of predictability	<b>Buy 2</b>	FSR is > 10% above the MRA, lower degree of predictability	<b>Buy</b>	48%	34%
<b>Neutral 1</b>	FSR is between -10% and 10% of the MRA, higher degree of predictability	<b>Neutral 2</b>	FSR is between -10% and 10% of the MRA, lower degree of predictability	<b>Hold/Neutral</b>	45%	35%
<b>Reduce 1</b>	FSR is > 10% below the MRA, higher degree of predictability	<b>Reduce 2</b>	FSR is > 10% below the MRA, lower degree of predictability	<b>Sell</b>	7%	32%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 30 June 2006.

#### KEY DEFINITIONS

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Predictability Level** The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

**Rating/Return Divergence (RRD)** This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

#### EXCEPTIONS AND SPECIAL CASES

**US Closed-End Fund ratings and definitions are:** Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

**UK and European Investment Fund ratings and definitions are:** Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

**Core Banding Exceptions (CBE):** Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

#### Companies mentioned

Company Name	Reuters	Rating	Price	Price date/time
Intertek Group plc <sup>2,4b</sup>	ITRK.L	Buy 1	615p	18 Jul 2006 23:38 BST
SGS <sup>4a,5,13</sup>	SGSN.VX	Buy 1	CHF1,088.00	18 Jul 2006 23:38 BST

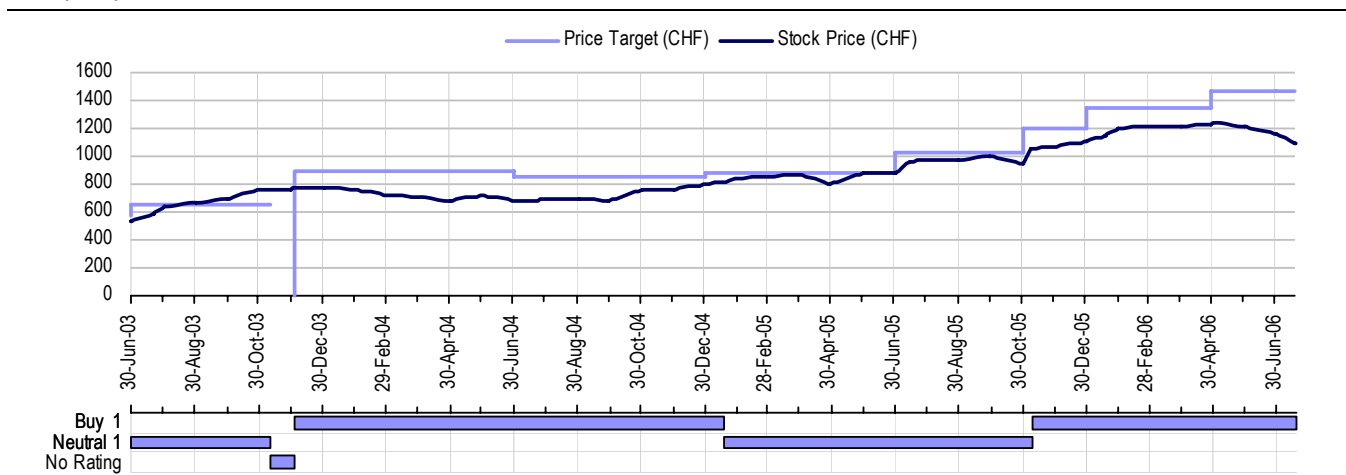
Company Name	Reuters	Rating	Price	Price date/time
Wendel <sup>4a</sup>	MWDP.PA	Neutral 1	€87.65	18 Jul 2006 23:38 BST

Source: UBS. BST: British summer time.

2. UBS AG, its affiliates or subsidiaries has acted as manager/co-manager in the underwriting or placement of securities of this company/entity or one of its affiliates within the past five years.
- 4a. Within the past 12 months, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company/entity.
- 4b. Within the past three years, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company/entity.
5. UBS AG, its affiliates or subsidiaries expect to receive or intend to seek compensation for investment banking services from this company/entity within the next three months.
13. UBS AG, its affiliates or subsidiaries beneficially owned 1% or more of a class of this company's common equity securities as of last month's end (or the prior month's end if this report is dated less than 10 days after the most recent month's end).

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

### SGS (CHF)



Source: UBS; as of 18 July 2006.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

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