

**Equity Research  
Switzerland**

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## 1H05 a surprise on the upside – focus now on growth

SGS delivered solid 1H05 results that slightly exceeded our expectations. Sales came in at CHF 1.56 bn (+12% yoy), EBIT at CHF 229 mn (+29% yoy) and net profit at CHF 170 mn (+37% yoy, VontE: CHF 163 mn, consensus CHF 165 mn). Despite the good results, the company did not raise its FY05 EPS estimate of CHF 45. This may be due to anticipated weaker performance from the Trade Assurance Services division in 2H05. Some high-margin PSI (PreShipment Inspection) contracts may not be renewed, which would mean lower sales and profits from this business. The jump in the share price since May 2005 appears to be justified by the good 1H05 results and a high likelihood that EPS will surpass its target in FY05. We think the upside potential is limited, given the fair price of CHF 920 per share.

**CEO is pushing growth:** In addition to small-scale acquisitions, SGS aims to achieve double-digit organic growth in the medium term. To this end, SGS is expanding its services in the individual divisions.

**Limited potential to widen the EBIT margin:** The big 200bp increase in the EBIT margin to 14.7% in 1H05 is unlikely to be repeated. There is little scope for further efficiency improvements in the divisions, and competitors are putting pressure on prices. The previous EBIT margin target of 16% was not confirmed at the analysts' conference.

**Limited upside:** For now, we see the share performing in line with the market. SGS is heavily dependent on global GDP growth. Our DCF model indicates fair value at CHF 920 per share. The rating remains Market Perform.



**PER SHARE DATA**

Price SGSN.VX on 13-07-05 CHF	926.00
No. of shares SGSN.VX in '000	7,650
Market cap. SGSN.VX (CHF mns)	7,084
Other Market cap. (CHF mns)	0
Total market capitalization (CHF mns)	7,084
Free float %	52
August von Finck & Family (voting 24 %)	24
Worms & Cie (voting 24 %)	24
Average daily trading volume (12 months)	19,610

**SHARE VALUATION**

CHF	2003	2004	2005E	2006E
EPS	29.6	36.5	46.5	52.9
EPS growth %	111	23	27	14
P/E	31.3	25.4	19.9	17.5
CEPS	30.9	38.6	46.5	52.9
P/CE	30.0	24.0	19.9	17.5
Dividend	9.00	12.0	13.0	14.0
Dividend yield %	1.0	1.3	1.4	1.5
Book value	140	161	194	233
Price/Book	6.6	5.8	4.8	4.0
EV/EBITDA	17.3	13.9	11.4	9.9

**HIGH    12-month    LOW**

926.00	676.00
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**BREAKDOWN**

Sales 2004	CHF mns	% Change	Share
- by segment			
Agricultures	257	6	9%
Minerals	320	14	11%
Oil, Gas & Chemicals	575	31	20%
Life Sciences	106	80	4%
Consumer Testing	361	32	13%
System & Services	235	3	8%
Industrial	380	15	13%
Environmental	209	21	7%
Automotive	188	-11	7%
Trade Assurance	255	16	9%
Total	2,886	18	100%

**KEY DATA**

CHF mns	2004	2005E	2006E
Sales	2,885	3,175	3,430
EBIT	394	478	540
EBIT margin %	13.7	15.1	15.7
Shareholders' net profit	279	356	405
Return on equity %	22.7	24.0	22.7
Total assets	2,212	2,300	2,350
Equity	1,255	1,506	1,803
Equity ratio %	56.7	65.5	76.7
Interest-bearing debt	18.0	18.0	18.0
Cash	456	586	776
Operating Cash Flow	425	454	510
Capex	-201	-180	-180

**EXCESS PERFORMANCE**

	SPIX <sup>1</sup>	DJSFISV <sup>2</sup>
3M	-0.7%	-2.3%
6M	0.8%	-0.6%
12M	17.1%	5.8%

<sup>1</sup> SPI ex Div.  
<sup>2</sup> DJ STOXX Financial Services

## Deviation analysis reveals portfolio stars

### Consumer Testing and Minerals better than expected

The Consumer Testing and Minerals divisions show the greatest positive deviation from our estimates. They profited from robust sales growth in Asia. The Minerals division employed 700 more employees in 1H05 than in the previous year's period. Further, laboratory costs were lowered by 70bp. With the help of acquisitions, Consumer Testing should be able to take over market leadership from Intertek in the future. This unit derived great benefit from better utilization rates for labs in Asia. The table below provides an overview of the extent of the deviation from our estimates.

1H05 MINERALS SERVICES AND CONSUMER TESTING SALES AND EBITA (CHF MNS)					
	1H04	1H05E	1H05A	Delta	Comments
<b>Minerals Services</b>	150.7	165.0	176.8	11.8	Expansion in India, China, Russia
- total growth (%)	13.7	9.5	17.3		
- as % of total group	10.8	10.9	11.4		
EBITA	21.4	23.0	27.2	4.2	Lab costs cut by 70bp yoy
- total growth (%)	42.7	7.5	27.1		
- as % of total group	11.9	10.5	11.9		
Operating margin	14.2	13.9	15.4		
<b>Consumer Testing Services</b>	165.6	200.0	214.2	14.2	Portfolio star, expansion efforts in Asia intensified
- total growth (%)	31.0	20.8	29.3		
- as % of total group	11.9	13.2	13.8		
EBITA	28.6	40.0	45.6	5.6	Better utilization of labs via technology transfers to Asia
- total growth (%)	61.6	39.9	59.4		
- as % of total group	15.8	18.2	19.9		
Operating margin	17.3	20.0	21.3		

Source: Vontobel Equity Research

### Trade Assurance had the highest negative deviation

The Trade Assurance unit was the only unpleasant surprise. This is a result of the unit's heavy dependence on PSI (PreShipment Inspection) contracts. PSI contracts make up 66% of divisional sales. The PSI contract with Venezuela, which will not be renewed with either Intertek or SGS, accounts for 1% of SGS's sales and 0.75% of its EBIT in FY05. Furthermore, PSI contracts with Peru, Ethiopia and Burkina Faso were likewise not renewed. Thus results came in below our forecasts.

1H05 TRADE ASSURANCE SALES AND EBITA (CHF MNS)					
	1H04	1H05E	1H05A	Delta	Comments
<b>Trade Assurance Services</b>	133.0	135.0	119.5	-15.5	Over-reliant on PSI revenues
- total growth (%)	37.5	1.5	-10.2		
- as % of total group	9.6	8.9	7.7		
EBITA	29.9	33.0	25.1	-7.9	Non-renewal of contracts with Peru, Venezuela, Ethiopia
- total growth (%)	49.5	10.4	-16.1		
- as % of total group	16.6	15.0	11.0		
Operating margin	22.5	24.4	21.0		

Source: Vontobel Equity Research

**Most other divisions reported better than expected**

The following table shows that on the whole, the remaining divisions reported positive deviations. Despite the high price of oil, the EBIT margin for Oil, Gas & Chemicals was depressed by competitive pressure from Intertek.

<b>1H05 REMAINING DIVISIONS SALES AND EBITA (CHF MNS)</b>					
	<b>1H04</b>	<b>1H05E</b>	<b>1H05A</b>	<b>Delta</b>	<b>Comments</b>
<b>Agricultural Services</b>	124.3	130.0	137.8	7.8	Market share gains
- total growth (%)	1.9	4.6	10.9		
- as % of total group	8.9	8.6	8.9		
EBITA	9.7	12.0	15.0	3.0	Reduction in fixed costs
- total growth (%)	-21.8	23.7	54.6		
- as % of total group	5.4	5.5	6.6		
Operating margin	7.8	9.2	10.9		
<b>Oil, Gas &amp; Chemicals Services</b>	282.5	300.0	302.0	2.0	High oil prices call for inspection services
- total growth (%)	33.3	6.2	6.9		
- as % of total group	20.3	19.7	19.4		
EBITA	33.7	40.0	36.9	-3.1	Price pressure from Intertek
- total growth (%)	45.3	18.7	9.5		
- as % of total group	18.7	18.2	16.1		
Operating margin	11.9	13.3	12.2		
<b>Life Science Services</b>	50.9	60.0	62.0	2.0	In search of acquisition objects
- total growth (%)	72.0	17.9	21.8		
- as % of total group	3.7	3.9	4.0		
EBITA	5.8	7.0	8.7	1.7	
- total growth (%)	100.0	20.7	50.0		
- as % of total group	3.2	3.2	3.8		
Operating margin	11.4	11.7	14.0		
<b>Systems &amp; Services Certification</b>	114.2	130.0	127.0	-3.0	ISO 9000 generates steadily less sales
- total growth (%)	8.3	13.8	11.2		
- as % of total group	8.2	8.6	8.2		
EBITA	14.2	18.0	19.7	1.7	Reduction in fixed costs
- total growth (%)	0.7	26.8	38.7		
- as % of total group	7.9	8.2	8.6		
- Operating margin (%)	12.4	13.8	15.5		
<b>Industrial Services</b>	182.3	190.0	209.4	19.4	Growth from X-Per-X acquisition
- total growth (%)	14.9	4.2	14.9		
- as % of total group	13.1	12.5	13.4		
EBITA	21.0	25.0	27.3	2.3	
- total growth (%)	36.4	19.0	30.0		
- as % of total group	11.6	11.4	11.9		
Operating margin	11.5	13.2	13.0		
<b>Environmental Services</b>	97.3	105.0	110.9	5.9	New labs in Asia
- total growth (%)	23.9	7.9	14.0		
- as % of total group	7.0	6.9	7.1		
EBITA	6.4	10.0	11.0	1.0	
- total growth (%)	52.4	56.3	71.9		
- as % of total group	3.5	4.5	4.8		
Operating margin	6.6	9.5	9.9		
<b>Automotive Services</b>	89.0	105.0	97.3	-7.7	Difficult US market
- total growth (%)	-20.5	18.0	9.3		
- as % of total group	6.4	6.9	6.2		
EBITA	9.8	12.0	12.3	0.3	
- total growth (%)	-18.3	22.4	25.5		
- as % of total group	5.4	5.5	5.4		
Operating margin	11.0	11.4	12.6		

Source: Vontobel Equity Research

## EPS 05E raised by 5%, EPS 06E by 4%

### EPS raised after the good 1H05 results

A look at SGS's reporting history shows that around 45% of its net profit for the full-year is generated in the first half. Working on this assumption, we could expect EPS of nearly CHF 50 for FY05. Note, however, that the Trade Assurance division contributed nearly 16% of group EBIT in FY04. It looks as if this division's results will be weaker in 2H05, suggesting to us that EPS 05E will be CHF 46.5. The target of CHF 45 is very likely to be exceeded. The following table lists our new estimates for FY05 and FY06.

#### DIVISIONAL SALES AND EBITA FOR FY05 AND FY06 (CHF MNS)

	2004	2005 old	2005 new	2006 old	2006 new		2004	2005 old	2005 new	2006 old	2006 new
<b>Agricultural Services</b>	<b>257.1</b>	<b>265.0</b>	<b>280.0</b>	<b>275.0</b>	<b>290.0</b>	<b>Systems &amp; Services Certification</b>	<b>235.4</b>	<b>255.0</b>	<b>265.0</b>	<b>275.0</b>	<b>285.0</b>
- total growth (%)	6.3	3.1	8.9	3.8	3.6	- total growth (%)	2.5	8.3	12.6	7.8	7.5
- as % of total group	8.9	8.4	8.8	8.1	8.5	- as % of total group	8.2	8.1	8.3	8.1	8.3
<b>EBITA</b>	<b>23.6</b>	<b>28.0</b>	<b>33.0</b>	<b>32.0</b>	<b>35.0</b>	<b>EBITA</b>	<b>30.5</b>	<b>39.0</b>	<b>40.0</b>	<b>41.0</b>	<b>44.0</b>
- total growth (%)	-2.9	18.6	39.8	14.3	6.1	- total growth (%)	-12.1	27.9	31.1	5.1	10.0
- as % of total group	6.0	6.1	6.9	6.1	6.5	- as % of total group	7.8	8.4	8.4	7.9	8.1
Operating margin	9.2	10.6	11.8	11.6	12.1	- Operating margin (%)	13.0	15.3	15.1	14.9	15.4
<b>Minerals Services</b>	<b>319.5</b>	<b>350.0</b>	<b>370.0</b>	<b>380.0</b>	<b>400.0</b>	<b>Industrial Services</b>	<b>379.8</b>	<b>410.0</b>	<b>420.0</b>	<b>440.0</b>	<b>450.0</b>
- total growth (%)	14.1	9.5	15.8	8.6	8.1	- total growth (%)	15.1	8.0	10.6	7.3	7.1
- as % of total group	11.1	11.1	11.7	11.2	11.7	- as % of total group	13.2	13.0	13.2	12.9	13.1
<b>EBITA</b>	<b>46.3</b>	<b>50.0</b>	<b>57.0</b>	<b>55.0</b>	<b>62.0</b>	<b>EBITA</b>	<b>46.1</b>	<b>52.0</b>	<b>55.0</b>	<b>57.0</b>	<b>61.0</b>
- total growth (%)	30.4	8.0	23.1	10.0	8.8	- total growth (%)	32.1	12.8	19.3	9.6	10.9
- as % of total group	11.8	10.8	11.9	10.5	11.5	- as % of total group	11.8	11.3	11.5	10.9	11.3
Operating margin	14.5	14.3	15.4	14.5	15.5	Operating margin	12.1	12.7	13.1	13.0	13.6
<b>Oil, Gas &amp; Chemicals Services</b>	<b>574.6</b>	<b>610.0</b>	<b>610.0</b>	<b>650.0</b>	<b>650.0</b>	<b>Environmental Services</b>	<b>208.6</b>	<b>223.0</b>	<b>230.0</b>	<b>238.0</b>	<b>245.0</b>
- total growth (%)	30.9	6.2	6.2	6.6	6.6	- total growth (%)	21.3	6.9	10.3	6.7	6.5
- as % of total group	19.9	19.4	19.2	19.1	19.0	- as % of total group	7.2	7.1	7.2	7.0	7.1
<b>EBITA</b>	<b>68.6</b>	<b>80.0</b>	<b>75.0</b>	<b>91.0</b>	<b>90.0</b>	<b>EBITA</b>	<b>16.8</b>	<b>23.0</b>	<b>25.0</b>	<b>27.0</b>	<b>28.0</b>
- total growth (%)	43.2	16.6	9.3	13.8	20.0	- total growth (%)	50.0	36.9	48.8	17.4	12.0
- as % of total group	17.5	17.3	15.7	17.4	16.7	- as % of total group	4.3	5.0	5.2	5.2	5.2
Operating margin	11.9	13.1	12.3	14.0	13.8	Operating margin	8.1	10.3	10.9	11.3	11.4
<b>Life Science Services</b>	<b>106.5</b>	<b>120.0</b>	<b>125.0</b>	<b>135.0</b>	<b>145.0</b>	<b>Automotive Services</b>	<b>187.7</b>	<b>220.0</b>	<b>210.0</b>	<b>240.0</b>	<b>230.0</b>
- total growth (%)	80.2	12.7	17.4	12.5	16.0	- total growth (%)	-11.0	17.2	11.9	9.1	9.5
- as % of total group	3.7	3.8	3.9	4.0	4.2	- as % of total group	6.5	7.0	6.6	7.1	6.7
<b>EBITA</b>	<b>12.8</b>	<b>15.0</b>	<b>18.0</b>	<b>18.0</b>	<b>22.0</b>	<b>EBITA</b>	<b>20.0</b>	<b>25.0</b>	<b>25.0</b>	<b>28.0</b>	<b>28.0</b>
- total growth (%)	116.9	17.2	40.6	20.0	22.2	- total growth (%)	-3.8	25.0	25.0	12.0	12.0
- as % of total group	3.3	3.2	3.8	3.4	4.1	- as % of total group	5.1	5.4	5.2	5.4	5.2
Operating margin	12.0	12.5	14.4	13.3	15.2	Operating margin	10.7	11.4	11.9	11.7	12.2
<b>Consumer Testing Services</b>	<b>360.6</b>	<b>420.0</b>	<b>445.0</b>	<b>480.0</b>	<b>500.0</b>	<b>Trade Assurance Services</b>	<b>255.4</b>	<b>270.0</b>	<b>220.0</b>	<b>287.0</b>	<b>235.0</b>
- total growth (%)	32.4	16.5	23.4	14.3	12.4	- total growth (%)	16.4	5.7	-13.9	6.3	6.8
- as % of total group	12.5	13.4	14.0	14.1	14.6	- as % of total group	8.9	8.6	6.9	8.4	6.9
<b>EBITA</b>	<b>65.2</b>	<b>86.0</b>	<b>100.0</b>	<b>105.0</b>	<b>115.0</b>	<b>EBITA</b>	<b>61.5</b>	<b>64.0</b>	<b>50.0</b>	<b>68.0</b>	<b>55.0</b>
- total growth (%)	65.5	31.9	53.4	22.1	15.0	- total growth (%)	36.4	4.1	-18.7	6.3	10.0
- as % of total group	16.7	18.6	20.9	20.1	21.3	- as % of total group	15.7	13.9	10.5	13.0	10.2
Operating margin	18.1	20.5	22.5	21.9	23.0	Operating margin	24.1	23.7	22.7	23.7	23.4

Source: Vontobel Equity Research

### Stock fairly valued

Our DCF model indicates fair value at CHF 920 per share. We think that double-digit organic sales growth is an overly ambitious target, and replace it with 8%. For the EBIT margin, too, our model uses a conservative estimate of 15%. The WACC of 7.4% reflects the fact that SGS is a cyclical stock and thus justifies a beta of 1.2x. The fair value given by our DCF model is CHF 920 per share. We are leaving our Market Perform rating for SGS unchanged.

## Appendix: DCF model

CALCULATION OF WACC	
rf: Risk-free interest rate (in %)	3.5
rm: Equity market yield (in %)	7.5
Beta	1.2
Alpha	1.5
EK/(EK+FK): Target capital structure: equity ratio (in %)	60.0
s: Tax rate (%)	24.0
kFK: Cost of debt (%)	5.0
kEK: Cost of equity (%) = (rf) + (Beta x (rm - rf)) + Alpha	9.8
WACC: Cost of capital = (kEK*(EK/(EK+FK))) + (kFK * (1-(EK/EK+FK)) x (1 - s))	7.4

Source: Vontobel Equity Research

DCF MODEL SGS						
Calculation free cash flow (CHF mns)	Dec 05	Dec 06	Dec 07	Dec 08	Dec 09	Dec 10
Sales	3175.0	3430.0	3704.4	4000.8	4320.8	4666.5
% growth		8.0	8.0	8.0	8.0	8.0
EBIT	478.0	540.0	555.7	600.1	648.1	700.0
in % of sales	15.1	15.7	15.0	15.0	15.0	15.0
./. Taxes on EBIT	-117.0	-128.0	-133.4	-144.0	-155.5	-168.0
in % of EBIT	24.5	23.7	24.0	24.0	24.0	24.0
NOPLAT	361.0	412.0	422.3	456.1	492.6	532.0
+ Depreciation / Amortization	120.0	130.0	137.1	148.0	159.9	172.7
in % of sales	3.8	3.8	3.7	3.7	3.7	3.7
./. Increase in net working capital	-26.0	-30.0	-41.2	-44.5	-48.0	-51.8
in % of sales increase		-11.8	-15.0	-15.0	-15.0	-15.0
./. Capital expenditures	-180.0	-180.0	-200.0	-200.0	-200.0	-200.0
in % of sales	5.7	5.2	5.4	5.0	4.6	4.3
Free cash flow	275.0	332.0	318.2	359.7	404.4	452.8
% growth		20.7	-4.2	13.0	12.4	12.0
<b>Calculation of company's value</b>						
		Dec 06	Dec 07	Dec 08	Dec 09	
Number of years		1.47	2.47	3.47	4.47	
Discount factor		0.90	0.84	0.78	0.73	
Discounted free cash flows		299	267	281	294	
Growth rate of free cash flow in perpetuity (in %)						1.5
Residual value						5578
Enterprise value						6719
Net cash, (net debt) (2005E)						620.0
Minority interests						-324.0
Shareholder value						7015
Number of shares (mns, end 2005E)						7.7
<b>Value per share</b>						<b>920</b>

Source: Vontobel Equity Research

<b>CONSOLIDATED FINANCIAL DATA (CHF MNS)</b>							
	2000	2001	2002	2003	2004	2005E	2006E
<b>REVENUES</b>	<b>2,369</b>	<b>2,332</b>	<b>2,392</b>	<b>2,454</b>	<b>2,885</b>	<b>3,175</b>	<b>3,430</b>
- change (%)	-23	-2	3	3	18	10	8
EBITDA	257	247	311	396	506	598	670
- change (%)	-21	-4	26	27	28	18	12
- as % of revenues	10.9	10.6	13.0	16.1	17.6	18.8	19.5
DEPRECIATION	-104	-101	-95	-96	-115	-120	-130
- as % of revenues	4.4	4.3	4.0	3.9	4.0	3.8	3.8
EBITA BEF. E.O. ITEMS	154	146	216	300	391	478	540
- change (%)	-16	-5	48	39	31	22	13
- as % of revenues	6.5	6.2	9.0	12.2	13.6	15.1	15.7
E.O. ITEMS	9	-178	-80	3	3	0	0
<b>EBITA</b>	<b>162</b>	<b>-32</b>	<b>136</b>	<b>303</b>	<b>394</b>	<b>478</b>	<b>540</b>
- change (%)	-14	-120	-526	123	30	21	13
- as % of revenues	6.8	-1.4	5.7	12.3	13.7	15.1	15.7
GOODWILL AMORTISATION	-4	-8	-9	-10	-16	0	0
EBIT	158	-40	127	293	378	478	540
- change (%)	-14	-120	-526	123	30	21	13
- as % of revenues	6.7	-1.7	5.3	11.9	13.1	15.1	15.7
FINANCIAL RESULT	25	17	13	10	6	10	12
PRETAX PROFIT	183	-23	140	303	384	488	552
- change (%)	3	-113	-704	116	27	27	13
- as % of revenues	7.7	-1.0	5.9	12.3	13.3	15.4	16.1
TAXES	-51	-44	-27	-68	-90	-116	-129
- tax rate (%)	28	-187	20	22	23	24	23
GROUP NET PROFIT	131	-67	113	235	294	372	423
- change (%)	10	-151	-269	108	25	26	14
- as % of revenues	5.5	-2.9	4.7	9.6	10.2	11.7	12.3
MINORITY INTERESTS	-7	-8	-4	-8	-15	-16	-18
<b>SHAREHOLDERS' NET PROFIT</b>	<b>124</b>	<b>-75</b>	<b>109</b>	<b>227</b>	<b>279</b>	<b>356</b>	<b>405</b>
- change (%)	-59	-160	-245	108	23	27	14
- as % of equity shareholder	11.3	-7.7	12.2	21.1	22.7	24.0	22.7
CASH FLOW FROM OPERATIONS	239	142	301	325	425	454	510
- change (%)	-13	-82	404	57	25	16	12
- as % of revenues	10.1	1.8	9.1	13.9	14.7	15.5	16.1
CAPITAL EXPENDITURES	-99	-117	-121	-171	-201	-180	-180
-5-year average	-157	-148	-141	-139	-142	-158	-171
<b>DATA PER REGISTERED (CHF, ADJ)</b>							
EARNINGS	15.9	-9.6	14.0	29.6	36.5	46.5	52.9
- change (%)	-59	-160	246	111	23	27	14
CASH EARNINGS PER SHARE	16.5	-8.5	15.2	30.9	38.6	46.5	52.9
DIVIDEND	5.8	6.0	7.3	9.0	12.0	13.0	14.0
- payout ratio (%)	36	-62	52	30	33	28	26
CASH FLOW	31	18	39	42	56	59	67
BOOK VALUE	141	125	115	140	161	194	233
TOTAL ASSETS	2,122	1,991	1,850	2,022	2,212	2,300	2,350
CASH	642	649	531	526	456	586	776
NET DEBT	-488	-446	-402	-493	-438	-568	-758
- as % of group equity	-44	-44	-44	-45	-35	-38	-42
GOODWILL AND INTANGIBLES	33	60	107	147	304	304	304
EQUITY SHAREHOLDER	1,099	982	897	1,072	1,229	1,486	1,783
GROUP EQUITY	1,120	1,007	915	1,090	1,255	1,506	1,803
- as % of total assets	53	51	49	54	57	65	77
NO. OF REG. (MNS)	7.823	7.822	7.773	7.662	7.650	7.650	7.650

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## **Methodical approach / Rating system**

Please see [www.vontobel.ch](http://www.vontobel.ch) for details on our methodical approach and rating system.

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