

## Equity Research Switzerland

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## FY 2006 results: another excellent year

### Results in line with expectations, but valuation is high

- With 10.3% organic growth and an underlying EBIT margin improvement of 60 bps, SGS reported solid 2006 results and is on track to meeting its 2008 financial goals. We update our 12-month price target to CHF 1450, which would price SGS in line with its historical average multiples (13.7x EV/EBIT forward) one year out.
- SGS's new CEO Chris Kirk confirmed that he saw substantial development potential in all ten existing business lines and would even envisage adding one or two new lines. He reconfirmed the existing 2008 financial targets and indicated that one of his priorities for 2007 would be to accelerate the process of identifying and closing acquisitions. We expect these to be multiple smaller acquisitions, as were done in 2006 (8 acquisitions representing 4% of sales).
- Valuation remains high: At a P/E of 21x for 2007E and 19x for 2008E as well as EV/EBIT of 15.3x for 2007E and 13.2x for 2008E, SGS is trading at a 20-29% premium versus Intertek. SGS's EV/EBIT multiples compare to its historical 10-year average of 13.7x. Pricing SGS in line with historic forward EV/EBIT would suggest fair value of CHF 1300 per share today and CHF 1450 in one year's time. We update our 12-month price target to CHF 1450 and maintain our Market Perform rating.



**PER SHARE DATA**

|  |        |
|--|--------|
| Price SGSN.VX on 12-01-07 CHF            | 1,395  |
| No. of shares SGSN.VX in '000            | 7,634  |
| Market cap. SGSN.VX (CHF mns)            | 10,649 |
| Other Market cap. (CHF mns)              | 0      |
| Total market capitalization (CHF mns)    | 10,649 |
| Free float %                             | 59     |
| August von Finck & Family (voting 24 %)  | 24     |
| IFIL (voting 13 %)                       | 13     |
| AGF (voting 4 %)                         | 4      |
| Average daily trading volume (12 months) | 23,540 |

**SHARE VALUATION**

| CHF              | 2005 | 2006 | 2007E | 2008E |
|------------------|------|------|-------|-------|
| EPS              | 48.8 | 58.5 | 65.1  | 72.5  |
| EPS growth %     | 35   | 20   | 11    | 11    |
| P/E              | 28.6 | 23.8 | 21.4  | 19.3  |
| CEPS             | 48.8 | 58.5 | 65.1  | 72.5  |
| P/CE             | 28.6 | 23.8 | 21.4  | 19.3  |
| Dividend         | 50.0 | 16.0 | 20.0  | 22.0  |
| Dividend yield % | 3.6  | 1.2  | 1.4   | 1.6   |
| Book value       | 192  | 203  | 251   | 303   |
| Price/Book       | 7.3  | 6.9  | 5.6   | 4.6   |
| EV/EBITDA        | 16.7 | 14.2 | 12.0  | 10.5  |

**HIGH    12-month    LOW**

|       |  |       |
|-------|--|-------|
| 1,399 |  | 1,057 |
|-------|--|-------|

**BREAKDOWN BY**

| Sales 2005           | CHF mns      | % Change  | Share       |
|----------------------|--------------|-----------|-------------|
| - by segment         |              |           |             |
| Agricultures         | 295          | 15        | 9%          |
| Minerals             | 394          | 23        | 12%         |
| Oil, Gas & Chemicals | 635          | 11        | 19%         |
| Life Sciences        | 125          | 18        | 4%          |
| Consumer Testing     | 476          | 32        | 14%         |
| System & Services    | 274          | 16        | 8%          |
| Industrial           | 445          | 17        | 13%         |
| Environmental        | 235          | 13        | 7%          |
| Automotive           | 200          | 7         | 6%          |
| Trade Assurance      | 229          | -11       | 7%          |
| <b>Total</b>         | <b>3,308</b> | <b>15</b> | <b>100%</b> |

**KEY DATA**

| CHF mns                  | 2005  | 2006  | 2007E |
|--------------------------|-------|-------|-------|
| Sales                    | 3,308 | 3,821 | 4,300 |
| EBIT                     | 502   | 624   | 700   |
| EBIT margin %            | 15.2  | 16.3  | 16.3  |
| Shareholders' net profit | 371   | 444   | 497   |
| Return on equity %       | 25.8  | 28.8  | 25.9  |
| Total assets             | 2,765 | 2,852 | 3,336 |
| Equity                   | 1,475 | 1,592 | 1,996 |
| Equity ratio %           | 53.3  | 55.8  | 59.8  |
| Interest-bearing debt    | 101   | 7.00  | 7.00  |
| Cash                     | 531   | 239   | 560   |
| Operating Cash Flow      | 411   | 549   | 689   |
| Capex                    | -205  | -224  | -246  |

**EXCESS PERFORMANCE**

|     | SPIX <sup>1</sup> | DJSFISV <sup>2</sup> |
|-----|-------------------|----------------------|
| 3M  | 7.3%              | 1.8%                 |
| 6M  | -1.5%             | -11.3%               |
| 12M | 6.8%              | -17.6%               |

<sup>1</sup>SPI ex Div.

<sup>2</sup>DJ STOXX Financial Services

## FY 2006 results: few surprises and in line with expectations

Sales of CHF 3821 mn compare to our estimate of CHF 3825 mn and represent 15.5% revenue growth, of which 10.3% was organic. This puts SGS solidly in line with its revenue growth targets of 10% organic and 15% total growth. Reported EBIT of CHF 624 mn (CHF 605 mn excluding exceptional gains) was 2% above our estimate, while net income of CHF 443 mn was exactly in line with our forecast.

### Comparison of Actual versus Estimated Results

| FY 2006 results               |        | 2005         | 2006         | Growth | 2006E        | Delta ACT vs EST |
|-------------------------------|--------|--------------|--------------|--------|--------------|------------------|
| <b>Revenues</b>               | CHF mn | <b>3,308</b> | <b>3,821</b> | 15.5%  | <b>3,825</b> | -0.1%            |
| % growth                      |        | 14.7%        | 15.5%        |        | 15.6%        |                  |
| <b>Operating Income</b>       | CHF mn | <b>502</b>   | <b>624</b>   | 24.3%  | <b>612</b>   | 2.0%             |
| % of net sales                |        | 15.2%        | 16.3%        |        | 16.0%        |                  |
| <b>Operating Profit (adj)</b> | CHF mn | <b>502</b>   | <b>605</b>   | 20.5%  | <b>591</b>   | 2.4%             |
| Operating profit margin       |        | 15.2%        | 15.8%        |        | 15.5%        |                  |
| <b>Net profit</b>             | CHF mn | <b>371</b>   | <b>443</b>   | 19.4%  | <b>443</b>   | 0.0%             |

The consensus estimate range was CHF 612-634 mn for operating income and CHF 443-459 mn for net income.

The group EBIT margin (excluding exceptionals) increased by 60 bps to 15.8%, showing continued progress towards the 2008 target of 17%. The group tax rate increased to 24.9% in FY 2006 compared to 23.5% in the prior year.

By division, as expected the strongest organic growth rates were seen for Consumer Testing (+22%), OCG (13%) and Minerals (16%). Their performance more than offset the expected weakness in Trade Assurance (-26%) and slower growth in Environmental (6%). EBIT margins increased significantly for seven out of ten divisions, which is a reflection of the impact of higher volumes, better utilization of the laboratory network and an ongoing shift to higher value added services. A table of results by division is shown on page 5. The three with declining EBIT margins were TAS, Environmental, and Life Science. For TAS, this was a consequence of the loss of the Nigerian and Venezuelan PSI contracts at the end of 2005. We expect a stabilization in this division in 2007. The margin development for the Life Science division was disrupted by the large acquisitions made during 2006 and the associated restructuring. Environmental, as seen in H1 reporting, continues to underperform the group. Its performance was also disrupted by a disposal during the year.

There were some divergences by division compared to our expectations, for example lower growth in Agriculture due to variations in harvest and crop conditions, but there were no substantial surprises at the group level. We therefore make no significant changes to our financial estimates.

### Company Outlook

Management's outlook for 2007 is for a continuation of "the positive trend experienced in 2006" and the group remains committed to achieving the previously communicated financial goals of CHF 5 bn in turnover, a 17% EBIT margin and earnings per share of CHF 80 by 2008.

We have forecast 10% organic growth for 2007 and an additional 50 bp increase in the EBIT margin to 16.3% which would result in EPS growth of 12%.

### Feedback from the company presentation

The company presented its full-year results at an investor meeting. This was the first presentation by Chris Kirk in his new role as CEO – he replaced Dan Kerpelmann at the end of November 2006.

Mr. Kirk stated that he sees all 10 existing business lines as core, and could possibly see SGS entering one or two new business areas in the future. He indicated that there have been no changes to the company's strategy, but that one of his priorities would be to accelerate the pace of acquisitions.

During 2006, the company managed eight acquisition and two disposals which had impacts of +4.2% and -0.6% respectively on group sales. Management stated that it looked at 40-50 potential acquisition targets during the year. To accelerate the pace, the corporate finance team (currently four persons) will be expanded, in order to speed up the analysis and vetting of prospective acquisitions, and the corporate team will become involved earlier in the process.

The resources available to the company for acquisitions are its net cash position of CHF 250 mn, the annual cash flow of CHF 300-400 mn and of course a potential leveraging of the balance sheet (EBITDA of CHF 800 mn and net equity of CHF 1.5 bn ).

### Valuation remains high

As shown in the peer valuation table below, SGS is trading at an EV/EBIT multiple of 15.3x. in 2007E and 13.2x in 2008E. This compares to a historical average of 13.7x (FWD) over 1994-2006.

### Peer Group Valuation

| Company             | Price<br>l.c. | EV/sales   |            | EV/EBITDA   |             | EV/EBIT     |             | P/E         |             | Sales growth |           | EPS growth |            | PEG        |            |
|---------------------|---------------|------------|------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|-----------|------------|------------|------------|------------|
|                     |               | 2007       | 2008       | 2007        | 2008        | 2007        | 2008        | 2007        | 2008        | 2007         | 2008      | 2007       | 2008       | 2007       | 2008       |
| Intertek Group      | 850           | 2.0        | 1.7        | 9.9         | 8.5         | 12.9        | 10.3        | 17.4        | 14.9        | 9%           | 11%       | 12%        | 16%        | 1.6        | 1.1        |
| Eurofins Scientific | 53            | 2.1        | 1.8        | 13.0        | 10.0        | 18.7        | 13.7        | 31.3        | 21.1        | 22%          | 17%       | 57%        | 48%        | 0.9        | 0.7        |
| <b>SGS</b>          | <b>1,399</b>  | <b>2.5</b> | <b>2.2</b> | <b>12.1</b> | <b>10.5</b> | <b>15.3</b> | <b>13.2</b> | <b>21.5</b> | <b>19.3</b> | <b>13%</b>   | <b>9%</b> | <b>12%</b> | <b>12%</b> | <b>2.0</b> | <b>1.8</b> |

Premium SGS/Intertek 21% 24% 18% 27% 24% 29% 46% -17% -3% -28% 28% 71%

The valuation premium versus Intertek is 18-29% depending on the valuation metric used. Although we believe a premium can be justified based on SGS's more diversified product portfolio and current market share gains, we expect largely similar earnings growth rates over the medium term and would have a tendency to favor Intertek at this level of valuation difference.

Pricing SGS in line with its historical forward EV/EBIT would suggest fair value of CHF 1300 per share today, CHF 1450 in one year's time and CHF 1600 by the end of 2008. We update our 12-month price target to CHF 1450.

**Conclusion**

SGS is clearly on track to meet its 2008 financial goals and we are attracted to the positive fundamentals of the sector, SGS's leading market position and quality of management. However, its high absolute and relative valuation multiples lead us to maintain our Market Perform rating.

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## SALES AND EBIT BY DIVISION

### Organic yearly revenue change in %

| Division                       |   | 1H 05       | 2H 05       | 2005        | 1H 06       | 2H 06       | 2006        | 2007E       |
|--------------------------------|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| -Agricultural services         | % | 10.9        | 13.3        | 12.2        | 9.3         | 2.0         | 5.8         | 7.0         |
| - Minerals services            | % | 19.1        | 13.8        | 17.1        | 18.1        | 14.5        | 16.1        | 14.0        |
| - Oil&Gas                      | % | 8.9         | 8.9         | 9.5         | 13.9        | 15.0        | 13.4        | 10.0        |
| - Consumer Products services   | % | 26.0        | 29.1        | 27.2        | 28.2        | 17.2        | 22.0        | 16.0        |
| - International Cert. services | % | 12.8        | 17.7        | 15.3        | 16.1        | 13.7        | 14.9        | 12.0        |
| -Trade Assurance               | % | -9.6        | -11.7       | -10.5       | -30.9       | -21.5       | -26.1       | 1.0         |
| - Industrial Services          | % | 14.9        | 13.2        | 12.6        | 11.8        | 15.1        | 13.1        | 9.0         |
| - Environmental Services       | % | 11.2        | 7.0         | 9.0         | 7.0         | 5.9         | 6.3         | 6.0         |
| -Automotive                    | % | 0.0         | -2.0        | -0.5        | 3.3         | 4.0         | 4.0         | 5.0         |
| -Life Science                  | % | 18.1        | 13.3        | 15.6        | -1.8        | 20.9        | 9.1         | 7.0         |
| <b>Total revenues</b>          | % | <b>11.1</b> | <b>12.1</b> | <b>11.3</b> | <b>10.6</b> | <b>10.0</b> | <b>10.2</b> | <b>10.3</b> |

### Divisional Operating Profit Breakdown

| Division                             |        | 1H 05      | 2H 05      | 2005       | 1H 06      | 2H 06      | 2006       | 2007E      |
|--------------------------------------|--------|------------|------------|------------|------------|------------|------------|------------|
| -Agricultural services               | CHF mn | 15         | 18         | 34         | 19         | 21         | 39         | 43         |
| - Minerals services                  | CHF mn | 27         | 37         | 63         | 38         | 43         | 81         | 93         |
| - Oil&Gas                            | CHF mn | 40         | 40         | 79         | 52         | 61         | 113        | 126        |
| - Consumer Products services         | CHF mn | 46         | 56         | 102        | 65         | 72         | 137        | 168        |
| - International Cert. services       | CHF mn | 20         | 26         | 47         | 28         | 31         | 59         | 67         |
| -Trade Assurance                     | CHF mn | 25         | 23         | 49         | 11         | 12         | 23         | 26         |
| - Industrial Services                | CHF mn | 28         | 31         | 59         | 32         | 43         | 75         | 86         |
| - Environmental Services             | CHF mn | 11         | 15         | 26         | 11         | 13         | 24         | 30         |
| -Automotive                          | CHF mn | 13         | 12         | 25         | 15         | 15         | 30         | 32         |
| -Life Science                        | CHF mn | 9          | 10         | 19         | 11         | 13         | 25         | 30         |
| <b>Total OP before Group costs</b>   | CHF mn | <b>234</b> | <b>268</b> | <b>502</b> | <b>281</b> | <b>323</b> | <b>605</b> | <b>700</b> |
| Group corporate costs                | CHF mn | 1          | -1         | 0          | 0          | 0          | 0          | 0          |
| <b>Total EBIT before Group costs</b> | CHF mn | <b>235</b> | <b>267</b> | <b>502</b> | <b>281</b> | <b>323</b> | <b>605</b> | <b>700</b> |
| Exceptional operating items          | CHF mn | 0          | 0          | 0          | 0          | 0          | 19         | 0          |
| <b>Total reported EBIT</b>           | CHF mn | <b>235</b> | <b>267</b> | <b>502</b> | <b>281</b> | <b>323</b> | <b>623</b> | <b>700</b> |

### Divisional Operating Profit Margin Breakdown

| Division                       |   | 1H 05       | 2H 05       | 2005        | 1H 06       | 2H 06       | 2006        | 2007E       |
|--------------------------------|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| -Agricultural services         | % | 11.2        | 11.5        | 11.4        | 11.9        | 12.9        | 12.4        | 12.5        |
| - Minerals services            | % | 15.4        | 17.2        | 16.4        | 16.7        | 17.7        | 17.2        | 17.2        |
| - Oil&Gas                      | % | 13.0        | 12.0        | 12.5        | 13.9        | 14.8        | 14.4        | 14.4        |
| - Consumer Products services   | % | 21.7        | 21.3        | 21.4        | 22.8        | 23.3        | 23.1        | 23.5        |
| - International Cert. services | % | 16.1        | 17.8        | 17.0        | 18.3        | 18.6        | 18.5        | 18.5        |
| -Trade Assurance               | % | 21.0        | 21.4        | 21.2        | 13.7        | 13.8        | 13.7        | 15.0        |
| - Industrial Services          | % | 13.1        | 13.2        | 13.2        | 13.1        | 16.0        | 14.6        | 15.0        |
| - Environmental Services       | % | 10.0        | 12.0        | 11.1        | 9.0         | 10.3        | 9.7         | 11.0        |
| -Automotive                    | % | 13.6        | 11.7        | 12.6        | 13.7        | 13.3        | 13.5        | 13.5        |
| -Life Science                  | % | 14.2        | 16.3        | 15.2        | 12.1        | 13.3        | 12.7        | 14.0        |
| <b>Total reported EBIT</b>     | % | <b>15.1</b> | <b>15.3</b> | <b>15.2</b> | <b>15.3</b> | <b>16.4</b> | <b>16.3</b> | <b>16.3</b> |

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- "Discounted free cash flow" model
- Key business figures and ratios (valuation and profitability, e.g. NAV, embedded value and franchise value) compared to the sector (peer group comparison) and in relation to the company's history
- "Sum-of-the-parts" model

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|----------------------|--|
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| <i>Perform</i>       | Performance of between +5% and -5% expected to the benchmark |
| <i>Underperform</i>  | Underperformance of more than -5% expected to the benchmark  |

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