Europe Switzerland
Business Services Outsourcers

Deutsche Bank

31 May 2011

SGS

Reuters: **SGSN.VX** Bloomberg: **SGSN VX** Exchange: **VTX** Ticker: **SGSN**

Continued re-invention

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Confirmation of long term targets at investor days in Canada

SGS enjoys a superior positioning within an extremely attractive industry that is exposed to outsourcing, globalization and increasing regulations. All l-t targets were confirmed at the investor days in Canada. Management mentioned high single-digit like-for-like (l-f-l) sales growth ytd, achievable also for the rest of 2011. SGS did not suffer from major negatives relating to recent events in Africa/Middle East and Japan. With the stock trading at a PE of 19.2x (2011E), we see the sound business model discounted in the current share price, hence our Hold rating.

Key message from the investor days in Canada

SGS gave an overall very upbeat presentation with a lot of focus on divisional detail. Sales growth remains close to 10% ytd and should stay there for the rest of the year. SGS demonstrated its ability to integrate small M&A deals (through various presentations by previous owners that are still with SGS). It is impressive how SGS replicates these locally acquired competences / products on a global basis. One gets the impression SGS is steadily moving upstream in all fields with more consulting and value added services, hence it continues to re-invent itself and generate sales growth and margin upside potential. Margins should be further supported by a continued focus on costs, IT optimization and investments in technology. On M&A, we expect more small deals in the future.

Margin development

Most of SGS's 20% EBIT margin target for 2014E (our estimate: 18.9%) seems to be driven by mix effects (continued move towards upstream business), efficiency and operating leverage, resulting from targeted strong sales growth. However, we believe that SGS has undergone some tough restructuring in the past and seems a pretty well run business already, hence further efficiency measures might be harder to achieve. As some end-markets are rather competitive, pricing might be at risk. Last but not least, M&A targets could be dilutive to the group's profitability.

Valuation and risks

We derive our TP for SGS via a DCF model, applying a WACC of 8.5%, long term growth assumption of 2.5% and long term EBIT margin of 20%. Downside risks: a potential slowdown in international trade, increased protectionism, reputation risks, currency fluctuations, country risks or general GDP developments. Better utilization of the group's net cash position, with a potentially more aggressive buyback program or a larger acquisition could lead to upside (see p.28 for more).

Forecasts and ratios

Year End Dec 31	2009A	2010A	**2011E**	2012E
Revenue (CHFm)	4,712	4,757	**4,965**	5,196
EBITDA (CHFm)	1,022	1,061	**1,138**	1,178
DB EPS (CHF)	72.60	75.85	**85.49**	88.68
DB EPS growth (%)	-3.4	4.5	**12.7**	3.7
P/E (DB EPS) (x)	17.6	19.8	**19.2**	18.5
EV/EBITA (x)	11.8	13.6	**13.4**	12.6
Yield (%)	4.7	4.3	**2.6**	2.7

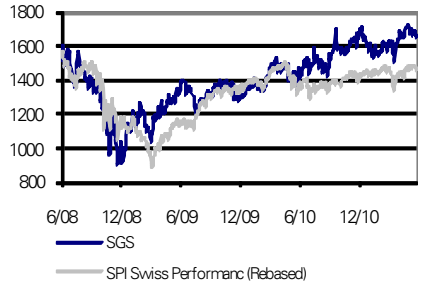
Source: Deutsche Bank estimates, company data

Company Update

Hold

Price at 30 May 2011 (CHF)	**1,644.00**
Price Target (CHF)	**1,700.00**
52-week range (CHF)	**1,717.00 - 1,410.00**

Price/price relative

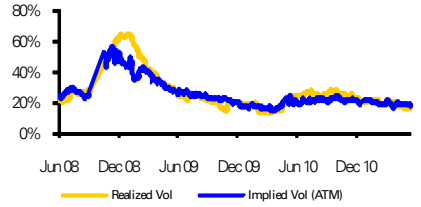


Performance (%)	1m	3m	12m
Absolute	*-4.3*	*1.7*	*12.4*
SPI Swiss Performance IX	*-1.0*	*0.0*	*6.7*

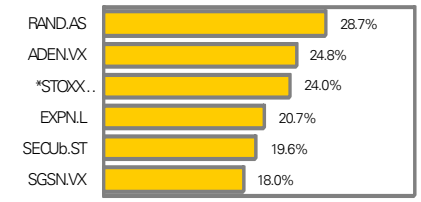
Stock & option liquidity data

Market cap (CHF)(m)	12,657.6
Shares outstanding (m)	8
Free float (%)	67
Option volume (und. shrs., 1M avg.)	847

Implied & Realized Volatility (3M)



Implied Volatility (3M, ATM) vs. Peers



*Weighted-avg. of index components
Data as of 27-May-11

Deutsche Bank AG/London

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Model updated:31 May 2011

Running the numbers

Europe

Switzerland

Outsourcers

SGS

Reuters: SGSN.VX Bloomberg: SGSN VX

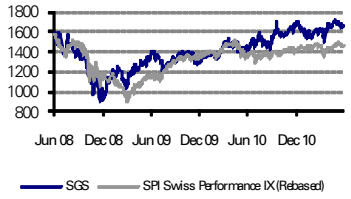
Hold

Price (30 May 11)	CHF 1,644.00
Target price	CHF 1,700.00
52-week Range	CHF 1,410.00 - 1,717.00
Market Cap (m)	CHFm 12,658 USDm 14,858

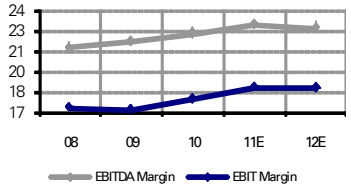
Company Profile

SGS is global leader in inspection, verification, testing and certification. The company employs circa 64,000 people and operates a network of more than 1,250 offices and laboratories around the world. SGS operates the following ten divisions: Agricultural Services, Minerals Services, Oil, Gas and Chemicals Services, Life Science Services, Consumer Testing Services, Systems and Services Certification, Industrial Services, Environmental Services, Automotive Services and Governments & Institutions Services. SGS provides industrial inspection, analysis, testing, and verification services worldwide.

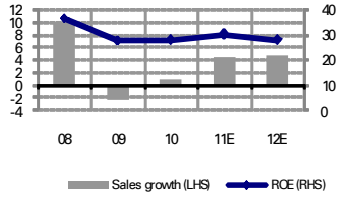
Price Performance



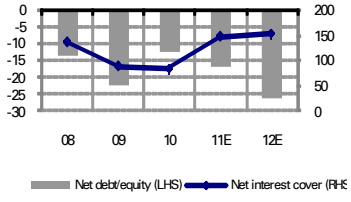
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec	2008	2009	2010	2011E	2012E
Financial Summary					
DB EPS (CHF)	75.16	72.60	75.85	85.49	88.68
Reported EPS (CHF)	89.83	69.88	74.81	84.32	87.51
DPS (CHF)	50.00	60.00	65.00	42.00	45.00
BVPS (CHF)	236.9	269.2	268.7	288.0	333.6
Weighted average shares (m)	8	8	8	8	8
Average market cap (CHFm)	10,253	9,836	11,561	12,658	12,658
Enterprise value (CHFm)	10,042	9,397	11,341	12,342	12,047
Valuation Metrics					
P/E (DB) (x)	17.7	17.6	19.8	19.2	18.5
P/E (Reported) (x)	14.8	18.3	20.1	19.5	18.8
P/BV (x)	4.64	5.02	5.84	5.71	4.93
FCF Yield (%)	5.5	6.4	4.6	4.9	5.1
Dividend Yield (%)	3.8	4.7	4.3	2.6	2.7
EV/Sales (x)	2.1	2.0	2.4	2.5	2.3
EV/EBITDA (x)	9.8	9.2	10.7	10.8	10.2
EV/EBIT (x)	12.4	12.0	13.7	13.6	12.7
Income Statement (CHFm)					
Sales revenue	**4,818**	**4,712**	**4,757**	**4,965**	**5,196**
Gross profit	**2,244**	**2,164**	**2,216**	**2,378**	**2,541**
EBITDA	**1,024**	**1,022**	**1,061**	**1,138**	**1,178**
Depreciation	214	228	225	220	221
Amortisation	0	8	8	9	9
EBIT	**810**	**786**	**828**	**909**	**948**
Net interest income(expense)	-6	-9	-10	-6	-6
Associates/affiliates	0	0	0	0	0
Exceptionals/extraordinaries	127	-20	-4	0	0
Other pre-tax income/(expense)	2	6	3	5	0
Profit before tax	**933**	**763**	**817**	**908**	**942**
Income tax expense	219	200	215	232	240
Minorities	22	25	26	27	28
Other post-tax income/(expense)	0	0	0	0	0
Net profit	**692**	**538**	**576**	**649**	**674**
DB adjustments (including dilution)	-113	21	8	9	9
DB Net profit	**579**	**559**	**584**	**658**	**683**
Cash Flow (CHFm)					
Cash flow from operations	**838**	**840**	**783**	**883**	**907**
Net Capex	-278	-209	-250	-260	-260
Free cash flow	**560**	**631**	**533**	**623**	**647**
Equity raised/(bought back)	-542	89	85	0	0
Dividends paid	-281	-391	-480	-500	-323
Net inc/(dec) in borrowings	0	0	0	0	0
Other investing/financing cash flows	-228	-24	-352	0	0
Net cash flow	**-491**	**305**	**-214**	**123**	**323**
Change in working capital	*-22*	*13*	*-33*	*-22*	*-25*
Balance Sheet (CHFm)					
Cash and other liquid assets	583	792	815	938	1,261
Tangible fixed assets	721	751	756	796	835
Goodwill/intangible assets	759	777	982	973	964
Associates/investments	2	1	2	2	2
Other assets	1,516	1,415	1,426	1,472	1,523
Total assets	**3,581**	**3,736**	**3,981**	**4,181**	**4,585**
Interest bearing debt	335	316	556	556	556
Other liabilities	1,384	1,310	1,317	1,341	1,366
Total liabilities	**1,719**	**1,626**	**1,873**	**1,897**	**1,922**
Shareholders' equity	1,825	2,073	2,069	2,218	2,568
Minorities	37	37	39	66	94
Total shareholders' equity	**1,862**	**2,110**	**2,108**	**2,284**	**2,663**
Net debt	*-248*	*-476*	*-259*	*-382*	*-705*
Key Company Metrics					
Sales growth (%)	10.2	-2.2	1.0	4.4	4.7
DB EPS growth (%)	14.2	-3.4	4.5	12.7	3.7
EBITDA Margin (%)	21.3	21.7	22.3	22.9	22.7
EBIT Margin (%)	16.8	16.7	17.4	18.3	18.3
Payout ratio (%)	55.7	85.9	86.9	49.8	51.4
ROE (%)	36.5	27.6	27.8	30.3	28.2
Capex/sales (%)	6.0	4.7	5.5	5.2	5.0
Capex/depreciation (x)	1.4	1.0	1.2	1.2	1.2
Net debt/equity (%)	-13.3	-22.6	-12.3	-16.7	-26.5
Net interest cover (x)	135.0	87.3	82.8	145.9	152.2

Source: Company data, Deutsche Bank estimates

Investment thesis

Outlook

SGS enjoys a superior positioning (mid teen global market share) within an extremely attractive industry. The company is global leader in inspection, verification, testing and certification. SGS employs circa 64'000 people and operates a network of more than 1,250 offices and laboratories around the world. The company looks to be well positioned to benefit from its exposure to secular trends of outsourcing, globalization and increasing regulations. Furthermore, management continues to diversify its business and expand geographically mainly into emerging markets. SGS's global network and increasingly strong brand facilitates continued market share gains from smaller local competitors. Due to these facts, we believe SGS is well positioned to deliver profitable growth going forward.

Unsurprisingly, all long-term targets were confirmed at the investor days in Canada. Management mentioned high single-digit like-for-like (l-f-l) sales growth ytd that should continue to be achievable for the rest of 2011. SGS did not suffer from major negatives relating to recent events in Africa/Middle East and Japan. The company demonstrated its ability to integrate small M&A deals through various presentations by previous owners that are still with SGS. It is impressive how SGS replicates these locally acquired competencies / products on a global basis. One gets the impression SGS is steadily moving upstream in all fields with more consulting and value added services, hence it continues to re-invent itself and generate sales growth and margin upside potential. Margins should be further supported by a continued focus on costs, IT optimization and investments in technology. On M&A, we expect more small deals in the future.

Most of SGS's 20% EBIT margin target for 2014E (our estimate: 18.9%) seems to be driven by mix effects (continued move towards upstream business), efficiency and operating leverage, resulting from targeted strong sales growth. However, we believe that SGS has undergone some tough restructuring in the past and seems a pretty well run business already, hence further efficiency measures might be harder to achieve. As some end-markets are rather competitive, pricing might be at risk.

With the stock trading at a PE 2011E of 19.2x, we see the sound business model well discounted in the current share price and continue to rate the stock Hold.

Valuation

We use a DCF model to derive our price target of CHF1700 for SGS, with a WACC of 8.5% (beta: 1, risk-free rate: 3.5%, equity risk premium: 5.0%) and a long-term growth assumption of 2.5%. Our long term growth assumption is mainly driven by the global inflation rate. Furthermore, our long term EBIT margin assumption is 20%.

Risks

Downside risks to our investment case include a potential slowdown in international trade. Increased protectionism, reputation risks, currency fluctuations, country risks and the general GDP development can have adverse impact on SGS's share price. Furthermore, the announced acquisition strategy carries some inherent risks. To the upside, better utilization of the group's net cash position, with a potentially more aggressive buyback program or a larger acquisition could lead to additional share price upside. Furthermore, better than expected market share gains, better international trade developments or better performance of margin accretive moves could impact the share price positively.

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Analyst day feedback

SGS hosted investor days on 26 and 27 May in Canada. Overall it was a very upbeat presentation with a lot of focus on divisional detail. Management mentioned that all ten businesses have shown high growth (l-f-l) ytd and the overall l-f-l growth rate should persist for the rest of the year. Hence, there seems no negative impact from the events in Africa and Japan. In Japan (c.CHF50m sales), the impact was mainly in its systems and certification business due to postponed or delayed re-certifications, but the company has been benefitting from food radiation testing. In the US the lobby against high costs in toy testing should not have a large impact on SGS. Overall, we see no change in the underlying growth dynamics.

SGS demonstrated its ability to integrate small M&A deals (through various presentations by previous owners that are still with SGS). It is impressive how SGS replicates these locally acquired competences / products on a global basis. One gets the impression that the company is steadily moving upstream in all fields with more consulting and value added services, hence it continues to re-invent itself and generate sales growth and margin upside potential. Margins should be further supported by an ongoing focus on costs, IT optimization and investments in technology. Currently 80% of the systems are on one ERP platform (Oracle), and in three years 100% will be on the same platform. This will not result in headcount reduction, due to greater redeployment as a result of ongoing growth. On M&A, we expect the company to continue making small deals.

SGS highlighted key themes for some of its business segments and its positioning in these markets. The company also gave details on its North America operations and its growth strategy for the region.

Minerals Services

Mining projects from start to finish (from feasibility study to operating a mine) take around 4-6 years with an important time gap between investment and first revenue. Feasibility studies can take up to four years and cost up to USD100m, after which only in 1 in 10,000 becomes a mine. Generally, good deposits are harder to find, being located in more remote areas with little or no infrastructure and/or with more political risks and rising costs.

SGS highlighted the following current trends in the mining business:

- Mismatch between supply and demand
- Continued price volatility
- Increased exploration activities
- Greater need for financing
- Social and environmental issues
- Infrastructure shortage (ports or rail of poor quality in some emerging markets)

Thus, any mining project faces several technical, operational and financial risks, which SGS can help to mitigate. SGS offers exploration support, lab analysis, defines the size and shape of the deposit, gives recovery assessments and provides technical reports thereon for use by various stakeholders, which can be taken to the bank for financing. Further, the company develops potential process flows and a pilot plant for demonstration using real ore and producing mine concentrate similar to what the live mine will produce. About 100 to 150 SGS people can work in a pilot plant, which can be run 24/7. Once the mine goes into operation,

SGS embeds itself into the plant. The company also addresses environmental issues with environmental impact studies, geo compliance resources reports, etc. Hence, SGS's services cover the total value chain versus the previous traditional business of certification of the quality and quantity of the output.

Agricultural Services

SGS highlighted that by 2050 the world population should reach 9.1bn (currently c.6.9bn) of which 70% will be urban. Hence, food production needs to increase by 70% over the current level, which requires estimated annual gross investment of USD209bn. SGS emphasized that **international trade** (e.g. cereal imports from developing countries) is likely to double over the period and **technology** will be crucial to achieving these increased needs, ensuring sustainability factors as well. As a result, the following areas should gain prominence:

- Trade inspection and testing
- Precision farming of seed and crop
- Laboratory food safety and genetics

The key factors for sustainable growth in agriculture:

- **Governments and institutions** should focus on 1) protection and regulation, 2) subsidization and facilitation of investment in technology and 3) outsourcing of land for cultivation (into other countries).
- **Big traders and banks** are expected to continue to invest in farming. This should result in more upscale farming leading to benefits of scale, reduced costs and increased use of technology.
- **Science and technology** developments should be focused on the 1) use of bespoke seeds and crops (biotechnology), 2) controlling inputs (for yield improvement) and 3) the use of robotics and automation.
- The **Public** should continue to stress sustainability. Public opinion will be key and issues like food chain transparency and food safety should continue to gain importance.

SGS's Agricultural Services business is focused on moving up the value chain. The company launched new seed and crop services in 2007 to take advantage of key market trends (technology, R&D outsourcing, commercial farming, and agricultural development as an asset class).

SGS provides services in the following areas:

- Soil testing, water testing (e.g. SGS helps to reduce fertilizer use, which saves costs and conserves soil),
- Seed testing,
- Crop protection (field trials and testing, product chemistry),
- Harvesting (monitoring, quality map) and
- Contract research: testing pesticides in the field for bioefficacy and crop safety.

SGS plans to grow in this segment by 1) acquiring key market players (Nvirocrop RSA in January 2011, Agri-Food Labs Canada in March 2011 and ARA USA in May 2011), 2) entering new geographies and 3) introducing new services. SGS experienced organic growth of >30% in 2010 in its food and crop services business and estimates this business accounts for c.15% of the total agricultural segment revenue in 2011.

Industrial Services

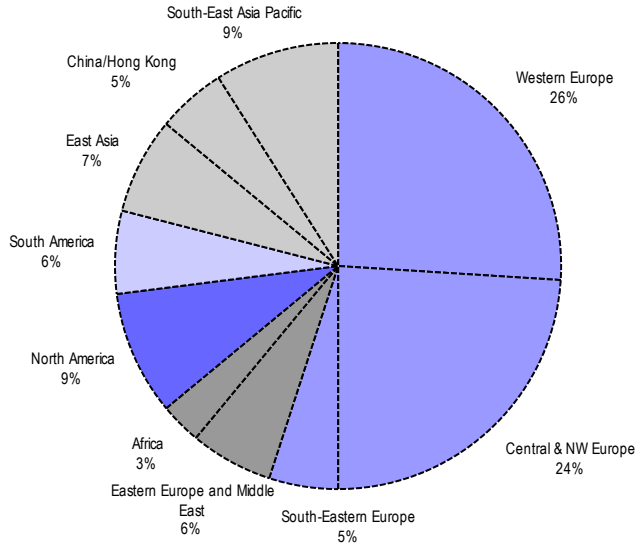
SGS Industrial Services operates in more than 80 countries employing around 9000 people worldwide. SGS's services in this segment increase safety and quality and reduce technical and commercial risks faced by various industries. SGS assures asset integrity (asset needs to fit purpose) from design to decommissioning, across all industries, globally. SGS has a large portfolio of service offerings addressing safety, quality, compliance, reliability, and maintainability issues for the overall production cycle in any industry including design, procurement fabrication, construction commissioning, operation, maintenance and modification. Its range of services includes:

- Statutory and voluntary inspections,
- Supply chain services,
- Material testing (laboratory),
- Asset integrity,
- Import / product certification,
- Project services (due diligence, risk management, project management, supervision) and
- Technical staffing services (SGS provides an external network of available specialists).

SGS's Industrial Services business primarily serves the **oil & gas**, **power**, **construction** and **transportation** industries. The different client segments that SGS caters to are plant operators/owners, EPC contractors, consulting companies, construction companies, suppliers of technical components, government authorities, investors, insurers, and trading companies.

SGS Industrial Services derives more than half of its revenue in Europe (55% excluding Eastern Europe in 2010). We highlight the regional sales mix in Figure 1.

Figure 1: SGS Industrial Services regional revenue breakdown, 2010



Source: Company data

Wage inflation is an issue in some Asian markets, due to the high demand for specialists. SGS copes with this through increasing use of technologies that drive labour efficiency.

Oil, Gas & Chemicals

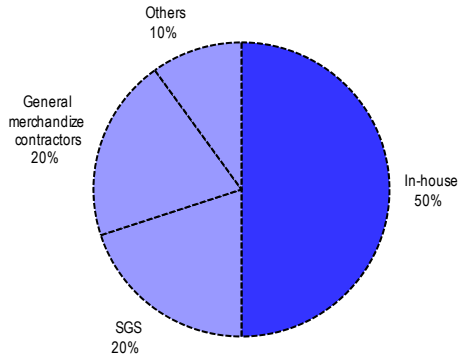
SGS elaborated on its Plant & Terminal Operations (PTO), which refers to its product handling services at oil refineries, chemical plants and terminals. SGS entered the PTO business with the acquisition of US-based Petroleum Services Corporation (PSC) in 2004. Thus most of its PTO business is in the US and Canada. SGS's global PTO sales in 2010 totaled USD160m of which USD117m was generated in North America. Its services include:

- Barge loading and unloading: PSC is the oldest and largest barge loading and unloading service in the US (loading and unloading c.36,000 barges p.a.),
- Rail and truck loading and unloading (c.300,000 railcars and trucks p.a. at more than 50 plant sites),
- Rail switching operations,
- Marine dock operations (75 major marine facilities in North America),
- Warehouse operations (mostly in plastics, fertilizers and rubber products) and
- Tank farm and pipeline operations (pumping), and underground Storage operations (liquefied gases).

PTO margins are below the overall Oil, Gas and Chemicals business, but have been growing over time. The PTO business is the least capital intensive business within the division, as it is mostly personnel oriented. Margin volatility is low as costs are closely related to revenue. For example, during hurricanes or flooding, clients have to pay even if the work is affected.

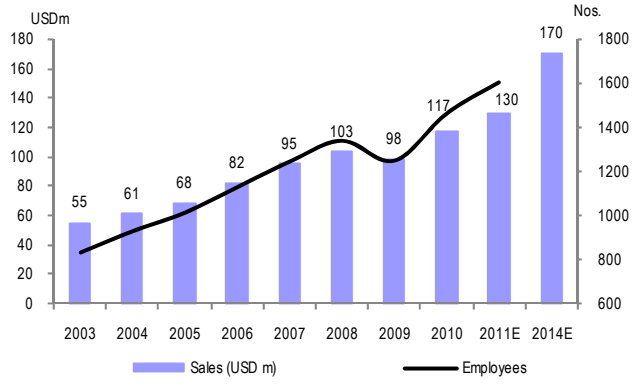
SGS highlighted that though the Gulf Coast remains the best PTO outsourcing region, other regions are also evolving towards outsourcing (unions are a major barrier). 50% of customers carried their own PTO operations in the Gulf Coast versus 85% in Non-Gulf Coast areas (SGS claimed a 20% market share in the Gulf Coast PTO market).

Figure 2: Gulf Coast PTO market share



Source: SGS

Figure 3: SGS PTO business evolution and target



Source: SGS

SGS believes that PTO outsourcing should continue to grow as companies continue to focus on core functions and cost control, in order to be more competitive. New opportunities should come from the US chemical industry, which has announced major expansion projects after years of decline, and upsourcing should be a key theme. SGS has more than doubled its North American PTO business from USD55m in 2003 to an estimated USD130m in 2011 and targets revenue of USD170m by 2014.

Life Sciences Services

The key theme at the Life Sciences Services presentation was biologics. SGS highlighted that pharmaceutics have over the last century moved from chemistry to biology. Biologics are more specific, more effective, can be preventive (vaccine), and target severe diseases that are more prevalent in the 21st century (e.g. cancer, inflammatory). From just two drugs out of the top 20 in 2000, biologics (vaccines, monoclonal antibodies) are expected to account for half of the top 20 drugs by 2015. Vaccines are expected to grow at a 13.5% CAGR p.a. and monoclonal antibodies market are expected to grow at a 11.8% CAGR p.a. from 2010 to 2015 (Source: Frost & Sullivan, SGS).

Key trends for mid-term growth in biologics:

- 40% of global biologics sales will be off patent by 2015.
- >USD100bn of biologic sales are expected to be off patent by 2020.
- Emergence of biosimilar (c.25-30% lower price than originator, which would provide savings to patients, and help stabilize the healthcare systems). Biosimilar needs more testing and hence is a great opportunity for SGS.

SGS is positioned along the full drug development chain, from molecule to market, with activity in preclinical, exploratory development, confirmatory development, post-approval, routine production and trade distribution. The company has a network of 18 labs worldwide offering global testing services proposition with top equipment and scientific experience. This is important as R&D is often done in the US, but production is done in emerging markets. SGS helps in method development and validation, characterizing biopharma, ensuring potency and efficacy, and ensuring safety.

Figure 4: SGS targets for LSS business in 2014

Segment	Est. Market size	Est. CAGR	Current position	2014 target
Early Phase	USD2-3bn	6-8%	EU: Top 3, 7-8%; Not present in NorAm and Asia	EU: Top 3,10%; Not present in NorAm and Asia
Bio-analysis	USD1.2bn	6%	EU : Top 3, present in NorAm not present in Asia	EU : Top 3; develop business in NorAm and Asia
Biopharmaceutical	USD1.0bn	11+%	EU <1%, NorAm <1%, China developing	EU: 5-10%; NAM 5-10%; Asia 5-10%
Analytical services (small molecule)	USD1.4bn	5-6%	Overall 5%	Overall 5%

Source: Deutsche Bank, company data

SGS targets to become no1 in biologics testing (large molecules) by:

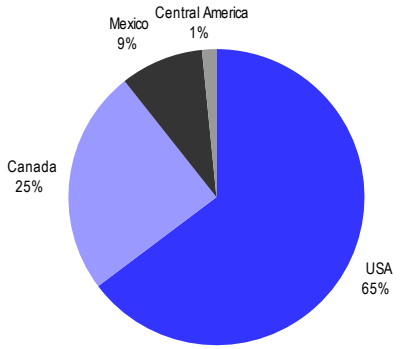
- Reinforcing its unique worldwide selling proposition,
- Achieving preferred partner position with big pharma-biotech companies in biologics testing (global key accounts).

In biopharma, the 2014 target is supported by the M-Scan acquisition in October 2010, and network extension (four new labs in the UK, US, China and Germany).

North America

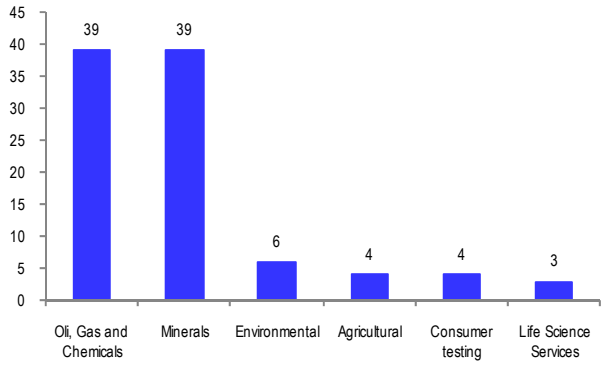
SGS gave a detailed presentation on its business in North America. SGS is present in 150 locations across North America with 100 laboratories and more than 6200 employees (US: 4130, Canada: 1570, Mexico: 580, Central America: 100). The company is active in all ten business segments in the region but is a dominant player in Oil, Gas & Chemicals (OGC) and Minerals with a solid reputation with blue-chip companies. SGS has a solid safety record, which is extremely important in North America especially with oil majors.

Figure 5: Distribution of employees in North America



Source: Company data

Figure 6: Distribution of laboratories in North America



Source: Company data

The key opportunities identified by SGS for the North American market are:

- Growing upstream market,
- High oil price,
- Outsourcing (non-core functions by refineries, lab testing by pharma and mining companies) and
- Increased regulation (food, environmental and automotive industries).

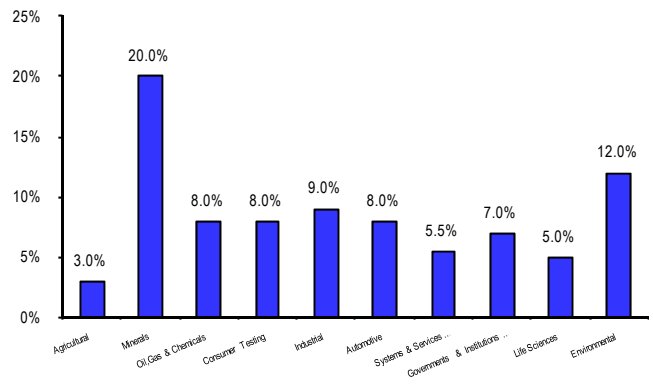
The key challenges faced by SGS in the region are high labour cost, finding suitable technical expertise, shifting of production to low-cost regions. SGS is focused on **operational excellence** (standardizing sales process, cost management, human resources), **leadership**, and business development to grow its business in the North American market.

Current trading

One of its main competitors, Bureau Veritas (BV; EUR57.09, Buy) reported a strong Q1 2011 development with organic growth of 7.3% yoy (adjusted), while in its outlook statement the company guided for organic growth exceeding that of the previous year, and consistent with H2 2010. With the first trimester 2011 results, another competitor, Intertek (GBp1997, Hold), reported 8% yoy l-f-l growth. In the outlook statement, Intertek management communicated the expectation of high single digits l-f-l sales growth for 2011.

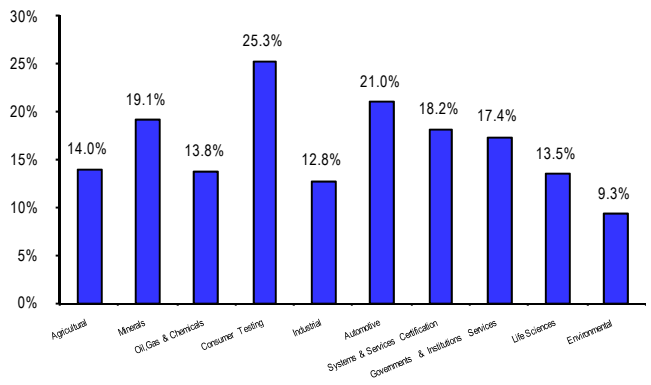
Following competitor read through, the recent update on SGS at Deutsche Bank's Swiss Equities Conference and the investor days in Canada, our H1 2011E l-f-l sales growth forecast of +9.1% seems well supported. While all divisions at SGS should have grown in 2011, the strongest performance is expected in Minerals (13% of sales), Industrial (16% of sales) and Environmental (6% of sales).

Figure 7: Top-line growth forecast H1 2011E



Source: Deutsche Bank estimates

Figure 8: EBIT margin forecast H1 2011E



Source: Deutsche Bank estimates

Agricultural

Q2 is the most important quarter for agriculture as this is when most agricultural inputs are applied in the Northern Hemisphere. This spring growing season in Europe has been characterized by dry and hot weather across many key growing countries (France, Germany, the UK). The US weather has also been unsettled, resulting in delayed planting, but the situation seems to be normalizing.

At BV, the agriculture segment is supported by regulations and required tests, particularly in pesticides and GMOs.

Consumer products

At BV, consumer products sales grew by +1.6% yoy in organic terms during Q1 2011. However, sales growth was slowed during Q1 due to the disadvantageous calendar effect caused by the Chinese New Year and a company related issue (the loss of exclusive supplier status with two US clients). During March 2011, growth at BV's consumer business returned to a more normalized organic growth of 6%. For H2 2011, BV guided for a return to structural growth levels in sales, driven by momentum in the electrical & electronics segment in Asia and a company related issue (start of a new contract for a major US retailer).

For consumer goods, Intertek reported that T1 2011 was a seasonally slower period, hence, l-f-l sales growth was lower than expected mainly as a result of an unusually long new year holiday shut-down period in China. However, the drive of global retailers to source goods where production costs are lowest remains a driver for the segment.

Commodities

Overall, BV reported organic growth of 13.4% yoy in the commodity related business. Momentum in the metals and minerals segment was driven by the high level of investment spending in exploration production. However, coal inspection and testing suffered from the floods in Australia. BV guided for continued double-digit organic growth for the rest of 2011.

For Intertek, the commodities division had good revenue growth. Demand for petroleum related cargo inspections and non-inspection related testing in North America increased slightly as clients' trading, refining and fuel development activities expanded compared to the prior year period. Minerals and Government Services had a strong start to the year with high global demand for minerals driving exploration and mining activity.

Certification

Excluding a contract loss, BV's organic sales growth during Q1 2011 was 2.8% yoy, affected by a low level of new orders booked in Q4 2010 and delays to audits scheduled in Japan.

Industry

Intertek reported that industry services sales grew well and that there was a pipeline of new contract opportunities with demand coming from both emerging and developed markets. Global and local clients seem to be seeking support with infrastructure projects.

Government Services & International Trade

BV reported government services & international trade organic sales growth of 18.8% yoy. Growth was driven by an increase in volumes inspected in the portfolio of existing contracts and the rising momentum of new verification of conformity contracts.

Intertek mentioned that government services are benefiting from higher imports.

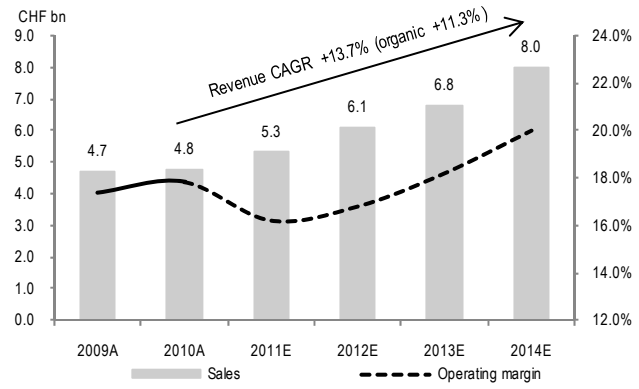
Financial targets

SGS outlined the following targets for the period 2010-2014:

- Revenue to reach CHF8bn by 2014 at CAGR of 13.7% p.a. with acquired revenues of CHF0.7bn (organic revenue CAGR 11.3%).
- Operating income (before amortization and non-recurring items) to double from CHF0.8bn in 2010 to CHF1.6bn in 2014.
- Operating margin of 20% by 2014.
- Net income of CHF1.1bn and EPS of CHF140 by 2014.
- Operating cash flows of 15-17% of revenue during the period.
- Accelerated capital expenditure of CHF500m during the period.
- Development program funding of CHF150m over the period.

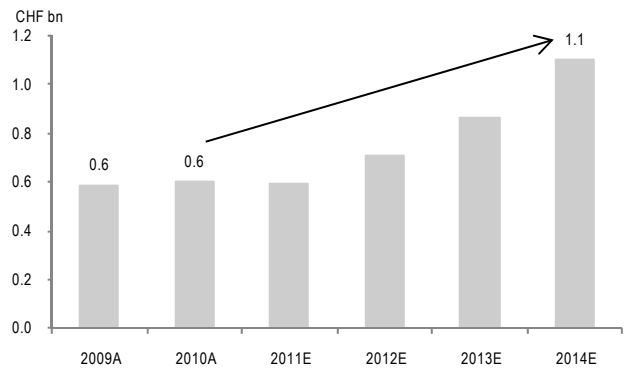
Key assumptions for SGS's targets are strength in CHF, no major downturn in the world economy, lack of quality projects for capex plans, and valuation of potential M&A targets.

Figure 9: SGS sales and EBIT margin target for 2010-14



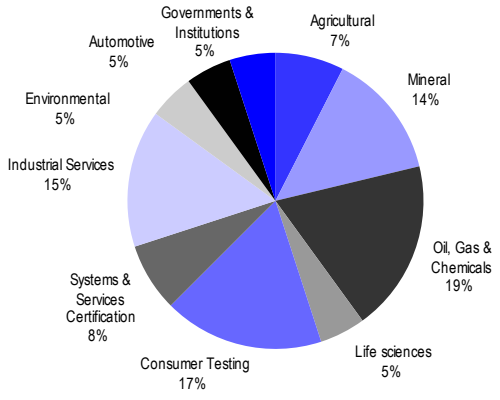
Source: Deutsche Bank and company data;

Figure 10: SGS net income target for 2014



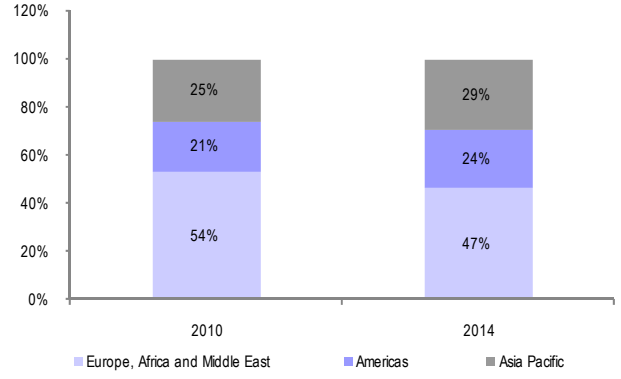
Source: Deutsche Bank and company data

Figure 11: SGS targeted business sales split in 2014



Source: Deutsche Bank and company data

Figure 12: SGS targeted regional sales split in 2014



Source: Company data

We summarize the company targets in comparison with consensus and our estimates in Figure 13.

Figure 13: Company targets versus Consensus and DB estimates

	2010A	2011E	2012E	2013E	2014E
Revenue (CHF m)					
Company target	**4757**	**5300**	**6100**	**6800**	**8000**
BBG Consensus		5132	5691	6317	
DB estimate		4965	5196	5566	5953
Operating income (CHF m)					
Company target	**848**				**1600**
Consensus		884	1024	1185	
DB estimate		918	957	1045	1137
Operating margin					
Company target	**17.8%**				**20.0%**
Consensus		17.2%	18.0%	18.8%	
DB estimate		18.5%	18.4%	18.8%	19.1%
Adjusted net income (CHFm)					
Company target	**599**				**1100**
Consensus		624	720	829	
DB estimate		658	683	747	809
EPS (CHF m)					
Company target	**77.8**				**140**
Consensus		82.4	94.8	108.8	
DB estimate		85.5	88.7	97.0	105.0

Source: Company data, Bloomberg Finance L.P., Deutsche Bank estimates

Valuation

Overview

According to our current forecasts, SGS is trading at 18.5x PE 2012E compared to its closest peers Bureau Veritas (15x) and Intertek (18.3x). On EV/EBITDA basis the stock is trading at 10.2x (2012E EBITDA), on a par with its peers. In Figure 14 we highlight key valuation multiples over time.

Figure 14: Valuation overview 2004-2014E

Valuations (CHF m)	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Market capitalisation	5525.7	7044.9	7130.4	9406.6	10236.7	9810.5	11513.7	12657.6	12657.6	12657.6	12657.6
Net debt	(438.0)	(430.0)	(215.0)	(378.0)	(248.0)	(476.0)	(259.0)	(381.6)	(704.8)	(1071.5)	(1516.3)
Minorities	26.0	36.0	30.0	36.0	37.0	37.0	39.0	66.3	94.4	123.4	153.8
Enterprise value	**5061.7**	**6578.9**	**6885.4**	**8992.6**	**9951.7**	**9297.5**	**11215.7**	**12209.7**	**11858.4**	**11462.8**	**10987.6**
EBITDA	506.0	642.0	777.0	908.0	1024.0	1022.0	1061.0	1138.3	1178.2	1282.5	1392.4
EBIT	391.0	502.0	605.0	711.0	810.0	822.0	848.0	918.3	957.4	1044.8	1137.0
EPS	37.9	47.9	55.0	65.8	75.2	76.2	77.8	85.5	88.7	97.0	105.0
EV / EBITDA (x)	**10.0**	**10.2**	**8.9**	**9.9**	**9.7**	**9.1**	**10.6**	**10.8**	**10.2**	**8.9**	**7.9**
EV/ EBIT (x)	**12.9**	**13.1**	**11.4**	**12.6**	**12.3**	**11.3**	**13.2**	**13.3**	**12.4**	**11.0**	**9.7**
PE (x)	**18.9**	**19.0**	**16.5**	**18.3**	**17.7**	**16.7**	**19.2**	**19.2**	**18.5**	**16.9**	**15.7**

Source: Deutsche Bank estimates and company data

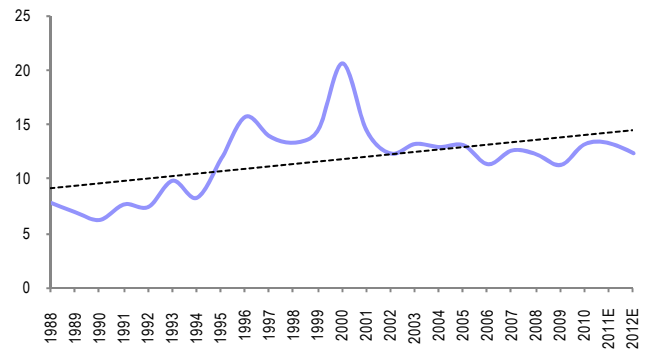
As highlighted in Figure 15, SGS has generated attractive and resiliently growing free cash flows over time. The FCF yield on market cap is 5.1% (2012E) and 5.6% (2013E).

Figure 15: FCF Analysis 2014E

FCF calculation (CHF m)	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
EBITDA	506.0	642.0	777.0	908.0	1024.0	1022.0	1061.0	1138.3	1178.2	1282.5	1392.4
Change in NWC	11.0	(80.0)	(32.0)	12.0	(22.0)	13.0	12.0	(22.4)	(25.2)	(40.5)	(43.2)
Capex	(201.0)	(205.0)	(248.0)	(285.0)	(290.0)	(221.0)	(250.0)	(260.0)	(260.0)	(260.0)	(260.0)
Tax	(90.0)	(119.0)	(155.0)	(172.0)	(219.0)	(200.0)	(215.0)	(231.6)	(240.2)	(262.5)	(291.6)
Net financials	6.0	5.0	(1.0)	2.0	(4.0)	(3.0)	(7.0)	(1.2)	(6.2)	(6.2)	(6.2)
FCF	**232.0**	**243.0**	**341.0**	**465.0**	**489.0**	**611.0**	**601.0**	**623.1**	**646.6**	**713.1**	**791.3**
As a % of market cap	**4.2%**	**3.4%**	**4.8%**	**4.9%**	**4.8%**	**6.2%**	**5.2%**	**4.9%**	**5.1%**	**5.6%**	**6.3%**
FCF as a % of EV	**4.5%**	**3.6%**	**5.0%**	**5.1%**	**5.0%**	**6.6%**	**5.4%**	**5.1%**	**5.5%**	**6.3%**	**7.3%**

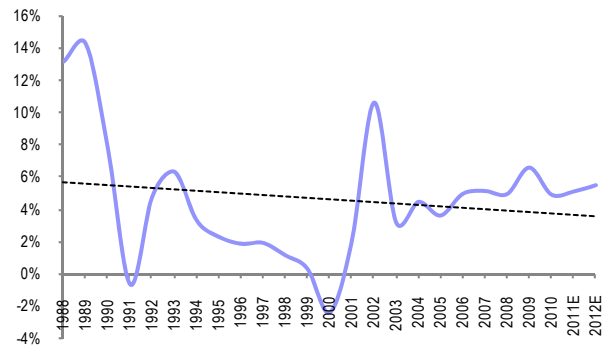
Source: Deutsche Bank estimates and company data

Figure 16: EV/EBIT over time, 1988-2012E



Source: Deutsche Bank estimates and company data

Figure 17: FCF yield on EV over time, 1988-2012E



Source: Deutsche Bank estimates and company data

Peers

Figure 18: Peer valuation

Company	Rating	Currency	Price	Price target	P/E		EV/EBITDA		EV/EBIT		Net debt to EBITDA	EBITDA margin (%)	EBIT margin (%)
			5/30/11		2011 E	2012 E	2011 E	2012 E	2011 E	2012 E	2011 E	2011 E	2011 E
Bureau Veritas	Buy	EUR	57.1	70.0	16.6	15.0	10.7	9.5	12.9	11.3	1.3	19.2	16.0
Intertek Group	Hold	GBP	1996.0	1927.0	20.1	18.3	11.4	10.3	14.8	13.4	0.2	20.2	15.6
SGS	Hold	CHF	1644.0	1700.0	19.2	18.5	10.8	10.2	13.3	12.4	(0.3)	22.9	18.5
Average					**18.7**	**17.3**	**11.0**	**10.0**	**13.7**	**12.4**	**0.4**	**20.8**	**16.7**

Source: Deutsche Bank estimates

DCF

Our target price of CHF1700 is derived from a DCF valuation based on a WACC of 8.5% and a long-term growth rate of 2.5% which is mainly based on inflation. Our WACC assumption is based on a risk free rate of 3.5%, a beta of 1, a debt premium of 2.5% and an equity risk premium of 5.5%.

Figure 19: DCF valuation

(CHF m)	2011E	2012E	2013E	2014E	2015E	2017E	2018E	2019E	FCF t+1
Sales growth (%)	4.4%	4.7%	7.1%	7.0%	5.0%	5.0%	5.0%	5.0%	
Depreciation as a % of sales	4.4%	5.0%	4.7%	4.4%	4.4%	4.4%	4.4%	4.4%	
Operating margin (%)	18.3%	18.3%	18.6%	18.9%	19.0%	19.3%	19.6%	20.0%	
Effective tax rate (%)	25.5%	25.5%	25.5%	26.0%	26.0%	26.0%	26.0%	26.0%	
Capex as a percentage of sales	5.2%	5.0%	4.7%	4.4%	4.4%	4.4%	4.4%	4.4%	
WC as a % of sales	0.5%	0.5%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	
Free cash flow	558.9	585.9	648.2	720.5	763.6	816.4	872.5	937.5	960.8
									15,974.1
Discount factor	0.6	1.6	2.6	3.6	4.6	5.6	6.6	7.6	7.6
Discounted free cash flow (DCF)	532.9	514.9	525.0	537.8	525.4	517.7	509.9	505.0	8604.8
Enterprise value	**12773.6**								
Net Cash	381.6								
+ Participations-Minorities	(66.3)								
Net shareholder value	**13088.9**								
Shares in issue (m)	7.7								
DCF value per share	**1700**								

Source: Deutsche Bank estimates

Company overview

History

SGS was founded in 1878 as a French grain shipment inspection house. SGS, now a global leader in inspection, verification, testing and certification, operates a network of more than 1,250 offices and laboratories around the world and employs roughly 64,000 employees.

General overview

Fragmented client base, strong customer loyalty and relatively predictable sales pattern

SGS's customer base is relatively fragmented, i.e. the group's top 100 clients together account for less than 15% of group sales. The contract scope is wide, ranging from basic quantity checks to very sophisticated tailor-made services involving laboratory testing. Revenue patterns are quite predictable since a big portion is generated from **recurring contracts**. Customer **loyalty is high** as it can be expensive and time consuming to change from one provider to another. Furthermore, many services are specialized and only delivered by certain certification companies. Acquiring and processing the first certification cycle is costlier than subsequent recurring testing and certification processes.

Key entry barriers are reputation, network and brand

French, Bureau Veritas and UK-based, Intertek are the major global competitors to SGS. Due to significant entry barriers like a global network that seems very difficult to replicate, reputation, and a recognized brand, it is difficult to imagine the emergence of a completely new global player in the industry.

1) Globalization, 2) outsourcing, and 3) increasing quality needs drive growth

SGS benefits from global trends that can be summarized under the three key areas: 1) globalization, 2) outsourcing and 3) increasing quality needs. Outsourcing and global sourcing put an increasing emphasis on the monitoring of process quality, which has to be developed, implemented and checked for compliance.

Protectionism another growth driver

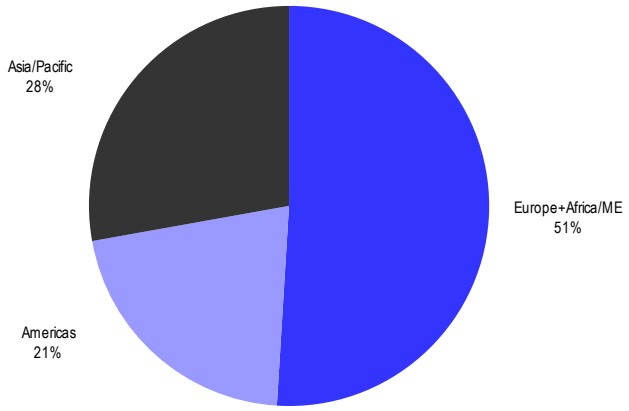
Furthermore, we believe that **protectionism** rather than freight forwarding companies should be a growth driver for the sector. We believe that standards and testing are "great weapons" to be utilized by countries to avoid imports. Classical segments could be consumer products, but also commodities (e.g. French grain versus genetically modified US grain).

SGS operates globally across 10 different business lines in three main areas:

- **Inspection Services:** SGS inspects and verifies the quantity, weight and quality of traded goods. Inspection takes place prior to shipment at the manufacturer's or supplier's premises.
- **Testing Services:** These services test product quality and performance against various health, safety and regulatory standards. It is done by SGS in state-of-the-art laboratories close to the customer's premises.
- **Certification Services:** SGS certifies whether products, systems or services meet the requirements of standards set by governments, standardization bodies (e.g. ISO 9000) or by SGS customers. SGS also develops and certifies its own standards.

In Figure 20, we highlight the geographical sales distribution of SGS. During 2009 Europe, Africa and Middle East contributed 51%, America contributed 21% and Asia Pacific contributed 28% of group sales. SGS is striving to strengthen its footprint in the Americas as well as in the Asia Pacific markets through organic growth initiatives and acquisitions. As highlighted in the geographic EBIT split in Figure 22, Europe, Africa and Middle East (49% of group EBIT in 2009) and Asia Pacific (41% of group EBIT) contribute the most to group profits. The gradual shift toward the more profitable Asian business should continue to boost overall group profitability.

Figure 20: Group sales split 2010

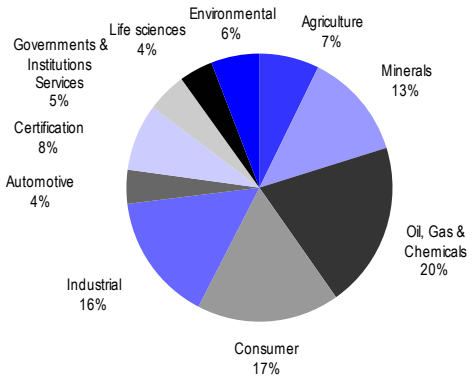


Source: Company data

Divisional overview

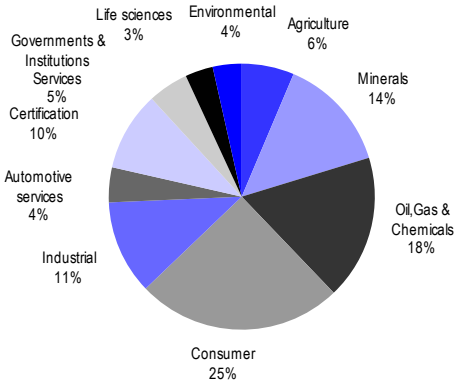
SGS's divisional exposure is highlighted in Figure 21 and Figure 22.

Figure 21: Divisional sales split, 2010



Source: Company data

Figure 22: Divisional EBIT split, 2010



Source: Company data

Barriers to entry

The industry's services range from basic quantity checks to highly sophisticated laboratory testing. Barriers to entry vary depending on the service provided and the country, with various specific local regulatory environments. Main barriers to entry into the industry are:

- Establishment of a certification and inspection franchise that is recognized by government authorities, international standards organizations and customers. Companies entering the certification market have to be accredited, which requires solid internal management systems. Thus, agencies invest regularly in new norms, the training of their staff, in the development of innovative services in order to value their competencies and their brand names.
- Development of a global network that is capable of serving an international client base. Being global enables agencies to leverage their experience across borders and attract global clients. Size is also a key advantage to capture the largest or the most complex contracts and take advantage of economies of scale.
- Focus on staff utilization rate, personnel turnover, recruitment and training are key for strong performance and large players are best positioned to deliver on these criteria. Furthermore, customers look for service providers with appropriate financial strength and the ability to mobilize large teams to perform short-duration projects. Hence, large specialists can deliver better proposals than comparable in-house solutions and other third party offers.
- Last but not least, a strong brand name and a good reputation are absolutely key within this industry.

Growth drivers

While each end market is characterized by specific dynamics, we believe the following growth drivers seem to positively impact almost all divisions of SGS:

Global trade

- Global trade: We believe globalization results in increased global trade flows, which are a major driver of growth for SGS, generating among other things the desire to trace the origin of goods. Historical evidence shows that global trade seems to grow at roughly double the speed of underlying global GDP growth. Furthermore, we believe in the increasing importance of intra-regional trade (within China for example).

Protectionism

- Furthermore, we believe that protectionism, rather than freight forwarding companies, should be a growth driver for the sector. We believe that standards and testing are "great weapons" to be utilized by countries to avoid imports. Classical segments could be consumer products, but also commodities (e.g. French grain versus genetically modified US grain).

More regulations and standards

- Increasing regulations and standards: Increasing and tougher regulations and standards as well as international harmonization positively drive testing and certification activities in all of SGS's sub-segments. Standards have been applied with growing intensity over the past decades. Well-defined standards are important to guarantee the smooth functioning of markets. Standards are necessary to ensure the protection of human health and/or the environment. Even though there may be differences regarding the degree of protection (e.g. Genetically Modified Organisms (GMO)) among or within societies, there is a general trend toward increasing the complexity of standards.

Health and safety issues

- Health and safety issues: Companies are increasingly aware of health and safety issues and environmental and liability risks of their products and services, with regard to employees and their commercial partners. This is positive for certification and standard activities (e.g. ISO norms, sustainable development).

Increased quality requirements

- Increasing quality requirements: Consumer awareness of quality and safety encourages companies to increasingly ensure the quality of their products and services through verification, standards and testing services. Quality seems to have become an increasingly important differentiation argument for producers, since it can have a cooling effect on price competition.

Increased product variety and shorter product life cycles

- Product variety and shorter product life cycles: There seems to be a general trend of increasing product variety in various sectors (e.g. automotive or clothing industry). We believe that companies generally try to increase product variety in recessionary environments to compensate for a lack of growth with potential market share gains. Such industry behavior cushions the effects of GDP weakness for SGS and its peers in our opinion, since the number of goods to be tested increases.

Increased outsourcing

- Increased outsourcing: Companies tend to outsource those tasks to specialists who are able to meet their needs at higher quality and lower cost.

Additional growth drivers for SGS

New innovative services

- Additional services: SGS continues to expand its existing customer base with additional services.

Market share gains

- Market share gains: We believe SGS has the potential to gain market share from smaller local players due to its global reach.

Acquisitions

SGS has always believed in growth via acquisitions and has acquired a number of companies across various segments over the past few years in order to reinforce or penetrate new sectors. We expect the group to continue to make smaller bolt-on acquisitions in the normal course of its business. In 2010, SGS acquired 10 companies (for a total consideration of CHF302m) and in 2011 another 11 companies were acquired ytd. We estimate inorganic revenue growth of c.2.6% in 2011 (>CHF100m in revenue) from M&A activity to date. The group's strategic growth plan for 2010-2014 targets CHF0.7bn revenues from acquisitions by 2014.

To achieve additional CHF700m revenue, the group needs to spend around CHF1.4-1.8bn (CHF0.3bn already spent in 2010) at an estimated EV/sales of 2-2.5x. In our view, SGS could take on 2x EBITDA (2014E: CHF1392m) or CHF2.8bn in net debt. We do not forecast any future acquisition in the model, hence any future deal could offer potential upside to our EPS forecasts. Should SGS spend CHF1bn at a 15x PE multiple, the EPS impact on 2014E would be 6.5%.

Figure 23: Estimated impact of acquisition on SGS 2014 earnings, CHFm

		Enterprise value paid				
		250	500	1000	1500	2000
	10	2.9%	5.7%	11.4%	17.1%	22.8%
	11	2.5%	5.0%	10.1%	15.1%	20.2%
	12	2.2%	4.5%	9.0%	13.5%	18.0%
	13	2.0%	4.0%	8.0%	12.1%	16.1%
PE paid (x)	14	1.8%	3.6%	7.2%	10.9%	14.5%
	15	1.6%	3.3%	6.5%	9.8%	13.1%
	16	1.5%	3.0%	5.9%	8.9%	11.9%
	17	1.3%	2.7%	5.4%	8.1%	10.8%
	18	1.2%	2.5%	4.9%	7.4%	9.8%

Source: Deutsche Bank estimates

In Figure 24 we highlight the group's recent acquisitions.

Figure 24: Recent acquisitions (2009 – to date)

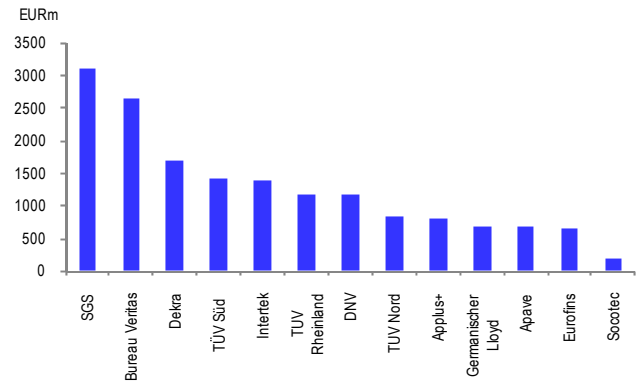
Date	Target	Geography	Business segment	Sales (CHFm)	Employees
Feb-09	Ustav Paliv a Maziv	Czech Republic	Oil, Gas and Chemicals	3.8	48
Nov-09	EKO-PROJEKT LTD	Poland	Environmental	5.4	167
Jan-10	Intron Group	Netherlands	Industrial	19.6	121
Mar-10	Verilab SA	Chile	Minerals	4.2	110
Apr-10	Korea Construction Test & Analysis	Korea	Industrial	7.0	60
Apr-10	Australian Soil Testing Pty Ltd.	Australia	Industrial	1.4	16
Aug-10	Am'tech Medical	France	Life Sciences	3.8	17
Sep-10	Yan Tai HuaJian Inspection Engineering Co., Ltd	China	Industrial	NA	120
Nov-10	M-Scan Group	UK	Life Sciences	11.7	61
Dec-10	Atest SA	Switzerland	Industrial	2.8	11
Dec-10	FCC vehicle inspection business	Spain+ Argentina	Automotive	96.7	833
Jan-11	International Electrical Certification Centre	Hong Kong	Consumer Testing	1.3	22
Jan-11	Tianjin Tianbao Construction Materials testing Co, Ltd.,	China	Industrial	NA	15
Jan-11	Chemical characterization business of LGC Group	UK	Oil, Gas and Chemicals	1.2	8
Jan-11	NviroCrop Group	South Africa	Agricultural	2.9	17
Jan-11	Lippens Geotechniek	Belgium	Minerals	1.8	10
Feb-11	Auto Contrôle Evaluation Services (ACE).	France	Automotive	0.8	NA
Mar-11	Agri-Food Laboratories Inc.	Canada	Agricultural	3.0	30
Apr-11	Sertec S.r.l.	Italy	Oil, Gas& Chemicals, Life Sciences	9.7	85
May-11	AG Research Associates	United States	Agricultural	5.2	30
May-11	Air emission business of Kema	Netherlands	Environmental	0.8	2
May-11	Oil & gas measurement assurance business	United States	Oil, Gas and Chemicals	1.0	9

Source: Company data

Global market structure

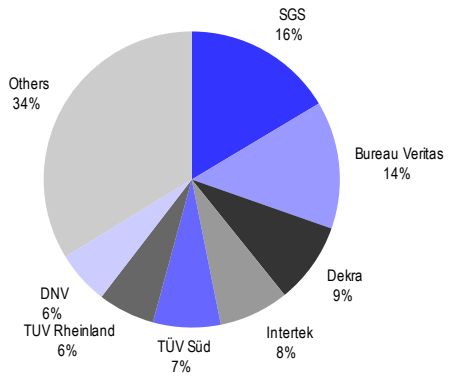
We estimate the global testing, inspection, and certification (TIC) industry serves a c.EUR60bn market. Out of this market c.30-35% is served by specialized and independent agencies such as SGS, Bureau Veritas and Intertek while the rest is not yet outsourced. Figure 25 and Figure 26 highlight the competitive landscape of the industry.

Figure 25:Top players in 2009 (sales in Euro m)



Source: Deutsche Bank and company data

Figure 26: Outsource TIC Market shares, 2010



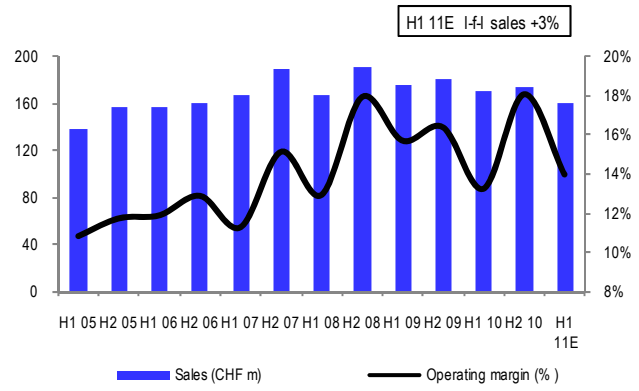
Source: Deutsche Bank estimates

The industry covers all sectors (primary, secondary and tertiary), companies of various scales of operation (from small to large), and all regions. A large portfolio of services is offered, ranging from very basic (commodities quantity control) to tailored and sophisticated services

(tests in laboratories, critical products / building conformity assessment). The market is still highly fragmented with only a few global players operating in multiple sectors (SGS, BV and Intertek) while the rest of the market (DNV, Dekra, TüV Süd and others) comprises mid-size organizations that often focus only on one region or on a limited number of sectors and areas of expertise. However, the industry is in a consolidation phase with large players like SGS focused on adding to their capabilities and increasing their local presence.

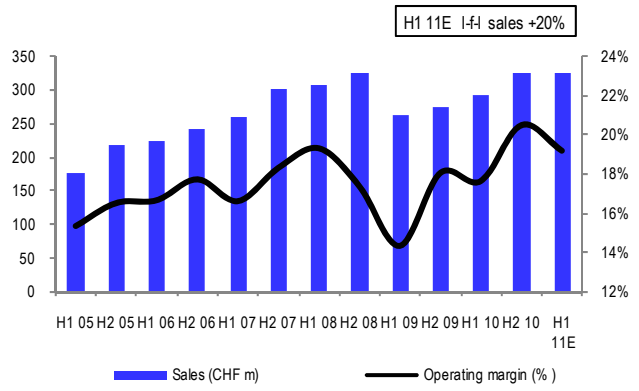
Divisional performance

Figure 27: Agricultural Services



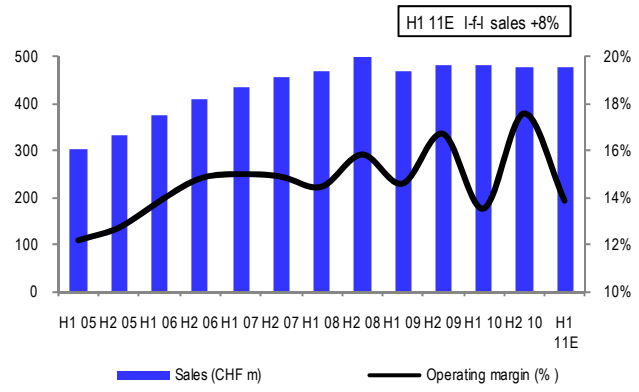
Source: Company data and Deutsche Bank estimates

Figure 28: Mineral Services



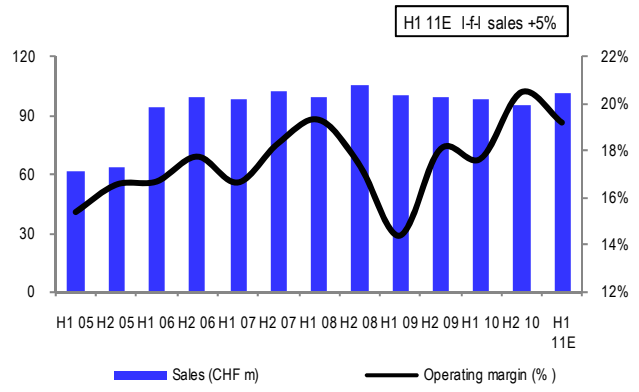
Source: Company data and Deutsche Bank estimates

Figure 29: Oil, Gas & Chemical Services



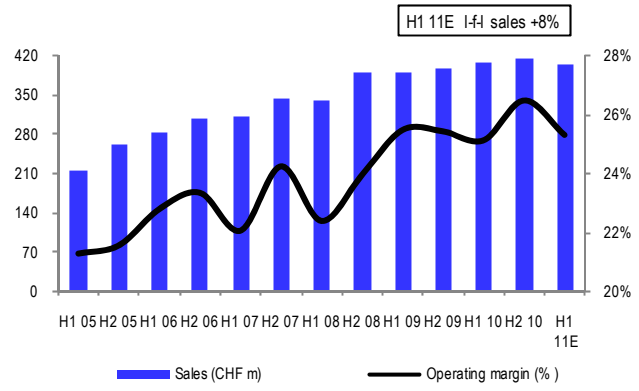
Source: Company data and Deutsche Bank estimates

Figure 30: Life Sciences Services



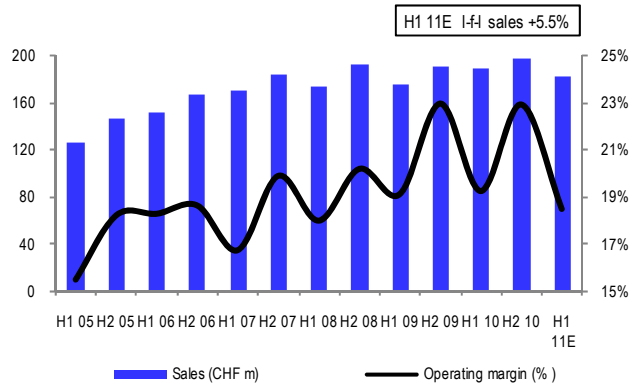
Source: Company data and Deutsche Bank estimates

Figure 31: Consumer Testing Services



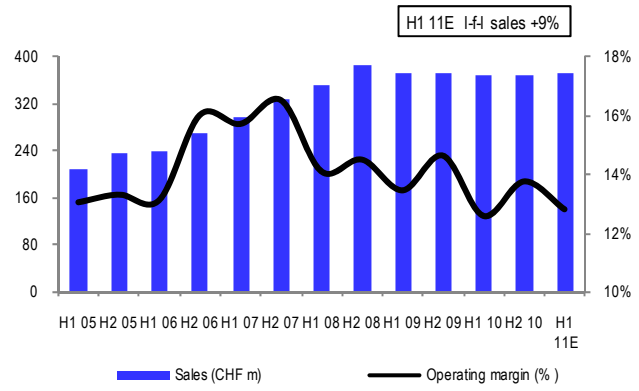
Source: Company data and Deutsche Bank estimates

Figure 32: Systems & Services Certification



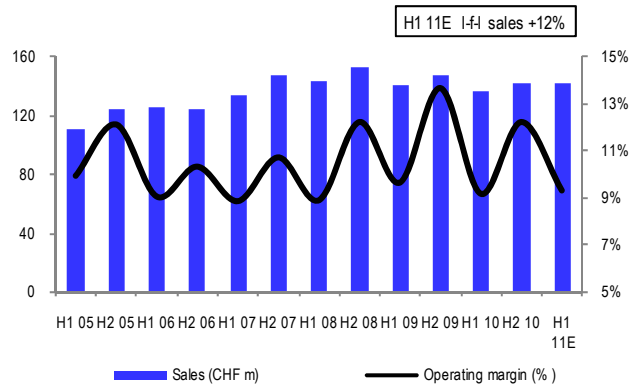
Source: Company data and Deutsche Bank estimates

Figure 33: Industrial Services



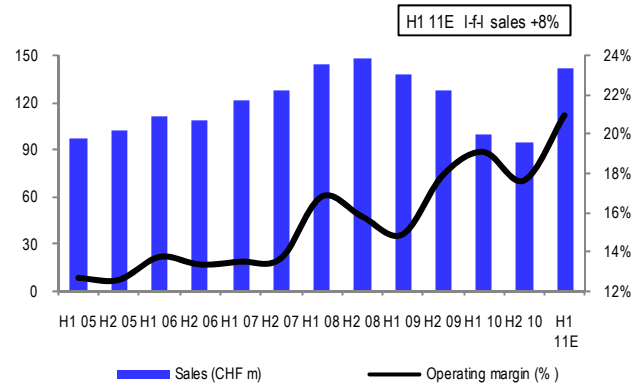
Source: Company data and Deutsche Bank estimates

Figure 34: Environmental Services



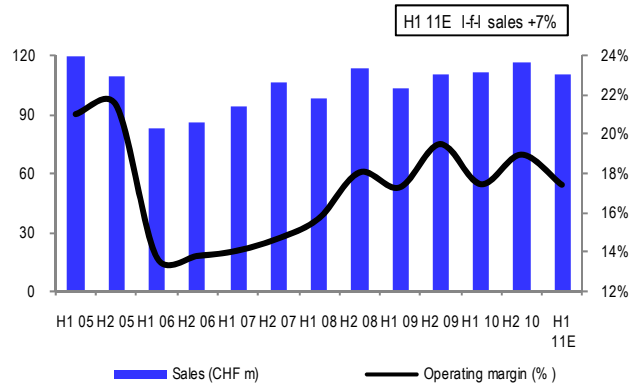
Source: Company data and Deutsche Bank estimates

Figure 35: Automotive Services



Source: Company data and Deutsche Bank estimates

Figure 36: Government & Institution Services



Source: Company data and Deutsche Bank estimates

Management and ownership

Board of Directors

Sergio Marchionne (born 1952, Italian/Canadian, Chairman)
Sergio Marchionne is the CEO of Fiat Spa since 2004 and was appointed the CEO of the Chrysler Group in June 2009. He is also the CEO and chairman of Fiat Industrial Spa, resulting from the demerger with Fiat Spa, and he joined the board of Exor in 2010. Mr. Marchionne was appointed as the CEO of SGS in 2002 and has been chairman of the board since 2006. Before joining SGS he was CEO of the Lonza Group (spun off from Alusuisse Lonza), of which he was the chairman till 2005. Mr. Marchionne holds a bachelor's degree in law and a master's in business administration.

Tiberto Ruy Brandolini d'Adda (born 1948, Italian, Board Member)
Mr. Brandolini has been on the SGS Board since March 2005. He is also the chairman at Sequana Capital and IFIL Investissements, Luxembourg and had served as chairman and CEO of the Exor Group from 2003 to 2007. He is on the boards of Espirito Santo Financial Group, Giovanni Agnelli e C., Fiat SpA, IFI S.p.A, and Vittoria Assicurazioni SpA. Mr. Brandolini d'Adda is a Knight of the Legion of Honour.

August Von Finck (born 1930, German, Board Member)
Mr. Von Finck descends from the banking family von Finck. His grandfather, Wilhelm von Finck, founded "Merck, Finck & Co." in 1870, the private bank which was at the origin of companies including Munich Re, Allianz insurance and the Löwenbräu breweries, among others. Based in Munich, he belongs to several boards of directors and holds interests in a number of German, Swiss and Austrian companies as well as in groups from other countries. In Switzerland, August von Finck's participations include Mövenpick and Von Roll.

François Von Finck (born 1968, Swiss, Board Member)
Mr. Von Finck has a banking background and is currently the managing director of Carlton Holding in Basel. Mr. Von Finck holds an MBA from Georgetown University.

Shelby R. du Pasquier (born 1960, Swiss, Board Member)
Mr. Shelby R. du Pasquier holds degrees from Geneva University Business School and School of Law as well as from Columbia University School of Law (LLM). He was admitted to the Geneva Bar in 1984 and to the New York Bar in 1989. He became a partner of Lenz & Staehelin in 1994.

Dr. Peter Kalantzis (1945, Swiss/Greek, Board Member)
Dr. Peter Kalantzis holds a Ph. D. in Economics and Political Sciences from the University of Basel. Dr Kalantzis is the chairman of Mövenpick Holding, Clair, Von Roll Holding, Lamda Development and member of board of several other European companies. Prior to 2000, he served as the member of the executive committee of the Alusuisse-Lonza Group, and was actively involved in the de-merger and stock market launch of Lonza, as well as the merger process of Alusuisse and Alcan.

John Elkaan (born 1976, Italian, Board Member)
Mr. John Elkaan is the chairman of Fiat group in which he has served as a board member since 1997 and vice chairman since 2004. He is also the chairman of Exor and Giovanni Agnelli e C. Sapaz. Mr. Elkaan obtained a scientific baccalaureate from Lycee Victor Duruy in Paris and graduated in engineering and management from Politecnico, Turin.

Dr. Cornelius Grupp (born 1947, Austrian, Board Member)
Dr. Cornelius Grupp is the owner and general manager of Tubex Holding, Stuttgart (produces aluminum aerosol cans, aluminum tubes and plastic tubes for packaging industry) and CAG Holding, Austria (engaged in aluminum, glass and fiber products). Dr. Grupp holds a Doctorate in Law and Masters in Business Administration. He is the honorary consul of Austria to the land of Baden-Wurttemburg.

Management

Functional heads
Chris Kirk (born 1956, British, CEO)
Chris Kirk has been the CEO of SGS since November 2006 before which he was the head of the Minerals and Environmental Services business for three years. Mr. Kirk joined SGS in 1981 in New Zealand taking on different roles ultimately as general manager of New Zealand. After that he held a number of senior positions in Thailand, Ghana, Singapore and Australia and was appointed to the operations council in 2002, as COO of the South East Asia/Pacific region.

Geraldine Matchett (born 1972, Swiss, CFO)
Geraldine Matchett was appointed CEO in March 2010 before which she was the financial controller of the group. She joined SGS in 2004 as a part of corporate finance team before which she worked in Deloitte, Switzerland (with SGS as her main client) and previously in KPMG London. Ms. Matchett is a Chartered Accountant and holds a Masters degree in Sustainable Development from Cambridge University.

Olivier Merkt (born 1962, Swiss, Legal & Compliance)
Olivier Merkt joined SGS in 2001as in-house counsel and graduated to the current position in 2008. Previously, he was engaged in private practices ultimately with Ernst & Young Legal, Geneva. Mr Merkt holds a Doctorate in law.

Jean-Luc de Buman (born 1953, Swiss, Corporate Communications & IR)
Jean-Luc de Buman spent the first part of his career in the financial industry. He joined SGS in 1998 and is responsible for all aspects of internal and external communication as well as the relationship between the company and the investor community. Mr. de Buman is also Head of corporate development and M&A.

Francis Lacroze (born 1953, Swiss, Strategy & Continuous Improvement)

Dominique Ben Dhaou (born 1965, Swiss, Human Resources)

Regional Chief Operating Officers
- Western Europe: Pauline Earl (born 1961, British)
- South Eastern Europe: Duilio Giacomelli (born 1950, Italian)
- Central & North-west Europe : Dirk Hellemans (born 1958, Belgian)
- Eastern Europe and Middle East: Teymur Abasov (born 1972, Azerbaijani)
- Africa: Fred Herren (born 1955, Swiss)
- North America: Jeffrey McDonald (born 1964, Australian)
- South America: Alejandro Gomez de la Torre (born 1959, Peruvian)
- China and Hong Kong: Helmut Chik (born 1966, Hong Kong Chinese)

- South Eastern Asia and Pacific: Anthony Hall (born 1963, Australian)
- Eastern Asia: Dennis Yang (born 1949, Taiwanese)

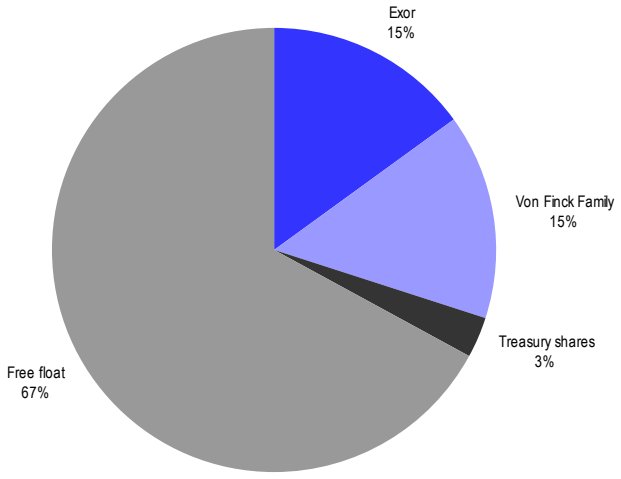
Business heads

- Agricultural Services: Jeff Newell (born 1950, British)
- Minerals Services: Michael Belton (born 1960, British)
- Oil, Gas & Chemical and Environmental Services: Alim Saidov (born 1964, Azerbaijani)
- Life Science Services: Anne Hays (born 1959, French)
- Consumer Testing Services: Frankie Ng (born 1966, Swiss)
- Systems and Services Certification: Malcolm Reid (born 1963, British
- Industrial Services: Beat In-Albon (born 1952, Swiss)
- Automotive Services: Thomas Klukas (born 1965, German)
- Government and Institutions Services: Fred Herren (born 1955, Swiss)

Shareholder structure

SGS's share capital comprises 7.8m registered ordinary shares of par value of CHF1 having equal dividend and voting rights. The free float is currently 67%. The largest shareholders of the company are Exor (formerly IFIL), held by Italy's Agnelli Family (founders of Fiat) with a 15% stake and the Von Finck family with a 14.96% stake. In 2009, the Von Finck family sold off 40% of its erstwhile 25% stake in the company bringing it to the same level as Exor.

Figure 37: SGS's shareholder structure, 2010



Source: SGS

Risks

The main risks to our investment case are:

General GDP development
As SGS is present in various segments and geographies, an overall decline in worldwide economic activity and slowdown in international trade would impact SGS sales and earnings.

Currency fluctuations
Since most of its revenue are generated outside Switzerland, the group's revenue and EPS is vulnerable to currency fluctuations. Currency risks are mainly translational in nature.

Acquisition risks
SGS is focused on growth through acquisitions, acquiring 10 companies in 2010, and as such faces typical risks associated with acquisitions including strategic fit, prices paid and integration.

Client risks
SGS has several large contracts particularly from government agencies. Loss of any such contract can affect revenue in the near term.

Reputation risks
The inherent nature of SGS's business is based on solid reputation and reliability of its services. Any adverse news development or execution misstep would result in loss of reputation and impact revenues.

Country and political risks
A lot of SGS businesses, particularly government-related are dependent on legislative or regulatory requirement. Any change in these legislations/regulations due to government changes or otherwise could affect SGS revenue and earnings in near term.

Other
Continued inflation-related wage pressure in emerging markets can impact SGS margins.

Financials

Figure 38: Summary of group P&L

Year end Dec (CHF m)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Turnover	4372.0	4818.0	4712.0	4757.0	4964.9	5196.4	5565.6	5953.4
Lfl growth (%)	12.1%	14.3%	1.3%	3.1%	9.6%	7.2%	7.1%	7.0%
M&A impact (%)	0.9%	2.3%	1.1%	0.9%	2.6%	0.0%	0.0%	0.0%
Salaries and wages	(2076.0)	(2243.0)	(2229.0)	(2222.0)	(2259.0)	(2312.4)	(2426.6)	(2542.1)
Subcontractor's expenses	(307.0)	(331.0)	(319.0)	(319.0)	(327.7)	(343.0)	(367.3)	(392.9)
Other operating expenses	(1081.0)	(1220.0)	(1142.0)	(1155.0)	(1239.9)	(1362.8)	(1489.2)	(1626.0)
EBITDA	908.0	1024.0	1022.0	1061.0	1138.3	1178.2	1282.5	1392.4
EBITDA margin (%)	20.8%	21.3%	21.7%	22.3%	22.9%	22.7%	23.0%	23.4%
EBITDA growth (%)	16.9%	12.8%	-0.2%	3.8%	7.3%	3.5%	8.8%	8.6%
Depreciation & amortization	(197.0)	(214.0)	(228.0)	(225.0)	(219.9)	(220.8)	(237.7)	(255.4)
EBITA (adj.)	711.0	810.0	822.0	848.0	918.3	957.4	1044.8	1137.0
EBITA margin (%)	16.3%	16.8%	17.4%	17.8%	18.5%	18.4%	18.8%	19.1%
EBITA growth (%)	17.5%	13.9%	1.5%	3.2%	8.3%	4.3%	9.1%	8.8%
EBIT	690.0	937.0	794.0	836.0	909.3	948.4	1035.8	1128.0
EBIT margin (%)	15.8%	19.4%	16.9%	17.6%	18.3%	18.3%	18.6%	18.9%
EBIT growth (%)	10.6%	35.8%	-15.3%	5.3%	8.8%	4.3%	9.2%	8.9%
Net financial	2.0	(4.0)	(3.0)	(7.0)	(1.2)	(6.2)	(6.2)	(6.2)
Profit before taxes	692.0	933.0	791.0	829.0	908.1	942.1	1029.6	1121.7
Taxes	(172.0)	(219.0)	(200.0)	(215.0)	(231.6)	(240.2)	(262.5)	(291.6)
Tax rate (%)	-24.9%	-23.5%	-25.3%	-25.9%	-25.5%	-25.5%	-25.5%	-26.0%
Minority interests	(20.0)	(22.0)	(25.0)	(26.0)	(27.3)	(28.1)	(29.0)	(30.4)
Net profit	500.0	692.0	566.0	588.0	649.2	673.8	738.1	799.7
Net growth (%)	12.9%	38.4%	-18.2%	3.9%	10.4%	3.8%	9.5%	8.3%
Ordinary net profit	515.0	579.0	587.0	599.0	658.2	682.8	747.1	808.7
Net growth (%)	19.5%	12.4%	1.4%	2.0%	9.9%	3.7%	9.4%	8.2%
EPS (CHF)	65.79	75.2	76.2	77.8	85.5	88.7	97.0	105.0

Source: Deutsche Bank estimates and company data

Figure 39: Summary of group cash flow statement

Year end Dec (CHF m)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Net income	500.0	692.0	566.0	588.0	649.2	673.8	738.1	799.7
Depreciation	164.0	180.0	186.0	225.0	219.9	220.8	237.7	255.4
Amortization of goodwill	33.0	34.0	37.0	8.0	9.0	9.0	9.0	9.0
Change in other provision	(24.0)	(41.0)	(50.0)	0.0	0.0	0.0	0.0	0.0
Minorities	20.0	22.0	25.0	26.0	27.3	28.1	29.0	30.4
Reintegration of taxes, interest income	0.0	223.0	203.0	0.0	0.0	0.0	0.0	0.0
Actual cash tax paid	(5.0)	(195.0)	(217.0)	0.0	0.0	0.0	0.0	0.0
Other adjustments	23.0	(55.0)	77.0	(76.0)	0.0	0.0	0.0	0.0
Net change in working capital	12.0	(22.0)	13.0	12.0	(22.4)	(25.2)	(40.5)	(43.2)
Cash flow from operating activities	723.0	838.0	840.0	783.0	883.1	906.6	973.1	1051.3
Capital expenditure	(285.0)	(290.0)	(221.0)	(250.0)	(260.0)	(260.0)	(260.0)	(260.0)
Investment & acquisitions	(71.0)	(184.0)	0.0	(302.0)	0.0	0.0	0.0	0.0
Disposal of assets	9.0	12.0	12.0	2.0	0.0	0.0	0.0	0.0
Change in financial assets	0.0	5.0	16.0	(1.0)	0.0	0.0	0.0	0.0
Net cash investing activities	(347.0)	(457.0)	(193.0)	(551.0)	(260.0)	(260.0)	(260.0)	(260.0)
Dividend & capital reductions	(178.0)	(281.0)	(391.0)	(480.0)	(500.5)	(323.4)	(346.5)	(346.5)
Purchase / sale treasury shares	(8.0)	(201.0)	15.0	85.0	0.0	0.0	0.0	0.0
Actual net interest paid	(9.0)	(15.0)	(16.0)	(15.0)	0.0	0.0	0.0	0.0
Increase in capital	104.0	(341.0)	74.0	0.0	0.0	0.0	0.0	0.0
Other	(11.0)	(34.0)	(24.0)	(36.0)	0.0	0.0	0.0	0.0
Net cash financing activities	(102.0)	(872.0)	(342.0)	(446.0)	(500.5)	(323.4)	(346.5)	(346.5)
Net (debt) / cash at beginning of year	215.0	378.0	248.0	476.0	259.0	381.6	704.8	1071.5
Change in net cash / (debt)	274.0	(491.0)	305.0	(214.0)	122.6	323.2	366.7	444.8
Other	(111.0)	361.0	(77.0)	(3.0)	0.0	0.0	0.0	0.0
Net (debt) / cash at end of year	378.0	248.0	476.0	259.0	381.6	704.8	1071.5	1516.3

Source: Deutsche Bank estimates and company data

Figure 40: Summary of group balance sheet

Year end Dec (CHF m)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Inventories	206.0	184.0	201.0	202.3	223.3	230.3	241.2	252.4
Trade receivables	867.0	919.0	812.0	772.0	805.7	843.3	903.2	966.2
Other receivables	184.0	194.0	174.0	216.7	207.9	214.3	224.5	234.9
Marketable Securities	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Cash	429.0	574.0	783.0	806.0	928.6	1251.8	1618.5	2063.3
Current assets	1695.0	1880.0	1979.0	2006.0	2174.6	2548.7	2996.4	3525.7
Land, buildings, equipment	738.0	721.0	751.0	756.0	796.1	835.2	857.6	862.2
Investments in associates	2.0	2.0	1.0	1.0	2.0	2.0	2.0	2.0
Other non-current assets	39.0	37.0	36.0	37.0	42.0	42.0	42.0	42.0
Deferred tax	143.0	182.0	192.0	199.0	193.0	193.0	193.0	193.0
Goodwill	563.0	594.0	629.0	621.0	763.0	754.0	745.0	736.0
Other intangibles	153.0	165.0	148.0	361.0	210.0	210.0	210.0	210.0
Fixed assets	1638.0	1701.0	1757.0	1975.0	2006.1	2036.2	2049.6	2045.2
Total	3333.0	3581.0	3736.0	3981.0	4180.6	4585.0	5045.9	5570.9
Loans	40.0	325.0	308.0	3.0	3.0	3.0	3.0	3.0
Trade payables	452.0	403.0	388.0	401.0	409.8	419.3	434.2	449.3
Current tax liabilities	69.0	107.0	72.0	72.0	91.0	91.0	91.0	91.0
Other creditor	505.0	542.0	524.0	527.0	522.8	539.0	564.6	590.8
Current liabilities	1066.0	1377.0	1292.0	1003.0	1026.6	1052.4	1092.8	1134.1
Loan with warrants								
Other loans	20.0	10.0	8.0	553.0	553.0	553.0	553.0	553.0
Deferred and other tax liabilities	64.0	65.0	77.0	77.0	63.0	63.0	63.0	63.0
Provisions for liabilities	176.0	267.0	249.0	240.0	254.0	254.0	254.0	254.0
Long-term liabilities	260.0	342.0	334.0	870.0	870.0	870.0	870.0	870.0
Total liabilities	1326.0	1719.0	1626.0	1873.0	1896.6	1922.4	1962.8	2004.1
Share capital	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Reserves	1963.0	1817.0	2065.0	2061.0	2209.8	2560.2	2951.8	3405.0
Shareholders' equity	1971.0	1825.0	2073.0	2069.0	2217.8	2568.2	2959.8	3413.0
Minority interests	36.0	37.0	37.0	39.0	66.3	94.4	123.4	153.8
Total	3333.0	3581.0	3736.0	3981.0	4180.6	4585.0	5045.9	5570.9

Source: Deutsche Bank estimates and company data

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
SGS	SGSN.VX	1644.00 (CHF) 30 May 11	8,14

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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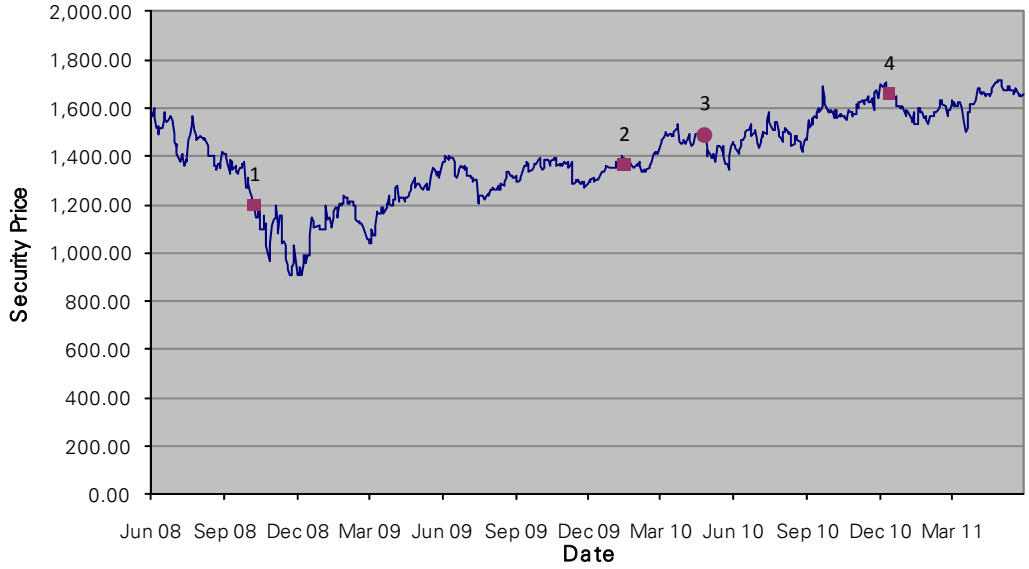
Historical recommendations and target price: SGS (SGSN.VX)

(as of 5/30/2011)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9, 2002

1.	9/10/2008:	Buy, Target Price Change CHF1,400.00	3.	26/4/2010:	Downgrade to Hold, CHF1,500.00
2.	15/1/2010:	Buy, Target Price Change CHF1,500.00	4.	13/12/2010:	Hold, Target Price Change CHF1,700.00

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Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

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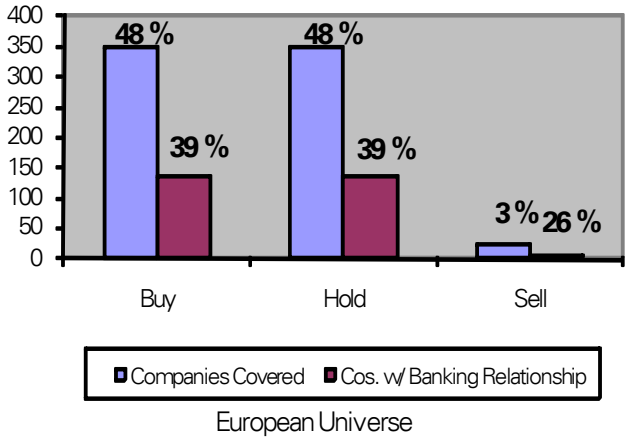
Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



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