Equity Research

SGS N

Support Services / Switzerland

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Initial coverage

10 January 2007

Stock vs Sector	**Outperform**
Sector vs Market	**Underperform**
Price (9 January 2007)	**CHF1,373.0**
Target price	**CHF1,600.0 (+17%)**

Market cap./Free float (CHFbn)	10.7/6.8
EV (CHFbn)	10.7
12-month high/low (CHF)	1,394.0/1,057.0
Reuters/Bloomberg	SGSN.VX/SGSN VX
DJ STOXX50	3,717.3
Risk rating	B

Per share data (CHF)	**12/05**	**12/06e**	**12/07e**	**12/08e**
EPS restated	46.62	56.96	68.27	80.37
EPS reported	45.82	56.96	68.27	80.37
EPS (IBES)	49.45	58.06	66.21	75.22
CFPS	59.59	74.02	91.33	106.6
Net dividend	30.47	17.09	20.48	24.11

Stockmarket ratios*	**12/05**	**12/06e**	**12/07e**	**12/08e**
P/E (x)	19.5	21.1	20.1	17.1
P/E rel.DJ STOXX50 (%)	147.7	167.4	169.8	155.4
P/CF (x)	15.3	16.2	15.0	12.9
P/BV (x)	5.0	6.2	5.6	4.5
Net yield (%)	3.4	1.4	1.5	1.8
EV/Sales (x)	2.1	2.4	2.4	2.0
EV/EBITDA (x)	10.9	12.2	11.5	9.7
EV/EBIT (x)	13.9	15.5	14.4	12.1

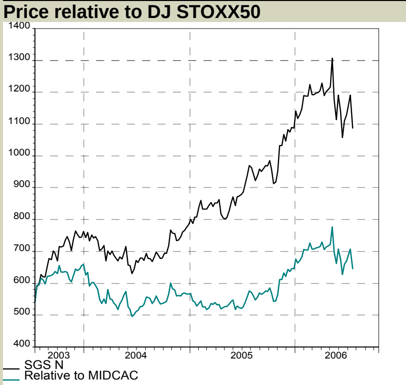
** Yearly average prices for FY to end-12/05, 12/06*

P&L highlights (CHFm)**	**12/05**	**12/06e**	**12/07e**	**12/08e**
Sales	3,308	3,831	4,505	5,123
Restated EBIT	502	600	740	867
Attrib. net profit (adj.)	371	446	534	629

*** Switch to IFRS data from FY ended 12/04*

Performance (%)	**1w**	**1m**	**3m**	**12m**
Absolute	1	1	12	22
Rel. Support Services	2	(3)	3	5
Rel. DJ STOXX50	2	(2)	8	13

Price relative to DJ STOXX50



Source: Datastream

Please refer to important disclosures at the end of this report.

Tried and tested qualities

► **A GARP stock, continuing positive momentum**

We initiate coverage on SGS with an Outperform rating and DCF-derived target price of CHF1,600 (including value created from acquisitions). Further multiples expansion would be justified by the company's growth/blue chip characteristics: strong growth (+6-8% pa), fragmented markets, high operating margin (16%) and returns (RoCE 30%), no debt. While our rating does not stand out from the crowd, we think continuing top-line momentum, organic- and acquisition-led, will provide further upside.

► **Diversification provides new sources of growth**

SGS's markets are driven by long-term trends, i.e. consumers seeking ever safer products, and tighter regulations. In addition, the group has demonstrated its ability to regularly outperform its market. We expect a sales CAGR of 15.7%, of which 10.5% organically. There seems to be little risk from a slowdown. The broadening of the services range has reduced the exposure to cyclical end-markets to an estimated 50% of sales.

► **Reinforcing leadership, a safe avenue for value creation**

There are many bolt-on acquisition opportunities in this fragmented market (SGS is leader, 7% share). Paid on attractive multiples (11x EBIT), they will create value thanks to cross-selling. SGS's interest in Bureau Veritas (6% market share), seem to be met with resistance from the latter's parent company Wendel, a sign that the market should remain attractive.

► **Operating margin should further improve**

After an impressive performance (EBIT margin of 6% in 2001, 15% in 2005), we expect an annual 60bp EBIT margin gain for 2006-2008e, led by the fixed costs structure, the positive mix effect (consumer testing, oil, minerals) and the catch-up of ailing divisions, leading to a 19% 2006-2008e EPS CAGR.

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EXANE BNP PARIBAS

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Investment case

We initiate coverage with an Outperform rating and a DCF-derived target price of CHF1,600, showing 17% upside. We view SGS as a GARP company, combining growth prospects and defensive characteristics. We expect a 2006-2008e EPS CAGR of 19%. Although our rating does not stand out from the crowd, we see further upside from continuing strong top-line momentum and value-creating acquisitions.

Swiss-based SGS is a global leader in inspection, verification, testing and certification (mainly ISO standards). Through a network of 1,000 offices and accredited laboratories worldwide, the company tests quality, quantity, and performance, inspects raw materials, food, crops, petroleum and consumer goods (textiles, toys) and also certifies products, machinery and processes for compliance with international or local standards in a broad range of industries.

Strong fundamentals justify high multiples

SGS is the leader in an attractive (+6-8% pa), very fragmented, high-margin market, which is driven by increasing demand from consumers for ever-safer products, tightening regulations and the growing outsourcing of testing laboratories. Its very sound balance sheet also allows it to play a role in the sector's consolidation and will compound the traditional high barriers to entry in its segment (a well-recognised brand, various accreditations, global infrastructure).

Like leading groups in other sectors, SGS is trading at multiples that are above the market average (2007e EV/EBIT of 14.2x and P/E of 19.9x).

Table 1: SGS's status comparable to various market leaders

	Market cap (EURm)	2000-2005 lfl sales growth (%)	2006-2008e lfl sales growth (%)	2007e EBIT margin (%)	2008e EBIT margin (%)	2007e EV/ EBIT (x)	2008e EV/ EBIT (x)	2007e P/E (x)	2008e P/E (x)	2007e net debt / Market cap (%)	2007e Op.FCF/ Sales (%)
Essilor	8,299	5.7	6.5	17.2	17.6	15.3	13.5	24.0	21.0	4	15.9
Legrand	5,895	3.2	3.9	15.6	15.8	12.6	11.6	16.6	15.1	24	15.4
L'Oréal	44,772	7.0	6.6	16.4	16.8	14.6	13.3	22.1	19.6	7	14.6
Reckitt Benckiser	25,299	7.0	5.9	22.5	22.9	15.5	13.9	20.3	18.5	4	22.9
Average top-quality companies		5.7	5.7	17.9	18.3	14.5	13.1	20.8	18.6	9.8	17.2
UK peer Intertek Group	1,994	9.9	8.0	15.6	15.6	12.1	10.8	17.6	15.9	7.5	14.8
SGS	6,581	7.1	10.5	16.4	16.9	14.2	11.9	19.9	16.9	(3)	15.0
SGS (at target price)	7,747					16.8	14.1	23.4	19.9		

Source: Company, Exane BNP Paribas estimates

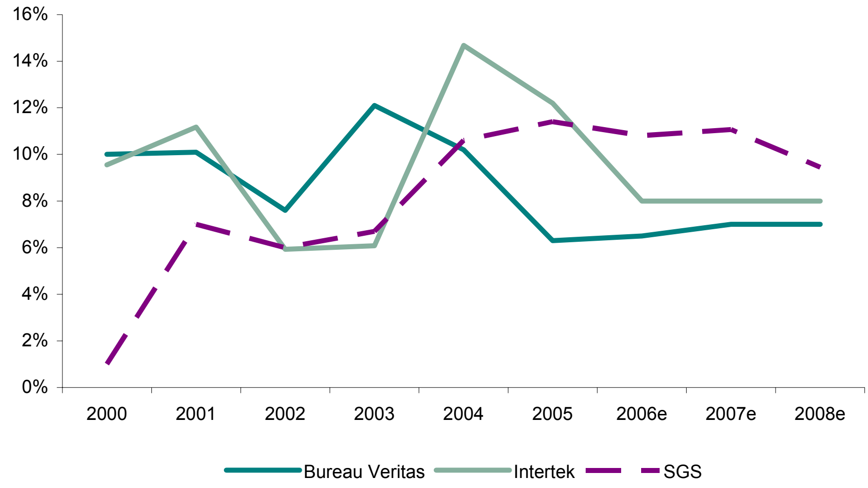
Our analysis suggests that SGS's current premium to its competitor Intertek is justified given its higher growth prospects (more favourable product mix and visibility), its size (SGS is three times larger) and stronger balance sheet.

Top line is key

Given the group's strong growth trend in recent years, and high operating leverage (personnel costs represent 50% of sales and 60% of costs), sales growth is a key factor in the group's market valuation.

There was a clear acceleration in organic sales growth at SGS in 2004 and 2005, topping 11% on average in the period versus 5% on average in 2000-2003. In H1 06, like-for-like sales growth was 10.4% (+13.7% stripping out the underperforming Trade Assurance Services business, which was affected by one-off items), and we expect +10.8% for the full year.

Chart 1: 2000-2008e organic sales growth for the three global players



Source: Company, Exane BNP Paribas estimates

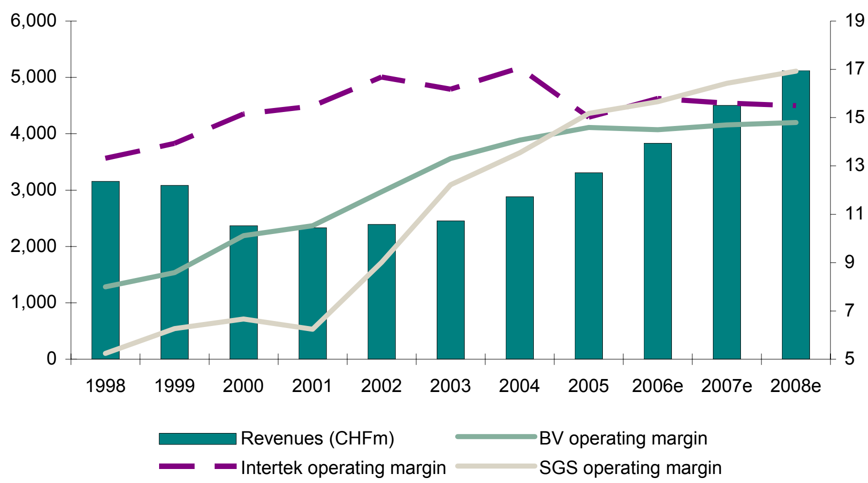
Although the group had previously lagged behind its competitors, this acceleration in organic growth reflects management's initiatives to reposition the company in higher growth markets and broaden the services it offers (by further penetrating existing supply chains and increasing the number of contacts for a product or a commodity as it moves from the manufacturer or the producer to the end-customer).

However, it could also reflect the positive impact of the market environment, especially for the most cyclical divisions Consumer Testing Services, Mineral Services and Oil, Gas and Chemicals, which grew at 27%, 16% and 12%, respectively, in 2004-2006e (the three divisions together account for 48% of sales and 54% of EBIT).

Margin expansion potential still exists

Following a restructuring programme initiated in 2002 (cost cutting, emphasis on efficiencies) by the then CEO Sergio Marchionne (now CEO of Fiat but chairman of SGS), SGS has dramatically improved its performance: in four years it has more than doubled its operating margin from 6% in 2001 to 15% in 2005, thus narrowing the gap with the industry leaders, mainly in the very profitable Consumer Testing division.

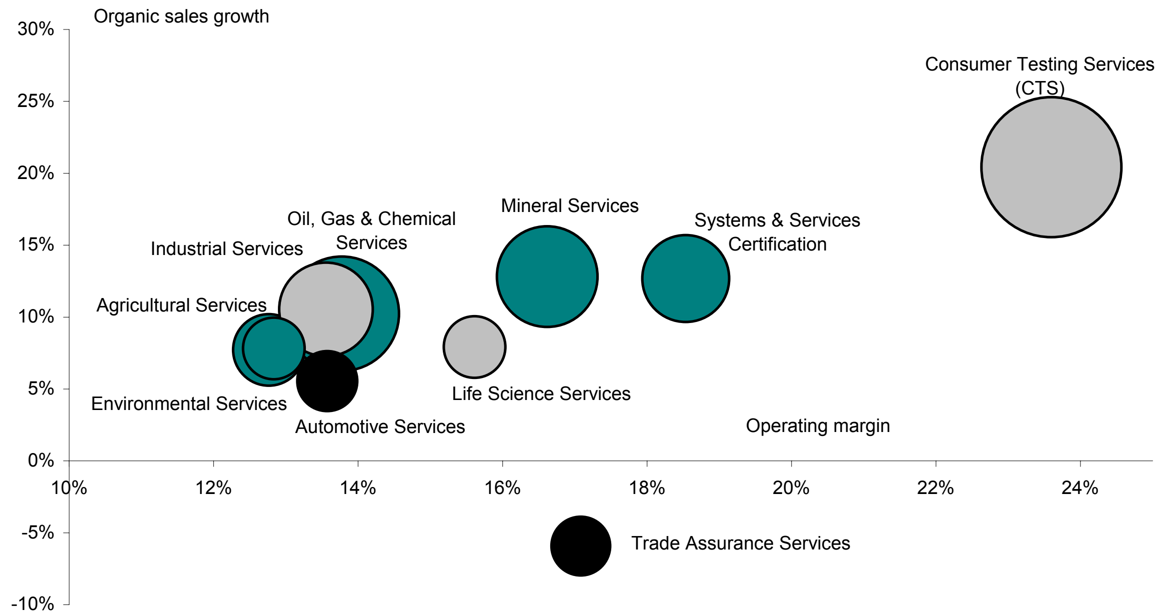
Chart 2: SGS performance versus major peers for the 1998-2008e period



Source: Companies, Exane BNP Paribas estimates

We believe that the company will be able to improve its operating margin by 60bp pa over the next three years and will thus reach its 2008 profitability targets (17%, vs 15.2% reported in 2005). This reflects: 1) strong operating leverage (every 1% of additional revenue growth could improve operating profit by around 3%, particularly as labs are currently under-utilised and operating at around 70-80% of capacity; and 2) a positive business mix effect with the increased contribution of highly skilled and value-added services (more testing and less inspection) as well as the faster growth of the most profitable divisions, namely Life Science, Consumer Testing Services and Oil, Gas & Chemicals.

Chart 3: SGS performance by division for the 2006-2008e period



Note: the grey circles represent SGS's key areas of development, the black circles are the most challenging divisions.

Source: Exane BNP Paribas estimates

External growth: another key driver of upside

There is strong evidence that SGS will play a significant role in sector consolidation in the coming years. The market is highly fragmented, management has a strong track record of making value-creating acquisitions, and the company has the necessary financial strength (positive net cash position of around CHF250m at end-2006e and FCF generation of about CHF500m pa for the next three years) and ambitious revenue growth targets for end-2008 (revenues of CHF5bn, operating margin of 17% and earnings per share of CHF80, implying a 15% top-line CAGR, of which 5% pa externally). Moreover, management has been more proactive lately (with the arrival of a new CEO, Chris Kirk – the former head of SGS's Mineral and Environmental Services) and recently reiterated that it would be pursuing an aggressive M&A strategy.

After a quiet 2005, corporate activity gathered pace at SGS in 2006 (i.e. eight bolt-on acquisitions adding CHF145m in annual revenues, +4%, for a total consideration estimated at CHF255m, or 1.7x sales on average). We expect this trend to continue, in order to expand SGS's network business (density build) and to acquire new expertise (rolled out throughout the network) in targeted growing segments (Life Science, Industrial, energy infrastructure). Based on an average price of 11x EV/EBIT (equivalent to 1.7x revenues and operating margin of 15%), SGS is bound to create value.

A potential big M&A deal, not likely in the short term

The recent management change has rekindled the M&A theme for SGS, fuelling talk of a deal with no. 2 Bureau Veritas (BV), as market speculation has demonstrated, which the latter has nevertheless denied. BV's parent company, Wendel Investissement, does not seem ready to sell in the short term (which could imply that Wendel sees strong potential for BV's market). However, this option will likely remain on SGS's agenda and could materialise within the next two to three years. From an industrial perspective, such a deal would make sense. SGS and BV have a good product and geographic fit. The combined company (estimated revenues of CHF7.5bn) would be a clear leader, with a 12% market share, clearly ahead of Intertek (with around 2%), and would have a broader portfolio (new markets, such as Marine). The deal would generate substantial synergies through cross-selling and a more efficient service network.

Our DCF valuation yields a CHF1,600 target price (+17%)

Our standalone valuation, i.e. without any acquisitions, does not offer substantial upside (DCF of CHF1,450, or +6%). This is, however, a very unlikely scenario. Our target price, therefore, relies on an acquisition-based scenario and assumptions in line with the company's 2008 targets, i.e. an EBITA margin set to peak at around 17% in 2008 and to stabilise at 16.8% thereafter. This assumes that acquisitions will represent 5% additional annual growth in 2006-2008e and thereafter will add 1% annual growth during the modelling period. Based on the company's target of CHF5bn in sales in 2008, i.e. implying the acquisition of more than CHF150m in sales each year between 2006 and 2008, we estimate value creation at CHF150 per share, given the cross-selling revenue opportunities and cost synergies. This lifts our valuation to CHF1,600 versus a standalone valuation of CHF1,450.

Main risks to our Outperform rating

The major risk relates to the cycle. SGS's business model is sensitive to global economic growth because its business is supported by international trade, the flow of commodities and trends in Asia. It is nevertheless worth noting that the group may be more resilient than in the past, having successfully diversified its revenue profile by broadening its range of new services at every stage of the supply chain, thus becoming less dependent on volume variation. We estimate that around 50% of the business is now relatively recurrent.

Consumer Testing (which accounts for 14% of group revenues) is the most sensitive business to global economic growth, whereas about 30% of SGS's revenues are related to commodities (Oil, Gas, Chemicals and Minerals).

Our forecasts incorporate a modest slowdown in growth in Consumer Testing, Oil, Gas and Chemicals and Minerals, the most cyclical divisions in 2007e and 2008e (our economists forecast a slight slowdown in the global economy in 2007). In a bleaker scenario, in which our growth estimates for these divisions are halved, the group's like-for-like growth would be 7.7% vs 10.7% in our current forecasts. We estimate that the group's valuation could then reach CHF1,180.

Next catalysts

The next catalysts include the publication of full-year 2006 results on 15 January 2007. We expect SGS to report a very good set of figures (highlighting double-digit organic sales growth and margin expansion of 50bp to 15.7%) and an improving outlook for 2007 as well as a clear confirmation of its 2008 targets.

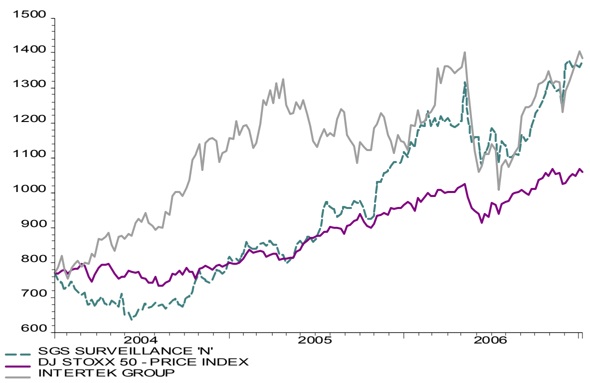
Valuation should go higher

Share price driven by earnings upgrades

SGS's strong three-year performance

The SGS share's outperformance of the DJ Stoxx 50 has been satisfactory over the past three years (15%), but the shares have progressed roughly in line with those of SGS's closest peer, Intertek Group. On absolute terms, the stock has jumped 80% over a three-year period.

Chart 4: SGS 3 and 1 year absolute and relative share price performance vs STOXX 50 and direct peer



Source: Datastream

This reflects improving fundamentals in a favourable market environment. Indeed, the stock's performance has been correlated to earnings upgrades. Over the past 18 months, the average consensus estimates for 2006e EBIT have been raised by 21%, from CHF509m to CHF618m. We expect EBIT of CHF621m (CHF600m before exceptional items).

Table 2: JCF consensus for 2006 EBIT between May 2005 and November 2006

Consensus	Nov. 2006	Sept. 2006	July 2006	May 2006	Feb. 2006	Nov. 2005	May 2005
EBIT (CHFm)	618	617	606	604	601	567	509

Source: JCF

Relatively good performance from a short-term perspective as well

In 2006, the stock's performance was decent and roughly in line with the market (+15%). There were two clear stages.

After a strong rally until May 2006, which took it to a peak of CHF1,348, the stock lost some momentum on the heels of the general market sell-off, followed by in-line H1 performances disclosed in mid-July 2006 (one-off integration costs following some acquisitions). Second, the ownership reshuffle at SGS, initiated in early September 2006 by Sequana Capital's share swap proposal, led to some arbitrage (stock down 4% on the day of announcement to CHF1,100). Beyond the short-term impact, this shareholder structure reshuffle is resulting in a higher free float for SGS (from 53% to around 63%) and a more simplified shareholder structure (the Von Finck family still holds 23.7% of the capital and the Agnelli family – through IFIL Investment – now owns 13.16% of the capital directly whereas it previously held the stake through Sequana Capital.

Since September, the stock has rebounded strongly (+20%) on the back of encouraging economic indicators for the global economy and, more importantly, the trend toward further consolidation in the sector coupled with some noise about a potential merger with Bureau Veritas, one of its direct competitors. This speculation was fuelled by the recent change in SGS's CEO, prompting investors to expect a deal in the short term. Although a potential deal with Bureau Veritas does not seem to be on the agenda in the short term, there is clear evidence that it may happen in the medium term, given the strong industrial rationale behind merging the two companies. This will support the stock.

Looking ahead, we expect a supportive news flow. One key catalyst includes the publication of full-year 2006 figures on 15 January 2007, at which time we expect the company to report a very good set of results (highlighting double-digit organic sales growth and margin expansion of 50bp to 15.7%) and give an upbeat outlook for 2007. In addition, the likelihood of value-creating acquisitions in the coming years should be supportive.

Table 3: Next key events in the coming months within the sector

Event	Date	Comments
SGS FY06 results	15 Jan. 2007	Strong set of results and positive guidance for 2007 expected
Intertek FY06 preliminary results	5 Mar. 2007	Positive read-across for the sector and SGS
SGS AGM	19 Mar. 2007	
Intertek AGM	11 May 2007	
Intertek trading update	End-Jun. 2007	
SGS H1 07 results	Jul. 2007	Likely to be the confirmation of strong dynamics & potential upgrades

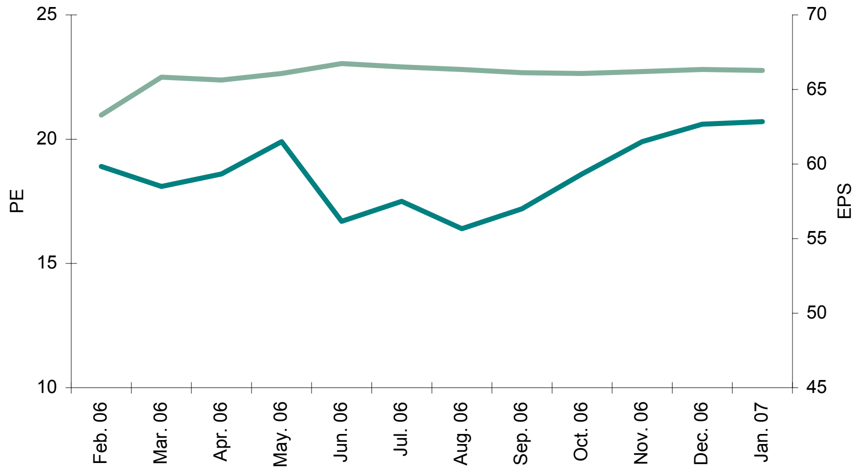
Source: Companies

Upward EPS revisions but stable P/E multiple

Over the past 18 months, the P/E multiple has remained virtually stable, whereas EPS have been revised upward. Indeed, there were significant positive revisions to the numbers, which did not lead to any particular multiple expansion.

While SGS's growth profile and visibility are improving, its shares are currently trading roughly on the same multiples (19-20x) as they have done over the past five years (20-22x). The numbers have, however, been inflated recently by some potential M&A opportunities and, more precisely, speculation about a significant deal with BV.

Chart 5: Analysis of SGS's P/E over the past 12 months



Source: Datastream

The stock has the status of a sector leader

Like leading groups in other sectors, SGS is trading at multiples that are above the market average (2007e EV/EBIT of 14.2x and P/E of 19.9x). These generous multiples simply reflect, in our view, the demonstrated capacity to regularly outperform its peers at the top line and to transform this solid growth into more dynamic EBIT growth thanks to good product mix, efficient cost management and good pricing power.

Table 4: SGS already has the status of a sector leader

	Market cap (EURm)	2000-2005 Ifl sales growth (%)	2006-2008e Ifl sales growth (%)	2007e EBIT margin (%)	2008e EBIT margin (%)	2007e EV/ EBIT (x)	2008e EV/ EBIT (x)	2007e P/E (x)	2008e P/E (x)	2007e net debt/ Market cap (%)	2007e Op.FCF/ Sales (%)
Essilor	8,299	5.7	6.5	17.2	17.6	15.3	13.5	24.0	21.0	4	15.9
Legrand	5,895	3.2	3.9	15.6	15.8	12.6	11.6	16.6	15.1	24	15.4
L'Oréal	44,772	7.0	6.6	16.4	16.8	14.6	13.3	22.1	19.6	7	14.6
Reckitt Benckiser	25,299	7.0	5.9	22.5	22.9	15.5	13.9	20.3	18.5	4	22.9
Average		5.7	5.7	17.9	18.3	14.5	13.1	20.8	18.6	9.8	17.2
Sodexho	7,194	4.5	6.5	4.7	4.8	13.1	11.7	21.3	19.0	14	5.6
Compass Group	8,536	7.0	5.7	4.9	5.0	12.8	11.6	19.9	17.7	17.0	4.6
Rentokil Initial	4,491	4.2	4.0	13.6	14.0	13.6	12.5	16.2	14.4	32.0	11.8
Average support services companies		5.2	5.4	7.7	7.9	13.2	11.9	19.1	17.0	21.0	7.3
SGS	6,581	7.1	10.5	16.4	16.9	14.2	11.9	19.9	16.9	(3)	15.0
SGS (at target price)	7,747					16.8	14.1	23.4	19.9		

Source: Company, Exane BNP Paribas estimates

More importantly, these companies have often enjoyed much higher valuation in their growth development, as highlighted by Sodexho's valuation multiple over the past ten years, when there was very little outsourcing in the contract catering market (1995-2005). Indeed, Sodexho was trading on average at an EV/EBIT of 15.1x vs 13.1x currently for 2007e.

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Peer group analysis: a premium to smaller player is justified

SGS's only listed peer is Intertek

SGS competes with French company Bureau Veritas, which is owned by the listed financial vehicle Wendel Investissement, and also with London-listed company Intertek. To put this competition into perspective, SGS is three times bigger than Intertek (in terms of both market cap and revenues) and 30% bigger than BV from a sales point of view.

Table 5: Main key players within the inspection testing and certification industry

	Listed	AGR	OGC	MIN	CTS	IND	AUT	LSS	TAS	SSC	ENV	Marine
SGS	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	
TUV					X	X	X					
Bureau Veritas *	(X)				X	X			X	X		X
Dekra						X	X					
Intertek	X	X	X		X				X	X		
DNV						X				X		X
Socotec						X					X	
Germanischer Lloyd						X						X
Applus							X			X	X	
Eurofins	X				X			X			X	
Moody International						X				X		

Legend: AGR: agricultural services / AOG: Oil, Gas & Chemical services / MIN: Minerals services / CTS: Consumer Testing Services / IND: industries services/ AUT: automotive industries / LSS: Life Science Services / TAS: Trade Assurance Services / SSC: System & Services Certification, ENV: Environmental services

**Bureau Veritas is held by financial quoted vehicle Wendel Investissement*

Source: Company, Exane BNP Paribas estimate

SGS is the largest listed stock to play the inspection, testing and certification sector, alongside its smaller UK competitor, Intertek. We believe that a comparison with Intertek is the most relevant as it operates in nearly all the same segments as SGS, especially in the largest ones namely consumer goods testing and the oil industries. We therefore use it as our primary peer for valuation purposes.

Premium to Intertek is warranted

Historically, SGS used to trade at significant premiums to Intertek (10-20%). The premium currently stands in the high end of the range (15-20%) based on 2007e numbers. However, looking at 2008e, the premium is no more than 10%, whereas we believe that an approximately 20% premium to Intertek is warranted given:

– Its stronger growth (in the double digits versus high single digits, thanks to the broader range of new value-added services) and a better margin profile (positive mix effect and continued upside in the key Consumer Testing division), with a 2006-2008e EPS CAGR of 19% for SGS vs 12% for Intertek.

– Its stronger balance sheet (net cash position of CHF250m at end-2006e versus Intertek's net debt of CHF230m), implying more flexibility for external growth (with limited risks as the group will focus on small- or medium-sized fill-in acquisitions) or cash returns to shareholders.

– A much more diversified portfolio (no single business represents more than 20% of group revenues and profit whereas Intertek still derives 50% of its profit from just one division (Labtest in consumer goods testing), thus reducing the risk profile.

– A better track record over the past couple of years. Despite frequent management changes, SGS has always matched its forecasts, unlike Intertek (which has disappointed over the past two years).

To conclude, we see SGS's premium as justified and sustainable. Although there is no evidence that the valuation gap should widen further between the two companies (as the performance differential should narrow slightly as Intertek has recently made a comeback and most of the margin gap has been closed), the potential upside for the SGS share will stem from a further sector rerating and potentially from further earnings upgrades.

A broad peer group comparison favours SGS's valuation

As we mentioned earlier, except for Intertek, there are no pure listed comparables that are present in all segments in which SGS operates. There are a few players specialising in two or three of these segments, such as the French-based Eurofins Scientific (food, environment and Life science) and a lot of competitors in the Life Science market with outsourcers such as Covance, Qinetiq and Icon.

Table 6: Peer group comparison

	SGS	Intertek	Eurofins	QINETIQ	Covance	Parexel	Tecan	Kendle	Charles River Laboratories	ICON	MDS Inc
Price on 8 January in local currency	1,358.00 CHF	857.00 GBp	54.60 EUR	200.00 GBp	58.91 USD	28.97 USD	47.90 USD	31.45 USD	43.25 USD	29.00 GBp	21.11 CAD
Market cap (EURm)	6,692	1,983	756	1,931	2,850	596	434	342	2,187	1,224	1,977
2006e EV/sales	2.4	2.0	2.2	1.1	2.6	1.0	1.4	2.2	3.0	2.4	2.5
2007e EV/sales	2.3	1.9	1.8	1.1	2.2	0.9	1.3	1.4	2.7	2.0	2.4
2008e EV/sales	2.0	1.7	1.5	1.0	1.9	0.7	1.2	1.2	2.4	1.8	2.1
2006e EV/EBITDA	12.2	10.5	17.1	9.1	14.2	8.5	10.0	14.2	10.7	16.6	15.1
2007e EV/EBITDA	11.3	9.6	13.5	8.5	11.8	6.8	8.5	8.6	10.2	13.6	13.4
2008e EV/EBITDA	9.5	8.7	10.5	8.0	9.8	5.3	7.3	7.2	8.3	11.5	10.6
2006e EV/EBIT	15.5	13.4	28.0	12.8	18.3	12.9	12.3	18.1	14.8	21.4	14.2
2007e EV/EBIT	14.2	12.1	20.9	12.0	14.9	9.5	10.3	10.9	13.1	16.8	15.2
2008e EV/EBIT	11.9	10.8	15.3	11.3	12.4	7.4	9.0	9.2	11.4	13.7	12.4
Tax Rate (%)	25	30	35	30	30	30	30	30	30	30	30
2006e EV/NOPAT	20.7	19.2	43.0	18.3	26.1	18.4	17.6	25.8	21.1	30.6	20.2
2007e EV/NOPAT	18.9	17.3	32.1	17.1	21.3	13.5	14.8	15.5	18.7	23.9	21.7
2008e EV/NOPAT	15.8	15.5	23.5	16.1	17.8	10.6	12.9	13.2	16.3	19.6	17.7
2006e P/E	23.4	19.8	48.5	19.1	26.8	24.1	15.1	23.6	19.7	27.4	28.9
2007e P/E	19.9	17.6	32.2	17.5	22.2	18.8	12.8	17.9	17.4	21.2	24.0
2008e P/E	16.9	15.9	0.0	16.3	18.8	14.6	10.9	14.3	15.3	17.4	16.8
Dividend yield (%)	2.2	1.5	0.0	1.7	0.0	0.0	0.6	0.0	0.0	0.0	0.6
Product sales mix (%)											
Oil, Gas & Chemical Services	19	20									
Consumer Testing Services (CTS)	14	51									
Industrial Services	13	-									
Mineral Services	12	9									
Agricultural Services	9	12									
Systems & Services Certification	8										
Environmental Services	7		25								
Trade Assurance Services	7	7									
Automotive Services	6										
Life Science Services	4		25	100	100	100	100	100	100	100	100
Other (Marine, Food)			50								
% total sales	100	100	100	100	100	100	100	100	100	100	100

Source: Company, Exane BNP Paribas estimates

SGS currently trades at 14x 2007e EV/EBIT and 20x 2007e P/E, and at 12x and 17x, respectively for 2008e, for average annual EPS growth of 19% in 2006e-2008e period. Relative to the broad basket of companies in the table above, SGS's valuation does not appear particularly demanding, given its higher growth profile. However, the bulk of the peer group is composed of CRO companies, thus making the comparison less appropriate.

Table 7: SGS premium/(discount) versus broad peers

(%)	SGS vs Intertek	SGS vs broad peers		SGS vs CRO	
	Average	Mean	Average	Mean	Average
2006e EV/sales	18	20	13	20	6
2007e EV/sales	24	35	31	33	34
2008e EV/sales 08e	**18**	**32**	**30**	**30**	**34**
2006e EV/EBITDA	16	(1)	14	(1)	(2)
2007e EV/EBITDA	18	11	18	11	20
2008e EV/EBITDA	**10**	**13**	**15**	**12**	**17**
2006e EV/EBIT	15	(4)	9	(1)	7
2007e EV/EBIT	17	8	17	11	13
2008e EV/EBIT	**10**	**9**	**5**	**9**	**5**
2006e EV/NOPAT					
2007e EV/NOPAT	8	(12)	2	(7)	0
2008e EV/NOPAT	9	(1)	9	3	6
2006e P/E	3	0	(2)	2	(2)
2007e P/E	18	(4)	(1)	1	(2)
2008e P/E	**13**	**2**	**11**	**5**	**8**

Source: Company, Exane BNP Paribas estimates

SGS shares have historically traded at an average of 21x forward P/E for higher EPS growth on average in the period, against the backdrop of restructuring and strong operating leverage.

In addition, the recent transaction prices for unlisted companies within the sector offer some support for SGS's valuation. Bridgepoint sold the Anglo-Dutch company Alcontrol, specialising in the feed & food and environmental testing segments, to Candover at the end of 2004 for EUR340m, i.e. at multiples of 2.6x 2005e sales, 10.6x 2005e EBITDA and 14.8x 2005e EBIT, all slightly above SGS's current multiples.

DCF valuation: CHF1,600 per share

Upside of 17%

Our DCF approach implies a 12-month target price of CHF1,600 (+17%). Our target price factors in acquisitions as it is highly likely that this part of the group's growth will be realised in the coming years. This implies a valuation of 19.9x 2008e, in line with historical P/Es.

We note, however, that a standalone valuation, i.e. without any acquisitions, implies a target price close to current price levels (CHF1,450, or 6% upside).

Standalone valuation: slightly above current price levels

It is worth noting that, with no acquisitions, our DCF-driven valuation for SGS would imply a target price of around CHF1,450, thus showing slight upside from current share price (+6%). This is based only on organic sales growth (we assume that SGS will be able to increase sales by 4.5% during the modelling period) and an EBIT margin of 16.8% in 2008e, slightly below the company's guidance of 17%. For the modelling period, we have assumed an average margin of 16.5% (vs 15.7% in 2006e).

In addition, this relies on a relatively low WACC, at 8.1%, with a beta of 0.9x. This beta reflects SGS's low risk profile, resulting from its high visibility on growth, strong management track record and low financial risks (SGS has a positive net cash position of CHF250m for 2006e).

Table 8: SGS DCF standalone valuation

Assumptions		CHFm				
Sales growth rate (%)	4.5	NPV FCF	5,313	46%		
Life span of assets	11.3	Terminal value	6,193	54%	Growth to infinity (%)	2.5
Gross tangible assets/Sales (%)	48	Total	11,507			
EBITDA margin (%)	20.6	Other assets				
EBIT margin (%)	16.5	Cash (Debt)	243		End 2006e	
Ch. in WCR as % of sales	(0.1)	Minorities	(181)			
Risk premium (%)	4.5	Other debt	(225)			
Risk-free rate (%)	3.8	Valuation	11,344			
Risk rating	0.9	No. of shares (m)	7.822		Price	1,373
Spread (%)	1.0				Upside (%)	6
Cost of equity (%)	8.0					
Cost of debt before tax (%)	5.3	Value/Share (CHF)	**1,450**			
Market capitalisation (CHFm)	10,630					
WACC (%)	8.1					
Tax rate(%)	25					

CHFm	2005	2006e	2007e	2008e	2009e	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e	2020e	CAGR (%)
Sales	3,308	3,831	4,243	4,644	5,029	5,392	5,635	5,888	6,153	6,430	6,719	7,022	7,338	7,668	8,013	8,213	5.8
Growth (%)	14.7	15.8	10.8	9.4	8.3	7.2	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	2.5	
EBITDA	642	762	876	974	1051	1124	1172	1222	1274	1328	1384	1443	1508	1576	1647	1695	6.1
EBITDA margin (%)	19.4	19.9	20.6	21.0	20.9	20.9	20.8	20.8	20.7	20.7	20.6	20.6	20.6	20.6	20.6	20.6	
D&A	(140)	(162)	(177)	(195)	(210)	(226)	(234)	(245)	(256)	(267)	(279)	(292)	(305)	(319)	(333)	(345)	5.7
EBIT	502	600	698	780	841	898	938	977	1018	1061	1105	1151	1203	1257	1314	1350	6.2
EBIT margin (%)	15.2	15.7	16.5	16.8	16.7	16.7	16.6	16.6	16.5	16.5	16.4	16.4	16.4	16.4	16.4	16.5	
Tax	(119)	(152)	(182)	(213)	(206)	(220)	(230)	(239)	(249)	(260)	(271)	(282)	(295)	(308)	(322)	(331)	5.9
Tax rate (%)	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	
Cash flow	523	609	694	761	845	904	942	982	1024	1068	1113	1161	1213	1268	1325	1364	6.2
Change in WCR	(60)	10	15	15	5	5	4	4	4	4	4	5	5	5	5	3	
Capex	(205)	(227.9)	(255)	(282)	(307)	(323)	(336)	(351)	(367)	(384)	(402)	(421)	(440)	(460)	(481)	(407)	
Capex/CA (%)	6.2	6.0	6.0	6.1	6.1	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	5.0	
Free cash flow	258	391	454	494	543	587	610	635	661	688	716	745	778	812	849	960	6.1

Source: Exane BNP Paribas estimates

Without acquisitions, we believe that SGS does not offer substantial upside from current levels. However, there is evidence that, given its firepower and its ambition (management reaffirmed its appetite and its 2008 targets), SGS will inevitably embark on an external growth strategy within two years.

Acquisition-based scenario: significant upside

Our acquisition-based scenario relies on assumptions in order to match the company's 2008 targets. This model is based on the following.

– For 2006-2008e, annual average sales growth of 15% (of which 10.5% organically, supported by strong underlying demand for testing and certification and market share gains thanks to the broader range of services offered). This assumes that acquisitions will represent 5% pa in additional growth during the period.

– An EBIT margin expansion of 180bp during the period 2006-2008e (i.e. 60bp pa) to 16.9% (on an improving product mix, strong operating leverage and better efficiencies). This is in line with the company's targets (17% in 2008).

– After that, we assume 6% revenue growth pa (including 1% externally) and margins peaking at 17.2% in 2010e vs 15.2% in 2005. This corresponds to an average of 16.8% for the model period.

– A capex/revenue ratio remaining within the historical range (albeit in the low end, at 6.0%) in the period. This follows a recent acceleration (7% in the past two years) with more investments made in the network in order to match the surge in demand, especially in Asia.

– A stable average tax rate of 25% for the entire forecasting period.

– A slight continued improvement in net working capital over the period (4-5% related to sales), in line with management's anticipation.

– A 2.5% growth rate to infinity, a figure slightly above our usual 2% for Support Services, given the strong underlying growth in the industry.

For our target price, we use a WACC at 8.3%, slightly above those for our stand alone valuation, to reflect higher risks associated with the acquisition strategy, which is likely to accelerate in the coming years.

Table 9: SGS DCF valuation based on an acquisition scenario

Assumptions		**CHFm**				
Sales growth rate (%)	6.0	NPV FCF	5,036	40%		
Life span of assets	11.3	Terminal value	7,642	60%	Growth to infinity (%)	2.5
Gross tangible assets/Sales (%)	48	Total	12,678			
EBITDA margin (%)	20.9	Other assets				
EBIT margin (%)	16.8	Cash (Debt)	243		End 2006e	
Ch. in WCR as % of sales	(0.1)	Minorities	(181)			
Risk premium (%)	4.5	Other debt	(225)			
Risk-free rate (%)	3.8	Valuation	12,515			
Risk rating	1.0	No. of shares (m)	7.822		**Price**	**1,373**
Spread (%)	1.0				**Upside (%)**	**17**
Cost of equity (%)	8.2					
Cost of debt before tax (%)	5.3	Value/Share (CHF)	**1,600**			
Market capitalisation (CHFm)	10,630					
WACC (%)	8.3					
Tax rate (%)	25					

CHFm	**2005**	**2006e**	**2007e**	**2008e**	**2009e**	**2010e**	**2011e**	**2012e**	**2013e**	**2014e**	**2015e**	**2016e**	**2017e**	**2018e**	**2019e**	**2020e**	**CAGR (%)**
Sales	3,308	3,831	4,505	5,123	5,614	6,027	6,389	6,772	7,179	7,609	8,066	8,550	9,063	9,607	10,183	10,438	7.8
Growth (%)	14.7	15.8	17.6	13.7	9.6	7.4	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	2.5	
EBITDA	642	762	929	1081	1,190	1,284	1,354	1,429	1,508	1,590	1,686	1,787	1,894	2,008	2,128	2,183	8.2
EBITDA margin (%)	19.4	19.9	20.6	21.1	21.2	21.3	21.2	21.1	21.0	20.9	20.9	20.9	20.9	20.9	20.9	20.9	
D&A	(140)	(162)	(189)	(214)	(231)	(246)	(264)	(280)	(296)	(314)	(333)	(353)	(374)	(397)	(420)	(418)	7.6
EBIT	502	600	740	867	959	1,038	1,091	1,149	1,211	1,276	1,353	1,434	1,520	1,611	1,708	1,765	8.4
EBIT margin (%)	15.2	15.7	16.4	16.9	17.1	17.2	17.1	17.0	16.9	16.8	16.8	16.8	16.8	16.8	16.8	16.8	
Tax	(119)	(152)	(182)	(213)	(235)	(254)	(267)	(282)	(297)	(313)	(331)	(351)	(372)	(395)	(418)	(432)	8.1
Tax rate (%)	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	
Cash flow	523	609	747	868	955	1,030	1,087	1,147	1,211	1,278	1,354	1,436	1,522	1,613	1,710	1,751	8.3
Change in WCR	(60)	10	15	15	6	6	5	5	6	6	6	7	7	7	8	3	
Financial investments			(340)	(255)	(77)	(84)	(90)	(96)	(102)	(108)	(114)	(121)	(128)	(136)	(144)		
Capex	(205)	(228)	(270)	(307)	(338)	(362)	(385)	(405)	(428)	(457)	(487)	(515)	(545)	(581)	(615)	(518)	
Capex/Sales (%)	6.2	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	5.0	
Free cash flow	258	391	152	321	546	589	617	651	687	719	759	806	856	903	959	1236	7.1%

Source: Exane BNP Paribas estimates

Based on the company's target of CHF5bn in sales in 2008 (i.e. implying the acquisition of more than CHF150m in sales each year from 2006 to 2008), we estimate value creation at close to CHF150 per share (+10%), coming mainly from revenue cross-selling opportunities as well as from some cost synergies. This lifts our valuation to CHF1,600.

In our model, we assume an average acquisition multiple of 1.7x EV/Sales and apply a 15% EBITA margin after one year, i.e. 11x normalised EBITA.

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Our main valuation scenarios

Alongside our base case for SGS, we have developed two alternative scenarios in terms of both top-line growth and changes in margin. The table below details the main assumptions and related target prices.

Table 10: Our three scenarios for SGS

	Bull case	Core case	Bear Case
Target price	1,700	1,600	1,180
Upside/Downside from current price levels (%)	24	17	(14)
2006-2008e organic sales growth (%)	12	10.5	7
Sales growth for the modelling period (%)	6.5	6.0	4.0
2008e EBITA margin (%)	17.2	16.9	16.0
EBITA margin for the modelling period (%)	17.0	16.8	15.0
Acquisitions (%)	Acquisition accretion (1.5% pa)	Some acquisition accretion (1% pa)	No acquisitions
2008e EPS	80.4	80.4	65.4
2008e P/E multiple	16.9	16.9	20.8

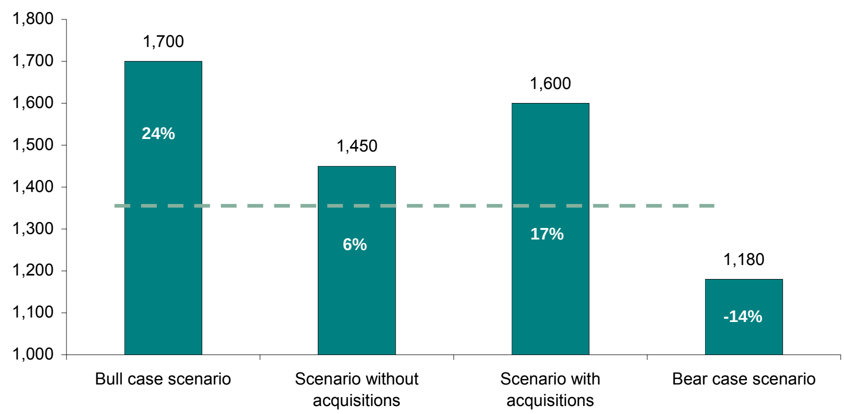
Source: Exane BNP Paribas estimates

This bull/bear analysis suggests that risks are weighted to the upside.

– The bear scenario (14% downside) implies an economic slowdown and a direct negative impact on the cyclical commodity businesses. In our bear case, we assume that organic sales growth reaches only 7% for 2006-2008e and further margin progress is limited, resulting in a 16.0% target for 2008, or 100bp below the company's guidance. In addition, it suggests an average EBIT margin for the modelling period of 15.0%, i.e. slightly below the level achieved in 2005.

– The bull scenario implies that management would be able to exceed its 2008 targets by delivering higher double-digit organic sales growth (12%) coupled with margin progress and more accretive acquisitions. This lifts our valuation to CHF1,700, showing nearly 25% upside.

Chart 6: Snapshot of our main valuation scenarios for SGS versus current price (CHF)



Source: Exane BNP Paribas estimates

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Sensitivity analysis

The following table shows the effect that changes in the terminal FCF growth rate and WACC could have on the target price.

Table 11: Sensitivity analysis of SGS's DCF valuation (CHF)

Growth to infinity / WACC	7.4%	7.7%	8.0%	8.3%	8.6%	8.9%	9.2%
1.5%	1,712	1,613	1,524	1,443	1,370	1,303	1,241
2.0%	1,819	1,707	1,606	1,515	1,434	1,359	1,292
2.5%	1,948	1,818	1,703	1,600	1,508	1,425	1,350
3.0%	2,106	1,953	1,819	1,701	1,596	1,502	1,417
3.5%	2,306	2,121	1,961	1,822	1,700	1,593	1,497

Source: Exane BNP Paribas estimates

Table 12: Sensitivity analysis of SGS's EBITA margin in DCF valuation (CHF)

Growth to infinity / EBITA margins	13.8%	14.8%	15.8%	16.8%	17.8%	18.8%	19.8%
1.5%	1,117	1,224	1,337	1,443	1,556	1,669	1,776
2.0%	1,176	1,287	1,404	1,515	1,633	1,750	1,861
2.5%	1,245	1,361	1,484	1,600	1,723	1,846	1,962
3.0%	1,327	1,449	1,578	1,701	1,830	1,959	2,081
3.5%	1,426	1,556	1,693	1,822	1,959	2,097	2,226

Source: Company, Exane BNP Paribas estimates

Every 100bp variation in EBITA margin (on average for the modelling period) represents a change of around 7% (all else being equal) in SGS's DCF-driven valuation. Note that, given the business's strong operating leverage, this is mainly fuelled by top-line volumes.

Our estimates versus consensus

Overall, we expect SGS to enjoy a three-year earnings CAGR of 19% for the 2006-2008 period. Our estimates are based on a worldwide growth assumption of around 4% pa for the next two years and an acquisitions flow in line with management's guidance.

Table 13: IBES consensus for SGS versus our estimates

CHF	2005	2006e		2007e		2008e	
		Mean estimate	Exane	Mean estimate	Exane	Mean estimate	Exane
Revenues (m)	3,308	3,821	3,831	4,228	4,505	4,629	5,123
% change	15	16	16	11	18	9	14
EBIT (m)	502	618	621	702	740	809	867
% change	33	23	24	14	19	15	17
EPS	47.4	58.0	57.0	66.2	68.3	74.9	80.4
% change	33	22	20	14	20	13	18

Source: IBES, JCF, Exane BNP Paribas estimates

For both 2007 and 2008, our numbers are around 6% above market expectations. The CHF80 discrepancy in our EPS estimate (in line with the company's 2008 target) vs consensus expectations, comes from the fact that we already factor external growth.

In our view, it is very likely that guidance could be reached or even exceeded if industry dynamics remain favourable. For example, consensus was clearly below the company's guidance in 2005, six months before SGS exceeded its ambitious EPS targets (at CHF45 or a three-year CAGR of 27%).

EXANE BNP PARIBAS

SGS: the right player in the right place

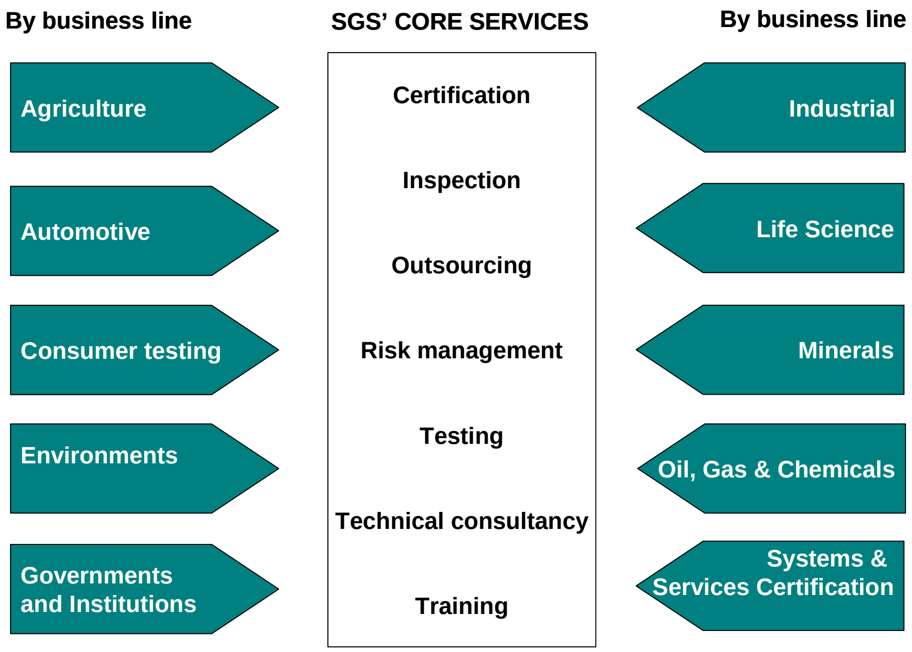
A global leader in testing and certification

SGS is the largest inspection, verification, testing and certification company in the world. The Swiss-based company operates in the fast-growing, high-margin testing, inspection and certification markets, verifying that the products and commodities bought or sold by its customers conform with a wide range of safety, regulatory, quality and performance standards.

The group employs over 43,000 people in a network of more than 1,000 offices, accredited laboratories or certification units.

Operating in a large number of market segments, SGS has ten divisions (business lines) providing customers with the following range of conformity assessment services.

Chart 7: SGS' core services for every industry



Source: Company, Exane BNP Paribas estimates

The three main business lines are as follows:

– **Inspection services:** inspection and verification of the quantity (weight, value) and the quality of traded goods. This can be done at the factory during production, or with a random inspection of final stored products or on-site at the time of loading and unloading.

– **Testing services:** checking product quality and performance against various health, safety and regulatory standards.

– **Certification services:** certifying that products, services or systems meet the standard requirement of governments, international standardisation bodies (mainly ISO) or SGS' customers. The group also develops and certifies its own standards (such as Qualicert, a recognised standard of quality).

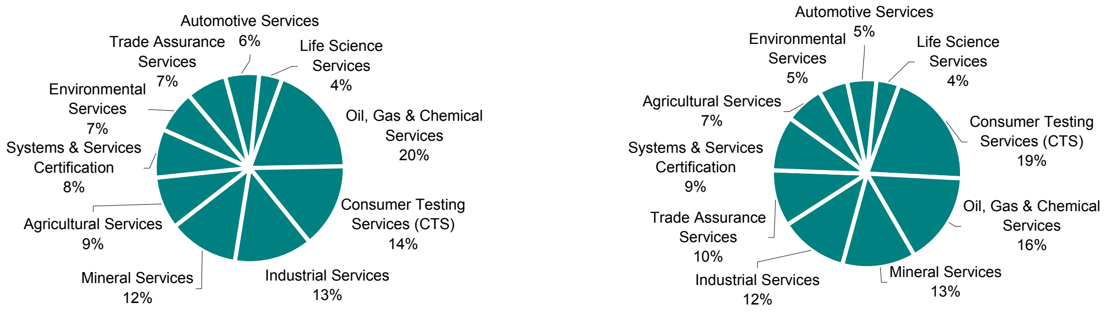
SGS's business model is sensitive to global economic growth because its business is supported by international trade, the flow of commodities and the dynamics of Asia. Nevertheless it is worth noting that the group may be more resilient than in the past, having successfully diversified its revenue profile by broadening its range of new services at every stage of the supply chain, making it less dependant on volumes and trade flow.

The group has a well diversified revenue base split by industry, customer and geography.

Revenues are spread across a broad range of industries: the group is not reliant on any one division since the first contributors in terms of revenues and EBIT are Consumer Testing Services (CTS) and Oil, Gas & Chemicals Services, each generating 20% of the total. Back in 2000, Trade Assurances Services (government contracts for pre-shipment) accounted for 38% of the group operating profit vs just 5% today.

Also, the company is not dependent on any specific customer or contract, the largest accounts for CHF10m (EUR6m) of sales (less than 0.3% of the group's total).

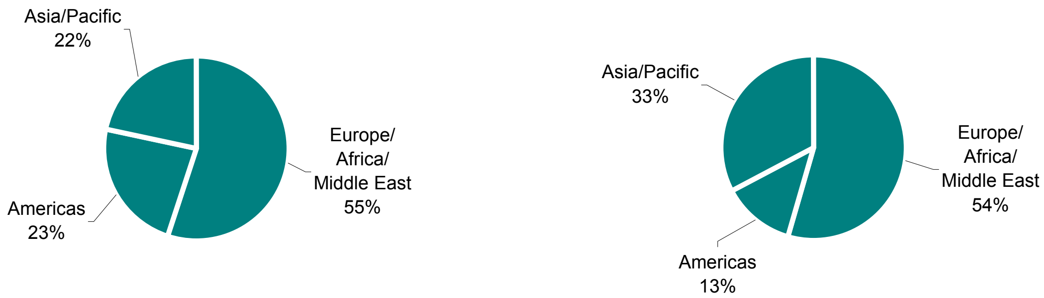
Chart 8: 2005 divisional split of revenues and EBITA



Source: Company

Europe/Africa/Middle East is the most important area in terms of sales, because it accounts for 55% of the group's total, whereas the Asia/Pacific region (where growth is the strongest) and North America both generate 22-23% of revenues. However, Asia accounts for 33% of group profits. As a rule of thumb, 35-40% of SGS sales are denominated in euros, 30-35% in US dollars or equivalents.

Chart 9: 2005 geographical split of revenues and EBITA



Source: Company

EXANE BNP PARIBAS

A very dynamic market

A market growing at 6-8%, with little outsourcing

It is not easy to estimate the size of the markets in which the company operates due to their vast size and the fact that data are only available from the sector's major players for the outsourced part of the market.

The global outsourced inspection, testing and certification market is estimated at CHF50bn (EUR35bn) and has grown by 6-8% pa over the last 10 years.

Much of the work is managed in house; there is relatively little outsourcing. Third-party companies (such as SGS, Bureau Veritas and Intertek) share a combined market share of about 20%. In-house inspection and testing represent about 40% of the total market and the 20% left is not allocated. This means that the potential market would be huge if the outsourcing trend were to speed up.

According to management, SGS' markets are forecast to grow at 8% on average over the coming years, ranging from +4% in the environmental services to +15% in the consumer testing business. This is supported by strong secular industry drivers and also cyclical drivers of demand.

Table 14: Market characteristics by segment and SGS' position

	Market growth forecasts (CAGR) (%)	Degree of cyclicality	Market trends	SGS' current position (market share)
Agricultural Services	7	+	Traceability concerns Move towards logistics outsourcing Government monopolies	World leader
Mineral Services	12	++	High oil prices driving energy minerals demand Increased movement towards risk management Growth in process & trade services Lower Geochem growth rate	World leader (40%)
Oil, Gas & Chemical Services	5	++	Strong demand in Asia Production capacity increasing in Middle East/China High prices driving alternative energy materials	World leader in trade (30%), strong player in upstream services
Life Science Services	11	-	Drug safety standards & guidelines expanding Generic market growing faster than therapeutic market Outsourcing driven by rising R&D costs and price pressure	Significant regional player in Europe
Consumer Testing Services (CTS)	15	+++	Strong growth for high-tech electronics, environmental & social responsibility component Hard-lines driven by product diversification	Number 2 (10%) behind Intertek
Systems & Services Certification	9	+	Fastest growth of sector-specific certifications Rapid growth of ISO 22000 food certification vs ISO 9001	Global leader in core standards certification (11%)
Industrial Services	7	++	Delocalisation of supply chain Ageing asset base leading to life extension & maintenance Demand for cost reduction Construction growth in China, India, ME & eastern Europe	Number 2, leader in some local markets
Environmental Services	4	-	Volume growing due to increased regulations & awareness Pricing flat in core lab services Developing markets beginning to focus on environment	Regional leader (4%)
Automotive Services	5	+	Statutory and commercial market mature in western Europe and North America Growing market in South America, Asia & Africa	World commercial leader, local statutory leader (2%)
Trade Assurance Services	8	+	Traditional pre-shipment inspection (PSI) market declining Forestry & security services growing	World leader (34%)

Legend: +++ indicates highly cyclical business whereas – indicates no or few economic sensitive

Source: Company, Exane BNP Paribas estimates

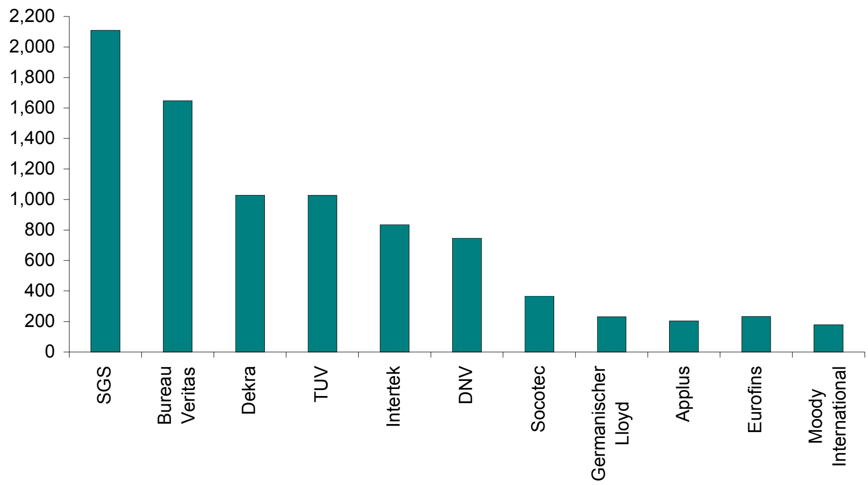
High barriers to entry limit competition

The size of the possible market for testing companies suggests there is room for everybody and that the competitive environment is not tough. There is little risk of new entrants as it takes time to build a reputation (a well recognised brand is necessary to win business), to qualify for the various accreditations, and significant investments are necessary to build a tangible global infrastructure (the service provider has to be able to work with clients in multiple locations).

There are just a handful of global competitors: the market is dominated by three players of any real scale, SGS (estimated 6% of the outsourced market share), Bureau Veritas (owned by French financial vehicle Wendel Investment, with 5%) and UK-based Intertek (2%).

Cotecna, BSI, Dekra, DNV, TÜV are other key competitors, but they concentrate on a particular service or industry and/or geographical area. The chart below illustrates the main players of SGS' market by size (in terms of revenues).

Chart 10: Main actors within the inspection, testing and certification market (revenues in EURm)



Source: Company data, Exane BNP Paribas estimates

The industry's pricing environment is stable. There are some variations reflecting the geographical area and the services offered. The pricing power is relatively high in the high-skilled end of the market (high margin testing and quality control) where competition is rather limited. On the other hand, competition is fiercer at the low-skilled end of the market, especially for basic inspection (pre-shipment inspection) or traditional testing (especially in consumer testing where Intertek has suffered pricing pressure recently in some segments).

Largely a “spot” market

The inspection and testing market is largely a “spot” market. Shipments inspection related contracts are drawn up as and when needed. Customer billing varies by type of service, although the service (such as the quality control of a product, inspection of the quantity of commodities or sample testing) is largely charged per unit (or by the hour), with an average invoice of CHF1,000 (EUR600).

Although there is an increasing trend towards long-term contracts (traceability related, outsourced labs), the bulk of the SGS' business is upon requirement, as is the case for its main competitors. This gives the impression that it is not a very predictable business, but in reality there are solid and visible underlying long-term trends.

Table 15: Main characteristics by business line

Segment	Market size (CHFbn)	Market characteristics	Key drivers	Major competitors	Customers	Type of contracts
Agricultural Services		Mature market Restrictive regulations	Traceability concerns, GMO products Food-borne diseases Outsourcing of logistics	ITS, Inspectorate Clients themselves	Cargill, Glencore, Nidera Food importers, exporters, commodity traders	
Mineral Services	1.3			BSI Inspectorate, AH Knight	Mining companies (Rio Tinto, Anglo Gold) Trading companies (Glencore)	Spot, 3-month Several years
Oil, Gas & Chemical Services	1.5	Outsourcing rate 30% Linked to oil prices and inventory levels (more exploration leads to more testing)	Renewal energies	Caleb Brett (Intertek) BSI, Saybolt group, Inspectorate (Inspection)	Major oil & chemical manufacturers, traders (BP, Shell, Total, BASF)	Two-thirds spot One-third long term (1-5 years)
Life Science Services					Major pharmaceutical groups	
Consumer Testing Services (CTS)	6.0		Eco-testing requirements Increasing demand for green textiles Increased safety consciousness	Underwriter Laboratories (UL), Labtest (Intertek) Bureau Veritas		
Systems & Services Certification	3.0	ISO (80% of the market) Retention rate of certification 97%		Bureau Veritas Lloyds, KPMG Thousand of local players	Widespread, local, regional International customers	Recurring revenue Per cycle, certification audit and surveillance visits
Industrial Services				Intertek, Socotec, Lloyds		
Environmental Services	6.3	Very fragmented			Manufacturers, governments, insurers Consumers	
Automotive Services	10	Statutory car inspection		Vascor, Autocom (US) Unicar (Europe)	Manufacturers, governments, insurers, consumers	Fees per test LT concession contract (Ireland)
Trade Assurance Services	0.5			Bureau Veritas, Intertek, Cotecna	Governments and institutions	Long-term inspection contract+ Spot

Source: Company, Exane BNP Paribas estimates

Strong drivers of demand in the industry

The testing, inspection and certification market is a developing industry sector with very favourable long-term dynamics, especially for high skilled services (testing rather than inspection services). It relies on both secular trends and cyclical factors.

There is evidence that the markets in which SGS operates will continue to grow substantially in response to the following trends.

– A worldwide trend towards increasing safety requirements, regulations and standards and greater emphasis on the quality and performance of goods and commodities.

– Increasing varieties of products in order to meet consumer demand (testing is required on a sample of each new variety).

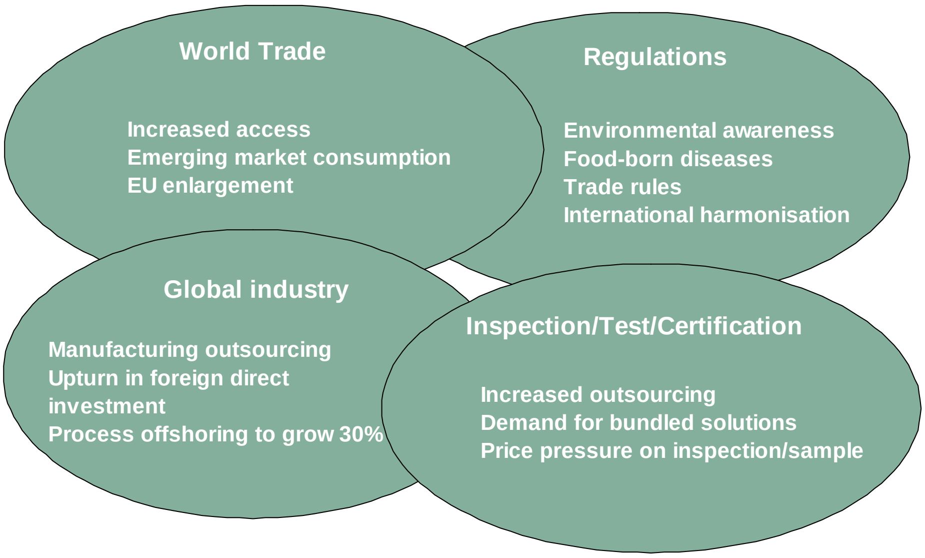
– Decreasing product life cycles, leading to an increase in the number of new products developed each of which must be tested.

– The continuing migration of manufacturing operations from developed countries to less developed countries.

– An increase in global trade flows.

– A growing trend towards outsourcing testing laboratories.

Chart 11: The major trends and drivers within the industry



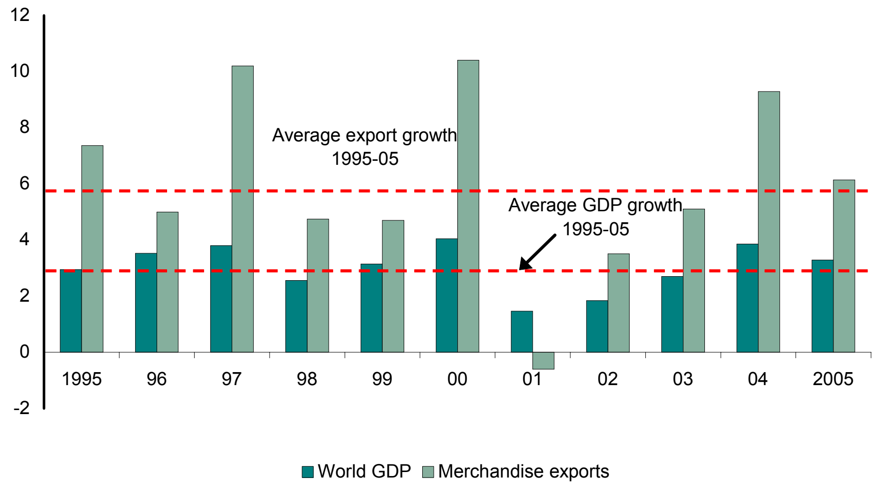
Source: companies, Exane BNP Paribas estimates

Trends towards "globalisation" of the economy and increased trade flow

Globalisation is an important driver of business, as companies' customer bases increasingly span the world. They therefore strive to provide their services or products on a global basis throughout the supply chain.

The increased trade flow (historically, trade between countries has grown at twice the growth rate of GDP, as shown by the following chart) and a further delocalisation of the supply chain has lead to more testing, inspection and certification of quality for exports from developing countries to developed countries, in order that products sourced abroad comply with local standards (in terms of both quality and safety). There is an inexorable shift of production from western countries to Asia (China, India, Malaysia, Vietnam, etc.) and also eastern Europe or South America. Key players are completing laboratory capacities in these fast-growing regions. This explains why these regions are growing much faster than any other area in the world (as highlighted by export flows, see the following chart).

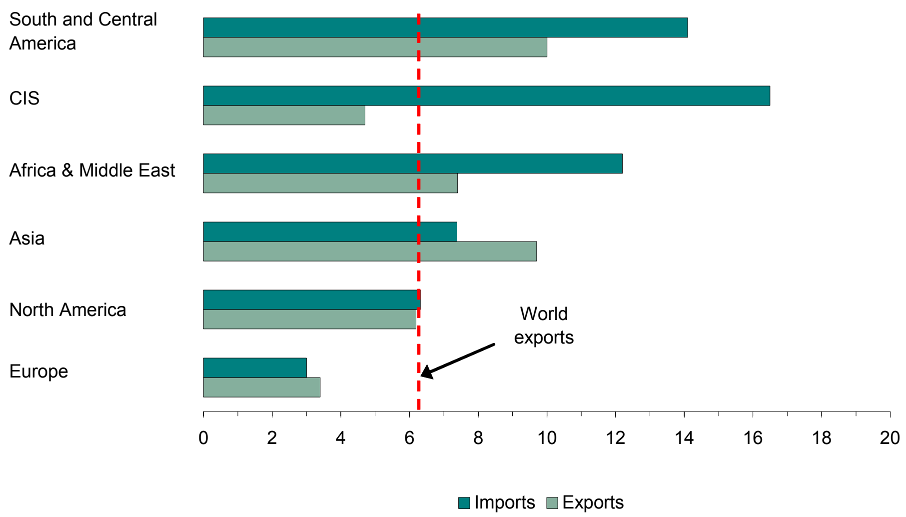
Chart 12: 1995-2005 growth in the volume of world merchandise trade and GDP (annual percentage change)



Source: WTO

Note that the trade flows are likely to be influenced by government legislation and trade laws. For example, the decision to relax the WTO quotas applying to Chinese textile exports into the USA and Europe on 1 January 2005 (with total abolition in 2008) has naturally led to a surge in Chinese textile imports.

Chart 13: Real merchandise trade growth by region (annual percentage change)



Source: WTO

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Regarding the question of an economic slowdown and its impact on SGS's growth profile, it is worth noting that the world trade has historically grown twice as fast as global GDP growth (i.e. at above 6% vs 3%). In addition, a slowdown in a specific region could be offset by another.

A more regulated world

The key driver of the industry is the global trend towards more regulatory restrictions, higher quality and greater safety, which again is leading to more testing and certification. All clients operate in an increasingly stringent regulatory environment. Quality, Health, Environment, Social Accountability (QHSE, SA) regulations and standards are not only becoming tougher and more complex in developed countries but also in emerging markets (derived from European or American standards).

Quality and safety are essential elements in any product. Testing that products comply with the broad spectrum of national and international standards in terms of quality, performance and regulations can help eliminate costly production errors. Moreover, changes in the seasons and fashion impose fast processes throughout the entire supply chain. Early detection of substandard materials and unreliable production avoids unexpected costs and delays and protects a company's brand.

In two specific fields there is an obvious general increasing need for safety and quality: food and environment.

Flight for quality and safety in food

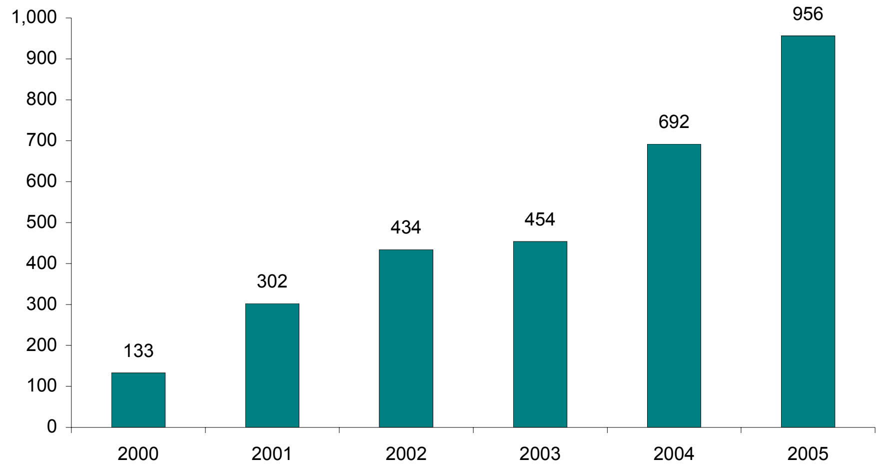
Food safety is a global concern. There is a growing demand from customers to know exactly what they eat, (i.e. the nature and origin of food products). The growing list of health crises (BSE, listeria, salmonella and avian flu) and recent developments in food production have led to more stringent quality regulations (ISO 22000, the only universal food safety management standard). Concerns about Genetically Modified Organisms (GMOs) have resulted in greater demand for identifying and tracing the origins of soya and maize.

The challenge is threefold: allaying consumers' fears; finding solutions to the public health problems resulting from a global food chain; and enabling food companies to avoid the economic and image-related fallout that inevitably accompany a health scare.

Past events have demonstrated that inadequate food controls can dramatically impact customers' day-to-day lives and turn around the fortunes of successful companies. Pressure from consumers, ecological associations and governmental bodies is now forcing the whole food supply chain (primary producers, catering establishments, restaurants, hotels, food producing companies, food transporting companies, retailers, food storing companies and animal feed manufacturers) to implement safer food management systems. Primary producers, processors, retailers and catering establishments now recognise the need for independent monitoring of their products, processes and services.

Demand for food tests is expected to continue to grow apace, as highlighted by the following chart, which shows the number of health alerts in the European Union in 2000-2005.

Chart 14: Health alerts in the European Union over 2000-2005



Source: EU, The Rapid Alter System for Food & Feed (RASFF)

Increased global environmental regulation

There are two main factors that are increasing the demands for industry and other bodies to comply with environmental requirements:

– the endorsement of new environmental regulations and the will of the authorities to enforce existing environmental regulations;

– the increasing global awareness about health and safety issues and about environmental and liability risks.

Environmental markets have room to grow further given the rise of outsourcing. Industrials are finding it increasingly difficult to maintain top-flight, in-house laboratories given the development of new analysis methods and lower detection thresholds. Controls on polluting products, which have been made necessary by tougher environmental laws, are generally outsourced to specialist labs. The same holds true for public agencies, which no longer hesitate to outsource analyses to private companies. For example, as regards chemical products, the implementation of the European directive REACH (Registration Evaluation Authorisation of Chemicals) between now and 2008 will require that manufacturers and importers provide regulatory authorities with analyses of the substances they use. This new law will significantly benefit testing laboratories such as SGS in the coming months and years.

There are numerous examples of authorities controlling the use of specific substances. These include restricted substance testing and services (RSTS) in conjunction with the RoHS directive (Restriction of Hazardous Substances). The July compliance deadline for this directive has created a significant upswing in volume in laboratories, especially in the electronics goods sectors. Another example is EU directives related to the environmentally-friendly disposal of electrical and electronic equipment waste.

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Outsourcing labs

Whatever the industry, the trend of outsourcing laboratories is accelerating on the back of customers increasingly focusing on core businesses, which is often the case in a competitive environment. Outsourcing lab management allows them to lower their costs and shorten their deadlines.

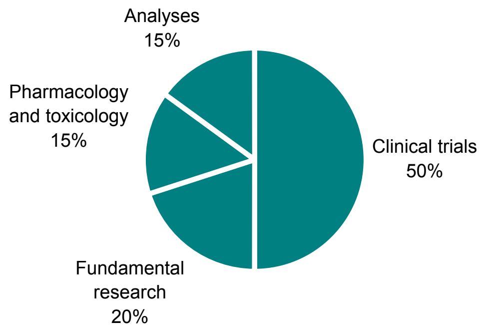
This trend has been especially obvious in the Oil, Gas & Chemical industries where the majors have chosen to enter outsourcing contracts with the sector specialists. Industry sources suggest that, for the time being, less than 10% of laboratory work is outsourced.

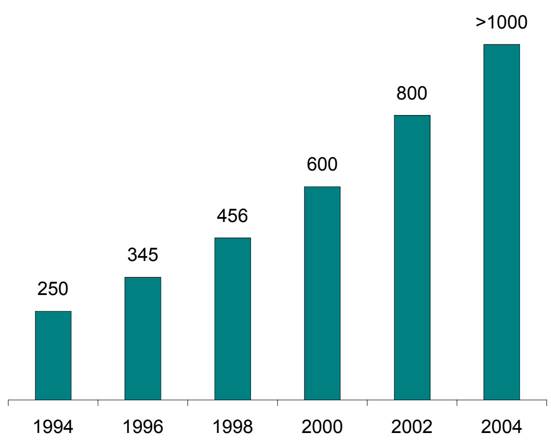
Customers in industrial services are also outsourcing inspections, project management and material testing in order to focus on core activities.

Outsourced services are also on the upswing in pharmaceutical testing. Companies in the sector believe it is a way of injecting flexibility into their cost structure and optimising the allocation of capital to product development and marketing. This has the effect of lowering unit costs as the volumes processed rise. Moreover, the creation of more specialised teams, thanks to the optimisation of the analytical process, should lead to an improvement in the overall quality of the analyses.

It is estimated that pharmaceutical companies outsource 20% of their R&D activities, i.e. a market of roughly USD10bn. Half of these services involve assuming control of clinical trials, while the remaining 50% are split between fundamental research (20%), pharmacology and toxicology (15%) and analyses (15%).

Chart 15: Outsourced testing market and outsourced R&D for pharmaceutical products (USDm)





Source: Eurofins Scientific, Exane BNP Paribas estimates

The bio-analytical services outsourcing market is worth an estimated CHF1.8bn (USD1.5bn). This market grew by some 15% pa on average between 1994 and 2004.

The favourable long term industry dynamics leads us to be relatively confident about the future of SGS’s development. We believe that the group's strong competitive market position, its large scale and its strong balance sheet leave it well placed to take advantage of the industry's secular growth.

Solid organic growth: visibility

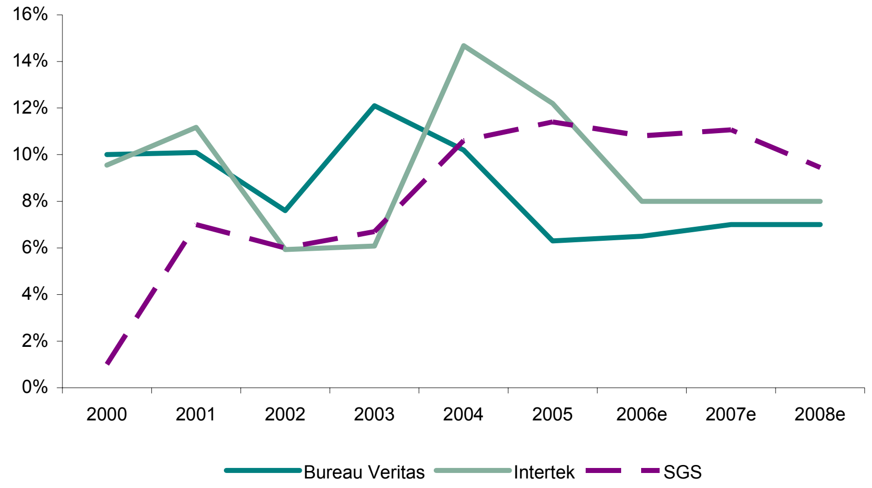
A new growth phase for SGS

Impressive organic growth over the past two years

SGS experienced erratic sales growth in 2000-2003, when it lagged its direct competitors Intertek and Bureau Veritas (which recorded high single or double-digit growth). However, in 2004 the group recorded impressive double-digit organic growth, highlighting a clear change in the trend.

This acceleration in organic sales growth is the result not only of positive market conditions over the past few years, but also of management's initiatives and investments (repositioning in higher growth markets and broadening of services offered and capacities with significant investments in its laboratory network).

Chart 16: 2000-2008e organic sales growth performance for the three global players



Source: Company, Exane BNP Paribas estimates

Having significantly invested in 2004 and 2005, the company now has spare capacity available to respond to the initial surge in volumes. This allowed it to capture market share and to narrow the gap on industry leaders.

The recent strong performance therefore reflects the combination of strong underlying growth in the markets addressed, market share gains, a wider range of services and geographic expansion. The combination would also justify organic sales growth of over 10%. This would compare to high single-digit growth at its direct peers (Intertek currently growing at 8% and Bureau Veritas at only 6% given a less favourable business mix with no exposure to commodities-related divisions).

FY06 will mark SGS's third year of strong organic growth (+10.8% estimated after 10.4% achieved in H1 06) and we feel comfortable that this growth rate is sustainable for the foreseeable future, as highlighted by our forecasts, which follow.

Table 16: SGS organic sales growth for 2002-2008e

%	FY02	FY03	FY04	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Agricultural Services	6.9	0.0	7.4	11.8	9.3	9.0	9.1	7.0	7.0
Mineral Services	1.2	4.8	16.0	17.1	18.1	15.0	16.4	12.0	10.0
Oil, Gas & Chemical Services	0.9	15.8	12.6	9.4	13.4	12.0	12.7	10.0	8.0
Life Science Services	9.7	(4.5)	(4.2)	15.5	(0.5)	2.0	0.7	12.0	11.0
Consumer Testing Services (CTS)	1.2	12.5	22.1	27.2	32.3	25.0	28.3	18.0	15.0
Systems & Services Certification	12.3	13.3	3.9	15.1	17.2	15.0	16.0	12.0	10.0
Industrial Services	11.0	3.4	15.1	12.5	12.7	12.5	12.6	11.0	8.0
Environmental Services	9.0	6.2	9.2	8.8	6.9	8.0	7.4	8.0	8.0
Automotive Services	28.4	(3.3)	(13.4)	(0.7)	3.3	4.0	3.6	7.0	6.0
Trade Assurance Services	(7.7)	5.5	17.0	(10.5)	(31.0)	(20.0)	(25.8)	3.0	5.0
Group revenues growth	**6.0**	**6.7**	**10.6**	**11.4**	**10.4**	**11.1**	**10.8**	**11.1**	**9.4**

Source: Company, Exane BNP Paribas estimates

Ambitious but realistic 2008 targets

At its H1 results publication in mid-July 2006, SGS reiterated its confidence in reaching its 2008 targets (first presented in November 2005), i.e. CHF5bn in sales, EBIT margin of 17% and EPS of CHF80. This was also confirmed at the end of November following the arrival of the new CEO, Chris Kirk.

Table 17: SGS 2008 targets

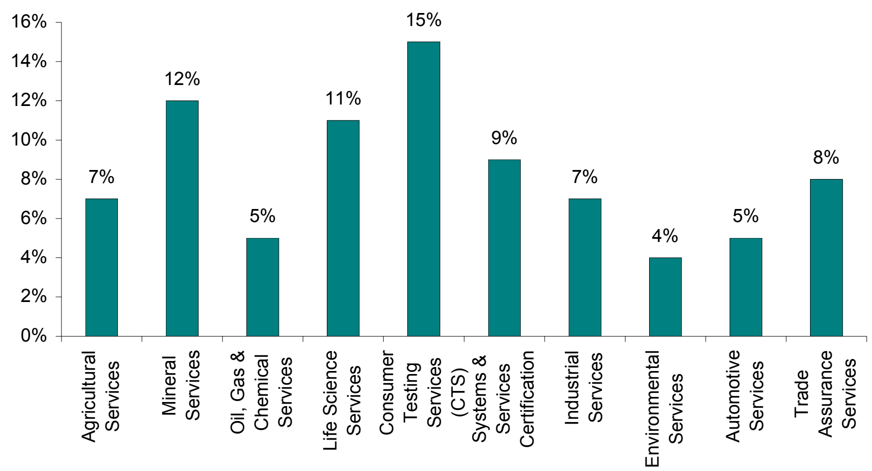
	2008 targets	2005 reported	2006-08e CAGR	Comments	Strategy
Revenue	CHF5bn	CHF3.3bn	15%	10% organic, 5% acquisitions (i.e. CHF500m)	Expand the service offerings and geographic footprint
Operating margin	17.0%	15.2%	60bp pa		Improve the operating system
Earnings per share	CHF80	CHF48.9	18%		

Source: Company, Exane BNP Paribas estimates

As shown in the preceding table, this implies a 15% top-line CAGR of which 10% organically and 5% externally. This also implies an annual 60bp improvement in margins and 18% EPS CAGR.

According to management, SGS' markets are forecast to grow at 8% on average over the coming years (based on its business mix), from +4% in the environmental services to +15% in the consumer testing business.

Chart 17: Market CAGR by segment



Source: Company, Exane BNP Paribas estimates

SGS's organic sales growth target implies that SGS will grow faster than the market as a whole. Based on the company's market growth estimate, SGS should deliver only around 8% organic sales growth. All else being equal, this leads to revenues of CHF4.2bn in 2008. To reach its double-digit target, the company will absolutely need to grow faster. It should be able to do this by broadening its range of new services (mainly turning to value-added services) and thus should be able to generate CHF4.5bn in revenues in 2008 by organic means alone. Finally, in order to reach the 2008 target of CHF5bn, SGS would have to grow by 5% externally pa.

Increasing the range of services further

Penetrating higher up the supply chain

Increasing upstream penetration is one of the key factors behind SGS's outperformance of the market during the past three years. Since 2004, SGS has launched a plethora of new services to boost demand in its mature, core activities (product, commodity or process inspection, testing and certification). This has included the development of additional up and downstream valued-added services throughout the value chain, such as quality assurance, risk management services, end-to-end traceability schemes, product consultancy, process assessment, training services or social accountability.

The services and product offering have been extended in all divisions and industries For example, new services in food safety and information management have been developed by the Systems & Certification division; the Industrial division has developed new services for the alternative energy market; the Oil, Gas & Chemicals division has introduced innovations in analytical testing and field measurement with gas-to-oil ratio determination, mercury detection and laser calibration; and the Agricultural division has added cotton inspection services.

SGS is more than a test lab

SGS can intervene at any level of the supply chain. It tests goods at each critical point, from farms to storage, transport and shipment, or extraction, production and packaging. The company thus creates greater clarity in all aspects of transactions from raw materials to finished products.

More importantly, SGS builds relationships at an early stage in the product lifecycle. For example, SGS assists the French retail giant Carrefour to source soya, from choosing the producer in Latin America (tracing the origins and analysing seeds for purity prior to sowing) through to storage, transport, inspection of shipments right up to the point where the product reaches the final customer. This sort of approach has significantly boosted SGS's top line.

The company has outlined plans to broaden its client base and service offering organically and thus to grow faster than the market. The following table details the main new services introduced by SGS in every market and sub-market. For example, in the declining pre-shipment inspection business, SGS has launched a number of innovative offerings, including TradeNet and ValuNet.

Table 18: SGS organic initiatives

Division	Organic growth plan 2006-2008e for the division
Agricultural Services	- Expansion of services in domestic markets (supply chain management, inland grading, lab testing) - Complement basic inspection services with processing, trading & compliance services (lab, quality control & storage management outsourcing for primary processors, trade execution outsourcing for traders, regulatory compliance assurance)
Mineral Services	- Introduce higher value and automated metallurgy services (ultratace analysis, automated sampling) - Introduce risk management (verification, collateral) - Expand MinnovEx capabilities globally
Oil, Gas & Chemical Services	- Upgrade network & laboratories in Middle East - Globalise plant & terminal operations - Introduce new testing offerings (mercury detection, allocation accounting, crude oil assay) - Expand laboratory upsourcing
Life Science Services	- Expand early stage clinical research presence in Europe - Establish QC and clinical research footprint in USA - Introduce biopharmaceutical & pharmacogenomic testing offering - Ramp up Asia laboratories - Strengthen worldwide sales & customer service capability
Consumer Testing Services (CTS)	- Diversify hard-line portfolio - Continue development in electronics (leverage new Asia capacity) - Leverage leadership in restricted substance testing (expand to cover emerging regulations) - Leverage capabilities for strategic account/segment revenue growth
Systems & Services Certification	- Introduce specific offerings and sales focus to specific strategic segments (automotive, food, medical, services) - Expand international sales force for global strategic accounts (automotive, food, medical, services) - Create new offerings (certification scoring product, six Sigma certification product) - Continue back room efficiency initiatives
Industrial Services	- Focus on energy & construction segments - Develop comprehensive asset integrity management services for oil & gas - Translate statutory inspection business from Germany/Spain to Eastern Europe - Penetrate China, India and expand in Middle East
Environmental Services	- Leverage SGS network to enter markets with emerging regulations (eastern Europe, South Africa) - Develop comprehensive analytic solutions for existing mining and oil& gas clients - Expand data management services to provide higher value - Continue networking laboratories for efficiency
Automotive Services	- Grow statutory vehicle inspections in mature & developing regions (private vehicles & public transportation) - Focus off-lease business in Europe - Develop blended offerings for automotive manufacturer
Trade Assurance Services	- Restructure Pre-Shipment Inspection (PSI) ahead of traditional market decline - Expand evolved PSI offering (TradeNet, ValuNet) - Continue growth of alternative government & private sector trade services (forestry, climate change monitoring)

Source: Company, Exane BNP Paribas estimates

By introducing new services further up the supply chain, SGS is building competitive barriers to entry. This also enables it to increase revenue per customer (often twofold) by being involved with the product at more points along the supply chain. This is also a key factor for margin expansion as, in addition to the operating leverage from higher volumes, the new services often deliver higher margins (they are sometimes three times as profitable).

Key new sub-segments

SGS recently identified niche markets that are set to grow and where it currently has little or no presence. This has allowed the company to make timely investments in management capabilities, lab infrastructure and expertise, and so be well positioned for capturing the bulk of the market growth.

Strategic growth initiatives include cross-functional services, bringing tailored offerings to under-served but growing strategic markets such as governments, energy infrastructure or financial services.

Table 19: Strategic markets for SGS

Segment	Market attractiveness	Needs	SGS's positioning
Governments & institutions	Government = biggest contributor to GDP, growing by 8% in 2005-2008e	Waste management	Consolidate dedicated government solutions marketing & sales team
	Governments mandate much of compliance & risk management market	Trade security & facilitation	Bundle TAS, statutory auto, environmental & new offering
	Trending towards privatisation, outsourcing & public-private partnerships	Environmental monitoring	Support with selected lobbying efforts
		Quality systems, biometrics Origin tracing	
Financial services	Basel II driving banks to increased risk management	Project financing & underwriting	Bundle industrial & trade inspection, asset integrity & collateral
	Similar trends for insurance underwriting	Trade financing (bankability inspection)	Management services
	In-house capabilities focused on actuarial assessment	Leasing (residual value assessment)	Develop dedicated offerings
Energy infrastructure	Oil pricing driving big infrastructure investments	Industrial supply chain inspection & construction support	Build/acquire local presence and laboratory footprint
	Shanghai Chemical Industry Park		Develop cross-sector sales team
	Middle East & Africa refineries	Process planning & simulation	Bundle know-how from portfolio & acquisitions
Software	Independent software QA/QC growing to USD17bn by 2009 from USD13bn	Functional and integration testing	Consolidate emerging players to build skill base
	60% of demand driven by users of mission critical software	Standards compliance	Develop dedicated go-to-market team
	Market evolving from testing to full life cycle QA	Risk analysis	Leverage industrial, financial and services channel from current portfolio
		Software process certification	

Source: Company, Exane BNP Paribas estimates

A focus on fast-growing segments

At the presentation of the company's three-year plan (2006-2008), management reaffirmed the focus on both organic and external developments and the external prospects for three of the ten divisions, namely, Consumer Testing Services, Life Science Services and Industrial Services, totalling 31% of group sales and 36% of operating profit.

Consumer Testing Services (CTS): the key growth driver

This division is the key to the group's ambitions for the top line and margins. It contributes 14% of group sales but 20% of EBITA, with margins that now far exceed 20%.

A wide service offering

With extensive lab coverage, Consumer Testing Services inspects a range of consumer products for retailers and manufacturers, including design, quality and safety (textiles, toys, footwear, hardware, household goods, electrical and electronic goods and food). Asian manufactured textiles and toys destined for western consumption are a major part of its business.

Early detection of poor product design, sub-standard material supply and production flaws avoids unexpected costs and helps protect a brand's image. SGS services help ensure that products comply with regulations, standards and contractual specifications and so avoid barriers that would otherwise hamper progress to the market.

Consumer Testing Services is active in four major areas, worth a combined CHF6bn.

Table 20: Four major areas in the consumer testing services division

	Softlines	Hardlines	Electricals and electronics	Food
Description	Textiles and apparel, home textiles Footwear, leather and rubber/ latex products	Toys and premium/gifts, houseware Hardware: DIY, hand and power tools, fasteners, lawn and garden Automotive parts, furniture, sporting goods	Luminaries, audio, video and automotive E&E Household and industrial products, IT, telecommunications	Animal origin, plant origin, beverages Bakery and meals
Market size	CHF1bn	CHF0.9bn	CHF2.3bn	CHF2bn
Market leader	Intertek (Labtest)	Bureau Veritas	UL	Eurofins Scientific
Other competitors	Bureau Veritas	Intertek (Labtest)	Intertek (ETL/SEMKO)	Silliker
SGS market ranking	Number 2	Number 3	Top 10	Number 3

Source: Company, Exane BNP Paribas estimates

SGS provides efficient support and risk protection along the entire food supply chain, using local food experts and laboratories. It covers raw, semi-manufactured foodstuffs and final products in all the principal food segments including animal origin food products (meat, seafood, dairy products), plant origin food products (fruit and vegetables) and bread, beverages and meals.

Strong recent dynamics and market share gains

SGS has benefited from a strong momentum in consumer testing in recent years. This has helped close the gap on industry leaders and lift market share to an estimated 10%, in line with the market leader Labtest/Intertek (12%) and far ahead of Bureau Veritas Consumer Products (6%).

Table 21: The two leaders in consumer testing

CHFm	SGS Consumer Testing Services	Intertek Labtest/ETL Semko
2005 sales	476.2	673.0
Organic growth (%)	27.2	10.6
EBITA	102.1	157
EBITA margin (%)	21.4	23.3

Source: Company, Exane BNP Paribas estimates

The division's margin has expanded over the past four years, driven by strong organic sales growth and an improving business mix, with a shift towards more testing rather than inspection. This reflects early and substantial investments in management capabilities, technical infrastructure and competencies over the past two to three years whereas competitors such as Intertek have been cautious in terms of investments.

SGS has not only invested significant amounts in new lab infrastructure, especially in the Asia-Pacific region, but it has also built up expanded sales teams in key markets such as the USA and Europe (business in Asia has to be won at retailer level). This has enabled SGS to gain market traction with significant contracts wins.

We think that the group is now well placed to consolidate its position. It is planning to take the position of market leader from Intertek by 2008, on the back of both organic and external developments.

SGS has already significantly invested and thus is ready to respond to the initial surge in volume. This has given the group a clear advantage over less well prepared competitors and allowed it to capture market share and narrow the gap on market leader Intertek Labtest. SGS clearly needs to keep capacity for the spot business in order to absorb strong increases in demand, for example as a result of changes in regulations (e.g. Chinese textile quotas) or market trends.

SGS is thus winning market share in fast growing segments such as restricted substances testing and services (across all product categories), textiles testing (with new laboratories in India, China or Turkey) or electronic and electronic communications/software (3G, GSM and Bluetooth). In contrast, Intertek's market shares are generally flat or even shrinking.

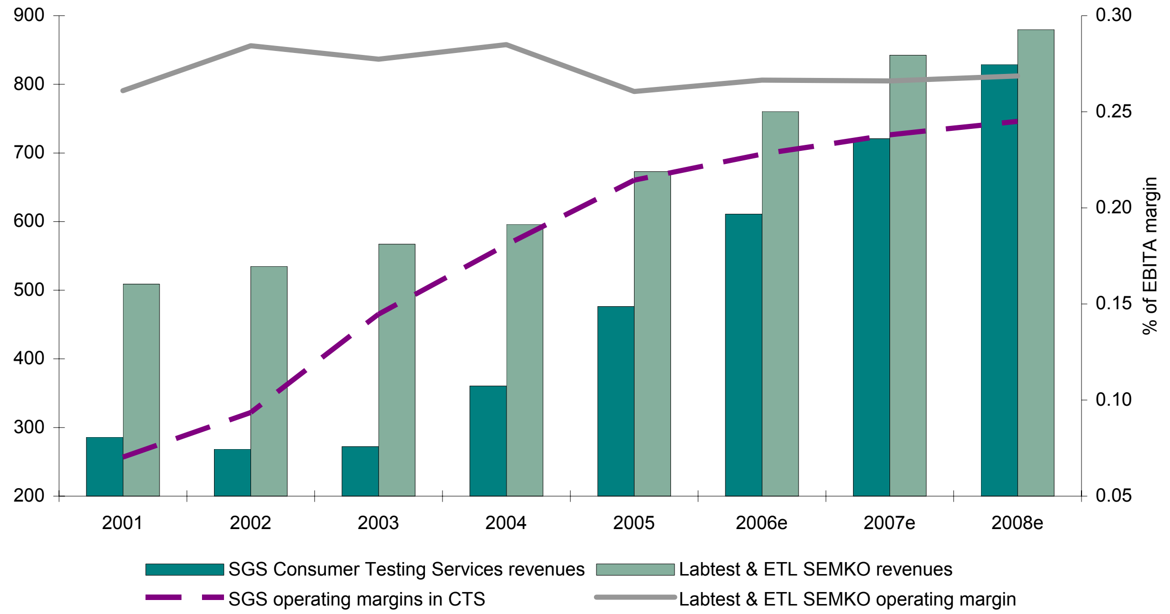
Asia the growth driver

Asia contributes more than 60% of the Consumer Testing Services division's sales (China, Hong Kong and India alone account for over 50%), and, we suspect, much more at the operating level. With about 3,000 employees (7% of the group total) and more than 50 laboratories, the group has clearly put the focus on expansion in Asia, which is still an El Dorado given the flow of product production or sourcing in lower-cost countries.

SGS enjoys good growth across all activities and especially for high-tech electronics testing, environmental & social responsibility components.

Despite an impressive catch-up in terms of both revenues and margins, SGS still lags Intertek in terms of profitability.

Chart 18: Consumer testing: SGS vs Intertek (revenues in CHFm)



Source: Company, Exane BNP Paribas estimates

Labtest boast margins of around 30%, or 10% above SGS's. There are two main explanations: Labtest has greater exposure to Asia (around 80% of divisional sales, being the leader) and is more focused on testing.

That said Labtest's margins are not totally comparable to the margin at the Consumer Testing Services division. They would be more so if we were to add the contribution of the Electrical & Electrics (E&E) segment, which is included in ETL SEMKO at Labtest, whereas SGS has its E&E segment within the consumer testing division. On this basis, Labtest has an adjusted margin above 25% in 2006e (see the following table).

Table 22: Margins for Intertek's Labtest & ETL SEMKO divisions

%	2001	2002	2003	2004	2005	2006e	2007e	2008e
Labtest operating margins	31.5	33.5	32.7	34.0	31.4	32.2	32.2	32.2
ETL SEMKO operating margin	13.1	13.4	12.7	14.3	15.2	15.5	15.7	15.6
Labtest + ETL SEMKO margins	26.1	28.4	27.7	28.5	26.1	26.6	26.6	26.9

Source: Company, Exane BNP Paribas estimates

Going forward, we anticipate continued strong momentum thanks to positive industry dynamics and the company's positioning. We expect SGS to maintain a strong top line over the next two years, with margin rising to around 24%, further closing the gap on Intertek, by bringing more volumes to each individual lab.

By mid 2007, SGS will feel the benefit of the implementation of the European directive REACH (Registration Evaluation Authorisation of Chemicals) which requires manufacturers and importers to provide regulatory authorities with analyses of the chemical substances they use. The positive impact is difficult to assess but this should be obviously positive for the CTS division.

Table 23: CTS, revenue and EBITA (2005-2008e)

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Revenue	**262**	**476.2**	**283.4**	**327.5**	**610.9**	**807.7**	**998.7**
Overall growth (%)	34.4	32.1	32.3	25.0	28.3	32.2	23.6
Organic (%)	**28.0**	**27.2**	**32.3**	**25.0**	**28.3**	**18.0**	**15.0**
Acquisitions (%)		3.8	0.0	0.0	0.0	14.1	8.6
Forex (%)		1.0	0.0	0.0	0.0	0.0	0.0
EBITA	**56.5**	**102.1**	**64.6**	**74.7**	**139.3**	**189.8**	**244.7**
Growth (%)	53.1	56.6	39.2	34.1	36.4	36.3	28.9
EBITA margin (%)	21.6	21.4	22.8	22.8	22.8	23.5	24.5

Source: Company, Exane BNP Paribas estimates

Obviously, China and other Asian countries (Korea, India, Taiwan) will continue to be the main drivers of the division's growth and margins as investments come on line and laboratory utilisation rates rise. The underlying growth drivers remain strong for the coming years (range, increased quality and safety, continued migration to low-cost countries leading to increased demand for testing, verification and certification).

Life Science Services: critical size/mass to acquire

Life Science Services (4% of sales and operating profit) provides services for drug development from pre-clinical studies to post approval testing (recruitment of volunteers, study report and sample preparation). The quality control business provides quality assurance services and safety testing.

The underlying trends are very strong with growth estimated at 15%, helped by a good performance in quality control testing and clinical research operations.

This is a key division for SGS's future development with a focus on increased early-stage research and quality control services.

The company has made significant investments in new labs (in Singapore, Hong Kong, Korea, India) offering new strong capacities and leverage and has recently progressed in its development with the first international master agreement for quality control services with a top five pharmaceutical company.

SGS is aiming to build up its presence among pharma research laboratories, one of the most important segments of the analysis and testing market, by local or regional acquisitions.

Of the six acquisitions carried out since the beginning of 2006, two were made to strengthen the company's capabilities as a contract research organisation (CRO) providing outsourced R&D services for clinical and pre-clinical trials related to new molecules.

With the recent acquisition of AsterCephac, a French provider of early clinical drug trials, SGS has transformed the Life Science Services division from a single clinic and lab operation in Belgium to a multi-clinic/lab operator with one of the largest capacities in Europe for early stage clinical research trials and bio-analytical testing.

Investments (lab start-up costs in Asia) and acquisition-related restructuring and integration costs trimmed 190bp from the division's margin in H1 06. However, we expect the trend to reverse slightly in H2 06 helped by productivity gains in North American and European laboratories and strong leverage from recent investments, meaning full-year margin erosion will be weaker than in H1 06 (-90bp at 14.3%).

We expect a recovery in organic sales growth as a result of better critical mass and cross-selling opportunities in the network. Double digit growth seems achievable in 2007 and 2008, especially compared to the expected 15% market growth rate.

Table 24: Life Science Services, revenue and EBITA (2005-2008e)

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Revenue	**63.3**	**125.3**	**94.0**	**96.2**	**190.2**	**294**	**390**
Overall growth (%)	13.8	17.7	51.6	52.0	51.8	54.6	32.9
Organic (%)	**13.2**	**15.5**	**(0.5)**	**2.0**	**0.7**	**12.0**	**11.0**
Acquisition (%)		1.0	50.7	50.0	50.3	42.6	21.9
Forex (%)		1.1	1.4	0.0	0.7	0.0	0.0
EBITA	**10.4**	**19.1**	**11.4**	**15.9**	**27.3**	**47.0**	**64.5**
Growth (%)	46.5	49.2	29.5	54.1	42.8	72.5	37
EBITA margin (%)	**16.4**	**15.2**	**12.1**	**16.5**	**14.3**	**16.0**	**16.5**

Source: Company, Exane BNP Paribas estimates

Industrial Services: building on local leadership

The industrial services division (13% of sales and 12% of operating profit), covers all types of services related to quality, safety and conformity for industry clients in sectors such as manufacturing, construction, power generation, oil & gas.

The division is the third area of focus identified by SGS and is also one of the largest of the group's ten business lines. SGS has local leadership in selective/specific services or areas in this very fragmented market, where industrial inspection and testing is dominated by local players. The company is, however, still far behind the global leaders Bureau Veritas or TÜV. We expect acquisitions in the near future.

Growth (+5-7% pa) is linked to the overall economic cycle and is fuelled by further delocalisation of supply chain to Asia, Middle East and eastern Europe, high construction growth in emerging countries (Asia, Middle East, eastern Europe) and rising energy prices.

In our view, the group is well positioned to serve the market in large scale public infrastructure projects coming onstream in Asia, energy infrastructure (Russia, Africa, and Middle East) and alternative energy. The recently introduced range of new services and the geographic exposure should provide extra growth.

Table 25: Industrial Services, revenue and EBITA (2005-2008e)

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Revenue	**235.3**	**444.7**	**240.2**	**264.7**	**504.9**	**642.2**	**760.3.**
Overall growth (%)	19.1	17.1	14.7	12.5	13.5	27.2	18.4
Organic (%)	**12.8**	**12.5**	**12.7**	**12.5**	**12.6**	**11.0**	**8.0**
Acquisition (%)		3.4	0.1	0.0	0.0	16.1	10.4
Forex (%)		1.2	1.9	1.0	0.9	0.0	0.0
EBITA	**31.3**	**58.6**	**31.5**	**36.0**	**67.5**	**87.3**	**104.2**
Growth (%)	23.2	27.1	14.5	15.8	15.2	29.4	19.3
EBITA margin (%)	**13.3**	**13.2**	**13.1**	**13.6**	**13.4**	**13.6**	**13.7**

Source: Company, Exane BNP Paribas estimates

Systems Certification: growing industry-specific certifications vs mature traditional ones

SGS is the leader in the very fragmented management systems and services certification market, which is worth around CHF3bn. It represents 8% of group sales and 10% of group profit. With approximately 11% market share, thanks to early investments over the past 20 years, it is ahead of Bureau Veritas (around 9%). The group provides auditing and certification services for compliance with general standards (essentially ISO) and also more recently with industry specific standards spanning a wide range of industries in the world (70 countries). The company also offers value-added products such as integrated management systems, sustainable development reporting, corporate responsibility verification and training. The certificates awarded by SGS are recognised worldwide.

Following decades of strong growth, the market has matured: in developed countries traditional third-party certification (ISO 9000-9001 standards) is giving way to industry-specific certification and customer driven audit programmes.

There is encouraging demand in customised audit solutions for large multinational enterprises and industry specific certification schemes such as ISO 22000 (food security), ISO 14000 (environment), TS 16949 (automotive), AS 9100 (aerospace), ISO13485 (medical devices).

This shift has been under way in Western Europe and North America since 2003 and is starting to emerge in developing countries such as East Asia, Eastern Europe and South East Asia. China is migrating towards an industry specific programme as manufacturing and service industries mature in their role in the global supply chain. The traditional schemes (ISO9000-9001) are thus losing a little bit of momentum.

Recent performances have been very strong (high double-digit growth and margin improvements). We expect momentum to remain strong, albeit slightly slower (+10-12%), mainly driven by developing markets (China, eastern European countries) and sector-specific certifications. All in all, we expect a 2006-2008e CAGR for organic sales of around 13%.

Table 26: Systems certification, revenue and EBITA (2005-2008e)

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Revenue	**147**	**274**	**151.4**	**169.1**	**320.4**	**358.9**	**394.8**
Overall growth (%)	21.3	16.4	19.2	15.0	16.9	12.0	10.0
Organic (%)	**17.1**	**15.1**	**17.2**	**15.0**	**16.0**	**12.0**	**10.0**
Acquisition (%)		0.0	0.0	0.0	0.0	0.0	0.0
Forex (%)		1.3	2.0	0.0	0.9	0.0	0.0
EBITA	**26.8**	**46.5**	**27.7**	**31.3**	**59.0**	**66.6**	**73.6**
Growth (%)	62.4	52.5	35.8	19.8	26.8	12.9	10.6
EBITA margin (%)	**18.2**	**17.0**	**18.3**	**18.5**	**18.4**	**18.6**	**18.7**

Source: Company, Exane BNP Paribas estimates

Strong momentum for commodity-related divisions

Oil & Gas benefiting from high oil prices

The Oil, Gas & Chemicals division has a worldwide network of over 130 laboratories and offices (partly on-site). It is the group's largest business unit, contributing 19% of group sales and 16% of EBIT. The division is well positioned to benefit from rising oil prices and the ongoing volatility in inventory levels and is market leader with around 30% of the market.

Since 2003, growth in the industry has been driven by high and volatile oil prices and production capacity increases, mainly in Asia and Middle East.

Indeed, developments in the oil industry have lead to more exploration activity, thus implying more testing and inspection services. The capex spent on exploration, development and production has clearly risen significantly over the recent years, bolstered by the decline of excess oil production capacity.

In addition, a certain part of inspection contracts of SGS (about 20%) depend on revenues proportional to the contract value, so higher oil prices imply higher sales. Moreover, the volatility of oil prices leads to more transactions (the same shipload changing hands several times). Finally, there is a rising trend towards outsourcing to laboratories as exploration activity is rising.

On the back of this strong demand, SGS has recently invested in oil and gas testing capacity in China. This translates into clear top line and margin acceleration (which should be the case in 2006) and market share gains (by winning laboratory contracts from major oil and chemical companies) from main players within the industry (Caleb Brett, a division of Intertek, UK based BSI (Inspectorate) and Saybolt, a subsidiary of US Core Laboratories).

We remain positive about the division's prospects: growth should remain solid (high single digits after strong double digits), supported by favourable underlying markets as well as new environmental regulations regarding fuels and the increased upstream and downstream penetration of its services within the oil industry.

Table 27: Oil, Gas & Chemical services, revenue and EBITA (2005-2008e)

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Revenue	**333.3**	**635.3**	**374.3**	**386.5**	**760.8.**	**849.1**	**903.8**
Overall growth (%)	14.1	10.6	22.4	17.3	19.8	11.6	8.0
Organic (%)	**9.9**	**9.4**	**13.4**	**12.0**	**12.7**	**10.0**	**8.0**
Acquisition (%)		0.3	5.0	5.3	5.2	1.6	0.0
Forex (%)		0.8	4.0	0.0	1.9	0.0	0.0
EBITA	**42.5**	**79.4**	**51.9**	**50.6**	**102.5**	**115.9**	**126.5**
Growth (%)	19.7	15.7	30.7	27.5	29.1	13.0	9.2
EBITA margin (%)	**12.8**	**12.5**	**13.9**	**13.1**	**13.5**	**13.8**	**14.0**

Source: Company, Exane BNP Paribas estimates

Minerals helped by rocketing commodities prices

SGS Minerals (12% of group sales, 13% of EBIT) is the market leader with over 50 laboratories and around 40% market share, worth CHF1.3bn. The division offers a wide range of risk management and outsourcing services to clients concerned with value chains associated with coal and coke, fertilisers, non-ferrous and precious metals and raw materials for the steel industry.

The underlying market trends are positive, helped by favourable cyclical factors. Once again, greater exploration spending is driven by higher commodities prices, and lead to higher testing and inspection. This bodes well for SGS' Minerals activities.

The recent strong performances have been driven by rising mineral markets and fluctuations in prices over the past few years. The company's focus on energy minerals, precious metals and non ferrous metals explains the swing in margins. For the coming years, we believe that double-digit growth sales growth is achievable but with margins stable at around the 16.7% level (despite the increased contribution of value-added services such as collateral management or consulting services) as we now believe that upside is rather limited with divisional margins close to the group's target of 17.0%.

Table 28: Mineral services, revenue and EBITA (2005-2008e)

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Revenue	**216.9**	**393.7**	**225.3**	**253.7**	**479.0**	**536.4**	**590.1**
Overall growth (%)	28.5	23.2	30.1	15.0	21.7	12.0	10.0
Organic (%)	**15.4**	**17.1**	**18.1**	**15.0**	**16.4**	**12.0**	**10.0**
Acquisition (%)		3.3	6.5	0.0	3.0	0.0	0.0
Forex (%)		2.8	5.5	0.0	2.5	0.0	0.0
EBITA	**35.9**	**63.1**	**37.6**	**42.6**	**80.2**	**89.5**	**98.5**
Growth (%)%	42.5	36.3	41.4	16.8	27.1	11.2	10.1
EBITA margin (%)	**16.6**	**16.0**	**16.7**	**16.8**	**16.7**	**16.7**	**16.7**

Source: Company, Exane BNP Paribas estimates

Putting an economic slowdown into context

Regarding the question of economic slowdown and its impact on SGS's growth, it is worth looking in more depth at the degree of cyclicality of the group.

Bears will argue that a possible economic slowdown will restrict the company's growth. The main risk of a slower economy in the USA (and subsequently worldwide) is not nil but we believe that if it were to occur, the fallout would be less severe than some fear. We believe that the group should prove to be more resilient than in the past following a successful diversification of its revenue profile (with new services and new areas).

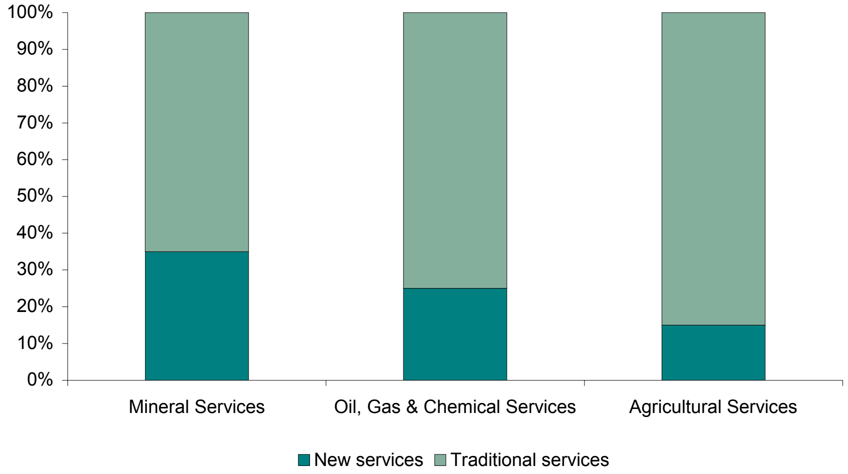
Looking at the SGS's revenue breakdown, there is evidence that a sharp slowdown would affect some divisions. The hardest hit would be the Consumer Testing, which accounts for 14% of revenues and 20% of EBIT. In addition, about 30% of the SGS's revenues are related to commodities (oil, gas, chemicals and minerals - excluding agriculture, which is seen as defensive), and would be at risk if prices were to decline or demand to slow down. However, the other segments (Environment, Automotive) are less sensitive to the economy.

At first glance, a downturn in the global economy would imply reduced trade flow. Note, however, that the world trade has historically grown twice faster than the world GDP growth (i.e. at over 6% vs 3%). Moreover, a slowdown in one region could be offset by growth in another.

More importantly, since 2004, SGS has launched a plethora of new services to boost demand in its mature, core activities (product, commodity or process inspection, testing and certification). These have included the development of additional up and downstream valued-added services throughout the value chain, which often have links to an earlier stage in the product lifecycle. This made SGS less cyclical and sensitive to trade flow, i.e. a decrease in volumes.

The following chart depicts the breakdown of the contribution to divisional sales of the new services and traditional (and thus more cyclical) services. At the moment, these new services have been concentrated in Mineral, Oil, Gas & Chemicals and Agriculture services, but they should be extrapolated to other divisions in the coming years.

Chart 19: Breakdown of the contribution to divisional sales of new services vs traditional services



Source: Company, Exane BNP Paribas estimates

Finally, it is worth noting an increasing trend towards long-term contracts in many sectors (traceability related, outsourced labs), thus making a relatively significant part of SGS's business recurrent and more visible by nature. This is the case in the Oil, Gas & Chemicals, Mineral services and Life Science divisions. In addition, other divisions, such as Systems & Services Certification, Automotive services and Trade Assurance Services (representing circa 20% of group revenues and profit), are based on long-term contracts, most of them with high retention rates (the retention rate for certification is 97%). All in all, we estimate that approximately half of the group's revenues are more or less recurring.

In conclusion, we firmly believe that the group's successful diversification of its revenue profile should help protect it from any fallout from an economic slowdown.

External growth clearly on the agenda

There is strong evidence that SGS will play a significant role in sector consolidation in the coming years. The market is highly fragmented, management has a strong track record for making accretive acquisitions, the company has the necessary financial strength (positive net cash position) and ambitious revenue growth targets for end-2008. Moreover, management has been more proactive lately (with the arrival of a new CEO Chris Kirk, replacing Dan Kerpelman) and recently reiterated that it would be pursuing an aggressive M&A strategy.

We think that M&A potential is likely to underpin further upward earnings revisions in coming quarters. For the time being, the consensus does not envisage such a scenario.

A highly fragmented market

Whatever the segment, the overall industry is still highly fragmented with the bulk of companies positioned on local markets, offering a limited range of services. The degree of fragmentation differs from one segment to another. There is not a lot of available data but we estimate that less than a third of the total market is outsourced. In addition, the three main players control no more than 30% of this total outsourced market.

The fragmented inspection and testing services sector will thus inevitably see a rising number of mergers and acquisitions in the coming years.

The market is ripe for continued consolidation

All major players within the sector (SGS, Bureau Veritas, Intertek) highlight significant potential for small and mid-sized acquisitions and their intent to play an active role in the consolidation process. SGS is targeting annual external growth of 5% for the next three years. Bureau Veritas expects a two-fold increase in sales during the 2005-2009e period, implying growth of around 15% pa (of which half would come from organic growth). In 2005, the French company acquired EUR150m of revenues with over ten acquisitions, mainly industrial services. Intertek, in its H1 results release on 4 September 2006, said it will participate in consolidation through friendly deals and that it has a very good pipeline for more acquisitions.

Still many laboratories to be acquired

There is a large number of potential targets in every sector in which the group operates. According to both the ISO (International Organisation for Standardisation), and ILAC (International Laboratory Accreditation Cooperation), there are at least 25,000 accredited laboratories worldwide. In addition, there are labs which are not accredited, most of which are small, specialised and private.

In the food and environment segments, the market offers many consolidation opportunities. Apart from France-based Eurofins Scientific (sales of EUR233m in the food, environment and pharmaceuticals industry), Anglo-Dutch group ALcontrol (sales of EUR130m) and US group Silliker (bioMérieux Alliance, sales of USD155m), most of the competition in food and environment comes from niche players and in-house labs (customers wishing to focus on their core businesses), which are potential targets.

SGS says it might be interested in Eurofins' portfolio. However, to date, there has been no indication that Eurofins Scientific is for sale. The company is controlled by the Martin family, which holds 49% of the capital but 66% of the voting rights.

In the pharmaceutical industry, the CRO business is relatively structured. The top ten players - essentially based in North America (Covance, Quintiles) - control 60% of the market. There are smaller players, however, which specialise in a specific region and/or niche. We are convinced that there is a long list of laboratories, mainly in North America, which could be on SGS's radar screen.

Table 29: The top ten CRO by sales

Company	Country	2005 revenues (USDm)
Covance	USA	1,192
Charles River Laboratories	USA	1,122
Quintiles Transnational	USA	1,121
PPD	USA	922
MDS Inc.	Canada	484
Parexel	USA	375
SFBC International	USA	335
ICON	Ireland	327
Kendle	USA	202
Omnicare	USA	184

Source: Companies

Strong firepower for gaining network density

SGS, a cash machine

At the end of June 2006, SGS had a positive net cash position of about CHF50m, which is substantially lower than the CHF430m at the end of 2005, due to management's decision to return the bulk of cash not used in acquisitions to shareholders (2005 was not a big acquisition year). Shareholders received CHF50 per share through a nominal capital reduction of CHF19 and a CHF31m dividend. We estimate net cash at circa CHF250m by end-2006.

We estimate that SGS can generate FCF of CHF500m pa on average in the 2006-08e period. This high cash generation (11% of sales) is due to its high profitability (EBITDA margin of 20%), low tax rate (24.5%) and its relatively low capital intensity (capex of 6% of sales). This abundant FCF could finance small- or medium-sized fill-in acquisitions. In addition, we do not expect any re-leveraging of the balance sheet, unless there were to be a big acquisition, which is unlikely in the short term.

A track record in accretive bolt-on acquisitions

Acquisitions are a key element of SGS's strategy to improve its network and its profitability. Small infill acquisitions provide strong leverage by expanding capabilities, accelerating geographical coverage and achieving critical mass in specific areas.

SGS's targets would:

- imply EBIT multiples within historical norms.
- enhance the business segment's operating margin within 12 months.

SGS has a good track record in making small infill acquisitions, enlarging its network business (density-build), adding new expertise and creating value (minimum high teens return required). SGS generally buys small companies that can be quickly integrated and with limited risks. The idea is to leverage services acquired in other geographical areas through the group's large office network. Thus, SGS acquires know-how which is rolled out through the network (for example, the service range on food product benefits from Fresenius). The likely small (or medium) size of future acquisitions limits execution and integration risks.

Although SGS did not meet its 2005 corporate activity target (about CHF70m of revenues from acquisitions), it has been more active in 2006, making eight small infill acquisitions. Two of these acquisitions were in Life Science, three in the Oil, Gas & Chemicals, one in Environment services and two in Consumer Testing (focusing on telecoms. SGS paid a total of approximately CHF255m for these companies, giving an average transaction multiple of 1.7x revenues.

Over the past five years, acquisitions in the industry have been made at multiples in the range of 0.8-1.2x revenues, but recent inflation has lifted these multiples closer to 1.3-1.5x or higher. Although this reflects higher EBIT margins for businesses acquired, as well as a focus on more expensive segments such as Life Science (where average multiples exceed 2x sales in many cases, as shown with AsterCephac, but remain at around 10x EV/EBIT), it also shows some inflation of the price multiple. The table below outlines the acquisitions made in the past 36 months.

Table 30: List of acquisitions made by SGS over the 3 years

Date	Acquisition	Division	Segment- Details	Country	Employees	Price	Sales (CHFm)	Margin (%)	P/Sales (es.)
Nov. 06	Wireless Test Systems Inc.	Consumer Testing Services	Leader in CDMA testing services (develop automated tests and verification software products for the wireless market	USA	21	12.6	8.4	c.20	1.5
Nov. 06	SRS Tech Co.	Oil, Gas & Chemicals	Global leader in leak testing of Liquefied Natural Gas vessels & provider of Non Destructive Testing services to the petrochemical sector	South Korea	120	19.5	13	c.20	1.5
Aug. 06	McMurray Resources Research and Testing Ltd	Environmental Services/OGC	Provider of materials testing, environmental services and geological services / Industry leader in bitumen yield determination	Canada	NA	14	9		1.6
Aug. 06	7 Layers UK	Consumer Testing Services	Third party test services for designers and manufacturers of wireless communication products	UK	43	20	14		1.4
Mar. 06	Laroute SA	Oil, Gas & Chemicals	Major provider of additives treatment services to the oil industry	Switzerland	80	45	28		1.6
Mar. 06	Cotax AS	Oil, Gas & Chemicals	Norwegian laboratory testing and analysis serving the oil and gas industry	Norway	18	3	2		1.6
Feb. 06	Northview Sciences	Life Science	Life science laboratory services provider in North America	US	100	27	13		2.1
Jan. 06	aster.cephac	Life Science	Full service provider of early clinical pharmacology trials	France	330	116	55		2.1
Aug. 05	Paradigm Analytical Laboratories Inc.	Environmental Services					8		
Aug. 05	Casco Australia Pty Ltd	Agricultural services	Coal, agriculture feed, food and environment	Australia	120		10		
Aug. 05	MinnovEX Technologies Inc.	Mineral services	Metallurgical technologies	Canada	50		11		
Aug. 05	Groupe Auto Sécurité	Automotive Services	Statutory Vehicle Inspection	France			15		
Aug. 05	Auto Marine Services Ltd.	Automotive Services					NA		
Feb. 05	X-Per-X Inc	Mineral services	Metallic and electrical product	Canada	128		15		
Jan. 05	Aquatic Health Chile SA	Agricultural services	Salmon producing sector	Chile	81		NA		
July 04	Securitest and Aco Sécurité	Automotive Services	Third largest network of franchises in France (880 centres)	France	200		24	c.15	1.0
May 04	Petroleum Service Corporation	Oil, Gas & Chemicals	Largest barge tankerman service in the USA	US	800		75	c.13	
Mar. 04	Institut Fresenius	Life Science/Food/ Consumer	German market leading Institut Fresenius	Germany	1,600		85	c.13	1.2
Feb. 04	Vernolab	Oil, Gas & Chemicals	European leader for the analyses of lubricants in service and fuels	France	90		13	c.14	
Dec. 03	Medisearch International	Life Science	Service clinical trial research (CRO)	Belgium	200		28	c.14	1.0

Source: Company, Exane BNP Paribas estimates

SGS's acquisition plan

Focus on three key segments

As we mentioned earlier, SGS management has clearly identified the areas/segments where it has ambitions for growth. Segments earmarked for expansion include Life Science, Industrial and Consumer Testing. In Consumer Testing, the aim will be to close the gap on the leader Intertek (Labtest). In industrial services, the objective is to grow positions in niche markets and specific segments locally or regionally. In addition, the group should be active in niche segments such as energy infrastructure and also in environmental services.

Table 31: Segment focus for future acquisitions

Segment	Details
Life Science	Expand QC presence in the USA, expand clinical research presence in both Europe and USA
Industrial Services	Targeted regional acquisitions for market positions
Consumer Services	Strengthen E&E, enter personal care in the USA & Europe
Oil, Gas & Chemical Services	Targeted lab expansion
Environmental Services	Targeted lab expansion
Energy infrastructure	Targeted local labs
Software	Independent QA/AC businesses

Source: Company, Exane BNP Paribas estimates

External growth target of 5% pa for 2006-08e

SGS has targeted annual external growth of 5% through 2008 (to reach EUR5bn sales at this date). Therefore, SGS would need to acquire total additional annual revenues of about CHF500m over the 2006-2008e period (of which approximately CHF145m was already bought in 2006).

Based on an average multiple of 1.7x sales, we estimate the total cost at CHF850m, of which CHF255m has already been spent in 2006.

Table 32: Acquisition scenarios for SGS to reach 2008 targets

Assumptions	Amount of revenues (CHFm)		
2006-2008e	500	5% pa	
of which 2006e	145		
of which 2007e	200		
of which 2008e	150		
Segment	**2006e**	**2007e**	**2008e**
Life Science Services	68	67	50
Consumer Testing Services	22	67	50
Industrial Services	-	67	50
Other (energy)	55		
Total (CHFm)	145	200	150
% of additional sales	4	6	5
Revenues acquired	145	200	150
Price paid (1.7x on average)	255	340	255
Total price paid in 2006-08e			850

Source: Company, Exane BNP Paribas estimates

There has been some price inflation in recent transactions. There is, therefore, a risk that it will become increasingly difficult to create value, especially for medium-size acquisitions. A good illustration is the acquisition of AsterCephac (a provider of early clinical pharmacology trials). Acquired at 2x sales, it will be difficult to turn it into an accretive deal within 12 months, as is usually the case and management recognises this. However note that the acquisition is marginal at the group level in terms of margin dilution and it seems that this is the only single failure from the recent acquisitions flows.

We assume an average transaction multiple of 1.7x EV/Sales and apply an EBITA margin after one year of 15%, i.e. 11x normalised EBITA. This increase in the average transaction price reflects the shift in the company's offer towards services for the pharma industry (CRO), where transaction multiples are far higher than the 1.2-1.5x sales seen in the other testing segments.

A potential big M&A deal?

There has been recent renewed speculation about a SGS's potential interest for one of its large rivals, UK-based Intertek Group plc and privately held French Bureau Veritas. This was fuelled by SGS's Chairman Sergio Marchionne, who recognises that the group could make a large deal and takes an interest in some competitors, especially Bureau Veritas.

That said, we do not think that such deal is likely in the short term, given that Bureau Veritas is not (yet) for sale. Moreover, management clearly denied recent speculation on this subject. Meanwhile, Intertek's CEO also recently denied that his company could be a target for a takeover (although the company's free float is 100%) and reaffirmed, on the contrary, that it plans to play an active role in sector consolidation. Note that, if either of these companies were to be purchased, it would most likely occur under a friendly deal.

A more likely interest for Bureau Veritas

Of the two competitors, there is evidence that SGS may be more interested in Bureau Veritas than in Intertek.

Bureau Veritas, the number two player (EUR1,647m of revenues in 2005, i.e. 30% smaller than SGS from a revenue perspective), is currently owned by Wendel Investissement. Over the past three years, Wendel has progressively increased its stake in Bureau Veritas and now owns 99% of its capital. There is evidence that Wendel is not yet ready to sell this key asset (alongside stakes such as Oranje Nassau, Editis, Stallergenes or Legrand), but a disposal cannot be ruled out in the foreseeable future, depending on the price.

A merger with Bureau Veritas, a perfect fit

From an industrial perspective, combining SGS with Bureau Veritas makes sense. It would generate significant revenues synergies as there would be a considerable and obvious fit in terms of geography and products. All in all, this would enable SGS to significantly enlarge its portfolio of activities and customers. Indeed, each company has strong and specific leading positions. SGS is number one in Agriculture, Minerals and Oil, Gas & Chemicals (combined, these divisions represent more than 40% of group sales) while Bureau Veritas has limited or even no exposure to these segments. On the other hand, Bureau Veritas is number one worldwide in Industrial services (nearly 60% of its revenues) whereas SGS has a very small presence (13% of group sales). In addition, both companies have leading positions in Systems & Services (each has about 100,000 certified customers), giving a combined global market share close to 20%. Finally each company has some specific exposure (Automotive services for SGS or Marine for Bureau Veritas), giving access to new markets.

In addition, some overlap in areas such as Industrial services and Systems certification would imply substantial potential cost synergies, especially in markets such as France where both companies have strong positions.

Table 33: SGS and Bureau Veritas revenues breakdown stand alone and together

SGS Revenues by division	FY06e CHFm	FY06e EURm	Split (%)	Bureau Veritas Revenues by division	FY06e EURm	Split (%)	SGS + Bureau Veritas	FY06e EURm	Split (%)
Agricultural Services	328	206	9	Industry services	207	11	All Industrial services	1,357	32
Mineral Services	479	302	13	In-Service Verification	250	14	Agricultural Services	206	5
Oil, Gas & Chemical Services	761	479	20	Health, Safety and Environment	203	11	Mineral Services	302	7
Life Science Services	190	120	5	Building/Facilities	379	21	Oil, Gas & Chemical Services	479	11
Consumer Testing Services	611	385	16	System Certification Services	201	11	Life Science Services	120	3
Systems & Services Certification	320	202	8	Gvt services & Intern. Trade	130	7	Consumer Product Services	626	15
Industrial Services	505	318	13	Consumer Product Services	242	13	Systems & Services Certification	403	9
Environmental Services	248	156	6	Marine	216	12	Environmental Services	156	4
Automotive Services	219	138	6				Automotive Services	138	3
Trade Assurance Services	171	107	4	All Industrial services	1,039	57	Gvt services & Intern. Trade	237	6
							Marine	216	5
Group revenues	3,831	2,413	100	Group revenues	1,828	100	Group revenues	4,241	100

Source: Company, Exane BNP Paribas estimates

The two companies appear very complementary in terms of their geographical presence. Bureau Veritas has strong exposure to France (more than a third of its sales) and its former colonies, for historical reasons, where SGS's exposure is much more limited (less than 2,000 employees vs around 10,000 for Bureau Veritas).

Scenario of a purchase

Assuming SGS were to buy Bureau Veritas, we believe that Bureau Veritas could be worth around EUR3.6bn, or the equivalent of CHF5.7bn. This implies a 2007e EBITA multiple of 12x, or 1.7x revenues.

The deal could have a positive impact on SGS’s accounts. We think that Bureau Veritas could boost group sales by 78% and enhance 2007 EPS by 26% on a full-year basis. This is based on a transaction price of CHF5.7bn for Bureau Veritas and takes into account an EBIT margin dilution of 90bp on a full-year basis. Note that this excludes any potential synergies (revenues or costs) from the integration of the two businesses, which will be undoubtedly significant.

Table 34: Bureau Veritas's financial impact on SGS's 2007e pro forma P&L

CHFm	SGS	100% of Bureau Veritas (EURm)	100% of Bureau Veritas (CHFm)	Pro forma SGS (CHFm)	Variation (%)
Sales	4,243	2,134	3,308	7,552	78
EBITDA	875.8	354	549	1,425	63
EBITDA margin (%)	20.6	16.6	16.6	18.9	
EBITA	698	314	486	1185	70
EBITA margin (%)	16.5	14.7	14.7	15.7	(90bp)
Interest income (charge), net	3.5		0	(254)	
Profit before tax	702	314	486	931	33
Income taxes	(172)	(108)	(167)	(269)	56
Tax rate (%)	24.5	34.4	34.4	28.9	18
Minority interests	(26)	0	0	(26)	0
Net profit for the year	504	206	319	636	26

Source: Exane BNP Paribas estimates

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From a financing point of view, it is clear that the group has the capacity to gear up its balance sheet (net cash position of CHF250m at end-2006e). Because SGS is highly cash generative (we expect FCF of around CHF500m pa on average for the next three years), it can sustain a high level of debt. Assuming that the acquisition would be fully financed by debt, SGS's debt level would rise to CHF4.9bn, implying interest charges of around CHF260m at a cost of debt of 5.2%. As a result, it would definitely stretch SGS's balance sheet given the sizeable cash outlay. Post the Bureau Veritas deal, the key financial ratios would look stretched as shown in the table below.

Table 35: Bureau Veritas acquisitions financial information

Total amount paid (CHFm)	5,730	
Net financial position of Bureau Veritas	0	
Total cash out by SGS (CHFm)	5,730	
Additional debt for SGS (CHFm)	4,947	
Additional interest charges (CHFm)	257	
Financial ratios	**Before**	**After**
Net debt/EBITDA	NA	3.5
Interest cover (x)		4.7

Source: Exane BNP Paribas estimates

Therefore, assuming SGS buys Bureau Veritas without a capital increase, the deal would be financially constraining, as highlighted by the financial ratios. This confirms that a more credible scenario would imply a different financing arrangement, and the creation of a combined company, rather than a buyout by SGS.

In our view, the most likely scenario will be the creation of a combined company orchestrated by the three main shareholders with three different nationalities, namely Italian (the Agnelli family), German (the Von Finck family) and French (the Wendel family).

An interesting fit with Intertek?

Intertek (GBP580m of revenues in 2005, a third of SGS's), could be another interesting fit for SGS, although a Bureau Veritas deal is more likely.

Intertek commands a clear leadership in consumer goods services (half of its profit), with strong positions in the UK and USA; It has also significant positions in the Oil & Gas market. However it is worth noting that there could be several issues that may prevent a merger, namely as dominant position in the Oil & gas market.

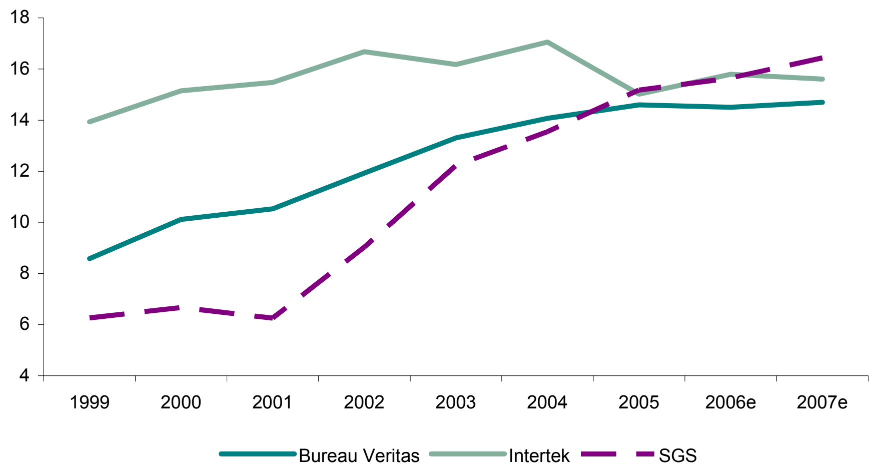
From a financial viewpoint, we believe that SGS could buy Intertek (GBP1.3bn or CHF3bn) in a deal fully financed by debt, by releveraging its balance sheet.

Margin expansion: still some room ahead

SGS's operating margins have more than doubled in the past four years, moving from 6.1% in 2001 to 15.2% in 2005. This was fuelled by a significant restructuring plan starting in 2002 (headcount reduction, costs savings, business efficiencies), improved asset utilisation and strong revenue growth.

Although the bulk of margin progress appears behind the company (with a shift towards higher value-added services), our analysis suggests that there is still scope for modest margin expansion.

Chart 20: EBIT margin trends for the three main industry players (%)



Source: Company, Exane BNP Paribas estimates

As illustrated in the chart above, most of the potential for SGS to catch up with Intertek and Bureau Veritas has been tapped. Nevertheless, in our view, there is still room for margin improvement, thanks to the specific operating leverage of the SGS business, the still unused capacity in its labs and the payoff from past restructuring. In addition, the catch up in more profitable divisions (consumer testing services vs Intertek) and stronger exposure in higher margin businesses (Oil or Minerals vs Bureau Veritas) will help to exceed competitors' performances.

For the 2006-2008e period, we anticipate an average annual margin progression of 60bp from 15.2% to 16.9%, a little below the company's 2008 target (17.0%). In H1 06, the group operating margin expanded further (by 20bp) helped by the service offering mix, geographical distribution, volume leverage and efficiency gains in service delivery.

Table 36: Our EBITA margin estimates by division for 2005-2008e

(%)	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Agricultural Services	11.8	11.4	11.9	12.4	12.2	13.0	13.0
Mineral Services	16.6	16.0	16.7	16.8	16.7	16.5	16.5
Oil, Gas & Chemical Services	12.8	12.5	13.9	12.6	13.2	13.5	14.0
Life Science Services	16.4	15.2	12.1	17.8	15.0	16.5	17.0
Consumer Testing Services (CTS)	21.6	21.4	22.8	22.6	22.7	23.5	24.0
Systems & Services Certification	18.2	17.0	18.3	18.5	18.4	17.5	17.5
Industrial Services	13.3	13.2	13.1	13.6	13.4	14.0	14.0
Environmental Services	12.1	11.1	9.0	13.5	11.3	13.5	14.0
Automotive Services	12.5	12.6	13.7	12.2	13.0	13.5	14.0
Trade Assurance Services	21.4	21.2	13.7	20.1	17.0	19.0	20.0
Group EBITA margin (%)	**15.6**	**15.2**	**15.3**	**16.0**	**15.7**	**16.4**	**16.9**

Source: Company, Exane BNP Paribas estimates

We see several drivers for margin improvement including:

1) Strong operating leverage.

2) Mix effects.

3) Further rationalisation and better efficiencies.

Strong operating leverage

The power of volumes: a strong volume-driven margin improvement

Over the past three years, SGS has clearly demonstrated the power of its operating leverage. The bulk of the margin increase was related to the organic sales performance of SGS, with higher volumes mainly fuelled by the expansion of services provided.

Due to the nature of the business and SGS's scale, the group needs to support a large network of branch offices. Labs have a fixed cost structure to support, essentially staff (personnel costs represent 50% of sales and 60% of total costs) and also to a lesser extent some equipment. As a result, there is strong leverage with respect to margin potential as most of the costs are fixed. All in all we assume they are nearly two-thirds of total costs. The table below depicts SGS's cost structure. Note that in other operating expenses, fixed costs include rental expenses, insurance and communication costs.

Table 37: SGS cost structure as a percentage of sales (1996-2006e)

CHFm	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Sales	2,954	3,271	3,154	3,085	2,369	2,332	2,392	2,454	2,885	3,308	3,831
Salaries & wages	(1,492)	(1,716)	(1,725)	(1,673)	(1,246)	(1,255)	(1,252)	(1,236)	(1,472)	(1,687)	(1,912)
As a % of sales	50.5	52.5	54.7	54.2	52.6	53.8	52.4	50.4	51.0	51.0	49.9
Subcontractor's expenses	(182.8)	(194.9)	(179.8)	(170.4)	(146.7)	(133.1)	(142.0)	(140.1)	(173.1)	(198.5)	(207.6)
As a % of sales	6.2	6.0	5.7	5.5	6.2	5.7	5.9	5.7	6.0	6.0	5.4
Other operating expenses	(864.7)	(931.5)	(938.5)	(903.7)	(715.0)	(697.4)	(686.8)	(677.6)	(735.0)	(780.4)	(950.1)
As a % of sales	29.3	28.5	29.8	29.3	30.2	29.9	28.7	27.6	25.5	23.6	24.8
Depreciation	(120.7)	(143.3)	(145.8)	(144.3)	(103.5)	(101.3)	(95.2)	(100.7)	(114.6)	(140.0)	(161.7)
As a % of sales	4.1	4.4	4.6	4.7	4.4	4.3	4.0	4.1	4.0	4.2	4.2
Operating income	293.7	284.9	165.3	193.3	157.9	145.6	215.6	300.0	390.8	502.1	599.9
As a % of sales	9.9	8.7	5.2	6.3	6.7	6.2	9.0	12.2	13.5	15.2	15.7

Source: Company, Exane BNP Paribas estimates

On the back of strong top-line growth, SGS should be thus able to improve significantly its operating margin, owing to its mainly fixed cost base. Given the nature of the business, every 1% of additional revenue growth could improve operating profit by around 3% if it is not accompanied by any proportional operational cost hikes. This could translate into a 40bp improvement in the operating margin.

Under-utilised resources

The network's flexibility is a key element for pushing margins higher. Thanks to an improved capacity utilisation rate, we expect SGS to increase its operating margin.

SGS currently runs its lab at approximately 75-80% utilisation, with differences per segment and geographic area. Management admits that there is plenty of spare capacity in the network. We share the view that capacity utilisation at SGS's laboratories could be better optimised.

For example, in environmental services, the company is starting to capitalise on its infrastructure by fully using its lab (from the Fresenius acquisition) via cross-selling and by increasing the number of samples analysed.

Another example related to the key consumer goods testing division shows that SGS is clearly still under-utilising capacity in many segments. Indeed, the capacity utilisation rate in the Electric and Electronics business segment is between 50% and 75%. This is especially the case for capacity in Asia, where the demand remains very strong. Just a few of the 50 laboratories are working on a three-shift basis (24 hours a day/7 days a week).

Assuming that 50% of the labs could work at that rhythm, the incremental profit margin would be substantial. Management estimates that a CHF1 increase in turnover at a single lab would boost operating profit by CHF0.5.

The lab capacities are under-utilised due to investments made in the past two years to allow more volume to be absorbed if necessary. Today, the company has spare capacity already available to respond to an initial surge in volume. This leaves room for top-line acceleration and thus margin leverage over the coming months.

The situation related to direct competitor Intertek Labtest underlines the necessity of disposing of large asset capacity. In the past two years, on the back of a strong acceleration in demand in Asia (mainly in textiles with the Chinese textile quotas impact), Intertek has been suffering from its strategy of under-investment with limited infrastructure development facing strong volume growth. Indeed, more labs were running at full or even over-capacity in 2004 and even 2005. This means that orders had to be refused and customers were lost, which in turn meant further investment to make good the lag.

We are confident that SGS would have enough volume growth in the coming months to raise the number of 24/7 labs. The impact will be felt automatically in margins.

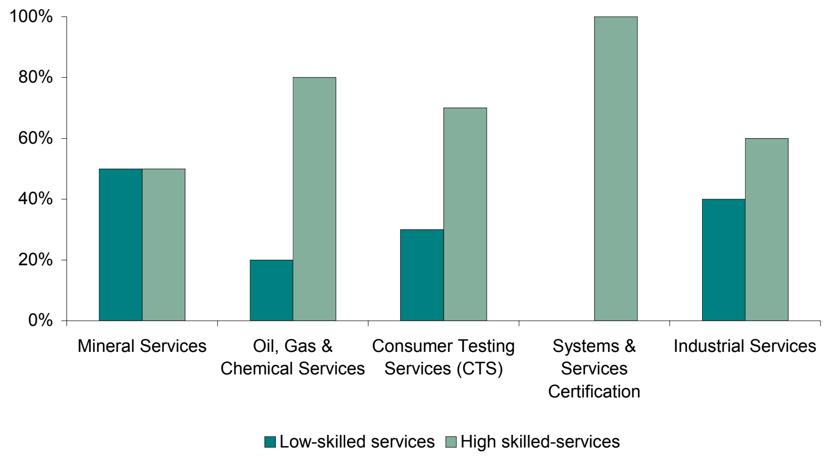
Positive business mix effects

Margins will continue to benefit from mix effects, essentially business and segment mix.

Increased contribution of higher value-added products

Over the past four years, SGS's product offering has increasingly moved towards high skill services (value-added), characterised by more testing and less inspection (with a low level of sophistication). The group is now providing more quality control types of services, away from simple quantity control. As we mentioned earlier under the heading " Increasing the range of services further"), the introduction of new services further up the supply chain is a key factor for margin progress as, on top of strong operating leverage with higher volumes, the new services often deliver higher margins (they are 3x more profitable in some cases).

Chart 21: Current SGS business mix for the main segments



Source: Company, Exane BNP Paribas estimates

The bulk of the switch has been made in many divisions. The key example is in Consumer Testing Services where the testing content has grown significantly: the split is now 70% testing, 30% inspection vs the opposite four years ago. However, there is potential for further improvement, providing an additional boost for margins.

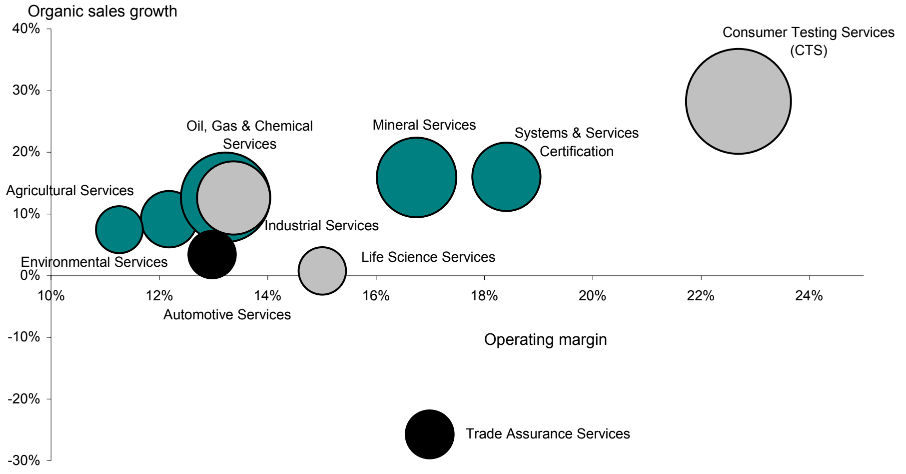
In the Oil, Gas & Chemicals division, there is an increasing proportion of divisional sales (above 35%) derived from outsourcing vs 65% for “spot” market cargo inspection, which is characterised by tighter pricing in the inspection space and lower margins. On the contrary, outsourcing contracts (customers are handing over the running of in-house laboratories to SGS) provide much greater visibility (recurring stream) and deliver higher margins than the spot business, particularly when third-party business starts running through the labs.

Also, there may be some other positive business mix effects in some divisions. In the Consumer Testing division, SGS is also pushing growth in the most profitable areas such as hardlines and softlines (vs E&E or food), again having a positive margin effect at the divisional line and group level.

Higher growth for higher margin business

Consumer Testing is the most profitable division, followed by Systems & Services Certification, Mineral services, Life Science and Industrial services divisions. All these activities generate above group average growth in both metrics (organic sales growth and EBITA margins), particularly as SGS has put a clear emphasis on these promising divisions through both organic development and acquisitions. The following chart illustrates the weight of higher-margin and growth businesses within the company portfolio.

Chart 22: SGS's performances by division in 2006e

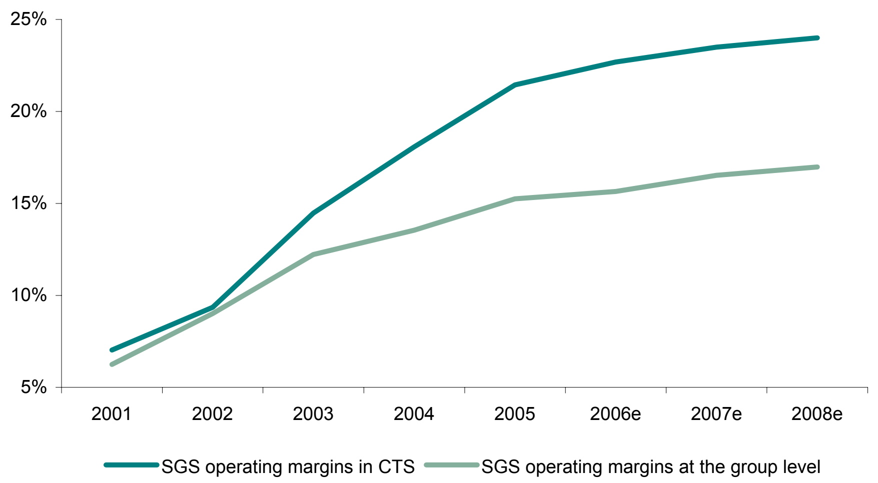


Note: the grey circles represent SGS's key areas of development, the black circles are the most challenging divisions

Source: Company, Exane BNP Paribas estimates

The Consumer Testing division contributes 14% of group revenues but 20% of group EBITA (with margins close to 22%), making it the key division at group level. We believe that margins will improve further in the coming years, thus implying an increased contribution at group level. The Consumer Testing division generates its highest margins in Asia (China, Hong Kong, Vietnam, India, and Malaysia), where momentum is set to remain buoyant. This should be a key trigger for SGS's future performance.

Chart 23: EBITA margin trends for both CTS and at the group level



Source: Company, Exane BNP Paribas estimates

Margins would be boosted by the combined effect of an improvement in the business mix and of the operating margin moving up into line with the best industry standards (Intertek) in a key division such as Consumer Testing Services.

Further rationalisation

Alongside strong operating leverage, we think that SGS may be able to optimise its network with further rationalisation and IT investments. The *Network Advantage* initiative was recently launched to succeed the *Continuous Improvement Programme* introduced in 2003. The new plan consists of six sigma projects aimed at laboratory efficiency at the group level.

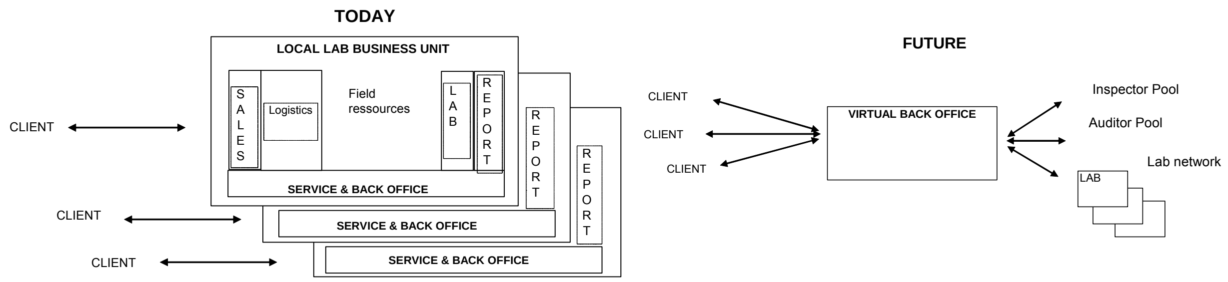
The plan is to create a flexible network of laboratories with shared capacity and capabilities, a high-volume lab "factory" model. In addition, the company is creating a virtual back office to support labs, inspections and audits with optimised dispatch and support functions. Lastly, the group is trying to better align both the flexible network and virtual back office with customer requirements and business goals (increased customer satisfaction through reduced lead times and improved quality).

Table 38: SGS's plans for optimising its network and back office

Plan	Goal
Create a flexible network of labs with shared capabilities	Increased customer satisfaction through reduced lead times and improved quality
Create a virtual back office to support labs, inspections and audits with optimised dispatch and support functions	Release network capacity to support organic growth
Align with both customer requirements and business goals	Expand customer offerings through cross-border fulfilment
	Create standardised operating model to facilitate acquisition integration

Source: Company

Chart 24: SGS's ongoing IT project implementation



Source: Company

Restructuring leverage in some divisions

Two divisions in SGS's business lines have recently underperformed and are in the midst of a restructuring process. We see significant leverage for both business lines.

Trade Assurance Services

Trade Assurance Services (4% of group sales and 5% of operating profit) offers services to governments and international institutions to facilitate compliant international trade, enhance tax and customs revenue collection and support the management of environmental programmes. Under Pre-Shipment Inspection (PSI) contracts, SGS inspects and reviews the quantity, quality and price of goods at the point of shipment to facilitate the assessment of import duties and taxes (to avoid capital flight) and to verify compliance with customs regulations.

There have been radical changes in what has historically been the highest-margin business (38%, with SGS doing most of its business in a few countries under very lucrative contracts): it has become more competitive and the services have become more sophisticated. Despite these trends, SGS still commands a 50% market share and enjoys margins slightly above those of the group (17.5% estimated for 2007e).

Over the past 24 months, revenue and margins have been on declining trends for traditional pre-shipment inspection. This results from contracts coming to an end for Pre-Shipment Inspection schemes in many countries, such as in the Democratic Republic of Congo, Nigeria and Venezuela.

To compensate for this, SGS has demonstrated its innovative qualities by penetrating new niche markets, such as the container scanning market (X-ray scanner control) or alternative government and private sector trade services (forestry, climate change monitoring). In addition, the group has launched new PSI offerings such as **SGS ValuNet** (to support customs administrations in their efforts to fight valuation fraud and to meet the requirements of the WTO Agreement on Customs Valuation) and **SGS ValuNet** (international trade management system encompassing the entire trade value chain, including import and transhipment processing procedures).

H1 06 results reflected a transition period with the loss of pre-shipment contracts (-31%, following the loss of the Nigerian and Venezuelan contracts) and a downturn in profitability (-800bp yoy to 13.7%) as the cost base remained constant at the same time. In Nigeria, SGS did not adapt its cost base as an old contract was expected to be replaced by a new one (a scanner-based destination inspection contract) in H2 06. As a result, new contracts will provide leverage on the fixed cost base and thus the impact will be softer in H2 06 (-270bp to 18.7%) before disappearing in 2007.

We believe that SGS is clearly moving towards a new business model by restructuring PSI ahead of a decline in the traditional market. While sales are declining in the short term, we expect some modest growth in the future (3-5%) and stable margins (at around the 17-18% level) as the strategy of migrating to new services starts to pay off.

Table 39: Our top-line and EBITA margin assumptions for 2005-2008e

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Trade Assurance Services revenues	**109.2**	**228.7**	**83.3**	**87.4**	**170.7**	**175.8**	**184.6**
Overall growth (%)	(10.8)	(10.5)	(30.3)	(20.0)	(25.4)	3.0	5.0
Organic growth (%)	**(11.5)**	**(10.5)**	**(31.0)**	**(20.0)**	**(25.8)**	**3.0**	**5.0**
Acquisitions (%)		0.0	0.0	0.0	0.0	0.0	0.0
Forex (%)		0.0	0.7	0.0	0.3	0.0	0.0
Trade Assurance Services EBITA	**23.4**	**48.5**	**11.4**	**16.3**	**29.2**	**30.8**	**32.3**
Growth (%)	(28.4)	(21.1)	(56.0)	(27.7)	(39.8)	10.9	5.0
EBITA margin (%)	**21.4**	**21.2**	**13.7**	**18.7**	**16.3**	**17.5**	**17.5**

Source: Company, Exane BNP Paribas estimates

Automotive Services

Automotive Services (6% of group revenues and 5% of operating profit) offers vehicle inspection solutions (design, operation, safety and emissions) to governmental regulatory agencies, manufacturers, shippers, insurance companies and, more recently, to consumers. It also provides supply chain monitoring services for manufacturers throughout the distribution process.

SGS delivers independent and timely information on the condition of new cars, or vehicles coming off lease or for periodic inspection (statutory car inspection). The group has a leading position in the US for new car inspections (about 50%) and has also developed a strong presence in the statutory vehicle inspection market (highly fragmented), mainly in European countries (Ireland, France, UK, Spain) and in South America (Argentina, Chile). SGS owns a network of inspection centres that perform the tests in accordance with the legislation in force.

In recent years, SGS has begun to focus its business model on statutory vehicle inspection rather than on new car and off-lease inspection, which is a tougher, more cyclical and less profitable segment. Statutory vehicle inspection is a promising, CHF10bn market, driven by a growing trend towards outsourcing and huge opportunities, as many countries have no statutory inspection at all. Two pertinent examples are the management of black cabs in the City of London and a five-year contract for the licensing of public services vehicles in Ireland.

This has led to a reduction in unprofitable, low-margin contracts, especially in the US. As a result, we expect operating margin to rise as less profitable activities are abandoned. Overall, we suspect that, in the medium term, it is highly likely that SGS will operate only statutory contracts.

We expect SGS to post strong organic sales growth and some margin expansion thanks to opportunities for new statutory inspection vehicle contracts, given its expertise and its worldwide network (substantial vehicle databases).

Table 40: Our top-line and EBITA margins assumptions for 2005-2008e

CHFm	H2 05	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Automotive Services revenues	**102.9**	**200.2**	**111.5**	**107.0**	**218.5**	**233.8**	**247.8**
Overall growth (%)	4.3	6.7	14.6	4.0	9.2	7.0	6.0
Organic (%)	**(2.1)**	**(0.7)**	**3.3**	**4.0**	**3.6**	**7.0**	**6.0**
Acquisition (%)		6.8	8.3	0.0	4.1	0.0	0.0
Forex (%)		0.6	3.0	0.0	1.5	0.0	0.0
Automotive Services EBITA	**12.9**	**25.2**	**15.3**	**13.6**	**28.9**	**31.6**	**34.7**
Growth (%)	25.2	26.0	15.9	13.3	14.6	9.3	9.9
EBITA margin (%)	**12.5**	**12.6**	**13.7**	**12.7**	**13.2**	**13.5**	**14.0**

Source: Company, Exane BNP Paribas estimates

Bundled services, not a real threat yet

There is an increasing trend towards providing customers with comprehensive packages. Increasingly, SGS is bundling different service offerings together, rolling out service packages over a larger geographic area.

In the Oil, Gas & Chemical services division, SGS is developing services aimed at providing end-to-end traceability and product conformity. These offerings enable the division to bundle several services together, thus offering high-margin package services. In addition, it is also starting to provide global offerings for oil and mineral services, thus reaching and linking two different industries at the same time.

In agriculture, it is also providing integrated service packages throughout the supply chain, linking warehouse and silo management, weigh-bridge management, pest control and laboratory analysis within the product portfolio.

It could be argued that such a trend will lead to margin pressure. According to management, there is no clear evidence of that and, in some cases, bundled services are even showing higher margins as new bundled offerings improve pricing power.

In any case, the potential risk of margin pressure at the group level appears negligible given that, for the time being, bundled services do not represent a substantial part of SGS's business. The bulk of its business clearly remains individual services, with fees charged on a per unit basis.

Overall, as barriers to entry are high (it takes time to build a reputation and to build a global infrastructure) and pricing power is relatively high (especially for high-end services), the risks of price pressure on services appear limited. Bear in mind that SGS supplies a critical service at a relatively low price, often at a fraction of a percent of the customers' cost of goods sold.

Preview of full-year results

Our expectations for FY06

Strong set of results

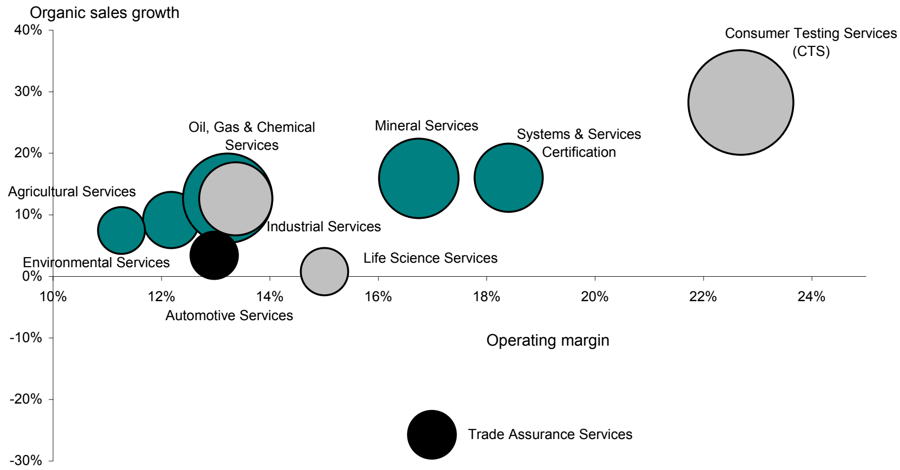
SGS will publish its full-year 2006 results on 15 January 2007, the first SMI company to do so. It will then hold an analyst meeting. We expect a strong set of results. The company should once again deliver a double-digit organic sales growth rate, in line with, or even better than, the trends achieved in H1 (+10.4%), fuelled mainly by Asia-Pacific (+25%).

Overall, we expect 15.8% revenue growth, to CHF3,831bn, of which 10.8% organically, 3.2% through changes to the structure and 1.8% due to forex effects.

On the margin front, SGS should be able to improve its underlying EBITA margin by 50bp to 15.7% (16.2% including exceptional items) thanks to i) the increased contribution from Asia; ii) faster growth at the higher-margin businesses, such as the Consumer Testing services divisions (with a positive impact from investments made in H1 06 in Korean cell phone testing labs); iii) positive performances by commodities-related divisions; iv) the sequential improvement in Life Science in H2 vs H1 (lower integration costs following the acquisitions made in 2006); and v) a smaller decline in Trade Assurance Services (linked to a less significant impact from the loss of Nigerian and Venezuelan contracts and the first contribution from new ones).

By division, the best contributors should be Consumer Testing Services, Mineral Services, Oil Gas & Chemical services and Systems & Certifications. This will be slightly offset by weak performances from Automotive Services and Trade Assurance Services.

Chart 25: SGS performances by division for 2006e



Note: the grey circles represent SGS's key areas of development, the black circles are the most challenging divisions

Source: Company

Bullish outlook for 2007

Beyond the figures themselves, management is expected to confirm the group's strong capacity for growth, thanks to favourable secular trends and positive short-term market conditions. We suspect that SGS will guide for continued double-digit growth (this is likely to be in the 10-12% range) and margin progress vs last year. In addition, we expect supportive news flow related to SGS's acquisition activity in 2007.

Table 41: 2001-2008 revenue and EBITA estimates (CHFm)

Revenues	FY01	FY02	FY03	FY04	FY05	H1 06	H2 06e	FY06e	FY07e	FY08e
Agricultural Services	254	250	242	257	295	157	171	328	351	375
Mineral Services	203	268	280	320	394	225	254	479	536	590
Oil, Gas & Chemical Services	415	399	439	575	635	374	387	761	849	904
Life Science Services	58	62	59	107	125	94	96	190	294	391
Consumer Testing Services (CTS)	286	268	272	361	476	283	328	611	808	999
Systems & Services Certification	201	213	230	235	274	151	169	320	359	395
Industrial Services	474	321	330	380	445	240	265	505	642	760
Environmental Services	0	163	172	209	235	125	123	248	256	277
Automotive Services	204	239	211	188	200	112	107	219	234	248
Trade Assurance Services	237	210	220	255	229	83	87	171	176	185
Group revenues	**2,332**	**2,392**	**2,455**	**2,885**	**3,308**	**1,845**	**1,986**	**3,831**	**4,505**	**5,123**
EBITA										
Agricultural Services	11	25	24	24	34	19	21	40	45	49
Mineral Services	13	27	36	46	63	38	43	80	89	98
Oil, Gas & Chemical Services	30	32	48	69	79	52	51	103	116	127
Life Science Services	3	3	6	13	19	11	16	27	47	64
Consumer Testing Services (CTS)	20	25	39	65	102	65	75	139	190	245
Systems & Services Certification	19	24	35	31	47	28	31	59	67	74
Industrial Services	29	34	35	46	59	32	36	68	87	104
Environmental Services	0	10	11	17	26	11	16	27	35	39
Automotive Services	(4)	14	21	20	25	15	14	29	32	35
Trade Assurance Services	24	23	45	62	49	11	16	28	31	32
Group EBITA	**146**	**216**	**300**	**391**	**502**	**281**	**318**	**600**	**738**	**867**

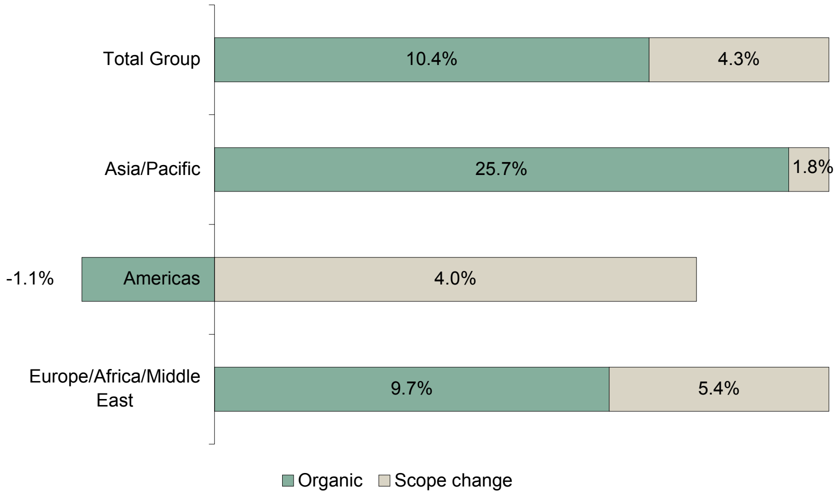
Source: Company, Exane BNP Paribas estimates

We expect the 2006 trend (double-digit organic sales growth) to continue for at least the next two years. Overall we expect margins to grow by about 60bp pa, depending on the speed of change in the business mix and the move to 24/7 lab schedules, coupled with solid volume growth. Along with the contribution from higher growth at the higher-margin divisions, the catch-up potential for a return to growth and profitability from underperforming TAS and Life Science divisions will be supportive. We see room for earnings upgrades in the coming quarters.

H1 06 results review

The group's performances have been driven mainly by Asia-Pacific (+26% organically) and somewhat weakened by negative growth in the Americas.

Chart 26: Growth by region in H1 06 (organically and scope change)



Source: Company

Strong margin improvement driven mainly by volume growth

SGS's margin improvement has been driven by organic developments rather than by acquisitions or exceptional items, as highlighted in the following table.

Table 42: Breakdown of operating income growth (CHFm)

	Change in EBIT	Yoy change (%)
Operating income H1 05	235	
Organic	27	11.5
Forex	10	4.1
Acquisitions	10	4.3
Disposals	0	
Exceptional items	20.8	8.9
Operating income H1 06	302	28.5

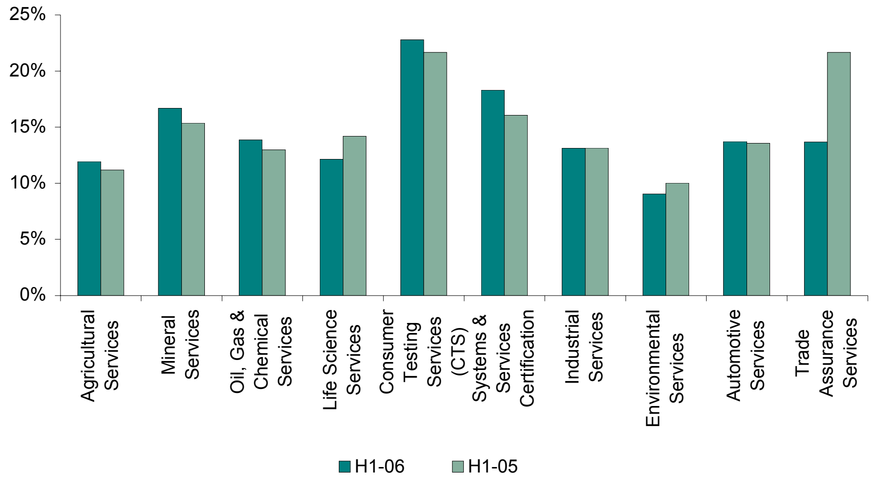
Source: Company, Source: Exane BNP Paribas estimates

Margins have improved at seven of the ten divisions

All of the group's divisions have enjoyed margin expansion (or at least stabilisation), apart from the traditionally challenging businesses (trade assurance services and environmental services) and Life Science (due to acquisition costs). The divisions with the fastest margin growth were systems and services certification, which saw its margin rise 180bp to 18.1%, Mineral services (+130bp to 16.7%) and Consumer testing (+110bp at 22.8%).

EXANE BNP PARIBAS

Chart 27: H1 06 operating performance by business line vs last year



Source: Company

More interestingly, if we strip out the decline in the TAS divisions (-800bp), margin growth would have been 50bp instead of 20bp in the first half of 2006. This gives us greater confidence in SGS's ability to improve its operating margin, all things being equal.

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Appendices

Company background

A little bit of history

SGS was established in 1878 in Rouen (France). Its founders understood the need for traders to be represented when vessels were loaded and discharged. To ensure that contractual terms were complied with, SGS set up a network of specialists and laboratories in major ports. Over time, the group has diversified its business lines and its expertise by including inspection, testing and certification services. Growth has been both organic and external. SGS was incorporated in 1919 and was listed on the Swiss Exchange in 1985.

Brief overview of the management team

Over the past five years, there have been many changes to the senior management team. The man who led the restructuring in 2002 and put the company on its growth track (Sergio Marchionne) left the company in June 2004 to join Italian car maker Fiat and become its CEO at the request of the Agnelli family. He is still very involved in SGS's development, as he has been its Chairman since the beginning of 2006. He was replaced by Werner Pluss, as interim CEO, who resigned three months later for health reasons. He was followed by Johan Allegaert from September 2004 to April 2005. Thereafter, Dan Kerpelman managed the company and built a strong reputation over 18 months. But, very recently (November 2006), there was another reshuffling at the request of the Operation Council and Sergio Marchionne: Mr Kerpelman was replaced by Chris Kirk, the head of both Minerals and Environmental Services at SGS. He has been with the group for 25 years. It seems that this decision reflects both personality and cultural differences. According to the Chairman, it was a matter of leadership (in terms of the dynamics for change) and Dan Kerpelman was not ready for more change, especially external growth.

Key management information

Name	Position	Nationality	Comments
Chris Kirk	CEO	Scottish	Chris Kirk became CEO of SGS on 29 November 2006, replacing Dan Kerpelman (who had held the position for 18 months). Prior to this, he was Executive Vice President of both Minerals and Environmental Services. He joined SGS in 1981 in New Zealand and has held a number of senior positions in Thailand, Ghana, Singapore and Australia.
Sergio Marchionne	Chairman	Italian	Sergio Marchionne (CEO of Fiat) was elected Chairman of SGS at the beginning of 2006. He was CEO of SGS from 2002 to 2004 and has been the man for change.
Richard Tobin	CFO	American	Richard Tobin (age 43) has been CFO of SGS since June 2004. He had previously been COO North America. He holds a Master in Business Administration.
Jean-Luc de Buman	Corp. Communications and Investor Relations	Swiss	JL De Buman (age 53) has been at SGS's IR for eight years. Before joining SGS in 1998, he was Country Head in Sales Fixed Income at UBS (Switzerland).

Source: Company

In 2003, the group initiated a long-term discretionary incentive plan for senior executives that are members of the operation council (comprising 24 managers in charge of the day-to-day management of the company). The LTIP only pays out if the group reaches or exceeds specific EPS targets. In 2003 the group set a 2005 EPS target of at least CHF45 (CAGR of 27.9%), which it exceeded. The new target is EPS of CHF80 for 2008e, implying around 18% EPS growth pa over the 2006-2008e period. We see this plan as a strong motivational tool for the senior executive team.

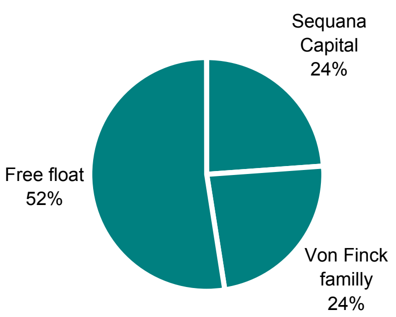
A controlled shareholder structure which has changed recently

The two major shareholders of SGS are the Von Finck family, the group's founder (with 23.7% of the voting rights) and the investment company IFIL – controlled by the Agnelli family - (with 13.2%), resulting in a free float of 63%.

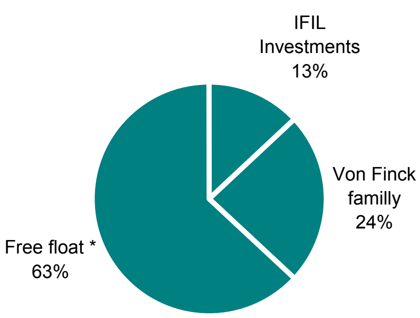
One of the two main shareholders, Sequana Capital (the French holding firm controlled by the Agnelli family's group, IFIL, formerly known as Worms & Cie) recently initiated an ownership reshuffle at SGS, involving a share swap proposal. The operation took place from October to December 2006 in order to refocus Sequana Capital on its paper activities. This resulted in IFIL holding 12.6% of SGS directly, corresponding to its 23.8% indirect stake through Sequana Capital. In addition, the group has recently made some purchases on the market (for 0.6% of the capital).

Change in shareholder structure at SGS at end-2006

Before the Sequana swap



After the Sequana swap



** including AGF's and the Worms family's stakes following the Sequana deal*

Source: Company.

We do not view a decrease in the two shareholders' stakes as credible in the coming years: the Von Finck family has affirmed its commitment to the group over time. The Agnelli family has shown that it is more likely to increase its direct stake in SGS than to reduce it. An overhang risk is not, in our view, therefore a real cause for concern.

Business description by division

Business description by division

Agricultural Services	Mineral Services	Oil, Gas & Chemical Services	Life Science Services	Consumer Testing Services (CTS)
Trade & shipping related services	**Trade & shipping related services**	**Field inspection, laboratory testing & blending**	**Quality control testing**	**Testing**
Cleanliness inspections	Sampling	Representation at site of operation	**Agrochemical product registration services**	Materials testing to confirm suitability of raw materials & components
Supervision	Weight determination	Monitoring of terminal & vessel operations	Clinical research services	Performance testing to establish conformity to contractual requirements
Sampling	Hatch & hold inspection	Advice on maintenance of cargo integrity	Early stage	Safety testing to reduce liability exposure vs National/Intern. Regulations
Analysis	Draft survey	Ship & shore tank and pipeline inspection & calibration	Late stage	Eco testing to analyse restricted, hazardous substances
Fumigation & denaturing	Tally	Loss control monitoring & investigation	**Bioanalytical services**	Comparative testing to benchmark one product against similar product
Risk management	Stockpile inventory	Condition inspection	Data management & statistics	Product certification to certify products against industry standards
Full outturn guarantee	Visual inspection	Cleanliness inspection	Regulatory affairs	**Inspection**
Comprehensive cover	Laboratory testing	Sampling & measurement	**Health economics and pharmacovigilance**	Pre-Production, Initial and During Production Checks to inspect available materials
Quality risk protection	Witnessing	Sealing		Final random inspection to inspect statistically all criteria specified in the service instructions
Guarantee of rejection	**Exploration and mine-site services**	**Cargo treatment to add value**		(product appearance, functions, quality, quantity, marking and packing)
Guarantee of fumigation	**Financing and risk management services**	**Outsourcing**		Retail store check to evaluate product presentation and shelf life (sample selection for testing)
Collateral management services	Stock monitoring & control			**Technical assistance**
Supply chain monitoring	Collateral management			
Identity Preservation Programme & Traceability	Guarantees			
Food/feed safety	**Technical consulting-value chain management**			
Outsourcing	Mechanical sampling			
Grading on site	**Technical consulting-metallurgy/mineralogy**			
Laboratory				
Forwarding, warehousing				

Table continued on next page

Business description by division (cont.)

Systems & Services Certification	Industrial Services	Environmental Services	Automotive Services	Trade Assurance Services
Compliance products/certification	Traditional non-destructive testing (gamma, x-ray, crawler)	**Laboratory analytical services**	**For governments:**	**Revenue enhancement**
Quality (ISO 9001, healthmark)	Component inspections of boilers, heat exchangers, tanks, pumps & valves	Soils, sediments, sludge & minerals	Statutory vehicle inspection programmes for both safety and emissions	Import verification programmes
Environmental (ISO 14001, EMAS)	Pipes, compressors, turbines, electrical and control equipment	Water: drinking, surface, sea, ground, sewage and wastewater	Provision of advanced electronic information management systems	Risk management services
OHS (OHSAS 18001)	Steel mill, shop and site inspections	Wastes: hazardous and solid, municipal	**For industry:**	SGS ValuNet
Social (SA 8000, CE marking)	Pipeline inspection and testing	Air	Distribution	**Trade facilitation**
Medical devices	Welding and coating inspection	Oils	Remarketing inspection (network of independent inspectors)	SGS TradenetTM
Industry related standards/certification	Certification of welding procedures and welder qualifications	**Field based services**	Auditing services	**Transit monitoring**
Aerospace (AS 9100, EN 9100, JISQ 9100)	Inspections and certification of pressure systems and witnessing of pressure tests	**Field service applications**	Certification services	Trade compliance and security services
Automotive (QS 9000, VDA 6, ISO/TS 16949)	Construction monitoring and testing	Ambient and indoor air, stack emissions and burn tests		Cargo scanning services
Food (HACCP, SQF, GMP, EurepGap, BRC)	Building inspections	Water sampling, monitoring, assessments and modelling		**Sustainable development**
Forestry (FSC, PEFC, SFI, CSA)	Material testing laboratories	Contaminated site sampling, monitoring and supervision		Sustainable forestry programmes
IT (ISO 17799, Tick-IT)	Inspection of lifting equipment	Waste sampling and studies		Climate change programme
Logistic (TAPA)	Inspections of electrical installations and equipment	Geological, hydro-geological and hydrology monitoring		Aid monitoring services
Telecom (TL 9000)	**Material testing and non destructive examination**	Noise and vibration mapping and monitoring		
Service certification (Qualicert)	**Reliability services and integrity management**	Indoor environmental quality monitoring and studies		
Supplier assessment	**Supply chain services**	Occupational health and safety monitoring		
Added-value products	**Product and import certification**	**Specialty services**		
Integrated management systems	**Technical consultancy and training services**	Outsourced laboratory management		
Quality excellence		Environmental data management		
Corporate responsibility		Environmental drilling		
Training		Geo technical services		
		Training		

Source: Company

Main competitors

Details on Intertek

Customer group	Oil, Chemical & Agri	Consumer Goods	Commercial & Electrical	Government services
Division name	**Caleb Brett**	**Labtest**	**ETL SEMKO**	**FTS**
Details of activities	Inspection and analytical services to the oil, gas, chemical, agricultural, mineral and pharmaceutical industries	Service for industries producing products such as textiles, footwear, toys and hardlines in areas of design, quality, safety & social responsibility	Services to a wide range of industries: in the electrical, electronic, medical, building, industrial & automotive components sectors	Check safety and quality of imports verify duty collection, cargo security services and technical inspection services
Revenues (2005) (GBPm)	218	143.2	144.4	74.5
Organic growth (%)	15.4	8.7	12.4	10.2
Operating profit (GBPm)	17.9	44.9	22	16.3
Operating margins (%)	8.2	31.4	15.2	21.9
Employees	6,726	5,034	2,876	862
Offices	365	89	65	46
Laboratories	220	44	57	1

Source: Company, Exane BNP Paribas estimates

Details on Bureau Veritas

Customer group	Industry & facilities	Consumer Products	Government Services & International Trade	Marine
Division name	LCIE	BV Consumer Products	Bivac International	
Details of activities	Construction, property, energy & processes, manufacturing, power & utilities, food	Inspection, audits, assessments for: Toys and premiums, softlines, hardlines, electrical products		Shipbuilding, shipowner
Market positions	No. 1 worldwide position (technical inspections)	No. 3 worldwide position	Key player for government services	No. 2 position in number of vessels
	Global leader in certification (8% market share)	No. 2 for toys and textiles worldwide (no. 1 USA)	Niche player for international trade	No. 6 position in tonnage
Revenues (2005) (EURm)	1,107	197	163	180
% revenues	67	12	10	11

Source: Company

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Rating definitions

Stock Rating (vs Sector)

Outperform: The stock is expected to outperform the industry large-cap coverage universe over a 12-month investment horizon.
Neutral: The stock is expected to perform in line with the industry large-cap coverage universe over a 12-month investment horizon.
Underperform: The stock is expected to underperform the industry large-cap coverage universe over a 12-month investment horizon.

Sector Rating (vs Market)

Outperform: The sector is expected to outperform the DJ STOXX50 over a 12-month investment horizon.
Neutral: The sector is expected to perform in line with the DJ STOXX50 over a 12-month investment horizon.
Underperform: The sector is expected to underperform the DJ STOXX50 over a 12-month investment horizon.

Key ideas

BUY: The stock is expected to deliver an absolute return in excess of 30% over the next two years. Exane BNP Paribas' Key Ideas Buy List comprises selected stocks that meet this criterion.

Distribution of Exane BNP Paribas' equity recommendations

As at 13/03/2006 Exane BNP Paribas covered 370 stocks. The stocks that, for regulatory reasons, are not accorded a rating by Exane BNP Paribas are excluded from these statistics. For regulatory reasons, our ratings of Outperform, Neutral and Underperform correspond respectively to Buy, Hold and Sell; the underlying signification is, however, different as our ratings are relative to the sector.

35% of stocks covered by Exane BNP Paribas were rated Outperform. During the last 12 months, Exane acted as distributor for BNP Paribas on the 6% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 16% of the companies accorded this rating*.

47% of stocks covered by Exane BNP Paribas were rated Neutral. During the last 12 months, Exane acted as distributor for BNP Paribas on the 1% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 5% of the companies accorded this rating*.

18% of stocks covered by Exane BNP Paribas were rated Underperform. During the last 12 months, Exane acted as distributor for BNP Paribas on the 5% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 11% of the companies accorded this rating*.

** Exane is independent from BNP Paribas. Nevertheless, in order to maintain absolute transparency, we include in this category transactions carried out by BNP Paribas independently from Exane. For the purpose of clarity, we have excluded fixed income transactions carried out by BNP Paribas.*

Commitment of transparency on potential conflicts of interest

Complete disclosures, please see www.exane.com/compliance

Exane

Pursuant to Directive 2003/125/CE and NASD Rule 2711(h)

Questions	Answers
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- Has Exane managed or co-managed in the past 12 months a public offering of securities for the subject company/ies?	**NO**
- Has Exane been acting as distributor for BNP Paribas, when BNP Paribas managed or co-managed in the past 12 months a public offering of securities for the subject/ies	**NO**
- Has Exane received compensation for investment banking services from the subject company/ies in the past 12 months or expects to receive or intends to seek compensation for investment banking services from the subject company/ies in the next 3 months?	**NO**
2. Liquidity provider agreement and market-making	
- At the date of distribution of this report, does Exane act as a market maker or has Exane signed a liquidity provider agreement with the subject company/ies?	**NO**
3. Corporate links	
- Does the research analyst principally responsible for the preparation of this report or a member of his/her household serve as an officer, director or advisory board member of the subject company/ies.	**NO**
4. Analyst's personal interest	
- Does the research analyst principally responsible for the preparation of this report own a financial interest in the subject company/ies?	**NO**
5. Significant equity stake	
- Does Exane own 1% or more of any class of common equity securities of the subject company/ies as of the end of the month immediately preceding the date of publication of the research report or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month?	**NO**
- Does Exane own a stable shareholding in the subject company, above the legal threshold defined in article L 233-7 of the French Commercial Code?	**NO**
6. Disclosure to Company	
- Has this report been presented to the subject company/ies prior to its distribution?	**NO**
7. Additional material conflicts	
- Is Exane aware of any additional material conflicts of interest with regard to the distribution of the research?	**NO**

Source: Exane

BNP Paribas

Exane is independent of BNP Paribas (BNPP) and the agreement between the two companies is structured to guarantee the independence of Exane's research, published under the brandname « Exane BNP Paribas ». Nevertheless, to respect a principle of transparency, we separately identify potential conflicts of interest with BNPP regarding the company/(ies) covered by this research document.

Potential conflicts of interest: None.

Source: BNP Paribas

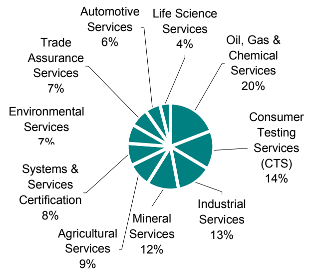
SGS N profile

Business

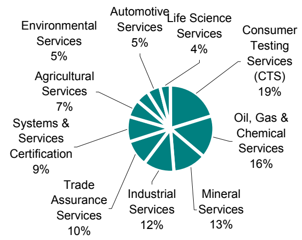
SGS, a Switzerland-based company, is the world leader in inspection, verification, testing and certification. Organised by industry focus into ten divisions (see the pie charts below), the group operates a network of over 1,000 offices and laboratories in more than 100 countries and employs over 43,000 staff.

In 2002, the group embarked upon a restructuring process, allowing it to refocus on a growth strategy, which started to pay off two years later. The group is well positioned to benefit from underlying strong demand for stringent quality and security requirements.

Revenue breakdown by division 2005



EBIT breakdown by division 2005



Management

CEO	Chris Kirk
CFO	Richard Tobin
Investor Relations	Jean-Luc De Buman
Chairman	Sergio Marchionne

Shareholders (%)	Stake	Voting rights
Von Finck August	23.7	-
IFIL InvestmentsSpA	13.16	-
Free float	63	-

Sector ratings

	Rating	Price (EUR)	Target price (EUR)	Upside/ (downside) (%)
► Big caps (Priced at 9 January 2007)				
Adecco R	(=)	CHF80.9	CHF85.0	5
Compass Group	(=)	292.5p	300.0p	3
Rentokil Initial	(+)	163.8p	180.0p	10
Sodexho	(+)	47.9	52.0	9
► Midcaps (Priced at 9 January 2007)				
Autogrill	(=)	14.3	13.7	(4)
Eurofins Scientific	(=)	53.3	52.0	(2)
Fimalac	(=)	72.1	71.0	(1)
Générale de Santé	(=)	31.0	30.0	(3)
Geodis	(+)	163.6	175.0	7
Norbert Dentressangle	(+)	68.4	66.0	(3)
Orpea	(+)	67.6	78.0	15
Vedior	(=)	15.9	15.0	(5)

Recent Exane publications

Date	Company	Type	Title	Pages
21 Nov. 2006	Rentokil Initial	Update	The glimmer of a recovery	24
17 Oct. 2006	Orpea	Update	Growth engine	13
21 Sep. 2006	Compass Group	Update	A teaser and a trigger	20
20 Sep. 2006	Sodexho	Update	It's happy hour	28
25 Jul. 2006	Eurofins Scientific	Report	Buying credibility on big pharma	32

Diary

Date	Event
15 Jan. 2007	FY 2006 Results
19 Mar. 2007	AGM

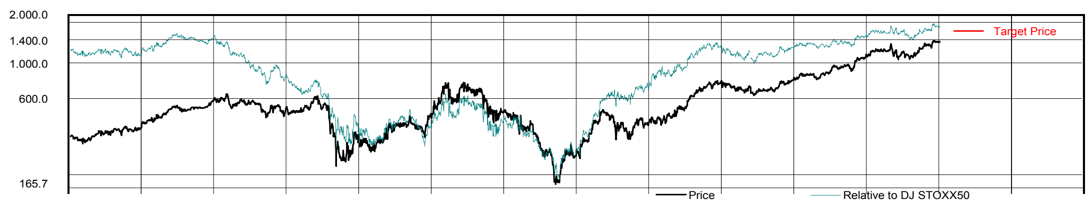
Price at 09/01/07: CHF1 373.0
Target price: CHF1 600.0 / + 16.5%

Stock rating vs Sector: Outperform
Sector rating vs Market: Underperform

SGS N

Support Services - Switzerland

12-mth high / low (CHF)	1 394.0 / 1 057.0		
Enterprise value (CHFm)	10 652		
Mkt cap. / Free float (CHFm)	10 740 / 6 766		
Performance	**1mth**	**3mths**	**12mths**
Absolute	1%	12%	22%
Rel. (Sector)	(3%)	3%	5%
Rel. (DJ STOXX50)	(2%)	8%	13%
Reuters/Bloomberg	SGSN.VX / SGSN VX		
Analyst: Laurent Brunelle			
CAGR	**1996/2006**		**2006/2008**
EPS restated (*)	6%		19%
CFPS	3%		20%



PER SHARE DATA (CHF)	**Dec. 95**	**Dec. 96**	**Dec. 97**	**Dec. 98**	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06e**	**Dec. 07e**	**Dec. 08e**
No of shares year end, basic, (m)	8.905	8.605	7.897	7.822	7.822	7.822	7.822	7.978	7.958	7.958	7.958	7.822	7.822	7.822
Average no of shares, diluted, excl. treasury stocks (m)	8.905	8.605	7.897	7.822	7.822	7.822	7.822	7.978	7.958	7.958	7.958	7.822	7.822	7.822
EPS restated	25.93	30.94	29.75	15.63	41.86	15.05	14.11	24.82	29.78	34.93	46.62	56.96	68.27	80.37
% change	*NS*	*19.3%*	*(3.9%)*	*(47.5%)*	*167.9%*	*(64.1%)*	*(6.3%)*	*75.9%*	*20.0%*	*17.3%*	*33.4%*	*22.2%*	*19.9%*	*17.7%*
EPS reported	25.90	30.74	29.01	(37.04)	40.46	16.46	(9.61)	13.66	28.04	34.34	45.82	56.96	68.27	80.37
CFPS	36.10	52.80	45.16	18.69	34.04	21.45	23.41	25.45	44.73	47.57	59.59	74.02	91.33	106.58
Book value (BVPS) (a)	129.9	145.8	117.7	59.6	127.5	140.5	125.4	112.4	134.7	146.1	180.8	192.3	243.5	303.4
Net dividend	11.20	13.20	13.60	0.00	4.80	5.80	6.00	6.00	8.85	11.80	30.47	17.09	20.48	24.11
STOCKMARKET RATIOS	**YEARLY AVERAGE PRICES for end Dec. 95 to Dec. 06**					**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06e**	**Dec. 07e**	**Dec. 08e**
P / E (P/ EPS restated)	14.0x	16.1x	18.6x	28.1x	8.9x	40.3x	23.9x	16.1x	19.3x	20.2x	19.5x	21.1x	20.1x	17.1x
P / E relative to DJ STOXX50	80%	103%	101%	126%	43%	199%	100%	73%	121%	145%	148%	167%	170%	155%
P / CF	10.1x	9.4x	12.2x	23.5x	11.0x	28.2x	14.4x	15.7x	12.8x	14.8x	15.3x	16.2x	15.0x	12.9x
FCF yield	3.5%	4.5%	2.1%	(2.3%)	0.2%	(2.2%)	0.2%	4.9%	3.5%	4.1%	3.1%	4.1%	4.5%	5.3%
P / BVPS	2.79x	3.42x	4.69x	7.36x	2.93x	4.31x	2.69x	3.55x	4.26x	4.83x	5.03x	6.24x	5.64x	4.53x
Net yield	3.1%	2.6%	2.5%	0.0%	1.3%	1.0%	1.8%	1.5%	1.5%	1.7%	3.4%	1.4%	1.5%	1.8%
Payout	43.2%	42.7%	45.7%	0.0%	11.5%	38.5%	42.5%	24.2%	29.7%	33.8%	65.4%	30.0%	30.0%	30.0%
EV / Sales	0.95x	1.30x	1.39x	1.33x	0.79x	1.88x	1.01x	1.19x	1.67x	1.83x	2.11x	2.43x	2.36x	2.05x
EV / Restated EBITDA	7.1x	9.3x	10.8x	13.9x	7.5x	17.3x	9.9x	9.1x	10.3x	10.4x	10.9x	12.2x	11.5x	9.7x
EV / Restated EBIT	10.0x	13.1x	16.3x	27.0x	13.4x	29.0x	17.1x	13.2x	13.6x	13.5x	13.9x	15.5x	14.4x	12.1x
EV / OpFCF	18.3x	15.9x	36.8x	NC	33.3x	NC	115.3x	16.7x	21.2x	17.6x	21.0x	17.2x	15.8x	13.3x
EV / Capital employed (incl. gross goodwill)	4.3x	4.8x	4.8x	5.0x	3.5x	5.2x	3.2x	4.1x	5.4x	5.7x	5.6x	6.2x	5.6x	4.7x
ENTERPRISE VALUE (CHFm)	**2 489**	**3 845**	**4 549**	**4 198**	**2 438**	**4 456**	**2 349**	**2 843**	**4 087**	**5 286**	**6 984**	**9 325**	**10 652**	**10 489**
Market cap	3,232	4,293	4,358	3,433	2,926	4,741	2,639	3,189	4,562	5,618	7,239	9,393	10,740	10,740
+ Adjusted net debt	(879)	(822)	(337)	(85)	(616)	(488)	(446)	(402)	(493)	(439)	(430)	(243)	(263)	(427)
+ Other liabilities and commitments	0	37	35	39	76	85	81	80	61	150	219	219	219	219
+ Revalued minority interests	212	436	588	891	148	210	163	65	77	126	181	181	181	181
- Revalued investments	76	99	95	79	95	92	88	89	120	169	225	225	225	225
P & L HIGHLIGHTS (CHFm)	**Switch to IFRS data from FY ended 12/04**				**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06e**	**Dec. 07e**	**Dec. 08e**
Sales	**2,628**	**2,953**	**3,271**	**3,154**	**3,085**	**2,369**	**2,332**	**2,392**	**2,454**	**2,885**	**3,308**	**3,831**	**4,505**	**5,123**
Restated EBITDA (b)	**352**	**414**	**422**	**302**	**327**	**257**	**238**	**311**	**396**	**508**	**642**	**762**	**929**	**1,081**
Depreciation	(103)	(121)	(143)	(146)	(144)	(104)	(101)	(95)	(96)	(115)	(140)	(162)	(189)	(214)
Restated EBIT (b) (*)	**249**	**294**	**279**	**156**	**183**	**154**	**137**	**216**	**300**	**393**	**502**	**600**	**740**	**867**
Reported operating profit (loss)	250	317	278	(256)	183	169	(40)	127	293	380	502	621	740	867
Net financial income (charges)	49	44	43	2	5	18	17	13	10	6	5	1	2	3
Affiliates	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other					203									
Tax	(61)	(88)	(79)	(24)	(57)	(51)	(44)	(27)	(68)	(93)	(119)	(152)	(182)	(213)
Minorities	(8)	(9)	(12)	(12)	(16)	(7)	(8)	(4)	(8)	(15)	(17)	(24)	(26)	(28)
Goodwill amortisation	(0)	(2)	(6)	(10)	(11)	(4)	(8)	(9)	(10)	-	-	-	-	-
Net attributable profit reported	231	264	229	(290)	316	129	(75)	109	227	278	371	446	534	629
Net attributable profit restated (c)	**231**	**264**	**229**	**113**	**316**	**114**	**102**	**189**	**227**	**278**	**371**	**446**	**534**	**629**
CASH FLOW HIGHLIGHTS (CHFm)	**Dec. 95**	**Dec. 96**	**Dec. 97**	**Dec. 98**	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06e**	**Dec. 07e**	**Dec. 08e**
EBITDA (reported)	**353**	**440**	**427**	**(101)**	**338**	**276**	**69**	**231**	**399**	**495**	**642**	**783**	**929**	**1,081**
EBITDA adjustment (b)	**(2)**	**(26)**	**(4)**	**402**	**(11)**	**(19)**	**170**	**80**	**(3)**	**13**	**0**	**(21)**	**0**	**0**
Other items	(5)	87	(26)	(95)	18	(59)	(26)	(92)	1	(43)	(44)	0	0	0
Change in WCR	(52)	(98)	(84)	(80)	(85)	(167)	(76)	72	(33)	36	(60)	10	15	15
Operating cash flow	**294**	**403**	**312**	**126**	**261**	**32**	**137**	**291**	**364**	**501**	**538**	**772**	**944**	**1,096**
Capex	(158)	(161)	(188)	(181)	(187)	(121)	(116)	(121)	(171)	(201)	(205)	(228)	(270)	(307)
Operating free cash flow (OpFCF)	**136**	**242**	**124**	**(55)**	**73**	**(90)**	**20**	**171**	**193**	**300**	**333**	**544**	**674**	**789**
Net financial items + tax paid	(14)	(32)	(21)	(46)	(66)	(21)	(16)	(12)	(29)	(66)	(102)	(151)	(180)	(211)
Free cash flow	**122**	**211**	**102**	**(101)**	**8**	**(111)**	**5**	**159**	**164**	**234**	**231**	**392**	**494**	**578**
Net financial investments	12	(8)	(27)	(19)	17	19	(24)	(44)	(6)	(180)	(80)	(199)	(340)	(255)
Other	0	(22)	(22)	18	506	1	23	(112)	3	(40)	(70)	0	0	0
Capital increase (decrease)	0	(137)	(425)	(43)	0	0	0	0	0	0	0	(144)	0	0
Dividends paid	(90)	(101)	(114)	(106)	0	(38)	(45)	(47)	(70)	(68)	(90)	(236)	(134)	(160)
Increase (decrease) in net financial debt	**(43)**	**56**	**485**	**252**	**(531)**	**128**	**42**	**44**	**(91)**	**54**	**9**	**187**	**(20)**	**(163)**
Cash flow, group share	**322**	**454**	**357**	**146**	**266**	**168**	**183**	**203**	**356**	**379**	**474**	**579**	**714**	**834**
BALANCE SHEET HIGHLIGHTS (CHFm)	**Dec. 95**	**Dec. 96**	**Dec. 97**	**Dec. 98**	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06e**	**Dec. 07e**	**Dec. 08e**
Fixed operating assets, incl. gross goodwill	403	552	629	626	437	420	457	480	562	797	1,015	1,280	1,702	2,050
WCR	179	253	324	211	268	434	286	216	196	138	223	213	198	183
Capital employed, incl. gross goodwill	**582**	**805**	**953**	**837**	**705**	**853**	**743**	**696**	**758**	**935**	**1,238**	**1,493**	**1,900**	**2,233**
Shareholders' funds, group share	1,157	1,254	930	466	997	1,099	981	897	1,072	1,163	1,439	1,505	1,905	2,373
Minorities	35	57	52	49	22	20	26	18	18	26	36	60	86	114
Provisions/ Other liabilities	344	415	403	485	397	314	270	272	281	354	418	397	397	397
Net financial debt (cash)	(879)	(822)	(337)	(85)	(616)	(488)	(446)	(402)	(493)	(439)	(430)	(243)	(263)	(427)
FINANCIAL RATIOS (%)	**Dec. 95**	**Dec. 96**	**Dec. 97**	**Dec. 98**	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06e**	**Dec. 07e**	**Dec. 08e**
Sales (% change)	NS	12.4%	10.7%	(3.6%)	(2.2%)	(23.2%)	(1.6%)	2.6%	2.6%	17.6%	14.7%	15.8%	17.6%	13.7%
Organic sales growth						1.0%	7.0%	6.0%	6.7%	10.6%	11.4%	10.8%	11.1%	9.4%
Restated EBIT (% change) (*)	NS	18.1%	(4.9%)	(44.2%)	17.3%	(15.9%)	(10.7%)	57.5%	38.9%	31.0%	27.7%	19.5%	23.3%	17.2%
Restated attributable net profit (% change) (*)	NS	15.3%	(11.8%)	(48.0%)	167.9%	(64.1%)	(6.3%)	79.4%	19.7%	17.3%	33.5%	20.1%	19.9%	17.7%
Personnel costs / Sales	51.0%	50.5%	52.5%	54.7%	54.2%	52.6%	53.8%	52.3%	50.5%	49.7%	48.8%	49.9%	50.1%	50.0%
Restated EBITDA margin	13.4%	14.0%	12.9%	9.6%	10.6%	10.9%	10.2%	13.0%	16.1%	17.6%	19.4%	19.9%	20.6%	21.1%
Restated EBIT margin	9.5%	9.9%	8.5%	4.9%	5.9%	6.5%	5.9%	9.0%	12.2%	13.6%	15.2%	15.7%	16.4%	16.9%
Tax rate	20.5%	24.2%	24.3%	NC	28.8%	26.9%	NC	18.1%	21.7%	24.1%	23.5%	24.5%	24.5%	24.5%
Net margin	9.1%	9.3%	7.4%	(8.8%)	10.8%	5.7%	(2.9%)	4.7%	9.6%	10.2%	11.7%	12.3%	12.4%	12.8%
Capex / Sales	6.0%	5.5%	5.8%	5.7%	6.1%	5.1%	5.0%	5.0%	7.0%	7.0%	6.2%	5.9%	6.0%	6.0%
OpFCF / Sales	5.2%	8.2%	3.8%	(1.7%)	2.4%	(3.8%)	0.9%	7.1%	7.9%	10.4%	10.1%	14.2%	15.0%	15.4%
WCR / Sales	6.8%	8.6%	9.9%	6.7%	8.7%	18.3%	12.3%	9.0%	8.0%	4.8%	6.7%	5.6%	4.4%	3.6%
Capital employed (excl. gross goodwill) / Sales	21.8%	25.1%	25.8%	23.0%	21.8%	34.6%	29.1%	24.7%	24.9%	21.9%	24.5%	27.8%	32.6%	35.2%
ROE (before goodwill)	20.0%	21.2%	25.3%	26.2%	32.8%	10.7%	11.2%	22.1%	22.1%	23.9%	25.8%	29.6%	28.0%	26.5%
Gearing	(74%)	(63%)	(34%)	(17%)	(60%)	(44%)	(44%)	(44%)	(45%)	(37%)	(29%)	(16%)	(13%)	(17%)
EBITDA / Financial charges	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC
Adjusted financial debt / EBITDA	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC	NC
ROCE, excl. gross goodwill	34.5%	30.1%	25.1%	16.2%	19.3%	13.7%	15.3%	30.0%	38.4%	47.3%	47.5%	42.6%	38.0%	36.3%
ROCE, incl. gross goodwill	34.0%	27.6%	22.2%	14.0%	18.4%	13.2%	13.9%	25.4%	31.0%	31.9%	31.0%	30.3%	29.4%	29.3%
WACC	8.6%	8.2%	7.9%	7.7%	8.8%	8.6%	9.3%	9.1%	9.4%	9.5%	8.5%	9.0%	8.3%	8.3%
Average number of employees	35,054	37,216	39,584	39,144	37,506	30,532	30,625	32,288	32,436	36,659	41,460			

(a) Intangibles: CHF429.00m, or CHF54 per share. (b) adjusted for capital gains/losses, impairment charges, exceptional restructuring charges, capitalized R&D, pension charge replaced by service cost

(*) also adjusted for goodwill for pre IFRS years, (c) adj.for capital gains losses, imp.charges, capitalized R&D, exceptional restructuring

EXANE BNP PARIBAS

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