

COMPANY NOTE

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30 May 2011

Jefferies

SGS (SGSN VX)

Highlights from Investor Day – LT Opportunities Shine Through the Smoke

Key Takeaway

Long-term trends in SGS's business remain compelling and the group appears to have partly side-stepped the pitfalls seen by its peers YtD. This remains a good long-term holding, in our view, but given the demanding valuation we see little room for near-term relative outperformance. We reiterate HOLD.

YtD growth robust despite some external shocks. SGS has seen high single-digit LFL expansion YtD despite a number of negative external shocks (Ivory Coast stoppage, North African unrest, Japanese tsunami fallout). That said, revenue growth is slightly below our published forecast and SGS's 2010 exit rate, but we do not see this as a surprise given recent Bureau Veritas and Intertek Group updates. The company saw growth in all 10 divisions and across all its regions.

Investment plan not as depressing as feared. Along with good revenue growth, SGS's management highlighted relatively strong margin performance YtD – suggesting profitability has held up despite the ramp-up in investment. While partly a function of lagged costs related to investments, it is also increasingly clear that guidance for a significant dip in margins in the early stages of the 2014 plan was excessively cautious.

M&A imminent. After issuing a significant chunk of debt, expectations are high for SGS to make a number of more sizeable acquisitions. The company did little to dispel those expectations, noting a full deal pipeline and that last week's operating council meeting was heavily M&A focused. Management did, however, point to rising deal multiples and stressed that it remains very disciplined on price.

While short-term trends were the most newsworthy takeaway, **longer-term trends were the key focus of SGS's investor event.** Key themes across the presentations and lab tours were the push upstream, increased bundling of services, and SGS's scale and technology advantages. While we continue to believe this cycle will be less robust than the last for SGS and its peers, the presentations did serve to highlight the growth opportunities across the business and the work left to be done in optimising operations.

Valuation/Risks

We have modestly adjusted our estimates for slightly slower than expected growth, but better margin evolution. Our CHF1,600/share target price continues to be derived by applying a 13x EV/EBIT multiple to forward EBIT. The key risk is the roll-out of the 2014 investment plan, and some potential flops along the way.

CHF	Prev.	2010A	Prev.	2011E	Prev.	2012E	Prev.	2013E
Rev. (MM)	--	4,757.0	5,093.1	4,936.0	5,753.7	5,580.0	--	6,289.0
EBITDA (MM)	--	1,061.0	1,109.7	1,093.0	1,300.2	1,272.0	--	1,487.0
EBIT (MM)	--	836.0	874.1	857.0	1,013.5	991.0	--	1,150.0
Net Profit	--	588.0	612.8	592.0	709.6	680.0	--	789.0
EPS								
FY Dec	--	77.64	80.94	78.13	93.73	89.75	--	104.28
FY P/E		21.4x		21.2x		18.5x		15.9x

HOLD

Price target CHF1,600.00
Price CHF1,660.00

Financial Summary

Net Debt (MM):	CHF(157.0)
Net Debt/Capital:	(20.0)%
Dividend Yield:	4.5%

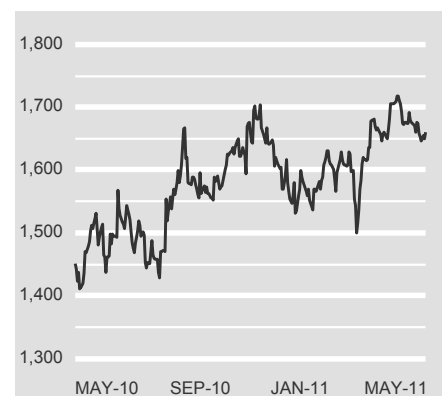
Market Data

52 Week Range:	CHF1,724.00 - CHF1,363.36
Total Entprs. Value (MM):	CHF12,459.0
Market Cap. (MM):	CHF12,616.0
Insider Ownership:	NA
Institutional Ownership:	NA
Shares Out. (MM):	7.6
Avg. Daily Vol.:	23,667

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Price Performance



Consumer - No structural changes afoot

Given the recent consumer division challenges highlighted by Intertek and Bureau Veritas, that division was in the limelight at the investor event, despite not officially being on the agenda. While confirming some issues surrounding a longer Chinese New Year, SGS's consumer division head suggested the impact on the business was less severe than that highlighted by the peers. Revenues YtD in the division are up, but only modestly given the lack of regulatory catalysts and the New Year issue, and profitability is down just a touch.

More importantly, in our view, management also stressed that it was seeing no structural changes in the consumer business – which is in contrast to some of the noises being made by BV. The group suggested that the trend toward multi-sourcing of consumer testing business is one which has largely played out at this point – and not a new found source of pricing pressure – with relatively few single source contracts remaining. Management also seemed sanguine on the impact of Chinese wage inflation and the move inland and outside China for manufacturing. Migration of capacity is expected to be gradual, and the trend was seen as an opportunity for the group, as smaller testing rivals do not have the resources and knowhow to follow the manufacturing base.

Upstream in action

The site visits on SGS's two-day investor event highlighted not just the group's traditional testing business, but also provided some insight into the push towards upstream and into more consulting/R&D related services.

The visit to the group's Lakefield minerals site demonstrated the group's complete mine cycle offering, with the more traditional geochemistry lab work being complimented by upstream discovery related services and also full process development services. While geochem is a scale-driven business, the orebody modelling and process development services allow the group to get more deeply embedded with miners and take an increasing share of mine development spend.

Other noteworthy presentations were from the oil & gas division, which highlighted new technological innovations that are capable of dramatically reducing sample turnaround time on rigs and also the potential in port outsourcing work; the agriculture division that highlighted the growing CRO opportunity in crop research and increasing demand for precision farming; and the industrial division that highlighted significant potential for mobile workflow management systems to improve efficiency.

Exhibit 1: SGS Income statement

December year end	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E
Income Statement (CHFm)												
Turnover	2392.0	2454.0	2885.0	3308.0	3821.0	4372.0	4818.0	4712.0	4757.0	4936.3	5580.4	6289.0
% change	2.6%	2.6%	17.6%	14.7%	15.5%	14.4%	10.2%	-2.2%	1.0%	3.8%	13.0%	12.7%
EBITDA	311.0	396.0	508.0	642.0	800.0	908.0	1024.0	1022.0	1061.0	1092.5	1271.9	1487.5
margin %	13.0%	16.1%	17.6%	19.4%	20.9%	20.8%	21.3%	21.7%	22.3%	22.1%	22.8%	23.7%
EBIT	127.0	293.0	380.0	502.0	623.8	690.0	937.0	794.0	836.0	857.5	990.7	1149.8
margin %	5.3%	11.9%	13.2%	15.2%	16.3%	15.8%	19.4%	16.9%	17.6%	17.4%	17.8%	18.3%
Pre-Tax	140.0	303.0	386.0	507.0	622.8	692.0	933.0	791.0	829.0	836.9	964.0	1123.0
Net income	109.0	227.0	278.0	371.0	442.8	500.0	692.0	566.0	588.0	591.5	679.5	789.5
margin %	4.6%	9.3%	9.6%	11.2%	11.6%	11.4%	14.4%	12.0%	12.4%	12.0%	12.2%	12.6%
Balance Sheet (CHFm)												
Working Capital	216.0	196.0	139.0	223.0	252.0	256.0	274.0	224.0	208.0	212.3	240.0	270.4
WC as a % of turnover	9.0%	8.0%	4.8%	6.7%	6.6%	5.9%	5.7%	4.8%	4.4%	4.3%	4.3%	4.3%
Capital Employed	1317.0	1404.0	1561.0	1994.0	1980.0	2337.0	2558.0	2773.0	2998.0	3773.5	4098.5	4481.1
Net Debt	-402.0	-493.0	-438.0	-430.0	-215.0	-378.0	-248.0	-476.0	-259.0	-156.5	-139.7	-211.5
Gearing	-44.8%	-46.0%	-37.7%	-29.9%	-13.8%	-19.5%	-13.6%	-23.0%	-12.5%	-7.2%	-5.7%	-7.5%
Cash Flow (CHFm)												
Cash Flow	219.0	395.0	486.0	598.0	582.8	694.0	802.0	827.0	816.0	852.6	990.7	1161.9
Capex	-121.0	-171.0	-201.0	-205.0	-224.0	-271.0	-278.0	-209.0	-250.0	-358.4	-418.5	-408.8
WCR	32.0	-70.0	-61.0	-187.0	-31.0	12.0	-22.0	13.0	-33.0	-4.3	-27.7	-30.5
Free-Cash Flow	130.0	154.0	224.0	206.0	327.8	435.0	502.0	631.0	533.0	490.0	544.5	722.7
Key Valuation Ratios												
Shares Outstanding (m)	7.8	7.7	7.5	7.6	7.6	7.6	7.6	7.5	7.6	7.6	7.6	7.6
Stock Price (CHF)	388.5	604.0	720.5	956.0	1,226	1,452	1,250	1,197	1,518	1,660	1,660	1,660
Market Cap*	3,020	4,644	5,396	7,260	9,307	11,085	9,496	8,975	11,493	12,568	12,568	12,568
EPS net	14.02	29.52	37.12	48.85	58.33	65.47	76.19	75.48	77.64	78.13	89.75	104.28
PER net	27.7	20.5	19.4	19.6	21.0	22.2	16.4	15.9	19.6	21.2	18.5	15.9
CFPS	28.2	51.4	64.9	78.7	76.8	90.9	105.6	110.3	107.8	112.6	130.9	153.5
PCF	13.8	11.8	11.1	12.1	16.0	16.0	11.8	10.9	14.1	14.7	12.7	10.8
P/NAV	3.4	4.3	4.6	5.0	6.0	5.7	5.2	4.3	5.6	5.8	5.1	4.5
ROCE	9.2%	21.5%	25.6%	28.2%	31.4%	32.0%	33.1%	29.8%	29.0%	25.3%	25.2%	26.8%
ROE	12.6%	21.9%	25.2%	27.0%	29.9%	26.8%	39.1%	28.5%	29.7%	28.5%	28.8%	29.3%
EV	2,618	4,151	4,958	6,830	9,092	10,707	9,248	8,499	11,234	12,411	12,428	12,356
EV / Sales	1.1	1.7	1.7	2.1	2.4	2.4	1.9	1.8	2.4	2.5	2.2	2.0
EV / EBITDA	8.4	10.5	9.8	10.6	11.4	11.8	9.0	8.3	10.6	11.4	9.8	8.3
EV / EBIT	20.6	14.2	13.0	13.6	14.6	15.5	9.9	10.7	13.4	14.5	12.5	10.7
Yield %	1.6%	1.2%	1.3%	1.2%	4.2%	1.6%	2.8%	4.2%	4.2%	3.9%	3.1%	3.5%

* historical data are average figures

Source: Jefferies International Ltd.

Company Description

SGS is the largest global inspection, testing, verification and certification player. Through its international network of laboratories, the company inspects, samples and analyzes raw materials, food, crops and consumer goods, as well as certifying products and machinery for compliance with local and international standards.

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Other Companies Mentioned in This Report

- Bureau Veritas (BVI FP: €57.31, HOLD)
- Intertek Group (ITRK LN: p1,997.00, HOLD)

Rating and Price Target History for: SGS (SGSN VX) as of 05-27-2011

01/16/09 B:CHF1400	07/16/09 B:CHF1375	11/11/09 B:CHF1425	01/18/10 B:CHF1550	07/19/10 H:CHF1600
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Rating and Price Target History for: Bureau Veritas (BVI FP) as of 05-27-2011

07/30/08 H:EUR44	08/28/08 H:EUR43	10/31/08 H:EUR27	02/11/09 H:EUR33	05/06/09 H:EUR34	07/29/09 H:EUR35	08/28/09 H:EUR36	11/05/09 H:EUR35	02/02/10 H:EUR39	05/04/10 H:EUR40	05/06/10 H:EUR42
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06/22/10 H:EUR44	08/27/10 H:EUR50	01/13/11 H:EUR56
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Rating and Price Target History for: Intertek Group (ITRK LN) as of 05-27-2011



Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	609	52.40%	41	6.73%
HOLD	501	43.10%	28	5.59%
UNDERPERFORM	52	4.50%	3	5.77%

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