Jefferies International Ltd.

March 31, 2006

Services
Diversified Commercial

Switzerland

Initiating Coverage

SGS (VX: SGSN VX)

Fully Fit After Inspection

Investment Summary

We expect SGS to continue to deliver strong organic growth, rising margins and high returns. We believe that the fundamentals in the global testing and inspection market remain very strong, and that SGS will enhance its leading position through offering new services and making bolt-on acquisitions.

Rating:	BUY
Price:	CHF1,232.00
Price Target:	CHF1,450.00
Bloomberg:	**VX: SGSN VX**

Market Data

52-Week Range:	CHF1,263.00-CHF802.00
Total Entprs. Value (MM):	CHF9,052.2
Shares Out. (MM):	7.6
Market Cap. (MM):	CHF9,363.2
Float (%):	53.0%
Avg. Daily Vol.:	18,834

Financial Summary

Net Debt (MM):	(CHF311.00)
Net Debt/Capital:	(19%)
Yield:	4%

CHF	2005A	2006E	2007E	2008E
Rev. (MM)	**3308.0**	**3821.0**	**4279.0**	**4771.0**
EV/Rev.	**2.7x**	**2.4x**	**2.1x**	**1.9x**
EBITDA (MM)	**642.0**	**788.6**	**905.1**	**1,017.9**
EV/EBITDA	**14.1x**	**11.5x**	**10.0x**	**8.9x**
EPS				
FY Dec	**48.90**	**59.10**	**69.00**	**78.70**
FY P/E	25.2x	20.8x	17.9x	15.7x
EBIT	**502.0**	**613.6**	**713.6**	**811.9**
EV/EBIT	**18.0x**	**14.8x**	**12.7x**	**11.1x**
Net Profit	**371.0**	**448.6**	**524.2**	**597.6**
Consensus	**48.90**	**57.80**	**66.00**	**72.20**

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Event

We are initiating coverage of SGS with a Buy rating and a 12-month price target of CHF 1,450.

Key Points

Ambitious Targets Achievable. SGS CEO Dan Kerpelman recently outlined the company's 3-year growth plan, including 2008 financial targets of CHF 5bn in revenue, an operating margin of 17% and EPS of CHF 80. We believe that these targets are achievable, and we estimate that SGS will enjoy a 3-year earnings growth CAGR of 17.2% for the 2006-08 period.

Impressive Organic Growth. Following organic growth of 10.7% in 2004 and 11.4% in 2005, we expect another good year of 11.2% organic growth in 2006. In our view, this will be driven by increased trade flows stemming from the strong global economy, further penetration of existing supply chains through new services and continued market share gains.

Margins Still Rising. After rising 140 bp and 160 bp in 2004 and 2005, respectively, to 15.2%, we believe there is further room for EBIT margin improvement, albeit at a slower pace. Margins should expand through better utilisation of SGS's global laboratory network, the addition of new higher-margin services and faster growth from Asia where labour costs are much lower.

Stepping Up Acquisition Activity. After adding just 1.8% to sales in 2005 from acquisitions, we believe SGS is set to step up its activity in this area. According to our estimates, the top three players (SGS, Bureau Veritas and Intertek) control 30%-35% of the outsourced market, leaving plenty of room for further deals. SGS has targeted annual external growth of 5% through 2008, and with net cash of CHF 430m on the balance sheet at year-end 2005, it has considerable financial firepower. We conservatively estimate a CAGR of 3% from acquisitions between 2005 and 2008.

The Big Fish. In time, we believe that SGS would be interested in buying Bureau Veritas, the No. 2 player, as significant cost synergies would likely be available. Bureau Veritas is currently owned by Wendel Investissement (MF FP, €97.3, Buy), which may look to sell it in the next couple of years.

Valuation/Risks

SGS currently trades on 20.8x our 2006 EPS estimate of CHF 59.1 and 17.9x our 2007 EPS estimate of CHF 69, which represents a premium of 8% and 4%, respectively, to its closest publicly traded competitor Intertek (ITRK LN, 829.5p, NC). We believe SGS deserves a 20% premium to Intertek due to its faster growth prospects, rising margins, larger size and stronger balance sheet. Our 12-month price target of CHF 1,450 is based on 21x our 2007 EPS estimate.

Key risks in our view include a downturn in the global economy leading to reduced trade flows, increased protectionism and a reduction in global commodity prices (particularly oil, gas and minerals).

Executive Summary

Company Description

SGS provides inspection, testing, verification and certification services worldwide. Through its international network of laboratories, the company inspects, samples and analyses raw materials, food, crops and consumer goods, as well as certifying products and machinery for compliance with local and international standards.

An Ambitious but Achievable Growth Plan

SGS CEO Dan Kerpelman recently outlined the group's three-year growth plan, including 2008 financial targets of CHF 5bn in revenue, an operating margin of 17% and EPS of CHF 80. This compares to 2005 results of CHF 3.3bn, 15.2% and CHF 48.9, respectively. The group aims to achieve this target through organic sales growth of 10% and external sales growth of 5%. SGS posted organic growth of 10.7% in 2004 and 11.4% in 2005, and it has expanded operating margins in almost every division for the past two years. We believe that these targets are certainly achievable, especially as we believe that industry dynamics will remain favourable and the market is ripe for continued consolidation. Indeed, we believe that SGS will post a three-year EPS CAGR for the 2006-08 period of 17.2%.

Global Growth, Additional Services & Increased Market Share

In our opinion, there are three key factors that should drive organic sales growth at SGS going forward — global growth, further penetration of existing supply chains through offering additional services, and market share gains. With the outlook for global growth still positive and the trend toward 'globalization' still firmly in place, we believe the macro economic backdrop should remain favourable for SGS for at least the next couple of years, as trade flows and global exports continue to increase.

SGS has also expanded margins over the last few years by offering additional services on top of its more traditional inspection and testing services, and by further penetrating the 'supply chain' by increasing its number of contact points with a commodity or a product as it travels from the manufacturer to the end-customer. We believe there is significant room for this to continue, which should in turn drive the third key factor — increased market share. We currently estimate that SGS has about 15% global market share, and in our opinion it still has significant opportunities to increase this, either organically through new services or externally through leveraging its balance sheet.

Valuation

Premium to Intertek Could Expand Further

SGS currently trades on 20.8x and 17.9x our 2006 and 2007 EPS estimates, respectively, which represents a premium of 8% and 4%, respectively, to its closest publicly traded competitor Intertek. On an EV/EBIT basis, the premium is 8% and 3%, respectively. We believe SGS deserves a 20% premium to Intertek due to its faster growth prospects, rising margins, larger size and stronger balance sheet. Applying a multiple of 21x to our 2007 EPS estimate of CHF 69 yields our CHF 1,450 price target. This represents a 2007 PE/G ratio of 1.2x, and is reinforced by our DCF valuation of CHF 1,492.

Risks

Trade Flows & Commodity Prices

In our opinion, the key risks for SGS are related to the global economy, trade flows and commodity prices. Any global economic downturn would likely lead to reduced trade flows and thus lower business levels for SGS, as would a significant increase in protectionism. Furthermore, about 40% of revenues come from commodity-related businesses (agriculture, oil, gas, minerals and chemicals) and a sharp fall in current high prices would likely be negative for SGS. Geopolitical issues and increased insecurity could also reduce trade flows, but would at the same time probably increase the importance of testing and certification. Offsetting these risks, we also note that SGS has a well-diversified revenue base split by industry, customer and geography.

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Company Overview

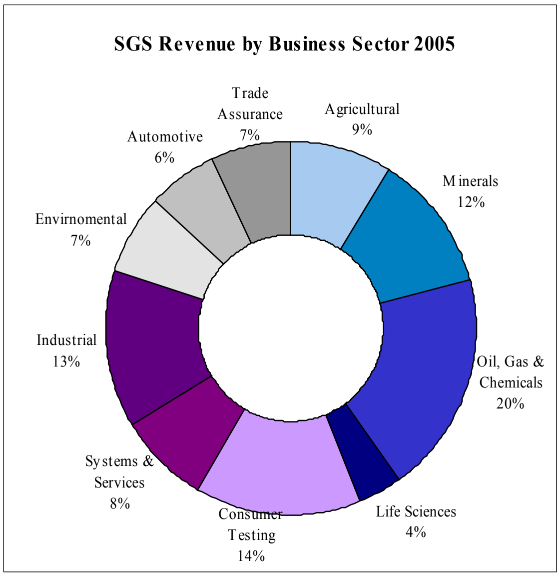
Company Description

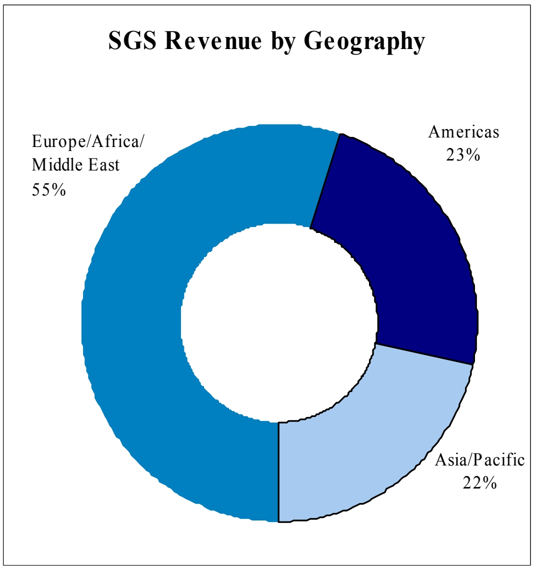
SGS is the world's leading inspection, testing and certification company. SGS provides an extremely broad range of services across the global economy ranging from certification of agricultural goods through to testing in the life sciences sector. Amongst other things, the company tests, inspects and assures the quality of our food, our clothing, our cars, and our environment.

Revenues are spread across a broad economic base, but the company's largest source of revenue is from its oil, gas & chemicals services business, which accounted for 20% of revenues in 2005. On a geographical basis the company derives a disproportionate share of revenue from its Europe/Africa/Middle East region. The Asia/Pacific region, however, has seen the fastest growth over the last five years.

SGS has 42,000 employees worldwide and operates roughly 1,000 offices and laboratories.

Exhibit 1: SGS Revenue Breakdown





Source: SGS, Jefferies Intl.

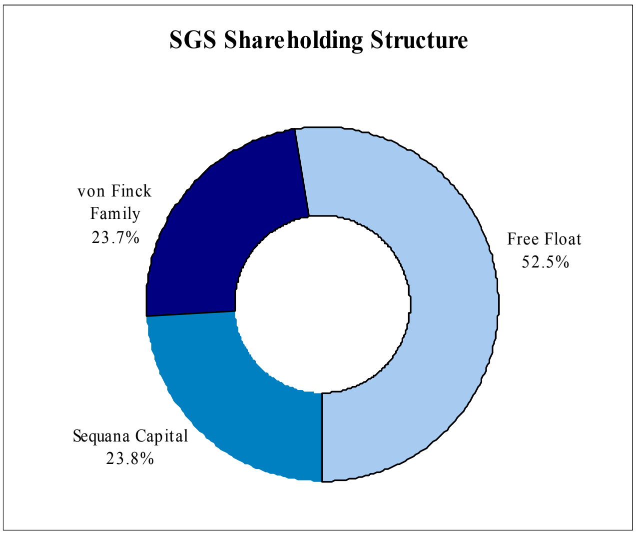
History

SGS was founded in 1878 in Rouen as a grain shipment inspection house and was originally focused on the certification of grain loading and discharge from vessels. Over the course of the 20th century the company diversified its business to include inspection, testing and certification services across a broad spectrum of the global economy. More recently, the company has been actively engaged in increasing its exposure to the life sciences sector. SGS was incorporated in 1919 and was listed on the Swiss Exchange in 1985.

Shareholder Structure

The two key shareholders of SGS are the von Finck family (23.7%) and Sequana Capital (23.8%). Sequana, an investment company, acquired an initial 11.34% stake in SGS in 2000, which was subsequently increased to 20% in 2001 and 23.8% in 2003.

Exhibit 2: SGS Shareholding Structure



Source: SGS, Jefferies Intl.

Strategic Analysis

Further Penetrating the Supply Chain through New Services

Offering new services is a key part of SGS's growth strategy. SGS started its business by offering just certificates, but now offers a whole range of different services to its customers such as market analysis and product consultancy. These new services not only have higher margins in most cases, but also enable SGS to raise its revenue per customer by touching the product at more points along the supply chain. For example, in its agricultural services division, SGS now earns revenue from offering advice to farmers and logistics outsourcing as well as testing and inspecting physical product shipments. We believe that roughly 40% of the company's organic growth over the last few years has come from offering new products and services along with corresponding market share gains, with the balance coming from the overall growth of the market of 7%–8%.

Margins Set to Continue Rising

SGS is targeting operating margins of 17% in 2008 versus 15.2% in 2005 and 13.2% in 2004. Margin enhancements have been driven by adding new products and services as well as better capacity utilization of SGS's global laboratory network. We believe these trends will continue, and we forecast operating margins of 16.1%, 16.7% and 17% in 2006, 2007 and 2008, respectively. Indeed, we note recent comments by SGS Chairman Sergio Marchionne, who was quoted as saying that margins could go *"significantly above the actual level".*

We believe that most of SGS's divisions will experience rising margins for at least the next couple of years, and we attach particular importance to the consumer testing division, which generates 14.4% of sales but 20.3% of operating profit. Together with life sciences and industrial services, SGS has targeted consumer testing as a strategic focus for growth. SGS is currently No. 2 in the market behind Intertek, but believes it can become No. 1 in the next three years. SGS currently generates 21.4% operating margins in this division versus 29.8% at Intertek's Labtest division, which has more business in Asia.

Acquisitions Accelerating, Industry Consolidating

Despite only adding 1.8% to the top line in 2005 through external growth, we believe that SGS's acquisition activity is set to accelerate. In its strategic plan, the group has targeted 5% annual growth from acquisitions, and it has already bought three companies in 2006, which we estimate will add 3% to sales. Going forward, we conservatively assume 3% annual growth from acquisitions, despite the group's very solid balance sheet, with net cash of CHF 430m at year-end 2005. In terms of acquisition criteria, deals are normally accretive at the segment level, and SGS typically pays around 1x sales (except for life sciences deals where the cost is more often 2x sales).

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We have assumed that acquisitions are spread evenly across the group's 10 business segments, but we also note that new verticals could be targeted. SGS has highlighted government services, financial services, software and energy infrastructure as new strategic growth areas where it currently has little or no presence. We also note that competitors continue to be active on the acquisition front, and that smaller players are increasingly unable to compete on a global basis with the larger players such as SGS, which have global customers and can thus reap more benefits from deals including operational efficiencies and cross-selling opportunities.

Healthy Competitive Environment & Healthier Returns

We would characterize the pricing environment for the testing and inspection industry as generally stable, as healthy competition between the three largest players is offset by new value-added services. Competition is fiercer in certain segments such as consumer testing, where Intertek has suffered pricing pressure in some areas. We believe that the larger players will continue to dominate and to generate superior returns. SGS generated an impressive 35% ROCE (defined as post-tax return on average capital employed including goodwill) in 2005 (comparable to its peers) and an ROE of 27%.

Waiting for the Big Deal

We believe that the purchase of Bureau Veritas by SGS would create an industry giant as well as generating important synergies. While such a deal would give SGS access to new markets where it does not have a presence such as marine services, there would also be considerable overlap in areas such as systems certification, oil & gas services and industrial services. This overlap would in our view allow significant cost savings, taking the form of better utilization of the laboratory network and reduced overheads. Bureau Veritas is currently owned by the French investment company Wendel Investissement, which we believe will be looking for an exit strategy in a couple of years, either through an IPO or a trade sale. SGS is about 30% bigger than Bureau Veritas based on 2005 sales.

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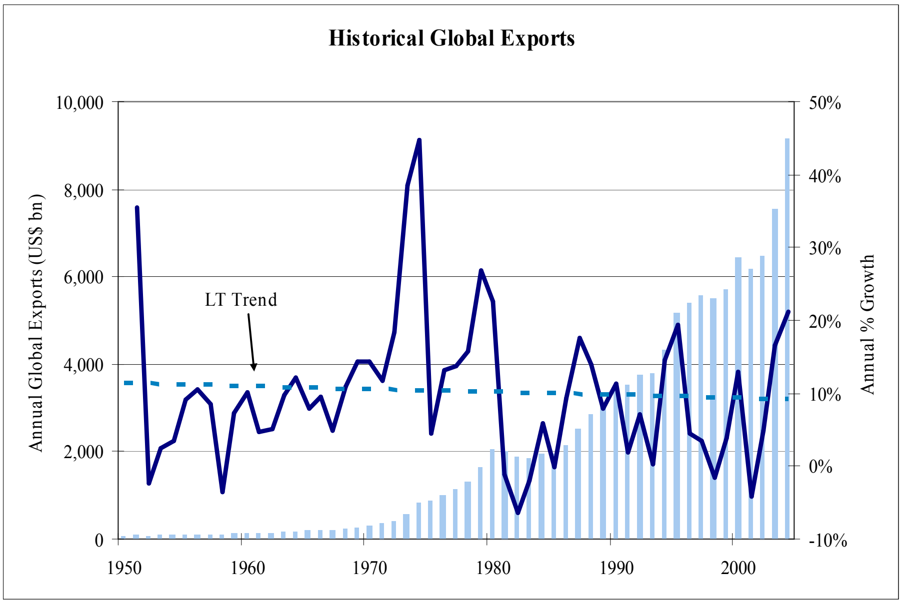
Overview of the Testing and Certification Sector

Secular Outsourcing Trend Offsets Trade-Related Cyclicality

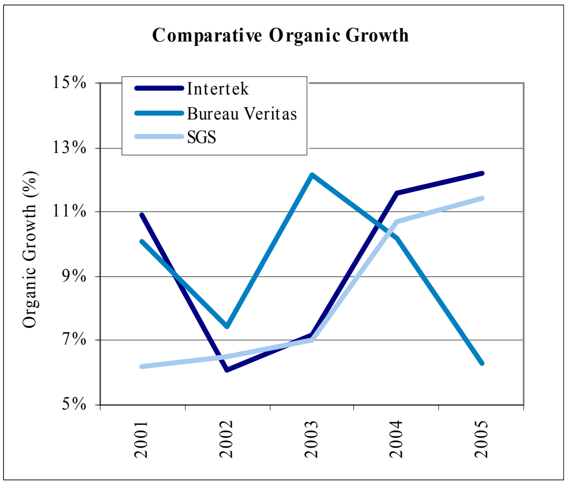
Whilst there is little concrete data available, we believe (based on published data from the largest competitors) that the global inspection, certification and testing market has grown by 7%–8% annually over the last 10 years. Three large competitors dominate the global market — SGS, Intertek and Bureau Veritas. SGS is the largest company, with about 15% market share of the outsourced sector, with Bureau Veritas and Intertek having market shares of about 12% and 6%, respectively. On top of the outsourced market, a large segment (perhaps as much as two-thirds) of the market remains in-house, but the trend is clearly toward increased outsourcing, which in our opinion somewhat offsets cyclicality related to global trade flows.

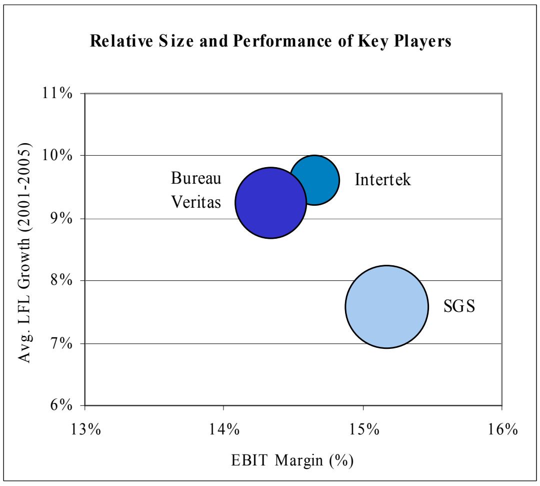
Exhibit 3: Global Export Trends



Source: WTO, Jefferies Intl.

Exhibit 4: Testing and Certification Market Trends





Source: Company documents, Jefferies Intl.

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Increased Regulation Drives Testing and Certification

A key industry driver remains the global trend toward stricter regulatory, quality and safety standards, leading to more testing and certification. Examples of this include the growing use of the global 'ISO' standards and recent EU directives related to the environmentally friendly disposal of electrical and electronic equipment waste (WEEE). Increased trade flows and further delocalization of supply chains also generally leads to more testing and quality control, particularly for exports from developing to developed countries. Demand for these services is coming from governments as well as from the 'consumer conscience', i.e., the propensity of consumers to pay more attention to what they are consuming, where it comes from and how it will be disposed of.

Consolidation Accelerating

We believe that consolidation in the industry is set to accelerate over the next couple of years. Both SGS and Bureau Veritas have stated their intentions to make bolt-on acquisitions in order to strengthen existing product lines or to enter new markets. Once again, globalization is an important driver, as companies have global clients and need to offer their services on a global basis throughout the supply chain. In 2005, Bureau Veritas made 16 acquisitions totaling over €150m in sales, compared to SGS, which made seven acquisitions for the equivalent of roughly €50m in sales. We believe that SGS is ready to gear up its balance sheet to accelerate its acquisition programme in order to meet its 2008 financial targets. In the longer term, we believe that a takeover of Bureau Veritas by SGS could make sense from both an industrial and financial standpoint.

Exhibit 5: SGS Acquisitions 2004 - Present

Acquisition	Acquisition Date	Est. Annual Revenue	Division
2004			
Institut Fresenius	Mar-04	CHF 71m	Various
Petroleum Services Corp.	May-04	CHF 65m	Oil, Gas & Chemical
2005			
Acquatic Health Chile SA	Jan-05	n/a	Agriculture
X-Per-X Inc.	Feb-05	CHF 15m	Industrial
Auto Marine Services Ltd.	Feb-05	n/a	n/a
MinnovEX Technologies Inc.	Jul-05	CHF 10m	Minerals
Casco Australia Pty. Ltd.	Aug-05	CHF 10m	Agriculture/Minerals
Auto Securite Group	Aug-05	CHF 15m	Automotive
Paradigm Analytical Laboratories Inc.	Nov-05	CHF 8m	Environmental
2006			
aster.cephac	Jan-06	CHF 55m	Life Sciences
Northview Biosciences Inc.	Feb-06	CHF 13m	Life Sciences
Cotax AS	Feb-06	CHF 2m	Oil, Gas & Chemicals

Source: SGS, Jefferies Intl.

Still a Spot Market

While SGS is attempting to sign longer-term contracts and increase its number of customer 'contact points', the market remains largely a spot market. SGS's average invoice is €400–€500, and its largest contract is around €8m. Clearly this means that revenue visibility is rather limited, but in our opinion this is more than offset by the very favourable long-term industry dynamics.

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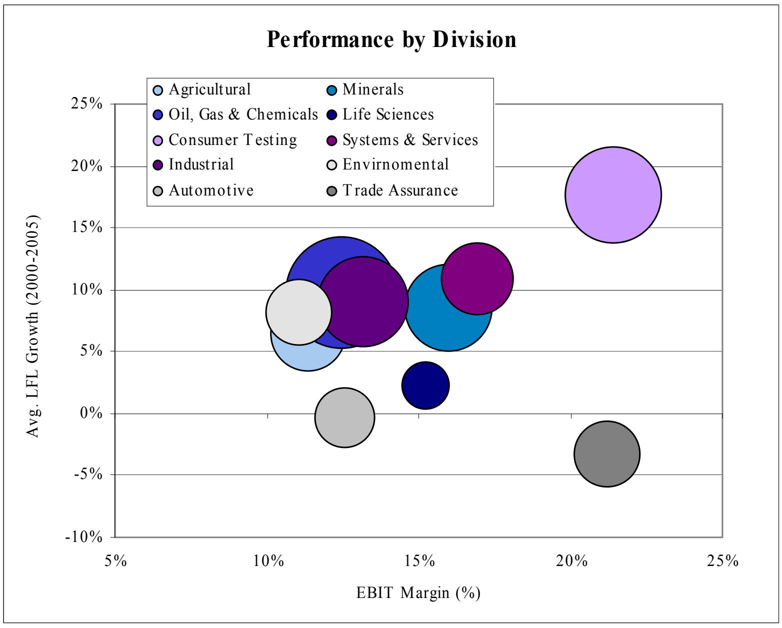
Overview by Business Segment

Exhibit 6: Relative Performance by Division

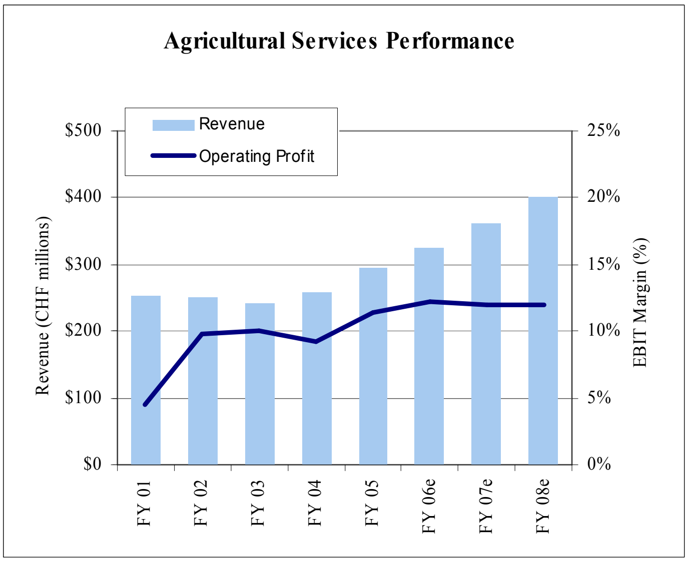


Source: SGS, Jefferies Intl.

1. Agricultural Services – Reducing Trade Dependency

The agricultural services division provides services to players across the entirety of the global food supply chain for goods ranging from grains to liquids. Among the company's services are goods inspection, weight and quality control, supervision of vessel loading and discharge, supply chain audits, assistance to storage and handling companies, shipment guarantees, collateral management for counterparties, and fumigation services. The company's customers include producers, trading houses, final users and financial players, and SGS is the global leader in this segment.

Exhibit 7: Revenue and EBIT Margin – Agricultural Services

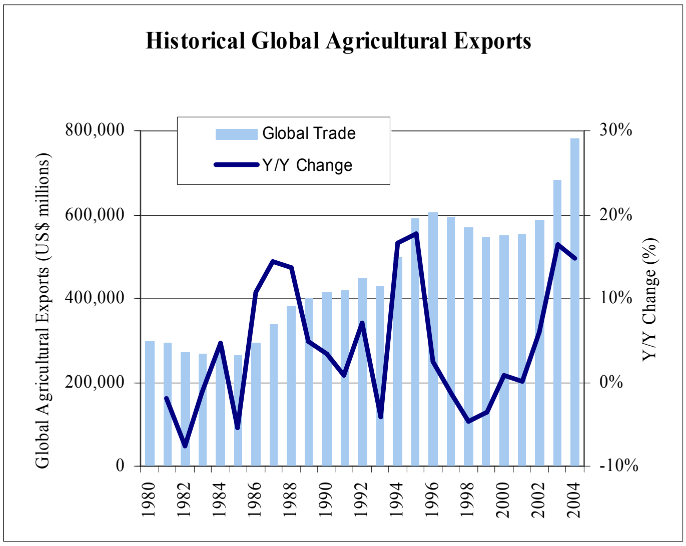


Source: SGS, Jefferies Intl.

After a number of challenging years leading into 2003 as a result of poor crop yields and low global agricultural trade growth, the division has rebounded strongly. Contract wins and strong sales of collateral management services combined with rebounding global agricultural exports have resulted in solid growth and margin expansion in the business.

Going forward, growth in the agricultural business will continue to come from increased regulation and formalization of trade procedures and increased agricultural trade flow. In terms of regulation of agricultural trade flows, one of the key drivers to the business is the proliferation of organically modified crops and ensuing demand for supply chain regulation and tracking to ensure quality and safety of food. On the agricultural trade front, the value of agricultural exports has grown at an annual rate of 4.1% since 1980 and has been particularly strong since 2001. On a company-specific level, of note is management's continued attempt to reduce the division's dependence on volatile trade flows through the introduction of new services including lab testing and logistics.

Exhibit 8: Agricultural Export Growth

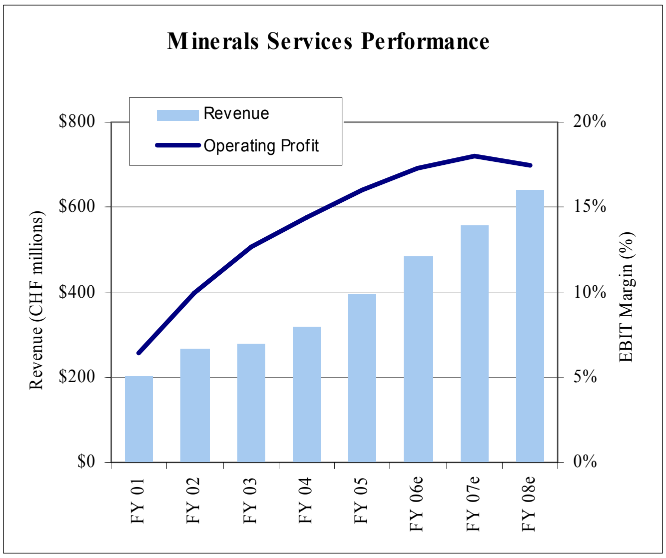


Source: WTO, Jefferies Intl.

2. Minerals Services – Price Volatility Still Key

The minerals services division provides risk management and outsourcing services to clients ranging from primary minerals exploration firms and producers to end-users of geochemical and metallurgical materials. The company operates laboratories globally which assess the quality of materials through numerous processes including sampling, analysis and grading. At the same time the company provides other value-added services including collateral management, tracking services and process consulting for the metals industry. SGS is the global leader in this business.

Exhibit 9: Revenue and EBIT Margin – Minerals Services

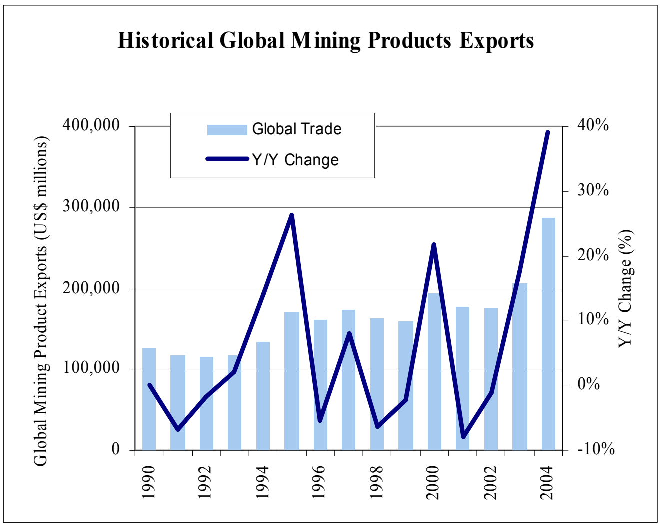


Source: SGS, Jefferies Intl.

Rising minerals markets virtually across the board have driven strong results for the minerals service division over the last couple of years with a compounded annual revenue growth of 18% since 2001. The company's exposure to base metals and precious metals along with strategic investments in these sectors has led to margin expansion from 6.5% in 2001 to 16% in 2005.

Going forward we would expect the division's results to continue to be sensitive to cyclical fluctuations in minerals prices. We note, however, that, as seen in the graphic below, there is an underlying long-term trend toward rising minerals exports which should help to moderate cyclical volatility. In terms of services we would note the greater importance of risk management services (verification and collateral services) and would also expect to see growth stemming from the rollout of technology from the MinnovEX, which was acquired in August 2005.

Exhibit 10: Mining Products Export Growth

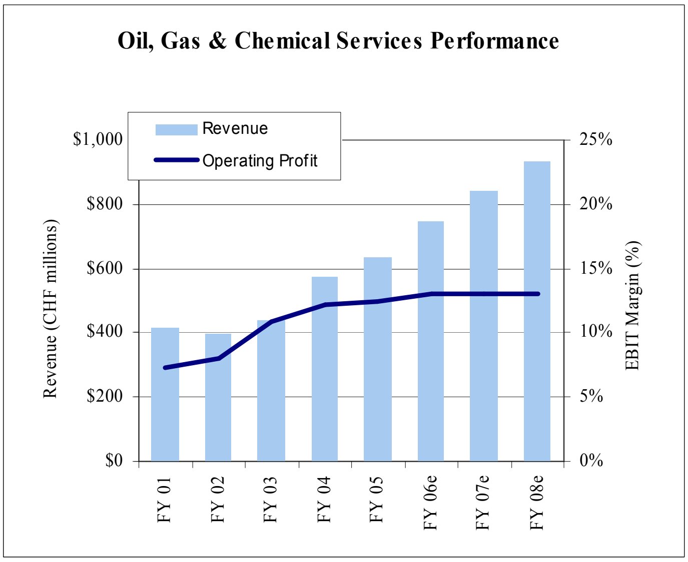


Source: WTO, Jefferies Intl.

3. Oil, Gas & Chemicals Services – Prices Set to Remain High

The oil, gas & chemicals division is SGS's largest division, accounting for 19% of revenue in 2005 and 16% of operating profit. The division provides inspection, testing and outsourcing services for up and downstream markets including production, trading, distribution and storage. The division's services include sampling, inspection, blending and additives services, laboratory analysis, collateral management, and other outsourcing services including logistics consulting and temporary staffing.

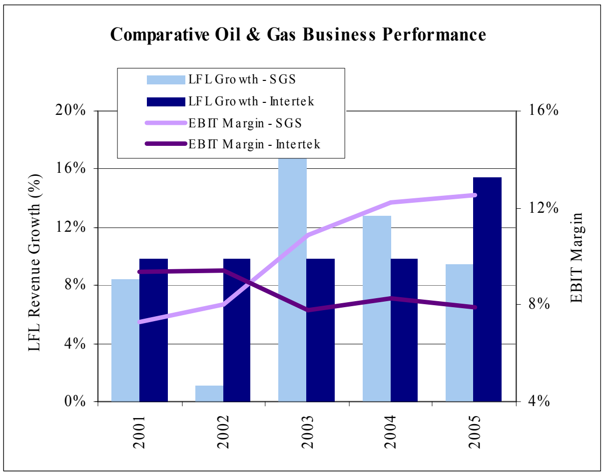
Exhibit 11: Revenue and EBIT Margin – Oil, Gas & Chemical Services



Source: SGS, Jefferies Intl.

After a difficult beginning to the decade which was marked by weakness in the oil market and consolidation in the oil industry, organic growth has been strong since 2003 driven by high and volatile oil prices and production capacity increases in Asia in the Middle East. Along with the market expansion SGS has outperformed Intertek in the segment with both stronger margin expansion and organic growth.

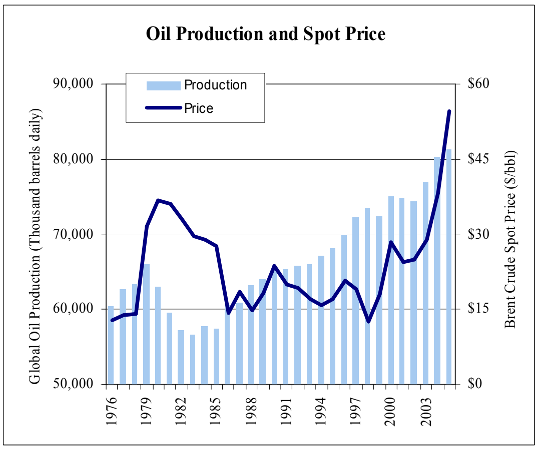
Exhibit 12: Comparative Oil & Gas Division Performance

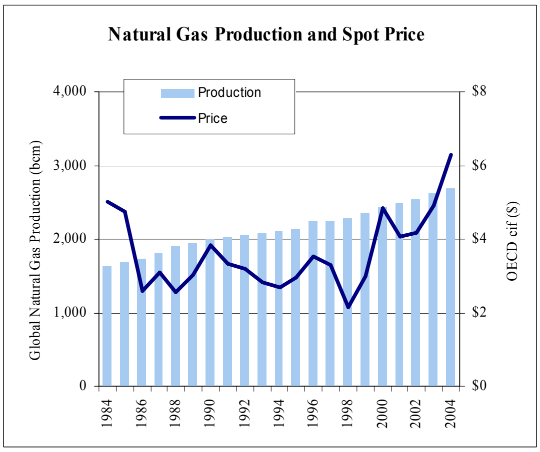


Source: SGS, Intertek, Jefferies Intl.

Going forward revenues should continue to be driven by oil price levels and volatility. In addition, growth should be aided by SGS's introduction of upstream offerings including mercury detection, allocation accounting and crude oil assay services to complement its market-leading position in trade-related services. We expect oil and gas prices to remain high, and believe that 2006 will see an acceleration of growth in this business for SGS to 15%, with margins remaining stable.

Exhibit 13: Historical Oil & Gas Production and Price





Source: BP

4. Life Sciences – New Business Bringing New Risks

The life sciences division provides services for drug and device development ranging from pre-clinical work through to post approval testing. The division's contract research group undertakes studies from Phase I through to Phase IV offering a range of services from recruitment of volunteers and sample preparation to the creation of full study reports. Along with clinical trials, the division also provides pre-clinical and clinical services including biological and chemical characterization, toxicology and stability testing, and biostatistical and regulatory affairs management. The quality control branch of the life sciences group provides quality assurance services, safety testing, and inspection services.

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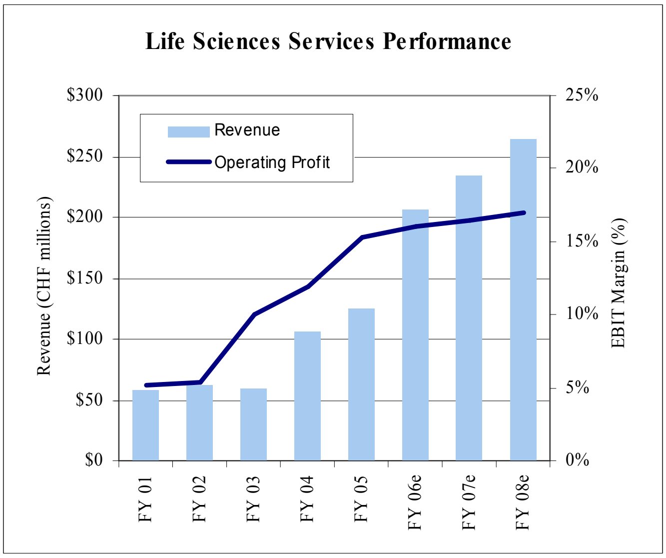
Exhibit 14: Revenue and EBIT Margin – Life Sciences Services

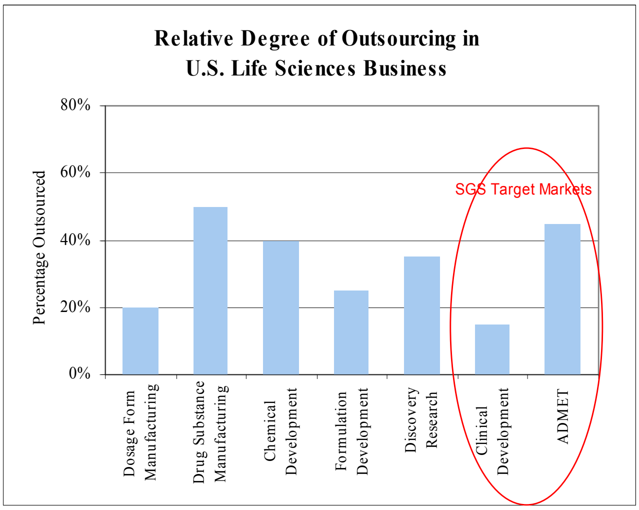


Source: SGS, Jefferies Intl.

After a number of challenging years that were characterized by increasing margins, but declining organic sales, growth in the life sciences business reaccelerated in 2004 and 2005. Aiding the division's growth has been the acquisition of Medisearch International in December 2003, assets from Fresenius in March 2004 and aster.cephac in 2005.

Going forward the CRO business as a whole faces a number of challenges. In general the clinical research business is relatively mature with significant competition, little differentiation between the major competitors, and pricing driven by mark-ups to supplier costs. While there remains a great deal of room for outsourcing in the life sciences sector (see table below), we believe that progress will continue to remain slow as a result of fears related to loss of control of pre-clinical and clinical development and also as a result of rationalization of laboratories following big pharma mergers, which has left unutilized capacity in the system.

Exhibit 15: Life Sciences Outsourcing



Source: American Pharmaceutical Outsourcing, Jefferies Intl.

Going forward SGS has made the life sciences a key pole of its growth strategy with a focus on increased early stage research, quality control services in the U.S. and new services such as biological and biochemical testing services. The group is also targeting the quality control side of the generic market, which offers significant growth prospects. The recent acquisition of aster.cephac has made SGS the leading early stage CRO in Europe. While we expect continued solid results, we are somewhat less optimistic than management about possible margin expansion going forward, as margins are already in line with the industry average.

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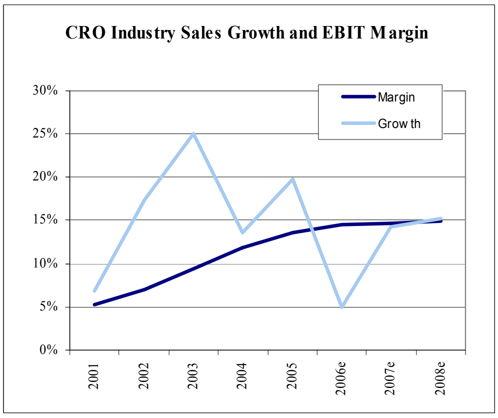
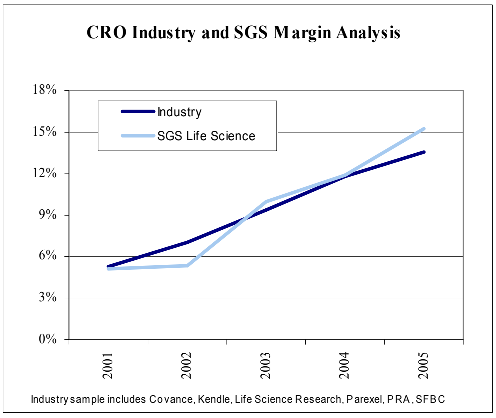
Exhibit 16: CRO Industry Performance



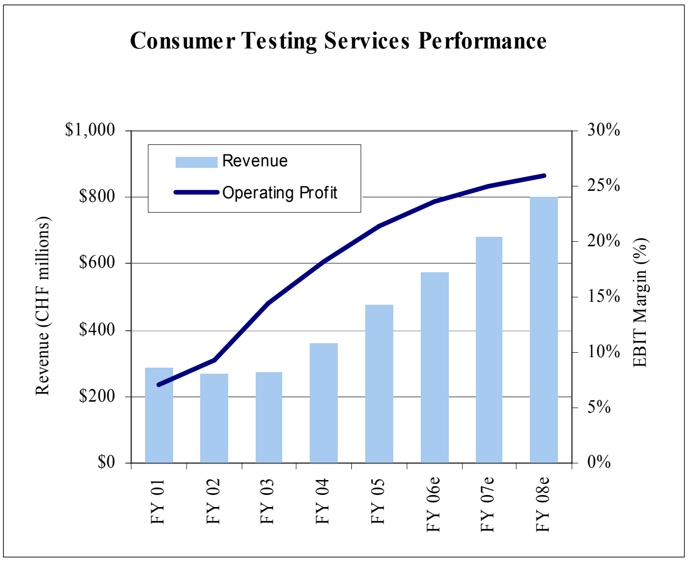


Source: JCF, Jefferies Intl.

5. Consumer Testing Services – High Margins Going Higher

The consumer testing segment provides testing and certification services across a range of consumer goods and products, and is roughly evenly split between softlines (i.e., textiles and clothing), hardlines (toys to building products), electrical products and electronics, and food. The division's primary service is the evaluation of product performance and safety. Other services include process and vendor assessment, supply chain monitoring, regulatory consulting and goods certification. The testing services are provided to clients across the supply chain including manufacturers, importers, exporters, and retailers.

Exhibit 17: Revenue and EBIT Margin – Consumer Testing Services



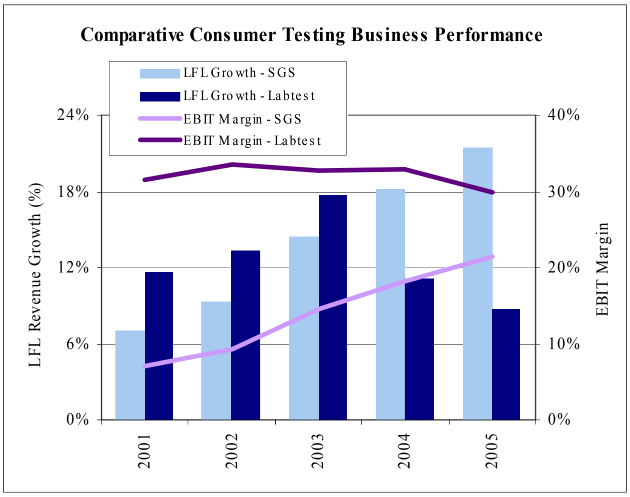
Source: SGS, Jefferies Intl.

The consumer goods testing division has been the company's strongest performer in terms of margin and organic growth since 2001. Growth has been led by significant investment in laboratory facilities, strong volume growth in Asia, and also by effective use of resources with some labs working 24 hours a day, 7 days a week. The company's strategic alliance with MET labs has also been beneficial, allowing penetration of the U.S. and Canadian certification markets.

Going forward we expect both positive industry dynamics and continued margin expansion to drive strong performance. For the industry as a whole, the ongoing shift of production to emerging markets and consequent demand for increased testing and certification of goods should continue to drive growth. Growth in SGS's consumer business specifically is likely to come from high-tech electronics testing and also from a trend toward more environmental testing.

As a result of continued operational efficiencies and volume growth we expect SGS to continue to narrow its performance gap with Intertek, and the company has targeted market leadership (overtaking Intertek) by 2008. Continued margin improvement in this division is in our opinion an important component of SGS's strategic growth plan. We expect margins to expand to 23.5% in 2006 and 25% in 2007, based on organic sales growth of 20% and 15%, respectively. Furthermore, we anticipate additional acquisitions in this segment going forward.

Exhibit 18: Comparative Consumer Testing Division Performance

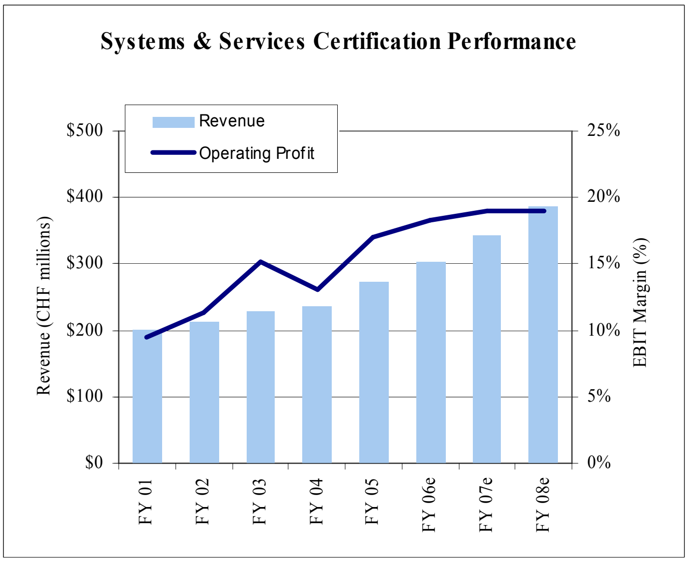


Source: SGS, Intertek, Jefferies Intl.

6. Systems & Services Certification – New Products & Developing Markets

The systems and services certification division provides auditing and certifying services to a diverse client base in industries ranging from aerospace and information technology to food and forestry. The division provides services including product certification, management system certification, logistic certification, service certification and second-party audits. At the same time the company is actively engaged in the development of international certification standards.

Exhibit 19: Revenue and EBIT Margin – Systems and Services Certification



Source: SGS, Jefferies Intl.

The certification business has seen relatively strong and stable growth since 2001, disrupted only by abnormally high sales in 2003 related to the deadline for ISO 9000 certification which negatively affected 2004. In general, despite slowing growth of the mature ISO 9000 certification, new standards such as ISO 14000 (environment), ISO

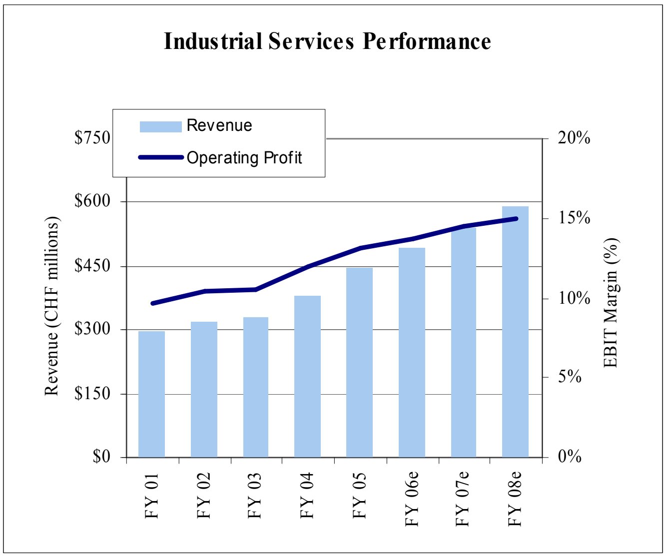
18000 (health & safety) and ISO 22000 (food) have sustained growth. At the same time growth in the certification industry has been fostered by ongoing certification growth in developing markets.

We expect these trends to continue, with growth being driven by developing markets (China and Eastern Europe in particular) and sector-specific certifications. SGS is targeting growth in sales to the automotive, food, medical and service sectors as well as developing new certification products such as Six Sigma.

7. Industrial Services – Another Strategic Focus

The industrial services division provides technical verification, inspection, quality control testing and conformity assessment for industrial clients in sectors including power generation, oil & gas, construction, and manufacturing. The division also provides services including import certification, technical staffing and training, and supply chain management and audits.

Exhibit 20: Revenue and EBIT Margin – Industrial Services



Source: SGS, Jefferies Intl.

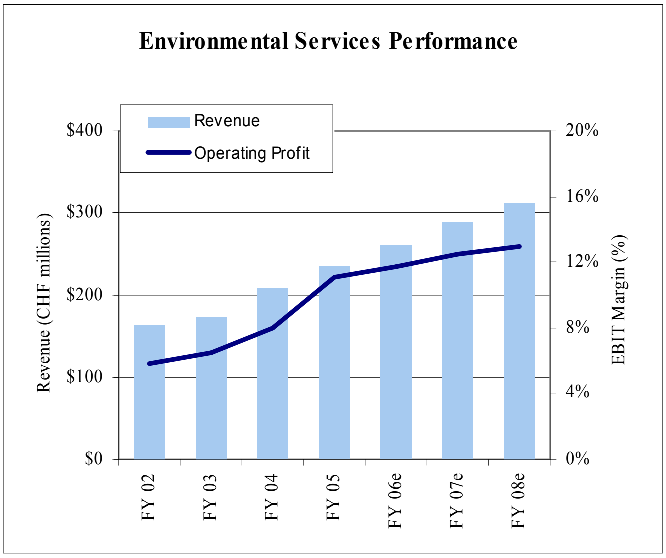
The industrial services division, like the oil & gas division, has benefited from rising energy prices globally. At the same time higher construction growth in emerging economies in Asia and Eastern Europe has also boosted results. Compounded revenue growth in the division has been 8.5% since 2001, and margins have increased to 13.2% in 2005 from 9.7% in 2001.

This division is the largest of SGS's served markets, but the company only has selective local market leadership. Together with life sciences and consumer testing, industrial services is the third area of strategic focus for SGS's three-year growth plan. We expect more acquisitions in industrial services, and we expect organic growth to come from further delocalization of supply chains as well as construction growth in China, India, the Middle East and Eastern Europe. The company should also continue to benefit from strong momentum in energy and construction markets globally.

8. Environmental Services – New Regulation

The company's environmental services division provides environmental testing services including environmental assessment, sampling, monitoring and laboratory analysis services for the measurement of pollutants in air, soil and water. Other services include environmental consulting, auditing, training, and emergency hazardous goods response services.

Exhibit 21: Revenue and EBIT Margin – Environmental Services



Source: SGS, Jefferies Intl.

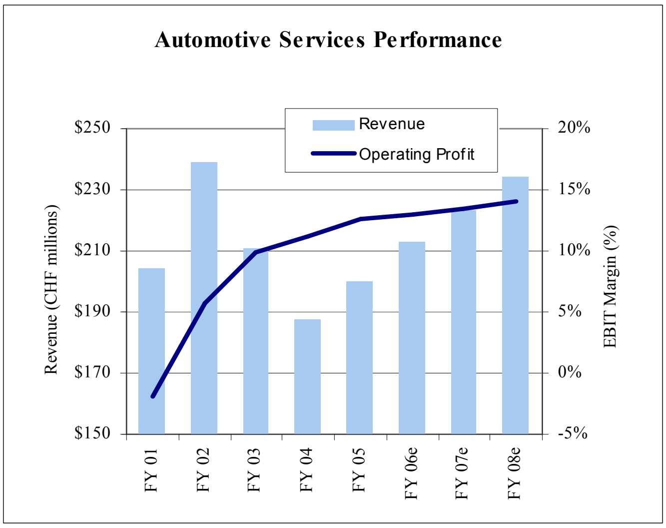
The environmental business has shown steady growth as a result of increased global environmental regulation leading to higher volumes. The company has fostered growth both through the rollout of services in emerging Asian markets and through a number of acquisitions including Institut Fresenius in March 2004 and Paradigm Analytical Laboratories in December 2005. Margins in the segment have shown gradual improvement following the restructuring of laboratories in mature markets such as the U.S. and Belgium in the early part of the decade.

Going forward the company expects to continue its expansion into new markets such as Eastern Europe and South Africa and to focus on the mining and oil & gas industries.

9. Automotive Services – Mature Markets Boosted by Acquisitions

The company's automotive services division provides vehicle inspection services and supply chain monitoring services to clients including manufacturers, shippers, insurance companies, governments and end users. The vehicle inspection group provides services including emissions testing, instrumentation inspection, and off-lease/off-rental inspections. The supply chain monitoring service spans the entirety of the vehicle supply process providing services from third party quality control inspections for manufacturers through to inspections along the distribution process.

Exhibit 22: Revenue and EBIT Margin – Automotive Services



Source: SGS, Jefferies Intl

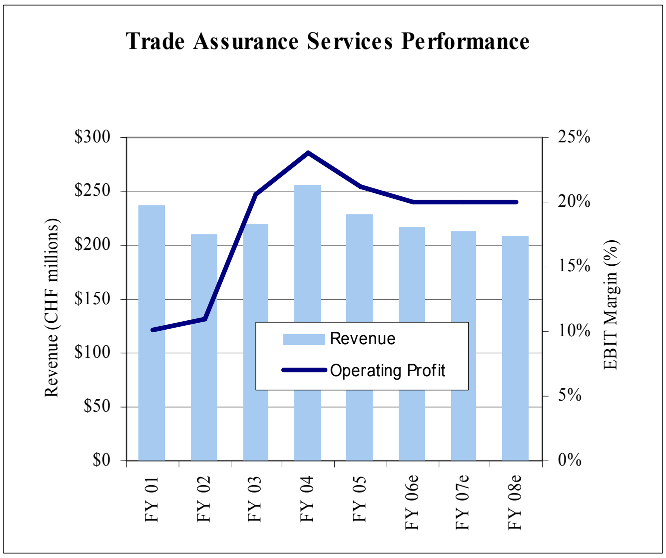
The automotive services business has had a number of weak years of organic growth as a result of slow growth in sales of automobiles, early returns of leased vehicles, and delayed contract awards for government testing programs. Despite the weakness in revenue growth, the automotive division has managed to grow margins from negative 1.9% in 2001 to 12.6% in 2005 by migrating to higher-return businesses.

Going forward we would expect growth in the division to be mixed as the privatization of the vehicle inspection market and contract wins are muted by an overall environment of mature statutory and commercial testing markets in developed countries. SGS is targeting growth in the statutory vehicle inspection market, as shown by its acquisition of Auto Sécurité Group in 2005.

10. Trade Assurance Services – Declining PSI Market

The trade assurance division provides trade facilitation services to governments and institutions. The services offered include pre-shipment inspection (PSI) and import verification, cargo scanning, customs support, valuation assistance, origin validation, and aid monitoring and risk profiling. The company holds a greater than 50% global market share for TAS services and the pre-shipment inspection business still represents about 60% of the division's revenue.

Exhibit 23: Revenue and EBIT Margin – Trade Assurance Services



Source: SGS, Jefferies Intl.

The dominant recent trend in government customs services has been one of in-sourcing with steadily decreasing demand for third-party services in the pre-shipment inspection market. In the face of the challenging PSI market, SGS has restructured its traditional services and has diversified into new markets including forestry, security and climate change monitoring offerings. While sales have remained relatively flat, margins in the segment have increased from 10.2% in 2001 to 21.2% in 2005.

Going forward we expect the company to continue to migrate to newer services, but that PSI will continue to weigh on the division's results, and we anticipate declining sales and stable margins in the near term.

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Financial Analysis

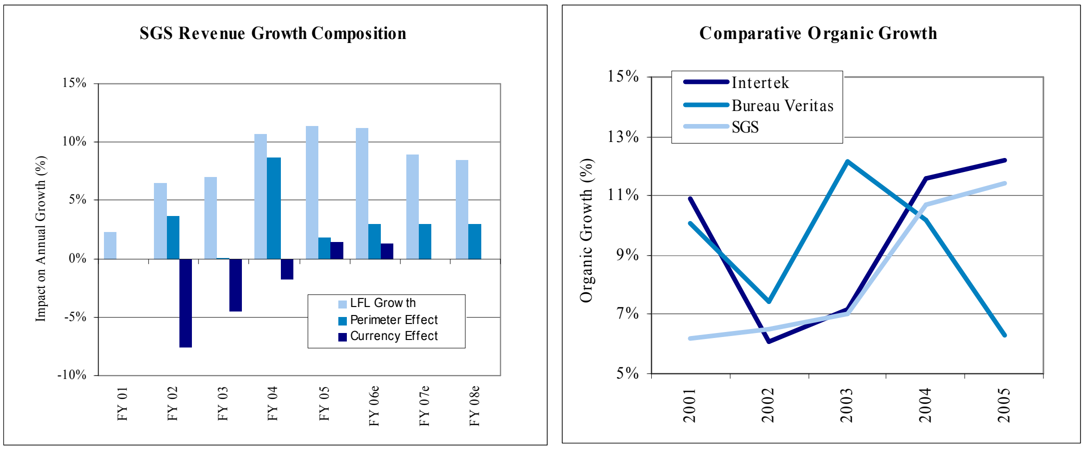
2002 Restructuring Programme Yielded Benefits

At the beginning of the decade SGS suffered significant problems at its trade assurance services division, due to payment delays from the Philippines government and contract losses. In fact, SGS is still owed several hundred million Swiss francs in total, although we put a zero probability on this money ever being recovered. Following these problems, Sergio Marchionne (now Chairman), was appointed as CEO and put in place a restructuring programme in 2002. Since then SGS has dramatically turned around its performance and gone from industry laggard to leader. Strength in the business has come from across the board with accelerating organic growth, improved margins and return metrics, and stronger cash flow and balance sheet management.

Organic Growth Has Been Strong

Over the last couple of years, organic growth has been strong across virtually all of the company's business lines. For the company as a whole, organic growth has been driven by an improved global commodity environment, positive testing industry dynamics, and strong growth from the heavily weighted consumer testing business. As depicted in the graphic below, SGS's organic growth performance has generally been in line with industry-wide growth.

Exhibit 24: Relative Performance - SGS, Intertek and Bureau Veritas

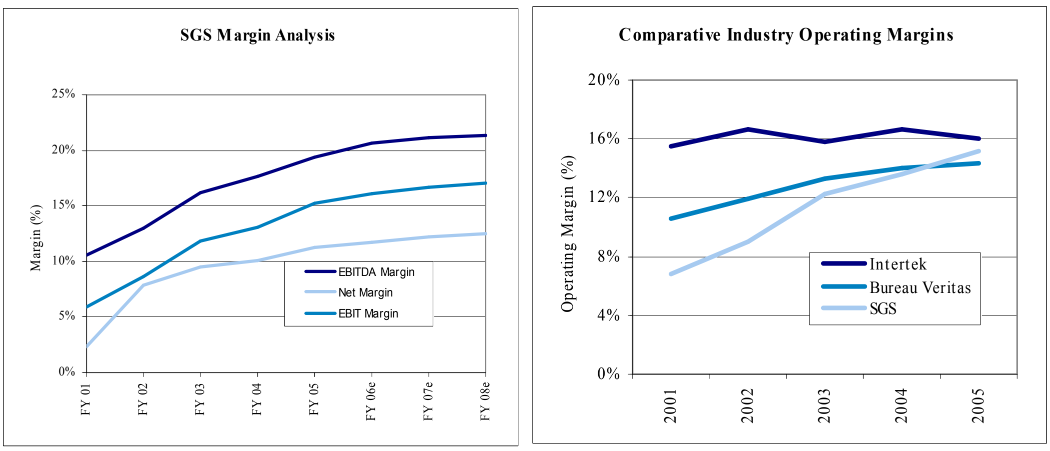


Source: Company documents, Jefferies Intl.

Margins Back to Industry Average, But Should Improve Further

Along with strong revenue growth, SGS has been able to substantially improve margins due to significant restructuring in the early part of the decade, a positive market environment, and improved asset utilization. As a result, operating margins for the group as a whole have more than doubled from 2001 to more than 15% in 2005. Going forward, we believe that opportunities for margin expansion remain significant, driven by new higher-margin services and operating leverage.

Exhibit 25: SGS Margin Performance and Comparative Industry Margins



Source: Company documents, Jefferies Intl.

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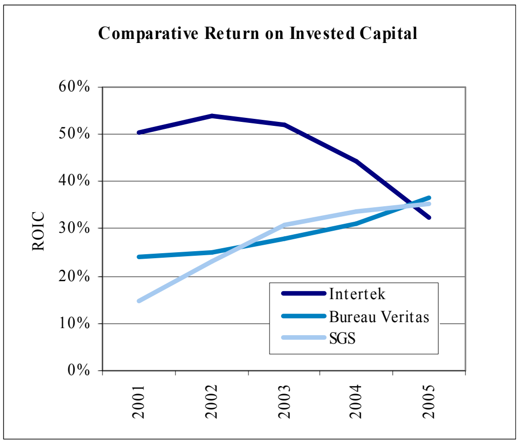
Operating Leverage Is High

Given that the majority of SGS's costs are fixed, the company is highly geared to top-line growth, and so our strong organic growth outlook is a key investment consideration. Labour costs remain the largest expense in the income statement for SGS, coming in at 48.8% of sales in 2005, down from 50.5% in 2003 and 49.7% in 2004. While labour is fairly flexible in emerging economies, it remains largely a fixed cost in Europe and to a lesser extent in the U.S. for SGS, meaning that we would expect a negative margin impact during any downturn. Offsetting this to some extent, SGS is growing faster in Asia/Pacific (+27% revenue growth in 2005) where the labour market remains more flexible and a lot cheaper.

Returns Are Impressive

Despite high investments in laboratories over the last few years, SGS has delivered excellent returns, which are now in line with its main peers. In 2005, SGS generated an impressive 35% ROCE and an ROE of 27%.

Exhibit 26: Comparative ROCE - SGS, Intertek and Bureau Veritas



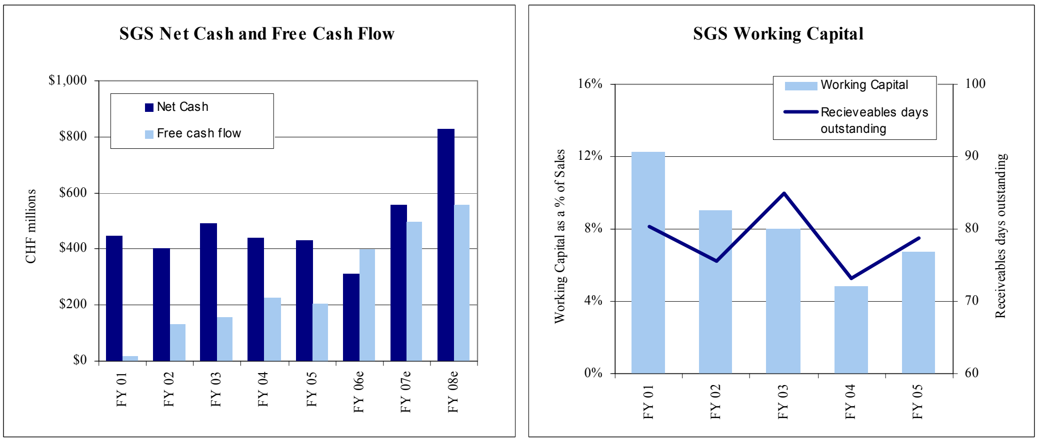
Source: Company documents, Jefferies Intl

Balance Sheet Remains Under-Leveraged, Despite Special Dividend

Following significant restructuring and reorganization in the early part of the decade, SGS has radically improved its operational efficiency. Working capital has been reduced to less than 7% of sales from over 12% in 2001. At the same time, free cash flow has increased markedly to over CHF 200m from CHF 18m in 2001. As a result of this focus on operational efficiency the company has maintained a solid cash balance while financing acquisitions and capital expenditures from cash flow. After significant investments in its laboratory network over the last few years, we expect capex as a percentage of sales to remain roughly stable in 2006 at 6%.

Going forward, we expect the company to continue to be able to fund its 5% annual external growth target as well as its capex needs from cash flow. This financial flexibility comes despite the company's intention to pay a CHF 50 special dividend (CHF 31 dividend and a CHF 19 reduction in nominal value of shares) in June, which would reduce the company's cash position by roughly CHF 380 (~90% of 2005 year-end net cash). Although future special dividends are possible in our opinion, we do not expect the company to make any significant changes to its stated 25%–35% payout policy (we estimate 30%), nor do we expect a significant share buyback program to be implemented in the near term.

Exhibit 27: SGS Balance Sheet and Cash Flow Analysis



Source: SGS, Jefferies Intl.

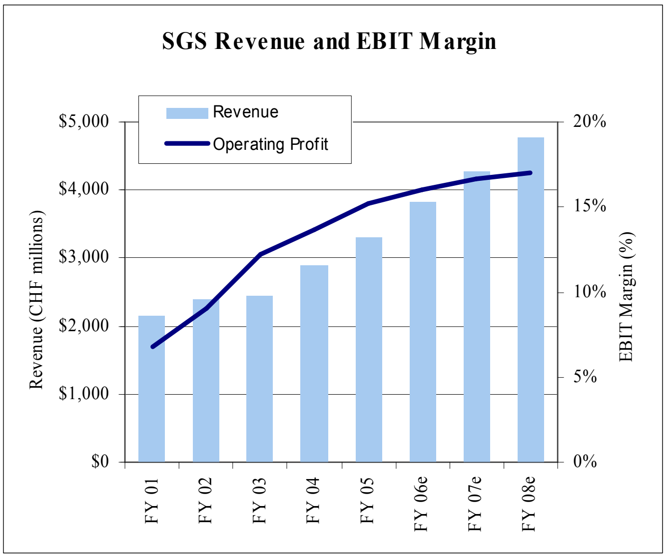
Forecasts

Although we are confident that SGS will be able to achieve its stated 2008 financial targets of CHF 5bn in revenue, an operating margin of 17% and EPS of CHF 80, our estimates for 2008 remain slightly below this target, mainly because we assume only 3% external growth going forward, compared to the company's 5% target. Nevertheless, our estimates are above consensus in terms of sales, EBIT and EPS for the next three years, implying that we believe earnings upgrades will continue.

For 2006, we anticipate revenue growth of 15.5% to CHF 3,821.4m, composed of 11.2% organic growth, 3% external growth and a positive currency effect of 1.3%. We note that about 35%–40% of SGS's sales are in euros, and about 30%–35% are in U.S. dollars or U.S. dollar equivalents, and that our forecasts are based on these currencies remaining at current levels against the Swiss franc (implying a positive currency effect of 2.8% in 1H 2006).

At the operating profit level, we are forecasting a further 90bp improvement in EBIT margins to 16.1%, and 22.3% growth in EBIT yoy to CHF 614m. We expect net profit of CHF 449m and EPS growth in 2006 of 20.9% to CHF 59.1, followed by EPS growth of 16.8% in 2007 and 14% in 2008, a three-year EPS CAGR of 17.2%.

Exhibit 28: SGS Revenue & EBIT Margin Forecasts



Source: SGS, Jefferies Intl.

Valuation

We Believe a Premium to Intertek Is Deserved

SGS currently trades on 20.8x and 17.9x our 2006 and 2007 EPS estimates, respectively, which represents a premium of 8% and 4%, respectively, to its closest publicly traded competitor Intertek. In recent years, SGS has on average traded at a premium to Intertek on a P/E basis (as much as 20%) but a slight discount on an EV/EBIT basis. We believe SGS deserves a 20% premium to Intertek due to its faster growth prospects, rising margins, larger size and stronger balance sheet.

Intertek currently trades on 17.2x 2007 consensus estimates, and applying a multiple of 21x (20% premium) to our 2007 EPS estimate for SGS of CHF 69 yields our CHF 1,450 price target. This represents a 2007 PE/G ratio of 1.2x, which in our view is not overly aggressive given the very positive organic growth outlook for the industry as a whole and for SGS in particular. Our price target is reinforced by our DCF valuation of CHF 1,492, using a WACC of 8.75%, peak EBIT margins of 17.5% and a long-term growth rate of 3%.

Our EPS forecasts remain above consensus for the next three years, and we believe that as consensus estimates rise, positive earnings momentum will drive SGS shares higher. Indeed, we anticipate a three-year EPS CAGR of 17.2% for SGS.

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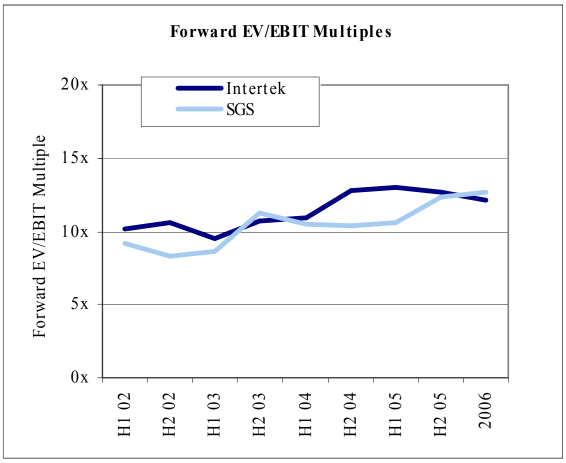
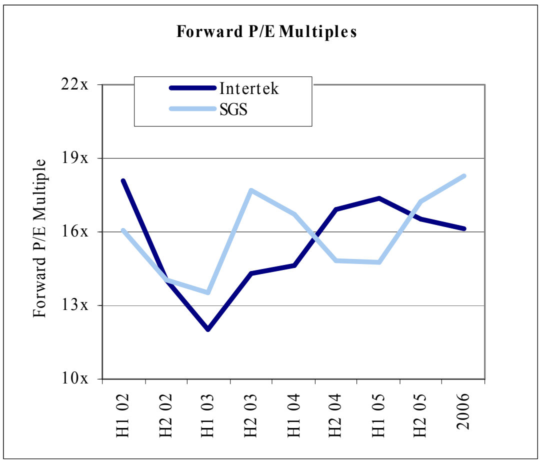
Exhibit 29: Relative Valuation – SGS and Intertek





Source: Company documents, JCF, Jefferies Intl.

Exhibit 30: Comparative Valuation

Company	Ticker	Rating	Price (Local FX)	Mkt cap (m) (Local FX)	EV/EBIT 2006E	EV/EBIT 2007E	P/E 2006E	P/E 2007E	P/CFPS 2006E	P/CFPS 2007E
Intertek	ITRK LN	NC	829.50	1,282	14.1	12.3	19.3	17.2	15.1	12.5
Eurofins Scientific	RF FP	NC	47.70	656	18.7	14.5	35.3	26.6	17.4	13.4
SGS	**SGSN VX**	**BUY**	**1232.00**	**9,637**	**15.2**	**12.7**	**20.9**	**17.9**	**14.5**	**12.7**
AVERAGE					16.4	13.4	27.3	21.9	16.3	12.9
Premium / Discount (-) to avg					-7%	-5%	-24%	-18%	-11%	-2%
Premium / Discount (-) to Intertek					**8%**	**3%**	**8%**	**4%**	**-4%**	**2%**

Source: Company documents, JCF, Jefferies Intl.

Exhibit 31: SGS 1-Year Share Price Performance

Source: JCF

Management

Against a backdrop of a steadily progressing business, there have been numerous changes in the company's senior management with four CEOs over the past five years. The current CEO, Dan Kerpelman, was brought on board from Kodak in April 2005. Mr. Kerpelman follows Johan Allegaert, who was interim CEO between September 2004 and April 2005; Werner Pluss, who resigned in September 2004 after a three-month tenure due to health reasons; and Sergio Marchionne, who was CEO between January 2002 and June 2004. We would not read too much into the management changes and are encouraged by Mr. Kerpelman's progress thus far in his tenure, as well as his three-year strategic growth plan.

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Exhibit 32: SGS Income Statement

Income Statement	H1 04	H2 04	FY 04	H1 05	H2 05	FY 05	H1 06e	H2 06e	FY 06e	FY 07e	FY 08e
Sales	**1390**	**1495**	**2885**	**1557**	**1751**	**3308**	**1835**	**1987**	**3821**	**4279**	**4771**
% change	**n/a**	**n/a**	**17.6%**	**12.0%**	**17.1%**	**14.7%**	**17.8%**	**13.5%**	**15.5%**	**12.0%**	**11.5%**
Salaries and wages			1435			1615	892	962	1854	2059	2277
Subcontractors' expenses			181			217	120	130	251	281	313
Others			761			834	450	478	928	1034	1163
EBITDA	**231**	**277**	**508**	**294**	**348**	**642**	**372**	**416**	**789**	**905**	**1018**
EBITDA margin %	**16.6%**	**18.5%**	**17.6%**	**18.9%**	**19.9%**	**19.4%**	**20.3%**	**21.0%**	**20.6%**	**21.2%**	**21.3%**
Depreciation and amortization	54	74	115	65	75	140	83	92	175	191	206
Recoveries on contracts	0	-3	-3	0	0	0	0	0	0	0	0
EBIT	**177**	**203**	**380**	**229**	**273**	**502**	**289**	**324**	**614**	**714**	**812**
EBIT margin %	**12.7%**	**13.6%**	**13.2%**	**14.7%**	**15.6%**	**15.2%**	**15.8%**	**16.3%**	**16.1%**	**16.7%**	**17.0%**
Financial result	4	2	6	4	1	5	2	1	3	5	6
Pre tax	**181**	**205**	**386**	**233**	**274**	**507**	**291**	**325**	**617**	**719**	**818**
Taxes	43	50	93	55	64	119	70	78	148	172	196
Tax rate	23.8%	24.4%	24.1%	23.6%	23.4%	23.5%	24.0%	24.0%	24.0%	24.0%	24.0%
Profit	**138**	**155**	**293**	**178**	**210**	**388**	**221**	**247**	**469**	**546**	**622**
Minority	6	9	15	8	9	17	10	10	20	22	24
Net income group share	**132**	**146**	**278**	**170**	**201**	**371**	**211**	**237**	**449**	**524**	**598**
Net income pre exceptionals	**140**	**151**	**291**	**170**	**201**	**371**	**211**	**237**	**449**	**524**	**598**
Shares Outstanding	7.5	7.5	7.5	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Earnings Per Share	17.63	19.50	37.12	22.38	26.47	48.85	27.82	31.25	59.07	69.02	78.69
Earnings Per Share - pre exceptionals	18.69	20.16	38.86	22.38	26.47	48.85	27.82	31.25	59.07	69.02	78.69

Source: SGS, Jefferies Intl.

Exhibit 33: SGS Balance Sheet

Balance Sheet	FY 04	H1 05	H2 05	FY 05	H1 06e	H2 06e	FY 06e	FY 07e	FY 08e
Cash	456	370	531	531	590	412	412	658	930
Receivables	579	652	713	713	791	856	856	959	1069
Inventories	118		147	147	163	177	177	198	220
Other Current Assets	133		134	134	134	134	134	134	134
Current Assets	**1286**	**1347**	**1525**	**1525**	**1678**	**1579**	**1579**	**1949**	**2354**
Property Plant & Equipment	493	547	586	586	647	674	674	725	790
Goodwill + intangibles	304	346	429	429	531	531	531	617	713
Other Assets	169	135	225	225	225	225	225	225	225
Total Assets	**2252**	**2375**	**2765**	**2765**	**3081**	**3009**	**3009**	**3516**	**4082**
Debt	18	7	101	101	101	101	101	101	101
Payables	330	347	329	329	365	395	395	443	493
Other Current Liabilities	361	411	442	442	501	531	531	579	630
Provisions	290	228	367	367	367	367	367	367	367
Other Long-Term Liabilities	64		51	51	51	51	51	51	51
Equity	1163	1382	1439	1439	1650	1508	1508	1897	2338
of which minorities	26		36	36	46	56	56	78	102
Total Liabilities	**2252**	**2375**	**2765**	**2765**	**3081**	**3009**	**3009**	**3516**	**4082**

Source: SGS, Jefferies Intl.

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Exhibit 34: SGS Cash Flow Statement

Cash Flow Statement	H1 04	H2 04	FY 04	H1 05	H2 05	FY 05	H1 06e	H2 06e	FY 06e	FY 07e	FY 08e
Net profit	169	109	278	229	142	371	211	237	449	524	598
Depreciation			98			117	83	92	175	191	206
Amortization			33			23	0	0	0	0	0
Minority Interests			15			17	10	10	20	22	24
Adjustments	24		62	-7		70	0	0	0	0	0
Cash flow	**193**	**293**	**486**	**222**	**376**	**598**	**304**	**339**	**644**	**738**	**828**
Working Capital	-54	-7	-61	-81	-106	-187	1	-18	-17	-29	-31
Cash flow from operations	**139**	**286**	**425**	**141**	**270**	**411**	**305**	**321**	**626**	**709**	**797**
Capex	-74	-127	-201	-90	-115	-205	-110	-119	-229	-214	-239
Free cash flow	**65**	**159**	**224**	**51**	**155**	**206**	**195**	**202**	**397**	**495**	**558**
Investments/Perimeter chg.	-196	2	-194	-22	-73	-95	-136	0	-136	-115	-128
Other	-3	83	80	-3	24	21	0	0	0	0	0
Cash flow from investments	**-273**	**-42**	**-315**	**-115**	**-164**	**-279**	**-246**	**-119**	**-365**	**-329**	**-367**
Dividends	-71	3	-68	-95	5	-90	0	-380	-380	-135	-157
Net flows	**-6**	**162**	**156**	**-44**	**160**	**116**	**195**	**-178**	**17**	**360**	**401**
Increase in Indebtedness	5	-33	-28	4	74	78	0	0	0	0	0
Change in Equity	-16	1	-15	0	-1	-1	0	0	0	0	0
Other	-3	-18	-21	11	-29	-18	0	0	0	0	0
Cash flow from financing	**-85**	**-47**	**-132**	**-80**	**49**	**-31**	**0**	**-380**	**-380**	**-135**	**-157**
Exchange Effect	4	6	10	-36	-5	-41	0	0	0	0	0
Net Cash Flow	**-215**	**203**	**-12**	**-90**	**150**	**60**	**59**	**-178**	**-119**	**246**	**273**
Cash at beginning of period	471	256	458	458	368	461	531	590	531	412	658
Cash at end of period	256	459	446	368	518	531	590	412	412	658	930

Source: SGS, Jefferies Intl.

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Exhibit 35: SGS Key Ratios

P&L (CHFm)	2002	2003	2004	2005	2006e	2007e	2008e
Year to December							
Turnover	2392.0	2454.0	2885.0	3308.0	3821.4	4279.2	4770.9
% change	2.6%	2.6%	17.6%	14.7%	15.5%	12.0%	11.5%
EBITDA	311.0	396.0	508.0	642.0	788.6	905.1	1017.9
margin %	13.0%	16.1%	17.6%	19.4%	20.6%	21.2%	21.3%
EBIT	127.0	293.0	380.0	502.0	613.6	713.6	811.9
margin %	5.3%	11.9%	13.2%	15.2%	16.1%	16.7%	17.0%
Pre-Tax	140.0	303.0	386.0	507.0	616.6	718.6	817.9
Net income	109.0	227.0	278.0	371.0	448.6	524.2	597.6
margin %	4.6%	9.3%	9.6%	11.2%	11.7%	12.2%	12.5%

Balance Sheet (CHFm)	2002	2003	2004	2005	2006e	2007e	2008e
Working Capital	216.0	196.0	139.0	223.0	240.5	269.3	300.2
WC as a % of turnover	9.0%	8.0%	4.8%	6.7%	6.3%	6.3%	6.3%
Capital Employed & goodwill	696.0	758.0	936.0	1238.0	1445.7	1611.7	1803.5
RoACE incl GW	17.7%	40.3%	44.9%	46.2%	45.7%	46.7%	47.5%
ROE	12.6%	21.9%	25.2%	27.0%	31.1%	28.8%	26.6%
Net Debt	-402.0	-493.0	-438.0	-430.0	-311.1	-556.8	-829.3
Gearing	-44.8%	-46.0%	-37.7%	-29.9%	-20.6%	-29.3%	-35.5%

Cash Flow (CHFm)	2002	2003	2004	2005	2006e	2007e	2008e
Cash Flow	219.0	395.0	486.0	598.0	643.6	737.6	827.6
Capex	-121.0	-171.0	-201.0	-205.0	-229.3	-214.0	-238.5
WCR	32.0	-70.0	-61.0	-187.0	-17.5	-28.8	-30.9
Free-Cash Flow	130.0	154.0	224.0	206.0	396.9	494.8	558.1

Key Valuation Ratios	2002	2003	2004	2005	2006e	2007e	2008e
Shares Outstanding (m)	7.77	7.69	7.49	7.59	7.59	7.59	7.59
Stock Price (CHF)	389	604	721	956	1,232	1,232	1,232
Market Cap*	3019.9	4644.2	5395.8	7260.3	9356.4	9356.4	9356.4
EPS net	14.0	29.5	37.1	48.9	59.1	69.0	78.7
PER net	27.7	20.5	19.4	19.6	20.9	17.9	15.7
CFPS	28.17	51.37	64.90	78.74	84.75	97.13	108.98
PCF	13.8	11.8	11.1	12.1	14.5	12.7	11.3
P/NAV	3.4	4.3	4.6	5.0	6.2	4.9	4.0
ROE	12.6%	21.9%	25.2%	27.0%	31.1%	28.8%	26.6%
EV	2617.9	4151.2	4957.8	6830.3	9045.2	8799.6	8527.1
EV / Sales	109.4%	169.2%	171.8%	206.5%	236.7%	205.6%	178.7%
EBIT mg %	5.3%	11.9%	13.2%	15.2%	16.1%	16.7%	17.0%
EV / EBITDA	8.42	10.48	9.76	10.64	11.47	9.72	8.38
EV / EBIT	20.61	14.17	13.05	13.61	14.74	12.33	10.50
Yield %	1.6%	1.2%	1.3%	1.2%	4.1%	1.4%	1.7%

* historical datas are average figures

Source: SGS, Jefferies Intl.

Company Description
SGS provides inspection, testing, verification and certification services worldwide. Through its international network of laboratories, the company inspects, samples and analyses raw materials, food, crops and consumer goods, as well as certifying products and machinery for compliance with local and international standards. Based in Geneva, SGS reported 2005 revenues of CHF 3,308m, and employs over 40,000 people worldwide.

ANALYST CERTIFICATIONS

I, Guy Thornewill, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

I, Alex Barnett, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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