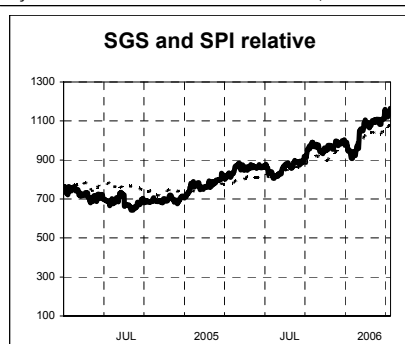


FY 2005 results

**Confident outlook after impressive 2005 figures
– BUY maintained, new price target CHF 1350**
BUY

Market cap.	CHF m	8900
Last price	CHF	1'165
52 week high	CHF	1204
52 week low	CHF	802
YTD performance	%	5.1
Economic value	CHF	1268
Soft factor ded.	%	0.0
Fair value NZB	CHF	1268
Div. ranking shs	m	7.6
Symbols	SGSN.VX, SGSN VX	



Key figures	2004	2005E	2006E	2007E	2008E	CAGR
(CHF)						02-08E
Net revenues (m)	2885	3308	3806	4209	4614	13.5
Growth rate (%)	17.6	14.7	15.0	10.6	9.6	
EBITDA (m)	508	642	750	849	948	19.1
Margin (%)	17.6	19.4	19.7	20.2	20.6	
EBIT (m)	380	502	603	693	782	21.9
Margin (%)	13.2	15.2	15.9	16.5	17.0	
Net profit (m)	278	371	442	507	577	20.5
Dividend	12.0	50.0	18.0	20.0	23.0	20.6

EPS revision	2004	2005E	2006E	2007E	2008E	CAGR
EPS new	36.4	48.6	57.9	66.4	75.6	20.6
EPS old		48.6	56.5	65.1	73.8	
% change		0.0	2.4	2.0	2.3	

Valuation (x)	2004	2005E	2006E	2007E	2008E
P / E	19.7	19.5	20.1	17.5	15.4
P / CEPS	18.8	19.5	20.1	17.5	15.4
P / BV	4.6	4.9	5.8	4.7	3.8
EV / EBITDA	11.4	12.7	11.6	9.8	8.3
Dividend yield (%)	1.7	5.3	1.8	2.0	2.3

Despite high market expectations, SGS was once again able to positively surprise the latter with its FY 2005 results. In the second semester, the company succeeded in accelerating the strong business development seen in H1 2005. In addition, management provided a confident outlook for 2006, and confirmed its financial targets for 2008. Given the group's strong 2005 performance and future outlook, its planned distribution to shareholders of CHF 50 (CHF 19 nominal value reduction, CHF 31 dividend) is unlikely to be coupled with a slowdown in acquisition activity, but is rather an indication of management's confidence in the group's overall business development.

BUY rating maintained with a new price target of CHF 1,350 (vs. CHF 1,200)

Based on our upgraded estimates, we have now derived a new fair value NZB (without acquisitions) of CHF 1,268 per share (vs. CHF 1,226), which leaves upside of 9% for the stock. We have also developed a financial model including future acquisitions. Based on these assumptions, we have derived a fair value NZB of CHF 1,409 per share, which shows the group's leverage potential in terms of acquisitions.

We still expect continuing strong development in the coming years, and consider management's 2008 targets to be realistic. We believe that the new strategic initiatives and the potential of the current portfolio, combined with future acquisitions, offer an exciting story for the months to come. Consequently, we have no hesitation in raising our price target to CHF 1,350 (up from CHF 1,200) and maintaining our BUY rating. Exceptionally, our new price target is based on our financial model including acquisitions, as we are confident that management will succeed in implementing its growth strategy.

- **Acceleration of business development in H2 2005 leads to outstanding FY results:** Thanks to a booming market in Asia and solid business development in Europe, SGS achieved impressive organic sales growth of 11.4%. The company benefited from the favorable trading conditions with commodity flows, as well as from outsourcing trends, and also from its earlier investments in network expansion. Six out of ten business units reported organic growth in excess of 10%. As expected, the division Trade Assurance Services reported a sales decrease due to the discontinuation of contracts in Venezuela, Peru, Ethiopia and Burkina Faso, as well as an unfavorable baseline effect. However, the non-PSI business (around 40% of the division) achieved solid double digit growth. Acquisitions net of disposals accounted for CHF 55m of sales at group level, or a positive impact of 1.4%, while foreign currencies had a positive impact of 1.8%, thus reversing the negative effect of the first semester.

The group's 27.2% increase in operating profit to CHF 502m was even more impressive. The operating profit margin improved by 160bp to 15.2%, in line with our expectations. Seven out of ten divisions were able to improve their operating margins by at least 100bp, the division Systems & Services Certification improving its margin by 390bp. The overall increase in operating profit was aided primarily by strong volume growth (operational leverage), improvement in the business mix towards more upstream services, as well as by synergies from past acquisitions. As outlined in our investment case, bolt-on acquisitions have played, and will continue to play, an important role in SGS' development. The operating margin of the acquired companies stood at 16.7%, surpassing the group average. On the other hand, the margins of the disposed businesses were low (2.7%).

Net income was up 33.5% to CHF 371m (vs. our CHF 369m), while net financial income and taxes were bang in line with our expectations.

The increase in net working capital (NWC) of CHF 61m was higher than we had expected (part of it due to strong business performance last December), but also not astonishing in light of such considerable growth. Management confirmed that its commitment to reduce NWC was still valid.

CAPEX amounted to CHF 205m or 6.2% of sales, which is relatively high in comparison with that of the group's competitors. More than a quarter of the CAPEX was dedicated to the star performer amongst the divisions – Consumer Testing Services – in order to expand and improve its lab's network (Guangzhou) and infrastructure (E&E). As often stated earlier, we believe that the increase in CAPEX in the past years was decisive for SGS' solid performance in the past semesters. The company's operating margins should benefit from these investments in the coming years.

- **Still waiting for larger acquisitions:** In the wake of the acquisition of aster.cephac at the beginning of 2005, we were expecting the announcement of a further acquisition along with the release of the 2005 figures. However, it appears that the company was unable to finalize a deal before the release (we believe that it has several targets in the pipeline). However, management disclosed the acquisition made in December 2005 in the USA of Paradigm Analytical Laboratories. The latter has an excellent reputation for innovation in the environmental testing market (soil and water analysis). Although it is small (USD 6m

sales), we believe that this acquisition fits the pattern of those made earlier, and bears some similarity to that of Institut Fresenius back in 2004. This indicates that SGS will definitely keep its Environmental Services Division within the group. Thanks to its technical innovations, Paradigm Analytical Laboratories will help SGS to shift its offering towards more value-added services, as well as to spread the acquired company's know-how across its network and thus increase efficiency in the labs. Such a scenario was witnessed following the acquisition of Fresenius: last year, the deployment of the laboratory as SGS European soil and water lab delivered 26% growth in sample volumes. We expect a similar result from Paradigm, albeit at a lower level.

In the past two years, the company has spent around CHF 350m on acquisitions, which is below its original estimate. We believe that M&A activities will increase in the current year in order to meet the company's 2008 targets (acquisitions should add around CHF 600m in sales within the next three years). On the back of our recent meeting with Intertek's CFO, who suggested that there were adequate opportunities for the main players to make acquisitions, we are confident that SGS will seek out the right targets to suit its strategy in the coming months. According to Intertek's CFO, neither Bureau Veritas nor SGS were involved in the bidding processes for its recent acquisitions.

In answer to concerns about the multiples SGS would be ready to pay for future acquisitions, CEO Dan Kerpelman made it clear that the strategic fit as well as the time-frame for the pay-back were crucial. In addition, given the track record of past acquisitions, we do not think that SGS will overpay in order to fuel external growth.

- **Cash back to shareholders, dividend yield in excess of 5%:** In the past, we have often mentioned the company's capacity to return cash to shareholders, in addition to its planned acquisitions: our analyses indicated that SGS could return CHF 60m p.a. to shareholders, retaining net cash of CHF 400m. We were therefore only surprised by the timing of the announcement of the nominal value reduction of CHF 19 per share, and by the size of the dividend: CHF 31 per share. We were expecting a CHF 15 per share dividend. Overall, the company will return nearly CHF 400m to shareholders. With regard to the high free cash flow generation, we believe that the company will keep a net cash position by year end. It is evident that the future capital structure will mainly depend on acquisitions. However, we still believe that the financial strength of the company will continue to facilitate additional returns of cash to shareholders in the coming years (in the form of a special dividend, for instance).

In our view, the decision to distribute CHF 50 to shareholders reflects the company's confidence that it is on track to achieve its 2008 targets (sales CHF 5bn, EPS CHF 80 per share, including acquisitions). For that reason we do not see the return of capital as a lack of acquisition opportunities, and this view has been confirmed by SGS' CEO.

- **Outlook 2006 and new NZZ estimates:** SGS provided a positive outlook for the current year, based on the sustained favorable environment of commodity demand, trade flows, the regulatory environment and outsourcing trends. Management expects similar top-line organic sales growth to that of last year (11.4%), and an improvement in operating margins. In addition, the company confirmed its financial targets for 2008 which were established last November (sales of CHF 5bn, operating margin of 17%, EPS of CHF 80).

Management hinted that various projects had been launched, and that the strategic plan was on track.

On the back of the FY 2005 figures and outlook, we have slightly updated our estimates for the different divisions for 2006ff. We now expect organic sales growth of 10.6% in the current year (vs. 10.0% previously). Given the recent comments of Intertek, Bureau Veritas, and even Dekra and TUV, we consider these goals to be realistic. All other assumptions remain largely valid. Overall, our estimate changes have had a positive impact on EPS 2006ff of around 2%.

- **Valuation:** Based on our new estimates, SGS is trading at a P/E 06E of 20.1x and an EV/EBITDA 06E of 11.6x. This valuation is at a premium (around 15%) to the group's competitor Intertek. We still consider a premium versus Intertek justifiable, given SGS' superior business mix, increasing market share in Consumer Testing and in Oil, Gas and Chemicals Services, higher operating leverage and sound financial situation.

Valuation Comparison								
Company	Currency	Share price	Market Cap in m in local curr.	P/E 2005E	P/E 2006E	EV/EBITDA 2005E	EV/EBITDA 2006E	
SGS	CHF	1165	8900	19.5x	20.1x	12.7x	11.6x	
Intertek Group	GBP	729	1127	17.8x	17.1x	10.6x	9.7x	

Source: NZZ Neue Zürcher Bank estimates, JCF

Based on our upgraded estimates, we have now derived a new fair value NZZ, based on EVA®/DCF models, of CHF 1268 per share (vs. CHF 1226, no deduction for insufficient soft factors), which leaves upside of 9% for the stock. This fair value does not include future acquisitions.

We have also developed a financial model including future acquisitions. In this model, we forecast the following key figures for 2008: sales of CHF 5047m, an operating margin of 16.9%, EPS of CHF 82.2, and around CHF 800m outlay for financing acquisitions. Based on these assumptions, we have derived a fair value NZZ of CHF 1409 per share, which shows the leverage potential in terms of acquisitions.

- **Opinion and recommendation:** The market environment has definitely favored SGS. However, the company has positioned itself in the past years in high-growing and high value-added services in order to reduce its dependence on commodity prices and trade flows. The investments made in the expansion of the laboratory network and overall infrastructure have only just started to pay off. Therefore, we expect further strong development in the coming years, and consider management's targets to be realistic. With respect to the latter, the strong 2005 results did management credit, and should have increased investors' confidence. We believe that the new strategic initiatives, the potential of the current portfolio, and potential future acquisitions offer an exciting picture for the months to come.

Consequently, we have no hesitation in raising our price target to CHF 1,350 (up from CHF 1,200) and maintaining our BUY rating. Exceptionally, our new price target is based on our financial model including acquisitions, as we are confident that management will succeed in implementing its growth strategy.

Agenda:

- 20 March, 2006
 - 18 July, 2006
- AGM
H1 2006 results

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