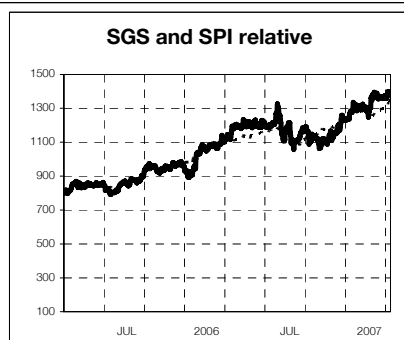


## FY 2006 results

**Robust FY 2006, unbroken trends into 2007, targets 2008 confirmed. Speed up acquisitions, please! → BUY and price target confirmed**

## BUY

Market cap.	CHF m	10478	Key figures	2005	2006	2007E	2008E	2009E	CAGR
Last price	CHF	1'396	(CHF)						04-09E
52 week high	CHF	1408	Net revenues (m)	3308	3821	4239	4675	5109	12.1
52 week low	CHF	1037	Growth rate (%)	14.7	15.5	10.9	10.3	9.3	
YTD performance	%	2.8	EBITDA (m)	642	777	875	984	1'094	16.6
<b>Economic value</b>	<b>CHF</b>	<b>1488</b>	Margin (%)	19.4	20.3	20.7	21.0	21.4	
Soft factor ded.	%	0.0	EBIT (m)	502	605	693	790	887	18.7
<b>Fair value NZB</b>	<b>CHF</b>	<b>1488</b>	Margin (%)	15.2	15.8	16.3	16.9	17.4	
Div. ranking shs	m	7.5	Net profit (m)	371	443	495	565	636	18.0
Symbols	SGSN.VX, SGSN VX		Dividend	50.0	20.0	20.0	23.0	25.0	15.8



EPS revision	2005	2006	2007E	2008E	2009E	CAGR
EPS new	49.4	59.1	66.0	75.3	84.8	18.0
EPS old		60.4		75.7	85.2	
% change			-1.1	-0.5	-0.5	

Valuation (x)	2005	2006	2007E	2008E	2009E
P / E	19.2	20.6	21.2	18.5	16.5
P / CEPS	19.2	20.6	21.2	18.5	16.5
P / BV	5.0	6.0	5.6	4.6	3.8
EV / EBITDA	12.4	12.9	11.5	9.9	8.6
Dividend yield (%)	5.3	1.6	1.6	1.9	2.0

SGS reported a robust set of results for fiscal year 2006. The company was once again able to achieve a double-digit organic growth rate in spite of the discontinuation of two high-margin contracts in the TAS division. The operating profit margin was improved by 65bp to 15.8%; however, if we exclude the TAS division, the margin improvement was in excess of 120bp - which underlines the strong performance of the other divisions. The fundamentals and trends remain unchanged going into 2007, and management confirmed its 2008 targets (sales of CHF 5bn, operating margin of 17%, EPS of CHF 80 per share). Chris Kirk, the new CEO, reiterated the group's goal of accelerating external growth - a prerequisite for achieving these targets.

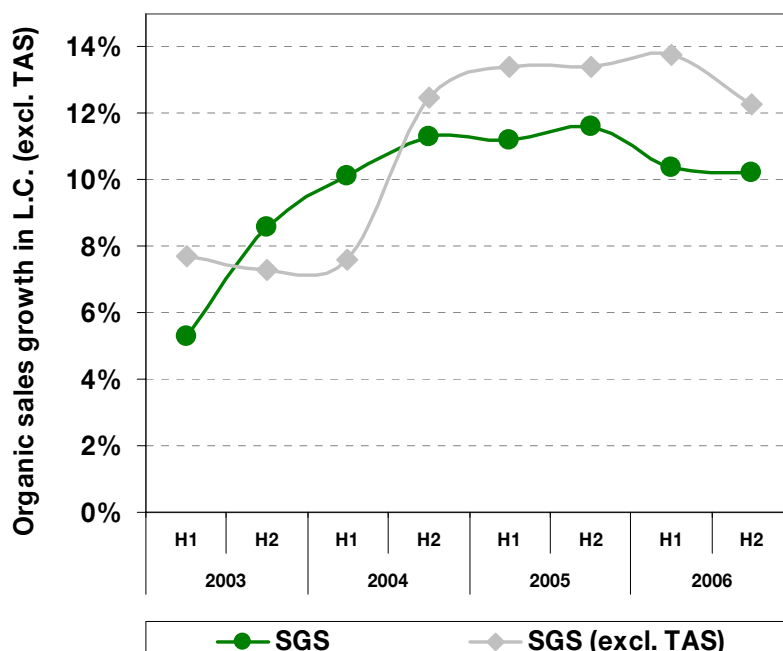
**BUY rating maintained with a price target of CHF 1,500**

Based on our altered estimates, we have now derived a new fair value NZB of CHF 1,488 per share (vs. CHF 1,510). We have also developed a financial model incorporating future acquisitions which indicates an economic value in excess of CHF 1,600 per share.

The reported figures demonstrated the group's resilience. The key indicators for the industry remain favorable going into the new year. In addition, we believe that the key fundamentals of our investment case are still intact. On a further positive note, Chris Kirk made an excellent impression during his first contact with the financial community. From this initial meeting, we got the impression that he is really aiming at re-boosting the motivation and dynamism of top management and all employees of the group. We therefore have no hesitation in reiterating our BUY rating with an unchanged price target of CHF 1,500.

- Strong organic sales growth, margin jumped by 60bp to 15.8%:**  
 Thanks to new geographical areas entering the commodities supply chain, as well as new laboratory outsourcing contracts and the deployment of new products, SGS reported a robust fiscal year 2006 with the exception of the Trade Assurance Services (TAS) division. Overall, sales grew by 15.5%. Organic sales growth amounted to 10.3%. However, if we consider the group result excluding the TAS division, organic growth would have been 13.0% according to our calculations. This compares to Intertek's estimated organic growth of around 6% and 9%-10% (excluding its FTS division – similar to TAS) respectively. Although the company did not disclose the split between volume growth and price increase, management stated that the pricing environment was definitely not prohibitive for the group.

#### Organic growth rate development



Source: Company data

Five out of ten business units reported organic growth in excess of 10%. The TAS division reported a sales decrease in excess of 26%, mainly due to the discontinuation of contracts in Venezuela and Nigeria (both valued at around CHF 80m on a yearly basis).

Acquisitions net of disposals accounted for CHF 119m of sales at group level, or a positive impact of 3.6%, while foreign currencies had a positive impact of 1.6%.

The group's 20.5% increase in operating profit to CHF 605m was impressive despite the significant negative impact of the TAS division. The operating profit margin improved by 60bp to 15.8% in line with our expectations. Excluding the TAS division (margin down 750bp to 13.7%), however, the margin improvement jumped by 120bp from 14.7% to 15.9%, a very solid result (NZB calculations). 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.

#### FY 2006: an overview of the divisions

	A	B	C	D	Comments
Agricultural Services	8.3	5.7	12.4	107	Focus on oil and seed testing
Mineral Services	12.2	15.9	17.2	137	7 new laboratories in geochemistry in 3 continents
Oil, Gas & Chemical Services	20.5	13.2	14.4	174	Demand forecast to grow
Consumer Services	15.5	21.7	23.1	164	New development opportunities in emerging countries
Systems & Services Certification	8.3	16.1	14.7	151	Further exploit back office efficiency gains
Automotive Services	5.8	4.0	13.5	94	Statutory vehicle inspection: 60% of the business
Industrial Services	13.4	13.1	14.6	146	Further expansion in Africa, Eastern Europe and Asia
Life Science Services	5.1	9.2	12.7	-252	Future is in Asia
Environmental Services	6.5	6.5	9.7	-139	Expansion in China and India
Trade Assurance Services	4.4	-26.1	13.7	-749	Stabilizing the division with non PSI business
<b>Total Group</b>	<b>100</b>	<b>10.3</b>	<b>15.8</b>	<b>65</b>	<b>Excl. TAS, 13% org. growth, 120bp margin jump</b>

A: Sales in % of group sales

B: Organic sales growth in %

C: Operating margin in %

D: Operating margin improvement in bps

Source: Company data, NZZ Neue Zürcher Bank estimates

The margin increase was especially significant in the Oil, Gas & Chemical Services, Mineral Services, Consumer Testing Services, Industrial Services and Systems & Services Certification Services, with an improvement in excess of 100bp. By contrast, Life Science Services notched up disappointing margins (lower revenues in clinical research, restructuring costs mainly on aster-cephac, lab start up costs in Asia, etc.), as did the Environmental Services division (negative impact of disposals, weather-related issues). The operating margin of the acquired companies which impacted FY 2006 amounted to 15.5%, slightly below that of the group.

SGS reported CHF 19m net income for exceptional items. Among them, CHF 36m were net gain on changes in the group's organization (disposals) offset by legal and warranty claims and restructuring costs.

Net income including exceptional items was up 19.4% to CHF 443m. The financial result (lower than last year due to a lower cash position deriving from an exceptional payment to shareholders in H1 06) was lower than our forecast. The tax rate of 24.9% was higher than in 2005 (23.5%) and exceeded our forecast of 24.0%. The main reasons for this were the impact of the acquired companies which are located in high tax jurisdictions (such as the USA and France), and the gain on one disposal (see below). Minority interests of CHF 25m were significantly higher than last year (CHF 17m), which can be mainly attributed to the booming business in China in CTS, where SGS operates through SGS CSTC Standards Technical Services (65% stake from SGS).

#### FY 2006: H1 vs. H2

In CHFm	H1 2006	H2 2006	FY 2006
Sales	1,845	1,976	3,821
Organic growth rate	10.4%	10.2%	10.3%
Organic gr. rate (excl. TAS)	13.7%	12.3%	13.0%
Underlying EBIT	281	324	605
Underlying EBIT margin	15.2%	16.6%	15.8%
Net profit	215	231	443

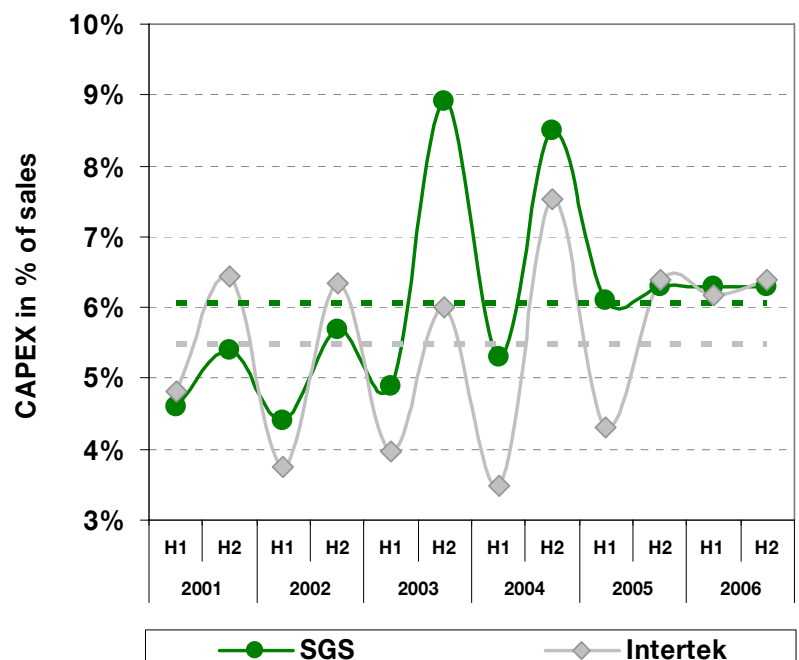
Source: Company data

Cash flow was up 34% to CHF 552m: the development of working capital has improved compared to prior semesters. This is the direct

consequence of management's increased focus on capital efficiency. DSO (Days Sales Outstanding) were down by two days compared to last year, positively impacted by the discontinuation of the contracts in Venezuela and Nigeria.

CAPEX amounted to CHF 242m or 6.3% of sales. Around 65% of these CAPEX were allocated to growth initiatives, with the rest given to maintenance. More than a quarter of the CAPEX was awarded 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, lab in Korea). We also noted the CHF 25m investment in the TAS division, mainly to acquire new scanners for the non-PSI business. As stated earlier, we believe that the increase in CAPEX in the past years was decisive for SGS' solid performance in past semesters. The company's operating margins should continue to benefit from these investments in the coming years.

### CAPEX development vs. Intertek



Source: Company data

- Speed up acquisitions, please!** Last year, SGS acquired nine companies. These companies represent annual sales of around CHF 165m. The price paid for these acquisitions (CHF 264m, including CHF 180m goodwill, implying a multiple of around 1.6x sales) was somewhat higher than the sums paid for acquisitions in past years. In the same period, SGS divested smaller, non-core activities (Pink Healthcare services, the Environmental business in Canada and an oenology laboratory in France) for a net cash inflow of CHF 70m, according to NZZ calculations. Given the above, we believe that SGS profited from divesting these business units which represented annual sales of around CHF 35m, as they no longer fitted the group's strategic goals, and also reaped reasonably high selling prices (around 2x sales).

During yesterday's presentation, management reassured the financial community by announcing that its pipeline of interesting targets was full, and that it had remained very active in screening the market for ideal partners. At the same time, management reiterated that it would continue to apply strict rules with regard to such a decision (price and timeframe for the payback, strategic fit, management, risk profile, unique technology, etc.).

In order to reach its CHF 5bn sales target in 2008, SGS needs to acquire an additional CHF 400m in sales in the coming months, according to our estimates. This is achievable, but it implies an acceleration of the acquisition rhythm early in 2007. This is one of the main missions assigned to new CEO Chris Kirk, who replaced Dan Kerpelman at the end of November. In the presentation, Chris added that he was also aiming at increasing the size of the acquisitions. In order to be more efficient with regard to the acquisitions process, the corporate development unit will be involved at the very beginning of the process (from the identification of the target), which was not the case before.

With regard to disposals, management does not expect any divestiture of material importance for the group in the mid-term.

- **Outlook and new NZZ estimates:** The company remains confident that it can achieve a similar organic growth path as seen in 2006, and further expand its operating margins. The 2008 targets (CHF 5bn sales, 17% operating margin, EPS of CHF 80) were confirmed.

On the back of the FY 2006 figures and outlook, we have updated our estimates for the different divisions for 2007ff (details in our financial model). We now expect organic sales growth of 11.1% in the current year. The slight increase compared to our previous forecast is related to the ongoing dynamics of the key divisions. We have also slightly increased our tax rate assumption. All other assumptions remain largely valid. Overall, our estimate changes have had a minor impact on EPS 2007ff.

#### New vs. old key figures (estimates)

In CHF m	FY 07E (old)	FY 07E (new)	FY 08E (old)	FY 08E (new)	FY 09E (old)	FY 09E (new)
Sales	4251	4239	4667	4675	5068	5109
Organic growth in %	10.8	11.1	9.8	10.3	8.6	9.3
Operating profit	693	693	784	790	886	887
Operating profit margin in %	16.3	16.3	16.8	16.9	17.5	17.4
Net profit	497	495	563	565	634	636
EPS in CHF	66.7	66.0	75.7	75.3	85.2	84.8

Source: company data, NZZ Neue Zürcher Bank estimates

**Valuation:** Based on our altered estimates, we have now derived a new fair value NZZ - based on EVA®/DCF models - of CHF 1,488 per share (vs. CHF 1,510, no deduction for insufficient soft factors). This fair value does not include future acquisitions.

We have also developed a financial model including future acquisitions (representing 5% additional growth per year) which shows a 'fair value NZZ' of more than CHF 1,600 per share, indicating the leverage potential in terms of acquisitions.

Based on our new estimates, SGS is trading at a P/E 07E of 21.2x and an EV/EBITDA 07E of 11.5x. This valuation is at a premium (around 15-20%) to the group's competitor Intertek. We still consider a premium



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