

Services Group  
Diversified Commercial

Switzerland

## SGS (VX: SGSN VX)

**Not Impervious, but Certifiably Steady**

**Company Update**  
**Price Target Change**  
**Estimate Change**

### Investment Summary

2008 results and '09 guidance drive home the message that the testing sector is withstanding economic headwinds. While not immune to economic conditions, we believe SGS's diversified portfolio and numerous defensive businesses along with excellent execution and strong balance sheet make it a solid holding for the year ahead.

Rating: BUY  
Price: CHF1,145.00  
Price Target: CHF1,400.00  
*Previous:* CHF1,600.00  
Bloomberg: VX: SGSN VX

### Market Data

52-Week Range: CHF1,607.00-CHF883.50  
Total Entprs. Value (MM): CHF8,454.0  
Market Cap. (MM): CHF8,702.0  
Shares Out. (MM): 7.6  
Avg. Daily Vol.: 23,667

### Financial Summary

Net Debt (MM): (CHF248.0)  
Net Debt/Capital: (20.0%)  
Dividend Yield: 4.0%

CHF	2007A	2008A	2009E	2010E
Rev. (MM)	4372.0	4818.0	5289.6	5737.8
<i>Prev.</i>	--	4771.5	5378.2	--
EV/Rev.	1.9x	1.8x	1.6x	1.5x
EBITDA (MM)	908.0	1,024.0	1,084.6	1,175.5
<i>Prev.</i>	--	1,017.0	1,121.4	--
EV/EBITDA	9.3x	8.3x	7.8x	7.2x
<b>EPS</b>				
<b>FY Dec</b>	<b>65.47</b>	<b>76.19</b>	<b>80.52</b>	<b>87.89</b>
<i>Prev. FY</i>	--	75.62	85.38	--
FY P/E	17.5x	15.0x	14.2x	13.0x
EBIT (MM)	690.0	809.8	862.9	930.3
<i>Prev.</i>	--	801.0	902.1	--
EV/EBIT	12.3x	10.4x	9.8x	9.1x
Net Profit	500.0	579.0	611.7	667.7
<i>Prev.</i>	--	577.0	651.5	--

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### Event

SGS released very good '08 results and bullish '09 guidance.

### Key Points

- While global turmoil swirled in H2, SGS managed to buck the trend and put together an extremely good set of figures. FY sales of CHF4,82b, while in line with our estimate, were driven by 15.3% lfl expansion, well ahead of our 13.2% forecast (with negative currency impact making up the difference). Along with the breadth of the organic expansion (commodity, industry, and defensive business all growing well), most notable was the acceleration of growth in H2, with 7 of 10 divisions outpacing the already good results posted in H1.
- FY profitability was in line with our expectations, with operating income of CHF810 just a touch below our CHF812 forecast and 16.8% operating margin spot on our estimate. Notable performances came from the traditional laggards including the Agriculture, Life Science and Environment divisions, which all saw improved capacity utilization. On the negative side, the Minerals, Consumer and Industrial divisions all fell slightly short of our estimates.
- EPS of CHF76.2 was a touch below our CHF77.6 forecast on higher than expected finance and tax costs.
- Guidance was the main focus of the analyst meeting following the results, with the company targeting single digit organic expansion in '09 and stable operating margin. While numerous danger spots for the year ahead were highlighted (minerals capex slowing, weak construction markets, clogged trade finance, dwindling numbers of consumer good manufacturers .... among others) management highlighted the diversity of the portfolio and unflinchingly guided to positive lfl growth across the company's 10 divisions for the year ahead.
- We have adjusted our estimates to reflect the good close of '08, the deteriorating economic environment, and management's '09 guidance. While we have become more conservative on the commodities businesses, our expectation of continued good performance in the more defensive divisions (Enviro, Life Sciences, GIS) leaves our '09 lfl forecast comfortably in positive territory (+4.7%) with slight operating margin erosion (50bps).

### Valuation/Risks

Taking an average trough P/E multiple of 17.5x seen in 2002-2004 and applying it to our '09 EPS estimate yields a price target of CHF1,400. That valuation is supported by our CHF1,415 DCF valuation. Trading on a 15%+ premium to BV and ITRK the relative valuation is punchy, but SGS remains the premium name in the sector given balance sheet strength and excellent execution. The key risk is that SGS proves to be a late cyclical and results come off significantly as '09 unfolds.

### Impact on Other Companies

Bureau Veritas (BVI FP, Hold) is to report FY sales February 10th - we would expect very similar figures and guidance.

Reviewing the results by division:

- The **Agricultural Services** business reported better than expected 9.3% lfl growth (vs. our 6.3% forecast) and a very healthy jump in margin to 15.6% (up 220bps y/y). H2 trading was marked by better harvests globally, falling shipping costs, and some relief from trade restrictions imposed with the '07/'08 run up in food prices. Looking forward, management remained optimistic that these factors can continue to drive results '09, but did strike a cautious tone with respect to the impact of tight credit markets on the global flow of agricultural goods. Given that caution, we have lowered our H1 growth estimates and are now looking for 4% organic growth in the division in '09 (weighted towards H2) and a slight dip in margin despite better mix as inland services grow.
- As expected, the **Minerals** business cooled somewhat in H2 after a blistering H1 which had been driven by the global mining boom. H2 organic growth nevertheless was a very strong 24.8% (vs. Our 24% forecast and 29% recorded in H1) and FY operating margin increased 140bps (vs our 240bps estimate). Looking ahead, collapsing prices for base metals and industrial minerals and consequent scaling back on industry capex will likely make 2009 challenging. We estimate that roughly  $\frac{1}{4}$  of revenues are base metals/capex related (with the remaining  $\frac{3}{4}$  derived from precious metals/coal/uranium or recurring revenue streams). Given continued strength in gold and base metals weakness we are forecasting flat revenues in the division in '09 and some margin erosion.
- Despite an extremely volatile market, the **Oil, Gas and Chemical** division recorded a reacceleration in growth and healthy margin expansion in H2. Good results continue to be driven by the push towards upstream services and emerging markets. While encouraged by the division's performance in a tough '08 market environment, 2009 will be challenging as end demand for chemicals and fuels is declining globally, and low oil prices are leading to a significant scaling back in industry capex. We are forecasting minimal sales growth in the division in '09 and 40bps deterioration in operating margin on suboptimal capacity utilization.
- The **Life Sciences** unit was a positive surprise in H2, as profitability levels of new capacity improved and the bioanalysis and early stage clinical research segments performed better. While we do have some concerns about the global biotech funding environment and potential slowing in R&D spend, this business remains defensive given its quality control (non discretionary) and pharma gearing. As a result, we are forecasting 6% growth in '09 and continued margin improvement as utilization of new capacity improves.
- The **Consumer** division reported mixed results. Organic growth of 16.9% came in above our 15% forecast and notably, did not show much in slowing in momentum in H2 despite being up against a tough comparable period (Asian toy testing scares surfaced in August 2007). Operating margin however, flat y/y at 23.2%, and a touch below our 23.5% forecast. Looking ahead, a contracting manufacturing base will likely dent the division's growth, but we continue to believe that U.S. regulatory changes and the defensive food business should enable continued organic expansion. We are tabling 8% lfl growth and 80bps margin erosion (driven largely by mix) for the year ahead.
- The **Systems & Certification** division reported in line FY results, with 9.7%lfl expansion (vs. Our 10% forecast) and modest 70bps margin expansion (vs. Our 90bps forecast). While the division has been a model of stability historically, a conscious effort to increase exposure to customized/discretionary audits (and less weighting of ISO9000/17000) is likely to have increased the cyclical nature of the business. Given that, we are forecasting a significant slowing in revenue growth in '09 and some margin deterioration as the custom audits typically represent higher margin business.
- **Industrial Services** results were mixed, with better than expected organic expansion (16.7% vs. our 14% forecast), but y/y operating margin erosion of 180bps (vs. our -110bps forecast). While the division continues to benefit from good energy infrastructure demand trends, weak construction markets in the Western world dented growth as '08 progressed. Construction and infrastructure demand is expected to remain weak in Europe through 2009 which we believe is likely to lead to a rapid deceleration in growth in the division over the course of this year. Newer markets such as alternative energy generation (wind power particularly) and resilience in emerging markets should however enable modest organic expansion across the division as a whole.
- The **Environmental Services** division reported slightly better than expected FY growth and margin expansion. While progress in the division has been gradual, new lab capacity in emerging markets appears to be bearing fruit and the Swiss landfill contract has given the division a shot in the arm. For 2009, we remain concerned by the business's exposure brownfield development projects, but believe nonetheless that the environment business is fairly defensive given significant recurring revenue streams. We are forecasting 6% lfl growth and stable operating margin for the year ahead.
- The **Automotive** business reported a good H2 result as very good statutory inspection business more than offset commercial inspection weakness. While there was some one-time business in Ireland in 2008 which will make

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the comparables tough, new contracts in the U.S. and improving performance in emerging markets should enable the statutory business to continue to grow in '09. We would expect the cataclysm in the global auto market to lead to a very difficult '09 for the commercial inspection business (~¼ of turnover), but expect the larger statutory business can keep overall 2009 growth in positive territory.

- The **Government Services** division turned in a very solid H2, easily surpassing our expectations. FY organic growth of 11.1% came on flat PIS revenues (despite the loss of the Ecuador contract) and growth in the scanner and product conformity assessment programs. The 18% margin recorded in H2 marked a sharp upturn (+330bps y/y) and was driven by good volumes in Angola and increasing maturity of the scanners business. Looking ahead, management remains comfortable that the PSI business should weather the economic storm well and also noted fixed revenue terms of an increasing portion of the business (ie. scanners).

	2007 Actual	2008 Actual	2008 Jefco Est.
<b>Agricultural Services</b>			
Sales	356.5	358.3	357.1
LFL Growth (%)	4.3%	9.3%	6.3%
Operating Profit	47.6	55.9	50.5
Operating Margin	13.4%	15.6%	14.2%
<b>Minerals Services</b>			
Sales	559.8	662.9	676.2
LFL Growth (%)	17.0%	27.6%	24.2%
Operating Profit	98.2	125.3	134.6
Operating Margin	17.5%	18.9%	19.9%
<b>Oil, Gas &amp; Chemical Services</b>			
Sales	891.3	953.5	981.2
LFL Growth (%)	12.4%	11.6%	10.5%
Operating Profit	133.4	140.3	142.6
Operating Margin	15.0%	14.7%	14.5%
<b>Life Sciences Services</b>			
Sales	200.4	204.4	204.0
LFL Growth (%)	4.2%	9.2%	6.1%
Operating Profit	24.1	27.5	24.8
Operating Margin	12.0%	13.5%	12.2%
<b>Consumer Testing Services</b>			
Sales	654.7	733.9	730.1
LFL Growth (%)	8.6%	16.9%	15.0%
Operating Profit	151.9	170.3	171.6
Operating Margin	23.2%	23.2%	23.5%
<b>Systems &amp; Services Certification</b>			
Sales	353.5	365.6	372.3
LFL Growth (%)	9.0%	9.7%	10.0%
Operating Profit	65.0	70.0	72.0
Operating Margin	18.4%	19.1%	19.3%
<b>Industrial Services</b>			
Sales	624.7	738.5	712.7
LFL Growth (%)	15.8%	16.7%	14.0%
Operating Profit	100.6	105.5	107.2
Operating Margin	16.1%	14.3%	15.0%
<b>Environmental Services</b>			
Sales	281.1	296.4	298.0
LFL Growth (%)	14.1%	10.4%	9.1%
Operating Profit	27.6	31.4	29.0
Operating Margin	9.8%	10.6%	9.7%
<b>Automotive Services</b>			
Sales	249.2	292.6	290.6
LFL Growth (%)	10.2%	23.8%	20.0%
Operating Profit	33.8	47.7	46.2
Operating Margin	13.6%	16.3%	15.9%
<b>Trade Assurance Services</b>			
Sales	200.4	211.9	210.7
LFL Growth (%)	20.0%	11.1%	8.7%
Operating Profit	28.8	35.9	33.0
Operating Margin	14.4%	16.9%	15.7%

Total	2007 Actual	2008 Actual	2008 Jefco Est.
Revenues	4,366	4,818	4,833
% Growth	14.2%	10.4%	10.7%
LFL Growth (%)	12.0%	15.3%	13.2%
Perimeter Effect (%)	0.8%	2.4%	2.1%
Currency Impact (%)	1.5%	-7.5%	-4.7%
Operating Profit	711.0	809.8	811.7
Operating Margin	16.3%	16.8%	16.8%
Net Profit	500.0	579.0	584.9
EPS	65.47	76.19	77.57

Source: Company data and Jefferies Research

Company	Ticker	Rating	Price (Local FX)	Mkt cap (m) (Local FX)	EV/Sales			EV/EBIT			P/E			CAGR (EPS)
					2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E	
Bureau Veritas	BVI FP	Hold	29.40	3,179	2.3	1.8	1.4	18.1	11.6	9.6	21.8	15.0	11.9	18.4%
Intertek Group PLC	ITRK LN	Buy	796.0	1,256	2.1	1.6	1.2	14.1	10.6	8.5	20.0	14.8	11.9	14.6%
SGS	SGSN VX	Buy	1,145	8,956	2.4	1.9	1.6	15.5	9.8	9.7	22.2	16.4	14.2	16.8%
Campbell Brothers	CPB AU	NC	18.52	982	1.5	1.2	1.0	10.1	6.4	6.1	12.5	7.9	8.7	12.6%
Eurofins Scientific AG	ERF FP	Buy	36.80	519	2.1	1.2	1.0	27.4	16.2	10.8	66.5	44.0	19.8	26.1%
<b>AVERAGE - BV, ITRK, SGS</b>					<b>2.3</b>	<b>1.7</b>	<b>1.4</b>	<b>15.9</b>	<b>10.7</b>	<b>9.3</b>	<b>21.3</b>	<b>15.4</b>	<b>12.7</b>	<b>16.6%</b>
<b>AVERAGE</b>					<b>2.1</b>	<b>1.5</b>	<b>1.2</b>	<b>17.0</b>	<b>10.9</b>	<b>8.9</b>	<b>28.6</b>	<b>19.6</b>	<b>13.3</b>	<b>17.7%</b>

\* All estimates except CPB AU are Jefferies figures. CPB AU uses Bloomberg estimates. '07 multiples are based on historical average prices.

December year end	2002	2003	2004	2005	2006	2007	2008	2009E	2010E	2011E
<b>Income Statement (CHFm)</b>										
Turnover	2392.0	2454.0	2885.0	3308.0	3821.0	4372.0	4818.0	5289.6	5737.8	6388.0
% change	2.6%	2.6%	17.6%	14.7%	15.5%	14.4%	10.2%	9.8%	8.5%	11.3%
EBITDA	311.0	396.0	508.0	642.0	800.0	908.0	1024.0	1084.6	1175.5	1326.5
margin %	13.0%	16.1%	17.6%	19.4%	20.9%	20.8%	21.3%	20.5%	20.5%	20.8%
EBIT	127.0	293.0	380.0	502.0	623.8	690.0	937.0	862.9	930.3	1055.0
margin %	5.3%	11.9%	13.2%	15.2%	16.3%	15.8%	19.4%	16.3%	16.2%	16.5%
Pre-Tax	140.0	303.0	386.0	507.0	622.8	692.0	933.0	850.6	928.4	1058.5
Net income	109.0	227.0	278.0	371.0	442.8	500.0	692.0	611.7	667.7	761.2
margin %	4.6%	9.3%	9.6%	11.2%	11.6%	11.4%	14.4%	11.6%	11.6%	11.9%
<b>Balance Sheet (CHFm)</b>										
Working Capital	216.0	196.0	139.0	223.0	219.0	191.0	-80.0	-86.8	-94.2	-104.9
WC as a % of turnover	9.0%	8.0%	4.8%	6.7%	5.7%	4.4%	-1.7%	-1.6%	-1.6%	-1.6%
Capital Employed & goodwill	696.0	758.0	936.0	1238.0	1519.0	1645.0	1400.0	1570.2	1779.1	2069.6
RoACE incl GW	17.7%	40.3%	44.9%	46.2%	45.2%	43.6%	61.5%	58.1%	55.6%	54.8%
ROE	12.6%	21.9%	25.2%	27.0%	30.6%	27.0%	40.6%	31.8%	28.3%	26.5%
Net Debt	-402.0	-493.0	-438.0	-430.0	-216.0	-418.0	-273.0	-356.7	-625.3	-889.7
Gearing	-44.8%	-46.0%	-37.7%	-29.9%	-14.1%	-21.7%	-15.5%	-17.9%	-25.6%	-29.9%
<b>Cash Flow (CHFm)</b>										
Cash Flow	219.0	395.0	486.0	598.0	582.8	694.0	860.0	855.4	936.9	1060.0
Capex	-121.0	-171.0	-201.0	-205.0	-224.0	-271.0	-278.0	-264.5	-286.9	-383.3
WCR	32.0	-70.0	-61.0	-187.0	-31.0	12.0	-22.0	6.8	7.4	10.7
Free-Cash Flow	130.0	154.0	224.0	206.0	327.8	435.0	560.0	597.8	657.3	687.4
<b>Key Valuation Ratios</b>										
Shares Outstanding (m)	7.8	7.7	7.5	7.6	7.6	7.6	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	1,145	1,145	1,145
Market Cap*	3,020	4,644	5,396	7,260	9,307	11,085	9,496	8,699	8,699	8,699
EPS net	14.02	29.52	37.12	48.85	58.33	65.47	76.19	80.52	87.89	100.20
PER net	27.7	20.5	19.4	19.6	21.0	22.2	16.4	14.2	13.0	11.4
CFPS	28.2	51.4	64.9	78.7	76.8	90.9	113.2	112.6	123.3	139.5
PCF	13.8	11.8	11.1	12.1	16.0	16.0	11.0	10.2	9.3	8.2
P/NAV	3.4	4.3	4.6	5.0	6.1	5.8	5.4	4.4	3.6	2.9
ROE	12.6%	21.9%	25.2%	27.0%	30.6%	27.0%	40.6%	31.8%	28.3%	26.5%
EV	2,618	4,151	4,958	6,830	9,091	10,667	9,223	8,342	8,073	7,809
EV / Sales	1.1	1.7	1.7	2.1	2.4	2.4	1.9	1.6	1.4	1.2
EBIT mg %	5.3%	11.9%	13.2%	15.2%	16.3%	15.8%	19.4%	16.3%	16.2%	16.5%
EV / EBITDA	8.4	10.5	9.8	10.6	11.4	11.7	9.0	7.7	6.9	5.9
EV / EBIT	20.6	14.2	13.0	13.6	14.6	15.5	9.8	9.7	8.7	7.4
Yield %	1.6%	1.2%	1.3%	1.2%	4.2%	1.6%	2.8%	4.4%	2.5%	2.7%

\* historical datas are average figures  
source: Jefferies International Ltd.

## 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 2006 revenues of CHF 3.8b, and employs over 40,000 people worldwide.

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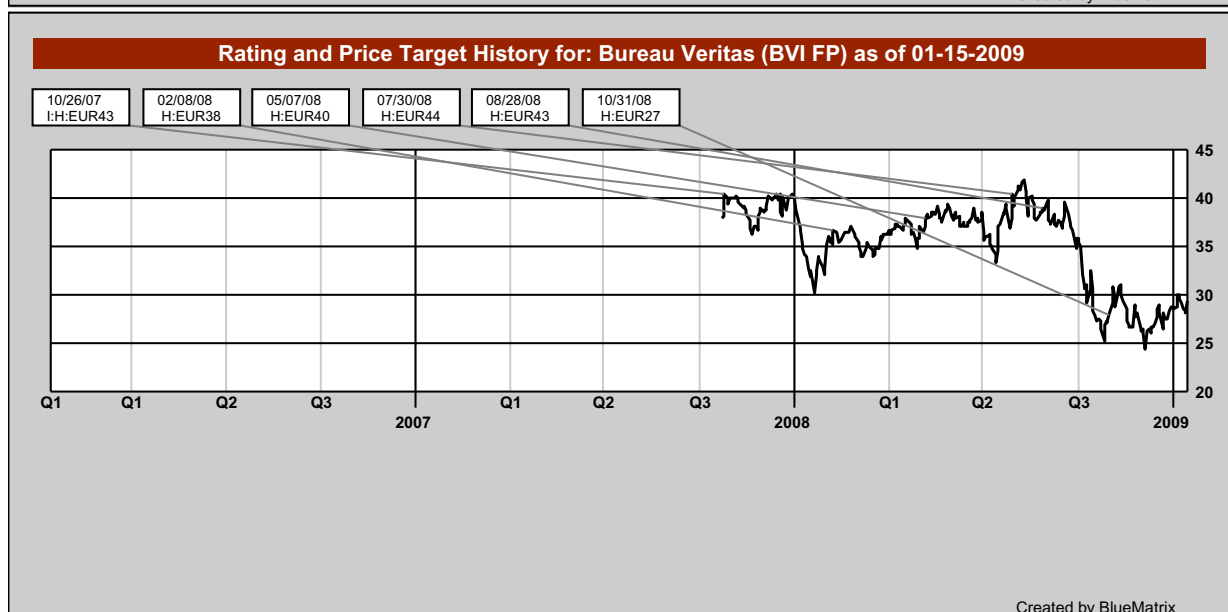
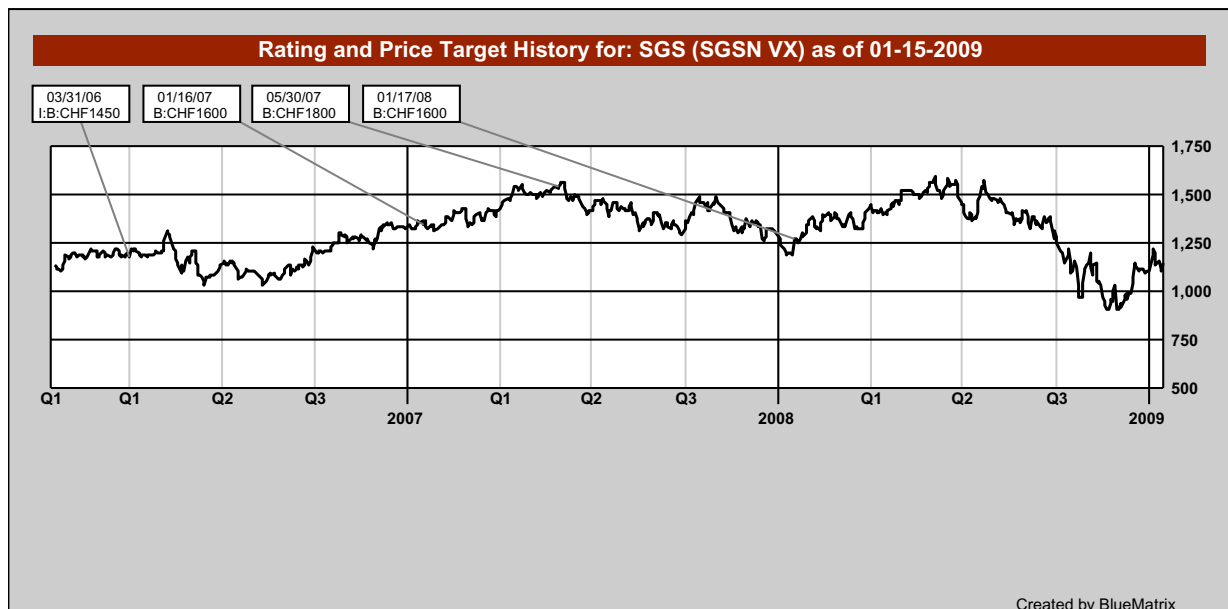
## Valuation Methodology

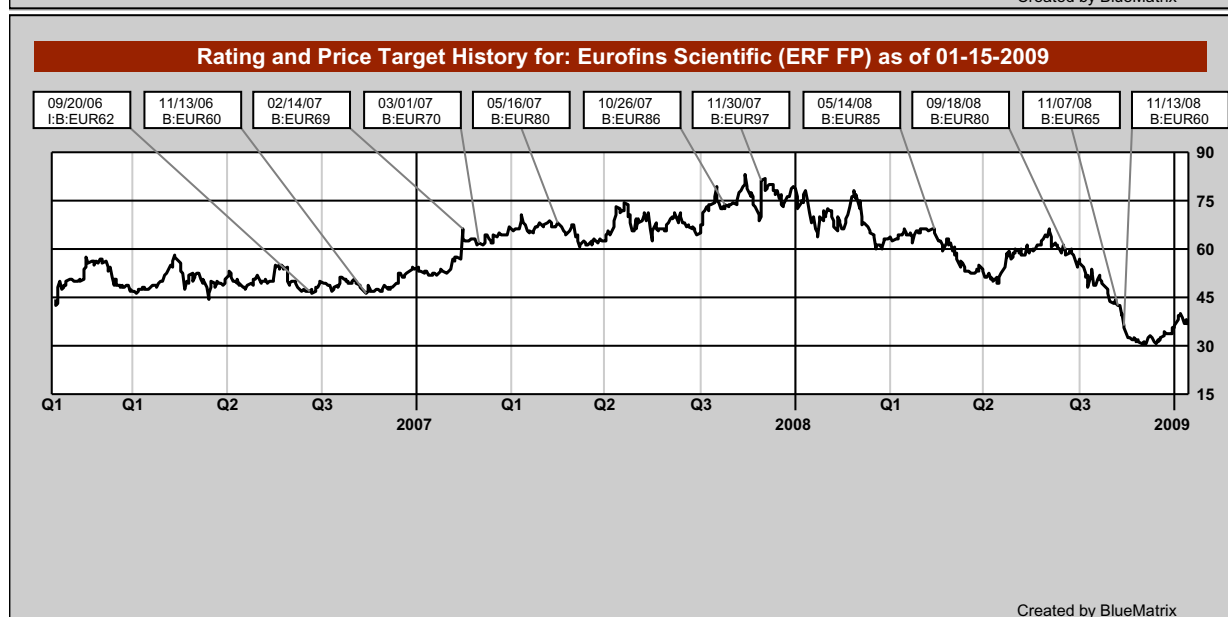
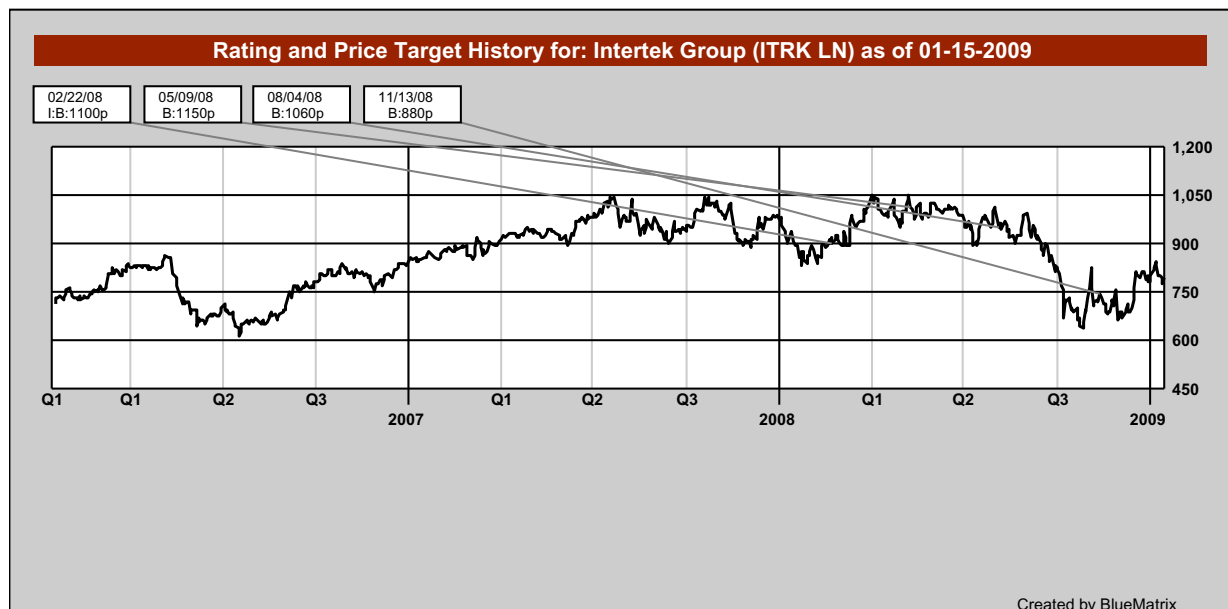
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## Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [BUY/ SB]	415	53.50	47	11.33
HOLD [HOLD]	291	37.50	24	8.25
SELL [SU/ UNPF]	70	9.00	5	7.14

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