

Services Group  
Diversified Commercial

Switzerland

## SGS (VX: SGSN VX)

### Cruising Through the Headwinds

#### Investment Summary

SGS's investor days re-emphasized the company's strong positioning in the current economic environment. Trading at a discount to historical multiples, with no slowdown in sight, we reiterate our Buy rating.

#### Company Update

Rating: BUY  
Price: CHF1,390.00  
Price Target: CHF1,600.00  
Bloomberg: VX: SGSN VX

#### Market Data

52-Week Range: CHF1,607.00-CHF1,189.84  
Total Entprs. Value (MM): CHF10,011.5  
Market Cap. (MM): CHF10,564.0  
Shares Out. (MM): 7.6  
Avg. Daily Vol.: 23,667

#### Financial Summary

Net Debt (MM): (CHF552.5)  
Net Debt/Capital: (20.0%)  
Dividend Yield: 2.5%

CHF	2006A	2007E	2008E	2009E
Rev. (MM)	3821.0	4372.0	4771.5	5378.2
EV/Rev.	2.6x	2.3x	2.1x	1.9x
EBITDA (MM)	800.0	908.0A	1,017.0	1,121.4
EV/EBITDA	12.5x	11.0x	9.8x	8.9x
<b>EPS</b>				
<b>FY Dec</b>	<b>58.40</b>	<b>65.47A</b>	<b>75.62</b>	<b>85.38</b>
FY P/E	23.8x	21.2x	18.4x	16.3x
EBIT (MM)	624.0	690.0A	801.0	902.1
EV/EBIT	16.0x	14.5x	12.5x	11.1x
Net Profit	443.0	500.0A	577.0	651.5

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#### Event

SGS's held 2 investor days, highlighting their Benelux operations and a number of global opportunities across their business lines.

#### Key Points

- While the bulk of SGS's investor days related to emerging mid term opportunities, in our opinion the key takeaway was management's positive short term outlook. Reiterating the optimism expressed with the July H1 results, CEO Chris Kirk continues to see few headwinds through YE and went so far as to say the management group is having fun right now as the markets are so good. While cautious post '08 due to the general market upheaval, management has yet to see anything which would drastically impact the business and hinted that '09 could be yet another year of double digit organic growth barring significant changes in the external environment.
- Less reassuring was the company's update on acquisitions. Management noted that prices remain elevated despite market turmoil - notably for larger acquisitions (Bodycote). While continuing to point to more reasonable pricing in the lower tiers, the company has remained very cautious and did not hint at a change in that position. We continue to believe that given the company's large net cash position and zero yield on those assets, M&A remains a key to boosting the share price, thus are disappointed by the slow progress.
- Other key takeaways from the investor day included positive signs in the Agriculture business (on the back of good crop yields) and OG&C division (due to oil prices which remain historically high and volatile), and some interesting near term opportunities in the Consumer (third party food testing in U.S.) and GSIT (global scanner business driven by U.S. regulation) divisions. We have overviewed the last two on the following page.

#### Valuation/Risks

On Friday's close SGS is trading on 18.4x this year's EPS - which is at the bottom of the 5yr. trading range. If the company can indeed continue to come good on its expectations for the remainder of '08 and for '09, we see no reason why we can't get back closer to the 21x level the shares have averaged since 2003. Our CHF1,600 target is based on that 21x multiple to our '08 EPS forecast. We also see some easy upside to estimates if SGS can boost external growth. On a relative basis SGS is trading in line with BV and at a 7% premium to ITRK on '08 PE's. We continue to believe SGS warrants the premium given its diversified business lines, good management and external growth potential.

#### Impact on Other Companies

ITRK should also benefit from many of the trends which are driving the optimism of SGS's management. Eurofins could be a beneficiary of potential U.S. food testing legislation.

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Highlighting what we believe were the two most salient mid term opportunities presented at the investor days:

- In the **Consumer** business the overall message was positive, with management seeing new U.S. toy testing legislation supporting growth in '09, but likely not matching the blistering pace seen in H2'07 and '08. More notable was management's discussion of potential in the food business, where the forecast is for 10% industry growth in '08 and where there are a number of drivers for strong expansion in the mid term. Management highlighted increasing consumer and industry concern regarding food safety (see recent listeria/melamine outbreaks) and production (sustainability becoming increasingly important) which could drive testing and certification volumes, but was most excited by potential on the regulatory front. While the E.U. continues to be regulation happy, the more significant change is in the U.S. where the government is currently undertaking a pilot project for third party certification of imported shrimp. That project could potentially be rolled out across the food chain and could create an extremely large opportunity.
- The other highlight from the investor day presentations was in the **GSIT** division. The company sees a great deal of potential in U.S. legislation which could ban entry of shipping containers into America which are not first scanned at the port of loading. If enacted, the legislation would necessitate the installation of scanning equipment in 700 ports globally with implementation slated for mid 2010 (elongated by a 2 year grace period). The scope of the project and resources required would likely necessitate outsourcing of the project, and SGS appears to have the inside track on providing the service (ITRK remains well behind in the scanner business, Cotecna very much oriented towards its African business, and BV continuing to be a marginal player). There remain political hurdles prior to the enactment of the legislation, but should the program proceed, it could transform the GSIT division in the next two years.

December year end	2002	2003	2004	2005	2006	2007	2008E	2009E	2010E
<b>Income Statement (CHFm)</b>									
Turnover	2392.0	2454.0	2885.0	3308.0	3821.0	4372.0	4771.5	5378.2	6062.8
% change	2.6%	2.6%	17.6%	14.7%	15.5%	14.4%	9.1%	12.7%	12.7%
EBITDA	311.0	396.0	508.0	642.0	800.0	908.0	1017.0	1121.4	1278.8
margin %	13.0%	16.1%	17.6%	19.4%	20.9%	20.8%	21.3%	20.9%	21.1%
EBIT	127.0	293.0	380.0	502.0	623.8	690.0	801.0	902.1	1030.5
margin %	5.3%	11.9%	13.2%	15.2%	16.3%	15.8%	16.8%	16.8%	17.0%
Pre-Tax	140.0	303.0	386.0	507.0	622.8	692.0	801.2	904.8	1034.7
Net income	109.0	227.0	278.0	371.0	442.8	500.0	577.0	651.5	747.6
margin %	4.6%	9.3%	9.6%	11.2%	11.6%	11.4%	12.1%	12.1%	12.3%
<b>Balance Sheet (CHFm)</b>									
Working Capital	216.0	196.0	139.0	223.0	219.0	191.0	206.9	233.3	262.9
WC as a % of turnover	9.0%	8.0%	4.8%	6.7%	5.7%	4.4%	4.3%	4.3%	4.3%
Capital Employed & goodwill	696.0	758.0	936.0	1238.0	1519.0	1645.0	1778.7	2010.0	2304.2
RoACE incl GW	17.7%	40.3%	44.9%	46.2%	45.2%	43.6%	46.8%	47.6%	47.8%
ROE	12.6%	21.9%	25.2%	27.0%	30.6%	27.0%	28.0%	26.4%	25.4%
Net Debt	-402.0	-493.0	-438.0	-430.0	-216.0	-418.0	-552.5	-841.9	-1060.7
Gearing	-44.8%	-46.0%	-37.7%	-29.9%	-14.1%	-21.7%	-25.8%	-32.8%	-34.8%
<b>Cash Flow (CHFm)</b>									
Cash Flow	219.0	395.0	486.0	598.0	582.8	694.0	911.1	970.9	1022.0
Capex	-121.0	-171.0	-201.0	-205.0	-224.0	-271.0	-251.3	-283.2	-319.3
WCR	32.0	-70.0	-61.0	-187.0	-31.0	12.0	-155.9	-26.3	-29.7
Free-Cash Flow	130.0	154.0	224.0	206.0	327.8	435.0	503.9	661.4	673.0
<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
Stock Price (CHF)	388.5	604.0	720.5	956.0	1,226	1,452	1,390	1,390	1,390
Market Cap*	3,020	4,644	5,396	7,260	9,307	11,085	10,607	10,607	10,607
EPS net	14.02	29.52	37.12	48.85	58.33	65.47	75.62	85.38	97.97
PER net	27.7	20.5	19.4	19.6	21.0	22.2	18.4	16.3	14.2
CFPS	28.2	51.4	64.9	78.7	76.8	90.9	119.4	127.2	133.9
PCF	13.8	11.8	11.1	12.1	16.0	16.0	11.6	10.9	10.4
P/NAV	3.4	4.3	4.6	5.0	6.1	5.8	4.9	4.1	3.5
ROE	12.6%	21.9%	25.2%	27.0%	30.6%	27.0%	28.0%	26.4%	25.4%
EV	2,618	4,151	4,958	6,830	9,091	10,667	10,055	9,765	9,546
EV / Sales	1.1	1.7	1.7	2.1	2.4	2.4	2.1	1.8	1.6
EBIT mg %	5.3%	11.9%	13.2%	15.2%	16.3%	15.8%	16.8%	16.8%	17.0%
EV / EBITDA	8.4	10.5	9.8	10.6	11.4	11.7	9.9	8.7	7.5
EV / EBIT	20.6	14.2	13.0	13.6	14.6	15.5	12.6	10.8	9.3
Yield %	1.6%	1.2%	1.3%	1.2%	4.2%	1.6%	2.5%	2.2%	2.5%

\* 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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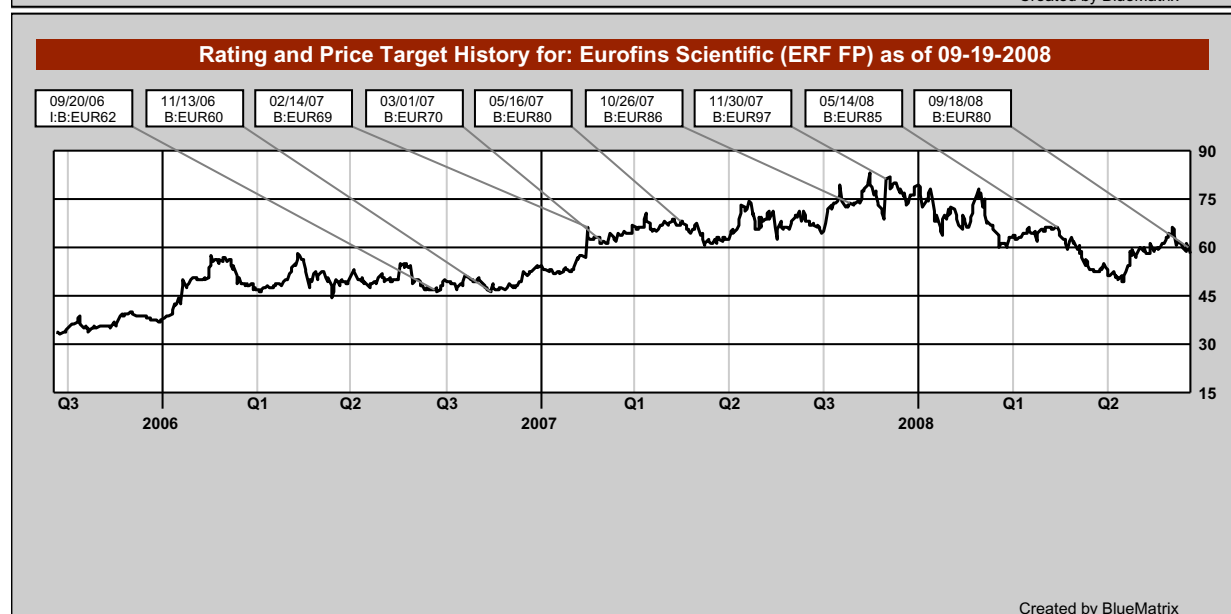
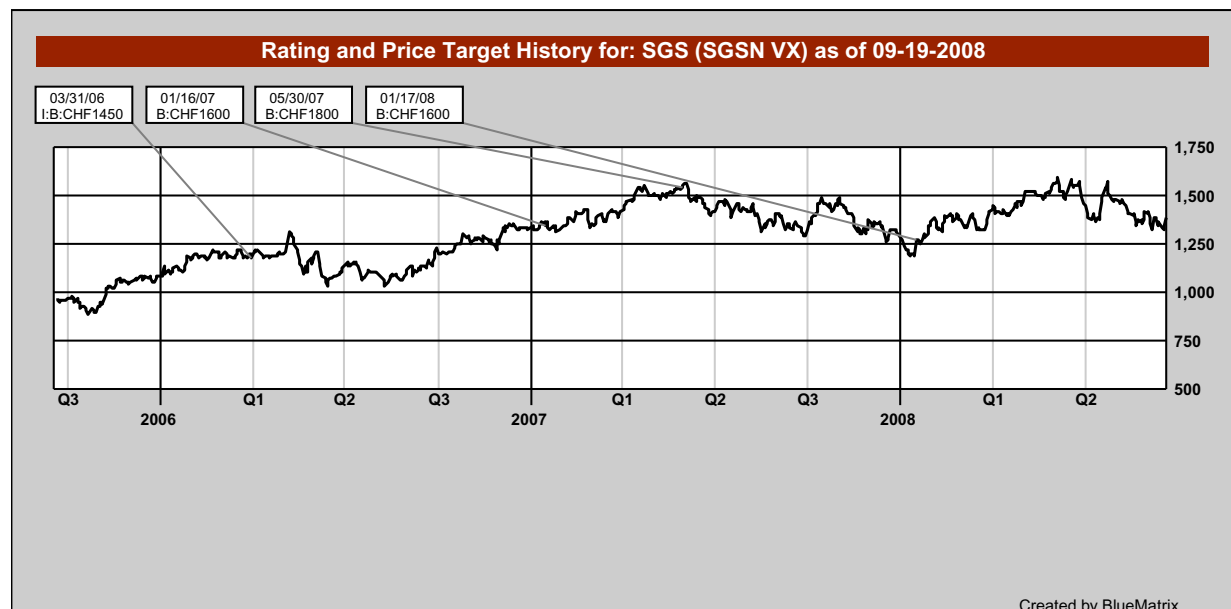
## Valuation Methodology

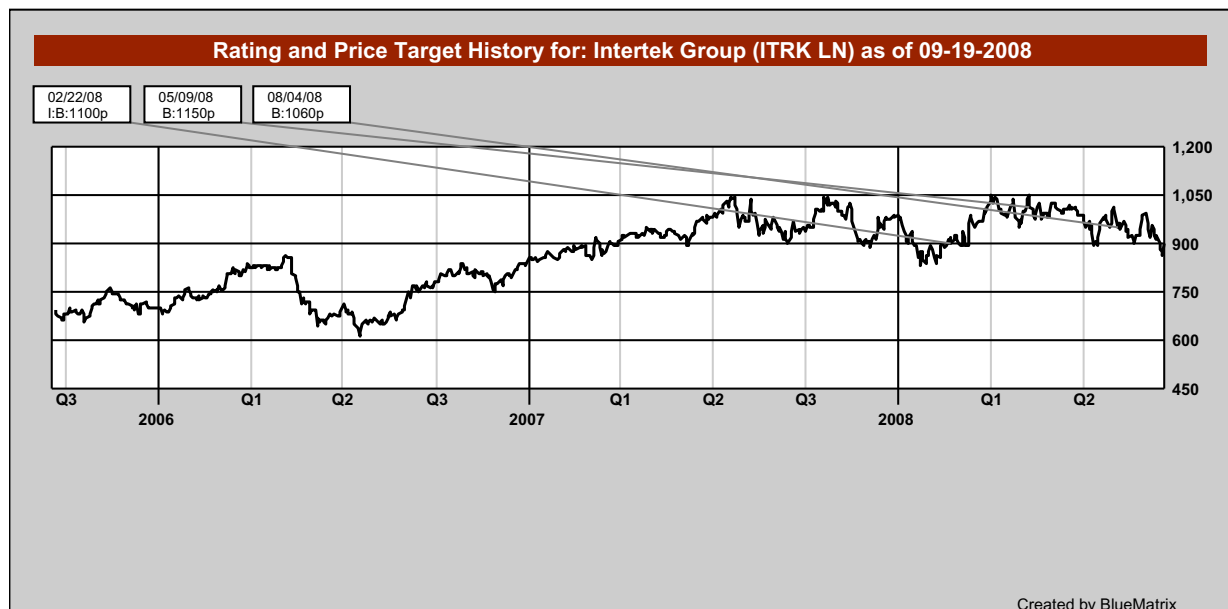
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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [BUY/ SB]	485	58.65	54	11.13
HOLD [HOLD]	303	36.64	26	8.58
SELL [SU/ UNPF]	39	4.72	3	7.69

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