

# Company Follow Up

Bank Leu Swiss Equity Research

## GOODS INSPECTION

14.07.2005 SMI 6,394

Registered shares		Price (CHF) 926			High/Low (52 weeks) CHF 932/671				New price target (12 mth) CHF 1,100			
in CHF	EPS	FCF	Dividend	Book value	P/E	EV/EBIT	EV/EBITDA	EV/Sales	FCF yield	Dividend yield	Price to book	
2007 E	62.0	45.1	21.00	272	14.9	9.2	7.9	1.53	4.9%	2.3%	3.4	
2006 E	54.7	38.0	18.00	228	16.9	10.9	9.2	1.74	4.1%	1.9%	4.1	
2005 E	46.7	25.9	15.00	190	19.8	13.3	10.9	2.00	2.8%	1.6%	4.9	
2004 A	35.7	15.3	12.00	157	26.0	17.7	13.6	2.31	1.7%	1.3%	5.9	
Lt growth:	12.5%				WACC:	8.3%						
PEG ratio 2005E:	1.6x				ROIC (2005E):	26.5%						

**Buy**

**SGS**

Bloomberg: **SGSN VX**  
Reuters: **SGSN.VX**

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### Following 1H2005 Results

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- Yesterday we received confirmation of our bullish view on SGS. Figures in 1H05 were good and there is no reason to believe that the uptrend will be broken in 2H05 or beyond 2005.
- The new CEO, Dan Kerpelman, delivered a relatively upbeat statement regarding the current trends in the industry as well as future possibilities for SGS.
- Although the CEO was not prepared to give specific guidance for the numbers beyond 2005, we have strong evidence that the story is not over. Following its restructuring the company will now focus on growth.
- We have slightly altered our mindset; for margins we were already on the cautious side but for organic growth have become more buoyant. We expect CHF 47 EPS in the current year, CHF 55 in 2006 and CHF 62 in 2007.
- As a clearer picture regarding the prospects of the company has emerged our confidence has risen. Moreover, newsflow is expected to stay positive.
- SGS's track record over the past three years speaks in favor of the company's ability to achieve its goals. The company is well diversified, and even though one or two businesses are currently performing below expectations (TAS, Automotive) this is not destroying the overall positive picture.
- We believe any downside to growth is very limited at the moment, indeed, H2's prospects seems to be excellent, too. The company's comments were largely positive regarding expected growth, margin improvements or projects in H2. Be aware that currencies in H2 will most likely be supportive for results. In addition, the outlook beyond 2005 is anything but gloomy.
- As a consequence we raise our 12-month price target from CHF 1,000 to CHF 1,100. At our adjusted price target SGS would trade at 20 times 2006 earnings, we believe this is a fair level.



## INVESTMENT CONCLUSION

Yesterday we received confirmation of our bullish view on SGS. Figures in 1H05 were good and there is no reason to believe that the uptrend will be broken in 2H05 or beyond. The new CEO, Dan Kerpelman, delivered a relatively upbeat statement regarding the current trends in the industry as well as future possibilities for SGS. Even though the CEO was not prepared to issue specific guidance for the numbers beyond 2005, we have strong evidence that the story is not over. Following its restructuring the company will now focus on growth. According to the CEO, "further margin gains cannot be ruled out", but he seemed to be very committed regarding double-digit organic top line growth. SGS's near-term focus will be more on total earnings than on percentage margin numbers.

We have slightly altered our mindset, we were already on the cautious side regarding margins but will become more buoyant on organic growth. We expect CHF 47 EPS in the current year, CHF 55 in 2006 and CHF 62 in 2007. As a clearer picture regarding prospects of the company has emerged our confidence has risen. Moreover, news flow is expected to stay positive. We expect SGS will announce additional acquisitions in the coming weeks. Finally, in autumn we expect more clearance from the company regarding its financial targets. Anything else than another demanding guidance would be a surprise.

SGS's track record over the past three years speaks in favor of the company achieving its goals. The company is well diversified, and even though one or two businesses are performing below expectations (TAS, Automotive), this is not destroying the overall positive picture.

Moreover, recent acquisitions seem to be well integrated into existing businesses; operating margin achieved out of acquisitions was above group average. Acquisitions increased revenues by CHF 36m but EBITA by CHF 6m, we calculate a margin of approximately 17% on the acquired new businesses, which is even slightly above group average and speaks in favor of the business model – operating leverage really works. Likewise, Life Science, Consumer Testing, Industrial and Environmental, which were all supported by external growth, achieved sound results, a clear sign that recent acquisitions were well integrated.

We believe any downside to growth is very limited at the moment, indeed, H2's prospects seems to be excellent, too. The company made largely positive comments regarding expected growth, margin improvements or projects in H2. Be aware that currencies in H2 will most likely be supportive for results. In addition, the outlook beyond 2005 is anything but gloomy.

The biggest risk we see is in Asia/Pacific, where most of SGS is generating most of its growth. The region grew by 26.0% in local currencies, far ahead of Americas (8.6%) and Europe/Africa & Middle East (7.6%). Any macro shock in Asia/Pacific would definitely dim the rosy picture from the company.

We see the probability of some short-term some switching occurring from outperforming SGS into underperforming Intertek shares; the industry outlook is positive and investors might see a chance to arbitrage between the two companies. Even in such a scenario we recommend staying on board, as soon as the dust settles SGS shares could be again on the way up.

As a consequence we raise our 12-month price target from CHF 1,000 to CHF 1,100. At our adjusted price target SGS would trade at 20 times 2006 earnings, we believe this is a fair level.

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## A CLOSER LOOK AT THE 1H05 NUMBERS

SGS results were slightly above our and market expectations. Organic growth was 11.3%, no sign of weakening compared with growth achieved in 2H04. Even more impressive was the operating margin, which was 40 basis points ahead of our forecast. Margin has increased from 10.1% in 1H04 to 11.3% in 2H04 and finally to 14.7% in 1H05. Results include the first time accounting for share-based payments, expenses were CHF 4m – excluding this charge, margin would be even higher. Moreover, provisions of CHF 11m were booked. We note excellent performance in Certification, Consumer, Minerals, Agro and Life Science, but a rather disappointing though not fully unexpected outcome of results in TAS (government contracts). We believe that Automotive was also not fully convincing. The unexpectedly large need for cash for working capital was explained by management as a timing issue and that 2H05 cash generation out of working capital is projected. At least DSO moved in the right direction during 1H05 – downward.

### SGS, key numbers in CHF m

	1H05 reported	1H05E Leu	Consensus	Change	1H04
<b>Revenues</b>	<b>1,557</b>	<b>1,575</b>	<b>1,530</b>	<b>12.0%</b>	<b>1,390</b>
- due to volume and prices	11.3%	11.9%			10.1%
- due to currency translation	-1.5%	-2.6%			0.8%
- due to acquisitions/(disposals)	2.3%	4.0%			7.6%
<b>EBITDA</b>	<b>294</b>	<b>279</b>	<b>288</b>	<b>27.8%</b>	<b>230</b>
<b>Operating income (EBITA)</b>	<b>229</b>	<b>226</b>	<b>224</b>	<b>29.4%</b>	<b>177</b>
- Margin	14.7%	14.3%			12.7%
Exceptionals	0	0			0
Goodwill	0	0			-8
<b>EBIT</b>	<b>229</b>	<b>226</b>		<b>35.5%</b>	<b>169</b>
Net financial income	4	3			4
<b>Net profit before taxes</b>	<b>233</b>	<b>229</b>		<b>34.7%</b>	<b>173</b>
Taxes	-55	-54			-43
- tax rate	23.6%	23.5%			24.9%
<b>Net profit after taxes</b>	<b>178</b>	<b>175</b>		<b>36.9%</b>	<b>130</b>
Minorities	-8	-8			-6
<b>Net profit</b>	<b>170</b>	<b>167</b>	<b>165</b>	<b>37.1%</b>	<b>124</b>
Free cash flow	48	102		-22.6%	62
Net cash	349	426			278

By segments we note surprising high organic growth, 19.1% in the rather boring commodity-based minerals division. The other commodity-type segment, Oil, Gas and Chemicals, achieved 8.9% organic growth, somewhat declining but still fine. According to management, competitiveness in this field has increased and pricing is tough. In consumer, organic growth achieved an excellent 25.6% and margins increased from 17.1% to 21.3%. Here SGS seems to be closing in on its nearest competitor Intertek (Labtest). Ahead of our forecast was Certification, which achieved an EBIT of CHF 20m versus our expectation of CHF 17m. Life Science was also strong, organic growth was 18.0% and margin increased from 11.2% to 14.0%. However, that business is building up from a relatively low base. Worse than expected was TAS, revenues declined on a comparable basis by 9.6%, we expected a decline of 5.0%. It was already known the Venezuela contract is expected to terminate in H2 “resulting in lower PSI revenues and profits in medium term”. During the analyst conference the CEO clarified the expected shortfall from the Venezuela contract as representing 1.0% of group revenues and 1.5% of group net income. Automotive was once again disappointing on the top line (1.1% organic growth) but profitability was fine (12.6% margin, higher than expected).

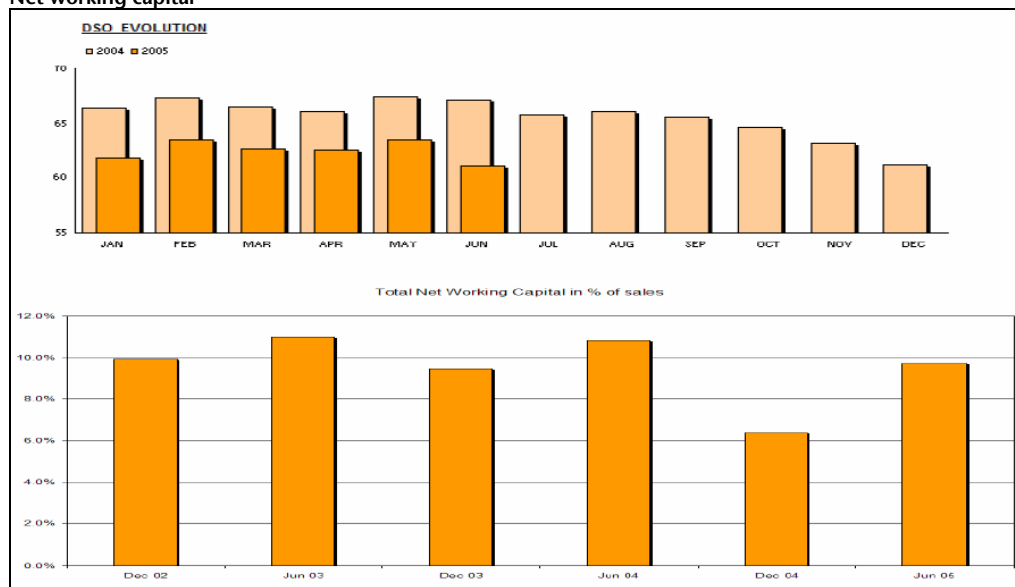
By segments in 1H05

in CHF m	Reported numbers					Bank Leu forecast				
	Sales	growth	organic	EBITA	margin	Sales	growth	organic	EBITA	margin
Agro	138	10.9%	10.9%	15	10.9%	129	4.0%	6.0%	14	10.8%
Minerals	177	17.3%	19.1%	27	15.4%	173	14.5%	17.5%	26	15.1%
Oil, Gas, Chem	302	6.9%	8.9%	37	12.2%	302	7.0%	10.0%	37	12.2%
Life Science	62	21.8%	18.1%	9	14.0%	72	41.2%	22.5%	9	12.5%
Consumer	214	29.3%	25.6%	46	21.3%	221	33.4%	27.5%	45	20.4%
Certification	127	11.2%	12.8%	20	15.5%	126	10.5%	12.5%	17	13.5%
Industrial	209	14.9%	12.2%	27	13.0%	206	13.1%	12.5%	27	13.1%
Environmental	111	14.0%	11.4%	11	9.9%	118	21.3%	17.5%	12	10.2%
Automotive	97	9.3%	1.1%	12	12.6%	105	18.0%	5.0%	12	11.4%
TAS	120	-10.2%	-9.6%	25	21.0%	122	-8.0%	-5.0%	27	22.1%
<b>Total</b>	<b>1,557</b>	<b>12.0%</b>	<b>11.3%</b>	<b>229</b>	<b>14.7%</b>	<b>1,575</b>	<b>13.3%</b>	<b>11.9%</b>	<b>226</b>	<b>14.4%</b>

SGS didn't collect any money from terminated but unpaid contracts (Philippines). There were no surprises below the EBITA line, financial income and tax rate was in line with what we had expected.

Only the cash flow statement needs some further explanation. We were rather surprised by the unusually high need for cash for working capital, which was CHF 81m in 1H, and following CFO and FCF that were approximately CHF 50m lower than we expected. Management explained that timing issues were mainly responsible for the rather unusual picture. DSO were fine and moved in the direction they should – downward.

Net working capital



Source: SGS presentation, Geneva 13 July 2005

In fact, the pictures from December to December and from June to June, respectively, look rather unspectacular. According to the CFO, in H1 prepaid expenses are relatively high (bonus payments, payments for insurance and social security payments). On the other side, in H2 receivables are usually paid down ahead of year end. The CFO therefore expects the release of cash out of net working capital for H2; at year end we believe our estimate is probably not too far away from the possible outcome.

The only unexplained unusual CF item left is the translation differences on flows that resulted in minus CHF 36m. We were not convinced by the explanation given, that the unusually high item should be the result of assets or liabilities valued at the period ends being on very different currency levels. So far we had the opinion that such differences resulting from balance sheet items are accounted in the P&L but not in the CF statement. More confusing is that exchange differences in the equity accounted for a plus of CHF 42m, that makes, in our eyes, absolutely no sense.

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**Positive outlook for most businesses for H2**

Agro	"Western Europe expected to accelerate in H2 as the product intervention cycle swings into high season"
Minerals	"mineralogy/metallurgy footprint will be expanded in South America in H2", "Two new geochemistry labs to be commissioned in Africa in Q3"
OCG	"We expect accelerated growth in H2 in line with winter stock building and overall positive demand for petroleum and chemicals"
Life Sciences	"New labs in East Asia to become operational in Q4"
Consumer	"Technology transfer from SGS Institut Fresenius to Asian lab network accelerating", "Laboratory infrastructure build out on E&E gaining traction with indications that first-mover advantage is secured"
Industrial	"Large QA/QC contract secured in H1 for Middle Eastern petrochemical firm"
Certification	"Other new products are being launched in H2"
Environmental	"The new labs in Asia are now accredited and have all delivered their first revenues, positioning them for future growth"
Automotive	"California data management contract will go live in Q4"

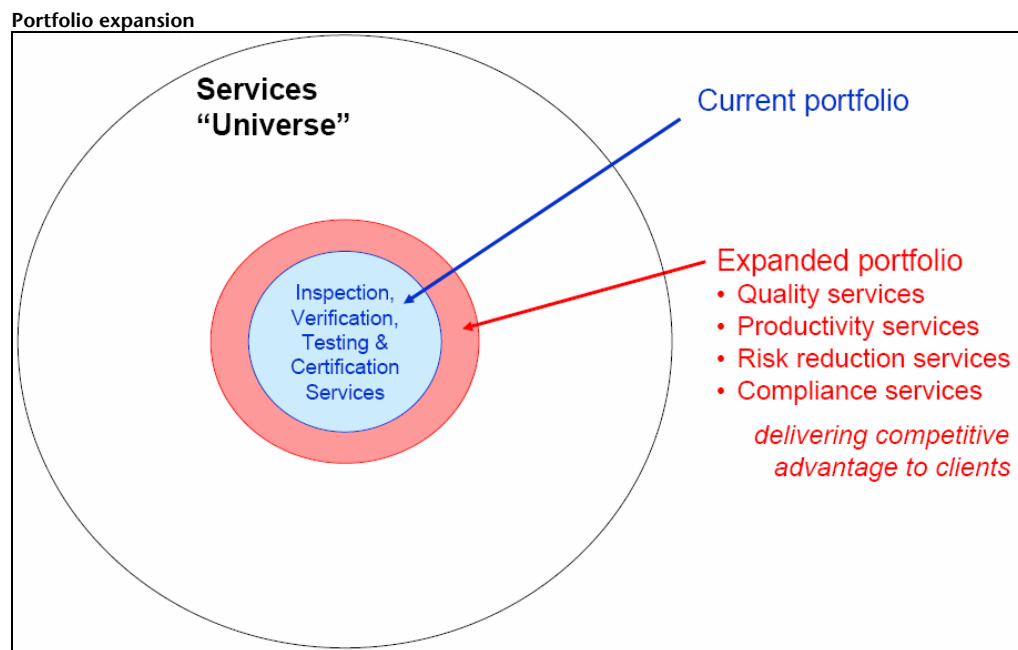
Source SGS

**GROWTH VISION**

The CEO gave a short overview regarding growth prospects of SGS that was in line with our view regarding the opportunities in the industry and for the company. According to the CEO's analysis, the existing markets provide enough opportunities and current capabilities afford access to new markets. Moreover, financing options are available. We feel SGS has the opportunity to grow its existing portfolio but also to expand into new fields.

Dan Kerpelman spent some time explaining the concept of expanding SGS's cross-border "virtual" lab which will lead to a more complete list of services. We believe the desired outcome would be an even more economical use of existing capacities. Moreover, the segment-centric marketing and bundling in such sectors as food, retail, pharmaceutical or government seems to offer growth prospects. To complete the list, the CEO also talked about strategic accounts management (mainly in the field of SSC and OCG), technology differentiation (in consumer testing) and utility businesses (in SSC).

Another area of growth exists in the possibility of leveraging core competencies, network and expertise in expanding current services into new fields; an example is offering services such as compliance advice for manufacturers in India on delivering their products into the Western Hemisphere. Risk reduction services could be an issue in the environmental services division, productivity services including the wide field of outsourcing, and so on.



Source: SGS presentation, Geneva 13 July 2005

As expected, guidance for 2005 EPS (CHF 45) was confirmed and we believe the company will finally surpass that target. Regarding its margin target, 16%, we now consider that SGS will come closer to it, as we initially thought.

Furthermore, SGS made positive comments regarding expected growth, margins or coming initiatives in most divisions .

### OUR FORECASTS UNTIL 2007 – VERIFICATION OF OUR 12-MONTH PRICE TARGET OF CHF 1,100

We have not changed our already cautious view significantly on margins, but have become more bullish on organic growth as we are convinced SGS can achieve double-digit numbers by 2007. As a result, we expect an EPS of CHF 55 in 2006 and CHF 62 in 2007.

	2006E		2007E	
	Old forecast	New forecast	Old forecast	New forecast
Organic growth	10.2%	11.5%	9.2%	10.2%
Operating margin	16.0%	16.0%	16.7%	16.5%
EPS in CHF	54.5	54.7	61.6	62.0

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## Revenues

in CHF m	2003 A	1H 2004 A	2H 2004 A	2004 A	1H 2005 A	2H 2005 E	2005 E	2006 E	2007 E	CAGR 02-07 E
<b>Agricultural Services</b>	<b>242</b>	<b>124</b>	<b>133</b>	<b>257</b>	<b>138</b>	<b>140</b>	<b>278</b>	<b>300</b>	<b>315</b>	
<u>Total change in %</u>	<u>-3.4%</u>	<u>1.9%</u>	<u>10.9%</u>	<u>6.3%</u>	<u>10.9%</u>	<u>5.3%</u>	<u>8.0%</u>	<u>8.0%</u>	<u>5.0%</u>	4.7%
- due to volume and prices	0.0%	1.0%	14.4%	7.4%	10.9%	5.2%	8.0%	8.0%	5.0%	
- due to currency translation	-3.4%	0.9%	-3.0%	-1.0%	-0.1%	0.1%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
<b>Minerals Services</b>	<b>280</b>	<b>151</b>	<b>169</b>	<b>320</b>	<b>177</b>	<b>191</b>	<b>367</b>	<b>412</b>	<b>444</b>	
<u>Total change in %</u>	<u>4.3%</u>	<u>13.7%</u>	<u>14.5%</u>	<u>14.1%</u>	<u>17.3%</u>	<u>12.9%</u>	<u>15.0%</u>	<u>12.0%</u>	<u>8.0%</u>	10.6%
- due to volume and prices	5.1%	12.0%	20.6%	15.7%	19.1%	11.1%	15.0%	12.0%	8.0%	
- due to currency translation	-5.6%	1.6%	-5.4%	-1.9%	-1.8%	1.8%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	5.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
<b>Oil, Gas &amp; Chemicals Services</b>	<b>439</b>	<b>283</b>	<b>292</b>	<b>575</b>	<b>302</b>	<b>325</b>	<b>627</b>	<b>678</b>	<b>718</b>	
<u>Total change in %</u>	<u>10.1%</u>	<u>33.3%</u>	<u>28.6%</u>	<u>30.9%</u>	<u>6.9%</u>	<u>11.4%</u>	<u>9.2%</u>	<u>8.0%</u>	<u>6.0%</u>	12.5%
- due to volume and prices	16.8%	12.6%	13.1%	12.6%	8.9%	9.2%	9.0%	8.0%	6.0%	
- due to currency translation	-6.3%	0.0%	-3.8%	-1.9%	-2.2%	2.2%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.7%	20.7%	20.5%	20.2%	0.4%	0.0%	0.2%	0.0%	0.0%	
<b>Life Sciences Services</b>	<b>59</b>	<b>51</b>	<b>56</b>	<b>107</b>	<b>62</b>	<b>72</b>	<b>134</b>	<b>157</b>	<b>185</b>	
<u>Total change in %</u>	<u>-4.1%</u>	<u>72.0%</u>	<u>88.5%</u>	<u>80.2%</u>	<u>21.8%</u>	<u>28.9%</u>	<u>25.5%</u>	<u>17.5%</u>	<u>17.5%</u>	24.5%
- due to volume and prices	-4.5%	-4.7%	-3.8%	-4.2%	18.1%	18.6%	18.5%	17.5%	17.5%	
- due to currency translation	0.5%	2.4%	-2.4%	0.0%	-0.6%	0.6%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.0%	74.3%	96.9%	84.3%	4.3%	9.7%	7.0%	0.0%	0.0%	
<b>Consumer Testing Services</b>	<b>272</b>	<b>166</b>	<b>195</b>	<b>361</b>	<b>214</b>	<b>257</b>	<b>471</b>	<b>565</b>	<b>650</b>	
<u>Total change in %</u>	<u>1.5%</u>	<u>31.0%</u>	<u>33.7%</u>	<u>32.4%</u>	<u>29.3%</u>	<u>31.6%</u>	<u>30.5%</u>	<u>20.0%</u>	<u>15.0%</u>	19.3%
- due to volume and prices	14.2%	19.3%	26.0%	22.1%	25.6%	24.2%	25.0%	20.0%	15.0%	
- due to currency translation	-4.9%	-0.2%	-4.9%	-2.6%	-1.6%	1.6%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	-6.2%	12.2%	14.1%	12.9%	5.3%	5.8%	5.5%	0.0%	0.0%	
<b>Systems &amp; Services Certification</b>	<b>230</b>	<b>114</b>	<b>121</b>	<b>235</b>	<b>127</b>	<b>144</b>	<b>271</b>	<b>292</b>	<b>316</b>	
<u>Total change in %</u>	<u>8.0%</u>	<u>8.3%</u>	<u>-2.5%</u>	<u>2.5%</u>	<u>11.2%</u>	<u>18.6%</u>	<u>15.0%</u>	<u>8.0%</u>	<u>8.0%</u>	8.2%
- due to volume and prices	14.0%	7.3%	0.9%	3.9%	12.8%	17.0%	15.0%	12.5%	10.0%	
- due to currency translation	-5.3%	0.9%	-3.7%	-1.4%	-1.6%	1.6%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
<b>Industrial Services</b>	<b>330</b>	<b>182</b>	<b>198</b>	<b>380</b>	<b>209</b>	<b>227</b>	<b>437</b>	<b>491</b>	<b>541</b>	
<u>Total change in %</u>	<u>3.0%</u>	<u>14.9%</u>	<u>15.2%</u>	<u>15.1%</u>	<u>14.9%</u>	<u>15.1%</u>	<u>15.0%</u>	<u>12.5%</u>	<u>10.0%</u>	11.0%
- due to volume and prices	3.5%	12.5%	17.8%	15.1%	12.2%	11.9%	12.0%	12.5%	10.0%	
- due to currency translation	-1.2%	2.1%	-2.3%	-0.1%	-0.4%	0.4%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.8%	0.0%	0.0%	0.0%	3.1%	2.9%	3.0%	0.0%	0.0%	
<b>Environmental Services</b>	<b>172</b>	<b>97</b>	<b>111</b>	<b>209</b>	<b>111</b>	<b>164</b>	<b>275</b>	<b>323</b>	<b>371</b>	
<u>Total change in %</u>	<u>5.8%</u>	<u>23.9%</u>	<u>19.0%</u>	<u>21.3%</u>	<u>14.0%</u>	<u>47.3%</u>	<u>31.8%</u>	<u>17.5%</u>	<u>15.0%</u>	
- due to volume and prices	6.2%	23.9%	7.8%	9.2%	11.4%	18.8%	15.0%	17.5%	15.0%	
- due to currency translation	-1.4%	3.3%	-3.5%	-0.1%	-0.8%	0.8%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	1.0%	9.4%	14.9%	12.2%	5.9%	27.7%	16.8%	0.0%	0.0%	
<b>Automotive Services</b>	<b>211</b>	<b>89</b>	<b>99</b>	<b>188</b>	<b>97</b>	<b>110</b>	<b>207</b>	<b>238</b>	<b>274</b>	
<u>Total change in %</u>	<u>-12.0%</u>	<u>-20.5%</u>	<u>-0.4%</u>	<u>-11.0%</u>	<u>9.3%</u>	<u>11.5%</u>	<u>10.5%</u>	<u>15.0%</u>	<u>15.0%</u>	2.8%
- due to volume and prices	-3.6%	-18.4%	-8.8%	-13.4%	1.1%	8.8%	5.0%	15.0%	15.0%	
- due to currency translation	-8.4%	-2.6%	-5.5%	-4.0%	-2.7%	2.7%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.0%	0.0%	14.4%	6.4%	10.9%	0.0%	5.5%	0.0%	0.0%	
<b>Trade Assurance Services</b>	<b>220</b>	<b>133</b>	<b>122</b>	<b>255</b>	<b>120</b>	<b>101</b>	<b>220</b>	<b>209</b>	<b>225</b>	
<u>Total change in %</u>	<u>4.7%</u>	<u>37.5%</u>	<u>-0.3%</u>	<u>16.2%</u>	<u>-10.2%</u>	<u>-17.9%</u>	<u>-13.9%</u>	<u>-5.0%</u>	<u>7.5%</u>	1.4%
- due to volume and prices	5.6%	37.8%	0.7%	17.0%	-9.6%	-18.5%	13.9%	-5.0%	7.5%	
- due to currency translation	-0.8%	-0.5%	-1.1%	-0.8%	-0.6%	0.6%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
<b>Total</b>	<b>2,455</b>	<b>1,390</b>	<b>1,495</b>	<b>2,885</b>	<b>1,557</b>	<b>1,730</b>	<b>3,287</b>	<b>3,665</b>	<b>4,038</b>	
<u>Total change in %</u>	<u>2.6%</u>	<u>18.4%</u>	<u>16.8%</u>	<u>17.5%</u>	<u>12.0%</u>	<u>15.7%</u>	<u>13.9%</u>	<u>11.5%</u>	<u>10.2%</u>	<u>11.0%</u>
- due to volume and prices	7.0%	10.1%	11.3%	10.7%	11.3%	10.1%	10.7%	11.5%	10.2%	
- due to currency translation	-4.5%	0.8%	-4.2%	-1.8%	-1.5%	1.3%	0.0%	0.0%	0.0%	
- due to acquisitions/(disposals)	0.1%	7.6%	9.7%	8.6%	2.3%	4.3%	3.3%	0.0%	0.0%	

## Operating income (EBITA)

in CHF m	2003 A	1H 2004 A	2H 2004 A	2004 A	1H 2005 A	2H 2005 E	2005 E	2006 E	2007 E	CAGR 02-07 E
<b>Agricultural Services</b>	<b>24</b>	<b>10</b>	<b>14</b>	<b>24</b>	<b>15</b>	<b>17</b>	<b>32</b>	<b>36</b>	<b>38</b>	9.0%
<i>margin</i>	10.0%	7.6%	10.6%	9.2%	10.9%	12.1%	11.5%	12.0%	12.0%	
<b>Minerals Services</b>	<b>36</b>	<b>21</b>	<b>25</b>	<b>46</b>	<b>27</b>	<b>30</b>	<b>57</b>	<b>66</b>	<b>71</b>	21.6%
<i>margin</i>	12.7%	14.0%	14.9%	14.5%	15.4%	15.6%	15.5%	16.0%	16.0%	
<b>Oil, Gas &amp; Chemicals Services</b>	<b>48</b>	<b>33</b>	<b>36</b>	<b>69</b>	<b>37</b>	<b>45</b>	<b>82</b>	<b>95</b>	<b>101</b>	25.7%
<i>margin</i>	10.9%	11.7%	12.2%	11.9%	12.2%	13.7%	13.0%	14.0%	14.0%	
<b>Life Sciences Services</b>	<b>6</b>	<b>6</b>	<b>7</b>	<b>13</b>	<b>9</b>	<b>11</b>	<b>19</b>	<b>24</b>	<b>31</b>	56.9%
<i>margin</i>	10.0%	11.2%	12.8%	12.0%	14.0%	14.9%	14.5%	15.0%	17.0%	
<b>Consumer Testing Services</b>	<b>39</b>	<b>28</b>	<b>37</b>	<b>65</b>	<b>46</b>	<b>58</b>	<b>104</b>	<b>127</b>	<b>149</b>	42.9%
<i>margin</i>	14.5%	17.1%	18.9%	18.1%	21.3%	22.6%	22.0%	22.5%	23.0%	
<b>Systems &amp; Services Certification</b>	<b>35</b>	<b>14</b>	<b>17</b>	<b>31</b>	<b>20</b>	<b>24</b>	<b>43</b>	<b>48</b>	<b>54</b>	17.3%
<i>margin</i>	15.1%	12.3%	13.6%	13.0%	15.5%	16.4%	16.0%	16.5%	17.0%	
<b>Industrial Services</b>	<b>35</b>	<b>21</b>	<b>25</b>	<b>46</b>	<b>27</b>	<b>32</b>	<b>59</b>	<b>69</b>	<b>76</b>	17.7%
<i>margin</i>	10.6%	11.4%	12.9%	12.1%	13.0%	13.9%	13.5%	14.0%	14.0%	
<b>Environmental Services</b>	<b>11</b>	<b>6</b>	<b>11</b>	<b>17</b>	<b>11</b>	<b>18</b>	<b>29</b>	<b>45</b>	<b>59</b>	44.3%
<i>margin</i>	6.5%	6.4%	9.5%	8.1%	9.9%	10.9%	10.5%	14.0%	16.0%	
<b>Automotive Services</b>	<b>21</b>	<b>10</b>	<b>10</b>	<b>20</b>	<b>12</b>	<b>15</b>	<b>27</b>	<b>33</b>	<b>41</b>	24.6%
<i>margin</i>	9.9%	10.9%	10.4%	10.7%	12.6%	13.3%	13.0%	14.0%	15.0%	
<b>Trade Assurance Services</b>	<b>45</b>	<b>29</b>	<b>33</b>	<b>62</b>	<b>25</b>	<b>19</b>	<b>44</b>	<b>42</b>	<b>47</b>	15.5%
<i>margin</i>	20.5%	21.7%	26.7%	24.1%	21.0%	18.8%	20.0%	20.0%	21.0%	
<b>Total operating income (EBITA)</b>	<b>300</b>	<b>177</b>	<b>214</b>	<b>391</b>	<b>229</b>	<b>267</b>	<b>495</b>	<b>585</b>	<b>667</b>	<b>25.3%</b>
<i>margin</i>	12.2%	12.7%	14.3%	13.6%	14.7%	15.4%	15.1%	16.0%	16.5%	

\*) In 1H03 Environmental Services has identified as a strategic business. Furthermore the remaining "Emerging Businesses" have been absorbed into the mainstream activities of Automotive and Life Sciences Services. That's why some of the divisional figures for 2H02 and FY02 are not available, yet.

Based on our estimates, SGS trades at an EV/EBITDA ratio of 7.9 times for 2007.

## Current valuation

	2005 E	2006 E	2007 E
Current share price	926.0	926.0	926.0
Current market capitalization (CHF m)	7,243	7,243	7,243
Net cash (CHF m)	673	856	1,071
Enterprise value (CHF m)	6,571	6,388	6,173
Price/book (x) E	4.9	4.1	3.4
Dividend yield	1.6%	1.9%	2.3%
Free cash flow yield	2.8%	4.1%	4.9%
PER (x) E	19.8	16.9	14.9
EV/Sales (x) E	2.00	1.74	1.53
EV/EBITDA (x) E	10.9	9.2	7.9
EV/EBITA (x) E	13.3	10.9	9.2
EV/EBIT (x) E	13.3	10.9	9.2

Note that, historically, the average 1-year forward EV/EBITDA ratio is 12 times. Moreover, applying a PER multiple of 20 times, a multiple that we look on as fair regarding the superior SGS business model and its huge growth prospects in the industry, we would expect to see share prices around CHF 1'100 until the end of 2005 and CHF 1'200 to the end of 2006. Note that comparable companies in the business service sector (outsourcers) trade, on average, on a PE ratio of more 17 times for 2005, the premium to SGS is currently at 15% and to its closest competitor, Intertek, the premium is "only" 8%. We believe the premium is fully justified by the superior growth prospect at SGS.

**Peer group comparison**

<b>in loc. curr.</b>	<b>Symbol</b>	<b>FY ends</b>	<b>Price</b>	<b>PE05E</b>
<b>Comparable companies in the business service sector (outsourcers)</b>				
Adecco	ADEN VX	Dec 31	63.40	17.7
Capita	CPI LN	Dec 31	3.6475	20.3
Compass	CPG LN	Sep-30	2.4050	12.2
Hays	HAS LN	June 30	1.3100	18.5
ITRK	ITRK LN	Dec 31	725.50	18.3
Rentokil	RTO LN	Dec 31	1.5875	12.9
Securitas	SECUB SS	Dec 31	136.50	17.3
Serco	SRP LN	Dec 31	2.4900	18.1
<b>SGS</b>	<b>SGSN VX</b>	<b>Dec 31</b>	<b>926.00</b>	<b>19.8</b>
Average valuation				17.2
Premium/(Discount) SGS vs. peer group average				15%

Sources: Bank Leu estimates, IBES estimates, Broker estimates

Also looking to our updated DCF model we calculate a fair value of approximately CHF 1'080 per share.

The most important input factors to our model are the following:

- We believe that 16.5% EBIT margin is achievable in 2007 at the latest and is sustainable.
- We believe that organic growth will slow from 11.5% in 2006 to “just” 7.0% in 2011. Our assumption for the perpetual growth rate (2011 ff.) is 2.5%.
- Our calculations use a cash operating tax rate of 25%, we believe in a fairly cautious approach. According to the company, some additional measures to optimize the group's global tax position were put in place in 2004, first benefits could be seen in 2005.
- We assume a WACC of 8.3%.
- We believe that the company' capex level will rise slower than initially expected after 2005, simply due to the fact that we expect most of the work in building up a lab infrastructure to be completed by that time. The pure maintenance level for the infrastructure is about CHF 100m, the rest is investment for future growth.

DCF

	2005 E	2006 E	2007 E	2008 E	2009 E	2010 E	2011 E	Base	Rate to infinity	CAGR 95-04A	CAGR 04-11E
<b>Revenues</b>	<b>3,287</b>	<b>3,665</b>	<b>4,038</b>	<b>4,442</b>	<b>4,842</b>	<b>5,229</b>	<b>5,595</b>			<b>3.8%</b>	<b>9.9%</b>
<i>growth rate</i>	13.9%	11.5%	10.2%	10.0%	9.0%	8.0%	7.0%				
<b>EBITA</b>	<b>495</b>	<b>585</b>	<b>667</b>	<b>734</b>	<b>800</b>	<b>864</b>	<b>925</b>			<b>9.8%</b>	<b>13.1%</b>
<i>as percentage of sales</i>	15.1%	16.0%	16.5%	16.5%	16.5%	16.5%	16.5%				
<b>COT</b>	<b>25.0%</b>	<b>25.0%</b>	<b>25.0%</b>	<b>25.0%</b>	<b>25.0%</b>	<b>25.0%</b>	<b>25.0%</b>				
<b>NOPAT</b>	<b>347</b>	<b>409</b>	<b>467</b>	<b>551</b>	<b>600</b>	<b>648</b>	<b>693</b>			<b>9.8%</b>	<b>14.2%</b>
Depreciation	105	110	115	120	130	140	150				
<i>as percentage of sales</i>	3.2%	3.0%	2.8%	2.7%	2.7%	2.7%	2.7%				
<b>Cash flow</b>	<b>452</b>	<b>519</b>	<b>582</b>	<b>671</b>	<b>730</b>	<b>788</b>	<b>843</b>			<b>7.1%</b>	<b>12.4%</b>
Net working capital	397	443	488	537	585	632	677				
<i>as percentage of sales</i>	12.1%	12.1%	12.1%	12.1%	12.1%	12.1%	12.1%				
Decrease/(Increase) in net working capital	-69	-72	-79	-83	-89	-95	-102				
<i>as percentage of sales</i>	-2.1%	-2.0%	-2.0%	-1.9%	-1.8%	-1.8%	-1.8%				
Capex	-180	-150	-150	-150	-150	-150	-150				
<i>as percentage of sales</i>	5.5%	4.1%	3.7%	3.4%	3.1%	2.9%	2.7%				
<i>Capex/Depreciation</i>	171%	136%	130%	125%	115%	107%	100%				
<b>Free cash flow</b>	<b>203</b>	<b>297</b>	<b>353</b>	<b>437</b>	<b>491</b>	<b>543</b>	<b>591</b>	<b>591</b>	<b>10,286</b>	<b>9.3%</b>	<b>25.6%</b>
<i>growth rate</i>	69%	47%	19%	24%	12%	11%	9%				
Discount factor	0.924	0.853	0.853	0.728	0.673	0.621	0.574		0.574		
Discounted FCF	187	254	301	318	330	337	340		5,905		
<b>Enterprise value</b>	<b>7,634</b>										
<b>+ Net cash 2005E (incl. treasury shares)</b>	<b>856</b>										
<b>- Minorities</b>	<b>30</b>										
<b>Equity value</b>	<b>8,459</b>										
Total number of shares (in millions)	7,822,166										
<b>Equity value per share in CHF</b>	<b>1,081</b>										
<b>Cost of equity:</b>											
Beta	0.95										
Risk free rate	3.5%										
Risk premium	5.0%										
WACC=ke (cost of equity) = Rf + (Beta x Risk premium)	8.3%										
<b>WACC</b>	<b>8.3%</b>										
<b>g 2011ff</b>	<b>2.5%</b>										
Rate to infinity (=wacc-g)	5.8%										

Sensitivity to our DCF

Fair value in CHF	WACC= 8.0%	WACC= 8.5%	WACC= 9.0%
rate to infinity = 3.0%	1,169	1,138	1,109
rate to infinity = 2.5%	1,096	1,068	1,040
rate to infinity = 2.0%	1,034	1,008	983

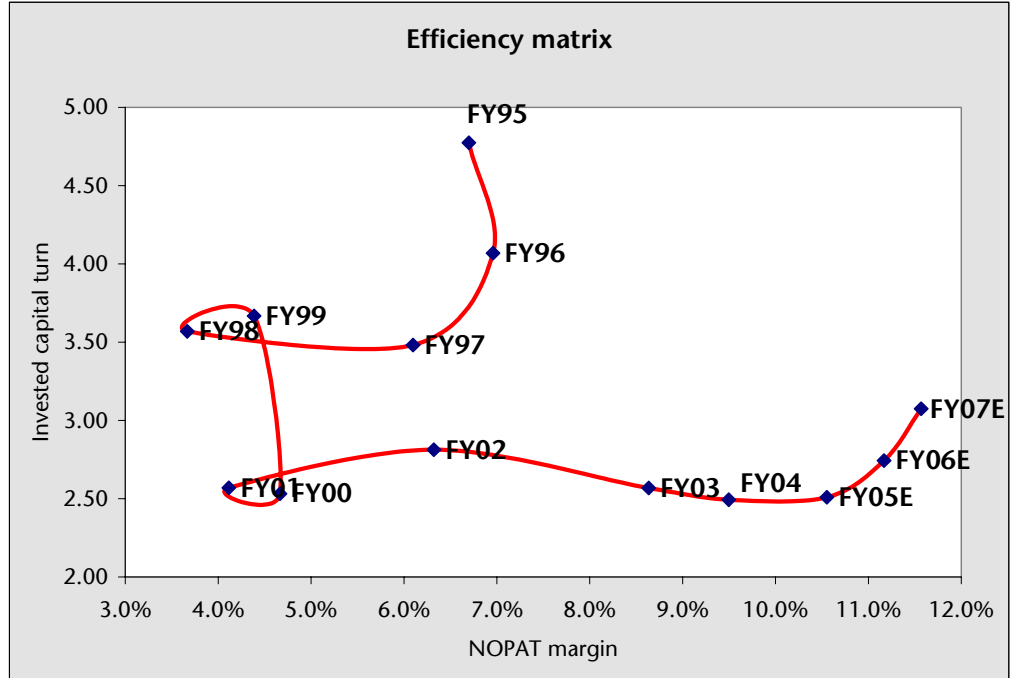
In the long term, a higher margin might be achievable, probably 17% or 18%. Below we underline the implications for the fair value of the shares in case margins surpass the actual 16.0% target (for that analysis we have not changed our general assumptions of 8.3% WACC and 2.5% perpetual growth rate):

Sensitivity to our DCF (2)

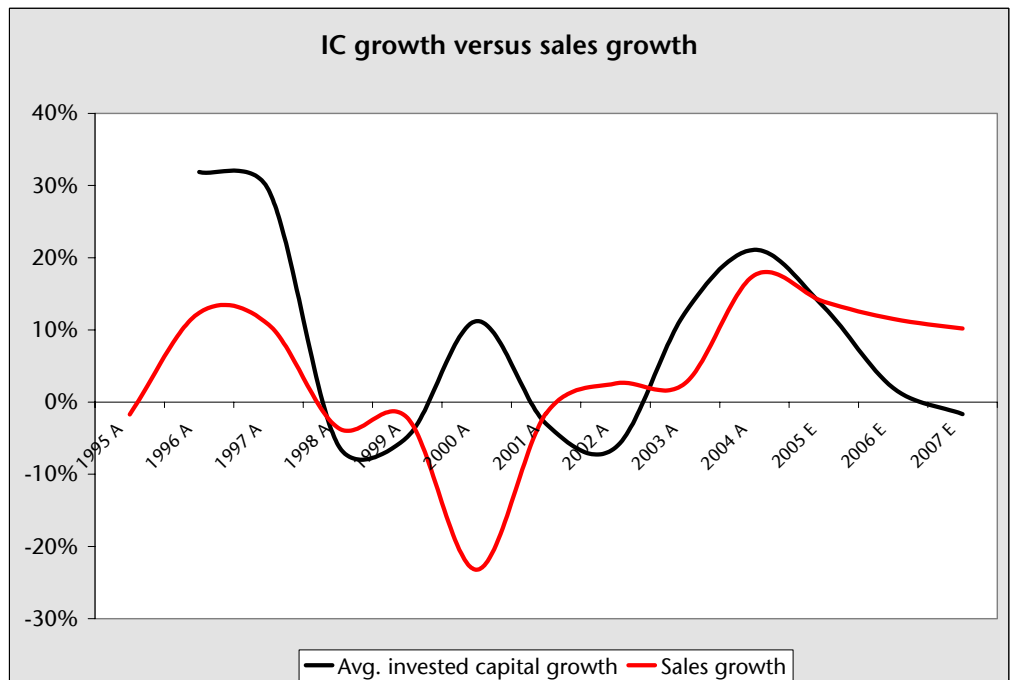
Assumptions:	WACC=8.3%	Rate to infinity= 2.5%	Fair Value in CHF
Sustainable long-term EBITA margin= 16.0%			1,048
Sustainable long-term EBITA margin= 16.5%			1,080
Sustainable long-term EBITA margin= 17.0%			1,111
Sustainable long-term EBITA margin= 17.5%			1,143
Sustainable long-term EBITA margin= 18.0%			1,174

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We stress that there is still huge upward potential in better use of capital. NOPAT margins are expected to improve further, but invested capital turn is still too low and could stay at unsatisfying levels in case of further build up of the capital base. However, the former management had already promised wise use of additional capital.



Source: Bank Leu estimates



Source: Bank Leu estimates

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**SCHEDULED EVENTS**

2005 Results

17 January 2006



Source: Bloomberg

**BRIEF PROFILE**

With over 41,000 employees and expected revenues of CHF 3.3bn in 2005, SGS is the market leader in the inspection and goods testing businesses. The company operates a network of about 1'000 offices. Its core business comprises the following divisions: inspecting, testing and verifying of agricultural products, minerals, petroleum, consumer goods, automotive services, industrial services, environmental services, life science services as well as the international certification business (ISO 9000, ISO 14000 and SA 8000) and testing imports and exports on behalf of governments and international organizations (Trade Assurance).

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## TABLES

## Profit and loss accounts (CHF m)

	2002 A	2003 A	2004 A	2005 E	2006 E	2007 E
<b>Revenues</b>	<b>2,392</b>	<b>2,454</b>	<b>2,885</b>	<b>3,287</b>	<b>3,665</b>	<b>4,038</b>
- growth rate	2.6%	2.6%	17.6%	13.9%	11.5%	10.2%
Salaries and wages	-1,252	-1,240	-1,515	-1,709	-1,899	-2,084
Subcontractors' expenses	-142	-155	-162	-184	-203	-222
Depreciation	-95	-96	-99	-105	-110	-115
Other operating expenses	-687	-663	-718	-793	-868	-950
<b>Operating income (EBITA)</b>	<b>216</b>	<b>300</b>	<b>391</b>	<b>495</b>	<b>585</b>	<b>667</b>
- growth rate	57.5%	38.8%	30.6%	26.6%	18.0%	14.1%
Exceptional operating income/(expenses)	-80	3	3	0	0	0
Goodwill amortization	-9	-10	-16	0	0	0
<b>Earnings before interest and tax (EBIT)</b>	<b>127</b>	<b>293</b>	<b>378</b>	<b>495</b>	<b>585</b>	<b>667</b>
Financial revenue, net	13	10	6	7	5	5
<b>Profit before taxes and minority interests</b>	<b>140</b>	<b>303</b>	<b>384</b>	<b>502</b>	<b>590</b>	<b>672</b>
Taxes	-27	-68	-90	-118	-139	-158
<b>Profit after taxes</b>	<b>113</b>	<b>235</b>	<b>294</b>	<b>384</b>	<b>451</b>	<b>514</b>
Minority interests	-4	-8	-15	-19	-23	-29
<b>Net profit</b>	<b>109</b>	<b>227</b>	<b>279</b>	<b>366</b>	<b>428</b>	<b>485</b>
- growth rate	-245.0%	108.0%	23.1%	31.0%	17.0%	13.4%

## Margin analysis

	2002 A	2003 A	2004 A	2005 E	2006 E	2007 E
<b>Revenue</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Salaries and wages	53.7%	53.2%	52.5%	52.0%	51.8%	51.6%
Subcontractors' expenses	6.1%	6.6%	5.6%	5.6%	5.6%	5.5%
Other operating expenses	29.4%	28.4%	24.9%	24.1%	23.7%	23.5%
<b>EBITDA</b>	<b>13.0%</b>	<b>16.1%</b>	<b>17.0%</b>	<b>18.3%</b>	<b>19.0%</b>	<b>19.4%</b>
Depreciation	4.0%	3.9%	3.4%	3.2%	3.0%	2.8%
<b>EBITA</b>	<b>9.0%</b>	<b>12.3%</b>	<b>13.6%</b>	<b>15.1%</b>	<b>16.0%</b>	<b>16.5%</b>
Amortization	0.4%	0.4%	0.6%	0.0%	0.0%	0.0%
<b>EBIT</b>	<b>8.7%</b>	<b>11.9%</b>	<b>13.0%</b>	<b>15.1%</b>	<b>16.0%</b>	<b>16.5%</b>
Tax rate	19.3%	22.5%	23.5%	23.5%	23.5%	23.5%
<b>Net profit</b>	<b>4.6%</b>	<b>9.2%</b>	<b>9.7%</b>	<b>11.1%</b>	<b>11.7%</b>	<b>12.0%</b>

**Balance Sheet (CHF m)**

	2002 A	2003 A	2004 A	2005 E	2006 E	2007 E
Fixed assets	569	682	927	973	1,022	1,073
Current assets	1,281	1,340	1,285	1,580	1,922	2,300
<b>Total assets / shareholders' equity and liabilities</b>	<b>1,850</b>	<b>2,022</b>	<b>2,212</b>	<b>2,554</b>	<b>2,944</b>	<b>3,373</b>
Shareholders' equity	897	1,072	1,229	1,485	1,784	2,124
Minority interests	18	18	26	30	30	30
Long-term liabilities	320	292	257	250	250	250
Current liabilities	615	640	700	789	880	969

**Cash Flows (CHF m)**

	2002 A	2003 A	2004 A	2005 E	2006 E	2007 E
Net profit/(loss)	109	227	279	366	428	485
Goodwill amortization	9	20	33	0	0	0
Depreciation	89	86	98	105	110	115
Financial income, net	-13	-10	-6	-7	-5	-5
Changes in provisions	-12	-2	-21	-11	0	0
Taxes	27	67	90	118	139	158
Other adjustments	10	7	13	0	0	0
Working capital movements	32	-70	-61	-69	-72	-79
<b>Net cash from operating activities</b>	<b>251</b>	<b>325</b>	<b>425</b>	<b>502</b>	<b>599</b>	<b>674</b>
CAPEX	-121	-171	-201	-180	-150	-150
Acquisitions/Disposals, net	-54	-31	-194	-25	0	0
Interest and dividends received	27	17	13	15	15	15
Others	30	84	67	0	0	0
<b>Net cash (used in) investing activities</b>	<b>-118</b>	<b>-101</b>	<b>-315</b>	<b>-190</b>	<b>-135</b>	<b>-135</b>
Payment of dividend	-47	-56	-69	-95	-117	-141
Purchase of treasury shares	-62	0	-15	0	0	0
Interest paid	-12	-9	-7	-12	-12	-12
Others	-87	-107	-42	0	0	0
<b>Net cash (used in) financing activities</b>	<b>-208</b>	<b>-172</b>	<b>-133</b>	<b>-107</b>	<b>-129</b>	<b>-153</b>
Net (Decrease)/Increase of cash and cash equivalents	-75	52	-23	205	335	386
Translation adjustments, forex	44	0	-2	0	0	0
Cash and cash equivalents at 1 January	490	419	471	446	651	986
<b>Cash and cash equivalents at 31 December</b>	<b>419</b>	<b>471</b>	<b>446</b>	<b>651</b>	<b>986</b>	<b>1,372</b>

**Financial Ratios**

	2002 A	2003 A	2004 A	2005 E	2006 E	2007 E
Self-financing ratio	48.5%	53.0%	55.6%	58.1%	60.6%	63.0%
Current ratio	208%	209%	184%	200%	218%	237%
Investment cover ratio 1	158%	157%	133%	153%	175%	198%
Investment cover ratio 2	214%	200%	160%	178%	199%	221%
CAPEX/Depreciation	136%	199%	205%	171%	136%	130%
ROE	11.6%	23.0%	24.3%	26.9%	26.2%	24.8%
ROA	5.7%	11.7%	13.2%	15.3%	15.6%	15.4%
NOPAT margin	6.3%	8.6%	9.5%	10.6%	11.2%	11.6%
Invested capital turn	2.81	2.57	2.49	2.51	2.74	3.07
ROIC	17.8%	22.2%	23.7%	26.5%	30.6%	35.6%
WACC	9.2%	8.8%	8.8%	8.8%	8.8%	8.8%
Spread	8.6%	13.4%	14.9%	17.7%	21.8%	26.7%

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