

SGS (CHF1020.00)

Target Price: CHF1200.00

BUSINESS SERVICES

2/Outperform

Market Cap: CHF7.794bn

SWITZERLAND

Keeping up momentum

SGS's CEO presented a new 2008 guidance consisting in a CHF5bn turnover (10% org.growth and 5% ext. growth p.a.), EBITA margins of 17% and EPS of CHF80; as well as a very credible growth plan based on new niche segments and a broader service offering. At this occasion, we raise our EPS for the next 3 years by 2% in average and set a new 12-month target of CHF1200.

	2005E	2006E	2007E
Sales (m)	3194.7	3511.5	3850.4
NAP rest. (m)	383.2	446.5	509.8
Clean EPS	49.80	58.04	66.27
P/E	20.5	17.6	15.4
EV/EBITDA	11.9	10.0	8.4
EV/EBITA	14.8	12.3	10.4
FCFY	4.1	4.6	5.4
ROE	28.8	27.4	25.8
Yield	1.5	1.7	2.0

- ▶ **New guidance:** During yesterday's analyst day, Dan Kerpelman presented its 2008 financial targets: CHF5bn turnover through organic growth (10%) and external growth (5%), EBITA margin of 17% and earnings per share of CHF80. Management's credibility is high given its track record in constantly beating its guidance.
- ▶ **Confirmation of excellent business momentum:** SGS's CEO confirmed that the industry's positive trends (increasing world trade flows, regulation and outsourcing) continue to provide the group with a fertile environment for growth.
- ▶ **Very credible growth plan:** On top of the current positive business momentum, the group expects to exploit many additional value creation opportunities through the penetration of new markets and acquisitions. On the basis of a thorough analysis of the industry's trends, opportunities and competitive landscape, Dan Kerpelman presented a very credible growth plan revolving around **(1)** a further expansion of the service offering (aimed at reducing trade dependency and further increasing the added value), **(2)** a rebalancing of the business portfolio (with further emphasis on the life science, consumer and industrial divisions), **(3)** a further geographical expansion (mainly in China, India, Middle East), and **(4)** the development of new strategic growth initiatives
- ▶ **Strategic Growth initiatives:** Dan Kerpelmann has set 4 priorities for new strategic initiatives: **(1)** governments & institutions, which offer strong potential for a whole array of services thanks to privatization and outsourcing, **(2)** financial services, where SGS plans to offer services aimed at risk reduction, **(3)** energy infrastructure, which is a segment set for impressive growth in the short to medium term, and **(4)** software, which provides interesting potential for independent QA/QC businesses.
- ▶ **Acquisitions:** Although Dan Kerpelman reiterated that acquisitions are enablers rather than pillars of SGS's strategy, he pointed out that the group is ahead of a strong phase of corporate activity, starting already in the very short term. These acquisitions will be mainly of small & medium size and focused on both the current portfolio (with a strong emphasis on the life science, industrial and consumer segments) as well as new strategic initiatives (in segments such as energy infrastructure and software). In view of SGS's inefficient capital structure (net cash position) and good track record in creating value through acquisitions, these acquisitions should be positive catalysts for the stock
- ▶ **New estimates:** We have increased our EPS by about 2% in average for the next 3 years in view of higher organic growth assumptions (now close to 10% p.a vs. 8.8% previously). No acquisitions are built in our model.
- ▶ **Valuation / Recommendation:** On the basis of our assumptions (annual organic growth of close to 10% for the next 3 years, EBITA margins and EPS moving gradually up to respectively 16.9% and CHF 73.3 by 2008E), the stock trades at P/E multiples of 17.6x and 15.4x, and EV/EBITDA of 10x and 8.5x, respectively for 2006E and 2007E. Although we do not yet include acquisitions in our model, it is worth highlighting that SGS's projected corporate activity is likely to increase our EPS by about 10% for the next three years. On that basis, the stock would trade at P/E multiples of 16 and 14, respectively for 2006E and 2007E.. We set a new 12-month price target of CHF1200.

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CHEUVREUX

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