

## 2/Outperform

## Business Services

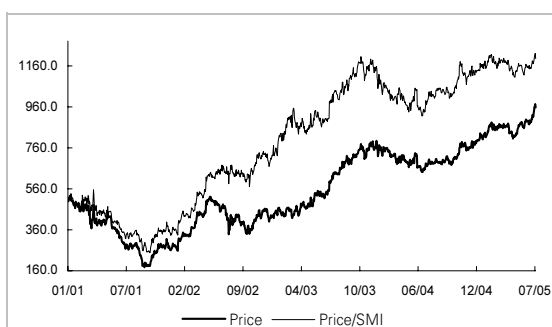
21 July 2005 – Rating downgrade

### How far the sky?

- ▶ **Healthy share performance since January.** SGS shares have risen nearly 20% since the start of the year. Investors can now legitimately question whether much of the future performance improvement has already been discounted or whether further upside could still be expected. We have therefore attempted to define the possible positive and negative catalysts that could bring either upside or downside to the stock.
- ▶ **Potential upside of CHF50-60 to our fair value.** Our analysis suggests that the positive catalysts include a further reduction in capital intensity and strategic medium-sized acquisitions, which could add CHF60-70 per share to our current fair value of CHF980 leading to CHF1040-1050 / share.
- ▶ **Risks facing SGS prevent us from raising our price target.** We believe the risks we have identified (possible increase in pricing pressure and/or operating costs, potential slowdown in organic growth, risk of major M&A deal) outweigh the possible positive returns related to highly subjective assumptions for fixed asset intensity reduction or corporate activity.
- ▶ **We therefore keep our target of CHF980 and downgrade the stock from 1/Selected to 2/Outperform** in view of the limited upside. SGS now ends a period characterized by a combination of restructuring and growth and starts a phase characterized by growth only, which increases the stock's risk profile.
- ▶ **Valuation.** Over the past 2 months, SGS's 10-15% discount to Intertek has turned into a 5% premium, which is justified in our view. A further expansion of this premium is difficult to justify.

<b>Closing price (20/07/05)</b>	<b>SFr957</b>			
<b>Target price</b>	<b>+2.4% SFr980</b>			
<b>Market capitalisation</b>	<b>SFr7,313m</b>			
<b>SMI</b>	<b>6510.67</b>			
<b>To 31/12 (SFr)</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Sales (m)	2885.2	3194.7	3479.1	3795.6
Net att. profit, rest. (m)	295.0	383.2	441.5	501.6
Free cash flow (m)	81.5	319.0	360.3	418.5
EBITDA margin (%)	17.6	19.1	20.1	20.8
Clean EPS	38.28	49.80	57.39	65.20
EPS, published	36.45	50.14	57.78	65.65
P/E (x)	20.8	19.2	16.7	14.7
Attrib. FCF yield (%)	1.3	4.3	4.9	5.7
EV/EBITDA (x)	11.5	11.1	9.4	7.9
EV/EBIT (x)	14.9	13.8	11.6	9.8
ROCE (%)	36.6	41.9	44.7	47.0
ROE (%)	25.6	28.8	27.1	25.5
P/BV (x)	5.4	5.2	4.3	3.5
Net debt/EBITDA (x)	(0.8)	(1.1)	(1.3)	(1.5)
Net dividend	12.00	15.00	17.30	19.70
Yield (%)	1.5	1.6	1.8	2.1

**Next event:** Analyst day – October 2005



<b>52-week range</b>	<b>SFr671–975</b>		
<b>Free float</b>	<b>SFr3953m</b>		
<b>No. of shares, adjusted</b>	<b>7.641m</b>		
<b>Daily volume</b>	<b>SFr23.47m</b>		
<b>Reuters/Bloomberg</b>	<b>SGSN.VX/SGSNVX</b>		
	<b>1 month</b>	<b>3 months</b>	<b>12 months</b>
<b>Absolute perf.</b>	<b>7.6%</b>	<b>15.0%</b>	<b>40.1%</b>
<b>Relative perf.</b>	<b>3.1%</b>	<b>4.5%</b>	<b>18.3%</b>
<b>Shareholders: Worms &amp; Cie. 23.7%, Von Finck Family 23.5%</b>			

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## ► SGS

### Company profile

**SGS is the world-wide leader in the inspection and testing industry.** The group, headquartered in Geneva (Switzerland), is active in approximately 140 countries through its network of subsidiaries and laboratories. The final output of each activity is a report or inspection certificate, issued on the basis of an inspection, verification programme or laboratory analysis. Major global competitors in a fragmented market are Intertek (UK) and Bureau Veritas (France). SGS's market shares amount to about 50% in Agriculture, 45% in Minerals, 30% in Oil & Gas, 15% in Hardlines & Softlines testing, 3.4% in Electronic and Electric equipment testing, 15% in Certification and 55% in Pre-Shipment inspection.

### Investment case

**Strong top-line growth:** We expect SGS to post an organic sales CAGR 04-07E of 9.6%, driven by the growing worldwide trade resulting from globalization, heightened consumer awareness for quality and safety, enhanced product variety and the developing emerging-market economies. In addition, the increasing acceptance of the benefits of outsourcing testing services should boost the size of the open market for independent testing companies such as SGS.

**Potential for margin improvement:** We expect margins to improve from the current level of 13.6% to 15.5% in 2005E and 16.8% by 2007E, driven by operational leverage and efficiencies, six sigma programs and the increasing capacity utilization of the existing labs.

**Attractive investment:** The SGS stock offers a good combination of growth and defensive characteristics, which makes it an attractive investment in the current uncertain environment.

### Valuation

**DCF fair value of SFr 980 per share.** Assumptions:

Top line growth (organic): 9.6% p.a in the 2004-2007E period, levelling down gradually to a level of 6% p.a in the medium term.

EBITA margin: gradually increasing up to a level of 16.8% by 2007E

Invested capital turns improving to a level of 2.5x by 2009E (from the level of 2.3x in 2004)

Tax rate: 24%

ROIC of 30% by 2005E

WACC of 8.7%

Growth duration period: 10 years (at the end of which the assumption of *no growth to perpetuity* is considered).

### SWOT analysis

#### Strengths

World-wide largest inspection and certification company  
Outstanding certification brand

Diversified portfolio of activity fields

Strong balance sheet with impressive war chest and leverage potential for acquisitions

#### Weaknesses

Higher than industry-average capital intensity

#### Opportunities

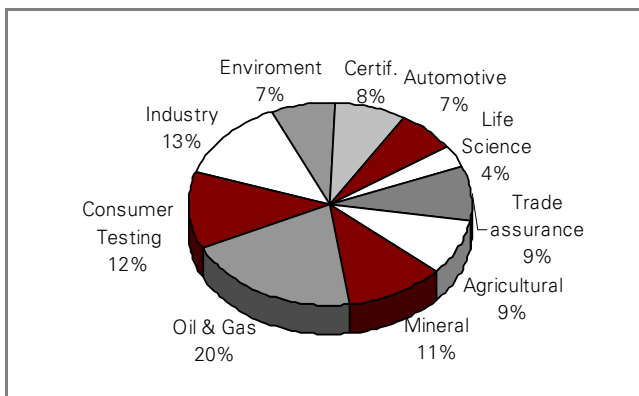
Widening opportunities of the breadth of existing services as well as the service portfolio itself

Further operational efficiency improvement opportunities

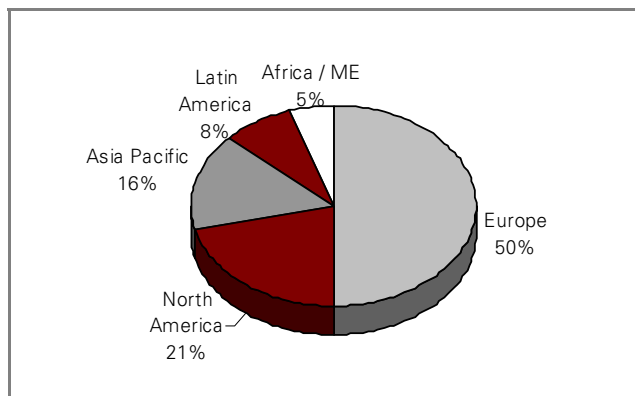
#### Threats

Pricing pressure in the inspection business. Although pricing pressure has not been felt yet in the testing business, it could appear in the medium term.

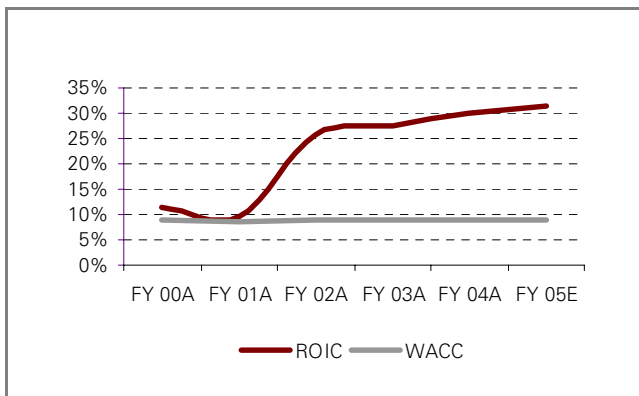
**Sales by business (2004)**



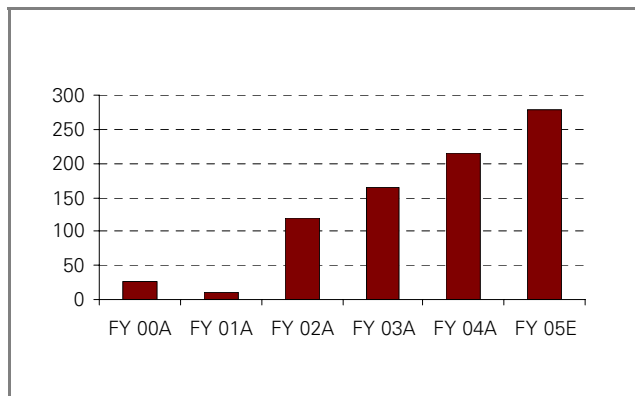
**Sales by countries (2004)**



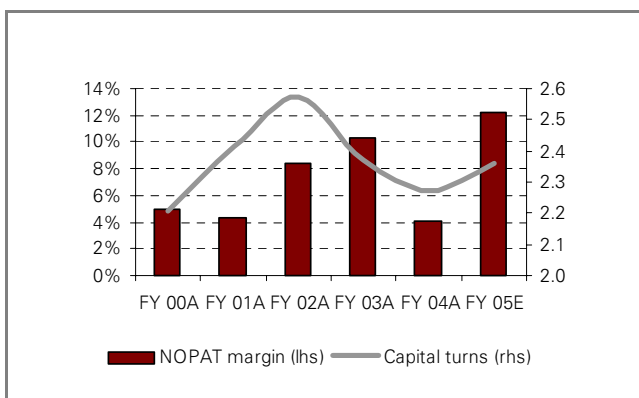
**ROIC progression**



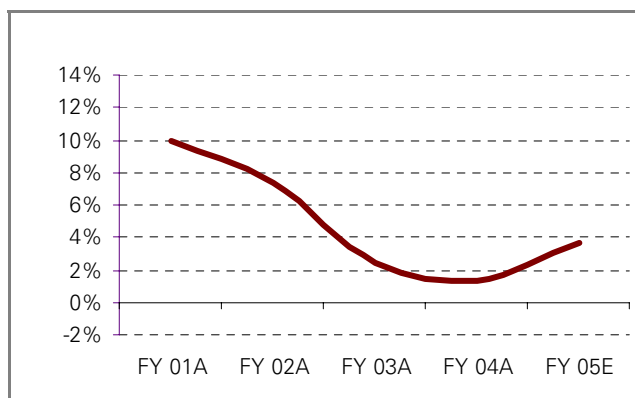
**EVA progression (SFrm)**



**ROIC breakdown**



**FCF yield (using year-end market cap)**



**Peer group comparison**

Company	P/E before GW		EV/EBITA		EV/EBITDA	
	05E	06E	05E	06E	05E	06E
SGS	19.2	16.7	13.9	11.7	11.2	9.4
Intertek	18.4	16.7	13.1	11.7	10.7	9.4
Premium / (Discount) of SGS vs. Intertek	5%	0%	6%	0%	5%	0%

Source: Cheuvreux

## INVESTMENT RECOMMENDATION

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SGS shares enjoyed a very healthy performance since the beginning of the year (close to 20%), reflecting two consecutive good set of figures (FY-04 results on the 13th of January and H1-05 results on the 13th of July) as well as the appointment of Dan Kerpelman as CEO by mid April 2005, which ended the period of uncertainty that followed the departure of Sergio Marchionne in June 2005. In addition, Dan Kerpelman's impressive background and track record provided the market with strong confidence with respect to the management of SGS in the future. In view of the solid share price performance experienced by the SGS stock over the past 6 months, it is now legitimate to wonder whether much of the future performance improvement has already been discounted or whether further upside could still be expected. We have, therefore, attempted to define which are the possible positive and negative catalysts that could bring either upside or downside to the stock.

### Where could further upside come from?

Following the release of H1-05 results on 13 July 2005, we have left our full year 2005 estimates broadly unchanged as H1 figures were in line with our estimates. On the basis of our current estimates, and against the current share price of SFr957, our DCF-based fair value of SFr980 suggests that the stock's valuation is almost fair. We have therefore defined which possible news flow outcomes could bring additional upside to our estimates and hence, to the share price. Our analysis suggests that a further reduction in SGS's fixed assets intensity, as well as medium-sized acquisitions represent the two possible positive triggers for the stock. When assuming a reduction of SGS's capital intensity to the levels boasted by Intertek, we would raise our fair value by about CHF60-70 per share, on top of our current fair value of CHF980, leading to CHF1040-1050 per share. It is worth noting, however, that the underlying assumptions are rather demanding, and that discounting this "best case" scenario now would be rather premature.

### Where could downside come from?

Just as we attempted to define which possible newsflow could bring additional upside potential, we also tried to identify what could put the share price under pressure. We believe that (1) a possible increase in pricing pressure, (2) a possible increase in operating costs, (3) a potential slowdown in organic growth and (4) a major M&A transaction would represent the major reasons for possible disappointment in the future. These risks have to be borne in mind when betting on further upside for the stock.

### Valuation

Based on our estimates for 2005E and 2006E, the SGS share is trading at EV/EBITDA multiples of 11.2x and 9.4x, EV/EBITA multiples of 13.9x and 11.7x, and P/E multiples (on adjusted EPS) of 19.2x and 16.7x, respectively. Over the past two months, SGS's 10-15% discount to Intertek has disappeared and turned into a 5% premium. We believe that this premium is justified in view of SGS's higher liquidity, stronger balance sheet, stronger growth profile and lower probability of disappointment. We find difficult however, to justify a strong further expansion of this premium.

### Conclusion

Since SGS is getting close to our price target, we have attempted to define what is the potential upside to our fair value. Our analysis suggests that an additional upside of CHF50-60 per share is likely when assuming that SGS reduces its capital intensity to the industry's best performance benchmarks levels (currently boasted by Intertek). Strategic medium sized acquisitions could also represent a positive stock catalyst.

However, we believe that the risks we have identified (possible increase in pricing pressure, possible increase in operating costs, possible slowdown in organic growth and risk of a major M&A transaction) outweigh the possible positive returns related to a highly subjective assumption of fixed asset intensity reduction or corporate activity.

We therefore keep our price target of CHF980 and downgrade the stock from 1/Selected to 2/Outperform, in view of the limited upside. SGS now ends a period characterized by a combination of restructuring and growth and starts a phase characterized by growth only. This implies that the group's margin improvement will be less predictable and more subject to downside potential than during the past three years, which modifies the risk profile of the investment case.

## I – VALUATION

### Our assumptions imply a fair value of CHF 980

We have summarized our assumptions in the figure below, and detailed them in the figures in the appendix.

#### SGS: Cheuvreux's assumptions

	2000	2001	2002	2003	2004	2005E	2006E	2007E	2008E	2009E
<b>Sales growth (%)</b>	-23.2	-1.6	2.6	2.6	17.6	10.7	8.9	9.1	8.3	7.8
Organic growth (%)										
<b>EBITA margin (%)</b>	6.7	6.2	9.0	12.2	13.6	15.4	16.3	16.8	16.9	17.0
<b>NOPAT margin (%)</b>	5.0	4.7	6.8	9.2	10.2	11.6	12.2	12.6	12.6	12.8
<b>Invested capital turns</b>	2.21	2.41	2.57	2.37	2.27	2.31	2.35	2.39	2.43	2.47
* Net working capital turns	4.48	6.14	7.67	8.34	10.79	10.75	10.75	10.75	10.75	10.75
* Fixed asset turns	4.35	3.98	3.87	3.31	2.88	3.02	3.13	3.24	3.34	3.44
<b>Tax rate (%)</b>	28.8	28.2	12.5	22.7	23.6	23.0	24.0	24.0	24.0	24.0

Source: Cheuvreux

On the basis of these assumptions, our DCF model indicates a fair value of around CHF 980 (see appendix).

### Peer comparison

Based on our estimates for 2005E and 2006E, the SGS share is trading at EV/EBITDA multiples of 11.4x and 9.4x, EV/EBITA multiples of 13.9x and 11.7x, and P/E multiples (on adjusted EPS) of 19.2x and 16.7x, respectively. When compared to the multiples of Intertek, its closest competitor, SGS shows a premium of about 5% on the basis of its 2005E earnings.

#### SGS vs. Intertek

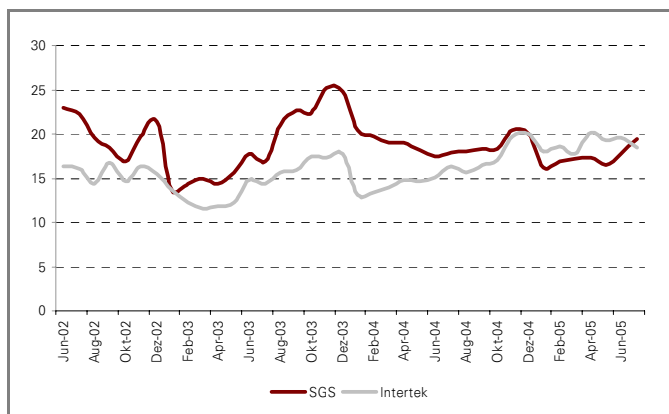
Company	P/E before GW		EV/EBITA		EV/EBITDA	
	05E	06E	05E	06E	05E	06E
SGS	19.2	16.7	13.9	11.7	11.2	9.4
Intertek	18.4	16.7	13.1	11.7	10.7	9.4
<b>Premium / (Discount) of SGS vs. Intertek</b>	<b>5%</b>	<b>0%</b>	<b>6%</b>	<b>0%</b>	<b>4%</b>	<b>0%</b>

All share prices as of 19/01/2005

Source: Cheuvreux

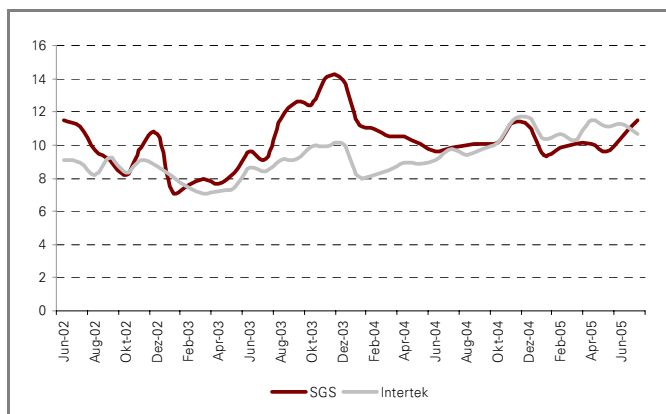
In view of the very differing share price performances of SGS and its competitor Intertek, it is interesting to track how their respective valuation multiples have evolved over time. In the chart below, we have displayed the P/E and EV/EBITDA multiples of both companies since the date of Intertek's IPO in June 2002. The chart clearly shows that SGS used to command a strong premium versus Intertek historically (which was not justified in our opinion, in view of Intertek's much superior ROIC of more than 45% at that time vs. less than 20% for SGS). This premium (25% in average, and up to 50% in 2003) has then turned into a 10-15% discount following the surge of Intertek's share price. This reflected one on hand the market's recognition of Intertek's superior ROIC and on the other hand a succession of unfortunate events that weighed on SGS's stock performance (share overhang, rumours about major M&A deal, departure of 2 CEOs).

P/E multiples (before goodwill amort. and excep.)



Source: Cheuvreux

EV/EBITDA multiples



Source: Cheuvreux

Over the past 6 months, SGS shares enjoyed a very healthy performance, reflecting two consecutive good set of figures (FY-04 results on the 13th of January and H1-05 results on the 13th of July) as well as the appointment of Dan Kerpelman as CEO by mid April 2005, which ended the period of uncertainty that followed the departure of Sergio Marchionne in June 2004. As a result, SGS's 10-15% discount to Intertek has disappeared and turned into a 5% premium.

**A 5-10% premium is justified in our view**

Our view is that SGS will not regain its historical 25-30% premium versus Intertek, which was unjustified in our opinion in view of Intertek's superior ROIC. However, we believe that SGS deserves a 5-10% premium in view of its higher liquidity (market cap of CHF 7.6bn vs. CHF 2.5bn for Intertek), stronger balance sheet (shareholder equity of CHF1.2bn vs. CHF -4m for Intertek), stronger growth profile (3yr EPS CAGR of 19% for SGS vs. 10% for Intertek) and lower probability of disappointment (Intertek's performance metrics are difficult to exceed while SGS still has much room for improvement). Our DCF-based price target of CHF 980 would imply a 5%-10% premium for SGS over Intertek, which seems reasonable in our opinion.

**We downgrade SGS from 1/Selected List to 2/Outperform**

### Conclusion / Recommendation

In view of SGS's H1-05 figures, in line with our estimates, we have left our 2005 broadly unchanged as well as our price target of CHF980. Since SGS's share price is getting close to our price target, we have attempted to define what is the potential upside to our fair value. Our analysis suggests that an additional upside of CHF50-60 per share is likely when assuming that SGS reduces its capital intensity to the industry's best performance benchmarks levels (currently boasted by Intertek). Strategic medium sized acquisitions could also represent a positive stock catalyst.

However, we believe that the risks we have identified (possible increase in pricing pressure, possible increase in operating costs, possible slowdown in organic growth and risk of a major M&A transaction) outweigh the possible positive returns related to a highly subjective assumption of fixed asset intensity reduction or corporate activity.

We therefore remove the stock from our Selected list and downgrade SGS to 2/Outperform, keeping our target of CHF980. SGS now ends a period characterized by a combination of restructuring and growth and starts a phase characterized by growth only. This implies that the group's margin improvement will be less predictable and more subject to downside potential than during the past three years, which modifies the risk profile of the investment case.

## II – WHAT IS THE UPSIDE?

SGS shares enjoyed a healthy performance since the beginning of the year (close to 20%), reflecting two consecutive good set of figures (FY-04 results on the 13th of January and H1-05 results on the 13th of July) as well as the appointment of Dan Kerpelman as CEO by mid April 2005, which ended the period of uncertainty that followed the departure of Sergio Marchionne in June 2005. In addition, Dan Kerpelman's impressive background and track record provided the market with strong confidence with respect to the management of SGS in the future. In view of the solid share price performance experienced by the SGS stock over the past 6 months, it is now legitimate to wonder whether much of the future performance improvement has already been discounted or whether further upside could still be expected. We have, therefore, attempted to define which are the possible positive and negative catalysts that could bring either upside or downside to the stock.

As described below, we believe that the positive catalysts include (1) a further reduction in capital intensity and (2) strategic medium-sized acquisitions, while negative catalysts consist of (1) a possible increase in pricing pressure, (2) a possible increase in operating costs (3) a possible slowdown in organic growth. (4) a major M&A transaction.

### Positive catalysts

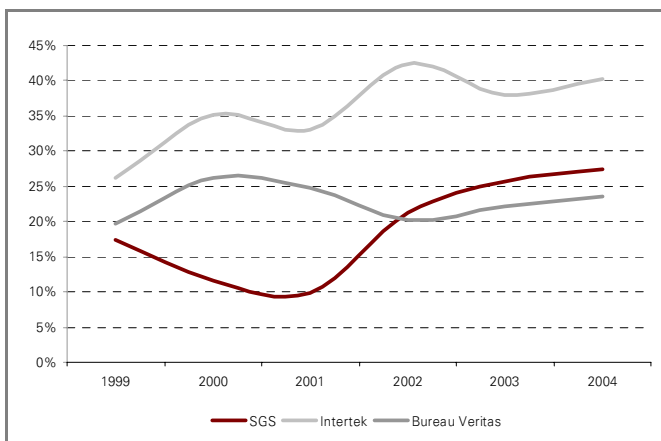
We believe that (1) a further reduction in capital intensity and (2) strategic medium-sized acquisitions represent the main positive catalysts for the stock.

#### *A further reduction in capital intensity*

#### Fixed assets intensity

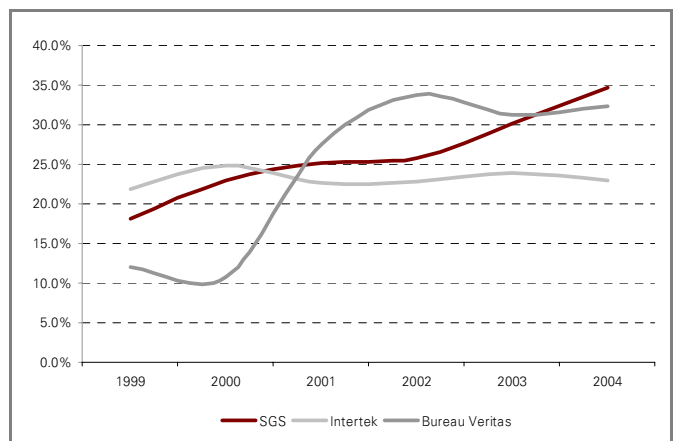
As shown below (left), SGS has already managed to strongly improve its ROIC since 2001, closing the gap with Bureau Veritas (which saw its ROIC decreasing between 2000 and 2002, mainly as a result of the acquisition of MTL and LCIE in 2001, and the related investment in goodwill). There is still an important gap between SGS (ROIC of 27.3% in 2004) and Intertek (ROIC of 40.2% in 2004) which results from 2 factors: (1) Intertek's ROIC was not negatively affected by acquisitions as its business model was almost entirely focused on internal growth. (2) Intertek's laboratory utilization rate is very high, with most of the labs working on a 3 shift basis (24/7). Therefore, Intertek's fixed asset intensity is the lowest in the sector as shown in the chart below (right).

ROIC (%) of the 3 main industry players



Source: Cheuvreux

Adjusted fixed assets (as % of sales) – 3 main players



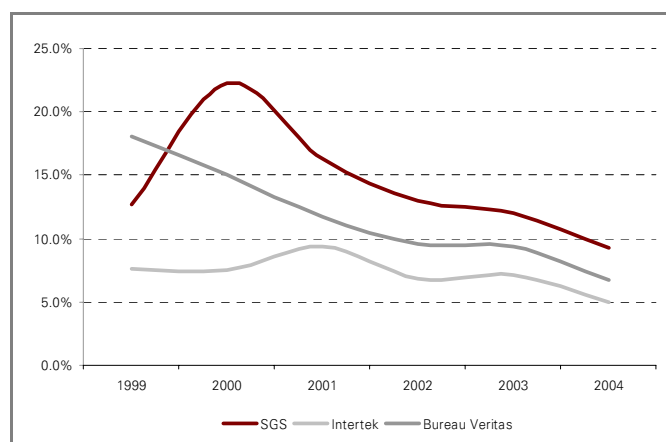
Source: Cheuvreux

This comparison with industry benchmarks reveals a further improvement potential, which would be a key driver of economic performance and hence shareholder value creation. To that respect, Dan Kerpelman indicated to us his strong focus on ROIC as a performance metric and critical factor for the approval of future capex. On the other hand, Dan Kerpelman indicated that one key priority for the group will be the improvement of the laboratory utilization rate thanks to an increasing use of a 3 shift practice (vs. 2 shifts), as well as the implementation of a cross-border "virtual" lab concept (implying a higher geographical reach of the existing labs, mainly in Europe, with the shipment of samples across the continent according to the lab specializations). Further indications that fixed capital turns are heading upwards would clearly represent a positive catalyst in our view, as it would warrant an acceleration of cash generation. The next datapoints on that matter will be provided by the FY-05 results in January 2006. For the time being, our current estimates do not assume improvements in the group's fixed capital intensity looking forward.

### Net working capital intensity

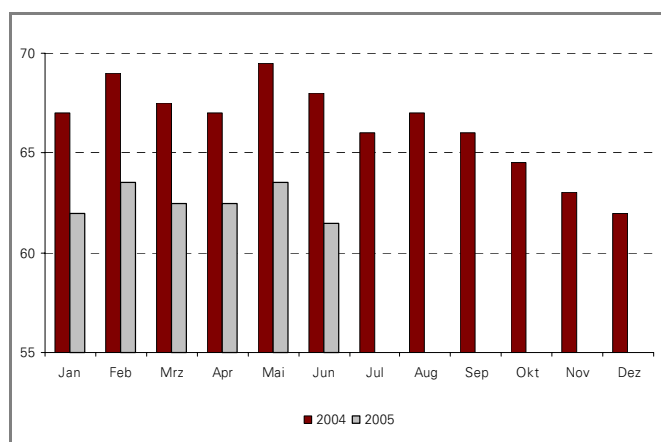
As shown in the figure below (left), SGS's net working capital as a % of sales has dramatically decreased since 2000, reflecting improvement measures taken by the management, changes in the business mix (for example the decreasing business contribution from government contracts) as well as the adoption of working capital management as a key objective of the operational leaders, totally tied to their incentive system. As shown on the chart below (right), SGS' management has managed to further decrease its DSOs during H1-2005 vs. H1-2004. By the end of 2005, we can expect SGS to further reduce the gap with its 2 competitors as far as the NWC intensity is concerned. From 2006 onwards, we do not believe that further major improvement is likely to be expected, as industry benchmarks suggest a floor level.

Net working capital (as a % of sales)



Source: Cheuvreux

SGS: monthly DSO evolution in 2004 and 2005



Source: Company data

### A possible CHF60-70 upside to the stock's fair value

All in all, when assuming a reduction of SGS's capital intensity to the levels boasted by Intertek, we would raise our fair value per share by about CHF60-70, on top of our current fair value of CHF980, leading to a total fair value of CHF1040-1050. It is worth noting, however, that the underlying assumptions are rather demanding. In fact it would imply a substantial increase of SGS's laboratory utilization rates. As described before, this is possible thanks to an increasing use of a 3 shift practice (vs. 2 shifts), as well as the implementation of a cross-border "virtual" lab concept. However, we believe that discounting this "best case" scenario now would be rather premature.

### Strategic medium-sized acquisitions

Another positive trigger could stem from corporate activity. Previous indications that about CHF400-500m should be spent p.a. on acquisitions suggest that such a corporate activity is likely in H2-05 (only CHF20m has been spent so far in 2005). The acquisitions carried out over the past two years were always made at reasonable

prices, very well integrated, and value-enhancing. Similar acquisitions looking forward would therefore represent an efficient use of the group's resources and a good value proposition for shareholders. Therefore, such positive catalysts are possible in H2-05, and could lead to further upside to the share price. In absence of financial details, we believe it is premature to discount any upside from these future acquisitions yet.

In addition, there are two risks to be borne in mind when considering acquisitions: (1) it seems that one area of focus for SGS' s corporate activity is the life science division (where acquisition multiples are usually the highest). (2) Increasing interest from private equity firms in this field of activity is driving upwards the price of possible takeover targets. These two risks could make possible future acquisitions less attractive than those carried out in the past. Although these risks have to be borne in mind, we believe that SGS's EVA-focused mindset prevents from big risks of value destruction.

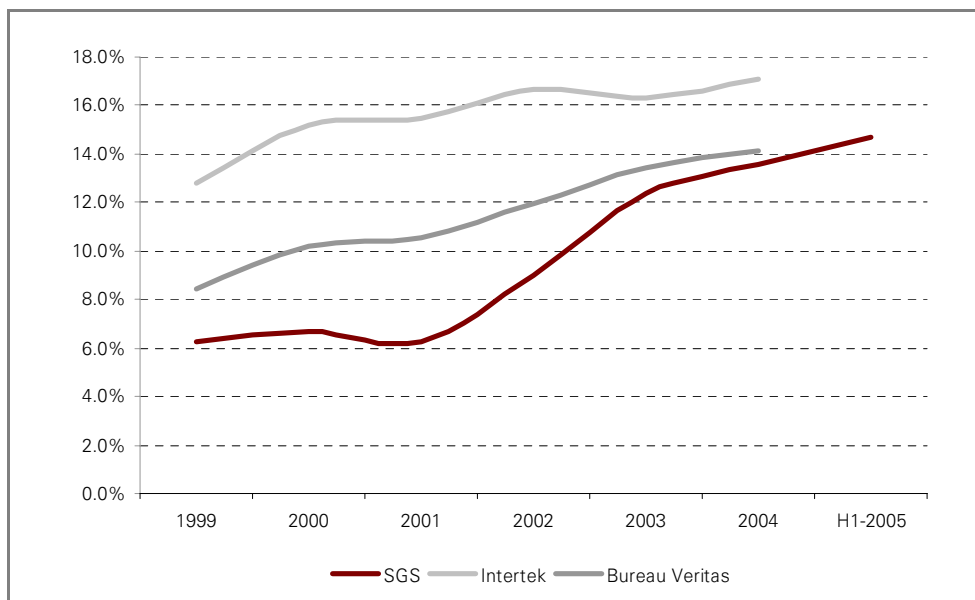
## Negative catalysts

Just as we attempted to define which possible newsflow could bring additional upside potential, we also tried to identify what could put the share price under pressure. As described below, we believe that (1) a possible increase in pricing pressure, (2) a possible increase in operating costs, (3) a possible slowdown in growth and (4) a major M&A deal would represent the major reasons for possible disappointment in the future.

### *A possible increase in pricing pressure*

One risk to consider looking forward is a possible increase in pricing pressure. As shown below, the expected convergence of the 3 main players' EBITA margins to a level of around 16% suggests an increasing industry maturity, which should lead, at some point of time, to pressure on prices.

**EBITA margins of the 3 main industry players**



Source: Cheuvreux

### Pricing pressure in the inspection business

This has already started in the inspection business, where many local companies compete on prices. Another reason is that SGS' competitors usually have a much narrower range of services (as opposite to SGS which adds to the traditional inspections services a full array of value-added upstream and downstream services). Therefore, these firms compete on prices on the only part of the value chain in which they operate, which is the inspection services. This phenomenon has been clearly noticed in the Oil & Gas services division, but also in other divisions.

### Competitive testing market

The testing business has not yet experienced pricing pressure. The size of the market and the nature of the competition (still very fragmented and with a big part still done in-house by the manufacturing companies or the retailers themselves) prevents from a price war situation. Therefore, we feel confident that a real pricing pressure is not likely to be felt in the coming 2 years. However, CEO Dan Kerpelmann described the testing market as being more and more competitive, which is an observation that is shared by its two major competitors. This would imply that pricing power is not likely to be strong looking forward, and that pricing pressure could start earlier than expected.

### A possible increase in operating costs

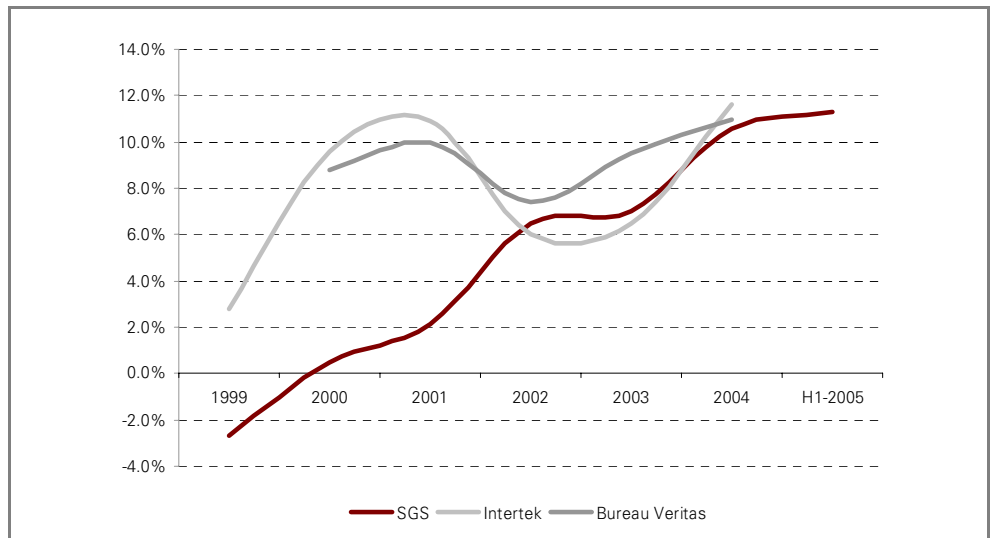
### Margin pressure

CEO Dan Kerpelman communicated its ambition to further grow the company's top-line through the extension of the current portfolio of services (with quality services, productivity services, risk reduction services and compliance services) and a focus on technology differentiation. Although these new services should provide incremental growth, they are also likely to trigger an increase in operating costs and hence a slight margin pressure. Now that the restructuring phase is over, the group's margin improvement will be less predictable and the cost of growing the business becomes a critical factor, which is likely to imply some temporary margin downside.

### A possible slowdown in organic growth

As shown in the figure below, the organic growth rates of the main 3 industry players have been strongly improving from 2002, reflecting the increasing globalization, China's entry in the WTO and the rising commodity prices. (SGS's organic growth has been rising strongly between 1999 and 2002 as a result of the portfolio restructuring).

Organic growth rates (continuing operations) of the 3 main industry players



Source: Cheuvreux

Although organic growth rates of 10% are likely to be sustainable in the short-to-medium term in view of the positive current trends, the base of comparison is obviously becoming increasingly challenging. Therefore, the probability of disappointment is much higher than during the past two years. Looking forward, changes in the current environment (such as difficult crop yields, drop in commodity prices, increase of trade barriers,...) could put these organic growth rates at risk.

### Further decline of the trade assurance services division

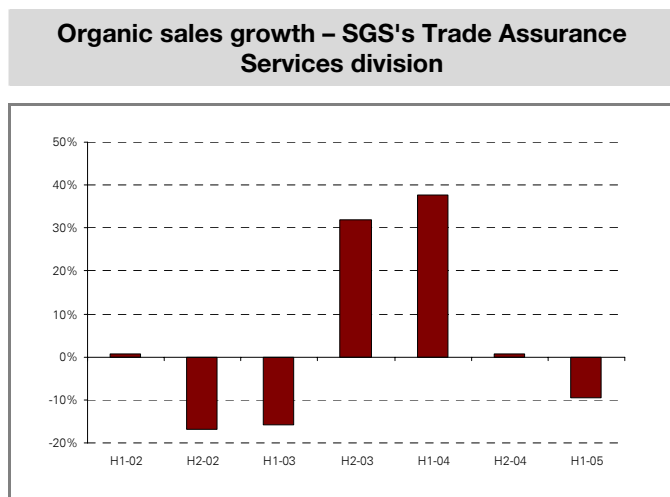
### PSI market set to decline...

Revenues in the Trade Assurance Services division declined by 9.6% in H1-05 due to the discontinuation of contracts in Peru, Ethiopia and Burkina Faso. SGS also expects

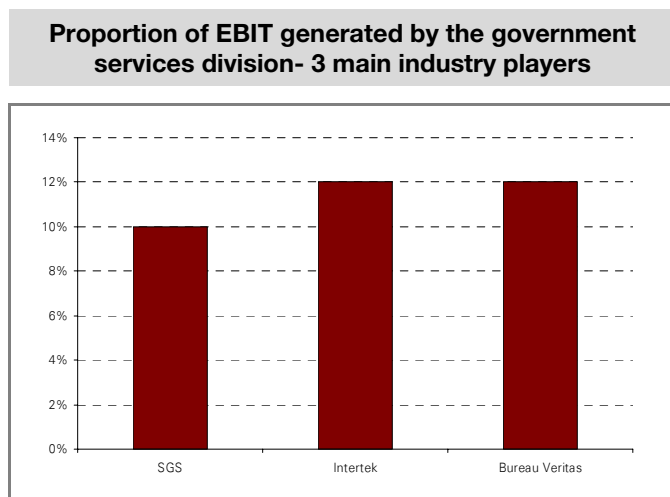
the two-year Venezuela contract to terminate in H2-05. As shown below (left), growth in the Trade Assurance Services division has been quite unpredictable in the past 7 half-year periods, due to the ongoing discontinuation of contracts. Intertek shows a similar pattern. This clearly shows that the whole market for traditional PSI-contracts is structurally set to decline and that further contract discontinuations are likely in the medium term. This is why SGS has taken the initiative to develop non-PSI services a few years ago to offset the declining PSI market. Today, these non-PSI services represent about one third of the total Trade Assurance Services division, which shows that the size of the whole division is still likely to be reduced looking forward, assuming that additional contracts will shrink or be lost in the traditional PSI part of the business (2/3 of the division). Since the TAS division is an above-average profitability division (with EBIT margins above 22% vs. group margins of 14.7%), this likelihood is a risk to be borne in mind by investors.

**...further increasing the incentive for industry consolidation**

As shown in the figure below on the right, the proportion of operating profit represented by these government services is about 10-12% for the three main industry players. Therefore, a further decline of the PSI market would represent an important earnings shortfall for all of these companies, and would consequently increase the incentive for further industry consolidation.



Source: Cheuvreux



Source: Cheuvreux

**A major M&A transaction**

**Increasing probability of big M&A transaction**

During the past two years, there has been much speculation about a major industry consolidation through the acquisition by SGS of Bureau Veritas. Although we do not see this as a likely outcome in the short term, we cannot rule out a merger of both companies in the medium term. In fact, since SGS's performance metrics are now getting closer to the industry's highest benchmarks, it is clear that the company will now aim at finding new levers of growth. The above-mentioned structural decline of one important source of profit generation (PSI revenues) is an additional factor pointing towards further industry consolidation.

Although such a deal is very much likely to be value-enhancing in the medium term in view of the numerous possible synergies, we believe that the short term impact on SGS's stock price would be negative. In fact, in consideration of the amount of goodwill SGS may have to pay when purchasing (or merging with) Bureau Veritas, its implied ROIC dilution is very likely to trigger a short-term downward pressure on the stock price. In our view, it is only in the medium term that the market would take into account the possible cost synergies resulting from economies of scale, and the higher profit margins or growth prospects resulting from the increased market power.

## APPENDIX 1: H1-04 RESULTS

### Overview

On 13 July 2005, SGS released H1 2005 results roughly in line with our top-of-consensus estimates (see our What's new dated 13 July).

#### SGS: Summary of H1-05 results

	H1 2004	H1 2005E	% chg yoy	CAC est.	% chg vs CAC est.
<b>Sales</b>	<b>1390.0</b>	<b>1557.0</b>	<b>12.0%</b>	<b>1556.9</b>	<b>0.0%</b>
Organic growth			11.2%	11.0%	
External growth			2.3%	3.0%	
Currency effects			-1.5%	-2.0%	
<b>EBITA</b>	<b>180.5</b>	<b>229.0</b>	<b>26.9%</b>	<b>230.3</b>	<b>-0.6%</b>
EBITA margin (%)	13.0%	14.7%		14.8%	
<b>Net income (before goodwill)</b>	<b>136.0</b>	<b>170.0</b>	<b>25.0%</b>	<b>172.5</b>	<b>-1.4%</b>

Source: CA Cheuvreux

### Sales

SGS increased sales by 12% to SFr 1556.9m, of which 11% stemmed from organic growth, 2.5% from acquisitions and -1.5% from currency effects. Positive surprises came mainly from the Consumer Testing division (+26% organic growth vs. our est. of 18%, mainly driven by market share gains in hardline & softline testing), the Mineral services division (+19.1% vs. our est. of 12%, driven by new contracts in Russia and Africa as well as the broadening of the service range) and the Life Science division which experienced a real turnaround (positive organic growth of 18% vs. our est. of 8%, after 2 years of declining organic growth, suggesting a good integration of acquisitions). The negative delta stemmed from the Trade Assurance division (-9.6% org. growth vs. our est. of 5%) as a result of 3 contracts discontinuation (Peru, Ethiopia and Burkina Faso).

#### Sales growth rates

	Org	Curr	Acq./ Div.	H1-05	Total
Agricultural services	10.9%	0.0%	0.0%	<b>137.8</b>	10.9%
Mineral services	19.1%	-1.8%	0.0%	<b>176.8</b>	17.3%
Oil, Gas & Chemicals	8.9%	-2.4%	0.4%	<b>302.0</b>	6.9%
Consumer testing services	26.0%	-2.0%	5.3%	<b>214.2</b>	29.3%
Systems and Services Certification	12.8%	-1.6%	0.0%	<b>127.0</b>	11.2%
Industrial services	12.2%	-0.4%	3.1%	<b>209.4</b>	14.9%
Life Sciences	18.0%	-0.5%	4.3%	<b>62.0</b>	21.8%
Environmental services	11.4%	-1.0%	3.6%	<b>110.9</b>	14.0%
Automotive	1.1%	-2.7%	10.9%	<b>97.3</b>	9.3%
Trade Assurance Services	-9.6%	-0.6%	0.0%	<b>119.5</b>	-10.2%
<b>Total</b>	<b>11.2%</b>	<b>-1.5%</b>	<b>2.2%</b>	<b>1 556.9</b>	<b>12.0%</b>

Source: Cheuvreux

**4 divisions out of 10  
show a growth  
deceleration**

A closer look at semi-annual performance highlights that 4 divisions out of 10 experienced a business deceleration: the Agricultural Services division (+10.9% organic growth in H1-05 vs. 14.4% in H2-04), the Oil, Gas & Chemicals (+8.9% organic growth in H1-05 vs. 13.1% in H2-04), the Industrial services division (+12.2% organic growth in H1-05 vs. 17.8% in H2-04) and the Trade Assurance Services division (-9.6% organic growth in H2 vs. 0.7% in H2-04).

**SGS: Organic sales growth rates in H1-04, H2-04 and H1-05**

	H1-04	H2-04	H1-05
Agricultural services	1.0%	14.4%	10.9%
Mineral services	12.2%	20.6%	19.1%
Oil, Gas & Chemicals	12.6%	13.1%	8.9%
Consumer testing services	19.1%	26.0%	26.0%
Systems and Services Certification	7.4%	0.9%	12.8%
Industrial services	12.7%	17.8%	12.2%
Life Sciences	-4.7%	-3.8%	18.0%
Environmental services	11.2%	7.8%	11.4%
Automotive	-17.9%	-8.8%	1.1%
Trade Assurance Services	37.7%	0.7%	-9.6%
<b>Total</b>	<b>10.2%</b>	<b>11.3%</b>	<b>11.2%</b>

Source: Cheuvreux

As expected, the **Agricultural Services division (8.9% of sales, 10.9% organic growth)** benefited from a positive base effect vs. H1-04 which suffered from adverse climatic conditions resulting in low crop yields. In addition, the division's sales growth was fuelled by new contract wins in cotton and tobacco inspection, as well as a successful development of non-trade related value-added services (collateral management, inland grading, commodity logistics services).

**The mineral division (11.4% of sales, 19.1% organic growth)** was fuelled by the high prices and the strong demand for minerals, as well as the strong momentum in countries such as South America, South East Asia Pacific and Eastern Europe.. On top of this, it also benefited from an increasing share of mine site geochemistry services (new contracts in Russia and Africa) and services on fertilizers.

**The Oil, Gas & Chemicals division (19.4% of sales, 8.9% organic growth)** gained market share again during H1-05 (in both the traditional and outsourcing business) with a significant improvement in the Caspian region, Russia and the Baltics. In addition, the expansion of the breadth of the service range further fuelled the turnover growth (with a substantial impact in Germany and Benelux).

The development of testing services (about 70% of divisional sales) continued to be the growth driver of the **Consumer Testing Services division (13.8% of sales, 26% organic growth)**. The division was positively influenced by market share gains in softlines, hardlines and E&E, and a further geographical penetration if China, India and Turkey. Share improvement of the top 25 global retailers has also been achieved thanks to new laboratory infrastructure..

The growth recorded in the **Systems and Services Certification division (8.2% of sales, 12.8% organic growth)** was rather pleasing following the poor performance experienced in H2-04 (0.9%). The division was positively impacted by a good take up of traditional ISO9000 products in emerging markets and a positive development of new standards (industry specific certification schemes) in developed markets.

**The Industrial Services division (13.4% of sales, 12.2% organic growth)** was positively influenced by a significant growth in the construction, statutory and maintenance-related activities (mainly in Spain, France, Benelux and Germany). In addition, important contracts for global supply chain services were won in Africa and Eastern Europe.

**The Life Sciences division (4% of sales, 18% organic growth)** experienced a strong organic sales growth, reflecting a positive integration of recent acquisitions and a consequent focus on organic growth, which translated into a good performance of both quality control testing and clinical research operations.

**The environmental services division (7.1% of sales, 11.4% organic growth )** achieved good revenue growth across most of the countries, with great successes in Italy, Spain, Canada and Chile.

**The Automotive Services division (6.3% of sales, 1.1% organic growth sales)** reached a turnaround point following two half-year periods of sales decline.

**The Trade Assurance Services division (7.7% of sales, -9.6% organic growth)** declined due to the discontinuation of PSI contracts in Peru, Ethiopia and Burkina Faso. Non-PSI services (which represent 1/3 of the division's turnover) grew by 11%, mainly due to TradeNet and Forestry.

## Operating profit

EBITA margins increased to 14.7% (slightly below our estimates of 14.8%), up 170bp vs. H1-04. Eight divisions out of ten reported margin improvements, but the main driver was the Consumer Testing division which saw its margins rising from 17.3% to 21.3% yoy (above our est. of 19.5%). Noteworthy is also the strong margin improvement in the Systems&Services Certification (from 11.5% to 15.5% yoy, above our estimates of 13.5%) which shows that the higher profitability of new standards offsets the pricing pressure in the mature ISO 9000 business.

**Strong margin improvement, mainly driven by volume growth**

### SGS EBITA margins

	H1-03A	H2-03A	FY-03A	H1-04A	H2-04E	FY-04E	H1-05A
Agricultural services	10.2%	9.9%	10.0%	7.8%	10.5%	9.2%	<b>10.9%</b>
Mineral services	11.3%	13.9%	12.7%	14.2%	14.8%	14.5%	<b>15.4%</b>
Oil, Gas & Chemicals	10.9%	10.9%	10.9%	11.9%	11.9%	11.9%	<b>12.2%</b>
Consumer testing services	14.0%	14.9%	14.5%	17.3%	18.8%	18.1%	<b>21.3%</b>
Systems& Serv. Certification	9.7%	11.4%	10.6%	11.5%	12.7%	12.1%	<b>15.5%</b>
Industry & Emerging	5.4%	7.5%	6.5%	6.6%	9.3%	8.1%	<b>13.0%</b>
Life Sciences	13.4%	16.6%	15.1%	12.4%	13.4%	13.0%	<b>14.0%</b>
Environmental services	10.7%	8.9%	9.9%	11.0%	10.3%	10.7%	<b>9.9%</b>
Automotive	9.8%	10.2%	10.0%	11.4%	12.6%	12.0%	<b>12.6%</b>
Trade Assurance Services	20.7%	20.4%	20.5%	22.5%	25.8%	24.1%	<b>21.0%</b>
<b>Total</b>	<b>11.7%</b>	<b>12.7%</b>	<b>12.2%</b>	<b>13.0%</b>	<b>14.1%</b>	<b>13.6%</b>	<b>14.7%</b>

Source: Cheuvreux

## Cheuvreux's estimates

Since H1-05 were in line with our expectations, we have left our full year estimates broadly unchanged (less than 1% change). During the financial analyst meeting, no new guidance was provided, which is understandable since the company's CEO has been appointed only for three months. A new guidance will be communicated by the end of October during an analyst day. The CEO reiterated however the current guidance for FY 2005 (EPS of CHF 45) and indicated that SGS should continue to grow its sales organically by 10% in the coming 2-3 years, which makes us confident with our estimates.

## APPENDIX 2: FINANCIAL TABLES

### SGS – Sales revenues by division and growth assumptions

SALES REVENUES (SFr m)	2001A	2002A	2003A	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Agricultural Services	254.0	250.4	241.8	257.1	281.2	298.1	313.0	328.7	345.1	362.3
Mineral Services	203.0	268.4	279.9	319.5	362.5	391.5	418.9	444.0	466.2	489.5
Oil, Gas & Chemicals Services	414.8	398.7	439.1	574.6	626.2	682.6	737.2	788.8	844.0	886.2
Consumer Testing Services	286.0	268.4	272.3	360.6	440.5	506.5	582.5	664.0	750.4	840.4
Industrial Services	474.0	320.6	330.1	379.8	438.6	482.5	530.7	578.5	630.5	687.3
Environmental Services		162.6	172.0	208.6	231.1	249.6	269.6	288.4	308.6	330.2
Systems and Services Certification	201.0	212.7	229.7	235.4	259.1	287.6	316.4	344.8	372.4	398.5
Automotive Services	204.0	238.9	211.0	187.7	203.8	226.2	253.3	278.7	301.0	319.0
Life Science Services	58.0	61.6	59.1	106.5	122.0	131.8	142.4	153.7	166.0	179.3
Trade Assurance Services	237.0	209.7	219.5	255.4	229.7	222.8	231.7	241.0	248.2	255.6
<b>Total</b>	<b>2331.8</b>	<b>2392.0</b>	<b>2454.5</b>	<b>2885.2</b>	<b>3194.7</b>	<b>3479.1</b>	<b>3795.6</b>	<b>4110.6</b>	<b>4432.5</b>	<b>4748.5</b>
SALES GROWTH ASSUMPTIONS	2001	2002A	2003A	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Agricultural Services		-1.4	-3.4	6.3	9.4	6.0	5.0	5.0	5.0	5.0
Organic		6.9	0.0	7.4	9.4	6.0	5.0	5.0	5.0	5.0
Mineral Services		32.2	4.3	14.1	13.5	8.0	7.0	6.0	5.0	5.0
Organic		1.2	4.8	16.0	14.1	8.0	7.0	6.0	5.0	5.0
Oil, Gas & Chemicals Services		-3.9	10.1	30.9	9.0	9.0	8.0	7.0	7.0	5.0
Organic		0.9	15.8	12.6	9.9	9.0	8.0	7.0	7.0	5.0
Consumer Testing Services		-6.2	1.5	32.4	22.1	15.0	15.0	14.0	13.0	12.0
Organic		1.2	12.5	22.1	19.9	15.0	15.0	14.0	13.0	12.0
Industrial Services		na	3.0	15.1	15.5	10.0	10.0	9.0	9.0	9.0
Organic		na	3.4	15.1	12.1	10.0	10.0	9.0	9.0	9.0
Environmental Services		na	5.8	21.3	10.8	8.0	8.0	7.0	7.0	7.0
Organic		na	6.2	9.2	9.5	8.0	8.0	7.0	7.0	7.0
Systems and Services Certification		5.8	8.0	2.5	10.1	11.0	10.0	9.0	8.0	7.0
Organic		12.3	13.3	3.9	10.8	11.0	10.0	9.0	8.0	7.0
Automotive Services		17.1	-11.7	-11.0	8.6	11.0	12.0	10.0	8.0	6.0
Organic		28.4	-3.3	-13.4	4.7	11.0	12.0	10.0	8.0	6.0
Life Science Services		6.2	-4.1	80.2	14.6	8.0	8.0	8.0	8.0	8.0
Organic		9.7	-4.5	-4.2	12.8	8.0	8.0	8.0	8.0	8.0
Trade Assurance Services		-11.5	4.7	16.4	-10.1	-3.0	4.0	4.0	3.0	3.0
Organic		-7.7	5.5	17.0	-9.8	-3.0	4.0	4.0	3.0	3.0
<b>TOTAL</b>		<b>2.6</b>	<b>2.6</b>	<b>17.5</b>	<b>10.7</b>	<b>8.9</b>	<b>9.1</b>	<b>8.3</b>	<b>7.8</b>	<b>7.1</b>
Organic		6.0	6.7	10.6	9.9	8.9	9.1	8.3	7.8	7.1

Source: Cheuvreux

**SGS: EBITA and EBITA margins by division**

<b>OPERATING PROFIT (SFr m)</b>	<b>2001A</b>	<b>2002A</b>	<b>2003A</b>	<b>2004E</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>	<b>2008E</b>	<b>2009E</b>	<b>2010E</b>
Agricultural Services	11.4	24.6	24.3	23.6	35.1	40.5	43.8	46.0	48.3	50.7
Mineral Services	13.1	26.7	35.5	46.3	56.9	60.7	64.9	68.8	72.3	75.9
Oil, Gas & Chemicals Services	30.2	32.0	47.9	68.6	83.9	95.6	103.2	110.4	118.2	124.1
Consumer Testing Services	20.1	25.1	39.4	65.2	97.6	116.5	145.6	166.0	187.6	210.1
Industrial Services	28.6	33.5	34.9	46.1	58.2	67.5	74.3	81.0	88.3	96.2
Environmental Services		9.5	11.2	16.8	26.0	33.7	37.7	40.4	43.2	46.2
Systems and Services Certification	19.0	24.2	34.7	30.5	40.2	46.0	50.6	55.2	59.6	63.8
Automotive Services	-3.9	13.7	20.8	20.0	27.2	31.7	35.5	39.0	42.1	44.7
Life Science Services	3.0	3.3	5.9	12.8	18.0	19.8	24.2	26.1	28.2	30.5
Trade Assurance Services	24.1	23.0	45.1	61.5	49.3	53.5	57.9	60.2	62.0	63.9
<b>TOTAL EBITA BEFORE EXCEPTIONALS</b>	<b>145.6</b>	<b>215.6</b>	<b>299.7</b>	<b>391.4</b>	<b>492.5</b>	<b>565.4</b>	<b>637.8</b>	<b>693.2</b>	<b>749.8</b>	<b>806.0</b>
<b>OPERATING PROFIT MARGINS</b>	<b>2001A</b>	<b>2002A</b>	<b>2003A</b>	<b>2004E</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>	<b>2008E</b>	<b>2009E</b>	<b>2010E</b>
Agricultural services	4.5	9.8	10.0	9.2	12.5	13.6	14.0	14.0	14.0	14.0
Mineral services	6.5	9.9	12.7	14.5	15.7	15.5	15.5	15.5	15.5	15.5
Oil, Gas & Chemicals	7.3	8.0	10.9	11.9	13.4	14.0	14.0	14.0	14.0	14.0
Consumer products services	7.0	9.4	14.5	18.1	22.2	23.0	25.0	25.0	25.0	25.0
Industrial Services	6.0	10.4	10.6	12.1	13.3	14.0	14.0	14.0	14.0	14.0
Environmental services		5.8	6.5	8.1	11.3	13.5	14.0	14.0	14.0	14.0
Systems and Services Certification	9.5	11.4	15.1	13.0	15.5	16.0	16.0	16.0	16.0	16.0
Automotive	-1.9	5.7	9.9	10.7	13.3	14.0	14.0	14.0	14.0	14.0
Life Sciences	5.2	5.4	10.0	12.0	14.8	15.0	17.0	17.0	17.0	17.0
Trade Assurance Services	10.2	11.0	20.5	24.1	21.5	24.0	25.0	25.0	25.0	25.0
<b>TOTAL EBITA BEFORE EXCEPTIONALS</b>	<b>6.2</b>	<b>9.0</b>	<b>12.2</b>	<b>13.6</b>	<b>15.4</b>	<b>16.3</b>	<b>16.8</b>	<b>16.9</b>	<b>16.9</b>	<b>17.0</b>

*Source: Cheuvreux*

**SGS – Income statement**

Year end December (SFr m)	2000	2001	2002	2003	2004	2005E	2006E
<b>Sales revenues</b>	<b>2368.9</b>	<b>2332.0</b>	<b>2391.9</b>	<b>2454.0</b>	<b>2885.2</b>	<b>3194.7</b>	<b>3479.1</b>
Salaries and wages	1245.8	1254.6	1252.3	1240.0	1471.5	1629.3	1774.4
Subcontractors' expenses	146.7	133.1	142.0	155.0	173.1	191.7	208.7
Other operating expenses	715.0	697.4	686.8	663.0	735.0	764.0	797.3
<b>EBITDA</b>	<b>261.4</b>	<b>246.9</b>	<b>310.8</b>	<b>396.0</b>	<b>505.6</b>	<b>609.7</b>	<b>698.8</b>
Depreciation	103.5	101.3	95.2	96.0	114.6	117.2	133.3
<b>EBITA before exceptionals</b>	<b>157.9</b>	<b>145.6</b>	<b>215.6</b>	<b>300.0</b>	<b>391.0</b>	<b>492.5</b>	<b>565.4</b>
Amortization	4.3	8.5	8.7	10.0	16.0		
EBIT before exceptionals	153.6	137.1	206.9	290.0	375.0	492.5	565.4
Exceptional operating items	8.7	-177.5	-79.6	3.0	3.0	0.0	0.0
<b>EBIT</b>	<b>162.3</b>	<b>-40.4</b>	<b>127.3</b>	<b>293.0</b>	<b>378.0</b>	<b>492.5</b>	<b>565.4</b>
Financial Income	35.0	29.3	20.0	9.0	10.8	10.8	17.0
Interest expenses	12.7	9.5	11.7	8.0	4.8	1.8	1.5
Other non operating income	2.3	0.0	4.9	9.0	0.0	0.0	0.0
Other non operating expenses	0.0	2.6	0.0	0.0	0.0	0.0	0.0
<b>Profit before taxes</b>	<b>186.8</b>	<b>-23.3</b>	<b>140.4</b>	<b>303.0</b>	<b>384.0</b>	<b>501.5</b>	<b>580.9</b>
Taxes	51.4	43.5	27.5	68.0	90.0	118.4	139.4
Minority interest	6.7	8.3	3.8	8.0	15.0	0.0	0.0
<b>Net income</b>	<b>128.7</b>	<b>-75.2</b>	<b>109.1</b>	<b>227.0</b>	<b>279.0</b>	<b>383.2</b>	<b>441.5</b>
<b>As a % of net sales</b>							
Salaries and wages	52.6	53.8	52.4	50.5	51.0	51.0	51.0
Subcontractors' expenses	6.2	5.7	5.9	6.3	6.0	6.0	6.0
Other operating expenses	30.2	29.9	28.7	27.0	25.5	23.9	22.9
<b>EBITDA margin</b>	<b>11.0</b>	<b>10.6</b>	<b>13.0</b>	<b>16.1</b>	<b>17.5</b>	<b>19.1</b>	<b>20.1</b>
Depreciation	4.4	4.3	4.0	3.9	4.0	3.7	3.8
<b>EBITA margin before exceptionals</b>	<b>6.7</b>	<b>6.2</b>	<b>9.0</b>	<b>12.2</b>	<b>13.6</b>	<b>15.4</b>	<b>16.3</b>
Amortization	0.2	0.4	0.4	0.4	0.6	0.0	0.0
EBIT margin before exceptionals	6.5	5.9	8.7	11.8	13.0	15.4	16.3
Financial income	1.5	1.3	0.8	0.4	0.4	0.3	0.5
Interest expenses	0.5	0.4	0.5	0.3	0.2	0.1	0.0
Profit before taxes	7.9	-1.0	5.9	12.3	13.3	15.7	16.7
Tax rate	28.8	28.2	12.5	22.7	23.6	23.6	24.0
<b>Net income</b>	<b>5.4</b>	<b>-3.2</b>	<b>4.6</b>	<b>9.3</b>	<b>9.7</b>	<b>12.0</b>	<b>12.7</b>

Source: Company data, CA Cheuvreux

**SGS – Balance sheet**

Year end December (SFr m)	2000	2001	2002	2003	2004	2005E	2006E
<b>Current assets</b>	<b>1609.6</b>	<b>1445.2</b>	<b>1280.4</b>	<b>1340.0</b>	<b>1285.0</b>	<b>1606.1</b>	<b>1933.4</b>
Cash and cash equivalents	442.3	490.2	419.3	471.0	400.0	631.0	876.4
Marketable securities	199.3	159.0	112.1	55.0	55.0	55.0	55.0
Accounts receivable from customers	641.5	513.3	494.7	571.0	579.0	638.9	695.8
Work-in-progress and inventories	114.0	111.9	108.4	108.0	111.0	121.4	132.2
Other current assets	212.5	170.8	146.0	135.0	140.0	159.7	174.0
<b>Fixed assets</b>	<b>511.9</b>	<b>545.4</b>	<b>569.1</b>	<b>682.0</b>	<b>927.0</b>	<b>1008.3</b>	<b>1082.8</b>
Property, plant & equipment	386.5	397.7	373.9	415.0	493.0	567.5	636.0
Financial assets	6.4	2.6	2.9	2.0	2.6	2.6	2.6
Intangibles (ex. Goodwill)	2.5	2.6	14.2	30.0	35.0	35.0	35.0
Intangibles (Goodwill)	30.6	57.3	92.5	117.0	269.0	269.0	269.0
Other fixed assets	85.8	85.3	85.6	118.0	127.4	134.2	140.2
<b>Total assets</b>	<b>2121.6</b>	<b>1990.7</b>	<b>1849.5</b>	<b>2022.0</b>	<b>2212.0</b>	<b>2614.4</b>	<b>3016.2</b>
<b>Current liabilities</b>	<b>644.0</b>	<b>670.8</b>	<b>614.9</b>	<b>640.0</b>	<b>700.0</b>	<b>772.8</b>	<b>839.6</b>
Short-term debt / Bank loans	109.5	161.4	81.9	22.0	22.0	22.0	22.0
Other interest bearing debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Accounts payable to suppliers	283.3	272.2	259.9	299.0	329.0	367.4	400.1
Other accounts payables	251.2	237.2	273.1	319.0	349.0	383.4	417.5
<b>Medium- and long-term liabilities</b>	<b>43.8</b>	<b>42.2</b>	<b>47.8</b>	<b>11.0</b>	<b>7.0</b>	<b>0.0</b>	<b>0.0</b>
Long-term bonds	0.0	0.0	0.0	11.0	7.0	0.0	0.0
Owed to credit institutions (loans)	43.8	42.2	47.8	0.0	0.0	0.0	0.0
Other long-term debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Provisions</b>	<b>313.9</b>	<b>270.2</b>	<b>272.0</b>	<b>281.0</b>	<b>268.3</b>	<b>302.7</b>	<b>311.1</b>
Deferred taxes	49.0	42.0	54.5	72.0	84.7	93.7	102.1
Non recurring precautionary provisions	106.8	123.2	123.6	135.0	113.6	135.0	135.0
Restructuring and other provisions	48.8	0.0	0.0	0.0	0.0	0.0	0.0
Employee benefit obligations	109.4	105.0	94.0	74.0	70.0	74.0	74.0
<b>Minority shareholders</b>	<b>20.5</b>	<b>25.8</b>	<b>18.1</b>	<b>18.0</b>	<b>26.0</b>	<b>18.5</b>	<b>18.5</b>
<b>Shareholders' equity</b>	<b>1099.3</b>	<b>981.7</b>	<b>896.6</b>	<b>1072.0</b>	<b>1229.0</b>	<b>1520.4</b>	<b>1847.0</b>
<b>Total Liabilities</b>	<b>2121.6</b>	<b>1990.7</b>	<b>1849.5</b>	<b>2022.0</b>	<b>2230.3</b>	<b>2614.4</b>	<b>3016.2</b>
Net Debt	-488.2	-445.6	-401.6	-493.0	-426.0	-664.0	-909.4

Source: Company data, CA Cheuvreux

**SGS – Discounted cash flow valuation**

(SFr m)	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
<b>Sales</b>	<b>3195</b>	<b>3479</b>	<b>3796</b>	<b>4111</b>	<b>4432</b>	<b>4748</b>	<b>5033</b>	<b>5335</b>	<b>5656</b>	<b>5995</b>
Sales growth	10.7	8.9	9.1	8.3	7.8	7.1	6.0	6.0	6.0	6.0
<b>EBITDA</b>	<b>609.7</b>	<b>698.8</b>	<b>788.8</b>	<b>863.2</b>	<b>940.4</b>	<b>1 018.6</b>				
EBITDA growth	20.6	14.6	12.9	9.4	8.9	8.3				
Depreciation	117.2	133.3	150.9	170.0	190.6	212.6				
<b>EBIT</b>	<b>492.5</b>	<b>565.4</b>	<b>637.8</b>	<b>693.2</b>	<b>749.8</b>	<b>806.0</b>				
NOPBT	492.5	565.4	637.8	693.2	749.8	806.0				
Cash Tax rate	21.8	22.5	22.5	22.7	22.7	22.8				
<b>NOPAT</b>	<b>385.4</b>	<b>438.1</b>	<b>494.0</b>	<b>536.1</b>	<b>579.3</b>	<b>621.9</b>	<b>654.3</b>	<b>693.6</b>	<b>735.2</b>	<b>779.3</b>
NOPAT margin	12.1	12.6	13.0	13.0	13.1	13.1	13.0	13.0	13.0	13.0
NOPAT growth	22.3	13.7	12.8	8.5	8.1	7.3	5.2	6.0	6.0	6.0
Chg in working capital	29.7	26.5	29.4	29.3	29.9	29.4	26.5	28.1	29.8	31.6
Chg in fixed assets	81.3	74.4	75.6	74.5	72.5	68.5	86.9	92.2	97.7	103.6
Chg in other assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Incremental Investment</b>	<b>111.0</b>	<b>100.9</b>	<b>105.0</b>	<b>103.8</b>	<b>102.4</b>	<b>97.9</b>	<b>113.4</b>	<b>120.3</b>	<b>127.5</b>	<b>135.1</b>
<b>FREE CASH FLOW</b>	<b>274.3</b>	<b>337.2</b>	<b>389.0</b>	<b>432.3</b>	<b>476.9</b>	<b>524.0</b>	<b>540.9</b>	<b>573.4</b>	<b>607.8</b>	<b>644.2</b>
Discount rate (WACC) (%)	8.7	8.7	8.7	8.7	8.7	8.7	8.7	8.7	8.7	8.7
Discount factor	0.92	0.85	0.78	0.72	0.66	0.61	0.56	0.51	0.47	0.44
PV of FCF	252.4	285.5	303.0	309.9	314.5	318.0	302.0	294.6	287.3	280.2
Cumulative PV of FCF	252.4	537.9	840.9	1 150.8	1 465.3	1 783.3	2 085.4	2 380.0	2 667.3	2 947.6
Residual Value	5 047	5 692	6 176	6 674	7 164	7 539	7 991	8 470	8 978	9 517
PV of Residual Value	4 644	4 819	4 811	4 784	4 725	4 575	4 462	4 352	4 245	4 140
<b>Enterprise Value</b>	<b>4 896</b>	<b>5 357</b>	<b>5 652</b>	<b>5 935</b>	<b>6 191</b>	<b>6 358</b>	<b>6 548</b>	<b>6 732</b>	<b>6 912</b>	<b>7 088</b>
Excess Cash	686	686	686	686	686	686	686	686	686	686
Minorities interest	19	19	19	19	19	19	19	19	19	19
Pension provisions	74	74	74	74	74	74	74	74	74	74
Total Debt	22	22	22	22	22	22	22	22	22	22
<b>Shareholder value</b>	<b>5 468</b>	<b>5 928</b>	<b>6 224</b>	<b>6 506</b>	<b>6 762</b>	<b>6 930</b>	<b>7 119</b>	<b>7 304</b>	<b>7 484</b>	<b>7 659</b>
Shares outstanding	7.82	7.82	7.82	7.82	7.82	7.82	7.82	7.82	7.82	7.82
<b>Value per share</b>	<b>699</b>	<b>758</b>	<b>796</b>	<b>832</b>	<b>864</b>	<b>886</b>	<b>910</b>	<b>934</b>	<b>957</b>	<b>979</b>
Years into future	1	2	3	4	5	6	7	8	9	10

*Source: Cheuvreux*

**SGS**

FY to 31/12 (SFr m)	1999	2000	2001	2002	2003	2004	2005E	2006E	2007E
<b>Profit &amp; Loss Account</b>									
<b>Sales</b>	<b>3 085.1</b>	<b>2 368.9</b>	<b>2 332.0</b>	<b>2 391.9</b>	<b>2 454.0</b>	<b>2 885.2</b>	<b>3 194.7</b>	<b>3 479.1</b>	<b>3 795.6</b>
% Change	-2.2%	-23.2%	-1.6%	2.6%	2.6%	17.6%	10.7%	8.9%	9.1%
<b>EBITDA</b>	<b>342.7</b>	<b>270.1</b>	<b>69.4</b>	<b>231.2</b>	<b>399.0</b>	<b>508.6</b>	<b>609.7</b>	<b>698.7</b>	<b>788.7</b>
% Change	NS	-21.2%	-74.3%	NS	72.6%	27.5%	19.9%	14.6%	12.9%
Depreciation	(144.3)	(103.5)	(101.3)	(95.2)	(96.0)	(114.6)	(117.2)	(133.3)	(150.9)
<b>EBITA</b>	<b>198.4</b>	<b>166.6</b>	<b>(31.9)</b>	<b>136.0</b>	<b>303.0</b>	<b>394.0</b>	<b>492.5</b>	<b>565.4</b>	<b>637.8</b>
% Change	179.0%	-16.0%	NS	NS	122.8%	30.0%	25.0%	14.8%	12.8%
Goodwill amortisation before OP	(10.7)	(4.3)	(8.5)	(8.7)	(10.0)	(16.0)	0.0	0.0	0.0
Goodwill amortisation [impairment test]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non recurring operational items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>187.7</b>	<b>162.3</b>	<b>(40.4)</b>	<b>127.3</b>	<b>293.0</b>	<b>378.0</b>	<b>492.5</b>	<b>565.4</b>	<b>637.8</b>
Net financial items	(0.4)	24.6	17.1	13.2	10.0	6.0	9.0	15.5	22.1
Non recurring financial items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other exceptional items	202.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax	(57.2)	(51.4)	(43.5)	(27.5)	(68.0)	(90.0)	(118.4)	(139.4)	(158.4)
Associates [contribution]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discontinuing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net profit [loss] before minorities</b>	<b>333.0</b>	<b>135.4</b>	<b>(66.9)</b>	<b>112.9</b>	<b>235.0</b>	<b>294.0</b>	<b>383.2</b>	<b>441.5</b>	<b>501.6</b>
Dividend to preferred shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minorities	(16.5)	(6.7)	(8.3)	(3.8)	(8.0)	(15.0)	0.0	0.0	0.0
<b>Net attributable profit [loss]</b>	<b>316.5</b>	<b>128.7</b>	<b>(75.2)</b>	<b>109.1</b>	<b>227.0</b>	<b>279.0</b>	<b>383.2</b>	<b>441.5</b>	<b>501.6</b>
Restatement [impairment test]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adj. for exceptional items	(202.9)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net attributable profit [loss], restated (*)</b>	<b>124.3</b>	<b>133.0</b>	<b>(66.7)</b>	<b>117.8</b>	<b>237.0</b>	<b>295.0</b>	<b>383.2</b>	<b>441.5</b>	<b>501.6</b>
% Change	144.4%	7.0%	NS	NS	101.2%	24.5%	29.9%	15.2%	13.6%
<b>Cash Flow Statement</b>									
<b>Cash flow</b>	<b>0.0</b>	<b>187.6</b>	<b>211.2</b>	<b>218.8</b>	<b>395.0</b>	<b>411.9</b>	<b>534.8</b>	<b>583.2</b>	<b>661.8</b>
% Change			12.6%	3.6%	80.5%	4.3%	29.8%	9.1%	13.5%
Change in WCR	0.0	(205.7)	(76.0)	32.0	(70.0)	44.0	(17.3)	(15.1)	(16.8)
Capex	0.0	(97.9)	(50.6)	(118.0)	(101.0)	(374.4)	(198.5)	(207.8)	(226.5)
<b>Net cash flow</b>	<b>0.0</b>	<b>(116.0)</b>	<b>84.6</b>	<b>132.8</b>	<b>224.0</b>	<b>81.5</b>	<b>319.0</b>	<b>360.3</b>	<b>418.5</b>
Financial investments	0.0	(19.4)	(8.4)	(84.7)	(16.0)	(60.0)	(7.5)	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividend paid	0.0	(37.5)	(45.4)	(46.9)	(56.0)	(69.0)	(91.7)	(115.0)	(132.5)
Capital increase	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other cash flow	0.0	45.1	(73.5)	(45.2)	(60.6)	(19.5)	18.3	0.0	0.0
Dec. [inc.] in net debt	0.0	(127.8)	(42.7)	(44.0)	91.4	(67.0)	238.1	245.3	286.0
<b>Balance Sheet</b>									
Shareholders' equity [group share]	997.4	1 099.3	981.7	896.6	1 072.0	1 229.0	1 520.4	1 847.0	2 216.1
Minority interests	21.7	20.5	25.8	18.1	18.0	26.0	18.5	18.5	18.5
Pension provisions	111.4	109.4	105.0	94.0	74.0	70.0	74.0	74.0	74.0
Other provisions	397.3	313.9	270.2	272.0	281.0	268.3	302.7	311.1	320.4
Net debt [cash]	(616.1)	(488.2)	(445.6)	(401.6)	(493.0)	(426.0)	(664.0)	(909.4)	(1 195.4)
Gearing [%]	NS	NS	NS	NS	NS	NS	NS	NS	NS
<b>Capital invested</b>	<b>911.7</b>	<b>1 054.9</b>	<b>937.1</b>	<b>879.1</b>	<b>952.0</b>	<b>1 167.3</b>	<b>1 251.6</b>	<b>1 341.2</b>	<b>1 433.6</b>
Goodwill	30.5	30.6	57.3	92.5	117.0	269.0	269.0	269.0	269.0
Intangible assets	2.7	2.5	2.6	14.2	30.0	35.0	35.0	35.0	35.0
Tangible assets	491.9	472.3	483.0	459.5	533.0	620.4	701.7	776.2	851.8
Financial assets	7.2	6.4	2.6	2.9	2.0	2.6	2.6	2.6	2.6
Associates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Working capital requirement	267.9	433.5	286.6	216.1	196.0	152.0	169.3	184.4	201.2
WCR as a % of sales	8.7	18.3	12.3	9.0	8.0	5.3	5.3	5.3	5.3
<b>Capital employed</b>	<b>800.2</b>	<b>945.3</b>	<b>832.1</b>	<b>785.2</b>	<b>878.0</b>	<b>1 079.0</b>	<b>1 177.6</b>	<b>1 267.2</b>	<b>1 359.6</b>

\* Before goodwill for historical data

**SGS**

FY to 31/12 (SFr)	1999	2000	2001	2002	2003	2004	2005E	2006E	2007E
<b>Per Share Data (at 20/7/2005)</b>									
EPS before goodwill	15.89	17.00	(8.53)	15.11	30.60	38.28	49.80	57.39	65.20
% Change	144.6%	7.0%	NS	NS	102.6%	25.1%	30.1%	15.2%	13.6%
EPS, reported	40.46	16.45	(9.61)	13.99	29.41	36.45	50.14	57.78	65.65
% Change	NS	-59.3%	NS	NS	110.2%	23.9%	37.5%	15.2%	13.6%
Goodwill per share	1.37	0.55	1.09	1.12	1.29	2.08	0.00	0.00	0.00
Dividend per share	4.80	5.80	6.00	7.30	9.00	12.00	15.00	17.30	19.70
Cash flow per share	0.00	23.98	27.00	28.06	51.00	53.46	69.50	75.81	86.03
% Change			12.6%	3.9%	81.8%	4.8%	30.0%	9.1%	13.5%
Book value per share	122.7	134.7	119.5	108.0	130.9	148.8	184.0	224.4	270.3
No. of shares, adjusted	7.822	7.822	7.822	7.773	7.662	7.645	7.641	7.641	7.641
Av. number of shares, adjusted	7.822	7.822	7.822	7.798	7.718	7.654	7.643	7.641	7.641
Treasury stock, adjusted	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
<b>Share Price [Adjusted]</b>									
Latest price	491.00	500.00	266.50	416.00	776.00	796.50	957.00	957.00	957.00
High	500.00	785.00	520.00	530.00	798.00	803.00	975.00	-	-
Low	270.00	431.00	175.00	257.50	409.00	633.00	785.00	-	-
Average price	380.56	615.50	344.72	406.51	582.47	717.38	860.20	-	-
Market capitalisation	3 840.7	3 911.1	2 084.6	3 233.7	5 945.6	6 089.4	7 312.6	7 312.6	7 312.6
Enterprise value	3 414.4	3 612.1	1 808.5	2 992.1	5 647.9	5 857.7	6 796.4	6 551.0	6 265.0
<b>Valuation</b>									
P/E	33.8	30.4	NS	29.7	26.5	22.0	19.2	16.7	14.7
P/E before goodwill	30.9	29.4	NS	27.5	25.4	20.8	19.2	16.7	14.7
P/CF	NS	20.8	9.9	14.8	15.2	14.9	13.8	12.6	11.1
Attrib. FCF yield [%]	NS	NS	3.9	4.0	3.7	1.3	4.3	4.9	5.7
P/BV	4.0	3.7	2.2	3.9	5.9	5.4	5.2	4.3	3.5
Enterprise value / Op CE	4.3	3.8	2.2	3.8	6.4	5.4	5.8	5.2	4.6
Yield [%]	1.0	1.2	2.3	1.8	1.2	1.5	1.6	1.8	2.1
EV/EBITDA, restated	10.0	13.4	26.1	12.9	14.2	11.5	11.1	9.4	7.9
EV/EBITA, restated	17.2	21.7	NS	22.0	18.6	14.9	13.8	11.6	9.8
EV/Sales	1.11	1.53	0.78	1.25	2.30	2.03	2.13	1.88	1.65
EV/Debt-adjusted cash flow	NS	20.8	8.8	14.0	14.2	14.1	12.8	11.4	9.7
<b>Financial Ratios</b>									
Interest cover	NS	NS	1.9	NS	NS	NS	NS	NS	NS
Net debt/Cash flow	NS	NS	NS	NS	NS	NS	NS	NS	NS
EBITDA margin [%]	11.1	11.4	3.0	9.7	16.3	17.6	19.1	20.1	20.8
EBITA margin [%]	6.4	7.0	NS	5.7	12.3	13.7	15.4	16.3	16.8
Net margin [%]	10.8	5.7	NS	4.7	9.6	10.2	12.0	12.7	13.2
Capital turn [Sales/ Op. CE]	3.9	2.5	2.8	3.1	2.8	2.7	2.7	2.8	2.8
Gearing [%]	NS	NS	NS	NS	NS	NS	NS	NS	NS
Payout ratio [%]	11.9	35.3	(62.4)	52.2	30.6	32.9	29.9	29.9	30.0
<b>Return [%]</b>									
Pre-tax ROCE	25.0	17.7	NS	17.4	34.6	36.6	41.9	44.7	47.0
ROE [%]	37.7	12.4	NS	13.0	23.7	25.6	28.8	27.1	25.5
Return on equity, restated	12.1	12.4	NS	13.0	23.7	25.6	28.8	27.1	25.5

## Important disclosures

### Applicable disclosure clauses

Company	Closing price	Rating	Disclosures
SGS	SFr957	2/Outperform	None

- A - One or more companies in the Crédit Agricole S.A. group own more than 1% of the total issued share capital of the Company.
- B - The Company owns more than 5% of the total issued share capital of Crédit Agricole SA.
- C - One or more companies in the Crédit Agricole S.A. group held as of the last trading day of the past month, a net sales position higher than 1% of the total issued share capital of the Company.
- D - The trading portfolio of one or more companies in the Crédit Agricole S.A. group contains shares of the Company.
- E - Crédit Agricole Cheuvreux and/or a company in the Crédit Agricole S.A. group is a market maker or a liquidity provider for the financial instruments of the Company.
- F - Calyon and/or a company of the Crédit Agricole S.A. group has been involved within the last three years in a publicly disclosed offer of financial instruments of the Company.
- G - Calyon and/or a company in the Crédit Agricole S.A. group has concluded or is party to a non confidential agreement relating to the provision of investment banking services (except publicly disclosed offers) to the Company during the past 12 months or that has given rise during the same period to the payment of compensation or to the promise to get a compensation paid.
- H - This research has been communicated to the Company and following this communication, its conclusions have been amended before its dissemination.
- I - A director or a board member of the Crédit Agricole S.A. group is an officer, director, or board member of the Company.

### Specific disclosure clauses

None.

### Cheuvreux's rating system

Ratings are built for a 6 to 12 month time horizon.

1/Selected List	Expected to outperform the market and is in our country selected list.
2/Outperform	Expected to outperform the market.
3/Underperform	Expected to perform at best in line with the market.
4/Sell	Expected to underperform the market substantially.
No Rating or Suspended	The investment rating and target price have been suspended. Such suspension is pursuant to Cheuvreux's policy in circumstances when Cheuvreux's parent company, Calyon, is acting in an advisory capacity in a merger or strategic transaction involving this company or when Calyon or Crédit Agricole has a beneficial interest in this company and in certain other circumstances.

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Germany	Crédit Agricole Cheuvreux Niederlassung – Frankfurt Branch	Bundesanstalt für Finanzdienstleistungsaufsicht (Bafin)
Italy	Crédit Agricole Cheuvreux Italia SIM SpA	Commissione Nazionale per le Società e la Borsa (Consob)
Netherlands	Crédit Agricole Cheuvreux - Amsterdam Branch	Autoriteit Financiële Markten (AFM)
Spain	Crédit Agricole Cheuvreux España SA SV	Comisión Nacional del Mercado de Valores (CNMV)
Sweden	Crédit Agricole Nordic AB	Finansinspektionen
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