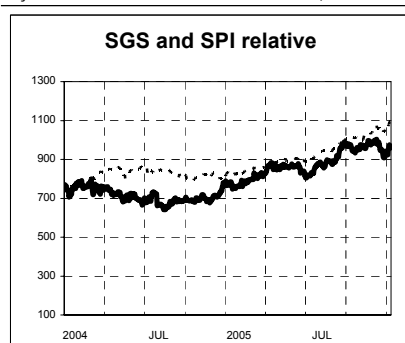


Investor Day

**Exciting targets for 2008 – earnings upgrade:
BUY maintained, new price target CHF 1,200**
BUY

Market cap.	CHF m	7785	Key figures	2003	2004	2005E	2006E	2007E	CAGR
Last price	CHF	1'019	(CHF)						02-07E
52 week high	CHF	1013	Net revenues (m)	2454	2885	3286	3649	4022	11.0
52 week low	CHF	744	Growth rate (%)	2.6	17.6	13.9	11.1	10.2	
YTD performance	%	27.9	EBITDA (m)	396	506	626	721	813	21.2
Economic value	CHF	1162	Margin (%)	16.1	17.5	19.1	19.8	20.2	
Soft factor ded.	%	0.0	EBIT (m)	290	375	498	582	665	26.3
Fair value NZB	CHF	1162	Margin (%)	11.8	13.0	15.2	16.0	16.5	
Div. ranking shs	m	7.6	Net profit (m)	227	279	369	432	497	35.4
Symbols	SGSN.VX, SGSN VX		Dividend	9.0	12.0	15.0	18.0	20.0	22.5



EPS revision	2003	2004	2005E	2006E	2007E	CAGR
EPS new	29.6	36.5	48.4	56.5	65.0	35.5
EPS old			48.6	56.5	65.1	
% change			-0.5	0.0	-0.1	

Valuation (x)	2003	2004	2005E	2006E	2007E
P / E	20.4	19.7	21.1	18.0	15.7
P / CEPS	19.5	18.6	21.1	18.0	15.7
P / BV	4.3	4.5	5.2	4.3	3.6
EV / EBITDA	13.9	11.5	11.7	9.8	8.3
Dividend yield (%)	1.5	1.7	1.7	2.0	2.3

SGS held its first Investor Day yesterday in Germany at Institut Fresenius, a company it acquired last year. During the event, management disclosed the group's ambitious financial targets for 2008: sales of CHF 5bn (or annual sales growth of 15% on average), operating profit of 17%, EPS of CHF 80 per share. In addition, management provided investors with a broad overview of its new strategic growth plan. As expected, acquisitions will play a key role in the future development of the company.

BUY rating maintained, new fair value NZB of CHF 1,162 per share

Based on our new estimates (using EVA®/DCF models), we have derived a new 'fair value NZB' of CHF 1,162 per share (previously CHF 1,107) with no deduction for insufficient soft factors, which leaves upside of 14% for the stock. We have also developed a second financial model including future acquisitions. In this scenario we assume sales of CHF 5032m, an operating margin of 16.9%, and EPS of CHF 82.8 for 2008. Based on these assumptions, we have derived a fair value NZB of CHF 1,329.

During the Investor Day, management not only announced its aggressive financial targets, but was also able to provide investors with a clear plan for strategic growth. Over the past months, management has made a extensive job of assessing all its business units and their growth potential. Although the company's targets are ambitious, the strategy provided at the event seems plausible. As stated in our last note, the initial chapter of the group's exciting growth story has begun, and should be followed by positive news flow in the coming months. In addition, despite of acquisitions, we believe that given its strong free cash flow, the company should be in a position to return cash to shareholders in the mid-term. We are maintaining our BUY rating on SGS's stock, with a new price target of CHF 1,200 per share (up from CHF 1,040).

- SGS new targets 2008: Sales of CHF 5bn, operating margin of 17% and EPS of CHF 80 per share:** Over the past six months, senior management has completed a thorough strategic business review which has led to three main conclusions: 1) the current portfolio is still relevant, with organic growth potential; 2) there is further room for value creation thanks to new markets and acquisitions; 3) the group's competitive advantage (quality, productivity, people) is essential for further growth. On the back of these conclusions, management has developed a growth strategy based on four pillars:

Increase current portfolio: Expand offerings and increase competitive barriers.

Accelerate the three core divisions (Life Science, Consumer Testing Services, Industrial Services): These divisions balance the group's revenue profile and offer attractive growth potential.

Execute strategic initiatives: The development of new strategic markets and special investment projects is the core of this pillar. Management outlined four strategic markets in which the company will focus its efforts in the coming years: 1) government and institutions (waste management, environmental monitoring, quality systems, etc.); 2) financial services (project financing and underwriting, leasing, risk assessment); 3) energy infrastructure (process planning and simulation, technical staffing, etc.); 4) software – a completely new service for SGS (risk analysis, integration testing, software process certification, etc.).

Improve the operating system, which should guarantee a sustainable competitive advantage.

Management has derived three key financial targets for the period 2006-2008, based on the pillars outlined above:

- As anticipated in our October note, SGS is targeting an average 15% sales growth rate p.a. for the period 2006-2008: two thirds should derive from organic growth, and one third from acquisitions. Thus, management is targeting **CHF 5bn in sales** in 2008.
 - Operating margin of 17%.**
 - EPS of CHF 80** per share.
- Acquisitions:** Apart from the clarification of financial goals, we expected the Investor Day to announce at least one acquisition. This was not the case, but we expect some news in this regard no later than the end of the year, given management's statement that it was still expecting to spend around CHF 200m on acquisitions in the current year (year-to-date, the company spent around CHF 100m). From 2006 onwards, management expects sales to grow on average at 5% p.a. through acquisitions (around CHF 600m from sales). The company provided very clear goals in this regard, differentiating between three types of acquisitions:

Current portfolio growth: 1) Targeted lab expansion in OGC, Minerals and Environmental; 2) statutory auto inspection.

Accelerated Life Science, Industrial and Consumer Testing

growth: 1) Expansion of quality control presence in the USA, and of clinical research presence in USA and Europe; 2) targeted regional acquisitions for market position in Industrial Services; 3) strengthening of E&E and entry into personal care in the USA and in Europe in Consumer Testing.

Strategic growth initiatives: 1) Targeting of local labs in energy infrastructure; 2) independent quality control and quality assurance in software.

Although management stated that the implied multiples for acquisitions should remain within historical norms (around 1.2x sales), we anticipate higher multiples (around 1.5x on average), given the higher margin businesses the company is targeting for future acquisitions. We understand that SGS currently has around 10 targets in the pipeline, all of which are companies with sales below CHF 250m.

- **NZZ estimates changed:** On the back of the new targets and management guidance, we have changed our estimates for 2006ff. However, we have not integrated possible impacts of acquisitions in our new forecasts. Overall, our fine-tuning in the different divisions has had only a minor impact on our EPS estimates.

New vs. old key figures (estimates)

In CHF m	FY 06E (old)	FY 06E (new)	FY 07E (old)	FY 07E (new)	FY 08E (old)	FY 08E (new)
Sales	3626	3649	3940	4022	4239	4398
Organic growth in %	9.7	10.0	8.7	10.2	7.6	9.4
Operating profit margin in %	15.9	16.0	16.7	16.5	17.3	17.1
EPS in CHF	56.5	56.5	65.1	65.0	73.0	73.8

Source: company data, NZZ Neue Zürcher Bank estimates

- **Valuation:** Based on our new estimates, SGS is trading at a P/E 06E of 18.0x and an EV/EBITDA 06E of 9.8x. This valuation is at a premium (around 5%) to the group's competitor Intertek (vs. a 10% premium early last month). We still consider a premium of around 10% - 15% versus Intertek justifiable, given SGS's superior business mix, increasing market share in Consumer Testing and in OGC, higher operating margin improvement potential and sound financial situation).

Valuation Comparison

Company	Currency	Share price	Market Cap in m in local curr.	P/E 2005E	P/E 2006E	EV/EBITDA 2005E	EV/EBITDA 2006E
SGS	CHF	1019	7785	21.1x	18.0x	11.7x	9.8x
Intertek Group	GBP	734	1125	18.8x	16.5x	11.0x	9.7x
SGS's premium/discount vs. Intertek				12.2%	9.0%	6.3%	1.0%

Source: NZZ Neue Zürcher Bank estimates, JCF

Based on our adjusted estimates (using EVA[®]/DCF models), we have now derived a new 'fair value NZZ' of CHF 1,162 per share (previously CHF 1,107) with no deduction for insufficient soft factors, which leaves upside of 14% for the stock.

We have also developed a financial model including future acquisitions. In this model, we forecast sales of CHF 5032m for 2008E, an operating margin of 16.9%, an EPS of CHF 82.8, and around CHF 800m outlay for financing acquisitions. Based on these new assumptions, we have

derived a fair value NZB of CHF 1.329 per share, which shows the leverage potential in terms of acquisitions.

- **Capital structure:** With an equity ratio of nearly 60%, SGS has a very sound, albeit under-leveraged, balance sheet. The company should have a net cash position of around CHF 500m at year end. As SGS generates around CHF 300-400m in operating free cash flow per year, it should continue to enjoy a comfortable cash position in the coming years. Considering the limited probability of a larger acquisition in the near term (Bureau Veritas, Intertek), and the relatively low dividend yield, the likelihood of the company returning cash to shareholders in the coming years (in a form to be defined by the board) is increasing, and was not denied by management at the investors' event. Although this topic is unlikely to be on the board's agenda next year (acquisitions are priority), we believe that this scenario could be realistic by mid-2007, as shown below.

Based on our financial model assumptions including acquisitions, the following potentials table shows that SGS could return around CHF 60m to shareholders per year on average (assumption: cushion net cash of CHF 400m), in addition to the cash spent on external growth. This also illustrates that SGS has many alternatives in place to better leverage its balance sheet, leading to additional shareholder value.

Potential for further cash return in CHF m	2006E	2007E	2008E
Opening net cash	503	506	527
Closing net cash	506	527	690
Cash for acquisitions	250	300	250
Potential for cash return (cum.)	106	127	290
Potential for cash return (annual)	3	21	163
Cash return per share (in CHF)	0.4	2.8	21.4
Recurring dividend per share (in CHF)	18.0	22.0	26.0
Total dividend per share potential (in CHF)	18.4	24.8	47.4
Cash yield (in %)	1.9%	2.6%	4.9%

Source: company data, NZB Neue Zürcher Bank estimates

In the unrealistic and theoretical assumption where SGS would not spend cash for acquisitions, we believe that the company could give at least CHF 250m back to shareholders per year on average in the period 2006-2008 (assumption: no acquisition, cushion net cash of CHF 400m).

In addition, we expect a share split in 2006 if the stock price consolidates at over CHF 1000 in the coming months.

- **Opinion and recommendation:** During its Investor Day event, management not only announced its ambitious financial targets, but also provided investors with a clear plan for strategic growth. In the past months, management has made a good job of assessing its business units and their growth potential. Although the company's targets are quite aggressive, management's strategy for reaching its 2008 goals is convincing. As stated in our last note, the initial chapter of the company's exciting growth story has begun, and should be followed by positive news flow in the coming months (FY 2005 results publication,

