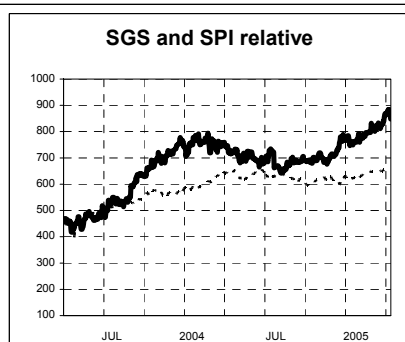


Company visit

Bright growth prospects, new CEO, sound balance sheet: SGS well on track

Market cap.	CHF m	6497	Key figures	2003	2004E	2005E	2006E	2007E	CAGR
Last price	CHF	848	(CHF)						02-07E
52 week high	CHF	888	Net revenues (m)	2454	2885	3126	3415	3660	8.9
52 week low	CHF	633	Growth rate (%)	2.6	17.6	8.4	9.2	7.2	
YTD performance	%	6.5	EBITDA (m)	396	506	582	666	758	19.5
Economic value	CHF	930	Margin (%)	16.1	17.5	18.6	19.5	20.7	
Soft factor ded.	%	0.0	EBIT (m)	290	375	470	551	628	24.9
Fair value NZB	CHF	930	Margin (%)	11.8	13.0	15.0	16.1	17.2	
Div. ranking shs	m	7.7	Net profit (m)	227	279	358	416	472	34.0
Symbols	SGSN.VX, SGSN VX		Dividend	9.0	12.0	15.0	18.0	20.0	22.5



EPS revision	2003	2004E	2005E	2006E	2007E	CAGR
EPS new	29.6	36.4	46.7	54.2	61.5	34.0
EPS old			46.4	53.1	60.2	
% change			0.6	2.1	2.2	

Valuation (x)	2003	2004E	2005E	2006E	2007E
P / E	20.4	19.7	18.2	15.6	13.8
P / CEPS	19.5	18.7	18.2	15.6	13.8
P / BV	4.3	4.5	4.3	3.6	3.1
EV / EBITDA	13.9	11.5	10.3	8.7	7.3
Dividend yield (%)	1.5	1.7	2.0	2.4	2.6

Fair value NZB of CHF 930 per share – 8% upside; positive stance on the stock

We have had a number of opportunities recently to interact with SGS's management, allowing us to assess the company's business model and future growth prospects in depth. The conditions in the market in which SGS operates are currently favorable; in addition, thanks to the group's position as global leader and to its sound financial situation, it has plenty of room and opportunities to further expand its business, both organically (>10% growth rate) and through acquisitions. We believe that SGS is on track to achieve its targets for 2005 (sales CHF 3bn, EBITA-margin 16%, EPS CHF 45).

Our 'fair value NZB' — based on EVA®/DCF models — stands at around CHF 930 per share, leaving an upside of 8%. In addition, based on our estimates, SGS is trading at a discount to one of its main competitors (Intertek), which we do not think is justified in view of the former's high growth rates, its margin improvement potential and sound balance sheet.

Over the past three years, SGS has transformed itself into a new, dynamic company, and was already able to reap the initial rewards for its efforts last year. We fully expect the company to remain on course with its current strategy under the newly announced CEO, and to benefit fully from structural changes in the years to come. In our view, the news-flow should remain favorable in the coming months. Although we are aware that the realization of some of the targets set for 2005 is already priced into the stock, we nevertheless feel that SGS shares still have potential, and should continue to surprise on the upside. The company offers a very attractive profile with both growth and defensive characteristics, thanks to its geographic and business diversification. However, we are maintaining our NEUTRAL rating in spite of our very positive stance on the stock.

- In the course of several meetings with management, we have been able to assess SGS's business model and its future growth prospects. We are extremely impressed by the growth potential of the company (organic growth of at least 10%), which remains very promising. The following provides an overview of the major and most interesting topics as discussed with management, and includes a short summary and outlook on each of six divisions.
- **Agricultural Services** (9% of sales, 6% of EBITA): After a difficult first semester 2004, the agricultural division is back on track. The company wishes to focus increasingly on value-added services (fumigation, Guaranteed Business Solutions) in order to decrease its dependence on crops, given their volatility. Another source of growth will be in-plant outsourcing initiatives, in relation to which contracts have been signed in Canada, Egypt and Russia. Management expects good revenue growth and a substantial increase in the 2005 operating profit. The division's main competitor in the sector is SGS itself, with an estimated market share of more than 50%.
- **Minerals Services** (11% of sales, 12% of EBITA): The fantastic momentum experienced by the minerals division in the second semester of 2004 (20.6% organic growth) is expected to continue, sustained by six additional outsourcing contracts and by a buoyant market in countries such as Russia, China, Brazil and India. Increased global demand for metal and ores, as well as high commodity prices, should further help this division in 2005. Further impetus for this business is being derived from the currently high petroleum prices, which have renewed demand for coal and RDFs (refuse derived fuels).
- **Oil, Gas & Chemicals Services** (20% of sales, 18% of EBITA): After the strategic acquisitions of Petroleum Services Corp. in the USA, and Vernolab in France last year, the OGC division will focus in the current year on leveraging the acquisitions (replication of 'in-plant logistic services' and 'comprehensive fuel and engine services package' across the network), and improving its operating profit margins. OGC should also benefit from its new laboratory facility in China, and in the Middle East from its new petrochemical capacity. Moreover, at the beginning of the year, SGS signed a long-term agreement with OMV (Central Europe's leading oil and gas group) to operate OMV's engine test bed facility in Vienna. We consider this outsourcing business in Austria as a unique opportunity for the division to strengthen its position in that region, and to leverage last year's acquisitions. The above should serve to reinforce the Swiss company's new position as number 1 worldwide in this sector, with over 35% market share (just ahead of Caleb Brett/Intertek).
- **Life Science Services** (4% of sales, 3% of EBITA): Despite the fact that SGS was able to expand last year (acquisitions of Medisearch and Institut Fresenius), and at the same time focus its relatively minor position in its very promising market (downsizing of labs carrying out animal testing), we consider the 2006 targets - CHF 400m sales and an operating margin of around 20% - to be rather ambitious. Still, in the course of our discussions, management made it clear that the strategic options in the business could be reviewed, should no acquisitions be made in the near future (USA, India). The main areas of focus for the existing and future business are: clinical research (focus on early-stage

services, Phase I, First in Man, bio-equivalence, proof of concept studies and bio-analytical services) and quality control (expansion of service portfolio to new customer segments, additional labs, etc.).

- **Consumer Testing Services:** (12% of sales, 17% of EBITA): The strategy of focussing on testing (rather than on inspection) has paid off: the higher-margin testing services now account for over 70% of the division's total sales. Last year, SGS spent around 25% of its CAPEX (CHF 51m) on this very promising, high-margin business. Furthermore, the company is ready to invest further: its sales network will be expanded in the current year in North America, Western Europe and in Japan. In the E&E business, the strategic alliance agreement signed in the last few weeks with Metlabs in the USA will allow SGS to penetrate the US and Canadian markets. As outlined by management, the notion that China is the only current source of growth is incorrect. The acquisition of Aquatic Health in South America (lab services in the seafood industry) is further evidence of the truth of this statement. According to management, this acquisition will already generate new business in Norway and Scotland in 2005. For this business, we expect a 300bp margin improvement to 21% for the current year.
- **Acquisitions still on the agenda, CHF 400m planned in 2005:** SGS did not reach its goal of spending around CHF 400m in 2004 on acquisitions. The company spent only roughly CHF 200m for Institut Fresenius, PSC, Vernolab, Sécuritétest and ACO Sécurité. According to management, SGS renounced its plan to acquire two companies in Europe (both around EUR 100-150m sales) at the end of 2004 because the price was far too high (this should reassure investors in terms of future acquisitions). We understand that Bureau Veritas and Intertek are not the only companies which are keen to acquire other players, but that there are other corporates who want to participate in the consolidation of this very fragmented market. Recently, Private Equity investors entered the market quite aggressively, acquiring attractive players, albeit at a very high price. According to our estimates, the price paid by SGS last year for its acquisitions was reasonable (around 1.0x sales, 7.0x EV/EBITA), especially when we consider the operational leverage that SGS was able to obtain with Institut Fresenius (replication of laboratory tests in other markets, for instance). In the current year, SGS has already announced the acquisition of two small companies: Aquatic Health SA (testing company servicing the fish cultivation industry in Chile, CHF 4-5m sales) and X-PER-X Inc., a Quebec-based Industrial Services firm (CHF 11m sales, acquisition concluded on 15 February, 2005). In the coming months, SGS is likely to make acquisitions in any of its 10 divisions, but we believe that it will likely prioritize the following units: Life Science Services (with focus on the USA and India), Industrial Services (in order to strengthen its position against Bureau Veritas), Environmental Services (in the USA, where there is great potential for further growth), Automotive Services, and in the Consumer Testing Services (high-end E&E, new labs in key European markets). We are not ruling out the possibility of SGS making an acquisition in another business area (several different businesses were offered to SGS in the last years, including auction companies, rating agencies, consulting companies, staffing businesses, etc.), but the probability is rather low. Last, but not least, we do not expect any major acquisition in the near term: Wendel Investissement increased its stake in Bureau Veritas to 99% last December, and is therefore unlikely to be willing to sell in the

coming months; the acquisition of Intertek would not be as sensible as would be a fusion with Bureau Veritas, as it would imply a dominant position in the OGC business.

- **Balance Sheet:** With an equity ratio of around 56%, SGS has a very sound, but under-leveraged, balance sheet. The company has a cash and cash-equivalents position of around CHF 500m, and is debt free. It plans to spend around CHF 200m in CAPEX annually, and CHF 400m on acquisitions. However, as SGS generates around CHF 500-600m operating cash flow per year, it will 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, we expect the company to return cash to shareholders in the coming years in a form to be defined by the board (dividend increase and/or an extraordinary dividend, share buy-back programme, reduction of nominal value).
- **New CEO starting 11 April, 2005:** After a waiting phase of several weeks, SGS has finally announced the appointment of a new CEO, Mr Dan Kerpelman. Before joining Eastman Kodak in 2002 as president of the Health Imaging Group (sales of USD 2.5bn, operating margin of around 15%), SGS's future CEO spent 17 years at GE, mostly within the Healthcare Unit. During his time in Global Quality, he led GE Medical System's Six Sigma initiative. SGS has taken its time to appoint a new CEO, but their choice could well be worth the wait. The company should be able to benefit from Kerpelman's broad experience: 1) as head of Kodak Health Imaging Division, he had a good track-record in successfully integrating acquisitions; 2) his broad understanding of the Healthcare business will definitely help SGS to strengthen its position in the Life Science Services; 3) SGS's Six Sigma initiative will definitely benefit from the arrival of the new CEO (new cost savings potential?); 4) thanks to his international profile, Kerpelman has been able to acquire new clients worldwide, which could also help SGS, given its presence in more than 150 countries. We look forward to receiving details of the new CEO's vision of the future SGS, and of his financial targets for the near-term, which should definitely have a positive impact on the stock.
- **Targets 2005 confirmed:** Management confirmed several times that the company was well on track to achieve its 2005 targets: CHF 3bn sales, 16% operating margin, EPS CHF 45. This is quite in line with our revised estimates, including the X-PER-X acquisition: CHF 3.1bn sales, 15% operating margin, EPS CHF 46.5. Management also confirmed that one of its main priorities (thanks to the implementation of the CerTIVVA programme, focusing on EVA, was to reduce the net working capital. We have adjusted our figures in the balance sheet to reflect the company's guidance.
- **Valuation:** Based on our estimates, SGS is trading at a P/E 06E ratio of 15.6x and an EV/EBITDA 06E ratio of 8.7x. This valuation is at a slight discount (5%) to its main competitor, Intertek, which we do not consider justified in view of SGS's high growth rates, margin improvement potential (operating leverage still intact) and sound balance sheet (equity ratio of 56%, net cash of CHF 0.5bn). We also expect high sales growth from the Consumer Testing Division, and a significant improvement in the divisional margin from the current 18% to more than 20% in the years to come. While we expect similar sales growth at Intertek, the

latter's currently high margins (>30%) are likely to come under pressure. Intertek experienced a weaker year in the field of oil, gas and chemicals in 2004. Meanwhile, SGS widened its share of the market with an impressive performance (sales growth of 31%, thanks to the acquisitions of PSC and Vernolab, organic growth of 13%, margin improvement of 100bp to 11.9%), and now reigns as top-dog in the market, ahead of Caleb Brett (Intertek's OGC division). It has thus laid a sound foundation for future growth. Due to the reasons mentioned above, we consider a premium of at least 10% versus Intertek justifiable. We have also made a second, broader valuation comparison of SGS to a group of European service companies. This shows that SGS's valuation has a premium of around 15%. In view of the highly cyclical character of several companies in this group, and the questionable earnings quality of certain firms (Compass), SGS likewise deserves a higher premium to this group.

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	860	6497	18.2x	15.6x	10.3x	8.7x
Intertek Group	GBP	718	1103	18.9x	16.8x	10.6x	9.3x
Securitas	SEK	109	37749	15.5x	13.9x	7.7x	6.8x
Rentokil Initial	GBP	159	2878	12.8x	11.5x	7.2x	6.9x
Compass Group	GBP	255	5511	12.0x	11.3x	7.2x	6.6x
Sodexo Alliance	EUR	24.1	3831	15.2x	13.5x	6.2x	5.6x
Randstad	EUR	33.5	3873	18.3x	14.9x	11.1x	8.8x
Vedior	EUR	14.4	2397	15.5x	12.5x	9.2x	7.8x
Adecco	CHF	64.3	12025	17.4x	14.6x	9.8x	8.2x
Average				16.0x	13.9x	8.8x	7.6x
Premium/discount				13.7%	12.8%	17.0%	14.2%
Premium/discount vs. Intertek				-4.0%	-7.0%	-2.7%	-6.1%

Source: NZZ Neue Zürcher Bank estimates, IBES/Multex estimates

- Our 'fair value NZZ', based on EVA®/DCF models, stands at CHF 930 per share (no deduction for insufficient soft factors) vs. CHF 886, which leaves an upside of around 8% for the stock.
- Opinion and recommendation:** SGS has transformed itself into a new, dynamic company over the past three years, and began to reap the initial rewards for its efforts last year. We fully expect the group to stay the course with its current strategy, and to benefit from the structural changes in the years to come. In our view, the news-flow is likely to stay very favorable in the short-term, with the following elements deserving special attention: a) additional value-enhancing acquisitions. SGS confirmed that acquisitions serve two objectives, i.e. strengthening and/or expanding the services portfolio and raising shareholder value; b) finalization of the numerous projects in the Life Sciences division; c) turnaround achieved in the Agricultural and Environmental divisions, new growth opportunities; d) on-going disposal of small business units (unsatisfactory sales growth rates and EBITA margins); e) better overall currency situation (especially with regard to the USD). A recovery by the USD could give net profit a substantial boost; f) new targets from the new CEO in the coming months. While we understand that the realization of some of the targets set for 2005 is already priced into the stock, we nevertheless feel that SGS shares still have potential. We consider it likely that they will continue to surprise on the upside, in view of the company's persuasive outlook, and the overall positive global economic environment. SGS offers a very attractive dual profile with growth and defensive characteristics, thanks to its geographic and

business diversification. However, considering the relatively low upside to our 'fair value NZZ', we are upholding our NEUTRAL rating for the time being, despite our very positive stance on the stock.

▪ **Agenda:**

- 23 March, 2005 AGM 2005
- 13 July, 2005 Announcement of H1 05 results

Disclaimer / Disclosure

© 2005. Publisher NZZ Neue Zürcher Bank, Brandschenkestrasse 10, 8002 Zurich. All rights reserved. When quoting, please cite NZZ Neue Zürcher Bank as the source. This report may not be copied, transmitted or distributed to any other party without the express written permission of NZZ Neue Zürcher Bank. This publication is derived from selected public sources we believe to be reliable, but neither its accuracy nor completeness is guaranteed. Opinions expressed herein reflect the current judgement of the author: they do not necessarily reflect the opinion of NZZ Neue Zürcher Bank and may change without notice. Neither the author, nor NZZ Neue Zürcher Bank, accepts any liability whatsoever with respect to the use of this publication, except as provided for under applicable regulations. This publication should not be construed as an offer, invitation or solicitation to subscribe for, purchase or sell any investment, and neither it nor anything it contains shall form the basis of any contract whatsoever. This publication is intended to provide information to assist investors in making their own investment decisions, not to provide investment advice to any specific investor. Investments discussed, and recommendations made herein, may not be suitable for all investors: readers must exercise their own independent judgement as to the suitability of such investments and recommendations in light of their own investment objectives, experience, taxation status and financial position. Past performance is not necessarily indicative of future performance; the value, price or income from investments may fall as well as rise. Some investments discussed in this report have a high level of volatility, and high volatility investments may experience sudden and larger falls in value, causing losses. Potential investors should not deal in derivatives unless they understand the nature of the contract that they are entering into, and the extent of their exposure to risk.

NZZ Neue Zürcher Bank has not acted as investment and / or commercial bankers for the companies mentioned in this report at any time during the past 36 months, and has therefore not received compensation for services related to the same.

The author of this report is not represented on the board of the companies mentioned in this report. The author of this report does not hold any long or short positions in stocks and / or derivative products of companies mentioned in this report. The flexible share of the author's remuneration is based on the overall result of the brokerage department of NZZ Neue Zürcher Bank. The financial success of single transactions in securities of the companies mentioned in this report has no impact on the author's remuneration.

NZZ Neue Zürcher Bank may rely on information barriers, such as Chinese Walls, to control the flow of information contained in certain areas of NZZ Neue Zürcher Bank into other areas or subsidiaries of the NZZ Group. In particular, NZZ Neue Zürcher Bank has undertaken organizational measures and controls that may prevent trading and / or asset management units of NZZ Neue Zürcher Bank from front- or parallel running.

NZZ Neue Zürcher Bank conducts a multi-stage valuation approach. In a first step, the economic value of the analysed companies is assessed on the basis of the EVA[®]/DCF-concepts. In a second step, NZZ Neue Zürcher Bank assesses a number of soft factors on a consistent and systematic basis. Insufficient soft factors lead to a deduction from the assessed economic value of the analysed companies. The result is called 'Fair value NZZ', from which target prices for buy and sell recommendations are derived. In third and fourth steps, NZZ Neue Zürcher Bank judges the earnings-growth momentum of the analysed companies as well as the relative valuation in comparison with domestic and / or international peer groups. The valuation process may result either in a buy, sell or neutral recommendation. The economic value, the 'Fair value NZZ' and the target price are based on a number of factors and assumptions. It should be noted that if any of these are inaccurate or are not achieved, it may be necessary to adjust the economic value, 'Fair value NZZ' and the target price. A detailed presentation of NZZ Neue Zürcher Bank's valuation process can be obtained on request.