

Industrials
Industrial Services

Switzerland

SGS (VX: SGSN VX)

Not a Margin Nightmare After All?

Company Update Estimate Change

Rating: HOLD
Price: CHF1,570.00
Price Target: CHF1,600.00
Bloomberg: VX: SGSN VX

Market Data

52-Week Range: CHF1,709.00-CHF1,282.42
Total Entprs. Value (MM): CHF11,735.9
Market Cap. (MM): CHF11,884.9
Shares Out. (MM): 7.6
Avg. Daily Vol.: 23,667

Financial Summary

Net Debt (MM): (CHF149.0)
Net Debt/Capital: (20.0%)
Dividend Yield: 4.5%

CHF	2009A	2010A	2011E	2012E
Rev. (MM)	4712.0	4757.0	5093.1	5753.7
Prev.	--	4812.9	5127.2	5792.4
EV/Rev.	2.5x	2.5x	2.3x	2.0x
EBITDA (MM)	1,037.0	1,061.0	1,109.7	1,300.2
Prev.	--	1,059.0	1,109.5	1,292.0
EV/EBITDA	11.3x	11.1x	10.6x	9.0x
EPS				
FY Dec	77.22	77.64	80.94	93.73
Prev. FY	--	78.67	80.27	92.99
FY P/E	20.3x	20.2x	19.4x	16.8x
EBIT (MM)	794.0	836.0	874.1	1,013.5
Prev.	--	827.7	846.9	983.1
EV/EBIT	14.8x	14.0x	13.4x	11.6x
Net Profit	566.0	588.0	612.8	709.6
Prev.	--	582.0	594.0	689.4

Alex Barnett, CFA, Equity Analyst

44 (0) 20 7029 8053, abarnett@jefferies.com

Event

We are increasing our estimates a touch on the back of SGS's solid FY results and bullish management sentiment.

Key Points

- **Back to boom times?** Despite a slightly slower than expected H2 (5.5% LFL growth vs. our 6.6% forecast) and still cautious guidance for high single digit 2011 growth, management's tone was almost unreservedly optimistic during their FY results meeting. Driving that optimism are buoyant minerals trends, a full recovery in consumer, a gradual rebound in some of the 2010 laggards, and early benefits from the group's investment plan. We have raised our 2011 organic growth estimates a touch, now looking for 9.2% LFL growth vs. 8.9% previously.
- **Is 20% far fetched?** SGS's excellent 2010 margin performance has us back to the drawing board on our LT margin assumptions and our handicapping of the group's 2014 targets. The 40bps y/y margin improvement in 2010 was driven by mix (both intra and inter division), improving pricing, and better capacity utilization – all of which should again impact 2011. While we continue to believe SGS will be hard-pressed to sustain the annual 40-50bps margin increases seen since 2005, we have increased our margin assumptions to reflect the new base established in 2010.
- **M&A a bigger piece of the puzzle?** SGS's recent flurry of M&A activity shows no signs of abating and already has the group ahead of external growth targets for 2011. The company noted a full pipeline of deals and attributed the recent spate of transactions to management attention and not loosening criteria on deals (borne out in part by the reasonable 9x EV/EBIT on 2010 deals). We have nudged up our 2011 M&A assumptions given management's continued aggressive tone.

Valuation/Risks

Our CHF1,600 target price remains unchanged and is derived by applying a 13x EV/EBIT multiple (the average level of the previous cycle) to our forward EBIT estimate. The key risk is the successful roll-out of the company's investment plan.

Impact on Other Companies

Read across from SGS's release to the testing sector is positive, pointing to a return to normal growth and highlighting potential for margin expansion. For Eurofins (ERF FP, Buy), the picture is mixed, with SGS posting a return to growth, but weaker than expected results in their environment and pharma businesses and pointing to pricing pressure in the businesses. SGS's huge H2 in minerals and bullish outlook read across very positively to Campbell Brothers (CPB AU, NC) – although flooding in Queensland could potentially be a short term setback for Campbell's big lab in the region.

SGS Results Analysis

Total	FY '09 Actual	FY '10 Actual	FY '10 Jef Est.	
Revenues	4,712	4,757	4,813	
% Growth	-2.2%	0.9%	2.1%	
LFL Growth (%)	1.3%	3.2%	3.8%	5.5% in H2 - below our 6.6% forecast
Perimeter Effect (%)	1.1%	0.9%	0.9%	Both US\$ and € significant headwinds and likely to remain so through 2011.
Currency Impact (%)	-4.6%	-3.2%	-2.5%	
Operating Profit	822	848	837	
Operating Margin	17.4%	17.8%	17.4%	40bps improvement resulting from better capacity utilization and mix. Beats from minerals, consumer and agri.
Net Profit	566	588	582	
EPS	75.49	77.64	77.60	
	FY '09 Actual	FY '10 Actual	FY '10 Jefco Est.	
Agricultural Services				
Sales	356.3	344.1	341.2	
LFL Growth (%)	4.0%	-0.1%	-1.0%	3% LFL in H2 slightly ahead of our forecast and H1. Inland business strong (up >30%), inspection business slow due to Eastern Europe (export bans) and S. America (trade finance issues).
Operating Profit	57.2	54.0	49.8	Margin improves significantly in H2 on mix.
Operating Margin	16.1%	15.7%	14.6%	
Minerals Services				
Sales	536.0	615.6	623.6	
LFL Growth (%)	-10.3%	12.2%	10.4%	Acceleration to 19% LFL in H2 as inspection, metallurgical and geochem business all rebound. Margin improves on better capacity utilization/mix improving pricing, and restructuring.
Operating Profit	87.2	117.9	112.6	Guidance for double digit 2011 growth.
Operating Margin	16.3%	19.2%	18.1%	
Oil, Gas & Chemical Services				
Sales	951.0	956.6	976.6	
LFL Growth (%)	0.1%	4.2%	5.9%	Slower than expected H2 pick-up (to 4.6% LFL). Trade business shows stable growth, upstream mixed - good Middle East performance offset by weaker Gulf of Mexico and Australia.
Operating Profit	149.2	148.9	146.5	Expect steady growth in up and downstream in 2011.
Operating Margin	15.7%	15.6%	15.0%	
Life Sciences Services				
Sales	199.9	193.6	198.6	
LFL Growth (%)	3.1%	2.6%	3.6%	4% H2 growth somewhat disappointing as clinical demand remained flat on weak demand at Paris/Antwerp labs. QC and bio-analysis grew.
Operating Profit	29.0	28.8	29.1	Margin growth driven by better capacity utilization - but partly offset by pricing pressure in clinical.
Operating Margin	14.5%	14.9%	14.7%	
Consumer Testing Services				
Sales	790.4	821.4	832.5	
LFL Growth (%)	9.1%	7.0%	8.8%	Slower than expected H2 rebound (to 8.4%) as wireless and toy testing remain slow. Good growth in textiles, automotive, food.
Operating Profit	201.1	211.9	208.8	Strong growth expected again in 2011.
Operating Margin	25.4%	25.8%	25.1%	
Systems & Services Certification				
Sales	367.3	386.1	389.1	
LFL Growth (%)	4.6%	7.9%	7.9%	Growth well balanced across regions (in contrast to '09 when emerging markets drove upside). Automotive, food and medical devices all performed well.
Operating Profit	77.6	81.6	81.4	
Operating Margin	21.1%	21.1%	20.9%	
Industrial Services				
Sales	743.6	737.9	742.5	
LFL Growth (%)	2.1%	-0.6%	-0.1%	Growth positive in H2, but still held down by slow construction demand in Europe (Spain in particular) and delayed Middle East infrastructure projects.
Operating Profit	104.3	97.1	98.7	
Operating Margin	14.0%	13.2%	13.3%	
Environmental Services				
Sales	287.7	278.4	282.2	
LFL Growth (%)	1.1%	-1.3%	0.4%	H2 growth ~2%, but still seeing weak European construction demand slow brownfield development. Good growth in emerging markets. H2 margin disappointing as pricing pressure lingers.
Operating Profit	33.6	29.8	30.9	Expect typical late cycle rebound to take hold in 2011.
Operating Margin	11.7%	10.7%	10.9%	
Automotive Services				
Sales	266.2	195.1	196.6	
LFL Growth (%)	-4.3%	-21.8%	-22.6%	FY growth ex Irish business is 3.1%. Margin improves on mix, restructuring gains in North America, and fee increases.
Operating Profit	43.5	35.9	36.5	Expect new statutory roll-outs to underlie good 2011 growth, but Ivory Coast turmoil a headwind.
Operating Margin	16.3%	18.4%	18.6%	
Governments & Institutions Services				
Sales	214.0	228.6	230.0	
LFL Growth (%)	6.9%	9.2%	11.3%	Growth slows in H2 as PSI business still not rebounding strongly and hit by slower Haiti and Bangladesh trade. Product Conformity assessment services perform well.
Operating Profit	39.4	41.6	42.3	
Operating Margin	18.4%	18.2%	18.4%	

Source: Company data and Jefferies Research

December year end	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E
Income Statement (CHFm)												
Turnover	2392.0	2454.0	2885.0	3308.0	3821.0	4372.0	4818.0	4712.0	4757.0	5093.1	5753.7	6487.0
% change	2.6%	2.6%	17.6%	14.7%	15.5%	14.4%	10.2%	-2.2%	1.0%	7.1%	13.0%	12.7%
EBITDA	311.0	396.0	508.0	642.0	800.0	908.0	1024.0	1022.0	1061.0	1109.7	1300.2	1523.7
margin %	13.0%	16.1%	17.6%	19.4%	20.9%	20.8%	21.3%	21.7%	22.3%	21.8%	22.6%	23.5%
EBIT	127.0	293.0	380.0	502.0	623.8	690.0	937.0	794.0	836.0	874.1	1013.5	1177.0
margin %	5.3%	11.9%	13.2%	15.2%	16.3%	15.8%	19.4%	16.9%	17.6%	17.2%	17.6%	18.1%
Pre-Tax	140.0	303.0	386.0	507.0	622.8	692.0	933.0	791.0	829.0	867.0	1006.7	1170.1
Net income	109.0	227.0	278.0	371.0	442.8	500.0	692.0	566.0	588.0	612.8	709.6	822.6
margin %	4.6%	9.3%	9.6%	11.2%	11.6%	11.4%	14.4%	12.0%	12.4%	12.0%	12.3%	12.7%
Balance Sheet (CHFm)												
Working Capital	216.0	196.0	139.0	223.0	252.0	256.0	274.0	224.0	188.0	195.7	221.1	249.3
WC as a % of turnover	9.0%	8.0%	4.8%	6.7%	6.6%	5.9%	5.7%	4.8%	4.0%	3.8%	3.8%	3.8%
Capital Employed	1317.0	1404.0	1561.0	1994.0	1980.0	2337.0	2558.0	2773.0	2978.0	3138.7	3481.4	3879.0
Net Debt	-402.0	-493.0	-438.0	-430.0	-215.0	-378.0	-248.0	-476.0	-262.0	-148.6	-130.0	-208.6
Gearing	-44.8%	-46.0%	-37.7%	-29.9%	-13.8%	-19.5%	-13.6%	-23.0%	-12.8%	-6.9%	-5.2%	-7.4%
Cash Flow (CHFm)												
Cash Flow	219.0	395.0	486.0	598.0	582.8	694.0	802.0	827.0	816.0	875.4	1027.6	1205.5
Capex	-121.0	-171.0	-201.0	-205.0	-224.0	-271.0	-278.0	-209.0	-250.0	-369.7	-431.5	-421.7
WCR	32.0	-70.0	-61.0	-187.0	-31.0	12.0	-22.0	13.0	-33.0	-7.7	-25.4	-28.2
Free-Cash Flow	130.0	154.0	224.0	206.0	327.8	435.0	502.0	631.0	533.0	497.9	570.7	755.7
Key Valuation Ratios												
Shares Outstanding (m)	7.8	7.7	7.5	7.6	7.6	7.6	7.6	7.5	7.6	7.6	7.6	7.6
Stock Price (CHF)	388.5	604.0	720.5	956.0	1,226	1,452	1,250	1,197	1,518	1,570	1,570	1,570
Market Cap*	3,020	4,644	5,396	7,260	9,307	11,085	9,496	8,975	11,493	11,886	11,886	11,886
EPS net	14.02	29.52	37.12	48.85	58.33	65.47	76.19	75.48	77.64	80.94	93.73	108.65
PER net	27.7	20.5	19.4	19.6	21.0	22.2	16.4	15.9	19.6	19.4	16.7	14.5
CFPS	28.2	51.4	64.9	78.7	76.8	90.9	105.6	110.3	107.8	115.6	135.7	159.2
PCF	13.8	11.8	11.1	12.1	16.0	16.0	11.8	10.9	14.1	13.6	11.6	9.9
P/NAV	3.4	4.3	4.6	5.0	6.0	5.7	5.2	4.3	5.6	5.5	4.8	4.2
ROCE	9.2%	21.5%	25.6%	28.2%	31.4%	32.0%	33.1%	29.8%	29.1%	28.6%	30.6%	32.0%
ROE	12.6%	21.9%	25.2%	27.0%	29.9%	26.8%	39.1%	28.5%	30.0%	29.5%	29.9%	30.3%
EV	2,618	4,151	4,958	6,830	9,092	10,707	9,248	8,499	11,231	11,738	11,756	11,678
EV / Sales	1.1	1.7	1.7	2.1	2.4	2.4	1.9	1.8	2.4	2.3	2.0	1.8
EV / EBITDA	8.4	10.5	9.8	10.6	11.4	11.8	9.0	8.3	10.6	10.6	9.0	7.7
EV / EBIT	20.6	14.2	13.0	13.6	14.6	15.5	9.9	10.7	13.4	13.4	11.6	9.9
Yield %	1.6%	1.2%	1.3%	1.2%	4.2%	1.6%	2.8%	4.2%	4.2%	4.1%	3.4%	3.9%

* historical data are average figures
source: Jefferies International Ltd.

Company Description

SGS is the largest global inspection, testing, verification and certification player. Through its international network of laboratories, the company inspects, samples and analyzes raw materials, food, crops and consumer goods, as well as certifying products and machinery for compliance with local and international standards.

ANALYST CERTIFICATIONS

I, Alex Barnett, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

As is the case with all Jefferies International Ltd. employees, the analyst(s) responsible for the coverage of the financial instruments discussed in this report receive compensation based in part on the overall performance of the firm, including investment banking income. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Aside from certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the analyst's judgement.

Meanings of Jefferies International Ltd. Ratings

Buy - Describes stocks that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

Hold - Describes stocks that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.

Underperform - Describes stocks that we expect to provide a total negative return (price appreciation plus yield) of 10% or more within a 12-month period.

Our focus on mid-capitalization and growth companies implies that many of the companies we cover are typically more volatile than the overall stock market, which can be amplified for companies with an average stock price consistently below \$10. For companies in this category only, the expected total return (price appreciation plus yield) for Buy rated stocks is 20% or more within a 12-month period. For Hold rated stocks with an average stock price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated stocks with an average stock price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% within a 12-month period.

NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Jefferies International Ltd. policies.

CS - Coverage Suspended. Jefferies International Ltd. has suspended coverage of this company.

NC - Not covered. Jefferies International Ltd. does not cover this company.

Restricted - Describes issuers where, in conjunction with Jefferies International Ltd. engagement in certain transactions, company policy or applicable securities regulations prohibit certain types of communications, including investment recommendations.

Monitor - Describes stocks whose company fundamentals and financials are being monitored, and for which no financial projections or opinions on the investment merits of the company are provided.

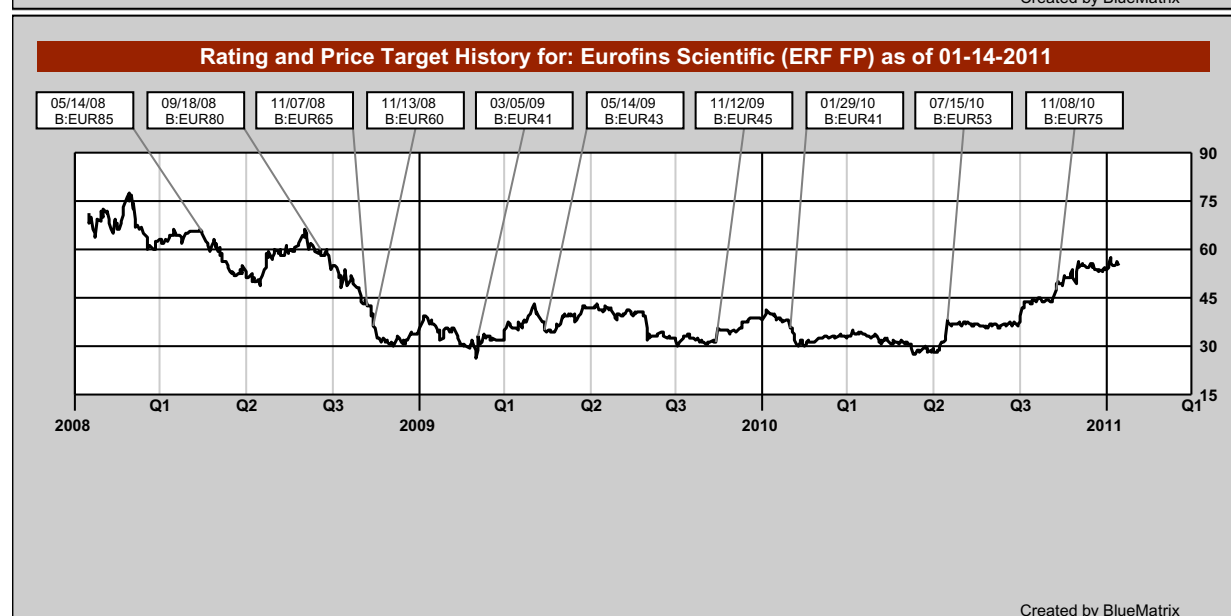
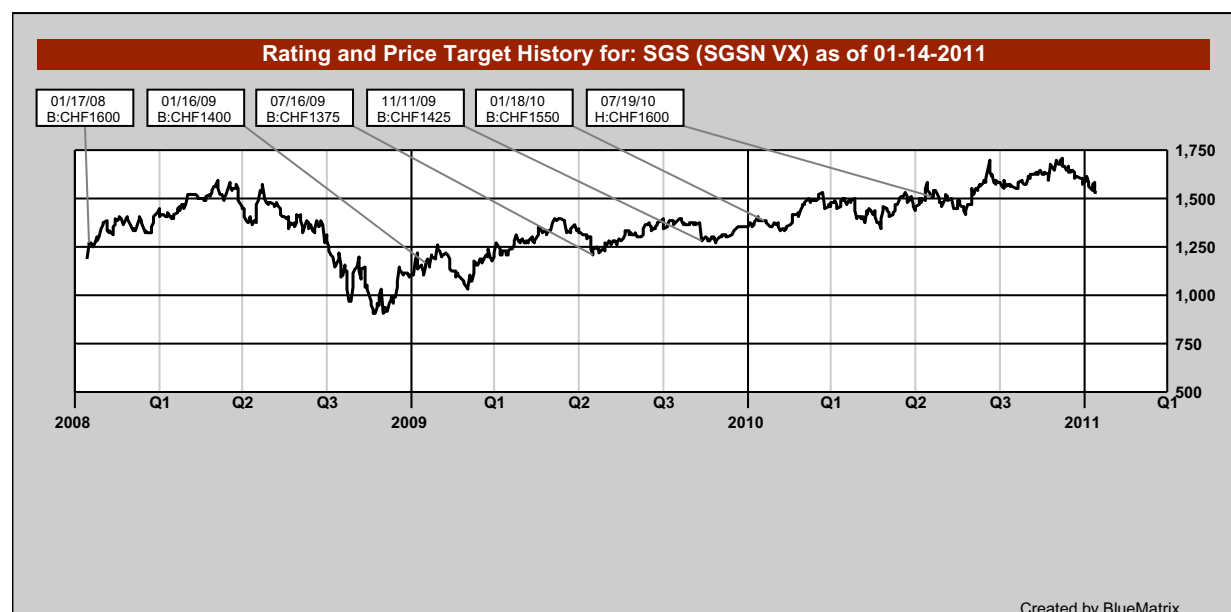
Valuation Methodology

Jefferies International Ltd. methodology for assigning ratings may include the following: market capitalization, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Risk which may impede the achievement of our Price Target

This report was prepared for general circulation and does not provide investment recommendations specific to individual investors. As such, the financial instruments discussed in this report may not be suitable for all investors and investors must make their own investment decisions based upon their specific investment objectives and

financial situation utilizing their own financial advisors as they deem necessary. Past performance of the financial instruments recommended in this report should not be taken as an indication or guarantee of future results. The price, value of, and income from, any of the financial instruments mentioned in this report can rise as well as fall and may be affected by changes in economic, financial and political factors. If a financial instrument is denominated in a currency other than the investor's home currency, a change in exchange rates may adversely affect the price of, value of, or income derived from the financial instrument described in this report. In addition, investors in securities such as ADRs, whose values are affected by the currency of the underlying security, effectively assume currency risk.



Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [BUY]	580	51.60	44	7.59
HOLD [HOLD]	498	44.30	25	5.02
SELL [UNPF]	46	4.10	5	10.87

This material has been issued and approved by Jefferies International Limited ("JIL"), a firm authorized and regulated in the United Kingdom ("UK") by the Financial Services Authority ("FSA"). Unless prohibited by the provisions of Regulation S of the U.S. Securities Act of 1933, this material will be distributed in the United States ("US"), by Jefferies & Company, Inc. ("JEFCO"), a US-registered broker-dealer, which accepts responsibility for its

contents in accordance with the provisions of Rule 15a-6, under the US Securities Exchange Act of 1934. Transactions by or on behalf of any US person may only be effected through JEFECO.

In the UK, this material is intended for use only by persons who have, or have been assessed as having, suitable professional experience and expertise, or by persons to whom it can be otherwise lawfully distributed. For Canadian investors, this material is intended for use only by professional or institutional investors. None of the investments or investment services mentioned or described herein is available to other persons or to anyone in Canada who is not a "Designated Institution" as defined by the Securities Act (Ontario). For investors in the Republic of Singapore, this material is provided by Jefferies International Limited through Jefferies Singapore Limited ("JSL") pursuant to Regulation 32C of the Financial Advisers Regulations. The material contained in this document is intended solely for accredited, expert or institutional investors, as defined under the Securities and Futures Act (Cap. 289 of Singapore). If there are any matters arising from, or in connection with this material, please contact JSL in Singapore at 80 Raffles Place #15-20, UOB Plaza 2, Singapore 048624, telephone: +65 6551 3950.

The information set forth herein was obtained from sources believed to be reliable, but has not been independently verified by JIL, JSL or JEFECO. Therefore, except for any obligation under the rules of the FSA we do not guarantee its accuracy. Additional and supporting information is available upon request. This is not an offer or solicitation of an offer to buy or sell any security or derivative instrument, or to make any investment. Any opinion or estimate constitutes the preparer's best judgment as of the date of preparation, and is subject to change without notice. JIL, JSL, JEFECO, their associates or affiliates, and their respective officers, directors, and employees may have long or short positions in, or may buy or sell any of the securities, derivative instruments or other investments mentioned or described herein, either as agent or as principal for their own account. Upon request JIL may provide specialized research products or services to certain customers focusing on the prospects for individual covered stocks as compared to other covered stocks over varying time horizons or under differing market conditions. While the views expressed in these situations may not always be directionally consistent with the long-term views expressed in the analyst's published research, the analyst has a reasonable basis and any inconsistencies can be reasonably explained.

This material does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this report is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of the investments referred to herein and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

JIL research reports are disseminated and available primarily electronically, and, in some cases, in printed form. Electronic research is simultaneously available to all clients. This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of JIL. JIL has adopted a conflicts management policy in connection with the preparation and publication of research, the details of which are available upon request in writing to: The Compliance Officer, Jefferies International Limited, Vintners Place, 68 Upper Thames Street, London EC4V 3BJ; telephone +44 (0) 20 7029 8000; facsimile +44 (0) 20 7029 8010.

Upon request Jefferies International Limited may provide specialized research products or services to certain customers focusing on the prospects for individual covered stocks as compared to other covered stocks over varying time horizons or under differing market conditions. While the views expressed in these situations may not always be directionally consistent with the long-term views expressed in the analyst's published research, the analyst has a reasonable basis and any inconsistencies can be reasonably explained.

© 2011 Jefferies International Ltd.