Global Equity Research

Switzerland

Industrial Services

UBS

UBS Investment Research

SGS

Rating	Buy 1
	Unchanged
Price target	CHF1,350.00/US$10.52
	Prior:CHF1,200.00/US$9.35
Price	CHF1,164.00/US$9.07 (ADR)

RIC: SGSN.VX BBG: SGSN VX

18 January 2006

FY 05 results review - Buy 1 reiterated, PT raised to CHF1350

■ Strong FY05 results gives renewed confidence in 08 targets

FY 05 results were robust, beating UBSe and consensus estimates. Organic sales growth accelerated to +11.7% y/y in H2 05 (from 11.1% in H1 05), while margins widened to 15.6% in H2 05 (+130bp y/y). With the strong performance spread across almost all divisions, we believe these results provided increased confidence in SGS's ability to reach (and potentially exceed) its 2008 financial targets.

■ Positively surprised by cash distribution to shareholders

In an effort to return excess cash to shareholders, the board will propose a CHF50 per share distribution to shareholders through a nominal capital reduction of CHF19 per share and a dividend of CHF31 per share.

■ Solid investment case, limited earnings downside risk

Given the strength and diversity of SGS's 10 divisions and the fact that growth is to a large extent being driven by secular growth trends, we feel there is limited downside risk to earnings estimates. We believe the investment case remains robust and believe M&A potential (in excess of the already announced targets) could provide further earnings upside risk.

■ Valuation: Reiterate Buy 1; PT raised to CHF1350

Our net EPS changes for 06-07E are between +4 to +5%. We reiterate our Buy 1 rating and increase our PT to CHF1350 from CHF1200 (DCF implied).

Highlights (CHFm)	12/03	12/04	12/05E	12/06E	12/07E
Revenues	2,454	2,885	3,308	3,713	4,061
EBIT	300	391	502	596	666
Net income (UBS)	234	292	371	436	488
EPS (UBS, CHF)	30.54	38.19	49.45	58.13	65.12
Net DPS (UBS, CHF)	9.00	12.00	50.00	18.00	20.00

Profitability & Valuation	5-yr hist. av.	12/04	12/05E	12/06E	12/07E
EBIT margin %	8.1	13.6	15.2	16.1	16.4
ROIC (EBIT) %	48.9	67.8	69.1	72.9	74.3
EV/EBITDA x	10.0	10.3	13.8	12.1	10.8
PE (UBS) x	14.5	18.8	23.5	20.0	17.9
Net dividend yield %	1.2	1.7	4.3	1.5	1.7

Source: Company accounts, Thomson Financial, UBS estimates. UBS EPS is stated before goodwill, exceptionals and other special items.
Valuations: based on an average share price that year, (E): based on a share price of CHF1,164.00 on 17 Jan 2006 00:43 GMT

Darren Cohen
Analyst
darren.cohen@ubs.com
+41-1-239 1657

Mark Shepperd
Analyst
mark.shepperd@ubs.com
+44-20-7568 1977

Jaime Brandwood, CFA
Analyst
jaime.brandwood@ubs.com
+44-20-7568 1976

Trading data (local/US$)

52-wk. range	CHF1,165.00-805.00/US$9.09-6.73
Market cap.	CHF9.10bn/US$7.09bn
Shares o/s	7.8m (REG)/782m (ADR)
ADR ratio	100 ADR :1 REG
Free float	62%
Avg. daily volume ('000)	24/OTC
Avg. daily value (CHFm)	25.6

Balance sheet data 12/05E

Shareholders' equity	CHF1.30bn
P/BV (UBS)	7.0x
Net cash (debt)	CHF0.43bn

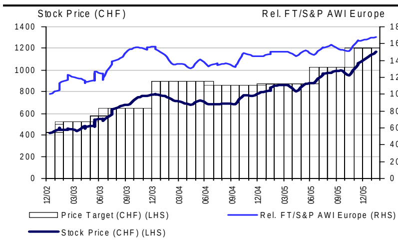
Forecast returns

Forecast price appreciation	+16.0%
Forecast dividend yield	4.3%
Forecast stock return	+20.3%
Market return assumption	6.3%
Forecast excess return	+14.0%

EPS (UBS, CHF)

	12/05E			12/04
	From	To	Cons.	Actual
H1E	21.70	22.10	-	16.74
H2E	24.46	26.69	-	20.67
12/05E	47.20	49.45	*47.08*	
12/06E	55.61	58.13	*54.41*	

Performance (CHF)



Source: UBS

www.ubs.com/investmentresearch

This report has been prepared by UBS AG

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 10

Results Overview

SGS reported a solid set of results, clearly exceeding UBS and consensus estimates. The headline figures were as follows:

- **Sales of CHF3.31bn** (+11.4% y/y organic; UBSe 3.24bn; consensus CHF3.18bn to CHF3.29bn);
- **EBITA of CHF502m** (+28% y/y; 15.2% margin; UBSe CHF488m; consensus CHF478m-495m)
- **Net income of CHF371m** (+34% y/y; UBSe 361m; consensus CHF348m-375m).

Organic growth - Organic sales growth accelerated to +11.7% y/y in H2 05 (from 11.1% in H1 05). It is worth noting that 7 out of 10 divisions reported double-digit organic growth. The main highlights in terms of organic growth, in our view, were the Minerals (+17.5% y/y); Consumer Testing Services (+27.5% y/y); Life Sciences (+15.6% y/y) and Systems & Services Certification divisions (+15.3% y/y).

Margin development – EBITA margins expanded to 15.2% for FY 05 (+160 bp y/y), with the H2 05 margin rising to 15.6% (+130 bp y/y and +90 bp h/h). 9 of the 10 divisions reported margin expansions y/y, with the most notable increases coming from Agricultural Services (9.2 to 11.4%). Life Sciences (12.0% to 15.2%); Consumer Testing (18.1% to 21.4%); SSC (13.0% to 17.0%) and Environmental (8.1% to 11.1%).

Free cash flow – came in below our expectations due to: (1) higher NWC charges and (2) changes in provisions (e.g. demobilisation of TAS etc.).

Cash return to shareholders – SGS surprised the market with an announcement of a CHF50 per share distribution to shareholders through a nominal capital reduction of CHF19 per share and a dividend of CHF31 per share. The CHF50 per share translates to a payout ratio for 2005 of c100%. The company anticipates a normalised 25-35% payout ratio to continue for 2006 onwards. While there appeared to be some concern that the cash distribution could reflect negatively on SGS's M&A prospects, SGS management reiterated their intentions to pursue an aggressive M&A strategy (in-line with previously announced 2008 financial targets) and dismissed any connection to between the cash distribution and its M&A plans. The company has in fact previously alluded to returning excess cash to shareholders in the absence of M&A activity, and given the mounting cash pile (CHF430m net cash at FY 05) and absence of significant acquisitions during 2005, the decision has been taken to return the bulk of this to shareholders.

Strategic Growth Plan

Renewed confidence in 2008 financial targets

Although SGS's strategic growth plan was announced only 2 months ago, we do believe that the FY 05 results provide us with renewed confidence in SGS's ability to reach its 2008 financial targets.

■ **Revenue of CHF5bn (Organic CAGR of 10%; Total CAGR of 15%)**

With SGS having maintained a double-digit organic growth rate 2 years in a row (+10.7% in 2004 and +11.5% in 2005) and with management still fairly upbeat on the outlook for all 10 divisions at this stage, we believe the 10% target p.a. is feasible. This is supported by the fact that SGS is not only benefiting from cyclical growth trends but also secular trends, with further support from a widening of the service offering. Our optimism with respect to the potential for SGS to make bolt-on acquisitions (i.e. to add c5% of sales p.a. from acquisitions), stems not only from the fact that SGS management claim their acquisition pipeline is currently full, but also due to the fact that Intertek and Bureau Veritas management have also eluded to significant potential for small to mid-sized bolt-on acquisitions. While Intertek has only recently increased momentum with respect to M&A activity, Bureau Veritas has been very active over the past few years. BV plans to double revenues from 2004 to 2009 (implied growth of 15% pa) through a combination of organic growth (c8%) and acquisitions. In 2005, BV made 10 acquisitions adding €150 million in sales (paying c1x sales). The BV CEO alluded to 20-40 additional acquisitions in the pipeline, adding that management sees definite potential for bolt-on acquisitions below €50 million given that smaller companies are finding it increasingly difficult to compete with the larger global players. SGS itself has made several small acquisitions over the past 2 years, adding roughly CHF270m+ in terms of group revenues (UBSe). Worth noting that SGS management have previously referred to a potential debt capacity of up to CHF1.5bn, implying that the group essentially has well in excess of CHF2bn to potentially spend on acquisitions.

■ **EBITA margin of 17.0%**

Margins in H2 05 reached 15.6%, only 140bp shy of the 2008 target of 17.0%.

■ **EPS of CHF80**

In order to reach its 2008 EPS target of CHF80 per share, SGS would need to grow its EPS by a CAGR of roughly +c18% for 05-08E. With revenues expected to grow at a rate of +15% p.a. (incl. Acquisitions), and since margins should in our view gradually widen towards 17.0%, the EPS target appears quite reasonable (assuming no significant changes in financing charges and taxes), and in fact we think it could be exceeded if M&A activity exceeds the initial targets.

Recap of the Strategic growth plan

According to management, the plan can be broken down as follows:

(1) **Grow the current portfolio** by expanding current offerings and increasing competitive barriers. In addition, **accelerate Life Sciences, Consumer Testing Services and Industrial Services** (largest potential market). SGS has laid out specific organic growth plans for each individual division. In addition, M&A activity in terms of bolt-on acquisitions is expected to intensify over the next 3 years with management targeting: (1) lab expansion in OGC, Minerals and Environmental; (2) Statutory auto

inspection (Automotive); (3) Regional expansion in Life Sciences; Industrial Services and Consumer Testing Services.

(2) **Execute Strategic growth initiatives –** SGS management has identified certain strategic markets (Governments & Institutions; Financial Services; Energy/Infrastructure and Software), which it believes is trending towards outsourcing and is currently underserved. As these industries require a multitude of services, SGS believes that these markets offer significant growth potential and therefore plans to penetrate these segments with newly developed service offerings, but at the same time, leveraging on existing know-how and the group network. SGS is targeting acquisitions in the Energy/Infrastructure and Software segments.

(3) **Improve the operating system –** While the first 2 steps are focused primarily on growth, SGS also plans to improve its "operating system" by: (1) creating a flexible network of labs (shared capacity and capability); (2) creating a virtual back office (to support labs, inspections etc.); and (3) attempt to align customer requirements with business goals.

Changes to estimates

Post the FY 05 results, the net changes to our 06/07 EPS estimates are +4% to +5%. We have left our group organic growth forecasts relatively unchanged, while having raised our EBITA margin assumptions by +20 to +30 bp for 06/07E. The change in the number of treasury shares (due to the inclusion of the foundations shares) has resulted in an EPS improvement of c+2%.

Table 1: Changes to UBS estimates

	New estimates			Old estimates			% change to estimates		
	2005	2006E	2007E	2005E	2006E	2007E	2005E	2006E	2007E
Revenues	3,308	3,713	4,061	3,242	3,645	3,984	2%	2%	2%
% change	14.7%	12.3%	9.4%	12.4%	12.4%	9.3%			
EBITA	502	596	666	488	576	647	3%	4%	3%
% EBITA-margin	15.2%	16.1%	16.4%	15.1%	15.8%	16.2%			
UBS adjusted net income	371	436	488	361	425	477	3%	3%	2%
% change	27.1%	17.5%	12.0%	23.5%	17.8%	12.2%			
UBS adjusted EPS	49.1	57.4	64.3	46.9	54.9	61.6	5%	5%	4%

Source: UBS estimates

Valuation and Conclusion

M&A not included in estimates, but factored into target valuation

Although the organic growth and margin target is only "slightly" above our current estimates, the company's absolute revenue target of CHF5bn and EPS target of CHF80 are ahead of our estimates due to the fact that we do not include future acquisitions in our estimates. With SGS having quantified specific targets for 2008, which include anticipated acquisitions, we adjust our DCF valuation to incorporate potential acquisitions until 2008 *(bear in mind that we only adjust our estimates for acquisitions for the purposes of deriving value for SGS, however, we do not as a policy adjust our underlying estimates for acquisitions until they materialise).*

DCF valuation

As discussed above, we incorporate expected bolt-on acquisitions in our DCF valuation for the purposes of deriving our PT for SGS. Our DCF valuation (see Chart 1 and calculations below) implies a value per share of CHF1350 (previously CHF1200). The main driver behind the change is (1) slightly higher forecasts for 06E/07 on the back of the FY 05 results; (2) a higher long-term growth assumption (from 2.0% to 2.5%) given our increased confidence in the mid to long-term growth prospects for SGS within the overall industry; and (3) a higher mid-term EBITA margin assumption (+20bp to 16.2%).

Chart 1: DCF Valuation

CHFm	2001	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Revenue	2,332	2,392	2,454	2,885	3,308	3,829	4,439	5,056	5,463	5,902	6,376	6,889	7,443	8,041
growth, %		*2.6%*	*2.6%*	*17.6%*	*14.7%*	*15.7%*	*15.9%*	*13.9%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*
organic growth **(1)**		*6.5%*	*7.0%*	*10.7%*	*11.5%*	*9.7%*	*9.4%*	*9.4%*	*9.4%*	*9.4%*	*9.4%*	*9.4%*	*9.4%*	*9.4%*
M&A **(1)**		*3.7%*	*0.2%*	*8.6%*	*1.9%*	*8.6%*	*6.5%*	*3.1%*	*-1.4%*	*-1.4%*	*-1.4%*	*-1.4%*	*-1.4%*	*-1.4%*
Currency		*-7.6%*	*-4.5%*	*-1.8%*	*1.2%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
EBITA	145	216	300	391	502	615	724	839	885	956	1,033	1,116	1,206	1,303
EBITA margin **(2)**	*6.2%*	*9.0%*	*12.2%*	*13.6%*	*15.2%*	*16.1%*	*16.3%*	*16.6%*	*16.2%*	*16.2%*	*16.2%*	*16.2%*	*16.2%*	*16.2%*
growth, %		*49.2%*	*39.1%*	*30.3%*	*28.4%*	*22.5%*	*17.7%*	*16.0%*	*5.4%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*
Less: Taxes	-38	-38	-62	-90	-118	-148	-174	-209	-221	-239	-258	-278	-301	-325
Tax Rate **(3)**	*26.4%*	*17.5%*	*20.6%*	*22.9%*	*23.5%*	*24.0%*	*24.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*
NOPLAT	106	178	238	301	384	467	550	630	664	718	775	838	905	978
Add: Depreciation **(4)**	102	95	96	115	140	166	193	219	237	256	277	299	323	349
% of sales	*4.4%*	*4.0%*	*3.9%*	*4.0%*	*4.2%*	*4.3%*	*4.3%*	*4.3%*	*4.3%*	*4.3%*	*4.3%*	*4.3%*	*4.3%*	*4.3%*
Gross Cash Flow	209	273	334	416	505	629	742	838	880	951	1,027	1,109	1,198	1,294
Less: Capex **(4)**	-117	-106	-171	-201	-190	-205	-237	-270	-292	-316	-341	-369	-398	-430
% of sales	*-5.0%*	*-4.4%*	*-7.0%*	*-7.0%*	*-5.7%*	*-5.4%*	*-5.4%*	*-5.4%*	*-5.4%*	*-5.4%*	*-5.4%*	*-5.4%*	*-5.4%*	*-5.4%*
NWC	286	216	196	139	175	211	244	278	300	325	351	379	409	442
NWC/Sales	*12.3%*	*9.0%*	*8.0%*	*4.8%*	*5.3%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*
-Increase in NWC	147	70	20	57	-36	-36	-34	-34	-22	-24	-26	-28	-30	-33
Free cash flow	239	237	183	272	298	393	472	545	587	634	685	740	799	864
growth, %		*-1%*	*-23%*	*49%*	*10%*	*32%*	*20%*	*16%*	*8%*	*8%*	*8%*	*8%*	*8%*	*8%*

Valuation	
NPV of Terminal value	7,069
NPV of cash flows	4,008
Enterprise Value	11,076
Less: Net debt 2006 ***(5)***	- 541
Less: Provisions	- 61
Add: Peripherals	7
Less: Minority interest	- 301
Equity Value	10,180
# of shares	7.5
Price per share	1,349

Assumptions	
WACC **(6)**	8.6%
Terminal growth	2.54%

WACC Computation	
Risk free rate	4.0%
Beta **(6)**	1.25
Equity risk premium	4.5%
Cost of equity	9.6%
Pre-tax cost of debt	6.0%
Tax-rate	25.0%
Post-tax cost of debt	4.5%
Debt/Total Capital **(6)**	20.0%
WACC	8.6%

Source: UBS estimates

DCF valuation notes:

(1) **Revenue:** We have left our organic growth assumptions broadly unchanged at c+9% y/y for 06-07E. As we firmly believe that SGS will reach its CHF5bn revenue target supported by acquisitions (making up any shortfall in organic growth below 10%), we have assumed that CHF700m in sales will be acquired (in addition to bolt-on acquisitions already made during 2005) over the next 3 years (UBSe CHF250m in 2006E; CHF250m in 2007E; CHF200m in 2008E). Approximately CHF55m in sales has already been acquired early January 2006 (Life Sciences – aster.cephac).

(2) **EBITA margin:** With acquisitions expected in certain higher margin segments, e.g. Life-Sciences; Consumer Testing Services (according to management), we have assumed that higher margin mix should support the

EBITA margin expansion to at least 16.6% by FY 08E (versus management's target of c17%). Management is targeting for the acquisitions to be margin accretive to the individual business segments' operating margin within 1 year.

(3) **Tax rate:** We have assumed the tax rate will gradually increase to c25% by 2008E.

(4) **Capex and depreciation:** According to SGS management, the capex/sales ratio should remain within the historical range (we have assumed a ratio of 5.4%).

(5) **Net debt:** According to our estimates, the average price paid for bolt-on acquisitions by SGS has ranged between 1.0-1.3x (price/sales). We have assumed in our DCF valuation that the CHF700m sales (incl. Recent Life Sciences acquisition) is acquired at a cumulative multiple of c1.3x price/sales (i.e. @ CHF910m). In deriving our net debt for 2006E, we have deducted the CHF910m paid for acquisitions from our previous underlying net cash assumption.

(6) **WACC calculation:** Our WACC remains unchanged at 8.6%.

Conclusion

From the table above it is possible to see the contrast between the PE valuation multiples on current estimates (assuming no M&A) versus management's target of reaching CHF80 EPS by 2008E (with the support of acquisitions). While the target valuation appears demanding for 2006E (c23x PE), the high EPS growth to 2008E (c+18% p.a.) translates to a c17x PE for 2008E. In addition, we expect that SGS should still be net cash positive by 2008 (even after the expected bolt-on acquisitions), which to some extent inflates the projected PE given the underleveraged balance sheet.

Table 2: PE at current price and price target (with and without M&A)

(Assuming no M&A)	2005E	2006E	2007E	2008E
Current EPS estimates (UBS adjusted)	49.1	57.4	64.3	70.8 (1)
PE @ CHF1165 (current price)	23.7	20.3	18.1	16.4
PE @ CHF1350 (price target)	27.5	23.5	21.0	19.1

(Assuming M&A - i.e. CHF700m in sales is acquired)	2005E	2006E	2007E	2008E
EPS (2)	49.1	57.8	68.0	80.0
PE @ CHF1165 (current price)	23.7	20.1	17.1	14.6
PE @ CHF1350 (price target)	27.5	23.3	19.8	16.9

Source: UBS estimates

Notes: (1) Assuming growth at +10.0% for 2008E

Notes: (2) For the purpose this comparison, we have assumed that EPS will grow linearly by +c18% p.a. to CHF80 per share in 2008E

We reiterate our Buy 1 rating, and believe the target valuation is justified when taking into account the following factors:

- Owing to certain market trends e.g. outsourcing, increasing regulations etc, SGS is becoming a less-cyclical business and has already demonstrated its ability to deliver strong y/y organic growth with relatively stable (and in some several cases increasing) margins;
- In our opinion, there are no significant downside risks for the stock in the near to mid-term. Although individual divisions do have certain risks (e.g. declining TAS pre-shipment inspection market), SGS's portfolio is made up of 10 divisions, which to a large extent reduces the risk that a disappointment in one division could significantly impact the group as a whole.
- SGS has a solid balance sheet. Even after assuming SGS spends CHF900m+ on acquisitions over the next few years, it would still, according to our estimates, be net cash flow positive by 2008E and should generate FCF in excess of CHF500m p.a. This would allow for further M&A potential in the future.
- We forecast SGS to generate a ROIC of 50%+ for 05E/06E (excl. acquisitions).
- SGS's existing management track record is excellent and the new CEO has made a strong impression.

Divisional estimates

Table 3: Divisional sales estimates

CHFm	H1 04	H2 04	2004	H1 05	H2 05	2005	2006E	2007E
Agricultural Services	124	133	257	138	157	295	324	347
% change vs. py	1.9%	10.9%	6.3%	10.9%	18.2%	14.7%	9.9%	7.0%
Organic	1.0%	14.4%	7.4%	10.9%	13.3%	12.2%	8.5%	7.0%
Minerals Services	151	169	320	177	217	394	455	491
% change vs. py	13.7%	14.5%	14.1%	17.3%	28.5%	23.2%	15.5%	8.0%
Organic	12.2%	20.6%	16.0%	18.8%	16.4%	17.5%	13.0%	8.0%
Oil, Gas & Chemicals	283	292	575	302	334	636	696	752
% change vs. py	33.3%	28.6%	30.9%	6.9%	14.2%	10.6%	9.5%	8.0%
Organic	12.6%	13.1%	12.6%	8.7%	10.2%	9.5%	9.5%	8.0%
Life Sciences Services	51	56	107	62	63	125	198	218
% change vs. py	72.0%	88.5%	80.2%	21.8%	13.8%	17.7%	57.9%	10.0%
Organic	-4.7%	-3.8%	-4.2%	18.1%	13.3%	15.6%	14.0%	10.0%
Consumer Testing Services	166	195	361	214	262	476	562	646
% change vs. py	31.0%	33.7%	32.4%	29.3%	34.4%	32.1%	18.0%	15.0%
Organic	19.1%	26.0%	22.1%	25.6%	29.1%	27.5%	18.0%	15.0%
Systems & Services Cert.	114	121	235	127	147	274	310	331
% change vs. py	8.3%	-2.5%	2.5%	11.2%	21.3%	16.4%	13.0%	7.0%
Organic	7.4%	0.9%	3.9%	12.6%	17.7%	15.3%	13.0%	7.0%
Industrial Services	182	198	380	209	235	445	500	550
% change vs. py	14.9%	15.2%	15.1%	14.9%	19.2%	17.1%	12.4%	10.0%
Organic	12.7%	17.8%	15.1%	12.1%	13.1%	12.6%	12.0%	10.0%
Environmental Services	97	111	209	111	124	235	260	281
% change vs. py	26.4%	19.0%	21.3%	44.0%	11.5%	12.7%	10.7%	8.0%
Organic	11.2%	7.8%	9.2%	11.2%	7.0%	9.0%	9.0%	8.0%
Automotive Services	89	99	188	97	103	200	226	244
% change vs. py	-20.5%	-0.4%	-11.0%	9.3%	4.3%	6.7%	13.0%	8.0%
Organic	-17.9%	-8.8%	-13.4%	1.1%	-2.0%	-0.5%	8.0%	8.0%
Trade Assurance Services	133	122	255	120	109	229	183	201
% change vs. py	37.5%	-0.3%	16.4%	-10.2%	-10.9%	-10.5%	-20.0%	10.0%
Organic	37.7%	0.7%	17.0%	-9.5%	-11.6%	-10.5%	-20.0%	10.0%
Total Sales	1,390	1,495	2,885	1,557	1,751	3,308	3,713	4,061
% change vs. py	18.4%	16.8%	17.5%	12.0%	17.1%	14.7%	12.3%	9.4%
organic	10.2%	11.3%	10.7%	11.1%	11.9%	11.5%	9.7%	9.4%
currency	0.7%	-4.2%	-1.8%	-1.3%	3.6%	1.2%	0.0%	0.0%
acquisitions/disposals	7.5%	9.7%	8.6%	2.2%	1.6%	1.9%	2.9%	0.0%

Source: Company data, UBS estimates

Table 4: Divisional EBITA estimates

CHFm	H1 04	H2 04	2004	H1 05	H2 05	2005E	2006E	2007E
Agricultural Services	9.5	14.1	23.6	15.0	18.5	33.5	40.5	45.0
% EBITA margin	7.6%	10.6%	9.2%	10.9%	11.8%	11.4%	12.5%	13.0%
Minerals Services	21.1	25.2	46.3	27.2	35.9	63.1	75.1	81.1
% EBITA margin	14.0%	14.9%	14.5%	15.4%	16.6%	16.0%	16.5%	16.5%
Oil, Gas & Chemical Services	33.1	35.5	68.6	36.9	42.5	79.4	93.9	101.5
% EBITA margin	11.7%	12.2%	11.9%	12.2%	12.7%	12.5%	13.5%	13.5%
Life Sciences	5.7	7.1	12.8	8.7	10.4	19.1	32.6	37.0
% EBITA margin	11.2%	12.8%	12.0%	14.0%	16.4%	15.2%	16.5%	17.0%
Consumer Services	28.3	36.9	65.2	45.6	56.5	102.1	129.2	155.1
% EBITA margin	17.1%	18.9%	18.1%	21.3%	21.6%	21.4%	23.0%	24.0%
Systems & Services Certification	14.0	16.5	30.5	19.7	26.8	46.5	52.6	53.0
% EBITA margin	12.3%	13.6%	13.0%	15.5%	18.2%	17.0%	17.0%	16.0%
Industrial	20.7	25.4	46.1	27.3	31.3	58.6	70.0	79.8
% EBITA margin	11.4%	12.9%	12.1%	13.0%	13.3%	13.2%	14.0%	14.5%
Environmental	6.2	10.6	16.8	11.0	15.0	26.0	32.5	37.9
% EBITA margin	6.4%	9.5%	8.1%	9.9%	12.1%	11.1%	12.5%	13.5%
Automotive	9.7	10.3	20.0	12.3	12.9	25.2	29.4	31.8
% EBITA margin	10.9%	10.4%	10.7%	12.6%	12.5%	12.6%	13.0%	13.0%
Trade Assurance Services	28.8	32.7	61.5	25.1	23.4	48.5	40.2	44.3
% EBITA margin	21.7%	26.7%	24.1%	21.0%	21.4%	21.2%	22.0%	22.0%
Total	177.1	214.3	391.4	228.8	273.2	502.0	596.2	666.4
% EBITA margin	12.7%	14.3%	13.6%	14.7%	15.6%	15.2%	16.1%	16.4%

Source: Company data, UBS estimates

■ SGS

SGS is the largest inspection, testing and certification organisation in the world. The core services offered by SGS (split between 10 divisions) can be divided into three categories: (1) inspection services - SGS inspects and verifies the quantity, weight and quality of traded goods; (2) testing services - SGS tests product quality and performance against various health, safety and regulatory standards; and (3) certification services - SGS certifies that systems or services meet the requirements of standards set by governments, standardisation bodies or by SGS customers.

■ Statement of Risk

A weakening US dollar should result in downside risk to our estimates given SGS's high US dollar translation exposure of between 40-45%.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Required Disclosures

This report has been prepared by UBS AG.

For information on the ways in which UBS manages conflicts and maintains independence of its research product; historical performance information; and certain additional disclosures concerning UBS research recommendations, please visit www.ubs.com/disclosures.

UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage[1]	IB services[2]
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	**Buy 2**	FSR is > 10% above the MRA, lower degree of predictability	**Buy**	40%	35%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	**Neutral 2**	FSR is between -10% and 10% of the MRA, lower degree of predictability	**Hold/Neutral**	50%	31%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	**Reduce 2**	FSR is > 10% below the MRA, lower degree of predictability	**Sell**	11%	30%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 31 December 2005.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.
Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).
Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.
Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.
UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

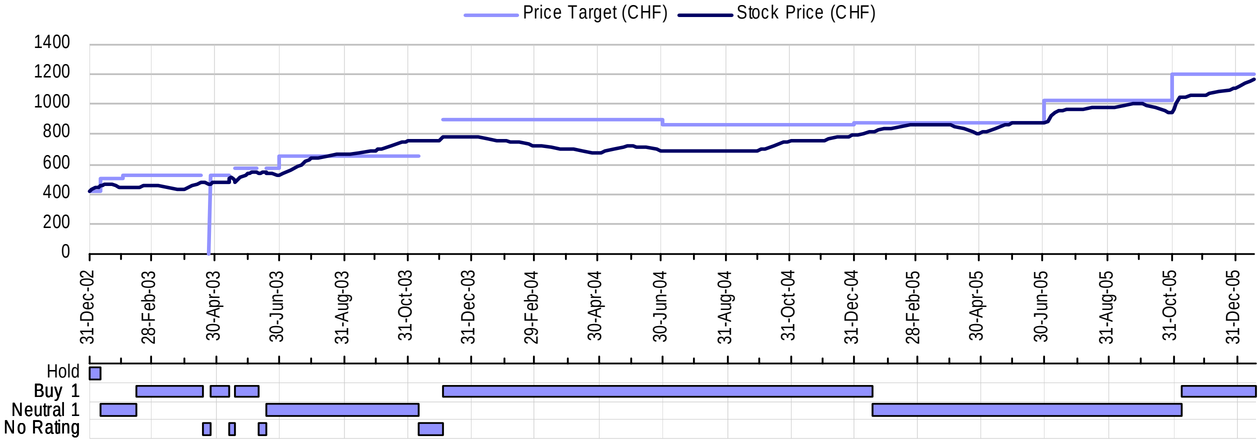
Company Name	Reuters	Rating	Price	Price date/time
SGS[4,5,13]	SGSN.VX	Buy 1	CHF1,164.00	17 Jan 2006 00:43 GMT

Source: UBS. GMT: Greenwich mean time.

4. Within the past 12 months, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company/entity.
5. UBS AG, its affiliates or subsidiaries expect to receive or intend to seek compensation for investment banking services from this company within the next three months.
13. UBS AG, its affiliates or subsidiaries beneficially owned 1% or more of a class of this company`s common equity securities as of last month`s end (or the prior month`s end if this report is dated less than 10 days after the most recent month`s end).

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

SGS (CHF)



Source: UBS; as of 17 January 2006.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

Global Disclaimer

This report has been prepared by UBS AG. In certain countries UBS AG is referred to as UBS SA.

This report is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning UBS AG, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. The report should not be regarded by recipients as a substitute for the exercise of their own judgement. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of UBS as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. UBS is under no obligation to update or keep current the information contained herein. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, groups or affiliates of UBS. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of UBS Investment Bank as a whole, of which investment banking, sales and trading are a part.

The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. Options, derivative products and futures are not suitable for all investors, and trading in these instruments is considered risky. Mortgage and asset-backed securities may involve a high degree of risk and may be highly volatile in response to fluctuations in interest rates and other market conditions. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither UBS nor any of its affiliates, nor any of UBS' or any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. **Additional information will be made available upon request.**

United Kingdom, Sweden and Netherlands: Except as otherwise specified herein, this material is communicated by UBS Limited, a subsidiary of UBS AG, to persons who are market counterparties or intermediate customers (as detailed in the FSA Rules) and is only available to such persons. The information contained herein does not apply to, and should not be relied upon by, private customers. **France:** Prepared by UBS Limited and distributed by UBS Limited and UBS Securities France SA. **Germany:** Prepared by UBS Limited. Distributed by UBS Limited and UBS Investment Bank AG. UBS Limited is regulated by FSA. UBS Investment Bank AG is regulated by Bundesanstalt fur Finanzdienstleistungsaufsicht. **Spain:** Prepared by UBS Limited and distributed by UBS Securities Espana SV SA, a member of the Comision Nacional del Mercado de Valores. **Russia:** Prepared and distributed by the Moscow Representative Office of UBS Cyprus Moscow Limited. **Switzerland:** Distributed by UBS AG to persons who are institutional investors only. **Italy:** Should persons receiving this research in Italy require additional information or wish to effect transactions in the relevant securities, they should contact UBS Italia SIM S.p.A. **South Africa:** UBS South Africa (Pty) Limited is a member of the JSE Limited. UBS South Africa (Pty) Limited is an authorised Financial Services Provider. **United States:** Distributed to US persons by either UBS Securities LLC or by UBS Financial Services Inc., subsidiaries of UBS AG; or by a group, subsidiary or affiliate of UBS AG that is not registered as a US broker-dealer (a "non-US affiliate"), to major US institutional investors only. UBS Securities LLC or UBS Financial Services Inc. accepts responsibility for the content of a report prepared by another non-US affiliate when distributed to US persons by UBS Securities LLC or UBS Financial Services Inc. All transactions by a US person in the securities mentioned in this report must be effected through UBS Securities LLC or UBS Financial Services Inc., and not through a non-US affiliate. **Canada:** Distributed by UBS Securities Canada Inc., a subsidiary of UBS AG and a member of the principal Canadian stock exchanges & CIPF. A statement of its financial condition and a list of its directors and senior officers will be provided upon request. **Hong Kong:** Distributed by UBS Securities Asia Limited. **Singapore:** Distributed by UBS Securities Pte. Ltd or UBS AG, Singapore Branch. **Japan:** Distributed by UBS Securities Japan Ltd to institutional investors only. **Australia:** Distributed by UBS AG (Holder of Australian Financial Services Licence No. 231087) and UBS Securities Australia Ltd (Holder of Australian Financial Services Licence No. 231098) only to "Wholesale" clients as defined by s761G of the Corporations Act 2001. **New Zealand:** Distributed by UBS New Zealand Ltd.

UBS

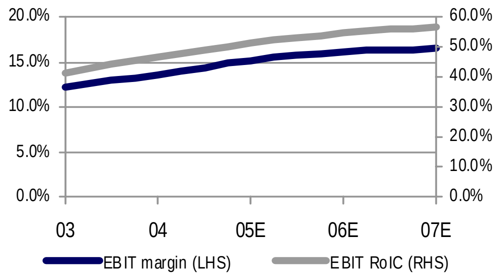
SGS

Per share (CHF)	12/03	12/04	12/05E	12/06E	12/07E
EPS (UBS adjusted, basic)	30.54	38.19	49.45	58.13	65.12
Cash EPS (UBS adjusted, basic)	44.38	55.33	68.11	77.54	86.22
Dividend per share (common, net)	9.00	12.00	50.00	18.00	20.00
NAV per share (BVPS)	132.86	150.53	166.14	161.06	207.34
Profit & loss (CHF m)					
Revenues	2,454	2,885	3,308	3,713	4,061
EBITDA (adjusted)	406	522	642	742	825
Operating income (EBIT, adjusted)	300	391	502	596	666
Pre-tax income (adjusted)	310	397	507	600	672
Net income (UBS adjusted)	234	292	371	436	488
Cash flow (CHF m)					
Operating income (EBIT, adjusted)	300	391	502	596	666
Depreciation & amortisation	106	131	140	146	158
Net change in working capital	(31)	11	(60)	(47)	(16)
Other (operating)	33	10	(3)	0	2
Operational cash flow	408	543	579	695	811
Tax paid	(39)	(72)	(119)	(144)	(161)
Capital expenditure	(146)	(187)	(190)	(187)	(182)
Net interest	10	6	5	4	6
Dividends paid	(56)	(69)	(90)	(391)	(141)
Net (acquisitions) / disposals	(20)	(54)	(23)	(194)	(95)
Other items	(66)	(222)	(170)	84	50
(Increase) decrease in net debt	90	(55)	(8)	(133)	287
Operating free cash flow (OpFCF) (CHF m)					
EBITDA (core)	406	522	642	742	825
Less maintenance capital expenditure	(95)	(107)	(115)	(129)	(139)
Less maintenance net working capital	(98)	(115)	(132)	(149)	(162)
OpFCF	213	300	394	465	523
Balance sheet (CHF m)					
Net tangible fixed assets	415	484	554	611	653
Net intangible fixed assets	147	304	310	316	320
Net working capital	196	139	175	222	238
Operating invested capital (IC)	758	926	1,038	1,148	1,211
Financial & other fixed assets	87	88	120	130	130
Net cash / (debt)	493	438	430	297	584
Provisions	0	0	0	0	0
Minority interests	(18)	(26)	(26)	(26)	(26)
Shareholders' funds	1,039	1,177	1,300	1,260	1,622
Profitability					
EBITDA margin	16.5%	18.1%	19.4%	20.0%	20.3%
EBIT margin	12.2%	13.6%	15.2%	16.1%	16.4%
EBIT RoIC	41.2%	46.4%	51.1%	54.5%	56.5%
Net RoE	24.2%	26.3%	29.9%	34.1%	33.9%
Interest cover (EBIT)	NM	NM	NM	NM	NM
Dividend cover (net)	2.2x	2.1x	0.6x	3.2x	3.3x
Productivity					
Labour % sales	50.5%	49.7%	47.6%	45.9%	45.8%
Depreciation % sales	4.3%	4.5%	4.2%	3.9%	3.9%
Capex % sales	5.9%	6.5%	5.7%	5.0%	4.5%
Invested capital turnover	3.4x	3.4x	3.4x	3.4x	3.4x
Tax rate	21.9%	22.7%	23.5%	24.0%	24.0%
Net debt / total equity	Cash	Cash	Cash	Cash	Cash
Momentum					
Revenue growth	+2.6%	+17.6%	+14.7%	+12.3%	+9.4%
EBIT growth	+39.1%	+30.3%	+28.4%	+18.8%	+11.8%
Net earnings growth	+18.5%	+24.8%	+27.0%	+17.5%	+12.0%
Dividend growth	+24.1%	+33.3%	>+200%	-64.0%	+11.1%
Value*					
Market capitalisation (CHF m)	4,568	5,620	9,105	9,105	9,105
Plus: Core net debt / (cash)	(448)	(466)	(434)	(363)	(440)
Plus: Pension provisions	61	61	61	61	61
Plus: Buy out of minorities	120	225	255	301	337
Less: Non-core assets	(87)	(88)	(120)	(130)	(130)
Enterprise value (EV, avg)	4,214	5,353	8,867	8,973	8,933
EV/Sales (core)	1.72x	1.86x	2.68x	2.42x	2.20x
EV/EBITDA (core)	10.4x	10.3x	13.8x	12.1x	10.8x
EV/EBIT (core)	14.0x	13.7x	17.7x	15.1x	13.4x
EV/OpFCF	19.8x	17.9x	22.5x	19.3x	17.1x
EV/Invested capital	5.8x	6.4x	9.0x	8.2x	7.6x
P/CE	13.2x	13.0x	17.1x	15.0x	13.5x
P/E	19.1x	18.8x	23.5x	20.0x	17.9x
Dividend yield (net)	1.54%	1.67%	4.30%	1.55%	1.72%
P/BV (average)	4.4x	4.8x	7.0x	7.2x	5.6x

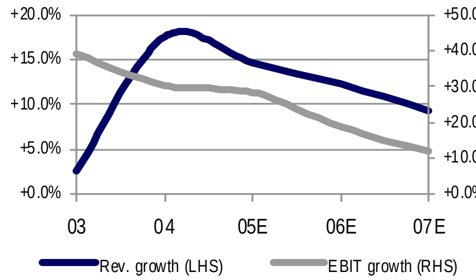
Source: UBS estimates, *Historical valuations are based on an `average for the year' share price. Current & future valuations are based on a share price of CHF1,164.00 on 17/01/2006

SGS is the largest inspection, testing and certification organisation in the world. The core services offered by SGS (split between 10 divisions) can be divided into three categories: (1) inspection services - SGS inspects and verifies the quantity, weight and quality of traded goods; (2) testing services - SGS tests product quality and performance against various health, safety and regulatory standards; and (3) certification services - SGS certifies that systems or services meet the requirements of standards set by governments, standardisation bodies or by SGS customers.

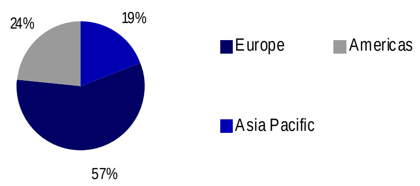
Profitability (EBIT margins & RoIC)



Momentum (Revenue & EBIT growth)



Geographic exposure (Revenues)



Value (EV/OpFCF & P/E)