

INDEPENDENT RESEARCH
UPDATE

27th May 2016

Business Services

Bloomberg	SGS VX
Reuters	SGS.VX
12-month High / Low (CHF)	2,178 / 1,626
Market capitalisation (CHFm)	16,708
Enterprise Value (BG estimates CHFm)	17,219
Avg. 6m daily volume ('000 shares)	23.40
Free Float	64.7%
3y EPS CAGR	7.9%
Gearing (12/15)	24%
Dividend yield (12/16e)	3.18%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (CHFm)	5,712	6,125	6,395	6,715
EBIT (CHFm)	916.90	983.80	1,036	1,099
Basic EPS (CHF)	71.98	85.06	92.63	98.80
Diluted EPS (CHF)	82.01	89.18	96.85	103.03
EV/Sales	3.01x	2.81x	2.69x	2.56x
EV/EBITDA	15.0x	13.3x	12.7x	12.0x
EV/EBIT	18.7x	17.5x	16.6x	15.6x
P/E	26.0x	24.0x	22.1x	20.7x
ROCE	20.9	21.4	21.8	22.4



SGS SA

SGS ! quality certified

Fair Value CHF2400 vs. CHF2150 (price CHF2,136)

BUY

The strong re-rating, especially after the FY results publication in mid-January, confirms the group's cost flexibility in an environment lacking visibility (stock price up c.9% ytd in absolute terms, outperforming the DJ Stoxx in Euro by 17.5%). Although the "old" main growth sectors, i.e. Oil, Gas and chemicals, Minerals and Industrial services are not delivering at the moment, we nevertheless understand after our contact with the company that current trading is much better than for Bureau Veritas in all segments. Taking into account this situation, lfl revenue growth in H1 should be in line with the FY 2016 guidance (between 2.5% and 3.5%) and the top of the range seems now reachable for the full year. We upgrade our lfl revenue growth, maintaining a flat adjusted operating margin vs. last year at 16.1%. Our FV moves to CHF2,400 from CHF2,150.

■ **Current trading largely in line with FY top-line guidance.** Early this year after the FY 2015 results, management expected to deliver FY2016 organic growth of between 2.5% and 3.5% after 2% in 2015. After a call with the company following Bureau Veritas's disappointing Q1 revenue, we understand that the current trading is much better for SGS (no release on Q1) and we have no reason to suspect H1 lfl revenue trend will be different to FY guidance. We decided to move our lfl revenue growth to 3.3% (vs. 2.5% previously) with 2.6% in H1 (released on 18th July) vs. 2.1%.

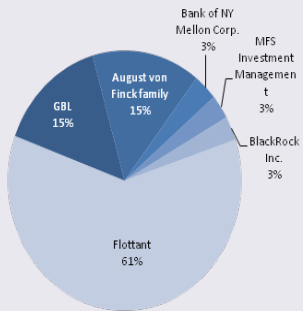
■ **FY flat margin guidance not at risk in this context.** FY2016 will benefit from the full remaining payback of CHF64m of restructuring measures taken in 2015, i.e. CHF40m and to a lesser extent from the new business structure and back-office reorganisation. Early this year, due to this situation and the negative impact from recent acquisitions (notably Accutest laboratories early this year in the USA), management's guidance was for a flat adjusted operation margin for FY2016. Such a guidance is not at risk in SGS's current trading environment.

■ **Our FV moves to CHF2,400 from CHF2,150:** Our FV is derived from the average valuation between a DCF and the 10-year historical EV/EBIT multiple used as the exit multiple FY+3. Multiples remain high at 17.5x EV/EBIT 2016e and 16.6x 2017e compared with an historical median of 14.8x but in our view justify regarding group performances. More, remember that in 2014, SGS' board secured the dividend for the next three years at a minimum of CHF65. Moreover, a share buy-back of CHF750m started in February 2015 up to December 2016, o/w CHF500m to be cancelled (representing almost 3% of the current market cap) and CHF250m for stock option purposes.



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Company description

SGS SA is a Swiss company that, through its subsidiaries, is engaged in the provision of inspection and inspection services, verification, testing, certification and quality assurance services, as well as risk management services, technical consultancy and training services. The Company organizes its activities in 10 business lines: Agricultural; Minerals; Oil, Gas and Chemicals; Life Science; Consumer Testing; Systems and Services Certification; Industrial; Environmental; Automotive and Governments and Institutions. The Company operates worldwide through a network of subsidiaries, branches and agencies. The Company divides its geographical operations into Europe, Africa, Middle East, Americas and Asia Pacific. Europe, Africa, Middle East comprises Western Europe, Central & North West Europe, South East Europe, Eastern Europe & Middle East and Africa. Americas comprises North America and South America. Asia Pacific comprises East Asia, China & Hong Kong, and South East Asia & Pacific.

Simplified Profit & Loss Account (CHFm)

	2013	2014	2015	2016e	2017e	2018e
Revenues	5,830	5,883	5,712	6,125	6,395	6,715
Change (%)	4.5%	0.9%	-2.9%	7.2%	4.4%	5.0%
EBITDA	1,210	1,245	1,144	1,292	1,353	1,434
Adjusted EBIT	977	947	917	984	1,036	1,099
Change (%)	3.8%	-3.1%	-3.2%	7.3%	5.3%	6.1%
Financial results	(38.0)	(41.0)	(43.0)	(39.0)	(35.0)	(35.0)
Pre-Tax profits	874	900	779	910	966	1,029
Exceptionals	23.0	8.1	48.0	7.5	7.5	7.5
Tax	(236)	(234)	(195)	(227)	(241)	(257)
Profits from associates	0.0	0.0	0.0	0.0	0.0	0.0
Minority interests	38.0	37.0	35.0	37.5	39.2	41.1
Net profit	600	629	549	645	685	731
Restated net profit	651	662	625	676	716	762
Change (%)	3.4%	1.7%	-5.6%	8.1%	6.0%	6.4%

Cash Flow Statement (CHFm)

Operating cash flows	977	1,021	902	1,025	1,076	1,141
Change in working capital	(29.0)	(109)	160	(13.2)	(8.6)	(10.2)
Capex, net	(341)	(299)	(286)	(337)	(352)	(369)
Financial investments, net	(84.0)	(101)	(104)	(183)	(89.5)	(94.3)
Dividends	(471)	(523)	(556)	(492)	(586)	(622)
Net debt	335	340	480	510	504	492
Free Cash flow	591	607	673	675	716	762

Balance Sheet (CHFm)

Tangible fixed assets	1,029	1,043	964	958	958	958
Intangibles assets	1,216	1,337	1,306	1,401	1,462	1,535
Cash & equivalents	964	1,341	1,490	1,075	1,069	1,069
current assets	1,597	1,778	1,787	1,916	2,001	2,101
Other assets	233	268	347	372	389	408
Total assets	5,039	5,767	5,894	5,722	5,879	6,071
L & ST Debt	1,308	1,690	2,214	1,847	1,847	1,848
Others liabilities	1,519	1,674	1,699	1,822	1,902	1,997
Shareholders' funds	2,212	2,403	1,981	2,053	2,129	2,226
Total Liabilities	5,039	5,767	5,894	5,722	5,879	6,071
Capital employed	3,316	3,620	3,287	3,449	3,559	3,689

Ratios

Operating margin	16.76	16.10	16.05	16.06	16.20	16.37
Tax rate	27.01	26.00	25.04	25.00	25.00	25.00
Net margin	11.17	11.26	10.95	11.04	11.20	11.35
ROE (after tax)	30.40	28.46	32.81	34.27	35.03	35.65
ROCE (after tax)	21.50	19.36	20.91	21.39	21.83	22.35
Gearing	15.14	14.15	24.23	24.84	23.69	22.10
Pay out ratio	89.08	86.70	82.94	85.00	85.00	85.00
Number of shares, diluted	7,708	7,702	7,630	7,585	7,401	7,401

Data per Share (CHF)

EPS	78.43	81.98	71.98	85.06	92.63	98.80
Restated EPS	85.27	82.69	82.01	89.18	96.85	103
% change	3.2%	-3.0%	-0.8%	8.7%	8.6%	6.4%
EPS bef. GDW	85.27	82.69	82.01	89.18	96.85	103
BVPS	287	312	260	271	288	301
Operating cash flows	127	133	118	135	145	154
FCF	76.63	78.80	88.19	89.03	96.71	103
Net dividend	65.00	68.00	68.00	68.00	72.30	78.73

Source: Company Data; Bryan, Garnier & Co ests.

1.1. Lfl revenue growth that should be largely in line with guidance even in H1

Following After a call with the company following Bureau Veritas's disappointing Q1 revenue, we understand that the current trading is much better for SGS (no release on Q1) and we have no reason to suspect H1 lfl revenue trend will be different to FY guidance. We decided to move our lfl revenue growth to 3.3% (vs. 2.5% previously) with 2.6% in H1 (released on 18th July) vs. 2.1%.

Fig. 1: Lfl revenue growth trend

	2013	2014	H1 2015	H2 2015	2015	H1 2016e	2016e
Agricultural	3,8%	6,6%	3,0%	4,6%	4,0%	6,0%	6,0%
Minerals	-7,8%	-4,3%	-1,9%	-1,7%	-1,8%	-1,0%	0,0%
Oil, Gas & Chemicals	9,4%	8,6%	0,2%	-4,4%	-2,2%	-1,0%	-0,5%
Life Science	0,1%	5,5%	0,4%	12,6%	6,4%	0,0%	0,0%
Consumer Testing	11,2%	6,9%	4,8%	5,0%	4,9%	5,0%	5,0%
Systems & Services Certification	3,9%	5,9%	6,6%	7,7%	7,2%	8,5%	8,5%
Industrial	2,1%	2,4%	-3,3%	-2,7%	-3,0%	-1,0%	-0,5%
Environmental	-0,3%	0,3%	5,2%	5,2%	5,2%	5,0%	5,0%
Automotive	10,4%	3,5%	6,6%	10,3%	8,5%	6,0%	7,0%
Governments & Institutions Services	11,1%	-0,4%	8,4%	15,5%	12,0%	10,0%	10,0%
Total	4,4%	3,9%	1,8%	2,2%	2,0%	2,6%	3,3%

Source: Company Data; Bryan, Garnier & Co ests.

1.2. Main changes

	2016			2017			2018		
	Old	New	Δ%	Old	New	Δ%	Old	New	Δ%
SALES	6 083	6 125	0,7%	6 343	6 395	0,8%	6 671	6 715	0,7%
EBITDA	1 260	1 292	2,5%	1 338	1 353	1,1%	1 441	1 434	-0,5%
	20,7%	21,1%	37 bp	21,1%	21,2%	5 bp	21,6%	21,3%	-25 bp
EBIT	985	984	-0,1%	1 040	1 036	-0,4%	1 109	1 099	-0,9%
	16,2%	16,1%	-13 bp	16,4%	16,2%	-19 bp	16,6%	16,4%	-25 bp
EPS	89,34	89,18	-0,2%	97,59	96,85	-0,8%	104,42	103,03	-1,3%

Source: Company Data; Bryan, Garnier & Co ests.

1.3. Valuation: DCF + Historical multiple FY+3

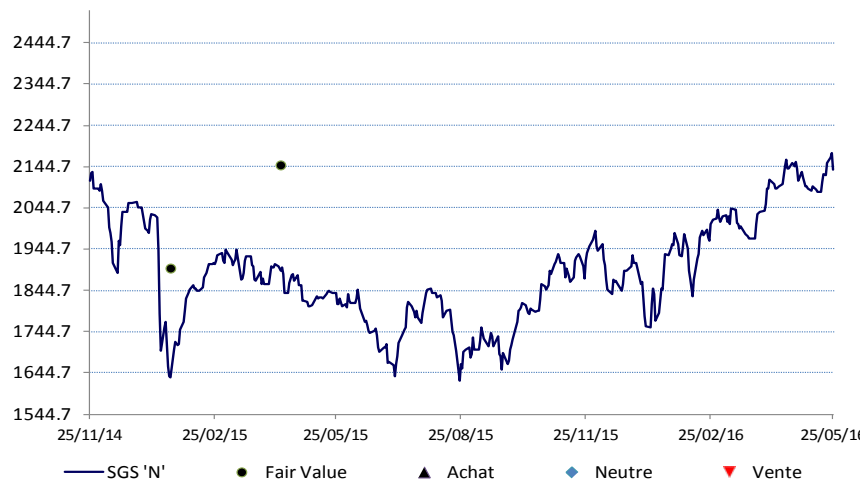
CHFm	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Long-term assumptions
Revenue	6 125	6 395	6 715	7 027	7 329	7 617	7 889	8 142	8 375	8 584	
% chg. In revenue	7,2%	4,4%	5,0%	4,6%	4,3%	3,9%	3,6%	3,2%	2,9%	2,5%	2,5%
EBITA	984	1 036	1 099	1 157	1 213	1 267	1 320	1 370	1 416	1 459	
EBITA margin	16,1%	16,2%	16,4%	16,5%	16,6%	16,6%	16,7%	16,8%	16,9%	17,0%	17,0%
- IS	246	259	275	289	303	317	330	342	354	365	
+ DAP	322	343	352	366	379	391	402	413	422	429	
as a % of revenue	5,3%	5,4%	5,2%	5,2%	5,2%	5,1%	5,1%	5,1%	5,0%	5,0%	5,0%
+ Chg in WCR	-13,2	-8,6	-10,2	-9,1	-7,9	-6,6	-5,1	-3,5	-1,8	0,0	
as a % of revenue	-0,2%	-0,1%	-0,2%	-0,1%	-0,1%	-0,1%	-0,1%	0,0%	0,0%	0,0%	0%
Operating Cash Flow	1 047	1 111	1 166	1 224	1 281	1 335	1 387	1 436	1 482	1 524	
- Capex	520	441	464	466	466	464	459	451	442	429	
as a % of revenue	8,5%	6,9%	6,9%	6,6%	6,4%	6,1%	5,8%	5,5%	5,3%	5,0%	5,0%
Free Cash Flow	527	670	702	758	815	871	928	985	1 040	1 095	
Discount coefficient	0,96	0,91	0,85	0,80	0,75	0,71	0,67	0,63	0,59	0,55	
Discounted FCF	508	607	598	607	613	617	618	616	612	605	

Sum of discounted FCF	5999	1712		
Terminal Value	16058	13844	14,8	Historical Multiple EV/EBIT 2003-2013
- Net Debt	480			
- Minority Interest	75			
+ Financial investments (book value)	347			Valuation using an historical median multiple as the exit multiple FY+3
Equity Value (CHFm)	21849	15349		
Number of shares (m)	7822,0			
Fair Value (CHF)	2793,3	1962,3		
Last Price (CHF)	2136,00	2136,00		
Upside/Downside	30,8%	-8,1%		

Source: Company Data; Bryan, Garnier & Co ests.

Price Chart and Rating History

SGS SA



Ratings

Date	Ratings	Price
27/06/13	BUY	CHF2033

Target Price

Date	Target price
14/04/15	CHF2150
23/01/15	CHF1900
21/01/15	Under review
09/01/14	CHF2350
16/12/13	CHF2300
27/06/13	CHF2400

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SELL ratings 9,2%

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