

GMG Equity Research

SGS
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18/10/2019

Key data

Market capitalization (millions CHF)	18.574
Entreprise value (million CHF)	19.651
Share price (CH)	2468

Stock absolute and relative performance (CHF)

In %	Absolute	Relative *
1 month	-0,2%	0,6%
3 months	2,6%	2,3%
6 months	-7,1%	2,2%
YTD	15,2%	7,5%
1 year	6,4%	7,0%
2018	-10,3%	1,7%
2017	26,7%	6,8%

*relative to SPI

Description

SGS is one of the leaders of the testing, inspection and certification sector (TIC). The firm's slogan, "when you need to be sure", sums up it well. SGS performs checks, tests or review of goods, cargos, designs of products, buildings or mines. These are often aimed at reassuring the customer he is getting what he has ordered and is about to pay for, or that the plans he is submitting for review are flawless.

The group operates worldwide across 9 divisions. The 4 largest are AFL, Min, OGC and CRS.

Agriculture, Food and Life (AFL) consists in part in checking the quality and quantity of food products when they are traded and in part in analysing the quality of finished products before consumption. Soil analysis and agro tech belong to the AFL division.

Minerals (Min) has a downstream side where SGS deals with inspecting the quality of minerals prior to their shipment out of the mine or harbour. In the upstream side, SGS helps mines planning their development and design. A ground survey is an example.

Oil, Gas and Chemical (OGC) provides the same type of services as Min, but in the energy sector.

Consumers and Retail (CRS) consists in checking the quality, safety, and conformity of products. SGS services are more and more required during the product's development phase.

Firm's performance

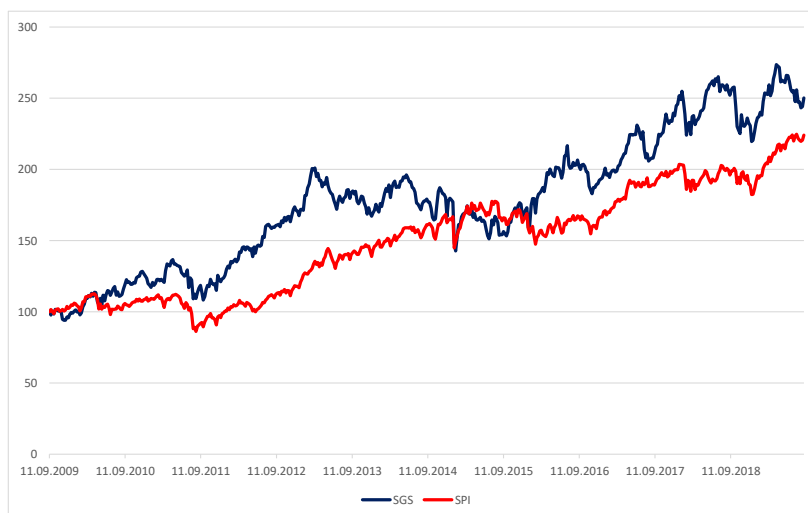
SGS posted impressive returns in the first decade of the millenium, when it was able, under a new and dynamic management, to reap the benefits of globalization.

The firm's performance has remained good, but less spectacular since 2009. On one hand, the theme of globalization has become less supportive. On the other hand, although being well diversified, SGS had grown more dependent on the energy and mining sectors. Both of them suffered a deep downturn from 2012.

Despite this headwind, SGS was able to keep on growing and generating good cash flows. A productivity program and efforts in streamlining the working capital were of help.

In the coming years, we believe SGS can extend recent trends or even improve them.

Share price (10 years)





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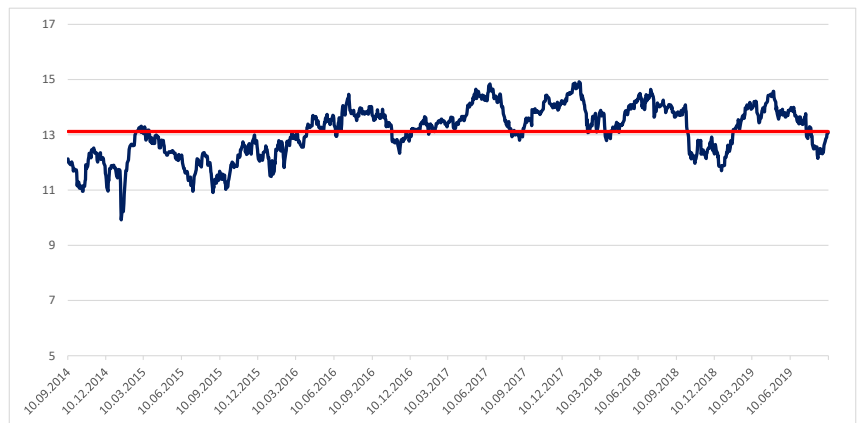
Valuation ratios

	12/16	12/17	12/18	12/19e	12/20e
EV/EBITDA	14,1	16,1	13,2	13,0	12,5
PER	26,0	27,7	23,2	28,2	25,9
Free Cash Flow Yield	4,5%	3,6%	4,6%	3,9%	4,0%
Dividend Yield	3,4%	3,0%	3,5%	3,2%	3,4%
P/BV	8,7	9,7	9,7	10,7	10,7

Bloomberg ESG ranking

Global ESG	45,0
Environment	33,3
Social	54,4
Governance	62,5

EV / EBITDA



Environment, Social & Governance comments

Environment

- Ambitious targets to reduce CO2 emissions by 20% per employee and revenue from 2014 to 2020.
- By 2020 SGS pledges 100% of its electricity consumption will be renewable.

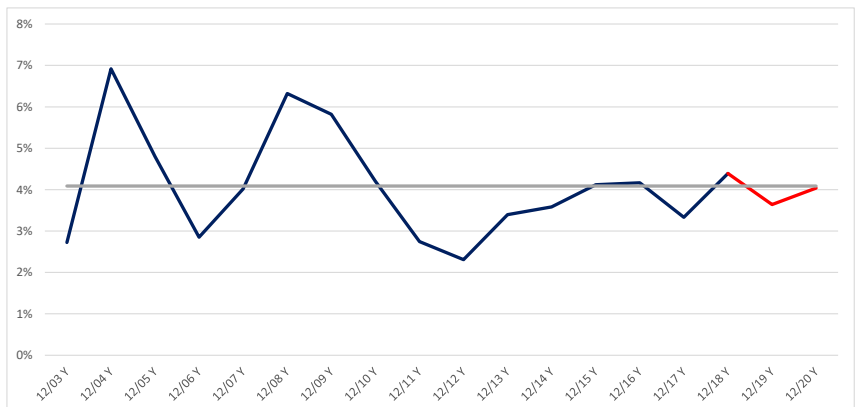
Social

- The firm has published ambitious targets such as reaching a rate of 30% for key positions held by women and reducing the rate of accidents in the workplace.

Governance

- The group has earned itself a reputation of underachieving its usually aggressive mid term targets. We remain cautious on the aim of reaching 17% operating margin in 2020 (previously 18%).
- Key shareholders are the Groupe Bruxelles Lambert (17%) and the Von Finck family (15%). Both are long term investors committed to regular dividend growth.

Free Cash Flow Yield

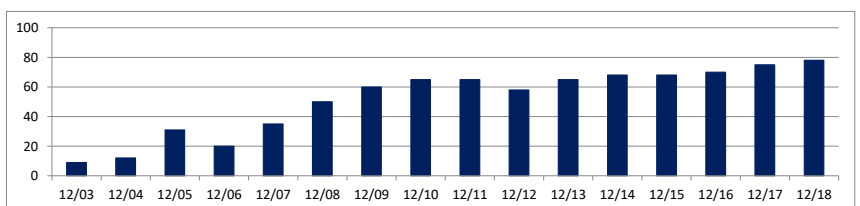


ESG affiliations and codes of conduct

UN Global Compact	✗
UN PRI (responsible investment)*	✗
Anti bribery policy	✓
Employee CSR training	✗
Fair remuneration policy	✗

* Applicable to financial institutions

Dividend per share (CHF)





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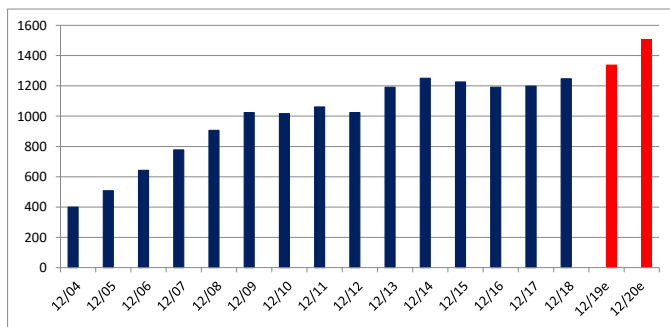
Performance ratios

	12/16	12/17	12/18	12/19e	12/20e
Operating Margin	13,6%	14,1%	14,1%	16,3%	16,2%
ROIC	16,1%	18,2%	17,0%		
ROE	34,2%	36,2%	38,9%		
WC / Sales	18,8%	24,6%	19,8%		
Net Debt / EBITDA	61,4%	56,0%	55,2%		
Net Debt / Equity	39,7%	34,8%	42,3%		
Capex / D&A	94,8%	96,4%	96,2%		

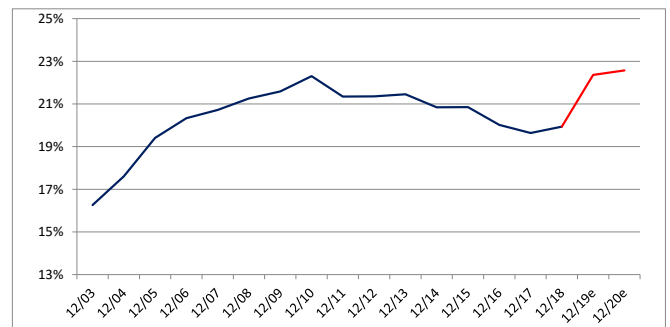
Financial statements (million CHF)

		12/16	12/17	12/18	12/19e	12/20e
Chairman:	Peter Kalantzis					
Tenure (years):	0,7					
CEO:	Frankie Ng					
Tenure (years):	4,7					
CFO:	Dominik De Daniel					
Tenure (years):	0,7					
Sales		5.985	6.349	6.706	6.752	6.916
<i>variation</i>			6,1%	5,6%	0,7%	2,4%
D&A costs		305	309	316		
EBITDA		1.198	1.247	1.337	1.510	1.561
<i>variation</i>			4,1%	7,2%	12,9%	3,4%
Net earnings		606	692	724	673	717
Total current assets		2.611	3.140	3.301		
Total fixed assets		2.738	2.803	2.767		
Shareholders equity		1.853	2.005	1.743		
Working capital		1.123	1.559	1.326		
Net debt		736	698	738		
Operating cash flow		964	944	1.032	987	1.068
Capex		-289	-298	-304	-307	-314
Free cash flow		675	646	728	680	754

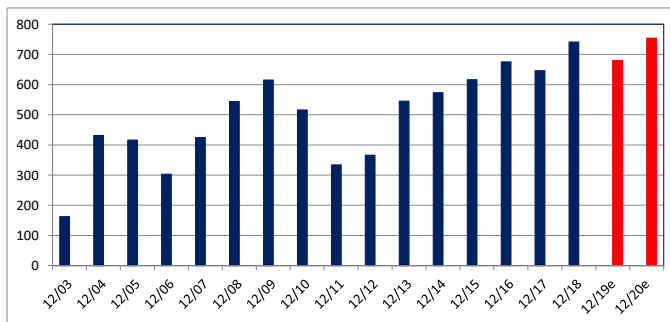
EBITDA



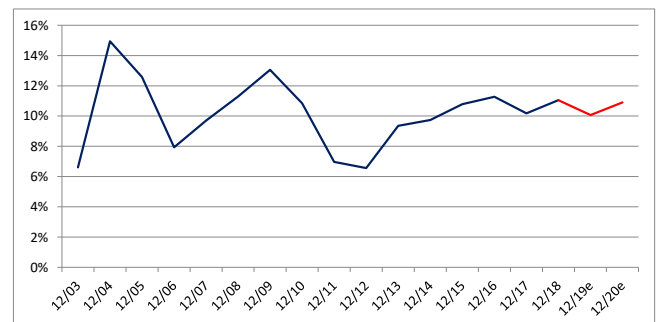
EBITDA margin



Free cash flow



Free cash flow & Free cash flow / sales





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SWOT

Strengths

- Leadership in testing, inspection and certification (TIC) services
- High barriers to entry
- Exposure to diversified and growing markets

Weaknesses

- As the best in class in the sector, SGS is struggling to improve its operational margin (the firm aims at 17% in 2020)

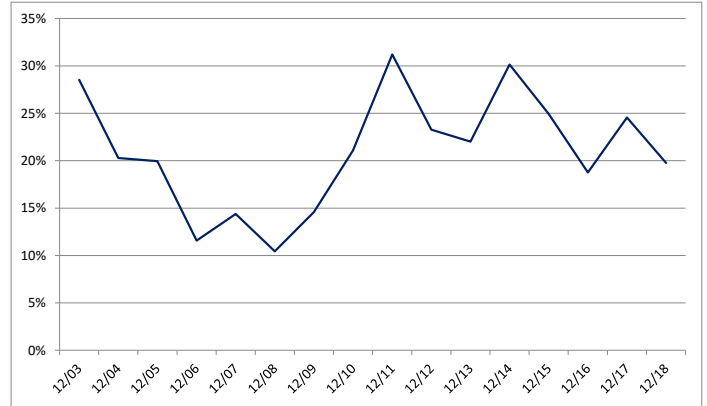
Opportunities

- Environmental, quality, safety and social traceability are themes that should sustain growth in many of SGS markets
- Technology can widen SGS scope of activities

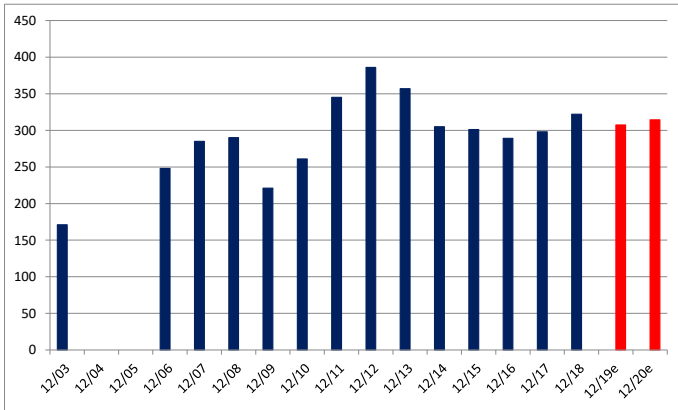
Threats

- Technology may jeopardize the need for intermediaries such as SGS in some of its activities

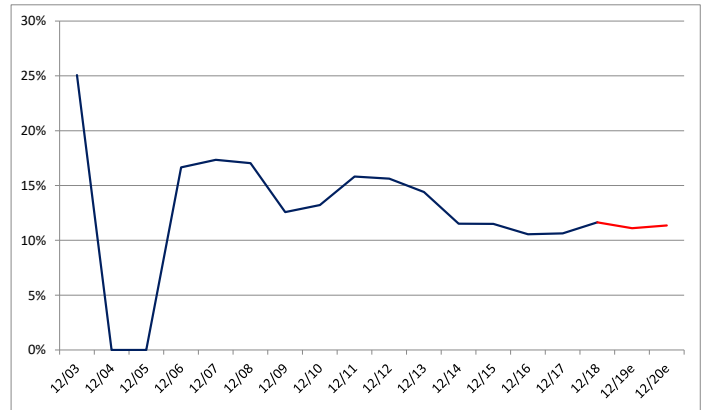
Working capital / sales



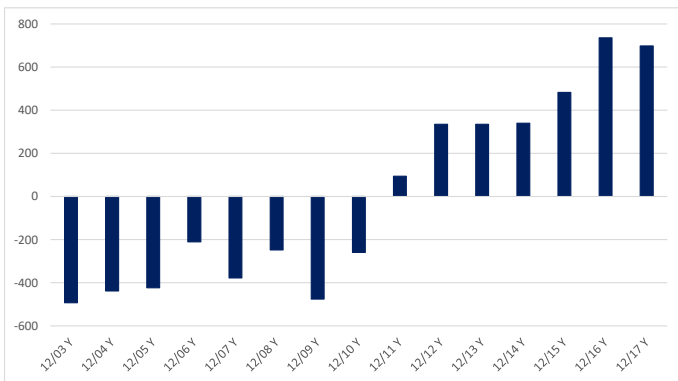
CAPEX



CAPEX / non current assets



NET DEBT



NET DEBT / EBITDA

