

8 March 2007

SQS Software Quality Systems AG

| Year end | Revenue (€m) | PBT* (€m) | EPS** (p) | DPS (p) | PE (x) | Yield (%) |
|----------|--------------|-----------|-----------|---------|--------|-----------|
| 12/05 | 54.7 | 3.7 | 14.7 | 0.0 | 13.3 | N/A |
| 12/06 | 78.9 | 5.3 | 18.7 | 0.0 | 10.5 | N/A |
| 12/07e | 95.0 | 7.9 | 21.3 | 5.4 | 9.2 | 2.8 |
| 12/08e | 104.0 | 10.1 | 21.6 | 6.0 | 9.1 | 3.1 |

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items.

** Historic EPS are adjusted to reflect actual tax and interest rates rather than reported and an exchange rate £1: 0.67 Euros as at Friday 23 Feb 2006.

Investment summary: Softer the better

Against the backdrop of solid growth in the overall market for IT Services, SQS is organically expanding at an impressive rate. As the case for the independent testing of IT projects becomes even more compelling, the company is well placed as the current European market leader. The valuation is undemanding and an adjusted p/e of c.10x is well supported by underlying profits growth, the potential for future dividend payments and intrinsic value in the DCF.

Growth sector

The European IT Services market is estimated to be worth c.€150bn p.a. and is growing at around 5% according to IDC research. The market for SQS's core activity of the independent testing and quality management of software is a small chunk of this, but organic growth is nonetheless far in excess of the total market.

Market leader

The market for software testing is both highly fragmented and dominated by inhouse providers. In the out-sourced independent sector, SQS dwarfs its nearest competitor and there is a good case to be made for continued strong growth in this market. SQS's record as shown by its blue chip client base, leaves it well placed to take advantage. The business has essentially doubled since the IPO in 2005 and the outlook for future growth is very positive.

Annual results 2006

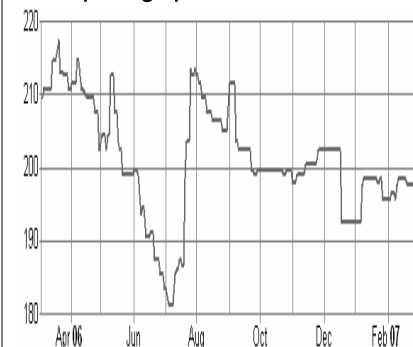
Organic top line growth of 18% in 2006 confirms the potential described above and underlying EPS increased by 27% to €28 cents. The commencement of dividends may be delayed by technicalities on the structuring of net assets but, if so, SQS will look at alternative means of redistributing cash to shareholders.

Valuation: Look beyond '08

The outlook for EPS growth is somewhat misleading since a rise in the 2008 tax charge limits progress in the next two years. However, CAGR of 7% in EPS out to 2009, makes an IFRS adjusted p/e of less than 10x look undemanding, while our DCF analysis suggests a base case valuation of 251p and scope for meaningful upside.

Price 195.5p
Market Cap £34m

Share price graph



Share details

Code SQS
Listing AIM
Sector Software & IT Services
Shares in issue 17.2m

Price

52 week High 215.5p Low 181.0p

Balance Sheet as 31 Dec 2006

Debt/Equity (%) 12.2
NAV per share (€c) 154.1
Net borrowings (€m) 3.2

Business

SQS is Europe's largest provider of independent software testing and quality management. The majority of the group's revenues are derived from consultancy services to a client base including a long list of blue-chip customers.

Valuation

| | 2006 | 2007e | 2008e |
|--------------|------|-------|-------|
| P/E relative | 74% | 53% | 59% |
| P/CF | 12.7 | 3.9 | 3.9 |
| EV/Sales | 0.4 | 0.4 | 0.4 |
| ROE | 14% | 15% | 15% |

Geography based on revenues

| UK | Europe | US | Other |
|-----|--------|----|-------|
| 30% | 70% | 0% | 0% |

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Investment summary: Softer the better

Company description

SQS is Europe's largest provider of independent software testing and quality management. The majority of the group's revenues are derived from consultancy services to a client base including a long list of blue-chip customers. SQS also generates revenues from its training and conference business and the development of specialised software tools. The company was founded 25 years ago in Germany by the current CEO and COO, and Germany remains the largest market. The UK has become increasingly important and Switzerland is also a key territory. There are operations in a number of other European markets as well as South Africa.

Valuation

The restated current PE of c.10x is not particularly demanding in its own right although at first glance, EPS growth appears to stagnate between 2007 and 2008. However, this masks strong underlying growth in PBT in the same period of 20%+ which does not translate into EPS growth due to a hike in the 2008 tax charge. Looking out to 2009 reveals a more interesting three-year CAGR in EPS of 7% which provides stronger justification for the current multiple. In addition our DCF analysis based on conservative assumptions and a discount rate of 15%, suggests an intrinsic value of 251p which adds further justification to the case for a re-rating. The potential for future dividend payments lends more support, although given legal technicalities this may be a year later than anticipated. If so, the company may look at alternative means of redistributing cash to shareholders in the current year.

Sensitivities

SQS has had a short life as a public company although many of the company's blue-chip clients have been customers for a long period of time. When assessing the potential factors which can impact the investment case, the following sensitivities should be considered:

- **Cyclicality:** Despite its advantages — and potentially positive impact on ROIs, external testing does represent an initial 'cost' and could therefore be vulnerable in a general economic downturn.
- **Acquisition risks:** The management's strategy is to continue to make in-fill acquisitions in a fragmented market although this does mean a heightened risk profile particularly if the company was to access the so far uncharted waters of the US and France.
- **IT services market growth:** Growth in the testing market is linked to overall growth in the IT market and any secular decline here would have a knock-on effect.
- **Off-shoring:** Growth in this trend could present a threat, although the company's own South African operations enable SQS to offer an in-house alternative.

Financials

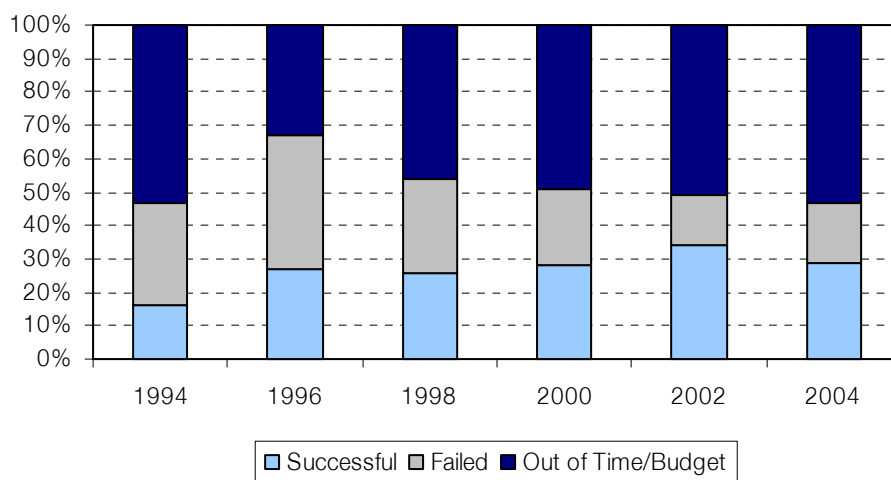
In essence, SQS is a strongly cash generative business with a robust balance sheet and low capital requirements. Once adjustment have been made to the IFRS treatment of tax and interest, the underlying earnings picture is one of healthy growth against the backdrop of a market with excellent prospects.

Independent testing: Outpacing a growth market

The market for software testing and quality management

The fundamental driver behind the demand for independent software testing and quality management is the dismal failure rate of IT projects. The Standish Group - a US based organisation dedicated to assessing risk, cost, return and value in IT — surveyed a wide variety of projects between 1994 and 2004. Its conclusion was that less than one third of such undertakings are successful — i.e. 71% of global IT projects either fail or fall behind time and budget.

Exhibit 1: IT projects: success vs. failure



Source: SQS

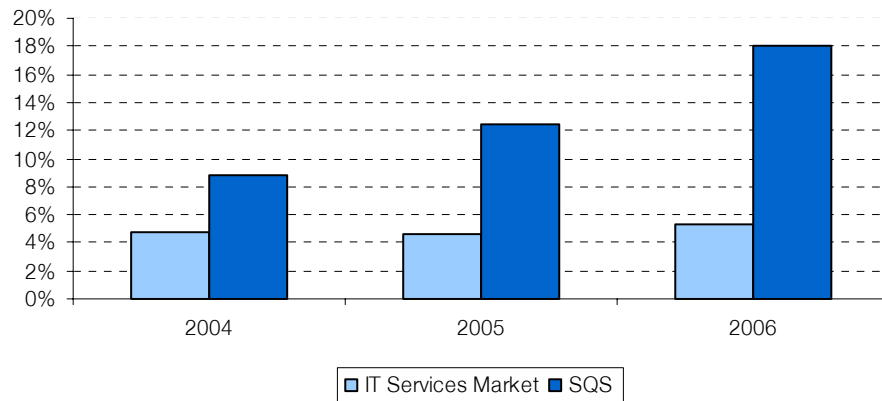
As further evidence, Coleman Parks Research published in December last year — and commissioned by SQS — surveyed IT directors and decision makers in the UK, Ireland and South Africa. The conclusions were that around 70% of these professionals believed that software testing should be carried out independently of engineering and software product development.

However, despite the commercial logic, independent testing is still a small fraction of the overall market with approximately 85% of testing carried out in-house. The potential for growth in the SQS offering is therefore significant and the fact that organic growth at the company has historically outstripped the expansion in the total IT market, is evidence that in-roads are being made.

Growth market

The evidence from Exhibit 2 very much supports the hypothesis that the rate of expansion in the market for independent testing is much faster than the growth in the demand for IT Services in general. Although there may be some market share gains within the SQS top line, the fragmented nature of this nascent industry still suggests that the big picture is a very positive one.

By way of a benchmark, International Data Corporation (IDC) estimate that growth in the total IT Services market in Europe in 2006 will be around 5% with the UK at 5.2% and Germany at 4.0%. In terms of an industry outlook, IDC and EITO both predict that the European IT services industry will grow at a rate of approximately 5% in 2007 and 2008.

Exhibit 2: Market/SQS revenue growth rate comparison 2004-2006

Source: EITO 2005, IDC 2006

Why is *independent* testing a compelling growth story?

Given the failure rates of projects described above, there is a strong case to be made that a 'second opinion' should be sought when corporates undertake major IT initiatives. This is particularly the case when the increasing complexity of software and IT systems is considered along with ever increasing automation of processes and interfaces.

In addition, compliance protocols and greater regulatory requirements — especially in the finance sector — underpin the need for impartial and independent input. A major driver in this respect has been the 2002 Sarbanes Oxley Act in the US which came about largely as a consequence of the collapse of Enron.

The principal requirements of Sarbanes Oxley are that companies must comply with strict procedures in documenting financial information including sales, assets and liabilities. The Act is intended to both combat corporate fraud and to protect investors, and, as a consequence, software systems to monitor all of the above must be of the highest and most rigorous standard. In turn, this places increased emphasis not only on the success of all related IT projects, but also on external and independent assessments of their effectiveness.

Another inevitable yardstick for the judgement of IT project is their 'economic value added' or rate of return. ROI pressure is inevitably present on any major investments whether IT related or not and measuring the specific impact can be problematic. Nonetheless, given both the failure rates and the implications of cost and time overruns, any increase in the likelihood of success through independent testing could have a positive impact on the ROI.

A recent example of how the case for independent testing is becoming more widely adopted, is a contract awarded to SQS by a major German insurance company. In this instance the customer did not issue a single contract for the implementation of a new IT system and testing, but instead awarded separate contracts for the software applications to one of the big Systems Integrators and for independent assessment to SQS.

Nature of the competition

As mentioned earlier, the external market for software testing is still relatively small and fragmented. SQS was at least twice the size in terms of revenue compared to its nearest independent competitor

in 2005, the Israeli based TESCOM. There are a number of non-independent players such as Logica CMG and Capita and the rest of the industry is largely made up of small Independent providers as well as individual contractors.

Business analysis: Consultancy revenues dominate

Outline of group activities

SQS is Europe's largest provider of independent software testing and quality management. The vast majority of the group's revenues are derived from consultancy services to a client base including a long list of blue-chip customers. SQS also generates revenues from its training and conference business and the development of specialised software tools.

Management

The company was co-founded 25 years ago in Germany by the current CEO and COO, Rudolf van Megen and Heinz Bons. Both studied at the University of Cologne with a focus on Informatics and then went on to complete R&D projects in relation to software testing and cost elimination. The CFO, Rene Gawron, joined SQS in 2001 having previously worked at Siemens.

Not only has there been continuity of leadership within SQS, but the company has also incorporated key personnel from bolt-on acquisitions — a strategy that commenced in 1997. Most recently this is apparent from the acquisition of Cresta in the UK where a number of the directors have been retained in senior operational roles in the UK.

Three key revenue drivers

IT Professional Services. 2006 turnover €73.6m (+45%)

SQS offers consultancy services in a variety of spheres including code quality management, assessments of software development and IT organisations. In addition, there is project and risk management in standard software packages and outsourcing. SQS also employs third-party contractors when a particular niche skill is required.

These revenues form the vast majority of group sales and within this segment approximately 85% of business is generated in the enterprise sector (i.e. where the client is effectively the IT director of a corporate customer). The remaining turnover is derived direct from industry and the testing of embedded systems typically in the automotive and defence sectors.

Tools, licences and maintenance. 2006 turnover €2.5m (+20%)

These are effectively software testing tools including version 8 of the SQS Test Professional Product. They can be sold independently without the associated consultancy input typical of an SQS contract although they are still a relatively small part of the group. Longer term, a growth in licence fee and maintenance income could represent an area of considerable potential as both a margin driver and a means of ensuring closer relationships with customers.

IT conferences, training and events. 2006 turnover €2.75m (+45%)

The principal event organised by SQS is its conference in Germany, although there is also a growing annual conference in the UK and one which has just recently commenced in Switzerland.

Nature of contracts

Contracts are typically awarded on a quarterly or project basis since they are generally linked to specific undertakings. 70-80% of sales relate to new projects while the remainder are maintenance revenues. Although relatively short contract periods could introduce some unpredictability to revenue flows, almost 400 customers means that, in aggregate, these tend to be smoothed out.

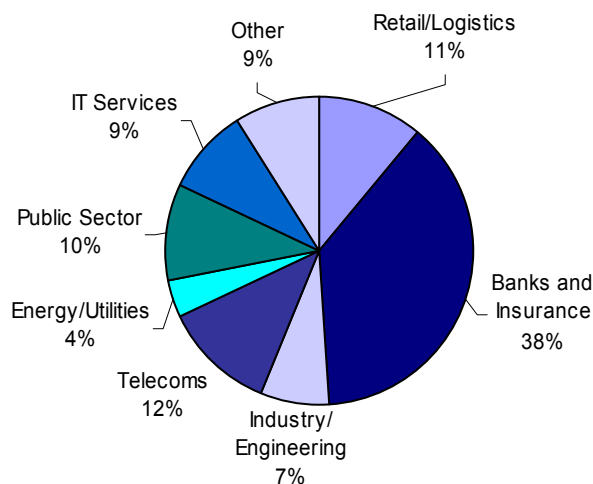
The fact that 75% of revenues also represent repeat business – i.e. emanating from existing or previous customers - re-enforces the credibility of the company in its market place. Of the 20 largest customers in 2006, three quarters were also customers five years ago. Customers are billed at a daily rate. The number and utilisation rates of consultants drives the top line across the group.

Customer base

As mentioned above, SQS had a total of approximately 400 clients at the end of 2006. The blue chip nature of the customer base is unquestionable and includes 50% of DAX 30 and 30% of Eurostoxx 50 companies, as well as 5 of the top 10 largest companies in the FTSE-100.

Following the Cresta acquisition, the concentration of revenues on the largest clients has also fallen with SQS's biggest customer now comprising less than 5% of group turnover. In aggregate, the top 10 clients now account for less than one third of turnover. SQS operates in principally eight industry sub-sectors with by far the largest being Financial Services where transaction based software is a key component:

Exhibit 4: Split of turnover by market segment 2006

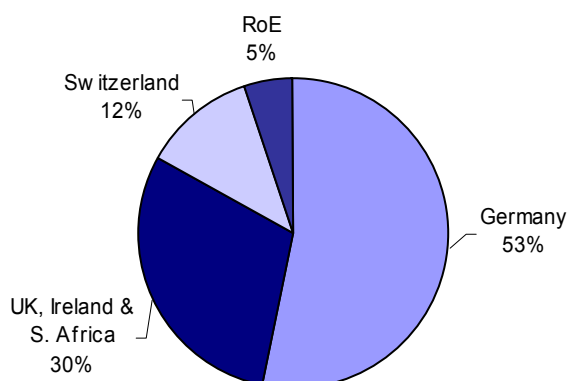


Source: SQS annual results

Within the logistics sector, software testing principally concentrates on the tracking systems employed by major carriers such as DHL and UPS, while in the telecoms and utilities sectors, tariff and billing systems are the focus. Manufacturing mainly involves the automotive and aviation industry and predominantly concentrates on embedded systems.

Geographic split and review

Exhibit 5: Regional revenue split 2006



Source: SQS annual results

Recent geographic diversification and expansion – particularly in the UK – has seen a reduction in SQS's reliance on its original German marketplace. The split of revenues above for 2006 reveals that the group now has a firm base in two equally strong markets in Germany and the UK and an increasing presence in other territories.

Germany. 2006 turnover €41.9m (+22%). During 2006, pricing power increased in the German market but it was later than had been anticipated and consequently gross margins were impacted. Nonetheless, profitability subsequently recovered in the latter part of the year and contracts have recently been renewed with all the major customers. Top line growth of 16% in embedded systems lagged the overall gain in the region and reflected a general contraction of Airbus business offset by strong growth in the automotive sector.

UK, Ireland & South Africa. 2006 turnover €23.7m (+159%). Although the largest European market for IT, the UK is also very fragmented and the acquisition of Cresta has significantly increased the scale of SQS's operations. At an underlying level, after a fairly flat H1 (which reflected the fact that a significant number of consultants were involved with Swiss-based projects), growth recovered strongly in the second half of 2006.

The South African operations warrant separate comment and can be expected to expand strongly as the trend towards off-shoring continues. Although in many cases European customers have software systems with a maturity level beyond the scope of most offshore companies, these mainly Far East based operators can handle some elements of a typical project. Consequently, its South African business gives SQS an in-house alternative to these competitors and means the company can offer a lower cost suite of services.

Switzerland. Turnover €9.8m (+34%). The Swiss market witnessed further progress in 2006 aided by the contribution from the UK, and successes with new Banking & Insurance clients. All of the top line growth was organic and represented the highest rate of underlying increase across the Group.

Strategy

Core strategy

Developing the pipeline of long-term outsourcing contracts is the key to future growth. This can be achieved through adding more consultants and services to develop the existing client base and in addition attracting new customers. As the recent Allianz contract win demonstrated, there are also opportunities to strengthen relationships with systems integrators such as IBM to involve independent testing as a matter of course in large scale IT projects. Within the testing industry new areas of growth are also opening up as demonstrated by increasing revenues in software testing of embedded systems and this sector will be an important growth driver in the future.

Acquisitions

Given the fragmented nature of the European IT testing industry and in order to accelerate the core strategy, SQS does intend to make further acquisitions which will scale up operations in both existing and new European markets. This has worked well so far in the UK and the pattern is likely to be repeated elsewhere. Scandinavia could provide opportunities in this respect as could the sizeable French market, although strict labour laws and a largely indifferent record of other IT operators introduces a greater degree of risk in the latter. The US is obviously a huge market for IT but as mentioned earlier, the testing industry is even less focused on sizeable independent companies than Europe and consequently expansion here is probably unlikely in the near term.

Cresta

SQS first entered the UK market with the acquisition of SIM in 2001 and the UK business has grown strongly subsequently. To accelerate this growth, SQS acquired Cresta in July 2006 - one of the largest independent testing companies in the market. Cresta also has operations in Ireland and South Africa and revenues in 2005 were €19.0m and PBT was €1.06m. Total consideration was a maximum of €26.4m, including €17.6m by way of earn out over the next two years. Conservatively, our assumptions include the total potential acquisition cost but not the full profit required to trigger it of a cumulative PBT £4.1m between July 1st 2006 and 30th June 2008. Cresta gives SQS market leadership in the UK and a broader client base and crucially, a number of the senior management team have been retained. The acquisition was earnings enhancing in H2 2006 and the UK recorded the highest operating margins across the Group for the full year. A record 35 clients wins from the combined UK division since the acquisition and switch to the SQS brand, confirms the business has bedded down well.

Annual results 2006

Exhibit 6: Summary of annual results for the 12 months to 31 December 2006

| €m | 2005 | 2006 | % |
|---------------------------------|-------------------|-------------------|----|
| | 12 mths to 30 Dec | 12 mths to 30 Dec | |
| Turnover | 54.7 | 78.9 | 44 |
| Operating profit (norm) | 4.5 | 5.7 | 28 |
| Profit/(loss) before tax (norm) | 3.7 | 5.3 | 44 |
| EPS (c) | 22.0 | 28.0 | 27 |
| Net debt | 0.3 | 3.2 | |

Source: SQS

Results

Sales of €78.9m were obviously boosted by the inclusion of Cresta, but total growth was even stronger than expected at 44% (18% organic, 26% acquisitive). Growth in Germany accelerated in the second half of the year as pricing power increased and a number of major contracts were renewed. Swiss revenues grew strongly by 34% and after a flattish first half in the UK, H2 witnessed significant growth in new business. Overall, SQS added a record 100 new customers in 2006 split evenly between organic additions and acquisitions.

Operating margins slipped a percentage point to 7.3% mainly reflecting the delayed H2 recovery in pricing in Germany and its impact on gross margins. At an underlying level, after adjusting for actual tax and interest paid, EPS grew 27% to €0.28. SQS had hoped to commence dividend payments but this may now require a restructuring of net assets not originally envisaged. Although something of a negative in the short term, it is a technical issue which will be resolved in the current year and in the meantime the company will examine alternative means of redistributing cash to shareholders.

Financials

Underlying top-line growth

Sales growth is essentially a function of the number of consultants and their annual utilisation and average daily rates. For example, in FY06 there was an average of 453 consultants, billing for 185 days at an average rate of €768. The utilisation rate is difficult to improve upon given training requirements and the amount of physical time available, so our underlying sales estimates reflect a rising number of consultants and modest growth in daily rates.

Robust balance sheet

The nature of the SQS business is low capital intensity and high cash generation, Underlying maintenance capex is only about €0.5m although a further c.€2m is capitalised on R&D and training courses. Given that actual tax and interest costs are overstated to reflect IFRS accounting in the P&L, there is strong underlying cash flow and with share issues accounting for much of the potential earn-out of Cresta, we would expect the group to be net cash positive by 2008. As the business continues to grow we would also expect continuing but modest working capital outflows over the next three years. (It is worth noting that both short and long term creditors include the earn-outs for Cresta which are assumed to be paid in shares. In 2006 short term liabilities were €7.3m in this respect and long term liabilities €3.6m).

Tax and interest

IFRS accounting dictates that the P&L must reflect a tax rate that would be due if the company had to pay the full tax rate in each of its territories while interest costs also have to reflect the potential impact of future earn outs. In addition, the 2006 tax charge was adjusted for a corporate income tax asset of €1.4m. Consequently, this resulted in a rise of €276k in the reported interest charge in 2006, while reported taxes were €388k lower than the actual tax charge paid. The net effect of these two factors is a small reduction in net earnings from €4.7m to an adjusted figure of €4.6m. The tax impact is clearly the greatest distortion but this should diminish in the future as German tax breaks reduce and the tax rate falls – possibly to 30% in 2008. Going forward, we have reflected the actual tax and interest payable in our forecasts to produce a more normalised picture.

Sensitivities

SQS has had a short life as a public company although many of the company's blue-chip clients have been customers for a long period of time. The following sensitivities should be considered:

Whilst there may be a case to argue that in-house risk assessments are less likely than the independent company to succeed in improving performance, companies may still be reluctant to incur costs with a third party provider. This could be a feature which is exaggerated in any cyclical downturn and potentially makes SQS particularly sensitive to the overall macro economic environment in Europe and to any secular changes in the IT market.

As discussed in the section on 'Strategy', SQS is also keen to pursue a strategy of in-fill acquisitions and there are inherent risks if the emphasis on non-organic growth increases. The risk profile of the group may also be heightened should acquisitions take SQS into new geographic territories – particularly in difficult markets such as France and the US. However, the latter is not currently on the agenda and is perhaps even less developed than Europe with individual consultants playing an even bigger role than in Europe. Off-shoring: Growth in this trend could present a threat, although the company's own South African operations enable SQS to offer an in-house alternative.

Valuation and conclusion

Adjusting PAT for the actual interest and tax rates means eps of €28 cents or 18.7p and generates a multiple of a little over 10x. The forecast multiple falls to c.8x by the end of 2009 which, given CAGR of 7% in eps over the same period, represents a reasonably attractive valuation in its own right. An additional plus to the valuation case will be the commencement of dividend payments which would open up the investment opportunity to a wider audience and also offer the prospect of some yield support.

On the negative side, 2008 represents a small blip in earnings progression but this should not be of a fundamental concern given it is a function of a rise in the actual tax charge as German tax breaks expire and also the final instalment on Cresta. Technical issues however may act as something of a drag on the share price given the negative connotations of a limited albeit rising free float (c.60% in 2008) and the associated stock overhang of the founders and ex-Cresta shareholders. Finally, our DCF valuation below does add to the case for a modest re-rating, since even if the growth rate in perpetuity falls to 5% and therefore more in-line with the overall growth in the IT Services market, there is potentially upside of 20%+ from current levels even given a discount rate of 15%.

Exhibit 7: DCF Valuation based on WACC of 15%

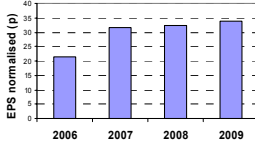
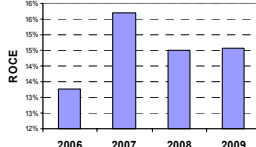
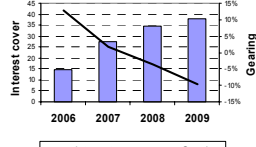
| | |
|---------------------------------------|-------------|
| Discount Rate | 15% |
| NPV Forecast Period €m | 33.0 |
| Growth rate in perpetuity | 5% |
| NPV Terminal Value €m | 31.9 |
| Net debt 2006 €m | 3.2 |
| Equity Value per share (pence) | 251p |

Source: Edison Investment Research

Exhibit 8: Financials

| | €'000s | 2005 | 2006 | 2007e | 2008e | 2009e |
|---|--------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Year-end 31st December | | | | | | |
| PROFIT & LOSS | | | | | | |
| Revenue | | 54,737 | 78,933 | 95,000 | 104,000 | 114,500 |
| Cost of Sales | | (35,563) | (51,997) | (61,750) | (67,600) | (74,425) |
| Gross Profit | | 19,174 | 26,936 | 33,250 | 36,400 | 40,075 |
| EBITDA | | 6,847 | 8,506 | 10,991 | 13,160 | 14,231 |
| Operating Profit (before GW and except.) | | 4,486 | 5,734 | 8,191 | 10,360 | 11,431 |
| Goodwill Amortisation | | 0 | 0 | 0 | 0 | 0 |
| Exceptionals | | 0 | (276) | 0 | 0 | 0 |
| Other | | 0 | 0 | 0 | 0 | 0 |
| Operating Profit | | 4,486 | 5,458 | 8,191 | 10,360 | 11,431 |
| Net Interest | | (773) | (390) | (300) | (300) | (300) |
| Profit Before Tax (norm) | | 3,713 | 5,344 | 7,891 | 10,060 | 11,131 |
| Profit Before Tax (IFRS) | | 3,713 | 5,068 | 7,891 | 10,060 | 11,131 |
| Tax | | (1,319) | (383) | (1,973) | (3,219) | (3,562) |
| Profit After Tax (norm) | | 3,475 | 4,573 | 5,918 | 6,841 | 7,569 |
| Profit After Tax (IFRS) | | 2,394 | 4,685 | 5,918 | 6,841 | 7,569 |
| Average Number of Shares Outstanding (m) | | 11.7 | 16.5 | 18.6 | 21.2 | 22.5 |
| EPS - normalised (c) | | 20.5 | 27.8 | 31.8 | 32.2 | 33.7 |
| EPS - IFRS (c) | | 20.5 | 28.4 | 31.8 | 32.2 | 33.7 |
| Gross Margin (%) | | 35.0% | 34.1% | 35.0% | 35.0% | 35.0% |
| EBITDA Margin (%) | | 12.5% | 10.8% | 11.6% | 12.7% | 12.4% |
| Operating Margin (before GW and except.) (%) | | 8.2% | 7.3% | 8.6% | 10.0% | 10.0% |
| BALANCE SHEET | | | | | | |
| Fixed Assets | | 16,747 | 36,033 | 36,000 | 41,400 | 41,400 |
| Intangible Assets | | 13,984 | 31,669 | 33,000 | 38,400 | 38,400 |
| Tangible Assets | | 2,763 | 4,364 | 3,000 | 3,000 | 3,000 |
| Investment in associates | | 0 | 0 | 0 | 0 | 0 |
| Current Assets | | 18,857 | 26,432 | 25,375 | 25,623 | 29,494 |
| Stocks | | 135 | 314 | 600 | 700 | 800 |
| Debtors | | 11,951 | 23,289 | 22,000 | 22,000 | 22,000 |
| Cash | | 6,465 | 2,565 | 2,375 | 2,473 | 6,194 |
| Current Liabilities | | (13,123) | (27,530) | (19,500) | (17,000) | (15,000) |
| Creditors & other liabilities | | (9,347) | (22,200) | (18,500) | (16,000) | (14,000) |
| Short term borrowings | | (3,776) | (5,330) | (1,000) | (1,000) | (1,000) |
| Long Term Liabilities | | (4,286) | (8,436) | (2,000) | 0 | 0 |
| Long term borrowings | | (2,971) | (465) | (2,000) | 0 | 0 |
| Other long term liabilities | | (1,315) | (7,971) | 0 | 0 | 0 |
| Net Assets | | 18,195 | 26,499 | 39,875 | 50,023 | 55,894 |
| CASH FLOW | | | | | | |
| Operating Cash Flow | | 4,106 | 2,909 | 8,294 | 10,560 | 12,131 |
| Net Interest | | (833) | (492) | (300) | (300) | (300) |
| Tax | | (509) | (841) | (771) | (1,973) | (3,219) |
| Capex | | (2,961) | (3,199) | (3,000) | (3,000) | (3,000) |
| Acquisitions/disposals | | 95 | (4,080) | (9,000) | (9,000) | 0 |
| Financing | | 14,120 | 2,755 | 7,382 | 7,300 | 0 |
| Dividends | | 0 | 0 | 0 | (1,490) | (1,891) |
| Net Cash Flow | | 14,018 | (2,948) | 2,605 | 2,098 | 3,721 |
| Opening net debt/(cash) | | 14,300 | 282 | 3,230 | 625 | (1,473) |
| HP finance leases initiated | | 0 | 0 | 0 | 0 | 0 |
| Other | | 0 | 0 | 0 | 0 | 0 |
| Closing net debt/(cash) | | 282 | 3,230 | 625 | (1,473) | (5,194) |

Source: Company accounts/Edison Investment Research

| Growth | Profitability | Balance sheet strength | Sensitivities evaluation | |
|---|---|--|--------------------------|---|
|  |  |  | Litigation/regulatory | ■ |
| | | | Pensions | ○ |
| | | | Currency | ■ |
| | | | Stock overhang | ○ |
| | | | Interest rates | ■ |
| | | | Oil/commodity prices | ○ |

| Growth metrics | % | Profitability metrics | % | Balance sheet metrics | Company details |
|---|------|-----------------------|------|-----------------------|-----------------|
| EPS CAGR 05-09e | 10.4 | ROCE 08e | 14.5 | Gearing 08e | N/A |
| EPS CAGR 07-09e | 2.0 | Avg ROCE 05-09e | 15.7 | Interest cover 08e | 34.5 |
| EBITDA CAGR 05-09e | 15.8 | ROE 08e | 14.0 | CA/CL 08e | 1.4 |
| EBITDA CAGR 07-09e | 9.0 | Gross margin 08e | 18.7 | Stock turn 08e | 2.5 |
| Sales CAGR 07-09e | 15.9 | Operating margin 08e | 10.0 | Debtor days 08e | 70.2 |
| Sales CAGR 07-09e | 6.4 | Gr mgn / Op mgn 08e | 1.9 | Creditor days 08e | 42.1 |
| Address: Stollwerckstr. 11, D – 51149 Cologne | | | | | |
| Phone: +49 22 03 91 5400 | | | | | |
| Fax: +49 22 0391 5415 | | | | | |
| www.sqs-uk.com | | | | | |

| Principal shareholders | % | Management team |
|-------------------------------------|--------------|--|
| Bons, van Megen (SQS founders) | 53.1 | CEO: Rudolf van Megen |
| Morley Fund Managers | 11.9 | Graduated from the University of Cologne with a degree in Business Administration focussing on informatics and then completed a number of R&D projects in software testing and efficiency. Joint founder of the SQS in 1982. |
| Artemis | 4.9 | |
| Former Cresta founders | 4.2 | |
| Herald Investment Management | 4.1 | |
| Clearstream International | 4.0 | |
| | | COO: Heinz Bons |
| | | Heinz Bons was the other joint founder of the company. He too studied at the University of Cologne with a focus on informatics and then also completed a number of R&D projects in software testing and efficiency. |
| Forthcoming announcements/catalysts | Date * | |
| AGM | 30 May 2007* | |
| Interim results | 6 Sep 2007* | CFO: Rene Gawron |
| | | Rene Gawron joined SQS in 2001 having previously worked for Siemens. While at Siemens he had various roles including head of business development for mobile telecom networks. |
| <i>Note: * = estimated</i> | | |

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