28 October 2009 | 14 pages

SAP AG (SAPG.DE)

Equity ☑
Estimate change ☑

A peculiar year, peculiar guidance?

- **Implied Q4** — The main surprise came from the guidance decrease implying -5.5/-12% Q4 SSRS decline. The low end of this guidance implies a sharp deterioration from Q3 (-4.7%) and spooked the market. During the call CEO Apotheker did describe the guidance as "very, very conservative" but the damage was done and SAP is likely to be range bound around €30-32
- **"A peculiar year"** — Management indicated that the pipeline and volumes continued to improve but that this is a "peculiar year" in which the closure rates are very sensitive to small changes in sentiment. This combined with the statement that maintenance should grow sequentially seems to support the higher degree of conservatism and not a plain decrease.
- **Margin leverage** — During the 1H09 the weak top-line was compensated by strong cost control. However Q3 was disappointing from this point too and the cost reduction decelerated. This surprised us as management always indicated that headcount savings should have a larger impact in the 2H. On a positive note management indicated that cost control would be maintained in 2010.
- **Where does this leave us?** — Even after reducing our est by 8% we believe the stock remains attractive at 15.5x FY10E. However it is hard to find a near term catalyst and we believe the stock will be range bound around €30-32 in the short term. We remain buyer but we are not brimming over with excitement after this set of numbers

Buy/High Risk	**1H**
Price (28 Oct 09)	€31.89
Target price	€38.00
Expected share price return	19.2%
Expected dividend yield	1.6%
Expected total return	**20.7%**
Market Cap	€39,092M
	US$57,892M

Price Performance (RIC: SAPG.DE, BB: SAP GR)

SAP AG (EUR)

Year to 31 Dec	2007A	2008A	2009E	2010E	2011E
Sales (€M)	10,245.0	11,733.0	10,629.9	10,994.4	12,104.0
Net Income (€M)	1,998.7	2,245.8	2,126.0	2,462.8	2,820.3
Diluted EPS (€)	1.66	1.89	1.79	2.05	2.33
Diluted EPS (Old) (€)	1.66	1.89	1.91	2.24	2.56
PE (x)	19.3	16.9	17.8	15.5	13.7
EV/EBITDA (x)	11.3	9.7	10.8	9.6	8.5
DPS (€)	0.46	0.50	0.50	0.63	0.62
Net Div Yield (%)	1.4	1.6	1.6	2.0	1.9

See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Dec	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	19.3	16.9	17.8	15.5	13.7
EV/EBITDA adjusted (x)	11.3	9.7	10.8	9.6	8.5
P/BV (x)	5.9	5.2	3.8	3.9	3.8
Dividend yield (%)	1.4	1.6	1.6	2.0	1.9
Per Share Data (€)					
EPS adjusted	1.66	1.89	1.79	2.05	2.33
EPS reported	1.60	1.90	1.68	2.00	2.28
BVPS	5.39	6.09	8.30	8.28	8.36
DPS	0.46	0.50	0.50	0.63	0.62
Profit & Loss (€M)					
Net sales	10,245	11,733	10,630	10,994	12,104
Operating expenses	-7,510	-8,428	-7,546	-7,591	-8,195
EBIT	**2,735**	**3,305**	**3,084**	**3,403**	**3,909**
Net interest expense	133	-63	-61	25	30
Non-operating/exceptionals	-9	-25	-263	0	0
Pre-tax profit	**2,859**	**3,217**	**2,761**	**3,428**	**3,939**
Tax	-920	-950	-770	-1,028	-1,182
Extraord./Min.Int./Pref.div.	-2	-1	0	0	0
Reported net income	**1,937**	**2,266**	**1,990**	**2,400**	**2,757**
Adjusted earnings	1,999	2,246	2,126	2,463	2,820
Adjusted EBITDA	3,191	3,916	3,585	3,906	4,362
Growth Rates (%)					
Sales	8.6	14.5	-9.4	3.4	10.1
EBIT adjusted	4.9	17.4	-6.1	10.4	14.5
EBITDA adjusted	6.6	22.7	-8.5	8.9	11.7
EPS adjusted	7.3	13.9	-5.1	14.7	13.4
Cash Flow (€M)					
Operating cash flow	**1,995**	**2,515**	**2,184**	**2,789**	**2,939**
Depreciation/amortization	321	548	421	412	363
Net working capital	-248	-266	-227	-23	-182
Investing cash flow	**-1,385**	**-3,769**	**-247**	**-275**	**-303**
Capital expenditure	-1,142	-719	-421	-412	-363
Acquisitions/disposals	-1,283	-4,179	173	137	61
Financing cash flow	**-1,273**	**1,289**	**-2,195**	**-2,070**	**-2,070**
Borrowings	0	2,288	-1,602	-1,321	-1,321
Dividends paid	-556	-594	-594	-750	-750
Change in cash	**-663**	**35**	**-259**	**445**	**566**
Balance Sheet (€M)					
Total assets	**10,377**	**14,083**	**14,085**	**14,215**	**14,788**
Cash & cash equivalent	2,819	1,662	1,411	1,856	2,422
Accounts receivable	2,888	3,141	2,953	3,054	3,362
Net fixed assets	1,317	1,405	1,403	1,265	1,205
Total liabilities	**3,869**	**6,827**	**4,206**	**4,266**	**4,637**
Accounts payable	715	538	582	663	796
Total Debt	10	2,321	99	0	0
Shareholders' funds	**6,508**	**7,256**	**9,879**	**9,949**	**10,151**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	31.1	33.4	33.7	35.5	36.0
ROE adjusted	27.6	32.6	24.8	24.9	28.1
ROIC adjusted	43.4	36.8	26.1	26.6	31.9
Net debt to equity	-43.2	9.1	-13.3	-18.7	-23.9
Total debt to capital	0.2	24.2	1.0	0.0	0.0

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A peculiar year, peculiar guidance?

The bar was not high this quarter and the market wanted SAP to hit either the license, margin or keep the guidance. Unfortunately SAP missed all three and the good work on guidance and execution of the last couple of quarters has been reversed in our view. The main concern came from the guidance which at the low-end is implying a rapid deterioration in Q4. While management tried to repair it with the statement that guidance was "very, very conservative", the damage was done. Cost control was also weaker than expected and while CFO Brandt indicated that 2010 would be another year of tight costs control, it was another disappointment. There is strong valuation support around €30-32 and the stock remains attractive in our view from a valuation perspective which is supporting our BUY case.

Results Overview

Figure 1. Results Summary (€m)

	3Q09A SAPG	3Q09E CIR	Difference	3Q09E Cons	Difference
Licence	525	540	-2.8%	555	-5.4%
SSRS	1,937	1,970	-1.7%	1,992	-2.8%
Total Revenues	**2,508**	**2,609**	**-3.9%**	**2,629**	**-4.6%**
Non-GAAP op profit ex restr	695	746.0	-6.8%	750	-7.3%
Non-GAAP op margin ex restr	*27.7%*	*28.6%*	*-0.9%*	*28.5%*	*-0.8%*
Non-GAAP EPS ex restr (€)	0.42	0.42	0.0%	0.42	0.0%

Source: Company Reports, Company Cons and CIRA Estimates

Figure 2. Impact of lower tax rate in Q3 (€m)

	3Q09 Actual	3Q09 Normalised
Operating profit ex restr	**695**	**695**
Other non-op income	-41	-41
Financial expense	-13	-13
Profit before tax	**641**	**641**
Tax	-138	-192
Tax rate	21.5%	30%
Loss from discontinued op	-1	-1
Net earnings	**502**	**448**
EPS ex restructuring (€)	**0.42**	**0.38**
Difference (€)		***0.05***

Source: Company Reports and CIRA Estimates

Q3 revenues and margin were both below consensus and our estimate. In addition SAP lowered its FY product guidance which at the lower end implies a Q4 deterioration. EPS was inline due to a one-off tax benefit which drove the underlying tax rate to 21%. Adjusted for this, we estimated a 5c (or 10%) EPS miss.

Licenses (at €525m) missed our number but came in at the bottom end of the market expectation number of €525-545m. Japan had a substantial negative impact and we calculate that the change in government and the corresponding freeze in spend resulted in a €15-20m license miss in just this region.

On margin, the headcount reduction is bearing fruit but it was not as significant as we expected. Margin ex restructuring of 27.6% represents an increase of 150bps yoy. However, this is smaller than the 410bps and 360bps achieved in Q1 and Q2 respectively. There are signs of reinvestments with R&D spending up €10m QoQ and G&A increasing €10m QoQ – they are normally flat / decline QoQ. During the call Werner indicated that this related to €40m stock based compensation. This could explain why the improvement was limited in Q3 but not why R&D and G&A moved up sequentially while they are normally flat/down.

However, the real disappointment came from the guidance which was reduced by 2% to 6-8% FY decline in SSRS. This implies a Q4 SSRS decline of 5.5-12% vs -6.2% 9M and -4.7% in Q3. During the call Leo Apotheker indicated that pipe and volume were encouraging but that 2009 was a "peculiar year" and described the guidance as "very, very conservative". Similarly Werner Brandt talked about very slight sequential maintenance growth in Q4 so concerns that Q4 could be a whitewash might be overdone. We therefore are at the high-end of the new SSRS guidance.

Licenses stabilizing

While licenses missed our and consensus estimates, it was just at the lower end of market expectations which was in the €525m-€545m range. On a y/y basis it was down 30% and down 3.3% on a sequential basis.

Figure 3. 3Q license reported vs expectations

	Licenses	Difference
Reported	525.0	
Citi	540.2	-2.8%
Consensus	554.0	-5.2%

Source: Company Reports, CIRA

Figure 4. Historical sequential growth analysis

	1Q	2Q	3Q	4Q
2003	-63.3%	22.4%	0.5%	115.0%
2004	-60.3%	34.3%	-1.2%	104.3%
2005	-58.0%	33.7%	2.5%	102.6%
2006	-56.1%	17.5%	11.4%	84.7%
2007	-54.8%	27.4%	-0.3%	98.3%
2008	-56.1%	44.4%	-15.0%	73.4%
Average	-58.1%	30.0%	-0.4%	96.4%
Average excl '08	**-58.5%**	**27.1%**	**2.6%**	**101.0%**
2009	-67.0%	30.0%	-3.3%	

Source: Company Reports, Citi Investment Research and Analysis

As can be seen from Figure 4 this is a bit lighter than normal seasonality would suggests. However, if we adjust for FX Q3 was exactly flat sequentially and should not be seen as a negative data-point in our view (Figure 5).

Figure 5. FX impact on license

License ex FX	**535.0**	**535.0**
FX	8.0	-10.0
License reported	543.0	525.0

Source: Company Reports, CIRA

In addition, there were a few exceptional movements during the quarter and the company hinted at weakness in Japan and a change in business model. We believe that is the main reason for the Q3 miss and not a change in the business model which is a gradual process.

We estimate that Japan licenses declined by 60-70% (SAP doesn't provide this split). If it would have dropped in line with the remaining part of the business (-30% y/y) licenses would have been €15-20m higher. SAP indicated that the change in Japanese government had frozen most business. However, this should come back over the coming two quarters.

The second explanation is the change of the business model to a greater degree of subscription and multi-year agreement. SAP has expanded the GEA strategy to the next layer of customers (was the top 35 and expanded this to the top 500). These agreements involve a great degree of standardization on SAP at a set price and license payment will take place on deployment and revenue recognition is therefore more gradual. While this will have had some impact during the quarter it is a more gradual process. However, it does put a question over Q4 seasonality which was normally being boosted by a large number of large deals.

Maintenance solid

Maintenance was solid and increased by 10% cc to €1,333m. There was some concern in the market that this was a sequential decline, but this is purely due to FX. Figure 6 shows that excluding FX maintenance was up 2.2% sequentially. This is still weaker than the last couple of years (4 year range 3-3.5%) and Werner Brandt indicated on the call that this was due to a €10m one-off which was taken in Q2 – adjusted for this it would have been +3%, in line with historical levels.

Figure 6. Maintenance

	2Q09	3Q09	change
Reported	1,337.0	1,333.0	-0.3%
Ex FX	1,299.0	1,327.0	2.2%

Source: Company Reports, CIRA

For Q4 management guided to a slight sequential increase in maintenance which should ease concerns that the reduced SSRS guidance is pointing to a substantial weakening in maintenance in Q4.

SSRS – emerging regions are turning around

SSRS or product revenues were down 5% to €1,940m and €30m short of our estimate. From a regional perspective (Figure 7) the emerging regions all showed a strong improvement which seems the opposite of management statement. As indicated in the prior section the main negative surprise came for Japan (-25%) and Germany also looks a bit light. Overall we were mainly surprised by EMEA – excluding Germany this region grew 6% and it seems that this is sustainable. Germany was weak but had a very tough comp (+20% in 3Q08) and this should ease next quarter (-9% in 4Q08).

Figure 7. SSRS Constant Currency Growth Rates

	1Q	2Q	3Q
EMEA	**-2.2%**	**-7.4%**	**-1.0%**
of which Germany	-8.6%	-7.3%	-13.0%
of which ROE	0.8%	-7.5%	5.9%
Americas	**-2.7%**	**-14.5%**	**-7.1%**
of which US	-7.1%	-14.5%	-9.4%
of which Rest of Americas	9.9%	-14.6%	-0.6%
APJ	**-10.5%**	**-9.2%**	**-12.5%**
of which Japan	-11.5%	-3.3%	-25.3%
of which Rest of APJ	-9.9%	-11.4%	-6.0%
Software & software related services	**-3.6%**	**-10.0%**	**-4.7%**

Source: Company Reports, Citi Investment Research and Analysis

But why is the guidance for Q4 so low?

As can be seen from the prior discussion, the reported SSRS revenues might have been light, but on an underlying basis there are no huge concerns in our view. So why has SAP taken the decision to lower the FY guidance by 200bp, which at the lower end implies a sharp Q4 slowdown? The answer from CEO Apotheker was that the guidance was "very, very conservative" given that this is a "peculiar year" in which closure rates are very sensitive to small changes in sentiment. This is somewhat reassuring but we remain concerned by the fact that with only nine weeks left in the quarter SAP decreased guidance by such a large extend.

Guidance was moved from a decline of 4-6% to a decline of 6-8%. This implies a reduction of 6.4% in Q4 growth projection from the previous set of guidance (see Figure 8). While the high-end of the guidance implies little change in Q4 (vs Q3) the low-end implies a sharp deterioration.

Figure 8. Implied ex FX growth rate (€m)

	9M08A	4Q08A	FY08A	ex FX 9M09A	Implied 4Q09 ex FX		Implied FY09 ex FX	
					High	Low	High	Low
New Guidance								
SSRS	5,931	2,692	8,623	5,561	2,545	2,372	8,106	7,933
Growth				-6.2%	-5.5%	-11.9%	-6%	-8%
Old Guidance								
SSRS	5,931	2,692	8,623	5,561	2,717	2,545	8,278	8,106
Growth				-6.2%	0.9%	-5.5%	-4%	-6%
Difference					**6.4%**	**6.4%**		

Source: Company Reports and CIRA Estimates

Will there be a Q4 budget flush? This is at risk.

Figure 9. Implied Q4 Licences (€m)

	4Q08	4Q09 High	4Q09 Low
Maintenance		1,358	1,358
Subscription		91	91
License	**1,323**	**1,040**	**867**
Growth inc FX		-21%	-34%
Growth ex FX		-19%	-32%
QoQ increase		198%	165%

Source: Company Reports, CIRA

Figure 10. Services constant currency growth

	Q1	Q2	Q3
Consulting	-8%	-20%	-22%
Training	-32%	-39%	-43%
Other services	-4%	-15%	-23%
Total services	**-11%**	**-23%**	**-25%**

Source: Company Reports, CIRA

Figure 11. OPEX

	1Q	2Q	3Q
R&D	364.0	371.0	381.0
S&M	495.0	542.0	497.0
G&A	131.0	125.0	135.0
OPEX	**990.0**	**1,038.0**	**1,013.0**
Y/Y change	(141.0)	(212.0)	(148.0)
Q/Q change	(158.0)	48.0	(25.0)

Source: Company Reports, CIRA

Given the fact that Werner Brandt indicated that maintenance would be up slightly (sequential) and we would expect another strong quarter of subscriptions (given the gradual shift towards this revenue recognition), the risk seems to be on the license. As can be seen in Figure 9 this would give an implied license range of €867-1,040m or 65%-98% sequential growth. Historical average dictates around 100% sequential improvement and even during the tough 4Q08 SAP still managed +73%. Again it seems that Apotheker might be right that the guidance is “very, very conservative”.

While this analysis makes sense on paper the market is less convinced and will probably wait until it hears more reassuring sounds out of SAP on the quarter before buying in. Our current license forecast is in line with normal seasonality and as a result we are at the high end of the new SSRS guidance.

Service revenues continue to deteriorate

Q3 services revenues declined 25%cc to €564m. Revenues from all types of services continue to see pressure in Q3 (see Figure 10). This is inline with comments from other IT services provider which expects a bottoming in 2H09 and do not expect a recovery until 2010. For SAP, we would expect its licence revenues to recover first with services to follow.

Cost control could have been better

After two quarters of strong cost control we were a bit surprised by the limited OPEX improvement in Q3. We calculate that OPEX declined €148m y/y but only €25m sequentially (Figure 11). This is surprising given the amount of headcount reduction during 1H, which we expected would have made an impact on Q3. One explanation could be that the employees in countries with limited labor regulations were let go first and this had a direct impact. Another explanation could be that SAP is increasing the discretionary spend ahead of an expected upturn. This would explain why both R&D and G&A cost rose on a sequential basis. During the call CFO Brandt offered a third solution and indicated that there was €40m stock based comp in the OPEX.

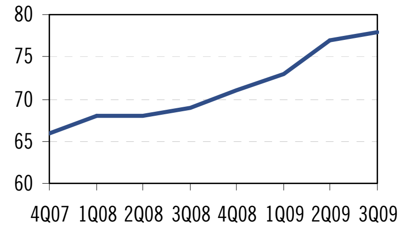
This could explain some of the gap but still doesn’t explain why in prior years R&D and G&A was flat/ down sequentially but was up this year. In addition, on a y/y basis R&D is only down 3.5% and the promise of lower cost of innovation seems to be based on limited cuts. We might have to wait till an upturn before this comes though.

The margin guidance was maintained at 25.5%-27% including restructuring, implying 27.4-29% ex restructuring. However as consensus (and we) were above this level this was another disappointment. According to VARA 2009 consensus was expecting 28.1% including restructuring and 30% ex restructuring.

Balance sheet & Cash Flow

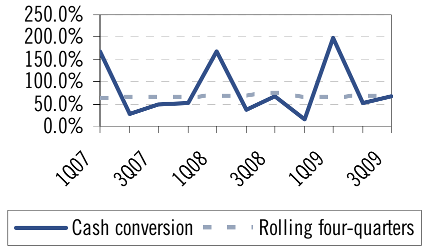
Q3 DSO increased by 1 day from Q2 - showing a stabilisation of payment terms. In 1H09, SAP had flexed its payment terms to accommodate business and this seems to be close to peak. 3Q09 Cash conversion was seasonally strong at 67%. We do not see a comparison to 3Q08's cash conversion of 68% as justified as this is distorted by the artificially low EBITDA caused by a profit warning.

Figure 12. DSO progression (days)



Source: Company Reports and CIRA Estimates

Figure 13. Cash conversion



Source: Company Reports and CIRA Estimates

Change in estimates

We reduce our estimates post results to taken into account the slower recovery and reduced margin accretion. As a result, we reduce our FY09, 10 and 11 EPS estimates by 6%, 8% and 9% respectively to €1.79, €2.05 and €2.33.

Conclusion

The bar was not high this quarter and the market wanted SAP to hit either the license, margin or keep the guidance. Unfortunately SAP missed all three and the good work on guidance and execution of the last couple of quarters has been reversed in our view. The main concern came from the guidance which at the low-end is implying a rapid deterioration in Q4. While management did try to repair it with the statement that guidance was "very, very conservative", the damage was done. Cost control was also weaker than expected and while CFO Brandt indicated that 2010 would be another year of tight costs control, it was another disappointment. There is strong valuation support around €30-32 and the stock remains attractive from a valuation perspective in our view which is supporting our BUY case.

Figure 14. SAP vs peer group valuation (as of 28/10/09)

Company	Rating	Ticker	FX	Price	Target Price	Market Cap	EV/Sales 2008E	EV/Sales 2009E	EV/Sales 2010E	Sales CAGR 08-10	EV/EBITA 2008E	EV/EBITA 2009E	EV/EBITA 2010E	EBITA CAGR 08-10	PE 2008E	PE 2009E	PE 2010E	EPS CAGR 08-10	EBITA Margin 2009
EU																			
Autonomy	1H	AUTN.L	USD	22.33	32.50	3,268	10.4	7.0	5.5	35.3%	25.2	15.2	10.3	53.5%	33.6	23.2	15.9	45.5%	46%
Aveva Group	2H	AVV.L	GBP	9.15	9.20	620	3.4	3.5	3.5	-5.7%	9.5	12.1	13.3	-19.7%	15.1	19.8	22.2	-17.4%	29%
Dassault System	2H	DAST.PA	EUR	39.97	40.00	4,711	3.0	3.0	2.9	-2.5%	11.6	12.2	11.5	-3.4%	20.2	22.4	21.7	-3.6%	24%
Misys	3H	MSY.L	GBP	2.14	1.75	1,171	2.0	1.7	1.5	18.9%	8.5	7.7	7.2	9.2%	22.7	23.7	18.3	11.4%	22%
Sage Group	2M	SGE.L	GBP	2.21	2.30	2,900	2.6	2.3	2.3	4.8%	11.0	9.9	9.4	6.4%	14.3	12.8	12.5	7.0%	24%
SAP AG	1H	SAPG.DE	EUR	31.89	38.00	39,092	3.2	3.6	3.4	-3.2%	11.5	12.5	11.0	1.5%	16.9	17.8	15.5	4.3%	29%
Software AG	3H	SOWG.DE	EUR	63.20	52.00	1,813	2.6	2.5	2.4	-1.5%	9.6	9.3	9.0	-2.6%	15.7	15.9	16.0	-0.9%	27%
Temenos Group	2H	TEMN.S	USD	23.15	25.93	1,395	3.5	3.8	3.3	1.4%	16.3	13.8	11.0	19.7%	26.0	20.7	16.7	24.8%	27%
Average							***3.8***	***3.4***	***3.1***		***12.9***	***11.6***	***10.3***		***20.6***	***19.5***	***17.3***		

Source: Company Reports and CIRA Estimates

Figure 15. Summary P&L (€m)

Profit and Loss statement	FY07	FY08	1Q	2Q	3Q	4Q	FY09E	FY10E	FY11E
Revenues	**10,245.0**	**11,733.0**	**2,409.0**	**2,576.0**	**2,508.0**	**3,139.9**	**10,629.9**	**10,994.4**	**12,104.0**
Less: cost of sales	(3,400.0)	(3,750.0)	(850.0)	(823.0)	(801.0)	(854.2)	(3,328.2)	(3,362.5)	(3,670.1)
Gross profit	**6845.0**	**7983.0**	**1,559.0**	**1,753.0**	**1,707.0**	**2,285.7**	**7301.7**	**7631.9**	**8433.9**
Operating costs	(4,127.0)	(4,690.0)	(990.0)	(1,038.0)	(1,013.0)	(1,176.7)	(4,217.7)	(4,228.7)	(4,524.8)
Other operating income/expenses	17.0	12.0	-	6.0	(1.0)	-	-	-	-
Total operating costs	**(4,110.0)**	**(4,678.0)**	**(990.0)**	**(1,032.0)**	**(1,014.0)**	**(1,176.7)**	**(4,217.7)**	**(4,228.7)**	**(4,524.8)**
of which: Amortisation	(42.0)	-	-	-	-	-	-	-	-
of which: Depreciation	(218.0)	(548.0)	(126.0)	(125.0)	(122.0)	(47.7)	(420.7)	(412.3)	(363.1)
of which: Stock-based compensation	(74.0)	(63.0)	(3.0)	(17.0)	(40.0)	(20.0)	(80.0)	(90.0)	(90.0)
of which: Acquisition related charges	(61.0)								
STAR expense	-	-	-	-	-	-	-	-	-
EBITDA - before stock-based compensation and acquisition charges	**3,130.0**	**3,916.0**	**698.0**	**863.0**	**855.0**	**1,176.8**	**3,584.8**	**3,905.6**	**4,362.2**
Operating Profit (pre-stock based com)	**2,870.0**	**3,368.0**	**572.0**	**738.0**	**733.0**	**1,129.0**	**3,164.0**	**3,493.3**	**3,999.1**
Operating Profit (EBIT) (Non-GAAP)	**2,735.0**	**3,305.0**	**569.0**	**721.0**	**693.0**	**1,109.0**	**3,084.0**	**3,403.3**	**3,909.1**
Other non-operating income/expenses	(1.0)	(25.0)	(4.0)	(18.0)	(41.0)	-	(63.0)	-	-
Net interest income/(charge)	133.0	(63.0)	(21.0)	(18.0)	(14.0)	(7.5)	(60.5)	25.0	30.0
Associates / Others	(38.0)	-	-	-	-	-	-	-	-
Exceptional items	30.0	-	(160.0)	(5.0)	(21.0)	(14.0)	(200.0)	-	-
Pre Tax (Non GAAP, adj CIR)	**2,964.0**	**3,280.0**	**547.0**	**702.0**	**678.0**	**1,121.5**	**3,040.5**	**3,518.3**	**4,029.1**
Pre Tax Profit (Non-GAAP)	**2,859.0**	**3,217.0**	**384.0**	**680.0**	**617.0**	**1,087.5**	**2,760.5**	**3,428.3**	**3,939.1**
Income taxes	(920.0)	(950.0)	(118.0)	(195.0)	(131.0)	(326.3)	(770.3)	(1,028.5)	(1,181.7)
Minorities (net)	(2.0)	(1.0)	-	-	-	-	-	-	-
Adj Net Earnings (Non-GAAP tax adj CIR)	**1,998.7**	**2,245.8**	**382.9**	**491.4**	**474.6**	**785.1**	**2,126.0**	**2,462.8**	**2,820.3**
Net Earnings (Non-GAAP)	**1,937.0**	**2,266.0**	**266.0**	**485.0**	**486.0**	**761.3**	**1,998.3**	**2,399.8**	**2,757.3**
Dividend	(556.0)	(594.0)	-	(594.0)	-	-	(594.0)	(750.0)	(750.0)
Extraordinary item (net)	(14.0)	-	-	-	-	-	-	-	-
Retained Earnings	**1367.0**	**1635.0**	**266.0**	**-109.0**	**486.0**	**761.3**	**1404.3**	**1649.8**	**2007.3**
Adjusted EPS (per CIR)	**1.655**	**1.886**	**0.323**	**0.414**	**0.399**	**0.661**	**1.79**	**2.053**	**2.328**
Adjusted EPS (per CIR) growth	7.3%	13.9%	13.8%	-5.4%	-9.5%	-9.0%	-4.7%	14.3%	13.4%
EPS (Basic)	1.604	1.903	0.224	0.408	0.409	0.641	1.682	2.000	2.276
EPS (Diluted)	**1.604**	**1.903**	**0.224**	**0.408**	**0.409**	**0.641**	**1.682**	**2.000**	**2.276**

Source: Company Reports and CIRA Estimates

SAP AG

Company description

SAP is the leading enterprise application software vendor worldwide. SAP develops and sells a complete suite of software that includes ERP, supply-chain management, customer relationship management, product lifecycle management, and other front- and back-office support software that allows companies to automate, integrate and improve their businesses and processes. It is also increasingly moving into infrastructure software to help customers reduce ongoing IT operating and maintenance costs and refocus investment on innovation rather than maintenance.

Investment strategy

We rate the shares of SAP Buy/High Risk (1H). SAP has the broadest and strongest product portfolio in its target markets and is embracing the "services orientated" vision that should help its customers significantly improve the cost and flexibility of their critical business systems and in doing so probably spend more with SAP. This strategy has helped SAP boost its market share over the last three years and has started to successfully take a higher percentage of the IT spend of its customers through an expansion in products and its professional services. This is the critical focus of its SAP Business Suite and Business Process Platform strategy, where the company has provided the quality, integrated alternative to best-of-breed products, as well as providing preconfigured solutions for over 25 different industry verticals. The net result of this twin strategy is that SAP should not only increase its addressable market but also help consolidate the enterprise software market as it brings new value propositions such as Business ByDesign to market. The net result should be continued organic EPS growth faster than its peers.

Valuation

Our target price of €38 is based on our DCF calculation using rolling 12-month revenues and earnings based on our FY09 EPS forecast. This target price is based upon 10-year assumptions of a 10% CAGR in revenues and an average operating margin of 35% (which we believe is possible as the business benefits from the BPP and leverage) together with a terminal P/E of 15x, a beta of 1.1, and a discount rate of 10%.

Risks

We rate SAP High Risk based on historical share price volatility and our assessment of industry-specific, financial and management risks. Volatility continues to contribute the highest risk factor to the stock. Key operational risks that could prevent SAP from reaching our target price include the US and European economies; potential conflicts with partners as the company moves into the consulting and infrastructure markets and increases its share of wallet; risk from entering a new product cycle; and a continued IT downturn. Delays in the timing of a European recovery could call into question our growth assumptions for the business as this region has under-invested and delivers a sub-group margin. The more long-term threat is that best-of-breed providers of enterprise software return to the forefront of the industry, or that customers are unwilling to commit to infrastructure products from SAP and thus impacts its ability to target a higher share of IT spending. Finally, it is possible that the likes of IBM or Microsoft enter this market and dramatically change the competitor landscape or alternatively IT spending does not recover to historical levels. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our financial and target prices.

Appendix A-1

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SAP AG (SAPG.DE)

Ratings and Target Price History
Fundamental Research

Analyst: Gerardus Vos, CFA
Covered since January 30 2008

	Date	Rating	Target Price	Closing Price
1	19-Jul-07	1H	*55.00	40.06
2	10-Apr-08	1H	*45.00	33.41

	Date	Rating	Target Price	Closing Price
3	7-Oct-08	1H	*35.00	26.74
4	19-May-09	1H	*38.00	30.89

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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