Sap AG SAP [NYSE] | ★★

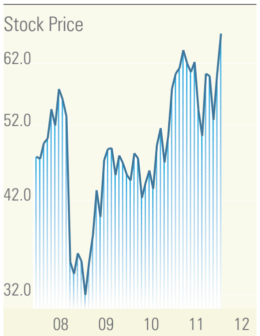
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
72.00 USD	59.00 USD	41.30 USD	79.65 USD	Medium	Narrow	C	—	Software - Application

HANA Shines in SAP's Solid 4Q

by Sunit Gogia
Senior Stock Analyst
Analysts covering this company do not own its stock.

Pricing data through March 16, 2012.
Rating updated as of
March 16, 2012.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Jan. 26, 2012
SAP announced a strong finish to fiscal 2011 with 17% year-over-year constant currency growth in software sales driving 10% growth in overall revenue. The results are in line with our estimates, and we are maintaining our forecasts. However, we are adjusting our fair value estimate to incorporate changes in the dollar/euro exchange rate since our last report.

Management reported double-digit sales growth in all major geographic regions, led by 26% growth in the Asia Pacific region. New products and initiatives such as HANA and mobility are gaining strong customer adoption and are also driving sales of SAP's core business applications. HANA generated an impressive EUR 160 million in revenue in its first six months on the market, validating management

Thesis Jan. 26, 2012
SAP has long dominated the market for enterprise resource planning software, but intensifying competitive pressures will cause growth to slow.

SAP's software provides customers with an integrated view and control of various business functions including operations, finance, human resources, supply chain management, and customer relationship management. SAP has increased the attractiveness of its products by customizing them to meet the specific needs of 25 different industries. This attention to customers' requirements has enabled SAP to gain a dominant global market share among large enterprises in 20 of its 25 target industries.

The key to SAP's economic moat is the stickiness of its products. Once customers spend millions of dollars to purchase and install SAP's software, they come to rely on the ERP system to manage critical business functions. Switching to a competitive offering requires not only additional software purchase and installation expense, but also a retraining of all users of the system and the internal IT staff that supports the ERP software. Not surprisingly, most enterprises are reluctant to rip and replace their ERP systems, and SAP's large enterprise customers rarely switch to alternative ERP products. Customers pay SAP annual support fees, providing the firm with a stable recurring revenue stream and a narrow moat.

SAP continues to have adequate opportunities in the large enterprise segment, but growth will be limited by intensifying competitive pressures. Oracle's emergence as a formidable single-stop vendor of enterprise business solutions, including software and hardware, could hurt SAP's competitive win rates. Management is rightly focused on developing new products such as HANA to spark growth as well as to reduce dependence on Oracle's database. SAP could also look to major acquisitions for growth, although we see few easy pickings. The company successfully expanded into the growing business intelligence market through its acquisition of Business Objects and has benefited from synergies between selling ERP and business intelligence software. However, we see the recent acquisition of Sybase as a mostly sound defensive move to reduce SAP's reliance on Oracle's database software. Although management anticipates that the Sybase acquisition will provide new growth opportunities in mobile business applications, we expect any competitive benefit in this regard to be of a short-term nature.

SAP has also targeted the fragmented small- and medium-size business segment, but it faces stiff competition in this market. Rivals like NetSuite have pioneered a subscription-based model to target SMB customers by delivering ERP software as a hosted service over the Internet. While SAP has followed suit with its own hosted ERP software service for the SMB market, we are skeptical of the firm's ability to effectively pursue multiple business models. The proposed acquisition of SuccessFactors does signal that management is getting more serious about cloud-based software services, but

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Sap AG	USD	85,655	19,284	5,253	3,740
Microsoft Corporation	USD	273,539	72,052	27,077	23,468
Oracle Corporation	USD	149,468	36,704	13,140	9,356
Salesforce.com, Inc.	USD	20,740	2,267	-35	-12

Morningstar data as of March 16, 2012.

success remains far from guaranteed. Selling hosted services in a competitive market could lead to lower operating margins, and when push comes to shove, we expect SAP to favor slower growth over lower profitability.

Valuation, Growth and Profitability

We are lowering our fair value estimate to $59 per ADR from $62 to incorporate changes in the dollar/euro exchange rate since our last report. Our revised fair value estimate is based on an exchange rate of EUR 0.7633 per $1 as of Jan. 25. Our model projects average annual internal revenue growth rate in the high single digits over the next five years, with the pending acquisition of SuccessFactors pushing overall revenue growth into the low-double-digit range in fiscal 2012. We have modeled operating margins remaining stable in the high 20s over the next five years, enabling SAP to generate average returns on invested capital well in excess of its 10% estimated cost of equity.

Risk

The primary risk to SAP's business stems from Oracle's strengthening competitive position as a single-stop vendor of ERP systems. Potential customers could use Oracle's comprehensive solutions as a means to consolidate software vendors. Additionally, about 60% of SAP's customers use Oracle's database software alongside SAP's application software, providing the former firm direct access to SAP's existing customer base. Finally, the profitability of SAP's SMB-focused products could be diminished by the emergence of new subscription-based business models that enable remote delivery of ERP software to customers via the Internet. Such delivery models can result in lower switching costs for customers and consequently lower economic returns for SAP.

Bulls Say

- SAP's large customer base coupled with the stickiness of its products serves as a bulwark against a competitive attack.
- The company's expertise in developing ERP software should enable it to effectively compete and gain market share in the SMB segment.
- SAP's focus on the business intelligence market could lead to significant growth as the company sells business intelligence software to its existing customer base.

Bears Say

- Oracle has acquired several erstwhile competitors of SAP and is now a significant competitive force in the ERP software market.
- SAP's decision to directly sell software to the SMB segment could create conflict between the company and traditional resellers of its ERP software.
- Growth outside the large enterprise ERP market could come at the cost of lower margins as SAP faces intense competition in this area.

Financial Overview

Financial Health: Following debt issued to finance the acquisition of Sybase, SAP has about EUR 4 billion in debt and nearly EUR 5 billion in cash and equivalents. Strong operating cash flow should enable the firm to comfortably repay its outstanding debt.

Sap AG SAP [NYSE] | ★★

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Company Overview

Profile: SAP is the leading provider of enterprise resource planning software. The company tailors its products to meet the unique needs of various industries and has more than 180,000 customers in more than 120 countries.

Management: Bill McDermott and Jim Hagemann Snabe took over as co-CEOs in February 2010 following the departure of former CEO Leo Apotheker. McDermott joined SAP in 2002 and has been leading the global sales operations. Snabe has been with SAP since 1990 and has led product-development efforts. Although such a co-CEO arrangement tends to be uncommon, SAP has successfully operated with joint CEOs in the past, and we expect McDermott and Snabe to work well together. In particular, Snabe's inclusion as co-CEO sends a strong message that a focus on research and development remains vital to SAP's ability to stave off competitive challenges. On the corporate-governance front, we appreciate that a significant majority of executive compensation is contingent on the company's operating performance. Supervisory board chairperson Hasso Plattner owns nearly 10% of SAP's outstanding equity, which is sufficient to align his interests with those of outside shareholders, in our opinion.

Sap AG SAP [NYSE] | ★★

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Analyst Notes

Jan. 26, 2012

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Dec. 06, 2011

SAP Demonstrates Commitment to Cloud With $3.4 Billion Acquisition of SuccessFactors

SAP's $3.4 billion acquisition of SuccessFactors is a significant financial commitment backing management's commentary regarding the increasing importance of cloud-based software solutions. We view the transaction as a defensive reaction to the growing acceptance of software-as-a-service-based human capital management solutions among large enterprises. SaaS vendors including SuccessFactors and privately held Workday have seen rapid growth in HCM solutions sales at the expense of on-premise solutions from traditional vendors such as SAP and Oracle, and the acquisition should significantly improve SAP

Disclaimers & Disclosures

No Morningstar employees are officers or directors of this company. Morningstar Inc. does not own more than 1% of the shares of this company. Analysts covering this company do not own its stock. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security.

Sap AG SAP

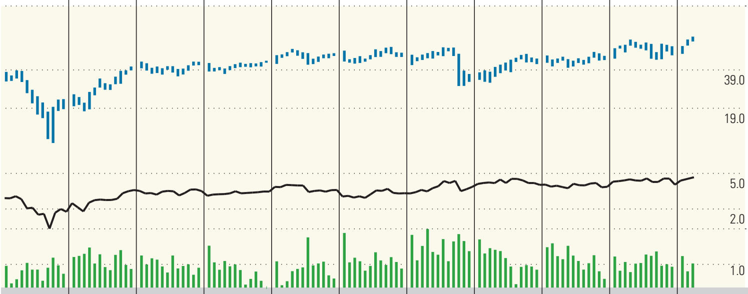
Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
19,284	85,655	Software - Application	Technology

SAP is the leading provider of enterprise resource planning software. The company tailors its products to meet the unique needs of various industries and has more than 180,000 customers in more than 120 countries.

Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★	72.00	59.00	Medium	Narrow	C

per share prices in USD

39.04	41.91	45.83	46.55	57.71	59.86	59.42	52.73	54.66	68.39	72.10	Annual Price High
9.96	18.30	35.02	36.60	43.30	44.17	29.31	31.13	40.95	47.39	52.78	Low
											Recent Splits



Price Volatility
Monthly High/Low
Rel Strength to S&P 500
52 week High/Low
72.10 - 47.39
10 Year High/Low
72.10 - 9.96
Bear-Market Rank
3 (10=worst)
Trading Volume Million

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2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	Stock Performance
-38.5	113.8	6.8	2.8	18.8	-2.7	-27.5	30.6	9.0	4.6	36.0	Total Return %
-15.1	87.4	-2.2	-0.2	5.2	-6.2	11.0	7.2	-3.8	4.6	24.3	+/- Market
1.3	42.7	-11.5	0.5	-0.3	-5.8	9.9	-20.4	-17.5	9.0	20.7	+/- Industry
0.7	0.3	0.3	0.8	0.8	1.2	2.1	1.1	0.8	1.1	0.8	Dividend Yield %
24293	52434	54934	56002	65797	62194	43174	55647	60107	62992	85655	Market Cap USD Mil

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM	Financials
6548	6964	7921	9339	10690	11773	14000	16925	14852	16686	19284	Revenue USD Mil
61.1	62.0	63.9	65.6	65.7	66.2	66.8	65.9	66.6	68.8	68.7	Gross Margin %
1171	-5436	1944	2509	2927	3212	3736	4156	3602	3469	5253	Oper Income USD Mil
17.9	-78.1	24.5	26.9	27.4	27.3	26.7	24.6	24.3	20.8	27.2	Operating Margin %
518	478	1214	1629	1879	2343	2624	2734	2433	2424	3740	Net Income USD Mil
—	0.38	0.98	1.31	1.50	1.90	2.18	2.29	2.05	2.03	3.15	Earnings Per Share USD
—	0.14	0.12	0.16	0.36	0.43	0.63	0.73	0.49	0.46	0.59	Dividends USD
—	1257	1241	1244	1249	1232	1206	1191	1189	1189	1190	Shares Mil
2.42	3.70	5.01	5.51	6.54	7.80	8.36	10.23	11.08	12.36	12.49	Book Value Per Share USD
882	1585	1697	2271	2019	2313	2650	3158	4196	3925	5378	Oper Cash Flow USD Mil
-337	-290	-310	-263	-329	-459	-548	-496	-313	-447	-647	Cap Spending USD Mil
545	1294	1386	2007	1691	1853	2101	2662	3883	3478	4730	Free Cash Flow USD Mil

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM	Profitability
9.9	8.6	18.0	18.8	18.0	20.1	19.3	15.2	12.7	10.6	13.3	Return on Assets %
20.8	17.0	32.7	31.6	28.9	31.4	30.3	27.2	22.2	19.8	26.1	Return on Equity %
7.9	6.9	15.3	17.4	17.6	19.9	18.7	16.2	16.4	14.5	19.4	Net Margin %
1.25	1.26	1.17	1.08	1.03	1.01	1.03	0.94	0.77	0.73	0.68	Asset Turnover
2.0	2.0	1.7	1.6	1.6	1.6	1.6	2.0	1.6	2.1	1.9	Financial Leverage

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	09-11	Financial Health
1382	2895	4124	6714	5878	4686	4686	-72	2638	2675	4660	Working Capital USD Mil
—	12	16	10	8	2	3	50	1003	1473	3079	Long-Term Debt USD Mil
2768	3017	4664	6223	6843	8097	9497	10066	12162	13157	15203	Total Equity USD Mil
—	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.08	0.11	0.20	Debt/Equity

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Valuation
45.9	38.0	31.0	31.8	26.5	21.8	16.1	22.2	24.8	18.1	24.3	Price/Earnings
—	—	—	—	—	—	—	—	—	1.0	1.5	P/E vs. Market
3.1	5.8	5.4	5.5	5.3	4.1	2.7	3.6	3.6	3.5	4.7	Price/Sales
8.1	11.3	8.8	8.2	8.1	6.5	4.3	4.6	4.6	4.3	5.7	Price/Book
13.8	27.3	22.2	29.4	27.0	21.7	14.4	12.9	15.3	12.6	16.9	Price/Cash Flow

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	16.8	6.8	7.8	7.1
Operating Income %	0.1	-1.7	2.1	12.4
Earnings/Share %	3.4	-1.7	4.8	11.7
Dividends %	-3.4	-9.4	3.5	9.2
Book Value/Share %	15.8	15.7	12.0	9.3
Stock Total Return %	31.5	29.4	10.4	7.6
+/- Industry	27.5	1.0	3.5	—
+/- Market	19.8	6.4	10.1	5.5

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	26.1	26.2	14.2	22.5
Return on Assets %	13.3	15.6	7.7	9.4
Fixed Asset Turns	9.5	8.3	9.6	7.5
Inventory Turns	—	458.7	11.6	16.6
Revenue/Employee USD K	353.3	315.5*	—	1051.8
Gross Margin %	68.7	66.8	68.2	39.8
Operating Margin %	27.2	24.7	18.2	16.7
Net Margin %	19.4	17.1	12.2	11.0
Free Cash Flow/Rev %	24.5	18.7	18.9	0.1
R&D/Rev %	13.7	0.1	—	9.4

Financial Position

Grade:	12-10 USD Mil	09-11 USD Mil
Cash	4720	5247
Inventories	16	—
Receivables	4157	3395
Current Assets	9583	10734
Fixed Assets	1944	2009
Intangibles	14498	14117
Total Assets	27959	28496
Payables	1457	1257
Short-Term Debt	1	1
Current Liabilities	6908	6074
Long-Term Debt	1473	3079
Total Liabilities	14803	13294
Total Equity	13157	15203

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	24.3	20.6	32.0	15.7
Forward P/E	15.9	—	—	13.6
Price/Cash Flow	16.9	15.4	16.8	7.5
Price/Free Cash Flow	19.2	18.0	20.5	17.8
Dividend Yield %	0.8	—	0.1	1.9
Price/Book	5.7	4.9	4.5	2.1
Price/Sales	4.7	3.5	3.9	1.3
PEG Ratio	1.4	—	—	1.6

Quarterly Results

Revenue USD Mil	Dec 10	Mar 11	Jun 11	Sep 11
Most Recent Period	5407.2	4118.0	4730.4	4840.8
Prior Year Period	4661.3	3529.5	3707.3	3832.1

Rev Growth %	Dec 10	Mar 11	Jun 11	Sep 11
Most Recent Period	16.0	16.7	27.6	26.3
Prior Year Period	34.0	47.3	—	52.8

Earnings Per Share USD	Dec 10	Mar 11	Jun 11	Sep 11
Most Recent Period	0.49	0.46	0.70	1.49
Prior Year Period	0.85	0.46	0.53	0.54

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Sap AG	85655	19284	24.3	26.1
Microsoft Corporatio	273539	72052	11.8	41.7
Oracle Corporation	149468	36704	16.4	24.5

Major Fund Holders

	% of shares
	—
	—
	—

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

Morningstar Research Methodology for Valuing Companies

Competitive Analysis → **Economic Moat™ Rating** → Company Valuation → **Fair Value Estimate** → Uncertainty Assessment → ★★★★★

Competitive Analysis	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	★★★★★	
Analyst conducts company and industry research: • Management interviews • Conference calls • Trade-show visits • Competitor, supplier, distributor, and customer interviews	The depth of the firm's competitive advantage is rated: • None • Narrow • Wide	Analyst considers company financial statements and competitive position to forecast future cash flows. Assumptions are input into a discounted cash-flow model.	DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.	An uncertainty assessment establishes the margin of safety required for the stock rating.	★ ★★ ★★★ ★★★★ ★★★★★	The current stock price relative to fair value, adjusted for uncertainty, determines the rating.

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades

We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."