SAP

Price EUR72.00

FY15 conference call feedback: solid on revenues, but there is no free lunch

Fair Value EUR75 (+4%) **NEUTRAL**

Bloomberg	SAP GR
Reuters	SAPG.DE
12-month High / Low (EUR)	74.9 / 55.9
Market Cap (EUR)	88,452
Ev (BG Estimates) (EUR)	91,156
Avg. 6m daily volume (000)	3 127
3y EPS CAGR	6.7%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.3%	4.5%	7.7%	-1.9%
Softw.& Comp.	-1.7%	2.7%	1.0%	-4.0%
DJ Stoxx 600	-5.2%	-8.6%	-15.5%	-7.5%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	20,798	21,817	23,220	24,803
% change		*4.9%*	*6.4%*	*6.8%*
EBITDA	6,884	7,133	7,498	8,114
EBIT	4,251	5,183	5,683	6,259
% change		*21.9%*	*9.6%*	*10.1%*
Net income	4,660	5,079	5,293	5,667
% change		*9.0%*	*4.2%*	*7.0%*

	2015	2016e	2017e	2018e
Operating margin	30.5	30.1	29.7	30.1
Net margin	14.8	18.0	18.3	18.6
ROE	13.2	15.3	15.0	14.8
ROCE	18.5	18.8	19.6	21.4
Gearing	24.7	10.5	-1.8	-12.8

(€)	2015	2016e	2017e	2018e
EPS	3.69	4.03	4.20	4.49
% change	-	*9.0%*	*4.2%*	*7.0%*
P/E	19.5x	17.9x	17.2x	16.0x
FCF yield (%)	3.4%	5.4%	5.6%	6.1%
Dividends (€)	1.20	1.30	1.40	1.50
Div yield (%)	1.7%	1.8%	1.9%	2.1%
EV/Sales	4.5x	4.2x	3.8x	3.4x
EV/EBITDA	13.7x	12.8x	11.7x	10.4x
EV/EBIT	14.9x	13.9x	12.7x	11.3x

We reiterate our Neutral rating and our DCF-derived fair value of EUR75 following the conference call held on last Friday , during which SAP released final FY15 results and confirmed FY16 guidance while updating its FY17 objectives. We are changing our adj. EPS ests. by +1% for 2016e, -2% for 2017 and -3% for 2018 and shave our mid-term op. margin assumption to 32% from 33% (-EUR2/share) given the non-IFRS op. profit outlook for FY17 which shows that SAP still has to in cloud infrastructure. On the other hand, we are increasing our mid-term lfl sales growth rate to 7% from 6.5% (+EUR2/share).

ANALYSIS

- **Solid but unsurprising cloud business, licence sales to prove resilient**. For FY17, SAP forecasts total sales of EUR23-23.5bn (vs. EUR21-22bn) - i.e. +5.5%/+7.5% lfl based on our ests. for 2016 -, o/w EUR3.8-4bn (vs. EUR3.5-3.6bn) in cloud subscriptions (est. +25%/+36% based on the EUR2.95-3.05bn guidance set for FY16). Cloud subscriptions are benefiting from high visibility, driven by new bookings up 75% in Q4 15, and a backlog up 45% to EUR3.7bn. Employee Central now has 1,000 customers, CEC (Customer Engagement & Commerce) has new cloud bookings up triple-digit, while new bookings for Business Networks were up 187%. On licences, the solid performance in Q4 15 stemmed from the surge in adoption for S/4HANA (to 2,700 from 1,300) and the availability of a more complete version in November. SAP is confident that licence sales will not shrink as the vast majority of S/4HANA customers buy on-premise and S/4HANA is just at the beginning of a cycle. More than one-third of S/4HANA customers are new. As such, SAP now considers 63-65% of sales will be recurring in 2017 vs. a previous 65-70% forecast, but cloud subscriptions could still exceed licence sales from 2018.

- **Disappointing margin prospects for 2017: investment still required**. Admittedly, SAP upgraded its FY17 non-IFRS target to EUR6.7-7bn from EUR6.4-6.7bn. However, the new guidance is below consensus (EUR7.1bn) and our own forecast (EUR7.2bn), and assumes a non-IFRS op. margin of 28.5-30.5% vs. consensus of 31.6% (vs. 31.2% for 2016) whereas our forecast was 31% (vs. 30.6% for 2016). To explain this stagnation/decline SAP mentions: 1). The need to keep building out the cloud infrastructure capability, and migrate existing databases on datacenters to the HANA platform in order to increase the efficiency of cloud operations; 2). SAP intends to keep investing in the sales force. That said, it does not expect the cloud gross margin, which was down 0.8ppt to 62.9% in Q4 15 while it was up 8.9ppt to 69.3% in Q3 15, to fall in 2016 – this should be flat or slightly up from the 66% (+1.7ppt) reported for 2015, but the progression will be way below our initial expectation for 2016 (71%). HANA Enterprise Cloud is expected to be profitable this year, while it lost money in 2015. NB. The surge in sales and marketing costs in Q4 15 (+22% at cc) was essentially related to a catch-up in sales commissions and bonuses.

- **No big M&A story for the next two years**. For 2015, free cash flow was up by 9% to EUR3bn or only 14% of sales - down from 16% for 2014, and below the low 20s it used to enjoy before it acquired cloud companies. For 2016, the free cash flow headwind caused by restructuring will be gone (only EUR40-60m restructuring costs vs. EUR621m for 2015 - which was above the top-end of the EUR585-615m guidance range). However, SAP's financial focus will remain on reimbursing the debt contracted for the acquisition of Concur. As such, for the next two years, SAP is unlikely to make big acquisitions, but remains open to returning cash to shareholders.

VALUATION

- SAP's shares are trading at an est. 13.9x 2016 and 12.7x 2017 EV/EBIT multiples.
- Net debt at 31st December 2015 was EUR5,752m (net gearing: 25%).

NEXT CATALYSTS

Investor Day on 4th February in New York from 9.30am EDT / 3.30pm CET / 2.30pm BST.

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