20th July 2016

TMT

# SAP

Price EUR71.65

## Q2 2016 conference call feedback: 2018 still the likely margin inflexion point

**Fair Value EUR75 vs. EUR74 (+5%)** **NEUTRAL**

| | |
|---|---|
| Bloomberg | SAP GR |
| Reuters | SAPG.DE |
| 12-month High / Low (EUR) | 74.9 / 55.9 |
| Market Cap (EUR) | 88,022 |
| Ev (BG Estimates) (EUR) | 90,991 |
| Avg. 6m daily volume (000) | 2 767 |
| 3y EPS CAGR | 7.6% |

| | 1 M | 3 M | 6 M | 31/12/15 |
|---|---|---|---|---|
| Absolute perf. | 5.7% | 0.9% | -0.9% | -2.4% |
| Softw.& Comp. | 4.3% | -0.9% | 1.8% | -3.0% |
| DJ Stoxx 600 | 3.5% | -3.4% | 1.3% | -7.8% |

| YEnd Dec. (€m) | 2015 | 2016e | 2017e | 2018e |
|---|---|---|---|---|
| Sales | 20,798 | 21,979 | 23,601 | 25,239 |
| *% change* | | *5.7%* | *7.4%* | *6.9%* |
| EBITDA | 6,884 | 7,222 | 7,708 | 8,302 |
| EBIT | 4,251 | 5,348 | 5,892 | 6,446 |
| *% change* | | *25.8%* | *10.2%* | *9.4%* |
| Net income | 4,660 | 4,788 | 5,451 | 5,806 |
| *% change* | | *2.7%* | *13.8%* | *6.5%* |

| | 2015 | 2016e | 2017e | 2018e |
|---|---|---|---|---|
| Operating margin | 30.5 | 30.3 | 30.1 | 30.4 |
| Net margin | 14.8 | 16.8 | 18.7 | 18.9 |
| ROE | 13.2 | 14.4 | 15.4 | 15.0 |
| ROCE | 18.5 | 18.2 | 20.1 | 21.7 |
| Gearing | 24.7 | 11.6 | -1.6 | -13.1 |

| (€) | 2015 | 2016e | 2017e | 2018e |
|---|---|---|---|---|
| EPS | 3.69 | 3.80 | 4.32 | 4.60 |
| *% change* | - | *2.7%* | *13.8%* | *6.5%* |
| P/E | 19.4x | 18.9x | 16.6x | 15.6x |
| FCF yield (%) | 3.4% | 5.0% | 5.8% | 6.2% |
| Dividends (€) | 1.15 | 1.20 | 1.30 | 1.40 |
| Div yield (%) | 1.6% | 1.7% | 1.8% | 2.0% |
| EV/Sales | 4.5x | 4.1x | 3.7x | 3.3x |
| EV/EBITDA | 13.6x | 12.6x | 11.4x | 10.1x |
| EV/EBIT | 14.8x | 13.7x | 12.3x | 10.9x |



**We reiterate our Neutral rating but have raised our DCF-derived Fair Value to EUR75 from EUR74. We have cut out adj. EPS ests. by 5% for 2016 on Venezuela and tax issues but increased them by 2% for 2017-18, as we have raised our operating margin forecasts (30.3% vs. 30% for 2016, 30.1% vs. 29.7% for 2017, 30.4% vs. 30% for 2018). Despite the likelihood that SAP can reach the top-end of FY2016 non-IFRS operating profit guidance (EUR6.4-6.7bn, BG est. EUR6.66bn), we consider 2018 should still be the inflexion point for the margin.**


### ANALYSIS

- **S/4HANA pace of adoption ahead of expectations**. With +8.4% for H1 2016, lfl Cloud & Software revenue growth was ahead of FY16 company guidance (+6-8% lfl) and makes management quite confident it can achieve it. Licence revenue growth was up 1.6% lfl over H1, ahead of the target for a slight decline implied for the year. Customer adoption of S/4HANA is ahead of expectations and benefits from cross-selling with other products. 40% of the 500 S/4HANA deals signed in Q2 stemmed from new customers and more than 10% of SAP's ERP installed base has signed on S/4HANA. In cloud apps, SAP recently signed Accenture as a customer on SuccessFactors (cloud HR) for its 375k staff, Fieldglass generated triple-digit growth, and Customer Engagement & Commerce generates strong double-digit growth for cloud and on-premise. The HANA Cloud Platform generated triple-digit growth. The number of 'go-lives' for S/4HANA was around 220 (vs. 146 at the end of Q1) and management considers reaching a high triple-digit number by end 2016 - which is less than the 1,000 mentioned at Sapphire Now in May however.
- **Quite confident on non-IFRS operating margin**. With 11% cc growth for H1 2016, non-IFRS operating profit is well ahead of the 1-6% cc growth implied in company guidance (EUR6.4-6.7bn at cc). Clearly the Q2 figure benefited from both licence sales and the success of the transformation programme started mid-2015, which generated mid-triple digit cost savings. H2 2016 is unlikely to benefit from such a positive trend as most of the benefit from restructuring, which started to be visible in H2, is set to fade. That said, management considers that, with now an optimised structure, SAP can continue to invest in high-growth areas while still expanding operating profit - which makes the company's guidance look conservative. In addition, management is a bit more conservative on cloud gross margin, as it expects it to be flat instead of flat or slightly increasing in 2016. This is not only due to a mix effect - SaaS applications up 50% with with a 51.5% margin vs. Business Network up 21% with a 76.3% margin -, but also due to the breakeven target for the private cloud business (HANA Enterprise Cloud) which is now expected to be reached by end-2016 instead of mid-year given the accelerated growth rate. Finally, SAP is still investing in staff and moving cloud applications onto HANA, thus replacing third-party databases.
- **Tax rate guidance increased**. SAP increased FY16 tax rate guidance to 27-28% from 22.5-23.5% for two reasons: 1) The write-off of deferred tax assets in Venezuela due to the disastrous economic and political situation in the country, 2) The intellectual property consolidation process for Hybris which is postponed to 2017 as SAP was not able to finalise it in time. In addition, SAP incurred EUR70m of fx losses on the Venezuelan bolivar fuerte (EUR100m loss over H1).

### VALUATION

- SAP's shares are trading at est. 13.7x 2016 and 12.3x 2017 EV/EBIT multiples.
- Net debt on 30th June 2016 was EUR4,436m (net gearing: 19%).

### NEXT CATALYSTS

Q3 2016 results on 21st October before markets open.

*Click here to download document*


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