24th October 2016

TMT

SAP

Price EUR81.98

Q3 2016 conference call feedback: confidence on revenues, but fairly valued

Fair Value EUR82 vs. EUR79 (0%) **NEUTRAL**

Bloomberg	SAP GR
Reuters	SAPG.DE
12-month High / Low (EUR)	82.4 / 64.9
Market Cap (EUR)	100,713
Ev (BG Estimates) (EUR)	104,149
Avg. 6m daily volume (000)	2 306
3y EPS CAGR	8.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.2%	6.9%	15.3%	11.7%
Softw.& Comp.	-0.3%	6.6%	11.0%	7.7%
DJ Stoxx 600	0.5%	1.1%	-1.5%	-5.9%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	20,798	22,096	23,849	25,652
% change		*6.2%*	*7.9%*	*7.6%*
EBITDA	6,884	7,147	7,732	8,397
EBIT	4,251	5,059	5,940	6,565
% change		*19.0%*	*17.4%*	*10.5%*
Net income	4,639	4,639	5,431	5,837
% change		*0.0%*	*17.1%*	*7.5%*

	2015	2016e	2017e	2018e
Operating margin	30.5	29.7	29.8	30.2
Net margin	14.8	15.6	18.7	18.9
ROE	13.2	13.6	15.7	15.4
ROCE	18.5	18.1	20.0	22.0
Gearing	24.7	13.6	-0.5	-13.0

(€)	2015	2016e	2017e	2018e
EPS	3.78	3.78	4.42	4.75
% change	-	*0.0%*	*17.1%*	*7.5%*
P/E	21.7x	21.7x	18.5x	17.3x
FCF yield (%)	3.0%	4.4%	5.3%	5.8%
Dividends (€)	1.15	1.20	1.30	1.40
Div yield (%)	1.4%	1.5%	1.6%	1.7%
EV/Sales	5.1x	4.7x	4.2x	3.8x
EV/EBITDA	15.5x	14.6x	13.0x	11.5x
EV/EBIT	16.8x	15.9x	14.1x	12.5x

We reiterate our Neutral rating and increase our DCF-derived Fair Value to EUR82 from EUR79, as we have revised our adj. EPS ests. by +1% for 2017-18 (+EUR1/share) and adjusted our working capital assumptions (+EUR2/share). We consider that more resilient than initially expected licence and maintenance revenues should offset headwinds on the non-IFRS operating margin in 2017 from the cloud revenue mix and cloud customers migrating to HANA. However we still do not see the non-IFRS operating margin taking off before 2018, and we consider the stock is fairly valued.

ANALYSIS

- **More confidence in revenues**. The slowdown in cloud subscriptions in Q3 (+29%, o/w +24% in America) was temporary as it was related to the move of Concur's fiscal year end to 31st December from 30th September. Cloud bookings growth is expected to accelerate in Q4 from +24% reported for Q3. For Q4, SAP is confident on licence revenues performing well despite tough comps (+11% lfl in Q4 2015), while maintenance benefits from higher licence revenues and very low attrition, and cloud subscription revenues may accelerate again thanks to Concur. Guidance for 2017 will be updated for FY16 results in January, but resilience of licence revenues would continue to be driven by S/4HANA and HANA sales. Finally, the average deal size in the higher ticket amounts is going up, and SAP sees a higher share of sales in this higher ticket volumes.
- **Cloud margins: a mix issue**. For 2016, the gross margin for cloud susbcriptions is expected to be nearly flat. Management does not expect any substantial increase in 2017, before a take off in 2018 for reaching 73% in 2020 as stated in the business plan released early 2015: 1) SAP continues to invest heavily in cloud operations to migrate all acquired cloud applications to HANA - SuccessFactors customers to fully migrate within the next 12 months, then Ariba, Fieldglass and Concur customers will do so afterwards; 2) cloud applications (ATS) with a lower gross margin (51.4%) grow almost 3x faster (+47.1% lfl) than Business Networks (+16.7% lfl) with a higher gross margin (76.8%); 3) within cloud applications (ATS), the private cloud offering HANA Enterprise Cloud is a triple-digit million euro business year-to-date and is at breakeven as expected but is expected to keep improving gross margin going forward. The Services gross margin fell 2.9ppt to 20.5% in Q3 due to EUR50m investments in co-innovation projects with customers. These projects are to be completed at the end of Q1 2017, allowing for improvement in 2017.
- **Update on S/4HANA**. The number of "go-lives" for S/4HANA is 350 (+130 vs. June), which looks far from the mid-to-high hundreds figure guided for the end of 2016, but SAP is happy with the way IT Services firms implement S/4HANA through the "value assurance program" (they are involved in more than 80% of S/4HANA implementation projects), and more than 50% of S/4HANA projects are related to full scope ERP (version 15-11). A couple of S/4HANA Cloud Edition customers will go live by end 2016, but the launch of the public cloud division in January 2017 will make it take off.
- **Acquisitions, dividends and share buy-backs**. SAP sees nothing big in terms of acquisitions in a foreseeable future - only "tuck-in" deals in areas like machine learning and the IoT for instance. Debt related to the acquisition of Concur will be totally redeemed by end-2016, which would open more capacity for M&A, more generous dividends (>35% of IFRS net profit), and a share buy-back programme in H2 2017. Note that DSOs, which were higher for a couple of quarters due to overdues in emerging countries, are expected to stabilise in Q4, then decrease again.

VALUATION

- SAP's shares are trading at est. 15.9x 2016 and 14.1x 2017 EV/EBIT multiples.
- Net debt on 30th September 2016 was EUR3,904m (net gearing: 16%).

NEXT CATALYSTS

FY16 results on 24th January 2017 before markets open.

Click here to download document

Analyst :
Gregory Ramirez
33(0) 1 56 68 75 91
gramirez@bryangarnier.com

Sector Team :
Richard-Maxime Beaudoux
Thomas Coudry
Dorian Terral

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY — Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL — Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL — Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56,7%   NEUTRAL ratings 31,2%   SELL ratings 12,1%

Research Disclosure Legend

1	Bryan Garnier shareholding in Issuer	Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer").	No
2	Issuer shareholding in Bryan Garnier	The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group.	No
3	Financial interest	A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report	No
4	Market maker or liquidity provider	A member of the Bryan Garnier Group is a market maker or liquidity provider in the securities of the Issuer or in any related derivatives.	No
5	Lead/co-lead manager	In the past twelve months, a member of the Bryan Garnier Group has been lead manager or co-lead manager of one or more publicly disclosed offers of securities of the Issuer or in any related derivatives.	No
6	Investment banking agreement	A member of the Bryan Garnier Group is or has in the past twelve months been party to an agreement with the Issuer relating to the provision of investment banking services, or has in that period received payment or been promised payment in respect of such services.	No
7	Research agreement	A member of the Bryan Garnier Group is party to an agreement with the Issuer relating to the production of this Report.	No
8	Analyst receipt or purchase of shares in Issuer	The investment analyst or another person involved in the preparation of this Report has received or purchased shares of the Issuer prior to a public offering of those shares.	No
9	Remuneration of analyst	The remuneration of the investment analyst or other persons involved in the preparation of this Report is tied to investment banking transactions performed by the Bryan Garnier Group.	No
10	Corporate finance client	In the past twelve months a member of the Bryan Garnier Group has been remunerated for providing corporate finance services to the issuer or may expect to receive or intend to seek remuneration for corporate finance services from the Issuer in the next six months.	No
11	Analyst has short position	The investment analyst or another person involved in the preparation of this Report has a short position in the securities or derivatives of the Issuer.	No
12	Analyst has long position	The investment analyst or another person involved in the preparation of this Report has a long position in the securities or derivatives of the Issuer.	No
13	Bryan Garnier executive is an officer	A partner, director, officer, employee or agent of the Bryan Garnier Group, or a member of such person's household, is a partner, director, officer or an employee of, or adviser to, the Issuer or one of its parents or subsidiaries. The name of such person or persons is disclosed above.	No
14	Analyst disclosure	The analyst hereby certifies that neither the views expressed in the research, nor the timing of the publication of the research has been influenced by any knowledge of clients positions and that the views expressed in the report accurately reflect his/her personal views about the investment and issuer to which the report relates and that no part of his/her remuneration was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.	Yes
15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

A copy of the Bryan Garnier & Co Limited conflicts policy in relation to the production of research is available at www.bryangarnier.com

London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the
Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the
Financial Conduct Authority (FCA) and the
Autorité de Contrôle prudential et de
resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Munich
Widenmayerstrasse 29
80538 Munich
Germany
+49 89 2422 62 11

New Delhi
The Imperial Hotel Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA