SAP SE (SAP)

Updated September 20th, 2018 by Nick McCullum

Key Metrics

Current Price:	$120	**5 Year CAGR Estimate:**	4.2%	**Volatility Percentile:**	27.3%
Fair Value Price:	$89	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	49.3%
% Fair Value:	135%	**5 Year Valuation Multiple Estimate:**	-5.8%	**Valuation Percentile:**	16.1%
Dividend Yield:	1.0%	**5 Year Price Target**	$137	**Total Return Percentile:**	27.1%

Overview & Current Events

SAP SE develops, sells, and maintains a variety of enterprise software products that are used by corporations, governments, and educational agencies. The company employs more than 93,800 people and has more than 404,000 customers in more than 180 countries. SAP is headquartered in Germany and reports financial results in Euros. American investors can initiate an ownership stake in SAP through American Depository Receipts that trade on the New York Stock Exchange under the ticker SAP with a market capitalization of US$147 billion.

In mid-July, SAP reported (7/19/18) financial results for the second quarter of fiscal 2018. In the quarter, total revenue increased by 4% under International Financial Reporting Standards (IFRS) – the international equivalent of U.S. GAAP – while adjusted (non-IFRS) revenue increased by 10% at constant currencies. Moving down the income statement, operating profit increased by 13% on an IFRS basis and 12% on an adjusted, constant-currency basis. Net income increased by 8% - or 5% on an adjusted basis – while IFRS diluted earnings-per-share also increased by 8%, or 5% on an adjusted basis. SAP's growth was largely driven by its cloud business. New cloud bookings increased by 24% - or 29% in constant currency – in the second quarter, while cloud subscriptions and support revenue grew 30% (or 40% on an adjusted, constant-currency basis). This strong cloud performance offset stagnancies in other parts of SAP's business. More specifically, software revenue declined by 9% on an IFRS and 5% on an adjusted basis in the reporting period. SAP also updated its 2018 financial guidance with the release of second quarter earnings. At constant currencies, the company expects revenue to growth by 6.0%-7.5%, operating profit to grow by 9.0%-11.0%, cloud and software revenue to grow by 7.5%-8.5%, and cloud subscriptions and support revenue to grow by 34.0%-38.0%. Despite SAP's strong performance, shares fell by 2% in the days following the announcement before rebounding quickly in the coming weeks.

Looking ahead, SAP is scheduled to release its third quarter financial results on October 18th, 2018.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.25	$2.20	$2.02	$3.27	$3.12	$3.83	$3.54	$3.21	$3.21	$4.03	***$4.45***	***$6.85***
DPS	$0.78	$0.68	$0.60	$0.87	$0.99	$1.11	$1.36	$1.22	$1.30	$1.36	***$1.50***	***$2.30***
Shares	1187.3	1188.8	1187.7	1190.3	1191.5	1193.7	1195.2	1197.5	1198.6	1197.0	***1197.5***	***1200.0***

SAP has managed to generate impressive business growth over the last ten years. More specifically, the last decade saw the enterprise software giant compound its adjusted earnings-per-share at 12.4% per year. Looking ahead, we believe that SAP's growth will likely moderate to the high single-digits. We are forecasting 9% annualized earnings-per-share growth over the next 5 years. SAP is expecting operating profit to grow by approximately 10% in fiscal 2018, and we believe that earnings-per-share are likely to expand by a similar amount, which gives us a 2018 earnings-per-share estimate of $4.45. Applying a 9% growth rate to this figure allows us to calculate a 2023 earnings-per-share estimate of $6.85.

Although SAP has a safe payout ratio, the company's dividend policy has been very conservative in the past. The company also has plenty of internal reinvestment opportunities given the promising growth in its cloud business. Accordingly, we expect that dividend growth will equal earnings-per-share growth over the next half-decade.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	21.2	19.3	23.4	17.7	21.3	20.3	21.4	22.4	25.6	25.7	***27.0***	***20.0***
Avg. Yld.	1.6%	1.6%	1.3%	1.5%	1.5%	1.4%	1.8%	1.7%	1.6%	1.3%	***1.4%***	***1.7%***

SAP's leadership in the global enterprise software industry means that the company has historically been granted a premium valuation multiple. More specifically, SAP has traded at an average price-to-earnings ratio of 21.8 over the last decade. We believe that a price-to-earnings ratio of 20.0 represents fair value for SAP. The company is trading at a price-to-earnings ratio of 27.0 today. If SAP's price-to-earnings ratio contracts to 20 over the next 5 years, this will reduce the company's annualized returns by 5.8% per year during this time period.

Investors should note that Germany imposes a 26% dividend withholding tax. This lowers SAP's net yield to 1.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

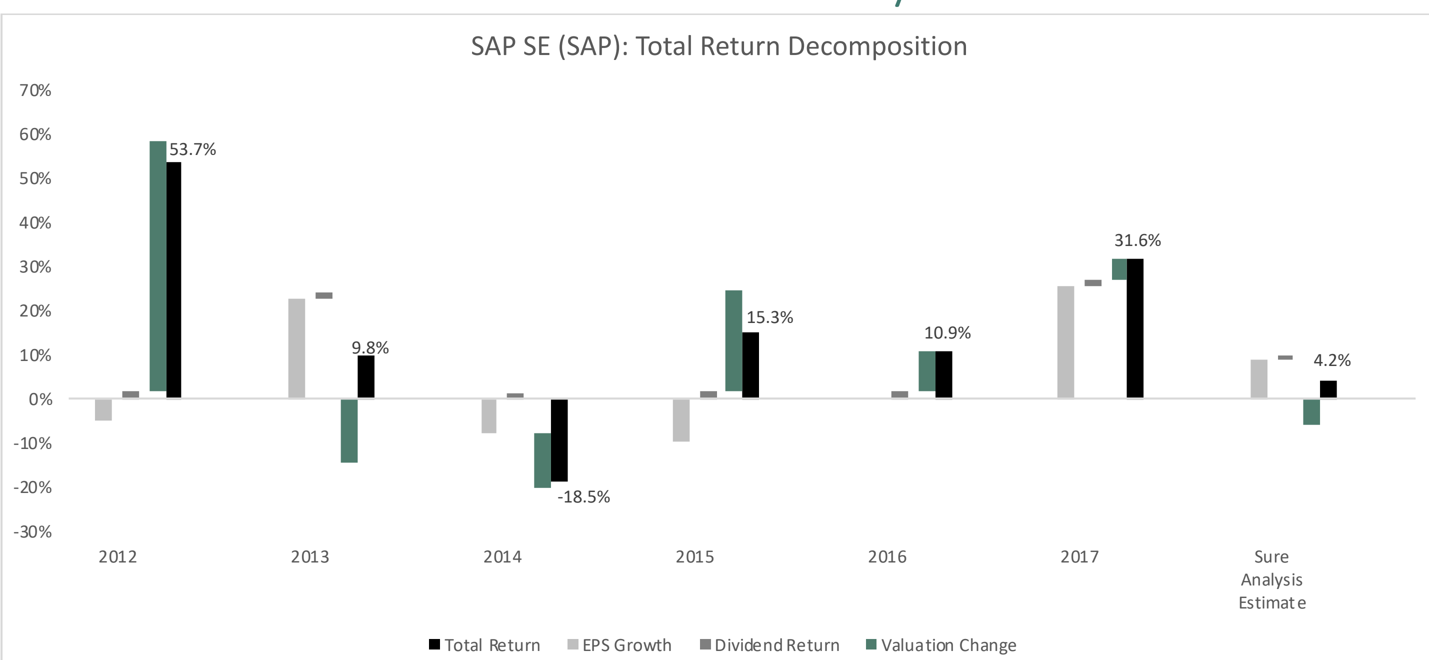
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	57.0%	52.2%	41.0%	45.8%	41.2%	41.8%	35.7%	35.7%	36.6%	36.5%	***36.0%***	***35.0%***
Debt/A	48.4%	36.5%	52.9%	45.3%	46.3%	40.8%	49.3%	43.7%	40.4%	39.9%	***40.0%***	***40.0%***
Int. Cov.	53.9	31.9	36.8	117	55.2	69.3	180.3	847	135.0	N/A	***N/A***	***N/A***
Payout	33.7%	40.5%	38.0%	38.4%	29.0%	31.7%	26.6%	29.7%	30.9%	34.7%	***33.7%***	***33.6%***
Std. Dev.	41.2%	28.5%	24.9%	32.1%	26.6%	15.7%	17.3%	23.8%	18.3%	10.6%	***17.0%***	***17.0%***

Qualitatively, SAP's strongest competitive advantage is its recurring revenue business model. At the end of the most recent reporting period, 66% of the company's revenue was recurring in nature. The company expects this metric to rise to 70%-75% by 2020. Recurring revenue allows the company to optimize customer retention rates and use the resulting cash flows to aggressively invest in compelling growth opportunities (such as its cloud business).

Final Thoughts & Recommendation

SAP is an example of a great business trading at a terrible price. Valuation contraction is set to meaningfully reduce its total returns. Due to low expect returns, SAP earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.