SAP AKTIENGESELLSCHAFT SYSTEMS APPLICATIONS PRODUCTS IN DATA
Form 20-F
March 22, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

o	**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the fiscal year ended December 31, 2005**
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the transition period from to**
o	**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **Date of event requiring this shell company report**

Commission file number: 1-14251
SAP AG
(Exact name of registrant as specified in its charter)
SAP CORPORATION
(Translation of Registrant s name into English)
Federal Republic of Germany
(Jurisdiction of incorporation or organization)

Dietmar-Hopp-Allee 16
69190 Walldorf
Federal Republic of Germany
(Address of principal executive offices)
Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one-fourth of one Ordinary Share, without nominal value	New York Stock Exchange
Ordinary Shares, without nominal value	New York Stock Exchange*

Securities registered or to be registered pursuant to Section 12(g) of the Act: None
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary Shares, without nominal value (as of December 31, 2005)**	316,457,821

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes þ No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No þ

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 þ

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares.

** Including 6,678,656 treasury shares.

Table of Contents

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Table of Contents

TABLE OF CONTENTS

Table of Contents

* Omitted because the Item is not applicable or the answer is negative.

** The Registrant has responded to Item 18 in lieu of this Item.

Table of Contents

INTRODUCTION

SAP AG is a German stock corporation (*Aktiengesellschaft*) and is referred to in this Annual Report on Form 20-F, together with its subsidiaries, as SAP, or as the Company, we, our, or us. Our consolidated financial statements included in Item 18. Financial Statements in this Annual Report on Form 20-F have been prepared in accordance with generally accepted accounting principles in the United States of America, referred to as U.S. GAAP.

In this Annual Report on Form 20-F: (i) references to U.S.$, $, or dollars are to U.S. dollars; (ii) references to euro are to the euro, a currency of the countries currently participating in the European Economic Monetary Union (EMU). Certain amounts that appear in this Annual Report on Form 20-F may not sum because of rounding adjustments. In this Annual Report on Form 20-F, except as otherwise specified, financial information with respect to SAP has been expressed in euro and/or dollars.

Unless otherwise specified herein, all euro financial data that have been converted into dollars have been converted at the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) on December 31, 2005, which was U.S.$1.1842 per 1.00. No representation is made that such euro amounts actually represent such dollar amounts or that such euro amounts could have been or could be converted into dollars at that or any other exchange rate on such date or on any other dates. The rate used for the convenience translations also differs from the currency exchange rates used for the preparation of the Consolidated Financial Statements. For information regarding recent rates of exchange between euro and dollars, see Item 3. Key Information Exchange Rates. At March 10, 2006, the Noon Buying Rate for converting euro to dollars was U.S.$1.1886 per 1.00.

Unless the context otherwise requires, references in this Annual Report on Form 20-F to ordinary shares are to SAP AG s ordinary shares, without nominal value, and references to preference shares are to SAP AG s non-voting preference shares, without nominal value, which were converted to ordinary shares as of June 18, 2001. References in this Annual Report on Form 20-F to ADSs are to SAP AG s American Depositary Shares, each representing one-fourth of one SAP ordinary share. SAP AG s Annual General Shareholders Meeting to be held on May 9, 2006 will consider among other things a proposal to change our share capital by an increase in subscribed capital from corporate funds pursuant to which each shareholder will receive three additional shares for each existing SAP ordinary share held. No new capital is being raised through this transaction. If shareholders approve the capital increase at the Annual General Shareholders Meeting and the resolution adopted is registered in the commercial register, the number of SAP ordinary shares held will increase fourfold automatically. As a result of this capital structure change, we anticipate that the ratio of ordinary share to ADSs would be adjusted to 1:1.

SAP, the SAP logo, R/2, R/3, mySAP, mySAP.com, xApp, xApps, SAP NetWeaver and other service names mentioned herein are trademarks or registered trademarks of SAP AG in Germany and in several other countries. This Annual Report on Form 20-F also contains product and service names of companies other than SAP that are trademarks of their respective owners.

Table of Contents

FORWARD-LOOKING INFORMATION

This Annual Report on Form 20-F contains forward-looking statements based on the beliefs of, and assumptions made by, our management using information currently available to them. Any statements contained in this Annual Report on Form 20-F that are not historical facts are forward-looking statements as defined in the U.S. Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events, including, but not limited to:

general economic and business conditions;

attracting and retaining personnel;

competition in the software industry;

implementing our business strategy;

developing and introducing new services and products;

freedom to use intellectual property;

regulatory and political conditions;

adapting to technological developments;

obtaining and expanding market acceptance of our services and products;

terrorist attacks or other acts of violence or war;

integrating newly acquired businesses;

meeting our customers requirements; and

other risks and uncertainties, some of which we describe under Item 3. Key Information Risk Factors.

The words aim, anticipate, believe, continue, could, counting on, is confident, estimate, expect, may, plan, project, predict, seek, should, strategy, want, will, would and similar expressions as th intended to identify such forward-looking statements. Such information includes, for example, the statements made in Item 5. Operating and Financial Review and Prospects, but also appears in other parts of this Annual Report on Form 20-F. Such statements reflect our current views and assumptions and all forward-looking statements are subject to various risks and uncertainties that could cause actual results to differ materially from those statements. The factors that could affect our future financial results are discussed more fully under Item 3. Key Information Risk Factors as well as elsewhere in this Annual Report on Form 20-F and in our other filings with the U.S. Securities and Exchange Commission (SEC). Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 20-F. We undertake no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

Table of Contents

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

ITEM 3. KEY INFORMATION

SELECTED FINANCIAL DATA

The following table represents selected consolidated financial information of SAP. The table should be read together with Item 5. Operating and Financial Review and Prospects. The selected consolidated financial data of SAP is a summary of, is derived from and is qualified by reference to, our consolidated financial statements and notes thereto audited for the years ended December 31, 2005, 2004, 2003, and 2002 by KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft (KPMG), independent auditors and for the year ended December 31, 2001 by ARTHUR ANDERSEN Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft mbH (Arthur Andersen), independent auditors.

The audited consolidated income statements, consolidated statements of cash flows and consolidated statements of changes in shareholders equity for the years ended December 31, 2005, 2004, and 2003, and the consolidated balance sheets at December 31, 2005 and 2004 are included in Item 18. Financial Statements.

	Year Ended December 31,					
	2005	**2005**	**2004**	**2003**	**2002**	**2001**
	U.S.$(1)					
	(in thousands, except per share data)					
Income Statement Data:						
Total revenue	10,080,418	8,512,429	7,514,493	7,024,606	7,412,838	7,340,804
Operating income	2,760,053	2,330,732	2,018,381	1,724,019	1,625,678	1,312,374
Income before income taxes and minority interest	2,743,029	2,316,356	2,072,642	1,776,615	1,107,698	1,068,757
Net income	1,772,045	1,496,407	1,310,521	1,077,063	508,614	581,136
Earnings per share(2)						
Basic	5.72	4.83	4.22	3.47	1.62	1.85
Diluted	5.70	4.81	4.20	3.46	1.62	1.85
Other Data:						
Weighted average number of shares outstanding(2)(3)						
Basic	309,816	309,816	310,802	310,781	313,016	314,309
Diluted	310,836	310,836	312,156	311,409	313,980	314,412
Balance Sheet Data:						
Total assets	10,732,099	9,062,742	7,585,472	6,325,865	5,608,463	6,195,604
Shareholders equity	6,847,326	5,782,238	4,594,253	3,709,445	2,872,091	3,109,513
Subscribed capital	374,750	316,458	316,004	315,414	314,963	314,826
Short-term bank loans and overdrafts	26,417	22,308	25,851	19,043	22,657	458,266
Long-term financial debt(4)	10,562	8,919	9,211	11,948	11,318	7,375

3

Table of Contents

(1) Amounts in the column are unaudited and translated for the convenience of the reader at U.S.$1.1842 to 1.00, the Noon Buying Rate for converting 1.00 into dollars on December 31, 2005. See Exchange Rates for recent exchange rates between the euro and the dollar. Our auditors have not audited these converted dollar amounts.

(2) Amounts are adjusted for our one-for-one conversion of preference shares to ordinary shares effective as of June 18, 2001.

(3) Includes preference and ordinary shares for periods prior to June 18, 2001, the effective date of the conversion of the preference shares into ordinary shares on a share-for-share basis.

(4) Long-term financial debt represents financial liabilities with a remaining life beyond one year, which is comprised of bank loans and overdrafts and convertible bonds issued pursuant to stock-based compensation plans. See Item 6. Directors, Senior Management and Employees Share Ownership Stock-Based Compensation Plans.

EXCHANGE RATES

The prices for ordinary shares traded on German stock exchanges are denominated in euro. Fluctuations in the exchange rate between the euro and the dollar will affect the dollar equivalent of the euro price of the ordinary shares traded on the German stock exchanges and, as a result, may affect the price of the American Depositary Shares (ADSs) in the United States. See Item 9. The Offer and Listing for a description of the ADSs. In addition, SAP AG pays cash dividends, if any, in euro, so that such exchange rate fluctuations will also affect the dollar amounts received by the holders of ADSs on the conversion into dollars of cash dividends paid in euro on the ordinary shares represented by the ADSs. The deposit agreement with respect to the ADSs requires the depositary to convert any dividend payments from euro into dollars as promptly as practicable upon receipt.

A significant portion of our revenue and expenses is denominated in currencies other than the euro. Therefore, movements in the exchange rate between the euro and the respective currencies to which we are exposed may materially affect our consolidated financial position, results of operations and cash flows. See Item 5. Operating and Financial Review and Prospects Foreign Currency Exchange Rate Exposure and for our foreign currency risk and hedging strategy see Item 11. Quantitative and Qualitative Disclosure About Market Risk Foreign Currency Risk.

The following table sets forth the average, high, low, and period-end Noon Buying Rates for the euro expressed as dollars per 1.00.

Year	**Average(1)**	**High**	**Low**	**Period-End**
2001	0.8909	0.9535	0.8370	0.8901
2002	0.9495	1.0485	0.8594	1.0485
2003	1.1411	1.2597	1.0361	1.2597
2004	1.2478	1.3625	1.1801	1.3538
2005	1.2400	1.3476	1.1667	1.1842

Month	High	Low	Period-End
2005			
July	1.2200	1.1917	1.2129
August	1.2434	1.2147	1.2330
September	1.2538	1.2011	1.2058
October	1.2148	1.1914	1.1995
November	1.2067	1.1667	1.1790
December	1.2041	1.1699	1.1842
2006			
January	1.2287	1.1980	1.2158
February	1.2100	1.1860	1.1925
March (through March 10, 2006)	1.2028	1.1886	1.1886

(1) The average of the applicable Noon Buying Rates on the last day of each month during the relevant period.

DIVIDENDS

Dividends are jointly proposed by SAP AG s Supervisory Board (*Aufsichtsrat*) and Executive Board (*Vorstand*) based on SAP AG s year-end stand-alone financial statements, subject to approval by the shareholders, and are officially declared for the prior year at SAP AG s Annual General Shareholders Meeting. Dividends paid to holders of the ADSs may be subject to German withholding tax. See Item 8. Financial Information Dividend Policy and Item 10. Additional Information Taxation.

The following table sets forth in euro the annual dividends paid or proposed to be paid per ordinary share in respect of each of the years indicated. The table does not reflect tax credits that may be available to German taxpayers who receive dividend payments. If you own our ordinary shares or ADSs and if you are a U.S. resident, please refer to Taxation in Item 10.

Year Ended December 31,	Dividend Paid per Ordinary Share	
		U.S.$
2001	0.58	0.53 (1)(4)
2002	0.60	0.69 (1)(4)
2003	0.80	0.95 (1)(4)
2004	1.10	1.39 (1)(4)
2005 (proposed)	1.45(2)	1.72 (2)(3)(4)

(1) Translated for the convenience of the reader from euro into dollars at the Noon Buying Rate for converting euro into dollars on the dividend payment date. The depositary is required to convert any dividend payments received from SAP as promptly as practicable upon receipt.

(2) Subject to approval of the Annual General Shareholders Meeting of SAP AG to be held on May 9, 2006.

(3) Translated for the convenience of the reader from euro into dollars at the Noon Buying Rate for converting euro into dollars on March 10, 2006, of U.S.$1.1886 per 1.00. The depositary is required to convert any dividend payments received from SAP as promptly as practicable upon receipt. The dividend paid can actually differ due to

changes in the exchange rate.

(4) One SAP ADS currently represents one-fourth of SAP AG s ordinary share. Accordingly, the final dividend per ADS is calculated as one-fourth of the dividend for one SAP AG share and is dependent on the euro/dollar exchange rate.

The amount of dividends paid on the ordinary shares depends on the amount of SAP AG profits to be distributed by SAP AG, which depends in part upon our performance. The timing and amount of future dividend payments will depend upon our future earnings, capital needs and other relevant factors in each case as proposed by the Executive Board and the Supervisory Board of SAP AG and approved at the Annual General Shareholders Meeting.

RISK FACTORS

Economic Risks

A downturn in the economic conditions in the regions in which we operate or in the software markets in those regions or in our customers specific industries has in the past resulted, and may result in the future, in a significant fluctuation of demand for our products, causing our revenues and profitability to suffer.

Implementation of SAP software products can constitute a major portion of our customers overall corporate budget, and the amount customers are willing to invest in acquiring and implementing SAP products and the timing of our customers investments have tended to vary due to economic or financial crises or other business conditions. A recession, slow or weak economic recovery of technology and software markets could have a material adverse effect on our business, financial position, operating results or cash flows. In particular, our profitability and cash flows may be significantly adversely affected by adverse economic conditions in Europe or the U.S. because we derive a substantial portion of our revenue from software licenses and services in those geographic regions.

One important feature of our long-term strategy for growth is to increase our offerings for the small and midsize enterprise (SME) segment. A slowdown in growth, recession, or slow or weak economic recovery could inhibit the creation and financial strength of those businesses and thereby delay or prevent altogether that key element of our growth strategy.

See Item 4 Business by Region for information on the regions in which we operate and Revenue by Industry Sector for information on the industries in which our customers operate.

Social and political instabilities including those caused by terrorist attacks, the risk of war or international hostilities as well as the risk of pandemic disease outbreaks could adversely impact our business.

The financial, political, economic and other uncertainties following terrorist attacks like those in the U.S., Spain and the UK, and other acts of violence or war, such as the conflict in Iraq, as well as the risk of pandemic disease outbreaks could damage the world economy and affect our and our customers investment decisions over an extended period of time. We believe that geopolitical uncertainties, including hostilities against the U.S., countries in Europe or any other country, or the threat of serious disease may lead to cautiousness by our customers in setting their capital spending budgets. Furthermore, such occurrences could make business continuity and business travel more difficult, thus interfering with customers decision making processes and our ability to sell products and provide services to them.

Because we expect to continue to expand globally, we may face specific economic and regulatory challenges that we may not be able to meet.

Our products and services are currently marketed in over 120 countries in the Europe, Middle East and Africa (EMEA), North and Latin America (Americas) and Asia-Pacific (APA) regions. In 2005, revenue

Table of Contents

derived from non-EMU member states totaled 5,371 million, representing approximately 63% of our total revenue. Sales in these regions are subject to risks inherent in international business activities, including, in particular:

- general economic or political conditions in each country or region;
- the overlap of differing tax structures;
- the management of an organization spread over various jurisdictions;
- exchange rate fluctuations; and
- regulatory constraints such as export restrictions, governmental regulations such as regulations of the Internet, and additional requirements for the design and for the distribution of software and services.

Other general risks associated with international operations include import and export licensing requirements, trade restrictions, changes in tariff and freight rates and travel and communication costs. There can be no assurance that our international operations will continue to be successful or that we will be able to effectively manage the increased level of international operations.

Market Risks

Consolidation in the software industry may result in instability of software demand and stronger peer companies in the long term.

The entire IT sector, including the software industry, is currently experiencing consolidation through mergers and acquisitions, particularly involving larger companies, such as the acquisitions of PeopleSoft, Inc. and Siebel Systems, Inc. by Oracle Corporation. Such consolidation in the industry may create uncertainty among potential customers about future IT investment plans, causing longer sales cycles for us. Also, consolidated companies may emerge as stronger competitors with more resources, a larger customer base and a wider variety of product offerings than we have.

Due to intense competition, our market share and financial performance could suffer.

The software industry is intensely competitive. As part of our business strategy, over the last few years we have focused our efforts in areas where demand is expected to grow more rapidly. In particular, we have been focusing on customer relationship management, a technology and application integration platform, solutions for small and midsize enterprises as well as industry-tailored solutions for specific industries such as retail and financial services. Our expansion from the traditional large enterprise resource planning (ERP) product offerings exposes us to different competitors in size, geographic location and specialty. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address customer needs better than we do. Competition, with respect to pricing, product quality and functionalities/features, and consulting and support services, could increase substantially and result in price reductions, cost increases or loss of segment share.

In response to competition, we have been required in the past, and may be required in the future, to furnish additional discounts or other concessions to customers or otherwise modify our pricing practices. These developments have impacted and may increasingly negatively impact our revenue and earnings.

The recent trend towards outsourcing business processes to external providers (business process outsourcing, or BPO) could result in increased competition for SAP with systems integrators, consulting firms, telecommunications firms, computer hardware vendors and other IT service providers. Companies pursuing business process outsourcing will not be interested in purchasing SAP software products to the extent the solution provided by the outsourcing provider includes the necessary software-based process support. The perception of value created by SAP s products among end user customers could be diminished to the extent outsourcing providers bundle SAP applications with their services. While most of SAP s revenues are currently derived from contracts directly with end user customers, an increased trend to outsourcing business processes to external providers could have a short-term adverse impact on SAP s revenues, earnings and results of operations. In addition, the distribution of applications through application service providers may in the short term reduce the price paid for SAP products or adversely affect other sales of SAP products.

The market in which we compete continues to evolve and, if it does not grow rapidly in the long term, our business will be adversely affected.

We are investing significant resources in further developing and marketing new and enhanced products and services. Demand and customer acceptance for recently introduced products and services are subject to a high level of uncertainty, especially where acquisition of SAP software products requires a large capital commitment or other significant commitment of resources. Moreover, newer offerings allow greater levels of flexibility in software application and data utilization, particularly by those individuals and enterprises that have historically relied upon traditional means of commerce and communication. Their adoption therefore will require a broad acceptance of new and substantially different methods of conducting business and exchanging information. These products and services involve a new approach to the conduct of business and, as a result, we have invested in, and intend to continue to pursue, intensive marketing and sales efforts to educate prospective customers regarding the uses and benefits of these products and services in order to generate demand. Demand for these products and services may not develop, which could have a material adverse effect on our business, financial position and results of operations or cash flows.

Our future revenue is dependent in part upon our installed customer base continuing to license additional products, renew maintenance agreements and purchase additional professional services.

Our large installed customer base has traditionally generated additional new software, maintenance, consulting and training revenues. We believe that recently developed or planned SAP offerings geared towards substantially expanding the potential scope of potential users within our installed customer base such as Mendocino, a joint solution offering developed with Microsoft Corporation, or our SAP xApp Analytics composite applications, pose an opportunity for SAP to continue to generate revenue from existing customers. Nevertheless, in future periods customers may not necessarily license additional SAP products or contract for additional services or maintenance. After an initial term, maintenance is generally renewable annually at a customer s option, and there are no mandatory payment obligations or obligations to license additional software. If our customers decide not to renew their maintenance agreements or license additional products or contract for additional services, or if they reduce the scope of their maintenance agreements, our revenues could decrease and our operating results could be adversely affected.

Strategic Planning Risks

Our failure to develop new relationships and enhance existing relationships with third-party distributors, software suppliers, system integrators and value-added resellers that help sell our services and products may adversely affect our revenues.

We have entered into agreements with a number of leading computer software and hardware suppliers and other technology providers to cooperate and ensure that certain of the products produced by such suppliers are compatible with SAP software products. We have also supplemented our consulting and support services (in the areas of product implementation, training and maintenance) through alliance partnerships with third-party hardware and software suppliers, systems integrators, consulting groups formerly associated with major accounting firms and other consulting firms. Most of these agreements and alliances are of relatively short duration and non-exclusive. In addition, we have established relationships relating to the resale of certain of our software products by third parties. These third parties include value-added resellers and, in the area of application hosting services, certain computer hardware vendors, systems integrators and telecommunications providers. Our growth strategy includes commencing and maintaining relationships with independent software vendors (ISVs) and value added resellers for our products targeted at SMEs.

There can be no assurance that these third parties or business partners, most of whom have similar arrangements with our competitors and some of whom also produce their own standard application or technology integration software in competition with us, will continue to cooperate with us when such agreements or partnerships expire or are up for renewal. In addition, there can be no assurance that such third parties or partners will provide high-quality products or services or that actions taken or omitted to be taken by such parties will not adversely affect us. The failure to obtain high-quality products or services or to renew such agreements or partnerships could adversely affect our ability to continue to develop product enhancements and new solutions that keep pace with anticipated changes in hardware and software technology and telecommunications, or could adversely affect our ability to penetrate target markets and consequently the demand for our software products.

Human Capital Risks

If we were to lose the services of members of management and employees or fail to attract new personnel who possess specialized knowledge and technology skills, we may not be able to manage our operations effectively or develop new products and services.

Our operations could be adversely affected if senior managers or other skilled personnel were to leave and qualified replacements were not available. Competition for managerial and skilled personnel in the software industry remains intense. Especially as we embark on the introduction of new and innovative technology offerings to our client base such as our SAP NetWeaver platform initiative, we are relying on being able to build up and maintain a specialized workforce with deep technological know-how to ensure an optimal implementation of such new technologies in accordance with our clients demands. Such personnel in certain regions (including the U.S. and Europe) are in short supply. We expect continued increases in compensation costs in order to attract and retain senior managers and skilled employees, especially as the economic environment improves. Most of our current employees, with the exception of selected managers, are subject to employment agreements or conditions that do not contain post-employment noncompete provisions and in the case of most of our existing employees outside of Germany, permit the employees to terminate their employment on relatively short notice. There can be no assurance that we will continue to be able to attract and retain the personnel we require to develop and market new and enhanced products and to market and service our existing products and conduct our operations successfully. Further, our recruiting of personnel may expose us to claims from other companies seeking to prevent their employees from working for a competitor.

If we do not effectively manage our growth, our existing personnel and systems may be strained and our business may not operate efficiently.

We have a history of rapid growth and will need to effectively manage our future growth to be successful. In 2003, 2004, and 2005, we experienced an industry-wide trend in customer spending away from a lower volume of very large contracts to a higher volume of smaller contracts. In order to support our future growth, we expect to continue in the long-term to incur significant costs to increase headcount in key areas of our business, explore and/or enter new markets and build infrastructure ahead of anticipated revenue. We announced in January 2005 our intention to hire an additional 3,000 employees in 2005 to support our revenue growth goals and increased our hiring plans during 2005, resulting in an ultimate addition of more than 3,600 new employees to SAP s workforce as of December 31, 2005. There can be no assurance that significant increases in employees and infrastructure will result in growth in revenue or operating results in the future. Also, there is no assurance that we can sufficiently staff such additional headcount in lower cost countries such as India or China due to, for example, a local increase in competition for workforce in such countries. As a result, our operating margin and revenue figures per employee could decline. In addition, the ability to control costs could adversely affect revenue, profitability and cash flow in the future.

Organizational and Governance-related Risks

Principal shareholders may be able to exert control over our future direction and operations.

As of March 10, 2006, the beneficial holdings of SAP AG s principal shareholders (not counting immediate family members) and/or the holdings of entities controlled by them constituted in the aggregate approximately 30.667% of the outstanding ordinary shares of SAP AG. If SAP AG s principal shareholders and/or the holdings of entities controlled by them vote the shares held by them in the same manner, it may have the effect of delaying, preventing or facilitating a change in control of SAP or other significant changes to SAP AG or its capital structure. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders.

Sales of ordinary shares by principal shareholders could adversely affect the price of our capital stock.

The sale of a large number of ordinary shares by any of the principal shareholders and related entities, or by any of them, could have a negative effect on the trading price of our ADSs or our ordinary shares. We are not aware of any restrictions on the transferability of the shares owned by the principal shareholders or any related entity.

We are subject to significantly increased governance-related regulatory requirements both in Germany and the U.S.

SAP AG as a stock corporation domiciled in Germany and listed in Germany and the U.S. is subject to governance-related regulatory requirements under both jurisdictions. These standards are among the highest standards world-wide and have grown considerably in the past few years. In the U.S., the Sarbanes-Oxley Act of 2002 requires the establishment, ongoing assessment and certification of an effective system of Internal Control over Financial Reporting accompanied by stringent documentation efforts for companies and their external auditors. In Germany, the 10-point program to strengthen corporate integrity and investor protection issued by the federal government in February 2003 has resulted in various legislative initiatives which, among other things, have been or may be lowering the requirements for shareholder lawsuits and have intensified or may intensify regulators control over insider trading as well as the work of external auditors. Pursuant to the EU Anti-discrimination Directive which will need to be implemented as national law in Germany, very broad anti-discriminatory requirements backed by the threat of damages may be imposed upon the human resources operations of companies in the future. Given the high level of complexity of these laws there can be no assurance that we will not be held in breach of certain regulatory requirements, e.g., through fraudulent or negligent behavior of individual employees, our failure to comply with certain formal documentation requirements or otherwise. Any corresponding accusation against us, whether merited or not, may have a material adverse impact on our reputation as well as the trading price of our ordinary shares and ADSs.

Table of Contents

U.S. judgments may be difficult or impossible to enforce against us or our Board members.

SAP AG is a stock corporation organized under the laws of Germany. With one exception, all members of SAP AG s Executive Board and Supervisory Board are non-residents of the U.S. A substantial portion of the assets of SAP and such persons are located outside the U.S. As a result, it may not be possible to effect service of process within the U.S. upon such persons or us or to enforce against them judgments obtained in U.S. courts predicated upon the civil liability provisions of the securities laws of the U.S. In addition, awards of punitive damages in actions brought in the U.S. or elsewhere may be unenforceable in Germany.

Communication and Information Risks

We may not be able to prevent harmful information leakage about future strategies, technologies and products.

We have established a range of security standards and organizational communication protocols to help ensure that internal, confidential communications and information about sensitive subjects such as our future strategies, technologies and products are not improperly or prematurely disclosed to the public. There is no guarantee that the established protective mechanisms will work in every case. SAP s competitive position could be considerably compromised if confidential information about the future direction of our product development or other strategies became public knowledge.

Our IT security measures may be breached or compromised and we may sustain unplanned IT system unavailability.

We rely on encryption, authentication technology and firewalls to provide security for confidential information transmitted to and from us over the Internet. Anyone who circumvents our security measures could misappropriate proprietary information or cause interruptions in our services or operations. The Internet is a public network, and data is sent over this network from many sources. In the past, computer viruses and software programs that disable or impair computers have been distributed and have rapidly spread over the Internet. Computer viruses could be introduced into our systems or those of our customers or suppliers, which could disrupt our network or make it inaccessible to customers or suppliers. Our security measures may be inadequate to prevent security breaches, and our business would be harmed if we do not prevent them. In addition, we may be required to expend significant capital and other resources to protect against the threat of security breaches and to alleviate problems caused by breaches as well as by any unplanned unavailability of our internal IT systems generally for other reasons.

Wide acceptance of the use of Web-based transactions may be hindered due to privacy concerns.

Consumers have significant concerns about secure transmissions of confidential information, especially financial information, over public networks like the Internet. This remains a significant obstacle to general acceptance of e-commerce and certain aspects of SAP s business. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments could result in compromises or breaches of our security measures or those of other technology providers. If any compromises of security were to occur, it could have the effect of substantially reducing the use of the Web for commerce and communications and therefore could adversely impact our long-term strategy for growth.

Table of Contents

Financial Risks

Our sales are subject to quarterly fluctuations and our sales forecast may not be accurate.

Our revenue and operating results can vary and have varied in the past, sometimes substantially, from quarter to quarter. Our revenue in general, and in particular our software revenue, is difficult to forecast for a number of reasons, including:

- the relatively long sales cycles for our products;
- the size and timing of individual license transactions;
- the timing of the introduction of new products or product enhancements by us or our competitors;
- changes in customer budgets;
- seasonality of a customer s technology purchases; and
- other general economic and market conditions.

As many of our customers make and plan their information technology (IT) purchasing decisions at or near the end of calendar quarters and a significant percentage of those decisions are made during the fourth quarter, even a small delay in purchasing decisions could have a material adverse effect on our results of operations. While our dependence on single, large scale sales transactions has decreased in recent years due to a relative increase in the number of license transactions concluded by SAP, mainly attributable to SAP s strengthened focus on the SME segment, there can be no assurance that our results will not be adversely affected by the loss or delay of one or a few large sales, which continue to occur especially in the enterprise customer segment.

We use a pipeline system, a common industry practice, to forecast sales and trends in our business. Our sales personnel monitor the status of proposals, including the date when they estimate that a customer will make a purchase decision and the potential revenue from the sale. While this pipeline analysis may provide us with some guidance in business planning, budgeting and forecasting, these pipeline estimates may not consistently correlate to revenue in a particular quarter and could cause us to improperly plan, budget or forecast. Because our operating expenses are based upon anticipated revenue levels and because a high percentage of our expenses are relatively fixed in the near term, any shortfall in anticipated revenue or delay in recognition of revenue could result in significant variations in our results of operations from quarter to quarter or year to year. We significantly increased in each year from 2003 through 2005, and plan to continue to increase throughout 2006, the following expenditures:

- expansion of our operations;
- research and development directed towards new products and product enhancements; and
- development of new distribution and resale channels, particularly for small and midsize enterprises.

Such increases in expenditures will depend, among other things, upon ongoing results and evolving business needs. To the extent such expenses precede or are not subsequently followed by increased revenue, our quarterly or annual operating results would be materially adversely affected and may vary significantly from preceding or subsequent periods.

Because we conduct our operations throughout the world, our results of operations may be affected by currency fluctuations.

Although the euro has been our financial and reporting currency since January 1, 1999, a significant portion of our business is conducted in currencies other than the euro. Approximately 63% of our consolidated revenue in 2005 was attributable to operations in non-EMU member states and translated into euro. As a consequence, period-to-period changes in the average exchange rate in a particular currency can significantly affect reported revenue and operating results. In general, appreciation of the euro relative to another currency has a negative effect on reported results of operations, while depreciation of the euro has a positive effect, although such effects may be short term in nature.

Fluctuations in the value of the U.S. dollar, the Japanese yen, the British pound, the Swiss franc, the Canadian dollar, and the Australian dollar have historically provided the greatest exposure to SAP s risk of currency fluctuations. As our business in emerging markets such as India and China continues to experience strong growth, these countries respective currencies are growing in importance as well. We continually monitor our exposure to currency risk and pursue a company-wide foreign exchange risk management policy. We have in the past and expect to continue in the future to at least partly hedge such risks with certain financial instruments. There can be no assurance that our hedging activities, if any, will be effective. See Item 11. Quantitative and Qualitative Disclosures about Market Risk Foreign Currency Risk.

Our revenue mix may vary and may negatively affect our profit margins.

Variances or slowdowns in our licensing activity may negatively impact our current and future revenue from maintenance and services since such maintenance and services revenues typically lag behind and are dependent upon software revenue. We generally license our products on a right-to-use basis pursuant to a perpetual license providing for an initial license fee based on the number and types of users or other applicable criteria. Maintenance fees, which are typically prepaid by our customers for periods of three to twelve months, are typically established based on a specified percentage of the initial license fee. In addition, changes in our pricing model, including an on-demand pricing model, could lead to a decline or delay in software sales and/or a decline or delayed increase in maintenance fees as our sales force and our customers adjust to the new pricing policies.

Any decrease in the percentage of our total revenue derived from software licensing could have a material adverse effect on our business, financial position, results of operations or cash flows.

The cost of derivative instruments for hedging of the STAR Plan may exceed the benefits of those arrangements.

Under our stock appreciation rights plan (the STAR Plan), stock appreciation rights (STARs) are granted to eligible employees of SAP. The STARs are primarily granted in the first quarter of each year and generally give the participants the right to a portion of the appreciation in the market price of the ordinary shares for the relevant measurement period. We have entered into in the past, and expect to enter into in the future, derivative instruments to hedge all or a portion of the anticipated cash flows in connection with the STARs in the event cash payments to participants are required as a result of an increase in the market price of the ordinary shares. We believe hedging anticipated cash flows in connection with the STARs limits the potential exposure associated with the STAR Plan, including potentially significant cash outlays and resulting compensation expense. There can be no assurance, however, that the benefits achieved from hedging our STAR Plan will exceed the related costs.

Table of Contents

Management s use of estimates may affect our results of operations and financial position.

Our financial statements are based upon the accounting policies as described in Note 3 of our consolidated financial statements included in Item 18. Financial Statements. Such policies require management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Facts and circumstances which management uses in making estimates and judgments may change from time to time and may result in significant variations, including adverse effects on our results of operations or financial position. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies.

Revenue recognition accounting pronouncements may adversely affect our reported results of operations.

We continuously review our compliance with all new and existing revenue recognition accounting pronouncements. Depending upon the outcome of these ongoing reviews and the potential issuance of further accounting pronouncements, implementation guidelines and interpretations, we may be required to modify our reported results, revenue recognition policies or business practices, which could have a material adverse effect on our results of operations. Our existing revenue recognition policies are described in Note 3 to our consolidated financial statements included in Item 18. Financial Statements and in Item 5. Operating and Financial Review and Prospects Critical Accounting Policies.

The market price for our ADSs and ordinary shares may remain volatile.

The trading prices of the ADSs and the ordinary shares have experienced and may continue to experience significant volatility. The current trading prices of the ADSs and the ordinary shares reflect certain expectations about the future performance and growth of SAP, particularly on a quarterly basis. However, our revenue can vary, sometimes substantially, from quarter to quarter, causing significant variations in operating results and in growth rates compared to prior periods. Any shortfall in revenue or earnings from levels projected by us quarterly or from projections made by securities analysts could have an immediate and significant adverse effect on the trading prices of the ADSs or the ordinary shares in any given period. Additionally, we may not be able to confirm our projections of any such shortfalls until late in the quarter or following the end of the quarter because license agreements are often executed late in a quarter. Finally, the stock prices for many companies in the software sector have experienced wide fluctuations, which have often not been directly related to an individual company s operating performance. The trading prices of our ADSs and ordinary shares may fluctuate in response to various factors including, but not limited to:

- the announcement of new products or product enhancements by us or our competitors;
- technological innovation by us or our competitors;
- quarterly variations in our results of operations;
- changes in revenue and revenue growth rates on a consolidated basis or for specific geographic areas, business units, products or product categories;
- speculation in the press or financial community;
- general market conditions specific to particular industries;
- general and country-specific economic or political conditions (particularly wars, terrorist attacks etc.); and
- proposed and completed acquisitions or other significant transactions by us or our competitors.

Table of Contents

Many of these factors are beyond our control. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. Any such securities class action litigation against us, with or without merit, could result in substantial costs and the diversion of management s attention and resources.

Project Risks

Customer implementation and installation of our products involves significant resources and is subject to significant risks.

Implementation of SAP software is a process that often involves a significant commitment of resources by our customers and is subject to a number of significant risks over which we have little or no control. Some of our customers have incurred significant third-party consulting costs and experienced protracted implementation times in connection with the purchase and installation of SAP software products. We believe that these costs and delays were due in many cases to the fact that, in connection with the implementation of the SAP software products, these customers conducted extensive business re-engineering projects involving complex changes relating to business processes within the customers own organization. However, criticisms regarding these additional costs and protracted implementation times have been directed at us, and there have been, from time to time, shortages of our trained consultants available to assist customers in the implementation of our products. In addition, the success of new SAP software products introduced by us may be adversely impacted by the perceived time and cost to implement existing SAP software products or the actual time and cost to implement such new products. We cannot provide assurances that protracted installation times or criticisms of us will not continue, that shortages of our trained consultants will not occur, or that our costs to perform installation projects will not exceed the fees we receive when fixed fees are charged by us.

Product Risks

Undetected errors, shortcomings in our security features or delays in new products and product enhancements may result in increased costs to us and delayed demand for our new products.

To achieve customer acceptance, our new products and product enhancements can require long development and testing periods, which may result in delays in scheduled introduction. Generally, first releases are licensed to a controlled group of customers after a validation process. Such new products and product enhancements may contain a number of undetected errors or bugs when they are first released. As a result, in the first year following the introduction of certain releases, we work with our early customers to correct such errors. There can be no assurance, however, that all such errors can be corrected to the customer s satisfaction, with the result that certain customers may bring claims for cash refunds, damages, replacement software or other concessions. The risks of errors and their adverse consequences may increase as we seek to introduce simultaneously a variety of new software products. Significant undetected errors or delays in new products or product enhancements may affect market acceptance of SAP software products, and any such events could have a material adverse effect on SAP s financial condition, cash flow, results of operations and reputation.

The use of SAP software products by customers in business-critical applications and processes and the increased complexity of our software create the risk that customers or other third parties may pursue warranty, performance or other claims against us in the event of actual or alleged failures of SAP software products, the provision of services or application hosting. We have in the past been, and may in the future continue to be, subject to such warranty, performance or other similar claims.

Table of Contents

In addition, certain of our Internet browser-enabled products include security features that are intended to protect the privacy and integrity of customer data. Despite these security features, our products may be vulnerable to break-ins and similar problems caused by Internet users, such as hackers bypassing firewalls and misappropriating confidential information. Such break-ins or other disruptions could jeopardize the security of information stored in and transmitted through the computer systems of our customers. Addressing problems and claims associated with such actual or alleged failures could be costly and have a material impact on our operations.

Although our agreements generally contain provisions designed to limit our exposure as a result of actual or alleged failures of SAP software products or the provision of services, such provisions may not cover every eventuality or be effective under applicable law. Any claim, regardless of its merits, could entail substantial expense and require the devotion of significant time and attention by key management personnel. The accompanying publicity of any claim, regardless of its merits, could adversely affect the demand for our software.

If we are unable to keep up with rapid technological changes, we may not be able to compete effectively.

Our future success will depend in part upon our ability to:

- continue to enhance and expand our existing products and services;
- provide best-in-class business solutions and services; and
- develop and introduce new products and provide new services that satisfy increasingly sophisticated customer requirements, that keep pace with technological developments and that are accepted in the market.

There can be no assurance that we will be successful in anticipating and developing product enhancements or new solutions and services to adequately address changing technologies and customer requirements or that we will be able to generate enough revenues to offset the significant research and development costs we incur in bringing these products and services to the market. We may fail to anticipate and develop technological improvements, to adapt our products to technological change, changing country-specific regulatory requirements, emerging industry standards and changing customer requirements or to produce high-quality products, enhancements and releases in a timely and cost-effective manner in order to compete with applications and other technologies offered by our competitors.

We depend on technology licensed to us by third parties, and the loss of this technology could delay implementation of our products or force us to pay higher license fees.

We license numerous third-party technologies that we incorporate into our existing products, on which, in the aggregate, we may be substantially dependent. There can be no assurance that the licenses for such third-party technologies will not be terminated or that we will be able to license third-party software for future products. In addition, we may be unable to renegotiate acceptable third-party license terms to reflect changes in our pricing models. While we do not believe that one individual technology we license is material to our business, changes in or the loss of third-party licenses could lead to a material increase in the costs of licensing or to SAP software products becoming inoperable or their performance being materially reduced, with the result that we may need to incur additional development costs to ensure continued performance of our products.

Table of Contents

Our strategy to position SAP NetWeaver as a business process platform may not succeed or may make certain of our products less desirable.

In 2003, we announced the introduction of the SAP NetWeaver platform, an integration and application platform. With SAP NetWeaver, customers could easily integrate systems, as well as develop, deploy, run, and maintain software programs. This new and innovative platform provided the foundation for running both SAP and external applications. We have devoted a significant amount of resources to the development and marketing of the SAP NetWeaver platform to gain awareness and market share.

In 2004, a more consolidated release of the SAP NetWeaver platform became available to customers. With this release, technology components were unified in a single platform reducing the need for custom integration and ensuring that mission-critical business processes were reliable, secure, and scalable. Also in 2004, we announced that the SAP NetWeaver platform provided the technical foundation for enterprise services architecture (ESA), a business-driven software architecture for the creation of services-based, enterprise-scale solutions. ESA takes the concept of service-oriented architecture (SOA) to a new level by transforming Web services into enterprise services. ESA supports business requirements through the use of enterprise services to compose applications and extend existing systems. The SAP NetWeaver 2004s release has evolved to become a composition platform with model-based development that customers can use to enhance open enterprise services that are delivered by mySAP Business Suite applications.

In 2005, we announced the evolution of the SAP NetWeaver platform into a business process platform. As a business process platform, SAP NetWeaver combines infrastructure technology with preconfigured application and process components for the quick composition and deployment of innovative business processes.

The failure to receive acceptance from customers of the SAP NetWeaver platform, development by competitors of superior technology or significant errors in the solution could have a material adverse impact on our revenues, earnings and results of operations.

A key component of our strategy for a broad adoption of the SAP NetWeaver platform as a business process platform is to work with our customers and partners to develop reusable enterprise services and process components that are stored in an enterprise repository. As such, we are working with certified third-party ISVs and the SAP NetWeaver platform serves as a basis for those ISVs to develop and offer their own business applications. To the extent that SAP cannot attract a sufficient number of capable ISVs delivering high-quality solutions based on the platform, the desired market penetration of SAP NetWeaver may not be achieved. Any ISV-developed solutions with significant errors may reflect negatively on SAP s reputation and thus indirectly impede SAP s own business operations. In addition, as with any open platform design, the greater flexibility provided to customers to use data generated by non-SAP software may reduce customer demand to elect and use certain of our software products.

Other Operational Risks

We may not be able to protect our intellectual property rights, which may cause us to incur significant costs in litigation and erosion in the value of our brands and products.

We rely on a combination of the protections provided by applicable trade secret, copyright, patent and trademark laws, license and non-disclosure agreements and technical measures to establish and protect our rights in our products. Despite our efforts, there can be no assurance that these protections will be adequate or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology. Also, it may be possible for third parties to copy certain portions of our products or reverse engineer or otherwise obtain and use information that we regard as proprietary. Accordingly, there can be no assurance that we will be able to protect our proprietary software against unauthorized third-party

Table of Contents

copying or use, which could adversely affect our competitive position. In addition, the laws of certain countries do not protect our proprietary rights to the same extent as do the laws of the U.S. or Germany.

Some of our competitors or entities focusing on patent acquisition and licensing may have been more aggressive than we have in applying for or obtaining patent protection for innovative proprietary technologies.

We have been issued patents under our patent program and have a number of patent applications pending for inventions claimed by us. Nonetheless, the use of open-source software has become more prevalent in the development of software solutions in the software industry. Accordingly, we are selectively embedding in our software certain third-party open-source software components, which include software code subject to a license that typically requires that the code be freely transferable. We have implemented strict and detailed approval processes around the deployment of such components which involve, among other things, a thorough check of any corresponding licensing terms. There can be no assurance that, in the future, patents of third parties will not preclude us from utilizing certain technology in our products or require us to enter into royalty and licensing arrangements on terms that are not favorable to us. Furthermore, there can be no assurance that, in the future, a third party will not assert that our products or our deployment of third-party software, including open source software, violate its patents, copyrights or trade secrets. Although we do not believe that we are infringing any proprietary rights of others, third parties have claimed and may claim in the future that we have infringed their intellectual property rights. Our software products have been, and we believe will increasingly be, subject to such claims as the number of products in our industry segment grows, as we expand our products into new industry segments and as the functionality of products overlap. Any claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays, subject our products to an injunction, require a complete or partial re-design of the relevant product, result in delays by customers in making spending decisions or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

If we acquire other companies, we may not be able to integrate their operations effectively and, if we enter into strategic alliances, we may not work successfully with our alliance partners.

In order to complement or expand our business, we have made and expect to continue to make acquisitions of additional businesses, products and technologies, and have entered into, and expect to continue to enter into, a variety of alliance arrangements. Our current strategy for growth includes, but is not limited to, the acquisition of companies with the aim of strengthening our geographic reach, broadening our offerings in particular industries, or complementing our technology portfolio. Management s negotiation of potential acquisitions or alliances, and management s integration of acquired businesses, products or technologies could divert its time and resources. In addition, risks commonly encountered in such transactions include:

- inability to successfully integrate the acquired business;
- inability to integrate the acquired technologies or products with our current products and technologies;
- potential disruption of our ongoing business;
- inability to retain key technical and managerial personnel;
- dilution of existing equity holders caused by capital stock issuances to the stockholders of acquired companies or capital stock issuances to retain employees of the acquired companies;
- assumption of unknown material liabilities of acquired companies;

Table of Contents

incurrence of debt or significant cash expenditure;

difficulty in implementing or maintaining controls, procedures and policies;

potential adverse impact on our relationships with partner companies or third-party providers of technology or products;

impairment of relationships with employees and customers;

regulatory constraints; and

problems with product quality, product architecture, legal contingencies, product development issues or other significant risks that may not be detected through the due diligence process.

In addition, acquisitions of additional businesses may require large write-offs of any in-process research and development costs related to companies being acquired and amortization costs related to certain tangible and intangible assets that are acquired. Ultimately, certain acquired businesses may not perform as anticipated, resulting in charges for the impairment of goodwill and/or other intangible assets. Such write-offs and amortization charges may have a significant negative impact on operating margins and net income in the quarter in which the business combination is completed and subsequent periods. In addition, we have entered and expect to continue to enter into alliance agreements for the purpose of developing new products and services. There can be no assurance that any such products or services will be successfully developed or that we will not incur significant unanticipated liabilities in connection with such arrangements. We may not be successful in overcoming these risks or any other problems encountered in connection with any such transactions and may therefore not be able to receive the intended benefits of those acquisitions or alliances.

We may incur losses in connection with venture capital investments.

We have acquired and expect to continue to acquire equity interests in or make advances to technology-related companies, many of which currently generate net losses. Such activities may individually and in the aggregate involve significant capital outlay. Most of these companies are recently established. It is possible that changes in market conditions, the performance of companies in which we hold investments or to which we have made advances or other factors negatively impact our results of operations and financial position or our ability to recognize gains from the sale of marketable equity securities. Additionally, under German tax laws capital losses or write-downs of equity securities are not tax deductible, which may negatively impact our effective tax rate, cash flows and net income going forward. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Realizability of Venture Capital Investments.

Our insurance coverage may not be sufficient to avoid negative impacts on our financial position or results of operations resulting from the settlement of claims.

We maintain extensive insurance coverage for protection against many risks of liability. The extent of insurance coverage is regularly reviewed and is modified if we deem it necessary. Our goal of insurance coverage is to ensure that the financial effects, to the extent practicable at reasonable cost, resulting from risk occurrences are excluded or limited. Despite these measures, certain categories of risks are not currently insurable at reasonable cost. Even where we obtain insurance, our coverage is subject to exclusions that may limit or prevent availability to recover under those policies. Any failure to obtain or recover under insurance policies may result in a significant adverse impact on our financial position or results of operations.

We are subject to claims and lawsuits against us that may result in adverse outcomes.

We are subject to a variety of claims and lawsuits. Adverse outcomes in some or all of the claims pending against us may result in significant monetary damages or injunctive relief against us that could

Table of Contents

adversely affect our ability to conduct our business. While management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on our financial position or results of operations, litigation and other claims are by their nature subject to inherent uncertainties, and management s view of these matters may change in the future. Actual outcomes of litigation and other claims may differ from the judgments made by management in prior periods, which could result in a material adverse impact on our financial position and results of operations.

ITEM 4. INFORMATION ABOUT SAP

Our legal corporate name is SAP AG, which was changed during 2005 from SAP Aktiengesellschaft Systeme, Anwendungen, Produkte in der Datenverarbeitung. SAP AG is translated in English to SAP Corporation. SAP AG was incorporated under the laws of the Federal Republic of Germany in 1972. Where the context requires in the discussion below, SAP AG refers to our predecessors, Systemanalyse und Programmentwicklung GbR (1972-1976) and SAP Systeme, Anwendungen, Produkte in der Datenverarbeitung GmbH (1976-1988). SAP AG became a stock corporation (*Aktiengesellschaft*) in 1988. Our principal executive offices, headquarters and registered office are located at Dietmar-Hopp-Allee 16, 69190 Walldorf, Germany. Our telephone number is +49-6227-7-47474. SAP AG s agent for U.S. federal securities law purposes in the U.S. is Brad Brubaker. He can be reached c/o SAP America, Inc. at 3999 West Chester Pike, Newtown Square, PA 19073.

AVAILABILITY OF THIS REPORT

We intend to make this Annual Report on Form 20-F and other periodic reports publicly available on our Web site (www.sap.com) without charge immediately following our filing with the U.S. Securities and Exchange Commission. We assume no obligation to update or revise any part of this Annual Report on Form 20-F, whether as a result of new information, future events or otherwise, unless we are required to do so by law.

DESCRIPTION OF THE BUSINESS

Overview

SAP was founded in 1972 and is today one of the world s leading providers of business software solutions and one of the world s three largest independent software companies based on market capitalization.

Today, SAP has around 32,000 customers with more than 100,000 installations in over 120 countries and employs more than 35,000 people in more than 50 countries in the Europe, Middle East, and Africa (EMEA), Americas, and Asia-Pacific regions.

SAP s core business is developing and licensing SAP business software solutions. The product portfolio includes the SAP NetWeaver platform, and the following software applications:

mySAP Business Suite applications, which help enterprises improve business operations ranging from supplier relationships to production to warehouse management, sales, and all administrative functions, through to customer relationships

Qualified mySAP All-in-One partner solutions and the SAP Business One applications for small and midsize enterprises (SMEs)

Specific solutions for more than 25 industries in industry sectors such as financial services, consumer products, public service, process industry, service industry and discrete industry sectors

Table of Contents

SAP also sells maintenance, consulting, and training services associated with its software products. Furthermore, SAP develops and markets products in close cooperation with business partners.

The company is listed on several exchanges, including the Frankfurt Stock Exchange and the New York Stock Exchange (NYSE) under the symbol SAP.

Evolution of SAP Solutions

We introduced our first generation of software in 1973, initially consisting of only a financial accounting application. The software was later expanded to include materials management.

Expanding beyond this first generation, SAP began to develop integrated, cross-functional, multi-language, multi-currency solutions for a broader range of business processes. In 1981, SAP introduced our second generation of application software, the SAP R/2 system, which could be installed on an enterprise-wide basis. SAP R/2 was our first enterprise resource planning (ERP) system, designed to integrate all aspects of business, including distribution centers, field operations centers, corporate headquarters, and sales offices. Among its many functions, SAP R/2 included cost accounting, human resource management, logistics, and manufacturing. We believe that SAP R/2 also reduced processing bottlenecks by improving and accelerating user access to data.

In 1988, we anticipated and capitalized upon growth in the demand for more decentralized business software solutions. During this period, we designed the initial version of the SAP R/3 system, moving from mainframe computers to open systems such as client/server networks composed of multiple computers. Introduced in 1992, SAP R/3 offered the functionality of SAP R/2 in an open, three-tier, client/server architecture, and quickly became the category leader in ERP systems. We believe that SAP R/3 not only improved manufacturing efficiency but also improved the efficiency of such processes as distribution, finance, sales, procurement, inventory, and human resources. In the years following the introduction of SAP R/3, we also introduced several new business software applications and enhanced existing products to operate independently of SAP R/3.

During the 1990s, we introduced several solutions built on SAP R/3 to provide capabilities tailored to specific industries. In addition, we developed new solutions to address a variety of critical business issues Emerging customer needs also led us to create additional solutions.

In 1999, we introduced the mySAP.com e-business platform. This Internet-based platform not only linked together disparate business functions but also enabled collaboration among different organizations. As a result, it enabled organizations to participate in a larger collaborative community of customers, suppliers, and partners, which could shift functions and responsibilities as needed.

In 2002, we renamed mySAP.com as mySAP Business Suite. mySAP Business Suite is a family of business applications that help organizations manage their entire value chains across extended business networks. mySAP Business Suite is designed to allow organizations to excel in a business environment that requires rapid adaptation to changing business conditions.

In 2003, the SAP NetWeaver integration and application platform was launched, allowing organizations to integrate systems and to develop, deploy, and maintain software programs. The SAP NetWeaver platform is designed to allow easy integration of key business processes in both SAP and non-SAP solutions. SAP NetWeaver also became the platform upon which all SAP solutions are delivered. In addition, we announced the successor to SAP R/3 called mySAP ERP. mySAP ERP provides organizations with a comprehensive enterprise resource planning solution that can be extended through the addition of other SAP applications, such as mySAP Customer Relationship Management, mySAP Supply Chain Management, and mySAP Supplier Relationship Management. mySAP ERP is part of the mySAP Business Suite family of applications and is powered by the SAP NetWeaver platform.

Table of Contents

Responding to the growing requirement for increased business flexibility and inter-operability between heterogeneous applications, we unveiled in 2004 enterprise services architecture (ESA), a blueprint for the creation of services-based, enterprise-scale solutions extending service-oriented architecture design fundamentals. A service is a self-contained task or piece of functionality that can be accessed by applications using open standards. Enterprise services represent reusable, more meaningful building blocks, aggregating granular service modules, for composing applications to automate complex enterprise business processes and scenarios. Enterprise services can communicate business logic between software applications running on disparate platforms. ESA offers the potential for increased adaptability, flexibility, and openness.

The SAP NetWeaver platform is the foundation for ESA. We are actively working today to build enterprise services into our own applications and to create a repository of enterprise services for use by selected partners and customers. We have created an ESA adoption program that is designed for SAP and companies in our partner network to demonstrate the potential benefits of ESA to prospective and existing customers.

SAP s Strategy

SAP s strategy is to build on a strong position in the core enterprise applications segment and grow into adjacent lines of business serving customers with new offerings by leveraging ESA and working with an increasingly broad set of software partners. The intent of the strategy remains to increase software license sales, segment share and profitability.

We plan to grow within our core segment of enterprise applications by increasing our penetration within existing accounts and by expanding our reach to new customers in potentially higher-growth market segments, industries and new geographies. We plan to grow sales by focusing on the small and midsize enterprise (SME) segment, providing attractive offerings to nonexpert business users and by delivering an application platform through which partners and customers can build, adapt, and run business applications. Although acquisitions may occur, we plan to support this growth strategy principally with organic development of our product portfolio.

Significant changes in customer requirements are emerging, such as the need for flexibility and interoperability between heterogeneous software systems, driven by broad economic trends including globalization and technology advancements. We see globalization as a trend that is increasing competition worldwide and establishing requirements for connectivity and interdependence among the world s markets, businesses, and governments. In this environment, businesses are seeking greater integration and flexibility in their business applications. The IT industry has responded by introducing service-oriented architectures that allow disparate systems to work together more efficiently and effectively through the use of broadly accepted development and communications standards. Our product strategy directly addresses these new customer requirements through ESA.

As part of our ESA strategy, we are currently working to transform the SAP NetWeaver platform as a business process platform. The business process platform will include enterprise services built into our own applications and the creation of a repository of enterprise services for use by customers and partners. The business process platform is intended to allow customers and partners to develop new composite business applications more easily using enterprise services, as well as allowing our software products and technology to provide greater flexibility and added value to customers. We expect this to create increased demand for our application software products and related technology and services. In addition, the business process platform will allow us to improve our efficiency and reduce time-to-market by allowing the reuse of software components in development, and by permitting the creation of composite applications more rapidly than traditional modes of application software development. Composite applications created by software partners will complement and extend our products, allowing us to reach a larger market.

Table of Contents

Going forward, our global services and field services organizations will remain an important part of successfully executing our strategic road map. The crucial role of services is to develop innovative ways to support the sale of software directly and indirectly. Our services will provide ramp-up services for new products, teach and lead other systems integrators, provide quality assurance (particularly in partner-led implementations) and find ways to streamline and standardize our services to make their delivery more efficient overall.

Strategic Road Map

We envision a path of profitable growth in three stages through 2010.

Through 2006, we will continue to focus on building world-class processes and products to drive efficiency for our customers. We expect to create incremental growth primarily based on existing solutions, including mySAP Business Suite applications, while continuing to promote some of the new offerings, such as the SAP NetWeaver platform, SAP xApp Analytics, Mendocino and SAP CRM on-demand solutions. Mendocino is a code name for a joint product from Microsoft and SAP that allows for the exchange of information between SAP s application software and Microsoft® Office products. SAP CRM on-demand solutions provide a hosted customer relationship management service that incorporates software functions, hosting and maintenance services using a subscription pricing model.

To support the ESA standard, we intend to continue to recruit ISVs and IT vendors who develop solutions for the SAP NetWeaver platform.

In 2007 and beyond, we plan to deliver the next wave of products to market, including new SAP industry solution portfolios and an ESA-based solution for SMEs. In addition, we expect to see a new set of ISV solutions delivered on the SAP NetWeaver platform and commensurate platform-based revenues.

In 2008 and beyond, we plan to further promote the adoption of ESA and the SAP NetWeaver platform and further expand our base of partners. mySAP Business Suite is expected to be fully services-enabled through the SAP NetWeaver platform. During this phase, we also intend to deliver additional next-generation products.

Strategic Priorities for 2006

The Executive Board has established four priorities for 2006:

To increase our market share, especially in the SME segment

To focus on increasing profitability by improving productivity in all areas

To better serve SAP users with new products such as Mendocino, SAP CRM on-demand solutions and analytical applications

To help customers transition to and gain benefits from ESA

Table of Contents

SAP Product and Service Portfolio

We offer the following products and services:

Table of Contents

Products

We license components of our software solutions on an individual user basis. Licenses may be issued for individual solutions and applications or for mySAP Business Suite, which is described below. In addition to the user licenses for a solution, certain specialized functionality that is not user-specific may be licensed separately as one of our software engines.

Applications

mySAP Business Suite

mySAP Business Suite is a group of business applications that aims at enabling organizations to manage the entire value chain across business networks. Each application is available individually or in combination with other applications or solutions, and each is based on the SAP NetWeaver platform. mySAP Business Suite applications help increase the effectiveness of business relationships and streamline the management of an organization s overall information technology (IT) infrastructure. Because of their flexible platform, mySAP Business Suite applications may be deployed on a variety of computer hardware types and software operating systems.

Table of Contents

mySAP Business Suite consists of the following SAP applications: mySAP CRM, mySAP ERP, mySAP PLM, mySAP SCM and mySAP SRM.

mySAP Customer Relationship Management (mySAP CRM)

mySAP CRM is a customer relationship management (CRM) application that provides functions to manage the entire customer interaction cycle. It contains industry-specific capabilities that support marketing, sales and service departments. The application provides the ability to view and manage data related to each customer interaction, including those interactions occurring through field organizations, the Internet, interaction centers and channel partners. mySAP CRM helps businesses:

- Identify and engage potential customers;
- Perform business transactions with customers;
- Fulfill individual customer needs as contracted; and
- Provide after-sales care such as customer service and product maintenance.

mySAP ERP

mySAP ERP is an enterprise resource planning (ERP) application that contains a broad range of functions that support analytics, human capital management, financials, procurement and logistics execution, product development and manufacturing, sales and service and corporate services. mySAP ERP includes the following four solutions that support key functional areas:

Financials

The mySAP ERP Financials solution is a finance, analytics, accounting, and financial compliance solution that is designed to help organizations handle financial transactions, process and interpret financial and business data and implement financial reporting controls for corporate governance.

Human Capital Management (HCM)

The mySAP ERP HCM solution is designed to help organizations optimize their investment in their employees. It enables organizations to enhance workforce performance by helping to streamline a wide range of essential human resources transactions and processes, including compliance with global regulatory requirements. It supports administration, payroll, benefits, legal reporting, online recruiting, blended learning, organizational management, compensation, manager self-services, employee collaboration and workforce analytics.

Corporate Services

The mySAP ERP Corporate Services solution helps organizations support and streamline administrative processes in the areas of project portfolio management; quality management; audit management; environment, health and safety; travel management; and real estate management. Although these processes exist in most enterprises, they are often viewed as not differentiating an entity from its peers. Therefore, our customers seek to conduct these processes with the utmost efficiency. mySAP ERP Corporate Services is designed to optimize these services through greater visibility into performance, greater control, and reduced financial and environmental risks.

Operations

The mySAP ERP Operations solution provides functions for automating and streamlining procurement and logistics execution, product development and manufacturing and sales and service. The solution also provides tools for analyzing data for better decision-making, as well as functions to promote individual employee productivity.

mySAP Product Lifecycle Management (mySAP PLM)

The mySAP PLM application is designed to enable organizations to manage the complete lifecycle of a product, from initial concept design and engineering to production ramp-up and product change management to service and maintenance. It is designed to align product development priorities with business strategy through portfolio management, idea and concept management and requirements management. It enables organizations to manage the product development process and facilitate collaboration through project, resource and cost management, thereby helping to bring products to market on time and within cost. mySAP PLM also enables organizations to effectively utilize cross-functional teams and achieve environmental, health and safety compliance by managing product life-cycle data, including documents, product master and structure, process recipes, service and maintenance structure and any changes to these data.

mySAP Supply Chain Management (mySAP SCM)

The mySAP SCM application enables organizations to manage their supply chain by helping to synchronize the entire supply chain, from sourcing through manufacturing, distribution and fulfillment. It also assists in integrating these processes within the enterprise as well as across the network of suppliers, customers and business partners. mySAP SCM enables organizations and their partners to easily view inventory levels, orders, supplier and customer allocations, forecasts, production plans and key performance indicators so that they can work together with greater coordination. In addition, mySAP SCM monitors advanced planning, fulfillment, logistics, warehousing and transportation processes with radio frequency identification (RFID)-enabled sense-and-respond capabilities to optimize the flow of goods and creates alerts in the event of deviation from plans.

mySAP Supplier Relationship Management (mySAP SRM)

mySAP SRM is an application that enables organizations to manage their spending with suppliers. mySAP SRM simplifies and automates the procurement process through a self-service requisitioning process. It includes functions for supplier qualification, negotiation and contract management processes. In addition, mySAP SRM enables trading partners to collaborate on specifications and request-for-quotation processes as well as to process orders and manage invoices electronically.

SAP Manufacturing

The SAP Manufacturing solution is designed to allow discrete and process manufacturers to plan, schedule and sequence, execute and monitor production and maintenance while supporting compliance with health and safety standards. It enables companies to integrate manufacturing with the supply chain and other enterprise business processes. It also allows users to detect material, capacity, order, machine and labor exceptions.

SAP Manufacturing runs on the SAP NetWeaver platform.

SAP Service and Asset Management

The SAP Service and Asset Management solution enables organizations to install, maintain, repair and uninstall or decommission products, equipment, assets and facilities. SAP Service and Asset Management allows service and maintenance organizations to grow service-related revenues when service is delivered for a fee, improve service efficiency and productivity, reduce service and maintenance costs, increase equipment uptime and reliability, trim investments in service spare parts, improve return on assets (ROA), improve bottom-line performance and increase customer and end-user satisfaction and loyalty.

SAP Service and Asset Management runs on the SAP NetWeaver platform.

SAP xApps Composite Applications

In 2002, we announced the SAP xApps family of composite applications, a new breed of applications. SAP xApps composite applications are either general-purpose or industry-specific composite applications that integrate with customers existing business applications and infrastructure in order to create more value from those applications and infrastructure. The SAP xApps family of composite applications refers to a specific category of composite applications based on the SAP NetWeaver platform and enterprise services.

SAP xApps composite applications are designed to support innovative business processes and to deliver specific business benefits. The first composite application introduced in the SAP xApps family was the SAP xApp Resource and Portfolio Management (SAP xRPM) composite application. SAP xRPM is a project and portfolio management application that can utilize business information from disparate systems and sources in the performance of business processes. As with the rest of the SAP xApps portfolio, SAP xRPM is a composite application that is delivered with pre-built, services-based integration to various desktop, human resources, financial, and project management systems.

SAP xApps Composite Applications for Mobile Business

SAP xApps composite applications for mobile business are designed to allow users of the mySAP Business Suite applications to access required business processes through standard mobile devices, such as personal digital assistants (PDAs) and mobile phones. SAP currently delivers the following composite applications for mobile business: SAP xApp Mobile Sales, SAP xApp Mobile Service, SAP xApp Mobile Asset Management, and SAP xApp Mobile Time and Travel. These composite applications run in an occasionally connected mode, which allows users to run their business processes with or without a network connection. The underlying technology which enables this capability is SAP NetWeaver Mobile, one of the components of the SAP NetWeaver platform.

SAP xApp Analytics

The SAP xApp Analytics composite application is designed to help business users take appropriate actions based on comprehensive views of their business data. SAP xApp Analytics allows users to analyze data from disparate sources, including third-party applications, legacy systems and externally syndicated information sources. SAP xApp Analytics also allows users to extend existing functionality, as well as to create their own analytic applications.

Other SAP xApps composite applications currently available include SAP Global Trade Services (SAP GTS), SAP xApp Emissions Management (SAP xEM), SAP xApp Product Definition (SAP xPD), SAP xApp Cost and Quotation and Management (SAP xCQM), SAP xApp Manufacturing Integration and Intelligence (SAP xMII), and SAP xApp Integrated Exploration and Production (SAP xIEP). SAP software and consulting partners can also develop SAP xApps Certified composite applications.

Table of Contents

SAP Industry-Specific Solution Portfolios

Business requirements and processes vary by industry. SAP has developed portfolios of industry-specific solutions that are based on mySAP Business Suite applications to support distinct business processes. These portfolios reflect SAP s extensive experience in servicing the unique needs of each of these industries. The portfolios are regularly updated based on insights gained from our close relationships with our customers and various industry groups.

Our industry portfolios are grouped into six industry sectors as shown below:

Process Industries
SAP for Chemicals
SAP for Mill Products
SAP for Oil & Gas
SAP for Mining

Discrete Industries
SAP for Aerospace & Defense
SAP for Automotive
SAP for Engineering, Construction & Operations
SAP for High Tech
SAP for Industrial Machinery & Components

Consumer Industries
SAP for Consumer Products
SAP for Retail
SAP for Wholesale Distribution
SAP for Life Sciences

Services Industries
SAP for Media
SAP for Logistics Service Providers
SAP for Postal Services
SAP for Railways
SAP for Telecommunications
SAP for Utilities
SAP for Professional Services

Financial Services
SAP for Banking
SAP for Insurance

Public Services
SAP for Healthcare
SAP for Higher Education & Research
SAP for Public Sector
SAP for Defense & Security

SAP Solutions for Small and Midsize Enterprises

SAP provides a broad range of business solutions for small and midsize enterprises (SMEs), which we define as companies with fewer than 2,500 employees or translated revenue of less than U.S.$1 billion. In general, the combination of certain criteria will determine the solutions and channel by which our customers purchase and implement SAP solutions. These criteria include:

company revenue;

number of employees;

standardized versus more custom solutions; and

level of desired partner involvement.

We regard the SME segment as consisting of two sub-segments:

In the lower-end segment are those companies that require prepackaged business solutions, and

In the higher-end segment are those companies that require more preconfigured and custom solutions.

Table of Contents

Based on this segmentation, SAP solution offerings for the SME segment consist of the following:

SAP Business One

The SAP Business One application is a business management application designed specifically for small businesses to enable them to integrate and automate their business processes via a single application. In addition, SAP Business One is targeted for subsidiaries of larger corporations which have adopted SAP solutions. It contains an intuitive user interface and supports business processes such as financial management, customer relationship management, purchasing, inventory management and manufacturing. It can be extended via a software development kit by customers and local partners for industry specific applications. SAP Business One is based on the technology gained through SAP s 2002 acquisition of TopManage.

mySAP All-in-One Partner Solutions

Qualified mySAP All-in-One partner solutions, which are delivered through a network of approved SAP channel partners, are based on mySAP Business Suite applications and SAP Best Practices that provide predefined business processes, and are designed to help customers and partners implement the software easily and quickly. SAP channel partners that offer mySAP All-in-One partner solutions build upon the foundation of the best practices incorporated into the product and provide additional support for other industry-specific best practices based on their unique knowledge and expertise. Qualified mySAP All-in-One partner solutions are sold, deployed, and supported exclusively by SAP channel partners as a defined-scope implementation with consulting services. There are currently over 550 qualified mySAP All-in-One partner solutions available worldwide.

SAP Packaged Solutions

We offer SAP packaged solutions based on mySAP Business Suite and pre-configured SAP Best Practices. We offer several types of SAP packaged solutions, including: general-purpose SAP ERP packaged solutions; SAP ERP packaged solutions that address the needs of a particular industry, such as the SAP ERP Automotive Supplier packaged solution; and the SAP Marketing and Campaign Management packaged solution.

Platform

The SAP NetWeaver Platform

As the technical foundation for enterprise services architecture (ESA), the SAP NetWeaver platform is designed to enable customers to integrate and process business information from disparate SAP or non-SAP sources in a variety of ways.

The SAP NetWeaver platform incorporates flexible Web services-based integration capabilities in a unified platform. The SAP NetWeaver platform aims at making it easier for customers to link both non-SAP and SAP applications to work together. It is based on industry standards and can be extended with commonly used development tools such as Java 2 Platform, Enterprise Edition (J2EE), Microsoft .NET, and IBM WebSphere.

The SAP NetWeaver platform provides a composition platform that enables IT departments to compose and orchestrate enterprise services using model-based development. With these enterprise services, organizations can rapidly enhance their existing business processes or develop and deploy new business processes. We believe that the SAP NetWeaver platform gives customers new ways of making use of their

Table of Contents

current application investments while also allowing them to create new applications that are composed of components from older, pre-existing applications.

SAP NetWeaver is the platform for the mySAP Business Suite family of business applications, SAP xApps composite applications and many partner solutions.

To help IT departments meet business requirements, we identify common IT practices and provide a tool that organizations can use to match business requirements to IT solutions based on the SAP NetWeaver platform. For each IT practice, the SAP NetWeaver platform supports a variety of key IT activities, all of which can be performed using the integrated components of the SAP NetWeaver platform.

The SAP NetWeaver platform supports the following IT practices:

User Productivity Enablement

SAP NetWeaver promotes enhanced collaboration, optimized knowledge management, enterprise search, business task management and personalized access to critical applications and data using Web-based portals and mobile interfaces. These IT activities are enabled by the SAP NetWeaver Portal component, including its knowledge management and collaboration functionality, and the SAP NetWeaver Mobile component.

Data Unification

SAP NetWeaver helps IT organizations ensure that all master data, including user-defined data and data related to customers, suppliers and employees, is accurate, free of duplicate records and normalized. Data unification can be achieved through master-data consolidation, master-data harmonization, central master-data management, enterprise data warehousing, product content management, and global data synchronization. These IT activities are enabled by SAP NetWeaver components such as SAP NetWeaver Master Data Management (SAP NetWeaver MDM), SAP NetWeaver Exchange Infrastructure (SAP NetWeaver XI), and SAP NetWeaver Business Intelligence (SAP NetWeaver BI).

Business Information Management

With the SAP NetWeaver platform, IT organizations can increase the visibility and reach of structured and unstructured enterprise data and help people at various levels and locations turn disparate raw data into integrated, meaningful, and actionable information. Business information management can be achieved through enterprise reporting, query, and analysis; business planning and analytical services; enterprise data warehousing; enterprise knowledge management; and enterprise search. These IT activities are enabled by SAP NetWeaver components such as SAP NetWeaver BI, SAP NetWeaver XI, and the knowledge management functionality of SAP NetWeaver Portal.

Business Event Management

With the SAP NetWeaver platform, organizations can manage business events by monitoring business activity, managing business tasks and enabling an Auto-ID infrastructure   integrating automated communication and sensing devices including radio frequency identification (RFID) readers and printers, Bluetooth devices, embedded systems, and bar-code devices. These IT activities are enabled by SAP NetWeaver components such as SAP NetWeaver Portal, SAP NetWeaver BI, SAP NetWeaver XI, and SAP Auto-ID Infrastructure.

Table of Contents

End-to-End Process Integration

With the SAP NetWeaver platform, IT organizations can make disparate applications and business partners systems work together consistently to perform business processes, exchanging information and executing transactions. End-to-end process integration can be provided through application-to-application processes, business-to-business processes, business process management, business task management and platform interoperability. These IT activities are enabled by SAP NetWeaver components and related applications such as SAP NetWeaver XI, adapters, and ARIS for SAP NetWeaver.

Custom Development

With the SAP NetWeaver platform, IT organizations can extract new value from existing investments in technology and skills by creating new, enterprise-scale applications. Organizations can develop, configure and adapt applications, as well as enable interoperability of different technology platforms. These IT activities are enabled by SAP NetWeaver components such as SAP NetWeaver Application Server (SAP NetWeaver AS) and tools such as SAP NetWeaver Developer Studio, SAP NetWeaver Visual Composer and SAP Composite Application Framework.

Unified Life-Cycle Management

With the SAP NetWeaver platform, IT organizations can automate software application management processes to help optimize all facets of a software application s life cycle to permit continuous operations and faster reaction to changing business requirements. These IT activities are enabled by SAP NetWeaver components and tools such as SAP NetWeaver AS, SAP NetWeaver Administrator, the Adaptive Computing Controller tool and SAP Solution Manager.

Application Governance and Security Management

With the SAP NetWeaver platform, organizations can govern applications and manage IT security through integrated user and access management, as well as authentication and single sign-on. These IT activities are enabled by SAP NetWeaver components such as SAP NetWeaver AS, SAP NetWeaver XI, and SAP NetWeaver Portal.

Consolidation

The SAP NetWeaver platform helps organizations consolidate user interfaces, information, and processes through the use of ESA. IT projects that support consolidation include master-data consolidation, enterprise data warehousing, enterprise knowledge management, platform interoperability and SAP NetWeaver operations. These IT activities are enabled by SAP NetWeaver components such as SAP NetWeaver Portal, SAP NetWeaver BI, SAP NetWeaver MDM, and SAP NetWeaver XI.

ESA Design and Deployment

With the SAP NetWeaver platform, organizations can create new, distinctive business processes flexibly.

Services

In addition to its software solution portfolio, SAP provides comprehensive service offerings that include consulting and education, which comprise field services, and support services, ramp-up services,

Table of Contents

hosting, support for business process outsourcing (BPO) and custom development, which comprise global services. Our global services and field services organizations together make up SAP Services.

Field Services

Field services include the following business areas:

SAP Consulting

SAP Consulting offers consulting, implementation, and optimization services that aim at delivering business value in all phases of the solution life-cycle.

SAP Consulting brings together SAP specialists, SAP product development professionals and certified partners to provide a single point of contact for customers seeking assistance with their SAP solutions. SAP Consulting offers the delivery of consistent services and methodologies at customer locations around the world.

SAP Consulting advises and supports customers during the entire solution life cycle, from the planning phase through building and running the solutions:

Planning phase: Ensure that an organization s IT infrastructure supports its business goals;

Building phase: Get software up and running quickly and cost-effectively; and

Running phase: Enable solutions to grow and adapt with changing customer needs.

SAP Education

The SAP Education organization provides the training and tools required to assist SAP customers and partners in maximizing the benefits attained from SAP solutions. SAP Education services include education needs analysis, education delivery via classroom or e-learning, assessment certification and continuous improvement.

The curriculum includes approximately 300 different courses, ranging from overview courses to expert courses. These courses are offered in more than 18 languages at more than 70 training centers worldwide, with more than 200,000 course participants per year.

Global Services

Global services includes the following business areas:

SAP Active Global Support

The SAP Active Global Support organization offers a broad range of services to support customers with planning, implementation, operations, upgrades and continuous improvement.

SAP Active Global Support aims at ensuring the optimum performance of customers SAP solutions and the maximum benefit to their business. For example, SAP experts advise customers on choosing and deploying the support structures and processes that best meet their needs. In addition, these experts can resolve system issues before the customer s system goes live. As a result, customers benefit from optimized system performance.

Once a customer s SAP solution is up and running, support and maintenance continue with help-desk services, online monitoring, remote maintenance, and on-site assistance. SAP Active Global

Table of Contents

Support can help customers spot bottlenecks, plan resources, and migrate to new releases and technologies.

Key offerings of SAP Active Global Support include:

- The SAP Standard Support option which provides the knowledge, tools, and functions to keep customers SAP environment up-to-date and running efficiently. It is designed to prevent bottlenecks and system downtime and to bring timely issue resolution.

- The SAP Premium Support option through which SAP s experts taking a more active role in establishing support operations. It provides a guaranteed service-level agreement (SLA) for response and corrective action and delivers an annual assessment that gives a detailed plan focused on the customer s priorities;

SAP Ramp-Up

SAP Ramp-Up is the standardized process for introducing SAP products to the market. All SAP application software products in all countries are introduced using this process. When a solution is ready for productive use, it enters the SAP Ramp-Up process. SAP Ramp-Up is designed to ensure the quality of SAP solutions by increasing process control and feeding field and customer experience directly into product development. It benefits customers by providing accelerated support channels and dedicated coaches with direct lines to SAP product development groups, SAP Consulting and SAP Active Global Support. SAP Ramp-Up is also designed to reduce the cost, time, and risk of both SAP Ramp-Up implementations and regular, mass-market implementations.

SAP Managed Services

The SAP Managed Services organization provides a comprehensive portfolio of services, running and managing SAP solutions on behalf of customers. More than 300 customers benefit from SAP Managed Services global reach, direct and continued access to SAP expertise, increased service and support, greater financial predictability, and the ability to free internal resources to focus on core competencies. SAP Managed Services offers:

Application Management Services

- Second and third level application support

- Application enhancements

- Application evolution

- Performance monitoring and optimization services

- Global delivery engagement model for 24x7 coverage

Hosting Services

- SAP Evaluation Hosting

- SAP Implementation Hosting

- SAP Application Hosting

- SAP Upgrade Hosting

- SAP Ramp-up Hosting

- SAP Development and Prototype Hosting

SAP Hosted E-Learning

SAP Remote Application Operation

Managed solutions for business ecosystems

34

Table of Contents

Support for Business Process Outsourcing

In addition to its traditional direct license model and reseller channels, SAP engages with leading business process outsourcing (BPO) providers that deliver their services to end customers on platforms based on SAP applications and services. These BPO providers typically enter into an agreement with SAP that includes a license agreement permitting the use of specified SAP applications in selected markets for the provision of BPO services to the end customer, such as outsourced human resources services, for a predefined duration. We do not offer BPO services, but contribute to better BPO deployments for our customers and partners through BPO-ready solutions and services such as implementation support and quality assurance.

SAP Custom Development

The SAP Custom Development organization develops custom solutions that address customers unique business requirements on the SAP NetWeaver platform. The service portfolio includes development services that help customers to extend and enhance existing SAP solutions or build new and innovative business solutions, and maintenance services to protect their custom solutions and SAP investment as their business evolves over time.

Seasonality

As is common in the software industry, our business has historically experienced the highest revenue in the fourth quarter of each year, due primarily to year-end capital purchases by customers. Such factors have resulted in 2005, 2004, and 2003 first quarter revenue being lower than revenue in the prior year s fourth quarter. We believe that this trend will continue in the future and that our revenue will continue to peak in the fourth quarter of each year and decline from that level in the first quarter of the following year.

Business by Region

We operate our business in three principal geographic regions, namely EMEA, which represents Europe, Middle East and Africa, the Americas, which represents both North America and Latin America, and Asia-Pacific, which represents Japan, Australia and parts of Asia. We allocate revenue amounts to each region based on where the customer is located. See Note 32 to our consolidated financial statements included in Item 18. Financial Statements for additional information with respect to operations by geographic region.

Table of Contents

The following table sets forth, for the years indicated, the total revenue attributable to each of our three principal geographic regions:

	2005	2004	2003
		(in millions)	
Germany	1,810.4	1,780.1	1,670.3
Rest of EMEA	2,702.4	2,443.4	2,299.6
Total EMEA	4,512.8	4,223.5	3,969.9
United States	2,342.8	1,893.7	1,736.0
Rest of Americas	656.8	530.1	480.2
Total Americas	2,999.6	2,423.8	2,216.2
Japan	406.2	387.4	441.5
Rest of Asia-Pacific	593.8	479.8	397.0
Total Asia-Pacific	1,000.0	867.2	838.5
Total revenue	8,512.4	7,514.5	7,024.6

EMEA. 53.0% of our 2005 total revenue was derived from the EMEA region, compared to 56.2% in 2004. After a strong revenue growth in 2004 of 6.4%, we achieved another revenue growth of 6.9% to 4,512.8 million in 2005 in the EMEA region. Revenue in Germany, SAP s home country, increased by 1.7% to 1,810.4 million. 40.1% of revenue for the EMEA region in 2005 was derived from Germany which is a slight decrease of 2 percentage points compared to 2004. The remainder of the revenue for the EMEA region in 2005 was derived primarily from the United Kingdom, Switzerland, France, the Netherlands and Italy. The number of our employees (full-time equivalents, or FTEs) in the EMEA region increased by 5.2% from 20,658 at December 31, 2004 to 21,729 at December 31, 2005. In Germany, the number of our employees (FTEs) increased by 2.9% to 13,916 at December 31, 2005 compared to 13,525 at December 31, 2004. See Item 6. Directors, Senior Management and Employees Employees.

Americas. 35.2% of our 2005 total revenue was derived from the Americas region, compared to 32.3% in 2004. Revenues increased from 2004 to 2005 by 23.8% to 2,999.6 million. Revenue from the United States in 2005 was 2,342.8 million, an increase of 23.7% from 1,893.7 million in 2004. The United States represented 78.1% of SAP s total revenue for the Americas region in both 2005 and 2004. On a constant currency basis revenue growth was 22.7% in 2005. Exchange rate fluctuations had a positive impact on revenue figures for the Americas region of 77.7 million or 3.2%. For the Americas region excluding the U.S., total revenue increased by 23.9% to 656.8 million in 2005 (12.8% on a constant currency basis). This was mainly derived from Canada, Brazil, Mexico and Venezuela. The number of employees (FTEs) in the Americas region increased by 19.0% from 6,684 at December 31, 2004 to 7,953 at December 31, 2005. The most notable increase was in the area of customer service and support, accounting for 45% of the increase, mainly due to the hiring of additional consultants to meet the growing demand of consulting projects in the region.

Asia-Pacific. 11.8% of our 2005 total revenue was derived from the Asia-Pacific region, compared to 11.5% in 2004. In 2005, SAP s revenue for the Asia-Pacific region was derived primarily from Japan, Australia, India, South Korea, China and Singapore. Our revenue in the Asia-Pacific region increased by 15.3% to 1,000.0 million in 2005. After a decrease for 2004 of 54.1 million, or 12.3%, revenue derived from Japan increased by 4.9% to 406.2 million in 2005. This represents 40.6% of total revenues in the Asia-Pacific region. On a constant currency basis, revenues derived from Japan increased by 6.7% from 2004 to 2005. In the rest of the Asia-Pacific region, total revenue increased 23.8% from 2004 to 2005 (18.8% increase on a constant currency basis). In the Asia-Pacific region, the number of employees (FTEs) increased by 27.3% from 4,863 as of December 31, 2004 to 6,191 as of December 31, 2005, mainly due to the expansion of our research and development facilities in India and China.

Table of Contents

Software Revenue by Solution

In 2001 we began to allocate software revenues to specific software solutions for internal reporting purposes. These allocations include revenues from contracts for specific solutions and for integrated solution contracts, which are mostly allocated based on the results of usage surveys provided by our customers for solutions that are licensed in a suite of business solutions. Such surveys reflect the customer s expected use of the various solutions within their integrated contract, although a customer s actual use may differ from their expectations at the time they complete the surveys. We are only able to monitor the total number of seats deployed but we have no ability to monitor differences between a customer s actual use of the specific software solutions and the usage reported in the surveys. Nevertheless, we allocate revenues for internal purposes, based upon the number of users and user type by solution as specified in the initial customer surveys. Revenues recognized are allocated to each applicable solution based upon weighted average values per solution resulting from the number of each user type per solution, as provided by the customer, multiplied by the respective price per user type as set forth in our standard price list. We then allocate the recognized revenue for the software license based upon each solution s weighted average values. The remainder of revenues, which relate to SAP R/3, industry solution portfolios and software engines are specifically identified in the license if applicable, and are allocated to the specific software solutions at fixed ratios based upon the functional capabilities to which they relate. This methodology is applied to each individual mySAP Business Suite and mySAP ERP contract. Although we believe this methodology of allocating revenue to specific software solutions is reasonable, and we apply this methodology on a consistent basis, there can be no assurance that such calculated amounts reflect the amounts that would result had we individually licensed each specific software solution.

At the beginning of 2004, we changed our usage surveys for determining software revenues by solution. The usage surveys no longer include certain technology components, including SAP Business Intelligence and SAP Portals, since such technology components are now integrated with the SAP NetWeaver platform. Therefore, prior year comparable figures are not available for certain solutions using the new method.

	2005	**2004**	**2003**
		(in millions)	
ERP	1,157.6	990.0	801.2
CRM	602.6	501.0	440.1
SCM	508.9	480.0	477.1
PLM	161.6	166.9	156.1
Business Intelligence/ Enterprise Portal/ SRM/ Marketplaces	n/a	n/a	273.1
SRM	176.0	147.1	n/a
SAP NetWeaver and other related components	176.0	76.0	n/a
Total software revenue	2,782.7	2,361.0	2,147.6

Revenue by Industry Sector

We identified six industry sectors in order to focus our product development efforts on the key industries of our existing and potential customers and to provide best business practices and specific integrated business solutions to those industries. We allocate our customers at the outset of an initial arrangement to an industry. All subsequent revenues from a particular customer are recorded under that

Table of Contents

industry sector for that customer. The following table sets forth the total revenues attributable to each of the six industry sectors for the years ended December 31, 2005, 2004, and 2003.

	2005	2004	2003
		(in millions)	
Process Industries	1,765.9	1,469.1	1,381.3
Discrete Industries	1,986.1	1,807.9	1,659.4
Consumer Industries	1,457.0	1,349.8	1,243.8
Service Industries	1,946.0	1,673.9	1,664.5
Financial Services	543.4	519.1	474.1
Public Services	814.0	694.7	601.5
Total revenue	8,512.4	7,514.5	7,024.6

Sales, Marketing and Distribution

SAP AG primarily uses its worldwide network of subsidiaries to market and distribute SAP s products and services locally. Those subsidiaries have entered into license agreements with SAP AG pursuant to which the subsidiary acquires the right to sublicense SAP AG s products to customers within a specific territory and agrees to provide primary support to those customers. Under these agreements, the subsidiaries retain a certain percentage of the revenue generated by the sublicensing activity. We began operating in the U.S. in 1988 through SAP America, Inc., a wholly owned subsidiary of SAP AG. Since then, the U.S. has become one of our most important geographic regions. In certain countries, we have established distribution agreements with independent resellers rather than with subsidiaries.

In addition to our subsidiaries sales forces, SAP has developed an independent sales and support force through value-added resellers who assume responsibility for the licensing, implementing and supporting of SAP solutions, particularly with regard to the SAP Business One application and qualified mySAP All-in-One partner solutions. We have also entered into alliances with major system integration firms, telecommunication firms and computer hardware providers to offer certain mySAP Business Suite applications.

We supplement certain of our consulting and support services through alliances with hardware and software suppliers, systems integrators and third-party consultants with the goal of providing customers with a wide selection of third-party competencies. The role of the alliance partner ranges from pre-sales consulting for business solutions to the implementation of our software products to project management and end-user training for customers and, in the case of certain hardware and software suppliers, to technology support.

SAP s marketing efforts cover large, multinational groups of companies as well as small and midsize enterprises. We believe our solutions and services meet important needs of all kinds of customers and are not dependent on the size or industry of the customer.

Capitalizing on the possibilities of the Internet, we actively make use of online marketing. Some of our solutions can be tested online via the Internet demonstration and evaluation system, which also offers special services to introduce customers and prospects to new solutions and services.

Partnerships, Alliances and Acquisitions

Partnerships and strategic alliances are a key element of our efforts to broaden the solutions and services offered to SAP customers and to extend the markets for our products and services. Our close collaboration with partners across the life cycle of a customer solution is a key element in enhancing customer satisfaction. We characterize our partnerships and strategic alliances into eight categories that together constitute what we refer to as the partner services network. Within most categories, our partners may achieve the status of a local or global partner. We expect our alliance partners to provide customers with joint strategic solutions. Our partners generally have a strong position in a particular line of business or cross-industry and complement the range of SAP solutions in these areas. The partner categories are: services partners, technology partners, software partners, hosting partners, business partners, content partners, education partners and support partners. Our partner network includes thousands of companies including independent software vendors, systems integrators, and business procurement outsourcing (BPO) providers across all partner categories.

We have entered into agreements with a number of leading software, technology and services companies to cooperate and ensure that certain of the software, technology and/or services, products and solutions offered by such suppliers complement our software products.

As discussed in Note 4 in Item 18. Financial Statements, we increased our ownership interest in our subsidiary SAP Systems Integration AG (SAP SI) in 2005 from 91.6% as of December 31, 2004 to 96.5% as of December 31, 2005. The aggregate purchase price for the SAP SI shares acquired in 2005 was 60.0 million (2004: 168.1 million) which was paid in cash. We believe the acquisition of the additional shares of SAP SI will help us strengthen our capabilities for IT-strategy consulting offerings in the future.

Part of our strategy involves growth through acquisitions and other transactions. We routinely evaluate various alternatives and engage in discussions and negotiations with potential parties to such transactions. In 2005, we acquired four unrelated companies and completed two business combinations in the form of asset deals, the results from which are included in our results since the respective dates of acquisition. We also acquired software (intellectual property) from other companies, without acquiring related businesses. These transactions were immaterial individually and in the aggregate. Three of the acquired companies developed and sold software, while the fourth provided support services. The two businesses acquired through asset deals developed and sold software. See Note 4 in Item 18. Financial Statements for further details.

On February 28, 2005, we entered into a definitive merger agreement to acquire all of the outstanding shares of Retek, Inc. (Retek), a provider of software solutions and services to the retail industry, for U.S.$8.50 per share. The aggregate purchase price, including the cash settlement of Retek s outstanding share-based awards and net of cash acquired, was expected to be approximately U.S.$394 million. On March 8, 2005, Oracle Corporation (Oracle) made a hostile tender offer to acquire Retek s outstanding shares at a price of U.S.$9 per share and announced that it had accumulated approximately 10% of Retek s outstanding shares already. On March 17, 2005, we increased our offer to U.S.$11 per Retek share and Oracle increased its offer to U.S.$11.25 per share. On March 22, 2005, we indicated that we would not provide an increased offer for Retek s outstanding shares. Retek then terminated the definitive merger agreement with us and we withdrew our tender offer for Retek.

We are not aware of any public takeover offers by third parties with respect to our shares that have occurred in 2005 or prior.

Intellectual Property, Proprietary Rights and Licenses

We rely on a combination of the protections provided by applicable trade secret, copyright, patent and trademark laws, license and non-disclosure agreements and technical measures to establish and protect our rights in our products.

We believe that none of the individual patents or technologies owned or licensed by us is material to our business. We may however be significantly dependent in the aggregate on technology that we license from third parties that is embedded into our products or that we resell to our customers.

We have licensed and will continue to license numerous third-party software products that we incorporate into and/or distribute with our existing products. We try to protect ourselves in the respective agreements by defining certain rights in case such agreements are terminated. The termination rights and terms of each license agreements vary, but the various protections generally include receiving maintenance for a certain period of time after termination, the right to distribute the then-current software release for a certain period of time after termination and/or the right to transfer the relevant intellectual property to SAP if we desire. In many cases we agree on an escrow of the relevant proprietary technology for the term of the agreement to allow us to provide maintenance in case we are unable to retain maintenance from the third-party licensor.

In 2004, as part of SAP s relationship with Microsoft Corporation, which started more than ten years ago, the two companies entered into a patent cross-license agreement to provide a better environment for joint technical collaboration and solutions development.

Internal Risk Management Policies and Procedures

We have a system comprising multiple mechanisms across the SAP Group that is designed to recognize and analyze risks early and respond appropriately. These mechanisms include recording, monitoring and controlling internal enterprise processes and business risks using internal reporting functions, a number of management and controlling systems and a planning process that is uniform throughout our group. We have created standard documentation of key business processes of SAP AG and all of its major subsidiaries, which are routinely assessed and tested as to their design and operating effectiveness to mitigate typical risks inherent in such processes in line with both German and U.S. requirements. SAP s Principles of Corporate Governance, ratified by our Executive Board and our Supervisory Board at the end of 2001 and updated in August 2002 and March 2004, constitute a further component in the system. They comprise, among others, standards and guidelines for the work of the Executive Board and Supervisory Board, and for the cooperation between them. In addition, we have implemented various additional measures to comply with requirements under the Sarbanes-Oxley Act. Amongst other measures, we established a Disclosure Committee, whose main task is to monitor the timing and content of information released to the financial markets. For further information on the measures we have implemented relating to the Sarbanes-Oxley Act, please refer to Item 6. Directors, Senior Management and Employees and Item 15. Controls and Procedures. Further elements of the system include a corporate-wide Code of Business Conduct which was formalized in 2003, comprehensive published reports and the work of the Supervisory Board in monitoring and controlling the Executive Board. In early 2003, we created a central dedicated Corporate Risk Management function along with a global network of risk management practitioners tasked to consolidate and enhance SAP s various existing risk management activities in accordance with a corporate-wide uniform methodology. Pursuant to SAP s Enterprise Risk Management program, various regular business activities including software development programs, customer implementation projects, internal IT system implementations and a variety of other corporate areas are continuously assessed against a range of predefined generic risk categories identified in a uniform corporate-wide Risk Catalog and aggregated in a corporate-wide risk management application, from which a regular enterprise risk report to SAP s CEO and CFO is derived. The Enterprise Risk

Management program tracks certain of the risks summarized in Item 3. Key Information Risk Factors in the same risk category structure as established by SAP s internal risk management reporting system.

ORGANIZATIONAL STRUCTURE

As of December 31, 2005, SAP AG was the holding company of 103 subsidiaries whose main task is the distribution of SAP s products and services on a local basis. Our primary research and development facilities, the overall group strategy and the corporate administration functions are concentrated at our headquarters in Walldorf, Germany.

The following table illustrates our most significant subsidiaries based on revenues:

Name of Subsidiary	Ownership %	Country of Incorporation	Function
Germany			
SAP Deutschland AG & Co. KG, Walldorf	100	Germany	Sales, consulting and training
Rest of Europe/ Middle East/ Africa			
SAP (UK) Limited, Feltham	100	Great Britain	Sales, consulting and training
SAP (Schweiz) AG, Biel	100	Switzerland	Sales, consulting and training
SAP France S.A., Paris	100	France	Sales, consulting and training
SAP ITALIA SISTEMI, APPLICAZIONI, PRODOTTI IN DATA PROCESSING S.P.A., Milan	100	Italy	Sales, consulting and training
SAP Nederland B.V., s-Hertogenbosch	100	The Netherlands	Sales, consulting and training
Americas			
SAP America, Inc., Newtown Square	100	USA	Sales, consulting and training
SAP Canada Inc., Toronto	100	Canada	Sales, consulting and training
Asia/Pacific			
SAP JAPAN Co., Ltd., Tokyo	100	Japan	Sales, consulting and training, research and development

DESCRIPTION OF PROPERTY

Our principal executive, administrative, marketing and sales, consulting, training, customer support and research and development facilities are located in Walldorf and neighboring St. Leon-Rot, Germany, approximately 60 miles south of Frankfurt/ Main. The number of workplaces at this combined location expanded by approximately 500 during 2005 to approximately 13,500 through increased occupancy and 200 additional leased workspaces in Walldorf.

The ongoing hiring activities in our global centers for development, service and support involved capital expenditures in 2005 of 5.8 million (primarily leasehold improvements) for further expansion. These expansions occurred mainly in India, where 1,430 workspaces were added, in Hungary (189 workspaces added), and in Israel (260 workspaces added). We intend to add approximately 900 additional workspaces in China by the end of 2006. As Prague, Czech Republic, was selected as the central location for our shared service activities in finance and sales for Europe, more than 200 workspaces were leased.

In 2005, we commenced construction activities in Walldorf and St. Leon-Rot, where two new buildings with workplace capacities of 2,000 and 900, respectively, are being added. We currently estimate that the total cost of construction will amount to approximately 160 million, which will be financed using our liquid assets. Construction activities in St. Leon-Rot ended in February 2006, while construction activities in Walldorf are expected to be finished in the first quarter of 2007. Upon completion of the construction of the buildings, we intend to terminate certain current office leases in Walldorf, the charge for which is not expected to be material.

As discussed in Note 29 in Item 18. Financial Statements, in 2004, SAP America, Inc. and SAP Properties, Inc., its wholly-owned subsidiary, sold a portion of the United States headquarters property in Newtown Square, Pennsylvania, which is partly occupied by SAP America, Inc, and partly by other subsidiaries. A portion of the property sold was subsequently leased back with different terms through 2014. The remaining owned property is used for our U.S. headquarters for the Americas and for regional operations for administration, marketing, sales, consulting, training, customer support and research and development.

We have financed all expansions through working capital and existing credit facilities described in this Form 20-F under Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

While it is difficult to ascribe production capacity to office space, we generally assume that we need approximately 183 square feet per employee for research and development activities and administrative services, and approximately 140 square feet per employee for sales, training and consulting activities.

The location of each of our major facilities, all of which are leased (unless otherwise indicated), is set forth below:

Country, City	**Facility Description**
Austria, Vienna	Sales, consulting, training, marketing and customer support
Belgium, Brussels	Sales, consulting and training
Brazil, São Paulo	Sales, consulting and training
Bulgaria, Sofia	Sales and development
Canada, Toronto, Ontario	Sales, consulting, training and marketing
China, Shanghai	Research and development
Czech Republic, Prague	Sales, consulting and training
Denmark, Copenhagen	Sales, consulting, training and customer support
France, Paris	Sales, consulting, training and marketing
Germany, Berlin	Research and development, sales and consulting
Germany, Dresden	Consulting and customer support
Germany, Freiberg	Consulting
Germany, Munich	Research and development, sales and consulting
Germany, Hamburg	Sales, consulting and training
Germany, Bensheim	Sales and consulting
Germany, Ratingen	Sales and consulting
Germany, St. Ingbert (owned)	Research and development, sales and consulting
Germany, Walldorf (owned)	Sales, consulting, research and development and customer support
Germany, St. Leon-Rot (owned)	Research and development and customer support
Germany, Mannheim	Consulting and IT
Hungary, Budapest	Sales, consulting, training and customer support
India, Bangalore (owned)	Research and development
India, Gurgaon	Customer support
Ireland, Dublin	Customer support
Ireland, Galway	Research and customer support
Israel, Ra anana	Research and development, sales and consulting
Italy, Milan	Sales, consulting and training
Japan, Tokyo	Sales, marketing and training
The Netherlands, Hertogenbosch	Sales, consulting and training
Russia, Moscow	Sales and consulting

Country, City	Facility Description
Singapore, Singapore	Sales, customer support and research and development
South Africa, Johannesburg	Sales, consulting, training, customer support, research and development
South Korea, Seoul	Sales and consulting
Spain, Madrid	Sales, consulting, training, research and development and customer support
Sweden, Stockholm	Sales, consulting, training, marketing and customer support
Switzerland, Biel (owned)	Sales and marketing
Switzerland, Regensdorf	Training
United Kingdom, Feltham (owned)	Sales, consulting, training and customer support
United States, Palo Alto, California	Research and development, sales and consulting
United States, Waltham, Massachusetts	Sales, consulting and training
United States, Chicago, Illinois	Sales, marketing, consulting, training and research and development
United States, Newtown Square, Pennsylvania (owned and leased)	Sales, consulting, training, research and development and customer support
United States, New York, New York	Sales, marketing, and consulting
United States, Foster City, California	Training
United States, Atlanta, Georgia	Sales, marketing, consulting and training

We believe that our facilities are in good operating condition and adequate for their present and anticipated usage. We are not aware of any environmental issue that may affect the utilization of our current facilities.

CAPITAL EXPENDITURES

SAP s capital expenditures for intangible assets and property, plant and equipment, were 262 million for the year ended December 31, 2005 (2004: 193 million, 2003: 219 million). Principal areas of investment during 2005 related to the purchase of computer hardware and other business equipment to support the ongoing increases in employees and global operations. Cars contributed 60 million due to the continued purchase of company cars for eligible employees in Germany. As discussed in Description of Property above, expenditures for construction of buildings occurred during 2005 mainly in Germany.

During 2006, we expect to spend approximately 165 million for the purchase of computer hardware and other business equipment, approximately 55 million for the purchase of cars, as well as approximately another 201 million to fund the new and on-going construction of additional facilities and certain leasehold improvements. See also Description of Property above, Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources and Note 32 to our consolidated financial statements in Item 18. Financial Statements, for further details regarding capital expenditures, including information about capital expenditures by geographic region.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not Applicable.

Table of Contents

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OVERVIEW

SAP consists of SAP AG and its network of 103 operating subsidiaries. We operate worldwide and define the following three geographic regions: EMEA, the Americas and Asia-Pacific. We have three lines of business that constitute our reporting segments: product, consulting and training. Furthermore, SAP focuses on six industry sectors, namely process, discrete, consumer, service, financial services and public services. For a discussion of our geographic regions and industry sectors, see Item 4. Information about SAP Description of the Business Business by Region, Revenue by Industry Sector, SAP Strategy and Note 32 to our consolidated financial statements included in Item 18. Financial Statements.

Our principal sources of revenue are sales of products and services. Product revenue consists primarily of software license fees and maintenance fees. License fees are derived from the licensing of SAP software products to customers. We provide standard maintenance for a fee based on a fixed percentage calculated on the net license fee paid by the customer. We also offer optional maintenance and support services for additional coverage and scope. Our service revenue consists of consulting, training and other service revenue; consulting revenue is primarily derived from the services rendered with respect to implementation of our software products and training revenue from customer project teams and end-users, as well as training third-party consultants with respect to SAP software products. See Item 4. Information about SAP Description of the Business Services for a description of the other services.

At the beginning of 2005, based on our prediction of growth in the economy as a whole and in the IT industry in particular, we set operational goals for the year with a main focus on software revenue growth and a further increase of our pro-forma operating margin. Our target was to increase software revenue in the range of 10 12% compared to 2004. On October 20, 2005 we raised our software revenue outlook and expected full-year 2005 software revenue to increase in the range of 12 14% compared to 2004. Regarding our pro-forma operating margin (excluding stock-based compensation and acquisition related changes) we expected an increase of 0.0 0.5 percentage points from 27.8% achieved in 2004.

In order to achieve the growth in revenue and operating margin, we expected increases in headcount in 2005 compared to the previous year, especially in sales, marketing, research, and development. We also expected a significant proportion of the new research and development jobs to be located in countries outside of Germany, such as India and China. We also expected the number of employees to increase in the United States, mainly in sales and marketing.

In fiscal year 2005, we achieved or exceeded our goals for revenue and operating margin. Software revenue increased from 2,361.0 million in 2004 to 2,782.8 million in 2005, representing an increase of 421.8 million or 17.9%. This exceeded our revised software revenue guidance of an increase in the range of 12 14%. Our operating margin increased from 26.9% in 2004 to 27.4% in 2005 and our pro-forma operating margin increased by 0.5 percentage point from 27.8% in 2004 to 28.3% in 2005, meeting the high end of our outlook which was a 0.0 0.5 percentage point increase. For the year ended December 31, 2005, our revenue and income before income taxes and minority interests were approximately 8,512.4 million and 2,316.4 million, respectively, as compared to 7,514.5 million and 2,072.6 million, respectively, for the year ended December 31, 2004. Net income was 1,496.4 million and 1,310.5 million for the years ended December 31, 2005 and 2004, respectively.

The following discussion is provided to enable a better understanding of our operating results for the periods covered, including:

- key factors that impacted our performance;
- discussion of our operating results for 2005 compared to 2004 and for 2004 compared to 2003; and
- our outlook for 2006.

Table of Contents

This overview should be read in connection with the more detailed discussion and analysis of our financial condition and results of operations in this Item 5, Item 3. Key Information Risk Factors, and Item 18. Financial Statements.

KEY FACTORS

Global Economy

Global economy continues to grow

The global economy continued to recover throughout the course of 2005. The news from North America and many of the Asian countries was predominantly good. The European economy also grew stronger as the year progressed, helped by low long-term interest rates, a retreating euro, and buoyant export markets. However, domestic demand in Europe remained flat. Surges in energy and commodity prices impeded global recovery. However, both the Paris-based Organisation for Economic Co-operation and Development (OECD) and the Washington, DC-based International Monetary Fund (IMF) report that the core inflation rates in most industrialized countries were low, with rates in the range 1% to 3%. Not even the steep increase in energy prices seriously impacted the global recovery. The IMF estimates that global gross domestic product (GDP) grew some 4.3%. That represents a decline compared to the overall 2004 figure of 5.1%, but deceleration during the first six months of 2005 was partially offset by a pick up in growth in the second half of the year.

The chief driver of growth was again China. China s economy grew 9.5% in 2004 and the IMF believes it grew 9.0% in 2005. India s economy also remains buoyant, with growth unchanged at 7%. The OECD reports 2.4% GDP growth in Japan (2004: 2.7%). The U.S. economy was again vigorous: The IMF estimates that U.S. GDP grew more than 3.5% in 2005, compared with 4.2% in the previous year.

Europe lags behind global growth

The economies of Europe underachieved in comparison with the global economy. According to the OECD, euro zone GDP growth, which was 1.8% in 2004, slowed to 1.4% in 2005. Both the OECD and the IMF point to slow demand on the European market and the increased oil price as an impediment to economic growth. Exporters alone are achieving the growth to keep the European Union (EU) economy afloat.

The OECD believes the German economy expanded only a disappointing 1.1% in 2005. In 2004, German GDP had grown 1.6% according to the IMF. The supporting pillar of the German economy, and the only part of the economy that remained vibrant, was export trade. On the fourth-quarter numbers, the Kiel Institute for World Economics comments that there are clear signs the German economy is experiencing a trend of improved growth. Key indicators, such as process industry order books, increasingly point toward improved growth, the Institute says.

IT Sector

Trend in IT industry remains stable

Information technology (IT) market-intelligence provider IDC estimates that the global IT market grew 5.9% in 2005. Another IT market researcher, Gartner, believes global IT market growth was only 4.9%. Gartner divides the IT market into hardware, packaged software, applications, and services segments.

The segment in which SAP chiefly operates is applications, which in 2005 expanded 5.6% worldwide according to IDC, or 8.4% according to Gartner. It indicated the IT market continued to grow, almost regardless of anything that happened in the political, climatic, or economic environments.

According to IDC s analysis, in 2005 the fastest-growing segment in the IT market was system infrastructure. That indicates that companies increasingly focused on optimizing and overhauling their IT infrastructure. Application-related segments in particular benefited from a growth spurt. In IDC s analysis, this means the trend toward replacing systems became more pronounced in 2005, which would boost new application implementations.

U.S. IT market grows almost 5%

IDC estimates the IT market in the United States, SAP s single most important market, grew 4.9% in 2005. Gartner s corresponding estimate is similar. Both research firms report 5% IT market growth in Western Europe, where the economic environment was more difficult than in the United States. IDC and Gartner report appreciably stronger growth of 6% or more for the year in the Asia-Pacific market. More than 90% of global IT business is with customers in North America, Western Europe, and the Asia-Pacific region.

The German Association for Information Technology, Telecommunications, and New Media (BITKOM) estimates that the German IT market grew 3.2%, which is similar to the corresponding 2004 growth figure. On the other hand, IDC believes the overall German IT market expanded only 2.7% in 2005. BITKOM estimates that the German market for system and applications software expanded 4.5%. IDC reports that the German IT services market grew 2% in the year.

OPERATING RESULTS

2005 Compared with 2004

Total Revenue.

Total revenue increased from 7,514.5 million in 2004 to 8,512.4 million in 2005, representing an increase of 997.9 million or 13.3%. At constant currencies, total revenue increased by 11.8%. Compared to 2004, the overall growth in 2005 was primarily driven by product revenue, while service revenue also increased moderately. Compared to 2004 software revenue grew by 17.9% and maintenance revenue grew by 12.5%. This growth exceeded our updated software revenue outlook from October 20, 2005.

Initially for 2005, we assumed a weaker euro with an average exchange rate of $1.30 per 1.00, which was then adjusted to $1.15 per 1.00 with our adjusted guidance communicated on October 20, 2005. The average exchange rate in 2005 was $1.24 per 1.00, compared to $1.25 per 1.00 in 2004. The rate evolved as follows for the period-end Noon Buying Rate expressed as dollars per 1.00.

Date	**Period-End**
December 2004	1.3538
March 2005	1.2969
June 2005	1.2098
September 2005	1.2058
December 2005	1.1842
March 10, 2006	1.1886

Ultimately the weakness of the euro over the year increased the euro value of revenues generated in other currencies. Foreign currency translation effects from the weakening value of the euro during the year positively impacted our total consolidated revenue by 111.1 million, or 1.3%, in 2005. In 2004, foreign currency translation effects from the strengthening value of the euro during the year negatively impacted our total consolidated revenue by 235.8 million.

The following discussion is based on how we allocate revenues for classification in our consolidated statements of income, which is dependent on the nature of the sales transaction regardless of the operating segment it was provided by:

Product Revenue. Product revenue, which consists of software revenue and maintenance revenue, increased from 5,184.2 million in 2004 to 5,958.4 million in 2005, representing an increase of 774.2 million or 14.9% (13.2% on a constant currency basis).

Software revenue increased from 2,361.0 million in 2004 to 2,782.8 million in 2005, representing an increase of 421.8 million, or 17.9%. With the weakening value of the euro compared to other currencies, this increase was impacted by a positive foreign currency translation effect. On a constant currency basis, software revenue grew by 15.4% from 2004 to 2005. The biggest contributor to software revenue growth in 2005 was again the Americas region (in particular the U.S.) where we accomplished a growth of 31.8% compared to 2004 (or 31.1% for the U.S.).

For a summary of software revenue by solution in 2005, see Item 4. Information about SAP Description of the Business Software Revenue by Solution. We have continued to implement our volume business model with a higher number of smaller contracts. New customers accounted for 33% of our 2005 software contracts, with the remaining 67% coming from our installed customer base (compared to 32% from new customers and 68% from our installed customer base in 2004). Based on the value of orders received, the new customer share decreased from 24% in 2004 to 22% in 2005.

In the small and midsize enterprise segment (enterprises with 2,500 or fewer employees, or annual revenue of U.S.$1 billion or less), we achieved above-average software revenue growth and strengthened our market position in 2005.

Maintenance revenue increased from 2,823.2 million in 2004 to 3,175.6 million in 2005, representing an increase of 352.4 million or 12.5%. On a constant currency basis, maintenance revenue grew by 11.4% from 2004 to 2005. With our growing installed customer base, this increase in maintenance revenue was primarily due to the growth of software sales throughout 2004 and due to additional software contracts closed during 2005. Accordingly, maintenance revenues continued to increase constantly on a rolling four quarter basis. In 2005 the biggest contributor to the increase in maintenance revenues based on volume came again, as in 2004, from the EMEA region. The EMEA region is still the biggest contributor to software sales group wide.

Product revenue as a percentage of total revenue increased from 69.0% in 2004 to 70.0% in 2005, driven by the growth in software and maintenance revenues.

Service Revenue. Service revenue increased from 2,273.0 million in 2004 to 2,481.4 million in 2005, representing an increase of 208.4 million or 9.2% (8.1% on a constant currency basis).

Consulting revenue increased from 1,970.6 million in 2004 to 2,138.9 million in 2005, representing an increase of 8.5%. On a constant currency basis the increase would have been 148.7 million or 7.5%. This growth in consulting revenue resulted mainly from the increase in the consulting work-force by 4.8% and a higher utilization of these resources for external projects in 2005. In addition, interim use of third-party resources increased by 9.5% in order to meet the rise in customer activities.

Consulting revenue as a percentage of total revenue decreased from 26.2% in 2004 to 25.1% in 2005, caused by the over-proportional growth of product revenue.

After two years of decreasing revenues in 2002 and 2003 and flat revenues in 2004, the training business showed a solid recovery with training revenue increasing from 302.4 million in 2004 to 342.5 million in 2005, or 13.2%. At constant currencies, training revenues increased by 12.0%. While traditional classroom training only grew marginally, most of the growth in training revenue was achieved in academy training, customer-specific training and education consulting. The training business also benefited from the alignment with the consulting business which helped drive the increase of revenues through joint customer engagements.

Service revenue also includes the revenue generated by the SAP Managed Services organization, which operates, manages and maintains SAP solutions. SAP Managed Services revenue increased from 58.4 million in 2004 to 68.3 million in 2005, representing an increase of 17.0%. On a constant currency basis, the increase would have been 9.7 million or 16.6%. Most of the growth of SAP Managed Services revenue came from the United States.

Total Operating Expenses.

At the beginning of the year, we explained in our business outlook guidance that 2005 would be a year of investment in the future. We have invested by increasing our workforce to support our current and future revenue growth targets. Total operating expenses increased from 5,496.1 million in 2004 to 6,181.7 million in 2005, representing an increase of 685.6 million, or 12.5%. On a constant currency basis, the increase in total operating expenses was 634.6 million, or 11.5%, which means that foreign currency translation effects from the weakening value of the euro during 2005 negatively impacted our total operating expenses by 51.0 million, compared to a positive impact of 111.1 million on total revenues.

The increase is mainly related to the following:

- We increased our sales and marketing expenses in 2005 by 222.6 million, or 14.6%, compared to 2004, reflecting additional investment in aligning our operations to volume business and in our sales organization.

- Our growing workforce resulted in an increase in personnel expenses, which went up from 2,968.0 million in 2004 to 3,371.5 million in 2005, or 13.6%. This increase in personnel expenses is the result of the overall headcount increase from 32,205 full-time equivalents as of December 31, 2004, to 35,873 full-time equivalents as of December 31, 2005, an increase of 11.4%. The biggest increase in headcount was in research and development, in which the worldwide full-time equivalent count rose 18% to 11,629. The increase is consistent with our organic growth strategy and commitment to meet product release schedules. We continued to keep a tight control on personnel expenses due to minimal fixed salary increases as well as by adding additional headcount primarily in the major emerging markets with modest salary levels such as China and India. The share of resources in low cost locations (Bulgaria, China, and India) increased from 8.2% in 2004 to 10.9% in 2005.

- The rise in the headcount and overall increase in business activity during 2005 resulted in higher travel expenses compared to 2004 (an increase of 55.8 million or 17.5%).

As a result of the strong product revenue growth, cost of purchased licenses increased by 19.5%.

As a consequence of the strong revenue growth and the increase in total operating expenses, operating income increased from 2,018.4 million in 2004 to 2,330.7 million in 2005, or by 15.5%. Operating margin increased from 26.9% in 2004 to 27.4% in 2005.

Pro-Forma Operating Income.

We have provided guidance and related information in 2005 and 2004 using pro-forma operating income on a consolidated basis. We use this information internally and believe this pro forma measure provides meaningful information to our investors because we exclude acquisition related charges and settlements of stock-based compensation plans to focus attention on the financial performance of our core operations. We exclude stock-based compensation expenses because we have no direct influence over the actual expense of these awards once we enter into stock-based compensation plans. This pro forma information is not prepared in accordance with U.S. GAAP and should not be considered a substitute for the historical financial information presented in accordance with U.S. GAAP. The pro forma measures used by us may be different from pro forma measures used by other companies.

At the beginning of 2005, our target was to improve our pro-forma operating margin (that is, the ratio of pro-forma operating income to total revenue) from the 27.8% achieved in 2004 by approximately 0.0-0.5 percentage points.

We were able to reach this target in 2005 and the pro forma operating margin increased by 0.5 percentage points to 28.3%. Pro forma operating income (excluding expenses for stock-based compensation and acquisition-related charges) increased from 2,086.1 million in 2004 to 2,409.3 million in 2005. Pro forma operating expenses (excluding expenses for stock-based and acquisition-related charges) in 2005 increased by 12.4% to 6,103.1 million.

A reconciliation from U.S. GAAP operating income to pro-forma operating income is as follows:

	2005	2004
	(in millions of)	
U.S. GAAP operating income	2,331	2,018
Acquisition-related charges	34	30
LTI 2000 Plan/ STAR Plan	45	37
Settlement of stock-based compensation plans in the context of mergers and acquisitions	0	1
Total stock-based compensation	45	38
Pro forma operating income excluding stock-based compensation and acquisition-related charges	2,410	2,086

In the second quarter of 2005, we redefined the acquisition-related charges used to determine our pro-forma operating income, pro-forma earnings per share, and other pro-forma measures. Previously, we treated the amortization of intangibles as acquisition-related charges only if the intangibles had been acquired in the context of the purchase of a business. However, we now expect that our acquisitions will often be purchases of a target company s intellectual property and related intangibles rather than purchases of the target business itself. Therefore, effective with the second quarter of 2005, we treat the amortization of all purchased intellectual property rights and related intangibles as acquisition-related charges. Changing the definition of acquisition-related charges had no material effect on previously published pro-forma figures because we had never before made significant stand-alone purchases of intellectual property.

Table of Contents

Detail of Operating Expenses.

Cost of Product. Cost of product consists primarily of:

customer support costs which include 24x7 message handling, services for upgrades, SAP EarlyWatch services, SAP GoingLive services and premium maintenance services (SAP Safeguarding services, SAP Empowering services and SAP MaxAttention support option) delivered by the SAP Active Global Support organization;

license fees and commissions paid to third parties for databases and the other complementary third-party products sublicensed by us to customers; and

costs of developing custom solutions that address customers unique business requirements.

In line with growing product revenues, cost of product has increased from 916.3 million in 2004 to 993.2 million in 2005, or by 8.4% mainly due to increased expenses for software license fees and the expansion of support resources. As a percentage of product revenue, cost of product decreased from 17.7% in 2004 to 16.7% in 2005.

Certain reclassifications were made to the previously reported amounts of cost of product and research and development expenses. See Note 8 in Item 18. Financial Statements.

Cost of Services. Cost of services consists primarily of consulting and training personnel expenses as well as expenses for third-party consulting and training resources. Cost of services increased from 1,783.5 million in 2004 to 1,924.6 million in 2005, or 7.9%. As a percentage of service revenue, cost of services decreased to 77.6% in 2005 compared to 78.5% in 2004.

One main reason for the increase in cost of services in 2005 was the growth in consulting headcount by 4.8% resulting in increased personnel expenses of 68.9 million. Furthermore, the higher interim use of third-party resources resulted in an increase of 49.0 million in third-party costs, compared to 2004. In comparison to 2004, an increase in the utilization of our resources for billable projects led to an increase in the service margin. In response to the change in demand to a more flexible customer delivery model, the training business has successfully managed a shift from fixed to flexible infrastructures, especially with respect to the focus on consolidating training facilities and ceasing operations in certain geographic locations.

Research and Development. Our research and development expenses consist primarily of:

personnel expenses related to our research and development employees;

amortization of computer hardware used in our research and development activities; and

costs incurred for independent contractors retained by us to assist in our research and development activities.

Research and development expenses increased from 908.0 million in 2004 to 1,088.6 million in 2005, or 19.9%. As a percentage of total revenue, research and development expenses increased from 12.1% in 2004 to 12.8% in 2005.

Overall, the number of research and development employees increased from 9,882 full-time equivalents in 2004 to 11,629 full-time equivalents in 2005, representing an increase of 17.7%. Although the number of employees increased during 2005, the related cost did not increase at the same rate due to a continuous effort of the research and development organization to move into cost effective locations, such as China and India. The share of employees working in the research and development area as part of the total number of employees increased from 30.7% for 2004 to 32.4% for 2005.

Sales and Marketing. Sales and marketing expenses increased from 1,523.7 million in 2004 to 1,746.2 million in 2005, or 14.6%. As a percentage of total revenue, sales and marketing expenses remained relatively constant, up slightly from 20.3% in 2004 to 20.5% in 2005. The increase in sales and marketing expenses in 2005 relates to the efforts to support our current and future revenue growth targets and mainly results from salaries for new sales personnel and higher bonus payments to sales and marketing employees due to the overachievement of revenue targets.

Overall employees in sales and marketing increased from 5,583 full-time equivalents in 2004 to 6,249 full-time equivalents in 2005, or 11.9%, and personnel expenses increased accordingly from 703.6 million in 2004 to 852.4 million in 2005, or 21.2%. We also continued to increase variable parts of salaries in 2005.

General and Administrative. General and administrative expenses increased from 366.4 million in 2004 to 435.2 million in 2005. This represents an increase of 18.8%. This rise included an increase in performance-related compensation as well as additional spending on shared service centers (finance, administration and human resources). As a percentage of total revenue, general and administrative expenses represented 5.1% in 2005 compared to 4.9% in 2004.

Other Operating Income/ Expense, Net. Other operating income/expense, net, changed from a net operating income of 1.8 million in 2004 to a net operating income of 6.2 million in 2005. The primary reason for the change was the reduction in the amount of restructuring costs for unused lease space and severance payments for exit activities from 7.0 million in 2004 to 1.7 million in 2005 (period expenses, net of adjustments).

The 2005 restructuring activities included organizational changes in some foreign subsidiaries, such as replacement of management and sales personnel mainly in the EMEA region. See Note 24 to our consolidated financial statements in Item 18. Financial Statements for discussion regarding the expenses incurred in connection with our exit activities, which include contract termination and similar restructuring costs for unused lease space as well as severance payments.

Financial Income/ Expense, Net.

Financial income/expense, net is comprised primarily of income/(losses) from equity method investments, gains/(losses) on sales of equity securities, and net interest income. Financial income/expense, net, decreased by 30.2 million from net financial income of 41.0 million in 2004 to net financial income of 10.8 million in 2005. The decrease mainly is attributable to unrealized losses from hedging anticipated cash-flow exposures associated with the employee STAR plan. The increase in the price of SAP stock contributed to such unrealized losses of 66.2 million in 2005 (2004: 14.6 million). This effect was partially offset by an increase in net interest income from 55.8 million in 2004 to 89.9 million due to higher liquid asset balances from cash flows generated from our operations in 2005.

Income Taxes.

Our effective income tax rate decreased from 36.5% in 2004 to 35.3% in 2005. This decrease was primarily due to the impact of tax exempted income and decreasing income tax rates in some countries. See Note 11 to our consolidated financial statements in Item 18. Financial Statements.

Net Income.

Net income increased from 1,310.5 million in 2004 to 1,496.4 million in 2005, representing an increase of 185.9 million, or 14.2%. Net income as a percentage of total revenue increased from 17.4% for 2004 to 17.6% for 2005. This slight increase was primarily due to the overall increase in total revenues of 997.9 million or 13.3% compared to 2004, primarily driven by strong growth in software revenues which grew by 17.9%, partially offset by an increase in total operating expenses of 685.6 million, or 12.5%, compared to 2004. Additionally, income tax expense increased only by 7.9% from 757.3 million in 2004 to 817.1 million in 2005, not proportionate to the increase of 11.8% in income before income taxes and minority interest. Basic earnings per share were 4.83 in 2005 compared to 4.22 in 2004.

Segment Discussion.

As described in Note 32 in Item 18. Financial Statements, we have three operating segments: product, consulting and training. Total revenue figures for each of our operating segments differ from the revenue figures classified in our consolidated statements of income because for segment reporting purposes, revenue is generally allocated to the segment that is responsible for the related transactions, regardless of the nature of the sales transaction. The segment contributions reflect only expenses directly attributable to the segments and do not represent the actual margins for the operating segments. Indirect costs such as general and administrative, research and development (including cost from software development contracts of 82.3 million (2004: 112.0 million)), charges for stock-based compensation and acquisition-related charges, and other corporate expenses are not allocated to the operating segments and therefore are not included in segment contribution. Depreciation and amortization of long-lived assets as well as other facility and IT-related expenses are allocated to each operating segment based on headcount or facility space occupied.

In 2005, the total impact of stock-based compensation and settlements of stock-based compensation plans included in total operating expenses in the consolidated financial statements was 45.0 million compared to 38.1 million in 2004. Therefore, segment contribution is not indicative of the actual profitability margin for the operating segments.

In 2005, 2.4 million (2004: 3.9 million) of exit costs related to unused lease space and severance payments were not allocated to the segments.

Product segment. The Product segment is primarily engaged in marketing and licensing our software products, performing software development services, and performing maintenance services. Maintenance services include technical support for our products, assistance in resolving problems, providing user documentation, updates and other support for software products, new versions, and support packages. Reflecting internal management responsibilities within our organization, the product segment includes the lines of business sales, marketing and service and support.

Product segment revenue increased by 14.2% from 5,292.9 million in 2004 to 6,044.3 million in 2005. On a constant currency basis, product segment revenue grew by 12.5%. Approximately 98% of revenues within the product segment are derived from software and maintenance revenue, with the remaining 2% derived from services revenue and other revenue. Software revenue as part of the total product segment revenue increased by 15.9% from 2,363.4 in 2004 million to 2,739.3 million in 2005. This corresponds to an increase of 13.5% based on constant currencies. Maintenance revenues increased by 12.3% from 2,817.4 million in 2004 to 3,162.7 million in 2005, an increase of 11.2% based on constant currencies.

Product segment expenses increased by 19.2% from 2,058.1 million in 2004 to 2,452.5 million in 2005, an increase of 18.0% based on constant currencies. Expenses of the line of business sales account for about half of the entire product segment expenses, while expenses of the line of business marketing account for roughly one fourth and expenses of the line of business service and support account also for roughly one fourth of overall product segment expenses. The increase in sales and marketing expenses results mainly from the higher headcount reflecting additional investment in aligning our operations to more volume business and associated personnel- and travel-related expenses as well as additional third-party and marketing expenses.

Product segment contribution increased by 11.0% from 3,234.8 million in 2004 to 3,591.9 million in 2005, or 59.4% of total segment revenue compared to 61.1% of total segment revenue in 2004. On a constant currency basis, product segment contribution increased by 9.0%. While we were able to increase product segment revenues, most notably in the U.S. operations, the percentage increase in our product segment expenses was slightly higher, resulting in the decrease in product segment contribution as a percentage of total revenue. The proportionally higher increase in segment expenses results mainly from the additional expenses incurred in the service and support area.

Consulting segment. The Consulting segment is primarily engaged in the implementation of our software products.

Consulting segment revenues increased by 8.8% from 1,910.3 million in 2004 to 2,078.1 million in 2005. In constant currency, revenue increased by 7.8%.

Consulting segment expenses increased by 9.1% from 1,484.0 million in 2004 to 1,619.0 million in 2005. In constant currency, segment expenses increased by 8.1%.

Geographically, the strong growth in the consulting services business comes from the Americas region, especially the United States and Latin America in which we also see the biggest increase in product revenues. The consulting revenue growth in the United States is mainly attributable to our investment in demand generation at the end of 2004 and at the beginning of 2005. The increase in demand was met by an increase in the SAP consulting work force by 4.8% and an increased billable utilization of these resources for external consulting projects. In addition, the interim use of third-party resources increased by 9.5% in order to meet the rise in customer activities. Revenue in the EMEA region also grew, although at a less significant rate than the Americas region, driven mainly by growth in the Eastern European countries. In the Asia-Pacific region consulting revenue increased marginally.

Consulting segment contribution increased by 7.7% from 426.3 million in 2004 to 459.1 million in 2005. In constant currency, the segment contribution increased by 6.7%. The consulting segment profitability was slightly reduced by 0.2 percentage points.

Training segment. The Training segment is primarily engaged in providing educational services on the use of our software products and related topics for customers and partners. Training services include traditional classroom training at SAP training facilities, customer and partner-specific training and end-user training, as well as e-learning.

Training segment revenues were 380.2 million in 2005, which represented a strong increase (23.8%) from 306.6 million in 2004. On a constant currency basis, training segment revenues would have been 375.6 million for 2005. While traditional classroom training grew only marginally, strong revenue growth was achieved primarily in academy training, customer-specific training, and education consulting. Although it only represented a small proportion (1.2%) of the total training revenue, e-learning continued to rise in popularity and grew significantly (135%) in 2005.

Training segment expenses increased from 209.0 million in 2004 to 248.0 million in 2005, or 18.6%. Costs have increased to support the growing business. In response to the change in customer demand to a more flexible delivery model, the training business has successfully managed a shift from fixed to flexible infrastructures by consolidating training facilities and ceasing operations in certain geographic locations. Revenue growth in all areas but traditional classroom training has helped drive an increase in profitability.

Training segment contribution increased by 35.5% from 97.6 million in 2004 to 132.2 million in 2005. The training segment profitability increased by 3.0 percentage points. This is primarily due to the growth of revenue streams with a lower cost of delivery, combined with the continued drive to flexibility in the core delivery model in response to customer demands.

2004 Compared with 2003

Total Revenue.

Total revenue increased from 7,024.6 million for 2003 to 7,514.5 million in 2004, representing an increase of 489.9 million or 7.0%. At constant currencies, total revenues increased by 10%. Compared to 2003, while services revenues also increased moderately, the overall growth in 2004 was primarily driven by product revenues. Both software and maintenance revenues grew by 9.9% compared to 2003. This growth was in line with what we expected at the beginning of 2004, when we stated that our target was to increase software

Table of Contents

revenue by 10% compared to 2003. We were able to increase our revenues in accordance with our guidance despite the continued rise of the euro exchange rate compared to other major currencies in 2004.

Compared to the dollar the exchange rate of the euro evolved as follows for the period-end Noon Buying Rate expressed as dollars per 1.00.

Date	Period-End
December 2003	1.2597
March 2004	1.2292
June 2004	1.2179
September 2004	1.2417
December 2004	1.3538
March 8, 2005	1.3342

Ultimately the strength of the euro over the year reduced the euro value of revenues generated in other currencies. Foreign currency translation effects from the strengthening value of the euro during the year negatively impacted our total consolidated revenue by 235.8 million in 2004. In 2003, foreign currency translation effects from the strengthening value of the euro during 2003 negatively impacted our total consolidated revenue by 577.3 million.

The following discussion is based on how we allocate revenues for classification in our consolidated statements of income, which is dependent on the nature of the sales transaction regardless of the operating segment it was provided by:

Product Revenue. Product revenue, which consists of software revenue and maintenance revenue, increased from 4,716.4 million in 2003 to 5,184.2 million in 2004, representing an increase of 467.8 million or 9.9% (13% on a constant currency basis).

Software revenue increased from 2,147.6 million in 2003 to 2,361.0 million in 2004, representing an increase of 213.4 million or 9.9%. With the rise of the euro compared to other currencies continuing in 2004, this increase was again impacted by the related negative foreign currency translation effects. On a constant currency basis software revenue grew by 13.3% from 2003 to 2004. The biggest contributor to the software revenue growth in 2004 was the Americas region (and in particular the U.S.) where we accomplished a growth of 23% compared to 2003 (or 25% for the U.S).

For a summary of software revenue by solution in 2004, see Item 4. Information about SAP Description of the Business Software Revenue by Solution. Based on orders received versus revenue recognized, the installed customer base accounted for 76% of SAP s 2004 signed software contracts, with the remaining 24% coming from new customers (74% from installed customer base and 26% from new customers in 2003). As already seen in 2003, we continued to experience an industry-wide trend away from a lower volume of very large contracts to a higher volume of smaller contracts in 2004. In the small and midsize enterprise segment, we achieved above-average software revenue growth and strengthened our market position in 2004. On the basis of orders received, 31% of software revenue was from small and midsize enterprises, compared to 28% of our software revenue in 2003.

Maintenance revenue increased from 2,568.8 million in 2003 to 2,823.2 million in 2004, representing an increase of 254.4 million or 9.9%. On a constant currency basis, maintenance revenue grew by 13.3% from 2003 to 2004. With our growing installed customer base, this change in maintenance revenue was primarily due to the growth of software sales throughout 2003 and by the additional software contracts closed during 2004. Accordingly maintenance revenues continued to increase constantly on a rolling four quarter basis. As a significant portion of our software sales are finalized in the last quarter of the year, the trend showing increases in the respective maintenance revenue that follows in subsequent quarters is expected to continue. The biggest contributor to the increase in maintenance revenues based on volume came from the sales region EMEA in 2004. The EMEA region was the biggest contributor to software sales group wide and in addition, this region had lower foreign currency translation effects compared to other regions.

Product revenue as a percentage of total revenue increased from 67.1% in 2003 to 69.0% in 2004, driven by the growth in software and maintenance revenues which both increased by 9.9% compared to 2003.

Service Revenue. Service revenue increased from 2,252.8 million in 2003 to 2,273.0 million in 2004, representing an increase of 20.2 million or 0.9% (4% on a constant currency basis).

Consulting revenue increased from 1,953.5 million in 2003 to 1,970.6 million in 2004, representing an increase of 0.9%. On a constant currency basis the increase would have been 82.5 million or 4.2%. This growth in consulting revenue resulted mainly from the increase in the consulting work force by approximately 7% in 2004. Despite a modest increase in the number of hours billed to our customers, the price pressure in the market environment that we experienced throughout 2003 continued in 2004 and hence adversely impacted the overall increase in consulting revenues.

Consulting revenue as a percentage of total revenue decreased from 27.8% in 2003 to 26.2% in 2004, caused by the over-proportional growth of product revenue.

Training revenue increased from 299.3 million in 2003 to 302.4 million in 2004, or 1.0%. At constant currencies, training revenues increased by 4.3%. As in 2003 there was a continuing trend noted in the customers demand behavior. Customers continued to restrict their spending on employee training courses and structurally, there was a continued shift in our customers demand away from traditional classroom training at our regional offices to requesting more customer specific on-site training and e-learning.

Total Operating Expenses.

Total operating expenses increased from 5,300.6 million in 2003 to 5,496.1 million in 2004, representing an increase of 195.5 million or 3.7%. On a constant currency basis the increase in total operating expenses was 350.8 or 6.6%, which means that foreign currency translation effects from the strengthening value of the euro during 2004 positively impacted our total operating expenses by 155.3 million, compared to a negative impact of 235.8 million on total revenues. In addition, our continued cost management measures throughout 2004 also contributed to the modest overall increase in total operating expenses compared to stronger revenue growth. We believe the increase was mainly attributable to the following:

We intentionally increased our sales and marketing expenses in 2004 to support our revenue growth targets. Sales and marketing costs increased by 112.7 million, or 8.0% compared to 2003.

Additional use of third parties: In 2004, we significantly expanded the use of third parties in our consulting and research and development departments on an interim basis to support our own resources with an associated increased cost of 33.3 million compared to 2003.

Our growing workforce resulted in an increase in personnel expenses, which went up from 2,936.6 million in 2003 to 2,968.0 million in 2004, or 1.1%. This moderate increase in personnel expenses was achieved even though the overall headcount increased from 29,610 full-time equivalents as per December 31, 2003, to 32,205 full-time equivalents as per December 31, 2004, an increase of 7.3%. We continued to keep a tight control on personnel expenses due to minimal fixed salary increases as well as by adding additional headcount primarily in low cost locations. The share of resources in low cost locations increased from 4.9% in 2003 to 8.2% in 2004.

The rise in the headcount and overall increase in business activity during 2004 resulted in higher travel expenses compared to 2003.

As a result of the strong revenue growth and the modest increase in total operating expenses, operating income increased from 1,724.0 million in 2003 to 2,018.4 million in 2004, or 17.1%. Operating margin increased from 24.5% in 2003 to 26.9% in 2004.

Pro Forma Operating Income.

We have provided guidance and related information in 2004 and 2003 using pro forma operating income on a consolidated basis. We use this information internally and believe this pro forma measure provides meaningful information to our investors because we exclude acquisition related charges and settlements of stock-based compensation plans to focus attention on the financial performance of our core operations. As discussed above, effective with the second quarter of 2005, we treat the amortization of all purchased intellectual property rights and related intangibles as acquisition-related charges, whether purchased in stand-alone transactions or as part of the acquisition of a business. Previously, we treated the amortization of intangibles as acquisition-related charges only if the intangibles had been acquired in the context of the purchase of a business. The change in definition had no material effect on previously published pro-forma figures. For purposes of our pro forma operating income, we also exclude stock-based compensation expenses because we have no direct influence over the actual expense of these awards once we enter into stock-based compensation plans. This pro forma information is not prepared in accordance with U.S. GAAP and should not be considered a substitute for the historical financial information presented in accordance with U.S. GAAP. The pro forma measures used by us may be different from pro forma measures used by other companies.

At the beginning of 2004 our target was to improve our pro forma operating margin (excluding expenses for stock-based compensation and acquisition-related charges) from the 27% achieved in 2003 by approximately 1 percentage point.

We were able to reach this target in 2004 and the pro forma operating margin increased by 1 percentage point to 28%. Pro forma operating income (excluding expenses for stock-based compensation and acquisition-related charges) increased from 1,879.6 million in 2003 to 2,086.1 million in 2004. Pro forma operating expenses (excluding expenses for stock-based and acquisition-related charges) in 2004 increased by 5.5% to 5,428.4 million.

Table of Contents

A reconciliation from U.S. GAAP operating income to pro forma operating income is as follows:

	2004	2003
	(in millions of)	
U.S. GAAP Operating income	2,018	1,724
Acquisition-related charges	30	26
LTI 2000 Plan/ STAR Plan	37	125
Settlement of stock-based compensation plans in the context of mergers and acquisitions	1	5
Total stock-based compensation	38	130
Pro forma operating income excluding stock-based compensation and acquisition-related charges	2,086	1,880

Detail of Operating Expenses.

Cost of Product. Cost of product consists primarily of:

customer support costs which include 24x7 message handling, services for upgrades, SAP EarlyWatch services, SAP GoingLive services and premium maintenance services (SAP Safeguarding services, SAP Empowering services and SAP MaxAttention support option) delivered by the SAP Active Global Support organization;

license fees and commissions paid to third parties for databases and the other complementary third-party products sublicensed by us to customers; and

costs of developing custom solutions that address customers unique business requirements.

Cost of product decreased from 962.8 million in 2003 to 916.3 million in 2004, or 4.8%. As a percentage of product revenue, cost of product decreased from 20.4% in 2003 to 17.7% in 2004.

Apart from a positive foreign currency translation effect, the efficiency improvements in the support organization that we accomplished in 2004 also had a positive effect. Due to new and more efficient processes the support organization could allocate more resources to support internal projects in other organizations such as the sales organization. Although the number of employees increased during 2004, the related costs increased less due to a continuous effort of the support organization to move into cost effective locations and due to the continuous efforts to improve the efficiency of our processes.

Cost of Services. Cost of services consists primarily of consulting and training personnel expenses as well as expenses for third-party consulting and training resources. Cost of services increased from 1,694.1 million in 2003 to 1,783.5 million in 2004 or 5.3%. As a percentage of service revenue, cost of services increased to 78.5% in 2004 compared to 75.2% in 2003.

One main reason for this increase was that we substantially increased the interim use of third-party resources reflected in third-party costs increasing by 33.3 million compared to 2003. Furthermore, the growth in consulting headcount by approximately 7% resulted in increased personnel expenses of 17.3 million or 1.5%. These newly employed consultants not yet being fully productive for the full year also negatively impacted the service profitability. Both the increase in third-party resources and headcount were a reflection of stronger internal support provided by our service organization to support other internal projects such as sales and ramp-up of products.

Foreign currency translation effects had a significant positive impact on cost of services. Cost of services increased by approximately 8.9% at constant currencies.

Research and Development. Our research and development cost consists primarily of:

personnel expenses related to our research and development employees;

amortization of computer hardware used in our research and development activities; and

costs incurred for independent contractors retained by us to assist in our research and development activities.

Research and development expenses increased from 872.2 million in 2003 to 908.0 million in 2004, or 4.1%. As a percentage of total revenue, research and development expenses decreased from 13.7% in 2003 to 12.2% in 2004.

Overall, the number of research and development employees increased from 8,854 full-time equivalents in 2003 to 9,882 full-time equivalents in 2004, representing an increase of 11.6%. Due to an increased share of resources in low cost locations personnel expenses were kept nearly constant. The share of employees working in the research and development department as part of the total number of employees increased to 30.7% for 2004 from 29.9% for 2003. As in all other areas, foreign currency translation effects had a positive effect on the overall increase in research and development expenses.

Sales and Marketing. Sales and marketing expenses increased from 1,411.0 million in 2003 to 1,523.7 million in 2004, or 8.0%. As a percentage of total revenue, sales and marketing expenses remained relatively constant, up slightly from 20.1% in 2003 to 20.3% in 2004. On a constant currency basis, sales and marketing expenses increased by approximately 11%. The increase in sales and marketing expenses in 2004 relates to the efforts to support our revenue growth targets for the year and mainly results from salaries for new sales personnel and higher bonus payments to sales and marketing employees.

Overall employees in sales and marketing increased from 5,170 full-time equivalents in 2003 to 5,583 full-time equivalents in 2004, or 8.0%, and total personnel expenses increased accordingly from 660.1 million in 2003 to 699.1 million in 2004, or 5.9%. We also continued to increase variable parts of salaries in 2004.

General and Administrative. General and administrative expenses increased from 354.0 million in 2003 to 366.4 million in 2004. This represented an increase of 3.5% or approximately 6% on a constant currency basis. The increase was mainly driven by an increase in travel expenses and the interim use of third-party services. As percentage of total revenue, general and administrative expenses slightly decreased from 5.0% in 2003 to 4.9% in 2004.

Other Operating Income/ Expenses, Net. Other operating income/expenses, net, reversed from a net operating expense of 6.5 million in 2003 to a net operating income of 1.8 million in 2004. The primary reason was the significant reduction in the amount of restructuring costs for unused lease space and severance payments for exit activities from 20.5 million in 2003 to 9.6 million in 2004.

The 2004 restructuring activities particularly included organizational changes in some foreign subsidiaries, such as replacement of management and sales personnel mainly in the EMEA region, and the Nordic countries in particular. See Note 24 to our consolidated financial statements in Item 18. Financial Statements for discussion regarding the expenses incurred in connection with our exit activities, which include contract termination and similar restructuring costs for unused lease space as well as severance payments.

Customer credit loss risks based on aging of receivables are classified as general bad debt expense as a component of other operating expense, net. For the year ended December 31, 2004, 1.8 million was recorded as other operating expense. For the years ended December 31, 2003, and 2002, 5.4 million and 5.3 million were recorded as other operating income, respectively, due to our decreased days sales outstanding (meaning the average number of days that passed before we were paid by our customers following the delivery of our software or the rendering of services).

Table of Contents

Financial Income/ Expense, Net.

Financial income/expense, net is comprised primarily of income/(losses) from equity method investments, gains/(losses) on sales of equity investments securities and net interest income. Financial income/expense, net improved from financial income of 16.3 million in 2003 to net financial income of 41.0 million in 2004, an increase of 24.7 million. The increase mainly resulted from higher net interest income, which went up from 43.4 million in 2003 to 56.3 million in 2004. This improvement was related to the increase in liquid assets resulting from the higher cash flows generated from our operations in 2004. Further contributing to the overall increase were the gains on sales of equity securities, which went up from 2.2 million in 2003 to 14.0 million in 2004.

Income Taxes.

Our effective income tax rate decreased from 39.0% for 2003 to 36.5% in 2004. This decrease was primarily due to the impact of tax exempted income and fewer non-tax deductible losses on investments than in the year 2003. See Note 11 to our consolidated financial statements in Item 18. Financial Statements.

Net Income.

Net income increased from 1,077.1 million in 2003 to 1,310.5 million in 2004, representing an increase of 233.4 million or 21.7%. Net income as a percentage of total revenue increased from 15.3% for 2003 to 17.4% for 2004. This increase was primarily due to the overall increase in total revenues of 489.9 million or 7% compared to 2003, primarily driven by strong growth in software and maintenance revenues which both grew by 9.9%, combined with the proportionally lower increase in total operating expenses of 195.5, or 3.7% compared to 2003. Additionally, financial income/expense, net improved from financial income of 16.3 million in 2003 to net financial income of 41.0 million in 2004, an increase of 24.7 million. Basic earnings per share were 4.22 in 2004 compared to 3.47 in 2003.

Segment Discussion.

As described in Note 32 in Item 18. Financial Statements, we have three operating segments: product, consulting and training. Total revenue figures for each of our operating segments differ from the revenue figures classified in our consolidated statements of income because for segment reporting purposes, revenue is generally allocated to the segment that is responsible for the related transactions, regardless of the nature of the sales transaction. The segment contributions reflect only expenses directly attributable to the segments and do not represent the actual margins for the operating segments. Indirect costs such as general and administrative, research and development, charges for stock-based compensation and acquisition-related charges, and other corporate expenses are not allocated to the operating segments and therefore are not included in segment contribution. Depreciation and amortization of long-lived assets as well as other facility and IT-related expenses are allocated to each operating segment based on headcount or facility space occupied.

In 2004 the total impact of stock based compensation and settlements of stock-based compensation plans included in total operating expenses in the consolidated financial statements was 38.1 million compared to 130.0 million in 2003. Therefore, segment contribution is not indicative of the actual profitability margin for the operating segments.

In 2004, 3.9 million (2003: 6.0 million) of exit costs related to unused lease space and severance payments were not allocated to the segments.

As discussed in Note 32 in Item 18. Financial Statements, through December 31, 2003, we accounted for internal sales and transfers between segments either on a cost basis or at estimated market prices, depending on the type of service provided. Effective January 1, 2004, in order to best manage the utilization of our internal resources, we started recording all internal sales and transfers based on fully loaded cost rates. We adjusted the management reporting of internal revenues such that internal sales and transfers are now reported as a cost reduction rather than internal revenues. This change in segment measures resulted in lower revenues and costs for the operating segments. Due to the high volume of intercompany activity between certain group entities (mainly the German, US, and UK subsidiaries), the change also resulted in higher margins for the segments. We also adopted a new calculation of the segment contribution in 2004 such that acquisition related charges no longer burden a segment s contribution.

Although there have been no changes in the composition of operating segments or in reportable operating segments, our original segment disclosures for 2003 have been presented along with revised information that conforms to the current presentation.

Product segment. The Product segment is primarily engaged in marketing and licensing our software products, performing software development services, and performing maintenance services. Maintenance services include technical support for our products, assistance in resolving problems, providing user documentation, updates and other support for software products, new versions, and support packages. Reflecting internal management responsibilities within our organization, the product segment includes the lines of business sales, marketing and service and support.

Product segment revenue increased by 10.3% from 4,797.8 million in 2003 to 5,292.9 million in 2004. On a constant currency basis, product segment revenue grew by 13.7%. Approximately 98% of revenues within the product segment were derived from software and maintenance revenue, with the remaining 2% derived from services revenue and other revenue. Software revenue as part of the total product segment revenue increased by 11% from 2,131.3 in 2003 million to 2,361.0 million in 2004. This corresponded to an increase of 14.3% based on constant currencies. Maintenance revenues increased by 10% from 2,565.9 million in 2003 to 2,817.4 million in 2004, an increase of 13.1% based on constant currencies.

Product segment expenses increased by 10.5% from 1,862.7 million in 2003 to 2,058.1 million in 2004, an increase of 13.5% based on constant currencies. Expenses of the line of business sales accounted for roughly more than half of the entire product segment expenses. Expenses of the line of business marketing accounted for roughly one fourth and expenses of the line of business service and support accounted for roughly one fifth of overall product segment expenses. The increase in sales and marketing expenses resulted mainly from the higher headcount and associated personnel-, travel- and other personnel related expenses as well as additional third-party and marketing expenses. The growth in service and support expenses was driven primarily by the decision to strategically shift the organizational responsibility for the maintenance of mature product releases from the development organization to the service and support teams.

Product segment contribution increased by 10.2% from 2,935.1 million in 2003 to 3,234.8 million in 2004, or 61.1% of total segment revenue compared to 61.2% of total segment revenue in 2003. On a constant currency basis, product segment contribution increased by 13.8%. While we were able to increase product segment revenues, primarily relating to the U.S. operations, the percentage increase in our product segment expenses was slightly higher, resulting in a slight decrease in product segment contribution as a percentage of total revenue. The proportionally higher increase in segment expenses resulted mainly from the additional expenses incurred in the service and support area.

Consulting segment. The Consulting segment is primarily engaged in the implementation of our software products.

Consulting segment revenues increased by 1.4% from 1,884.8 million in 2003 to 1,910.3 million in 2004. In constant currency, revenue increased by 5%. The market in the consulting segment continued to be very competitive in 2004 and our customers and partners remained very price-conscious throughout the year, adversely impacting the revenue growth in the consulting segment. In addition, our focus on growing product revenues also impacted the growth in consulting segment revenues.

Consulting segment expenses increased by 2.9% from 1,442.4 million in 2003 to 1,484.0 million in 2004. In constant currency, segment expenses increased by 6%. In markets with strong growth, such as the Americas region, more consultants were hired and more third-party services were engaged. The main contributing factor to the higher segment expenses was the increased headcount with the related increase in personnel and travel expenses.

Consulting segment contribution decreased by 3.6% from 442.4 million in 2003 to 426.3 million in 2004. In constant currency, the segment contribution decreased by 1%. The consulting segment profitability was reduced by 1.2 percentage points. Consultants had been more engaged in supporting the product segment, ramping up new products and supporting the sales cycle. The newly employed consultants not yet being fully productive for the full year also negatively impacted the consulting segment profitability.

Training segment. The Training segment is primarily engaged in providing educational services on the use of our software products and related topics for customers and partners. Training services include traditional classroom training at SAP training facilities, customer and partner specific training, end-user training as well as e-learning.

Training segment revenues were 306.6 million in 2004, which represented a slight decrease from 2003 (316.1 million). On a constant currency basis, training segment revenues would have been 316.8 million. Even though our customers continued to restrict their spending on employee training courses during the year, training segment revenues declined only modestly in 2004 due to an overall stabilization of the IT training market and our ability to effectively execute on a more flexible service portfolio. This process began in 2003 and was tailored to meet individual customer needs rather than standardized courses. As a result, there had been a continued decrease in traditional classroom training which was partially offset by additional customer specific, end-user training and e-learning.

Training segment expenses decreased from 221.8 million in 2003 to 209.0 million in 2004, or 5.8%. Our training segment initiated certain measures to reduce costs in 2003, which included consolidation of certain facilities and ceasing operations in certain geographic locations. A restructuring charge of approximately 9 million was incurred in 2003 for unused lease space. The cost reduction measures begun in 2003 had a positive impact in 2004 and contributed to the overall reduction in training segment expenses in 2004.

Training segment contribution increased by 3.5% from 94.3 million in 2003 to 97.6 million in 2004. The training segment profitability increased by 2.0 percentage points. This was due primarily to the fact that the cost reduction of our training segment effectively met the customer demand shift from classroom training to customized training.

OUTLOOK 2006

Forecast for the Global Economy

The IMF and the OECD do not expect that the economic climate in 2006 will be much different than it was 2005. Overall, they believe recovery in the global economy will not be stronger than in 2005. According to the IMF s forecast for 2006, global GDP the total value of all goods and services will grow 4.3%. Increased commodity prices and continuing subdued demand on the domestic market will hold back progress, especially in the industrialized countries of Europe. It expects growth to slow in the United States and Japan.

The OECD believes that, compared to many other markets, U.S. growth will still be relatively strong at 3.5%. The IMF expects growth to remain strong in Asia in 2006 notably in China (where it foresees 8.2% growth) and India (6.3%). It expects the Japanese economy to expand 2.0% in 2006 and again in 2007. Growth

Table of Contents

is expected to accelerate in the euro zone. The OECD forecasts GDP will increase 2.1% in the euro zone up from 1.4% in 2005. It expects a 2.2% expansion of the euro zone economy in 2007. For Germany, the OECD forecasts GDP growth will accelerate to 1.8% in 2006.

The primary risks to the global economy that the IMF and the OECD identify are further rises in oil prices, deterioration in the U.S. balance of payments, or sudden changes of major trading nations currency policy. International economic activity could also be severely impacted by major increases in long-term interest rates or a reversal of the current temperate trends in the financial and property markets. The OECD believes these risks could be contained if world trade were further opened up and there were progress in the agricultural policy reform negotiations, which would both stimulate more worldwide economic activity.

Forecast for the IT Industry

The generally healthy climate for business in 2006 should help the IT market. IT market intelligence provider IDC estimates that in 2006 the global IT market will expand 5.5% and that the applications segment of that market will do even better, growing 5.9%. Gartner defines the IT market slightly differently its 2006 growth forecast of approximately 4% reflects an anticipated hesitancy in the hardware and IT services segments. *Red Herring*, a U.S. magazine covering the IT market, foresees sustained pressure on prices in 2006, especially affecting the major vendors. Nonetheless, Gartner expects the applications market to expand 8% worldwide in 2006. That increase could be generated by products such as Microsoft and SAP s shared Mendocino development, *Red Herring* suggests.

Gartner forecasts that SMEs will spend some 7% more on IT in 2006 than in 2005, reasoning that companies will look to advanced IT support for their business processes for the edge in an ever fiercer competitive environment worldwide. Thus, many of them will modernize their systems and applications, Gartner believes.

In IDC s assessment, the SME market that SAP can address comprises some 64,000 companies with a headcount of 1,000 to 2,500 and 1.2 million companies with a headcount in the range 100 to 1,000. Citigroup estimates that SAP s share of the SME segment is some 10%, which already makes it the leader, ahead of Intuit, Microsoft, Sage, and Oracle.

Gartner expects SMEs to concentrate their IT investment on security, Internet business processes, and expanding their ERP systems. It believes larger companies in the SME spectrum (with 500 or more employees) will spend significantly on ERP. These are precisely the companies that are feeling the impact of more demanding compliance requirements such as those under the U.S. Sarbanes-Oxley Act. Gartner predicts they will also tend to invest in document management and CRM systems.

The U.S. IT market is SAP s single most important source of revenue, and here IDC estimates 5.0% growth in 2006 (2005: 4.9%). Gartner s corresponding estimate is similar. Despite the rather subdued outlook for the western European economy as a whole, IDC believes the IT market in the region will grow slightly faster than in the United States. Gartner, on the other hand, expects the western European IT market to grow more slowly. In the Asia-Pacific region, IDC predicts that the IT market will expand 5% in 2006, while Gartner projects 4.4% growth.

BITKOM estimates that growth of the German IT market in 2006 will comfortably exceed 3%. It bases its forecast on the results of its quarterly membership surveys. In IDC s view, the growth rate for the entire German IT market will grow from 2.7% in 2005 to 4.8% in 2006.

Red Herring warns that the practice of sourcing enterprise application software as Internet services rather than by buying licenses could be unhelpful to the major vendors. The practice was first observed in 2004, and is expected to reach significant proportions in 2006. IDC predicts that Internet providers of software as services will see their revenue grow 15% in 2006.

Table of Contents

Forecast for SAP

Operational goals for 2006: profitable growth

In 2006, we aim to post double-digit software and product revenue growth for the third year in a row and thus further strengthen our segment share. At the same time, we plan to continue to align our operations to volume business to increase the proportion of our revenue derived from SME customers. We also plan to continue to invest in research and development to drive forward development of a business process platform and bring strategic new products to market. At the beginning of the year, we published the following outlook for fiscal year 2006:

To provide additional transparency, we are providing for the first time an outlook for product revenues, which is comprised of software and maintenance revenues. We expect full-year 2006 product revenues to increase in the range of 13% to 15% compared to 2005. This growth rate is based on our expectation for full-year 2006 software revenue growth in the range of 15% to 17% compared to 2005. As in 2005, the growth is expected to be driven by the Americas and Asia-Pacific. Low single-digit revenue growth in Germany is likely, while high single-digit growth is expected for the rest of the EMEA region. Consulting and training revenues are expected to grow more slowly than product revenue.

We expect the full-year 2006 pro-forma operating margin, which excludes stock-based compensation and acquisition-related charges, to increase in the range of 0.5 to 1.0 percentage points compared to 2005.

We expect full-year 2006 pro-forma earnings per share, which exclude stock-based compensation, acquisition-related charges and impairment-related charges, to be in the range of 5.80 to 6.00 per share.

As in previous years, the major portion of the planned investment is earmarked for new hires, who would be taken on as needed to meet the actual requirements of business. If the year unfolds as planned, some 3,500 full-time equivalents would be added to the total headcount. The regional breakdown of headcount growth is planned to be similar to that of 2005. A significant proportion of the new jobs is expected to be located in India and China, while some 20% of the increase is expected in Germany.

This outlook assumes that:

The economy is stable.

The buying behavior of customers will conform to the usual seasonal pattern, with revenue at its strongest in the fourth quarter.

The average U.S. dollar to euro exchange rate is $1.23 per 1.00.

The effective group tax rate is 34.5%, which takes in account among other things an anticipated favorable effect of the municipal trade tax rate change enacted in January 2006 for the City of Walldorf, Germany, where our corporate headquarters is located.

In 2006, SAP intends to continue seeking opportunities to step up stock repurchasing from the 2005 previous level. The outlook for pro-forma EPS is based on 307 million shares.

The stated revenue, income, and margin targets of SAP for fiscal year 2006 are subject to a number of risks, over which we may have no influence or only limited influence. This outlook should be read in connection with the more detailed discussion and analysis of our financial condition and results of operations in this Item 5, Item 3. Key Information Risk Factors, and Item 18. Financial Statements.

Table of Contents

Prospects through 2010

In the medium term, we expect further advances and continuing revenue growth. The ESA road map is planned for completion in 2007, which means that the SAP NetWeaver platform will have evolved into a business process platform, which we plan to make widely available to other software companies for their developments, and that the mySAP Business Suite applications and mySAP All-in-One partner solutions will be fully based on the business process platform. We expect this to open up new ways for us to approach the market. At the same time, we want to strengthen our position in the SME segment and offer new strategic products, enabling us to tap into new markets. Currently, we estimate the size, in terms of product revenue volume, of the segments in which we operate to be approximately U.S.$30 billion. As we expand into new markets, we predict the size of the overall segments in which we operate to reach approximately U.S.$70 billion by 2010. We want to translate this potential into additional revenue growth. By 2010, we aim to earn around half of our software revenue with new, as yet unavailable, products, increase the number of customers to approximately 100,000, and receive 40% to 45% of our orders from customers in the SME segment.

The expected revenue growth, combined with productivity increases in all business processes, should lead to further margin improvements. Therefore, we expect our 2007 pro-forma operating margin to be over 30%.

FOREIGN CURRENCY EXCHANGE RATE EXPOSURE

Although our reporting currency is the euro, a significant portion of our business is nevertheless conducted in currencies other than the euro. International sales are primarily made through our subsidiaries in the respective regions and are generally denominated in the local currency, although in certain countries where foreign currency exchange rate exposure is considered high, some sales may be denominated in euro or U.S. dollars. Expenses incurred by the subsidiaries are generally denominated in the local currency. Accordingly, the functional currency of our subsidiaries is generally the local currency. Therefore, movements in the foreign currency exchange rates between the euro, and the respective local currencies to which our subsidiaries in countries that do not participate in the EMU are exposed, may materially affect our consolidated financial position, results of operations and cash flows. In general, appreciation of the euro relative to another currency has a negative effect on our results of operations, while depreciation of the euro has a positive effect. As a consequence, period-to-period changes in the average exchange rate in a particular currency can significantly affect our revenue, operating results and net income. The principal currencies in which our subsidiaries conduct business that are subject to the risks described in this paragraph are the U.S. dollar, the Japanese yen, the British pound, the Swiss franc, the Canadian dollar and the Australian dollar. We enter into derivative instruments, primarily foreign exchange forward contracts, to protect our anticipated cash flows from foreign subsidiaries from the effects of foreign currency exchange fluctuations. See also Item 11. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk and Note 31 in Item 18. Financial Statements.

Approximately 63% of our consolidated revenue in 2005 and approximately 60% in 2004 was attributable to operations in non-EMU participating countries and such revenues had to be translated into euros for financial reporting purposes. Fluctuations in the value of the euro had positive effects on our consolidated revenue of 111 million, income before income taxes of 21 million and net income of 23 million for 2005, and had negative impacts on our consolidated revenue of (236) million, income before income taxes of (56) million and net income of (43) million for 2004. See Item 11. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk.

The impact of foreign currency exchange rate fluctuations discussed in the preceding paragraph is calculated by translating current period figures in local currency to euros at the monthly average exchange rate for the corresponding month in the prior year. Throughout this Annual Report on Form 20-F, we

Table of Contents

discuss our financial performance without the effect of foreign currency fluctuations on a constant currency basis, which is calculated in the same manner.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared based on the accounting policies described in Note 3 to our consolidated financial statements in Item 18. Financial Statements in this Annual Report on Form 20-F. The application of such policies may require management to make significant estimates and assumptions. We believe that the following are our more critical accounting estimates used in the preparation of our consolidated financial statements that could have a significant impact on our future and current consolidated results of operations and financial position:

Revenue recognition

Valuation of accounts receivable

Accounting for stock-based compensation

Accounting for income taxes and other income tax related judgments

Realizability of strategic and venture capital investments

Please refer to Note 3 to our consolidated financial statements in Item 18. Financial Statements for further discussion of our accounting policies.

Revenue Recognition

Substantially all of our revenues are derived from the sale or the license of our software products and the sale of maintenance, consulting, development, training, and other services. Our standard license agreement provides a perpetual license to use our products based on the number of licensed users. We may license our software in multiple element arrangements if the customer purchases any combination of maintenance, consulting, development, training, or other services in conjunction with the software license.

We recognize revenue pursuant to the requirements of American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition* (SOP 97-2), as amended by SOP 98-9, *Software Revenue Recognition With Respect to Certain Transactions*; SOP 81-1, *Accounting for Performance of Construction-type and Certain Production-type Contracts*; the SEC s Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*; Emerging Issues Task Force (EITF) 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21); EITF 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*; and other authoritative accounting guidance.

We recognize revenue using the residual method when SAP-specific objective evidence of fair value exists for all of the undelivered elements (for example, maintenance, consulting, or other services) in the arrangement, but does not exist for one or more delivered elements (for example, software). We allocate revenue to each undelivered element based on its respective fair value which is the price charged when that element is sold separately or, for elements not yet sold separately, the price established by management if it is probable that the price will not change before the element is sold separately. We defer revenue for the undelivered elements (for example, maintenance, consulting, or other services) and recognize the residual amount of the arrangement fee attributable to the delivered element (for example, software), if any, when the basic criteria in SOP 97-2 have been met. If an undelivered element is not sold separately and management has not yet established a price for the undelivered element that will not change before the element is sold separately, revenues for all elements are deferred until the delivery criteria have been satisfied.

Table of Contents

Under SOP 97-2, provided that the arrangement does not involve significant production, modification, or customization of the software, revenue is recognized when all of the following four criteria have been met:

1. Persuasive evidence of an arrangement exists
2. Delivery has occurred
3. The fee is fixed or determinable, and
4. Collectibility is probable.

If at the outset of an arrangement we determine that the arrangement fee is not fixed or determinable, revenue is deferred until the arrangement fee becomes due and payable by the customer. If at the outset of an arrangement we determine that collectibility is not probable, revenue is deferred until payment is received. If an arrangement allows for customer acceptance of the software or services, we defer revenue until the earlier of customer acceptance or when the acceptance rights lapse.

We occasionally license software for a specified time period. Revenue for short-term time-based licenses, which generally include maintenance during the license period, is recognized ratably over the license term. Revenues for multi-year time-based licenses that include maintenance, whether separately priced or not, are recognized ratably over the license term unless a substantive maintenance renewal rate exists, in which case the amount allocated to software based on the residual method is recognized as software revenue when the basic criteria in SOP 97-2 have been met. Revenues from time-based licenses were not material in any of the periods presented in this Annual Report on Form 20-F.

If an arrangement includes the right to undelivered unspecified additional software products, the entire arrangement is accounted for as a subscription. Revenue from the arrangement is recognized ratably over the term of the arrangement beginning with the delivery of the first product. Revenues from subscriptions were not material in any of the periods presented in this Annual Report on Form 20-F.

We recognize revenue from resellers upon evidence of sell-through to the end customer. If we become aware that a reseller has granted contingent rights to an end-customer, we defer revenue recognition until a valid license agreement has been entered into without contingencies or, if applicable, until the contingencies expire.

In multiple-element arrangements involving software and consulting, training, or other services that are not essential to the functionality of the software, the service revenues are accounted for separately from the software revenues.

Maintenance revenues are recognized over the term of the maintenance contract. Our initial maintenance term is generally in the range of one to three years, renewable by the customer on an annual basis thereafter. The maintenance fee, including the fee for subsequent renewals, is typically established based on a specified percentage of the license fee paid by the customer. Our customers typically prepay maintenance for periods of three to twelve months. Maintenance revenues are recognized ratably over the term of the maintenance contract. If a maintenance customer is specifically identified as a bad debtor, we cease recognizing maintenance revenue except to the extent that maintenance fees have already been collected. For time-based licenses and subscriptions, we allocate a portion of the arrangement fee to maintenance revenue based on the estimated fair value of the maintenance.

Consulting, training and other service revenues are recognized as the respective services are performed, generally on a time-and-materials basis. Consulting revenues attributed to fixed-price arrangements are recognized using the proportional performance method, based on direct labor costs incurred to date as a percentage of total estimated project costs required to complete the project. Consulting services primarily comprise implementation support related to the installation and configuration of our software products and do not typically involve significant production, modification, or customization of the software. When total cost estimates exceed revenues in a fixed-price arrangement, the estimated losses are recognized

Table of Contents

immediately based upon an average fully burdened daily rate applicable to the consulting organization delivering the services.

Revenues for arrangements that involve significant production, modification, or customization of the software and those in which services are not available from third-party vendors and therefore deemed essential, are recognized, depending on the fee structure, on a time-and-materials basis or using the percentage of completion method of accounting. If we do not have a sufficient basis to measure the progress of completion, revenue is recognized when final acceptance is received from the customer. If the arrangement includes elements that do not qualify for contract accounting (for example maintenance, hosting) such elements are accounted for separately provided that the elements have stand-alone value and SAP-specific objective evidence of fair value exists. When total cost estimates exceed revenues in a fixed-price arrangement, the estimated losses are recognized immediately based upon an average fully burdened daily rate applicable to the unit delivering the services.

We periodically enter into joint development agreements with customers to leverage their industry expertise and provide standard software solutions for selected vertical markets. These customers generally contribute cash, resources, and industry expertise in exchange for license rights for the future solution. We recognize software revenue in conjunction with these arrangements based upon the percentage of completion method. Beginning in 2005, we classify the development costs associated with these arrangements as cost of product. See Note 8 to our consolidated financial statements in Item 18. Financial Statements for more information.

Hosting services are recognized ratably over the term of hosting contract. Revenues from hosting services were not material in any of the periods presented in this Annual Report on Form 20-F.

The assumptions, risks, and uncertainties inherent with the application of the percentage of completion method affect the timing and amounts of revenues and expenses reported. Numerous internal and external factors can affect estimates, including direct labor rates, utilization, and efficiency variances.

We account for out-of-pocket expenses rebilled to customers as maintenance, consulting, and training revenues.

We believe that our accounting estimates used in applying our revenue recognition policies are critical because:

- the determination that it is probable that the customer will pay for the products and services purchased is inherently judgmental;
- the allocation of proceeds to certain elements in multiple-element arrangements is complex;
- the determination of whether a service is essential to the functionality of the software is complex;
- establishing company-specific fair values of elements in multiple-element arrangements requires adjustments from time-to-time to reflect recent prices charged when each element is sold separately; and
- the determination of the stage of completion for certain consulting and development arrangements is complex.

Changes in the aforementioned items could have a material effect on the type and timing of revenue recognized. There have been no significant changes in our accounting estimates related to our revenue recognition policies that had a material impact on the amount of our reported revenue, results of operations or our financial position in 2005 and 2004.

Historically, SAP-specific objective evidence of fair value for certain undelivered elements in multiple-element arrangements has been determined on an enterprise-wide or country-wide basis, depending on the nature of the undelivered element. As economic conditions change in certain geographic locations in which we operate, we may need to modify our business practices in individual locations or worldwide, and future SAP-specific objective evidence of fair value of such undelivered elements may deviate from historical fair values. Consequently, the percentages and the amounts of the different types of revenue recognized in the future for multiple-element arrangements involving software could differ significantly from historical trends and could materially impact our reported revenues, results of operations and financial position in the future.

Valuation of Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. Total accounts receivable at December 31, 2005 and 2004 were 2,251.0 million and 1,929.1 million, respectively, which were net of an allowance for bad debts of 72.9 million in 2005 and 63.4 million in 2004. Included in accounts receivable are unbilled receivables related to costs and estimated earnings in excess of billings on uncompleted fixed fee consulting arrangements of 34.6 million and 43.0 million at December 31, 2005 and 2004, respectively. The allowance for doubtful accounts represents our best estimate of the amount of probable credit losses in our existing accounts receivable portfolio. We determine the allowance for doubtful accounts after giving consideration to specific customer past due amounts based on due dates and regional economic risks. Account balances are charged off against the allowance after all collection efforts have been exhausted and the potential for recovery is considered remote. Non-interest-bearing receivables with a term exceeding one year are discounted to their present value using local interest rates.

Total provisions for allowances for doubtful accounts charged to earnings approximated net 12.4 million, 1.7 million and 7.0 million during 2005, 2004, and 2003, respectively. The amount charged to earnings in 2004 was low compared to other years on average mainly due to successful collection of receivables previously reserved for. A factor contributing to the increase in the amount charged in 2005 was an increase in revenues in general. Specific customer credit loss risks are charged to the respective functional cost category of product or cost of service sold. Customer credit loss risks based on aging of the receivables are classified as general bad debt expense, which is included in Other operating income/expense, net as disclosed in Note 7 in Item 18. Financial Statements.

Charges for credit loss risks were as follows:

	2005	**2004**	**2003**
	(mio)	**(mio)**	**(mio)**
Specific customer credit loss risks	9.0	0.0	12.4
Customer credit loss risks based on aging of the receivables	3.4	1.7	(5.4)
Total provisions for allowances for doubtful accounts charged to earnings	12.4	1.7	7.0

Accounts receivable written-off against the allowance for doubtful accounts approximated 8.1 million, 7.7 million and 22.9 million during 2005, 2004, and 2003, respectively.

We believe that the accounting estimate related to the establishment of the allowance for doubtful accounts is a critical accounting policy because the assessment of whether a receivable is collectible is inherently judgmental and requires the use of assumptions about customer defaults that could change significantly and because changes in our estimates about the allowance for doubtful accounts could materially impact the reported assets and expenses in our financial statements. However, the recognition of allowances for doubtful accounts initially has no impact on our reported cash flows, our liquidity and capital resources. Net income could be adversely affected if actual credit losses exceed our estimates.

Accounting for Stock-Based Compensation

As further explained in Note 22 to our consolidated financial statements in Item 18. Financial Statements, we have several stock-based compensation plans. Through December 31, 2005, we accounted for stock-based compensation based on the intrinsic-value-based method prescribed by Accounting Principles

68

Table of Contents

Board Opinion 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations. Under this method, compensation expense is recorded only if on the date of grant the current market price of the underlying stock exceeds the exercise price or the exercise price is not fixed at the grant date.

SFAS 123 *Accounting for Stock-Based Compensation* (SFAS 123) and SFAS 148 *Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123* (SFAS 148) established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by SFAS 123 and SFAS 148, we elected to continue to apply the intrinsic-value-based method of accounting described above and adopted only the disclosure requirements of SFAS 123, as currently effective at December 31, 2005. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in 2005, 2004, and 2003.

Net Income

	2005	**2004**	**2003**
	(000)	**(000)**	**(000)**
As reported	1,496,407	1,310,521	1,077,063
Add: Expense for stock-based compensation, net of tax according to APB 25	31,130	23,445	85,700
Deduct: Expense for stock-based compensation, net of tax according to FAS 123	138,468	181,323	205,109
Pro forma	1,389,069	1,152,643	957,654

Earnings Per Share

	2005	**2004**	**2003**
Basic as reported	4.83	4.22	3.47
Diluted as reported	4.81	4.20	3.46
Basic pro forma	4.48	3.71	3.08
Diluted pro forma	4.48	3.70	3.08

We use the Black-Scholes valuation model to estimate the fair value of our stock options. As described in Note 22 to our consolidated financial statements in Item 18. Financial Statements, this valuation model requires that we use a number of assumptions, including expected future stock price volatility and expected option life (which represents our estimate of the average amount of time remaining until the options are exercised or expire unexercised). Expected future stock price volatility is estimated based upon historical stock price movements over the most recent period equal to the expected option life. Expected option life is based on the vesting period, the expected volatility of the underlying stock and on actual exercise activity related to previous option grants. Additionally, our share price on the date of grant influences the option value. Notwithstanding that the exercise price of most options equals or is connected to the quoted market price of our stock on the grant date, the higher the share price the higher the option value. In accordance with fixed-plan accounting under APB 25, changes in the option value after the grant date do not impact compensation expense.

We intend to continue using stock-based compensation awards to attract and retain senior managers and select employees. As discussed in Note 3 in Item 18. Financial Statements, the adoption of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), requires that stock-based awards be accounted for at fair value, rather than intrinsic value. We adopted SFAS 123R beginning January 1, 2006 using the modified version of prospective application. We expect the adoption of SFAS 123R will result in a reduction of our earnings and could result in dilution to our shareholders, and such adverse effect could be material. Also, the determination of the fair value of awards granted involves making certain assumptions. The above

Table of Contents

presented pro forma effects on reported net income as if the fair-value-based method was used to recognize compensation expense on equity-classified awards are not necessarily indicative of the impact the adoption of SFAS 123R will have on our future reported net income. The table above does not reflect the measurement of liability-classified awards at fair value and does not reflect the impact of estimating forfeitures of awards granted, both of which will be required under SFAS 123R. We are currently evaluating the expected share-based compensation expense for the year ended December 31, 2006.

For purposes of determining the estimated fair value of our stock options, we believe expected volatility is the most sensitive assumption. The fair value of awards granted under our SOP 2002 in 2005 was calculated based on an expected volatility of 24%. Changes in the volatility assumption could significantly impact the estimated fair values calculated by the Black-Scholes valuation model and, consequently, the required pro forma information reported in our consolidated financial statements.

The trading prices of our ordinary shares have experienced and may continue to experience significant volatility. The following table shows the income statement effect of certain assumed changes in the volatility covering all significant equity-award grants as of December 31, 2005, on the pro forma net income of 1,389 million as disclosed in Note 3 to our consolidated financial statements in Item 18. Financial Statements.

Assumed change in volatility in percentage-points	**10%**	**5%**	**+5%**	**+10%**
		(in millions of)		
Effect on pro forma net income for volatility assumption change	23	12	(10)	(21)
Pro forma net income using revised volatility assumption	1,412	1,401	1,379	1,368

Accounting for Income Taxes and Other Income Tax Related Judgments

We conduct operations and earn income in numerous foreign countries and are subject to changing tax laws in multiple jurisdictions within the countries in which we operate. In addition, there are numerous transactions where the ultimate tax outcome is uncertain such as those involving revenue sharing and cost reimbursement arrangements between SAP Group companies. Significant judgments are necessary in determining our worldwide income tax accruals and provisions. Although we believe we have made reasonable estimates about the ultimate resolution of our tax uncertainties, no assurance can be given that the final tax outcome of these matters will be consistent with what is reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision and net income in the period in which such determinations are made.

We had net deferred tax assets related to activities in various countries approximating 156.2 million and 141.4 million at December 31, 2005 and 2004, respectively, which are net of a valuation allowance of approximately 6.9 million and 1.4 million, respectively. We record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that we believe will more likely than not be realized. The valuation allowance increased in 2005 by 5.5 million and decreased in 2004 by 0.1 million. The increase in valuation allowance for 2005 was primarily attributed to a change in assessment of the realizability of net operating loss carryforwards. At December 31, 2005, we have net operating loss carryforwards in certain foreign tax jurisdictions of approximately 52.7 million that may be used to offset future taxable income in those jurisdictions. Of this amount, 21.1 million predominantly relates to state net operating loss carry forwards in the United States which will expire if not used in varying amounts over the next twenty years. Further, approximately 14.1 million of net operating loss carryforwards are available in other foreign tax jurisdictions which will expire if not used in varying amounts over the next three to seven years. The

Table of Contents

remaining net operating loss carryforwards currently have no expiration period for usage. The carrying values and realization of our net deferred tax assets are principally dependent upon:

- our ability to generate future taxable income;
- management s interpretation of applicable tax laws;
- management s assumptions and judgments regarding the use of tax planning strategies in certain tax jurisdictions; and
- assumptions about whether our results of future operations will generate sufficient taxable income to utilize our remaining net deferred tax assets.

We believe that our estimates pertaining to our accounting for income taxes are critical because:

- our judgments regarding future taxable income are based upon expectations of market conditions and other facts and circumstances. Any adverse change to the underlying facts or our assumptions could require that we reduce the carrying value of our net deferred tax assets; and
- our use of different estimates, assumptions and judgments in connection with tax planning strategies and tax uncertainties could result in materially different carrying values of our income tax asset and liability amounts and therefore could adversely impact our recorded income tax amounts.

As of December 31, 2005, we have cumulative undistributed earnings from certain foreign subsidiaries of approximately 2,371 million that are currently deemed to be permanently reinvested. A change in economic or other circumstances could impact our decision to repatriate some or all of these undistributed earnings which would result in the recognition of additional income tax liabilities.

Changes in any of the aforementioned items could have a material impact on our financial position and results of operations. There were no significant changes in estimates about our ability to realize our deferred tax assets nor have we made any significant changes to our plans about whether to permanently reinvest undistributed earnings of foreign subsidiaries that had a material impact on our consolidated financial condition or results of operations during 2005 and 2004.

Realizability of Venture Capital Investments

In the past and as a continuing part of our business strategy, we have made significant investments in technology related companies, some of which are start-up companies that are currently reporting and that have historically reported net losses. Due to the limited historical information available about many of these companies, our estimates concerning our ability to recover the carrying value of these investments involve significant judgments. Specifically, the determination of the fair value of an investment and the amount we can expect to realize upon liquidation of an investment is judgmental, as is the determination of whether a decline in value of an investment is other-than temporary. Changes in our estimates could have a material impact on our financial position and results of operations.

The carrying value of our venture capital investments at December 31, 2005 was 52.7 million (2004: 44.8 million). Although not significant in 2005, impairments and other charges related to our investments have had in the past, and could again have in the future, a material impact on our financial position and results of operations. In 2005, 2004, and 2003, we recognized impairment charges relating to our venture capital investments of 4.0 million, 5.1 million and 15.1 million, respectively.

Table of Contents

NEW ACCOUNTING STANDARDS NOT YET ADOPTED

See Note 3 in our consolidated financial statements in Item 18. Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

In 2005, as in 2004 and 2003, we have funded most of our growth internally from cash flow provided from operations. Over the past several years, our principal use of cash has been to support continuing operations and our capital expenditure requirements resulting from our growth, and to pay dividends on our shares and reacquire our shares in the open market. Cash and cash equivalents are primarily held in euro and U.S dollars as of December 31, 2005.

We believe that cash flows from operations, existing cash and cash equivalents, short-term marketable securities and available financing sources will be sufficient to meet our working capital needs and our currently planned capital expenditure requirements for the next twelve months. However, there can be no assurance that a downturn in the economy worldwide, in a particular region, or for our products and services in general, will not change this outlook.

As discussed in Note 4 in Item 18. Financial Statements, in 2005 we acquired minority shares of SAP Systems Integration AG (SAP SI) utilizing our cash at banks. In order to complement or expand our business in the future, we expect to make further acquisitions of additional businesses, products and technologies, and to enter into joint venture arrangements. These acquisitions or joint venture arrangements may require additional financing. In addition, continued growth in our business may from time to time require additional capital. There can be no assurance that additional capital will be available to us if and when required, or that such additional capital will be available on acceptable terms to us.

The table below presents our liquid assets for the years ended December 31:

	2005	**2004**
	(000)	
Cash at banks	455,522	458,909
Cash equivalents	1,608,552	1,046,884
Cash and cash equivalents	2,064,074	1,505,793
Liquid investments with original maturities exceeding 3 months and remaining maturities less than 1 year	910,850	918,272
Liquid investments with remaining maturities exceeding 1 year	238,648	772,477
	3,213,572	3,196,542

Our holdings of marketable securities as investments increased by 631 million to 643 million (2004: 12 million), of which 433 million were recorded as fixed assets and 210 million as non-fixed assets.

Total net interest income increased to 89.9 million in 2005 compared to 55.8 million in 2004 and 43.0 million in 2003. The increase is primarily due to higher levels of liquidity and higher interest rates. In addition to foreign currency exposure, we are generally exposed to fluctuations in the interest rates of many of the world s leading industrialized countries. Our interest income and expense is most sensitive to fluctuations in the level of U.S. and EMU interest rates.

Liquid assets in the amount of approximately 640 million are held in U.S.$ and approximately 2,075 million are held in euro.

Table of Contents

Analysis of Cash Flow Statement

Operating cash flow for 2005 was 1,607.9 million, representing a 13% decrease from 1,845.3 million in 2004. The decrease is partly due to back tax payments depleting deferred tax reserves. Also, in 2004 cash flow was buoyed by cash generated by the maturing of a forward exchange contract. Further, accounts receivable increased from 1,929.1 million at December 31, 2004 to 2,251.0 million at December 31, 2005, representing an increase of 321.9 million or 17%. Despite the increase in accounts receivable, which is consistent with the overall increase in revenues, we managed to reduce our rolling 12-month average collection period, which is measured in days sales outstanding (meaning the average number of days that passed before we were paid by our customers following the delivery of our software or the rendering of services) from 71 days in 2004 to 68 days in 2005 due primarily to our more stringent receivables management processes.

In 2005, net cash used in investing activities was 583.5 million, a decrease of 22% over 2004. The reduction is mainly due to the fact that substantial amounts of cash were transferred to short-term assets in the prior year. Change in liquid assets with maturities greater than 90 days was 541.2 million cash inflow in 2005 compared to 433.5 million cash outflow in 2004. Also, increasing our holding in SAP SI had led to greater outflows in 2004 than in 2005. Capital expenditures during 2005 for intangible assets and property, plant and equipment were 261.8 million, an increase of 69.1 million from 192.7 million in 2004. This included 240.7 million in property, plant and equipment additions (2004: 172.0 million), mainly a rise in building activity at the company headquarters and additional spending on IT infrastructure and company cars during 2005 to keep pace with the overall growth in employees and business activities.

Net cash used in financing activities was 554.9 million in 2005, an increase of 166.7 million from the 388.2 million of net cash used in 2004. Dividend payments were 340.4 million and 248.7 million in 2005 and 2004, respectively. Additionally we spent approximately 441.2 million in 2005 to purchase 3,394 thousand of our own ordinary shares (2004: 165.6 million to purchase 1,313 thousand of our own ordinary shares), some of which are held in treasury at December 31, 2005, under our stock buy-back program in order to satisfy subscription rights granted under our various stock-based compensation plans. Also, we spent approximately 13 million in 2005 to purchase 390 thousand ADSs (2004: 9 million to purchase 290 thousand ADSs).

Credit Lines

As of December 31, 2005, we had outstanding long-term financial debt of 8.9 million and outstanding short-term financial debt of approximately 22.3 million, consisting primarily of amounts borrowed under lines of credit.

We are currently party to a revolving 1 billion syndicated credit facility agreement with an initial term of 5 years ending November 2009. The use of the facility is not restricted by any financial covenants. Proceeds are for general corporate purposes. Borrowings under the facility bear interest of EURIBOR or LIBOR for the respective currency plus a margin ranging from 0.20% to 0.25% depending on the amount drawn. We are also required to pay a commitment fee of 0.07% per annum on unused amounts of the available credit.

We entered into this credit facility to increase our financial flexibility. We did not, however, draw down the facility in 2005, nor do we currently intend to draw down the facility. Consequently, there were no borrowings outstanding under the facility as of December 31, 2005.

As of December 31, 2005, SAP AG had additional available lines of credit totaling approximately 553.4 million. As of December 31, 2005, there were no borrowings outstanding under these lines of credit. Furthermore, certain of our foreign subsidiaries have lines of credit available that allow them to borrow funds in their respective local currencies at prevailing interest rates, generally to the extent SAP AG has guaranteed such amounts. As of December 31, 2005, approximately 217.7 million were available through such

Table of Contents

arrangements. Total aggregate borrowings under these lines of credit amounted to 24 million as of December 31, 2005.

AUTHORIZED CAPITAL

We also have available sources of cash through authorized capital as outlined in Item 10. Additional Information Share Capital.

OFF-BALANCE SHEET ARRANGEMENTS

We have entered into operating leases for office facilities for most of our subsidiaries, computer hardware and certain other equipment. These arrangements are oftentimes referred to as a form of off-balance sheet financing. Rental expenses under these operating leases are set forth below under Contractual obligations.

We have not entered into any transactions, arrangements or other relationships with unconsolidated, variable interest entities. We believe we don t have other forms of off-balance-sheet arrangements that would require disclosure other than those already disclosed.

Contractual Obligations

The table below presents our on- and off-balance sheet contractual obligations as of December 31, 2005:

Contractual Obligation	**Total**	**2006**	**2007**	**2008**	**2009**	**2010**	**thereafter**
				(000)			
Off-balance sheet							
Operating Leases	687,487	148,738	109,190	91,066	71,556	59,629	207,308
Purchase Commitments	78,783	78,598	140	45			
Other Commitments	38,820	23,386	2,031	1,759	1,633	1,603	8,408
On-balance sheet							
Bonds	6,927					1,686	5,241
Other Liabilities	838,778	749,243	42,723				46,812
Total	1,650,795	999,965	154,084	92,870	73,189	62,918	267,769

We have operating leases for office facilities for most of our subsidiaries, cars, computer hardware and certain other equipment. Rental expense for operating leases in 2005 was 165 million (2004: 153 million; 2003: 159 million).

Purchase commitments relate primarily to the construction of facilities, office equipment and car purchase commitments. Other commitments basically comprise food and security services and other facility commitments.

As described in Note 22 to our consolidated financial statements in Item 18. Financial Statements, bonds consist primarily of outstanding convertible bonds related to our LTI 2000 Plan.

Please refer to Note 25 to our consolidated financial statements in Item 18. Financial Statements for a detailed description of our other liabilities.

Benefit Plan Obligations and Costs

The obligations and expenses shown in our Consolidated Financial Statements for our benefit pension plans are not necessarily indicative of our future cash funding requirements. This is primarily due to deviations that can occur between the assumptions used in the actuarial valuation of our benefit plan obligations and costs and actual results of plan assets. In addition, although we currently do not expect to significantly increase cash contributions to our benefit plans in the near term, actual cash contributions may deviate from future funding requirements due to additional voluntary contributions to benefit plan assets.

Our contributions in 2006 to our defined contribution plans are expected to be between 75 million and 85 million, which is within the range of contributions over the last three years.

Our contributions in 2006 to our defined benefit pension plans are expected to be approximately 2 million for German plans and 7 million for non-German plans, all of which is expected to be paid as cash contributions.

The benefit obligations and the plan assets as of December 31, 2005 for our defined benefit plans represented increases of 76 million and 57 million, respectively, compared to December 31, 2004. Of the increases, 18 million for the benefit obligations and 21 million for the plan assets were attributable to foreign currency adjustments mainly due to the weaker euro against the U.S. dollar. A significant portion of the benefit obligations is for our foreign pension plans outside of Germany, primarily the U.S. plan which accounts for approximately 53% of total benefit obligations. Another 23 million in the changes in the total benefit obligations is due to actuarial loss.

For more information, see Note 23 to our consolidated financial statements in Item 18. Financial Statements.

Obligations Under Indemnifications and Guarantees

Our software license agreements generally include certain provisions for indemnifying customers against liabilities if our software products infringe a third party s intellectual property rights. To date, we have not incurred any material loss as a result of such indemnification and have not recorded any liabilities related to such obligations.

In addition, we occasionally provide function and/or performance guarantees in routine consulting contracts and/or development arrangements. Based on historical experience and evaluation, we do not believe that any material loss resulting from these guarantees is probable. In addition, because the guarantees relate to our own performance, no related liability has been recorded. We also generally provide a six to 12 month warranty on our software. Due to the nature of these warranties, which relate to the performance of our software, we cannot reasonably estimate the maximum exposure to loss resulting from the warranties. Our warranty liability is included in other reserves and accrued liabilities. See Note 24 to our consolidated financial statements in Item 18. Financial Statements.

As of December 31, 2005 and 2004, no guarantees were provided for performance or financial obligations of third parties.

RESEARCH AND DEVELOPMENT

As discussed in Item 6. Directors, Senior Management and Employees Executive Board, the Executive Board member responsibilities reflect the SAP s value chain. One of the Board areas, Research & Breakthrough Innovation, includes SAP Research, a group responsible for identifying emerging information technology trends, as well as researching and creating prototypes in strategically important SAP business areas. The fundamental business model of SAP Research is based on co-innovation through collaborative research with both academia and industry.

The Product & Technology Group, part of another SAP Executive Board area, Product, is responsible for developing and optimizing existing SAP solutions and improving products in development. The group s mission is to maximize satisfied usage of SAP software.

Table of Contents

SAP Labs is a global research and development organization with operations in nine countries Bulgaria, Canada, China, France, Hungary, India, Israel, Japan and the U.S. This regional diversification enhances the efficient use of local resources and allows for greater access to industry expertise and customers. SAP Labs focuses on development activities that address the needs of specific industries and geographic regions.

Research and development expenses for the years ending December 31, 2005, 2004, and 2003 were 1,088.6 million, 908.1 million and 872.2 million, respectively. Research and development expenses as a percentage of revenue were 12.8%, 12.1% and 12.4% for the years ended December 31, 2005, 2004, and 2003, respectively. As of December 31, 2005, 2004 and 2003, the percentage of employees (full-time equivalents) devoted to research and development was 32.4%, 30.7% and 29.9%, respectively.

We have entered into agreements with a number of leading computer software, technology and hardware suppliers and telecommunications providers to cooperate and enable certain of the products produced by such suppliers to be compatible with our solutions. These arrangements do not involve market or credit risk support on our behalf or by us, nor do they involve the issuance of our securities to provide the third-party suppliers with needed liquid resources. We evaluate the financial strength of the third-party suppliers with which we choose to cooperate, and we do not accept incremental financial risk through guarantees, loans, or other financial commitments.

Areas of Current and Future Research and Development Efforts

We believe that in the medium term, it is critical to continuously improve our portfolio of innovative products to maintain and reinforce our current leading position as a vendor of business software. We intend to continue investing substantial resources in technological research and development. Research and development activities in 2005 centered on the delivery of software solutions for the enterprise services architecture (ESA) roadmap, and on the on-schedule delivery of mySAP Business Suite solutions and all of the SAP industry solutions based on the SAP NetWeaver platform. Our significant areas of current technological research and development efforts include:

- enablement of our solutions based on enterprise services architecture;
- evolution of the SAP NetWeaver platform towards a business process platform;
- SAP software offerings, including mySAP CRM, mySAP SCM, mySAP ERP, mySAP PLM, mySAP SRM, SAP xApps composite applications, and SAP Business One;
- continuous innovation of SAP industry solution portfolios;
- increased focus on solutions targeted for small and midsize enterprises and business users; and
- new and innovative technologies.

Table of Contents

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

SUPERVISORY BOARD

The current members of the Supervisory Board of SAP AG, each such member s principal occupation, the year in which each was first elected and the year in which the term of each expires, respectively, are as follows:

Name	Age	Principal Occupation	Year First Elected	Year Term Expires
Prof. Dr. h.c. mult. Hasso Plattner, Chairperson (2)(3)(5)(7)(8)	62	Chairperson of the Supervisory Board	2003	2007
Pekka Ala-Pietilä(1)(8)	49	Executive Advisor to the CEO of Nokia Corporation	2002	2007
Prof. Dr. Wilhelm Haarmann (1)(3)(5)(9)	55	Attorney at Law, Certified Public Auditor and Certified Tax Advisor; HAARMANN Partnerschaftsgesellschaft, Rechtsanwälte, Steuerberater, Wirtschaftsprüfer	1988	2007
Dr. h.c. Hartmut Mehdorn (1)(7)	63	Chairperson of Executive Board, Deutsche Bahn AG	1998	2007
Prof. Dr. Dr. h.c. mult. August-Wilhelm Scheer(1)(6)(8)	64	Professor at Saarland University	2002	2007
Dr. Erhard Schipporeit(11)	57	Member of the Executive Board, E.ON AG	2005	2007
Dr. Dieter Spöri(1)(5)	62	Head of Corporate Representation Federal Affairs, DaimlerChrysler AG	1998	2007
Dr. h.c. Klaus Tschira(1)(4)	65	Managing Director, Klaus Tschira Stiftung gGmbH	1998	2007
Helga Classen, Vice Chairperson(5)(7)(10)	55	Employee, Deputy Data Protection Officer	1993	2007
Willi Burbach(7)(8)(10)	43	Employee, Developer	1993	2007
Bernhard Koller(4)(10)	56	Employee, Manager of Idea Management	1989	2007
Christiane Kuntz-Mayr (5)(8)(10)	43	Employee, Development Manager	2002	2007
Lars Lamadé(6)(10)	34	Employee, Risk Manager Service & Support	2002	2007
Dr. Gerhard Maier(3)(6)(10)	52	Employee, Development Project Manager	1989	2007
Dr. Barbara Schennerlein (5)(10)	49	Employee, Principal Consultant	1998	2007
Stefan Schulz(4)(8)(10)	36	Employee, Development Project Manager	2002	2007

Table of Contents

(1) Elected by SAP AG s shareholders on May 3, 2002.

(2) Elected by SAP AG s shareholders on May 9, 2003.

(3) Member of the Compensation Committee.

(4) Member of the Audit Committee.

(5) Member of the General Committee.

(6) Member of the Finance and Investment Committee.

(7) Member of the Mediation Committee.

(8) Member of the Technology Committee.

(9) Until January 1, 2006, Wilhelm Haarmann practiced as a partner of Haarmann Hemmelrath which served as special German tax counsel to SAP AG and counseled SAP with regard to other legal matters. On January 1, 2006, he joined HAARMANN Partnerschaftsgesellschaft in Frankfurt. Wilhelm Haarmann was determined to be the Audit Committee s financial expert until July 2005. Please refer to Item 16A. Audit Committee Financial Expert for details.

(10) Elected by SAP AG s employees on April 9, 2002.

(11) Elected by SAP AG s shareholders on May 12, 2005, replacing Dietmar Hopp who resigned from the Supervisory Board on the same day. Member of the Audit Committee, and determined to be the Audit Committee Financial Expert, replacing Wilhelm Haarmann.

For detailed information on the Supervisory Board committees and their tasks, including the Audit Committee and Compensation Committee, please refer to Item 10. Additional Information Corporate Governance.

The current members of the Supervisory Board of SAP AG that are members on other supervisory boards and comparable governing bodies of enterprises, other than SAP AG s, in Germany and other countries as of December 31, 2005, are set forth in Note 33 to our consolidated financial statements included in Item 18. Financial Statements. Apart from pension obligations towards employees, SAP AG has not entered into contracts with any member of the Supervisory Board that provide for benefits upon a termination of the employment of service of the member.

Pursuant to the German Co-determination Act of 1976 (*Mitbestimmungsgesetz*), in 2002 SAP AG was required to increase the number of members on the Supervisory Board from twelve to sixteen, comprised of eight representatives of the shareholders and eight representatives of the employees. German law required this increase since the number of employees of SAP AG and its group companies exceeded 10,000 employees in Germany in 2001. This increase was reflected in an amendment to SAP s Articles of Incorporation, which was approved at the Annual General Shareholders Meeting on May 3, 2002. Of the eight employee representatives, two must be nominated by the trade unions. The elected employees must be at least 18 years of age and must have been in the employment of SAP AG or one of its German subsidiaries for at least one year. They must also fulfill the other qualifications for election codified in Section 8 of the German Works Council Constitution Act. These qualifications include, among other things, not having been declared ineligible or debarred from holding public office by a court.

Table of Contents

EXECUTIVE BOARD

The current members of the Executive Board, the year in which each such member was first appointed and the year in which the term of each expires, respectively, are as follows:

Name	Year First Appointed	Year Current Term Expires
Prof. Dr. Henning Kagermann, CEO	1991	2007
Dr. Peter Zencke	1993	2008
Prof. Dr. Claus Heinrich	1996	2010
Gerhard Oswald	1996	2010
Dr. Werner Brandt	2001	2009
Shai Agassi	2002	2010
Léo Apotheker	2002	2010

In March 2005, we adopted a new form of organization designed to better implement our strategy and achieve goals. The Executive Board members responsibilities are now aligned along SAP s value chain, spanning innovation, research and development, production, services, marketing, training, consulting and sales.

A description of the management responsibilities and backgrounds of the current members of the Executive Board are as follows:

Henning Kagermann, CEO (*Vorstandssprecher*), 58 years old, physics graduate. Henning Kagermann joined SAP AG in 1982. He became a member of the Executive Board in 1991 and Co-CEO in 1998. In May 2003 he became sole CEO of the Executive Board. He has overall responsibility for SAP s strategy and business development, and is further responsible for corporate communications, global intellectual property, internal audit and top talent management.

Shai Agassi, 37 years old, computer science graduate and software entrepreneur. Shai Agassi joined SAP in 2001 as CEO of SAP Portals and became a member of the Executive Board in 2002. Prior to joining SAP, Shai Agassi founded a number of software companies in Israel between 1990 and 1994, and served in various positions in those companies. He moved one of these companies to California and renamed it TopTier Software, Inc., where he served as Chairperson, CTO and eventually CEO. TopTier was acquired by SAP in 2001, after which Shai Agassi became the CEO of SAP Portals, at that time a fully owned subsidiary of SAP. He is responsible for product development, the technology platform, the industry solutions, the partner network, and product and industry marketing.

Léo Apotheker, 52 years old, business economist. Léo Apotheker first joined SAP in 1988 and became a member of the Executive Board in 2002. He is responsible for sales, consulting, education, and marketing.

Werner Brandt, 52 years old, business administration graduate. Werner Brandt joined SAP in early 2001 as the Chief Financial Officer and member of the Executive Board. Prior to joining SAP, Werner Brandt was CFO and member of the Executive Board of Fresenius Medical Care AG since 1999. In this role, he was also responsible for labor relations. Before joining Fresenius Medical Care AG, Werner Brandt headed the finance function of the European operations of Baxter International. His responsibilities at SAP include finance and administration, shared services, and SAP Ventures.

Claus Heinrich, 50 years old, business management and operations research graduate. Claus Heinrich joined SAP in 1987 and became a member of the Executive Board in 1996. He is responsible for global human resources (including labor relations), quality management, internal IT and development labs (SAP Labs).

Gerhard Oswald, 52 years old, economics graduate. Gerhard Oswald joined SAP in 1981 and became a member of the Executive Board in 1996. He is responsible for global service and support, as well as custom development.

Peter Zencke, 56 years old, mathematics and economics graduate. Peter Zencke joined SAP in 1984 and became a member of the Executive Board in 1993. He is responsible for research and for the application platform.

The current members of the Executive Board of SAP AG that are members on other supervisory boards and comparable governing bodies of enterprises, other than SAP, in Germany and other countries as of December 31, 2005, are set forth in Note 33 to our consolidated financial statements in Item 18. Financial Statements. Apart from pension obligations, SAP AG has not entered into contracts with any member of the Executive Board that provide for benefits upon a termination of the employment of service of the member.

To our knowledge, there are no family relationships among the Supervisory and Executive Board members.

COMPENSATION, SHAREHOLDING, AND DEALINGS OF DIRECTORS AND OFFICERS

This section outlines the criteria that we apply to determine compensation for Executive Board and Supervisory Board members, discloses the amount of compensation paid, and describes the compensation packages. It also contains information about Executive Board members stock-based compensation plans, shares held by Executive Board and Supervisory Board members, and the directors dealings required to be disclosed in accordance with the German Securities Trading Act.

Executive Board

Compensation Package

The Executive Board compensation package is specified by the compensation committee of the Supervisory Board. Executive Board members compensation is intended to reflect our size and global presence as well as our economic and financial standing. We believe the level of compensation is internationally competitive to reward committed, successful work in a dynamic environment.

The compensation of the Executive Board as a body is primarily performance-based. It has three elements: a fixed element (salary), a performance-related element (directors profit-sharing), and a long-term incentive element (stock options). A compensation target is set for the total of fixed and performance-related elements. We review the compensation target every year in light of SAP s business and directors compensation at comparable companies on the international stage. Every year, the compensation committee of the Supervisory Board sets the target performance-related compensation, reflecting the relevant values in that year s budget.

Table of Contents

The elements of Executive Board compensation are paid as follows:

The fixed element is paid as a monthly salary.

The amount of performance-related compensation to be paid out in respect of 2005 depends on the SAP Group s achievement of its targets for pro-forma operating income before stock-based compensation expenses and acquisition-related charges and on software revenue growth. On February 3, 2006 the Supervisory Board s compensation committee assessed SAP s performance against the agreed targets and determined how much performance-related compensation was payable. SAP will make the payment after the Annual General Shareholders Meeting in May 2006.

The long-term incentive element takes the form of stock options issued on the terms of the SAP Stock Option Plan 2002 (SAP SOP 2002) that the Annual General Shareholders Meeting approved on May 3, 2002. The number of stock options to be issued to each individual member of the Executive Board was decided by the compensation committee at its meeting on February 10, 2005 and reflected the fair value of the options. Details of the plan and the terms of options under it are set out in Note 22 to our consolidated financial statements in Item 18. Financial Statements. For options granted to members of the Executive Board in and from February 2004, the SAP SOP 2002 plan terms provide that the Supervisory Board can cap subscription rights if it believes that an option holder would make a windfall profit by exercising them. If the total profit from the exercise at all times of rights under options issued to that holder at the same time exceeds two times the product of (i) the number of subscription rights received by that option holder; and (ii) the exercise price, that total profit is a windfall profit. It is determined by reference to the total of the differences, calculated individually for each exercised subscription right, between the closing price of the share on the exercise day and the exercise price. SAP bears any expenses incurred by the option holder through fees, taxes, or deductions related to the cap. The Supervisory Board can only cap subscription rights if it decides the windfall profits are due to not inconsequential, extraordinary, unforeseen appreciation for which the Executive Board is not responsible.

Amount of Compensation

Executive Board members compensation in fiscal year 2005:

	2005					2004
	Fixed elements		Performance-related compensation	Long-term incentive elements		
	Salary	Others*	Directors profit sharing	Stock options	Total	Total
				(000)		
Prof. Dr. Henning Kagermann (CEO)	618.0	18.3	4,104.0	1,344.5	6,084.8	5,258.7
Shai Agassi	412.0	100.2	2,736.0	752.9	4,001.1	3,312.4
Léo Apotheker	412.0	0.2	2,736.0	752.9	3,901.1	3,262.0
Dr. Werner Brandt	412.0	41.3	2,736.0	752.9	3,942.2	3,046.7
Prof. Dr. Claus E. Heinrich	412.0	20.0	2,736.0	752.9	3,920.9	3,277.8
Gerhard Oswald	412.0	14.2	2,736.0	752.9	3,915.1	3,270.4
Dr. Peter Zencke	412.0	21.9	2,736.0	752.9	3,922.8	3,281.8

Total	29,688.0	24,709.8

* Retirement pension plan contributions, insurance contributions, benefits in kind, compensation from seats on other governing bodies in the SAP Group

Table of Contents

Disclosed in the table above for the first time, the stock option values (2005: 5,861.9 thousand; 2004: 9,507.0 thousand) are the fair value of SAP SOP 2002 options at the time of grant to the respective members. During 2005, members of the Executive Board received the following stock options under SAP SOP 2002:

	Stock options
Prof. Dr. Henning Kagermann (CEO)	66,955
Shai Agassi	37,495
Léo Apotheker	37,495
Dr. Werner Brandt	37,495
Prof. Dr. Claus E. Heinrich	37,495
Gerhard Oswald	37,495
Dr. Peter Zencke	37,495
Total	291,925

End-of-service undertakings

Retirement Pension Plan

On January 1, 2000, SAP AG introduced a contributory retirement pension plan. At that time the performance-based retirement plan was discontinued for Executive Board members. Entitlements accrued up to December 31, 1999, were unaffected

In 2005, pension benefits of 474 thousand (2004: 247 thousand) were paid to former Executive Board members. As of December 31, 2005, the projected benefit obligation for former Executive Board members was 12,830 thousand (2004: 10,819 thousand).

Early Termination

The standard contract for all Executive Board members from January 1, 2006 provides that on termination before full term SAP AG will pay to the member the outstanding part of the compensation target for the entire remainder of the term, appropriately discounted for early payment. A member has no claim to that payment if he or she leaves SAP for reasons for which he or she is responsible.

If an Executive Board member s post on the Executive Board expires or ceases to exist because of or as a consequence of change or restructuring or due to a change of control, SAP AG and each Executive Board member has the right to terminate the employment contract within eight weeks of the occurrence by giving six months notice. A change of control is when an investor becomes obliged to make a takeover offer for SAP under the German Securities Acquisition and Takeover Act, when SAP AG merges with another company and becomes the subsumed entity, or when a domination or profit transfer agreement is concluded with SAP AG as the dependent company. An Executive Board member s contract can also be terminated before full term if his or her appointment as an SAP AG Executive Board member is revoked.

During the continuance of a 12-month postcontractual noncompete period, an Executive Board member is paid abstention compensation corresponding to 50% of his or her final average contractual compensation. SAP can deduct the abstention compensation from any other amount it owes the member, such as pension or early termination payments.

Long-Term Incentive Elements

Members of the Executive Board hold stock-based compensation awards granted to them in previous years under SAP SOP 2002 and LTI Plan 2000. Details and terms of the two plans are set out in Note 22 to our consolidated financial statements in Item 18. Financial Statements.

Table of Contents

SAP SOP 2002

The table below shows stock options held by members of the Executive Board on December 31, 2005, granted in 2003, 2004, and 2005 under SAP SOP 2002.

The exercise prices listed in the table for SAP SOP 2002 stock options are 110% of the base price of an SAP AG ordinary share. The base price is the arithmetic mean SAP share closing auction price in the Frankfurt stock exchange Xetra® trading system (or its successor system) over the five business days immediately before the issue date of that stock option. The lowest exercise price permitted is the closing auction price on the day before the issue date.

		Vested as of December 31, 2005		Not vested as of December 31, 2005		Total	
	Exercise price ( )	Number of options	Remaining term (years)	Number of options	Remaining term (years)	Number of options	Remaining term (years)
Prof. Dr. Henning Kagermann (CEO)	90.37	80,000	2.16			80,000	2.16
	149.99			50,000	3.13	50,000	3.13
	134.20			66,955	4.11	66,955	4.11
Shai Agassi	90.37	30,000	2.16			30,000	2.16
	99.13	30,000	2.33			30,000	2.33
	149.99			28,000	3.13	28,000	3.13
	134.20			37,495	4.11	37,495	4.11
Léo Apotheker	90.37	30,000	2.16			30,000	2.16
	149.99			28,000	3.13	28,000	3.13
	134.20			37,495	4.11	37,495	4.11
Dr. Werner Brandt	149.99			28,000	3.13	28,000	3.13
	134.20			37,495	4.11	37,495	4.11
Prof. Dr. Claus E. Heinrich	90.37	45,000	2.16			45,000	2.16
	149.99			28,000	3.13	28,000	3.13
	134.20			37,495	4.11	37,495	4.11
Gerhard Oswald	149.99			28,000	3.13	28,000	3.13
	134.20			37,495	4.11	37,495	4.11
Dr. Peter Zencke	90.37	45,000	2.16			45,000	2.16
	149.99			28,000	3.13	28,000	3.13
	134.20			37,495	4.11	37,495	4.11
Total		260,000		509,925		769,925	

During 2005, members of the Executive Board exercised stock options granted in earlier years under SAP SOP 2002 as follows:

Stock Options

	Number of	Weighted average

	options	**exercise price per option ( )**
Dr. Werner Brandt	30,000	90.37
Gerhard Oswald	45,000	90.37
Total	75,000	

Table of Contents

LTI Plan 2000

Beneficiaries under LTI Plan 2000 could choose between convertible bonds and stock options. The chief difference was in the way the exercise or conversion price was determined. The bond conversion price depends on the closing price of the SAP share the day before the bond was issued, while the option exercise price varies with the performance of the SAP share over time against the Goldman Sachs Software Index.

The table below shows stock options held by members of the Executive Board on December 31, 2005, granted in earlier years under LTI Plan 2000. The exercise prices listed for LTI Plan 2000 stock options reflect the prices payable by an Executive Board member for one SAP ordinary share upon exercise of the option on December 31, 2005. The exercise prices are variable. They vary with the performance of the SAP share over time against the Goldman Sachs Software Index.

LTI Plan 2000 Stock Options

		Vested as of December 31, 2005		**Not vested as of December 31, 2005**		**Total**	
	Exercise price ( )	**Number of options**	**Remaining term (years)**	**Number of options**	**Remaining term (years)**	**Number of options**	**Remaining term (years)**
Prof. Dr. Henning Kagermann (CEO)	77.95	28,032	4.14			28,032	4.14
	94.72	39,375	5.14			39,375	5.14
Shai Agassi							
Léo Apotheker	117.02	14,437	6.14	7,438	6.14	21,875	6.14
Dr. Werner Brandt							
Prof. Dr. Claus E. Heinrich	77.95	20,532	4.14			20,532	4.14
	94.72	27,500	5.14			27,500	5.14
Gerhard Oswald	117.02			10,625	6.14	10,625	6.14
Dr. Peter Zencke	77.95	6,981	4.14			6,981	4.14
	94.72	18,425	5.14			18,425	5.14
		155,282		18,063		173,345	

The table below shows convertible bonds held by members of the Executive Board on December 31, 2005, granted in earlier years under LTI Plan 2000. The exercise prices listed in the table for LTI Plan 2000 convertible bonds reflect the prices payable by an Executive Board member for one SAP ordinary share on conversion of the bond. The exercise prices are fixed and correspond to the quoted price of one SAP ordinary share on the business day immediately preceding the grant of the convertible bond.

LTI Plan 2000 Convertible Bonds

		Vested as of December 31, 2005		Not vested as of December 31, 2005		Total	
	Exercise price ( )	Number of bonds	Remaining term (years)	Number of bonds	Remaining term (years)	Number of bonds	Remaining term (years)
Prof. Dr. Henning Kagermann (CEO)	290.32	22,425	4.14			22,425	4.14
	191.25	31,500	5.14			31,500	5.14
	151.50	59,400	6.14	30,600	6.14	90,000	6.14
Shai Agassi							
Léo Apotheker	334.67	23,850	4.19			23,850	4.19
	191.25	30,000	5.14			30,000	5.14
	151.50	11,550	6.14	5,950	6.14	17,500	6.14
Dr. Werner Brandt	191.25	5,000	5.14			5,000	5.14
	151.50	19,800	6.14	10,200	6.14	30,000	6.14
Prof. Dr. Claus E. Heinrich	290.32	16,425	4.14	&nbs			