SAP AKTIENGESELLSCHAFT SYSTEMS APPLICATIONS PRODUCTS IN DATA
Form 20-F
April 03, 2007

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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, 2006**
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 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, 2006)**	1,267,537,248

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 49,250,676 treasury shares.

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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 US$, $, 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). Our financial statements are denominated in euros, which is the currency of our home country, Germany. 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 29, 2006, which was US$1.3197 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 14, 2007, the Noon Buying Rate for converting euro to dollars was US$1.3227 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. References in this Annual Report on Form 20-F to ADSs are to SAP AG s American Depositary Shares, each representing one SAP ordinary share. At SAP AG s Annual General Meeting of Shareholders held on May 9, 2006, the shareholders approved an increase in subscribed capital from corporate funds pursuant to which each shareholder received three additional shares for each existing SAP ordinary share held. This change was effective December 15, 2006. No new capital was raised through this transaction.

SAP, the SAP logo, R/2, R/3, xApp, xApps, SAP NetWeaver, Duet, PartnerEdge and other SA 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.

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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.

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USE OF NON-GAAP FINANCIAL MEASURES

This filing discloses certain financial measures, such as Adjusted operating income, Adjusted operating margin, Adjusted operating expenses, Adjusted net income, and Adjusted earnings per share (Adjusted EPS) which were referred to as pro forma measures in the previous filings, and constant currency period-over-period changes in revenue and operating expenses. These measures are not prepared in accordance with U.S. GAAP and are therefore considered non-GAAP measures. Our non-GAAP measures may not correspond to non-GAAP measures that other companies report. The non-GAAP measures that we report should be considered as additional to, and not as a substitute for or superior to, revenue, operating income, operating margin, net income, or other measures of financial performance prepared in accordance with U.S. GAAP. Our non-GAAP measures included in this report are reconciled to the nearest U.S. GAAP measure.

Adjusted Operating Income, Adjusted Operating Margin, Adjusted Operating Expenses, Adjusted Net Income, and Adjusted EPS

We believe that it is useful for investors to receive information on past and future-oriented financial data relied on by our management in running our business in addition to financial data prepared in accordance with U.S. GAAP. We have implemented an integrated management approach. We use consistent data to manage the performance of the Group for our planning, forecasting, reporting, compensation and external communications. This approach measures the performance of both management and employees by reference to financial results each can actually influence, and not to results over which we have no direct influence. Our management and employees cannot directly affect the expense for stock-based compensation because the fair value of our stock which directly impacts our stock-based compensation expense is heavily influenced by factors outside of our control, including the overall stock market and the share price fluctuations of other companies in the same industry. As a substantial portion of our stock-based compensation plans are cash settled and therefore liability-classified plans, our stock-based compensation expense if not hedged fluctuates in response to SAP stock price movements. Although acquisition-related charges include recurring items from past acquisitions such as amortization of acquired intangible assets, they also include an unknown component relating to current-year acquisitions. We cannot accurately assess or plan for that unknown component until we have finalized our purchase price allocation. Similarly, our Adjusted net income also excludes any impairment-related charges resulting from other-than-temporary declines in the market value of minority investments, which by their very nature are outside of our control.

The following expenses are eliminated from Adjusted operating income, Adjusted operating margin, Adjusted operating expenses, Adjusted net income, Adjusted EPS, and other non-GAAP measures based on Adjusted operating expense components:

- Stock-based compensation, including expenses for stock-based compensation as defined under U.S. GAAP as well as expenses related to the settlement of stock-based compensation plans in the context of mergers and acquisitions.

- Acquisition-related charges, including amortization of identifiable intangible assets acquired in acquisitions of businesses or intellectual property.

- Impairment-related charges, including other-than-temporary impairment charges on minority equity investments.

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Adjusted operating income and Adjusted operating expenses reconcile to the nearest U.S. GAAP measure as follows:

	U.S. GAAP Measure	Reconciliation Stock-based compensation expenses	Acquisition-related charges	Adjusted Measure
		millions		
2006				
Total operating expenses	6,837	99	43	6,695
Operating income	2,565	99	43	2,707
2005				
Total operating expenses	6,182	45	34	6,103
Operating income	2,331	45	34	2,410
2004				
Total operating expenses	5,496	38	30	5,428
Operating income	2,018	38	30	2,086

Adjusted net income, from which Adjusted EPS is derived, and Adjusted EPS reconcile to the nearest U.S. GAAP measure as follows:

	U.S. GAAP Measure	Reconciliation (net after tax) Stock-based compensation expenses	Acquisition-related charges	Impairment-related charges	Adjusted Measure
2006					
Net income in millions	1,871	71	27	1	1,970
Earnings per share in	1.53	0.06	0.02	0.00	1.61
2005					
Net income in millions	1,496	31	21	4	1,552
Earnings per share in	1.21	0.02	0.02	0.00	1.25
2004					
Net income in millions	1,311	24	18	5	1,358
Earnings per share in	1.05	0.02	0.02	0.00	1.09

The Adjusted operating income measures disclosed are the same measures that we use in our internal management reporting. Adjusted operating income was a key criterion, along with software revenue growth, for performance-related elements of management compensation.

In addition, in the past we gave full-year and long-term guidance based on non-GAAP financial measures. The guidance was provided on adjusted operating performance excluding stock-based compensation expenses and acquisition-related charges to focus on components that reflected the operational performance that management could directly influence and reasonably forecast for the periods covered by the guidance. Furthermore, by providing guidance based on adjusted income measures, we avoided having to update our market guidance whenever acquisition-related expenses changed, non-recurring impairment-related charges were recorded or the cost of stock-based compensation fluctuated because of a change in the price of our stock. Until 2007 we did not provide guidance on U.S. GAAP operating margin and earnings per share measures because those measures include expenses such as stock-based compensation, impairment-related charges, and acquisition-related charges.

We believe that the adjusted income measures have limitations, particularly as a result of the elimination of certain cost elements that may be material to us. We therefore do not evaluate our own past performance without considering both adjusted income measures and U.S. GAAP income measures. We also

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regularly analyze the differences between adjusted income measures and the respective most directly comparable U.S. GAAP income measures. We caution the readers of this report to follow a similar approach by considering the adjusted income measures only as an additional measure to, and not as a substitute for or superior measure to, revenue, operating income, operating margin, net income, cash flows, or other measure of financial performance prepared in accordance with U.S. GAAP.

Constant Currency Period-Over-Period Changes

We believe it is important for investors to have information that provides insight into our sales growth. Revenue measures determined under U.S. GAAP provide information that is useful in this regard. However, both growth in sales volume and currency effects impact period-over-period changes in sales revenue. We do not sell standardized units of products and services. Therefore we cannot provide relevant information on sales volume growth by providing data on the growth in product and service units sold. To provide additional information that may be useful to investors in breaking down and evaluating sales volume growth, we present information about our revenue growth and various values and components relating to operating income that are adjusted for foreign currency effects. We calculate constant currency year-over-year changes in revenue and income by translating foreign currencies using the average exchange rates from the previous year instead of the current year.

Constant currency period-over-period changes should be considered in addition to, and not as a substitute for or superior to, changes in revenues, expenses, income or other measures of financial performance prepared in accordance with U.S. GAAP.

We believe that data on constant currency period-over-period changes have limitations, particularly as the currency effects that are eliminated constitute a significant element of our revenues and expenses and may severely impact our performance. We therefore limit our use of constant currency period-over-period changes to the analysis of changes in volume as one element of the full change in a financial measure. We do not evaluate our growth and performance without considering both constant currency period-over-period changes and changes in revenues, expenses, income or other measures of financial performance prepared in accordance with U.S. GAAP. We caution the readers of this report to follow a similar approach by considering constant currency period-over-period changes only in addition to, and not as a substitute for or superior to, changes in revenues, expenses, income or other measures of financial performance prepared in accordance with U.S. GAAP.

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Constant currency year-over-year changes in revenue and operating income reconcile to the respective unadjusted year-over-year changes as follows:

	Percentage change from 2005 to 2006 as reported	Constant currency percentage change from 2005 to 2006	Currency effect
	%	%	%
Software revenue	10	12	(2)
Maintenance revenue	11	12	(1)
Software and maintenance revenue	**11**	**12**	**(1)**
Consulting revenue	9	10	(1)
Training revenue	12	12	0
Service revenue	**10**	**10**	**0**
Total revenue by Region[1]:			
EMEA region	9	9	0
United States	12	14	(2)
Rest of Americas region	18	16	2
Americas region	13	14	(1)
Japan	6	14	(8)
Rest of Asia Pacific Japan region	14	16	(2)
Asia Pacific Japan region	11	15	(4)
Total revenue	**10**	**11**	**(1)**

(1) Based on customer location

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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 presents selected consolidated financial information of SAP for the five most recent fiscal years. The selected consolidated financial information of SAP is a summary of, is derived from and is qualified by reference to, our consolidated financial statements. The selected consolidated balance sheet data as of December 31, 2004, 2003 and 2002 and the selected consolidated income statement data for the years ended December 31, 2003 and 2002 are derived from our audited consolidated financial statements. However, we have not included our audited consolidated financial statements for those periods in this document. The selected consolidated balance sheet data as of December 31, 2006 and 2005 and the selected consolidated income statement data for the years ended December 31, 2006, 2005 and 2004 are derived from our audited consolidated financial statements, which are included elsewhere in this document and have been audited by KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft (KPMG), independent registered public accountants, whose report appearing elsewhere in this document refers to the adoption of Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of December 31, 2006, the adoption of the fair value method of accounting for stock-based compensation as required by SFAS No. 123(R), *Share-Based Payment*, effective January 1, 2006, and a change in method for determining certain investments to be classified as current assets in 2006.

The audited consolidated financial statements for the years ended December 31, 2006, 2005 and 2004, are included in Item 18. Financial Statements.

	Year Ended December 31,					
	2006	2006	2005	2004	2003	2002
	US$[1]					
	(In thousands, except share data)					
Income Statement Data:						
Total revenue	12,407,982	9,402,123	8,512,429	7,514,493	7,024,606	7,412,838
Operating income	3,385,550	2,565,394	2,330,732	2,018,381	1,724,019	1,625,678
Income before income taxes and minority interest	3,529,932	2,674,799	2,316,356	2,072,642	1,776,615	1,107,698
Net income	2,469,656	1,871,377	1,496,407	1,310,521	1,077,063	508,614
Earnings per share[2]						
Basic	2.02	1.53	1.21	1.05	0.87	0.41
Diluted	2.01	1.52	1.20	1.05	0.87	0.41
Other Data:						
Weighted average number of shares outstanding[2]						
Basic	1,226,263	1,226,263	1,239,264	1,243,209	1,243,124	1,252,064
Diluted	1,231,650	1,231,650	1,243,342	1,248,623	1,245,636	1,255,920

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	Year Ended December 31,					
	2006	2006	2005	2004	2003	2002
	US$(1)					
	(In thousands, except share data)					
Balance Sheet Data:						
Cash and cash equivalents	3,165,605	2,398,731	2,064,074	1,505,793	838,737	897,285
Total assets	12,540,763	9,502,738	9,039,904	7,585,472	6,325,865	5,608,463
Shareholders equity	8,097,488	6,135,855	5,782,238	4,594,253	3,709,445	2,872,091
Subscribed capital	1,672,769	1,267,537	316,458	316,004	315,414	314,963
Short-term financial debt(3)	40,870	30,969	22,308	25,851	19,043	22,657
Long-term financial debt(3)	3,719	2,818	10,622	11,116	12,933	11,462

(1) Amounts presented in US$ have been translated for the convenience of the reader at 1.00 to US$1.3197, the Noon Buying Rate for converting 1.00 into dollars on December 29, 2006. See Exchange Rates for recent exchange rates between the euro and the dollar.

(2) Amounts are retrospectively adjusted for all periods presented for the effect of the December 15, 2006 fourfold increase in the number of shares under a capital increase pursuant to German law. See Item 9. The Offer and Listing General for more detail of the share increase.

(3) Financial debt represents bank loans, overdrafts and capital lease obligations. Short-term means a remaining life of one year or shorter; long-term, beyond one year. The balances include convertible bonds issued pursuant to stock-based compensation plans. See Item 6. Directors, Senior Management and Employees 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 and low Noon Buying Rates for the euro expressed as dollars per 1.00.

Year	Average(1)	High	Low
2002	0.9495	1.0485	0.8594

2003	1.1411	1.2597	1.0361
2004	1.2478	1.3625	1.1801
2005	1.2400	1.3476	1.1667
2006	1.2661	1.3327	1.1860

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Month	High	Low
2006		
July	1.2822	1.2500
August	1.2914	1.2735
September	1.2833	1.2648
October	1.2773	1.2502
November	1.3261	1.2705
December	1.3327	1.3073
2007		
January	1.3286	1.2904
February	1.3246	1.2933
March (through March 14, 2007)	1.3227	1.3094

(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 statutory financial statements, subject to approval by the shareholders, and are officially declared for the prior year at SAP AG s Annual General Meeting of Shareholders. 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 amounts shown in the table for 2005 and prior years are retrospectively adjusted for the effect of the fourfold increase in the number of shares resulting from the capital increase effective December 15, 2006 pursuant to German law. See Item 9. The Offer and Listing General for more detail of the share increase. 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 Item 10. Additional Information Taxation.

	Dividend Paid per Ordinary Share	
Year Ended December 31,		**US$**
2002	0.15	0.17[1][4]
2003	0.20	0.24[1][4]
2004	0.28	0.35[1][4]
2005	0.36	0.43[1][4]
2006 (proposed)	0.46[2]	0.61[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 Meeting of Shareholders of SAP AG to be held on May 10, 2007.

(3) Translated for the convenience of the reader from euro into dollars at the Noon Buying Rate for converting euro into dollars on March 14, 2007 of US$1.3227 per 1.00. The depositary is required to convert any dividend payments received from SAP as promptly as practicable upon receipt. The dividend paid may differ due to changes in the exchange rate.

(4) One SAP ADS currently represents one SAP AG ordinary share. Accordingly, the final dividend per ADS is equal to the dividend for one SAP AG ordinary 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 Meeting of Shareholders.

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, or 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 United States 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 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 United States, 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 have a negative impact on the world economy, contribute to a climate of economic and political uncertainty and affect our and our customers revenue growth and investment decisions over an extended period of time. We believe that geopolitical uncertainties, particularly hostilities against the United States or countries in Europe, 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.

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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 America and Latin America (Americas) and Asia Pacific Japan (APJ) regions. 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, regulation 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, has in recent years experienced a period of consolidation through mergers and acquisitions, particularly involving larger companies, such as the acquisitions of PeopleSoft, Inc., Siebel Systems, Inc. and the proposed acquisition of Hyperion Solutions Corporation by Oracle Corporation. Such consolidations 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 the completion of our enterprise service-oriented architecture road map, customer relationship management on-demand solutions, solutions for small and midsize enterprises as well as industry-tailored solutions for specific industries such as retail and financial services. Our expansion from 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.

The continuing trend towards outsourcing business processes to external providers (business process outsourcing, or BPO) or towards alternative licensing models such as distributing applications on an on-demand basis or through application service providers could result in increased competition for us with systems integrators, consulting firms, telecommunications firms, computer hardware and software vendors and other IT service providers.

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 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 require a broad acceptance of new and substantially different methods of conducting business and exchanging information, particularly by those individuals and enterprises that have historically relied upon traditional means of commerce and communication. 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 scope of potential users within our installed customer base such as Duet (formerly code named Project Mendocino), a joint solution offering developed with Microsoft Corporation, or our SAP xApp composite applications for analytics, pose an opportunity for us to continue to generate revenue from existing customers. If we are unable to enhance our existing products and services, develop new products according to market needs in a timely manner, customers may not necessarily license additional SAP products or contract for additional services or maintenance in the future. In addition, several of our larger customers are requiring enterprise-wide license agreements that satisfy current as well as planned customer use requirements. 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, if they reduce the scope of their maintenance agreements, or if they insist upon licenses that include future use requirements, 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, and 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 and value added resellers for our products targeted at small and midsize enterprises.

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 United States, Europe and India) are in short supply. We expect continued increases in compensation costs in order to attract and retain senior managers and skilled employees, especially in times of strong economic growth. 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 the past years, 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 increased our headcount by 11% in 2005 and by 10% in 2006. 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 skilled workers 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 14, 2007, the beneficial holdings of SAP AG s principal shareholders and the holdings of entities controlled by them constituted in the aggregate approximately 30% of the outstanding ordinary shares of SAP AG. If SAP AG s principal shareholders and 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 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 any of the principal shareholders or related entities.

We are subject to significantly increased governance-related regulatory requirements both in Germany and the United States

SAP AG as a stock corporation domiciled in Germany and listed in Germany and the United States is subject to governance-related regulatory requirements under both jurisdictions. These standards are among the highest standards worldwide and have grown considerably in the past few years. In the United States, 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. 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, for example, 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.

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 United States. A substantial portion of the assets of SAP and such persons are located outside the United States. As a result, it may not be possible to effect service of process within the United States 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

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the United States. In addition, awards of punitive damages in actions brought in the United States 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 our business. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments could result in compromises or breaches of security such as those that have generated widespread media attention. Continued high-profile cases of inadvertent and unauthorized disclosure of personal information 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.

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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 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 small and midsize enterprises (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 large enterprise 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 over the recent years, and plan to continue to increase throughout 2007, 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.

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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 64% of our consolidated revenue in 2006 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 our 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.

We generally license our software products for an upfront license fee based on the number and types of users or other applicable metrics. Maintenance fees are typically established based on a specified percentage of the license fee. 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 follow and are dependent upon software sales. Historically, the profit margin from our services arrangements is lower than that of our software sales. 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.

We have introduced new licensing models such as on-demand and subscription models which typically result in software revenue being recognized over time. Although revenue from such new models is still relatively insignificant, we expect it to grow in the future. A significant portion of the related cost of developing, marketing and providing our solutions to customers under such new models could be incurred prior to the recognition of revenue, thus impacting our profit margin in the short term.

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 normally 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 may 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.

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 to 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 and interpretations 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 revenue recognition policies are described in Note 3 to our consolidated financial statements included in Item 18. Financial Statements.

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

The trading prices of our ADSs and 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.

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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 shareholder lawsuits including securities class action litigation. Any such lawsuits 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 or actual time and cost to implement the SAP software 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 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 introducing 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 relative complexity of some of our software products 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.

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 or licensing costs to ensure continued performance of our products.

Our SAP NetWeaver platform strategy may not succeed or may make certain of our products less desirable.

Since the introduction of SAP NetWeaver, we have been executing on our application platform vision. While we remain an enterprise application provider, the objectives of our platform strategy are to decrease the cost of integration, enable process flexibility and innovation, and help build the so-called ecosystem of partners. With solutions built on the SAP NetWeaver platform, we are targeting to enhance our position in the enterprise software industry by extending core applications.

To promote a broad adoption of the SAP NetWeaver platform, we are working with certified third-party ISVs using SAP NetWeaver as a basis to develop and offer their own certified solutions. To the extent that we 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 our reputation and thus indirectly impede our 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. 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.

See Item 4. Information about SAP Description of the Business Evolution of SAP Solutions for a more detailed description of SAP NetWeaver.

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 copying or use, which could adversely affect our competitive position. In addition, the laws and courts of certain countries do not protect our proprietary rights to the same extent as do the laws and courts of the United States and 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, 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. 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. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

Additionally, 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 their respective open-source licenses that may require 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. Nevertheless, there can be no assurance that, in the future, a third party will not assert that our products or third-party software we deploy must be made publicly available under the terms of an open-source license, resulting in the loss of our proprietary advantage in the affected product.

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, including integrating different business and licensing models;
- 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 of the acquired business;
- 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;
- 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 an immediate charge to income for any in-process research and development costs of 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 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 arrangements for a variety of purposes including the development of 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 and may require additional funding from their investors. 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 may 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 Impairment Assessments.

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 our ability to recover under those policies. Further, there is no assurance that we will be able to obtain desired coverage at reasonable rates, or that such coverage will be available to us at all. 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 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 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. SAP AG is translated in English to SAP Corporation. SAP AG, formerly known as SAP Aktiengesellschaft Systeme, Anwendungen, Produkte in der Datenverarbeitung, 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

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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 United States is Brad Brubaker. He can be reached c/o SAP America, Inc. at 3999 West Chester Pike, Newtown Square, PA 19073.

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 SEC. 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. Our core business is developing and licensing business software solutions. We also sell maintenance, consulting, training and other services associated with our software products. Furthermore, we develop and market products in close cooperation with business partners.

Today, we count more than 38,000 customers in over 120 countries and employ more than 39,300 individuals in more than 50 countries in the EMEA, Americas, and Asia Pacific Japan regions. We are headquartered in Walldorf, Germany.

SAP consists of SAP AG and its network of 115 operating subsidiaries. We have three lines of business that constitute our reportable segments: product, consulting and training. We tailor our solutions to serve the needs of customers in various industries which are divided into 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, and Note 30 to our consolidated financial statements included in Item 18. Financial Statements.

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

With the vision to create standard application software for real-time business processing, we introduced the first generation of our software in 1973, initially consisting of a financial accounting application.

The SAP R/2 system, our second generation of application software, was then developed for mainframe, designed to handle different languages and currencies and to integrate many aspects of business, including distribution centers, field operations centers, corporate headquarters, and sales offices.

We recognized the demand for more decentralized business software solutions and designed the initial version of the SAP R/3 system, moving from mainframe computing to the three-tier architecture of database, application and user interface. Introduced in 1992, SAP R/3 quickly became the category leader in ERP systems. During the 1990s, we introduced several solutions built on SAP R/3 to provide capabilities tailored to specific industries.

In early 2000s, we continued to expand our product offerings to include the SAP Business Suite family of business applications that help enterprises improve business operations ranging from supplier relationships, production, and warehouse management to sales, administrative functions and customer relationships. We introduced the successor to SAP R/3 called the SAP ERP application, which is a component of SAP Business Suite.

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Until the late 1990s, companies typically deployed multiple hardware and software systems to manage their enterprise processes. In recent years, the companies have had to adapt their business models and processes to ever shorter innovation cycles and changing conditions. The rate of change that the business environment demands threatens to outstrip the ability of classic IT to respond quickly and efficiently. In response, we began as early as 2003 to adapt our portfolio of products to the new environment, mapping a route to a flexible new enterprise service-oriented architecture for software.

A service-oriented architecture (SOA) is an industry term referring to a software architecture that supports the design, development, identification, and consumption of standardized services across the enterprise, thereby improving reusability of software components and creating agility in responding to change. The term, service, as used in service-oriented architecture means a Web service which is a self-contained piece of functionality, such as delete purchase order, that can be accessed by applications across a network using mechanisms based on Web standards. An enterprise service, defined by us and our partners and customers, is a series of Web services combined with business logic that can be accessed and used repeatedly to support a particular business process, such as procure-to-pay or order-to-cash. Aggregating Web services into business-level enterprise services provides more meaningful building blocks for composing applications to automate enterprise-scale business scenarios.

One key benefit of enterprise service-oriented architecture, or enterprise SOA, is the ability to rapidly map complex business processes with reusable enterprise services. Companies can use enterprise services to flexibly compose or alter applications as rapidly as their markets and business process needs change. Our platform for realizing enterprise SOA is SAP NetWeaver. The version of the SAP ERP application we shipped in 2006 harnesses the potential of enterprise SOA. The SAP ERP application gives our customers both reliable, core ERP software and the means to flexibly add innovative business processes using enterprise services. We have already made more than a thousand enterprise services for the SAP NetWeaver platform available to our customers. Together with these enterprise services and the SAP NetWeaver platform, the latest version of SAP ERP can be used as a business process platform.

Applications created by utilizing enterprise services are often referred to as composite applications. xApps are an example of such composite applications, which are powered by SAP NetWeaver. There are various xApps available both from us and our partners. Customers or their system integrators can create custom xApps to meet the needs of an individual customer situation.

Newly Introduced Products and Product Versions

Building a Business Process Platform

In 2006, we adapted substantial parts of the SAP Business Suite family of applications, including SAP ERP, for enterprise SOA. This builds a business process platform on which our customers and partners can flexibly evolve original solutions, business processes, and business models.

As described above, the latest version of the SAP ERP application was made generally available in 2006 which is a major release with many product enhancements and ready-to-use enterprise services.

In the fall of 2006, we announced our new SAP ERP release strategy a road map envisioning the release of all of the new SAP ERP capabilities in a series of optional enhancement packages by 2010. This strategy sends a strong message to our customers and partners: We offer them a stable platform for several years on which to innovate while also benefiting from our technical advances.

We are encouraging our customers who currently run SAP R/3 to migrate to the SAP ERP application to take advantage of the potential of enterprise SOA. In 2006, more than 800 customers migrated to the SAP ERP application, increasing the total number of SAP ERP application customers to more than 7,300 by the end of year.

Solutions for Information Workers

Traditionally, our software solutions touched only a small group of users within our customers, including their IT and accounting professionals. Information workers, identified as those who are detached from enterprise processes and who rely on others for data retrieval, are not currently leveraging corporate assets resident in enterprise applications. We are bringing new products to address the needs of information workers who wish to take advantage of enterprise information. Examples of such products include Duet and SAP xApp Analytics.

Introduced in 2006, Duet is the first product jointly developed and supported by SAP and Microsoft. Duet enables employees to interact quickly and easily with selected SAP business processes and data without leaving the familiar Microsoft Office environment, simplifying the way information workers access and use SAP applications. The initial version of Duet included functions such as leave management, budget monitoring, and travel management; we plan to introduce more functions in the coming years.

SAP xApp Analytics is a composite application, powered by SAP NetWeaver, which is designed to help information workers define, monitor, and adjust actions in concert with strategic objectives and goals. SAP xApp Analytics offers visualization features, such as interactive charts and easy-to-use tools to create or modify analytic applications. Our range of SAP xApp composite applications grew strongly in 2006 and the trend is expected to continue.

CRM Development Milestones

Early in 2006, we announced a key new element in our portfolio an on-demand option for our SAP Customer Relationship Management (SAP CRM) application. The SAP CRM on-demand solution is designed for large and midsize organizations to manage sales, service, and marketing in an easy-to-use solution delivered directly via the Internet.

In February 2006, we unveiled our first on-demand capabilities for sales to manage customers, contacts, and sales pipeline. We expanded the SAP CRM on-demand solution with marketing and service capabilities later in the year.

In May 2006, we presented an extended portfolio of CRM applications offering on-demand Internet service or on-premise operation and seamless transitions across these options.

New Capabilities for SAP Business One

In July 2006, we announced new e-commerce and Web-based capabilities for the SAP Business One applications for small businesses with fewer than one hundred employees. These applications provide customers a unified view of business-critical information across sales, financials, manufacturing, reporting, and customer-facing activities in a single, easy-to-use application.

New Version of SAP All-in-One Solutions

In January 2007, we announced a new version of the SAP All-in-One solutions building on the latest developments in SAP ERP and the SAP NetWeaver platform. The solutions leverage the power of enterprise SOA to offer midsize customers and partners who serve them new levels of flexibility, simplification, and rapid deployment. They also provide streamlined business scenarios, enhanced analytical reporting, and integrated management of customer relationships.

Solutions Targeted for Smaller Midmarket Companies

In January 2007, we announced more details of our new approach to business software for smaller midmarket companies (with 100 to 1,000 employees). Our new solution yet to be made generally available (codenamed A1S) aims to exploit the advantages that enterprise SOA offers for business software. With this new solution, customers and partners will be able to rapidly adapt preconfigured business processes to fit their own requirements. We plan to market this offering as a trial solution, providing customers with a complete, personalized version to test before they buy. The solution is expected to offer smaller midmarket companies a short time to value, lower risk, and predictable cost. We plan to integrate e-learning and service and support in the product, which will be made available in hosted and on-demand options. We will leverage the Internet and telesales to market A1S.

SAP s Strategy

Trends and Orientation

New and constantly changing trends cause ever-shifting customer requirements. One such trend is the rise in the expectations of consumers, who increasingly dictate what products and services are offered on the market. This leads to another major trend: frequent and radical shifts in business models. Add to these today s easier access to capital worldwide, the impact of globalization on the individual s working environment, tighter regulation, and not to be forgotten the increasingly important role of IT as a driver of business model innovation.

Such rapid, multidimensional change comes with increased complexity. We view this complexity as creating a need for embedding IT throughout business organizations and their processes. Companies are recognizing that IT plays a critical role in controlling and simplifying this complexity. Thus, we believe our customers view IT as taking over a new strategic role in supporting growth, a departure from the formerly prevalent view of IT as a driver of cost efficiency. Moving forward, we expect IT to become strategic to business and be the enabler of continuous business innovation and operational excellence.

Our mission therefore remains: We will define and establish undisputed leadership in the emerging market for business process platform solutions, accelerate IT/business innovation for firms and industries worldwide, and thus contribute to economic development on a grand scale.

Based on these significant changes, our mission must be to deliver products and services that empower our customers:

- To be innovative
- To succeed with their business strategy
- To lift the productivity of their employees
- To comply with laws and regulations that apply to their efforts

The value customers derive from working with us is the key to growing prosperity. Thus, we intend not only to further expand our traditional core business, but also to unlock new business with smaller companies.

Expanding Our Traditional Core Business

We have grown strong with our customer base comprising many large global corporations and larger midsize companies with between 1,000 and 2,500 employees. Such companies use the SAP Business Suite family of applications, including the SAP ERP application, and SAP All-in-One solutions to automate their basic business transactions, enabling better management and governance.

We are adapting the SAP Business Suite family of applications and SAP All-in-One solutions for a new service-oriented architecture for business applications, known as enterprise SOA. These applications, based on SAP NetWeaver, constitute a business process platform on which our customers and partners can flexibly evolve original solutions, business processes, and business models.

Partners that develop their products on our SAP NetWeaver platform help us obtain new customers and new segments. We will work with partners to grow the spectrum of solutions for specific industries. We see potential for more growth in all regions, and we believe the Americas and Asia Pacific Japan are especially promising.

We expect our customers will increase their use of SAP systems to analyze data, recognize trends, and gather information on which to base decisions. We intend to create conditions for more productive work by providing crossovers between formally structured information in SAP systems and more loosely structured information in everyday desktop environments.

Developing New Midmarket Business

We already serve customers in the upper midmarket (1,000 to 2,500 employees) with SAP All-in-One solutions. Companies at the lower end of the midsize range, with about 100 to 1,000 employees, have specific requirements for software solutions. They tend to see a short time to value, minimum risk, and predictable cost as more important than a wealth of functions. Many such companies do not believe that their needs can be met by classic software offerings or by available on-demand solutions.

We intend to enter this market segment with a completely new approach to business software. Our new solution (mentioned above as A1S) is designed to exploit advantages that an enterprise SOA offers for business software. The new solution offers smaller midsize companies innovations aimed at faster, lower-risk implementation, continuous adaptability, and easier user adoption.

We believe that by combining a completely new product concept and an innovative business model we will gain access to new streams of potential revenue in a still largely untapped segment. We will invest in sales channels, process, infrastructure, and human resources, all oriented toward new customer relationships and a strong, diversified partner ecosystem.

Strategy for Growth

We will continue to direct our strategy toward growing our software revenue (increasingly from subscriptions and other software-related services). We plan to realize our potential for growth as follows:

- Organic growth: By supporting our growth strategy principally through organic development of our product portfolio.

- Co-innovation: By expanding our partner ecosystem to accelerate innovation by supporting the development of solutions and enterprise services built on the SAP NetWeaver platform and to leverage sales forces to address the various market and customer segments.

- Smart acquisitions: By targeting strategic fill-in acquisitions to add to our broad solution offering within industries or across industries by gaining specific technologies and capabilities that meet the needs of our customers.

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OUR SOFTWARE SOLUTIONS AND SERVICES OFFERINGS

We offer the following products and services:

Our primary go-to-market approach is by industry. We strive to support customers in a specific industry with best practice industry processes as well as with the ability to innovate processes in an industry context. We understand that the requirements of large multinational conglomerates are different from those of small and midsize companies. Therefore, we also provide solutions that are tailored in scope and flexibility to the needs of the small and midsize enterprises.

SAP Solution Portfolio

The SAP solution portfolio is comprised of the following:

For large enterprises, we offer more than 25 tailored solution portfolios for industries. Solution portfolios for industries are created by SAP through the assembly of general-purpose applications, industry-specific applications, service-enabled composite applications, and, potentially, partner products. These portfolios support industry-specific business processes using software that is tailored to various roles in a business.

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Our solution portfolios encompass the following six industry segments:

Process Industries
- Chemicals
- Mill Products
- Oil & Gas
- Mining

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

Consumer Industries
- Consumer Products
- Retail
- Wholesale Distribution
- Life Sciences

Services Industries
- Media
- Logistics Service Providers
- Postal Services
- Railways
- Telecommunications
- Utilities
- Professional Services

Financial Services
- Banking
- Insurance

Public Services
- Healthcare
- Higher Education & Research
- Public Sector
- Defense & Security

For small and midsize enterprises, we offer the SAP Business One application and SAP All-in-One solutions. SAP Business One targets small businesses with fewer than one hundred employees and offers capabilities for various work involved in managing a small business such as bookkeeping, reporting, sales and marketing, purchasing, and warehousing and inventory. It is developed by SAP and delivered by SAP channel partners who provide local services and support. SAP All-in-One solutions are designed to meet the requirements of midsize companies of up to 2,500 employees, and offer preconfigured industry-specific solutions for rapid deployment. SAP All-in-One solutions are developed and sold by SAP, and deployed and supported by either SAP or an experienced partner.

SAP Applications

SAP applications are the main building blocks of SAP solution portfolios for industries. They provide the software foundation with which organizations address their business issues.

SAP delivers the following types of applications:

General-purpose applications. These include the SAP Business Suite family of business applications which consists of SAP ERP (which further consists of SAP ERP Human Capital Management (SAP ERP HCM), SAP ERP Financials, SAP ERP Operations, and SAP ERP Corporate Services), SAP Customer Relationship Management (SAP CRM), SAP Product Lifecycle Management (SAP PLM), SAP Supply Chain Management (SAP SCM), and SAP Supplier Relationship Management (SAP SRM). These applications can be licensed individually or together as a suite, and in some cases, such as with customer relationship management and supplier relationship management, customers can choose to license the software as a service with SAP on-demand solutions. In addition, we offer various cross-industry optional applications such as SAP Global Trade Management, Environment, Health & Safety, Duet, and SAP solutions for radio frequency identification (RFID).

Industry-specific applications. These perform defined business functions in particular industries. These applications often are delivered as add-ons to general-purpose applications, particularly to the SAP ERP application. Some industry-specific applications may run stand-alone, and others require SAP ERP or other SAP Business Suite applications. Examples of industry-specific applications include the SAP Apparel and Footwear application for the consumer products industry and the SAP Reinsurance Management application for the insurance industry.

SAP xApps composite applications. These perform functions spanning multiple applications, departments, and organizations. These applications are designed to reuse, integrate, and orchestrate enterprise services that are provided by SAP NetWeaver. They can be general-purpose or industry-specific, and can be categorized into the following families: SAP xApps composite applications for analytics; SAP xApps composite applications for governance, risk, and compliance; SAP xApps composite applications for mobile business; and SAP xApps composition applications for personal productivity. Our software and consulting partners can also develop and offer SAP xApps Certified composite applications.

The SAP NetWeaver Platform

The SAP NetWeaver platform is the foundation of SAP s approach to a service-oriented architecture. In addition to complying with all relevant technology standards around Web services, SAP NetWeaver provides support for IT practices that enable customers to map their business problems to IT solutions by using combinations of SAP NetWeaver preintegrated functions.

SAP Services

The SAP Services portfolio of service offerings includes consulting, education, support, custom development, and managed services. The service offerings are categorized into software-related services and professional and other services. Software-related services include support services provided by the SAP Active Global Support organization and custom development provided by the SAP Custom Development organization. Revenue from these services was classified as software and maintenance revenue in our Consolidated Statements of Income until 2006. Beginning 2007, such revenue will be shown as software and software-related service revenue, together with revenue from our on-demand offerings and from subscriptions. See a more detailed discussion on this change in Item 5. Operating and Financial Review and Prospects Outlook for 2007 Forecast for SAP.

Professional and other services include consulting, education and managed services. As a result of the change in our income statement presentation in 2007 discussed in the preceding paragraph, certain revenue from managed services, such as so-called mandatory hosting contracts in which the hosting components cannot be separated from the software components, will be included in software and software-related service revenue.

Software-Related Services

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.

SAP Active Global Support. The SAP Active Global Support organization offers a broad range of services to support customers before, during and after implementation of our software solutions, providing around-the-clock technical support for high-priority messages to resolve issues as well as proactive, preventative services to mitigate potential problems before they get out of hand. 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, and the SAP Premium Support option through which SAP s experts take a more active role in establishing support operations. As part of the SAP Standard Support, customers are entitled to unspecified upgrades and enhancements to the software products they licensed.

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Professional and Other Services

SAP Consulting. The SAP Consulting organization offers consulting, implementation, and optimization services that aim at delivering business value in all phases of the solution life-cycle, from the planning phase through building and running the solutions. SAP Consulting advises and supports customers on designing business processes and IT infrastructure, helps customers with project management, solution implementation and integration, and helps with solution and IT landscape optimization to adapt to changing business needs of customers.

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.

SAP Managed Services. The SAP Managed Services organization provides a comprehensive portfolio of services, which include application management services and hosting services, running and managing SAP solutions on behalf of customers.

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 2006, 2005, and 2004 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 Japan, which represents Japan, Australia and parts of Asia. We allocate revenue amounts to each region based on where the customer is located. See Note 30 to our consolidated financial statements included in Item 18. Financial Statements for additional information with respect to operations by geographic region.

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

	2006	**2005**	**2004**
		(In millions)	
Germany	1,907.4	1,810.4	1,780.1
Rest of EMEA	2,994.3	2,702.4	2,443.4
Total EMEA	4,901.7	4,512.8	4,223.5
United States	2,617.0	2,342.8	1,893.7
Rest of Americas	776.3	656.8	530.1
Total Americas	3,393.3	2,999.6	2,423.8
Japan	431.3	406.2	387.4
Rest of Asia Pacific Japan	675.8	593.8	479.8
Total Asia Pacific Japan	1,107.1	1,000.0	867.2

Total revenue	9,402.1	8,512.4	7,514.5

EMEA. 52.1% of our 2006 total revenue was derived from the EMEA region, compared to 53.0% in 2005. After revenue growth in 2005 of 6.9%, we achieved stronger revenue growth of 8.5% to 4,901.7 million in 2006 in the EMEA region. Revenue in Germany, SAP s home country, increased by 5.4% to 1,907.4 million. 38.9% of revenue for the EMEA region in 2006 was derived from Germany which is a slight decrease of 1.2 percentage points compared to 2005. The remainder of the revenue for the EMEA region in 2006 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 631 FTEs or 2.9% from 21,729 at December 31, 2005 to 22,360 at December 31, 2006. In Germany, the number of our employees (FTEs) increased by 2.1% to 14,214 at December 31, 2006 compared to 13,916 at December 31, 2005. See Item 6. Directors, Senior Management and Employees Employees.

Americas. 36.1% of our 2006 total revenue was derived from the Americas region, compared to 35.2% in 2005. Revenues increased from 2005 to 2006 by 13.1% to 3,393.3 million. Revenue from the United States in 2006 was 2,617.0 million, an increase of 11.7% from 2,342.8 million in 2005 (14.0% increase on a constant currency basis). The United States represented 77.1% of our total revenue for the Americas region in 2006 compared to 78.1% in 2005. in 2006. For the Americas region excluding the United States, total revenue increased by 18.3% to 776.3 million in 2006 (15.8% on a constant currency basis). This was mainly derived from Canada, Brazil and Mexico. The number of employees (FTEs) in the Americas region increased by 16.0% from 7,953 at December 31, 2005 to 9,225 at December 31, 2006. The increase mainly resulted from the hiring of additional sales and marketing headcount, accounting for 34.5% of the increase, and from acquisitions.

Asia Pacific Japan. The Asia Pacific Japan region represented 11.8% of our total revenue in both 2006 and 2005. This revenue was derived primarily from Japan, Australia, India, China and South Korea. Our revenue in the Asia Pacific Japan region increased by 10.7% to 1,107.1 million in 2006. Revenue in Japan was 431.3 million, an increase of 6.2% from 406.2 million in 2005. This represents 39.0% of total revenues in the Asia Pacific Japan region in 2006 compared to 40.6% in 2005. On a constant currency basis, revenues derived from Japan increased by 13.9% from 2005 to 2006. In the rest of the Asia Pacific Japan region, total revenue increased by 13.8% from 2005 to 2006 (16.0% increase on a constant currency basis). In the Asia Pacific Japan region, the number of employees (FTEs) increased by 25.5% from 6,191 as of December 31, 2005 to 7,770 as of December 31, 2006, mainly due to the expansion of our research and development facilities in India and China.

REVENUE BY INDUSTRY SECTOR

We have 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 to an industry at the outset of an initial arrangement. All subsequent revenues from a particular customer are recorded under that industry sector. The following table sets forth the total revenues attributable to each of the six industry sectors for the years ended December 31, 2006, 2005, and 2004.

	2006	**2005**	**2004**
		(In millions)	
Process Industries	1,996.4	1,765.9	1,469.1
Discrete Industries	2,180.9	1,986.1	1,807.9
Consumer Industries	1,666.7	1,457.0	1,349.8
Service Industries	2,134.5	1,946.0	1,673.9
Financial Services	590.8	543.4	519.1
Public Services	832.8	814.0	694.7
Total revenue	9,402.1	8,512.4	7,514.5

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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. Under these agreements, the subsidiaries retain a certain percentage of the revenue generated by the sublicensing activity. We began operating in the United States in 1988 through SAP America, Inc., a wholly owned subsidiary of SAP AG. Since then, the United States has become one of our most important markets. In certain countries, we have established distribution agreements with independent resellers rather than with subsidiaries.

In addition to our subsidiaries sales forces, we have 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 SAP 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 SAP 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.

Traditionally, our sales model has been to charge a one-time, up front license fee for a perpetual license to our software (without any rights to future products) which is typically installed at the customer site. We now offer our solutions in a variety of ways which include on-demand, hosted solutions, and subscription-based models. Although revenues from these new types of models are currently not material, we expect such revenues to increase in the future and will introduce a new line in 2007 in our income statement to reflect this revenue stream.

Our 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 categories such as services, technology, software, hosting, content, education and support 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. Our partner network includes thousands of companies including independent software vendors (ISVs), systems integrators, and business process outsourcing (BPO) providers across all partner categories.

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Serving larger numbers of small and midsize enterprises (SMEs) requires new routes to market and supporting processes. To increase our presence among SMEs and to better address customers needs and buying preferences, it is becoming more important to collaborate with a network of our partners. In mid-2005, we launched the SAP PartnerEdge, a new channel partner program for our global partner network as part of our strategy to expand our business applications with small and midsize companies. We continued to implement the program throughout 2006 with a series of enablement components, including e-learning curricula available for partner organizations; an online partner collaboration network to promote their solutions, and ongoing global sales training and education programs for partners serving SME customers. Currently, SAP PartnerEdge serves ISVs focused on developing solutions for SAP Business One and SAP All-in-One applications, and the value-added reseller (VAR) partners who sell and implement them. We plan to evolve SAP PartnerEdge to offer a single, worldwide structure to serve ISV, systems integrator (SI) and technology partners that build solutions with technology for customers of all sizes, not just for SMEs.

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 services offered by such suppliers complement our software products and vice versa.

In May 2006, we announced the launch of a US$125 million global fund called the SAP NetWeaver Fund to stimulate our ISV ecosystem to develop next-generation composite applications on the SAP NetWeaver platform. There are more than 1,000 ISVs actively developing on the SAP NetWeaver platform, and they have already developed more than 1,500 solutions powered by SAP NetWeaver. The SAP NetWeaver Fund focuses on strategic minority investments in select companies committed to becoming part of the SAP ecosystem and building innovative solutions for or based on enterprise SOA.

Part of our strategy involves fill-in acquisitions to add to our solution offering within industries or across industries by gaining specific technologies and capabilities that meet the needs of our customers. We routinely evaluate various alternatives and engage in discussions and negotiations with potential parties to such transactions. In 2006, we acquired the outstanding shares of three unrelated companies and the net assets of two unrelated companies. The results of operations of these acquired businesses have been included with our results since the respective acquisition dates. All of these companies developed and sold software, which we plan to integrate or have integrated into our portfolio of product offerings. For example, one of the acquired companies, Virsa Systems, Inc., is a leading provider of compliance applications that monitor and enforce business controls in real time across enterprise systems and legacy applications. Virsa applications help customers maintain compliance with various national and international regulations, such as the U.S. Sarbanes-Oxley Act, Basel II, or U.S. Food and Drug Administration requirements. The completion of the Virsa acquisition allowed us to enhance SAP solutions for governance, risk and compliance (GRC). We retained the majority of the employees of these acquired entities and there was no material restructuring charge associated with the acquisitions. The amount of in-process research and development we expensed as a result of these acquisitions was immaterial. We also acquired software (intellectual property) from other companies, without acquiring related businesses. These transactions were immaterial to us individually and in the aggregate. See Note 4 to our consolidated financial statements in Item 18. Financial Statements for further details.

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 which was paid in cash. We acquired no shares of SAP SI in 2006. See Note 4 to our consolidated financial statements for more information regarding our plan to acquire the remaining shares of SAP SI.

There were no public takeover offers by third parties with respect to our shares that have occurred in 2006 or 2005.

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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.

We are a party to certain patent cross-license agreements with our strategic partners to provide a better environment for joint technical collaboration and solutions development.

We are named as a defendant in several legal proceedings for alleged patent infringements. Please see Note 27 to our consolidated financial statements for a detailed discussion of these legal proceedings.

ORGANIZATIONAL STRUCTURE

As of December 31, 2006, SAP AG was the holding company of 115 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.

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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, training, and research and development
Asia/ Pacific			
SAP JAPAN Co., Ltd., Tokyo	100	Japan	Sales, consulting training, and research and development

DESCRIPTION OF PROPERTY

Our principal office is located in Walldorf, Germany, where we occupy approximately 390,000 square meters of office space including our facilities in neighboring St. Leon-Rot, of which approximately 360,000 square meters is owned by us. We also own and lease office space in various other locations in Germany, totaling approximately 120,000 square meters, and in more than 50 other countries worldwide, totaling approximately 530,000 square meters. The space in most locations other than our principal office in Germany is leased. We own certain real properties in Newtown Square and Palo Alto, the United States; Bangalore, India; and a few other locations in and outside of Germany.

The office space we occupy includes approximately 230,000 square meters in the EMEA region, excluding Germany, approximately 140,000 square meters in North America, and approximately 80,000 square meters in India.

The space is being utilized for various corporate functions including research and development, customer support, sales and marketing, consulting, training, and administration. Note 30 Segment and Geographic Information to our consolidated financial statements discusses property, plant, and equipment by geographic region. Item 6. Directors, Senior Management and Employees discusses the numbers of our employees by business area and by geographic region, which may be used to approximate the capacity of our workspace in each region.

We believe that our facilities are in good operating condition and adequate for our present usage. We don t have any significant encumbrances on our properties. We are currently undertaking or planning to undertake construction activities in various locations to increase our capacity for future expansion of our business. Some of the significant construction activities are described below, under the heading Capital Expenditures.

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Capital Expenditures

We commenced the construction of new office buildings in Walldorf in 2005 to increase our workspace to accommodate approximately 2,000 additional employees. We estimate the total cost of construction to be approximately 131 million, of which we have paid approximately 83 million as of December 31, 2006. We are funding the construction with cash on hand. The planned completion is the first quarter of 2007. Upon completion of the construction of the buildings, we intend to terminate certain office leases in Walldorf, the charge for which is not expected to be material.

In the fourth quarter of 2006, we initiated planning activities for an additional building at our Newtown Square location with an estimated total cost of about 78 million which is being funded with internally generated cash flows. We entered into a contract with the architectural and engineering designers for approximately 5.5 million and are currently in negotiation with a few companies for the construction. The new building will increase our workspace by 20,000 square meters which is planned to be used mainly for office, sales and development activities. The construction is expected to be completed by the first quarter of 2009.

At our Palo Alto location, one of our key research and development facilities, we commenced in 2006 construction of new buildings to accommodate our headcount growth. This will increase workspace to accommodate an additional 600 workers. The estimated cost is 17 million, of which 5 million was already paid. The estimated completion is the first quarter of 2008. Also improvement to the existing facility at this location is expected in 2007, totaling about 4 million.

In India, mainly at our Bangalore location which is another key research and development center for us and our sales and customer support base for the growing Indian market, we are building new buildings to add workspace for about 2,500 additional employees. Total estimated cost is about 33 million, of which 9 million has been paid so far. These buildings are scheduled to be completed in 2007 and in 2008.

Our capital expenditures for property, plant, and equipment amounted to 312 million for 2006 (2005: 241 million; 2004: 172 million). The significant increase from 2005 to 2006, as well as from 2004 to 2005, was in large part due to the increase in construction in progress, the majority of which is attributable to the construction of new buildings in Walldorf as discussed above. Another factor in the increase is additional spending on real property such as land, buildings, and leasehold improvement (an increase from 20 million in 2005 to 33 million in 2006), particularly in China and India as well as in the United States. Our principal area of investment continues to be related to computer hardware and other equipment to support our growing operations globally, which accounted for more than 100 million, or one-third, of the spending in 2006. Cars contributed more than 60 million due to the continued purchase of company cars for eligible employees in Germany. See Note 19 to our consolidated financial statements in Item 18. Financial Statements for related discussion on property, plant, and equipment.

Our capital expenditures for intangible assets such as software licenses and acquired technologies also increased to 189 million in 2006 from 114 million in 2005 (2004: 39 million). The increase in 2006 was primarily attributable to the acquisitions of unrelated companies business and of net assets of other companies, as well as to increased activities in licensing. See Note 4 Acquisitions and Note 18 Goodwill/ Intangible Assets to our consolidated financial statements for further details of the acquisitions which were also the cause of an addition to goodwill in 2006 of 407 million (2005: 143 million; 2004: 197 million).

Also, see Note 30 Segment and Geographic Information for further details regarding capital expenditures by geographic region.

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ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OVERVIEW

Our principal sources of revenue are sales of software products and related services. Software revenue is primarily derived from software license fees that customers pay to use SAP products. We provide standard maintenance for a fee based on a fixed percentage of the license fee paid by the customer. The standard maintenance includes technical support services as well as unspecified software upgrades, updates and enhancements. 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 Our Software Solutions and Services Offerings for a description of other services we offer.

At the beginning of 2006, based on our prediction of growth in the economy as a whole and in the IT industry in particular, we set operational goals for fiscal year 2006:

To provide additional transparency, for the first time we provided an outlook for software and maintenance revenue (previously referred to as product revenue). We expected full-year 2006 software and maintenance revenue to increase in the range of 13% to 15% compared to 2005. This growth rate was 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 was expected to be driven by the Americas and Asia Pacific Japan. Low single-digit revenue growth in Germany was likely, while high single-digit growth was expected for the rest of the EMEA region. Consulting and training revenues were expected to grow more slowly than software and maintenance revenue.

We expected the full-year 2006 Adjusted 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 expected full-year 2006 Adjusted earnings per share, which exclude stock-based compensation, acquisition-related charges and impairment-related charges, to be in the range of 1.45 to 1.50 per share.

As in previous years, the major portion of the planned investment was assigned for new hires to meet the requirements of business growth. We anticipated roughly 3,500 additional full-time equivalents. The regional breakdown of headcount growth was planned to be similar to that of 2005. A significant proportion of the new jobs were expected to be located in India and China, while some 20% of the increase was expected to be in Germany.

This outlook was based on an average U.S. dollar to euro exchange rate of $1.23 per 1.00. On October 19, 2006 we announced the following update to our outlook for the fiscal year 2006:

We increased our expected full-year 2006 guidance for Adjusted earnings per share, which excluded stock based compensation, acquisition-related charges and impairment-related charges. We then expected Adjusted earnings per share to be slightly above the previously communicated range of 1.45 to 1.50 per share.

We reaffirmed that we expected full-year 2006 software and maintenance revenue to increase in a range of 13% to 15% compared to 2005. This growth rate was based on our expectation for full-year

2006 software revenue growth in a range of 15% to 17% compared to 2005. We announced that it appeared less likely that software and maintenance revenue growth as well as software revenue growth would reach the upper end of the aforementioned ranges.

We reaffirmed that we expected the full-year 2006 Adjusted operating margin, which excludes stock-based compensation and acquisition-related charges, to increase in a range of 0.5 to 1.0 percentage points compared to 2005. We announced it appeared less likely that the Adjusted operating margin increase would be at the upper end of the aforementioned range.

The outlook continued to be based on an U.S. dollar to euro exchange rate of $1.23 per 1.00.

In fiscal year 2006, we did not achieve all of our goals. Software and maintenance revenue increased from 5,958.4 million in 2005 to 6,604.6 million in 2006, representing an increase of 646.2 million or 10.8%. At constant currencies, software and maintenance revenue increased by 12.1%. Software revenue increased from 2,782.8 million in 2005 to 3,071.3 in 2006 representing an increase of 288.5 million or 10.4%. At constant currencies, software revenue increased by 12.3%. This was below our expectation.

Our operating margin decreased by 0.1 percentage point from 27.4% in 2005 to 27.3% in 2006 while our Adjusted operating margin, which excludes stock-based compensation and acquisition related charges, increased by 0.5 percentage point from 28.3% in 2005 to 28.8% in 2006, meeting the lower end of our outlook which was a 0.5 to 1.0 percentage point increase.

For 2006, our revenue and income before income taxes and minority interests were approximately 9,402.1 million and 2,674.8 million, respectively, as compared to 8,512.4 million and 2,316.4 million, respectively, for 2005. Net income was 1,871.4 million and 1,496.4 million for 2006 and 2005, respectively.

Earnings per share increased from 1.21 in 2005 to 1.53 in 2006. Adjusted earnings per share, which exclude stock-based compensation, acquisition-related charges and impairment-related charges, were at 1.61 in 2006 compared to 1.25 in 2005, which is 0.11 above the upper end of our guidance.

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 2006 compared to 2005 and for 2005 compared to 2004; and

- our outlook for 2007.

The above 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

According to analysts at the International Monetary Fund (IMF), the global economy continued on its path of positive growth throughout the course of 2006 and even exceeded expectations, as stated by the IMF in its most recent World Economic Outlook of September 2006. Output increased briskly in the first half of the year, the IMF reports. All of the indicators were pointing to further significant global growth in the final two quarters of 2006. For 2006, the IMF projects 5.1% year-over-year global output growth.

The IMF reports that growth was particularly strong in the United States early in the year, although the cooling real estate market slowed the economy in the second quarter of 2006. It was still too early to see precisely how much this continued to impact the U.S. economy in the period July through December since it would depend upon how well business fared in the face of higher commodity prices, among other things.

Nonetheless, the IMF was upbeat about the resilience of the U.S. economy and continues to project U.S. Gross Domestic Product (GDP) growth of 3.4% in 2006 (2005: 3.2%). The Organisation for Economic Co-operation and Development (OECD) views the economic slowdown in the second half of the year with more concern, and sees a risk that the projection might require a downward correction. However, the OECD does expect 3.3% economic growth in the United States in 2006.

The IMF reports that the economies in the euro area are growing stronger. This view projects that euro area output in 2006 will have risen more steeply than expected, likely topping 2.4%. In any case it would clearly outperform the previous year s 1.3% growth. Indeed, the OECD is predicting growth as high as 2.6% for the euro area. The upward trend is being driven by the euro area s powerhouse economy, Germany. There, the economy is picking up at such a rate that the IMF predicts German GDP will have increased 2.0% in 2006. In 2005, economic growth in Germany lagged at 0.9%.

Some of the booming market economies in the world s emerging countries are demonstrating highly dynamic performance. As a result, the IMF foresees 2006 growth rates for China and India of 10.0% and 8.3%, respectively. The IMF also says expansion in the Japanese economy will continue and shows sustainability. In 2006, its GDP grew 2.7% (2005: 2.6%). In Central and Eastern Europe as well, development has remained on a positive course. The IMF expects 5.3% output growth in this area in 2006 (2005: 5.4%). Russia s economy forged ahead in 2006, continuing the positive trend seen in previous years and growing some 6.5% (2005: 6.4%).

According to projections of the IMF, the volume of world trade increased by 8.9% overall in 2006 (2005: 7.4%). Emerging markets in particular recorded 13% growth in imports. The OECD assumes that total world trade grew 9.6% in 2006.

IT Sector

The respected U.S. market-intelligence provider IDC stated that the market for information technology (IT) developed positively over the course of 2006, though demand has lost some of its momentum since the second quarter. IDC projects that US$1,160 billion was spent on IT in 2006 (which is 6.3% more than in 2005), thanks to stable economic conditions. In IDC s analysis, the IT market comprises the hardware segment (US$447 billion), the software segment (packaged software (US$244 billion), of which spending on system infrastructure software, applications development, and applications are part), and the associated services segment (US$469 billion).

Within the software market, system infrastructure software sales grew faster than the overall IT market average. The market volume of the applications software segment, the main focus of our activity, likewise recorded considerable gains. IDC believes sales of applications in 2006 increased 7.3%, while the overall packaged software market enjoyed growth of 8.0%. Gartner, another market researcher specialized in the IT industry, reports a similar level of growth in the software market (7.3% in 2006) and projects a 7.0% increase in the applications segment in 2006.

According to our own calculations based on IDC s data, the core enterprise applications market addressable by us in 2006 was worth some US$33 billion, an increase since 2005 of about 6.9%. That market includes enterprise resource planning (ERP), customer relationship management (CRM), supply chain management (SCM), and manufacturing software and maintenance revenue. In the market for smaller businesses with headcount between 100 and 1,000, growth was somewhat stronger (7.3%) than in midsize companies with up to 2,500 employees (6.9%) and large enterprises employing workforces larger than 2,500 (6.5%).

2006 saw the IT market in North America expand by 6.0%, while IDC reports that the infrastructure software segment showed particularly lively development there in 2006, with projected growth of around 10.2%. This ongoing trend, which is still gaining strength, is driven by the need of enterprises for greater IT security, optimized infrastructure, high-performance management instruments, and system integration technology. IDC sees dynamic movement in the application software business as well, which expanded 7.3%

in 2006. One important basis for this growth is the rising interest of enterprises in strategic solutions such as business intelligence.

Growth in the IT market in Western Europe was more subdued than IDC projected early in the year. It adjusted its projection for 2006 growth from 6.9% to 4.0%. In IDC s analysis, postponement of planned investments until 2007 caused this reduction. Demand for packaged software and IT services in Western Europe held well at above-average rates, with growth rates of 6.7% and 5.0% respectively. All sub-segments experienced strong demand.

In Germany, IDC reports that overall the IT business expanded 2.9%. The packaged software segment of that market grew 6.1%. At 5.4%, growth in the software applications segment was similarly high in 2006, IDC reported. In its industry barometer published in late fall 2006, the German Association for Information Technology, Telecommunications and New Media (BITKOM) likewise noted the buoyant mood in the German IT market. Some 70% of companies surveyed by BITKOM projected sales increases for 2007. In particular, software vendors and IT service providers remained optimistic. In BITKOM s view, a sustained trend has emerged of an economy investing strongly in IT, with the focus on projects targeting increased efficiency of operational processes.

The IT market in Central and Eastern Europe, while only one-tenth the volume of the Western Europe market, proved very dynamic, according to IDC. 2006 saw spending on IT in this region increase 15.5%. Russia, where demand increased 18% in 2006, was the main source of this growth.

As reported by IDC, the dynamism of IT business in the Asia Pacific Japan region, with growth in 2006 of 6.7%, was influenced mainly by buoyancy in China and India. In Japan specifically, business is showing signs of a slight recovery. IDC slightly raised its prediction for the growth of demand in Japan in 2006 from 1.4% to 1.5%.

In relation to its projections, IDC identified economists declining confidence in the progress of the U.S. economy (the United States being the largest single market for IT) as a source of uncertainty in months to come.

OPERATING RESULTS

Total Revenue

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Total revenue	9,402,123	8,512,429	7,514,493	10.5%	13.3%

2006 compared with 2005. Total revenue increased from 8,512.4 million in 2005 to 9,402.1 million in 2006, representing an increase of 889.7 million or 10.5%. At constant currencies, total revenue increased by 11.5%. Compared to 2005, all revenue streams contributed to the overall growth in 2006. Software and maintenance revenue grew by 10.8% compared to 2005 with software revenue increasing by 10.4%. At constant currency, software and maintenance revenue grew by 12.1% and software revenue by 12.3%. This compares to our guidance of software and maintenance revenue to increase in a range of 13% to 15% with software revenue to increase in a range of 15% to 17%. Software and maintenance revenue represented 70.2% of our total revenue which is a slight increase of 0.2 percentage points compared to 2005. The average exchange rate in 2006 was $1.27 per 1.00, compared to $1.24 per 1.00 in 2005. The rate evolved as follows for the period-end Noon Buying Rate expressed as dollars per 1.00.

Date	Period-End
December 2005	1.1842
March 2006	1.2139
June 2006	1.2779
September 2006	1.2687
December 2006	1.3197

Ultimately the strength of the euro over the year reduced the euro value of revenue 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 1.0% in 2006.

2005 compared with 2004. 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 software and maintenance 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 stronger 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

Ultimately the weakness of the euro over the year increased the euro value of revenue 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 1.5% in 2005.

The following discussion is based on how we allocate revenue 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.

Software and Maintenance Revenue

	2006	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
		(In 000s)			
Software revenue	3,071,291	2,782,751	2,361,012	10.4%	17.9%
Maintenance revenue	3,533,282	3,175,642	2,823,189	11.3%	12.5%
Software and maintenance revenue	**6,604,573**	**5,958,393**	**5,184,201**	**10.8%**	**14.9%**

Software revenue represents fees earned from the sale or license of software to customers. Maintenance revenue represents fees earned from providing customers with technical support services and unspecified software upgrades, updates and enhancements.

2006 compared with 2005. Software and maintenance revenue increased from 5,958.4 million in 2005 to 6,604.6 million in 2006, representing an increase of 646.2 million or 10.8% (12.1% on a constant currency basis).

Software revenue increased from 2,782.8 million in 2005 to 3,071.3 million in 2006, representing an increase of 288.5 million, or 10.4%. With the stronger value of the euro compared to other currencies, this increase was impacted by a negative foreign currency translation effect. On a constant currency basis, software revenue grew by 12.3% from 2005 to 2006. The largest contributor to software revenue growth in 2006 was again the Americas region (in particular the United States) where we accomplished a growth of 11.9% compared to 2005.

The growth in software revenue was driven by an increased licensing of our software solutions including enterprise applications such as the SAP Business Suite family of applications and the platform-related products utilizing our SAP NetWeaver platform technology. While we continued to derive our software revenue from the existing customers who are upgrading from the R/3 system to the SAP ERP application, driven by the introduction of a new version of SAP ERP in mid-2006, or who are expanding their use of our software by increasing users or deploying additional SAP solutions, the revenue growth can also be attributed to an increased number of new customers. Approximately 31% of new contracts in 2006 came from new customers, with the remaining 69% coming from our installed customer base (compared to 33% from new customers and 67% from our installed customer base in 2005). Based on the value of orders received, the new customer share decreased from 22% in 2005 to 19% in 2006.

The SAP NetWeaver-related revenue grew by 55.3% to 754.4 million in 2006 from 485.9 million in 2005. The SAP NetWeaver stand-alone revenue increased by 56.1% to 169.2 million in 2006 from 108.4 million in 2005. As more new solutions are developed and introduced in the future based on our SAP NetWeaver platform, we expect the SAP NetWeaver-related revenue to grow further.

We continued to implement our volume business model with a higher number of smaller contracts. In the small and midsize enterprise segment (enterprises with 2,500 or fewer employees, or annual revenue of US$1 billion or less), we saw steady growth in terms of the number of order entries.

During 2006, we concluded so-called global enterprise agreements with four large customers. Structured as subscription contracts, global enterprise agreements include the license grant, the maintenance provisions and the right to unspecified future products. The four contracts amounted to a total value of about 400 million, which will be recognized as revenue over a period of 5 years.

Maintenance revenue increased from 3,175.6 million in 2005 to 3,533.3 million in 2006, representing an increase of 357.7 million or 11.3%. On a constant currency basis, maintenance revenue grew by 11.9% from 2005 to 2006. With our growing installed customer base, this increase in maintenance revenue was primarily due to the growth of software sales throughout 2005 and due to additional software contracts closed during 2006. Accordingly, maintenance revenue continued to increase constantly on a rolling four quarter basis. In 2006 the largest contributor to the increase in maintenance revenue based on volume came again, as in 2004 and 2005, from the EMEA region. The EMEA region continues to have the largest maintenance share in the SAP Group.

Software and maintenance revenue as a percentage of total revenue increased from 70.0% in 2005 to 70.2% in 2006.

2005 compared with 2004. 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 the Americas region (in particular the United States) where we accomplished a growth of 31.8% compared to 2004.

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.

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 revenue continued to increase constantly on a rolling four quarter basis. In 2005 the largest contributor to the increase in maintenance revenue based on volume came again, as in 2004, from the EMEA region. The EMEA region in 2005 was the largest contributor to software sales in the SAP Group.

Software and maintenance 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 revenue.

Service Revenue

	2006	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
		(In 000s)			
Consulting revenue	2,340,268	2,138,941	1,970,606	9.4%	8.5%
Training revenue	382,830	342,466	302,443	11.8%	13.2%
Service revenue	**2,723,098**	**2,481,407**	**2,273,049**	**9.7%**	**9.2%**

2006 compared with 2005. Service revenue increased from 2,481.4 million in 2005 to 2,723.1 million in 2006, representing an increase of 241.7 million or 9.7% (10.3% on a constant currency basis).

Consulting revenue increased from 2,138.9 million in 2005 to 2,340.3 million in 2006, representing an increase of 9.4%. On a constant currency basis the increase would have been 9.9%. This growth in consulting revenue resulted mainly from a higher utilization of the consulting workforce for external projects in 2006. In addition, interim use of third-party resources increased by 3.1% in order to meet the rise in customer activities.

Consulting revenue as a percentage of total revenue decreased from 25.1% in 2005 to 24.9% in 2006, caused by the over-proportional growth of software and maintenance revenue.

Training revenue increased from 342.5 million in 2005 to 382.8 million in 2006, or 11.8%. At constant currencies, training revenue increased by 12.4%. While traditional classroom training only grew marginally, most of the growth in training revenue was achieved in customer-specific training and education consulting. The training business also benefited from the alignment with the consulting business which helped drive the increase of revenue 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 68.3 million in 2005 to 91.7 million in 2006, representing an increase of 34.3%. Most of the growth of SAP Managed Services revenue came from the United States.

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2005 compared with 2004. 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 7.5%. This growth in consulting revenue resulted mainly from the increase in the consulting workforce 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 faster growth of software and maintenance revenue.

After two years of decreasing revenue in 2002 and 2003 and flat revenue 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 revenue 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 has benefited from the alignment with the consulting business which helped drive the increase of revenue through joint customer engagements.

SAP Managed Services revenue increased from 58.4 million in 2004 to 68.3 million in 2005, representing an increase of 17.0%. Most of the growth of SAP Managed Services revenue came from the United States.

Total Operating Expenses and Operating Income

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Total operating expenses	6,836,729	6,181,697	5,496,112	10.6%	12.5%
Operating income	2,565,394	2,330,732	2,018,381	10.1%	15.5%
Operating margin (Operating income as a percentage of total revenue)	27.3%	27.4%	26.9%		

2006 compared with 2005. At the beginning of the year, we laid out in our business outlook guidance that in 2006 we wanted to continue our alignment with volume business as well as make the investment in research and development to drive forward the development of a business process platform and bring strategic new products to market.

Accordingly total operating expenses increased from 6,181.7 million in 2005 to 6,836.7 million in 2006, representing an increase of 655.0 million, or 10.6%. On a constant currency basis, the increase in total operating expenses was 11.1%, which means that foreign currency translation effects from the strengthening value of the euro during 2006 positively impacted our total operating expenses, compared to a negative impact on total revenue.

The increase is mainly related to the following:

We increased our research and development expenses in 2006 by 246.2 million, or 22.6%, compared to 2005.

Our growing workforce resulted in an increase in personnel expenses, which went up from 3,371.5 million in 2005 to 3,833.1 million in 2006, or 13.7%. This increase in personnel expenses is the result of the overall headcount increase from 35,873 full-time equivalents as of December 31, 2005, to 39,355 full-time equivalents as of December 31, 2006, an increase of 9.7%. The biggest increase in headcount was in research and development, in which the worldwide full-time equivalent count rose 15.5% to 11,801. 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 10.9% in 2005 to 13.8% in 2006.

Cost of purchased licenses increased due to the strong growth in software and maintenance revenue.

We had higher travel expenses due to increased business activity.

As a result of the strong revenue growth and the increase in total operating expenses, operating income increased from 2,330.7 million in 2005 to 2,565.4 million in 2006, or by 10.1%. Operating margin decreased from 27.4% in 2005 to 27.3% in 2006.

2005 compared with 2004. At the beginning of 2005, we explained in our business outlook guidance that 2005 would be a year of investment in the future. We 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 revenue.

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 increased 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 software and maintenance 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.

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Adjusted Operating Income and Adjusted Operating Margin

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Adjusted operating income	2,707,924	2,409,339	2,086,125	12.4%	15.5%
Adjusted operating margin	28.8%	28.3%	27.8%		

We provided guidance and related information in 2006 and 2005 using Adjusted operating income, which is a non-GAAP financial measure, on a consolidated basis (See Use of Non-GAAP Financial Measures on page 3 for further discussion). The following discussion is based on this non-GAAP financial measure.

2006 compared with 2005. At the beginning of 2006, our target was to improve our Adjusted operating margin (that is, the ratio of Adjusted operating income to total revenue) from the 28.3% achieved in 2005 by approximately 0.5 to 1.0 percentage points.

We reached the lower end of our guidance range in 2006 and our Adjusted operating margin increased by 0.5 percentage points to 28.8%. Adjusted operating income (excluding expenses for stock-based compensation and acquisition-related charges) increased from 2,409.3 million in 2005 to 2,707.9 million in 2006. Adjusted operating expenses (excluding expenses for stock-based and acquisition-related charges) in 2006 increased by 9.7% to 6,694.2 million.

2005 compared with 2004. At the beginning of 2005 our target was to improve our Adjusted operating margin from the 27.8% achieved in 2004 by approximately 0.0 to 0.5 percentage points.

We reached this target in 2005 and our Adjusted operating margin increased by 0.5 percentage points to 28.3%. Adjusted 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. In 2005, Adjusted operating expenses (excluding expenses for stock-based and acquisition-related charges) increased by 12.4% to 6,103.1 million.

Operating Expenses

Cost of Software and Maintenance

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Cost of software and maintenance	1,099,966	993,227	916,278	10.7%	8.4%
As a percentage of software and maintenance revenue	16.7%	16.7%	17.7%		

Cost of software and maintenance 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.

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

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

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2006 compared with 2005. In line with growing software and maintenance revenue, cost of software and maintenance has increased from 993.2 million in 2005 to 1,099.9 million in 2006, or by 10.7%, mainly due to increased expenses for third-party license fees and the expansion of support resources. As a percentage of software and maintenance revenue, cost of software and maintenance remained stable at 16.7% in 2006 compared to 2005.

Overall, the workforce in this line of business increased from 4,460 full-time equivalents in 2005 to 5,368 full-time equivalents in 2006, representing an increase of 20.4%. The support organization has continued its efforts to improve the efficiency of our processes by moving into low-cost locations (Bulgaria, China and India). As of December 31, 2006, 19.2% of the support resources were based in the low-cost locations, which is an increase of 2.3 percentage points compared to 2005.

2005 compared with 2004. In line with growing software and maintenance revenue, cost of software and maintenance 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 software and maintenance revenue, cost of software and maintenance decreased from 17.7% in 2004 to 16.7% in 2005.

Cost of Services

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Cost of services	2,078,011	1,924,614	1,783,453	8.0%	7.9%
As a percentage of service revenue	76.3%	77.6%	78.5%		

Cost of services consists primarily of consulting and training personnel expenses as well as expenses for third-party consulting and training resources.

2006 compared with 2005. Cost of services increased from 1,924.6 million in 2005 to 2,078.0 million in 2006, or 8.0%. As a percentage of service revenue, cost of services decreased to 76.3% in 2006 compared to 77.6% in 2005, resulting in a higher margin.

Besides the growth in personnel expenses of 60.1 million, the higher interim use of third-party resources resulted in an increase of 37.7 million in third-party costs, compared to 2005. In comparison to 2005, 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 continued its focus to shift from fixed to flexible infrastructures.

2005 compared with 2004. 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

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Research and development	1,334,815	1,088,632	908,056	22.6%	19.9%
As a percentage of total revenue	14.2%	12.8%	12.1%		

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.

2006 compared with 2005. Research and development expenses increased from 1,088.6 million in 2005 to 1,334.8 million in 2006, or 22.6%. As a percentage of total revenue, research and development expenses increased from 12.8% in 2005 to 14.2% in 2006.

Main drivers for the expense growth were the headcount increase and higher demand for third-party resources in order to fulfill project requirements and meet scheduled releases of new products and versions.

Overall, the number of research and development employees increased from 10,215 full-time equivalents in 2005 to 11,801 full-time equivalents in 2006, representing an increase of 15.5%. The share of employees working in the research and development area as a percentage of the total number of employees increased from 28.5% for 2005 to 30.0% for 2006.

2005 compared with 2004. 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 8,744 full-time equivalents in 2004 to 10,215 full-time equivalents in 2005, representing an increase of 16.8%. 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 department as a percentage of the total number of employees increased from 27.2% for 2004 to 28.5% for 2005.

Sales and Marketing

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Sales and marketing	1,915,441	1,746,221	1,523,662	9.7%	14.6%
As a percentage of total revenue	20.4%	20.5%	20.3%		

2006 compared with 2005. Sales and marketing expenses increased from 1,746.2 million in 2005 to 1,915.4 million in 2006, or 9.7%. As a percentage of total revenue, sales and marketing expenses remained relatively constant, slightly down from 20.5% in 2005 to 20.4% in 2006. The increase in sales and marketing expenses in 2006 relates to our efforts to attain our current and future revenue growth targets and the continued alignment with the volume business.

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Overall employees in sales and marketing increased from 6,426 full-time equivalents in 2005 to 7,082 full-time equivalents in 2006, or 10.2%. The increase in personnel expenses from 852.4 million in 2005 to 1,003.3 million in 2006, or 17.7%, is mainly driven by the headcount increase and increased variable expenses.

2005 compared with 2004. Sales and marketing expenses increased from 1,523.7 million in 2004 to 1,746.2 million in 2005, or by 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 our 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 5,721 full-time equivalents in 2004 to 6,426 full-time equivalents in 2005, or 12.3%, 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 Administration

	2006	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
		(In 000s)			
General and administration	464,966	435,185	366,425	6.8%	18.8%
As a percentage of total revenue	4.9%	5.1%	4.9%		

2006 compared with 2005. General and administration (G&A) expenses increased from 435.2 million in 2005 to 465.0 million in 2006. This represents an increase of 6.8%. This rise is mainly driven by increased headcount as well as increased performance-related compensation. As a percentage of total revenue, G&A expenses represented 4.9% in 2006 compared to 5.1% in 2005.

Although the number of G&A employees increased by 9.3% in 2006, the related cost did not increase at the same rate mainly due to the implementation of shared service centers. As a result, the average G&A cost per employee decreased by 2.6% in 2006.

2005 compared with 2004. G&A 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, G&A expenses represented 5.1% in 2005 compared to 4.9% in 2004.

Other Operating Income/ Expense, Net

	2006	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
		(In 000s)			
Other operating income/expense, net	56,470	6,182	1,762	813.5%	250.9%
As a percentage of total revenue	0.6%	0.1%	0.0%		

Other operating income/expense, net consists of bad debt expense, restructuring expense, rental income, insurance proceeds received and other miscellaneous operating income and expenses.

2006 compared with 2005. Other operating income/expense, net increased from an income of 6.2 million in 2005 to an income of 56.5 million in 2006. In 2006 we revised our estimate to the allowance for doubtful accounts as described in Note 3 to our consolidated financial statements. This revision to the estimate resulted in a reduction of expenses of about 43.0 million in 2006, as compared to 3.4 million

charged to bad debt expense in 2005. See Note 7 to our consolidated financial statements in Item 18. Financial Statements for further details of Other operating income/expense, net.

2005 compared with 2004. Other operating income/expense, net changed from an income of 1.8 million in 2004 to an 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 21(b) 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

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Financial income/expense, net	121,708	10,785	40,987	1,028.5%	(73.7)%
As a percentage of total revenue	1.3%	0.1%	0.5%		

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.

2006 compared with 2005. Financial income/expense, net increased from an income of 10.8 million in 2005 to an income of 121.7 million in 2006. Higher rates of interest in 2006 led to a 33% rise in our net interest income to 120 million (2005: 90 million; 2004: 56 million). Also, we reviewed our presentation of stock appreciation right (STAR) plan hedging in light of new rules for accounting for stock-based compensation. Whereas in 2005 the effect of hedging STARs led to unrealized losses of 66 million in that connection (and losses of 15 million in 2004), for 2006 we have unrealized gains of 7 million from STAR plan hedging.

2005 compared with 2004. Financial income/expense, net decreased by 30.2 million from an income of 41.0 million in 2004 to an 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

	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
		(In 000s)			
Income taxes	801,612	817,053	757,269	(1.9)%	7.9%
As a percentage of Income before income taxes and minority interest	30.0%	35.3%	36.5%		

2006 compared with 2005. More tax-free or low-tax investment in equities and financial assets, lower rates of trade tax, and nonrecurring effects from the conclusion of tax audits in several countries and agreements we reached with tax authorities on various matters helped us reduce our effective tax rate to

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30.0% in 2006 from 35.3% in 2005. See Note 11 to our consolidated financial statements in Item 18. Financial Statements for further details on income taxes.

2005 compared with 2004. 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.

SEGMENT DISCUSSION

As described in Note 30 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 administration, 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, facility space occupied and other measures.

In 2006 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 99.4 million compared to 45.0 million in 2005 (2004: 38.1 million). Therefore, segment contribution is not indicative of the U.S. GAAP-based 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. In 2006, no significant costs related to unused lease space and severance payments were incurred.

The effect of the changes in estimate on the allowance for doubtful accounts, as described in Note 7 to our consolidated financial statements in Item 18. Financial Statements, was allocated to each segment, which resulted in a reduction of segment expenses for the product segment, the consulting segment, and the training segment in amounts of 30.4 million, 13.1 million, and 1.9 million, respectively, in 2006.

Values in the following table are stated in millions of euros, except for percentage and percentage point figures:

Product Segment	**2006**	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
External revenue	6,652	6,044	5,293	10.1%	14.2%
Segment expenses	(2,628)	(2,452)	(2,058)	7.2%	19.2%
Segment contribution	4,024	3,592	3,235	12.0%	11.0%
Segment profitability	60.5%	59.4%	61.1%	1.1 percentage points	(1.7) percentage points

Consulting Segment	**2006**	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
External revenue	2,300	2,078	1,910	10.7%	8.8%
Segment expenses	(1,703)	(1,619)	(1,484)	5.2%	9.1%
Segment contribution	597	459	426	30.2%	7.7%
Segment profitability	26.0%	22.1%	22.3%	3.9 percentage points	(0.2) percentage points

Training Segment	2006	2005	2004	Change 2006 vs. 2005	Change 2005 vs. 2004
External revenue	440	380	307	15.8%	24.0%
Segment expenses	(273)	(248)	(209)	10.0%	18.6%
Segment contribution	167	132	98	26.7%	35.5%
Segment profitability	38.1%	34.8%	31.8%	3.3 percentage points	3.0 percentage points

Product Segment

The product segment is primarily engaged in marketing and licensing our software products, performing software development services, and providing maintenance for our software products. Maintenance includes technical support for our products, assistance in resolving problems, providing user documentation, unspecified software upgrades, updates and enhancements. The product segment includes the lines of business sales, marketing and service and support.

2006 compared with 2005. Product segment revenue increased by 10.1% from 6,044.3 million in 2005 to 6,652.4 million in 2006, driven by an increased licensing of our software solutions which then contributed to an increase in maintenance revenue. On a constant currency basis, product segment revenue grew by 11.3%. Approximately 97.0% of revenue within the product segment is derived from software and maintenance revenue, with the remaining 3.0% derived from services revenue and other revenue. Software revenue as part of the total product segment revenue increased by 9.4% from 2,739.3 in 2005 million to 2,995.7 million in 2006. This corresponds to an increase of 11.3% based on constant currencies. Maintenance revenue increased by 10.2% from 3,162.7 million in 2005 to 3,484.0 million in 2006, an increase of 10.7% based on constant currencies. The disproportionate currency impact on software revenue compared to maintenance revenue was partly due to seasonality; software revenue is typically higher in the second half of the year (particularly in the fourth quarter) and is recognized immediately in most cases as opposed to ratably.

Product segment expenses increased by 7.2% from 2,452.5 million in 2005 to 2,628.3 million in 2006, an increase of 7.7% 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 product segment expenses results mainly from the headcount growth reflecting additional investment in aligning our operations to more volume business and associated personnel, travel and other personnel related expenses as well as additional third-party expenses.

Product segment contribution increased by 12.0% from 3,591.9 million in 2005 to 4,024.1 million in 2006, or 60.5% of total segment revenue compared to 59.4% of total segment revenue in 2005. On a constant currency basis, product segment contribution increased by 13.7%.

2005 compared with 2004. Product segment revenue increased by 14.2% from 5,292.9 million in 2004 to 6,044.3 million in 2005, driven by an increased licensing of our software solutions which then contributed to an increase in maintenance revenue. On a constant currency basis, product segment revenue grew by 12.5%. Approximately 98% of revenue within the product segment was 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 revenue 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 accounted for about half of the entire product segment expenses, while expenses of the line of business marketing accounted for roughly one-fourth and expenses of the line of business service and support accounted also for roughly one-fourth of overall product segment expenses. The increase in sales and marketing expenses resulted 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, while the segment profitability decreased from 61.1% in 2004 to 59.4% in 2005. On a constant currency basis, product segment contribution increased by 9.0%. While we were able to increase product segment revenue, 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 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.

2006 compared with 2005. Consulting segment revenue increased by 10.7% from 2,078.1 million in 2005 to 2,300.1 million in 2006. In constant currency, revenue increased by 11.3%.

Consulting segment expenses increased by 5.2% from 1,619.0 million in 2005 to 1,702.6 million in 2006. In constant currency, segment expenses increased by 5.5%.

Geographically, the strong growth in the consulting services business came from the Asia Pacific Japan region, especially in India and Korea where we also saw a significant increase in software and maintenance revenue. Demand in the region was met through a combination of increasing the local consulting workforce by 10.3%, increased billable utilization of SAP consultants, increased use of global delivery resources and increased use of third-party resources. Revenue growth in the Americas region continued with previous demand generation activities in the United States continuing to have a positive impact on the business. This increased demand was met through a combination of increased workforce, billable utilization and use of third-party resources. Revenue in the EMEA region also grew, particularly in our EMEA North, East, West, and South area, with strongest growth in France and Africa, although the EMEA region as a whole grew at a less significant rate than the Asia Pacific Japan and Americas regions.

In 2006, we focused more on the profitability of our consulting business than on its growth. Consulting segment contribution increased by 30.2% from 459.1 million in 2005 to 597.5 million in 2006. At constant currency, the segment contribution increased by 31.6%. The consulting segment profitability increased significantly by 3.9 percentage points to 26.0%.

2005 compared with 2004. Consulting segment revenue 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 came from the Americas region, especially the United States and Latin America in which we also saw the largest increase in software and maintenance revenue. The consulting revenue growth in the United States was 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 Japan 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 to 22.1%.

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.

2006 compared with 2005. Training segment revenue was 440.3 million in 2006, which represented a strong increase of 15.8% from 380.2 million in 2005 (16.6% increase on a constant currency basis). 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 (1.7%) of the total training revenue, e-learning continued to rise in popularity and grew significantly (33.0%) in 2006.

Training segment expenses increased from 248.0 million in 2005 to 272.7 million in 2006, or 10.0%. The cost of internal and external resources increased to support the growing business, particularly education consulting services which are resource intensive by nature. In response to the change in customer demand to a more flexible delivery model, the training business continued its focus to shift from fixed to flexible infrastructures.

Training segment contribution increased by 26.7% from 132.2 million in 2005 to 167.5 million in 2006. The training segment margin increased by 3.3 percentage points to 38.1%. 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.

2005 compared with 2004. Training segment revenue was 380.2 million in 2005, which represents a strong increase (23.8%) from 306.6 million in 2004 (22.5% increase on a constant currency basis). 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 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 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 margin increased by 3.0 percentage points to 34.8%. This was 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 responding to customer demands.

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OUTLOOK 2007

Forecast for the Global Economy

The IMF believes the current global recovery will continue in 2007, but with less vigor than in 2006. In 2007, it expects world output to increase 4.9%, which is 0.2 percentage points less than in 2006.

The IMF expects the U.S. economy to grow only 2.9%, the euro area economy only 2.0%, and the German economy 1.3% in 2007. It believes growth in Japan will fall back to 2.1%. Only in the emerging markets does the IMF expect strong economic growth to continue in 2007, with rates of 6.5% in Russia and 10.0% in China, for example.

The OECD believes output in its member states will increase 2.5% in 2007 and 2.7% in 2008. It expects the output of the United States to increase 2.4% (2008: 2.7%) and of the euro area 2.2% (2008: 2.3%).

The IMF identified the inflationary pressure that was trending up by the end of 2006 as a possible threat to its forecasts, along with bottlenecks on the financial markets or another oil price spike. Over the course of 2006, the growing inflationary pressure resulting from worldwide economic growth, high oil prices, and the significant price hikes for commodities played a particularly important role in assessments by economists. However, prices rose only moderately due to the fact that production capacity was increased in many places. Nevertheless, the central banks of the world s major economies such as in the United States, the euro area, and Japan raised their key rates in summer 2006 as a preventive measure to counteract possible risks of inflation. The IMF believes this will keep risk potential within an acceptable range.

Forecast for the IT Industry

Based on continuing global economic growth, the experts at IDC view the outlook for 2007 and 2008 with confidence. They forecast worldwide spending on IT will increase by 6.6% in both 2007 and 2008. It is projected that this growth will be shared about equally among Western Europe (2007: 5.3%; 2008: 6.3%), North America (2007: 6.1%; 2008: 5.8%), and the Asia Pacific Japan region (2007: 6.4%; 2008: 5.8%). Japan is expected to enjoy moderate growth rates of 2.4% in 2007 and 1.7% in 2008. In contrast, projections see disproportionately high IT spending in the Central and Eastern European markets, expanding by 14.0% and 13.6% in 2007 and 2008 respectively.

According to IDC, investment in applications software which is of key importance to our business should increase worldwide at an even higher rate than that of the overall IT market. IDC s experts are forecasting spending increases in this segment in 2007 and 2008 of 7.2% and 7.1%, respectively. Growth in the packaged software segment is expected to develop in all regions worldwide at a rate disproportionately higher than total spending for IT.

IDC expects the value of the IT market to grow to about US$1,476 billion by 2010. With our current products and the new products planned for the coming years, we will be in a position by 2010 to serve a market segment valued at more than US$70 billion.

Based on an IDC study of the ERP market, our assumption is that the SME market in particular will become the driver of growth by the year 2010. Thus, in IDC s view, the ERP vendors that will be most successful in this business environment will be those that have multiple, varied ERP product lines at their disposal for small businesses, midsize companies, and large enterprises, and at the same time maintain excellent sales partner and support programs.

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Forecast for SAP

In 2007, we intend to finish our enterprise SOA road map by delivering the service-oriented version of SAP Business Suite and our midmarket solution SAP All-in-One. In addition, we intend to introduce a new product (codenamed A1S) for smaller businesses, which is easy to try, easy to run, and easy to adapt.

Beginning 2007, we will change our Consolidated Statements of Income in an effort to provide more visibility and transparency about our revenue streams. First, we are renaming what we previously called Software and maintenance revenue. Going forward, this will be presented as Software and software-related service revenue. Second, we will present revenue from subscriptions and other software-related services as an additional item within the Software and software-related service revenue line. This new item includes revenue from subscriptions, software rentals, and other types of software-related service contracts. Subscription revenues flow from contracts that have both a software element and a maintenance element. Such a contract typically gives our customer the use of current software and unspecified future products. We take a fixed monthly fee for a definite term, which is generally five years. Software rental revenue flows from software rental contracts, also with software and maintenance elements but here the customer receives the use of current products only. Our other software-related services revenue includes revenue from our on-demand offerings, for example the SAP CRM on-demand solution, any future on-demand revenue from our new midmarket product, revenue from hosting contracts that do not entitle the customer to readily exit the arrangement, and revenue from software-related revenue-sharing arrangements, for example our share of revenue from collaboratively developed products.

Thus software and software-related service revenue is the sum of our software revenue, our maintenance revenue, and our revenue from subscription and other software-related services. In 2006 our total software and software-related service revenue was 6,605 million.

The 2007 outlook discussion below uses this new income statement presentation structure. The operating margin discussed in this outlook is the U.S. GAAP measure, not, as in previous years, our adjusted measure.

Our business outlook for 2007 (full year) assumes an effective tax rate in the range of 32.5% to 33.0%.

We expect year-over-year software and software-related service revenue growth in the range of 12% to 14% on a constant currency basis. The corresponding rate of growth in 2006 on a constant currency basis was 12%. We expect subscription and other software-related services to account for approximately 2% to 4% of total software and software-related services revenue.

To tap new business in the lower midmarket in the coming years, over a period of eight quarters we intend to invest about 300 million to 400 million in sales channels, process, infrastructure, and human resources, all oriented toward new customer relationships and a big, diversified partner ecosystem. We plan to fund these capital expenditures by using our operating cash flow. Depending on when we actually make these investments, in 2007 we expect to reinvest the equivalent of about one to two operating margin percentage points in preparing for additional future growth opportunities. Therefore, we assume our 2007 operating margin will be in the range 26.0% to 27.0%. Our 2006 operating margin was 27.3%.

We plan to increase our headcount by 3,500 full-time equivalents in 2007.

We plan to continue to buy back shares in the open market. If the Annual General Meeting of Shareholders in May 2007 so resolves, we expect to pay a dividend that provides a payout ratio of about 30%.

Assumptions underlying this outlook include future economic conditions as described in this section and customer purchasing behavior exhibiting the accustomed seasonality with sales peaking in the fourth quarter.

Prospects through 2010

In the medium term, we expect further advances and continuing revenue growth. The completion of our enterprise SOA road map and the introduction of our new business model for the smaller business segment will open up potential for us to service more markets. We anticipate the total volume of the software and software-related services segments in which we operate to grow from currently about US$30 billion to more than US$70 billion by 2010. We want to translate this potential into additional revenue growth. By 2010, we aim to earn approximately half of our orders received with new, as yet unavailable, products, and to increase the number of our customers to approximately 100,000. We expect to receive 40% to 45% of our orders from small businesses or midsize companies.

FOREIGN CURRENCY EXCHANGE RATE EXPOSURE

Although our reporting currency is the euro, a significant portion of our business is 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 28 in Item 18. Financial Statements.

Approximately 64% of our consolidated revenue in 2006 and approximately 63% in 2005 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 negative effects on our consolidated revenue of (88) million, income before income taxes of (64) million and net income of (53) million for 2006, and had positive impacts on our consolidated revenue of 111 million, income before income taxes of 21 million and net income of 23 million for 2005. 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 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 that can have a significant impact on amounts reported in our consolidated financial statements.

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We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. The accounting policies that most frequently require us to make estimates and judgments, and therefore are critical to understanding our results of operations, are:

- Revenue recognition
- Valuation of accounts receivable
- Accounting for stock-based compensation
- Accounting for income taxes and other income tax related judgments
- Impairment assessments
- Legal contingencies

Our management discussed these critical accounting policies with the Audit Committee of the Supervisory Board. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results. Please refer to Note 3 to our consolidated financial statements in Item 18. Financial Statements for further discussion of our accounting policies.

Revenue Recognition

We derive our revenues from the sale or the license of our software products and the sale of maintenance, consulting, development, training, and other services. 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 use the residual method pursuant to the requirements of American Institute of Certified Public Accountants (AICPA) Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2), as amended. This method allows us to recognize revenue for the delivered elements in multiple-element arrangements when the only undelivered element is one that has a vendor-specific objective evidence (VSOE) of the fair value of the element. We review our VSOE at least annually. If we are unable to establish or maintain a VSOE for elements, it could impact our revenues, results of operations and financial position because we may have to defer all or a portion of the revenue from the multiple-element arrangements.

We have ongoing relationships with many of our customers and often enter into several transactions with the same customer within close proximity in time. Therefore, it is critical to determine what constitutes a multiple-element arrangement with a particular customer. Also determining what constitutes a separate element in the arrangement may involve judgment; for example, a right to an incremental discount, if significant, on a customer s future purchases of software or services could become an element which we need to separately account for.

If a multiple-element arrangement involves significant production, modification, or customization of the software, or is otherwise determined to contain elements (such as consulting services) that are deemed to be essential to the functionality of the software elements, software revenue, which might otherwise be recognized immediately, needs to be deferred and recognized as the essential services are provided. The determination of whether the arrangement involves significant production, modification, or customization of the software or whether an element is essential to the other elements could be complex and require the use of judgment.

Also, the amount of revenue from custom development services and consulting services to recognize in a given period is typically based on the amount of work completed up to that point. This requires us to make estimates about total cost to complete the project and the stage of completion. The assumptions, risks, and uncertainties inherent in determining the stage of completion affect the timing and amounts of revenues and expenses reported. If we do not have a sufficient basis to measure the progress to completion, revenue is recognized when the project is complete and, if applicable, final acceptance is received from the customer. Changes in estimates of progress to completion and of contract revenues and contract costs are accounted for as cumulative catch-up adjustments to the reported revenues for the applicable contract.

Under SOP 97-2, provided that the arrangement does not involve significant production, modification, or customization of the software, 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. The determination of whether fees are fixed or determinable or whether the fees are collectible is inherently judgmental, and the timing or amount of revenue recognition could change if different assessments had been made.

Valuation of Accounts Receivable

Accounts receivable are recorded at invoiced amounts less an allowance for doubtful accounts. 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 using a two-step-approach. After giving consideration to the financial solvency of specific customers, we evaluate homogenous portfolios of receivables according to their default risk primarily based on the age of the receivable and historical loss experience.

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. Under U.S. GAAP, a valuation allowance must be recognized when it is probable that a credit loss will occur and the amount of such loss is reasonably estimable. Judgment is required when we evaluate available information about a particular customer s financial situation to determine whether an allowance for that specific account is necessary. Basing the general allowance for the remaining receivables on our historical loss experience, too, is highly judgmental as history may not be indicative of future development. Changes in our estimates about the allowance for doubtful accounts could materially impact the reported assets and expenses in our financial statements and net income could be adversely affected if actual credit losses exceed our estimates.

Total accounts receivable at December 31, 2006 and 2005 were 2,442.9 million and 2,251.0 million, respectively, which were net of an allowance for bad debts of 24.9 million in 2006 and 72.9 million in 2005. Net amounts charged to expense / (income) to provide for allowances for doubtful accounts were (40.4) million, 12.4 million, and 1.7 million during 2006, 2005, and 2004, respectively.

As discussed in Notes 3 and 7 to our consolidated financial statements in Item 18. Financial Statements, the revision in 2006 to our estimate of allowance for doubtful accounts, which include the change in general allowance percentages and the change in the way we group receivables to which the allowance percentages are applied, resulted in a reduction of bad debt expense in 2006 of 43.0 million. This revision in our estimate was partly driven by the recent trends including decreasing write offs and our improved days sales outstanding in certain countries and for the Group as a whole. See a related discussion under the heading Liquidity and Capital Resources Analysis of Consolidated Statements of Cash Flow below.

The amount charged to expense in 2004 was low compared to 2005 mainly due to successful collection of receivables previously provided for.

Specific customer credit loss risks are charged to the respective cost of software and maintenance or cost of service. 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:

	2006	**2005**	**2004**
	(In	**millions)**	
Specific customer credit loss risks	2.6	9.0	0.0
Customer credit loss risks based on aging of the receivables	(43.0)	3.4	1.7
Total amounts charged to expense/(income) for allowances for doubtful accounts	(40.4)	12.4	1.7

Accounts receivable written off against the allowance for doubtful accounts approximated 5.4 million, 8.1 million, and 7.7 million during 2006, 2005, and 2004, respectively.

Accounting for Stock-Based Compensation

As further explained in Note 29 to our consolidated financial statements in Item 18. Financial Statements, as of December 31, 2006 we had two stock-based compensation plans classified as equity awards (Long Term Incentive 2000 Plan and SAP Stock Option Plan 2002) and two stock-based compensation plans that are classified as liability (STAR Plan and Incentive Plan 2010). Furthermore we have various employee share purchase plans. Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS 123 (revised 2004), *Share-Based Payment* (SFAS 123R), using the modified-prospective transition method. Accordingly, equity-classified awards are measured at grant date fair value and are not subsequently remeasured. Liability-classified awards are remeasured to fair value at each balance sheet date until the award is settled.

Prior to January 1, 2006, we accounted for stock-based compensation based on the intrinsic-value-based method prescribed by Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations. Under this method, compensation expense was recorded only if on the date of grant the current market price of the underlying stock exceeded the exercise price or the exercise price was 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 until SFAS 123R was adopted on January 1, 2006.

The cumulative effect from the adoption of SFAS 123R, which consisted primarily of the effect of remeasuring liability-classified awards (STAR 2003, STAR 2004, and STAR 2005) from intrinsic value to fair value, was immaterial due to the insignificant difference between the intrinsic values and the fair values of the STARs outstanding as of December 31, 2005.

For the years presented in our consolidated financial statements in Item 18. Financial Statements, we did not change any plan terms of our existing stock-based compensation plans. We did not change any valuation methods compared to the valuations made under SFAS 123.

To estimate the fair values of our stock options and convertible bonds granted under the stock-based compensation plans classified as equity awards (Stock Option Plan 2002 and Long Term Incentive 2000 Plan) we consistently use the Black-Scholes valuation model. As described in Note 29 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 volatilities are based on implied volatilities from traded options on our stock with a maturity equal to the expected option life for options granted in 2006 and 2005. We think implied volatilities are a good basis for expected volatilities of our stock price as there is a sufficient number of options actively traded with various maturities and various exercise prices. For stock options granted in 2004 and before we used historical stock price movements over the most recent period equal to the expected option life to estimate future stock price volatility.

For options granted in 2005 and 2006 we used 3.5 years as an expected life of the options. This assumption was made in accordance with the guidance in Staff Accounting Bulletin No. 107 (SAB 107). According to the so-called simplified method it is appropriate to use the middle of the vesting term and the original contractual term as an estimate for the expected life of the options if no reliable historical data is available. Before the guidance in SAB 107 was released we used an expected life of 2.5 years for the options granted from 2002 to 2004.

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.

We intend to continue using stock-based compensation awards to attract and retain senior managers and select employees. However we intend to not grant any more options under equity-classified awards and instead make use of stock-based compensation awards classified as a liability.

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 SAP SOP 2002 in 2006 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. However, the impact on our operating income would not be material.

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 based on current tax laws and our interpretation of current tax laws, 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 recognize deferred tax assets and liabilities for temporary differences between the book and tax bases of assets and liabilities using enacted tax rates in effect for the year in which we expect the differences to reverse. We record a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized. In evaluating our ability to utilize our deferred tax assets, we consider all available positive and negative evidence, including our past operating results, our forecast of future taxable income. 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. Furthermore, 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, 2006, we have cumulative undistributed earnings from certain foreign subsidiaries of approximately 2,938 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.

Impairment Assessments

Goodwill and intangible assets

We account for all business combinations using the purchase method. As of the date of acquisition, we allocate the purchase price to the fair values of the assets acquired and liabilities assumed. Goodwill represents the excess of the cost of an acquired entity over the fair values assigned to the tangible assets acquired, to those intangible assets that are required to be recognized and reported separately from goodwill, and to the liabilities assumed. There is significant judgment involved in purchase price allocation upon business combinations and determining the appropriate reporting units to which the goodwill should be allocated. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), we review the carrying amount of goodwill for impairment on an annual basis. Additionally, we perform an impairment assessment of goodwill and other intangible assets whenever events or changes in circumstances indicate that the carrying value of goodwill and other intangible assets may not be recoverable. In making that assessment, we use certain assumptions and estimates about future cash flows, which are complex and often subjective. They can be affected by a variety of factors, including changes in our business strategy, our internal forecasts and estimation of our weighted-average cost of capital. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, different assumptions and estimates could materially affect our reported financial results. We did not record any impairment charges on our goodwill or intangible assets during fiscal 2006. As of December 31, 2006, the carrying amounts of our goodwill and intangible assets, net were 987.6 million and 262.6 million, respectively (2005: 626.5 million and 139.7 million, respectively).

Equity 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 equity securities investments, a significant portion of which represents venture capital investments, at December 31, 2006 was 82.8 million (2005: 45.4 million). The increase in 2006 was in large part attributable to new equity investments driven by our SAP NetWeaver Fund (See Item 4. Information about SAP Partnerships, Alliances and Acquisitions for more information on the SAP NetWeaver Fund). Although not significant in 2006, 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 2006, 2005, and 2004, we recognized impairment charges relating to equity securities investments of 1.2 million, 4.0 million, and 5.1 million, respectively.

Legal Contingencies

We are currently involved in various claims and legal proceedings. Quarterly, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss pursuant to SFAS No. 5, *Accounting for Contingencies*. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties relating to these matters, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position. The effects of changes in estimates of potential liabilities related to our legal contingencies had no material impact on 2006, 2005 or 2004.

NEW ACCOUNTING STANDARDS NOT YET ADOPTED

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

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of cash, cash equivalents and short-term investments are funds generated from our business 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, to pay dividends on our shares, to buy back SAP shares in the open market and to acquire businesses. Cash and cash equivalents are primarily held in euro and U.S. dollars as of December 31, 2006.

We believe that our working capital is sufficient to meet our present operational needs and, together with expected cash flows from operations, can support 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.

In order to complement or expand our business in the future, we have made and expect to make acquisitions of 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 cash and cash equivalents as well as short-term investments as of December 31:

	2006	**2005**	**% change**
	(In millions)		
Cash and cash equivalents	2,399	2,064	16.2%
Short-term investments	931	1,782	(47.8)%
Total	3,330	3,846	(13.4)%

Cash and cash equivalents consist of cash at banks and highly liquid investments with original maturity of three months or less, including money market funds, time deposits, and commercial paper.

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Short-term investments consist of investments with original maturities of greater than three months and remaining maturities of less than one year, including auction rate securities, variable rate demand notes, available-for-sale debt and marketable equity securities. Investments with maturities beyond one year or certain cost- and equity-method equity investments may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. See Note 3 to our consolidated financial statements in Item 18. Financial Statements for a related discussion on how we define short-term investments.

Total net interest income increased to 119.8 million in 2006 compared to 89.9 million in 2005 and 55.8 million in 2004. The increase is primarily due to 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 are most sensitive to fluctuations in the level of U.S. and EMU interest rates.

We operate globally and have subsidiaries in over 50 countries. Our foreign subsidiaries license SAP AG s software products to local customers and remit a certain percentage of the revenue to SAP AG in Germany as license fees. We have experienced and expect to experience situations where the amount of funds transferred from our subsidiaries in certain countries to Germany are restricted due to economic or legal reasons. The impact of such restrictions on our intercompany transfers has been and is expected to be insignificant.

Cash, cash equivalents and short-term investments in the amount of approximately 1,312 million are held in US$ and approximately 1,522 million are held in euro as of December 31, 2006.

Analysis of Consolidated Statements of Cash Flow

	Years ended December 31,				
	2006	**2005**	**2004**	**Change 2006 vs. 2005**	**Change 2005 vs. 2004**
		(In millions)			
Net cash provided by operating activities	1,847	1,608	1,845	15%	(13)%
Net cash used in investing activities	(134)	(583)	(748)	(77)%	(22)%
Net cash used in financing activities	(1,375)	(555)	(388)	148%	43%

Cash flow from operating activities increased by 239 million or 15% in 2006 due to increased cash receipts from customers driven by a 10% increase in total revenue and a 14% increase in deferred revenue, and in line with an increase in net income of 375 million from 2005. Consistent with the revenue growth, our accounts receivable balance increased by 192 million or 8% in 2006 while 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) remained at about 68 days in 2006. Cash used in investing activities decreased by 450 million or 77% in 2006 mainly due to a net inflow from short-term, equity, and other investments, arising out of their partial liquidation and reallocation between such investments and cash and cash equivalents. This factor is partially offset by cash payments for our acquisition of unrelated companies, totaling 492 million, net of cash received, for three software companies as discussed in Note 4 to our consolidated financial statements. Also, we continued to spend on intangible assets and property, plant and equipment, amounting to 367 million in 2006, a significant portion of which represented the cost of construction of office buildings in corporate headquarters. Cash used in financing activities increased significantly by 820 million or 148% in 2006; mainly because of a 31% increase in the amount of dividend distributed (2006: 447 million; 2005: 340 million) and a 153% increase in treasury stock purchases (2006: 1,149 million; 2005: 454 million).

Operating cash flow for 2005 was 1,608 million, representing a 13% decrease from 1,845 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 to 2,251 million at December 31, 2005, representing an increase of 322 million or 17%. Despite the increase in accounts receivable, which is consistent with the overall increase in revenues, we managed to reduce our days sales outstanding 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 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. 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 262 million, an increase of 69 million from 2004, driven by a rise in building activity at the corporate 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 555 million in 2005, an increase of 167 million from 2004. Dividend payments were 340 million and 249 million in 2005 and 2004, respectively. Additionally we spent approximately 454 million in 2005 to purchase our own ordinary shares and ADSs (2004: 175 million), some of which were 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.

Credit Lines

As of December 31, 2006, we had outstanding long-term financial debt of 1.6 million and outstanding short-term financial debt of approximately 31.0 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 2006, nor do we currently intend to draw down the facility. Consequently, there were no borrowings outstanding under the facility as of December 31, 2006.

As of December 31, 2006, SAP AG had additional available lines of credit totaling approximately 599 million. As of December 31, 2006, 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, 2006, approximately 109 million were available through such arrangements. The lines of credit have been reduced considerably as several subsidiaries do not have a need for credit facilities any more due to their cash flow and liquidity development. Total aggregate borrowings under these lines of credit amounted to 26 million as of December 31, 2006.

Authorized Capital

We also have available sources of cash through authorized capital as outlined in Note 23 to our consolidated financial statements in Item 18. Financial Statements.

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, as such term is defined in FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities an interpretation of ARB No. 51.* We believe we do not have other forms of material 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, 2006:

		Payments due by period			
Contractual obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
			(In millions)		
Long-term debt obligations[1]	2	1	1		
Capital (finance) lease obligations[2]	1	1			
Operating lease obligations[3]	657	149	205	134	169
Purchase obligations[4]	197	142	46	9	
Other long-term liabilities reflected on the balance sheet[5]	78		72	4	2
Total	935	293	324	147	171

(1) This represents a bank loan.

(2) This mainly represents capital leases of computer equipment and cars.

(3) 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 2006 was 182 million (2005: 165 million; 2004: 153 million).

(4) Purchase obligations represent agreements to purchase goods or services that are enforceable and legally binding on us that specify all significant terms, including: fixed or minimum quantities to be purchased, fixed; minimum or variable price provisions; and the approximate timing of the transaction.
The outstanding obligations include the construction of facilities, office equipment and car purchase commitments, food and security services and other facility commitments.

Our expected contributions to our pension and other postemployment benefit plans are not included in the table above. We expect to contribute in 2007 statutory minimum and discretionary amounts of 1.8 million to our German defined benefit plans and 45.6 million to our foreign defined benefit plans, all of which are expected to be paid as cash contributions. Our contributions to our German and foreign defined contribution plans have ranged from 76 million to 92 million in 2004 through 2006; we expect similar contributions to be made in 2007. See Note 21(a) to our consolidated financial statements in Item 18. Financial Statements for additional information.

(5) Amounts mainly consist of income tax payable (67 million), restructuring and other accruals (10 million) and trade accounts payable (0.4 million). Other noncurrent liabilities on the balance sheet such as pension and other postemployment benefit liabilities, deferred compensation, deferred income, deferred tax liabilities, and deferred

rent are not included in this table. Please see Notes 20 and 21 to our consolidated financial statements in Item 18. Financial Statements.

We expect to meet these contractual obligations with existing cash and our cash flows from operations. The timing of payments for the above contractual obligations is based on payment schedules for those obligations where set payments exist. For other obligations with no set payment schedules, estimates as to the

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most likely timing of cash payments have been made. The ultimate timing of these future cash flows may differ.

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 or performance guarantees in routine consulting contracts and 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 twelve 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 obligations. See Note 21(b) to our consolidated financial statements in Item 18. Financial Statements.

As of December 31, 2006 and 2005, 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 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.

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

We believe that in the medium term we must continuously improve our portfolio of products if we are to maintain and build on our current leading position as a vendor of business software. Research and development activities in 2006 centered on delivering applications for the enterprise SOA road map, launching new solutions for information workers, and enlarging our offering for midsize companies.

Research and development expenses for the years ended December 31, 2006, 2005, and 2004 were 1,334.8 million, 1,088.6 million, and 908.1 million, respectively. Research and development expenses as a percentage of total revenue were 14.2%, 12.8% and 12.1% for the years ended December 31, 2006, 2005, and 2004, respectively.

The importance of R&D was also reflected in the breakdown of employee profiles. In 2006, our total full-time equivalent headcount engaged in development work was 11,801 (2005: 10,215; 2004: 8,744). This is 30.0% of all Group employees (2005: 28.5%; 2004: 27.2%) and represents a 16% rise in the number of R&D

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employees since the previous year. Of the employees working in R&D, 52% (2005: 57%; 2004: 64%) are employed in Germany, 22% (2005: 18%; 2004: 12%) are in our high-growth development centers in China and India, and 18% (2005: 25%; 2004: 24%) are in our other development locations.

The expenses for R&D include mainly employee salaries and the cost of externally procured development services.

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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)	63	Chairperson of the Supervisory Board	2003	2007
Pekka Ala-Pietilä(1)(8)	50	Executive Advisor to the CEO of Nokia Corporation (until January 31, 2006) Co-founder and CEO Blyk Ltd. (from April 12, 2006)	2002	2007
Prof. Dr. Wilhelm Haarmann(1) (3)(5)(9)	56	Attorney at Law, Certified Public Auditor and Certified Tax Advisor; HAARMANN Partnerschaftsgesellschaft, Rechtsanwälte, Steuerberater, Wirtschaftsprüfer	1988	2007
Dr. h.c. Hartmut Mehdorn(1) (7)	64	Chairperson of Executive Board, Deutsche Bahn AG	1998	2007
Prof. Dr. Dr. h.c. mult. August-Wilhelm Scheer(1) (6)(8)	65	Professor at Saarland University	2002	2007
Dr. Erhard Schipporeit(11)	58	Former member of the Executive Board, EON AG, Management consultant	2005	2007
Dr. Dieter Spöri(1)(5)	63	Head of Corporate Representation Federal Affairs, DaimlerChrysler AG	1998	2007
Dr. h.c. Klaus Tschira(1) (4)	66	Managing Director, Klaus Tschira Stiftung gGmbH	1998	2007
Helga Classen, Vice Chairperson (5)(7)(10)	56	Employee, Chairperson of the Works Council of SAP AG and SAP Hosting AG & Co. KG	1993	2007
Willi Burbach(7)(8)(10)	44	Employee, Developer	1993	2007
Bernhard Koller(4)(10)	57	Employee, Manager of Idea Management	1989	2007
Christiane Kuntz-Mayr(5) (8)(10)	44	Employee, Development Architect	2002	2007
Lars Lamadé(6)(10)	35	Employee, Project Manager Service & Support	2002	2007
Dr. Gerhard Maier(3) (6)(10)	53	Employee, Development Project Manager	1989	2007
Dr. Barbara Schennerlein (5)(10)	50	Employee, Principal Consultant	1998	2007
Stefan Schulz(4)(8)(10)	37	Employee, Development Project Manager	2002	2007

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

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

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(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 founded HAARMANN Partnerschaftsgesellschaft in Frankfurt. Wilhelm Haarmann was determined to be the Audit Committee s financial expert until July 2005.

(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, 2006, are set forth in Note 31 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*), members of the Supervisory Board of SAP AG consists of eight representatives of the shareholders and eight representatives of the employees. 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.

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	2009
Dr. Peter Zencke	1993	2008
Prof. Dr. Claus Heinrich	1996	2010
Gerhard Oswald	1996	2010
Dr. Werner Brandt	2001	2009
Shai Agassi	2002	2007(1)

Léo Apotheker	2002	2010

(1) Resigned effective April 1, 2007. Additional information located below.

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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.

On March 28, 2007, SAP announced the resignation by mutual agreement of Executive Board member Shai Agassi effective April 1, 2007. The Supervisory Board named Executive Board member Léo Apotheker to the newly created role of Deputy CEO with immediate effect. SAP also announced that on April 1, 2007 an Executive Council will be established to realign SAP s development and field activities under a newly integrated management structure. Each member of the Executive Council will report either to Henning Kagermann or Léo Apotheker.

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

Henning Kagermann, CEO (*Vorstandssprecher*), 59 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, 38 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. After the integration of SAP Portals into SAP, Agassi was responsible for the application platform SAP NetWeaver. His responsibilities were further expanded to include product development, the technology platform, industry solutions, partner network, and product and industry marketing. Effective April 1, 2007 by mutual agreement he resigned from the Executive Board and is expected to become a special consultant to the Chairman of the Supervisory Board.

Léo Apotheker, 53 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. He became Deputy CEO on March 28, 2007.

Werner Brandt, 53 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 Inc. His responsibilities at SAP include finance and administration, shared services, and SAP Ventures.

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Claus Heinrich, 51 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, 53 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 and co-heads with Peter Zencke the new dedicated midmarket solution.

Peter Zencke, 57 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 the development of the enterprise SOA based application platform, co-heads with Gerhard Oswald the new dedicated midmarket solution, and global research.

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, 2006, are set forth in Note 31 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.

Compensation for Executive Board Members

Compensation Package

The Executive Board members compensation package is defined by the compensation committee, a committee of the Supervisory Board chaired by Prof. Dr. h. c. mult. Hasso Plattner (chairperson of the Supervisory Board). Its other members are Prof. Dr. Wilhelm Haarmann and Dr. Gerhard Maier.

Executive Board members compensation is intended to reflect the Group s size and global presence as well as our economic and financial standing. The level is internationally competitive to reward committed, successful work in a dynamic environment.

The compensation of the Executive Board as a body is 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). Along with the regular stock-based compensation plan, the Supervisory Board awarded additional nonrecurring stock-based compensation in the form of stock appreciation rights (STARs) to the Executive Board in 2006 for Incentive Plan 2010. However, it will not pay out unless SAP s market capitalization increases at least 50% over a five-year period.

A compensation target is set for the total of fixed and performance-related elements. We review the compensation target every year in the light of our business and directors compensation at comparable companies on the international stage. Every year, the compensation committee sets the target performance-related compensation, reflecting the relevant values in that year s budget. The number of stock options and STARs to be issued to each individual member of the Executive Board by way of stock-based compensation was decided by the compensation committee at its meeting on February 3, 2006 and reflected the fair value of the options and STARs.

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 2006 depends on the Group s achievement of its targets for Adjusted operating income that is, before stock-based compensation expenses and acquisition-related charges and on software revenue growth. On February 14, 2007 the Supervisory Board s compensation committee assessed SAP s performance against the agreed targets and determined how much performance-related compensation was payable. The payment will be made after the Annual General Meeting of Shareholders in May 2007.

The regular form of stock-based compensation is the issue of stock options under the terms of SAP SOP 2002 that the Annual General Meeting of Shareholders approved on May 3, 2002. The terms and detail of SAP SOP 2002 are reported in Note 29 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.

The additional nonrecurring stock-based compensation awarded in 2006 is comprised of STARs for the Incentive Plan 2010 stock-based compensation plan. This plan is a nonrecurring incentive with a term of up to five years, intended to give more encouragement than hitherto for originality and to ensure the Executive Board actions remain focused on a long-term goal. Incentive Plan 2010 is a stock-based compensation plan intended to reward a substantial increase in our market capitalization. The Executive Board will qualify for payout under the plan only if, not later than the end of 2010, SAP s average market capitalization during the last six months of a year is not less than 50% greater than its average value between July 1 and July 31, 2005 and SAP stock outperforms the GSTI Software Index over the same period. Payouts are scaled as follows:

If market capitalization does not increase by 50% or more, the Executive Board will receive no payout.

If market capitalization increases by more than 50% but less than 100%, target achievement will be measured progressively.

If SAP s market capitalization increases not less than twofold during the said period, the Executive Board will receive a payout of 100 million.

The STARs awarded to Executive Board members under this plan expire on December 31, 2010. If the target 100% increase in market capitalization is reached at an earlier date while at the same time the stock is outperforming the GSTI Software Index, the plan ends at that earlier date. All payouts under the plan are cash; no new SAP shares will be issued. A beneficiary cannot exercise a STAR if he or she would take a windfall profit, which is a substantial, extraordinary and unforeseen profit arising out of circumstances not intended by the Executive Board. All decisions in this regard or concerning appropriate reduction of plan

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payouts are at the sole discretion of the compensation committee of the Supervisory Board. The terms and detail of this plan are reported in Note 29 to our consolidated financial statements in Item 18. Financial Statements.

Amount of Compensation

Executive Board members compensation in fiscal year 2006:

	2006							2005
	Fixed Elements		Performance Related Compensation	Regular Long-Term Incentive Elements		Nonrecurring Long-Term Incentive Element		
	Salary	Other*	Directors Profit Sharing	Stock-Based Compensation (SAP SOP 2002)**	Total Before Nonrecurring Long-Term Incentive Element	Stock-Based Compensation (Incentive Plan 2010)**	Total	Total
	(000)							
Prof. Dr. Henning Kagermann (CEO)	710.7	17.0	2,673.7	949.0	4,350.4	4,680.1	9,030.5	6,084.8
Shai Agassi	474.4	59.5	1,782.5	632.7	2,949.1	3,120.1	6,069.2	4,001.1
Léo Apotheker	473.8	0.3	1,782.5	632.7	2,889.3	3,120.1	6,009.4	3,901.1
Dr. Werner Brandt	432.6	41.3	1,627.5	577.7	2,679.1	1,560.0	4,239.1	3,942.2
Prof. Dr. Claus E. Heinrich	432.6	20.0	1,627.5	577.7	2,657.8	1,560.0	4,217.8	3,920.9
Gerhard Oswald	432.6	14.8	1,627.5	577.7	2,652.6	1,560.0	4,212.6	3,915.1
Dr. Peter Zencke	432.6	27.7	1,627.5	577.7	2,665.5	1,560.0	4,225.5	3,922.8
Total					20,843.8		38,004.1	29,688.0

* Insurance contributions, benefits in kind, compensation from seats on other governing bodies in the SAP Group

** Fair value at the time of allocation

The values for regular stock-based compensation and nonrecurring stock-based compensation in the table above are the fair value of SAP SOP 2002 options at the time of grant to the respective members and of the STARs under the Incentive Plan 2010 at the time of allocation.

	2006		
	Regular Stock-Based Compensation	Nonrecurring Stock-Based Compensation	Total Fair

	SAP SOP 2002		Incentive Plan 2010		Value Of Long-Term Incentive Elements
	Quantity	Fair Value At Time Of Grant	Quantity	Fair Value At Time Of Grant	At Time Of Grant
					(000)
Prof. Dr. Henning Kagermann (CEO)	35,851	26.47	188,182	24.87	5,629.1
Shai Agassi	23,901	26.47	125,455	24.87	3,752.7
Léo Apotheker	23,901	26.47	125,455	24.87	3,752.7
Dr. Werner Brandt	21,823	26.47	62,727	24.87	2,137.7
Prof. Dr. Claus E. Heinrich	21,823	26.47	62,727	24.87	2,137.7
Gerhard Oswald	21,823	26.47	62,727	24.87	2,137.7
Dr. Peter Zencke	21,823	26.47	62,727	24.87	2,137.7
Total	170,945		690,000		21,685.3

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	2005				
	Regular Stock-Based Compensation		Nonrecurring Stock-Based Compensation		
	SAP SOP 2002		Incentive Plan 2010		Total Fair Value Of Long-Term Incentive Elements
	Quantity	Fair Value At Time Of Grant	Quantity	Fair Value At Time Of Grant	At Time Of Grant
					(000)
Prof. Dr. Henning Kagermann (CEO)	66,955	20.08			1,344.5
Shai Agassi	37,495	20.08			752.9
Léo Apotheker	37,495	20.08			752.9
Dr. Werner Brandt	37,495	20.08			752.9
Prof. Dr. Claus E. Heinrich	37,495	20.08			752.9
Gerhard Oswald	37,495	20.08			752.9
Dr. Peter Zencke	37,495	20.08			752.9
Total	291.925				5,861.9

The change during 2006 in the fair value of the stock options and STARs granted in 2006 to Executive Board Members was as follows:

	Fair Value At Time Of Grant	Fair Value On December 31, 2006
SAP SOP 2002 Stock Options (February 6, 2006 grant)	26.47	18.23
Incentive Plan 2010 STARs (March 6, 2006 grant)	24.87	14.02

End-of-Service Undertakings

Retirement Pension Plan

Members of the Executive Board receive retirement pension when they reach the retirement age of 60 and vacate their Executive Board seat or disability pension if, before reaching the regular retirement age, they become subject to occupational disability or permanent incapacity. Widow s pension is paid on the death of a former member of the Executive Board. Disability pension is 100% of the vested retirement pension entitlement and is payable until but not after the beneficiary s 60th birthday. Widow s pension is 60% of the retirement pension or vested disability pension entitlement at death. Entitlements are enforceable against SAP AG.

The benefit payable has been agreed with the active Executive Board members. If service is ended prematurely, pension entitlement is reduced in proportion as the actual length of service stands in relation to the maximum possible length of service.

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. The benefits are derived from any accrued entitlements on December 31, 1999 under performance-based pension agreements and a salary-linked contribution for the period commencing January 1, 2000. The contribution is 4% of applicable compensation up to the applicable income threshold plus 14% of applicable compensation above the applicable income threshold. For this purpose, applicable compensation is 90% of target annual salary. The applicable income threshold is the statutory annual income threshold for the state pension plan in Germany (West), as amended from time to time.

Exceptional agreements apply to Messrs. Léo Apotheker and Shai Agassi: Mr. Apotheker s agreement provides only for retirement pension, and the pension contribution reflects his participation in the French

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social security system. Mr. Agassi receives the pension contribution as an annual payout, so he has no pension entitlement. The annual payout is included in his disclosed compensation.

The following table shows the change in total projected benefit obligation (PBO) and in the total accruals for pension obligations to Executive Board members.

	Prof. Dr. Henning Kagermann (CEO)	Léo Apotheker	Dr. Werner Brandt	Prof. Dr. Claus E. Heinrich	Gerhard Oswald	Dr. Peter Zencke	Total
PBO January 1, 2006	5,592,058	462,069	529,437	3,252,434	3,525,780	4,127,569	17,489,347
less Plan assets market value January 1, 2006	3,952,372	579,113	313,834	1,512,327	1,732,440	2,559,739	10,649,825
Accrued January 1, 2006	1,639,686	(117,044)	215,603	1,740,107	1,793,340	1,567,830	6,839,522
PBO change in 2006	(257,394)	(16,752)	63,897	(237,154)	(241,536)	(251,614)	(940,553)
Plan assets change in 2006	630,102	24,274	94,352	251,077	282,635	387,276	1,669,716
PBO December 31, 2006	5,334,664	445,317	593,334	3,015,280	3,284,244	3,875,955	16,548,794
less Plan assets market value December 31, 2006	4,582,474	603,387	408,186	1,763,404	2,015,075	2,947,015	12,319,541
Accrued December 31, 2006	752,190	(158,070)	185,148	1,251,876	1,269,169	928,940	4,229,253

The following table shows the annual pension entitlement of each member of the Executive Board on reaching age 60 based on entitlements from performance-based and salary-linked plans vested on December 31, 2006.

	Prof. Dr. Henning Kagermann (CEO)	Léo Apotheker	Dr. Werner Brandt	Prof. Dr. Claus E. Heinrich	Gerhard Oswald	Dr. Peter Zencke
Annual pension entitlement at age 60 vested on December 31, 2006	289,827	45,487	34,364	165,487	184,553	207,188

To the extent that members continue to serve on the Executive Board and that therefore more contributions are made for them in the future, pension actually payable at age 60 will be more than shown in the table.

In 2006, pension benefits of 725 thousand were paid to former Executive Board members (2005: 474 thousand). On December 31, 2006, the projected benefit obligation for former Executive Board members was 12,541 thousand (2005: 12,830 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. There is a change of control when a takeover obligation to the shareholders of SAP AG arises under the German Securities Acquisition and Takeover Act, when SAP AG merges with another company and becomes the subsumed entity, or when a control 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 in connection with a change of control.

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 payment.

Long-Term Incentives for the Executive Board

Members of the Executive Board hold stock-based compensation awards granted to them in previous years under SAP SOP 2002 and LTI Plan 2000. The terms and detail of this plan are reported in Note 29 to our consolidated financial statements in Item 18. Financial Statements.

SAP SOP 2002

The table below shows Executive Board members holdings, on December 31, 2006, of stock options issued under the SAP SOP 2002 plan since its inception.

The exercise prices 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 closing auction price for SAP stock 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 exercise price must be not less than the closing auction price on the day before the issue date. As a result of the fourfold increase in the number of shares resulting from the capital increase which became effective December 15, 2006 (See Item 9. The Offer and Listing General for more detail of the share increase), upon exercise each stock option now entitles its beneficiary to four shares. For better comparability with the price of SAP stock since implementation of the capital increase, the following table shows not the number (quantity) of options but the number (quantity) of shares to which they entitle the holder. Consequently, the exercise prices shown are prices per share and not per option. The number of shares shown in the table is four times the number of options, and the exercise price for an option is four times the exercise price per share shown in the table.

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SAP SOP 2002 Stock Options

	Exercise Price per Share ( )	Vested On December 31, 2006 Quantity of Shares	Vested On December 31, 2006 Remaining Term In Years	Not Vested On December 31, 2006 Quantity of Shares	Not Vested On December 31, 2006 Remaining Term In Years	Total Quantity of Shares	Total Remaining Term In Years
Prof. Dr. Henning Kagermann (CEO)	22.59	320,000	1.16			320,000	1.16
	37.50	200,000	2.13			200,000	2.13
	33.55			267,820	3.11	267,820	3.11
	46.48			143,404	4.10	143,404	4.10
Shai Agassi	22.59	120,000	1.16			120,000	1.16
	24.78	120,000	1.33			120,000	1.33
	37.50	112,000	2.13			112,000	2.13
	33.55			149,980	3.11	149,980	3.11
	46.48			95,604	4.10	95,604	4.10
Léo Apotheker	37.50	112,000	2.13			112,000	2.13
	33.55			149,980	3.11	149,980	3.11
	46.48			95,604	4.10	95,604	4.10
Dr. Werner Brandt	37.50	112,000	2.13			112,000	2.13
	33.55			149,980	3.11	149,980	3.11
	46.48			87,292	4.10	87,292	4.10
Prof. Dr. Claus E. Heinrich	22.59	180,000	1.16			180,000	1.16
	37.50	112,000	2.13			112,000	2.13
	33.55			149,980	3.11	149,980	3.11
	46.48			87,292	4.10	87,292	4.10
Gerhard Oswald	33.55			149,980	3.11	149,980	3.11
	46.48			87,292	4.10	87,292	4.10
Dr. Peter Zencke	22.59	180,000	1.16			180,000	1.16
	37.50	112,000	2.13			112,000	2.13
	33.55			149,980	3.11	149,980	3.11
	46.48			87,292	4.10	87,292	4.10
Total		1,680,000		1,851,480		3,531,480	

During 2006, members of the Executive Board exercised stock options granted in earlier years under SAP SOP 2002 as follows:

SAP SOP 2002 Stock Options Exercised

Stock Options	2006	Stock Options	2005

	Quantity	Average Exercise Price ( )	Quantity	Average Exercise Price ( )
Léo Apotheker	30,000	90.37		
Dr. Werner Brandt			30,000	90.37
Gerhard Oswald	28,000	149.99	45,000	90.37
Total	58,000		75,000	

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 SAP stock over time against the GSTI Software Index.

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The table below shows stock options held by members of the Executive Board on December 31, 2006, granted in earlier years under LTI Plan 2000.

The exercise prices 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, 2006. Exercise prices vary with the performance of SAP stock over time against the GSTI Software Index. As a result of the fourfold increase in the number of shares resulting from the capital increase which became effective December 15, 2006 (See Item 9. The Offer and Listing General for more detail of share increase), upon exercise each stock option now entitles its beneficiary to four shares. For better comparability with the price of SAP stock since implementation of the capital increase, the following table shows not the number (quantity) of options but the number (quantity) of shares to which they entitle the holder. Consequently, the exercise prices shown are prices per share and not per option. The number of shares shown in the table is four times the number of options, and the exercise price for an option is four times the exercise price per share shown in the table.

LTI Plan 2000 Stock Options

		Vested On December 31, 2006		Not Vested On December 31, 2006		Total	
	Exercise Price per Share ( )	Quantity of Shares	Remaining Term In Years	Quantity of Shares	Remaining Term In Years	Quantity of Shares	Remaining Term In Years
Prof. Dr. Henning Kagermann (CEO)	19.35	112,128	3.14			112,128	3.14
	23.51	157,500	4.14			157,500	4.14
Léo Apotheker	29.05	87,500	5.14			87,500	5.14
Dr. Peter Zencke	19.35	27,924	3.14			27,924	3.14
	23.51	73,700	4.14			73,700	4.14
Total		458,752				458,752	

The table below shows convertible bonds held by members of the Executive Board on December 31, 2006, granted in earlier years under LTI Plan 2000. The exercise prices 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 share on the business day immediately preceding the grant of the convertible bond. As a result of the fourfold increase in the number of shares resulting from the capital increase which became effective December 15, 2006 (See Item 9. The Offer and Listing General for more detail of the share increase), upon conversion each bond now entitles its beneficiary to four shares. For better comparability with the price of SAP stock since implementation of the capital increase, the following table shows not the number (quantity) of convertible bonds but the number (quantity) of shares to which they entitle the holder. Consequently, the exercise prices shown are prices per share and not per bond. The number of shares shown in the table is four times the number of bonds, and the exercise price for a bond is four times the exercise price per share shown in the table.

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		LTI Plan 2000 Convertible Bonds					
		Vested On December 31, 2006		Not Vested On December 31, 2006		Total	
	Exercise Price per Share ( )	Quantity of Shares	Remaining Term In Years	Quantity of Shares	Remaining Term In Years	Quantity of Shares	Remaining Term In Years
Prof. Dr. Henning Kagermann (CEO)	72.58	89,700	3.14			89,700	3.14
	47.81	126,000	4.14			126,000	4.14
	37.88	360,000	5.14			360,000	5.14
Léo Apotheker	83.67	95,400	3.19			95,400	3.19
	47.81	120,000	4.14			120,000	4.14
	37.88	70,000	5.14			70,000	5.14
Dr. Werner Brandt	47.81	20,000	4.14			20,000	4.14
	37.88	120,000	5.14			120,000	5.14
Prof. Dr. Claus E. Heinrich	72.58	65,700	3.14			65,700	3.14
	47.81	88,000	4.14			88,000	4.14
	37.88	200,000	5.14			200,000	5.14
Gerhard Oswald	72.58	65,700	3.14			65,700	3.14
	47.81	88,000	4.14			88,000	4.14
Dr. Peter Zencke	72.58	65,700	3.14			65,700	3.14
	47.81	88,000	4.14			88,000	4.14
	37.88	200,000	5.14			200,000	5.14
		1,862,200				1,862,200	

Rights exercised by members of the Executive Board in 2006 under LTI Plan 2000 stock options and convertible bonds granted in earlier years:

	LTI Plan 2000 Stock Options Exercised			
	Stock Options 2006		Stock Options 2005	
	Quantity	Average Exercise Price ( )	Quantity	Average Exercise Price ( )
Dr. Werner Brandt			2,125	88.12
Prof. Dr. Claus E. Heinrich	48,032	74.07		
Gerhard Oswald	10,625	116.04	19,663	99.00

	58,657	21,788

	LTI Plan 2000 Convertible Bonds Exercised			
	Convertible Bonds 2006		Convertible Bonds 2005	
	Quantity	Average Exercise Price ( )	Quantity	Average Exercise Price ( )
Gerhard Oswald	25,000	151.50		
	25,000			

Stock Held By Executive Board Members

No member of the Executive Board holds more than 1% of the ordinary stock of SAP AG. Members of the Executive Board held a total of 287,384 SAP shares on December 31, 2006, that is after the increase in capital. On December 31, 2005, before the increase in capital, members of the Executive Board held a total of 31,346 SAP shares, corresponding in number to 125,384 post-capital-increase SAP shares.

The table below shows transactions by Executive Board members and persons closely associated with them notified to SAP pursuant to the German Securities Trading Act, section 15a, in 2006.

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Transactions in SAP Shares and ADRs

Notifying Party	Transaction Date	Transaction	Quantity	Unit Price ( )
Léo Apotheker	November 15, 2006	Exercise of Subscription Rights	30,000	90.37
Dr. Werner Brandt	July 17, 2006	Stock purchase	500	147.48
Prof. Dr. Claus E. Heinrich	June 12, 2006	Exercise of subscription rights	20,532	65.9461
	June 12, 2006	Exercise of subscription rights	27,500	80.1342
	June 12, 2006	Stock sale	48,032	157.1696
Gerhard Oswald	March 10, 2006	Exercise of subscription rights	25,000	151.50
	March 10, 2006	Exercise of subscription rights	28,000	149.99
	March 10, 2006	Exercise of subscription rights	10,625	116.0380
	March 10, 2006	Stock sale	63,625	172.54184

Executive Board: Other Information

We did not grant any compensation advance or credit to, or enter into any commitment for the benefit of, any member of our Executive Board in 2006 or the previous year.

As far as the law permits, SAP AG and SAP AG s affiliated companies in Germany and elsewhere indemnify and hold harmless their respective directors and officers against and from the claims of third parties. To this end, we maintain directors and officers group liability insurance. The policy is annual and is renewed from year to year. The insurance covers the personal liability of the insured group for financial loss caused by its managerial acts and omissions. There is no individual deductible as envisaged in the German Corporate Governance Code, section 3.8, paragraph 2. We believe the motivation and responsibility that the members of the Executive Board and Supervisory Board bring to their duties would not be improved by such a deductible element. For this reason, we regard a deductible as unnecessary for the insured group.

Compensation for Supervisory Board Members

Compensation Package

Supervisory Board members compensation is governed by our Articles of Incorporation, section 16. The section was amended by resolution of our May 9, 2006 Annual General Meeting of Shareholders to bring it into line with other German blue-chip companies. The fixed element and the cap on aggregate compensation were raised. The amendment also applied a recommendation of the German Corporate Governance Code to pay additional compensation to chairpersons and other members of committees of the Supervisory Board.

The amended section provides that each member of the Supervisory Board receives, in addition to the reimbursement of his or her expenditure, compensation composed of fixed elements and a variable element. The variable element depends on the dividend.

The fixed element is 75,000 for the chairperson, 50,000 for the deputy chairperson, and 37,500 for other members. For membership of a Supervisory Board committee, members receive additional fixed compensation of 2,500 (provided that the relevant committee meets during the fiscal year) and the chairperson of the committee receives 5,000. The fixed remuneration element is due for payment after the end of the fiscal year.

The variable compensation element is 8,000 for the chairperson, 6,000 for the deputy chairperson, and 4,000 for the other members of the Supervisory Board for each 0.01 by which the dividend distributed per share exceeds 0.25.

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However, the aggregate compensation excluding compensation for committee memberships must not exceed 200,000 for the chairperson, 150,000 for the deputy chairperson, and 100,000 for other memb