IFRS 15: Implications for SAP’s 2018 Financials

Dr. Christoph Hütten, Chief Accounting Officer SAP
Safe harbor statement

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AGENDA

How SAP transitions to IFRS 15

Most Significant IFRS 15 Effects on SAP’s Income Statement

Most Significant IFRS 15 Effects on SAP’s Balance Sheet

Supplemental Information

- SAP’s Transition Approach
- Details on Income Statement Effects
- Details on Balance Sheet Effect
How SAP transitions to IFRS 15
Specifics of the transition method chosen by SAP

Transition Approach 2
Modified Retrospective Method

Financial Statements 2017

<table>
<thead>
<tr>
<th>Statements</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
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Financial Statements 2018

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Expected Impact of IFRS 15
We expect the following impact in 2018: ...

- For most of SAP's contracts there is no difference in revenue recognition between previous policies and IFRS 15
  → No impact on revenue for these contracts

- Only those contracts that reach into 2018 transition to IFRS 15
  → Most of SAP's on premise contracts from before 2018 do not transition

- Contracts with differences between previous policies and IFRS 15 may experience
  → revenue or expense is recognised for a second time (Double Dip)
  → revenue or expense is not recognised at all (Black Hole)
## Most Significant IFRS 15 Effects on SAP’s Income Statement

### Summary

- **Certain Purchase Options for Additional On Premise Software**
  - Exercise of options existing on January 1: Additional software revenue
  - Revenue deferrals for options newly granted in 2018: Estimated to be insignificant

- **Capitalisation of Sales Commissions**
  - Higher capitalisation for cloud and start of capitalisation for on premise (net of capitalised amounts and amortisation)
  - Impact expected to decrease in 2019 et seq. due to higher amortisation

- **Certain Other Differences**
  - Differences in recording provisions for onerous contracts
  - Recognising revenue and expense for certain custom development projects upon ultimate delivery rather than over time

- **All Other Differences between IFRS 15 and Previous Policies**
  - Estimated to be immaterial for SAP’s revenue and profit

### Estimated Impacts*

<table>
<thead>
<tr>
<th>Category</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td>higher by substantially less than €0.1 billion</td>
</tr>
<tr>
<td></td>
<td>- Mostly software revenue</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td>lower by approx. €0.1 billion</td>
</tr>
<tr>
<td></td>
<td>- Cost of revenue higher by substantially less than €0.1 bn</td>
</tr>
<tr>
<td></td>
<td>- Sales and marketing expense lower by approx. €0.2 bn</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td>higher by approx. €0.2 billion</td>
</tr>
</tbody>
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* Impact = Difference between revenue and profit under IFRS 15 vs. what it would have been under the previous policies

Note: The estimates are based on several assumptions regarding business practices, performance etc. SAP will update these estimates as the year progresses and will report on actual IFRS 15 impact.
### Most Significant IFRS 15 Effects on SAP’s Balance Sheet

#### Summary

<table>
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<tr>
<th>Effects</th>
<th>Estimated Impacts*</th>
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<tr>
<td><strong>Recognition of Receivables and Contract Liabilities</strong></td>
<td></td>
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<tr>
<td>- Receivable: gradually as the service is provided and in full once invoice is due</td>
<td></td>
</tr>
<tr>
<td>- Contract liability: for undelivered but invoiced &amp; due or paid deliverables =&gt; not reflecting sales success of period</td>
<td></td>
</tr>
<tr>
<td><strong>Trade receivables and contract liabilities</strong></td>
<td>higher by approx. €0.8 to 0.9 bn per January 1, 2018, compared to accounts receivables and deferred revenue under previous policies per December 31, 2017</td>
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*Note: The estimates are based on several assumptions regarding business practices, performance etc. SAP will update these estimates as the year progresses and will report on actual IFRS 15 impact.*
AGENDA

How SAP transitions to IFRS 15

Most Significant IFRS 15 Effects on SAP’s Income Statement

Most Significant IFRS 15 Effects on SAP’s Balance Sheet

Supplemental Information

- SAP’s Transition Approach
- Details on Income Statement Effects
- Details on Balance Sheet Effect
How SAP transitions to IFRS 15
Different transition approaches available

### Transition Approach 1
**Retrospective Transition Method**

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**Expected Impact of IFRS 15**
We expect the following impact in 2018: ...

### Transition Approach 2
**Modified Retrospective Method**

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**Expected Impact of IFRS 15**
We expect the following impact in 2018: ...

**Old = Previous policies / New = IFRS 15 policies**
Most Significant IFRS 15 Effects on SAP’s Income Statement
Options for additional copies of licensed software (material rights)

Previous Policies

No accounting for option

All software revenue recognised upon software delivery

Contract with Customer

On Premise
Software XYZ

Option to buy
more of XYZ

IFRS 15 Policies

Option ≠ Material Right

All software revenue recognised upon software delivery

Portions of software will be recognised later under IFRS 15

For options granted before 2018 in a contract that transitions to IFRS 15:
Revenue will be recognised a second time

Current Expectation:
Future Revenue from Exercise of Existing Options: ~ € 0.1 billion
(thereof substantially less than €0.1 billion in each of the years 2018, 2019 and 2020)

New options expected to be rare in 2018 et seq. (depends on business behaviour)
Most Significant IFRS 15 Effects on SAP’s Income Statement

Capitalisation of sales commissions

**Contract with Customer**
- On Premise or Cloud
- Sales Personnel Receives Sales Commission

**Previous Policies**
- Cloud
  - Capitalise sales commissions that are direct* & incremental**
- On Premise
  - Don't capitalise sales commissions

**IFRS 15 Policies**
- Cloud
  - Capitalise sales commissions that are incremental** (even if not direct*)
- On Premise

Higher capitalisation of sales commissions under IFRS 15
For transitioning contracts from before 2018:
Expense recognised a second time

Current Expectation:
2018: net of capitalisation & amortisation = € 0.2 billion lower expense
Effect expected to decrease in 2019 et seq.

* Direct = paid to sales personnel directly working on the individual customer contract
** Incremental = cannot be earned through anything other than closing customer contracts
Most Significant IFRS 15 Effects on SAP’s Income Statement
Profit impact of on premise sales commissions in 2018 et seq.*

- Newly capitalised amount (Expense reduction)
- Amortisation (Expense increase)

* The size of the bars is only illustrative
Most Significant IFRS 15 Effects on SAP’s Balance Sheet

Receivables and Contract liabilities under IFRS 15 vs. previous policies

### Previous Policies
- Recognise receivable in full once invoice is issued and service has started
- Recognise deferred revenue for deliverables that are partially undelivered but invoiced or paid
  - => in full with receivable

### IFRS 15 Policies
- Recognise receivable
  - gradually as the service is provided
  - in full once invoice is due
- Recognise contract liability for deliverables that are undelivered but invoiced & due or paid
- Offset contract liability with contract assets from same contract

Receivables and contract liabilities are recognised
- later under IFRS 15 when invoice is due after service start date
- earlier under IFRS 15 when invoice is due before service start date
  - => Changes in contract liabilities do not reflect sales success of period

**Current Expectation:**
This policy change makes both, receivables and contract liabilities
per January 1, 2018 higher by ~ €0.8 to €0.9 billion compared to receivables
and deferred revenue under previous policies per December 31, 2017
Most Significant IFRS 15 Effects on SAP’s Balance Sheet

Timing of recognising contract liabilities (IFRS 15) vs. deferred revenue (previous policies)

**Example:** One Year Cloud contract closed on November 25, invoice issued and service starts on December 1, invoice due on January 15

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**Trade Receivable**

Old = Previous policies / New = IFRS 15 policies
Thank You

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