SAP AKTIENGESELLSCHAFT SYSTEMS APPLICATIONS PRODUCTS IN DATA
Form 20-F
March 23, 2004

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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

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to

Commission file number: 1-14251

SAP AKTIENGESELLSCHAFT

SYSTEME, ANWENDUNGEN, PRODUKTE IN DER DATENVERARBEITUNG

(Exact name of registrant as specified in its charter)

SAP CORPORATION

SYSTEMS, APPLICATIONS AND PRODUCTS IN DATA PROCESSING
(Translation of Registrant s name into English)

Federal Republic of Germany

(Jurisdiction of incorporation or organization)

Neurottstrasse 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
	New York Stock Exchange

American Depositary Shares, each representing one-fourth of one Ordinary Share, without nominal value	
Ordinary Shares, without nominal value	Frankfurt Stock Exchange 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 at the close of the period covered by the annual report:

Ordinary Shares, without nominal value (as of December 31, 2003)**	315,413,553

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 x No o

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

Item 17 o Item 18 x

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

** Including 4,565,000 treasury shares.

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

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

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INTRODUCTION

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

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

Unless otherwise specified herein, all euro financial data that have been converted into dollars have been converted at the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) on December 31, 2003, which was 1.00 per $1.2597. No representation is made that such euro amounts actually represent such dollar amounts or that such euro amounts could have been or could be converted into dollars at that or any other exchange rate on such date or on any other dates. The rate used for the convenience translations also differs from the currency exchange used for the preparation of the Consolidated Financial Statements. For information regarding recent rates of exchange between euro and dollars, see Item 3. Key Information Exchange Rates. At March 9, 2004, the Noon Buying Rate for converting euro to dollars was U.S.$ 1.2428 per 1.00.

Unless the context otherwise requires, references in this Annual Report on Form 20-F to ordinary shares are to SAP AG s ordinary shares, without nominal value, and references to preference shares are to SAP AG s non-voting preference shares, without nominal value, which were converted to ordinary shares as of June 18, 2001. References in this Annual Report on Form 20-F to ADSs are to SAP AG s American Depositary Shares, each representing one-fourth of an ordinary share.

On June 26, 2000, we effected a division of our capital stock by means of a three-for-one stock split of the ordinary shares and the preference shares. Contemporaneously with the stock split, we reduced the ratio of ADSs to preference shares from 12:1 to 4:1. All references to subscribed capital, ordinary shares, preference shares, shares outstanding, average number of shares outstanding, convertible bonds, stock options or per share amounts in this Annual Report on Form 20-F prior to the effectiveness of the stock split have been restated to reflect the three-for-one stock split on a retroactive basis.

The Annual General Shareholders Meeting and a special meeting of holders of the preference shares on May 3, 2001 approved a conversion of the preference shares into ordinary shares on a share for share basis, which came into effect on June 18, 2001. The amount of subscribed capital for ordinary shares was therefore increased by the amount of the outstanding preference shares on the effective date of the conversion.

SAP, the SAP logo, R/2, R/3, mySAP, mySAP.com, xApp, xApps, SAP NetWeaver and other SAP product and service nan herein are trademarks or registered trademarks of SAP AG in Germany and/or 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 beliefs of our management. 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;
- regulatory and political conditions;
- obtaining and expanding market acceptance of our services and products;
- terrorist attacks or other acts of violence or war;
- meeting our requirements with customers; and
- other risks and uncertainties, some of which we describe under Item 3. Key Information Risk Factors.

The words anticipate, believe, continue, counting on, is confident, estimate, expect, forecast, intend, may, plan, proje wants, will, would and similar expressions as they relate to us are intended to identify such forward-looking statements. 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 expectations. 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 their dates. We undertake no obligation to publicly update or revise any forward-looking statements.

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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 represents selected consolidated financial information of SAP. The table should be read together with Item 5. Operating and Financial Review and Prospects. The selected consolidated financial data of SAP is a summary of, is derived from and is qualified by reference to, our consolidated financial statements and notes thereto audited for the years ended December 31, 2003 and 2002 by KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft (KPMG), independent auditors and for the years ended December 31, 2001, 2000 and 1999 by ARTHUR ANDERSEN Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft mbH (Arthur Andersen), independent auditors. For a discussion of the risks relating to Arthur Andersen s audit of our financial statements, please see Item 3. Key Information Risk Factors We and our shareholders face certain risks related to our former employment of Arthur Andersen as our independent auditors.

The audited consolidated income statements, consolidated statements of cash flows and consolidated statements of changes in shareholders equity for the years ended December 31, 2003, 2002 and 2001, and the consolidated balance sheets at December 31, 2003 and 2002 are included in Item 18. Financial Statements. Certain reclassifications have been made to prior year amounts to conform to the current year s presentation.

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SELECTED FINANCIAL DATA

	Year Ended December 31, (in thousands, except per share and exchange rate data)					
	2003	2003	2002	2001	2000(2)	1999
	U.S.$(1)					
Income Statement Data:						
Total revenue	8,848,896	7,024,606	7,412,838	7,340,804	6,264,595	5,110,213
Operating income	2,171,747	1,724,019	1,625,678	1,312,374	802,658	796,180
Income before income taxes and extraordinary gain	2,238,002	1,776,615	1,107,698	1,068,757	1,012,869	980,347
Net income	1,356,776	1,077,063	508,614	581,136	615,732	601,001
Earnings per share(3)						
Basic	4.37	3.47	1.62	1.85	1.96	1.92
Diluted	4.36	3.46	1.62	1.85	1.95	1.90
Other Data:						
Weighted average number of shares outstanding(3)(4)						
Basic	310,781	310,781	313,016	314,309	314,423	313,815
Diluted	311,409	311,409	313,980	314,412	315,737	315,750
Balance Sheet Data:						
Total assets	7,968,692	6,325,865	5,608,463	6,195,604	5,618,971	4,826,889
Shareholders equity	4,672,788	3,709,445	2,872,091	3,109,513	2,517,081	2,559,355
Subscribed capital	397,327	315,414	314,963	314,826	314,715	267,805
Short-term bank loans and overdrafts	23,988	19,043	22,657	458,266	146,877	24,600
Long-term financial debt(5)	15,051	11,948	11,318	7,375	6,543	32,913

(1) Amounts in the column are unaudited and translated for the convenience of the reader at 1.00 to U.S.$ 1.2597, the Noon Buying Rate for converting 1.00 into dollars on December 31, 2003. See Exchange Rates for recent exchange rates between the euro and the dollar. Our auditors have not audited these converted dollar amounts.

(2) The 2000 figures have been adjusted for the effect of the change in the investment in Commerce One, Inc. (Commerce One) to the equity method. See Note 4 of Item 18. Financial Statements.

(3) Amounts are adjusted for our one-for-one conversion of preference shares to ordinary shares in 2001 and the three-for-one stock split in 2000.

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

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

Exchange Rates

The prices for ordinary shares traded on German stock exchanges are denominated in euro. Fluctuations in the exchange rate between the euro and the dollar will affect the dollar equivalent of the euro price of the ordinary shares traded on the German stock exchanges and, as a result, may affect the price of the ADSs in the United States. 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 for the ADSs requires the depositary to convert any dividend payments from euro into dollars as promptly as practicable upon receipt.

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

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

Year	Average[(1)]	High	Low	Period-End
1999	1.0588	1.1812	1.0016	1.0070
2000	0.9207	1.0335	0.8270	0.9388
2001	0.8909	0.9535	0.8370	0.8901
2002	0.9495	1.0485	0.8594	1.0485
2003	1.1411	1.2597	1.0361	1.2597

Month	High	Low	Period-End
2003			
July	1.1580	1.1164	1.1231
August	1.1390	1.0871	1.0986
September	1.1650	1.0845	1.1650
October	1.1833	1.1596	1.1609
November	1.1995	1.1417	1.1995
December	1.2597	1.1956	1.2597
2004			
January	1.2853	1.2389	1.2452
February	1.2848	1.2426	1.2441
March (through March 9, 2004)	1.2431	1.2088	1.2428

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

On March 9, 2004, the Noon Buying Rate for converting euro to dollars was U.S.$1.2428 per 1.00.

Dividends

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

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

Year Ended December 31,	Dividend Paid per Ordinary Share		Dividend Paid per Preference Share	
		U.S.$		U.S.$
1999	0.52	0.47(1)(4)	0.53	0.48(1)
2000	0.57	0.52(1)(4)	0.58	0.53(1)
2001	0.58	0.53(1)(4)	N/A	N/A
2002	0.60	0.69(1)(4)	N/A	N/A
2003 (proposed)	0.80(2)	0.99(2)(3)(4)	N/A	N/A

(1)

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

(2) Subject to approval of the Annual General Shareholders Meeting of SAP AG to be held on May 6, 2004.

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(3) Translated for the convenience of the reader from euro into dollars at the Noon Buying Rate for converting euro into dollars on March 9, 2004 of U.S.$1.2428 per 1.00. The depositary is required to convert any dividend payments received from SAP as promptly as practicable upon receipt. The dividend paid can actually differ due to changes in the exchange rate.

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

The amount of dividends paid on the ordinary shares depends on the amount of SAP AG profits to be distributed by SAP AG, which depends in part upon our performance. For years prior to 2001, a holder of preference shares was entitled to a cumulative annual preferred dividend which exceeded the annual dividend paid to holders of ordinary shares by an amount equal to 0.01 per preference share, but in no event less than a minimum dividend equal to 0.01 per preference share. The timing and amount of future dividend payments will depend upon our future earnings, capital needs and other relevant factors in each case as proposed by the Executive Board and the Supervisory Board of SAP AG and approved at the Annual General Shareholders Meeting.

Risk Factors

Substantial, prolonged declines in and slow or weak recovery of global technology and software markets in Europe, the Americas and Asia resulting from general adverse economic conditions may cause 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 investment have tended to vary due to economic or financial crises or other business conditions. Prolonged economic slowdowns or slow or weak economic recoveries may result in customers requiring us to renegotiate existing contracts resulting in less advantageous terms than those currently in place. A recession, slow or weak economic recovery or other difficulties in the economies where we license our products, including Europe, the Americas and Asia, 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 a prolonged economic slowdown in Europe or the U.S. because we derive a substantial portion of our revenue from software licenses and services in those geographic regions.

One important feature of our long-term strategy for growth is to increase our offerings for the small and mid-market segment. A recession, slow or weak economic recovery could inhibit the creation and financial strength of those businesses and thereby delay that element of our expansion.

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

To achieve customer acceptance, our new products and product enhancements can require long development and testing periods, which may result in delays in scheduled introduction. Generally, first releases are licensed after a validation process to a controlled group of customers. 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 generally devote significant resources working with 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 simultaneously to introduce a variety of new software products.

Although we test each new product and product enhancement release before introducing it to the market, there can be no assurance that significant errors will not be found in existing or future releases of SAP software products, with the possible result that significant resources and expenditures may be required in order to correct such errors or otherwise satisfy customer demands. In addition, the possibility cannot be excluded that customers may bring actions for damages, make claims for replacement of software, or demand other concessions from SAP. Significant undetected errors or delays in new products or product enhancements may affect market acceptance of SAP software products.

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We are subject to pricing pressure.

In response to competition, consolidation within the industries in which we operate and general adverse economic conditions, we have been required in the past, and may be required in the future, to furnish additional discounts to customers or otherwise modify our pricing practices. These developments have and may increasingly negatively impact our revenue and earnings. We generally license our products in individual software components or a suite of software components on a right to use basis pursuant to a perpetual license providing for an initial license fee based on the number and types of identified users or other applicable criteria. Subsequent maintenance fees are typically established based on a specified percentage of the initial license fee paid by the customer. Our customers typically prepay maintenance for periods of three to twelve months. Changes in our pricing model or any other future broadly-based changes to our prices and pricing policies could lead to a decline or delay in software sales and/or a decline or delay in maintenance fees as our sales force and our customers adjust to the new pricing policies.

We, together with certain business partners, offer certain SAP software products to small and midsize customers as a component of our hosted solutions or rental offerings, in which license and maintenance fees or rental payments may be paid to us on a per user, per month or similar subscription basis rather than an upfront license fee payment as under our standard pricing models. Our hosted solutions and rental programs have not generated significant revenues in 2003 and prior years. As part of our long-term strategy for growth, we expect that these programs will generate incremental revenue from small and midsize customers. There can be no assurance that such programs will be successful or, if successful, that they will not negatively impact our standard pricing models. The recent trend of outsourcing enterprise business applications or business processes could result in increased competition through the entry of systems integrators, consulting firms, telecommunications firms, computer hardware vendors and other application-hosting providers. We may be unable to offer an outsourcing model that customers demand, or competitors may offer better, lower priced or more desirable outsourcing models. In addition, the distribution of applications through application service providers may reduce the price paid for our products or adversely affect other sales of our products.

Terrorist attacks and risk of war or international hostilities could adversely impact our business.

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

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

The entire IT sector, including the software industry, is currently experiencing consolidation through mergers and acquisitions, particularly involving larger companies. Large companies continue to expand into related industries. Transactions in which we or our competitors participate could have a material adverse effect on us in a variety of ways, such as delaying sales due to customer uncertainty and subjecting us to competition from stronger established or new peer group companies with more resources, larger customer bases and a wider variety of products than we have.

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

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technology. Despite our efforts, 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 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 of certain countries do not protect our proprietary rights to the same extent as do the laws of the U.S. or Germany.

Some of our competitors may have been more aggressive than us in applying for or obtaining patent protection for innovative proprietary technologies.

Although we have been issued patents under our patent program and have a number of patent applications pending for inventions claimed by us, there can be no assurance that, in the future, patents of third parties will not preclude us from utilizing a 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. We expect that our software products 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. There can be no assurance that, in the future, a third party will not assert that our products violate its patents, copyrights or trade secrets. 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 or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

Our encryption technology may be breached or compromised.

We rely on encryption, authentication technology and firewalls to provide the necessary security for the 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, 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 or to alleviate problems caused by breaches.

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

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 believe that no one individual technology we license is material to our business, changes in or the loss of third party licenses could lead to a material increase in the costs of licensing or to SAP software products becoming inoperable or their performance being materially reduced, with the result that we may need to incur additional development costs to ensure continued performance of our products.

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

In 2003, we announced the introduction of SAP NetWeaver, our new, web-based technology and application platform. We have devoted a significant amount of resources to the development and marketing of SAP NetWeaver. SAP NetWeaver is a new and innovative solution serving as the basis of SAP s current product strategy. While all components of SAP NetWeaver are already released, we expect to release the complete SAP NetWeaver solution to reference customers by the end of March 2004. It represents a technological shift to a web-based, open platform design that we believe will make it easier for customers to link non-SAP software related data with SAP software. There are no assurances that customers will accept this technology change or that our competitors will not develop and market more effective technology platforms that better suit the needs of customers. Further, as with the introduction of any new product, there may be errors in the SAP NetWeaver component technology that might require the devotion of a substantial amount of resources to correct. SAP NetWeaver s failure to be accepted by customers, 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. 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.

Because our products are critical to the operations of our customers businesses, we could incur substantial costs as a result of warranty or product liability claims.

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

Although our agreements generally contain provisions designed to limit our exposure as a result of actual or alleged failures of SAP software products, the provision of services or application hosting or security features, 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.

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

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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 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. There can be no assurance that slow or weak economic recovery will not affect such third parties or partners or the products and services that they provide pursuant to the agreements with 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 the demand for our software products.

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 59.3% of our consolidated revenue in 2003 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.

Because a significant portion of our revenue is from countries other than EMU member states and denominated in currencies other than the euro, we have significant exposure to the risk of currency fluctuations, especially to fluctuations in the value of the dollar, the Japanese yen, the British pound, the Swiss franc, the Canadian dollar, and the Australian dollar. As of March 9, 2004, the Noon Buying Rate for converting euro to dollars was U.S.$1.2428 per 1.00 a sharp decrease in the value of the dollar relative to the euro compared to the Noon Buying Rate of December 31, 2002 of 1.0485 U.S.$.. Conversely, increases in the value of currencies relative to the euro may positively affect earnings, although such positive effects may be only short-term in nature.

We continually monitor our exposure to currency risk and pursue a company-wide foreign exchange risk management policy and may hedge such risks with certain financial instruments. However, 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.

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.

We continue to transform our suite of business applications to reduce the total cost of IT ownership for our customers and to allow our customers to better integrate heterogeneous systems. In addition we provide industry-specific business solutions. 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. Any such enhancements, solutions or services may not be successful in the marketplace or may not generate increased revenue. 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 offered by our competitors.

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

The software industry is intensely competitive. As part of our business strategy, we have focused our efforts in areas of our business where demand is expected to grow more rapidly. In particular, we have expanded our focus to include customer relationship management, supply chain management, technology integration platform solutions and the needs of small and medium sized businesses. Our expansion from the traditional large enterprise ERP product offerings exposes us to different competitors. Competition, with respect to pricing, product quality and consulting and support services, could increase substantially and result in price reductions, cost increases or loss of segment shares.

We compete with a wide range of global, regional and local competitors. Some of our competitors and many of our potential competitors are involved in a wider range of businesses, and some competitors and potential competitors have a larger installed customer base for their products and services, or have significantly greater financial, technical, marketing and other resources than we have, enhancing their ability to compete with us. There are many other companies engaged in the research, development and marketing of integrated web-based business solutions, standard business application software and associated applications development tools, decision support products and services. Some of these companies may develop (or may have already developed) an overall concept or individual product offering which may be perceived to be as good as or better than our product offerings.

New distribution methods (e.g. electronic channels) and opportunities presented by the Internet and electronic commerce have removed many of the barriers to entry to the segments in which we compete. Historically, most of our competitors provided solutions which covered certain functional areas offering the customer a software application product designed for a specific business or manufacturing process. Such products compete with individual functions offered by us. Our competitors have already broadened, or are implementing plans to broaden, the scope of their business activities. A competitor may be able to capitalize upon the success of a niche product by developing and marketing broader system applications in competition with us. Niche competitors may also benefit from alternative delivery systems, such as the Internet, to become more competitive with us.

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. In addition, we believe that competition will increase as a result of industry consolidations among potential customers of our products as well as among our competitors. It is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant segment shares. There can be no assurance that our strategies will prove to be successful or that our competitors strategies will not be more successful than ours.

We believe that our experience with business process applications, our increasingly flexible, component-based installation options and our focus on flexible, open standards technologies and industry solutions give us a strong competitive position. However, there can be no assurance that our strategies will prove to be successful or that our competitors strategies would not be more successful than ours.

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. In future periods, customers may not necessarily license additional products or contract for additional services or maintenance. After an initial term, maintenance is generally renewable annually at a customer s option, and there are no mandatory payment obligations or obligations to license additional software. If our customers decide not to renew their maintenance agreements or license additional products or contract for additional services, or if they reduce the scope of their maintenance agreements, our revenues could decrease and our operating results could be adversely affected.

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

From 2001 to 2003, our software revenue has decreased both in terms of absolute dollar value and as a percentage of total revenue while our maintenance revenue increased during the same period. Our service revenue increased from 2001 to 2002 but decreased from 2002 to 2003. Variances or slowdowns in our licensing activity may negatively impact our current and future revenue from services and maintenance since such services and maintenance revenue typically lag behind license fee revenue. In addition, growth in service revenue will depend on our ability to compete effectively in obtaining customer engagements to provide services related to SAP software products. Any decrease in the percentage of our total revenue derived from software licensing could have a material adverse effect on our business, financial position and results of operations or cash flows.

Customer implementation and installation 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 customer s own organization. We offer accelerated installation support and/or fixed fees for certain SAP software products installation projects. However, criticisms regarding these additional costs and protracted implementation times have been directed at us, and there have been, from time to time, shortages of our trained consultants available to assist customers in the implementation of our products. In addition, the success of new SAP software products introduced by us may be adversely impacted by the perceived time and cost to implement existing SAP software products or the actual time and cost to implement such new products. We cannot provide assurances that protracted installation times or criticisms of us will not continue, that shortages of our trained consultants will not occur or that the costs of installation projects will not exceed the fixed fees being charged by us.

Business process outsourcing may adversely impact our business

Some of our customers offer other companies business process outsourcing (BPO) services, which involve the transfer by end user customers of all of or significant portions of their internal processes to third-party BPO providers. Some or all of our existing end user customers and potential customers may decide to shift business process systems to BPO providers rather than continue to run these systems themselves, especially in the areas of human resources, finance, accounting and supply chain. The perception of value created by our products among end user customers could be diminished to the extent BPO providers bundle our applications with their services. While most of our revenues are currently derived from contracts directly with end user customers, a general trend to outsourcing business processes to BPO providers could have a material adverse impact on our revenues, earnings and results of operations.

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. Despite recent adverse economic trends, 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 to our clients demands. Such personnel in certain regions (including the U.S. and Europe) are in short supply. We expect continued increases in compensation costs in order to attract and retain senior managers and skilled employees, especially as the current weakened economy improves. Most of our current key employees are subject to employment agreements or conditions that (i) do not contain post employment non-competition provisions and (ii) in the case of most of our

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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.

Our internal risk management policies and procedures may not be sufficient for us to identify, analyze and respond appropriately in a timely manner.

We believe we have a system comprising multiple mechanisms across the SAP group to recognize and analyze risks early and respond appropriately. These mechanisms include recording, monitoring and controlling internal enterprise processes using internal reporting functions, a number of management and controlling systems and a planning process that is uniform throughout our group. We have created standard documentation of key business processes of SAP AG and its largest subsidiaries, which will be extended to all major subsidiaries in 2004. Further elements of the system include a corporate-wide Code of Business Practice which was formalized in 2003, our internal audit function, comprehensive published reports and the work of the Supervisory Board in monitoring and controlling the Executive Board. In early 2003, we created a central dedicated Corporate Risk Management function tasked to consolidate and enhance SAP s various existing risk management activities in accordance with a corporate-wide uniform methodology. SAP s Principles of Corporate Governance, ratified by our Supervisory Board at the end of 2001 and updated in August 2002 and March 2004, constitute a further component in the system. They comprise, among others, standards and guidelines for the work of the Executive Board and Supervisory Board, and for the cooperation between them. In addition, SAP promptly started to implement measures in accordance with the Sarbanes-Oxley Act, a U.S. law on corporate governance and financial reporting that came into effect on July 30, 2002. Amongst other measures, we established a Disclosure Committee, whose main task is to monitor the quality of information released to the financial markets. For further information on the measures we have undertaken relating to the Sarbanes-Oxley Act, please refer to Item 6. Directors, Senior Management and Employees and Item 15. Controls and Procedures.

Although we believe our risk management policies and procedures are sufficient, there is no guarantee that all risks will be identified, analyzed or responded to appropriately in a timely manner, especially those which are outside of our control.

Future changes in financial accounting standards regarding the accounting for stock based compensation may have an adverse effect on our reported results of operation.

As part of its convergence project, the Financial Accounting Standards Board (FASB) is currently reconsidering U.S. GAAP rules for stock-based compensation accounting in light of the recent standard issued by the International Accounting Standards Board that will require the expensing of all stock-based compensation awards. Changes requiring SAP to record stock-based compensation expense in the income statements for our employee stock options using the fair market value method would have a significant negative effect on our reported operating results. Changes to other existing accounting standards or the questioning of current accounting practices by the SEC, analysts, or the investing public may also adversely affect our reported financial results. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies.

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

Our financial statements are based upon the accounting policies as described in Note 3 of our consolidated financial statements and 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 operation or financial position. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies.

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

SAP is investing significant resources in further developing and marketing new and enhanced products and services. The areas of customer relationship management, supply chain management, technology integration solutions (including SAP NetWeaver) and solutions for the small and mid-market segment are expected to experience high growth rates. 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, the adoption of mySAP Business Suite solutions and newer offerings that allow greater levels of flexibility in software application and data utilization, particularly by those individuals and enterprises that have historically relied upon traditional means of commerce and communication, will require a broad acceptance of new and substantially different methods of conducting business and exchanging information. These products and services involve a new approach to the conduct of business and, as a result, we have invested in, and intend to continue to pursue, intensive marketing and sales efforts to educate prospective customers regarding the uses and benefits of these products and services in order to generate demand. Demand for these products and services may not develop, or SAP may not develop acceptable solutions in a timely or cost-effective manner. This could have a material adverse effect on our business, financial position and results of operations or cash flows.

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 under continuous review and is modified if we deem it necessary. Our goal of insurance coverage is to ensure that the financial effects, to the largest extent possible, resulting from risk occurrences are excluded or at least limited considering the costs associated with the insurance coverage. Despite these measures, it is possible that claims may have a significant adverse impact on our financial position or results of operations. Also, adequate insurance coverage may not be available to us at all.

Our sales forecasts may not be accurate.

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. We aggregate these estimates periodically in order to generate a sales pipeline. We compare the pipeline at various points in time to look for trends in our business. While this pipeline analysis may provide us with some guidance in business planning and budgeting, these pipeline estimates are necessarily speculative and may not consistently correlate to revenue in a particular quarter or over a longer period of time. A variation in the conversion of the pipeline into revenue or in the pipeline itself could cause us to improperly plan or budget and thereby adversely affect our business or results of operations. In particular, a slowdown in the economy may cause customer purchasing decisions to be delayed, reduced in amount or cancelled, which will in turn reduce the overall license pipeline conversion rates in a particular period of time.

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

We have a history of rapid growth and will need to effectively manage our future growth to be successful. In 2003, 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. Revenue on a per employee basis decreased from 2002 to 2003 by 8.0% from 252,361 to 232,211 and in average full time equivalents by 5.4% from 255,140 to 241,412. As such there can be no assurance that significant increases in employees and infrastructure will result in growth in revenue or operating results in the future. There can be no assurance that we can effectively retain and utilize our personnel, accurately forecast revenue and control costs, maintain and control adequate levels of quality of service (especially of our partners or other third parties) or implement and improve our operational and financial infrastructure.

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

In order to complement or expand our business, SAP has made and expects to continue to make acquisitions of additional businesses, products and technologies, and has entered into, and expects to continue to enter into, a variety of transactions, including alliance arrangements. Our current strategy for growth includes, but is not limited to, the acquisition of companies as a key element of future growth, especially acquisitions of smaller companies that specifically aim at strengthening our geographic reach, broadening our offering in particular industries, or complementing our technology portfolio. Management s negotiations of potential transactions, including acquisitions or alliances, and management s integration of acquired businesses, products or technologies could divert its time and resources. In addition, risks commonly encountered in such transactions include:

- inability to successfully integrate the acquired business;
- inability to integrate the acquired technologies or products with our current products and technologies;
- potential disruption of our ongoing business;
- inability to retain key technical and managerial personnel;
- dilution of existing equity holders caused by capital stock issuances to the stockholders of acquired companies or capital stock issuances to retain employees of the acquired companies;
- assumption of unknown material liabilities of acquired companies;
- incurrence of debt and/or significant cash expenditure;
- difficulty in maintaining controls, procedures and policies;
- potential adverse impact on our relationships with partner companies or third-party providers of technology or products;
- regulatory constraints;
- impairment of relationships with employees and customers; and
- problems with product quality, product architecture, legal contingencies, product development issues or other significant issues that may not be detected through the due diligence process.

In addition, acquisitions of additional businesses may require large write-offs of any in-process research and development costs related to companies being acquired and amortization costs related to certain acquired tangible and intangible assets. Ultimately, certain acquired businesses may not perform as anticipated, resulting in charges for the impairment of goodwill and/or other intangible assets. Such write-offs and amortization charges may have a significant negative impact on operating margins and net income in the quarter in which the business combination is completed and subsequent periods. In addition, we have entered and expect to continue to enter into alliance agreements for the purpose of developing new products and services. There can be no assurances 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.

Currency fluctuations may impact the value of our ADSs.

The currency in which our ordinary shares are traded is the euro. While the currency in which our ADSs are traded is the dollar, the trading price of our ADSs is expected to be largely based upon the trading price of the underlying ordinary shares in its principal trading market, the

Frankfurt Stock Exchange. Cash dividends payable to holders of ADSs will be paid to the depositary pursuant to the Amended and Restated Deposit Agreement

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between SAP AG and the depositary in euro and, subject to certain exceptions, will be converted by the depositary into dollars as promptly as practicable upon receipt for payment to such holders. The amount of dividends received by the holders of ADSs, therefore, will also be affected by fluctuations in exchange rates as well as by the specific exchange rate used by the depositary (which may incorporate fees charged).

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

The trading prices of the ADSs and the ordinary shares have experienced and may continue to experience significant volatility. The current trading price 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 other projections made by securities analysts could have an immediate and significant adverse effect on the trading price 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 individual companies operating performance. The trading price of the ADSs or the ordinary shares may fluctuate in response to such 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 competitors 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 analyst community;
- general market conditions specific to particular industries;
- general and/or country specific political conditions (particularly wars, terrorist attacks etc.); and
- proposed and completed acquisitions or other significant transactions by us or our competitors.

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

We may incur losses in connection with strategic and venture capital investments.

SAP has acquired and expects to continue to acquire equity interests in or makes advances to technology-related companies, many of which currently generate net losses. Such activities may individually and in the aggregate involve significant capital outlay. Most of these companies are recently established. It is possible that changes in market conditions, the performance of companies in which we hold investments or to which we made advances or other factors will negatively impact our results of operations and financial position or our ability to recognize gains from the sale of marketable equity securities. Additionally, due to changes in German tax laws in 2000 effective January 2001 (Steuersenkungsgesetz), capital losses or write-downs of equity securities are no longer tax deductible, which may negatively impact our effective tax rate, cash flows and net income going forward. See Item 4. Partnerships, Alliances and Acquisitions.

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

Our products and services are currently marketed in over 120 countries, with a focus on Europe, Middle East and Africa (EMEA), North and South America (Americas) and Asia-Pacific (APA) regions. In 2003, revenue derived from outside Germany totaled 5,354.3 million, representing approximately 76% of our total revenue. Sales in these regions are subject to risks inherent in international business activities, including, in particular:

- general economic or political conditions in each country;
- overlap of differing tax structures;
- management of an organization spread over various jurisdictions;
- exchange rate fluctuations; and
- regulatory constraints like export restrictions, governmental regulations of the Internet, additional requirements for the design and for the distribution of software and/or 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 manage effectively the increased level of international operations.

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

As of March 9, 2004, the beneficial holdings of SAP s principal shareholders (not counting immediate family members) and/or the holdings of entities controlled by them constituted in the aggregate approximately 34.568% of the outstanding ordinary shares of SAP AG. If SAP s principal shareholders and/or the holdings of entities controlled by them vote the shares held by them in the same manner, it may have the effect of delaying, preventing or facilitating a change in control of SAP or other significant changes to SAP 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.

As stated above, SAP s principal shareholders (not counting immediate family members) and/or related entities own beneficially approximately 34.568% of the outstanding ordinary shares of SAP AG as of March 9, 2004. The sale of a large number of ordinary shares by any of the principal shareholders and/or related entities could have a negative effect on the trading price of the ADSs or the ordinary shares. SAP is not aware of any restrictions on the transferability of the shares owned by the principal shareholders or any related entity.

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

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

Our sales are subject to quarterly fluctuations.

Our revenue and operating results can vary, 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;

the potential for delay of customer implementations of SAP software products;

changes in customer budgets;

seasonality of a customer s technology purchases; and

other general economic and market conditions.

As is common in the software industry, our business has historically experienced its highest revenue in the fourth quarter of each year, due primarily to year-end capital purchases by customers. Such factors have resulted in 2003, 2002 and 2001 first quarter revenue being lower than revenue in the prior year s fourth quarter. We expect to experience a similar trend of seasonality in the future and that our revenue will peak in the fourth quarter of each year and decline from that level in the first quarter of the following year.

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. We significantly increased in 2001 through 2003, and plan to continue to increase throughout 2004, the following expenditures depending on our results and outlook during 2004:

expenditures to fund continued development of our operations;

levels of research and development directed towards new products and product enhancements; and

development of new distribution and resale channels for small and midsize businesses.

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 operating results would be materially adversely affected and may vary significantly from preceding or subsequent quarters.

Increasing government regulation of the Internet could harm our business.

As the Internet commerce evolves, we expect that U.S. federal, U.S. State, German, European Union or other foreign governments will adopt laws or regulations covering issues such as taxation, user privacy, pricing, content and quality of products and services. For example, the United States Telecommunications Act sought to prohibit transmitting various types of information and content over the Internet. Several telecommunications companies have petitioned the U.S. Federal Communications Commission to regulate Internet service providers and other online service providers in a manner similar to long distance telephone carriers and to impose access fees on those companies. This could increase the cost of transmitting data over the Internet. Moreover, it may take years to determine the extent to which existing laws relating to issues such as property ownership, libel and personal privacy are applicable to the Internet. It is possible such laws or regulation could expose companies involved in electronic commerce to liability, which could limit the growth of electronic commerce generally. In addition, such regulation could weaken growth in Internet usage and decrease our acceptance as a communications and commercial medium. If enacted, these laws or regulations could limit the market for our products and services.

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

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

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We and our shareholders face certain risks related to our former employment of Arthur Andersen as our independent auditors.

Prior to May 3, 2002, Arthur Andersen served as our independent auditors. On May 3, 2002, we dismissed Arthur Andersen and retained KPMG as our independent auditors for the fiscal years ended December 31, 2002. On August 31, 2002, Arthur Andersen LLP, an affiliate of Arthur Andersen, ceased practicing before the SEC.

Arthur Andersen did not participate in the preparation of this report, reissue its audit report with respect to the consolidated financial statements included in this report, or consent to the inclusion in this report of its audit report. As a result, investors in SAP may have no effective remedy against Arthur Andersen in connection with a material misstatement or omission in the financial statements to which its audit report relates. In addition, even if such investors were able to assert such a claim, Arthur Andersen may fail or otherwise have insufficient assets to satisfy claims made by investors that might arise under Federal securities laws or otherwise with respect to its audit report.

SEC rules and regulations require us to present historical audited financial statements in various SEC filings, such as registration statements, along with Arthur Andersen s consent to our inclusion of its audit report in those filings. In light of the cessation of Arthur Andersen s SEC practice, we will not be able to obtain the consent of Arthur Andersen to the inclusion of its audit report in our relevant current and future filings. The SEC has provided regulatory relief designed to allow companies that file reports with the SEC to dispense with the requirement to file a consent of Arthur Andersen in certain circumstances, but purchasers of securities sold under our registration statements, which were not filed with the consent of Arthur Andersen to the inclusion of its audit report, will not be able to sue Arthur Andersen pursuant to Section 11(a)(4) of the Securities Act of 1933 and, therefore, their right of recovery under that section may be limited as a result of the lack of our ability to obtain Arthur Andersen s consent.

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

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

Item 4. *Information about SAP*

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

Availability of this Report

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

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Description of the Business

Overview

SAP is a leading provider of business software solutions, with headquarters in Walldorf, Germany and over 30,000 employees in more than 50 countries.

Our principal activities are the development, marketing, sales and support of a variety of software solutions, primarily enterprise application software products for organizations including corporations, governmental agencies, and educational institutions.

SAP solutions are designed to meet the demands of companies of all sizes from small via midsize businesses to global enterprises. The SAP NetWeaver open integration and application platform aims at reducing the complexity and total cost of ownership (TCO) of a customer s information technology landscape business process change and evolution. While SAP Business Suite solutions are helping enterprises around the world improve customer relationships, enhance partner collaboration, and create efficiencies across their supply chains and business operations. The core business processes of various industries, from aerospace to utilities, are supported by SAP s industry-specific solution portfolios. Today, more than 21,600 customers in over 120 countries run more than 69,700 installations of SAP software. With subsidiaries in more than 50 countries, the company is listed on several exchanges, including the Frankfurt Stock Exchange and NYSE under the symbol SAP.

SAP s total 2003 revenues decreased by 5.2% from 2002 to 7,024.6 million (2002: 7,412.8 million). Net income for 2003 increased by 111.8% to 1,077.1 million (2002: 508.6 million). In 2003, total revenues were derived as follows: sales of software products 2,147.6 million (30.6%), maintenance 2,568.8 million (36.5%), consulting services 1,953.5 million (27.8%), training services 299.3 million (4.3%), and other revenue 55.4 million (0.8%).

See Item 4. Information about SAP Description of the Business Revenue by Industry Sector and Note 34 to our consolidated financial statements for further details on revenues by industry sector.

Evolution of SAP s Solutions

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

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

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

During the 1990s, we introduced several solutions built on SAP R/3 to provide capabilities tailored to specific industries. In addition, we developed new solutions to address a variety of critical business issues, such as SAP Business Information Warehouse (SAP BW) for managing large quantities of data and SAP Advanced Planner and Optimizer (SAP APO) for managing supply and demand trends. Emerging customer needs also led us to create additional solutions.

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

In 2002, we renamed mySAP.com into mySAP Business Suite. mySAP Business Suite is a suite of powerful business solutions that help companies manage the entire value chain across business networks. mySAP Business Suite is designed to allow organizations to excel in a business environment that requires rapid adaptation to changing business conditions. SAP NetWeaver aims at lowering customers total cost of information technology (IT) ownership by allowing easy integration of key business processes.

In 2003, we announced SAP NetWeaver, our open integration and application platform. In addition, we announced the successor to SAP R/3 called mySAP ERP. mySAP ERP provides organizations with a complete enterprise resource planning solution that can be extended through the addition of other SAP solutions, for example: mySAP CRM, mySAP SCM and mySAP SRM. mySAP ERP is part of the mySAP Business Suite solution. In 2004 we intend to develop most of our SAP solutions on our SAP NetWeaver platform.

SAP s Strategy

SAP s business and product strategies have been designed to increase software license sales, segment share and profitability by offering solutions composed of software and services that enable the existing customer base and prospective new customers to increase business performance and flexibility. We expect to leverage our large customer base to generate revenues through licenses of additional software solutions, either individually by solution, or collectively as mySAP Business Suite.

Our product strategy is to extend the range of software applications and solutions that can deliver more value, faster implementation, and better integration, to meet the needs of core customers and reach new customer segments. As also discussed below, our solutions for small and mid-market segment are another area of anticipated growth for SAP.

One of the keys to our product strategy is the use of Enterprise Services Architecture (ESA), which SAP announced in January 2003. ESA represents an evolution towards a services oriented architecture. The architecture is designed to improve flexibility and reduce TCO. Based on open standards the architecture aims at enabling customers to integrate SAP and non-SAP solutions more quickly. In addition, it will extend the reach of our solutions to yet unsupported business processes. SAP NetWeaver is our open integration and application platform in order to realize an enterprise services architecture for our customers. SAP NetWeaver is described in detail below.

In the services area, SAP Customer Services Network (SAP CSN) offers consulting, education, active global support, hosting, and custom development services. The strategy is for SAP CSN to maintain 15%-20% of the overall SAP-related service revenues, with the remainder to be provided by SAP s global network of certified business partners. For that reason, SAP CSN focuses on the ramp up of SAP solutions, integration architecture and quality assurance.

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SAP intends to primarily pursue organic growth. In addition, as an element of our future growth we intend to acquire smaller companies to strengthen our geographic reach, broadening our offering in particular industries, and complementing our technology portfolio.

SAP Software Products

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

mySAP Business Suite

mySAP Business Suite is a suite of business solutions that aims at enabling companies to manage the entire value chain across business networks. Each solution is based on the SAP NetWeaver integration and application platform. As a result, mySAP Business Suite solutions allow companies to adapt quickly and remain flexible when faced with changing business conditions. In addition, mySAP Business Suite solutions aims at reducing TCO and managing a company s overall information technology infrastructure. Because of their flexible platform, mySAP Business Suite solutions may be deployed on a variety of computer hardware types and software operating systems.

mySAP Business Suite consists of the following SAP solutions:

mySAP Customer Relationship Management (mySAP CRM)

mySAP CRM helps organizations manage virtually every aspect of their relationships with customers. It includes a complete set of capabilities that help maximize the value delivered to and the value derived from customers throughout the customer interaction cycle.

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Key functions of mySAP CRM include support for sales, marketing, channel management, interaction center, and service management. In addition, mySAP CRM offers analytics that allow a company to leverage customer data for better and quicker business decisions. Through these capabilities, mySAP CRM continuously enhances an organization s ability to:

- identify and engage potential customers;
- perform business transactions with customers;
- fulfill individual customer needs as contracted; and
- provide after-sales care such as customer service and product maintenance.

mySAP ERP

mySAP ERP is an enterprise resource planning (ERP) solution that aims at enabling organizations to run their core business functions, including analytics, human resources, financials, operations, corporate services, and planning. mySAP Financials and mySAP Human Resources have been renamed to mySAP ERP Financials and mySAP ERP Human Capital Management, respectively. They are now part of mySAP ERP.

mySAP ERP addresses customer needs for an expandable enterprise resource planning environment. As such, it is available as an individual solution or as a part of mySAP Business Suite. Customers can upgrade from mySAP ERP to the full mySAP Business Suite either in a single step or incrementally as their business needs change. As a result, mySAP ERP offers an easy path to a comprehensive business solutions suite.

mySAP ERP runs on the SAP NetWeaver technology platform, as described below.

mySAP ERP Financials is a finance, analytics, and accounting solution that helps organizations process and interpret financial and business data, and handle financial transactions. In addition, it aims at an efficient management of profitability, business performance, and growth for organizations.

mySAP ERP Financials helps to gain organization-wide control over the business information that is essential to strategic and operational decision-making. This includes the ability to track financial accounting data within an international framework of multiple companies and organizations, languages, currencies, and books of accounts.

Key functional areas of mySAP ERP Financials include general ledger, special purpose ledger and subledger, cost management, and profitability analysis.

mySAP ERP Human Capital Management (mySAP ERP HCM) provides comprehensive tools to help an organization optimize its investment in its employees. It supports human resources professionals in managing employee capabilities down to the line-management level.

mySAP ERP HCM combines strategic human capital management features with workforce analytics. In addition, its employee transaction management capabilities aims at allowing a company to streamline a wide range of essential HR transactions and processes, including compliance with global regulatory requirements.

Key functional areas of mySAP ERP HCM include administration, payroll, benefits, legal reporting, online recruiting, blended learning, organizational management, compensation, manager self-services, employee collaboration, and workforce analytics.

mySAP Product Lifecycle Management (mySAP PLM)

mySAP PLM helps companies manage the complete life cycle of a product, from initial concept, to design and engineering, to production, to product change management and to service and maintenance. It allows companies and their suppliers to collaborate in such key processes as engineering, custom product development, and project, asset, and quality management.

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Key functional areas of mySAP PLM include life-cycle data management, life-cycle collaboration, program and project management, quality management, asset life-cycle management, and environmental health and safety.

mySAP PLM is particularly valuable to industries that require product innovation and rapid product development, such as high-tech, industrial manufacturing, construction, aerospace and defense, and automotive. Process, consumer products, and service industries can also benefit from the functions of mySAP PLM.

mySAP Supply Chain Management (mySAP SCM)

mySAP SCM helps companies manage materials, information, and finances along the entire supply chain, which encompasses the many processes involved in sourcing, manufacturing, and distribution. Supply chain management involves coordinating and integrating these processes both within an enterprise and among suppliers, customers, and business partners.

Key functions of mySAP SCM include supply chain planning, execution, collaboration, and coordination. Through these functions, mySAP SCM helps companies and their partners to easily view inventory levels, orders, supplier and customer allocations, forecasts, production plans, and key performance indicators so that they can work collaboratively toward an efficient supply chain. In addition, mySAP SCM supports fulfillment processes through availability checks, inventory management, and delivery. It also monitors the execution of supply chain activities, creating alerts in the event of deviation from plans. This helps a company to react quickly and remain flexible when faced with sudden changes in customer demand or production requirements.

mySAP Supplier Relationship Management (mySAP SRM)

mySAP SRM helps organizations manage their spending practices to achieve lower costs and higher profitability. It helps to connect suppliers through automated bidding and procurement processes. As a result, it offers immediate insights into spending trends while helping reduce the cost of goods and services organization-wide.

From strategy to execution, mySAP SRM covers the full supply cycle, helping organizations optimize supplier selection, increase collaboration, and compress purchasing cycle times. By standardizing key purchasing processes, mySAP SRM helps ensure that all buyers throughout the organization follow established rules and contract pricing guidelines.

mySAP SRM aims at a full integration with other procurement-related business processes, including supply chain management, product life-cycle management, customer relationship management, and ERP.

SAP R/3 Enterprise

SAP R/3 Enterprise is the last release of SAP R/3, succeeded by mySAP ERP. Standard maintenance will be provided until March 2009, extended maintenance will be provided until March 2012.

SAP Industry-Specific Solutions

Because different industries have different requirements and business processes, SAP has developed distinct industry-specific solutions that contain tailored versions of mySAP Business Suite solutions. These industry-specific solutions draw on SAP s extensive experience in serving the unique needs of each of these industries, and are frequently updated based on information derived through our close relationships with our customers and with various industry groups. We believe our focus on industry-specific solutions gives SAP a unique position in the marketplace over companies that offer generic business solutions.

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Our different industry solutions are grouped into six industry sectors as shown below:

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

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

Consumer Industries
- SAP for Consumer Products
- SAP for Retail

Services Industries
- SAP for Media
- SAP for Hospitality Services
- SAP for Logistics Service Providers
- SAP for Postal Services
- SAP for Railway Services
- SAP for Telecommunications
- SAP for Utilities
- SAP for Professional Services

Financial Services
- SAP for Banking
- SAP for Insurance
- SAP for Financial Service Providers

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

SAP NetWeaver

The technical foundation of our Enterprise Services Architecture is referred to as SAP NetWeaver. As discussed above, with it s integration and application platform it allows users to integrate and process business information from disparate sources in a variety of ways.

SAP NetWeaver incorporates the integration capabilities of today s flexible Web Services architecture and aims to be fully interoperable with two of the major development standards, Microsoft .NET and IBM WebSphere (J2EE). By doing so, SAP NetWeaver makes it easier for customers to link both non-SAP and SAP applications to work together. SAP NetWeaver also makes it easier for customers to evolve into a more flexible technology architecture while containing costs.

Through its ability to integration of data from different applications, SAP NetWeaver gives customers new ways of making use of all their current application investments while also allowing them to create new applications that are composed of components from older, pre-existing applications. For example, it brings together data from multiple SAP and non-SAP applications to be viewed through a Web-based portal. In addition, it enables analytical applications to gather the data from every other application and create a single, unified view for making better business decisions. SAP NetWeaver also aims at allowing the customer to organize multiple applications into an automated business process.

Because of its open platform design, we believe that SAP NetWeaver will permit customers to reduce the maintenance costs of all their IT systems. While all components of SAP NetWeaver are already released, we expect to release the complete SAP NetWeaver solution to reference customers by the end of March 2004. Sales for SAP NetWeaver alone are not expected to be significant as it is a value-added component of our products, and the majority of our existing customers will receive SAP NetWeaver as an upgrade to their current software packages. But SAP NetWeaver will make it easier for customers to upgrade older SAP applications and implement new ones.

SAP NetWeaver currently includes the following components:

SAP Business Intelligence (SAP BI)

SAP Business Intelligence is an information and knowledge management component that includes a business intelligence platform, a comprehensive set of data management tools, and data warehousing capabilities. It enables organizations to access, analyze, and disseminate relevant and timely information. Key features of SAP Business Intelligence include data warehousing, online analytical processing of information, report design and creation, and performance management.

SAP Enterprise Portal (SAP EP)

SAP Enterprise Portal is a Web-based gateway solution that brings together collaboration, knowledge management, and relevant content by integrating diverse information, applications, and services. The solution aims at allowing a user to access from one location many types of company-wide information, including SAP applications, third-party applications, databases, data warehouses, desktop documents, and Web content and services. SAP Enterprise Portal is designed to improve collaboration, speed information sharing, enhance availability of information for decision making and boost employee productivity. SAP Enterprise Portal includes patented technology that allows users to work with information from different sources. Drag and relate capabilities are designed to allow users to access, interconnect, update, edit, and delete information in multiple software applications and data sources without restrictions resulting from different technologies.

SAP Exchange Infrastructure (SAP XI)

SAP Exchange Infrastructure provides open integration technologies that support SAP and non-SAP software components working together, whether those solutions are being run by the same or different organizations.

SAP Mobile Infrastructure (SAP MI)

SAP Mobile Infrastructure is the foundation for all SAP solutions for mobile business. It provides an open and secure platform that permits mobile computing users to access software and data in either connected or disconnected mode.

SAP Master Data Management (SAP MDM)

SAP Master Data Management is a standardized offering designed to solve the challenges of data integration from multiple systems, physical locations, and vendors. SAP Master Data Management helps achieve information integrity across a network of suppliers and customers by allowing companies with different IT systems, including different software systems, to consolidate, harmonize, and centrally control data.

SAP Web Application Server (SAP Web AS)

SAP Web Application Server is the application platform of SAP NetWeaver. It is designed to allow an organization to gain more value from its existing IT assets by permitting the organization to deploy flexible solutions and develop new applications based on existing applications. It also facilitates the creation of Web-based services. This flexibility supports the exchange of data between different organizations, and the creation of business applications and processes that incorporate solutions from multiple entities IT systems with which the customer interfaces in its business.

SAP Solutions for Small and Mid-Market Segments

SAP provides a broad range of business solutions for the small and mid-market segments. In general, the combination of certain criteria such as:

- company revenue;
- the number of employees;

standardized versus more sophisticated solutions; and

level of desired partner involvement

will determine the solutions and channel by which our customers purchase and implement SAP solutions. The boundaries of these market segment definitions vary from country to country on a relative scale.

The small business market segment is served through a network of approved SAP business partners. Two families of solutions fall under this initiative: mySAP All-in-One and SAP Business One. Both offerings provide integrated application packages that are designed for quick implementation and priced for the small and mid-market segments. They are targeted primarily to independent small and midsize businesses, but are also of interest to subsidiaries of larger corporations in which the corporate applications are from SAP.

The mid-market segment includes two sub-segments: First, at the lower end, are those companies that require pre-packaged business solutions. These companies are served through a network of approved SAP business partners selling the mySAP All-in-One and SAP Business One solutions. Second, at the higher end of the mid-market segment, are those companies that require more sophisticated mySAP Business Suite solutions, which are delivered through SAP s direct sales and support organization.

SAP also collaborates with partners such as IBM, HP, American Express, and Dell, leveraging the distribution models of these companies to extend the customer and channel reach of mySAP All-in-One and SAP Business One solutions worldwide.

SAP solutions for the small and mid-market segments range in scope from mySAP Business Suite to SAP Business One:

mySAP Business Suite

Many mid-market organizations find that mySAP Business Suite offers scalable solutions that fit their requirements and budgets. These organizations are served through the SAP direct sales organization.

mySAP All-in-One

mySAP All-in-One solutions are software applications created and delivered through a network of approved SAP business partners. These solutions meet the needs of companies that require a high degree of industry-specific functionality. mySAP All-in-One solutions are based on components of mySAP Business Suite solutions and incorporate pre-defined business process knowledge that can be tailored to the specific needs of a customer. There are currently over 350 mySAP All-in-One certified solutions available worldwide.

SAP Business One

SAP Business One is an easy-to-use business automation software solution that aims at enabling emerging businesses to streamline their operational and managerial processes and gain better control of their organizations. Through its intuitive user interface, SAP Business One helps delivering on-demand access to critical real-time information. In addition, it supports standard horizontal (non-industry specific) business processes such as financial management, warehouse management, purchasing, inventory management, payment, and sales force automation. SAP Business One targets organizations with up to 250 employees. SAP Business One is based on the technology gained through SAP s 2002 acquisition of TopManage.

SAP xApps

In 2002 we announced a new breed of applications. SAP xApps composite applications deliver advanced business practices in applications that are easy to implement and that are built on existing software applications. SAP xApps are designed for SAP NetWeaver.

The first SAP xApps introduced was SAP xApp Resource and Program Management (SAP xRPM). SAP xRPM is a comprehensive project portfolio management application that aims at synchronizing information and processes from project, human resources, financial, and time-tracking systems both SAP and non-SAP.

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Other SAP xApps currently available include SAP xApp Emissions Management (SAP xEM) and SAP xApp Product Definition (SAP xPD). Certified partners can develop certain xApp solutions.

SAP Solutions for Mobile Business

SAP Solutions for Mobile Business allow users of SAP s solutions to access various SAP mobile business software applications beyond desktop PCs and wire-bound networks. The foundation of mySAP Mobile Business is a technology platform that enables this mobility. Online functionality enables users to deploy SAP solutions for mobile business inside a company through a wireless local area network or outside the company through wide-area mobile data networks. Off-line functionality allows applications to function locally so employees can use mobile devices such as smart phones and personal digital assistants without a network connection.

The two key functional areas of SAP solutions for mobile business are mobile access and mobile applications. Mobile access can be provided through all popular devices in both wired and wireless formats. SAP solutions for mobile business also provides mobile applications based on SAP s industry solutions and is designed to support industry-specific requirements.

Packaged Solutions

SAP packaged solutions comprise predefined combinations of applications, components, services, and content aimed at solving a specific business issue. They feature tightly scoped and limited-risk implementation, and are designed to mitigate risk and deliver faster return on investment.

SAP packaged solutions are delivered by SAP Consulting or SAP services partners, using accelerated implementation methodologies to help customers achieve a quick return on investment.

SAP Customer Services Network

In addition to its software solution portfolio, SAP provides comprehensive service offerings such as consulting, custom development, education, hosting, and support services in SAP Customer Services Network (SAP CSN). Delivered by SAP and its partners, these services focus on customers unique business requirements. SAP Customer Services Network helps customers to optimize benefit, cost and return on SAP and related IT investments.

As of December 31, 2003, 12,713 employees were providing consulting, support, and training services.

SAP CSN includes the following business areas:

SAP Consulting

SAP Consulting offers consulting, implementation, and optimization services to minimize risk and maximize return on an organization s investment in SAP software.

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

SAP Consulting covers:

- strategic consulting services to ensure that an organization s IT infrastructure supports its business goals;
- solution delivery services to get software up and running quickly and cost-effectively;
- operations services to enable solutions to grow and adapt with changing customer needs; and
- life-cycle management services to cover every phase of deploying and operating a customer s solution.

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SAP Education

SAP Education provides training required for SAP customers and partners to maximize the benefits attained from SAP systems. SAP Education services include assessment, education delivery, testing and certification, and continuous improvement.

SAP Education s curriculum includes more than 280 different courses, offered at more than 80 training centers worldwide, and onsite at customer locations.

SAP Active Global Support

SAP Active Global Support offers a broad range of services to cover planning, implementation, operations, upgrades, and continuous improvement.

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

Once a customer s SAP solution is up and running, support and maintenance continue with help-desk services, online monitoring, remote maintenance, and on-site assistance. SAP Active Global Support can help customers spot bottlenecks, plan resources, and migrate to new releases and technologies.

SAP Custom Development

SAP Custom Development (formerly known as SAP Global Custom Development Services) aims at delivering custom designed solutions to solve our customers unique business needs. The service portfolio includes not only full-scale custom development projects, but also spot-services such as custom development strategic planning, project management, and quality and risk assessment services for those customers that may already have development teams at hand. The services portfolio also includes continuous improvement services like maintenance to ensure the long-term health of our customers custom-developed solutions, as well as SAP Modification Clearing for those customers ready to remove existing software modifications as they move to newer releases of SAP software.

SAP Hosting

SAP Hosting allows organizations to move to SAP software solutions quickly, easily, and cost effectively. Its services include:

Application hosting: Provides infrastructure, implementation, operational, and ongoing support for selected applications that can be accessed by the customer through a Web browser.

Marketplace hosting: Includes hosting of marketplaces, private exchanges, auction sites, and specific, customized applications.

Application service provisioning (ASP) solutions: Combine software, infrastructure, service, support, and rapid implementation for turnkey solutions. These are delivered to customers as services from a single provider. With ASP solutions, customers do not obtain a perpetual license, but subscribe to the application service for a periodic fee.

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 2003, 2002 and 2001 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.

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Revenue by Geographic 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 South America, and Asia-Pacific, which represents Japan, Australia and parts of Asia. We allocate revenue amounts to the region in which the customer is located. See Note 34 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:

	2003	2002	2001
		(in millions)	
Germany	1,670.3	1,654.1	1,468.7
Rest of EMEA	2,299.6	2,394.1	2,317.5
Total EMEA	3,969.9	4,048.2	3,786.2
United States	1,736.4	1,969.7	2,084.1
Rest of Americas	479.8	531.9	640.0
Total Americas	2,216.2	2,501.6	2,724.1
Japan	441.5	485.9	444.1
Rest of Asia-Pacific	397.0	377.1	386.4
Total Asia-Pacific	838.5	863.0	830.5
Total revenue	7,024.6	7,412.8	7,340.8

EMEA. In recent years EMEA was the source of SAP s strongest revenue growth, but in 2003 revenue growth stalled in that region. In Germany, SAP s home country, where double-digit growth percentages were achieved in the past, economic conditions were particularly difficult in 2003, and revenue increased only slightly, by 1% to 1,670.3 million from 2002. Quarterly revenues in Germany were also uneven during 2003. For the first three quarters, revenues in Germany were lower in 2003 than for each corresponding quarter in 2002, whereas revenues in the fourth quarter of 2003 were up 4% as compared with the fourth quarter of 2002. Approximately 56.5% of our 2003 total revenue was derived from the EMEA region compared to 54.6% in 2002. Approximately 42.1% of revenue for the EMEA region in 2003 was derived from Germany compared to 40.9% in 2002. The remainder of the revenue for the EMEA region in 2003 was derived primarily from the United Kingdom, Switzerland, France, Italy and the Netherlands. The number of our employees in the EMEA region increased by 3.4% from 19,760 at December 31, 2002 to 20,428 at December 31, 2003. In Germany, the number of our employees increased by 3.6% to 13,475 at December 31, 2003 compared to 13,002 at December 31, 2002. See Item 6. Directors, Senior Management and Employees Employees.

Americas. Approximately 31.5% of our 2003 total revenue was derived from the Americas region compared to 33.7% in 2002. Revenues declined from 2002 to 2003 by 11.4% to 2,216.2 million. Revenue from the United States in 2003 was 1,736.4 million, representing approximately 78.3% of SAP s total revenue for the Americas

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region compared with 1,969.7 million and 78.7% of SAP s total for the Americas region for 2002, a decline of 11.8%. Exchange rate fluctuations in favor of the euro had a particularly strong negative impact on revenue figures for the Americas region. SAP s United States subsidiary reflected a 5% revenue growth figure on a constant currency basis. The 9.8% annual revenue decline in the remaining Americas regions from 2002 to 2003 also resulted primarily from currency translation effects. On a constant currency basis, SAP s revenue for the Americas region excluding the U.S. increased 8% from 2002 to 2003. The non-U.S. countries of the Americas region recorded total revenues of 479.8 million, a 9.8% decrease from 2002. Most non-U.S. revenue for the Americas region was derived from Canada, Brazil, Mexico, Venezuela and Colombia. The number of employees in the Americas region decreased by 4.2% from 6,345 at December 31, 2002 to 6,080 at December 31, 2003.

Asia-Pacific. Approximately 11.9% of our 2003 total revenue was derived from the Asia-Pacific region, compared to 11.6% in 2002. In 2003, SAP s revenue for the Asia-Pacific region was derived primarily from Japan, Australia, Singapore, India, South Korea and Malaysia. Our revenue in the Asia-Pacific region decreased from 2002 by 2.8% to 838.5 million in 2003. Revenue attributable to Japan decreased 44.4 million, or 9.1% from 485.9 million in 2002 to 441.5 million in 2003, and accounted for more than half of total revenues in the Asia-Pacific region. Exchange-rate fluctuations were a substantial factor in the revenue decline in Japan from 2002 to 2003. On a constant currency basis, revenues derived in Japan were essentially unchanged from 2002 to 2003. In the rest of the Asia/ Pacific region, total revenue increased 5.3% from 2002 to 2003 (16% increase on a constant currency basis) In the Asia-Pacific region, the number of employees increased by 14.5% from 3,269 as of December 31, 2002 to 3,743 as of December 31, 2003, which is mainly due to the expansion of our research and development facilities in India and China.

Software Revenue by Solution

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

	2003	2002	2001
		(in millions)	
mySAP SCM	477.1	464.0	582.9
mySAP CRM	440.1	473.0	444.9
mySAP PLM	156.1	168.0	196.0
mySAP BI/mySAP Enterprise Portals/ mySAP SRM/mySAP Marketplaces	273.1	259.0	415.9
mySAP Financials/ mySAP Human Resources	801.2	927.0	940.8
Total software revenue	2,147.6	2,291.0	2,580.5

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Revenue by Industry Sector

We identified six industry sectors in order to focus our product development efforts on the key industries of our existing and potential customers and to provide best business practices and specific integrated business solutions to those industries. We allocate our customers at the outset of an initial arrangement to an industry. All subsequent revenues from a particular customer are recorded under that industry sector for that customer. The following table sets forth the total revenues attributable to each industry sector for the years ended December 31, 2003, 2002 and 2001.

	2003	2002	2001
		(in millions)	
Process Industries	1,381.3	1,537.0	1,524.3
Discrete Industries	1,659.4	1,764.1	1,807.5
Consumer Industries	1,243.8	1,299.7	1,186.8
Service Industries	1,664.5	1,765.9	1,849.8
Financial Services	474.1	514.8	448.2
Public Services	601.5	531.3	524.2
Total revenue	7,024.6	7,412.8	7,340.8

Despite currency effects and the difficult economy in 2003, total revenue from the public services sector increased 13.2% from 2002. In an environment impacted by significant exchange-rate fluctuations, revenue from all other sectors declined from 2002 to 2003.

Revenue from the process industries sector declined the most, resulting in an overall decline of that sector s revenue compared to total revenue by approximately 1%. As in 2002, the service and discrete industries sectors generated the most revenue in 2003.

Sales, Marketing and Distribution

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

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

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 e-business solutions to the implementation of our software products to project management and end-user training for customers and, in the case of certain hardware and software suppliers, to technology support.

SAP s marketing efforts cover large, multinational groups of companies as well as smaller and midsize companies. 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. Solutions such as the mySAP Enterprise Portal 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.

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Partnerships, Alliances and Acquisitions

Partnerships and strategic alliances are a key element of broadening the solutions and services offered to SAP customers. SAP s close collaboration with partners across the life cycle of a customer solution is a key element in enhancing customer satisfaction. We characterize our partnerships and strategic alliances into eight categories that together constitute what we refer to as the SAP Partner Services Network. Within most categories, our partners may achieve the status of a local or global partner. We expect our alliance partners to provide customers with joint strategic solutions. Our partners generally have a strong position in a particular line of business or cross-industry and complement the range of SAP solutions in these areas. The partner categories are: Services Partners, Technology Partners, Software Partners, Hosting Partners, Business Partners, Content Partners, Education Partners and Support Partners. Our partner network includes more than 1,500 companies across all partner categories.

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

In 2001, we acquired the assets of TopTier, Inc. (TopTier) for approximately U.S.$ 379 million in cash excluding cash acquired. See Note 4 of Item 18. Financial Statements, for more information on the acquisition of TopTier. TopTier, which was renamed SAP Portals, Inc., specializes in technologies for creating enterprise portals. During 2002, SAP Portals and SAP Markets (another sub-group of SAP) and their subsidiaries were reintegrated and merged with and into SAP AG and certain subsidiaries of SAP AG.

As discussed in Note 36 to our consolidated financial statements in Item 18. Financial Statements, our strategic alliance with Commerce One expired, although certain terms of the strategic alliance agreement, which was entered into in 2000, as amended, survived expiration. The strategic alliance was focused on jointly delivering next-generation e-business marketplace solutions for the Internet economy. The agreement was amended in September 2003 to provide for various support and transition efforts in connection with the expiration.

Our shareholdings in Commerce One were not impacted by the expiration of the strategic alliance agreement. Under the terms of the strategic alliance agreement that are still effective, SAP AG has certain registration rights and pro-rata rights to purchase additional shares of Commerce One s common stock in the future, as well as the right to have a representative of SAP appointed to Commerce One s board of directors. We have also agreed to certain limitations on our ability to transfer our shares of Commerce One common stock, our ability to acquire more than 23% of Commerce One s outstanding common stock or to attempt to acquire Commerce One in a transaction not approved by Commerce One s board of directors. The carrying value of our investment in Commerce One was zero as of December 31, 2003 and 2002 as a result of the recognition of an other than temporary impairment charge and the continued application of the equity method of accounting in 2002. See additional discussion under Note 4 and 16 of Item 18. Financial Statements, and Item 5. Operating and Financial Review and Prospects Operating Results.

We are not aware of any public takeover offers by third parties in respect of our shares that have occurred in either the last or the current financial year. On March 23, 2004 we announced our intention to bid for all the shares not currently owned by us of SAP Systems Integration AG (SAP SI), our 70.3% owned subsidiary at a purchase price per share of 20.40. If all the shares not already owned by us are tendered in the offer, we expect the total purchase price for those shares together with costs associated with the transaction to be approximately 230 million. The offer is expected to be completed in the first half of 2004. We believe the acquisition of the additional shares will allow us to strengthen our global capabilities for IT-strategy consulting offerings. In 2003 and through March 23, 2004 we did not make a public takeover offer in respect of any other company s shares other than in respect of SAP SI. Part of our strategy involves growth through acquisitions and other transactions. We routinely evaluate various alternatives and engage in discussions and negotiations with potential parties to such transactions.

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Intellectual Property, Proprietary Rights and Licenses

We believe that none of the individual patent 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 embedding those technologies into our products or reselling to our customers.

We have and continue to license numerous third party software products that we incorporate into our existing products. The termination rights and term of these agreements vary. We try to protect us 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 in maintenance after termination, the right to distribute the then-current software release for a certain period of time after termination and the right to transfer the relevant intellectual property to SAP if we desire. In many cases we agree on an escrow for the term of the agreement to allow us to provide maintenance in case we are unable to retain it from the third party licensor.

Organizational Structure

As of December 31, 2003, SAP AG was the holding company of 96 subsidiaries whose main task is the distribution of SAP s products and services on a local basis. Our primary research and development facilities, the overall group strategy and the corporate administration functions are concentrated at our headquarters in Walldorf, Germany.

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

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

Description of Property

Our principal executive, administrative, marketing and sales, consulting, training, customer support and research and development facilities are located in Walldorf and St. Leon-Rot, Germany, approximately 60 miles south of Frankfurt/ Main. We commenced major expansions at these locations in 2000 and finished those enhancements in 2003 involving capital expenditures of 129 million through 2003. This expansion resulted in additional 240 thousand square feet or approximately 955 workplaces in St. Leon-Rot and 192 thousand square feet or approximately 1,215 workplaces in Walldorf.

In addition, during 2001, we expanded our data center in St. Leon-Rot involving capital expenditures of 62 million. The expansion added 172 thousand square feet necessary for running SAP s own IT system and IT equipment required to provide customer services such as support services. This expansion did not add material workspace for employees. Currently, we believe we have enough capacity in this data center for the next 5 years.

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We commenced major expansions at our owned research and development facility in Bangalore, India during 2003. During 2003 we increased capacity at the facility by 750 workplaces. Additional expansion is expected to be finalized by June 2004 that will result in an additional 400 workplaces. Together the expansions are expected to add 79 thousand square feet and involve capital expenditures of approximately 20.4 million in the aggregate, 2.1 million for the land and 18.3 million for the building. Depending on demand and growth, we can add additional workspace in later modular phases if necessary. We own sufficient undeveloped land to expand the facilities by up to 4,000 workplaces.

We own property in Newtown Square, Pennsylvania, which we use as our U.S. headquarters for the Americas and for regional operations for administration, marketing, sales, consulting, training, customer support and research and development. We own or lease sufficient undeveloped land to expand the facilities in Newtown Square. See Note 31 Other Financial Commitments of Item 18. Financial Statements, for details on an agreement to sell a portion of the United States headquarters property in Newtown Square, Pennsylvania.

We have financed all expansions through working capital and existing credit facilities described herein under Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

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

The location of each of our other facilities in excess of 40,000 square feet, all of which are leased (unless otherwise indicated), is set forth below:

Country, City	Facility Description
Austria, Vienna	Sales, consulting, training, marketing and customer support
Belgium, Brussels	Sales, consulting and training
Brazil, São Paulo	Sales, consulting and training
Bulgaria, Sofia	Sales and development
Canada, Toronto, Ontario	Sales, consulting, training and marketing
Czech Republic, Prague	Sales, consulting and training
Denmark, Copenhagen	Sales, consulting, training and customer support
France, Paris	Sales, consulting, training and marketing
Germany, Dresden	Consulting and customer support
Germany, Freiberg	Consulting
Germany, Munich	Research and development, sales and consulting
Germany, Hamburg	Sales, consulting and training
Germany, Bensheim	Sales and consulting
Germany, Ratingen	Sales and consulting
Germany, St. Ingbert (owned)	Research and development, sales and consulting
Germany, St. Leon-Rot (owned)	Research and development and customer support
Hungary, Budapest	Sales, consulting, training and customer support
India, Bangalore (owned)	Research and development
Ireland, Dublin	Customer support
Italy, Milan	Sales, consulting and training
Japan, Tokyo	Sales, marketing and training
Mexico, Mexico City	Sales, consulting, training and customer support
The Netherlands, s-Hertogenbosch	Sales, consulting and training
Portugal, Lisbon	Sales and consulting
Singapore, Singapore	Sales, customer support and research and development
South Africa, Johannesburg	Sales, consulting, training, customer support, research and development
Spain, Madrid	Sales, consulting, training, research and development and customer support
Sweden, Stockholm	Sales, consulting, training, marketing and customer support
Switzerland, Biel (owned)	Sales and marketing
Switzerland, Regensdorf	Training
United Kingdom, Feltham (owned)	Sales, consulting, training and customer support
United Kingdom, Hayes	Training
United States, Palo Alto, California	Research and development, sales and consulting
United States, Waltham, Massachusetts	Sales, consulting and training
United States, Chicago, Illinois	Sales, marketing, consulting, training and research and development
United States, Newtown Square	Sales, consulting, training, research and development and customer support
United States, Foster City, California	Training
United States, Atlanta, Georgia	Sales, marketing, consulting and training

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

Capital Expenditures

SAP s capital expenditures for intangible assets and property, plant and equipment, were 275 million for the year ended December 31, 2003, 309 million for the year ended December 31, 2002 and 378 million for the year ended December 31, 2001. Principal areas of investment during 2003 related to construction of buildings,

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primarily in Germany and India, and to the purchase of computer hardware to support ongoing increases in employees and global operations. During 2004, we expect to spend approximately 100 million for the purchase of computer hardware and other business equipment and approximately 61 million to fund the construction of additional facilities. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources and Note 34 to our consolidated financial statements in Item 18. Financial Statements, for further details regarding capital expenditures, including information about capital expenditures by geographic region.

Item 5. ***Operating and Financial Review and Prospects***

Overview

For the year ended December 31, 2003, our revenue and income before income taxes, minority interests and extraordinary gain were approximately 7,024.6 million and 1,776.6 million, respectively, as compared to 7,412.8 million and 1,107.7 million, respectively, for the year ended December 31, 2002. Net income was 1,077.1 million and 508.6 million for the years ended December 31, 2003 and 2002, respectively. SAP consists of SAP AG and our network of 96 operating subsidiaries and has a presence or a representation in over 120 countries.

We operate worldwide and define the following three geographic regions: EMEA, the Americas and Asia-Pacific. We have three lines of business that constitute our reporting segments: products, consulting and training. Furthermore, SAP focuses on six industry sectors, namely process, discrete, consumer, service, financial and public services. For a discussion of our geographic regions and industry sectors, see Item 4. Information about SAP Description of the Business Revenue by Geographic Region, Revenue by Industry Sector, SAP Strategy mySAP Business Suite and Note 34 to our consolidated financial statements included in Item 18. Financial Statements.

SAP s principal sources of revenue are sales of products and services. Product revenue consists primarily of software license fees and maintenance fees. License fees are derived from the licensing of SAP software products to customers. SAP provides optional maintenance for a fixed percentage calculated on the basis of the initial license fee paid by the customer. Maintenance entitles the customer to updates, upgrades and enhancements through new product releases, versions and correction levels, telephone support on the use of the products and assistance in resolving problems, remote support, access to online bulletin board support services as well as a world-wide remote monitoring and diagnostics service for SAP solutions. Our service revenue consists of consulting and training revenue, which is derived primarily from the services rendered with respect to implementation of our software products and training of customer project teams and end-users, as well as training third-party consultants with respect to SAP software products.

The following discussion is provided to enable a better understanding of our operating results for 2003, including:

- key factors that impacted our performance during 2003;
- discussion of our operating results for 2003 and 2002; and
- our outlook for 2004, including certain risks that may impact us.

This executive summary 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

Signs of worldwide economic recovery

For the global economy, 2003 was not as good as many had anticipated. Actual world economic growth was lower than expected. At the end of 2002, the World Bank forecasted overall economic growth of 2.5% for 2003. In September 2003, the World Bank revised that estimate to an even 2%. Likewise, the Organization for Economic Co-operation and Development (OECD) initially forecasted 1.8% growth for the euro zone in 2003, but later downgraded its expectations and in February 2004 published a final growth rate for the euro zone of just 0.4%.

Global development was hampered in the first few months of 2003 by the war in Iraq, the SARS outbreak, and other factors, but general economic production in the industrialized nations began to rise in the second quarter of 2003. However, growth was uneven. The U.S. led the improvement with a consumer-fueled recovery. Capital spending in the U.S. only began to increase toward the end of 2003.

After more than a decade of recession, the Japanese economy experienced a long-awaited recovery. According to the OECD, the Japanese economy benefited in particular from a better investment climate in the process industries and the positive development of neighboring economies. In contrast, the economy of the euro zone remained relatively stagnant. In their expert report published in the fall of 2003, the six leading German institutes for economic research predicted zero gross domestic product (GDP) growth for Germany in 2003.

IT market bottoms out

The global IT market moved in parallel with the overall economy, and industry analysts also lowered their forecasts over the course of the year. SAP assumes that the reluctance to invest in IT, which emerged in 2002, continued into 2003 and many companies cut their IT budgets during the year and lowered the average volume of their IT investments as they had done in 2002.

Industry analysts had varying opinions on the growth of the IT industry but there was a general tendency toward restraint in their forecasts for 2003. This restraint was inspired primarily by developments in Europe and Japan. International Data Corporation (IDC) analysts revised their figures downward; while in April 2003 they expected worldwide IT spending to grow 2.3% in 2003, they adjusted this figure to just 1% in July 2003. Forrester Research also lowered its growth estimate from 1.9% to 1.3% in the middle of 2003.

According to a survey by AMR Research of 200 IT decision-makers, IT spending rose again in the second half of the year in the U.S.. In the third quarter for example, IT spending was up 4.3% over the previous year. IT decision-makers in the U.S. responded skeptically in a Merrill Lynch survey in the third quarter of 2003. Survey respondents indicated that spending on IT had stabilized in 2003 but would not increase noticeably in the short term.

Based on IT spending in the first six months of 2003, IDC estimated growth of 8.6% for 2003 in the Asia/Pacific region, excluding Japan. IDC predicted that Japanese IT investment would decline 1%. IDC also reduced its forecast for Western Europe during the course of the year. In April, they had estimated that IT spending in western Europe would grow 2% in 2003, but by July they predicted less than 1% growth for the year. The European Information Technology Observatory (EITO) forecast that revenue would fall 0.7% in 2003. And the German Association for Information Technology, Telecommunications and New Media (BITKOM) estimated zero growth for Germany in 2003.

Over the course of the year, there were more and more indicators of hesitant recovery in the IT industry. After three years of restrained purchasing, for the time being, companies investment logjams peaked in 2003. According to analysts at Gartner, IT investment finally bottomed out in 2003.

Shifting Customer Demand

In 2003, the highest priority among IT decision-makers was to optimize their IT landscapes and obtain additional value from existing systems. This was confirmed, for example, in April 2003 by IDC s regular *Project Barometer* user survey about how the IT budget is spent. In the past, it was common for companies to fully reequip entire business areas with new software; in 2003, the trend was to add to existing IT in response to an isolated, immediate requirement. Companies focused mainly on tactical projects that brought quick-win and financial benefits with a rapid return on investment.

As a result, customers sought to reduce the total cost of ownership of their IT systems and focused investment more on technologies to make IT systems more efficient with end-to-end, interenterprise business processes and to optimize existing system landscapes with future-proof technology and all-round integration.

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Falling demand put great pressure on prices in the software industry. Moreover, faltering enterprise software investment led to further consolidation of the market. The acquisition of J.D. Edwards & Company by PeopleSoft, Inc., which was announced in July, altered the balance between the major vendors of enterprise software. Oracle Corp. s attempted hostile takeover of PeopleSoft, Inc. led to considerable insecurity in the market and, in SAP s opinion, increased the pressure on prices, particularly in the U.S. In SAP s experience, it is now more evident than ever that stability and security of investment play a critical role when customers decide on a software vendor. Consequently, we believe customers increasingly opted for long-term vendor partnerships based on trust.

The trend in the IT market was for companies to strive to simplify their IT structures. Talking to our customers, we also found that the trend toward homogeneous system landscapes continues. This approach is seen above all as a way of avoiding high integration costs.

Operating Results

2003 Compared With 2002

Total Revenue

At the beginning of 2003, we expected revenue to grow modestly for the year. We did not expect the ratio of product revenue to change significantly compared to 2002 and did not plan to increase the share of total revenue earned from services through disproportionate growth in consulting. Additionally, we did not expect revenue from training to be a significant growth contributor given the difficult spending environment. Early in 2003, there was a steady rise of the euro exchange rate compared to other major currencies, and consequently the impact on our results was not foreseeable. Compared to the dollar the exchange rate of the euro evolved as follows for the period-end Noon Buying Rate expressed as dollars per 1.00.

Date	Period-End
December 2002	1.0485
March 2003	1.0900
June 2003	1.1502
September 2003	1.1650
December 2003	1.2597
March 9, 2004	1.2428

Ultimately the strength of the euro over the year reduced the euro value of revenues generated in other currencies. Total revenue decreased from 7,412.8 million for 2002 to 7,024.6 million for 2003, representing a decrease of 388.2 million or 5.2%. Foreign currency translation effects from the strengthening value of the euro during 2003 negatively impacted our total consolidated revenue by 578.9 million that is 8.0% over 2002. The drop in 2003 total revenue was due to decreases in software revenue of 6.3%, consulting revenue of 11.4% and a decrease in training revenue of 27.7% compared to 2002. Following the trend of recent years, maintenance revenues increased by 6.0%, reducing the overall decrease in total revenues.

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

Product Revenue. Product revenue, which consists of software revenue and maintenance revenue, increased from 4,713.6 million in 2002 to 4,716.4 million in 2003, representing an increase of 2.8 million or 0.1%.

Software revenue decreased from 2,290.8 million in 2002 to 2,147.6 million in 2003, representing a decrease of 143.2 million or 6.3%. This decrease is substantially impacted by the negative foreign currency translation effects resulting from the appreciation of the euro compared to other currencies. While software revenue decreased by 6.3%, based on a constant currency basis, software revenue grew by 1% from 2002 to 2003.

For a summary of software revenue by solution in 2003 see Item 4. Information about SAP Description of the Business Software Revenue by Solution. Based on orders received versus revenue recognized, the installed customer base accounted for 74% of SAP s 2003 signed software contracts, with the remaining 26% coming from new customers (77% from installed customer base and 23% from new customers in 2002). We experienced an industry-wide trend away from a lower volume of very large contracts to a higher volume of smaller contracts.

Maintenance revenue increased from 2,422.8 million in 2002 to 2,568.8 million in 2003, representing an increase of 146.0 million or 6.0%. On a constant currency basis, maintenance revenue grew by 15% from 2002 to 2003. With our growing installed base, this change in maintenance revenue was due primarily to the growth of software sales throughout 2002 and by the additional software contracts closed during 2003. Accordingly, maintenance revenues continued to increase constantly on a rolling four quarter basis. As a significant portion of our software sales are finalized in the last quarter of the year, the trend showing increases in the respective maintenance revenue that follows in subsequent quarters is expected to continue. The biggest contributor to the increase in maintenance revenues came from the sales region EMEA in 2003 due to strong software sales and lower foreign currency translation effects compared to other sales regions.

Product revenue as a percentage of total revenue continues to be relatively high at 67.1%. The increase from 63.6% in 2002 was due primarily to the 14.0% decline in our service revenue.

Service Revenue. Service revenue decreased by 365.3 million, or 14.0%, from 2,618.1 million in 2002 to 2,252.8 million in 2003.

Consulting revenue decreased from 2,204.2 million in 2002 to 1,953.5 million in 2003, representing a decrease of 11.4%, but only 4% on a constant currency basis. The adverse economic conditions led to an overall price pressure environment. We focused more on improving profitability than on revenue growth. As a consequence we cut third party consulting resources previously deployed, which led to fewer revenues out of re-billed activities. Furthermore, mainly through normal attrition, the consulting work force decreased by approximately 3.5% on average, which contributed in a decline of consulting revenues.

Consulting revenue as a percentage of total revenue decreased from 29.7% in 2002 to 27.8% in 2003.

Training revenue decreased by 27.7% from 413.9 million in 2002 to 299.3 million in 2003. At constant currency, training revenues decreased by 21%. As in 2002 there was a continuing trend noted in the customers demand behavior. Customers continued to reduce their spending on employee training courses. Structurally, our customers demand shifted from traditional classroom training at our regional offices to requesting more customer specific on-site training and e-learning. We expect that this trend will continue in 2004.

Total Operating Expenses

Total operating expenses decreased from 5,787.2 million in 2002 to 5,300.6 million in 2003, representing a decrease of 486.6 million or 8.4%. Foreign currency translation effects from the strengthening value of the euro during 2003 positively impacted our total operating expenses by 372.3 million that is 6.4% over 2002.

Although total operating expenses declined, they were increased by expenses for stock-based compensation and settlements of stock-based compensation plans of 130.0 million in 2003 compared to 35.9 million in 2002.

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Approximately 113.7 million of the overall reduction of 486.6 million was achieved through the continued expense savings measures and carefully spent investments. We believe the decline is mainly attributable to the following:

Our continued careful hiring policy: The overall headcount rose in the first half year of 2003 by 164, in the second half by 649 full time equivalents. Despite a growing workforce, we managed to keep a tight control on personnel expenses due to minimal fixed salary increases as well as by shifting headcount from high cost locations to low cost locations. This resulted in an overall modest growth of personnel expenses, that were overcompensated by positive currency effects.

Focus on improving profitability in consulting: third party expenses in consulting went down due to a priority of profitability over revenue growth in a smaller and more competitive consulting services segment.

Additional replacements of third parties: We continued to replace third parties in our support and development departments by deploying our own resources and renegotiated vendor contracts.

Other stringent continued expense savings measures: Due to tight cost management, other expense items including travel dropped also on a constant currency basis. Furthermore we faced much lower restructuring expenses with 18.2 million in 2003 compared to 46.1 million in 2002.

Notwithstanding the decline in revenue and the impact of changes in foreign currency exchange rates from 2002 to 2003, due to our strict cost reduction measures, operating income increased by 6.0% in 2003 to 1,724.0 million. Gross operating margin increased to 24.5% in 2003 from 21.9% in 2002.

Pro forma operating income

We have provided guidance and related information in 2003 and 2002 using pro forma operating income on a consolidated basis. We use this information internally and believe this pro forma measure provides meaningful information to our investors because we exclude acquisition related charges and settlements of stock-based compensation plans to focus attention on the financial performance of our core operations. We exclude stock-based compensation expenses because we have no direct influence over the actual expense of these awards once we enter into stock-based compensation plans. This pro forma information is not prepared in accordance with U.S. GAAP and should not be considered a substitute for the historical financial information presented in accordance with U.S. GAAP. The pro forma measures used by us may be different from pro forma measures used by other companies.

At the beginning of 2003 our target was to improve our pro forma operating margin (excluding expenses for stock-based compensation and acquisition-related charges) from 23% by at least 1 percentage point. In October we increased our guidance to an increase of pro forma operating margin by 1 to 1.5 percentage points.

In 2003 the pro forma operating margin increased 4 percentage points to 27% despite the poor economic environment in many countries. Pro forma operating income (excluding expenses for stock-based and acquisition-related charges) increased from 1,688 million in 2002 to 1,880 million in 2003. Pro forma operating expenses (excluding expenses for stock-based and acquisition-related charges) in 2003 were reduced by 10% to 5,144.6 million.

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

	2003	2002
	(in millions of)	
U.S. GAAP Operating income	1,724	1,626
Acquisition-related charges	26	26
LTI 2000 Plan/STAR Plan	125	9
Settlement of stock-based compensation plans in the context of mergers and acquisitions	5	27
Total stock-based compensation	130	36
Pro forma operating income excluding stock-based compensation and acquisition-related charges	1,880	1,688

Cost of Product. Cost of product consists primarily:

customer support costs (message handling and bug fixing delivered by the Global Support Organization and Development Support); and

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

Cost of product decreased by 2.5% from 860.4 million for 2002 to 839.0 million for 2003. As a percentage of product revenue, cost of product decreased from 18.3% in 2002 to 17.8% in 2003.

Apart from the positive foreign currency translation effect, additional reductions have been realized in the area of expenses for third party products and cost optimization efforts relating to personnel expenses. As for the third party products, the efficiency was mainly achieved through a reduction of commissions paid, as contracts were renegotiated. Although the number of employees increased during 2003, the related costs increased less due to a continuous effort of the support organization to move into cost effective locations. Expenses for stock based compensation increased from 1 million in 2002 to 10 million in 2003. Included in cost of product are 3.6 million and 0.8 million bad debt expenses for 2003 and 2002, respectively.

Cost of Services. Cost of services consists primarily of consulting and training personnel expenses as well as expenses for third party consulting and training resources. Cost of services decreased by 13.4% from 1,955.8 million in 2002 to 1,694.1 million in 2003. As a percentage of service revenue, cost of services remained relatively stable with 75.2% in 2003 at 74.7% in 2002.

Foreign currency translation had a significant impact on cost of services. Cost services decreased by approximately 7% at constant currencies. As noted above, we cut the external consulting resources previously deployed by 21%, approximately 14% or approximately 91 million at constant currencies. The shortfall was partly compensated for by increased resource sharing within our group. We reduced the services headcount by approximately 2%, however expenses for stock based compensation increased from 6 million in 2002 to 33 million in 2003. Included in cost of services are 4.9 million and 5.1 million bad debt expenses for 2003 and 2002, respectively.

Research and Development. Our research and development consists primarily:

personnel expenses related to our research and development employees;

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

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

Research and development expenses increased by 86.6 million, or 9.5%, from 909.4 million in 2002 to 995.9 million in 2003. As a percentage of total revenue, research and development expenses increased from 12.3% in 2002 to 14.2% in 2003.

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Overall, the number of research and development employees increased from 8,173 in 2002 to 9,100 in 2003, representing an increase of 11.3%. The share of employees working in the research and development department as part of the total number of employees increased to 30.1% for 2003 from 27.8% for 2002. Due to the ongoing replacement of outsourced development activities to our in-house resources, personnel expenses increased while expenses for subcontractors decreased. Furthermore, due to new and more efficient processes the development organization could allocate resources from development support due to new and more efficient processes to the support organization. Therefore more capacity in total was available for research and development projects. As in all other areas, the foreign currency translation had a positive effect, while expenses for stocked-based compensation increased from 10 million in 2002 to 43 million in 2003.

Sales and Marketing. Sales and marketing expenses decreased by 13.3% from 1,627.2 million in 2002 to 1,411.0 million in 2003, representing 22.0% and 20.1% of total revenue for each year, respectively. At constant currencies, sales and marketing expenses decreased by approximating 9%.

Overall headcount in sales and marketing increased slightly from 5,143 million in 2002 to 5,267 million in 2003. However, total personnel expenses decreased mainly due to the foreign currency translation, while personnel expenses increased slightly at constant currencies. We continued to increase variable parts of salaries, improved efficiencies in the sales organization and decreased the reliance on external services. In marketing we shifted our strategy by hosting and sponsoring fewer large events. Stock based compensation expenses increased from 5 million in 2002 to 30 million in 2003. Included in sales and marketing expenses are 3.4 million and 7.2 million bad debt expenses for 2003 and 2002, respectively.

General and administrative. General and administrative expenses decreased by 11.2 % from 398.6 million in 2002 to 353.9 million in 2003, representing 5.4% and 5.0% of total revenue for each year, respectively. On a constant currency basis, general and administrative expenses decreased by approximately 5%. The remaining decrease was mainly driven by a reduction in travel expenses and third party services. Stock-based compensation expenses increased from 13.7 million in 2002 to 14.7 million in 2003. Included in general and administrative expenses are 0.2 million and 0.8 million bad debt expenses for 2003 and 2002, respectively.

Other operating expenses, Net. Other operating expenses, net decreased from 35.1 million in 2002 to 6.5 million in 2003. The primary reason was the reduction in the amount of restructuring costs for unused lease space and severance payments for exit activities from 46.1 million in 2002 to 20.5 million in 2003.

The 2003 restructuring included the following key activities:

Reduction of our workforce across all segments, including reductions related to the consolidation of our sales force organization; and

consolidation of additional facilities, including ceasing operations in certain geographic locations, especially in the training segment.

The following table summarizes the expenses incurred in connection with our 2002 and 2003 exit activities, and the related obligations as of December 31, 2002 and 2003:

	2003					
	Balance as of 01/01 (000)	**Expenses (000)**	**Payments (000)**	**Adjustments (000)**	**Currency (000)**	**Balance as of 31/12 (000)**
Unused lease space	7,577	17,164	(5,544)	0	(1,506)	17,691
Severance payments	11,159	3,384	(9,347)	(1,001)	(666)	3,529
	18,736	20,548	(14,891)	(1,001)	(2,172)	21,220

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	2002					
	Balance as of 01/01 (000)	Expenses (000)	Payments (000)	Adjustments (000)	Currency (000)	Balance as of 31/12 (000)
Unused lease space	2,874	12,960	(7,262)	0	(995)	7,577
Severance payments	10,121	33,148	(30,739)	0	(1,371)	11,159
	12,995	46,108	(38,001)	0	(2,366)	18,736

Customer credit loss risks based on aging of receivables are classified as general bad debt expense as a component of other operating expense, net. For the years ended December 31, 2003 and 2002, 5.4 million and 5.3 million were recorded as other operating income, respectively, due to our decreased days sales outstanding.

Financial Income/ Expense, Net

Financial income/ expense, net is comprised primarily of (losses)/income from associated companies, (losses)/gains on sales of equity investments securities and net interest income. Financial income/expense, net improved from net financial expense of 555.3 million in 2002 to net financial income of 16.3 million in 2003, an increase of 571.6 million. A significant portion of the change pertains to the other than temporary impairment charge of 297.6 million recognized in the second quarter of 2002 to write-down the carrying value of our equity method investment in Commence One to its estimated realizable value. Our equity in the net losses of Commerce One was 92.0 million in 2002. The carrying value of our total investments in Commerce One was reduced to zero in 2002 as a result of the recognition of the impairment charge and through the continuing application of the equity method of accounting. In accordance with U.S. GAAP, the application of the equity method has been suspended and we will not recognize any additional losses related to our interest in Commerce One as we have not guaranteed any of their obligations nor are we otherwise committed to provide Commerce One with further financial support. Also during 2002 other minority investments were written down to their respective fair values since the decline in their respective values were also deemed to be other than temporary. The investments were made primarily from SAP s venture capital activities. The amount of impairment charges plus our share in the net losses of these equity method investees other than Commerce One totaled 15.3 million in 2003 and 118.5 million in 2002.

Income Taxes

Our effective income tax rate decreased from 53.8% for 2002 to 39.0% in 2003. This decrease was primarily due to the impact on the tax rate in 2002 of the significant losses on investments, which are not deductible for tax purposes. Such losses were not significant in 2003. Adjusted for the effects of these and other unusual items, the adjusted effective tax rate for 2003 was 37.0%, which was 0.3% higher than the adjusted effective tax rate for 2002. See Note 11 to our consolidated financial statements.

Net Income

Net income increased from 508.6 million in 2002 to 1,077.1 million in 2003, representing an increase of 568.5 million or 111.8%. Net income as a percentage of total revenue increased from 6.9% for 2002 to 15.3% for 2003. This increase was primarily due to the impairment charge of 298 million in 2002 related to the write-down of the carrying value of our investment in Commerce One, our equity in the net losses of Commerce One of 92.0 million, impairment charges on equity investments plus our share in the net losses of equity method investees other than Commerce One of 128 million, approximately 114 million reduction of total operating expenses achieved through continued expense savings measures and carefully spent investments, the net decrease of 26 million from 2002 in restructuring costs, partially offset by negative foreign currency translation effects of approximately 151 million resulting from the strengthening euro and increased stock based compensation expenses of 94 million. Basic and diluted earnings per share were 3.47 in 2003 compared to 1.62 in 2002.

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Segment Discussion

As described in Note 34 of 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 project, regardless of the nature of the sales transaction, and it also includes inter-segment revenue. Segment contribution consists of total segment revenue offset only by expenses directly attributable to the segments. Expenses such as general and administrative costs, research and development activities, stock based compensation and other corporate costs that are included in determining our consolidated operating income are not allocated to the operating segments and therefore are not included in segment contribution. In 2003 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 130.0 million compared to 35.9 million in 2002. Therefore, segment contribution is not indicative of the actual profitability margin for the operating segments.

In 2003, 6.0 million (2002: 34.2 million) of exit costs related to unused lease space and severance payments were not allocated to the segments.

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

- line of business sales is a profit center organization that covers software revenue and the corresponding sales resources;

- line of business marketing is a cost center organization;

- line of business service and support is a profit and cost center organization, based on the activity.

Product segment revenue decreased by 0.5% from 5,270.0 million in 2002 to 5,246.3 million in 2003. On a constant currency basis, product segment revenue grew by 8%. Approximately 90% of revenues within the product segment are derived from software and maintenance revenue. Further external revenues in the product segment are derived from services revenue and other revenue. As noted above external software revenue as part of the total product segment revenue decreased by 6% from 2,266.5 in 2002 million to 2,131.3 million in 2003, (an increase of 1%) based on constant currencies. External maintenance revenues increased by 6% from 2,419.8 million in 2002 to 2,565.9 million in 2003, (an increase of 15%) based on constant currencies. Internal product segment revenues are mainly due to charges from the marketing and service and support organization roughly on the same level in 2003 as in 2002.

Product segment expenses decreased from 2,584.3 million in 2002 to 2,322.6 million in 2003. Expenses of the line of business sales account for roughly half of the entire product segment expenses. Expenses of the line of business marketing are roughly less than one fourth and expenses of the line of business service & support are roughly more than one fourth of overall product segment expenses. The reduction of overall product segment expenses is mainly due to currency translation effects. In addition, reductions in volume have been achieved by decreasing travel, marketing and commissions paid for third parties products, a decrease of overall marketing spending and shifts of support activities into low cost locations. Product segment expenses include restructuring charges of approximately 1 million (2002: 6 million), primarily for severance payments.

Product segment contribution increased by 9% from 2,685.7 million in 2002 to 2,923.7 million in 2003, or 55.7% of total segment revenue compared to 51.0% of total segment revenue in 2002. Based on a constant currency basis, product segment contribution increased by 15%. While we were able to keep product segment revenues relatively constant with other currencies devaluating against the , the currency impact helped us to decrease product segment expenses, primarily relating to the U.S. operations. Our achievements in real cost cuttings, mainly in the area of commissions paid for third parties products, impacted the product segment contribution directly.

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Consulting segment. The consulting segment is primarily engaged in the implementation of our software products. Consulting segment revenue decreased by 10% from 2,654.2 million in 2002 to 2,392.0 million in 2003. On constant currency, consulting segment revenue decreased by 4%. In addition to the currency impact, the reduced revenues are a reflection of very competitive and price-conscious market conditions with less engagements in price competitive segments by us. Additionally, the consulting organization has partially shifted its resources to more internal development projects than in previous years.

Consulting segment expenses decreased by 9.5% from 2,128.4 million in 2002 to 1,927.1 million in 2002, in line with the decrease in revenues. As noted above, we decreased the use of third party resources were reduced. In the contrary we made more use of our global consulting organization by sharing resources across the local organizations and the currency impacted segment expenses accordingly. Consulting segment expenses include a restructuring charge of approximately 1 million (2002: 8 million) for severance payments and unused lease space.

Consulting segment contribution decreased by 11.8% from 525.8 million (19.8% of total consulting revenue) in 2002 to 464.9 million (19.4% of total consulting revenue) in 2003. Based on a constant currency basis, consulting segment contribution decreased by 3%. The flexible adoption of the cost structure led to a consistent segment profitability with decreased revenues. Accordingly, the decrease in revenues could be absorbed by reducing external partner resources.

Training segment. The training segment is primarily engaged in providing educational services on the use of our software products and related topics for customers and partners. Training services include traditional classroom training at SAP training facilities, customer and partner specific training, end-user training as well as e-learning. Training segment external revenue decreased by 27% from 435.0 million in 2002 to 316.1 million in 2003. On a constant currency basis, external revenue decreased by 23%. The decrease was a result of an overall shrinking market, with local prices remaining at a constant level. At the beginning of 2003, companies seemed more focused on cutting costs than growing and maintaining employee skills. Depressed economic conditions led customers to hold back on traditional classroom training and the travel it involved. This decline in classroom training was partially offset by additional customer specific, end-user training, and e-learning.

Training segment expenses decreased by 24% from 376.4 million in 2002 to 287.5 million in 2003. With decreased demand, the education-specific high percentage of fixed costs (primarily rent and personnel expenses) could not be reduced in the same manner. In addition, training segment expenses include a restructuring charge of approximately 9 million (2002: 1 million) for unused lease space.

Training segment contribution decreased over proportional, by 34% from 142.6 million (27.5% of total training revenue) in 2002 to 94.6 million (24.8% of total consulting revenue) in 2003. This is due primarily to the fact that the cost reduction of our training segment could not entirely compensate for the decline in customer demand and the restructuring charges primarily for unused lease space.

2002 Compared With 2001

Total Revenue

At the beginning of 2002 SAP expected a revenue growth of 15% for the year with all sales regions and revenue types (software, maintenance, consulting and training revenues) contributing positively. During the year this expectation was reduced due to the weak global economies and the strengthening of the euro in relation to the local currencies in the major geographic areas in which we operate. Based on realized results of the second quarter of 2002, our 2002 annualized growth expectations were reduced to 5% 10% and after our third quarter 2002 results we reduced our 2002 annualized growth even further. Consequently we focused on increasing our operating margin. Total revenue increased from 7,340.8 million for 2001 to 7,412.8 million for 2002, representing an increase of 72.0 million or 1.0%. Foreign currency translation effects from the strengthening value of the euro during 2002 negatively impacted our total consolidated revenue by 420.2 million or 5.7%. The growth in 2002 total revenue was due to increases in product revenue of 0.3%, consulting revenue of 5.8% and a decrease in training revenue of 11.2% compared to 2001.

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

Product Revenue. Product revenue increased from 4,701.8 million in 2001 to 4,713.6 million in 2002, representing an increase of 11.8 million or 0.3%. Software revenue decreased from 2,580.5 million in 2001 to 2,290.8 million in 2002, representing a decrease of 289.7 million or 11.2%. For a summary of software revenue by solution in 2002 see Item 4. Information about SAP Description of the Business Software Revenue by Solution. Based on orders received versus revenue recognized, the installed customer base accounted for 77% of SAP s 2002 signed software contracts, with the remaining 23% coming from new customers (68% for installed customer base and 32% for new customers in 2001). SAP faced the industry-wide trend away from fewer contracts for very large capital projects to an increased volume of smaller contracts. Maintenance revenue increased from 2,121.3 million in 2001 to 2,422.8 million in 2002, representing an increase of 301.5 million or 14.2%. With the increase of our installed base, this strong growth in maintenance revenue was due primarily to the growth of the 2001 software sales and positively affected by the additional software contracts closed during 2002. As a significant portion of our software sales are entered in the last quarter, the trend related to the increase in the respective maintenance revenue that follows in subsequent quarters is expected to continue. The biggest contributor to the increase in maintenance revenues came from the sales region EMEA in 2002, due to strong software sales and lower foreign currency translation impact due to the weakened euro.

Product revenue as a percentage of total revenue still remained relatively high at 63.6% in 2002. The slight decrease from 64.1% in 2001 was due primarily to the 11.2% decline of software revenue and the 5.8% growth in our consulting revenue.

Service Revenue. Service revenue increased by 69.0 million, or 2.7%, from 2,549.1 million for 2001 to 2,618.1 million for 2002. Consulting revenue increased from 2,082.9 million in 2001 to 2,204.2 million in 2002, representing an increase of 5.8% compared to the extremely strong revenue growth of 27% in 2001 over 2000. The difference in growth results mainly from the different hiring pace. While our consulting workforce grew significantly in 2001, there was almost no growth in 2002. In regards to the subcontracting of third party consultants, the level as a percentage of sales remained in 2002 compared to 2001 relatively stable. Consulting revenue as a percentage of total revenue increased from 28.4% in 2001 to 29.7% in 2002. With decreasing rates in the consulting business, the increase was primarily due to an increase in utilization rates of our own consultant, supported by the establishment of a Global Consulting Organization, which addresses the consulting needs of major multinational corporations and leverages the utilization of consultants across countries and regions. The increase in software sales in 2001 also had a positive impact on consulting revenues in 2002. Furthermore, in 2002 a significant portion of our consulting revenue was generated by sub-contracted external consultants.

Training revenue decreased by 11.2% from 466.2 million in 2001 to 413.9 million in 2002. This decrease was a result of an overall shrinking market and the changed demand structure. Customers were willing to invest less in classical classroom training and became more reluctant to travel to training facilities of classroom training providers. The strong decrease in classroom training was partly offset by customer specific and end user trainings.

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Total Operating Expenses

Total operating expenses decreased from 6,028.4 million for 2001 to 5,787.2 million for 2002, representing a decrease of 241.2 million or 4.0%. This was achieved by the stringent cost management measures that SAP introduced in 2001 and accelerated during 2002 as the growth expectations were reduced in order to achieve the targeted margin improvement. While total operating expenses in the first half of 2002 increased by 5%, they were reduced by 12% in the second half of 2002 compared to the same period of 2001 leading to the overall reduction of 4%. The reduction in overall costs was achieved without significant reduction in our employee workforce. Instead, the successful result was achieved by a restrained hiring policy, cuts in variable compensation, reassignment of outsourced development work to internal resources, and tight control of other expenses including travel expenses. We achieved further economies by simplifying our global infrastructure, renegotiating vendor contracts to improve efficiency, and general streamlining processes. As in previous years, the biggest component of our operating expenses was our personnel cost. In 2002, operating expenses of 9 million for stock-based compensation were 86% lower than in 2001. Total personnel expenses in 2002 including stock-based compensation were 2,965 million, a 2% increase over 2001. This moderate increase was primarily due to our restrained hiring policy and positive impact of foreign currency translation effects due to the strengthened euro. While in the first half of 2002 the number of full time equivalents increased by 944, the number of fulltime equivalents was reduced by 557 in the second half of 2002 following a cautious hiring policy in the first half versus a stringent hiring freeze in the second half of 2002.

As a result of our strict cost reduction measures, operating income increased by 24% in 2002 to 1,626 million. The gross operating margin increased to 22% in 2002 from 18% in 2001.

Pro forma operating income

At the beginning of 2002 SAP s target was to improve its pro forma operating margin (excluding expenses for stock-based compensation and TopTier acquisition-related charges) from 20% to at least 21%. Pro forma operating income (excluding expenses for stock-based compensation and TopTier acquisition-related charges) rose 18% in 2002 to 1,686 million, resulting in a pro forma operating margin of 22.7% significantly exceeding our target despite the poor economic environment. Pro forma operating expenses (excluding expenses for stock-based compensation and TopTier acquisition-related charges) in 2002 were reduced by 2% in comparison with the previous year, to 5,727 million.

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

	2002	**2001**
	(in millions of)	
U.S. GAAP Operating income	1,626	1,312
Amortization of intangible assets	24	18
In process research and development	0	6
Amortization of goodwill	0	37
Total TopTier related acquisition costs	24	61
STAR Plan	1	50
LTI 2000 Plan	8	14
Settlement of stock-based compensation plans in the context of mergers and acquisitions	27	34
Total stock-based compensation	36	98
Pro forma operating income excluding stock-based compensation and TopTier acquisition costs	1,686	1,471

Cost of Product. Cost of product decreased by 3.0% from 887.4 million for 2001 to 860.4 million for 2002. As a percentage of product revenue, cost of product decreased from 18.9% in 2001 to 18.3% in 2002. This efficiency was achieved through a reduction of commissions paid for third parties products as contracts were renegotiated. Although the number of installations steadily increased during 2002, the increase in product related

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support was lower than in 2001. Included in cost of products are 0.8 million and 8.4 million bad debt expenses for 2002 and 2001, respectively.

Cost of Services. Cost of services decreased by 0.5% from 1,965.0 million for 2001 to 1,955.8 million for 2002. As a percentage of service revenue, cost of services decreased to 74.7% in 2002 from 77.1% in 2001 as the overall service profitability increased. While third party expenses remained relatively stable, the average headcount in consulting increased only moderately. The increase in consulting revenue and utilization rates as noted above resulted in a profitability increase. Our training profitability decreased, because the shortfall in our training revenues as described above could not be completely offset by our reduction in our training infrastructure. Included in cost of services are 5.1 million and 4.8 million bad debt expenses for 2002 and 2001, respectively.

Research and Development. Research and development expenses increased by 11.1 million, or 1.2%, from 898.3 million in 2001 to 909.4 million in 2002. As a percentage of total revenue, research and development expenses increased from 12.2% for 2001 to 12.3% for 2002. The number of research and development employees increased from 7,665 in 2001 to 8,173 in 2002, representing an increase of 6.6%. The percentage of employees working in the research and development department compared to total employees increased to 27.8% for 2002 from 26.5% in 2001. The primary reason for the increase of research and development expenses in 2002 compared to 2001 is the increase in headcount during 2002. The increase in expenses is lower than what could be expected due to the increase in employees because of our ongoing replacement of outsourced development activities to our in-house resources.

Sales and Marketing. Sales and marketing expenses decreased by 9.5% from 1,797.6 million for 2001 to 1,627.2 million for 2002, representing 24.5% and 22.0% of total revenue, respectively. The primary reasons for the reduction were synergies caused by our reintegration of SAP Markets and SAP Portals operations, selected adjustments of the sales workforce which were dependent on the results achieved during the year, and cuts in advertising and sponsoring expenditures. The number of employees in sales and marketing grew by 1.4% from 5,071 in 2001 to 5,143 in 2002. Included in sales and marketing expenses are 7.2 million and 21.0 million bad debt expenses for 2002 and 2001, respectively.

General and administrative. General and administrative expenses increased by 3.4% from 386.0 million for 2001 to 399.3 million for 2002, representing 5.3% and 5.4% of total revenue, respectively. During 2002 we took steps to substantially reduce our general and administrative costs, however, these savings were largely offset by additional charges for our internal restructuring measures. Included in general and administrative expenses are 0.8 million and 2.7 million bad debt expenses for 2002 and 2001, respectively.

Other operating expenses, net. Other operating expenses, net decreased by 62.7% from 94.2 million for 2001 to 35.1 million for 2002. The primary reason for the decrease was the application of SFAS 142 in 2002. As a result of the adoption of SFAS 142, we no longer amortize goodwill and, therefore, unless goodwill is found to be impaired in the future, it no longer affects net income. In 2002, other operating expenses, net included restructuring charges of 46.1 million related to on-going employee termination costs in the United States. The majority of these termination costs were paid during 2002 and the remaining portion of these costs, approximating 13.0 million are expected to be paid in the first quarter of 2003.

The following table summarizes the expenses incurred in connection with our 2001 and 2002 exit activities, and the related obligations as of December 31, 2001 and 2002:

	2002				
	Balance as of 01/01 (000)	**Expenses (000)**	**Payments (000)**	**Currency (000)**	**Balance as of 31/12 (000)**
Unused lease space	2,874	12,960	(7,262)	(995)	7,577
Severance payments	10,121	33,148	(30,739)	(1,371)	11,159
in number of employees		*768*			
Total	12,995	46,108	(38,001)	(2,366)	18,736

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	2001				
	Balance as of 01/01 (000)	**Expenses (000)**	**Payments (000)**	**Currency (000)**	**Balance as of 31/12 (000)**
Unused lease space	0	2,840	(0)	34	2,874
Severance payments	0	10,796	(795)	120	10,121
in number of employees		*322*			
Total	0	13,636	(795)	154	12,995

Customer credit loss risks based on aging of the receivables are classified as general bad debt expense as a component of other operating expense, net. For the year ended December 31, 2002 5.3 million was recorded as other operating income due to our decreased days sales outstanding. In 2001, 14.7 million was recorded as other operating expense primarily due to adjustments in the allowance based on the length of time by considering trends within and ratios involving the age of the accounts receivable.

Financial Expense, Net

Financial expense, net increased from 233.0 million for 2001 to 555.3 million for 2002, an increase of 322.3 million. The primary reason for this increase was the other than temporary impairment charge of 297.6 million recognized in the second quarter of 2002 to write-down the carrying value of our equity method investment in Commence One to its estimated realizable value. Our equity in the net losses of Commerce One was 161.6 million in 2001 and 92.0 million in 2002. The carrying value of our total investments in Commerce One has been reduced to zero as of December 31, 2002 as a result of the recognition of the impairment charge and through the subsequent continuing application of the equity method of accounting. In accordance with U.S. GAAP, the application of the equity method has been suspended and we will not recognize any additional losses related to our interest in Commerce One as we have not guaranteed any of their obligations nor are we otherwise committed to provide Commerce One with further financial support. Also during 2002 other minority investments were written down to their respective fair values since the decline in their respective values were also deemed to be other than temporary. The investments were made primarily from SAP s venture capital activities. The amount of impairment charges on minority investments plus our share in the net losses of these equity method investees other than Commerce One totaled 128.1 million in 2002 and 72.5 million in 2001.

Income Taxes

Our effective income tax rate increased from 44.6% for 2001 to 53.8% in 2002. This increase was primarily attributable to the 389.6 million loss associated with our investment in Commerce One and 98.5 million loss of impairment charges for other investments, which are not deductible for tax-purposes. Further, as a result of new German tax legislation enacted in 2002, an incremental income tax charge of 1.6 million was recognized. Adjusted for the affects of these and other unusual items, the adjusted effective tax rate for 2002 was 36.7%, which was 1.3 percentage points lower than the adjusted effective tax rate for 2001. See Note 11 to our consolidated financial statements.

Net Income

Net income decreased from 581.1 million in 2001 to 508.6 million in 2002, representing a decrease of 72.5 million or 12.5%. Net income as a percentage of total revenue decreased from 7.9% for 2001 to 6.9% for 2002. This decrease was primarily due to the impairment charge of 297.6 million related to the write-down of the carrying value of our investment in Commerce One, the negative foreign currency translation effects resulting from the strengthening euro (88.8 million) and the incremental restructuring costs (32.5 million pretax) partially offset by cost reductions in our sales and marketing activities (170.3 million pretax) and the net increase in foreign currency transactions gains (41.0 million pretax). Basic and diluted earnings per share were 1.62 in 2002 compared to 1.85 in 2001.

In accordance with the new U.S. accounting standard, SFAS 142, amortization of goodwill no longer affects our net income. If we had been able to apply this standard from January 1, 2001, our reported net income for

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2001 would have been 66.0 million higher and our reported basic and diluted earnings per share would have been increased by 0.21.

Segment Discussion

In 2002, 34.2 million (2001: 9.2 million) of exit costs related to unused lease space and severance payments were not allocated to SAP s segments.

Product-segment revenue decreased from 5,299.9 million in 2001 to 5,270.0 million in 2002, or 0.4%. This slight decline is primarily attributable to the decrease in our software product sales offset by the increase in maintenance revenue, as discussed above. Furthermore, foreign currency translation has affected our revenue negatively. Segment contribution increased from 2,424.1 million (45.7% of total segment revenue) in 2001 to 2,685.7 million (51.0% of total segment revenue) in 2002. This increase in contribution and in margin in 2002 was achieved through our reduction in expenses related to sales, marketing and commissions paid for third parties products.

Consulting-segment revenue increased from 2,458.3 million in 2001 to 2,654.2 million in 2002, or 8.0%. The increase in software sales in 2001 had a positive impact on consulting revenue in 2002. Further, we were able to increase the utilization rates of our own consultants, which was supported by the establishment of our Global PSO as discussed above. Segment contribution increased from 424.2 million (17.3% of total consulting revenue) in 2001 to 525.8 million (19.8% of total consulting revenue) in 2002. This increase in contribution and in margin is primarily due to the increase in external revenues and the increase in utilization of our own consultants.

Training-segment revenue decreased from 598.3 million in 2001 to 519.0 million in 2002, or 13.2%. This decrease was a result of an overall shrinking market and the changed customer demand structure. Customers became less willing to invest in traditional classroom training and were more reluctant to travel to training facilities. This decline in classroom training was partially offset by additional customer specific and end user training. Segment contribution decreased from 179.3 million (30.0% of total training revenue) in 2001 to 142.6 million (27.5% of total training revenue) in 2002. This decrease in contribution and in margin is due to the decrease in external revenues and the fact that the cost reduction of our training segment could not entirely compensate for this decline in customer demand.

Outlook 2004

Forecast for the IT Industry

Modest growth Surveys by various industry analysts about the IT investments planned for the year show that the IT industry is cautiously optimistic at the start of the new year. Most surveys forecast an above-average increases in spending on software and services in 2004.

Experts predict a number of focal areas Industry experts believe several specific solutions and technologies such as Business Intelligence (BI), Web Services, Analysis Software, Customer Relationship Management (CRM) and Project Lifecycle management (PLM) to have particular potential for growth in 2004.

IT industry expected to consolidate further The IT industry is expected to continue to consolidate in 2004. Smaller software vendors will increasingly function as providers of niche products. According to a study from December 2003, analysts at Gartner Group have calculated that, within the next two years, over half of the listed IT companies will be acquired by a few, large companies.

Forecast for SAP

Strategically positioned for 2004 We also believe that the economy bottomed out in 2003 and expect a gradual improvement to the economic conditions and the investment climate in 2004.

Five strategic priorities for 2004 The Executive Board has set five strategic priorities for SAP in 2004. These priorities are based on the assumption that the economy bottomed out in 2003 and that a gradual improvement in the economy in which we operate and in the economy in general will occur during 2004.

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We will focus on growth and, in particular on growth in software sales. The aim is to make the most of the economic upturn.

We will focus in particular on SAP NetWeaver. We want to establish this solution as our main integration and application platform. The aim is to gain as many NetWeaver reference customers as possible in 2004.

mySAP ERP will be another focus. We want to make it clear to customers that mySAP ERP is a clear improvement on its predecessor SAP R/3.

The success of mySAP CRM in previous years should continue. We want to encourage strong sales of this solution and thus reinforce its leading position in the CRM segment.

In the small and mid-market segment, we want to increase the number of customers and expand our partner network for indirect sales. In particular, we want to grow our segment share in the EMEA and Americas regions and enlarge the partner network in the Asia/Pacific region.

Operational goals of increasing software revenue and profitability Anticipating growth in the economy as a whole and in the IT industry in particular, and based on our strategic position, we have set the following operational goals for 2004. Our priority will be revenue growth in particular software revenue in 2004.

We will work to increase software revenue 10% over the 2003 number. We expect above-average growth rates in the United States and the Asia/Pacific region with an improvement in the EMEA region over the course of the year. The financial services and public services industries should see above-average growth. We also expects significant growth from business with small and mid-market customers.

Although we are giving priority to growth in 2004, we want to continue with stringent cost management measures and further increase profitability. We provided guidance that we will work to increase pro forma operating margin (excluding stock-based compensation and acquisition related changes) to increase by one percentage point, compared to the 27% achieved in 2003.

To achieve this growth in revenue and earnings, we plan to invest more in 2004 than in the previous year, especially in sales, marketing, research, and development. Total headcount is predicted to grow approximately 5%, with growth rates being higher in countries other than Germany.

To further optimize our cost structure, we expect a significant proportion of the new research and development jobs to be located in India and China without reducing headcount in other locations. The number of employees is also expected to increase in the United States.

These operational goals are based on the expected improvements to the economic situation as well as a number of other assumptions. These include the expectation that the buying behavior of customers will conform to the usual seasonal pattern, with revenue at its strongest in the fourth quarter. We also assume that, in 2004, customers will continue to invest in smaller projects with short implementation cycles rather than in large projects lasting several years. We do however expect average software contract order entry volumes to stabilize over the course of the year and thus not decrease as much as they did in 2003.

The targets for revenue and earnings take into account the likely development of the different currencies that affect our business. We are working on the basis of an average exchange rate of U.S.$1.25 = 1.00.

Strategy with regard to acquisitions We view the acquisition of companies as a key element of future growth. In particular, we intend to acquire smaller companies with the specific aims of strengthening our geographic reach, broadening our offering in particular industries and complementing our technology portfolios.

Risk Factors

The stated revenue, income, and margin targets of SAP for fiscal year 2004 are subject to a number of risks, over which we may have no influence or only limited influence. This outlook should be read in connection with the more detailed discussion and analysis of our financial condition and results of operations in this Item 5, Item 3. Key Information Risk Factors, and Item 18. Financial Statements.

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Foreign Currency Exchange Rate Exposure

Although our reporting currency is the euro, a significant portion of our business is nevertheless conducted in currencies other than the euro. International sales are primarily made through our subsidiaries in the respective regions and are generally denominated in the local currency, although in certain countries where foreign currency exchange rate exposure is considered high, some sales may be denominated in euro or 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 and operating results. The principal currencies in which our subsidiaries conduct business that are subject to the risks described in this paragraph are the dollar, the Japanese yen, the British pound, the Swiss franc, the Brazilian real, the Canadian dollar and the Australian dollar.

Approximately 59.3% of our consolidated revenue in 2003 and approximately 60.4% in 2002 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 (577.3) million, income before income taxes of (174.0) million and net income of (151.1) million for 2003 and consolidated revenue of (348.2) million, income before income taxes of (109.9) million and net income of (88.8) million for 2002. See Item 11. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk.

Critical Accounting Policies

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

Revenue Recognition;

Valuation of Accounts Receivable;

Accounting for Stock Based Compensation;

Accounting for Income Taxes and Other Income Tax Related Judgments; and

Realizability of Strategic and Venture Capital Investments.

Please refer to Note 3 to the accompanying financial statements for further discussion of SAP s accounting policies.

Revenue Recognition

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

We recognize revenue pursuant to the requirements of AICPA Statement of Position (SOP) 97-2 Software Revenue Recognition (SOP 97-2), as amended by SOP 98-9 Software Revenue Recognition, With Respect to Certain Transactions, SOP 81-1, Accounting for Performance of Construction-type and

Certain Production-type Contracts, the SEC s Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, Emerging Issues Task Force (EITF) 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21), EITF 03-05, Applicability of AICPA Statement of Position 97-2, Software Revenue Recognition , to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software, and other authoritative accounting guidance.

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

Under SOP 97-2, provided that the arrangement does not require significant production, modification, or customization of the software, we recognize revenue when 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, assuming all other revenue recognition criteria have been met. If at the outset of an arrangement we determine that collectibility is not probable, revenue is deferred until payment is received. If an arrangement allows for customer acceptance of the software or services, we defer revenue recognition until the earlier of customer acceptance or when the acceptance right lapses.

For arrangements with resellers, we consider the factors outlined in SOP 97-2 in assessing whether the fee is fixed or determinable and whether the collectibility criteria for revenue recognition have been met. We believe that transactions involving resellers that license software prior to having finalized non-contingent agreements with their ultimate customer, even if no contingencies exist in our license with the reseller, present a higher uncertainty regarding fixed or determinable fees and collectibility. As a result, we believe revenue recognition upon sell-through from the reseller to the end-user customer is appropriate for all agreements involving resellers.

We view our resellers as an extension of our direct sales force. Notwithstanding our resellers involvement, we generally try to enter into binding license agreements directly with the end-user customer (i.e., the reseller s role is similar to a salesperson s role). If we are unable to enter into a binding license agreement directly with an end-user customer, or if we become aware that a reseller has granted contingent rights to an end-user customer, we defer revenue recognition until a valid license agreement has been entered into without contingencies or, if applicable, until the contingencies expire.

We recognize revenue when the software is delivered (assuming all other revenue recognition criteria have been met). Based on a few individual agreements with certain of our resellers, we, rather than the reseller may deliver the product directly to the end user.

Depending on the country in which the maintenance agreement is executed, our initial maintenance term is generally in the range of one to three years, renewable by the customer on an annual basis thereafter. The maintenance fee, including the fee for subsequent renewals, is typically established based on a specified percentage of the license fee paid by the customer. Our customers typically prepay maintenance for periods of three to twelve months. Maintenance revenues are deferred and recognized ratably over the term of the maintenance contract. If a customer on maintenance is specifically identified as a bad debtor, we cease recognizing maintenance revenue except to the extent that maintenance fees have already been collected.

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Our consulting and training revenues are accounted for separately from the license revenues in situations when the services are deemed not to be essential to the functionality of the software. Consulting and training revenues are recognized as the services are performed, generally on a time and materials basis. Consulting revenues attributed to fixed price arrangements are recognized using the percentage of completion method based on direct labor costs incurred to date as a percentage of total estimated direct labor costs to complete the project. Consulting services primarily comprise implementation support related to the installation and configuration of our products and do not typically require significant production, modification, or customization of the software. In arrangements that require significant production, modification, or customization of the software and where services are not available from third party suppliers, the consulting and license fees are recognized, depending on the fee structure, on a time and materials basis or using the percentage of completion method. When total cost estimates exceed revenues in a fixed price arrangement, the estimated losses are recognized immediately based upon an average fully burdened daily cost rate applicable to the consulting organization delivering the services.

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

For arrangements involving hosting, when all other revenue recognition criteria have been met, we recognize product revenue upon delivery of a software license key and hosting revenue over the hosting period unless:

- the customer cannot take possession of the software at any time during the hosting period without significant penalty; or
- the customer cannot contract with another hosting provider without significant effort or expenditure; or
- the software s functionality is compromised by the termination of our hosting services.

Under these circumstances, we recognize all revenue under the arrangement ratably over the longer of the hosting period or the maintenance period. Hosting revenues recognized to date have not been significant.

We believe that our accounting estimates to apply our revenue recognition policies are critical because:

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

Changes in the aforementioned items could have a material effect on the type and timing of revenue recognized.

There have been no significant changes in our accounting estimates related to our revenue recognition policies that had a material impact on the amount of our reported revenue, results of operations or our financial position in 2003 and 2002.

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

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Valuation of Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Total accounts receivable at December 31, 2003 and 2002 were 1,770.7 million and 1,967.1 million, respectively, which is net of an allowance for bad debts of 71.0 million and 92.5 million, respectively. Included in accounts receivable are unbilled receivables related to costs and estimated earnings in excess of billings on uncompleted fixed fee consulting arrangements of 105.5 million and 182.7 million at December 31, 2003 and 2002, respectively. The allowance for doubtful accounts represents our best estimate of the amount of probable credit losses in our existing accounts receivable portfolio. We base our estimate on a systematic, ongoing review and evaluation which we perform every month. As part of this evaluation, we determine the allowance for doubtful accounts after giving consideration to specific customer risks, regional economic risks and the length of time certain accounts receivable have been outstanding. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. If the financial condition of our customers deteriorates, impairing their ability to make payments, we may need to establish additional allowances in excess of our original estimates.

Total provisions for allowances for doubtful accounts charged to earnings approximated net 7.0 million, 7.6 million and 52.7 million during 2003, 2002 and 2001, respectively. Specific customer credit loss risks are charged to the respective functional cost category of product or cost of service sold. Customer credit loss risks based on aging of the receivables are classified as general bad debt expense, which is included in Other operating income/(expense) as disclosed in Note 7 of Item 18. Financial Statements.

Total provisions for allowances for doubtful accounts charged to the respective functional cost category of product or cost of service sold approximated 12.3 million, 12.9 million and 38.0 million during 2003, 2002, and 2001, respectively.

The allowances for doubtful accounts based on total accounts receivable that are considered past due are recorded as a component of other operating expense, net. For the years ended December 31, 2003 and 2002, 5.4 million and 5.3 million were recorded as other operating income, respectively, due to our decreased days sales outstanding. In 2001, 14.7 million was recorded as other operating expense primarily due to adjustments in the allowance based on the length of time by considering trends within and ratios involving the age of the accounts receivable. Accounts receivable written-off against the allowance for doubtful accounts approximated 22.9 million, 21.2 million, and 19.2 million during 2003, 2002, and 2001, respectively.

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

Accounting for Stock-Based Compensation

As further explained in Note 24 to the consolidated financial statements, SAP has several stock-based compensation plans. We currently apply the intrinsic-value-based method of accounting for employee stock-based compensation prescribed by Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations. Under this method we recognize compensation expense only if awards are granted with an exercise price that is not fixed or less than the fair value of our ordinary shares on the date of grant. Statement of Financial Accounting Standards (SFAS) No. 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, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by existing accounting standards, we have elected to continue to apply the intrinsic-value-based method of accounting described above, and we have adopted the disclosure requirements of SFAS 123 and SFAS 148. The summary of significant accounting policies in Note 3 to our consolidated financial

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statements provides the required pro forma effects on our reported net income for 2003, 2002 and 2001 as if the fair-value-based method was used to recognize compensation expense as follows:

Net Income

	2003	2002	2001
	(000)	(000)	(000)
As reported	1,077,063	508,614	581,136
Add: Expense for stock-based compensation, net of tax according to APB 25	85,700	5,600	40,357
Deduct: Expense for stock-based compensation, net of tax according to FAS 123	205,109	138,203	