ADRs and International Investing

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Fall 2007
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Why diversify internationally

- Increases diversification, reduces overall investment risk

- Valuation of markets outside the U.S. might be better
  - European stock valuations are on average 15% lower than their U.S. counterparts, and Asian stocks are about 25% lower than U.S. peers based on price/earnings ratio.*

- Weak US$

- Most global markets outperformed the U.S. S&P 500 for the fourth consecutive year as a local benchmark stock market indices in Australia, Brazil, China, Japan, India, Mexico, Norway, and Spain, among others, set all-time highs in 2006.

- The best company in a given sector might not be headquartered in the U.S.
  - From 1992 – 2002, in 7 of 10 sectors, the best stock was from a non-US company**

- 52% of the world`s investment opportunity is outside the U.S., only about a quarter of the world`s largest companies are American**

- Most of the long term growth is outside the developed world (demographics)

Source: *WSJ, viewpoint, **Factset
How to invest internationally

- U.S. global companies provide international exposure as more than 40% of their earnings typically comes from outside the U.S.
  - e.g. McDonalds, Microsoft, GE, Coca Cola, Nike

- Mutual funds that invest in global equities

- A foreign index fund
  - Country or region
  - ETF

- A non-U.S. company
  - Home country
  - American Depositary Receipt (ADR)
Common Difficulties of International Investing

Investing directly in non-U.S. local markets might cause some difficulties:

- Quotes and dividends are in foreign currencies, converting to U.S. dollars is costly and inefficient.
- Clearing, trading and settlement in foreign countries is unfamiliar and cumbersome – language barriers often exist.
- Trading costs and global custodian charges are often much higher than they are in the U.S.
- Dividend withholding and other taxes are often cumbersome and high.
- Annual reports, proxies and other corporate information may not be in English.
# The Solution - ADRs

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The Solution: American Depositary Receipts (ADRs)

- Negotiable certificate representing shares of a non-U.S. based company
- Treated as U.S. domestic securities under U.S. law. Quoted and traded in U.S. dollars
- May be listed (NYSE, AMEX), quoted for trading (NASDAQ) or traded OTC
- For most U.S. individual investors a good way to invest in overseas companies that has the benefit of protections and transparency offered by U.S. securities regulations
History of ADRs

- **1927** First DR program created, U.K.-based Selfridges Department Store, Established to facilitate foreign investment by large U.S. institutions
- **1950s** Several large multinationals in Western Europe, Australia and Japan started to list in the U.S.
- **1970s** Dozens of programs developed for mining companies
- **1980s** Market experienced tremendous growth, but still fewer than 200 DR programs globally
- **1990s** SEC Rule changes, privatizations, global offerings, emerging markets opening bring high visibility to DR issuing and investing
- **1990s–2000** Technology boom, M&A activity drive the market further ahead
- **2006** 1,984 sponsored DR programs from over 76 countries
How ADRs work

- Issuer assigns a bank as depositary for its sponsored DR program
- Depositary issues and cancels ADRs and acts as registrar, transfer agent and paying agent for the DR program
- Investor generally uses broker or depositary's direct investment plan as intermediary to issuer (e.g. DB-Direct Program)

Diagram:

- U.S. Investor
  - Delivers ADRs
  - Local Broker
  - Buys company’s shares in its domestic market
  - Local Custodian for Depositary Bank
  - Depositary Bank (e.g. Deutsche Bank)
  - Issues ADRs
  - U.S. Clearing
American Depositary Receipt (ADR)

Both terms are used interchangeably:
US dollar denominated negotiable instruments issued in the US by a depositary bank (e.g. Deutsche Bank), representing ownership in non-US securities.

An ADR can represent any number or fraction of underlying shares:

- 1 SAP ADR ca. US$47 each
- 1 Cemex ADR ca. US$35 each
- 10 Cemex ORD shares ca. Mex$ 39

- 1 SAP ORD share ca. €36
Where do ADRs trade

- ADRs can be found on the NYSE, NASDAQ and AMEX, or traded over the counter (OTC).

- If an ADR is listed, you can benefit from readily available price and trading information.
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Benefits of ADRs for Investors

- Quoted and traded in U.S. Dollars: trade, clear and settle in accordance with U.S. Regulations
- Easy access to markets that have some of the world`s best companies and/or better valuation than home market
- Opportunity to diversify portfolio while using US$
- ADRs tend to outperform their home markets
- ADRs offer lower trading and custody costs
- Often more tax efficient
- Prompt dividend payments
- Improved information flow - timely corporate action notifications

Investors can choose DRs from over 1,984 companies and 76 countries (sponsored programs).
Benefits of ADRs for listed companies

- Adhere to transparency and disclosure standards of the world's largest equity market
- Access to additional markets for stock as well as for products
- Increase retail and institutional investor acceptance
- Gain access to U.S. investors that are unable to invest overseas
- Enhance share valuation
  (According to two recently published studies, non-U.S. companies that list on U.S. exchanges are valued more highly than comparable companies that don't list.)*
- Increase potential liquidity by enlarging the market for the company's shares
- Stock-option program for U.S. Employees
- Be comparable to U.S. competitors

* Why are Foreign Firms Listed in the U.S. Worth More? by Craig Doidge, G. Andrew Karolyi and Rene M. Stulz of Ohio State University // ADRs, Analysts, and Accuracy: Does Cross Listing in the U.S. Improve a Firm's Information Environment and Increase Market Value? by Mark H. Lang (University of North Carolina), Karl V. Lins (University of Utah), and Darius Miller (Indiana University),
Some DR Issuers May Seem Foreign
Other DR Issuers Make Products You Use Everyday
Benefits of ADRs

How to buy ADRs

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Benefits of ADRs

Trends in the ADR market

Specific risks
Two easy ways to buy ADRs

- Through your Broker
  (Traditional or on-line broker)
  - Purchase ADRs through brokerage firms just as you would purchase any U.S. security
  - Gain advice and benefits of in-depth research from experts in the business

- Through a Direct Stock Purchase Plan
  - Either directly
  - Or through their ADR bank
Dividends are paid in U.S. dollars.

Most European companies pay out dividends once a year.

- U.S. taxes: treated just like U.S. stock dividends
- Home market taxes: Taxes may additionally be withheld by the ADR company's home country. Depending on individual circumstances, foreign taxes withheld might be applied as a credit against U.S. taxes, or tax reclaim opportunities may be offered.

**E.g. Germany:** Dividends are subject to a German withholding tax of 21.1% of the gross amount. Under terms of the Convention for the Avoidance of Double Taxation Agreement between the U.S. and Germany, eligible ADR holders may reclaim 6.1%, thereby reducing their withholding tax to 15%. ADR holders eligible for the refund must be residents of the U.S. in accordance with the aforementioned Convention.

**Contact your broker or tax adviser for more information and U.S. tax forms!**
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U.S. investment in non-U.S. equities

- Foreign equity investment by U.S. investors (DRs and non-U.S. shares) increased 21% to $3.5 trillion at Sept 2006 over Sept 2005.

- U.S. investors continue to increase foreign ownership percentage (2006: 18.3% vs. 2005: 16.8%) relative to total portfolios, as well as overall dollar value.

- U.S. Investors continue to favor developed markets: UK, Japan, France, Switzerland, Germany and The Netherlands.

- Emerging Markets posted the largest percentage annual increase (South Korea, Taiwan, Mexico, Israel).

Source: Bank of New York
DR Trends

- Share volume of listed DRs reached $1.7 trillion in 2006, surpassing the previous highest level in 2000 by more than 25% and an increase of 58% year-on-year.

- DRs traded on the major U.S. stock exchanges continued to be the most liquid, comprising 79% of worldwide DR trading volume.

Source: Deutsche Bank, The Bank of New York
DR Trends

- There are 1,984 total sponsored DR programs, of which 478 are listed on an U.S. Exchange, a 4% increase over 2005.

- 139 new sponsored DR programs from 29 countries were established in 2006, of which 49 were ADR programs, 21 of these were listed on an U.S. exchange.

- More than half of new DR programs were established by emerging markets issuers – BRIC countries (Brazil, Russia, India, China).

- Top three places in terms of number of programs remain India, the U.K. and Australia.
Institutional DR Investors

- U.S. institutional investor demand continued to drive increase in DR trading during 2006.
- Mutual funds, separately managed accounts, hedge funds and exchange-traded funds continued to significant purchasers of DRs.

DR Trading Value by Exchange or Market, 2006, $ bn

- OTC, 50
- Amex/Other, 32
- NYSE, 1,232
- London/IOB, 288
- NASDAQ, 268

Largest DR Investors

- Fidelity Management & Research
- Capital Research & Management
- Dodge & Cox
- Wellington Management
- Brandes Investment Partner
- NWQ Investment Management
- Alliance Bernstein Capital Mgmt
- Lazard Asset Management
- Capital Guardian Trust
- Barclays Global Investors

Source: FactSet, December 2006
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Specific Risks

Investing in ANY security involves a certain amount of risk – along with rewards

As ADRs are backed by non-U.S. securities risks specific to ADRs might include:

- Currency risk - although ADRs are U.S. dollar denominated securities and pay dividends in U.S. dollars, they do not eliminate the currency risk associated with an investment in a non-U.S. company.

- Country risk – political, economic and social conditions in the home market may impact the stock price

U.S. GAAP vs. non-U.S. GAAP (IFRS)

- ADR listed companies have to file a form 20F each year in which they reconcile all their numbers under U.S. GAAP

- Most of Europe reports under IFRS, e.g. SAP reports under U.S. GAAP and reconciles to IFRS
How to research ADR companies

Same sources as for U.S. companies:

- Bloomberg
- Value line (for selected non-U.S. companies)
- S&P
- Depositary website e.g.
  - Deutsche Bank: www.adr.db.com
  - Citibank: http://wwss.citissb.com/adr/www/
  - J.P. Morgan: www.adr.com
  - Bank of New York: www.adrbny.com
- Company website e.g.
  - www.sap.com/investor
- SEC website
SUMMARY

- International equities are a good way to diversify your portfolio
- ADRs are a great way to access the international equity market
- ADRs are negotiable certificates representing shares of a non-U.S. company
- Key benefits of listed ADRs include disclosure and transparency – the level of information is the same as for other U.S. securities
- U.S. investment in foreign equities is growing over the long term
- Many global markets outperform the U.S. S&P 500

Investing internationally can be successful for your portfolio IF you do the same as you would do with any U.S. stock:

**DO YOUR HOMEWORK: RESEARCH !!**
ADRMs and International Investing

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