



ORACLE CORPORATION

(Ticker: ORCL)



Stock Price: \$87.5 (01/07/2021)	Company Size: \$233.7B	Author: Madhu Chaudhary
Company Rank: -	Sector: Information Technology	Industry: Software

Oracle is focused on providing application and infrastructure software and hardware technologies on cloud to a wide variety of businesses.

IN THIS FIRST FOCUS WE'LL COVER:

► Summary of the Business

ORCL is one of the largest software companies globally and offers database management, enterprise business, and other cloud-engineered software products & services.

► Recent Developments

ORCL's top-line grew due to strong growth in its cloud-based offerings. Operating margin expanded marginally due to slight change in revenue mix.

► Competitive Environment

ORCL's peers include SAP, Salesforce, AWS, Azure, Google Cloud etc. In IaaS market, Oracle held 2% market share in Q1 2021 whereas in SaaS segment, it captured 4% market share in FY 2020.

► Conclusions/Recommendations

Oracle is well-placed to capitalize on the ongoing rapid shift in IT infrastructure from on-premise to cloud through its IaaS and SaaS offerings. Despite the growth in cloud segment, given the sheer size of the business, overall company growth is likely to be mediocre in the near to medium term. Current valuation adequately bakes in that growth outlook. We assign a **"YELLOW LIGHT"** rating to Oracle Corporation (ORCL).



Grab-and-Go™ THESIS

An investment in ORCL is a play on increased demand for IaaS and SaaS based solutions. The company has grown to become one of the major players in the cloud infrastructure market through its flagship database management offering. Its success will depend on its ability to successfully migrate its on-premise license-based hardware and software users on cloud.

Data as of 01/07/21 unless specified

Enterprise Value:	\$289.1B	Market Cap:	\$233.7B	Revenue Fwd (TTM):	\$44.2B (\$41.4B)
YTD Return:	0.2%	Fwd (TTM) Price/Sales:	5.3x (5.2x)	RSI:	37.3
Adj. EBIT Margin TTM	46.9%	Revenue Growth (TTM, YoY):	5.1%	ROIC (TTM):	36.5%
52-Week High:	\$106.3	52-Week Low	\$59.7	200-day Moving Avg.	\$86.6
Adj. Net Income TTM	\$14.3B	CFO	\$10.3B	FCF	\$7.1B

Insider Transactions: In 2021, Larry Ellison (Founder & Chairman) sold 9.2M shares, Safra A. Catz (CEO) sold 7.2M shares.

SUMMARY OF BUSINESS

Founded over three decades ago by Larry Ellison who continues to serve as its Chairman and CTO, Oracle has since evolved from a pureplay database management hardware provider to a software giant specialized in offering a whole suite of business infrastructure and application software products and services. Oracle offers necessary business process infrastructure development or Infrastructure-as-a-Service (IaaS) solutions including compute, storage, and network services which the customers can use as a foundation to develop their own business applications. Oracle also offers plug-and-play business application software or Software-as-a-Service (SaaS) products such as Enterprise Resource Planning (ERP), Customer Relationship Management (CRM), and many others. Interestingly, Oracle's customers can deploy its solutions on cloud, on-premises, and on hybrid models giving them flexibility and control over their IT infrastructure. While its legacy on-premise hardware offerings gained strong traction in the past, increased demand for cloud-based business process solutions has led company to make several acquisitions lately. In

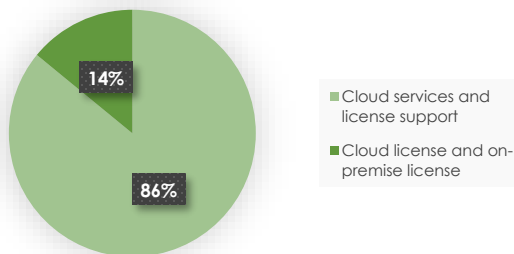
fact, the company has made over 25 acquisitions spending more than \$40B in the last five years. A few of its notable acquisitions include NetSuite in 2016 for \$9.3B, Moat and Aconex in 2017 for a combined \$2B, and several others. In December 2021, the company acquired Cerner, a health information technology company to cater to the large and fast-growing healthcare technology market.

The company operates via its three operating segments.

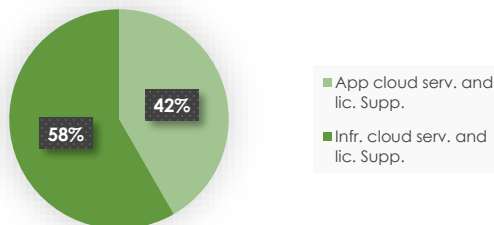
Cloud and License: This business segment includes revenue earned from selling licenses of its combined cloud and on-premise packages, subscriptions for its cloud services (SaaS, PaaS, and IaaS), and license support. Within this segment, recurring cloud services which include its "Fusion" range of application software offerings such as Fusion ERP, Fusion CRM, Fusion SCM, etc., cloud infrastructure services such as Autonomous Database, and license support contributed 86% of total segment revenue whereas its one-time license-based combined cloud and on-premise offerings

accounted for 14% of total segment revenue in [Q2 2022](#). In its cloud services and license support subsegment, infrastructure cloud services and license support accounted for 58% of total cloud services and license support revenue whereas application cloud services and license support contributed the rest. Overall, Cloud and License business segment remained company's largest business division and accounted for 85% of total revenue in [Q2 2022](#).

Cloud and License Revenue Mix - Q2 2022



Cloud Serv. and Lic. Supp. Rev. Mix - Q2 2022

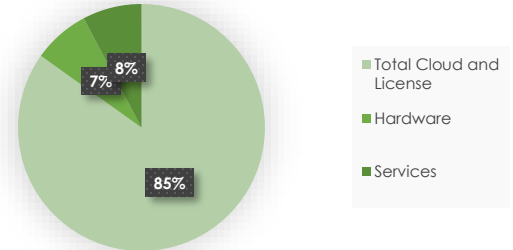


Source: [Company's 10-Q](#)

Hardware: Through this segment, company sells a broad section of enterprise hardware products and hardware-related software products such as servers, storage, operating systems, etc. This business segment contributed 7% to the total top-line in [Q2 2022](#).

Services: Oracle also offers a range of consultancy and advanced customer services relating to its application and infrastructure offerings. This segment accounted for 8% of total revenue in [Q2 2022](#).

Revenue Mix - Q2 2022



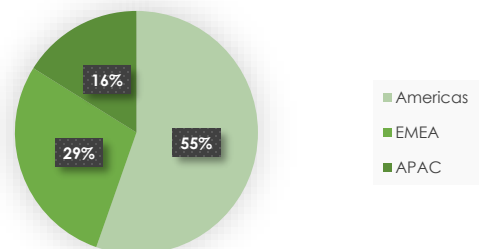
Source: [Company's 10-Q](#)



LB•LOGIC We like the fact that majority of company's top-line is recurring. This ensures stability and predictability in cash flows. The company's ongoing smooth transformation from seller of legacy on-premise products to cloud-based is monumental given the scale of the firm's operations.

Based on geography, Americas contributed 55% of total revenue in Q2 2022 whereas EMEA and APAC accounted for 29% and 16% of total top-line in Q2 2022 as shown in the graph below.

Geographical Mix - Q2 2022



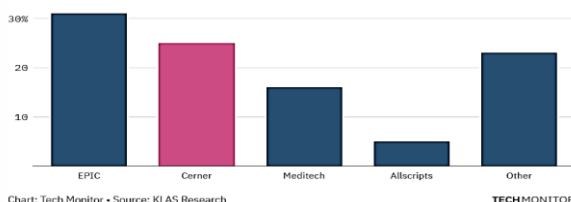
Source: [Company's 10-Q](#)

The company largely relies on its direct sales force to sell its cloud, license, hardware, support, and services. Besides, it also drives sales through

indirect channels via partners consisting of product suppliers, resellers, etc. Its customers come from a variety of different industry verticals such as financial, banking, e-commerce, automotive, and several others.

More recently the company bought Cerner, a leading provider of Electronic Health Record (EHR) solutions for \$28.3B making it one of the biggest acquisitions in the technology space in some time. Cerner recorded \$5.7B in total revenue of which over 80% was recurring, \$1.2B in adjusted operating income representing 21% of total sales, \$974M in adjusted net earnings, and \$1.2B in FCFs for TTM ending [Q3 2021](#). Oracle will likely benefit from large combined revenue/cost synergies post the acquisition integration in the form of Cerner's international expansion as well as technological collaboration. Additionally, through this purchase, Oracle also benefits from the addition of large total addressable market in the form of healthcare spending in the US which reached \$4T in FY 2020. Cerner holds a significant position in the US EHR market with around 25% market share

Cerner is one of the world's biggest EMR firms
Share of the US electronic medical records market in 2020.



Source: [Tech Monitor](#)

RECENT DEVELOPMENTS

In [Q2 2022](#), the company reported \$10.4B in total revenue, translating into 6% YoY growth from \$9.8B in Q2 2021. Top-line grew due to 7% YoY growth each in company's cloud and license and service business segment. Cloud and license business segment revenue increased due to 6% YoY growth in revenue from cloud services and

"With this acquisition, Oracle's corporate mission expands to assume the responsibility to provide our overworked medical professionals with a new generation of easier-to-use digital tools that enable access to information via a hands-free voice interface to secure cloud applications. This new generation of medical information systems promises to lower the administrative workload burdening our medical professionals, improve patient privacy and outcomes, and lower overall healthcare costs." - [Larry Ellison, Chairman and Chief Technology Officer](#)



LB•LOGIC Traditionally, company's legacy on-premise hardware offerings were well suited for enterprise-scale businesses due to high cost associated with it. However, its recent transformation to cloud-based services has opened a significant opportunity among SMBs as well. Besides, acquisitions such as Cerner have also expanded company's addressable market significantly.

license support. Within cloud services and license support subsegment, application cloud services and license support (SaaS-based offerings) grew from \$2.9B in Q2 2021 to \$3.1B in Q2 2022 whereas its IaaS-based offerings registered 5% YoY growth. The growth in company's SaaS-based offerings was largely attributable to addition of

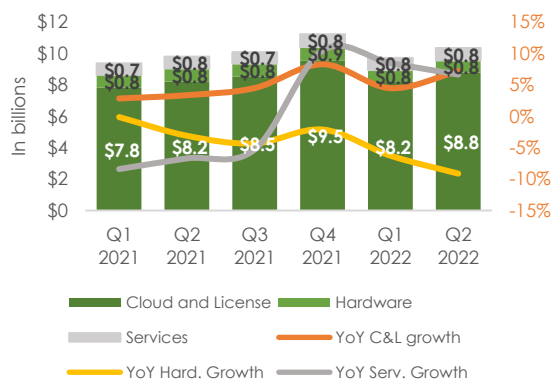
new customers. In fact, Fusion ERP, or company's SaaS-based ERP offering that is one of the largest and fastest-growing division of company's cloud service subsegment, recorded a total of 8,500 customers out of which only 1,000 came from its already existing 7,500 customer-base of on-premise ERP solution. Additionally, it also added 28,000 new NetSuite customers bringing total cloud ERP customer count to 35,500.

"But remember, only 1,000 of those 8,500 came from our old on-premise business. 6,500, plenty to come. So, 7,500 of these 8,500 were not running Oracle ERP before we came out with our cloud product. Those are all new customers, add to that the 28,000 new NetSuite customers. So, Oracle has a total of 35,500 cloud ERP customers that are new to Oracle. Only 1,000 of our on-premise install bases has migrated so far." - [Larry Ellison - Chairman & CTO](#)

Interestingly, company's cloud and license business segment revenue also increased due to 13% YoY growth in cloud and on-premise licenses largely driven by strong traction in company's flagship database management offerings among large-scale businesses such as Salesforce. For full-year 2022, the company expects its cloud service revenue to register a YoY growth in the mid-20s.

Hardware side of the business declined 9% YoY in Q2 2022 due to company's increased focus on its SaaS and IaaS offerings whereas service segment registered 7% YoY growth due to increased sales of its cloud-based services.

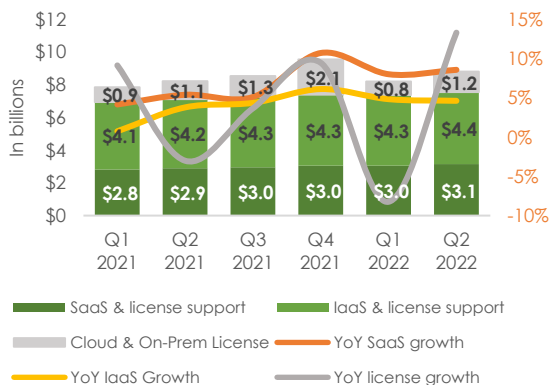
Revenue Trend



Source: [Company's Financial Tables](#)

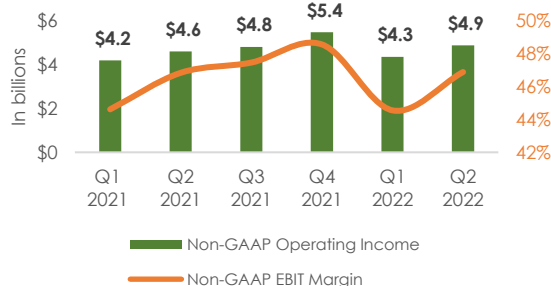
Non-GAAP operating income stood at \$4.9B in [Q2 2022](#), up 6% YoY from \$4.6B in Q2 2021 due to strong growth in top-line. On a margin basis, the company reported a 47% EBIT margin improving marginally (5-bps) from Q2 2021's operating margin due to a slight change in revenue mix towards cloud-based solutions which are more profitable than its on-premise offerings. The company estimates operating margin to remain above 44% for full-year 2022.

Cloud and License Revenue Trend



Source: [Company's Financial Tables](#)

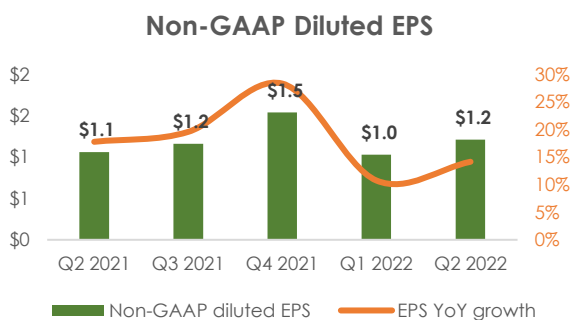
Non-GAAP EBIT Margin Trend



Source: [Company's Financial Tables](#)

Oracle reported \$3.4B in non-GAAP net income in Q2 2022 as compared to \$3.2B in Q2 2021. On a

per share basis, non-GAAP diluted EPS increased 14% YoY from \$1.1 in Q2 2021 to \$1.2 driven by growth in company's infrastructure and applications cloud business as well as a 9% YoY decline in shares outstanding as a result of buybacks. In [Q3 2022](#), the company expects non-GAAP EPS to grow between 2% and 6% YoY in constant currency.



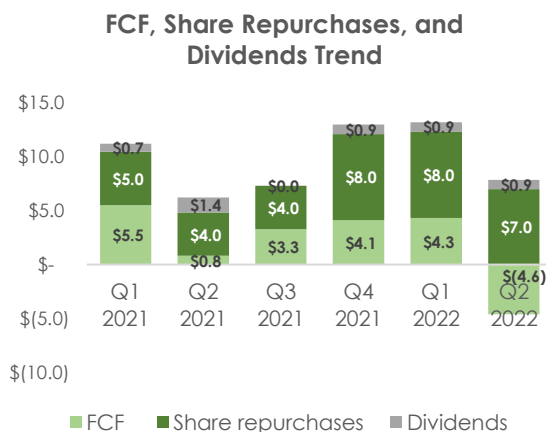
Source: Company's financials

Cash & cash equivalents amounted to \$18B in Q2 2022 whereas the company recorded \$73B in total long-term debt consisting of notes payables and other borrowings. This brought company's net debt at \$55B in Q2 2022. Additionally, the company's almost \$30B acquisition of Cerner will lead to further leveraging of the balance sheet. That being said, company's leverage or net debt to adjusted operating income ratio of 2.9x is manageable given the recurring nature of the company's cash flow streams. Besides,

COMPANY MANAGEMENT

Founder, [Larry Ellison](#) serves as the Chairman of company's board and CTO. He also remained the CEO of the company from its founding in 1977 until 2014. Prior to founding Oracle, he worked for Ampex Corporation where he developed a database management software for the CIA and which became an inspiration to start his own database management company. Mr. Ellison is a University of Illinois and University of Chicago dropout. Here is a small [documentary](#) of Mr.

company's interest expense is well covered by its operating income as evidenced by 7.3x interest coverage ratio pre-Cerner's purchase. It is worth noting here that more debt may lead the company to temporarily slow its share repurchases plan that has been partially supported by debt along with FCFs. In fact, the company has made \$27B worth of share repurchases and paid \$3.4B in total dividends on a TTM basis despite recording just \$7B in FCFs. The board of directors has further authorized an additional \$10B worth of share repurchases which might change in case, the management decides to go slow on returning cash to shareholders following Cerner's acquisition.



Source: Company's Financial Tables

Ellison depicting his rise in the tech business. He also holds about [42%](#) of total shares outstanding as of September 13th, 2021 which makes him the largest shareholder in the company.

[Safra A. Catz](#) has served as the company's CEO since 2014. She joined Oracle in 1999 and has worked in various senior-level roles including CFO since then. Prior to joining Oracle, Ms. Catz worked as the investment banker at Donaldson, Lufkin & Jenrette. She holds a bachelor's degree

from the Wharton School of the University of Pennsylvania and a J.D. from the University of Pennsylvania Law School.



LB•LOGIC We like the fact that ORCL is a founder led business with a focus on long-term growth. Besides, 42% shareholding of Larry Ellison, Founder signifies a lot of skin in the game.

INDUSTRY AND COMPETITION

The pandemic in 2020 accelerated ongoing migration of critical IT infrastructure of businesses such as data centers and enterprise applications like CRM, SCM, etc. from on-premise to cloud. In fact, [Gartner](#) in its recent research estimated that worldwide end-user spending on public cloud is estimated to register a 2-year CAGR of 21% to reach \$400B in FY 2022 from \$270B in FY 2020. Amongst all public cloud solutions, SaaS is estimated to remain the largest segment and is forecasted to register a 2-year CAGR of 19% to reach \$145B in FY 2022. Besides, cloud system infrastructure services or IaaS is forecasted to grow the fastest among all other segments at a 2-year CAGR of 34% to become the second-largest division in this market worth \$107B in FY 2022. Oracle with over 40 years of experience in this market is well positioned to capitalize on this shift considering its already established massive customer base for both of its on-premise and cloud-based solutions.

Table 1. Worldwide Public Cloud Services End-User Spending Forecast (Millions of U.S. Dollars)

	2020	2021	2022
Cloud Business Process Services (BPaaS)	46,131	50,165	53,121
Cloud Application Infrastructure Services (PaaS)	46,335	59,451	71,525
Cloud Application Services (SaaS)	102,798	122,633	145,377
Cloud Management and Security Services	14,323	16,029	18,006
Cloud System Infrastructure Services (IaaS)	59,225	82,023	106,800
Desktop as a Service (DaaS)	1,220	2,046	2,667
Total Market	270,033	332,349	397,496

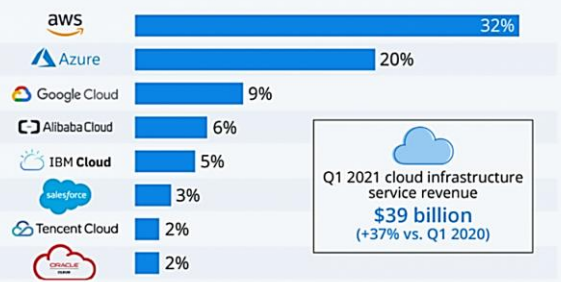
BPaaS = business process as a service; IaaS = infrastructure as a service; PaaS = platform as a service; SaaS = software as a service
Note: Totals may not add up due to rounding.

Source: [Gartner, April 2021](#)

Oracle being a cloud infrastructure service provider faces intense competition from cloud giants such as Amazon's AWS, Microsoft Azure, Google Cloud, Alibaba Cloud, IBM, and several others. In the cloud-based enterprise business applications market, company competes against Salesforce, SAP, Microsoft, Google, Adobe, Workday, etc. As per [Statista](#), cloud infrastructure service market was largely dominated by AWS, Azure, and Google Cloud that held a combined over 60% market share in Q1 2021 while Oracle captured a 2% market share as evident from the chart below.

Amazon Leads \$150-Billion Cloud Market

Worldwide market share of leading cloud infrastructure service providers in Q1 2021*



Q1 2021 cloud infrastructure service revenue **\$39 billion** (+37% vs. Q1 2020)

Source: Statista

In enterprise application software market, Oracle remained behind Salesforce, Microsoft, and SAP

TREND ANALYSIS: VALUATION

The company's stock has rallied over 100% since the virus outbreak in early FY 2020 due to accelerated trend in cloud migration. This has led company to trade at a Price to Earnings ratio of 34x on a forward basis which is significantly

that together held over 20% market share in FY 2020 whereas Oracle captured a 4% market share as per Statista.

LB•LOGIC Despite holding a leadership position in markets such as ERP and database management as per Gartner, Oracle lags market leaders both in the bigger IaaS and SaaS markets. It will take time and acquisitions to make a significant impact in terms of market share in the high growth segments.

higher than its own historical average. On comparing it with its peers, the company's valuation seems full currently.

Company name	Revenue Growth FWD	EBITDA Margin TTM	Net Income Margin TTM	Price-to-Earnings FWD	EV-to-EBITDA FWD
Microsoft Corporation	16.1%	48.7%	38.5%	33.0X	23.9X
SAP SE	2.4%	24.7%	20.8%	26.8X	15.6X
Adobe Inc.	17.0%	41.7%	30.6%	48.0X	27.7X
Oracle Corporation	6.8%	44.5%	24.8%	33.6X	13.4X
VMware, Inc.	8.6%	24.1%	16.1%	29.3X	10.4X

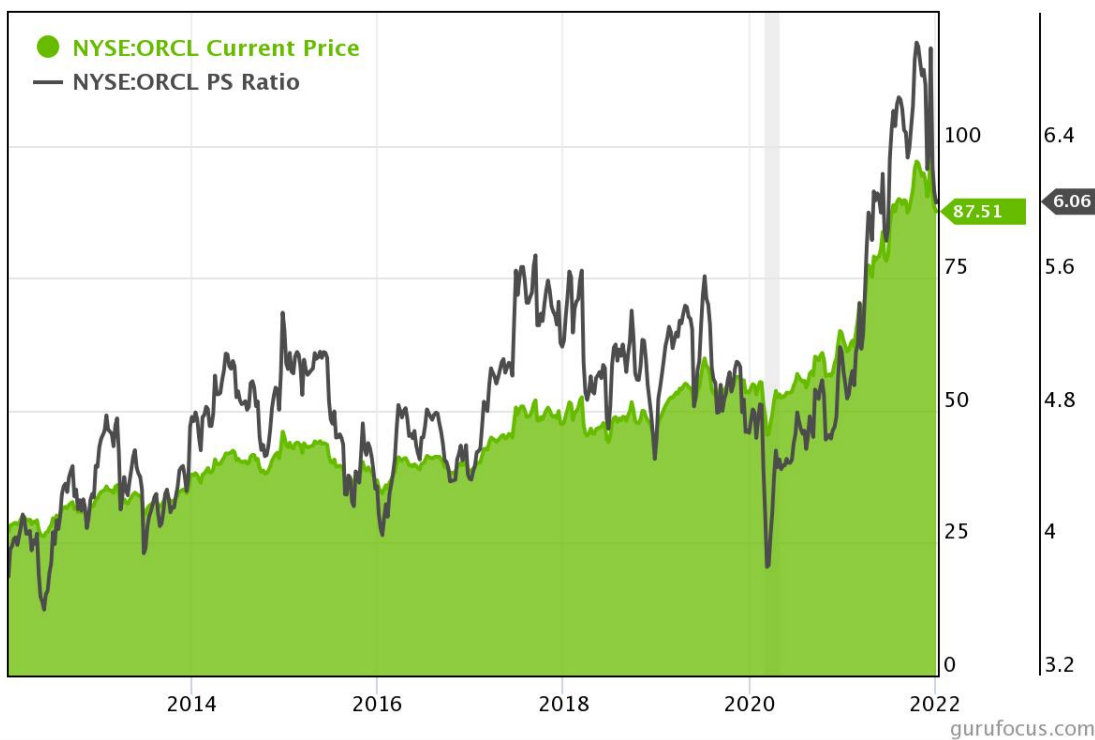
Source: Seeking Alpha

CONCLUSION / RECOMMENDATION

Leveraging secular tailwind evolving from a fundamental shift in IT infrastructure of businesses from on-premise to cloud, Oracle is well placed to grow its top and bottom-line going forward. Besides, recent acquisitions have also opened a significant market opportunity in large and fast-growing industry verticals. That being said, intense competition both in IaaS and SaaS segments from well-established or so-

called walled gardens may put a ceiling on company's growth. Additionally, at current valuation all the future upside opportunities seem to be already priced in. Therefore, we assign a "YELLOW LIGHT" rating to Oracle Corporation (ORCL).

Stock Chart for Oracle Corporation (ORCL)



Performance Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
RETURN ON INVESTED CAPITAL (%)	18.3%	15.8%	16.9%	26.9%	32.5%	31.5%
ADJ. EBIT MARGIN (%)	42.6%	42.9%	43.6%	44.0%	44.5%	46.9%
ADJ. NET EARNINGS (BILLIONS USD)	11.2	11.6	12.9	13.1	12.7	14.1
YoY Earnings Growth (%)	-10.0%	2.9%	11.7%	1.7%	-3.5%	11.4%
NET REVENUE (BILLIONS USD)	37.0	37.7	39.4	39.5	39.1	40.5
YoY Revenue Growth (%)	-3.1%	1.8%	4.4%	0.3%	-1.1%	3.6%

Valuation Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
SHARE PRICE (USD)	40.1	45.5	47.1	50.6	53.3	79.6
SHARES OUTSTANDING (BILLIONS)	4.1	4.1	3.9	3.3	3.1	2.8
MARKET CAP (BILLIONS USD)	164.3	186.6	183.6	166.9	165.2	222.8
PRICE/SALES RATIO	4.4X	4.9X	4.7X	4.2X	4.2X	5.5X

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