

ORACLE®



ORACLE: BEAR CASE

MONEY MAKING MELTING POT



Company Overview

- Largest provider of digital enterprise solutions and databases
- Cloud-based, on premise, and hybrid systems/hardware, along with associated support and services
- Dominant company in the database space for several decades



Business Segments



Cloud and Licensing

- Oracle Cloud Software-as-a-Service (SaaS)
- Infrastructure-as-a-Service (IaaS)
- Licensed Databases, middleware, and development tools
- Java computing language



Hardware

- Oracle Engineered Systems (on-site integration hardware)
- SPARC and Intel microprocessors for server support
- Storage, combination of several different types of storage technology including disks, drives, tapes, and servers



Services

- Consulting services
- Security enhancement, ongoing patches to update and fix flaws/bugs/glitches in the system
- Training and educational programs



Why Bearish?

- Overvalued relative to history/DCF basis
- Stock price supported by massive share repurchases
- Highly competitive market (cloud computing, associated software and applications)
- Behind in compatibility, competitors have cloud services compatible with various different types of devices, late to the IaaS party
- Customer stickiness in question with the desertion of Amazon



Recent News

Share Repurchasing

- Oracle spent roughly \$10 billion on share repurchases in the third quarter

Customer Services

- March 19th, Oracle announced their new Advanced Customer Success Services concierge program to give customers the resources they need to achieve the best benefits of cloud computing

Q3 Earnings

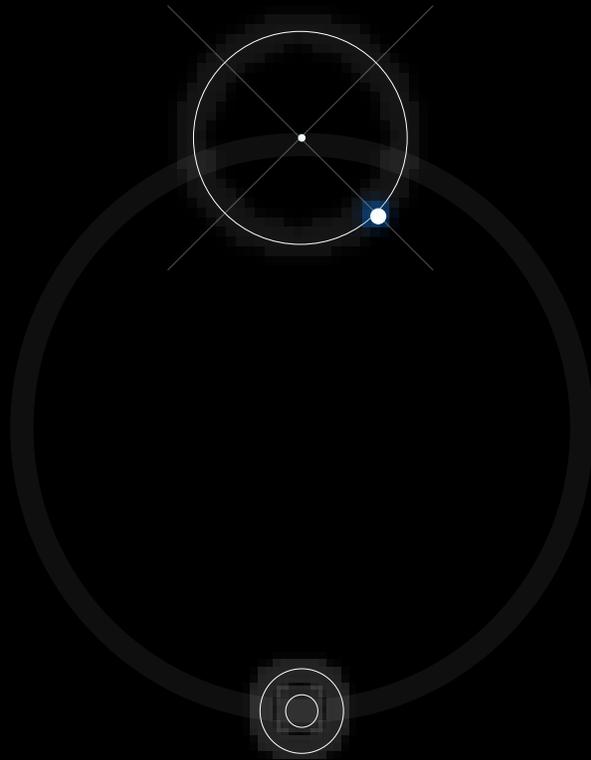
- Non-GAAP EPS of \$0.87 beats by \$0.03 & GAAP EPS of \$0.76
- Revenue of \$9.61B beats by \$20M
- BMO lowers its FY20 estimates for Oracle
 - They think ORCL can sustain a roughly 2% cloud computing revenue growth



RISKS

- Oracle underinvests in their cloud computing compared to companies like Amazon & Microsoft
- Very reliant on their cloud and license business as it was 82% of their revenues in 2018
- Loss of licenses
- New technological developments
- Oracle is facing threats by SAP
 - SAP's ERP customers will be forced to use SAP databases because SAP will no longer support ERP systems that run on Oracle databases





DISCOUNTED CASH FLOWS

Our Default

Earnings Per Share ⓘ :

\$ 3.40

Growth Rate In the Next ⓘ :

10

Years:

5

%

Terminal Growth Rate ⓘ :

4

%

Years of Terminal Growth ⓘ :

10

Discount Rate ⓘ :

12

%

Business Predictability ⓘ :



Save Parameters



DCF

Reverse DCF ^{NEW}

Fair Value ⓘ :

36.39

Tangible Book Value ⓘ :

\$ -7.12

Add to Fair Value

Growth Value ⓘ :

24.25

Terminal Value ⓘ :

12.13

Stock Price:

\$ 52.64

Margin Of Safety:

-45%



Bear Case

Earnings Per Share 	:	\$	<input type="text" value="3.40"/>	
Growth Rate In the Next 	:	<input type="text" value="10"/>	Years: <input type="text" value="2.5"/> %	
Terminal Growth Rate 	:	<input type="text" value="4"/>	%	
Years of Terminal Growth 	:	<input type="text" value="10"/>		
Discount Rate 	:	<input type="text" value="12"/>	%	
Business Predictability 	:	<input type="radio"/>  <input type="radio"/>  <input type="radio"/>  <input type="radio"/>  <input type="radio"/>  		
<input type="button" value="Save Parameters"/>				



DCF	Reverse DCF 
Fair Value 	31.1
<hr/>	
Tangible Book Value 	\$ <input type="text" value="-7.12"/>
	<input type="checkbox"/> Add to Fair Value
Growth Value 	21.56
Terminal Value 	9.53
Stock Price:	\$ <input type="text" value="52.64"/>
Margin Of Safety:	-69%



Bull Case

Earnings Per Share ? :	\$ 3.40
Growth Rate In the Next ? :	10 Years: 8 %
Terminal Growth Rate ? :	4 %
Years of Terminal Growth ? :	10
Discount Rate ? :	10 %
Business Predictability ? :	 ?
<input type="button" value="Save Parameters"/>	

➔

DCF	Reverse DCF <small>NEW</small>
Fair Value ? :	51.84
<hr/>	
Tangible Book Value ? :	\$ -7.12
	<input type="checkbox"/> Add to Fair Value
Growth Value ? :	30.78
Terminal Value ? :	21.06
Stock Price:	\$ 52.64
Margin Of Safety:	-2%



Reverse DCF

Earnings Per Share ⓘ : \$ 3.40

Growth Rate In the Next ⓘ : 10 Years

Terminal Growth Rate ⓘ : 4 %

Years of Terminal Growth ⓘ : 10

Discount Rate ⓘ : 10 %

Business Predictability ⓘ :  ⓘ

Save Parameters



DCF Reverse DCF ^{NEW}

Growth Rate ⓘ : 8.23%

Stock Price: \$ 52.64

Revenue Growth Rate ⓘ : 8.20%(10y) 3.60%(5y) 9.90%(1y)

EBITDA Growth Rate ⓘ : 8.20%(10y) 1.70%(5y) 12.10%(1y)

EPS without NRI Growth Rate ⓘ : 4.10%(10y) -13.00%(5y) 246.30%(1y)

Free Cash Flow Growth Rate ⓘ : 8.80%(10y) 1.30%(5y) 5.60%(1y)

Book Value Growth Rate ⓘ : 10.80%(10y) 4.50%(5y) -43.90%(1y)



Oracle's Moat

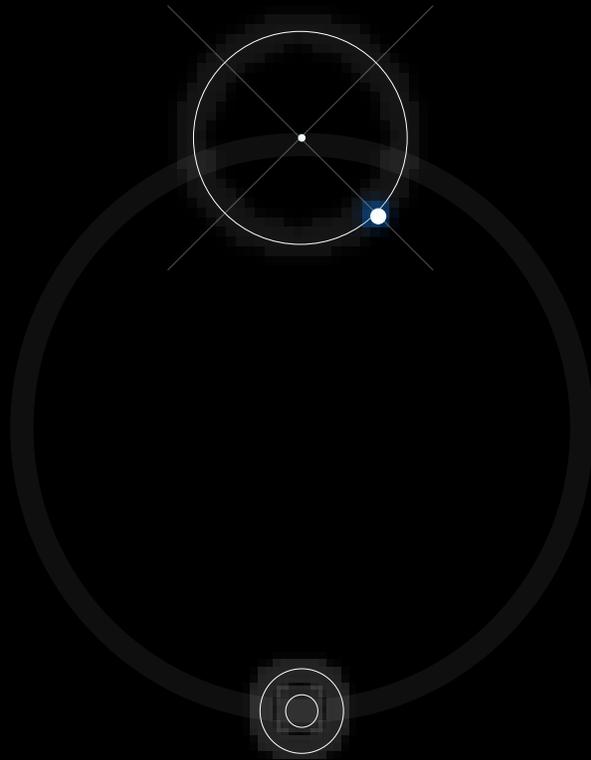
- The switching costs are at risk
- Many companies like Amazon are leaving Oracle's services
- Amazon plans to leave all Oracle services by 2020
- The German company SAP, well-known for its Enterprise Resource Planning (ERP) and data management programs has had over 80% of customers switch from Oracle to Successfactors



CLOUD COMPUTING

- The practice of using a network of remote servers hosted on the Internet to store, manage, and process data, rather than a local server or a personal computer.
- Oracle began cloud computing around 2011
- Oracle is in fourth after Amazon, Microsoft, & Google
- Oracle has underinvested in its cloud offering compared to peers
- No government contracts





MANAGEMENT



Management



Safra A. Catz

CEO

- CEO of Oracle since 2014
- Member of Oracle's Board of Directors since 2001
- Former President and CFO for Oracle
- Is in control of the operations, legal and finance departments



Mark Hurd

CEO

- Joined Oracle in 2010
- Replacement for former Oracle CEO, Larry Ellison
- Has control of sales, service and marketing departments



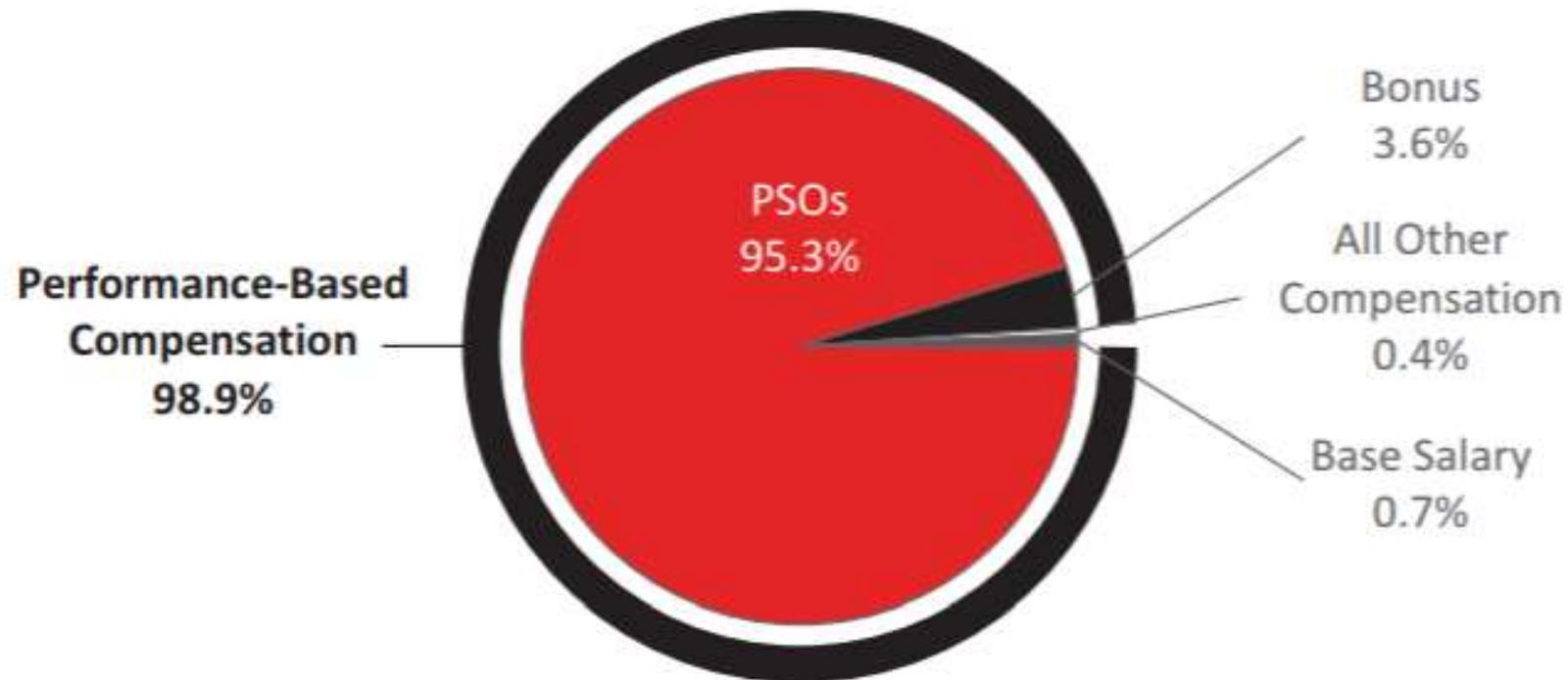
Larry Ellison

Chairman of the Board

- Founder and former CEO of Oracle
- Owns 30% of Oracle's Stock
- Significant control over decisions
- Resistant to Cloud Computing in 2008, changed his mind in 2011



Elements of Fiscal 2018 Compensation
Mr. Ellison, Ms. Catz, Mr. Hurd and Mr. Kurian



Significant Fiscal 2018 Compensation Changes in Response to Stockholder Feedback

In fiscal 2018, Mr. Ellison, Ms. Catz, Mr. Hurd and Mr. Kurian each received an equity award consisting entirely of PSOs that may be earned only upon the attainment of rigorous stock price, market capitalization and operational performance goals over a five-year performance period. When the grant date fair value of the PSOs is annualized over the five-year performance period, it represents a **47% decrease** from the value of the fiscal 2017 equity awards granted to each of Mr. Ellison, Ms. Catz and Mr. Hurd and a **59% decrease** from the value of the fiscal 2017 equity awards granted to Mr. Kurian.



DuPont Analysis

	NPM	TAT	FLM	ROE
Oracle	9.6%	0.29	2.97	8.27%
Microsoft	27.3%	0.44	3.13	37.59%
Google	25.7%	0.64	1.31	21.56%
Amazon	4.30%	1.58	3.73	25.37%



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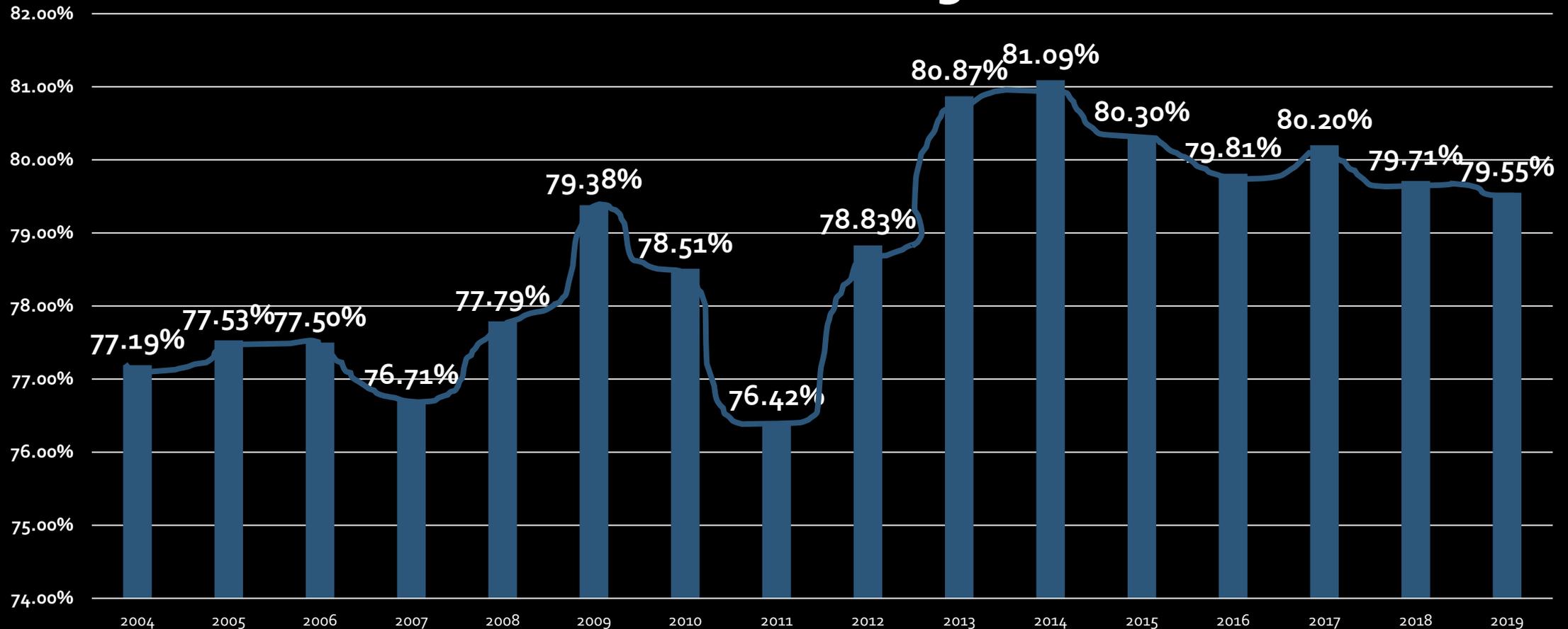


INTERPRETATIONS OF FINANCIAL STATEMENTS



The Gross Profit Margin for 2018 is **79.71%** > 20%.

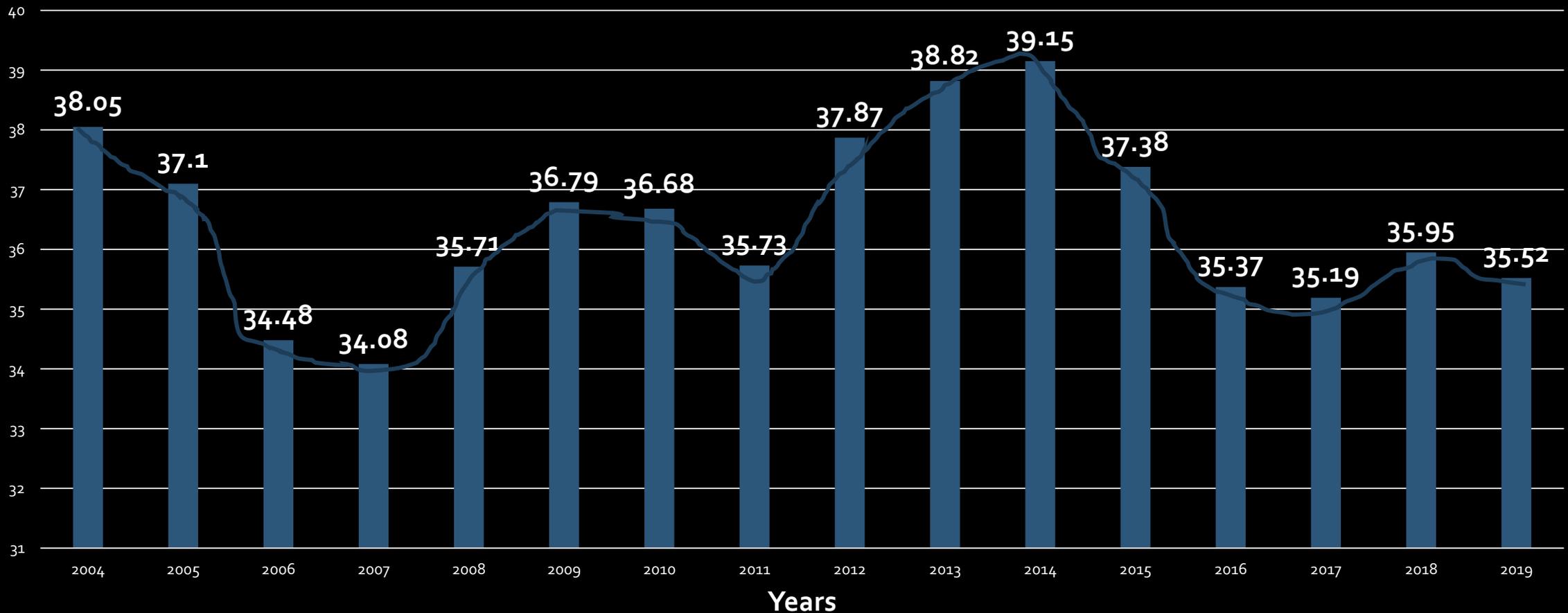
Gross Profit Margin



Operating Margin

Declining

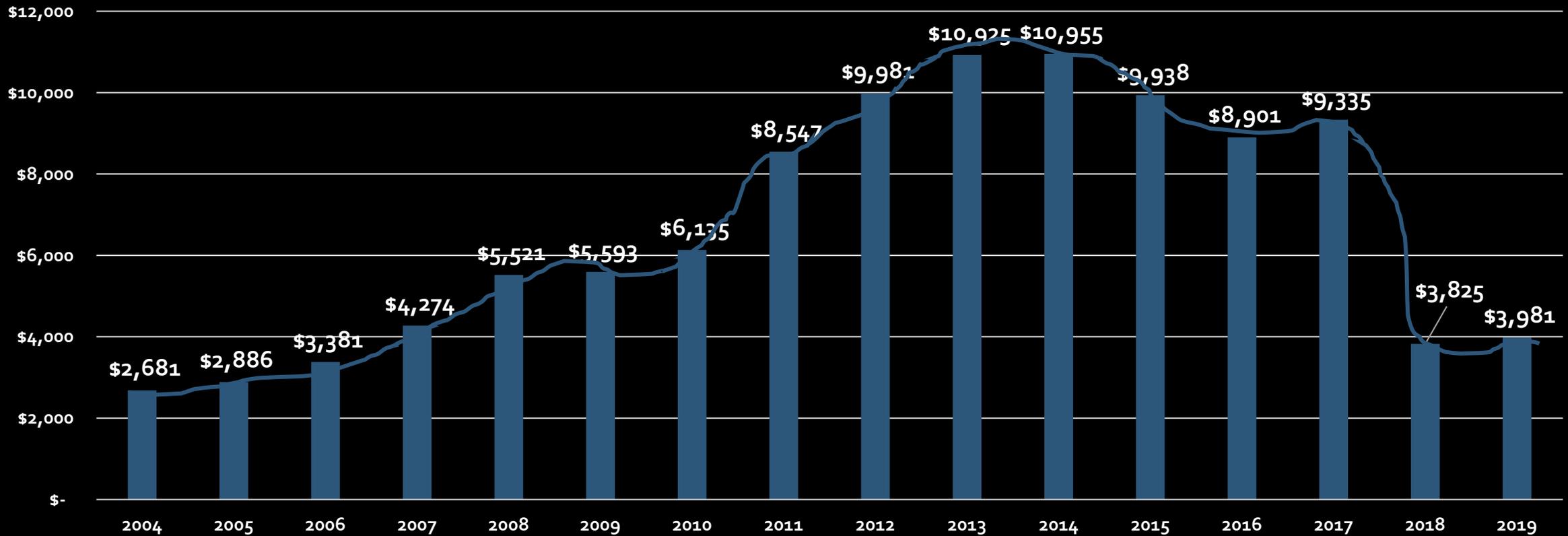
Operating Margin



Net Earnings

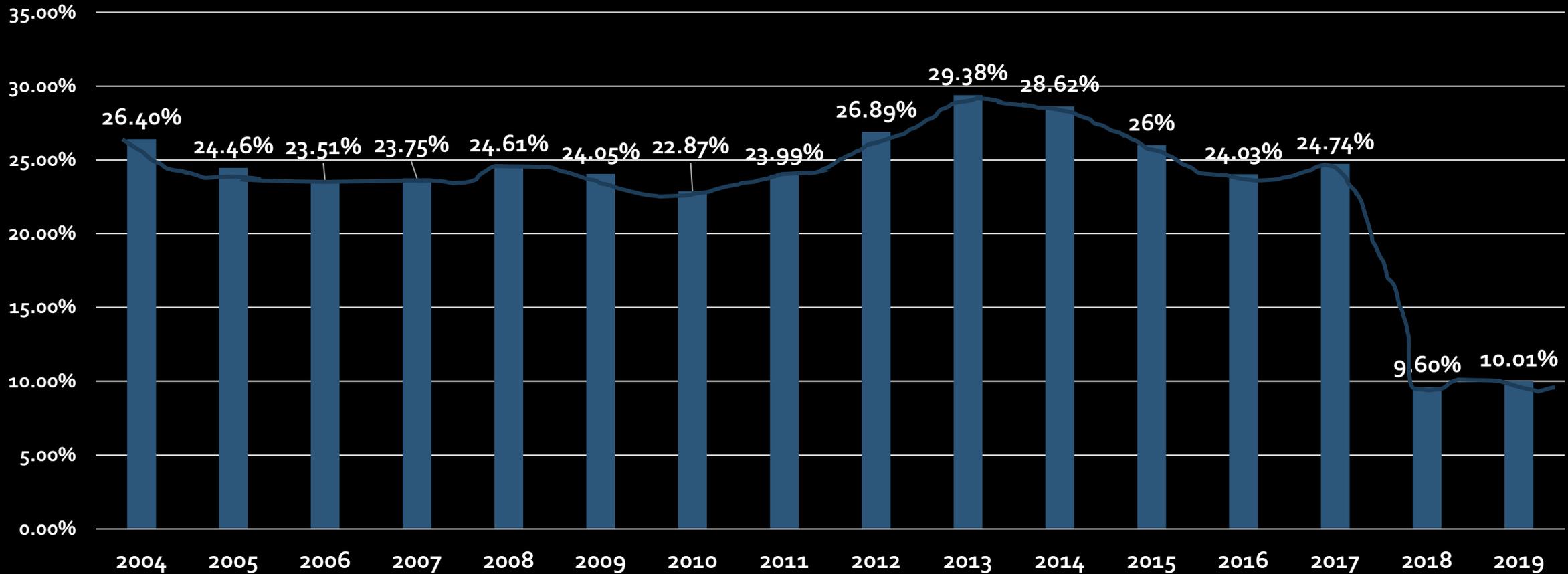
Declining

Net Earnings



The Net Margin of 2018 is **9.60%** > **10%** But **Declining**

Net Margin



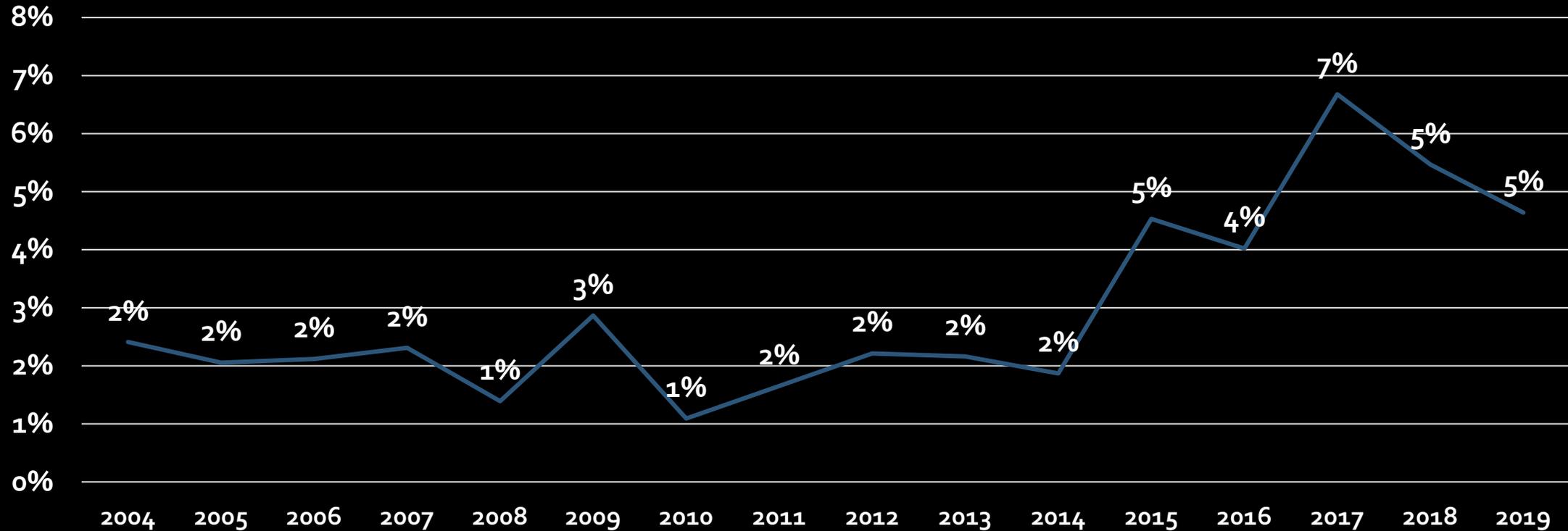
Margin Decline Causes

- In 2018 their Net Earnings were down because of -\$9 Billion of Tax Provision Expenses compared to previous years.
- Since 2013 their Interest Expenses have been increasing from \$797 Million to \$2 billion in 2018.
- In 2017, their cash flow from investing was much lower than previous years at -\$21 Billion because of a purchase that cost \$11 Billion



Capital Expenditures of GP for 2018 is **5%** < 25%

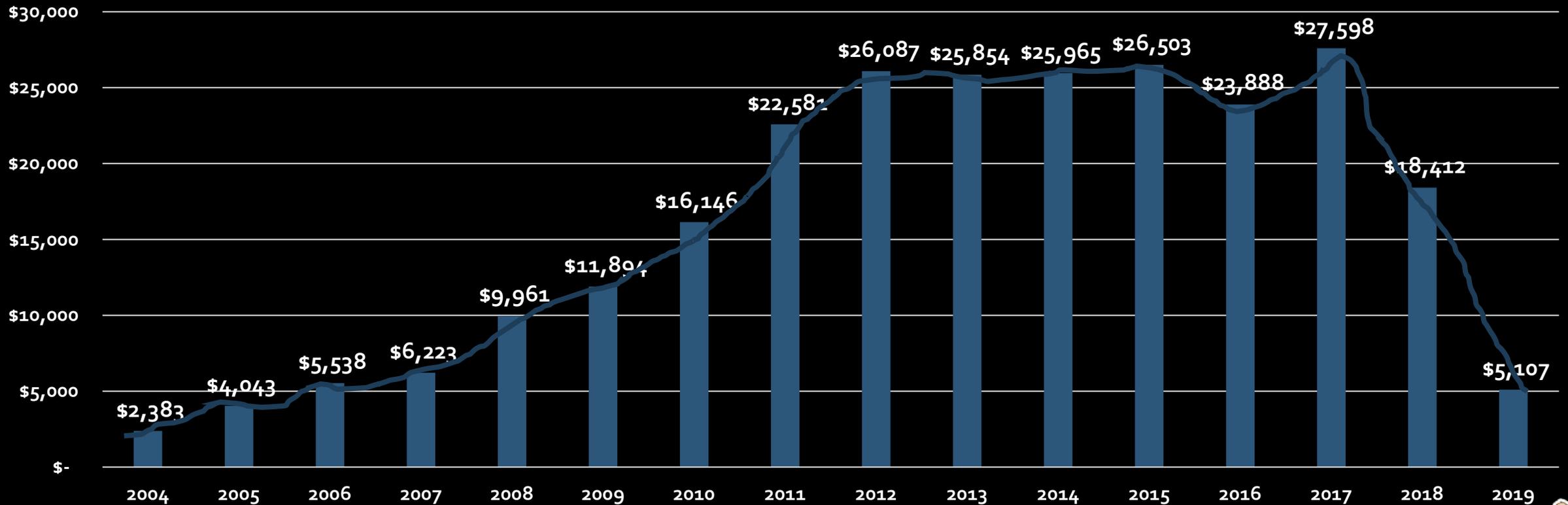
Capital Expenditures of GP



Retained Earnings

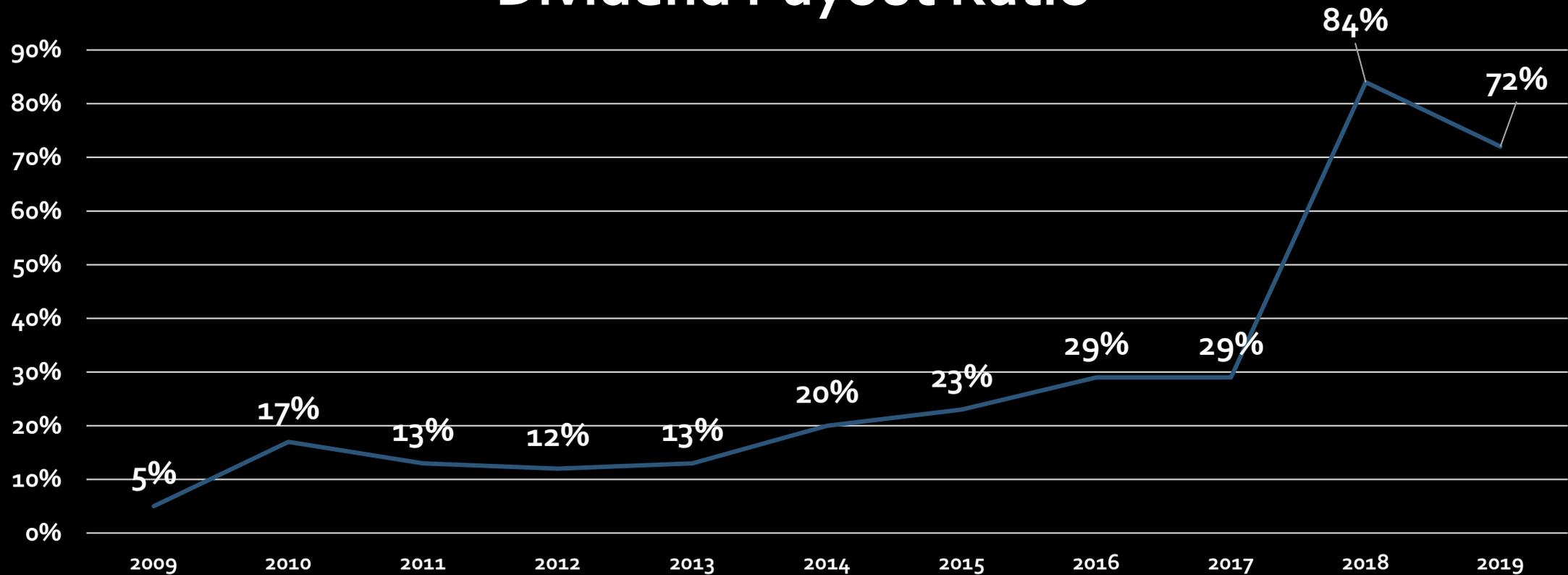
Declining

Retained Earnings



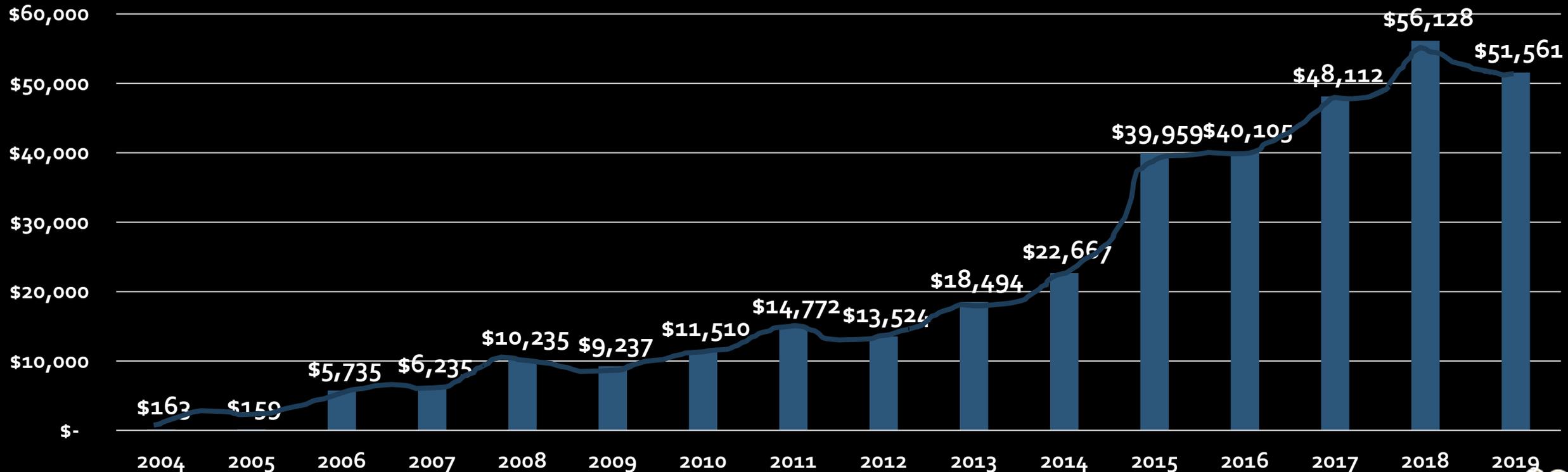
The Dividend Payout Ratio of 2018 is **84%** > 60%

Dividend Payout Ratio



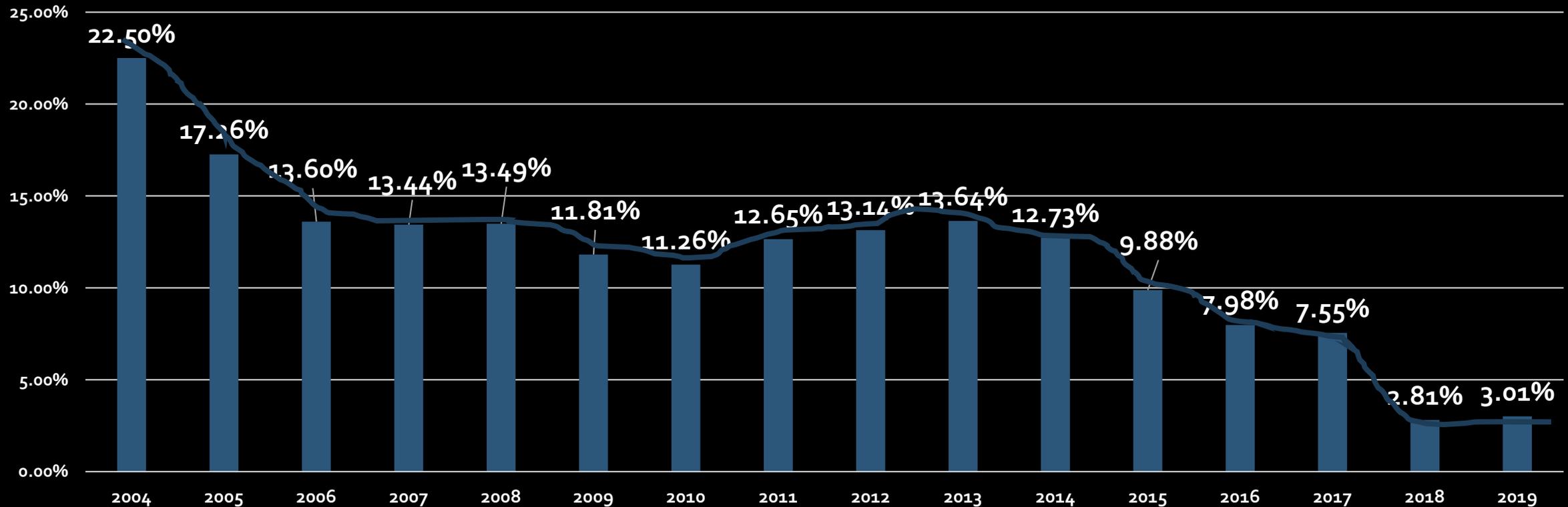
The Obligation Ratio of 2018 is **0.36** < 5 Years
Increasing

Long Term Debt



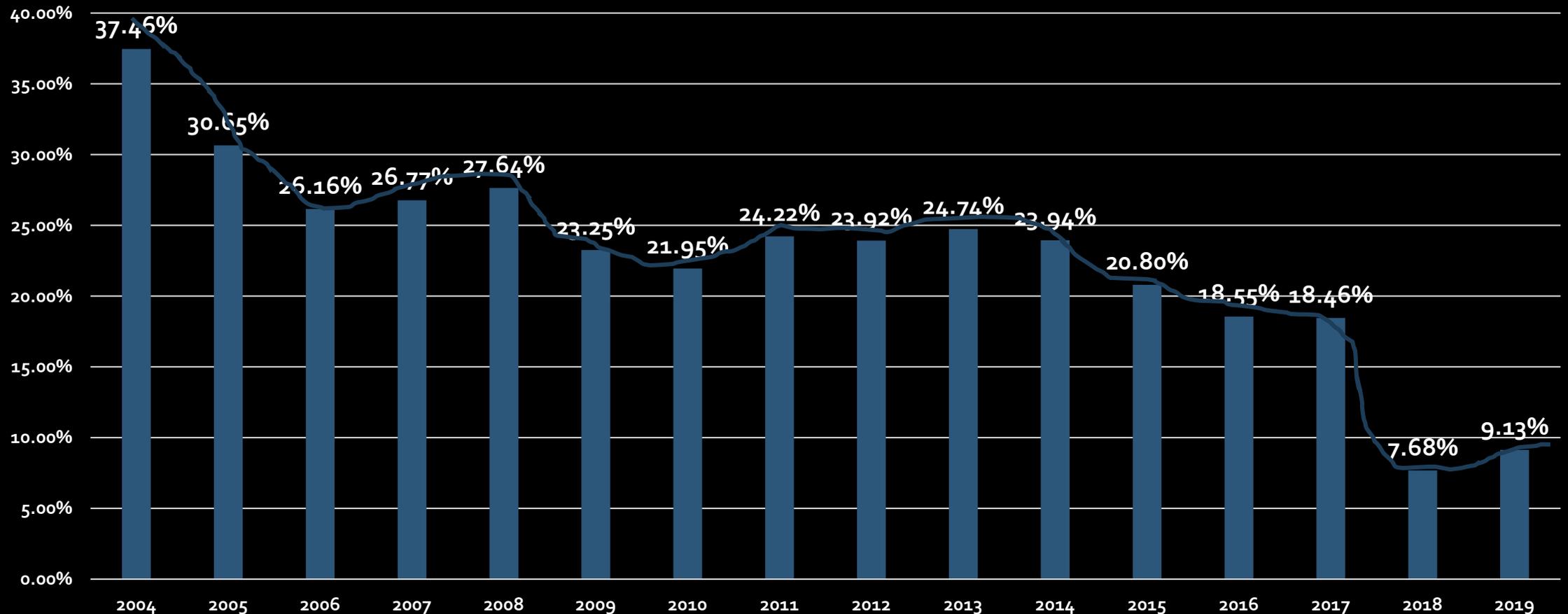
The ROA of 2018 is **2.81%** <15%

Return on Assets



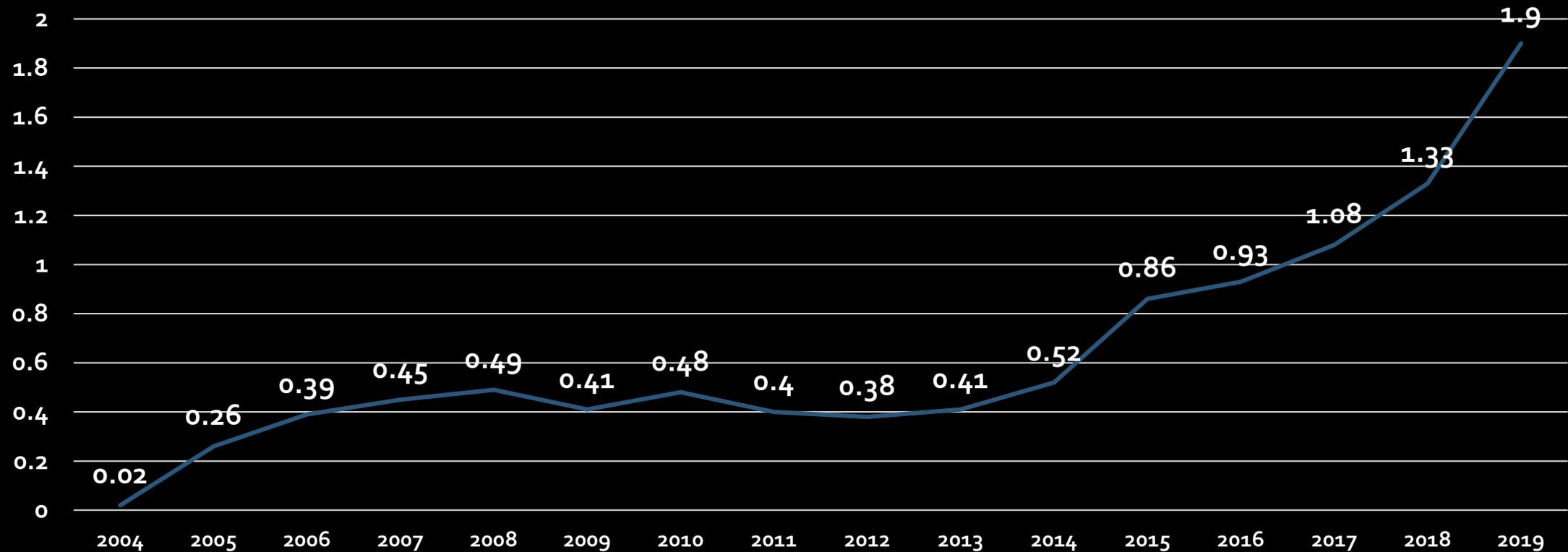
The ROE of 2018 is **7.68%** < 15%

Return on Equity (ROE)



Debt to Equity Ratio for 2018 is **1.33** < 0.8

Debt to Equity Ratio



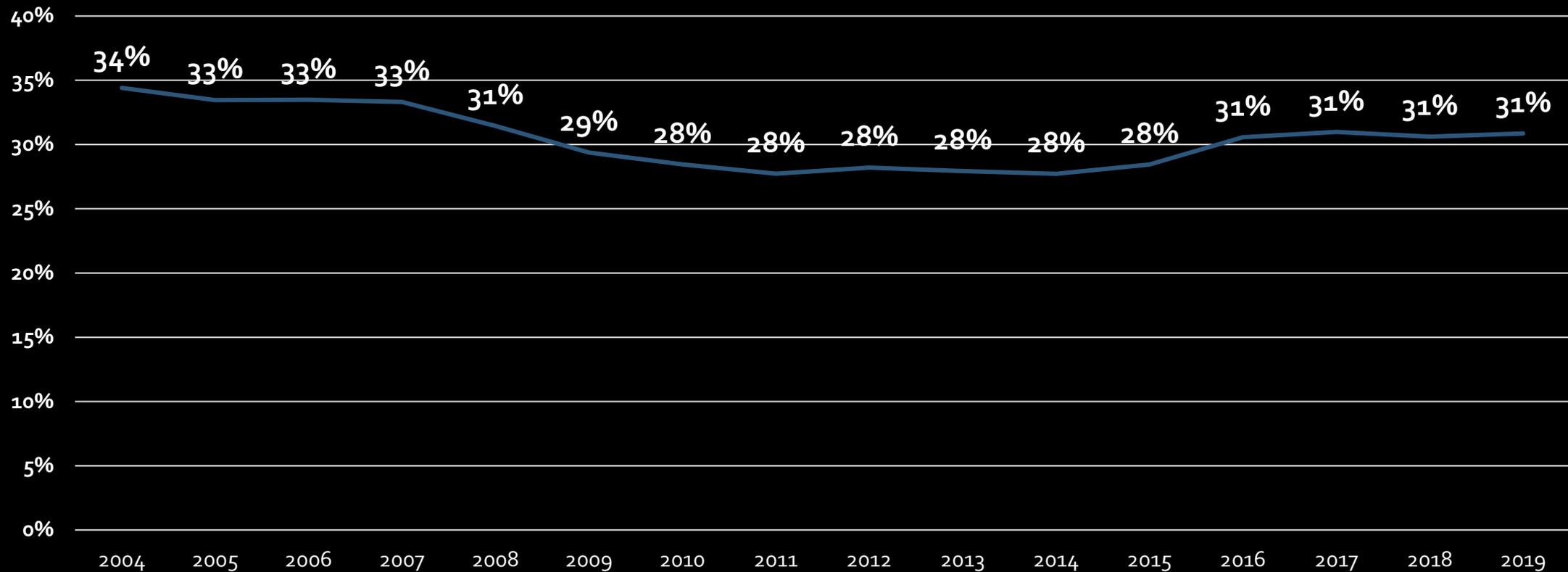
Cause of Debt to Equity **Increasing**

- Given that the debt-to-equity ratio measures a company's debt relative to the value of its net assets, it is most often used to gauge the extent to which a company is taking on debt to leverage its assets.
- A high debt/equity ratio is often associated with high risk; it means that a company has been aggressive in financing its growth with debt.
- Oracle has been issuing more debt to finance their operations.



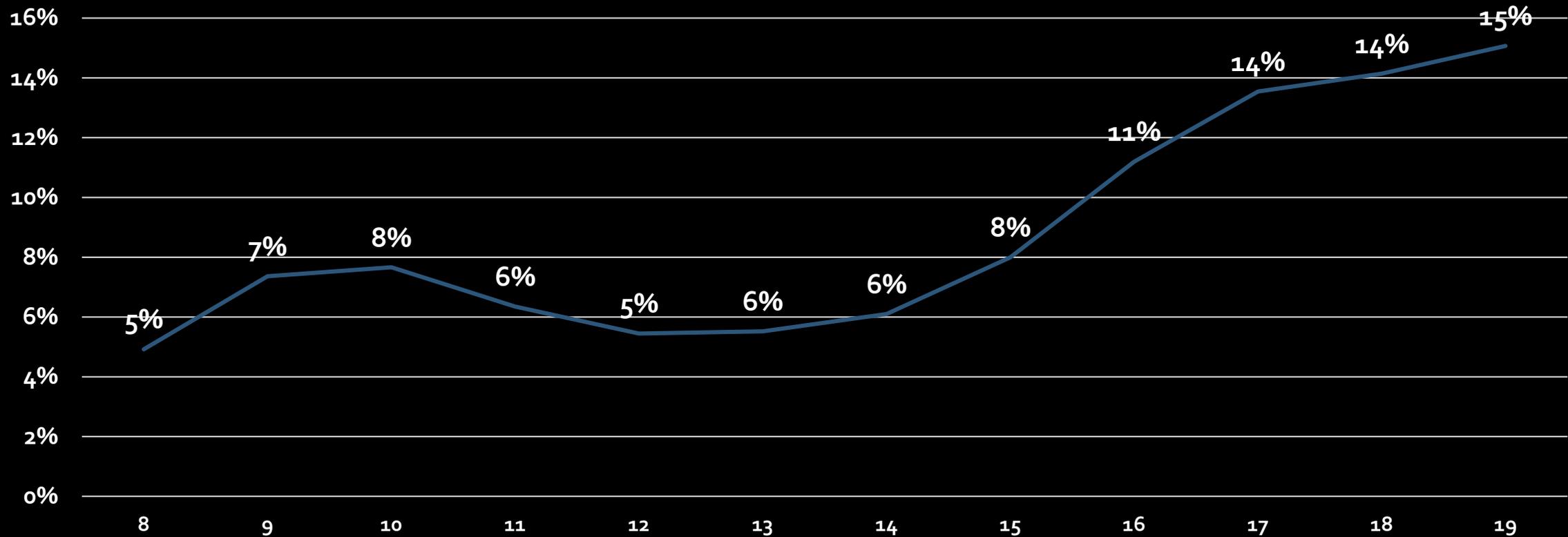
% SA of Gross Profit for 2018 is **31%** < 80%

% Selling, General, Admin Expenses of Gross Profit



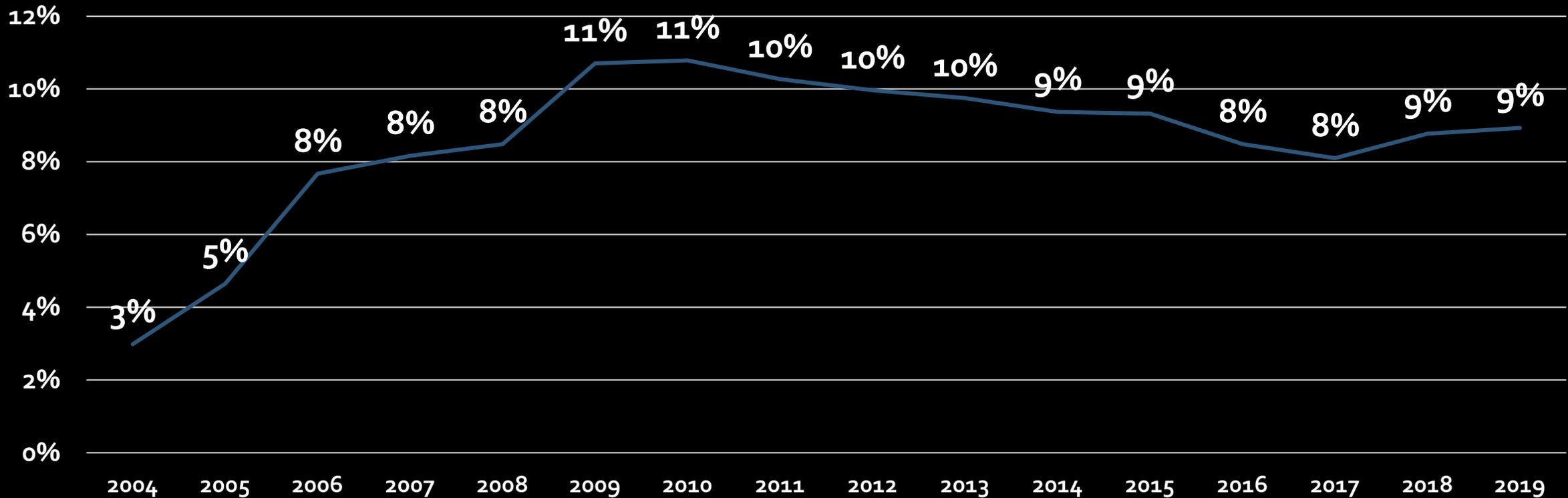
% Interest of Operating Profit of 2018 is **14%** < 15%

% Interest of Operating Profit



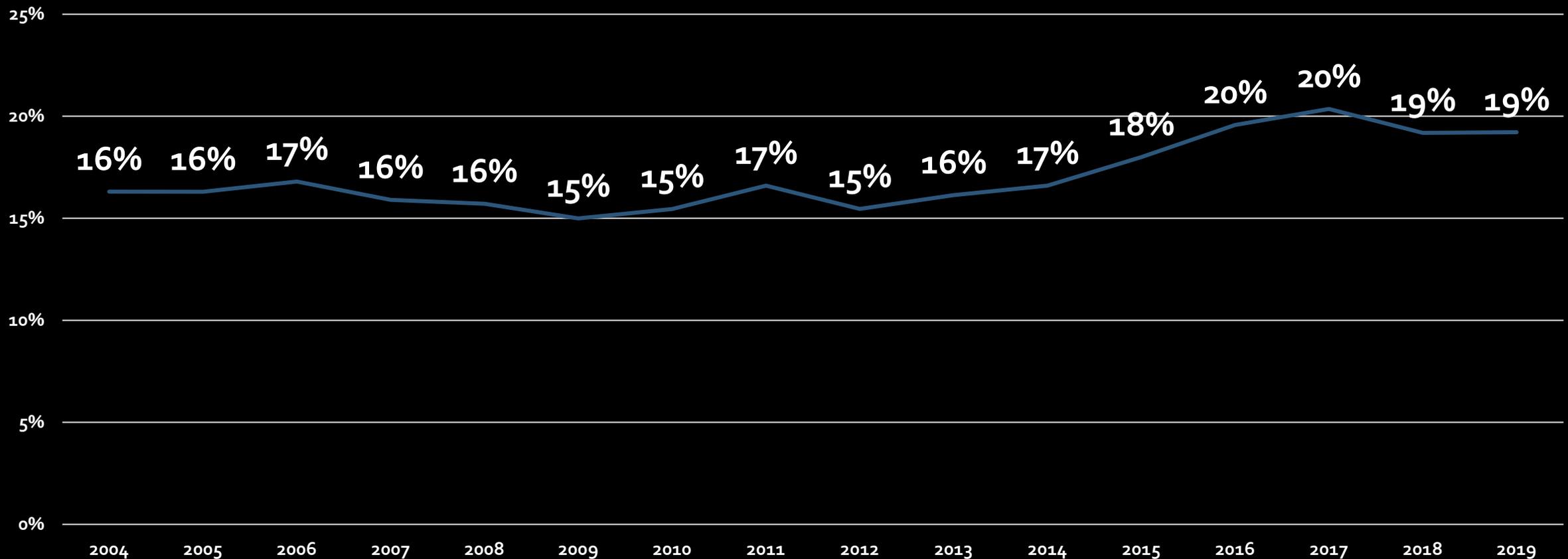
% Depreciation of Gross Profit of 2018 is **9%** < 10%

% Depreciation of Gross Profit



R&D to Gross Profit of 2018 is **19%** > 10%

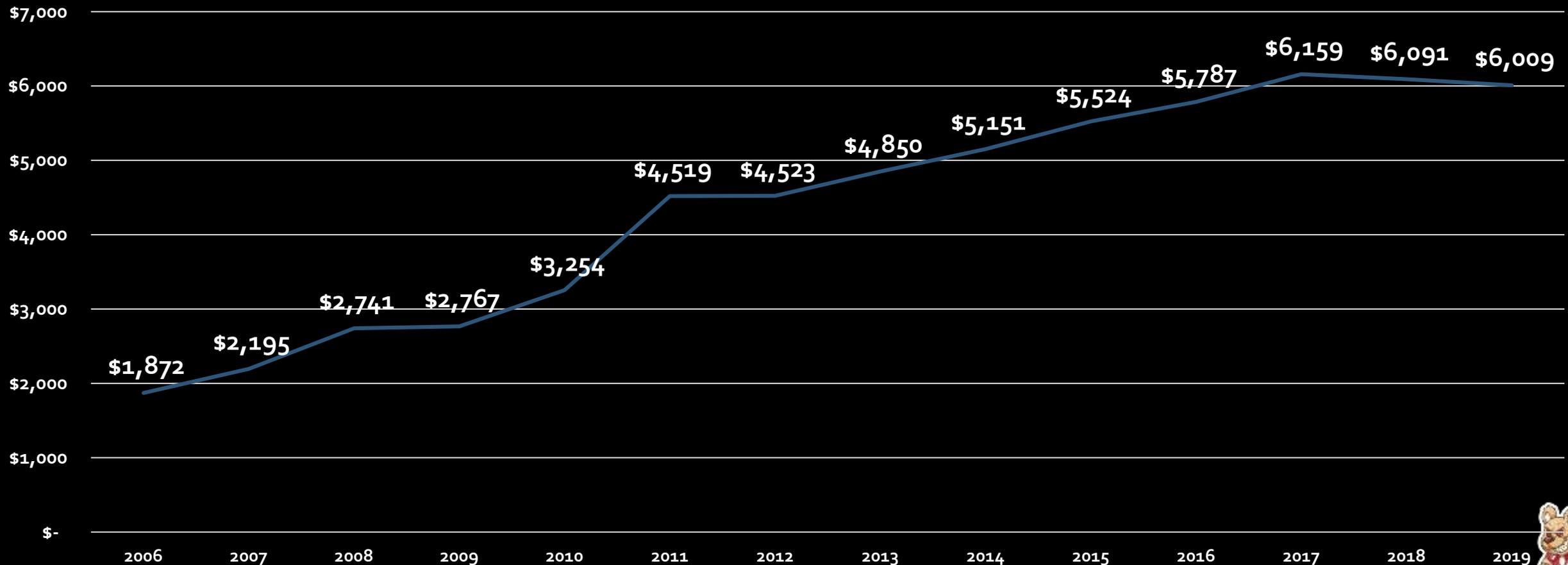
Research & Development to Gross Profit



Research & Development

Increasing

Research & Development in Millions



Oracle has 3 Business Segments:

- Their cloud and license business, represented 82% for 2018, 80% for 2017 and 78% for 2016 to total revenue.
- Their hardware business, represented 10% for 2018, 11% for 2017 and 13% for 2016 to total revenue.
- Their services business, represented 8% of our total revenues in fiscal 2018 and 9% of Their total revenues in each of fiscal 2017 and 2016.
- We can observe how the cloud license business is the only segment increasing. The hardware and their service businesses are becoming less effective.
- This is a problem because they have underinvested in their cloud software compared to Microsoft, and Amazon. Morning Star states that by 2022 non-relational databases will exceed the pace of relational databases by 36% versus 9%.



Amazon Web Services (AWS)

	Year Ended December 31,		
	2016	2017	2018
Net Sales:			
North America	\$ 79,785	\$ 106,110	\$ 141,366
International	43,983	54,297	65,866
AWS	12,219	17,459	25,655
Consolidated	\$ 135,987	\$ 177,866	\$ 232,887



Microsoft Intelligent Cloud Service

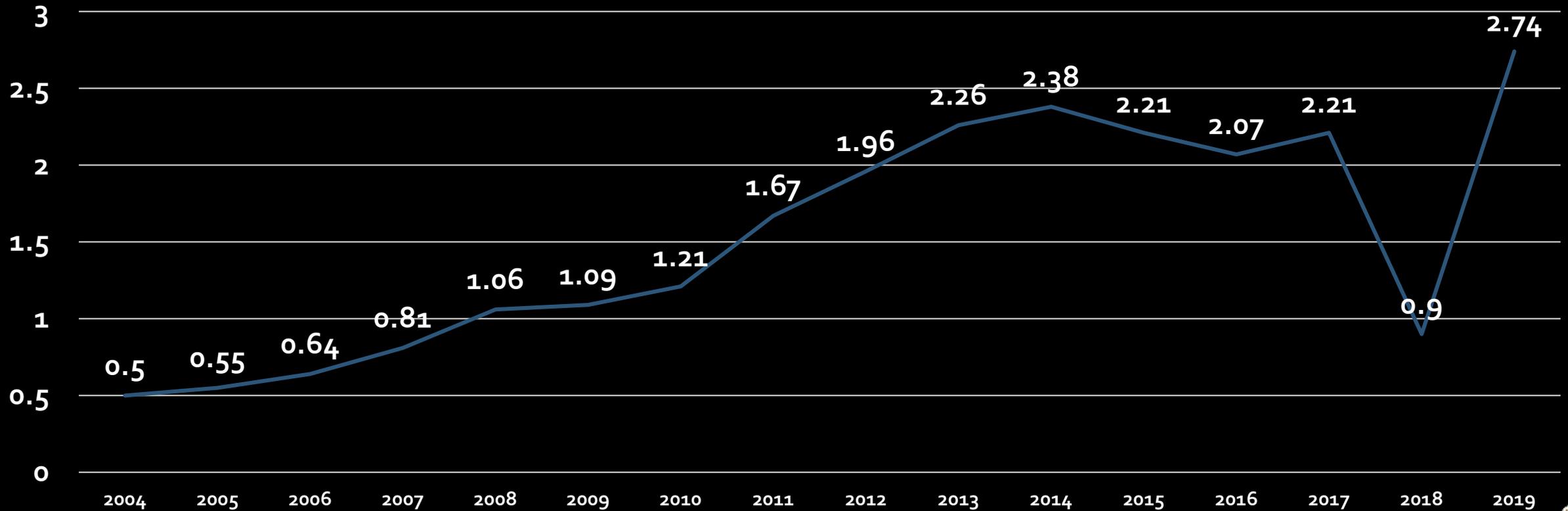
(In millions, except percentages)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
Revenue					
Productivity and Business Processes	\$ 35,865	\$ 29,870	\$ 25,792	20%	16%
Intelligent Cloud	32,219	27,407	24,952	18%	10%
More Personal Computing	42,276	39,294	40,410	8%	(3)%
Total	\$ 110,360	\$ 96,571	\$ 91,154	14%	6%
Operating Income (Loss)					
Productivity and Business Processes	\$ 12,924	\$ 11,389	\$ 11,756	13%	(3)%
Intelligent Cloud	11,524	9,127	9,249	26%	(1)%
More Personal Computing	10,610	8,815	6,183	20%	43%
Corporate and Other	0	(306)	(1,110)	*	*
Total	\$ 35,058	\$ 29,025	\$ 26,078	21%	11%

* Not meaningful



Earnings Per Share

EPS

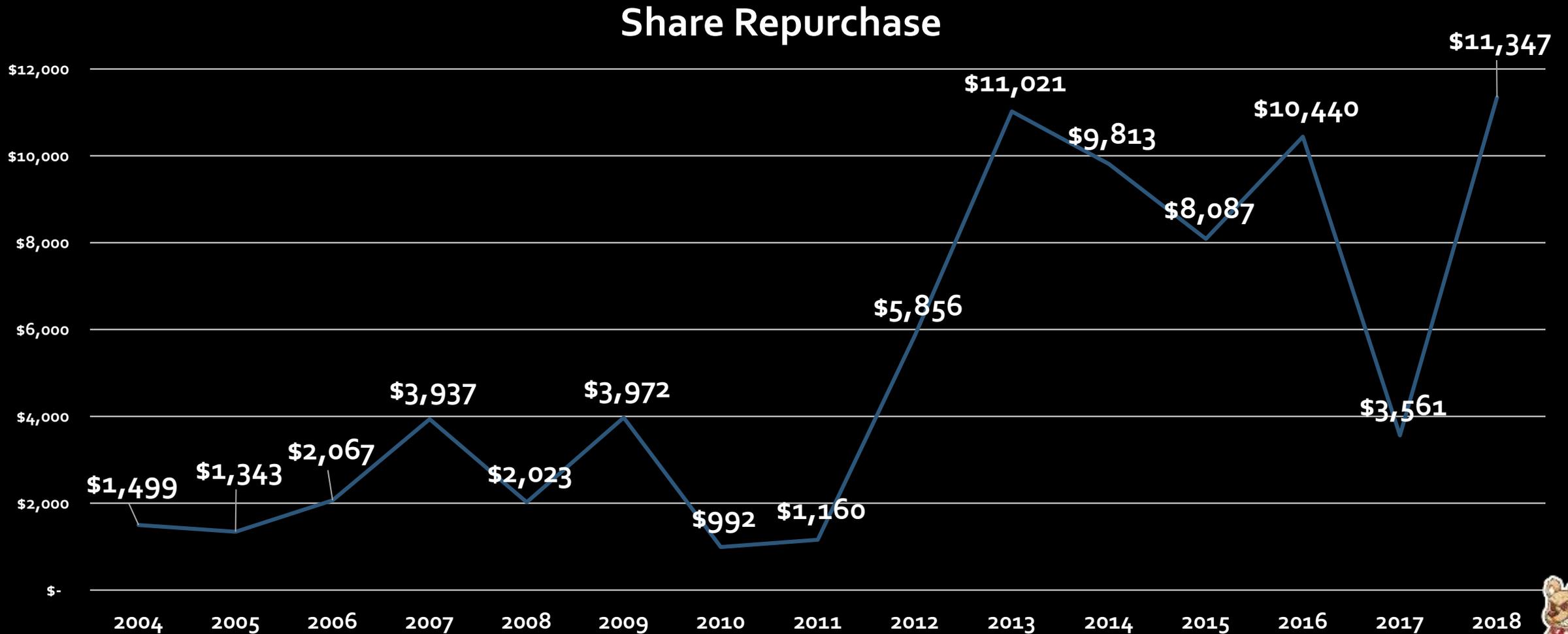


Share Repurchase Driving up EPS

- On February 12, 2019 Oracle bought back \$12 Billion of common stock.
- Oracle's Market Capital back in September was \$201 Billion and as of February 19, 2019 Oracle has a Market Capital of \$186 Billion.
- In 2018 Oracle had EPS of 0.9 this massive share repurchase increased the EPS to 2.74 in 2019. The increase of EPS was not organic growth it was simply due to management engineering.
- It is not the first time Oracle has done this aggressive Share Repurchase.
- This is a problem because they could have used this money to invest more into their cloud software.



Share Repurchases



Berkshire Selling Oracle Shares

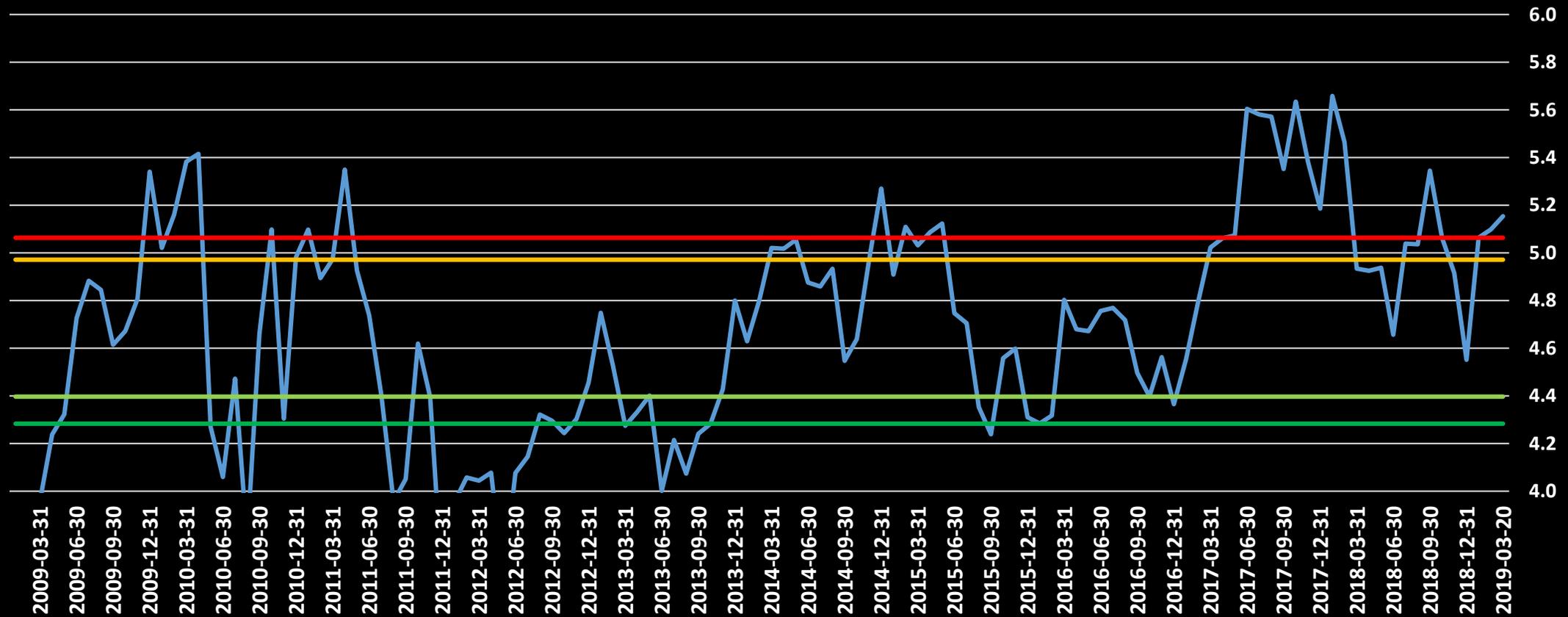
- Towards the end of the 3rd Quarter Berkshire purchased over \$2.1 Billion worth of shares, and at the 4th Quarter Berkshire had zero.
- It is unusual to see a technology company in Berkshire, but even more unusual that they had Oracle for less than one Quarter.
- Warren stated that he does not understand Oracle, He doesn't know where the cloud software will be in the future.



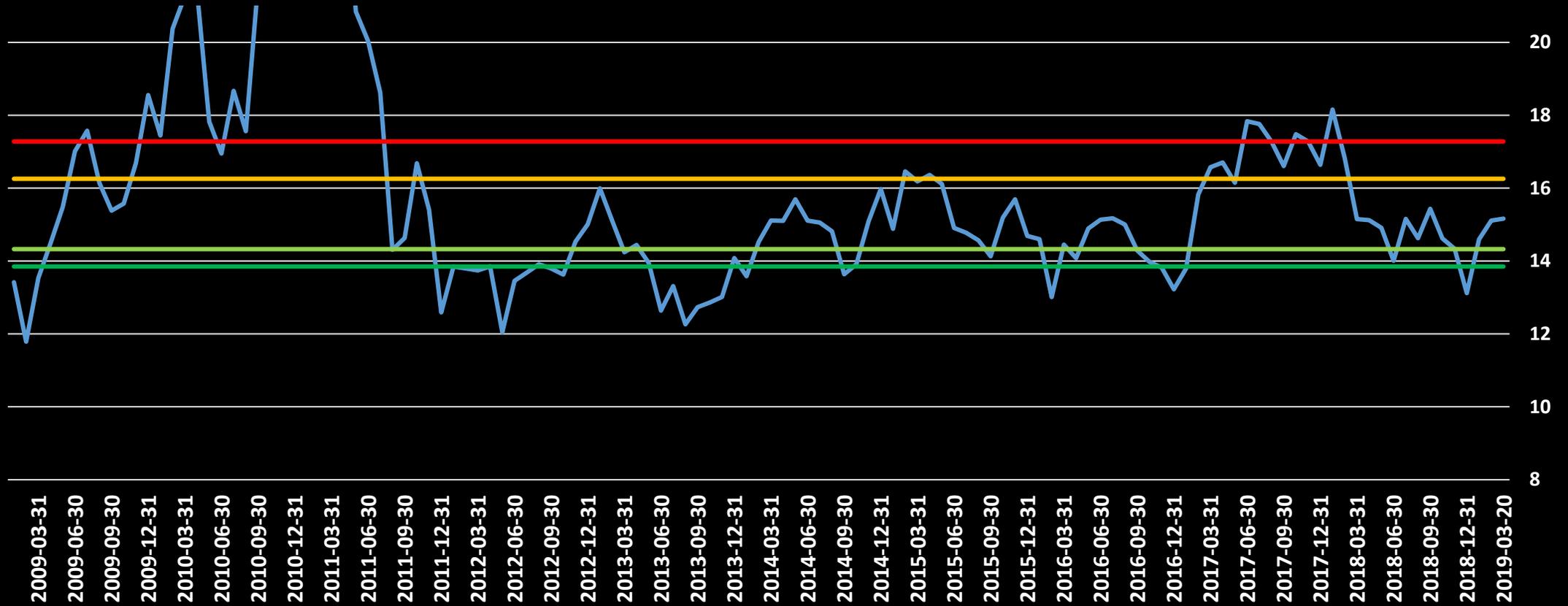
Value Bands



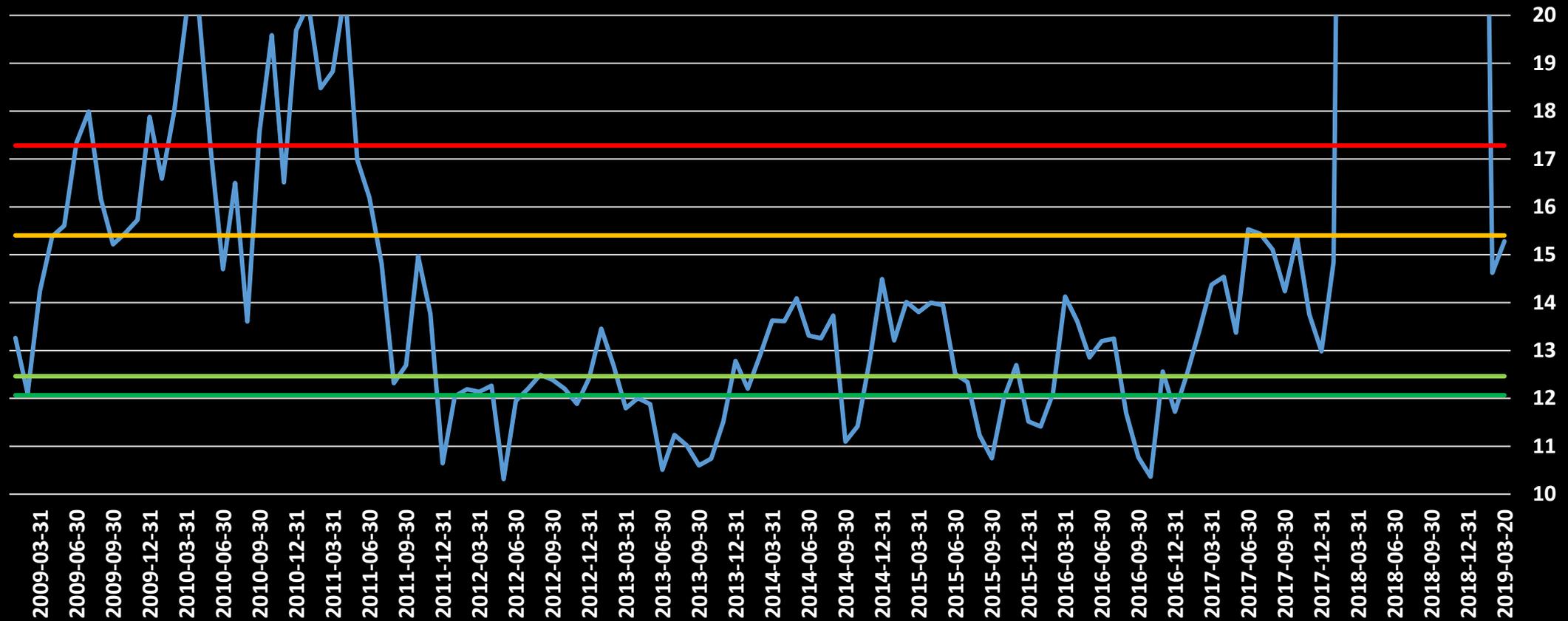
Price/Sales



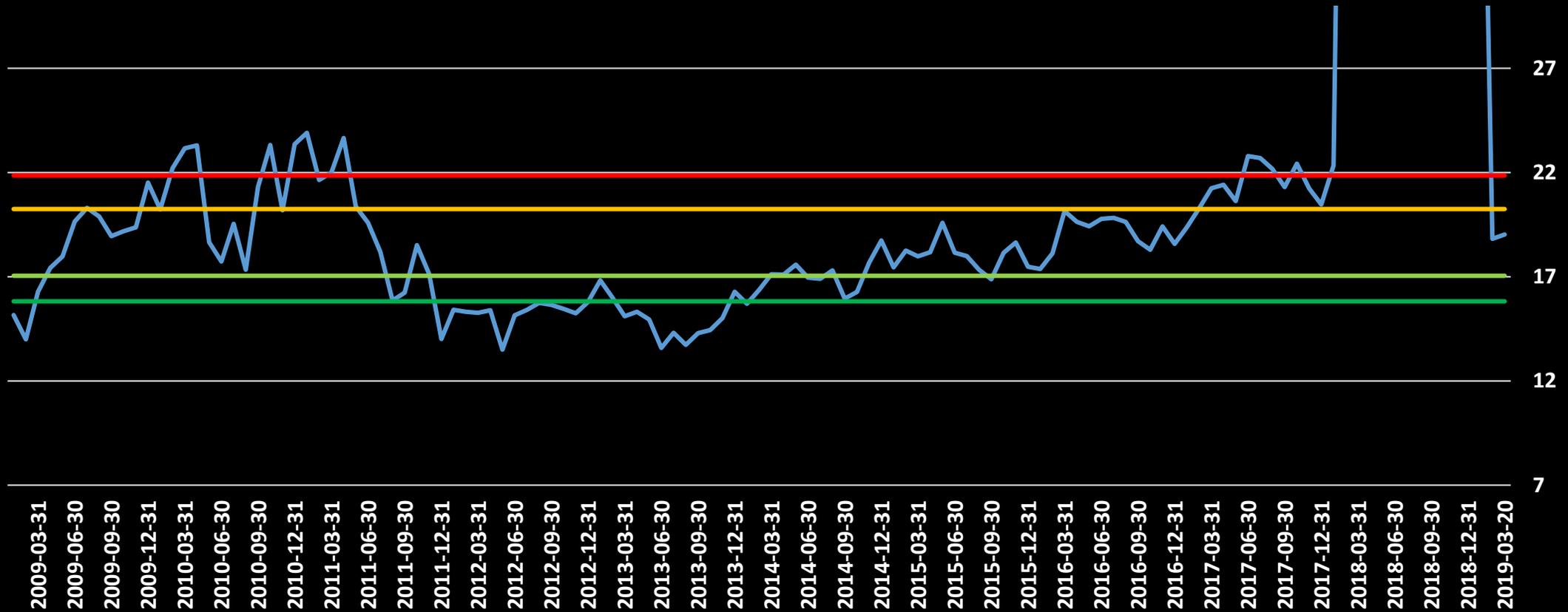
Price/Owner's Earnings



Price/Earnings Less Cash



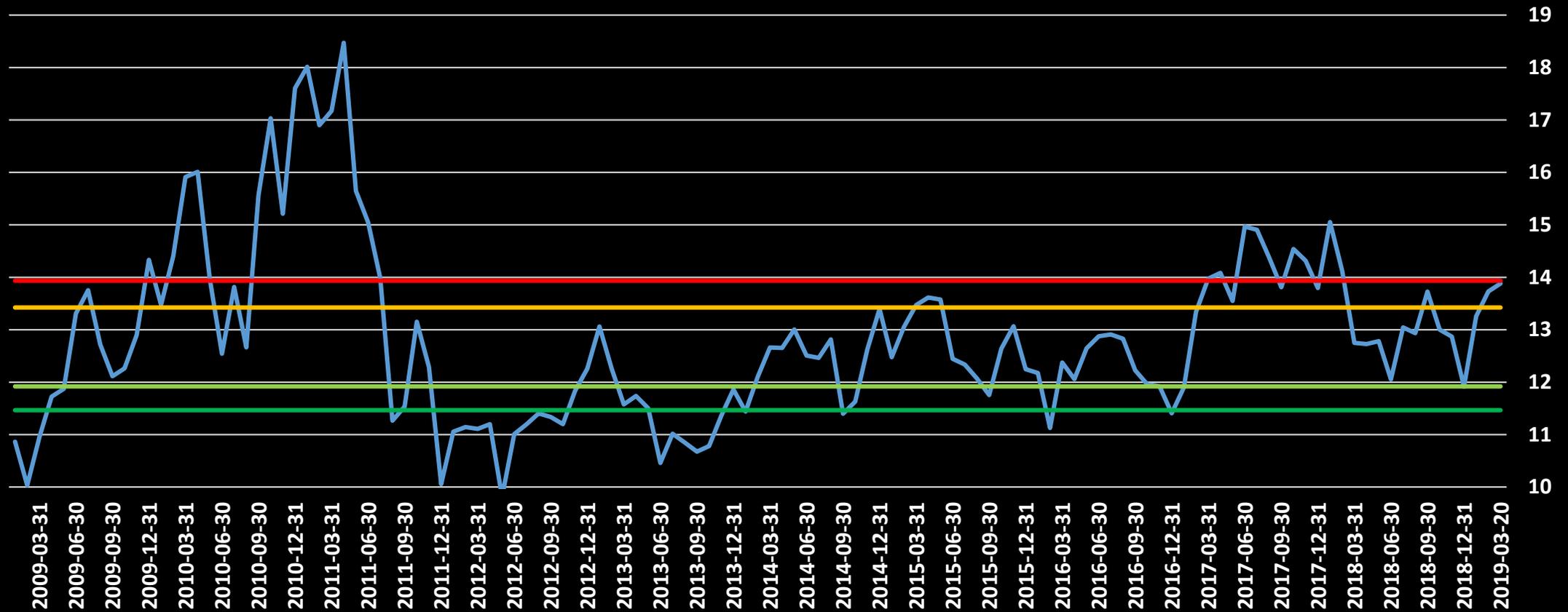
Price/Earnings



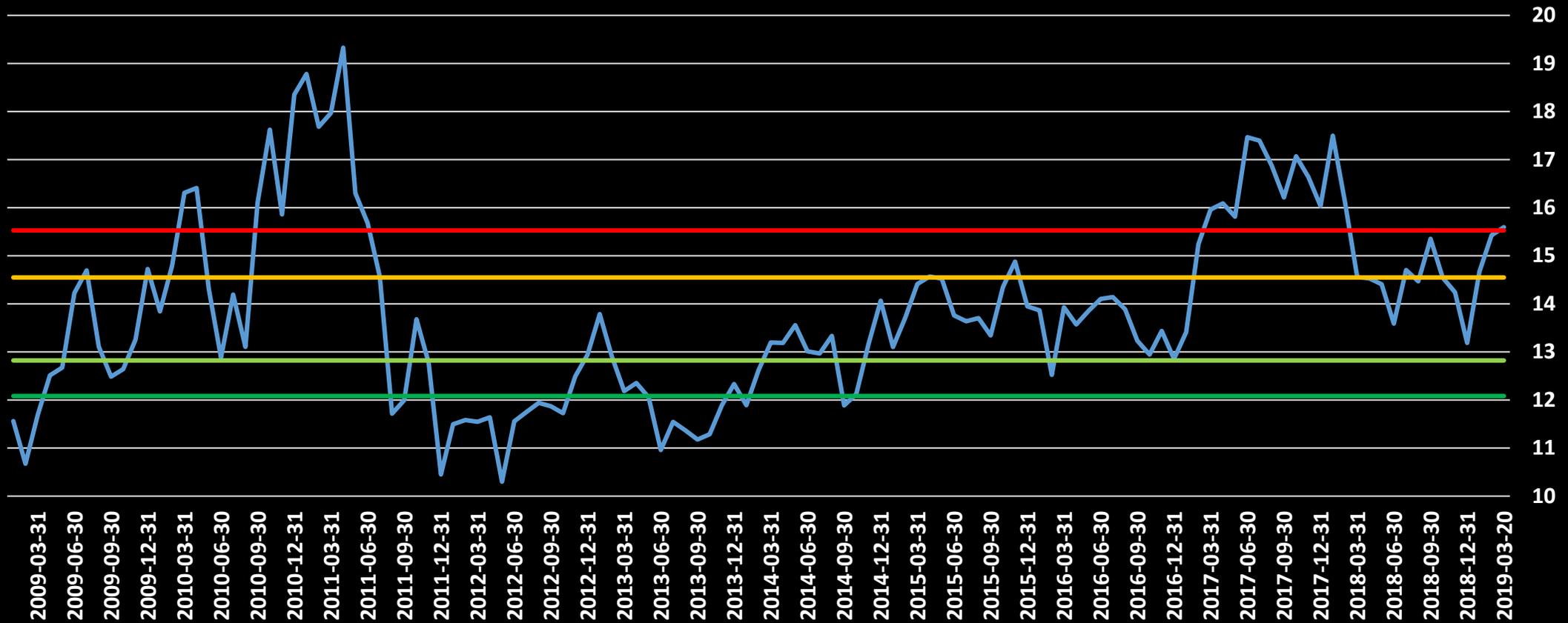
Price/Book



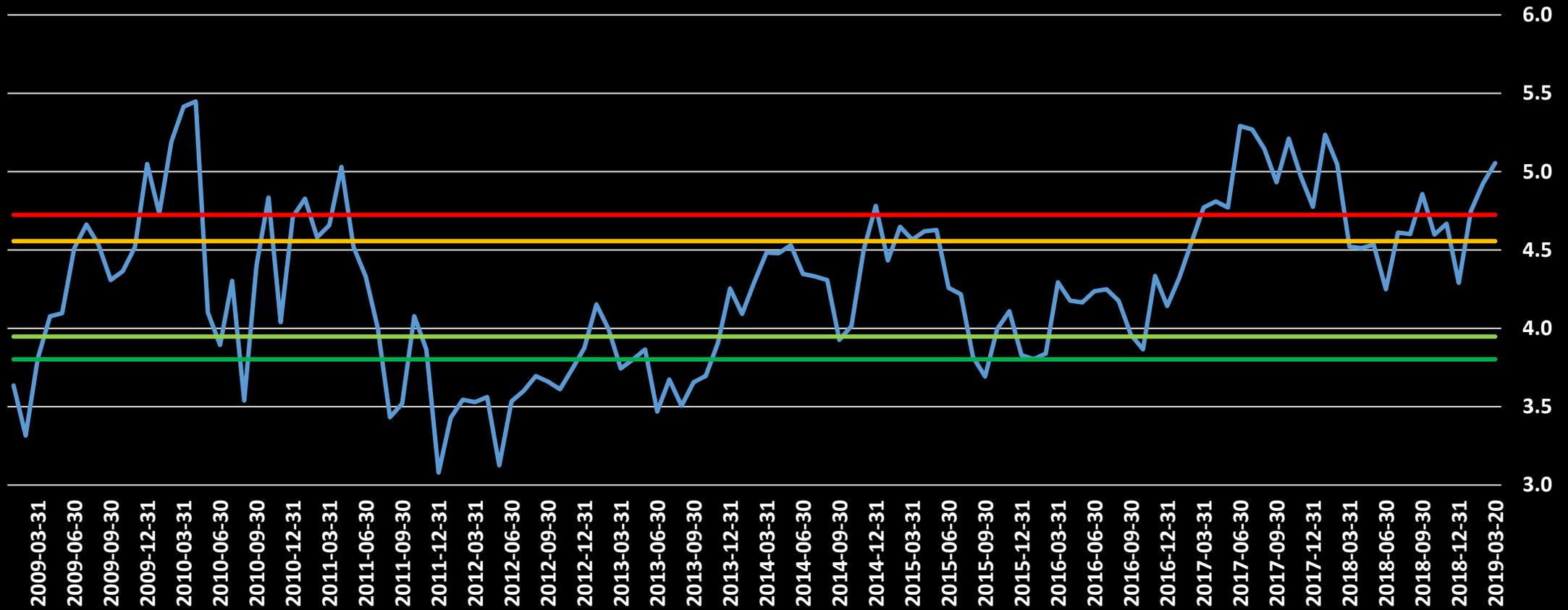
Price/Cashflow



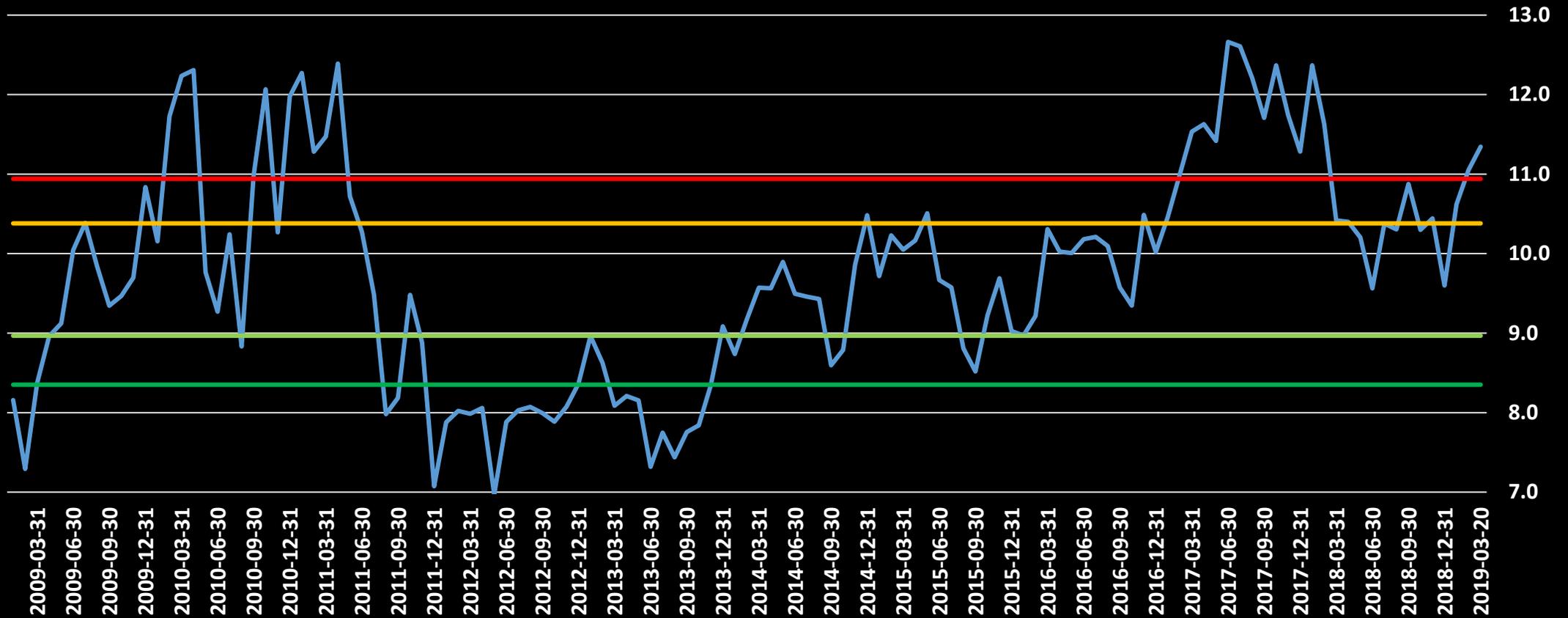
Price/Free Cashflow



EV/Revenue



EV/EBITDA

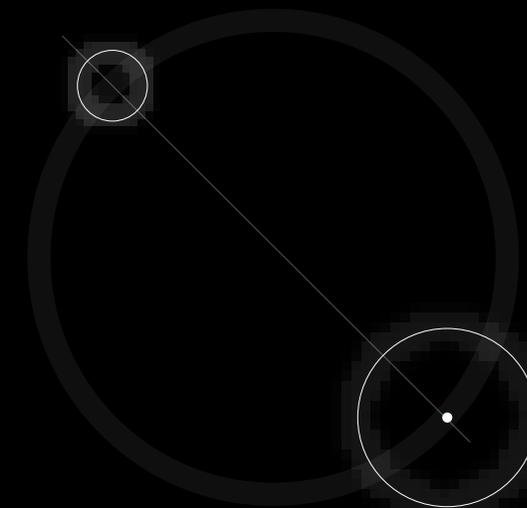


EV/EBIT





- Been dominant player for a long time, but the game has changed
- Makes up around 9-10% of BIC portfolio
- Recommend reducing to 5%, method to be determined by other team



CONCLUSION

Eroding Moat
Heightened Competition
High Valuation
Reliance on Key Personnel

