Goldman Sachs Group Inc (GS) Q2 2019 Earnings Call Transcript

GS earnings call for the period ending June 30, 2019.

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Goldman Sachs Group Inc (NYSE:GS)
Q2 2019 Earnings Call
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Prepared Remarks:

Operator

Good morning. My name is Dennis, and I will be your conference facilitator today. I would like to welcome everyone to the Goldman Sachs Second Quarter 2019 Earnings Conference Call. This call is being recorded today, July 16, 2019.

Thank you. Ms. Miner, you may begin your conference.

Heather Kennedy Miner -- *Managing Director and Head of Investor Relations*

Good morning. This is Heather Kennedy Miner, Head of Investor Relations at Goldman Sachs. Welcome to our second quarter earnings conference call.

On this call, we will reference our earnings presentation, which can be found on the Investor Relations page of our website at www.gs.com. Note, information on forward-looking statements and non-GAAP measures appear on the earnings release and presentation. This audiocast is copyrighted material of The Goldman Sachs Group, Inc. and may not be duplicated reproduced or rebroadcast without our consent.

Today on the call, I'm joined by our Chairman and Chief Executive Officer, David Solomon; and our Chief Financial Officer, Stephen Scherr. David will start with a high-level review of our financial performance, the operating environment, give an update on several recent strategic decisions and discuss our stress test results. Stephen will then cover second quarter results across each of our businesses. We will be happy to take your questions after that.

I'll now pass the call over to David. David?

David M. Solomon -- *Chairman and Chief Executive Officer*

Thanks, Heather, and thanks, everyone, for joining us this morning. I'm very happy to be here with you.

Let me begin on page one. We reported second quarter 2019 revenues of $9.5 billion, down slightly versus last year, but nonetheless, reflecting solid franchise performance amid a mixed operating environment. Net earnings were $2.4 billion, resulting in earnings per share of $5.81. All in, we posted a return on equity of 11.1%, and a return on tangible equity of 11.7%. Our business performed well and remain solidly positioned for future growth.

In Investment Banking, we ranked number one in global announced and completed M&A, and number one in global equity underwritings year-to-date. Our equity market making business delivered its second highest quarter in four years, and our franchise continues to generate broad-based market share gains across regions. We produced the highest quarterly I&L revenues in eight years, aided by significant gains from our private equity investment -- investing activities, reflecting our ability to source opportunities for the firm and our clients, and record net interest income in debt I&L, which annualizes to $3.5 billion. Lastly, our assets under supervision increased by over $60 billion, so another record of $1.7 trillion.

Turning to page two. Our second quarter results were generated in an operating backdrop that presented both opportunities and challenges. This quarter, perhaps more than others, reflected changing market sentiment in each of the three component months. Against the shift in sentiment, we continue to witness relatively solid underlying economic fundamentals. This year, we expect real GDP growth of approximately 2.5% in the US and 3.4% globally.

European growth remains a bit more subdued at about 1.5%. As recently reported, China is running in the low 6% range, slower than it has been in many years, but still supportive of global growth. All in, while slowing, the global macro backdrop remains broadly constructive.

The strong fundamentals that prevailed across markets were nonetheless overshadowed for most of the second quarter by geopolitical uncertainty. Client activity in April l turned quiet amid low volatility, particularly in fixed income markets. Conditions in May deteriorated as geopolitical events caused significant shift in risk appetite. Fears of expanding trade wars draw concerns that new tariffs in China and Mexico would erode the prospect for continued growth.

In response, equity volatility there increased. Global markets turned risk off. The US yield curve inverted and client activity slowed across a variety of products as our corporate and investor clients stayed on the sideline. The trade issues also catalyzed concern among global central banks, prompting dovishness with the Bank of Japan and the ECB, emphasizing potential further stimulus and the US markets now anticipating multiple Fed rate cuts this year .

The articulated dovish sentiment spurred a relief rally and increased client optimism and activity, albeit late in the quarter. This set up June to be a stronger backdrop to close out the quarter. The market sentiment of June has continued through today. We've seen a pause in the US, China trade war, accommodative views from central banks and a continued march upward in global equity markets.

Credit financing markets remain open and strategic transactions are getting announced. As we look ahead, we remain cautious on the geopolitical front but optimistic given the resiliency of global markets.

Importantly, our clients' long-term needs for advice, financing and access to markets endure across cycles.

Switching gears, I'd like to provide some insights on two important strategic decisions we made in the second quarter and our alternatives and wealth management businesses. First on alternatives, which is our core strength for Goldman Sachs for the past 30 years, we recently completed an internal reorganization of our investing activities across the firm. More specifically, we have realigned our Special Situations Group, real estate, Merchant Banking and several other investing platforms under common Merchant Banking business.

We have a world-class investing franchise with a strong track record, unique sourcing and execution capabilities and long-standing relationships with the largest institutional investors. Going forward -- excuse me, going forward, these teams will operate across four asset classes: private equity, growth equity, private credit and real estate.

By bringing together our investment professionals, we will accelerate our ability to raise significant third-party capital. We expect this change will enable us to generate more durable recurring fee-based revenues over time. This will be a transition, and we are mindful in protecting the revenue potential of these businesses as we grow third-party assets.

Second, we announced plans to acquire United Capital, a registered investment advisor with approximately $25 billion in assets under supervision, 220 advisors and 90

offices around the country. United Capital represents a key step forward toward our long-term strategic goal of providing comprehensive wealth management services to individuals across the wealth spectrum.

Upon closing the transaction today, United Capital will become a powerful complement to our Ayco business, our leading financial executive counseling and investment advisory business, it serves many of the largest corporations in the United States. We are excited about the incremental scale that United capital brings, allowing us to serve a broader set of wealth management clients. On a combined basis, Ayco and United Capital will serve clients with over $80 billion of assets under supervision, representing a strong base from which to grow our mass affluent wealth franchise.

It remains ambitious -- it remains our ambition to continue to serve ultra high net worth individuals through our long-standing PWM business, individuals with $1 million to $5 million of investable assets to Ayco and the broader mass affluent segment through a hybrid of digital and human engagement as an extension of markets over time.

Before turning the call over to Stephen, I would like to spend a moment on the recent Federal Reserve stress test results released in late June, which showed bank's ability to withstand over $400 billion of stress losses. Overall, the industry fared well in this year's examination. From where I sit, the results of the stress test clearly demonstrate the overall safety and soundness of the US financial system.

We also appreciate the ongoing efforts to increase the transparency of the test and very much agree with the Fed's overall assessment of the US banking system is sufficiently well-capitalized to support the economy, even after a severe shock.

Turning specifically to our performance on the 2019 CCAR examination, as you no doubt are aware, we disclosed the Federal Reserve did not object to our plan of up to $8.8 billion of capital return, including a 47% increase in our quarterly common stock dividend. This change reflects the Board and Management's view that dividend growth is a critical component to delivering strong shareholder returns and reflects our progress over recent years, increasing more durable fee-based revenues to support the higher dividend.

Lastly, I would like to briefly touch on our strategic communication plan over the coming quarters. Importantly, we continue to work toward providing a strategic update this coming January and will share a specific date once confirm. This update will include the financial targets for the firm to which we will hold ourselves accountable and a broader review of our business strategy.

With that, I will turn it over to Stephen, to walk through the results in each of our businesses.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Thanks, David.

Let's run through the numbers. Let me begin on page three of the presentation. As David mentioned, the environment in the second quarter turned out to be mix. Against this backdrop, we continue to serve our clients and focus on executing on our strategic priorities. Let's run through the numbers in detail.

Moving on to page four. Investment Banking produced net revenues of $1.9 billion, up 3% versus the first quarter and down 9% versus a robust year-ago quarter. Financial Advisory revenues of $776 million were down 3% versus last year.

During the quarter, we participated in announced transactions of approximately $465 billion and closed on $235 billion of deal volume, contributing to our number one M&A league table rankings year-to-date. Client dialogues remain healthy, and we are seeing momentum across sectors, including TMT, healthcare and notably, financials, which had been rather dormant for a number of years.

Moving to underwriting. Equity underwriting net revenues of $482 million, improved significantly versus the first quarter, which experienced the government shutdown and held roughly flat versus a strong quarter last year. Year-to-date, we ranked number one globally in equity underwriting, supported by $16 billion of deal volume across over 100 transactions this quarter. We held leadership roles in bringing many notable companies to the public markets during the quarter, including Uber, Avantor, Pinterest and Slack.

Turning to debt underwriting. Net revenues were $605 million, down 20% from a year ago. The second quarter last year included a number of significant contributions from investment grade and leverage finance activity, which did not repeat to the same extent this quarter. Our deal flows in this quarter were consistent with trends across the industry, which reflected materially lower volumes in the loan market and lower activity in acquisition-related financings, particularly with financial sponsors.

Nonetheless, our franchise remains well positioned, with our high-yield league table rank rising to the number two spot year-to-date, further reflecting our competitive strength. Our investment banking backlog decreased slightly versus the end of the first quarter, as we monetized a portion of our pipeline through the completion of several large equity underwritings. Nonetheless, our backlog increased sequentially in both advisory and debt underwriting. And while markets can change quickly, we are optimistic that our clients will remain active in executing strategic transactions in the coming quarters, given healthy levels of client dialog and continued needs to access financing markets.

Moving to Institutional Client Services on page five. Net revenues were solid at $3.5 billion in the second quarter, down 3% versus last year as our diversified business experienced low client activity in FICC, offset by strength in equities.

FICC client execution net revenues were $1.5 billion in the second quarter, down 13% year-over-year, reflecting

both the mixed operating environment and generally lower client activity despite notable strength in Europe. Overall, the opportunity set presented in the second quarter prove more challenging versus a year ago. Specifically, we saw lower volumes in our macro businesses, amid low volatility and shifting client sentiment.

Relative to last year, client activity in rates and currencies, including emerging markets was more subdued, as trade and tariff concerns, more than economic data drove sentiment and constrained client engagement. Uncertainty during the quarter, around the timing and magnitude of anticipated rate cuts by the Fed was also a contributing factor.

As tariff threats lessened and the direction of rates became more apparent, we saw improved client activity, particularly late in the quarter. In currencies, both implied and realized volatility in major FX pairs, stood at historic lows throughout the quarter, resulting in very low activity levels among our clients. Commodities performance by contrast was a positive. Results increased year-over-year and solid contributions from our investor products, oil, gas, and power businesses.

In our micro businesses, we saw lower activity in credit, but better results in mortgages. In credit, issuance activity and our inventory levels were down relative to a year ago, as investors remain more cautious following the spread widening experienced at the end of 2018 and grew more discerning in credit exposure selection. We saw lower structured finance client activity versus a year ago, while flows in credit came alongside from a more muted origination backdrop, particularly in investment grade debt and leverage loans as I had mentioned earlier.

Separately, mortgage revenues increased amid better performance. The environment notwithstanding, and as I have said previously, we are investing heavily to automate our workflows, serve our clients electronically, monitor our cost base, and deliver structured solutions in capital efficient formats.

Turning to equities on page six. Net revenues for the second quarter were $2 billion, up 14% sequentially and up 6% versus a year ago. We believe our success reflects our continuing consolidation of global market share and a dedication to serving clients across a full suite of cash, derivatives, and prime services, in both high-touch and low touch channels.

Equities client execution net revenues of $772 million increased 13% relative to the first quarter and were up 12% versus a year ago. Results were aided by stronger performance in both cash and derivatives versus the second quarter of 2018. Net revenues from commissions and fees were $777 million, up 9% sequentially, aided by strength in EMEA. We also continue to grow market share in low-touch execution.

Security services net revenues of $458 million, rose 24% sequentially and 5% year-over-year. Sequential improvement was driven by seasonal trends, and a rebound in average client balances as sentiments improved.

Moving to Investing & Lending on page seven. Collectively, our activities in I&L produced net revenues of $2.5 billion in the second quarter. Equity securities generated robust net revenues of $1.5 billion, driven by company-specific events like IPOs and the performance of corporates in the portfolio, contributing to revaluations. Second quarter results were up 20% versus a year ago, primarily reflecting higher net gains from public equities.

As you can see on the slide, approximately 25% of our net revenues were from real estate and 75% were from our corporate investments. Within the corporate portfolio, nearly half of the performance came from investments that went public during the quarter. These results included a gain of approximately $375 million from the IPO of Tradeweb. Our investment in Tradeweb, which we've owned since 2008 was accounted for under the equity method, given our significant influence at the time of the investment. As a consequence, we did not recognize revaluation P&L on Tradeweb over the time of our investment.

In addition to Tradeweb, we would draw your attention to several other notable investments that IPO-ed this quarter, including Avantor, Uber, and HeadHunter, which grew the notional size of our public holdings. Taken together, these four investments represent approximately 55% of our $2.6 billion public investment portfolio.

Turning to page eight. Net revenues from debt securities and loans were $989 million and included $872 million of net interest income and modest mark-to-market gains.

Our total loan portfolio was $98 billion, up $2 billion sequentially, driven by corporate loan growth and we note 82% of our total loan portfolio is secured. Our credit provision was $214 million, down 4% versus last quarter. Our firmwide net charge-off ratio remains low at approximately 60 basis points.

On page nine, turning to Investment Management. We produced $1.6 billion of revenues in the second quarter, driven by our diversified global asset management business and leading private wealth franchise. Net revenues included management and other fees of $1.4 billion, which were up 5% versus the first quarter and up 4% versus last year, reflecting continued growth in assets under supervision.

By contrast, we generated significantly lower incentive fees relative to the outsized $316 million last year. Incentive fees in the second quarter of last year were driven by the timing of realizations and performance across a variety of our alternative investment funds. We also saw lower transaction revenues from PWM client trading activity.

Assets under supervision finished the quarter at a record $1.7 trillion, up $61 billion versus the first quarter, driven by $17 billion of long-term net inflows, $12 billion of liquidity inflows, and $32 billion of market appreciation.

Now, let me turn to expenses on page 10. Our total operating expenses of $6.1 billion were flat versus the second quarter of last year, reflecting lower litigation and lower compensation and benefits expense, offset by

increased expense for technology and consolidated investments. For the year-to-date, total expenses were $12 billion, down 6% year-over-year.

Our year-to-date efficiency ratio was 65.6%, up 100 basis points versus a year ago, driven by lower revenues and ongoing investments, partially offset by lower compensation expense. On the topic of investment spend, as we've spoken in the past, cumulatively, we are making very substantial organic investments to build new businesses and digital platforms. The depth of that investment cycle will be in 2019 and 2020. Investment spending will continue into 2020, when we will also see a more meaningful impact of the reserve build supporting our initial growth in the Apple Card portfolio, following our expected launch later this summer.

Year-to-date, the total pre-tax cost from Marcus, Apple Card, and our new transaction banking platform is approximately $275 million, resulting in a drag of roughly

60 basis points on our ROE. Our cumulative pre-tax loss for these businesses from the inception of each, through the second quarter was approximately $1.3 billion, which has been embedded in the performance of the firm. As these businesses scale over the coming years, this drag should not only reverse but become an accretive contributor to the firm's ROE.

Next, on taxes. Our reported tax rate was 23% for the quarter and 20% for the year-to-date, including discrete tax benefits in the first quarter. We continue to expect our full-year 2019 tax rate to be consistent with our medium-term estimate of approximately 22% to 23%.

On the compensation ratio, our philosophy remains steadfast through our principles obtain for performance. Reduction in the year-to-date ratio to 36% is a reflection, as always, of our best estimate of the compensation accrual for the firm, which for the full-year 2018 was just below 34%. Also as we have noted in the past, as we grow more scale and platform-driven businesses, it is our expectation that compensation will decline, as a proportion of total operating expenses and the efficiency ratio will become a more relevant measure for the firm. These platform businesses should carry higher marginal margins at scale and be less reliant on compensation as a cost contributor.

Turning to capital on page 11. Our common equity Tier 1 ratio was 13.8% using the standardized approach and 13.5% under the advanced approach. The ratios each increased by 10 basis points versus the first quarter, driven by higher retained earnings. Our SLR was 6.4% flat sequentially.

In the quarter, we returned a total of $1.6 billion to shareholders, including stock repurchases of $1.25 billion and $319 million in common stock dividends. Our basic share count ended the quarter at another record-low of 372 million shares. Our book value per share was $214, up 10% versus a year ago.

As David mentioned, we are pleased that the Federal Reserve did not object to our 2019 capital plan of up to $8.8 billion of total capital return, including share repurchases of up to $7 billion, 40% higher than last CCAR cycle. While we continue to assess capital return in the context of the market environment and opportunities for accretive investment in our business, consistent with our long-held strategy, we are encouraged by the increased flexibility afforded by our strong capital position.

We enjoy the option of returning a significant portion of our earnings to shareholders over the coming year. Following our successful completion of the Federal Reserve's annual stress test, let's spend a moment reviewing our philosophy on capital.

First, our long-term view on capital allocation remains unchanged. We first look for opportunities to invest in our business at attractive returns. To the extent, we have excess, after these investments, we will endeavor to return it to shareholders.

Second, with respect to dividends versus buybacks, we aspire to having a higher dividend long term, as it's an important component of total shareholder return and it's further reflective of the firm's confidence in our ability to generate more recurring and predictable sources of revenue. That said, we continue to value the flexibility of share repurchases as they allow us to be more dynamic with capital allocation, based on the environment and business opportunities.

Third, regarding the stress capital buffer. Based on our calculations and the proposed rule, which may differ materially in its final form, we estimate an SCB of approximately 5.5%, based on the 2019 stress test results. This would imply a total CET1 requirement, excluding management buffers, in the neighborhood of 12.5% to 13%, which compares favorably to our second quarter 2019 standardized ratio of 13.8%. While we view the CCAR authorization as a ceiling and not a floor on the amount of capital we will return, we are pleased to note that the $8.8 billion capacity should position the firm well to manage capital at appropriate levels.

Turning to page 12 for balance sheet and liquidity. Our balance sheet was $945 billion, up $20 billion versus last quarter. On the liability side, deposits increased to $166 billion, including consumer deposits of over $50 billion, which we have more than doubled since last year.

During the quarter, we saw further progress, migrating businesses into our bank entities to take advantage of their more diversified and lower cost funding. Our global core liquid assets averaged $225 billion during the quarter, which we continue to note, may decline, as we have opportunities to support client demand.

Before taking questions, a few brief closing thoughts. While our second quarter performance was solid despite the mixed operating environment, we believe, as David said, the overall economic growth backdrop should remain supportive of our business. As we go forward, we are executing diligently on three core objectives; one, serving our clients with excellence and growing our existing business.

Two, diversifying our business into adjacent and new businesses. And three, operating more efficiently in all that we do. If we do these things well, we are confident

we can deliver strong long-term returns for our shareholders.

With that, thank you again for dialing in, and we'll now open up the line for questions.

Questions and Answers:

Operator

(Operator Instructions) And your first question is from the line of Glenn Schorr with Evercore. Please go ahead.

Glenn Schorr -- *Evercore ISI -- Analyst*

Thanks very much. Maybe just start with the real quickly. You mentioned providing a strategic update this coming January. I'm curious what form you're thinking about, meaning Investor Day update slides on the call, things like that?

David M. Solomon -- *Chairman and Chief Executive Officer*

So thanks, Glenn, and good morning. I appreciate the question. We are committed to giving the strategic updates and in particular, providing targets in January. As we're working toward this fall, where we'll know the exact format and also the specific date, we'll communicate it

Glenn Schorr -- *Evercore ISI -- Analyst*

Okay. Well, as long as the numbers are good, I'm cool.

David M. Solomon -- *Chairman and Chief Executive Officer*

In I&L, I'm curious, I know you're going through the process of consolidating the businesses and I'm sure there are some challenges there. But my question is on, you've always been good at this. But I feel like managing conflicts between advisor, balance sheet investment and third-party funds will just be that much harder as you bring this altogether and grow third-party. I wonder if you could talk a little bit about that and how you will allocate investments across on-balance sheet versus third-party, things like that?

Sure. And I appreciate the question. It's obviously something we spend a lot of time thinking about it. We have spent a lot of time thinking about it because when you look at these businesses, which in the past, I did organized over multiple parts of the firm, we're now internally reorganizing and bringing them together. But we've been doing this for 30 years. We are one of the largest alternative asset managers in the world. We manage a very, very significant amount of third-party and client capital. And I can't say that there are issues from time to time that come out of this business model. But we're focused on striking the right balance and have proven over a long period of time that I think we can do this consistently.

I think one of the things that you get by streamlining the organization and facing our clients as an integrated operation, is it actually should make this process, the decision-making process easier and more clear. And so we recognize it's something that we will have to continue to do well over a long period of time. We are -- I'm talking

to our clients and listening to our clients, and they feel bringing the businesses together and organizing them potentially will help us do that.

Operator

Your next question comes from the line of Chris Bolu with Autonomous. Please go ahead.

Christian Bolu -- *Autonomous Research -- Analyst*

Good morning, David and Stephen.

David M. Solomon -- *Chairman and Chief Executive Officer*

Good morning.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Good morning.

Christian Bolu -- *Autonomous Research -- Analyst*

Just on the targets. We look forward to getting your targets in January. But how should we think about the timeframe for achieving targets? Are you setting targets you can meet over the next one years to two years? Or should be looking for more long-term aspirational targets that could take more like five years to get to?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Thanks, Christian. I would say that the targets that we will focus on will be both returns and equally efficiency. And in the course of putting those out, our timeframe will be over the medium to longer term. We're in the midst, as I said in the prepared remarks of making some meaningful investments in the business. The depth of that is going to be over the course of this year and into 2020, and the returns on that will play out over the medium term. And so the targets will be that.

Along the way, we'll continue to point out, as we did on this call, with greater clarity as to the precision of what it is we're spending and what we're spending for and the direction of travel and the type of returns we expect to get. But in that, we're investing in particular businesses like the Apple Card, like Marcus, like transaction banking. Those will have return profiles. Equally, we're investing in platforms that will bring greater efficiency to existing businesses. Those two should have return profiles to them, perhaps even inside some of the projects we have, but we will give you the medium-term targets, but take you along in terms of what plays out between now and then.

Christian Bolu -- *Autonomous Research -- Analyst*

Great. Thank you very much. And then on the alternatives business, I was excited to see you what does it looks like when you bring it all together. I don't know if you can help us just preview maybe the size, when you put all those strands together, kind of what the size and maybe the growth profile of that business looks like today. And then as you look to maybe compete more against the alternative asset managers, if we're tricking one here, but how do you balance the sort of the delicate issue of

doing what's right for Goldman versus competing against like a key clientele?

David M. Solomon -- *Chairman and Chief Executive Officer*

Sure. So first, with respect to the business, broadly, we plan to operate across four broad asset classes that we operate in today currently. And that includes private equity, that includes growth equity, private credit, and also real estate. And so over time, we will provide more transparency to you on the assets that currently exist in all four of these channels, which are significant and to our aspirations over time to increase the amount of third-party capital that we manage in these different asset classes.

With respect to the balance and operating is, as I said to the previous question, we have been doing this for 30 years. These businesses are very significant in size right now. We have said publicly that when you look at the businesses that we operate here, collectively, they make us one of the top five alternative asset managers in the world today. And so we will continue to navigate and execute that the same way we have over the last 30 years and a very, very significant business. And the fact that we're internally reorganizing it, so that we can better serve our clients does not change the process that we've executed on for a very, very long period of time.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

The one other point I'll add to respond to your question is that, as David rightly points out, this will be a transition. During that transition, we do not anticipate a revenue shortfall by this movement. Meaning, we'll maintain balance sheet with the flexibility of reallocating balance sheet into different of these sleeves, as David pointed out. And it's also worth noting that different sleeves, whether it's credit, real estate, with respect to, for example, equity carry different capital density and the opportunity to realize higher returns on the balance sheet deployed will be there. So, we are very well aware of maintaining the revenue flow that's here. And as David pointed out, this will be a transition over time.

Operator

Your next question comes from the line of Michael Carrier with Bank of America. Please go ahead.

Michael Carrier -- *Bank of America Merrill Lynch -- Analyst*

Analyst

Good morning. Thanks for taking the questions. First one, just on capital. So, you received the approval for more buybacks, plus the dividend capital ratios have improved a lot. You are doing some on the M&A front, still investing in the business. So, I guess just looking for some color on, if this is sustainable, meaning being able to do everything given the repositioning of the balance sheet. And probably importantly, where you are on that front, particularly within, like the FICC business and the alternative business?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Sure. So, I think it's fair to say, as a general matter, this year's CCAR clearly demonstrates the direction of travel that we want to go in terms of overall capital return. And the scope of what we asked and what otherwise was approved reflects on our commitment to put capital back to shareholders. It's important to note those, and as I said in the commentary, our posture has not changed. Meaning, as stewards of capital, we are looking at and for opportunities where we can invest in an accretive way to generate long-term shareholder return. We're going to continue to do that and you see that in the investments that we're making. Away from that and in excess of it, we'll continue to return capital back to shareholders. And I think what played out in the context of CCAR is a reflection of what we are comfortable with in terms of what we're going to look to put out, given where the market and circumstances are.

On the question you raised about FICC, the focus for FICC, not born of this quarter in particular, but since we came on and started to look and reunderwrite the business, it's been around capital efficiency and equally cost in the context of delivering in to our clients. And so that continues to be a focus of ours in terms of the franchise.

When you look at FICC in particular, I would say that the business is focused on clients in the context of expanding out the corporates, transaction banking and the like. It's focused on the development of platforms,

the investment in those platforms, such as Marquee, on-pricing engine and investment grade credit. Equally, the e-commodities business, and equally having the talent to be good calibrators of risk intermediation, which is at the core. When we do this and we do this right, and it is a core historical competency for the firm. We're going to continue to look at ways of accomplishing that with greater capital and cost efficiency.

Michael Carrier -- *Bank of America Merrill Lynch -- Analyst*

Okay. Thanks. And then just a follow-up question. Just on the strategic review, I think there is a lot of focus on sort of the revenue opportunities and where you guys are focused. Just given some of the investments and then the longer term, the focus on the efficiency ratio, just wanted to get an update or run through some of the initiatives that are in place and the progress you guys are making to lower the cost base over time and improve the efficiency ratio.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Sure. So, I would -- I'll answer that in kind of in two components. One is that the new business is being built, whether that's the consumer business, credit card business as a part of it or transaction banking, those businesses are intended to be built as scaled businesses. Meaning, the compensation component attached to that is lower. You have cost and investment made such that the marginal margin in those businesses are operating at full scale, continues to grow. And so you achieve greater efficiency on a higher revenue number that comes in. That's the way I would describe the newer initiatives.

The second component is what we're doing in and around the introduction of platforms and technology to our standing incumbent businesses. I just mentioned a few examples of what we're doing in FICC and in the securities business more broadly. These two are lowering the throughput of trades. It's lowering the ability, where I should say the price point to engage with clients where they want to meet us, which is, it's less human capital, it's more platform driven, it carries higher efficiency to it. And that's the direction of travel.

I'd also say equally true about the incumbent businesses, part of what we're doing in the federation to support the businesses, including in places like compliance is the deployment of technology in order to render us more efficient, such that we can support the businesses in a much more cost efficient way then where we've been historically.

Operator

Your next question is from the line of Steven Chubak with Wolfe Research. Please go ahead.

Steven Chubak -- *Wolfe Research -- Analyst*

Hey. Good morning.

David M. Solomon -- *Chairman and Chief Executive Officer*

Good morning.

Steven Chubak -- *Wolfe Research -- Analyst*

So, I appreciate the color on the stress capital buffer. Certainly the 5.5% reinforces the strength of your capital position. Given your current ratio is 70 basis points to 120 basis points above that, you're likely to accrete additional capital over the next four quarters. I'm just wondering how you're thinking about sizing the appropriate management buffer. And maybe just philosophically, what are some of the factors that will impact that calculus?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Well, I think part of the calculus is the direction of travel, right, of where these regulations are, what the final SCB ruling looks like. Equally, there is inevitably variability that comes and fluctuation in CCAR results and the way in which stresses imposed. So, we'll maintain a buffer that's sort of mindful of those variabilities in the overall calculus itself.

In terms of the general direction of capital, sort of philosophically, it is -- it really is what I had laid out earlier. And that is, I think you should take the results in the CCAR. In particular what we petitioned and what was left unobjective to by the Fed as the direction we'd like to go. We've got a lot on our plate in terms of investments that are being made, but we are quite confident under the circumstances of being able to put a reasonable amount of capital back. And I'd also point out that the

dividend increase for this third quarter now approved by our Board is a 47% jump in the dividend, which is also a reflection of the confidence in the increasing durability and profile of the revenues of the firm.

Steven Chubak -- *Wolfe Research -- Analyst*

No, thanks for that, Stephen. And just one more for me on efficiency. You sized a $1.3 billion investment in some of the newer initiatives. Given you noted that investment spend will likely peak in '19 and maybe the early part of 2020, I was hoping you could speak to whether we should expect to see some efficiency progress as early as 2020 and what's a reasonable expectation in terms of the marginal margin? I know the newer initiatives are tougher to assess, but maybe on some of the legacy businesses, given some of the changes you plan to implement on the platforms there?

Stephen M. Scherr -- *Executive Vice President and*

Chief Financial Officer

Yeah. So obviously, the efficiency ratio is in one part a function of revenue, so we'll see where the fortunes of the firm take us. On the expense base. I think in the near term, there is sort of quick to be realized certain cost efficiencies in our trading costs. Meaning, what's happening on platforms that are introduced, that underpin incumbent businesses that are not looking for, if you will, new flows to come on, but we're transacting with clients in a different manner and form than what we've done in the past.

Just one really small example. If you look at our investment grade business and you look at the bond pricing engine, we can then play both sides of a risk trade in a way that would have taken thousands of man-hours, right, in order to compute. You would have had inefficiency in terms of its time value. Now, we're able to provide a platform where the client can engage and look to conform and develop a portfolio on a much more efficient basis -- cost efficient basis than would have happened in the past.

So, I think there are sooner efficiency, or I should say efficiency to be realized sooner in the context of platforms underpinning incumbent businesses, there'll be a longer timeframe as you note in the context of realizing efficiency in some of the newer initiatives that we're building.

Operator

Your next question is from the line of Betsy Graseck with Morgan Stanley. Please go ahead.

Betsy Graseck -- *Morgan Stanley -- Analyst*

Hi. Good morning.

David M. Solomon -- *Chairman and Chief Executive Officer*

Good morning, Betsy.

Betsy Graseck -- *Morgan Stanley -- Analyst*

A question on how you're thinking about consumer credit and I ask the question for two parts. One is the upcoming

Apple Card and then the Marcus portfolio. And on the Apple Card, I know you can't go through details. We put some estimates together. And I know recently where -- again, based on a lot of assumptions, I end up with an expectation that you're running at about a -- that you would expect to run somewhere around a 1% ROA. Now that's, again, a lot of assumptions, but it's based on the information that's out there on lower rates for the credit quality versus peers, what peers are charging and no fee.

And I -- that another of my question is, how are you thinking about consumer lending? Is it a business that you think is inherently more risky than your current business, which is running at about a 1% ROA? Or do you -- do I have it wrong? What am I missing? And should this be a business that generates higher than a 1% ROA? That's basically the another question.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Sure. Thank you. So, let me start by saying, there is no denying that the consumer business, whether Card or Marcus is a risk business. Meaning, no matter that it's delivered digitally or that the credit card will take a different digital sort of profile than traditional credit cards, this is a risk business and that's where our focus is. I would say the risk is not just on credit risk and financial risk, but equally operational risk in the context of what we're building and so we're quite conscious on all of those elements.

What's important for us is that, we look at this on a risk-adjusted return basis, not simply on a return on asset construct. And that's what's critical and that's the way we're looking at it. It would be, Betsy, for me premature to sort of speculate what the pace of growth looks like on this. I would simply say that risk calibration, risk decisions in and around the Card belong entirely to Goldman Sachs as the bank. And we're set up to make those.

I'd also say that if you look at the level and rate of growth in the Marcus loan business, while it continues to grow and perform well, we have slowed the increase in growth in that, in contemplation of taking on increasing consumer credit through the card business. So, we look at it both in its totality, so each is marginally different in the way in which credit is dispersed. But this is a risk business, and we'll continue to look at it as we grow it out on a risk-adjusted return basis.

Betsy Graseck -- *Morgan Stanley -- Analyst*

So, on a -- really a follow-up has to do with the expected at-scale efficiency that you think you're going to be running these businesses at, when they're at scale. Given the fact that you did a new build, should I be thinking about the efficiency and of these businesses in line with FinTechs which run at intermediate expense ratio that's 30% of other legacy competitors? Or should I look to bank competitors as a more reasonable expense ratio or somewhere in between?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

I would say that, while we've been in beta now for a couple of months and have grown the portfolio on that basis, it's nowhere near at the scale of what our expectations would be as we grow it out. And so it would be premature for me to kind of speculate as to the efficiency. We'll start to reflect more on that once we launch and once we start to build this portfolio out, so it's a little early.

What I can tell you is that what we have built jointly with Apple, both on the front-end and on the back-end is intended to be operationally resilient, but equally is intended to be efficient both in terms of the delivery, the app -- I should say the application, all through the delivery and on the back-end. And so my expectation is that the efficiency will be reflected in that, but again premature to sort of put numbers around it.

Operator

Your next question comes from the line of Mike Mayo with Wells Fargo Securities. Please go ahead.

Mike Mayo -- *Wells Fargo Securities -- Analyst*

Hi. To continue on the investment spend, as it relates to expansion of markets outside the US, where do you stand with the additional countries and what else might you consider?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

So, I think, I think on that, Mike, the press has been sort of ahead of our plans in the context of speculating sort of the next country in which Marcus would expand. Obviously, our first place outside the United States was in the UK, where the deposit platform has really exceeded our expectations in terms of what has been capable of generating. There will be opportunities for us to expand in that market.

There has been quite a bit of speculation about Germany. It's not surprising that the speculation goes there, both in the context of a growing business that we have in Continental Europe and the depth of the deposit market in Germany. But it's too early to forecast as and if and when we would expand there, though I understand the speculation on that. So for the moment, we've got a lot on our plate in terms of the execution around the platform in the United States and in the UK, and we'll continue to pursue that.

Mike Mayo -- *Wells Fargo Securities -- Analyst*

All right. And then one follow-up, unrelated question. 1MDB, did you take any additional reserves for that? What's the status? There is a new statement by the Head of the SEC on July 3rd, saying that it might be a little bit easier to resolve these sorts of matters. What's your take in all this?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

So, just on the reserves, we took incremental legal reserves this quarter of $66 million. We don't give detail on what the elements of that reserve are. I would say that we are adjusting our RPL to $2.5 billion from $2 billion

where it was. I should point out that in providing that number to you, it's important to recognize that, that number is our best estimate as of this date. It will be published in the Q. Events that may play out between now and the Q could alter that RPL. And again, there are different accounting regimes and thresholds that apply. One probable -- one possible relating to the RPL and so that's where I can offer you, by the way of what's happened financially.

In terms of statements otherwise being made, I think it would be inappropriate for me to sort of speculate on what others intend by statements they make. I think as we've said in the past, we're in a cooperative engagement with the authorities. We intend to stay that way. And as and when there are further developments, we'll be in a position to -- to talk about that a bit more.

Operator

Your next question is from the line of Kian Abouhossein with J.P. Morgan. Please go ahead.

Kian Abouhossein -- *J.P. Morgan -- Analyst*

Yes. Hi. I have two questions. The first one is related to your equity revenues, which were clearly very strong, also against some peers reporting so far. And I just want to understand where that's coming from. Because clearly the drivers are more muted, such as volatilities down on the equity derivative world. Transaction volumes are OK-ish, but nothing in terms of the numbers that you have shown in terms of year-on-year and quarter-on-quarter growth rates. Can you just give a bit more color of where the drivers are? And do you see market share movements in this area?

And secondly, just coming back to your FICC business. We now heard from you over the last 12 months to 18 months and expansion in more liquid products and traditional client base. And can you a bit more detail on the FX and rates expansion, both on clients and products? And when should we see actually some of that investments having an impact on your revenue base? Because I don't see you yet outperforming your peers in this area, but clearly would be great to get an understanding if you are, if you feel differently. And why and what investments you're doing in order to close the gaps in those two segments?

David M. Solomon -- *Chairman and Chief Executive Officer*

So, I'll start with equities. I'll make a broad comment on

FICC and Stephen will give you a little bit more detail. We are very pleased with the performance of our equity franchise. Broadly, the performance really was across the franchise. It was throughout derivatives and cash. I would say, given the market dynamics broadly, there is some sense of consolidating share and I think we've been the benefit of that. And as we've been stating on this call and over the handful over the last quarters, we continue to make investments in our low-touch activity and our low-touch capabilities, and we are starting to see some benefits from those investments in our low-touch capabilities.

With respect to FICC broadly, I do want to highlight as was highlighted, I think, on page five of the presentation. Our business is 90% market intermediation, a much higher component of market interremediation, then the people that we compete or we benchmark against. So if you have a 60-40 mix and market intermediation is softer, which it clearly was given the environment we had this quarter, your NIM portion or you're non-market intermediation portion has less volatility. But we continue to make investments as you highlight in some of these products and in particularly in broadening out the client base, I'd ask Stephen to provide just a little bit more detail on how we think some of that is going through.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Thanks, David. So just to pivot to FICC and to be direct to your question, if you look at FX in rates, part of the progress that we were making is on broadening out the client franchise to more corporates than to the institutional clients to which we typically, if not exclusively has engaged. And we're starting to see some early progress in that, I would say in this quarter, in particular within Europe.

I'd also say that as part of an effort to expand out and penetrate further the corporate base around FX and rates, we're seeing some benefit come to us, by way of the joint venture between banking and FICC, where banking obviously owns an entry point into the corporates and the ability to carry through those products into the corporate franchise where we have a demonstrably strong set of relationships, I think will bear dividend.

What's more, I would say that if you look at a variety of different initiatives and builds, including transaction banking or corporate cash management, this one's built, will carry the potential to bring forward a more captive FX business that didn't exist inside the firm. I think that too could prove to be a benefit. And just on that particular project, Goldman Sachs is already a customer, if you will, of our own platform and we aim to bring customers and clients on, in across 2020. And so we are seeing early signs of progress on this, but there is no running from the observation you make, which is, we have yet to sort of perform at the potential we are confident this business can show. We're very confident in unlocking that potential. Some of these new initiatives will no doubt take a little bit of time before they bear out. But the direction we're moving is a positive one.

Operator

Your next question comes from the line of Brennan Hawken with UBS. Please go ahead.

Brennan Hawken -- *UBS -- Analyst*

Good morning, guys. Thanks for taking the question. NII as a portion of the I&L's debt portfolio, could you maybe help us think about rate sensitivity there depending on how you calculate NIM, if it's 360 or 365 day count and NIM is down either a few or upper single digit bps quarter-over-quarter? What are the benchmark rates, gents, predominantly in that portfolio we should watch?

How much of the strong NII growth that you guys have seen over the past few years has been balanced versus rate? And then how should we think about how the softening rate environment might impact NII growth going forward? Thanks.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Sure. Thanks for the question. I think the best way to answer that question is to just point out where we differ, if you will, from some other bigger commercial banks in the context of both, we have a different liability mix and equally a different composition to our assets.

On the liability side, there is a portion of our funding that's fixed, a portion that's floating. And so it's not as dynamically correlated, if you will, to the way in which rates otherwise move. And I think our NII growth, generally speaking, will benefit from a liability mix that's starting to skew toward deposits. And so that's the perspective I would offer on the liability side,

On the asset side, much of the assets that we have are floating-rate based and equally and importantly is a higher velocity turn to the assets that underlie this. And that too has a more -- or leads to a more muted impact to which we otherwise might see in some of the bigger commercial banks as a function of the direction in which rates are moving

Brennan Hawken -- *UBS -- Analyst*

Okay. And then the part on how much we've seen as far as rate or NIM improvement versus balances in the last few years. Is it possible to break that down, or is that something that might fall off?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

I think, I would encourage you to follow up, sort of with -- for an answer that's more precise than what I can give you now. I would say that some of this has to do with balances in terms of the size and scope, recognizing that the lending that we're doing, which is generating this net interest income is quite strategic in the context of the clients that are served by the lending itself. And I'd also point out, as I did in the remarks, that about 82% of this is secured financing. And so I offer that to you. But Heather and the team can provide you with greater insight onto the particulars.

Operator

Your next question is from the line of Jim Mitchell with Buckingham Research. Please go ahead.

Jim Mitchell -- *Buckingham Research -- Analyst*

Hey. Good morning. Maybe just a quick follow-up on the fixed income discussion. Just want to make sure I understand how do you get your, I assume, internal ROE targets in that business. Is it -- do you see it entirely coming from efficiency improvements and expanding the footprint into more flow business? Or is there some component of capital that comes out, whether it's

derivatives or something else? Do you need to see the level of capital declined as well? Or can it come from those other ways?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Sure. So the way we've been looking at it, as we've been scrutinizing and reunderwriting that business is we're focused on both the numerator and the denominator of the ROE calculation, meaning it's important nobody lose focus that we need to mind how much revenue is coming in. That is, how do we want to define the tangible market that we face, what's the revenue capture that we can take in, what's the expense as an offset to that revenue to establish the numerator in the calculus. And none of that is to ignore capital efficiency in the context of what the denominator contains.

So, this is really, as we've talked about it, a wholesale reunderwriting of the business, but be assured, both of these are in scope, in the context of the way in which we're looking at the business, both revenue, net of expense and looking at capital and the revenue being driven largely by an ambition to have a more expansive addressable market to include corporates, in addition to that, which we otherwise have focused on historically.

Jim Mitchell -- *Buckingham Research -- Analyst*

And as you pull that capital out, do you worry at all if there is any kind of revenue risk in that pivot to a lower capital or denominator? Or do you feel that's not really the case?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

No, I mean -- listen, there is never is kind of a linear calculus. Okay? So the businesses for us in FICC are not themselves four-wall, meaning anything we do with respect to a business in FICC has knock-on implications for businesses that fit outside the securities business. Take, for example, wherever it is we decide to do around credit for commodities, it has knock-on implications. So the thread on the adjacency of all of our businesses gets pulled.

So, we're mindful of that and need to take stock of what we do around capital. The one other thing I would point out, which I've talked about publicly before is, in addition to thinking about both the numerator and the denominator, embedded in the numerator is equally an effort to sort of optimize our own funding, meaning how do we bring our cost of funds down. Retail deposits has been an example of that. But our treasury team is working hard, both in terms of the amount of liquidity we run with, how that liquidity is managed in addition to identifying more efficient lower cost funding sources in order to render these businesses more competitive.

Operator

Your next question comes from the line of Devin Ryan with JMP Securities. Please go ahead.

Devin Ryan -- *JMP Securities -- Analyst*

Hey. Great. Good morning, David and Stephen.

David M. Solomon -- *Chairman and Chief Executive Officer*

Hey. Good morning.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Good morning.

Devin Ryan -- *JMP Securities -- Analyst*

First question just on United Capital with the deal closing, just look to maybe get a little more perspective on how you're thinking about the business opportunity, I guess broadly. And as it connects with Ayco, is there a bigger appetite to expand into the mass affluent segment, whether it be adding financial buyers or more M&A? Or does capital really give you just a big enough footprint to achieve what you are looking to do in the business, especially with Ayco?

David M. Solomon -- *Chairman and Chief Executive Officer*

Sure. I appreciate the question. We are excited actually. Today I believe we're closing the Capital acquisition on this very day. And obviously, it brings with us 220 RIAs and 90 offices around the United States. And what it's really doing is, we think we have a very, very interesting channel to continue to build the mass affluent segment through Ayco. But this particular transaction accelerates our ability to do that. Between Ayco and United Capital of $80 billion of assets under management, that's a good base from which to grow from. We think we can continue to make progress and what we'll call the $1 million to $5 million of investable assets, mass affluent wealth management category through this channel. And that we can have good growth with the extended platform we now have.

But if another opportunity came up that we thought could further accelerate it because it is still a very fragmented business and we have a very, very big infrastructure, so we can continue. The fee in terms of all the wealth, in terms of what the asset management and wealth management products we have in our asset management business, we'll consider it. This was not something -- this acquisition was not something that was targeted for a year that we were really running after. It came up for sale. We looked at it. We thought it was a really good fit to accelerate our business and so we decided to act on it.

Devin Ryan -- *JMP Securities -- Analyst*

Got it. Very helpful. Thanks. And then just a follow-up. Just to think about the third-party alternative capital fund raising. Any expectations on whether it be the trajectory or cadence of how we should be thinking about that, just as we are just starting to think about modeling it?

David M. Solomon -- *Chairman and Chief Executive Officer*

Yeah. I appreciate the question, Devin, and I know that you're all anxious to model it. Over time, we will provide a lot more transparency on how we see that plan rolling out. As you would expect, we have a lot of businesses across the firm. We put them together, and the first thing you do when you put those people together is you cast them to develop plans on a go-forward basis. So, we are in the process of that. And as those plans come forward, we will be more communicative and transparent as to what expectation we think you can have with that business over time.

Operator

Your next question is from the line of Gerard Cassidy with RBC. Please go ahead.

Gerard Cassidy -- *RBC Capital Markets -- Analyst*

Thank you. Good morning.

David M. Solomon -- *Chairman and Chief Executive Officer*

Good morning.

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Chief Financial Officer

Good morning.

Gerard Cassidy -- *RBC Capital Markets -- Analyst*

In your comments on the debt underwriting, you mentioned deal flows in the quarter were consistent with the trends across the industry, which reflected material lower volumes in the loan market in M&A activity area. And you specifically cited it was with the financial sponsors. Can you share with us what are the financial sponsors seeing today? What do you think will stop them from doing more deal activity in the quarter? And any outlook for the second half of the year from those financial sponsors?

David M. Solomon -- *Chairman and Chief Executive Officer*

Well, look, in a high end, there is no quite -- at a high level, there is no question that, that activity has been more muted. I guess when you think about the cycle and you think about the continued run in equity markets and the accommodative monetary policy we have, which is certainly inflated for assets, it's been tougher, more competitive, you have to pay more in order to succeed. I also think the financing environment and in particular the SMID (ph) regulatory overlay, it had some impact over this cycle in muting how far the private equity activity may have moved in this cycle had the regulatory environment been different.

That said, the private equity investors still have an enormous arsenal of unspent capital, big reserve. And I think this business continues to have secular growth. And so as the environment evolves, I think there will be periods of time where we will see increased activity versus what we've seen in the first half of the year. I don't think we have a great explanation of this specifically has done it. But if you think about what the first half of the year has brought in terms of the macro overlay, it's not surprising probably that it's been a little bit more muted.

Gerard Cassidy -- *RBC Capital Markets -- Analyst*

Very good. And then as a follow-up on slide 12, you gave us your balance sheet, of course, the allocation. And you

mentioned that in the quarter, there was a $20 billion quarter-to-quarter increase, reflecting client demand to use your balance sheet. Can you share with us, as the total loans or total assets, what percentage of it is clients using your balance sheet? And then second, when you look at the revenues those customers bring to you, as a percentage of those assets, where do those stand? And how does that compare to about a year ago?

David M. Solomon -- *Chairman and Chief Executive Officer*

So, as always, the fluctuation in the balance sheet is a reflection of our ability to respond to opportunities and the interest of our clients. And so balance sheet fluctuation is all a function of client service. Hard to decompose the balance sheet to say what's client, what not -- what is not client. Truth, we know all of it, right, is in some manner or form related to client activity and across all of our businesses in the firm. And so that's really the way I would view sort of balance sheet both in terms of growth size and its composition.

Operator

Your next question comes from the line of Brian Kleinhanzl with KBW. Please go ahead.

Brian Kleinhanzl -- *Keefe, Bruyette, & Woods -- Analyst*

Yeah. Thanks. Just one quick question. On the markets, I saw that the rate pay came down toward the end of the quarter. Can you just walk through what your -- how you came up with that decision to lower the rates or you just

looking at the Fed fund's future? Should we expect more rate cuts there kind of what's been depositor behavior?

Stephen M. Scherr -- *Executive Vice President and Chief Financial Officer*

Sure. Sure. So, we made a decision and it was the first. Since we began our retail deposit business, we made an adjustment downward. We did it in the context of rendering ourselves competitive in light of what others have done. It's also worth noting at or around the time, we reduced the rate. We saw others, in the competitive set, reduced the rate as well. We saw no material adverse reaction to our movement, no sort of pronounced outflows, nothing to really call attention to. I think you should assume that we will be fluid and flexible and agile in rate movement up or down relative to where the competitive set is. And we'll sort of comport ourselves that way, both in our US platform and in the UK.

Brian Kleinhanzl -- *Keefe, Bruyette, & Woods -- Analyst*

Okay. Thanks.

Operator

At this time, there are no further questions. Please continue with any closing remarks.

David M. Solomon -- *Chairman and Chief Executive Officer*

Okay. Since there are no more questions, I would like to take a moment to thank everyone for joining the call. On behalf of our senior management team, we hope to see many of you in the coming months. If any additional questions arise in the meantime, please don't hesitate to reach out to Heather. Otherwise, enjoy the rest of your day, and we look forward to speaking with you in October.

Operator

Ladies and gentlemen, this does conclude the Goldman Sachs Second Quarter 2019 Earnings Conference Call. Thank you for your participation. You may now disconnect.

Duration: 69 minutes

Call participants:

Heather Kennedy Miner -- *Managing Director and Head of Investor Relations*

David M. Solomon -- *Chairman and Chief Executive Officer*

Stephen M. Scherr -- *Executive Vice President and*

Chief Financial Officer

Glenn Schorr -- *Evercore ISI -- Analyst*

Christian Bolu -- *Autonomous Research -- Analyst*

Michael Carrier -- *Bank of America Merrill Lynch -- Analyst*

Steven Chubak -- *Wolfe Research -- Analyst*

Betsy Graseck -- *Morgan Stanley -- Analyst*

Mike Mayo -- *Wells Fargo Securities -- Analyst*

Kian Abouhossein -- *J.P. Morgan -- Analyst*

Brennan Hawken -- *UBS -- Analyst*

Jim Mitchell -- *Buckingham Research -- Analyst*

Devin Ryan -- *JMP Securities -- Analyst*

Gerard Cassidy -- *RBC Capital Markets -- Analyst*

Brian Kleinhanzl -- *Keefe, Bruyette, & Woods -- Analyst*

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Oracle Corp (ORCL) Q2 2020 Earnings Call Transcript

ORCL earnings call for the period ending

ORCL earnings call for the period ending November 30, 2019.

Motley Fool Transcribers (MFTranscribers)
Dec 13, 2019 at 12:30AM

Oracle Corp (NYSE:ORCL)
Q2 2020 Earnings Call
Dec 12, 2019, *5:00 p.m. ET*

Contents:

IMAGE SOURCE: THE MOTLEY FOOL.

Prepared Remarks:

Operator

Welcome to Oracle's Second Quarter 2020 Earnings Conference Call.

Now I would like to turn the call over to Ken Bond, Senior Vice President. Ken?

Ken Bond -- *Senior Vice President, Investor Relations*

Thank you, Holly. And good afternoon everyone and welcome to Oracle's Second Quarter Fiscal Year 2020 Earnings Conference Call. A copy of the press release and financial tables, which includes a GAAP to non-GAAP reconciliation and other supplemental financial information can be viewed and downloaded from our

Investor Relations website.

On the call today are Chairman and Chief Technology Officer, Larry Ellison and CEO Safra Catz. As a reminder, today's discussion will include forward-looking statements, including predictions, expectations, estimates or other information that might be considered forward-looking.

Throughout today's discussion, we will present some important factors relating to our business, which may potentially affect these forward-looking statements.

These forward-looking statements are also subject to risks and uncertainties that may cause actual results to differ materially from statements being made today. As a result, we caution you against placing undue reliance on these forward-looking statements and we encourage you to review our most recent reports, including our 10-K and 10-Q and any applicable amendments for a complete discussion of these factors and other risks that may affect our future results or the market price of our stock.

And finally, we are not obligating ourselves to revise our results or publicly release any revision to these forward-looking statements in light of new information or future events. Before taking questions we'll begin with a few prepared remarks.

And with that, I'd like to turn the call over to Safra.

Safra Ada Catz -- *Chief Executive Officer and Director*

Thanks, Ken. But before I start, I'd like to acknowledge and thank you all for the many, many sincere condolences we received upon Mark's passing. Thank you. They mean a lot to us.

As you can see we had another solid quarter. This quarter, we finished with total revenue growth within my guidance range and EPS at the high-end. Cloud Services and License Support continue to see material growth and given that it represents more than 70% of our total revenue, it more than offsets declines in some smaller non-strategic businesses.

We continue to be encouraged that our overall revenue growth will further accelerate, as we reach the final stages of this ongoing shift in business mix. Of late, I've been spending much more time with customers. The overriding theme I hear is the compelling nature of our technology and how it is critical to the success of their businesses, feature-rich, simple, secure, performance and priced right. They see Oracle is being strategic to their ongoing operations and they tell me repeatedly that Oracle is the right partner to run their mission critical assets, both in the cloud and on-premise. Their comments reinforce our conviction that our product strategy is right.

At Oracle, we've upgraded our internal systems to the cloud. And we are sharing our experience with customers by describing the stunning benefits and efficiencies that can be realized from the move. And though we have thousands of customers and references, our own experience adopting Oracle cloud applications and infrastructure, allows us to serve as a unique and knowledgeable advisor to customers who want to know how to go about their own digital transformation.

To give you some context, let me share just a few of the many benefits we are seeing in our business. With Fusion ERP Cloud, we are now able to close our books and report earnings in 12 days or less. Many companies don't report their results for weeks, and not only can we get our results out faster but we saved money too, by using the AI and processes in Fusion ERP Cloud we've been

able to eliminate more than 30% of our manual accounting activities.

And enabled by Fusion HCM Cloud we have seen employee satisfaction level soar with all-time high rates for things like hiring and on-boarding new employees. We've also made it easier for our managers and employees as Fusion HCM reduces the time needed to complete the talent review process by more than 70%. And separately, we are saving more than 20,000 hours of manager time each year with our Accelerated Job Offer process.

In sales, we're using our Front Office Cloud platform augmented with machine learning and our own Data Cloud to help ourselves -- our sales people sell more and sell more quickly. With Marketing Cloud, campaign planning now takes days rather than weeks and with built-in machine learning we've seen a doubling in lead conversion. We automatically capture millions of activities in Sales Cloud each year and with CPQ Cloud ordering is much faster and easier, with over 70% of our transactions fully automated. We needed that to handle the increased volumes of transactions as a result of our customers move to the cloud.

In addition, we have adopted the Gen 2 Infrastructure including Autonomous Database for our custom apps. Our internal IT costs to run these systems are down by millions, while at the same time we are adopting more than 100 new features each quarter.

Here it Oracle, we are going to continue using our own cloud technology as an intelligent automation engine, and continue to simplify our business model and processes. In turn, I expect that our revenue growth rates will increase and see even more expense efficiencies. And as a result, I expect that you will see us expand our margins and grow EPS double-digits for the foreseeable future.

Now on to the numbers. I will review our non-GAAP results using constant dollar growth rates unless I state otherwise. Currency for Q2 was largely in line with my guidance at nearly 1% and the fact that the growth rates look the same in a few categories is simply because of rounding. Total Cloud Services and License Support revenues for the quarter were $6.8 billion, up 3% accounting for over 70% of total company revenues and most of this is recurring revenue.

Cloud and On-premise License revenues were $1.1 billion, down 7% as more of our GBU customers order cloud instead of license. In terms of ecosystem, GAAP application ecosystem revenues were $2.9 billion, up 4%, with Fusion Apps up in the low 30s, including Fusion ERP, up 38% and Fusion HCM, up 23%, NetSuite ERP was up 28%, vertical Fast was up low-double-digits, while Data Cloud stabilized.

On a trailing 12-month basis more than 90% of our application ecosystem revenue is recurring. GAAP infrastructure ecosystem revenues were $5 billion, up 1% with total database revenue up 1% highlighted by BYOL and Autonomous Database revenues, both up over 200%. But off of small base for now. On a trailing 12-month basis more than three-quarters of our infrastructure ecosystem revenue is recurring. Just a few days ago, we were able to get our first Gen 2 Exadata Cloud at customer fully deployed and connected, it was done in just four days. Previously, with our Gen 1 architecture this typically took significantly longer. As a result, we are very optimistic about the impact our Gen 2 clouded customer will have on our business. No other cloud provider has the right technology to actually do this.

In terms of geographies, we saw double-digit revenue growth in SaaS revenue in all regions except EMEA, with the especially strong results in Latin America and Japan.

Gross margin for Cloud Services and License Support was 85%, down slightly from last quarter due to accelerated investments in our Gen 2 Cloud to address higher demand worldwide. As we get to scale, I expect our Cloud gross margins will grow higher, driving an acceleration in our gross profit growth. By the way, our strategic hardware products delivered on-premise, which includes Exadata grew double-digits for the quarter. Once again, showing that our installed base of customers, focused on our world-leading database platform continues to grow. Total revenue for the quarter were $9.6 billion, up 1% from last year.

Non-GAAP operating income was $4 billion, essentially unchanged from last year and operating margin was 42%, down from 43% last year. The non-GAAP tax rate for the quarter was 18.8%, slightly below our base tax rate of 20% and EPS was $0.90 in USD, up 13% in constant currency and 12% in USD. The GAAP tax rate was 17.7% and GAAP EPS was $0.69 in USD, up 15% in constant currency, 14% in USD. Operating cash flow over the last four quarters, was $13.8 billion. Over the last four quarters capital expenditures were $1.6 billion and free cash flow was $12.2 billion.

We now have approximately $27 billion in cash and marketable securities and short-term net deferred revenue balance is $8.1 billion, down 1% in constant currency, due to timing differences in customer payments. Also, the prior year deferred balance was affected by our transition to ASC 606. Gross deferred revenue was up over 1% in constant currency and would have been up over 3% if not for the ASC 606 transition changes.

We remain committed to returning value to our shareholders through technical innovations, strategic acquisitions, stock repurchases, and prudent use of debt and the dividend. This quarter, we repurchased 91 million shares for a total of $5 billion. Over the last 12 months, we've repurchased nearly 500 million shares for a total of $26 billion and over the last five years, we have reduced the shares outstanding by more than 25%. The Board of Directors again declared a quarterly dividend of $0.24 per share.

My guidance today is on a non-GAAP basis and in constant currency. Assuming current exchange rates remain the same as they are now, currency should have a 1% negative effect on total revenue and $0.01 cent negative effect on EPS. So for Q3, total revenues are

expected to grow 1% to 3% in constant currency and assuming a 1% currency headwind, total revenues are expected to grow 1% to 3% in USD. Now I realize that my USD and constant currency revenue guidance sounds like they are the same number, but it's just rounding similar to our revenue growth this quarter. I do expect a currency impact of 1% -- of nearly 1%.

Non-GAAP EPS in constant currency is expected to grow between 10% to 12% and be between $0.96 and $0.98 in constant currency, and assuming a $0.01 headwind, non-GAAP EPS in USD is expected to grow between 9% and 11% and be between $0.95 and $0.97 in USD. Total CapEx for fiscal year '20 is expected to be around $2.2 billion, but it could move higher based on demand for data center growth.

My EPS guidance for Q2 and fiscal year '20 assumes a base tax rate of 20%. However, one-time tax events could cause actual tax rates for any given quarter to vary from our base tax rate. But I expect that in normalizing for those one-time tax benefits -- tax events, our tax rate will average around 20% in fiscal year 2020.

And finally, for fiscal year 2020, I continue to expect that in constant currency total revenue will grow faster than last year and that we -- and that we will report double-digit EPS growth for the year.

And with that, I'll turn it over to Larry for his comments.

Lawrence J. Ellison -- *Co-Founder, Chairman and Chief Technology Officer*

Thank you. Safra. As I've said before, there are two key product areas that will determine Oracle's future in the cloud; Cloud ERP Applications and the Autonomous Database. Being the clear number-one in both of these two giant applications and infrastructure as market segments will enable the success of our other application and infrastructure products in adjacent market segments. This is already happening in applications. We have a huge lead in Cloud ERP with over 7,000 Fusion ERP customers and 20,000 NetSuite ERP customers. Our closest cloud European competitor is Workday and they claim to have a few hundred ERP customers. Workday's lack of success in cloud ERP is creating opportunities for Oracle and Cloud HCM. More and more we are seeing HCM is being purchased as a part of an ERP cloud application suite. As a result, today we have more HCM customers than Workday. And we're beginning to see that same integrated suite strategy beginning to drive our sales of CX Customer Experience Applications and sales and service and in marketing. SAP never rewrote their ERP applications for the cloud. As a result, SAP's installed base is very vulnerable. We've already replaced and successfully migrated many mid-size SAP customers from SAP to Fusion ERP. Importantly, a few months from now in Q1, in the calendar year 2020, one of SAP's biggest customers will go live on Fusion ERP.

Many of SAP's largest customers are already working with us to develop plans to migrate to Fusion ERP. SAP's customer base is up for grabs. They didn't rewrite their applications for the cloud that has created an enormous opportunity for Oracle. We're already the clear number-one in the Cloud ERP market as measured in market share, and our Cloud ERP business is already growing at a rate of over 30%. By offering a safe and compelling alternatives to SAP's old technology, we can increase our applications growth rate far beyond that 30%. We are very, very comfortable that we will be the overwhelming winner in this generation of Cloud ERP business.

Now let's look at some application wins in the quarter. Advanced Publications, a media company bought ERP. Albertsons bought ERP, EPM and Supply Chain. CH Robinson worldwide, a truck transportation company bought ERP and EPM. DHL supply chain, big German company, bought ERP, EPM and Supply Chain. Edwards Lifesciences, a medical equipment company bought ERP. By the way, I'm not mentioning any HCM -- associated HCM deals. So, I have a separate list for HCM. So a lot of these guys maybe next quarter, I'll put the HCM deals right next to the ERP deals. So you could see -- because I'll be repeating a lot of these names when I get to my HCM list and that's a point I made earlier that people are now looking at HCM, it's just another module that we need the back office, very important. Edwards Lifesciences bought ERP. Ferguson, a manufacturing firm bought ERP and Supply Chain. Global Companies, big energy from bought ERP, EPM and Supply Chain. NCR Financial Services bought ERP, EPM and Supply Chain. NetScout, telecommunications company bought Supply Chain. Mutual Life Assurance bought ERP and Supply Chain. Southern Star Central Gas Pipeline, big energy company bought ERP. Technip other energy company bought ERP.

By the way, SAP is supposed to be very strong in energy. Texas Children's Health Care -- Hospital bought ERP, EPM and Supply Chain. Unilever bought ERP and Supply Chain. Baker Hughes, energy company but ERP and EPM and Supply Chain. Carlson Wagonlit, travel services ERP, EPM and Supply Chain. Kuwait Petroleum, energy company bought ERP, EPM and Supply Chain. Liberty Global, communications company ERP, EPM and Supply Chain. Manpower, big global services company bought ERP, EPM and Supply Chain. Sherwin-Williams that's what they bought ERP, EPM and Supply Chain, the suite. A lot of people buying multiple modules, it's not just ERP. It's ERP, it's EPM, enterprise performance management, it's supply chain, it's manufacturing. Bank of New York Mellon bought ERP, EPM and Supply Chain.

Airport Terminal Services -- oh I'm sorry, now I'm in my HCM group, I'm in the HCM, all grouped together. Airport Terminal Services but HCM. Apparel Bosco, retail, HCM. Bank Saudi Fransi bought HCM. CenterPoint Energy, another energy company, bough HCM. Cummins, manufacturing company, HCM. Graybar Electric bought HCM. Hologic, HCM. HUS that's the hospital -- both are hospitals in Finland run by the federal government in Finland, bought HCM. Mountaire Farms, HCM. North Atlantic Refining, again, this is my HCM list, big energy company and SAP's stronghold in the energy sector, bought HCM from us. Southern Central Pipeline, big gas company, energy,HCM. Technip, energy company, HCM. Tenet Healthcare bought HCM. Texas Children's Hospital bought HCM. And WHATABRANDS bought HCM. Birmingham City Council bought HCM. Kuwait Petroleum

Company, a big energy company bought HCM. MEDNAX, healthcare, HCM. Phoenix Life Holdings, HCM.

In Customer Experience, Equinix bought Service. Ferguson Enterprises bought Service. Ferrari bought Sales and Marketing. IKEA bought Service. Nordstrom bought Service. PayPal bought Marketing. Rabobank bought Service. And Santander Bank bought Service.

Okay. Let me move on to the other segment, which is Autonomous Database and Gen 2 Infrastructure. In the database market we are the overwhelming number-one, with the combination of a dominant share on-premise and very strong market share in the cloud. Though I have yet to see any good data on an database market share in the cloud. Our database business is growing very, very rapidly, because we have an enormous technology advantage in the cloud over all of our competitors with Autonomous Database. So, Autonomous Database is the world's only autonomous database. What does that mean? That means when you configure the system, you don't do anything. The system configures itself, robots configure the system. The reason Capital One lost all that data at AWS is because one of the Capital One people made a configuration error. You can't make configuration errors with the Autonomous Database because human beings don't configure the system.

A lot of these above the full headlines of people losing their data are caused by human errors, People forget to patch systems. Remember that one, they patch some but not all, all of the systems, and Equifax, it was a patchy struts database, didn't get patched. They didn't find them all. Guess what Autonomous Database automatically patches itself when a security flaw is detected. And by the way they detected that's security flaw over at Equifax. They knew what that is, they just didn't get around the patching. Patching is hard. Didn't find all the databases you had to schedule downtime. You don't schedule downtime with the Autonomous Database. You patch the Autonomous Database while the database is still running. You don't patch the database, it's the robots, our robots patch the database that's why it's autonomous. There's no human labor, so there is no human error. So if you're wanting to pay less and not have that human labor you get rid of all those mistakes. This is a gigantic technology advantage. By the way -- and were 10 times faster than anything Amazon have that means we're much cheaper than anything Amazon have.

Much safer, much easier to use, build applications faster. So we already have thousands of Autonomous Database customers running in our public cloud. We added 2,000 more of this quarter. And our Autonomous businesses, as

Safra said, is growing in excess of 200%, Autonomous deal-based business, off a small base. Admittedly, it's a relatively new product, but it's on its way to being the most successful new product introduction in our company's history. Now, this triple-digit growth rate, I expect will spike up dramatically because of another thing, Safra just mentioned, our introduction of our Autonomous Database Cloud at Customer, Gen 2 Cloud at Customer. Now when people can start putting Autonomous Database, they are all -- I mean all our Autonomous Database customers, let me be clear, are in

our public cloud. A lot of our customers, especially those in regulated markets, big banks, people -- government agencies, defense ministries, people at that -- they need the Autonomous Database capabilities behind their firewall in their data center. And over the next few months, we are rolling out this Autonomous Database Gen 2 Cloud at Customer. So all of our cloud competitors are trying to create these outposts of their cloud on the floor -- on the floors of their customers. We actually have it working. And in fact we're in our second generation of this, we did it early. We did a reasonable first-generation job, but the second time is a charm and this new Gen 2 stuff was -- can be installed in a day. Now, the first one we installed in four days. We expect to do that even faster. There'll be more time spent unpacking the hardware and plugging it in than readying the software, because it just syncs up with our public cloud, and you're up and running. This is going to be a huge opportunity for us to dramatically increase the adoption rate on Autonomous Database. Very excited about that, Okay. When that happens we think by any measure, we will be not only we'll have the overwhelming market share lead on-prem but the overwhelming market share lead in the cloud. We expect to hold onto our database franchise in a big way. So our -- it's interesting the both of our Autonomous Database and our Cloud Applications are running in our new Gen 2 highly secure infrastructure and by the end 2020, by the end of next calendar year, this time next year, I'll be able to say that we have more Gen 2 data centers in more countries than Amazon Web Services has data centers period. We're adding lots and lots of data centers in lots and lots of countries. And again, we'll have more data centers in more countries than Amazon by the end -- a year from now. That's very, very exciting.

Now let's look at some of our Autonomous Database and Gen 2 Infrastructure wins this quarter. Okay. AFIA International, a big manufacturing firm. Albertsons, this is another -- this is more synergies that I've got to mention when people buy our applications, they buy our ERP applications. They also build data warehouses associated with those applications. They do a lot of work. So a lot of our application customers are beginning to be infrastructure -- Autonomous Database customers and Infrastructure customers. So, yes, when you buy ERP you might also buy HCM, but when you buy ERP, you're also going to buy the Fusion Data Warehouse, which is in the Autonomous Database product and Infrastructure product. You're going to buy Analytics and our Gen 2 Data Center. You become an infrastructure customer as well as an application customer and we see a lot of overlap. We often see people buying suites of applications ERP plus HCM plus Sales and things like that, but also applications plus infrastructure. Aon Financial Services, Biogen bought Autonomous Data Warehouse, Cisco Systems, again Gen 2 Infrastructure and the Autonomous Data Warehouse. Clearstream services, same thing Gen 2 Infrastructure, Autonomous Data Warehouse. Embraer Aviation, the Brazilian aircraft manufacturer, Autonomous Database and Gen 2 Infrastructure. Equity Bank of Kenya Autonomous Database, Gen 2 Infrastructure. Watson Oil Company, a

big distribution company in the United States, Gen 2 Infrastructure. Health Care Services Corp, Gen 2 Infrastructure and Autonomous Database. Interac, Gen 2 Infrastructure. King Faisal Specialist Hospitals and Research Center, Autonomous Database, Autonomous Transaction Processing.

Encore [Phonetic] University, Autonomous Database, Gen 2 Infrastructure. Manchester, Autonomous Database and Gen 2 Infrastructure. MGM Entertainment, Autonomous Database, Autonomous Transaction Processing. Provident Health Care Services, Autonomous Databas, Autonomous Transaction Processing. Schenker Logistics in Germany, Autonomous Data Warehouse. Sauer [Phonetic], Gen 2 Infrastructure. Swiss Post Gen 2 Infrastructure, Autonomous Data Warehouse. Target, based in the United States, Autonomous Database -- Autonomous Data Warehouse. Technip, energy company, but I mentioned they bought I believe HCM, ERP, bought the full suite and Gen 2 Infrastructure and Autonomous Database. The Boston Globe, Gen 2 Infrastructure, Autonomous Database. Thermos, Autonomous Database, Autonomous Transaction Processing. Tibersof, Autonomous Database. Tideworks Netherlands, Gen 2 Infrastructure. Tokyo Gas and Electric, Autonomous Data Warehouse, Gen 2 Infrastructure. TriMark USA, Gen w2 Infrastructure. Walgreens, Autonomous Data Warehouse, Autonomous Transaction Processing, Gen 2 Infrastructure.

WiZink Bank, Autonomous Data Warehouse, Gen 2 Infrastructure. ZIM, the big shipping company, you see a

lot of Maersk, you see that is ZIM lots of lots of containers, Autonomous Database, Autonomous Transaction Processing and Gen 2 Infrastructure. AXA Equitable Life Insurance, Autonomous Database, Gen 2 Infrastructure. Banco de Chile, Autonomous Database, Autonomous Data Warehouse, Gen 2 Infrastructure. Baxter Healthcare, Autonomous Data Warehouse. Cigna Corporate Services, Autonomous Data Warehouse, Gen 2 Infrastructure. Eventbrite, Gen 2 Infrastructure. Ford Motor Company, Gen 2 Infrastructure, Autonomous Database, Autonomous Warehouse. Mary Kay, Gen 2 Infrastructure. Samsung Electronics Gen 2 Infrastructure, Autonomous Database, Autonomous Rransaction Processing. Verifone, Gen 2 Infrastructure, Autonomous Database and Autonomous Transaction Processing.

With that, I will turn it over to the audience for questions.

Ken Bond -- *Senior Vice President, Investor Relations*

Thank you, Holly. Thank you, Larry. Holly, if you could please prepare the audience for questions.

Questions and Answers:

Operator

[Operator Instructions] And our first question is going to come from the line of Michael Turits, Raymond James.

Michael Turits -- *Raymond James -- Analyst*

Hey, good evening everybody. Safra it's great to see that you reaffirmed your guidance for the full-year for revenue acceleration and double-digit EPS growth. But with the 3Q guide it does suggest a very strong fourth quarter on top of what was the fourth -- strong fourth quarter in the last year. So can you give us a little bit of visibility into what's driving that confidence? And also, I know it's early, but given what that means for fourth quarter, what does that mean in terms of what it implies about fiscal '21?

Safra Ada Catz -- *Chief Executive Officer and Director*

So, we've got everything finally out and available, and as Larry and I both mentioned, we've got Cloud at Customer. We have a lot of orders for that that we have not deployed yet. So we've got a lot of demand there. We've got Autonomous Database, we've got new versions of the Autonomous Database on track, we've got the entire Fusion Suite rolling, including all of the additional modules, have all been continuously upgraded. So we've got immense amount of demand and we have enormous pipelines and our conversion rates are increasing. And so, the pipe has just expanded so dramatically than -- I know we're going to have more bookings, but also previous bookings as those deals are ramping up and more users are using the products. We are very, very upbeat about the second half, but even more so next year. We believe that the momentum we will have in the second half of this year will more than carry through to 2021.

Michael Turits -- *Raymond James -- Analyst*

Great. Thanks very much.

Safra Ada Catz -- *Chief Executive Officer and Director*

Sure.

Operator

And our next question is going to come from the line of Heather Bellini, Goldman Sachs.

Heather Bellini -- *Goldman Sachs -- Analyst*

Great. Thank you so much for the time and I'm going to try and get away with two questions. But I guess the first one, Safra, as you mentioned about license this quarter, it was a little lighter than what I think people were expecting. I know we're talking about a big base, but if there is anything you could call out in terms of whether it's the sales force reorg or just macro or whatever, in terms of the results in the quarter on that line? And then, I know just covering the company throughout, given the lumpiness historically between Q2 and Q3, I know sometimes deals push from one quarter to the next and typically it's better to just average those two quarters. But how do you feel about the outlook for the Q3 License number? And then I just have one follow-up if you don't mind?

Safra Ada Catz -- *Chief Executive Officer and Director*

I generally feel very good about the Q3 License number. As you said, it is lumpy. The one thing we do have is that the GBUs, which are of course, not a giant part of our License business, but are significant. They have moved and their cloud products have become available, and I do expect that most of the orders for new services in the GBUs will come through as cloud services instead of just plain license. But I don't think that will be as significant. I

do expect that licenses in fact we'll be just fine in Q3, other than GBU piece.

Heather Bellini -- *Goldman Sachs -- Analyst*

Okay and then -- just my follow up I mean these calls just still don't feel the same without Mark being on them and with all due respect to him -- to his passing, just knowing how hard it is going to be to replace him. I mean, is there anything to share with us regarding you getting some -- you getting someone to kind of help take his place and some of the responsibilities that you've taken over?

Lawrence J. Ellison -- *Co-Founder, Chairman and Chief Technology Officer*

Okay. This is Larry. I'm going to answer that question because I get the questions. So how is our search for a second CEO going? I remember we announced two CEOs, the first time people thought that was a bit odd. And so now people are finding that we have one CEO is a bit odd. So, let me make it very simple, how is our search going for the news -- for a second CEO. We don't have one. We have no plans for having a second CEO. It was an unusual situation, where Mark and Safra were an absolutely fantastic team, but we have complete confidence in our existing management team. We're doing a lot of recruiting, you'll see a lot of announcements at the next layer down that we're hiring a bunch of people at the next layer down, who are potential CEOs when both Safra and I retire and which is not anytime soon. And so, we're going to strengthen the

management team, but one of the strategies for strengthening that team is not to hire a second CEO.

Heather Bellini -- *Goldman Sachs -- Analyst*

Thank you very much.

Ken Bond -- *Senior Vice President, Investor Relations*

Next question please. Thank you, Heather.

Operator

Next question is going to come from the line of Brad Zelnick, Credit Suisse.

Brad Zelnick -- *Credit Suisse -- Analyst*

Great. Thanks so much. Larry, the momentum in Autonomous Database is a fantastic, growing over 100% in your public cloud, but having been in market now for over a year. I know, Investors are wondering when we might see an inflection in your financial results from Autonomous and I appreciate many customers are including some of the required database option in their deals, but now that you're making it available on Gen2 Cloud at Customer. How should we think about the appetite from your installed base? How material can it be to your financials? And is there anything you might compare it to in Oracle's history?

Lawrence J. Ellison -- *Co-Founder, Chairman and Chief Technology Officer*

No. I mean there -- either in terms of the technological breakthrough. Well, yeah, I guess we had the first diverse

commercial relational database at the very beginning. I mean that's kind of created Oracle Corporation. Right? So we had the very first commercial relational database. We had one before IBM did or anyone else did. So that created -- that turned this company from an idea into the company that manages most of the world's information. So I would say Autonomous Database is that same kind of things. It is so much different, so much safer to use, so much more reliable than anything else that's in the market. I think everyone is going to use it, virtually everyone is going to use it. Now that said, it is -- it takes a while, when you introduce an all-new product. The good news is we have a huge installed base here, it takes a while for that -- for us to ship in, if you will, a next-gen technology and get people comfortable with it and using it. And that first year we've seen a lot of early adopters, but the early adopters are now in the thousands, and we think eventually the only database we'll offer is Autonomous Database. It will replace everything else.

And by the way, our Autonomous Database is only available in Q4. If we put a cloud in -- if we put our cloud in your data center, that's our Exadata machine and our Middleware machines and all of that's in our storage in your data center and in our public cloud. So we think it'll be consumed in one of those two ways and that will replace our entire base. So it means that our existing database business, from a financial standpoint, will more than double or triple, triple probably is a reasonable estimate to look at. Now, of course, when you're in your business, it's all about timing and I wish I could tell you exactly how much we'll sell over that over the next 18

months. That's kind of tricky. Now, we don't have that many data points. We have four quarters of data points. And then the first couple of quarters, it was still new. So, we really only have a couple of quarters of data points. All I can say is none of us ever seen an adoption rate like this before.

Ken Bond -- *Senior Vice President, Investor Relations*

Fantastic. Thank you, Larry.

Operator

Our next question is going to come from the line of Phil Winslow, Wells Fargo.

Philip Winslow -- *Wells Fargo -- Analyst*

Okay. Great. Thanks for taking my question. Just wanted to focus in on the Applications business. Obviously, we saw a nice pick back up here quarter-to-quarter in terms of the year-over-year growth rate. I guess the question is Safra, and I guess Larry too, would you think about the sort of different curves that build up that business.

Obviously, you've talked about in the past, some of the headwinds from things like Data Cloud and then also some of the wins that we saw on your Fusion -- Fusion ERP and that's this quarter. Where are we, when we stack all those curves together? Are we past sort of those headwinds that we're now looking at sort of acceleration from here? In other words, Q1 was a trough or just help us kind of, Larry, that up, if you could?

Safra Ada Catz -- *Chief Executive Officer and Director*

So let me get it started and then, Larry, can add when he needs to add. So first of all, the Data Cloud has stabilized. I don't know if it will stay that way, but that was a very significant headwind for us in that whole business. It is completely stabilized. It grew ever so slightly. Additionally, the adoption in our ERP Cloud is now such -- it's in the thousands. We have many, many references and what happens in our business is that, once you are sort of obviously referenceable it becomes much, much easier for other potential customers to move ahead. One of the things that has been, to some extent, leading to a wait and see attitude by some historical E-Business Suite customers was the adoption of -- first availability and now adoption of Supply Chain. Our Supply Chain now has many, many customers and so more of our customers are willing and interested in moving. Remember, every single quarter, a 100-plus new features become available, and some of those have been, must have features for extremely happy customers in E-Business Suite. Simultaneously, as Larry mentioned, SAP customers have realized that SAP's offerings are not cloud offerings. If you use our SAP's technology, you don't get a 100 new features, every quarter. Theirs simply a hosted offering, which means that we are the obvious choice for customers who want to go through and really adopt a digital approach in their business. And so for us, this is going to be success leads more success. It's an incredibly virtuous cycle. And as Larry mentioned, what it also means is that additional modules are going with and that's clearly showing up in our other segments. And of course, HCM, which is obviously a match and then

ultimately the front office, where we've got a lot of new technology, rolling out that is being adopted.

Lawrence J. Ellison -- *Co-Founder, Chairman and Chief Technology Officer*

Yeah. I think a lot of SAP is -- again in the mid-market, we are replacing a lot of SAP customers and we've got them live and we have references. But right at the very apex that SAP's customer base and their top 50 customers around the world. They are looking at this one particular implementation that where we expect to go live in March of next year and I would describe them is really rooting for us. They want to have an alternative to a $1 billion SAP upgrade. SAP end-of-life, their current stuff in 2025. So if you're a bigger customer, you got to make -- that some people have bought, as you bought ahead, as bought S/4HANA in the cloud with no planned -- with no really good plan to implement. It's a five-year implementation. They're getting price quotes of $1 billion for the upgrade. Imagine going from your existing SAP system taking out Oracle replacing HANA and that's the only change. Basically that's the only change and it's hosted. It's not cloud. There is no cloud. I think everyone said, oh, it's easy for Oracle to say, go to SAP's website and try to find the SAP Cloud for ERP. I mean, you can find it for the stuff they bought. You can find it for Callidus, which is on one cloud. You can find it for Ariba, which is on another cloud. I mean, you can find it for little Survey Monkey and all the stuff that they bought. But they forgot to write ERP -- and that's their business, they forgot to rewrite ERP, the projects that they had to do, they called Business By Design failed. They canceled it. So there is no cloud option for SAP's customers. They can't go to Workday. Workday can't even handle mid-market ERP. So believe me, they want an alternative SAP. Makes sense, right? That they should want alternative. But we've just got to demonstrate that we can safely take these enormous companies to the cloud in a way that they are not putting their business in any risk. And that's why this one particular joint implementation they're other watching closely. But by the way, they're not just watching and waiting. A number of their biggest customers in the heart of Germany, lots of them are working with us. These are German customers. The core of SAP are working with us and taking some of their -- moving some of their divisions already, some of their divisions to Oracle Fusion to persuade themselves that we can do this safely. They've gone that far. They don't want to continue with this obsolete code.

This is -- this opportunity is gigantic because we have one ERP customer -- competitor on-premise. They don't have a cloud offering that's SAP. And we've got one ERP cloud competitor that just is not doing very well, I think hard time getting their business off the ground, it doesn't scale. There are a lot of problems. So we have a chance here to be -- to get what used to be in the old world called Gate's Share for ERP, like Microsoft Office to be -- Microsoft Office as ERP and it's sitting there and we just have to get this last proof point out to SAP's largest customers, yes, we can do this. We can do it safely and we will be overwhelmingly the largest application company in the cloud.

Ken Bond -- *Senior Vice President, Investor Relations*

Thank you, Larry. Next question please.

Operator

And our next question is going to come from the line of Mark Moerdler, Sanford Bernstein.

Mark Moerdler -- *Sanford Bernstein -- Analyst*

Thank you very much for taking my question. Autonomous Database, sounds like it's really starting to gain traction. Given the shift to sales personnel to selling Autonomous, can you give us some more color specifically? Specifically are you seeing the customers buying the required modules as license, are they including it with the cloud, are you seeing changes in the size of the customer, size of the pipeline, time it take from customer interest to adoption any of that would be really appreciated?

Lawrence J. Ellison -- *Co-Founder, Chairman and Chief Technology Officer*

Okay. I'm happy to do that. I think the most interesting thing that's going on is, we've decided to take, if you will, AWS approach to selling Autonomous Database in the cloud. So we almost prefer selling a $30,000 deal to $100,000 deal because the $30,000 deal we can close in four weeks. So we think the way to sell Autonomous Database is to get it installed on a project in one of our customers, get it going, help them become successful and then once they under -- once they actually get their hands on Autonomous Database and they have working

apps, and they've working projects, working data warehouses, working transaction processing systems, you start and you land and expand. So we are selling thousands and thousands of small deals and some of those deals are already coming back as larger deals. But our approach, again, is to -- and most of it is not BYOL because there is small, I mean, some of it is BYOL but the majority is not BYOL. It was interesting, in the early days in ERP, when we are ERP people used to say, well, these maybe your E-business Suite customers. No, they were new logos. In the early days in cloud ERP for us, they were new logos. Believe it or not, we're actually seeing new logos in database. But again, most of them are our customers, but they are not using their existing licenses. They're going ahead and using a standard cloud license what we call paid up. They pay us big up, you pay for what you use. I mean it's the promise of the cloud and we're getting thousands of these because we think the best selling technique for Autonomous Database is try it, get it running, watch it backs itself up, it upgrades itself, it tunes itself, it can configures itself. There is nothing like it. We just got to win those hearts and minds and the way to do that is go wide across our entire customer base. That's what's going on. And again, it's working very, very well. I think it's working very, very well because we're seeing -- just beginning to see the first people coming back and going from $30,000 a month to $600,000 a month.

Ken Bond -- *Senior Vice President, Investor Relations*

Great. Next question please.

Operator

Our final question for today will come from the line of Kirk Materne, Evercore.

Kirk Materne -- *Evercore -- Analyst*

Yes. Thanks very much and thanks for taking the question. Safra, I just wonder if you could comment on just sort of the geographic landscape for you all. Looked like Europe was perhaps a little bit softer than your other geographies this quarter, maybe that's just macro. I was wondering if you just add a little bit color on sort of what you're seeing across the different theaters? Thanks.

Safra Ada Catz -- *Chief Executive Officer and Director*

Yeah. This quarter EMEA only grew in the single-digits as some of the other regions did grow in high-double-digits, some very high double-digits. And I think there is nothing really special going on one way or the other. Sometimes it's just the way the quarter falls out for them. But overall, our business remains very strong and I think that next quarter could be completely different. So it was -- it's really nothing. We're not seeing a massive change, even month-over-month or quarter-over-quarter from what it's look like. Obviously, there are some regions doing very, very well for a number of different reasons as they get to roll out new capabilities. We've got a lot of -- we've got data centers opening and have opened very, very successfully in Latin America, and in Asia and in Japan and so we've got a lot of usage and increase in some of those areas, which help to explain some of the big growth in some of those areas. But EMEA, I think we'll see there

is nothing special in particular. I have no real color to add and we'll see what happens after today's election in the UK.

Kirk Materne -- *Evercore -- Analyst*

Sounds good. Thank you.

Ken Bond -- *Senior Vice President, Investor Relations*

Thank you, Safra. A telephonic replay of this conference call will be available for 24 hours. Dial-in information can be found in the press release issued earlier today. Please call the Investor Relations department, any follow-up questions from this call, we look forward to speaking to you.

With that, I'll turn the call back to, Holly, for closing. Thank you.

Operator

[Operator Closing Remarks]

Duration: 55 minutes

Call participants:

Ken Bond -- *Senior Vice President, Investor Relations*

Safra Ada Catz -- *Chief Executive Officer and Director*

Lawrence J. Ellison -- *Co-Founder, Chairman and Chief Technology Officer*

Michael Turits -- *Raymond James -- Analyst*

Heather Bellini -- *Goldman Sachs -- Analyst*

Brad Zelnick -- *Credit Suisse -- Analyst*

Philip Winslow -- *Wells Fargo -- Analyst*

Mark Moerdler -- *Sanford Bernstein -- Analyst*

Kirk Materne -- *Evercore -- Analyst*

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