Deutsche Bank
Research

Rating
Buy

North America
United States

TMT
Software

Company
Oracle

Reuters	Bloomberg	Exchange	Ticker
ORCL.N	ORCL US	NSM	ORCL

Date
12 December 2023

Company Update

Price at 11 Dec 2023 (USD)	115.13
Price target	135.00
52-week range	126.71 - 79.58

F2Q Supply Surprise, But Not Demand

Valuation & Risks

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Key changes			
Revenue (USDm)	53,606.6 to 53,308.8	↓	-0.6%

Source: Deutsche Bank

We reiterate our Buy rating and $135 TP, following F2Q results that were hampered by supply constraints and require some explanation. Cloud revenue was ~$50mn (FX adj.) shy of expectations, largely due to conscious capacity planning decisions made to accommodate large scale OCI customers at the expense of near-term revenue. These are not just GenAI workloads, but include multiple significant customer ramps across different regions, deployment types, etc. Appreciating OCI is crucial to the ORCL bull thesis; we can understand the negative stock reaction, but note anecdotal evidence of robust demand, including $0.5bn q/q increase in RPO, +11% cRPO y/y @cc (ex-Cerner), two new $1bn+ deals called out by Larry Ellison, and very importantly a commitment to maintaining 50%+ OCI growth for "a few years" at an increasing scale. Substantiating the fact pattern was lower CapEx in the quarter at $1.1bn vs. Street $1.8bn, though with an expected nearly $6bn in F2H (FY unchanged), consistent with supply ramping and backlog materialization. Management acknowledges a degree of increased risk associated with the timing of larger customer commitments coming online, but characterized delays to the order of months (vs. longer) and within the scope of obligations made to committed customers (i.e. not disappearing).

As for guidance, the F3Q revenue outlook +6%-8% y/y @cc came in near Street and excluding Cerner suggests a ~3pt acceleration to 8%-10% y/y @cc with total Cloud revenue +26-28% y/y ex Cerner, accelerating from 25% in F2Q and off of a 1pt tougher compare. While the company didn't explicitly take down its prior stated goal of growing Cloud ex Cerner to at least similar to last year's +29% y/y @cc, we acknowledge the implied hockey stick required in F4Q and instead now reduce our FY24 estimate to 26.8% vs. 28.5% prior.

We remain particularly enthused for the third leg of the Oracle growth story which we believe is only just getting started and catalyzed by the announced Microsoft Azure partnership in September. Management expects to light up 20 new Oracle Cloud data centers co-located and connected to Azure, with an initial 2,000 full racks of Exadata database machines to meet pent up demand. This capacity was sized by Microsoft and represents enough capacity to host tens of thousands of customers. This is meaningful validation of the opportunity, for which we have surfaced very real initial customer demand in our checks, and represents a 4-5x multiple on the company's ~$14bn infrastructure technology (mostly DB) license support base.

We maintain our Buy rating and $135 DCF-derived target price, implying 23x CY24E non-GAAP EPS.

What we liked

(1) Revenue guidance for F3Q at +6%-8% y/y @cc came in near Street and excluding Cerner suggests a ~3pt acceleration to 8%-10% y/y @cc, albeit also against an easier License comp. We continue to model ex-Cerner growth of ~8% for FY24. **(2)** Non-GAAP OM of 40.8% was 10bps above Street at 40.7%, despite another GM miss, and expanded 1.3pts y/y as the company fully lapped the Cerner acquisition and continues to drive leverage in S&M (15% of revenue from 17% last year) and to a lesser extent R&D as overall OpEx dollars were -3% y/y vs. a revenue base that grew 5%. **(3)** We believe F3Q guidance implies a third straight quarter of y/y operating margin expansion (DBe 42.8%; +1.0pts y/y) even as GM trends down on mix headwinds, demonstrating efficiency as it marches toward a FY24 OM target of ~43% and LT FY26 OM target of 45%. **(4)** Chairman Larry Ellison indicated he expects to maintain 50%+ OCI growth for "a few years", based on the demand seen across a wide range of customers, geographies and deployment types. This would be well above our base case forecasts through FY26 and we believe even the most bullish buyside expectations. **(5)** Oracle continued to highlight what it views as significant cloud infrastructure advantages in helping attract large customers, with two $1bn+ deals anticipated to be signed in the next few weeks. **(5)** Infrastructure Support revenue was flat y/y cc, despite the early impact of contract price increases that started in December that we believe some investors expected to provide more of a boost. While we'll continue to watch this high-margin revenue line, it's encouraging that one of the biggest headwinds here appears to be due to migration to Oracle cloud offerings.

What we're watching

(1) Total revenue at +4% y/y @cc was near the midpoint of guidance (3%-5%), but slightly below Street (~4.3%) due largely to a shortfall on Cloud and to a lesser extent a sequential decline in Services. Ex-Cerner revenue growth was higher at +6% y/y @cc, reflecting peak Cerner License activity a year ago and prior to the planned model transition to ratable Cloud revenue, though still at the lower end of guidance (6%-8%). **(2)** F2Q Cloud revenue ex-Cerner +25% y/y @cc missed guidance of 27%-29%. In USD Total Cloud was ~$90m below, driven by the combination of a 1pt lower FX tailwind (~$40m impact) and softer underlying performance (~$50m impact) that was primarily attributed to an intra-quarter audible in OCI (PaaS/IaaS) towards prioritizing larger customer contracts that require greater chucks of capacity and can take longer to bring online. **(3)** Overall PaaS/IaaS eased to +50% y/y @cc (from +64% in F1Q), including OCI consumption growth of +71% (from 91%), though we believe continued to take share in the broader public cloud market. **(4)** Prior FY24 Cloud (ex-Cerner) revenue guidance of >29% y/y @cc was not explicitly reiterated and we are now modeling this closer to 27% as we believe that while demand is healthy, a lot of timing and execution pieces would now have to fall favorably into place to get near the prior target. While F3Q Cloud guidance of 26%-28% y/y @cc was below the prior target trajectory, it does imply a ~2pt sequential acceleration and an even more encouraging pickup up in the pace of q/q net adds, which if achieved could help rebuild momentum/ confidence into the year end and looking to FY25. **(5)** SaaS revenue growth held up at ~14% y/y @cc (vs. ~14.5% organic last quarter), though ex-Cerner appears to have decelerated against a bit easier comp with grow in Fusion ERP (+19% y/y cc) and NetSuite (+20% y/y cc) both ticking down a point and "other SaaS" (Data Cloud, Taleo, etc.) remaining challenging. **(6)** Cerner revenue appears to have declined

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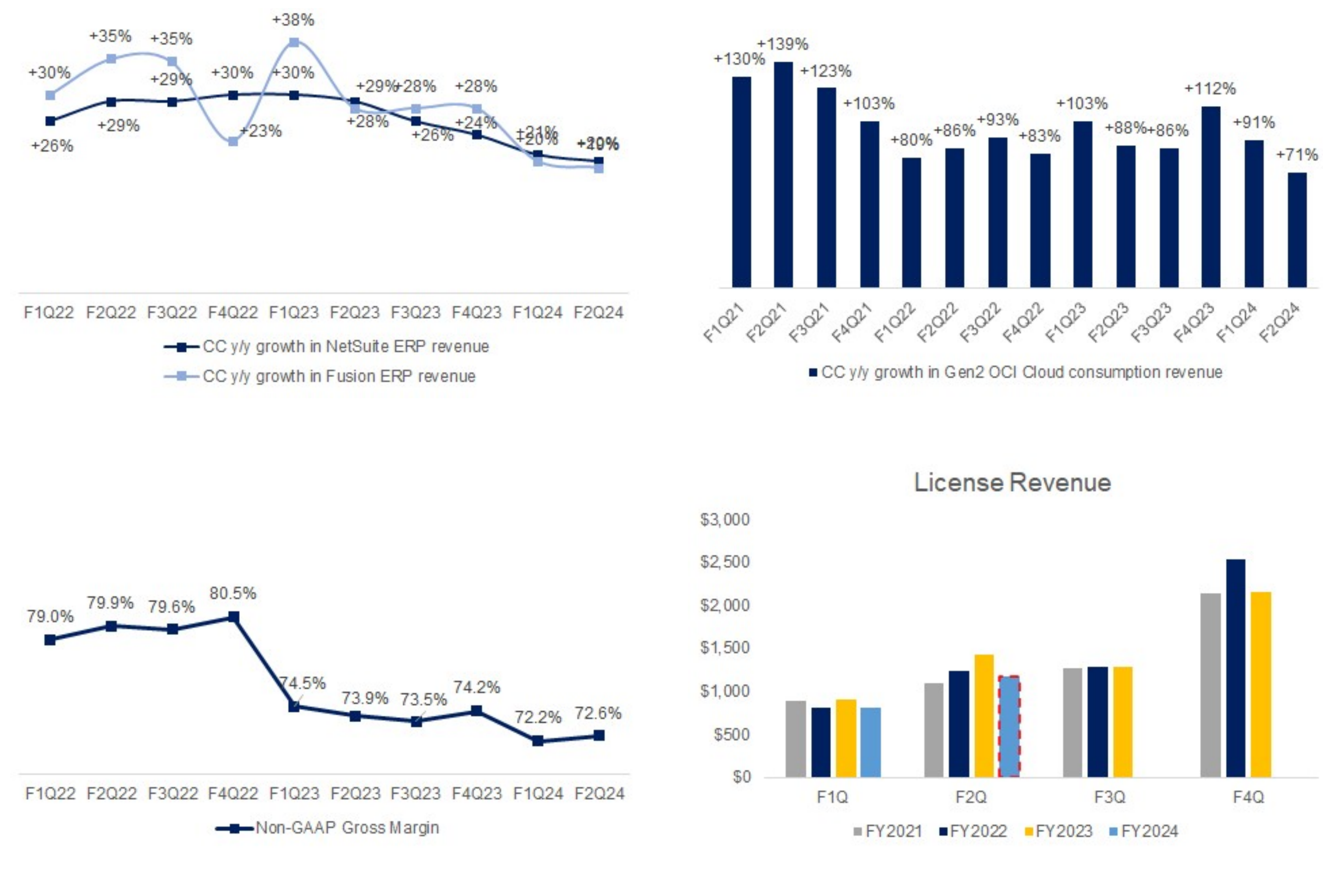
~10% y/y and was a 2pt drag on overall growth, which we believe is mainly attributable to its transition away from License/Maintenance to fully ratable Cloud revenue and broader transition issues as mgmt. works to modernize the Cerner product portfolio in hopes of reenergizing growth. **(7)** Database subscription revenue eased to +4% y/y @cc from +6% last quarter with slower Exadata/ Autonomous cloud database services growth of +40%/+26% y/y @cc (from 46%/42%). We look for this to meaningfully inflect ahead as Oracle Database@Azure begins rolling out (seeing ~2,000 racks of demand) and unlocks their ability to more fully execute on their on-prem migration opportunity. **(8)** License revenue came in at -19% y/y @cc (below Street at -17%) and reflects the model transition at Cerner and general push to ratable Cloud subscriptions. We now anticipate full year License revenue to decline ~10% @cc. **(9)** Non-GAAP GM of 72.6% was down 1.3pts y/y and below Street at 73.0% on mix shift to cloud infrastructure, lower License sales and a drop in Services GM. We will be looking for more substantial improvement in OCI and SaaS GM thru FY24 and into FY25. **(10)** Capex took another surprising stepdown to $1.1bn in F2Q, though this is likely timing related as the full year view (~$8bn and closer to +15% adj. for FY23 1Xs) was unchanged. The implied step-up in F2H is expected to be accompanied by OCI capacity and consumption coming online, and we continue to expect revenue growth + operating margin expansion + flat capex to translate into double digit FCF growth in FY24.

Estimates and valuation

Incorporating F1Q results and guidance into our model we adjust down our FY24/25 revenue estimates to $53.31/$58.11bn and our FY24/25 non-GAAP Operating Income to $22.81/$25.57bn. Following our model update, our DCF-based TP is maintained at $135. Downside risks to our rating and target price include: 1) Key man/woman risk, 2) Change in the competitive environment; 3) Changes in the IT spending environment; and 4) Cerner integration.

Figure 1: Key Charts



Source : Company reports

Figure 2: F2Q Summary

Oracle (ORCL)
In $mn except EPS

	2Q24A					
	Actual	Dbe	Actual vs. Dbe	Cons.	Actual vs. cons.	Company guidance
Income Statement						
Cloud Svcs & License Support	9,639	9,744	-1.1%	9,688	-0.5%	
Y/Y Growth	+12.1%	+13.3%		+12.7%		
Q/Q Growth	+1.0%	+2.1%		+1.5%		
*Y/Y Growth - CC**	+11.0%	+11.3%		+11.6%		
Cloud and On-Prem License	1,178	1,175	+0.2%	1,200	-1.8%	
Y/Y Growth	-17.9%	-18.1%		-16.4%		
Q/Q Growth	+45.6%	+45.3%		+48.3%		
*Y/Y Growth - CC**	-19.0%	-20.1%		-17.5%		
Hardware	756	740	+2.2%	742	1.9%	
Y/Y Growth	-11.1%	-13.0%		-12.7%		
Q/Q Growth	+5.9%	+3.6%		+3.9%		
Services	1,368	1,390	-1.6%	1,409	-2.9%	
Y/Y Growth	-1.7%	-0.1%		+1.2%		
Q/Q Growth	-1.1%	+0.5%		+1.9%		
Total Revenue	**12,941**	**13,049**	**-0.8%**	**13,053**	-0.9%	
Y/Y Growth	+5.4%	+6.3%		+6.3%		
Q/Q Growth	+3.9%	+4.8%		+4.8%		
*Y/Y Growth - CC**	+4.0%	+4.3%		+4.9%		*+3% to +5%*
Non-GAAP Gross Profit	9,389	9,524	-1.4%	9,552	-1.7%	
Non-GAAP GM (%)	72.6%	73.0%		73.2%		
Non-GAAP OI	**5,536**	**5,590**	**-1.0%**	**5,562**	-0.5%	
Non-GAAP OM (%)	42.8%	42.8%		42.6%		
Y/Y Growth	+8.8%	+9.9%		+9.4%		
Non-GAAP Net Income	3,762	3,739	+0.6%	3,747	0.4%	
Net margin (%)	29.1%	28.6%		28.7%		
Non-GAAP EPS	**$1.34**	**$1.32**	**+1.3%**	**$1.33**	0.4%	$1.30-$1.34
Operating Metrics						
Operating Cash Flow	**143**	**2,003**	**-92.9%**	**1,823**	-92.2%	
Y/Y Growth	*-83.2%*	*+135.9%*		*+114.7%*		
Capex	**1,080**	2,316		1,895	22.2%	
Levered Free Cash Flow	**(937)**	**(314)**	**NM**	**(72)**	**-1201.4%**	

*Source : Company Reports, DB Estimates, Bloomberg Finance LP. *DB estimates for cc*

Figure 3: Estimates Summary

Oracle (ORCL)
In $mn except EPS

	3Q24E					FY24E				FY25E			
	New estimates	Old estimates	New v. old	Cons.	Company guidance	New estimates	Old estimates	New v. old	Cons.	New estimates	Old estimates	New v. old	Cons.
Income Statement													
Cloud Svcs & License Support	9,942	9,927	+0.1%	9,952		39,480	39,554	-0.2%	39,593	44,088	44,109	-0.0%	44,405
Y/Y Growth	+11.4%	+11.3%		+15.8%		+11.8%	+12.0%		+12.1%	+11.7%	+11.5%		+12.2%
Q/Q Growth	+3.1%	+1.9%		+4.2%		---	---		---	---	---		---
Y/Y Growth - CC	+11%	+11%		+13%		+11%	+11%		+11%	+12%	+12%		+11%
		0%											
Cloud and On-Prem License	1,224	1,241	-1.4%	1,210		5,196	5,388	-3.6%	5,328	5,310	5,550	-4.3%	5,228
Y/Y Growth	-5.0%	-3.6%		-15.7%		-10.1%	-6.8%		-7.8%	+2.2%	+3.0%		-1.9%
Q/Q Growth	+3.9%	+5.6%		+49.6%		---	---		---	---	---		---
Y/Y Growth - CC	-5%	-4%				-10%	-7%			+2%	+3%		
		0%											
Hardware	779	751	+3.7%	772		3,069	3,008	+2.0%	2,939	2,976	2,917	+2.0%	2,990
Y/Y Growth	-4.0%	-7.4%		-9.1%		-6.3%	-8.1%		-10.2%	-3.0%	-3.0%		+1.7%
Q/Q Growth	+3.0%	+1.6%		+8.2%		---	---		---	---	---		---
		0%											
Services	1,369	1,395	-1.8%	1,404		5,564	5,611	-0.8%	5,677	5,729	5,778	-0.9%	5,853
Y/Y Growth	-0.5%	+1.4%		+0.9%		-0.5%	+0.3%		+1.5%	+3.0%	+3.0%		+3.1%
Q/Q Growth	+0.1%	+0.3%		+1.5%		---	---		---	---	---		---
		0%											
Total Revenue	**13,313**	**13,314**	**-0.0%**	13,336		**53,309**	**53,561**	**-0.5%**	53,774	**58,103**	**58,354**	**-0.4%**	58,331
Y/Y Growth	+7.4%	+7.4%		+8.6%	6%-8%	+6.7%	+7.2%		+7.6%	+9.0%	+8.9%		+8.5%
Q/Q Growth	+2.9%	+2.0%		+7.1%		---	---		---	---	---		---
Y/Y Growth - CC	+7%	+8%		+8%	6%-8%	+6.3%	+6.7%		+6.7%	+9.0%	+9.0%		+8.7%
		0											
Non-GAAP Gross Profit	9,663	9,703	-0.4%	9,764		38,806	39,190	-1.0%	39,501	42,251	42,567	-0.7%	42,973
Non-GAAP GM (%)	72.6%	72.9%		73.2%		72.8%	73.2%		73.5%	72.7%	72.9%		73.7%
		0											
Non-GAAP OI	**5,702**	**5,689**	**+0.2%**	5,691		**22,808**	**23,000**	**-0.8%**	22,984	**25,572**	**25,720**	**-0.6%**	25,596
Non-GAAP OM (%)	42.8%	42.7%		42.7%		42.8%	42.9%		42.7%	44.0%	44.1%		43.9%
Y/Y Growth	+10.0%	9.7%		+11.9%		+9.1%	10.0%		+2.2%	+12.1%	11.8%		+11.4%
		0											
Non-GAAP Net Income	3,862	3,717	+3.9%	3,835		15,487	15,421	+0.4%	15,675	17,663	17,801	-0.8%	17,416
Net margin (%)	29.0%	27.9%		28.8%		29.1%	28.8%		29.2%	30.4%	30.5%		29.9%
Non-GAAP EPS	**$1.37**	**$1.31**	**+5.2%**	$1.37	$1.35-$1.39	**$5.50**	**$5.42**	**+1.5%**	$5.57	**$6.29**	**$6.15**	**+2.2%**	$6.23
		0											
Operating Metrics		0											
Operating Cash Flow	**5,002**	**4,499**	**+11.2%**	5,142		**18,050**	**19,103**	**-5.5%**	18,614	**21,917**	**22,201**	**-1.3%**	21,648
Y/Y Growth	+17.0%	5.2%		+505.7%		+5.1%	11.3%		+8.4%	+21.4%	16.2%		+16.3%
CapEX	2,529	2,363	+7.0%			7,990	8,537	-6.4%		9,878	9,774	+1.1%	
Levered Free Cash Flow	2,473	2,136	+15.8%	2,838		10,060	10,566	-4.8%	10,276	12,039	12,427	-3.1%	13,172

*Source : Company Reports, DB Estimates, Bloomberg Finance LP. *DB estimates for cc*

Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Oracle	ORCL.N	115.13 (USD) 11 Dec 2023	1, 2, 7, 8, 14, 15, 24

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at https://research.db.com/Research/Disclosures/EquityResearchDisclosures. Aside from within this report, important risk and conflict disclosures can also be found at https://research.db.com/Research/Disclosures/Disclaimer. Investors are strongly encouraged to review this information before investing.

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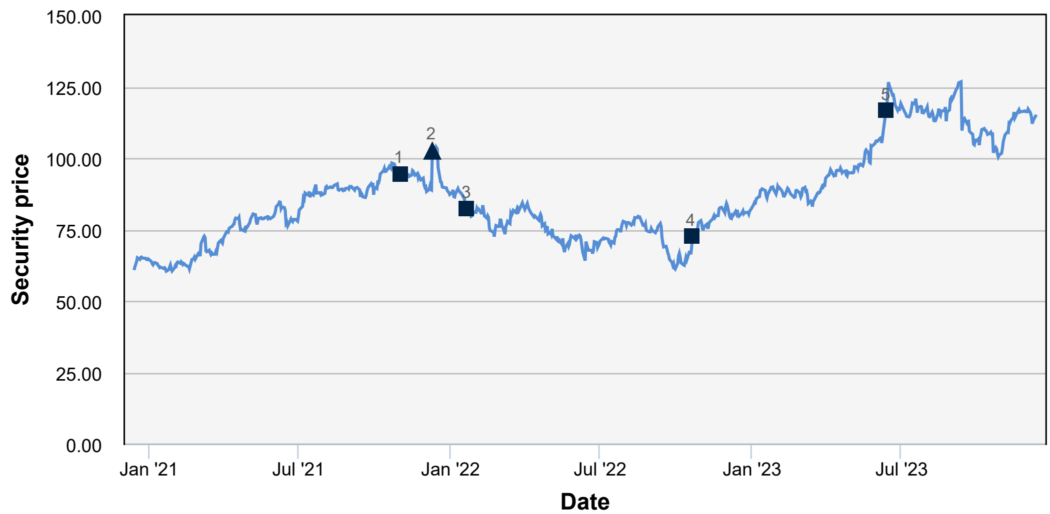
Historical recommendations and target price: Oracle (ORCL.N)

(as of 12/11/2023)



Current Recommendations
- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	11/01/2021	Hold, Target Price Change USD 110.00, Current Price USD 94.38 Brad Zelnick
2.	12/10/2021	Upgraded to Buy, Target Price Change USD 120.00, Current Price USD 102.63 Brad Zelnick
3.	01/21/2022	Buy, Target Price Change USD 110.00, Current Price USD 82.22 Brad Zelnick
4.	10/21/2022	Buy, Target Price Change USD 120.00, Current Price USD 72.70 Brad Zelnick
5.	06/13/2023	Buy, Target Price Change USD 135.00, Current Price USD 116.68 Brad Zelnick

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Buy: Based on a current 12-month view of TSR, we recommend that investors buy the stock.

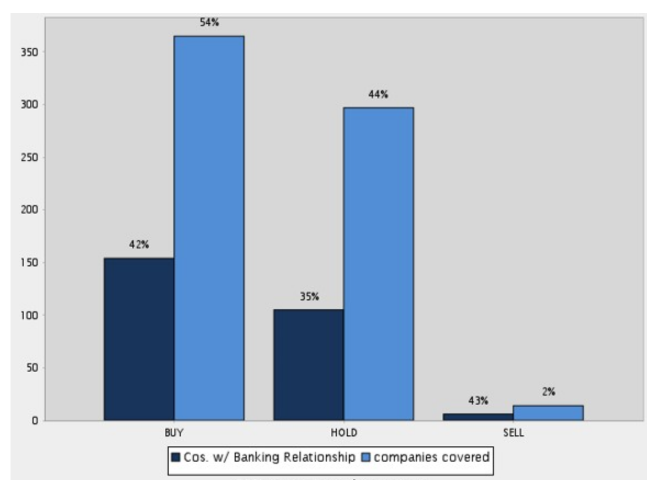
Sell: Based on a current 12-month view of TSR, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

TSR = Total Shareholder Return. Percentage change in share price from current price to projected target price plus projected dividend yield

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships



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