

## Equities

30 April 2012 | 27 pages

# Oracle Corporation (ORCL)

## Bounding the SaaS Threat: A Look at Application Scenarios

- Company Update
- Target Price Change

- **Diving into SaaS / apps secular concern** – ORCL has underperformed software peers since the Nov quarter earnings report by over 14%. The most significant risk in our view to the long-term story is the potential for SaaS to eat into Oracle's applications revenue. In parallel, Oracle is early in its Fusion applications release, which is likely causing some stall today, but could build apps momentum as the offering matures.
- **Secular risk is real...** – Oracle's organic apps license growth has turned negative in the last two quarters. We estimate that 27% of Oracle's profit comes from apps, with the largest revenue streams being ERP, CRM, and BI. In ERP and CRM, Oracle faces displacement threats, with impact amplified by apps dragging database revenue.
- **...but damage is bounded** – We analyze 3 scenarios, with the "base" case baked into our price target. (We revised to \$34 as we roll forward the DCF). In the "bear" case, the highest possible growth for SaaS vendors presents \$3/share of downside (~\$31). In the "bull" case, Fusion accelerates growth and adds \$1/share in value (~\$35).
- **Looking forward** – Fusion could be in the dark before the dawn, but the question is: a) timing; b) magnitude of upsell. Positive progress would point toward the "bull" case we have outlined. Competitive SaaS momentum is key. If Workday, which is gaining much traction in ORCL's enterprise market, follows the growth trajectory of peer CRM (CRM.N; US\$156.66; 1), this would point towards the "bear" case we have outlined.
- **What a difference a year makes** – A year ago, ORCL was at the high end of its historical valuation range (20% premium to S&P) vs. the low end now (10% discount). Secular concerns are heightened with a focus on SaaS (which we address here) and NoSQL/Big Data/in-memory DBs. Current concerns appear overblown and largely in the stock at current levels. Potential catalysts over the next six months include: seasonal Q4 strength, likely upcoming Oracle database release and a reversal of hardware revenue declines in FY13.

|                              |                |
|------------------------------|----------------|
| <b>Buy</b>                   | <b>1</b>       |
| Price (27 Apr 12)            | US\$29.24      |
| Target price                 | US\$34.00      |
|                              | from US\$32.00 |
| Expected share price return  | 16.3%          |
| Expected dividend yield      | 0.8%           |
| <b>Expected total return</b> | <b>17.1%</b>   |
| Market Cap                   | US\$145,472M   |

### Price Performance (RIC: ORCL.O, BB: ORCL US)



| EPS          | Q1           | Q2           | Q3           | Q4           | FY           | FC Cons      |
|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>2011A</b> | 0.42A        | 0.51A        | 0.54A        | 0.75A        | 2.22A        | 2.22A        |
| <b>2012E</b> | <b>0.48A</b> | <b>0.54A</b> | <b>0.62A</b> | <b>0.78E</b> | <b>2.41E</b> | <b>2.42E</b> |
| Previous     | 0.48A        | 0.54A        | 0.62A        | 0.78E        | 2.41E        | na           |
| <b>2013E</b> | <b>na</b>    | <b>na</b>    | <b>na</b>    | <b>na</b>    | <b>2.68E</b> | <b>2.63E</b> |
| Previous     | na           | na           | na           | na           | 2.68E        | na           |
| <b>2014E</b> | <b>na</b>    | <b>na</b>    | <b>na</b>    | <b>na</b>    | <b>3.00E</b> | <b>2.89E</b> |
| Previous     | na           | na           | na           | na           | 3.00E        | na           |

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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**Oracle Corporation (ORCL)**

30 April 2012

| ORCL.O: Fiscal year end 31-May |               |                |                |                |                | Price: US\$29.24; TP: US\$34.00; Market Cap: US\$145,472m; Recomm: Buy |                |               |               |               |               |
|--------------------------------|---------------|----------------|----------------|----------------|----------------|--|----------------|---------------|---------------|---------------|---------------|
| Profit & Loss (US\$m)          | 2010          | 2011           | 2012E          | 2013E          | 2014E          | Valuation ratios   | 2010           | 2011          | 2012E         | 2013E         | 2014E         |
| Sales revenue                  | 26,821        | 35,623         | 37,186         | 39,343         | 42,052         | PE (x)   | 17.5           | 13.2          | 12.1          | 10.9          | 9.7           |
| Cost of sales                  | -5,765        | -8,401         | -7,946         | -8,124         | -8,351         | PB (x)   | 4.8            | 3.7           | 3.2           | 2.5           | 2.1           |
| Gross profit                   | 21,056        | 27,222         | 29,240         | 31,219         | 33,701         | EV/EBITDA (x)  | 9.5            | 7.4           | 6.6           | 6.0           | 5.1           |
| Gross Margin (%)               | 78.5          | 76.4           | 78.6           | 79.4           | 80.1           | FCF yield (%)  | 5.8            | 7.2           | 8.6           | 9.6           | 10.7          |
| <b>EBITDA</b>                  | <b>11,954</b> | <b>15,316</b>  | <b>16,702</b>  | <b>17,780</b>  | <b>19,464</b>  | Dividend yield (%)   | 0.7            | 0.7           | 0.8           | 0.8           | 0.8           |
| EBITDA Margin (%)              | 44.6          | 43.0           | 44.9           | 45.2           | 46.3           | Payout ratio (%)   | 12             | 9             | 10            | 9             | 8             |
| Depreciation                   | -298          | -368           | -444           | -370           | -362           | ROE (%)  | 22.0           | 24.2          | 22.9          | 21.8          | 20.5          |
| Amortisation                   | -1,973        | -2,428         | -2,371         | -1,991         | -1,644         | <b>Cashflow (US\$m)</b>  | <b>2010</b>    | <b>2011</b>   | <b>2012E</b>  | <b>2013E</b>  | <b>2014E</b>  |
| <b>EBIT</b>                    | <b>9,683</b>  | <b>12,520</b>  | <b>13,887</b>  | <b>15,419</b>  | <b>17,458</b>  | EBITDA   | 11,954         | 15,316        | 16,702        | 17,780        | 19,464        |
| EBIT Margin (%)                | 36.1          | 35.1           | 37.3           | 39.2           | 41.5           | Working capital  | 244            | -728          | 98            | 230           | 218           |
| Net interest                   | -632          | -645           | -579           | -380           | -252           | Other  | -3,422         | -3,373        | -3,526        | -3,601        | -4,020        |
| Associates                     | 0             | 0              | 0              | 0              | 0              | <b>Operating cashflow</b>  | <b>8,776</b>   | <b>11,215</b> | <b>13,275</b> | <b>14,409</b> | <b>15,662</b> |
| Non-op/Except                  | -714          | -367           | -265           | -80            | -80            | Capex  | -230           | -450          | -506          | -300          | -320          |
| <b>Pre-tax profit</b>          | <b>8,337</b>  | <b>11,508</b>  | <b>13,043</b>  | <b>14,959</b>  | <b>17,126</b>  | Net acq/disposals  | -10,089        | -5,631        | -6,306        | -800          | -800          |
| Tax                            | -2,107        | -2,863         | -3,142         | -3,720         | -4,256         | Other  | 0              | 0             | 0             | 0             | 0             |
| Extraord./Min.Int./Pref.div.   | -95           | -97            | -90            | -80            | -100           | <b>Investing cashflow</b>  | <b>-10,319</b> | <b>-6,081</b> | <b>-6,812</b> | <b>-1,100</b> | <b>-1,120</b> |
| <b>Reported net profit</b>     | <b>6,135</b>  | <b>8,548</b>   | <b>9,810</b>   | <b>11,159</b>  | <b>12,769</b>  | Dividends paid   | -1,004         | -1,061        | -1,209        | -1,184        | -1,160        |
| Net Margin (%)                 | 22.9          | 24.0           | 26.4           | 28.4           | 30.4           | <b>Financing cashflow</b>  | <b>2,567</b>   | <b>516</b>    | <b>-5,729</b> | <b>-1,498</b> | <b>-1,474</b> |
| Core NPAT                      | 8,494         | 11,400         | 12,319         | 13,395         | 14,712         | <b>Net change in cash</b>  | <b>917</b>     | <b>6,250</b>  | <b>553</b>    | <b>11,812</b> | <b>13,068</b> |
| <b>Per share data</b>          | <b>2010</b>   | <b>2011</b>    | <b>2012E</b>   | <b>2013E</b>   | <b>2014E</b>   | <b>Free cashflow to s/holders</b>                                      | <b>8,546</b>   | <b>10,765</b> | <b>12,769</b> | <b>14,109</b> | <b>15,342</b> |
| Reported EPS (\$)              | 1.21          | 1.67           | 1.92           | 2.23           | 2.60           |  |                |               |               |               |               |
| Core EPS (\$)                  | 1.67          | 2.22           | 2.41           | 2.68           | 3.00           |  |                |               |               |               |               |
| DPS (\$)                       | 0.20          | 0.21           | 0.24           | 0.24           | 0.24           |  |                |               |               |               |               |
| CFPS (\$)                      | 1.73          | 2.19           | 2.60           | 2.88           | 3.19           |  |                |               |               |               |               |
| FCFPS (\$)                     | 1.68          | 2.10           | 2.50           | 2.82           | 3.13           |  |                |               |               |               |               |
| BVPS (\$)                      | 6.13          | 7.85           | 9.21           | 11.50          | 14.23          |  |                |               |               |               |               |
| Wtd avg ord shares (m)         | 5,014         | 5,040          | 5,044          | 5,044          | 5,044          |  |                |               |               |               |               |
| Wtd avg diluted shares (m)     | 5,073         | 5,128          | 5,105          | 5,004          | 4,904          |  |                |               |               |               |               |
| <b>Growth rates</b>            | <b>2010</b>   | <b>2011</b>    | <b>2012E</b>   | <b>2013E</b>   | <b>2014E</b>   |  |                |               |               |               |               |
| Sales revenue (%)              | 15.3          | 32.8           | 4.4            | 5.8            | 6.9            |  |                |               |               |               |               |
| EBIT (%)                       | 14.8          | 29.3           | 10.9           | 11.0           | 13.2           |  |                |               |               |               |               |
| Core NPAT (%)                  | 14.9          | 34.2           | 8.1            | 8.7            | 9.8            |  |                |               |               |               |               |
| Core EPS (%)                   | 16.2          | 32.8           | 8.6            | 10.9           | 12.1           |  |                |               |               |               |               |
| <b>Balance Sheet (US\$m)</b>   | <b>2010</b>   | <b>2011</b>    | <b>2012E</b>   | <b>2013E</b>   | <b>2014E</b>   |  |                |               |               |               |               |
| Cash & cash equiv.             | 18,469        | 28,848         | 32,683         | 44,495         | 57,563         |  |                |               |               |               |               |
| Accounts receivables           | 5,585         | 6,628          | 6,224          | 6,670          | 7,134          |  |                |               |               |               |               |
| Inventory                      | 259           | 303            | 218            | 219            | 223            |  |                |               |               |               |               |
| Net fixed & other tangibles    | 4,828         | 4,948          | 5,530          | 5,460          | 5,418          |  |                |               |               |               |               |
| Goodwill & intangibles         | 29,746        | 29,413         | 30,893         | 29,702         | 28,858         |  |                |               |               |               |               |
| Financial & other assets       | 2,691         | 3,395          | 3,552          | 3,636          | 3,706          |  |                |               |               |               |               |
| <b>Total assets</b>            | <b>61,578</b> | <b>73,535</b>  | <b>79,099</b>  | <b>90,182</b>  | <b>102,902</b> |  |                |               |               |               |               |
| Accounts payable               | 775           | 701            | 588            | 607            | 627            |  |                |               |               |               |               |
| Short-term debt                | 3,145         | 1,150          | 0              | 0              | 0              |  |                |               |               |               |               |
| Long-term debt                 | 11,510        | 14,772         | 14,777         | 14,777         | 14,777         |  |                |               |               |               |               |
| Provisions & other liab        | 14,949        | 16,667         | 17,402         | 18,145         | 18,881         |  |                |               |               |               |               |
| <b>Total liabilities</b>       | <b>30,379</b> | <b>33,290</b>  | <b>32,767</b>  | <b>33,529</b>  | <b>34,285</b>  |  |                |               |               |               |               |
| Shareholders' equity           | 30,798        | 39,776         | 45,985         | 56,306         | 68,270         |  |                |               |               |               |               |
| Minority interests             | 401           | 469            | 347            | 347            | 347            |  |                |               |               |               |               |
| <b>Total equity</b>            | <b>31,199</b> | <b>40,245</b>  | <b>46,332</b>  | <b>56,653</b>  | <b>68,617</b>  |  |                |               |               |               |               |
| <b>Net debt</b>                | <b>-3,814</b> | <b>-12,926</b> | <b>-17,906</b> | <b>-29,718</b> | <b>-42,786</b> |  |                |               |               |               |               |
| Net debt to equity (%)         | -12.2         | -32.1          | -38.6          | -52.5          | -62.4          |  |                |               |               |               |               |

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For definitions of the items in this table, please click [here](#).



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## Summary

Oracle shares have underperformed software peers since the November earnings report by 14% with a handful of factors contributing. The most significant risk in our view to the long-term story here is the potential for SaaS-based applications to eat into Oracle's applications revenue stream. In addition to SaaS competition, Oracle is in the early stages of its Fusion applications release, which is likely causing some stall in the business but could accelerate some apps momentum as customers get more comfortable with this release. In this report, we analyze the handful of factors at play in Oracle's applications business as well as present three cases for the apps business over the next five years.

One the stock, we made several changes to our view and also highlight upcoming catalysts here, which we believe are under-appreciated.

We are raising our price target to \$34 from \$32 based on two factors. First, we rolled forward our DCF assumptions to baseline off of FY13 (which starts June 1<sup>st</sup>). Secondly, based on the analysis we present in this note, we adopted the "base" case applications scenarios in our DCF.

We believe there are three catalysts for the shares over the next six months:

1. Continued strength in database and the likelihood of a new DB release in the late summer, which could accelerate DB growth
2. Signs the hardware business could finally be bottoming, a big psychological factor for the stock (but not a big numbers mover)
3. A strong Q4, which more convincingly shows that the weak November quarter was an anomaly.

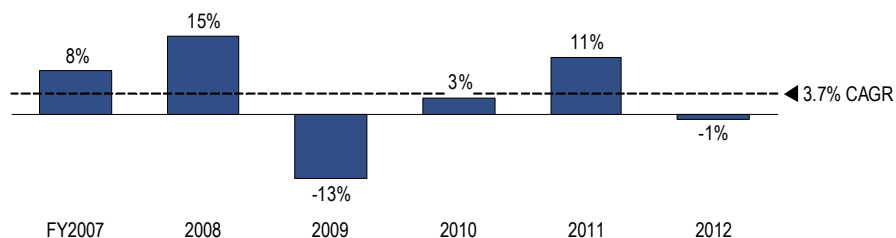
The main risk remains that the applications business remains lackluster, with Fusion adoption still not ramping and SaaS competition intensifying.

## **~40% of Oracle's Applications revenue is under threat from SaaS**

Oracle's apps business is a quilt-work of organic development and acquisitions over the last decade. In FY05, Oracle's apps revenue of just over two billion dollars was almost exclusively its organically developed E-Business Suite (EBS) that showed inconsistent growth. By the end of FY11, this revenue stream had grown nearly 4x to \$7.5B via major acquisitions including PeopleSoft (Jan 2005), Siebel (Jan 2006), and Hyperion (Apr 2007), as well as other smaller transactions.

Overall, this acquisition strategy has been successful for two reasons. First, the company has been able to expand its customer relationships both for horizontal applications like HR, CRM, and business intelligence as well as key vertical market presence such as telecom and retail, resulting in full-on suite selling. Secondly, revenue and expense synergies from such acquisitions have been clear as the company is able to cross-sell, as well as leverage its sales force and its back-office overhead on a larger revenue base.

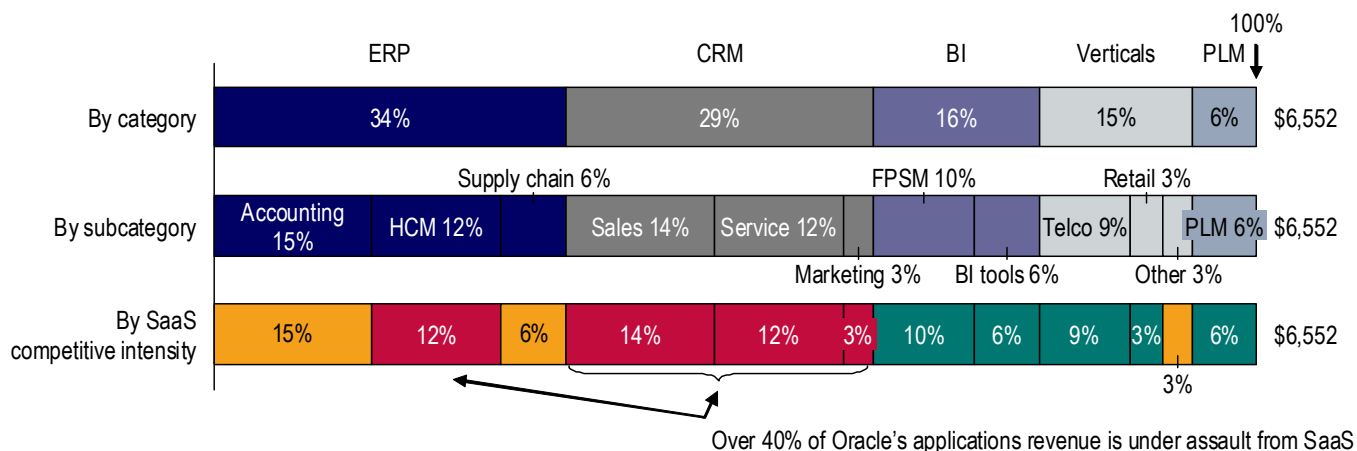
Figure 1. Constant currency organic growth rate (Y/Y) of Oracle's Applications business



Source: Company Reports and CIRA Estimates

In SEC filings, the company does continue to disclose total inorganic contributions when material. Using this data along with currency data that the company also reports, the organic constant currency growth rate of Oracle's applications businesses has been just 3.7% over the last six years (see figure above). Below, we show what we believe to be the demography of Oracle's applications business based on IDC estimates as well as our own analysis.

Figure 2. Breakdown of Oracle's calendar 2010 Applications license & maintenance revenue by category and degree of threat from SaaS



Source: IDC and Citi Investment Research and Analysis

In parallel to the applications consolidation discussed above and undertaken by Oracle since FY05, we have seen a significant rise in software applications deployed with a Software-as-a-Service (SaaS) model. There is still significant debate in the market as to how much SaaS is market expansive (bringing software down to a buyer that couldn't deploy before) vs. how much is cannibalistic to existing on-premise application sales.

Based on this demography above and the competition in various sectors, we see about 40% of Oracle's applications business exposed to SaaS competition.

We note above in the demography of Oracle's applications business, the three top revenue streams are Peoplesoft, eBusiness Suite and Siebel. In two of these areas (Peoplesoft and Siebel), the company faces significant competition from SaaS players, salesforce.com and Workday (private).

## CRM Market: Movin' on up

The CRM market is undergoing significant change, as the market moves from client-server to cloud computing. The distributed nature of sales force automation (SFA) helped salesforce.com and Upshot (acquired by Oracle) win over small businesses and departments of larger enterprises. Over time, the "land and expand" penetration of going up has proven successful for salesforce.com. RightNow followed a similar path in customer service, but we believe had greater challenges in a) targeting a displacement market and b) addressing a market that had greater functional requirements. Both salesforce.com and RightNow have made significant inroads in customer service, and we see service as the next pillar to fall in CRM after sales.

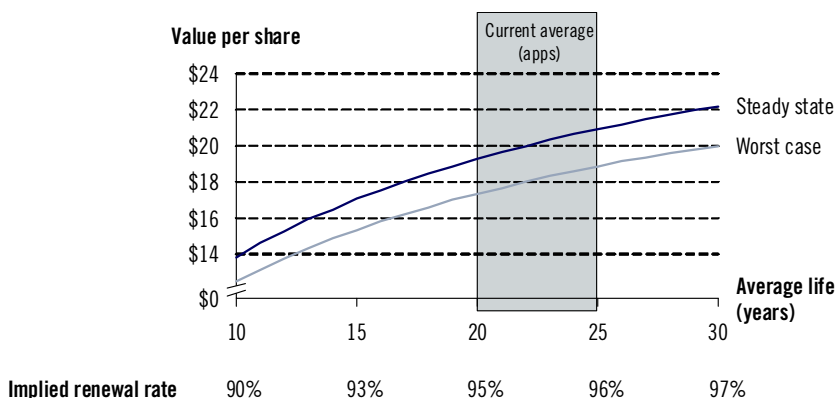
## HCM Market: Is this the CRM sequel?

Cloud competition has also been very successful in penetrating the human capital management (HCM) space. The market is bifurcated into "edge" applications like (e.g. recruiting, performance management, and learning) and "core" HCM, which includes a "system of record" holding employee data. Edge apps have been very successful in penetrating HR. HR has historically been ignored or de-prioritized by IT, and cloud vendors such as SuccessFactors and Taleo largely bypassed IT, much as salesforce.com did in the CRM market. Workday is a different animal, as it targets the largest enterprises. Workday founders Duffield and Bhusri are veterans from PeopleSoft and have crafted Workday as a next-generation PeopleSoft system. As such, the company has picked off core SAP and Oracle accounts such as Intuit, Chiquita, Flextronics, and momentum could accelerate as the HCM platform matures. Entry into the Financials (Accounting, Accounts Payable, etc.) market is also from the PeopleSoft playbook, and while just ~10% of Workday's current customers use its Financials, this could increase rapidly in the next few years.

## What is at stake

What is clear, however, is that much of Oracle's share value rests on its maintenance base of revenue, which we estimate to be worth \$19/share, about a quarter of which is from applications. Later in this report, we examine the impact of secular trends on the company's applications and related database maintenance stream as well as the impact of other drivers on license revenue.

Figure 3. Value of Oracle's maintenance annuity

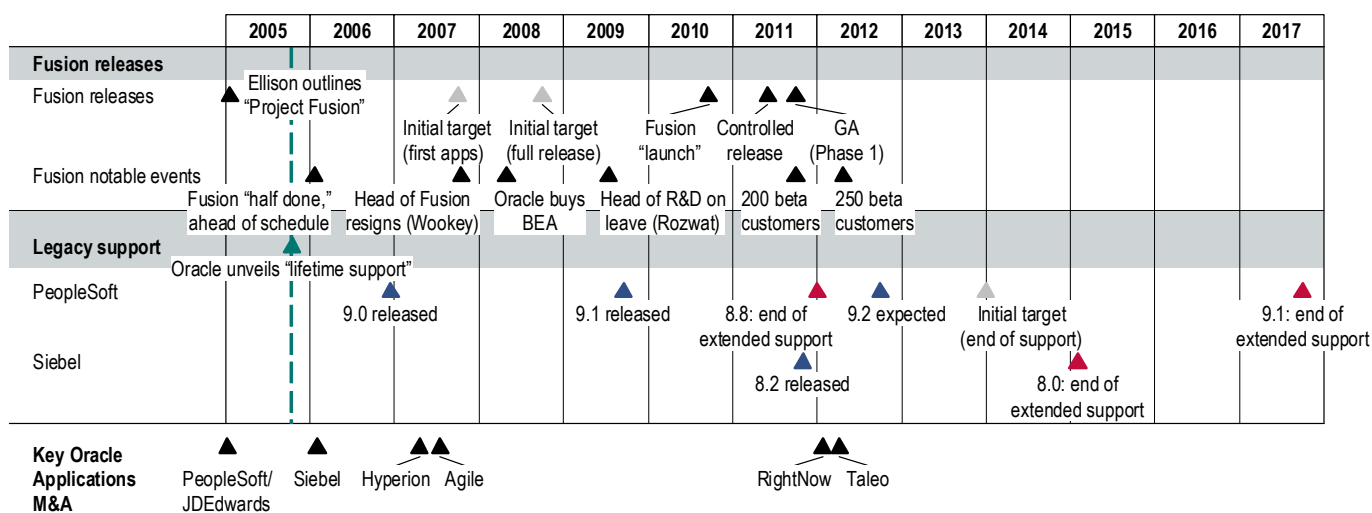


Source: Citi Investment Research and Analysis

## Oracle Fusion: Savior or False Profit?

Since acquiring PeopleSoft in 2005, Oracle has pursued two paths in delivering value to applications customers: 1) Apps unlimited, a strategy where Oracle continued development on legacy applications platforms indefinitely; and 2) Fusion Applications suite, the next generation of enterprise suite applications which unifies the technologies of various acquired applications products. Oracle Fusion Applications Suite is both a platform for new functionality and an upgrade path for customers of Oracle's ERP and CRM software – i.e. E-Business Suite, Siebel, PeopleSoft, and JD Edwards customers. The product has been 7 years in the making, having started initially after the PeopleSoft acquisition. Fusion went through several re-starts after subsequent acquisitions (Siebel, BEA, and Hyperion) that increased the complexity of offering upgrade paths from more legacy platforms using a middleware platform that was itself in flux.

Figure 4. Fusion Applications timeline

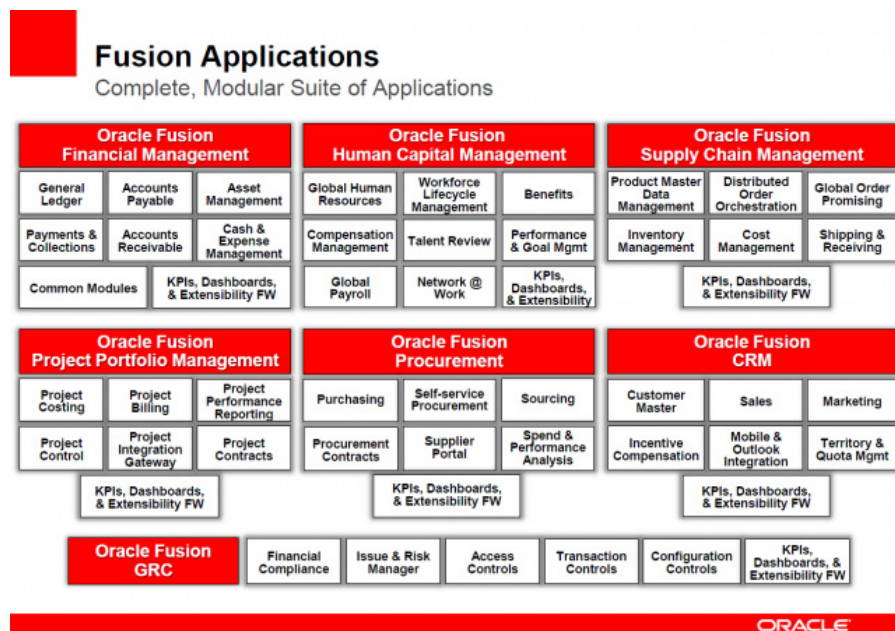


Source: Citi Investment Research and Analysis

Oracle announced general availability of Phase 1 of Fusion Applications at OpenWorld in the fall of last year, which includes the modules shown below. While in theory Fusion encompasses many functional areas, we believe key focus areas for deployment are, in order of frequency, "edge" modules (e.g. territory management for CRM), upgraders from E-Business Suite, and greenfields. Upgrade costs from legacy PeopleSoft, JD Edwards, and Siebel platforms are significant as deploying Fusion appears to be generally a re-implementation as upgrade paths are not easy since customizations can be difficult to port.



Figure 5. Phase 1 of Fusion Applications is centered around edge applications



Source: Company presentation

With the release of phase 1 of Fusion, Oracle also launched SaaS as an alternative deployment model to traditional on-premise software. This introduction of SaaS-Fusion was augmented with the acquisitions of SaaS-based application vendors Taleo and Right Now. Oracle's Fusion apps SaaS-based offering as well as Taleo and Right Now are all "single tenant". Our view is that the multi-tenant SaaS architecture has an advantage over single-tenant architecture, especially in new customers as multi-tenant applications are easier to upgrade and innovation can come to these applications faster. Since the core of Fusion was not architected for multi-tenancy from the start, we believe the company will be at a competitive disadvantage in competing against salesforce.com and Workday in engagements where the customer highly values this attribute of the competing products. It is unlikely that at this stage in the Fusion development cycle that Oracle will re-architecture the core products to be multi-tenant. We do expect "edge" modules will be increasingly multi-tenant and also we expect Oracle will price more consumptively in general to capture this value-proposition of SaaS (less Capex, more OpEx).

## Where Fusion will win

Much of Oracle's customer base prefers Fusion on premise, and those that don't will be slow to move completely.

Fusion will no doubt appeal to Oracle's current core set of enterprise customers, who skew toward on-premise due to their size (SaaS has been more popular with smaller businesses due to the lower upfront costs and speed in getting live). Enterprises tend to move more slowly than SMBs, because of a general conservatism and generally larger switching costs due to layers of customization that accumulate over time. Much of Oracle's core customer base will choose Fusion over competing solutions because they prefer:

1. **On-premise solutions** – to enable control over their entire software and hosting environment. Some customers want control over their environment for security, flexibility, or regulatory reasons. Also, single-instance (vs. multi-tenant) SaaS provides some perceived security benefit as well.



2. **A broader set of functionality** – to support all current business processes. While competitors such as Workday support large sets of enterprise customers running HCM functionality, it takes time to build out. Large enterprise customers who want to move financial accounting systems to a pure SaaS vendor today do not have much choice unless they are willing to build out their own solutions on top of a vendor's platform. This is uneconomical.
3. **A vendor they know** – most customers are likely comfortable with Oracle as a vendor and the applications there are licensing from Oracle today. There is always a fair bit of inertia in enterprise applications and while a move to Fusion will require work, most customers will likely stick with what they have, as evidenced by high renewal rates historically for Oracle applications. We note later that two-thirds of Oracle Peoplesoft customers are on one of two new versions. These customers are likely to stick with Oracle.

#### Fusion SaaS can address certain niches.

In addition, the Fusion SaaS offering will appeal to certain niches. Multi-tenancy has been introduced in certain modules within Oracle's Fusion Applications. Over time, we expect this trend to continue as Oracle iterates on Fusion. For example, human capital management (HCM) modules are multitenant, as are parts of E-Business Suite (EBS). Oracle built Fusion in this way to 1) lower costs for EBS hosting partners such as KBACE, and 2) respond to multitenant SaaS competitors such as SuccessFactors in the HCM space. We believe Fusion SaaS is primed for these three opportunities.

### Where Fusion is challenged

#### Oracle's business model and sales force is not geared for selling SaaS.

Oracle might have challenges in selling Fusion as SaaS. For an execution perspective, Oracle's sales force is accustomed to selling upfront licenses, and even with the help of SPIFs on Oracle CRM On Demand, the company has still had challenges making inroads against salesforce.com. In addition, the ratable revenue model from SaaS could drive short-term revenue deceleration, since more of the revenue is taken in later periods compared with the license software model. As we have seen with other companies such as Adobe, investor concerns around a subscription revenue model could cloud the near-term outlook.

### Defining "success" for Fusion

We think of Fusion as the next version of E-Business Suite with migration tools pre-built for customers on the latest versions of PeopleSoft, Siebel, and JD Edwards. As such, Fusion has two primary goals:

1. **Defending against new competitors** – This is the most critical goal for Oracle. Workday and Salesforce.com are beginning to displace Oracle in more and more installations (see our Appiro call write-up, [SaaS at a Ripping Point](#)). Edge competitors such as SuccessFactors have been successful at increasing their footprint to gradually take over entire HCM segments. With Oracle's applications maintenance revenue stagnating, we see Fusion as a moment of truth for Oracle. Key metrics here will include: win rates, number of Fusion installations, and growth in edge applications.
2. **Winning over legacy customers** – Just two-thirds of PeopleSoft customers are on the latest two versions of the software, which means that one-third of customers will face significant upgrade costs, which is a natural point for them to look at SaaS alternatives—namely Workday. We believe this is the most serious threat to Oracle's application business. Evidence of adoption among Oracle's current customer base of applications—either edge or core Fusion applications—will be proof of customer loyalty. Customers who don't migrate to

Fusion are at risk of going for 3<sup>rd</sup>-party maintenance or (worse yet) ripping Oracle software for competitors. Customers who commit to Fusion are likely to stay for another 10 years. Key metrics here will include number of customers, depth of Fusion upgrades (e.g. edge only vs. core), and upgrade rates.

3. **Driving license upsells** – Existing Oracle applications customers will receive Fusion version of their apps with “like for like” functionality included with maintenance. Beyond this, selling additional applications into a customer that has already moved their existing apps to Fusion is an opportunity. For example, we could see customers add vertical apps on top of horizontal apps, consolidation among horizontal applications, and new modules such as territory management for CRM. Also, beyond the applications business, we believe Fusion can be a catalyst in the “technology” area (database + middleware). Incremental Fusion license capacity may pull incremental database. We’ve heard from early Fusion customers that broad adoption of Fusion applications requires the customers to deploy Fusion technology in the areas of security, middleware and business intelligence. This is both a benefit and a curse. On the positive end, the adoption of Fusion components makes Oracle even stickier in its accounts and drives revenue that could be meaningful as customers expand these deployments. On the negative side, the need to bring in Fusion components with Fusion apps potentially makes the project bigger than it is today and dissuades customers from moving forward as quickly.

Oracle noted at its October 2011 Oracle OpenWorld event that it had 200 customers that had licensed Fusion and recent datapoints suggest this is ~250 currently. We note that at user conference events over the next year, Fusion is a significant topic of focus. We expect that Oracle OpenWorld 2012 will be an important next milestone in gauging early customer momentum.

## Scenario Analysis: Quantifying the Risk and Opportunity

We modeled the risk to Oracle’s revenue from the rise of SaaS competition. We focused on two specific vendors, salesforce.com and Workday, and extrapolated the impact into other markets. The risk to Oracle’s revenue from SaaS is threefold:

1. **Increased loss rates** – For new business, the maturity of SaaS applications allows competitors to increasingly target enterprises. The growth of SaaS competitors will be headwind to Oracle’s software revenue by reducing the amount of new business.
2. **Displacements of Oracle applications** – Customers are increasingly ripping PeopleSoft HCM and Siebel CRM in favor of solutions from SFDC and Workday. These displacements could cause Oracle’s maintenance stream to go into long-term secular decline.
3. **Displacements of Oracle technology associated with Oracle applications (i.e. “Pull Through”)** – Oracle’s suite strategy has been successful in getting customers to buy bundles of applications and infrastructure such as databases and middleware. Displacement of Oracle applications also results in Oracle infrastructure, as the marginal revenue from a new SaaS instance to Oracle is near zero.

4. **Displacements of Oracle technology associated with non-Oracle applications** – Even if Oracle is able to maintain share in applications, the growth of the SaaS market could result in Oracle technology displacements.

There are ways for Oracle to mitigate the risk or near-term impact. For example, Oracle bundles its maintenance contracts such that customers who rip a Siebel instance often see now immediate reduction in maintenance paid to Oracle. However, while contract terms might cause the financial impact to lag, over the long-run, we see a very real threat.

We also included an upside case where Fusion success more than offsets the incremental competitive impact of the SaaS vendors on Oracle's applications business as well as pulls-through technology revenue.

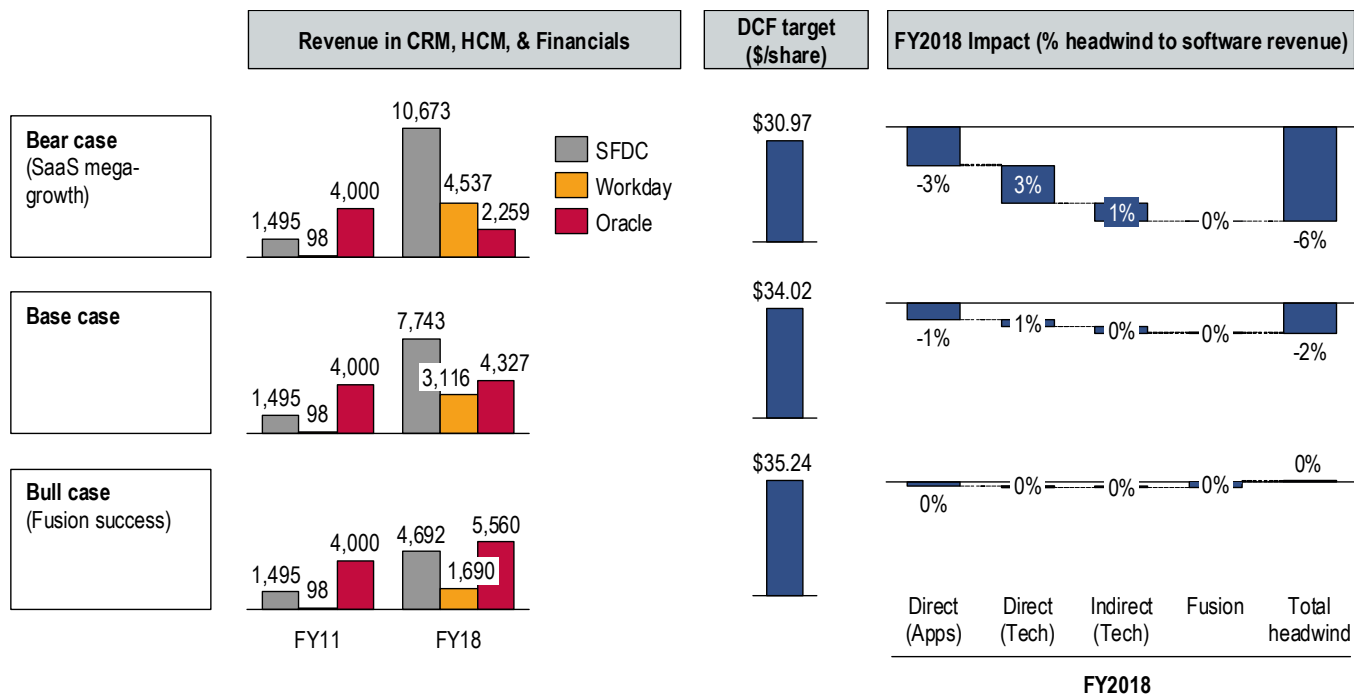
## Scenarios

We created three scenarios to model the potential impact from the rise of SaaS competitors. We first model the impact on revenue and profitability and then we roll this impact through our 10-year DCF-based valuation methodology to quantify the impact.

Additionally, we have adjusted our base DCF scenario to be inline with the "base" case below.

In the base case, we believe Oracle revenue can grow 6% over the next 5 years and 4% in years 6-10 with margins at 49%. In that case, as shown below, we assume that Oracle's HCM + CRM + accounting software business is \$4.3B in revenue in FY18, while we assume salesforce.com is a \$7.7B revenue company (in sales, service and marketing) and we assume Workday is a \$3.1B revenue company (in HCM and accounting). The impact of this SaaS revenue is 2% of Oracle's revenue in FY18. This 2% is compared to a scenario where the SaaS vendors were not competing with ORCL. Below we show this similar impact for the "SaaS mega growth" case as well as the "Fusion success" case where Fusion apps more than offset any declines from SaaS competition.

Figure 6. Summary of SaaS scenarios – Financial impact from SaaS



Source: Company reports, Citi Investment Research and Analysis

Figure 7. Key modeling assumptions in applications sensitivity

| Assumptions                            | Description   | Fusion success  | Base case | SaaS mega-growth |
|--|---|-----------------|-----------|------------------|
| <b>SFDC revenue CAGR 2012-2018</b>     | SFDC growth rate in SFA and Service   | 18%             | 26%       | 31%              |
| <b>Workday revenue CAGR 2012-2018</b>  | Workday growth rate in HCM & Financials   | 41%             | 56%       | 67%              |
| <b>HCM displacements (medium term)</b> | Points of acceleration above current displacement rate (estimated 35% in HCM, 20% in Financials), FY10-13 | 0%              | 2%        | 0%               |
| <b>HCM displacements (long term)</b>   | Points of acceleration above medium-term displacement rate, FY13-17                                       | 0%              | 2%        | 0%               |
| <b>CRM displacements (medium term)</b> | Points of acceleration above current displacement rate (estimated 15%), FY10-13                           | 0%              | 5%        | 8%               |
| <b>CRM displacements (long term)</b>   | Points of acceleration above medium-term displacement rate, FY13-17                                       | 0%              | 3%        | 5%               |
| <b>Fusion uplift</b>                   | Growth uplift provided by Fusion beyond current Citi forecast   | 2%              | 0%        | 0%               |
| <b>Competitor growth</b>               | Relative growth of SFDC and Workday vs. base case (base = 100%)   | 70%             | 100%      | 120%             |
| <b>SFDC overlap</b>                    | Proportion of SFDC business in enterprise (Oracle's market)   | 33%             | 50%       | 60%              |
| <b>Workday overlap</b>                 | Proportion of Workday business in enterprise (Oracle's market)  | 75%             | 90%       | 100%             |
| <b>License equivalence</b>             | Amount of license + maintenance a dollar of SaaS subscription displaces                                   | 90%             | 100%      | 125%             |
| <b>Pull-through factor</b>             | Amount of Oracle database and middleware pulled by applications, as % of applications                     | 25%             | 50%       | 100%             |
| <b>New to market</b>                   | For SaaS spaces outside HCM and ERP, how much is new to market (growing pie vs. displacement)             | 50%             | 40%       | 30%              |
| <b>Incremental margin</b>              | Oracle's contribution margin from software  | 75% (all cases) |           |                  |

Source: Citi Investment Research and Analysis

## Stock sentiment and potential impact on the stock

Sentiment around Oracle is decidedly negative. Investors are worried about risks to the applications business (as evidenced by the sequential decline in apps maintenance revenue), risks to the database business, and continued execution

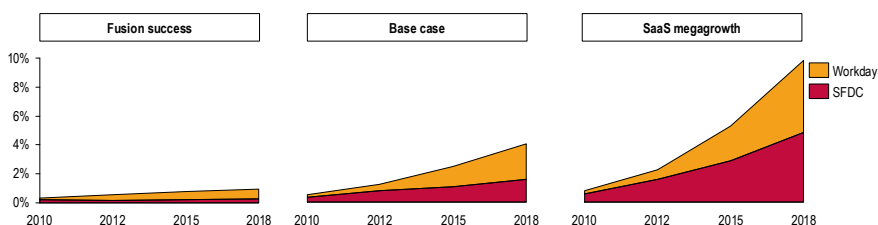
issues in hardware. Of these issues, we see the applications issue as the most impactful in terms of potential downside, because the risks are the most tangible and numbers here drive the stock. We will address database issues in depth in a later report. In our view, hardware does not drive enough operating profit to meaningfully impact the share price.

We value Oracle's maintenance revenue stream (assuming no new license revenue) at \$19/share. The bulk of this revenue is technology, not applications even if we assume very aggressive pull-through. Under the most dire SaaS scenarios outlined above, we see a potential downside in apps of ~\$4.50/share. While competitors are doing well and we see this scenario as possible but not likely, we note the shares are already trading below this level (~\$31).

## What to watch going forward

Although we have a bias to the upside on applications (vs. current investor sentiment), the SaaS mega-growth scenario is possible. Key metrics to watch going forward are:

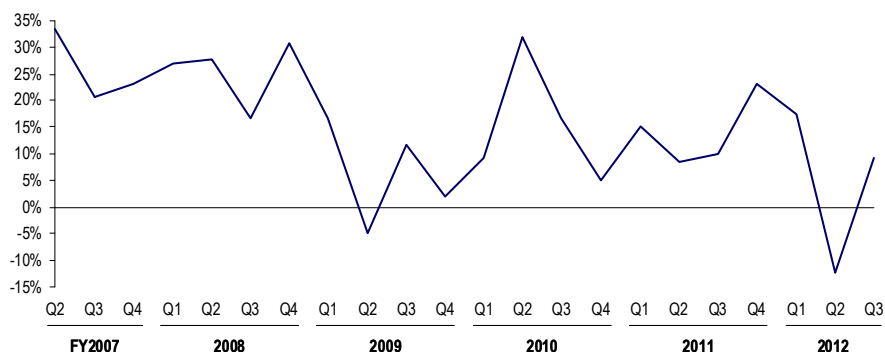
**Figure 8. Impact from Workday and SFDC displacements (as % of apps revenue)**



Source: Company reports, Citi Investment Research and Analysis

- **Growth rate at Workday.** In our modeling, Workday poses the greater long-term threat to Oracle. Only one-third of salesforce.com's revenue comes from enterprises (vs. a majority at Oracle), so the overlap is smaller than SFDC's overall size would suggest. In addition, Oracle's exposure to CRM is smaller than its exposure to ERP (HCM + Financials). For both these reasons, we expect Workday will be the bigger contributor to Oracle displacements in 2014 according to our base case.
- **Maintenance trends.** Maintenance billings will be the lead indicator of the strength of the applications business. Drops in the renewal rate or concessions on pricing should be visible, since we know the license trajectory. We note recent volatility in Oracle's maintenance stream suggest we are seeing some impact already.

Figure 9. Calculated maintenance billings (% Y/Y growth)



Source: Company reports

- **Fusion metrics.** We look for meaningful Fusion metrics and traction among the customer base. While we do not expect the company to disclose much meaningful information here, we will be looking to their customer base for clues on the success of Fusion.
- **M&A activity.** Oracle has moved into the SaaS space more forcefully with acquisitions of RightNow and Taleo. RightNow is written on a .NET stack and Taleo functionality was supposedly offered in Fusion. Both acquired companies had single-tenant SaaS solutions (except for Taleo's small business product). Both acquisitions appear to highlight an increased focus on apps, albeit in conflict with the broader strategy at Oracle. Irrational M&A could signal a heightened sense of desperation at Oracle.

## Our Stock View

We are raising our target price to \$34 from \$32 as we adjust for two factors. First, we rolled forward our DCF assumptions to baseline off of FY13 (which starts June 1st) and also embedding the "base" case of our applications scenarios in our model. We continue to recommend the shares and given near-term sentiment, relative valuation and upcoming catalysts, we now prefer Oracle over Microsoft as our favorite large-cap software name. We continue to believe that if Microsoft executes well on Windows 8 and the operating system is well received on multiple platform (notably touch-based devices), then Microsoft shares have more upside over the long term. For example, we've noted that in the case where Microsoft is able to grow its Windows client profits by 5% annually for the next 10 years, the stock is worth in the low to mid \$40s (vs. current \$35 share price).

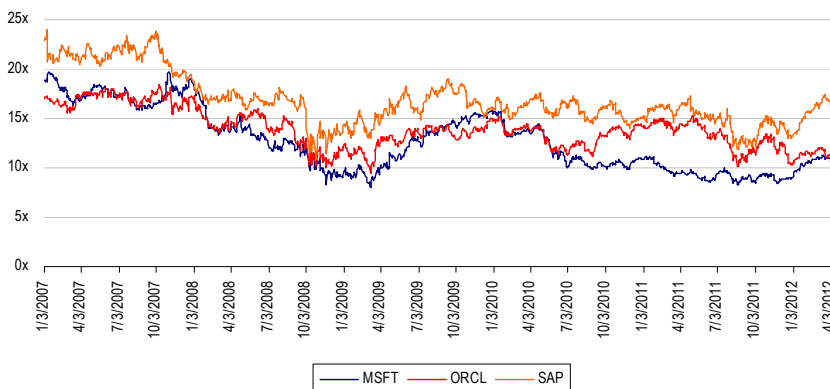
Figure 10. Oracle P/E multiple vs. the S&P 500 at trough levels



Source: FactSet, Citi Investment Research and Analysis

Oracle trades at the low-end of its valuation range both versus the S&P and ironically is now trading at the same earnings multiple as Microsoft (albeit Oracle excludes stock opinions while Microsoft expenses them). Lastly, ORCL trades at one of the biggest discounts to peer SAP that we've seen in recent years.

Figure 11. NTM P/E ratios of ORCL, MSFT and SAP



Source: FactSet, Citi Investment Research and Analysis

On the catalyst front, we see multiple positive catalysts in the six months ahead, including:

1. Database, which we believe generates ~70% of Oracle's profits, continues to see ~10% license growth. We expect this will continue and we believe it is likely the company releases a new version of its database (12c?) in the summer or early fall.
2. Hardware has declined meaningfully in FY12 and expect these declines will level off in FY13. This is driven by SPARC / Solaris declines flattening out in terms of absolute dollar decline while we expect growth in engineered systems (Exadata / Exalogic, etc.) becoming a meaningful enough dollar volume to offset SPARC / Solaris losses. While hardware profits don't contribute meaningfully to Oracle overall (<5%), we believe hardware revenue has had a significant psychological impact on Oracle stock.



3. Q4 is typically a strong quarter for Oracle and the compares are relatively easy. For example, on a Y/Y basis, the company has its easiest licenses compares of FY12 in Q4. Also, the Q/Q license growth we model is below 4Q11 and well below the 4Q10 and 4Q09 Q/Q growth. If Q4 is strong, then we believe investors will increasingly view the weak November results as an aberration.

The main risk remains that the applications business remains lackluster, with Fusion adoption still not ramping and SaaS competition intensifying.

Figure 12. Oracle Corporation – Comparable Company Valuations

| <i>in millions</i>         |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          |       |       |       |
|----------------------------|--------|--------------|---------------|------------|--------------------------|------------------|------------------------|-------|-------|---------------------------|-------|-------|----------------|----------|-------|-------|-------|
| Company                    | Rating | Target Price | Price 4/27/12 | Market Cap | Net Cash as % of Mkt Cap | Enterprise Value | EV as Multiple of FCFF |       |       | EV as Multiple of Revenue |       |       | Revenue Growth |          | P/E   |       |       |
|                            |        |              |               |            |                          |                  | CY11E                  | CY12E | CY13E | CY11E                     | CY12E | CY13E | '10-'11E       | '11-'12E | CY11E | CY12E | CY13E |
| ORCL                       | 1      | \$34.00      | \$29.24       | \$145,646  | 9%                       | \$132,720        | 10.5x                  | 9.4x  | 8.7x  | 3.6x                      | 3.4x  | 3.2x  | 14%            | 5%       | 12.5x | 11.4x | 10.2x |
| <b>Large-Cap Tech</b>      |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          |       |       |       |
| MSFT                       | 1      | \$35.00      | \$31.98       | \$268,576  | 19%                      | \$216,860        | 8.4x                   | 7.6x  | 7.2x  | 3.0x                      | 2.8x  | 2.7x  | 8%             | 7%       | 11.9x | 11.3x | 10.4x |
| SAP                        | 1      | € 65.00      | € 50.51       | € 60,124   | 3%                       | € 58,084         | 12.4x                  | 16.9x | 9.8x  | 4.1x                      | 3.6x  | 3.3x  | 14%            | 12%      | 17.8x | 16.1x | 13.8x |
| <b>Hardware</b>            |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          |       |       |       |
| DELL                       | 2      | \$19.00      | \$16.44       | \$28,994   | 31%                      | \$20,026         | 3.1x                   | 3.7x  | 3.7x  | 0.3x                      | 0.3x  | 0.3x  | 2%             | 1%       | 7.9x  | 7.6x  | 7.1x  |
| EMC                        | 1      | \$33.00      | \$28.32       | \$59,621   | 12%                      | \$52,202         | 8.5x                   | 7.1x  | 6.5x  | 2.6x                      | 2.3x  | 2.1x  | 18%            | 12%      | 18.7x | 15.9x | 14.0x |
| IBM                        | 1      | \$235.00     | \$206.81      | \$239,187  | NA                       | \$255,820        | 11.2x                  | 9.9x  | 9.2x  | 2.4x                      | 2.4x  | 2.3x  | 7%             | 2%       | 15.3x | 13.8x | 12.4x |
| NTAP                       | 1      | \$50.00      | \$39.03       | \$14,200   | 29%                      | \$10,058         | 8.3x                   | 7.4x  | 6.0x  | 1.7x                      | 1.5x  | 1.3x  | 25%            | 16%      | 17.1x | 14.9x | 12.6x |
| TDC                        | NR     | --           | \$70.88       | \$11,880   | 4%                       | \$11,398         | 24.7x                  | 23.2x | 19.1x | 4.8x                      | 4.3x  | 3.9x  | 22%            | 12%      | 30.4x | 26.8x | 23.6x |
| <b>Apps</b>                |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          |       |       |       |
| ARBA                       | NR     | --           | \$39.35       | \$3,916    | 6%                       | \$3,693          | 84.2x                  | 35.5x | NA    | 7.9x                      | 6.7x  | 6.2x  | 22%            | 18%      | 45.8x | 39.5x | 31.0x |
| JDAS                       | NR     | --           | \$29.22       | \$1,243    | 2%                       | \$1,222          | 9.8x                   | 8.4x  | 8.5x  | 1.8x                      | 1.7x  | 1.6x  | 9%             | 6%       | 13.3x | 12.4x | 11.2x |
| MANH                       | NR     | --           | \$50.94       | \$1,035    | 10%                      | \$935            | NA                     | NA    | NA    | 2.8x                      | 2.5x  | 2.3x  | 11%            | 11%      | 21.9x | 20.2x | 18.1x |
| QADI                       | NR     | --           | \$12.50       | \$198      | 30%                      | \$139            | 5.9x                   | NA    | NA    | 0.6x                      | 0.5x  | NA    | 11%            | 6%       | 17.6x | 13.2x | NA    |
| SGE-GB                     | 2      | £2.94        | £2.88         | £3,791     | NA                       | £3,965           | 11.3x                  | 10.9x | 10.3x | 3.0x                      | 2.9x  | 2.8x  | -5%            | 2%       | 0.1x  | 0.1x  | 0.1x  |
| ULTI                       | NR     | --           | \$76.70       | \$2,023    | 8%                       | \$1,854          | NA                     | 53.3x | 33.8x | 6.9x                      | 5.6x  | 4.6x  | 18%            | 23%      | NM    | 75.8x | 54.7x |
| <b>Database/Middleware</b> |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          |       |       |       |
| BMC                        | 2      | \$36.00      | \$41.06       | \$6,763    | 21%                      | \$5,342          | 6.6x                   | 6.7x  | 7.0x  | 2.5x                      | 2.3x  | 2.2x  | 7%             | 6%       | 12.6x | 11.8x | 10.9x |
| CA                         | 2      | \$25.00      | \$26.54       | \$12,889   | 12%                      | \$11,287         | 8.0x                   | 7.4x  | 8.1x  | 2.4x                      | 2.3x  | 2.2x  | 8%             | 3%       | 12.2x | 10.8x | 10.0x |
| INFA                       | NR     | --           | \$46.64       | \$5,008    | 12%                      | \$4,405          | 27.3x                  | 23.2x | 19.5x | 5.6x                      | 4.9x  | 4.3x  | 21%            |          | 32.8x | 28.9x | 24.8x |
| PRGS                       | NR     | --           | \$23.72       | \$1,491    | 20%                      | \$1,196          | 11.0x                  | 12.6x | 9.8x  | 2.2x                      | 2.3x  | 2.2x  | 0%             |          | 16.4x | 19.2x | 16.1x |
| RHT                        | 1      | \$68.00      | \$60.91       | \$11,766   | 11%                      | \$10,506         | 25.6x                  | 23.3x | 18.3x | 9.6x                      | 8.0x  | 6.8x  | 24%            |          | 57.5x | 50.7x | 43.1x |
| TIBX                       | NR     | --           | \$33.18       | \$5,473    | 5%                       | \$5,218          | 25.2x                  | 21.7x | 20.3x | 5.6x                      | 5.0x  | 4.5x  | 21%            |          | 32.5x | 28.9x | 25.2x |
| <b>SaaS Apps</b>           |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          |       |       |       |
| CNOR                       | NR     | --           | \$57.09       | \$3,113    | 9%                       | \$2,834          | 55.0x                  | 38.6x | 33.5x | 7.6x                      | 6.1x  | 5.1x  | 21%            |          | 57.1x | 64.8x | 47.7x |
| CRM                        | 1      | \$163.00     | \$156.66      | \$21,542   | 4%                       | \$20,640         | 48.8x                  | 37.6x | 30.1x | 9.3x                      | 7.0x  | 5.3x  | 36%            |          | NM    | 92.4x | 65.7x |
| N                          | NR     | --           | \$45.31       | \$3,147    | 4%                       | \$3,011          | 66.7x                  | 54.4x | 36.3x | 12.7x                     | 10.1x | 8.1x  | 22%            | 26%      | NM    | NM    | NM    |
| <b>Median</b>              |        |              |               |            |                          |                  | 11.3x                  | 14.8x | 9.8x  | 3.0x                      | 2.9x  | 2.8x  |                |          | 17.6x | 16.1x | 15.1x |
| <b>Mean</b>                |        |              |               |            |                          |                  | 23.1x                  | 20.5x | 15.6x | 4.5x                      | 3.9x  | 3.5x  |                |          | 23.1x | 27.4x | 22.6x |
| <b>Software Median</b>     |        |              |               |            |                          |                  | 22.3x                  | 18.8x | 15.7x | 3.6x                      | 3.2x  | 3.0x  |                |          | 23.3x | 23.5x | 21.7x |
| <b>Software Mean</b>       |        |              |               |            |                          |                  | 29.9x                  | 23.8x | 18.1x | 4.6x                      | 4.1x  | 3.6x  |                |          | 28.5x | 28.3x | 23.9x |
| <b>S&amp;P 500</b>         |        |              |               |            |                          |                  |                        |       |       |                           |       |       |                |          | 14.2x | 13.0x |       |

CIRA Coverage: Richard Gardner covers DELL, EMC, HPQ, IBM, NTAP; Gunnar Plagge covers SGE and SAP

Source: Citi Investment Research and Analysis, Factset

Figure 13. DCF assumptions – Software coverage universe

| Ticker  | Price<br>4/27/12 | Price<br>Target | Rating | Revenue CAGR |         | FY+1<br>Margins | Terminal<br>Margins | Expansion/<br>Contraction | CapEx % of<br>Rev | Equity Dilution |         | Terminal<br>Multiple | Implied Val. At Price Target |             |
|---------|------------------|-----------------|--------|--------------|---------|-----------------|---------------------|---------------------------|-------------------|-----------------|---------|----------------------|------------------------------|-------------|
|         |                  |                 |        | Yr 3-5       | Yr 6-10 |                 |                     |                           |                   | Yr 3-5          | Yr 6-10 |                      | CY12 PE                      | CY12 EV/FCF |
| ADBE    | \$33.58          | \$38.00         | 1      | 7%           | 6%      | 37%             | 41%                 | 4%                        | 3%                | 27%             | 27%     | 8x                   | 13.9x                        | 11.4x       |
| ADSK    | \$39.63          | \$40.00         | 2      | 8%           | 7%      | 25%             | 34%                 | 10%                       | 2%                | 27%             | 27%     | 9x                   | 19.1x                        | 11.4x       |
| BMC     | \$41.06          | \$36.00         | 2      | 5%           | 4%      | 35%             | 33%                 | -2%                       | 1%                | 27%             | 27%     | 8x                   | 10.8x                        | 5.6x        |
| CA      | \$26.54          | \$25.00         | 2      | 2%           | 1%      | 35%             | 39%                 | 4%                        | 1%                | 30%             | 30%     | 6x                   | 9.2x                         | 6.2x        |
| CHKP    | \$58.99          | \$74.00         | 1      | 10%          | 6%      | 59%             | 64%                 | 5%                        | 1%                | 14%             | 14%     | 11x                  | 20.7x                        | 15.2x       |
| CRM     | \$156.66         | \$163.00        | 1      | 26%          | 19%     | 14%             | 31%                 | 16%                       | 4%                | 60%             | 20%     | 12x                  | 81.1x                        | 51.7x       |
| CTXS    | \$85.78          | \$97.00         | 1      | 12%          | 11%     | 28%             | 34%                 | 6%                        | 2%                | 20%             | 20%     | 11x                  | 21.0x                        | 16.3x       |
| FIRE    | \$51.57          | \$37.00         | 2H     | 17%          | 14%     | 17%             | 30%                 | 13%                       | 2%                | 50%             | 25%     | 10x                  | 49.0x                        | 21.0x       |
| FTNT    | \$26.22          | \$28.00         | 2H     | 14%          | 12%     | 23%             | 35%                 | 12%                       | 2%                | 50%             | 25%     | 10x                  | 38.0x                        | 16.6x       |
| INTU    | \$57.98          | \$59.00         | 1      | 8%           | 8%      | 34%             | 38%                 | 5%                        | 3%                | 26%             | 26%     | 10x                  | 19.0x                        | 14.8x       |
| JIVE    | \$24.00          | \$22.00         | 1H     | 30%          | 18%     | -9%             | 27%                 | 36%                       | 3%                | 50%             | 25%     | 12x                  | NM                           | NM          |
| MSFT    | \$31.98          | \$35.00         | 1      | 5%           | 3%      | 42%             | 33%                 | -10%                      | 4%                | 14%             | 14%     | 6x                   | 12.0x                        | 8.7x        |
| ORCL    | \$29.24          | \$32.00         | 1      | 6%           | 5%      | 46%             | 51%                 | 5%                        | 1%                | 29%             | 29%     | 8x                   | 13.2x                        | 11.0x       |
| QLIK    | \$29.64          | \$32.00         | 2      | 19%          | 16%     | 15%             | 34%                 | 19%                       | 1%                | 50%             | 20%     | 12x                  | 53.5x                        | 34.5x       |
| RHT     | \$60.91          | \$68.00         | 1      | 18%          | 13%     | 26%             | 31%                 | 8%                        | 2%                | 30%             | 15%     | 12x                  | 48.7x                        | 26.8x       |
| SYMC    | \$16.48          | \$22.00         | 1      | 2%           | 2%      | 27%             | 28%                 | 1%                        | 4%                | 25%             | 25%     | 8x                   | 13.4x                        | 9.5x        |
| VMW     | \$112.41         | \$90.00         | 3      | 14%          | 11%     | 31%             | 42%                 | 12%                       | 5%                | 35%             | 15%     | 12x                  | 34.7x                        | 18.3x       |
| VRSN    | \$41.70          | \$47.00         | 1      | 5%           | 3%      | 50%             | 60%                 | 10%                       | 9%                | 30%             | 15%     | NA                   | 21.3x                        | 13.2x       |
| WBSN    | \$21.17          | \$21.00         | 2      | 2%           | 0%      | 20%             | 20%                 | 0%                        | 4%                | 10%             | 10%     | 7x                   | 10.9x                        | 8.9x        |
| Average |                  |                 |        | 12%          | 9%      | 28%             | 37%                 | 9%                        | 3%                | 32%             | 22%     | 10x                  | 27.2x                        | 16.7x       |

Source: Citi Investment Research and Analysis

Figure 14. Oracle Corporation – Income Statement (in \$ millions, unless otherwise stated)

|                                       | F09A          | F10A          | Aug 10A      | Nov 10A      | Feb 11A      | May 11A       | F11A          | Aug 11A      | Nov 11A      | Feb 12A      | May 12E       | F12E          | Aug 12E      | Nov 12E      | Feb 13E      | May 13E       | F13E          | F14E          |
|---------------------------------------|---------------|---------------|--------------|--------------|--------------|---------------|---------------|--------------|--------------|--------------|---------------|---------------|--------------|--------------|--------------|---------------|---------------|---------------|
| New software licenses                 | 7,123         | 7,534         | 1,286        | 1,999        | 2,214        | 3,736         | 9,235         | 1,498        | 2,048        | 2,374        | 3,963         | 9,883         | 1,584        | 2,198        | 2,565        | 4,287         | 10,634        | 11,426        |
| Software license updates and products | 11,996        | 13,177        | 3,475        | 3,667        | 3,756        | 3,978         | 14,876        | 4,035        | 3,996        | 4,068        | 4,237         | 16,336        | 4,302        | 4,327        | 4,432        | 4,608         | 17,669        | 19,200        |
| Software Revenues                     | 19,119        | 20,711        | 4,761        | 5,666        | 5,970        | 7,714         | 24,111        | 5,533        | 6,044        | 6,442        | 8,200         | 26,219        | 5,886        | 6,525        | 6,996        | 8,895         | 28,303        | 30,626        |
| Hardware systems                      |               | 1,506         | 1,079        | 1,112        | 1,035        | 1,157         | 4,383         | 1,029        | 953          | 869          | 928           | 3,779         | 971          | 941          | 909          | 975           | 3,795         | 3,947         |
| Hardware support                      |               | 912           | 680          | 686          | 656          | 687           | 2,709         | 656          | 634          | 610          | 650           | 2,550         | 631          | 620          | 616          | 660           | 2,527         | 2,599         |
| Hardware Revenues                     |               | 2,418         | 1,759        | 1,798        | 1,691        | 1,844         | 7,092         | 1,685        | 1,587        | 1,479        | 1,578         | 6,329         | 1,602        | 1,560        | 1,525        | 1,635         | 6,322         | 6,546         |
| Services Revenues                     | 4,375         | 3,906         | 1,068        | 1,185        | 1,146        | 1,248         | 4,647         | 1,180        | 1,180        | 1,141        | 1,233         | 4,734         | 1,159        | 1,200        | 1,171        | 1,270         | 4,800         | 4,896         |
| <b>Total Revenues</b>                 | <b>23,494</b> | <b>27,035</b> | <b>7,588</b> | <b>8,649</b> | <b>8,807</b> | <b>10,806</b> | <b>35,850</b> | <b>8,398</b> | <b>8,811</b> | <b>9,062</b> | <b>11,011</b> | <b>37,282</b> | <b>8,648</b> | <b>9,284</b> | <b>9,692</b> | <b>11,800</b> | <b>39,424</b> | <b>42,068</b> |
| Cost of software license and support  | (1,075)       | (1,046)       | (303)        | (304)        | (295)        | (347)         | (1,249)       | (293)        | (293)        | (300)        | (390)         | (1,276)       | (294)        | (326)        | (350)        | (418)         | (1,388)       | (1,502)       |
| Cost of services                      | (3,694)       | (3,385)       | (892)        | (965)        | (949)        | (997)         | (3,803)       | (932)        | (923)        | (916)        | (974)         | (3,745)       | (927)        | (960)        | (937)        | (1,003)       | (3,827)       | (3,903)       |
| Cost of hardware systems products     |               | (848)         | (556)        | (524)        | (464)        | (511)         | (2,055)       | (471)        | (471)        | (424)        | (446)         | (1,812)       | (466)        | (451)        | (427)        | (448)         | (1,793)       | (1,805)       |
| Cost of hardware support              |               | (420)         | (300)        | (355)        | (293)        | (308)         | (1,256)       | (282)        | (256)        | (256)        | (273)         | (1,067)       | (268)        | (263)        | (259)        | (277)         | (1,068)       | (1,092)       |
| Gross profit                          | 18,725        | 21,336        | 5,537        | 6,501        | 6,806        | 8,643         | 27,487        | 6,420        | 6,868        | 7,166        | 8,929         | 29,383        | 6,692        | 7,284        | 7,720        | 9,653         | 31,348        | 33,765        |
| Gross margin %                        | 79.7%         | 78.9%         | 73.0%        | 75.2%        | 77.3%        | 80.0%         | 76.7%         | 76.4%        | 77.9%        | 79.1%        | 81.1%         | 78.8%         | 77.4%        | 78.5%        | 79.7%        | 81.8%         | 79.5%         | 80.3%         |
| Sales and marketing                   | (4,571)       | (4,998)       | (1,310)      | (1,511)      | (1,596)      | (2,075)       | (6,492)       | (1,604)      | (1,668)      | (1,670)      | (2,226)       | (7,168)       | (1,681)      | (1,777)      | (1,791)      | (2,394)       | (7,643)       | (8,203)       |
| % of revenue                          | 19.5%         | 18.5%         | 17.3%        | 17.5%        | 18.1%        | 19.2%         | 18.1%         | 19.1%        | 18.9%        | 18.4%        | 20.2%         | 19.2%         | 19.4%        | 19.1%        | 18.5%        | 20.3%         | 19.4%         | 19.5%         |
| Research and development              | (2,612)       | (3,082)       | (1,044)      | (1,064)      | (1,069)      | (1,110)       | (4,287)       | (979)        | (1,034)      | (1,071)      | (1,111)       | (4,195)       | (1,097)      | (1,122)      | (1,143)      | (1,231)       | (4,593)       | (4,784)       |
| % of revenue                          | 11.1%         | 11.4%         | 13.8%        | 12.3%        | 12.1%        | 10.3%         | 12.0%         | 11.7%        | 11.7%        | 11.8%        | 10.1%         | 11.3%         | 12.7%        | 12.1%        | 11.8%        | 10.4%         | 11.6%         | 11.4%         |
| General and administrative            | (691)         | (781)         | (236)        | (120)        | (249)        | (217)         | (822)         | (271)        | (237)        | (220)        | (226)         | (954)         | (220)        | (227)        | (229)        | (235)         | (912)         | (940)         |
| % of revenue                          | 2.9%          | 2.9%          | 3.1%         | 1.4%         | 2.8%         | 2.0%          | 2.3%          | 3.2%         | 2.7%         | 2.4%         | 2.1%          | 2.6%          | 2.5%         | 2.4%         | 2.4%         | 2.0%          | 2.3%          | 2.2%          |
| Total operating expenses              | (12,643)      | (14,560)      | (4,641)      | (4,843)      | (4,915)      | (5,565)       | (19,964)      | (4,832)      | (4,882)      | (4,857)      | (5,645)       | (20,216)      | (4,954)      | (5,126)      | (5,135)      | (6,007)       | (21,223)      | (22,230)      |
| Operating income                      | 10,851        | 12,475        | 2,947        | 3,806        | 3,892        | 5,241         | 15,886        | 3,566        | 3,929        | 4,205        | 5,366         | 17,066        | 3,694        | 4,158        | 4,557        | 5,793         | 18,201        | 19,838        |
| % of revenue                          | 46.2%         | 46.1%         | 38.8%        | 44.0%        | 44.2%        | 48.5%         | 44.3%         | 42.5%        | 44.6%        | 46.4%        | 48.7%         | 45.8%         | 42.7%        | 44.8%        | 47.0%        | 49.1%         | 46.2%         | 47.2%         |
| Total other income                    | (487)         | (819)         | (122)        | (124)        | (188)        | (188)         | (622)         | (212)        | (151)        | (169)        | (145)         | (677)         | (149)        | (107)        | (103)        | (101)         | (460)         | (352)         |
| Pre-tax income                        | 10,364        | 11,656        | 2,825        | 3,682        | 3,704        | 5,053         | 15,264        | 3,354        | 3,778        | 4,036        | 5,221         | 16,389        | 3,544        | 4,051        | 4,454        | 5,692         | 17,741        | 19,486        |
| Income taxes                          | (2,972)       | (3,162)       | (696)        | (1,050)      | (941)        | (1,177)       | (3,864)       | (889)        | (994)        | (908)        | (1,279)       | (4,070)       | (868)        | (992)        | (1,091)      | (1,395)       | (4,347)       | (4,774)       |
| Tax rate % (non-GAAP)                 | 28.7%         | 27.1%         | 24.6%        | 28.5%        | 25.4%        | 23.3%         | 25.3%         | 26.5%        | 26.3%        | 22.5%        | 24.5%         | 24.8%         | 24.5%        | 24.5%        | 24.5%        | 24.5%         | 24.5%         | 24.5%         |
| Non-GAAP Net income                   | 7,392         | 8,494         | 2,129        | 2,632        | 2,763        | 3,876         | 11,400        | 2,465        | 2,784        | 3,128        | 3,942         | 12,319        | 2,676        | 3,058        | 3,363        | 4,298         | 13,395        | 14,712        |
| % of revenue                          | 31.5%         | 31.4%         | 28.1%        | 30.4%        | 31.4%        | 35.9%         | 31.8%         | 29.4%        | 31.6%        | 34.5%        | 35.8%         | 33.0%         | 30.9%        | 32.9%        | 34.7%        | 36.4%         | 34.0%         | 35.0%         |
| Diluted shares outstanding (avg)      | 5,130         | 5,073         | 5,083        | 5,117        | 5,149        | 5,164         | 5,128         | 5,150        | 5,123        | 5,080        | 5,067         | 5,105         | 5,042        | 5,016        | 4,991        | 4,966         | 5,004         | 4,904         |
| <b>Non-GAAP EPS</b>                   | <b>1.44</b>   | <b>1.67</b>   | <b>0.42</b>  | <b>0.51</b>  | <b>0.54</b>  | <b>0.75</b>   | <b>2.22</b>   | <b>0.48</b>  | <b>0.54</b>  | <b>0.62</b>  | <b>0.78</b>   | <b>2.41</b>   | <b>0.53</b>  | <b>0.61</b>  | <b>0.67</b>  | <b>0.87</b>   | <b>2.68</b>   | <b>3.00</b>   |

Source: Company Reports and CIRA Estimates

Figure 15. Oracle Corporation – Balance Sheet (in \$ millions)

| (FY End: May)  | F09A   | F10A   | Aug 10A | Nov 10A | Feb 11A | May 11A | F11A   | Aug 11A | Nov 11A | Feb 12A | May 12E | F12E   | Aug 12E | Nov 12E | Feb 13E | May 13E | F13E   | F14E    |
|--|--------|--------|---------|---------|---------|---------|--------|---------|---------|---------|---------|--------|---------|---------|---------|---------|--------|---------|
| Cash and cash equivalents                            | 8,995  | 9,914  | 12,018  | 10,420  | 11,864  | 16,163  | 16,163 | 13,162  | 13,286  | 13,781  | 16,722  | 16,722 | 21,633  | 22,805  | 25,093  | 28,534  | 28,534 | 41,602  |
| Marketable securities                                | 3,629  | 8,555  | 11,619  | 14,425  | 12,491  | 12,685  | 12,685 | 18,498  | 17,726  | 15,961  | 15,961  | 15,961 | 15,961  | 15,961  | 15,961  | 15,961  | 15,961 | 15,961  |
| Trade receivables, net                               | 4,430  | 5,585  | 3,721   | 4,406   | 4,495   | 6,628   | 6,628  | 4,194   | 4,434   | 4,656   | 6,224   | 6,224  | 4,700   | 4,897   | 5,169   | 6,670   | 6,670  | 7,134   |
| Inventories  |        | 259    | 235     | 236     | 276     | 303     | 303    | 259     | 218     | 172     | 218     | 218    | 228     | 223     | 214     | 219     | 219    | 223     |
| Deferred tax assets                                  | 661    | 1,159  | 1,142   | 1,219   | 1,193   | 1,189   | 1,189  | 1,262   | 1,239   | 1,290   | 1,290   | 1,290  | 1,290   | 1,290   | 1,290   | 1,290   | 1,290  | 1,290   |
| Prepaid expenses and other current assets            | 866    | 1,532  | 1,529   | 2,017   | 2,140   | 2,206   | 2,206  | 1,831   | 1,579   | 1,678   | 2,262   | 2,262  | 1,695   | 1,746   | 2,041   | 2,346   | 2,346  | 2,416   |
| Total current assets                                 | 18,581 | 27,004 | 30,264  | 32,723  | 32,459  | 39,174  | 39,174 | 39,206  | 38,482  | 37,538  | 42,676  | 42,676 | 45,507  | 46,923  | 49,767  | 55,020  | 55,020 | 68,626  |
| Property, net  | 1,922  | 2,763  | 2,835   | 2,870   | 2,894   | 2,857   | 2,857  | 2,930   | 2,900   | 2,936   | 2,917   | 2,917  | 2,899   | 2,881   | 2,864   | 2,847   | 2,847  | 2,805   |
| Intangible assets, net                               | 7,269  | 9,321  | 9,124   | 8,526   | 8,324   | 7,860   | 7,860  | 7,662   | 7,152   | 7,455   | 6,974   | 6,974  | 6,576   | 6,179   | 5,781   | 5,383   | 5,383  | 4,139   |
| Goodwill   | 18,842 | 20,425 | 20,901  | 20,889  | 21,425  | 21,553  | 21,553 | 21,831  | 21,994  | 23,819  | 23,919  | 23,919 | 24,019  | 24,119  | 24,219  | 24,319  | 24,319 | 24,719  |
| Other assets   | 802    | 2,065  | 2,131   | 2,235   | 2,564   | 2,091   | 2,091  | 2,230   | 2,382   | 2,613   | 2,613   | 2,613  | 2,613   | 2,613   | 2,613   | 2,613   | 2,613  | 2,613   |
| Total assets   | 47,416 | 61,578 | 65,255  | 67,243  | 67,666  | 73,535  | 73,535 | 73,859  | 72,910  | 74,361  | 79,099  | 79,099 | 81,614  | 82,714  | 85,244  | 90,182  | 90,182 | 102,902 |
| Notes payable, current and other current liabilities | 1,001  | 3,145  | 2,260   | 2,255   | 0       | 1,150   | 1,150  | 0       | 0       | 0       | 0       | 0      | 0       | 0       | 0       | 0       | 0      | 0       |
| Accounts payable                                     | 271    | 775    | 706     | 762     | 673     | 701     | 701    | 614     | 445     | 442     | 588     | 588    | 680     | 704     | 614     | 607     | 607    | 627     |
| Income taxes payable                                 | 0      | 0      |         |         |         |         | 0      |         |         |         |         | 0      |         |         |         |         | 0      | 0       |
| Accrued compensation and related benefits            | 1,409  | 1,895  | 1,438   | 1,642   | 1,872   | 2,320   | 2,320  | 1,553   | 1,582   | 1,665   | 2,316   | 2,316  | 1,949   | 2,032   | 2,056   | 2,509   | 2,509  | 2,649   |
| Deferred revenue                                     | 4,592  | 5,900  | 6,903   | 5,742   | 5,849   | 6,802   | 6,802  | 7,925   | 6,091   | 6,285   | 7,160   | 7,160  | 8,046   | 6,756   | 6,756   | 7,710   | 7,710  | 8,306   |
| Other current liabilities                            | 1,876  | 2,976  | 2,493   | 2,935   | 2,888   | 3,219   | 3,219  | 2,964   | 2,954   | 3,240   | 3,240   | 3,240  | 3,240   | 3,240   | 3,240   | 3,240   | 3,240  | 3,240   |
| Current liabilities                                  | 9,149  | 14,691 | 13,800  | 13,336  | 11,282  | 14,192  | 14,192 | 13,056  | 11,072  | 11,632  | 13,304  | 13,304 | 13,916  | 12,731  | 12,665  | 14,066  | 14,066 | 14,822  |
| Notes payable and other non-current liabilities      | 9,237  | 11,510 | 14,778  | 14,780  | 14,752  | 14,772  | 14,772 | 14,789  | 14,778  | 14,777  | 14,777  | 14,777 | 14,777  | 14,777  | 14,777  | 14,777  | 14,777 | 14,777  |
| Income taxes payable                                 | 2,423  | 2,695  | 2,679   | 2,791   | 3,078   | 3,169   | 3,169  | 3,281   | 3,383   | 3,216   | 3,216   | 3,216  | 3,216   | 3,216   | 3,216   | 3,216   | 3,216  | 3,216   |
| Deferred revenue                                     | 204    | 388    | 375     | 350     | 334     | 316     | 316    | 311     | 269     | 269     | 269     | 269    | 269     | 269     | 269     | 269     | 269    | 269     |
| Deferred tax liabilities                             | 480    | 424    | 349     | 349     | 350     | 59      | 59     |         |         | 0       | 0       | 0      | 0       | 0       | 0       | 0       | 0      | 0       |
| Other non-current liabilities                        | 478    | 671    | 762     | 787     | 811     | 782     | 782    | 1,183   | 1,141   | 1,201   | 1,201   | 1,201  | 1,201   | 1,201   | 1,201   | 1,201   | 1,201  | 1,201   |
| Total liabilities                                    | 21,971 | 30,379 | 32,743  | 32,393  | 30,607  | 33,290  | 33,290 | 32,620  | 30,643  | 31,095  | 32,767  | 32,767 | 33,379  | 32,194  | 32,128  | 33,529  | 33,529 | 34,285  |
| Shareholder's equity                                 | 25,090 | 30,798 | 32,106  | 34,412  | 36,617  | 39,776  | 39,776 | 40,892  | 41,920  | 42,919  | 45,985  | 45,985 | 47,888  | 50,173  | 52,768  | 56,306  | 56,306 | 68,270  |
| Noncontrolling interests                             | 355    | 401    | 406     | 438     | 442     | 469     | 469    | 347     | 347     | 347     | 347     | 347    | 347     | 347     | 347     | 347     | 347    | 347     |
| Total liabilities and shareholder's equity           | 47,416 | 61,578 | 65,255  | 67,243  | 67,666  | 73,535  | 73,535 | 73,859  | 72,910  | 74,361  | 79,099  | 79,099 | 81,614  | 82,714  | 85,244  | 90,182  | 90,182 | 102,902 |

Source: Company Reports and CIRA Estimates

Figure 16. Oracle Corporation – Cash Flow Statement (in \$ millions)

| (FY End: May)   | F09A    | F10A     | Aug 10A | Nov 10A | Feb 11A | May 11A | F11A     | Aug 11A  | Nov 11A | Feb 12A | May 12E | F12E     | Aug 12E | Nov 12E | Feb 13E | May 13E | F13E     | F14E     |
|---|---------|----------|---------|---------|---------|---------|----------|----------|---------|---------|---------|----------|---------|---------|---------|---------|----------|----------|
| <b>Cash flow from operations</b>  |         |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Net income  | 5,592   | 6,135    | 1,352   | 1,870   | 2,116   | 3,210   | 8,548    | 1,840    | 2,192   | 2,498   | 3,280   | 9,810    | 2,115   | 2,496   | 2,804   | 3,744   | 11,159   | 12,769   |
| Depreciation  | 263     | 298      | 99      | 95      | 89      | 85      | 368      | 117      | 109     | 124     | 94      | 444      | 93      | 93      | 92      | 92      | 370      | 362      |
| Amortization of intangible assets   | 1,713   | 1,973    | 603     | 614     | 612     | 599     | 2,428    | 592      | 592     | 606     | 581     | 2,371    | 498     | 498     | 498     | 498     | 1,991    | 1,644    |
| Deferred income taxes   | (395)   | (511)    | (15)    | (61)    | (98)    | (79)    | (253)    | (116)    | (21)    | (63)    | 0       | (200)    | 0       | 0       | 0       | 0       | 0        | 0        |
| Minority interests in income  | 84      | 96       | 26      | 22      | 26      | 23      | 97       | 27       | 25      | 20      | 25      | 97       | 20      | 20      | 20      | 20      | 80       | 100      |
| Stock-based compensation  | 355     | 436      | 130     | 124     | 129     | 127     | 510      | 148      | 150     | 176     | 156     | 630      | 157     | 157     | 158     | 158     | 630      | 640      |
| Tax benefits on the exercise of stock   | 252     | 203      | 24      | 118     | 80      | 103     | 325      | 39       | 55      | 29      | 30      | 153      | 29      | 29      | 29      | 29      | 115      | 115      |
| Excess tax benefits on the exercise o   | (97)    | (110)    | (10)    | (76)    | (127)   | (2)     | (215)    | (24)     | (29)    | (18)    | (46)    | (117)    | (41)    | (41)    | (41)    | (41)    | (166)    | (186)    |
| Non-cash restructuring  | 0       |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| In-process R&D  | 10      |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Net investment gains related to equity  | (6)     |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Other, net  | 118     | 13       | 0       | (24)    | 66      | 93      | 135      | 0        | 1       | (6)     | 0       | (5)      | 0       | 0       | 0       | 0       | 0        | 0        |
| Changes in operating assets and liabilities, net of effects from acquisitions |         |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Decrease in trade receivables, net  | 336     | (219)    | 1,942   | (599)   | 34      | (2,106) | (729)    | 2,483    | (355)   | (100)   | (1,568) | 460      | 1,524   | (197)   | (272)   | (1,501) | (446)    | (464)    |
| Decrease in inventories, net  |         | 73       | 11      | 14      | (34)    | (19)    | (28)     | 57       | 36      | 46      | (46)    | 93       | (10)    | 5       | 10      | (6)     | (1)      | (4)      |
| Decrease in prepaid expenses and  | 145     | 340      | 348     | (68)    | (19)    | (247)   | 14       | 469      | (45)    | (337)   | (584)   | (497)    | 567     | (52)    | (294)   | (305)   | (84)     | (70)     |
| Decrease in accounts payable and  | (691)   | (360)    | (898)   | 278     | (201)   | 701     | (120)    | (1,374)  | 68      | (47)    | 797     | (556)    | (275)   | 106     | (66)    | 446     | 211      | 160      |
| Increase (decrease) in income tax   | 142     | (79)     | (529)   | (84)    | 22      | 495     | (96)     | 159      | 25      | 75      | 0       | 259      | 0       | 0       | 0       | 0       | 0        | 0        |
| Decrease in deferred revenues   | 433     | 489      | 734     | (1,280) | (18)    | 795     | 231      | 1,004    | (1,548) | 8       | 875     | 339      | 887     | (1,291) | 0       | 954     | 550      | 596      |
| Net cash provided by operating activit  | 8,254   | 8,777    | 3,817   | 943     | 2,677   | 3,778   | 11,215   | 5,421    | 1,255   | 3,011   | 3,595   | 13,282   | 5,563   | 1,822   | 2,937   | 4,088   | 14,409   | 15,662   |
| <b>Cash flows from investing activities</b>                                   |         |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Purchases of marketable securities a  | (9,315) | (15,703) | (7,650) | (9,152) | (6,059) | (8,148) | (31,009) | (12,588) | (8,834) | (8,323) | (6,000) | (35,745) | (6,000) | (6,000) | (6,000) | (6,000) | (24,000) | (24,000) |
| Proceeds from maturities and sales o  | 8,404   | 11,220   | 4,684   | 6,469   | 8,006   | 7,961   | 27,120   | 6,768    | 9,567   | 10,137  | 6,000   | 32,472   | 6,000   | 6,000   | 6,000   | 6,000   | 24,000   | 24,000   |
| Acquisitions, net of cash acquired  | (1,159) | (5,606)  | (832)   | 26      | (867)   | (174)   | (1,847)  | (343)    | (228)   | (2,262) | (200)   | (3,033)  | (200)   | (200)   | (200)   | (200)   | (800)    | (800)    |
| Purchases of equity and other investm   | 0       |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Capital expenditures  | (529)   | (230)    | (118)   | (121)   | (133)   | (78)    | (450)    | (160)    | (129)   | (142)   | (75)    | (506)    | (75)    | (75)    | (75)    | (75)    | (300)    | (320)    |
| Proceeds from sale of property  | 0       |          |         |         | 85      | 20      | 105      |          |         |         |         | 0        |         |         |         |         | 0        | 0        |
| Increase in other assets  | 0       |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Net cash used for investing activitie   | (2,599) | (10,319) | (3,916) | (2,778) | 1,032   | (419)   | (6,081)  | (6,323)  | 376     | (590)   | (275)   | (6,812)  | (275)   | (275)   | (275)   | (275)   | (1,100)  | (1,120)  |
| <b>Cash flows from financing activities</b>                                   |         |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Payments for repurchases of common  | (3,972) | (992)    | (249)   | (255)   | (245)   | (411)   | (1,160)  | (800)    | (998)   | (1,659) | (250)   | (3,707)  | (250)   | (250)   | (250)   | (250)   | (1,000)  | (1,000)  |
| Proceeds from issuances of common   | 760     | 874      | 169     | 565     | 294     | 348     | 1,376    | 182      | 252     | 79      | 150     | 663      | 150     | 150     | 150     | 150     | 600      | 600      |
| Payment of dividends to stockholders  | (250)   | (1,004)  | (251)   | (253)   | (253)   | (304)   | (1,061)  | (304)    | (303)   | (302)   | (300)   | (1,209)  | (298)   | (297)   | (295)   | (294)   | (1,184)  | (1,160)  |
| Proceeds from borrowings, net of issu   | 0       | 7,220    | 3,204   | 0       | 0       | 1,150   | 4,354    | 0        | 0       | 0       | 0       | 0        | 0       | 0       | 0       | 0       | 0        | 0        |
| Repayment of borrowings   | (1,004) | (3,582)  | (885)   | (5)     | (2,253) | 0       | (3,143)  | (1,150)  | 0       | (255)   | 0       | (1,405)  | 0       | 0       | 0       | 0       | 0        | 0        |
| Excess tax benefit on the exercise of   | 97      | 110      | 10      | 76      | 53      | 76      | 215      | 24       | 29      | 18      | 21      | 92       | 21      | 21      | 21      | 21      | 86       | 86       |
| Distributions to noncontrolling interest                                      | (53)    | (59)     | (38)    | 0       | (27)    | 0       | (65)     | (163)    | 0       | 0       | 0       | (163)    | 0       | 0       | 0       | 0       | 0        | 0        |
| Net cash provided by financing activi   | (4,422) | 2,567    | 1,960   | 128     | (2,431) | 859     | 516      | (2,211)  | (1,020) | (2,119) | (379)   | (5,729)  | (377)   | (375)   | (374)   | (372)   | (1,498)  | (1,474)  |
| Effect of exchange rates on cash  | (501)   | (107)    | 243     | 108     | 167     | 82      | 600      | 112      | (487)   | 194     | 0       | (181)    | 0       | 0       | 0       | 0       | 0        | 0        |
| Discontinued ops  |         |          |         |         |         |         |          |          |         |         |         |          |         |         |         |         |          |          |
| Net increase (decrease) cash  | 732     | 918      | 2,104   | (1,599) | 1,445   | 4,300   | 6,250    | (3,001)  | 124     | 496     | 2,941   | 560      | 4,912   | 1,171   | 2,288   | 3,441   | 11,812   | 13,068   |
| Cash at beginning of period   | 8,262   | 8,995    | 9,914   | 12,018  | 10,420  | 11,864  | 9,914    | 16,163   | 13,162  | 13,286  | 13,781  | 16,163   | 16,722  | 21,633  | 22,805  | 25,093  | 16,722   | 28,534   |
| Cash at end of period   | 8,994   | 9,913    | 12,018  | 10,419  | 11,865  | 16,164  | 16,164   | 13,162   | 13,286  | 13,782  | 16,722  | 16,723   | 21,633  | 22,805  | 25,093  | 28,534  | 28,534   | 41,602   |

Source: Company Reports and CIRA Estimates

## Oracle Corporation

### Company description

Oracle is the largest enterprise software company in the world and a principal supplier of computer server and storage systems through its recent acquisition of Sun Microsystems. Founded in 1977, Oracle began as one of the first vendors of relational database software, the original Oracle product that now commands close to 50% market share. In 1987, Oracle began selling application software and after an acquisition spree in the 2004-2006 timeframe, Oracle became the second-largest supplier of enterprise application software after SAP.

### Investment strategy

We rate Oracle Buy with the following key investment points:

- **Unique ability to drive software margin leverage** — Oracle has uniquely driven industry-high margins across its base of software revenue vs. peers that rely on one or two products. With incremental software margins in the 60-70% range, we expect overall margins will continue to creep higher after the Sun reset. This should continue to drive upside to street estimates, where margin leverage has been systematically underestimated.
- **One of the strongest competitive positions in software** — We believe Oracle's nearly 50% share of database could move higher as favorable platform shifts continue. SaaS represents a threat to apps, but acquisitions will help Oracle maintain share.
- **Maintenance revenue stream worth \$17 alone** — Shrewd acquisition strategy has enabled the company to amass this valuable maintenance base.

### Valuation

Our \$34 price target for Oracle is based on a 10-year discounted cash flow with a terminal value based on an 8x multiple. We are assuming revenue growth of 8% in years 1-2, medium-term CAGR (years 3-5) of 6% and long-term (years 6-10) growth of 5%. Over the next 10 years, we also assume the company will drive 5 points of margin expansion. Our DCF assumes a risk-free rate of 2.4%, 6.6% equity risk premium and a beta of 1.12.

### Risks

Annuity earnings from the maintenance business provide downside risk and dampen cyclical trends affecting the broader software industry. The key short-term risks include-

- **Macro IT spending.** The macro snapback in software is starting to fade. Oracle has seen improving license growth, but the snapback might not materialize.

Key long-term risks include:

- **Fusion product transition.** Fusion Applications are important in signaling Oracle's direction in SaaS and in protecting its large installed base of customers from poaching by competitors.

- **SaaS.** Pure-play SaaS vendors and increased SaaS competition from traditionally packaged vendors (e.g. SAP BBD) could siphon growth away from Oracle beyond what we have forecast, and offerings such as Workday could eventually displace Oracle installations.
- **3rd-party maintenance.** Third-parties entering the maintenance business could enter the market more significantly than we have forecast.
- **Challenges to core database business.** Alternative database architectures including SAP's HANA and open-source NoSQL architectures could displace Oracle's stronghold in databases.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

## Appendix A-1

### Analyst Certification

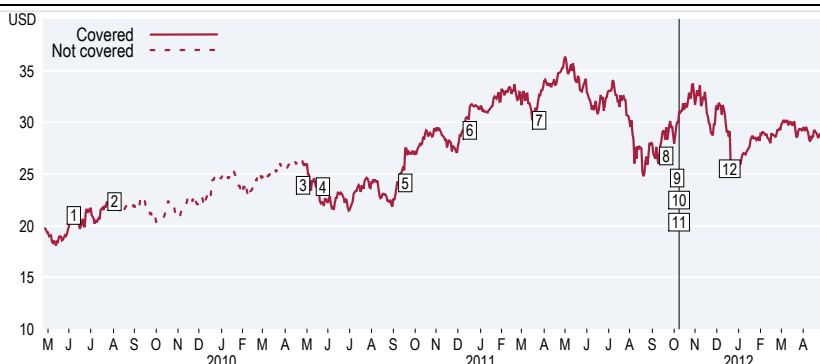
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#### Oracle Corporation (ORCL)

#### Ratings and Target Price History Fundamental Research

Analyst: Walter H Pritchard, CFA  
Covered since April 27 2010



|   | Date      | Rating              | Target Price | Closing Price |
|---|-----------|---------------------|--------------|---------------|
| 1 | 7-Jun-09  | 1M                  | *24.00       | 20.71         |
| 2 | 4-Aug-09  | Coverage terminated |              |               |
| 3 | 27-Apr-10 | *1L                 | *32.00       | 25.98         |
| 4 | 25-May-10 | 1L                  | *28.00       | 22.20         |

|   | Date      | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 5 | 17-Sep-10 | 1L     | *30.00       | 27.48         |
| 6 | 17-Dec-10 | 1L     | *34.00       | 31.46         |
| 7 | 25-Mar-11 | 1L     | *35.00       | 32.64         |
| 8 | 21-Sep-11 | 1L     | *33.00       | 29.54         |

|    | Date      | Rating                      | Target Price | Closing Price |
|----|-----------|-----------------------------|--------------|---------------|
| 9  | 6-Oct-11  | 1L                          | *34.00       | 30.07         |
| 10 | 8-Oct-11  | Stock rating system changed |              |               |
| 11 | 8-Oct-11  | *1                          | 34.00        | 29.91         |
| 12 | 20-Dec-11 | 1                           | *32.00       | 29.17         |

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time



## Oracle Corporation (ORCL)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Walter H Pritchard, CFA

Covered since April 27 2010



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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#### Data current as of 31 Mar 2012

|  | 12 Month Rating |      |      | Relative Rating |      |      |
|--|-----------------|------|------|-----------------|------|------|
|  | Buy             | Hold | Sell | Buy             | Hold | Sell |
| Citi Investment Research & Analysis Global Fundamental Coverage            | 52%             | 37%  | 11%  | 10%             | 79%  | 10%  |
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