ORACLE

FRAMEWORK Investing

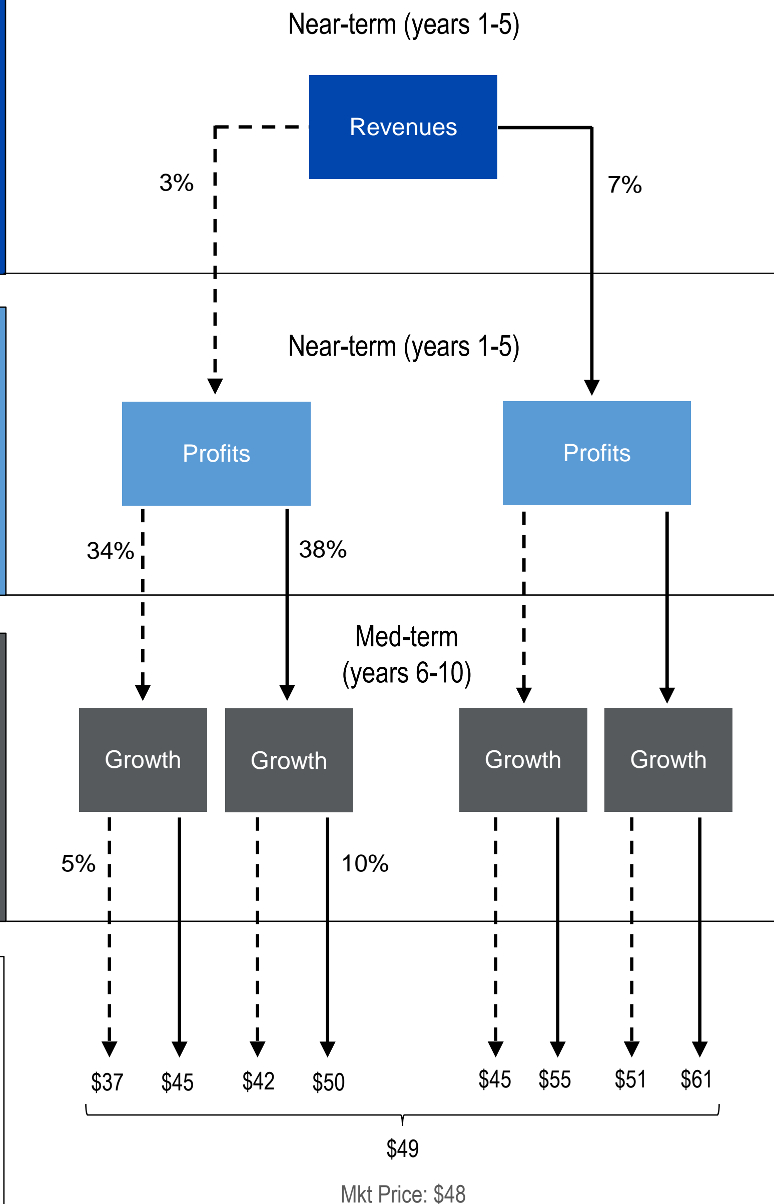
Valuation Waterfall

Revenue Growth
Oracle came late to the Cloud revenue model, but has embraced it over the past few years and, lately, extended it with a hybrid model known as "BYOL" (Bring Your Own License). BYOL allows customers to buy a software license and install it on Cloud servers rather than just "renting" the software as in a straight Cloud model. We believe that Amazon is increasingly viewing Oracle as a Cloud infrastructure provider competitor.

Profitability
The move to the Cloud has lowered Oracle's profitability by a few hundred basis points as the firm has had to build (and depreciate) data centers that it uses to provide its as-a-Service offerings. However, over the past few quarters, Cloud profitability has made a dramatic upturn as ORCL's fixed costs are spread over an expanding client base. ORCL's BYOL program offers clients Cloud flexibility while maintaining high profitability licenses.

Medium-Term Cash Flow Growth
ORCL has been investing heavily in the Cloud and has innovated with its BYOL offering in a way that is attractive for customers and owners alike. ORCL's ownership of the Java platform may generate positive cash flow even though it is open sourced. Its hardware offering, from the acquisition of Sun Micro in 2010, is a drag in terms of revenue growth, but a plus in terms of strategic advantage. As Cloud business matures, expect CF growth to speed up.

Fair Value Range
Our fair value range extends from $38 to $61 / share with an average value of $48 / share using a **discount rate of 10%**. We think that the relatively higher valuations are probably more likely. As detailed in a recent series of articles, we believe corporate governance at Oracle is improving. Executive compensation has been roughly cut in half and we believe that owners will be happy of Ellison, Catz, and Hurd are able to earn their newest option grants.



Analysis by: Erik Kobayashi-Solomon, Framework Investing

11 August 2018

Methodology

Framework Investing analyses focus on three main valuation drivers: revenue growth, profitability, and medium-term cash flow growth. We estimate a best- and worst-case scenario for each of these drivers resulting in a total of $2^3 = 8$ fair value scenarios based on discounted cash flow methodology. Profitability is measured by Owners' Cash Profit (OCP) margin and our measure of free cash flow is termed Free Cash Flow to Owners (FCFO). We use a discount rate of 10% for large capitalization stocks. A wide spread of lowest and highest fair values indicates a firm whose value is uncertain. Risk depends on the stock price's relationship to the valuation range. Best-case scenarios are represented with a solid line; worst-case scenarios, with a dotted one.

Information provided by Framework Investing, should not be used as investment advice. Framework Investing does not act in the capacity of a Registered Investment Advisor. For investment advice geared towards your specific needs, we encourage you to contact your financial planner or advisor.

© 2018 Framework Investing | www.FrameworkInvesting.com