FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Oracle's IDR to 'BBB'; Outlook Negative; Rating Watch Resolved

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Fitch Ratings - Chicago - 07 Nov 2022: Fitch Ratings has downgraded Oracle Corporation's Long-Term Issuer Default Rating (IDR) and unsecured debt to 'BBB' from 'BBB+', and resolved the Rating Watch Negative. Fitch has also assigned 'BBB' rating to the new unsecured notes issuance. The Rating Outlook is Negative. Fitch has also downgraded the Short-Term IDR and CP rating to 'F2' from 'F1'.

The downgrades follow Oracle's incurrence of term loan and plan to issue unsecured notes for refinancing of outstanding DDTL for the Cerner Corporation acquisition that was closed in June 2022. The proceeds from the new notes will be used to repay the $10.1 billion bridge financing currently outstanding. The ratings also contemplate Oracle's intent to limit share repurchases to approximately $600 million per quarter and dividend increases in a manner consistent with its historical pattern until gross leverage is reduced to approximately 3.5x.

KEY RATING DRIVERS

High Financial Leverage: Oracle's financial leverage is high for the rating category. Fitch estimates Oracle's gross leverage to approach 3.5x by FYE 2024 through a combination of EBITDA growth and $4.75 billion debt maturity payment. Fitch assumes Oracle will repay maturities until its gross leverage reaches 3.5x.

Strong Financial Flexibility: Oracle has strong financial flexibility, with staggered maturities of its debt through 2061, and $20.8 billion due through fiscal FY 2026. Oracle had access to about $11.2 billion of cash and cash equivalents and marketable securities as of fiscal 1Q23 and generates approximately $9 billion of post-dividend FCF annually.

Significant Recurring Revenue: Fitch expects significant recurring revenue and FCF from Oracle's large installed customer base, high renewal rate and increasing scale of its cloud products. These strengths should continue throughout the transition to cloud from on-premise solutions. Fitch believes cloud revenue has reached critical mass and will offset revenue declines in other categories, including on-premise revenue, resulting in modest revenue growth.

Solid Competitive Position: Fitch believes Oracle is uniquely positioned for cloud-service leadership by its solid as-a-service markets, including enterprise resources, human resources, supply chain, manufacturing, data and marketing, as well as its ability to leverage its large database and middleware installed base across both on-premise and cloud. With the Cerner acquisition, Oracle has established a solid position within the growing health care IT industry.

Oracle faces tough competition from strong but narrowly focused as-a-service companies, particularly Workday, Inc (human capital management and financial planning and analysis) and Salesforce.com, Inc. (sales, marketing and service). Historical on-premise competitors, particularly SAP SE, also are shifting to cloud offerings but lag Oracle in scale and growth. Fitch believes the customer and product diversification that comes with scale will fortify Oracle's operating profile.

Improving Cloud Profitability: Fitch expects margins to gradually expand over the medium term on the back of rising scale efficiency in Oracle's cloud products. Oracle's operating EBITDA rose by mid- to high-single digits in the previous few quarters, stronger than revenue growth, reflecting modest margin expansion. Fitch expects its operating EBITDA margin to trend toward 50% over the intermediate term, as growth in cloud products offsets a decline in on-premise products and operational optimization post Cerner merger is realized.

Significant Shareholder Returns: Beyond the commitment associated with the debt issuance to limit shareholder returns, Fitch expects shareholder returns in excess of annual FCF in the absence of large acquisitions. The annual dividend is likely to grow, with the remainder going to share repurchases. The company repurchased $16.2 billion in shares during fiscal 2022 and $552 million in 1Q FY23. Fitch anticipates ongoing capital not used for acquisitions or repayment of maturing debt to be returned to shareholders, consistent with management's articulated strategy.

Historically Acquisitive: Fitch recognizes potential event risk around acquisitions and expects Oracle to constrain share repurchases in lieu of making large acquisitions. Incremental debt is possible with large acquisitions. Incremental debt is possible with large acquisitions that require external financing. In addition to the Cerner acquisition, the company acquired NetSuite, a provider of cloud applications, in 2016 for $9.1 billion. Oracle subsequently made several smaller acquisitions, including CrowdTwist, DataFox, Grapeshot, Iridize, Moat, Oxygen Systems and Vocado. Fitch believes more acquisitions are likely, potentially resulting in significant aggregate acquisition spending.

DERIVATION SUMMARY

Fitch's ratings are supported by our expectation that Oracle will reduce its debt at a pace aligned with its debt maturities and limit its shareholder returns until its gross leverage reaches 3.5x. Beyond the company's intended gross leverage target, Fitch expects the company to primarily allocate its FCF towards shareholder returns and acquisitions while maintaining its gross leverage at levels consistent with Fitch's rating sensitivities.

In spite of the shareholder-friendly policies, Oracle's material cash balance and cash generation capabilities provide the company with ample financial flexibility. Fitch expects Oracle to generate approximately $9 billion in post-dividend FCF and had approximately $11.2 billion in cash and cash equivalent and marketable securities as of fiscal 1Q23. Unexpected deterioration in Oracle's operating profile, potentially due to change in market dynamics, would also have consequential impact on Oracle's credit protection metrics.

In spite of Oracle's strong operating profile, Fitch believes Oracle faces competitive pressure from other cloud-based enterprise application providers such as Salesforce.com, Inc. and Workday, Inc. While these competitors compete in narrower sub-segments, they are growing at significantly faster pace, potentially gaining share against the incumbents.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

--Organic revenue growth in the low- to mid-single digits;

--EBITDA margins remain stable in the high 40s;

--Dividends rise to approximately $4 billion annually;

--Debt maturity through FY 2024 is repaid;

--Acquisitions average $200 million per year.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Gross leverage remains below 3.0x;

--(Cash flow from operations-capex)/total debt with equity credit sustains above 20%;

--Revenue growth at or above mid-single digits and EBITDA margin remaining stable at over 45%, reflecting a stable competitive position.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Gross leverage remains above 3.5x;

--(Cash flow from operations-capex)/total debt with equity credit sustains below 15%;

--Revenue declines over a sustained period and EBITDA margins remain below 40%, reflecting an eroding market position.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Solid Liquidity: Fitch expects Oracle's liquidity to remain solid. As of Aug. 31, 2022, liquidity was supported by $11.2 billion of cash, cash equivalents and marketable securities; a $6 billion CP program; and Fitch's expectation for $12 billion of annual pre-dividend FCF.

Manageable Maturity Profile: Oracle's maturity schedule is manageable, and Fitch believes the company has sufficient financial flexibility through expected FCF generation and cash on the balance sheet to address maturities. Upcoming maturities through FY 2024 total $4.75 billion of unsecured notes.

ISSUER PROFILE

Oracle is a provider of enterprise application systems with nearly 84% of its revenues derived from the core enterprise application products and cloud services. Oracle remains one of the major players in the space with major competitors including SAP, Microsoft Dynamics, and Infor. Oracle has been adapting its products for cloud offerings in recent years as customers are increasingly embracing cloud-delivered services with as-a-service models.

While Oracle offers its cloud-based solutions (SaaS, PaaS, and IaaS) as standalone services, it leverages its large installed base of on-premise enterprise applications by offering its customers the flexibility to migrate from its on-premise licenses to cloud-based services with "bring your own license" (BYOL) offering.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Oracle has an ESG Relevance Score of '4' for Governance Structure due to the apparent concentration of board influence by its chairman, which has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

Fitch assigned a score of '4' for Oracle's Governance Structure reflecting the negative credit impact from lack of board independence and effectiveness and ownership concentration.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Oracle Corporation	LT IDR	BBB Rating Outlook Negative	Downgrade	BBB+ Rating Watch Negative
	ST IDR	F2	Downgrade	F1 Rating Watch Negative
senior unsecured	LT	BBB	New Rating	
senior unsecured	LT	BBB	Downgrade	BBB+ Rating Watch Negative
senior unsecured	ST	F2	Downgrade	F1 Rating Watch Negative

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 29 Oct 2022)

Corporate Rating Criteria (pub. 29 Oct 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Oracle Corporation	EU Endorsed, UK Endorsed

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