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Oracle Corp. Rating Lowered To 'BBB' On Cerner Acquisition; Rating Remains On CreditWatch Negative

- On June 7, Austin, Texas-based enterprise software provider Oracle Corp. announced that a majority of the outstanding Cerner shares were validly tendered, and the other conditions to the tender offer have been satisfied or waived.
- We lowered our issuer credit ratings on the company and its debt to 'BBB' from 'BBB+'.
- We also affirmed our 'A-2' short-term rating.
- The ratings remain on CreditWatch with negative implications pending financial policy guidance from the company. If the company defers debt issuance and financial policy guidance beyond its upcoming open window, we will likely resolve the CreditWatch listing based on our analytical judgement.

SAN FRANCISCO (S&P Global Ratings) June 8, 2022—S&P Global Ratings today took the rating actions listed above.

A further downgrade is still possible, though we believe Oracle will likely maintain an investment-grade rating.

The downgrade of Oracle to 'BBB' reflects the higher leverage resulting from the Cerner acquisition and our view that any financial policy the company could articulate is not likely to justify a rating higher than 'BBB' because following any possible deleveraging period, the company will probably find new opportunities to leverage its balance sheet. We think 'BBB-' is a possible outcome as well, but 'BB+' is not likely. In its press release announcing the transaction, the company said it "anticipates retaining an investment-grade credit rating." We believe it would be extremely difficult to manage such a large debt structure in the high-yield market, providing management a good incentive to deliver on this expectation. However, we are uncertain about whether these steps will justify a 'BBB' or a 'BBB-' rating. We will resolve the CreditWatch placement after we have a better understanding of Oracle's balance sheet management plan. Given that ratings are approaching critical levels, we expect the company will define a financial policy, but it is possible that it will not. If we downgrade the long-term rating to 'BBB', the short-term rating would remain 'A-2'. However, if we were to downgrade Oracle to 'BBB-', we would lower the short-term rating to 'A-3'.

Based on the 12 months ended Feb. 28, 2022, Oracle's leverage pro forma for the Cerner acquisition would be 5x (4x when excluding the \$4.7 billion litigation payment from the most recent quarter). We consider Oracle's peak leverage to be high and maintaining an investment-grade rating will likely require curtailing share repurchases and reducing gross debt. We think sustaining the 'BBB' rating would require more than one year of financial policy discipline, whereas supporting a 'BBB-' could be achieved in about a year.

The acquisition will not affect our view of the quality of Oracle's business.

Cerner would contribute only a small portion of the combined company's adjusted EBITDA, which we estimate will be in the mid- to high-single-digit-percentage area. Cerner has faced many operating challenges over the past few years, including large restructuring expenses, the pausing of the Veterans Administration project implementation, excessive spending on software licenses, and lack of visibility into business unit profits and losses. In addition, there has been too much product customization for clients, which demonstrates that the company has limited capacity to scale its core product to a broad range of customers in its current form. The company attracted an activist investor (Starboard Value) in 2019, and there were several C-suite changes in 2020 and 2021, including the CEO and CFO. We think Oracle can fix many of these problems over the next few years after taking Cerner off the public market, where it is subject to investor scrutiny on a quarterly basis.

Despite these challenges, Cerner grew revenues by mid-single-digit percentages in 2019, and it returned to growth in 2021 after a rebasing year in 2020 that included culling unprofitable contracts and divesting businesses. This suggests that despite operational challenges, Cerner's products are ingrained in its customers' operations and that the business is durable. Cerner provides Oracle the opportunity to diversify into the health care IT market, where it can leverage its enterprise software and cloud capabilities.

Oracle's strength in the database market is a key credit support.

The company's leading position in the relational database market, which is highly profitable and recurring, allows it to maintain its substantial research and development capacity to broaden its product suite as the enterprise IT industry migrates to the cloud. At the same time, competition within the database segment is fierce, with Microsoft a solid No. 2 player and Amazon Web Services expanding rapidly from a small base. As a result, we view Oracle's ability to maintain its technology leadership (autonomous databases, for example) and migrate customers to the cloud through its own infrastructure-as-a-service (IaaS) platform as critical to its long-term success.

Oracle's primary focus continues to be the cloud.

Its software-as-a-service (SaaS) products-- Fusion enterprise resource planning (ERP) and NetSuite ERP (for small- to mid-market customers), in particular-- continue to gain rapid adoption. Oracle's platform-as-a-service (PaaS) and IaaS businesses are more limited in scale and breadth than those of the top public cloud peers but provide an opportunity to keep customers on its platform and make their transition to the cloud more seamless. Software remains a sticky, recurring business, but the cloud has disrupted the market and made it easier for customers to switch vendors. Oracle's long-term success will depend on its ability to remain a critical vendor as enterprises gradually migrate to the cloud. Oracle's largest competitors have more capacity for organic and inorganic investment and dedicate fewer resources to shareholder returns. Oracle also faces strong competition and innovation from niche players. These competitors could gain influence in enterprise IT, but we believe Oracle's leadership in relational databases and its expanding base of SaaS applications will allow it to maintain its position.

We could lower the rating to 'BBB-' if we believe Oracle is unlikely to sustain net leverage below the mid-3x area. Conversely, we could affirm the 'BBB' rating if we believe the company has a credible financial policy commitment to achieve leverage below the mid-3x area. If Oracle intends to issue notes (as opposed to taking on a multiyear term loan), we would expect it to do so during its next open window and at the same time make a financial policy commitment of some sort given the rating's close proximity to the non-investment-grade rating threshold. If the company defers new financing, we will likely resolve the CreditWatch listing after its next open window expires before the end of its current quarter in August, based on our analytical judgment.

ESG credit indicators: E-2, S-2, G-2

ESG credit factors have had no material influence on our credit rating analysis of Oracle. Although we believe Larry Ellison's significant voting power could result in aggressive business decisions, we also view favorably the influence within enterprise IT that the company has maintained under his leadership.

Related Criteria

- [General Criteria: Environmental, Social, And Governance Principles In Credit Ratings](#), Oct. 10, 2021
- [General Criteria: Group Rating Methodology](#), July 1, 2019
- [Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments](#), April 1, 2019
- [Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings](#), March 28, 2018
- [General Criteria: Methodology For Linking Long-Term And Short-Term Ratings](#), April 7, 2017
- [Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers](#), Dec. 16, 2014
- [General Criteria: Methodology: Industry Risk](#), Nov. 19, 2013
- [General Criteria: Country Risk Assessment Methodology And Assumptions](#), Nov. 19, 2013
- [Criteria | Corporates | General: Corporate Methodology](#), Nov. 19, 2013
- [General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities](#), Nov. 13, 2012
- [General Criteria: Principles Of Credit Ratings](#), Feb. 16, 2011

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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