FitchRatings

Fitch Downgrades Oracle's IDR to 'A'; Outlook Negative

Fitch Ratings-Chicago-10 October 2018: Fitch Ratings has downgraded Oracle Corporation's Long-Term Issuer Default Rating (IDR) to 'A' from 'A+'. The Rating Outlook is Negative. Fitch has affirmed Oracle's Short-Term IDR at 'F1'. Fitch's actions affect $58 billion of total debt. A full list of rating actions follows at the end of this release.

Fitch's rating action reflects its belief that Oracle's gross leverage will remain elevated relative to the expectations for the 'A+' category for an extended period of time as the company transitions its capital structure post U.S. tax reform. While the company has yet to articulate its financial policy or how the company will allocate significant levels of excess cash, Fitch expects the company will reduce debt at a pace aligned with its current maturity schedule. Fitch's forecasted deleveraging trajectory, which anticipates leverage declining to 2x by the end of Oracle's fiscal year 2022, is more consistent with the 'A' rating category. Oracle has increased the pace of share repurchase in recent quarters, and Fitch expects Oracle to use most of its excess cash for shareholder returns or acquisitions. As Oracle's leverage remains elevated for the 'A' rating category, the Negative Outlook reflects the risk that the company may elect to delay debt reduction to levels consistent with the 'A' rating category. Deviations from Fitch's expectations could result in negative rating actions. Despite the high gross leverage, Fitch expects Oracle's strong operating profile to sustain with annual FCF generation of over $10 billion. In conjunction with its strong balance sheet, Fitch expects Oracle to have ample liquidity to address debt maturities.

KEY RATING DRIVERS

Strong Financial Flexibility: Despite its shareholder-friendly financial policy, the company has strong financial flexibility with the staggered maturities of its $58 billion of gross debt through 2055 and $17 billion due through FY2022. Oracle has access to nearly $60 billion of cash and cash equivalent as of Q1 FY2019 and continues to generate over $13 billion of pre-dividend FCF annually.

Significant Recurring Revenue: Fitch expects significant recurring revenue and FCF from Oracle's large installed customer base, high attach-and-renewal rates (ARR) and increasing scale for its cloud products; we expect these strengths to continue through the transition from on-premise solutions to cloud. Despite the decline of on-premise revenues, Fitch believes cloud revenues have reached critical mass that the growth would more than offset the decline in other categories. During FY2018, total revenue growth of 5.6% was supported by 7.4% in software revenue.

Solid Competitive Position: Fitch believes Oracle's solid positions across key as-a-service markets (including enterprise resource, human resources, supply chain and manufacturing, data and marketing) and ability to leverage its significant database and middleware installed base across both on-premise and cloud uniquely positions Oracle for cloud service leadership. Oracle faces significant competition from strong but narrowly focused as-a-service players, particularly Workday (Human Capital Management) and Salesforce.com (sales, marketing, and service). Historical on-premise competitors, particularly SAP, 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.

Less profitable cloud to improve with scale: Oracle's operating EBITDA grew by 9.8% in fiscal 2018 following the 2.4% growth in 2017 with the improving scale for cloud products. Fitch expects operating EBITDA margin to remain in the mid-40s over the intermediate term as strong growth in cloud products offset decline in on-premise products. Over the medium term, we expect margins to gradually expand on the back of rising scale efficiency in Oracle's cloud products.

Significant shareholder returns: Fitch expects significant shareholder returns in excess of annual FCF in the near term in the absence of large acquisitions. Fitch expects annual dividend growth in low-single digits with the remainder going to share repurchases. Fitch anticipates ongoing capital not used for organic or inorganic growth and repayment of maturing debt to be returned to shareholders, consistent with management's articulated strategy. The company does not have explicit financial targets including ceilings on share repurchase.

Historically acquisitive: Fitch recognizes potential event risk around acquisitions. Fitch expects Oracle to constrain share repurchases in the event of large acquisitions. Incremental debt is possible with large acquisitions that require external financing. The company acquired NetSuite, a provider of cloud applications, on Nov. 7, 2016 for $9.1 billion. Prior to NetSuite, Oracle acquired MICROS, a provider of integrated software, hardware and services solutions for the hospitality and retail industries, in fiscal 2015 for $4.5 billion. Fitch believes similarly sized deals are likely, potentially resulting in significant aggregate acquisition spend.

Substantial Cash on Balance Sheet: The tax reform of 2017 has enabled Oracle to efficiently reposition its offshore cash for domestic use; as of 1Q FY2019, the company had $60 billion in cash and cash equivalent. Fitch expects Oracle to use the cash primarily for shareholder returns and acquisitions while repaying debt as it matures. During Q1 FY2019, the company repurchased $10 billion in shares, an increase from $5 billion the previous quarter; we expect the pace to continue while excess cash remains on its balance sheet.

DERIVATION SUMMARY

Fitch's ratings are supported by our expectation that Oracle will gradually reduce its debt despite having gained the ability to efficiently reposition its offshore cash for domestic use. This deviates from Fitch's previous expectations that Oracle would rapidly repay its debt to reduce its gross leverage to levels consistent with the 'A+' rating category. Fitch's forecasted deleveraging trajectory over the rating horizon is more consistent with the 'A' rating category. Oracle has increased the pace of share repurchase in recent quarters; Fitch expects Oracle to use most of its excess cash for shareholder returns or acquisitions.

In spite of the shareholder-friendly policies, Oracle's strong balance sheet and cash generation capabilities provide the company with ample financial flexibility. However, in the absence of clear financial targets including ceilings on share repurchase, the Negative Outlook reflects the risk that the company may elect to maintain or increase its gross debt levels which would result in credit protection metrics remaining outside the range that is consistent with 'A' rating category. Fitch expects Oracle's gross leverage to decline with debt maturities and eventually to less than 2x. Deviations from Fitch's expectations could result in negative rating actions. 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.

As Oracle transitions from on-premise enterprise applications to cloud-based SaaS, Fitch expects the company to remain a major player in the enterprise application segment. During FY2018, Oracle's software revenue grew by 7.4%, an acceleration from the 4.2% growth the previous year. The decline in hardware revenue and stable services revenue resulted in overall revenue growth of 5.6%.

In spite of Oracle's acceleration of growth in FY2018, 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-single-digits;
--EBITDA margins remaining stable in the high 40's;
--Dividends gradually rising from approximately $3.3 billion in FY2019 to $3.8 billion in FY2022;
--Debt is repaid as they mature through our forecast period;
--Acquisitions averaging $1 billion per year;
--Substantially all excess cash on balance sheet after debt repayment and acquisitions is used for shareholder returns.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Stabilization of Rating Outlook
--Fitch's expectation that gross leverage would decline to 2.5x by FY2021 through reduction of $8.95 billion of debt maturities ($2 billion in FY2019; $4.5 billion in FY2020; and $2.45 billion in FY2021);
--Gross leverage further declines to 2x by FY2022 and remains below 2x in the long term;
--EBITDA margins remain stable at over 45%;
--Annual FCF (post-dividend) sustains at over $10 billion.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
--Fitch's expectation of gross leverage remaining above 2.5x by FY2021 and above 2x by FY2022;
--Fitch's expectation of gross leverage remaining above 2x in the long-term;
--Sustained revenue decline reflecting weaker market positioning;
--Expectation that EBITDA margin will sustain below 40% as a result of operational challenges;
--Annual FCF (post-dividend) sustains near or below $5 billion due to negative revenue growth or structurally lower profitability.

LIQUIDITY

Solid Liquidity: Fitch expects Oracle's liquidity will remain solid. As of Aug. 31, 2018 liquidity was supported by: (i) $46 billion of unrestricted cash, cash equivalents and marketable securities, (ii) $3 billion Commercial Paper (CP) program, and (iii) Fitch's expectation for $10 billion of annual 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 balance sheet to address maturities. The next scheduled maturities are in FY2019 when $2 billion of unsecured notes are due.

Debt Structure:
--$2 billion senior unsecured notes due FY2019;
--$4.5 billion senior unsecured notes due FY2020;
--$2.45 billion senior unsecured notes due FY2021;
--$8.25 billion senior unsecured notes due FY2022;
--$41 billion senior unsecured notes due after FY2022.

FULL LIST OF RATING ACTIONS

Fitch has taken the following rating actions:

Oracle Corporation
- Long-Term IDR downgraded to 'A' from 'A+'; Outlook Negative;
- Short-Term IDR affirmed at 'F1';
- $3 billion CP program affirmed at 'F1';

- Senior unsecured notes downgraded to 'A' from 'A+'.

Contact:

Primary Analyst
Alen Lin
Senior Director
+1-312-368-5471
Fitch Ratings, Inc.
70 W. Madison St.
Chicago, IL 60602

Secondary Analyst
Jason Pompeii
Senior Director
+1-312-368-3210

Committee Chairperson
David Peterson
Senior Director
+1-312-368-3177

Date of Relevant Rating Committee: Oct. 9, 2018.

Summary of Financial Statement Adjustments - Fitch has made no material financial adjustments.

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@fitchratings.com

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10023790)

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