Oracle Corporation Japan

Q1 Financial Results Briefing for the Fiscal Year Ending May 2024

September 26, 2023

Event Summary

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S. Krishna Kumar	Director, Corporate Executive Officer, CFO
Yuki Nishio	Director, Investor Relations

[Analyst Names]

Mitsunobu Tsuruo	Citigroup Global Markets
Kaori Chiba	JPMorgan Securities
Hiroto Segawa	Morgan Stanley MUFG Securities
Hideaki Tanaka	Mitsubishi UFJ Morgan Stanley Securities
Satoru Kikuchi	SMBC Nikko Securities

Presentation

Nishio: Now, I'd like to turn this call over to K.K. Senior Vice President, JPAC and Japan CFO.

S. Krishna Kumar*: Thank you very much, Nishio-san. Good afternoon, everyone, and welcome to Oracle Japan's Q1 FY2024 Earnings Conference Call.

We had Oracle Cloud World in Las Vegas last week, which is Oracle's largest global celebration of customers and partners. Oracle Corporation announced a lot of references and new technology, including our cloud infrastructure, database applications, multi-cloud strategy and developer technologies. We have a lot of playbacks available on the Oracle website for your viewing pleasure, which will give you a broad understanding of where Oracle's product innovation is heading towards.

Also, as per our financial tables from this quarter onwards, we will disclose the revenue breakdown of cloud services and license support from this quarter. You can see the excellent growth in our cloud revenues, as you can see from the tables.

We have become the enterprise technology vendor of choice because we have products and services that help our customers drive cost efficiency and modernize their businesses.

In our Q1, we continuously advanced our on-premise as well as our cloud services business. We deployed cloud to different customers, especially cloud infrastructure, to modernize their mission-critical systems continuously. We had a lot of marquee cloud customers in various industries, especially the financial and manufacturing industries.

I will name a couple of customers for you to get an understanding of what we are doing in the different industries.

Intelligent Wave, one of the leading credit card business service providers in Japan, selected Oracle Cloud Infrastructure to expand its service platform for credit card franchises to meet growing demand for cashless transactions.

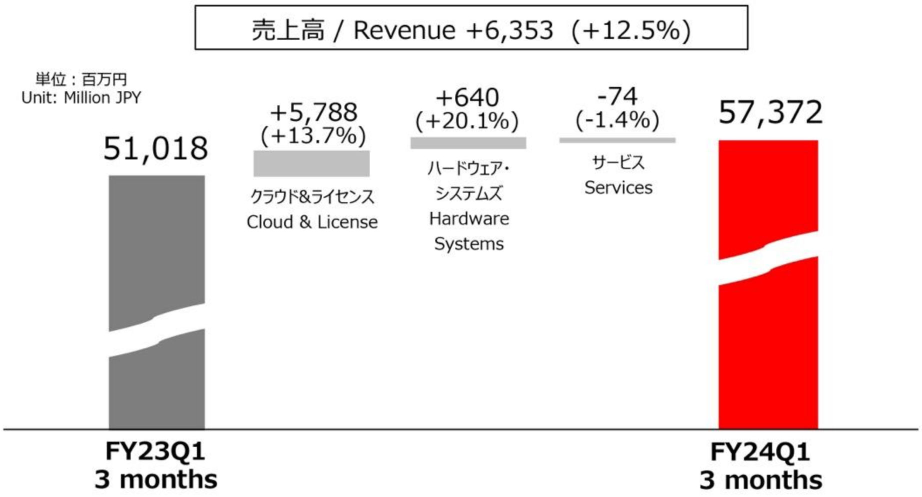
UQ Communications, one of the mobile service providers in Japan, enhanced their company's business continuity plan by moving its base station management systems to Oracle Cloud Infrastructure.

Rakuten Mobile has chosen Oracle Communications' cloud native converged policy and charging solutions to support its fast-growing 4G and 5G services.

Kansai Electric Company, the retail arm of one of Japan's largest integrated power utilities is using Oracle Utilities customer care and billing to provide customers with new rate options and services that can increase satisfaction.

This was just to give you a sense of the broad outreach in the market that we have with our different products and services and to underline Oracle's presence in most mission-critical systems, applications, and industries.

1.売上高対前年同期比　Revenue YoY

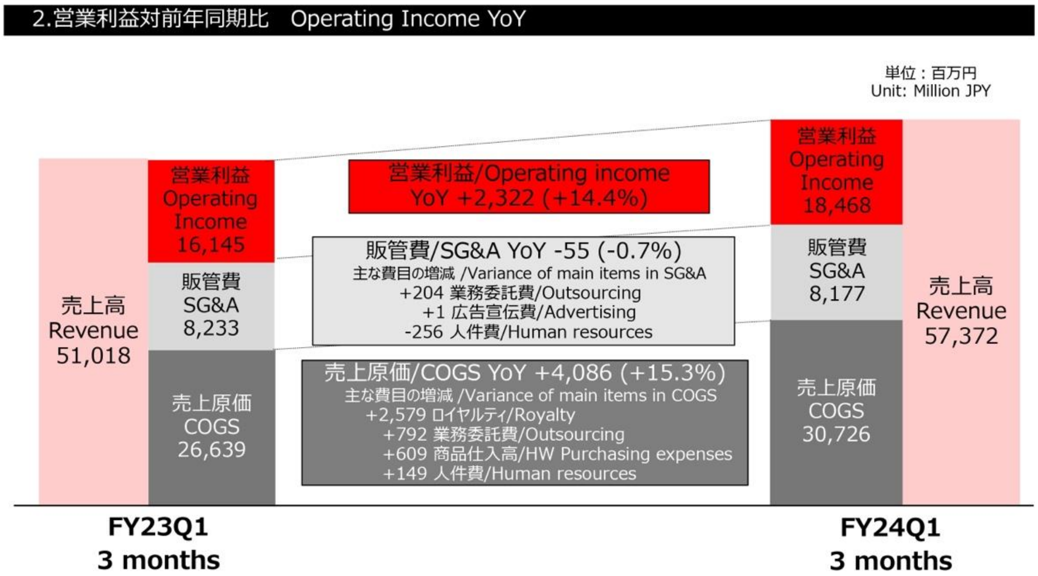


So let me now move on to the numbers. As you can see, we are very happy with our performance in Q1. Total revenue of JPY57,372 million growing at 12.5% compared to the previous year, driven by strong growth in our license and our cloud revenue.

Cloud services revenue was JPY12,742 million, up 37.4% and now represents almost 22% of the Company's total revenues.

Growth rates of Fusion ERP cloud and NetSuite were also very strong and in high double digits. Infrastructure consumption revenues also gave us strong momentum, which includes autonomous database.

Our remaining performance obligation is also growing very strongly. These RPO numbers show our strong backlog for the next couple of years in cloud services.



Operating income was JPY18,468 million, increasing 14.4% YoY. Net income, at JPY12,877 million, was up 13.7%.

Total revenue and all three margins indicated a record high in Q1. We are very pleased with our Q1 numbers, and we hope to continue the momentum into the year. Thank you very much.

Question & Answer

Nishio [M]: So, the first question is from Citigroup, Tsuruo-san.

Tsuruo [Q]: Looking at the breakdown of the cloud revenue, I have two questions. The first question is about Q1 being strong but Q2 being weak. If you could give us the background as to the seasonality of this revenue trend.

S. Krishna Kumar [A]*: I think, as we grow our cloud revenues, some of these seasonalities will normalize in the future. As I look into my forecast for the year, I see cloud revenues growing very consistently across. In the past, there may have been some lumpy quarters. But the very nature of cloud revenue, unlike license, which can be extremely lumpy, as you know, the very nature of the cloud business is different. You basically book a contract and then the customer consumes and then you get revenue when the customer makes consumption. We don't get revenue when we book contracts. So, by their very nature, cloud revenues will over time become consistent as our contract book continues to grow and expand.

Nishio [M]: The second question from Tsuruo-san is about the revenue growth rate of cloud.

Tsuruo [Q]: Recently, it seems to be very successful. Also, if you could explain to me how sustainable it is and your expectation of the growth rates throughout the year.

S. Krishna Kumar [A]*: Well, I think here's how I'll answer this question. I have been telling you people on this call that we see a lot of traction, both for our infrastructure and our SaaS business. I have just recently seen some market data and Oracle is by far the leader for NetSuite and for Oracle Fusion ERP cloud in the Japanese market by a large distance. We are leaders by a large distance.

On the infrastructure side, we have signed some VR, you know, the NRI contract. It's a very key sort of contract for us in terms of us demonstrating that we can really manage large mission-critical systems on our cloud. We also have a lot more in the pipeline in the next few quarters. So, I have absolutely no doubt in my mind that we will continue to produce stellar performance on the cloud. And so we'll have to wait and watch.

I don't want to predict a number specifically for the year at this point in time. A lot of things are moving parts. Some of the bookings, if they get even delayed by a quarter, we miss consumption. If we miss consumption, we can't make the revenue. So I don't want to make any guesses at this point. All I can leave you with is that there are a lot of interesting things are happening in the Japanese market and we are happy with the way our business is progressing.

Sorry if it was too long. I'm sorry.

Nishio [M]: The next question is from Chiba-san of JPMorgan.

Chiba [Q]: In all subsegments of cloud and license, this revenue is going up and it is accelerating. Were there any large deals or were there any deals that were brought forward? If there were any particular factors, please share those with us.

And what was the progress rate against your internal expectations? Is it pretty much in line with your internal forecast or are you seeing some upside?

S. Krishna Kumar [A]*: As I already said, we are happy with the way our business is progressing, the way the pipeline is [getting] up for the future. If you see the last few quarters, the license business is not decelerating.

It's actually growing. If I look at the last three or four quarters, our license business has actually grown very strongly. And you can see the momentum in Q1 as well because as people move more and more workloads to cloud, there will always be a question mark on whether we can sustain our license business or not. So far, we are not seeing that phenomenon. So I think, by the time we start seeing some weakness in license, we are hoping that our cloud business would be able to cover all of those shortcomings by the time our cloud business would be at a size which then can take care of any declines that we may see in the future in the license business.

So I think there's no specific large deal or anything that I can talk about. I think it was just good business overall across all industries and across all segments of the market.

Nishio [M]: The second question from Chiba-san is also in the area of, I believe, cloud and license.

Chiba [Q]: How about the pipeline from Q2 and onwards? If you compare with three months ago, do you feel any expansion or acceleration?

S. Krishna Kumar [A]*: I think I actually answered this question already, but I'll just repeat it. As I said, we feel very good about our business going forward into the fiscal year. We have lined up some really key transactions over the next nine months or so which we hope to book. And as I said, in cloud, bookings do not necessarily mean revenue in the same quarter or even in the same fiscal year. Booking means a customer is committed to consume our services and then, when he consumes, we take revenue. So in that sense, our revenue trends will become more linear as we go into the future. Our reliance on license may come down, a bulk of the revenue will come from very predictable contracts, whether it's a support contract or it's a cloud contract. So we should be able to bring in consistent performance every quarter as we move forward.

So, yes, we are happy with what we are seeing for the next nine months and beyond. We are happy with our product offering. Our infrastructure cloud runs the fastest and the cheapest in cloud. If you are fast, you're also cheap because you're paying for the amount of time it takes to compute. If it takes lesser time to compute, you automatically become cheaper. So, we're just extremely happy with our positioning.

Nishio [M]: The next question is from Segawa-san of Morgan Stanley Securities.

Segawa [Q]: The gross profit margin rate is coming down by 1.4 percentage points YoY. Please give me color to that. Please explain to me the background of it. Related to this, royalty rate against cloud and license revenue is going up, meaning that the cost ratio is increasing. Are they due to any changes in the product mix, or the offering mix, or are there any structural factors that are affecting this increase?

S. Krishna Kumar [A]*: On the gross profit, basically, I have always maintained that our gross margins will be somewhere in our early 30s, which is what we have done over the last few years. I do not anticipate a change in that assessment for the foreseeable future.

Regarding the royalty ratio, it keeps going sort of up and down slightly because of the sales product mix changes, as you've already pointed out. And that's what it is. So, we are not overly concerned about our profitability at this point in time.

Nishio [M]: Next, a second question from Segawa-san.

Segawa [Q]: RPO contract liability at the end of August, the growth has been high at a 24% YoY basis. At the very beginning of today's earnings call, you mentioned about several references, but were there any large-size deals or orders coming in from a specific customer in Q1? If you could share us some reasons why this contract liability was high in Q1, that would be helpful. Also, if you could give some information as to the inquiries or the approaches from potential customers in terms of industry or by segment verticals, that will be helpful.

S. Krishna Kumar [A]*: Well, I think the contract liabilities, as I already mentioned, it's seen a strong growth. Our RPO is seeing a strong growth. We are seeing multiple-year contracts—both for support and for cloud contracts—are increasing. So customers want to lock in for several years. Once they like the product, they're moving their mission-critical system, they want to lock in their price as well. So, we are seeing a tendency to lock in for several years into the future and then also expand on that. So, you have a workload today that you think that you're going to use for the next five years, so you lock it, you lock your price, you lock a contract for the next five years, and then you move on to the next workload. And then when you want to bring that in, you expand the contract. So, that's the phenomenon that we are seeing in the cloud.

We also saw some customers actually coming to us with requests for a multiple-year contract for our support business, which used to be primarily annual contracts. Now, we are seeing customers coming to us signing multiple-year contracts. So that's probably one of the reasons why the RPOs and the contract liabilities are going up.

The second question was on industry outlook, right?

Segawa [M]: Yes.

S. Krishna Kumar [A]*: Yes. So, I already gave you some names and you can see the breadth of the industries that are signing up. We see good demand from financial services. Financial services have always been very strong for Oracle, and so it continues to be strong in the cloud as well. We are seeing a lot of demand from manufacturing as well and services. I also talked about some telecom names in my opening remarks. So I think, overall, cloud is something that is going to grow across industries. Everybody will move to the cloud. Some will move slow; some will move fast. But I think people have understood, the customers have understood, enterprise customers in Japan especially now understood that there is a lot of value in moving their workloads to the cloud. We hope to capitalize on that.

Nishio [M]: The third question from Segawa-san is about the number of employees, about the hiring.

Segawa [Q]: As of the end of August, the number of employees was 3% down, minus 3%, on a YoY basis. Regarding the hiring and retaining of the employees, is it progressing according to plan? Do you have any struggles in retaining or hiring resources?

S. Krishna Kumar [A]*: I've said this a lot of times, Oracle as a company and Oracle Corporation Japan as a company, we want to run our business in the most efficient manner possible, so we continue to look at our businesses. We continue to invest in some businesses, reduce our expenses in some other businesses. So, this is an ongoing process.

You've seen that we pretty much remained flattish on headcount for the last several quarters. But on the other hand, our revenues have been growing. As we move more and more stuff to cloud, we hope to become more productive. Our existing resources, who are the top talent in the industry, I'm sure will become more and more productive, and we hope to increase and drive much higher revenues on a lower cost base. That's the whole objective that we have.

Nishio [M]: The next question is from Tanaka-san of Mitsubishi UFJ Morgan Stanley.

Tanaka [Q]: This is about on-premise license and hardware. Is it possible for this business to continue high growth going forward? Do you have a sufficient pipeline in place?

S. Krishna Kumar [A]*: I think we will take whatever comes our way. That's how I will talk about these two businesses.

Our focus is on moving our customers to cloud, and that is where our investment goes to. However, we are happy to take all the license orders and all the hardware orders, whatever comes our way. I don't think this business will be a high-growth business, but it should be very, very sustaining for us for the near future. We call this our sustaining businesses, and then we have a high-growth business in the nature of cloud. So if we put both of these businesses together, that's where you get higher growth rates for our revenues, going forward.

So, in terms of pipeline, is it enough? It is enough for whatever we are anticipating. We continue to work with our customers, both for on-premise. It's the same customer that uses our licenses on premise and on the cloud, so they choose where to deploy licenses. Sometimes, they put it on cloud; sometimes, they put it on premise. So, as I said, we will continue to see sustaining businesses in these two lines.

License will always be lumpy. Some quarters will be really good, some quarters will not be so good, but we'll continue to see strong growth rates on the cloud business consistently.

Nishio [M]: The next question is from Kikuchi-san of SMBC Nikko.

Kikuchi [Q]: There are some overlapping questions. The one that has not been answered yet is about outsourcing expense. There has been an increase. Could you tell me the breakdown of this outsourcing fee and also the outlook going forward?

S. Krishna Kumar [A]*: Basically, our outsourcing expense consists of a lot of different items, especially the resources and the data center, the usage that we do for which the Oracle Corporation charges us money. There is a mechanism, there is a global process, which is used to charge every country, not only Japan, but every country that uses data center. They get charged for usage of the data center. The more we use, the more it will increase. So, if cloud revenue is going up, then part of the outsourcing expense will also go up. It's like you have to look at it almost like the cost of goods sold. Some of the outsourcing expenses are like cost of goods sold. So, the more you consume in the cloud, the higher that particular portion of the gross charge will be, and that's not something that we can control.

So, globally, energy prices go up, electricity prices go up, obviously, cost of data center will go up. If the Japanese yen depreciates further, I may see the expense may go up. On the other hand, if the Japanese yen appreciates against the US dollar, I may get some benefit on the outsourcing expense. So, it's very difficult to predict this. But to make a long story short, it is primarily related to our usage in our cloud services.

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