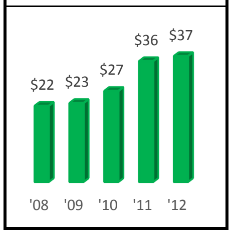
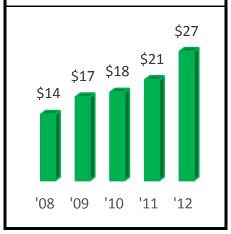
Oracle Corporation
June 21, 2013

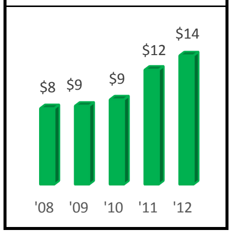
General Overview

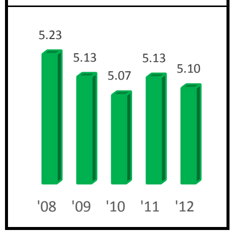
Oracle (ORCL) is the world's largest provider of enterprise software solutions for many of the world's largest corporations. The company sell's software for database management, middleware, and applications. The application software provides solutions for human resource management, customer relationships management, financial management and governance, procurement, project portfolio management, supply chain management, and more. ORCL's solutions help to streamline operations for more than 98% of all Fortune 500 companies.

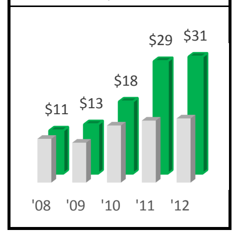
Revenue	Gross Profit	Owner Earnings	Share Count	Balance Sheet
$37,121,000,000	$27,224,000,000	$14,347,872,000	2008 Shares = 5.29B	Cash = $30 Billion
5-Year CAGR = 13.4%	5-Year CAGR = 18.5%	5-Year CAGR = 14.8%	2012 Shares = 5.1B	Debt = $16 Billion











Purchase Logic

ORCL is one of the world's largest software companies with more than 390,000 customers – including all 100 of the Fortune 100. The company's enterprise software is deeply ingrained in the business processes of their clients creating very stable recurring revenue with retention rates approaching 100%. We purchased ORCL after a 10% drop in price following a 'poor' earnings result for the second quarter of 2013. During this quarter the company posted record revenues, record profits, and repurchased a large portion of stock, but Wall Street was not impressed. Analysts were anticipating growth rates in excess of what was achieved and we were able to buy an outstanding business at a fair price. We bought our stake in ORCL at roughly 14x forward looking earnings.

Key Metrics

The key metrics for Oracle are Revenue, Gross Profit, Owner Earnings, Share Count, and the Balance Sheet. The business factors that drive each metric are describe in detail below.

<u>Revenue</u>

The company derives revenue from three operating divisions: 1) Software and Cloud, 2) Hardware Systems and 3) Services. Software and cloud revenue is generated by selling products that help enterprises with functions such as customer relationships management (CRM), customer service, financial reporting, project management, human capital and talent management, and others. The software and cloud division accounts for 76% of all revenue. These software solutions automatically perform complex functions, such as project management or customer relationships, and in turn reduces the overall expenses for ORCL's customer base. Hardware systems and Services account for the remaining 24% and are lower margin than the software business, but are an essential part of the sales process. In 2012 ORCL generated more than $37 billion in revenue.

<u>Gross Profit</u>

ORCL has outstanding pricing power which is reflected in the gross profits of the business. Once the company installs a software application for a customer it is extremely expensive for that customer to switch – which gives ORCL pricing power. In the last 10 years gross profits have increased every year without exception demonstrating the vital role ORCL plays in the enterprise world. The company's software is licensed on an annual basis creating strong recurring revenue. The gross margins on this software revenue are in excess of 90%. In 2012 ORCL posted $31 billion in gross profits.

Owner Earnings

Owner earnings are calculated by subtracting all other expenses from the gross profits of the business. These expenses include sales and marketing, general and administrative, research and development, and lease payments for office space. As a software company ORCL enjoys amazing operating leverage. As software is utilized across more clients the work required to provide services to these additional client's is minimal. In the last 10 years ORCL has increased owner earnings every year without exception.

Share Count

ORCL is a mature company and in recent years has been allocating a large portion of owner earnings to repurchasing shares. This share repurchase activity is exceedingly effective when the share price is low and increases our portion of the business quickly. For this reason we like ORCL as an investment at lower prices and expect the share count to decrease in the coming years at a faster rate than historically due to an increased allocation to repurchase activity and a lower price multiple.

Balance Sheet

ORCL has a rock solid balance sheet. The company has a diverse set of earnings from a variety of countries globally. These countries typically have lower income tax rates than the United States and for that reason profits earned internationally are left at the foreign locations to avoid paying US taxes. Instead of repatriating these funds to the US and paying a large tax bill ORCL invests international profits into US treasuries and borrows in the United States. This brings the money home without paying taxes. We fully anticipate ORCL to continue to earn large profits overseas and invest into US treasuries while simultaneous borrowing in US. As long as the cash flows from interest earned equal the cash flows on interest paid it is a very intelligent way to avoid taxation.

Historical Performance of Key Metrics

Year	'08	'09	'10	'11	'12
Total Revenue	$22,430,000,000	$23,252,000,000	$26,820,000,000	$35,622,000,000	$37,121,000,000
Gross Profit	$13,805,000,000	$17,449,000,000	$18,458,000,000	$21,056,000,000	$27,224,000,000
Owner Earnings	$8,260,560,000	$8,527,780,800	$9,211,910,400	$12,446,280,000	$14,347,872,000
Share Buybacks	$735,000,000	$3,212,000,000	$118,000,000	-$216,000,000	$5,123,000,000
Share Count	5,229,000,000	5,130,000,000	5,073,000,000	5,128,000,000	5,095,000,000
Cash	$11,043,000,000	$12,624,000,000	$18,469,000,000	$28,848,000,000	$30,676,000,000
Debt	$11,236,000,000	$10,238,000,000	$14,655,000,000	$15,922,000,000	$16,474,000,000

Revenue

Revenue has compounded at an annual growth rate of 13.4% for the last 5 years setting a new record in each consecutive year. We fully anticipate revenue to continue climbing in one direction due to the highly sticky nature of ORCL's software solutions. However, the shift to cloud compounding will reduce the number of perpetual license deals sold which could impact the growth rate of future business in the upcoming years. We anticipate growth between 2% and 12% in any given year with a 5 year average of 6%.

Gross Profit

In the last 5 years gross profit has compounded at a rate of 18.5% - slightly faster than revenue. The rapid growth in gross profit can largely be attributed to the operating leverage inherent in ORCL's business model. As the number of companies utilizing ORCL's software products continues to grow the commensurate work associated with these additional customer is less than the contribution to revenue. It is our expectation that gross profits will grow roughly in line with revenue for the next 5 years. The reason we anticipate in-line growth, rather than continued gross margin expansion, is the nature of ORCL's product mix moving forward. As ORCL sells more SaaS products upfront license fees will drop and the majority of earnings will come from lower margin recurring subscription revenue.

Owner Earnings

Owner earnings has compounded at an annual rate of 14.8% during the last 5 years. We anticipate the overall earnings of the business to compound in line with revenue and gross profits, but anticipate earnings per share to outpace overall business growth.

Share Count

The share count has declined from 5.29 billion shares in 2008 to 5.1 billion shares in 2012. ORCL has matured as a business and has been allocating an increasing percentage of earnings to share repurchases. When the price of ORCL stock is low these share repurchases are extremely effective and greatly accelerate the growth in earnings per share. We anticipate ORCL to allocate roughly 33% of all earnings to share repurchases moving forward and the share count to rapidly decrease as additional funds are allocated to this activity.

Balance Sheet

ORCL currently has an 'essentially' debt free balance sheet. The company has $30 billion in cash held overseas and $16 billion in debt. The cash held overseas is invested in US treasuries and investment grade corporate bonds. The interest received on these investments roughly offsets the interest payments required on the $16 billion in borrowings. This system allows ORCL to earn cash in foreign countries where taxes are lower and borrow money in the US to access these profits domestically without paying US corporate tax rates. We expect ORCL to maintain this practice until the US declares a 'tax holiday' on foreign funds held.

Summary of Key Metrics

Metric	**Expectations**
Revenue	Growth ranging from 2% to 12% per year Average of 6% over 10 years
Gross Profit	Growth proportional to Revenue
Owner Earnings	Growth proportional to Revenue
Share Count	33% of all profits allocated to share repurchases Repurchase approximately 3% of the business per year
Balance Sheet	Profits earned overseas will not be repatriated Borrowings in the US equal to interest earned on foreign cash

The Moat Around The Metrics

There are two primary moats that help protect ORCL's profitability long into the future: High Switching Costs and Economies of Scale.

High Switching Costs

The software programs designed by ORCL are deeply imbedded in the work flow of the enterprise clients that ORCL services. These programs are utilized by thousands of employees across the organization and have been an integral part of the business workflow for years. The data entered into ORCL's databases and software applications would be expensive to migrate to a new software system. In addition to these data migration costs the time and energy required to educate the workforce on how to use the new system would be even more expensive and employees in general are very resistant to change. These challenges make ORCL's products extremely sticky and the company typically retains clients at a rate of nearly 100%.

Economies of Scale

As a software provider ORCL benefits greatly from economies of scale. As the company allocates resources to R&D the enhancements to existing products benefit all customers. Due to the large customer base ORCL was able to spend more than $4.5 billion in R&D in 2012. This R&D spend is leverage across thousands of client accounts allowing ORCL to perform a tremendous volume of work on the company's software products at very little incremental cost to a single customer. This economy of scale is very difficult for smaller companies to compete against.

Risks

ORCL is one of the most stable and reliable businesses in the world. As owners of ORCL we've assumed very little risk, but the potential hazards as business owners for the short-term and long-term are described below.

Short-Term Risks

- SaaS. SaaS presents a short term risk for ORCL in the form of revenue and margin pressure. Historically software companies sold perpetual licenses to new customers and received large cash payments upfront and then 'maintenance' revenue annually as recurring revenue. This model made software businesses, like ORCL, cash rich. The industry has been shifting to Software-as-a-Service models where clients pay a subscription. This removes the large cash payments upfront traditionally paid to software vendors. We believe this will put short-term pressure on ORCL's business model, but in the long term the healthy recurring revenue streams will remain intact.
  - Low Risk
- Cloud computing. Cloud computing shifts datacenter capacity from on premise (where the client actually owns a dedicated datacenter) to off-site. This helps increase capacity factors for hardware components and reduces the capital required for the industry globally due to increased efficiencies in the resources. However, this also will temporarily reduce the growth in ORCL's datacenter products, such as hardware, until the excess global capacity is consumed.
  - Low Risk
- Acquisitions. In the past ORCL has been an extremely acquisitive company – purchasing smaller competitors rapidly. There is the potential that the quality and price paid for acquisitions could deteriorate and the capital allocated to this activity provide a poor return.
  - Moderate Risk

Long-Term Risks

- Complacency. The biggest risk for ORCL is the same risk faced by all large and dominant enterprises – complacency. If ORCL remains focused on providing high quality software solutions to help streamline client processes and maintains a world class R&D program the company will continue to earn outstanding profits long into the future. In the event the company becomes complacent the decline in market share and profits would be very gradual, but we would be inclined to sell our position if changes are not made to reinvigorate a commitment to excellence.
    - Low Risk

Conclusion

ORCL is one of the world's largest software companies with more than 390,000 customers – including all 100 of the Fortune 100. The company's enterprise software is deeply ingrained in the business processes of their clients creating very stable recurring revenue with retention rates close to 100%. The key metrics for ORCL are Revenue, Gross Profit, Owner Earnings, Share Count, and the Balance Sheet. We expect ORCL to continue growing at a rate of 2% to 12% per year with a 5 year average of 6%. During this time frame our expectation is that ORCL will allocate roughly 33% of earnings (or more) to share repurchases reducing the share count by approximately 3% per year. We bought our stake in ORCL at roughly 14x forward looking earnings which compares favorably to the average price of 15x earnings for an S&P 500 constituent.

Works Cited

1) *ORCL Annual Report - SEC Filing 10-K.* EDGAR, 2012.

Disclaimer

No part of this document is to be reproduced without our written permission. This document has been prepared and issued by Selective Wealth Management (“SWM”) on the basis of publicly available information, internally developed data and other sources believed to be reliable. The information contained herein is not guaranteed, does not claim to be comprehensive and is strictly for informational purposes only. SWM does not assume any liability for any direct, indirect or consequential loss that may result from the reliance by any person upon any such information or opinions. Any expressions of opinions are subject to change without notice. This document does not constitute an offer or an invitation to trade or invest. No party should treat any of the contents herein as advice. Investing contains risks.