The Raise of the Oracle – Oracle to Buy NetSuite for $9.3bn

Oracle Corporation (ORCL) - market cap as of 18/11/2016: $165.25bn
NetSuite Inc. (N) - market cap as of 18/11/2016: $7.36bn

Introduction

On July 28, 2016, Oracle Corporation announced that it entered into an agreement to purchase NetSuite, in a transaction valued at approximately $9.3bn. The deal values NetSuite at $109 per share, which represents a 19% premium to where the stock traded the previous day. The acquisition was officially completed on November 7, 2016.

About Oracle Corporation

Oracle Corporation is a multinational computer technology firm, based in California. The firm delivers various cloud applications and platform services to more than 420,000 customers in 145 countries. Research reports state that Oracle was the second-largest software maker by revenue in 2015, following Microsoft Corporation.

Oracle has historically been very active in terms of M&A activity. In May, the company purchased the cloud-based software company Opower for $532m. Opower provides a comprehensive spectrum of services that target mostly the utility industry and has a geographical reach that includes 9 different countries. Additionally, Oracle paid $663m for Textura Corporation, a leading provider of construction contracts and payment management cloud services.

With its 135.000 employees, Oracle generated $37bn of revenue in 2016. Moreover, the firm is a leader in CSR (corporate social responsibility), supporting 3.1 million students annually and minimizing its environmental impact.

About NetSuite

NetSuite was founded in 1998 by Evan Goldberg and is often regarded as the first cloud computing company. The firm currently offers cloud-based enterprise resource planning (ERP), customer relationship management (CRM), as well as Omni-Channel commerce software.

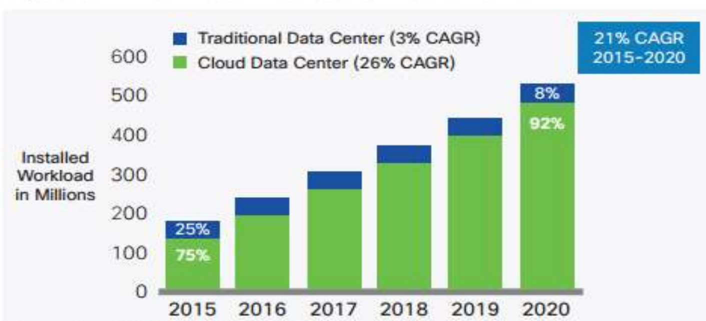
NetSuite has 30,000 customers, mainly small and medium-sized companies, in more than 100 countries. Approximately one quarter of its employees are based in a Philippine office, while additional offices are located in Denver, Las Vegas, Austin and Chicago. Over the past years, the firm received more than 80 awards from industry groups for its products and innovation.

NetSuite generated a total revenue of $243.9m for the third quarter of 2016. This value represents a 26% increase over the same period in the previous year. Revenue from subscription and support accounted for $190m, while professional services for $53.9m.

Industry overview – Cloud Computing

Despite a certain degree of uncertainty persisting around the cloud and its applications, the last couple of years have been characterized by bullish forecasts regarding the global adoption of this new technology. The market of cloud services is expecting to grow at a fast pace, with Forrester, a research firm, projecting

Figure 9. Workload Distribution: 2015-2020

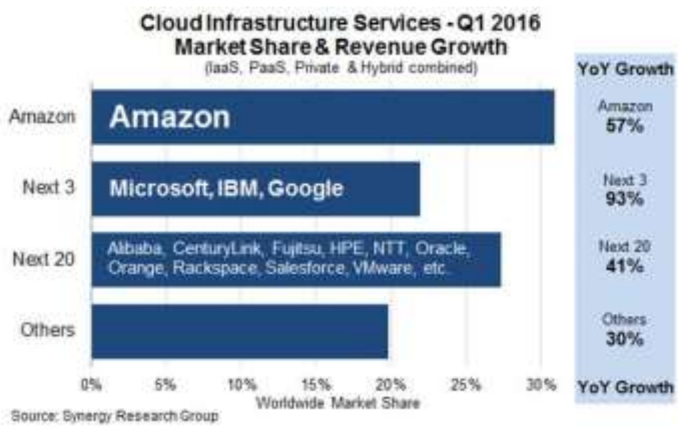


Source: Cisco Global Cloud Index, 2015-2020.

that the amount of money invested by businesses for cloud computing activities will almost triple from 2014 level to $191bn.

Figure 13. SaaS Most Highly Deployed Global Cloud Service from 2015 to 2020

It is common to divide the sector, according to the type of service models, into the following different sub-areas: (i) Software as a Service (SaaS), (ii) Platform as a Service (PaaS), (iii) Infrastructure as a Service (IaaS).
Nowadays, SaaS, which consists of software applications delivered over the internet (e.g. email and cloud storage), represents the bulk of the whole cloud computing and, furthermore, it is the cloud model expected to deliver the steepest rise.



Globally, the major players are American companies. The list includes: Salesforce.com – the largest pure cloud software Company – Microsoft, Amazon and Oracle. Moreover, other strong competitors are Japan's Fujitsu and German SAP.

Given the overall environment depicted above, it should come as no surprise that many players are trying to position themselves with the purpose of seizing the future expected opportunities that might very well arise within the field. None of us should be surprised if, as the security issues related to these services vanish, more companies begin to move from on-premises (requiring traditional privately controlled data centres) to cloud-based solutions. One likely path would see major companies making strategic acquisitions to strengthen their position.

Deal Structure

On July 28, 2016, Oracle announced the merger with NetSuite for $109 per share, implying an equity value of $8.6bn and a total EV of $9.3bn. The deal is expected to be immediately accretive to Oracle's earnings in the full fiscal year after closing.

The purchase price is 10.2x NetSuite's revenues, a slightly higher multiple than 9.7x - the average multiple paid in comparable deals: Salesforce–Demandware and Microsoft–LinkedIn (you can read about Microsoft-LinkedIn here).
Even though the deal might look pricy, it's important to notice the limited number of cloud related comparable transactions available

Buyer	Target	EV/T12 Revenues
Oracle	NetSuite	10.2
Salesforce	Demandware	11.8
Microsoft	Linkedin	7.5
Average		9.7

Source: Market Realist

The all-cash transaction has faced a fierce opposition by NetSuite's largest institutional shareholder, T. Rowe Price Group. The investment management firm, that used to hold 17.7% of NetSuite, pointed out conflicts of interests (Larry Ellison - Oracle's Executive Chairman - and his family already owned 39.5% of NetSuite) and asked for a price of $133 per share. This opposition delayed the tender offer, but did not stop it, nor alter its features: indeed, on November 7, 2016, the deal officially closed at $109 per share.

Deal Rationale

The NetSuite deal follows a wave of acquisitions of other cloud software companies. Rivals Microsoft and Amazon (which alone hold 31% of the market) have already built significant and profitable operations around cloud computing and much of the deal-making in the sector has been driven by them.

For Oracle, the deal came at a crucial time. Though expanding fast, Oracle is still lagging behind in the cloud market. Thus, in order to grow competitive, acquiring NetSuite is a strategic imperative for Oracle. Its cloud-computing business will benefit by expected $1bn revenues annually and will give the whole corporation a chance to offset the decline in its traditional software business. Indeed, looking at Q4 2016 data, we notice that Oracle's cloud revenues rose by 68%, while its hardware revenues fell by 7% and its software license revenues fell by 2%.

Moreover, there are evident complementarities between the two firms. While Oracle's offerings are aimed mainly at large businesses and governments, NetSuite's focus is on small and medium-sized businesses. Thus, the merger represents the opportunity for Oracle to make inroads with smaller corporate customers. NetSuite, on the other hand, can leverage Oracle's global scale and reach to accelerate its pace of innovation.

Finally, having recently announced a $14bn bond sale and holding cash reserves for $56bn, Oracle has no problem in financing its acquisitions, which are also a way to put into good use the huge sums of money parked (mostly) outside the US.

Market Reaction

Following the announcement on July 28, 2016, NetSuite shares jumped 18% to $108.41 (close to the offer price of $109) and Oracle shares rose by 0.6% to $41.19. As of November 19, 2016, Oracle trades at $39.86.

Advisers

Moelis & Co acted as financial advisor for Oracle.