IaaS moves into the spotlight as Oracle continues cloud growth

Oracle beats 3Q FY17 earnings estimates, growing cloud revenues across all three pillars
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Ovum view

Summary

Oracle announced its 3Q FY17 results on March 15, 2017, with the key metric of SaaS plus PaaS revenue up 74% (in constant currency) from the previous year at $1.0bn. IaaS revenue, an area in which Oracle is ramping up its presence through a global network of second-generation data centers, was up 19% in constant currency at $178m. Total revenues were up 3% (in constant currency) at $9.2bn. In an executive briefing for Ovum following its earnings announcement, Oracle chief executive Mark Hurd highlighted that the company is now on a $5.0bn annual run-rate for non-GAAP cloud revenue, and is seeing overall growth in both its application and database businesses.

Oracle's cloud journey reaches an inflection point

As enterprise cloud adoption gathers momentum, one would expect to see strong growth in cloud business from the leading vendors, and this is indeed what Oracle and its peers are demonstrating. However, the more important metric in analyzing the transition is whether this cloud growth is offsetting the decline in on-premise software license revenues. It should be noted that the shift towards cloud business is not a simple one-for-one replacement, since the license and cloud models are different, meaning that one needs to dig deeper into the headline figures to gain insight. One way of doing this is to look at the total value of cloud revenue plus new software license revenue.

In its fiscal third quarter, Oracle’s SaaS and PaaS revenue – combined with new software license business – grew 11% in constant currency on a non-GAAP basis. Furthermore, its total database business – again combining cloud-based database-as-a-service (DBaaS), new software licenses, and support – grew for the third consecutive quarter. Ovum believes that this represents an inflection point in Oracle’s transition from on-premise to cloud revenues, and that this momentum will accelerate further in succeeding quarters. The company has shown impressive growth in SaaS over the past couple of years, with pillars including customer experience, HCM, and ERP starting to move to the cloud, and managing to attract many net new customers, as well as converting the existing application customer base.

The company’s database business is arguably an even-more important indicator of enterprise cloud migration: as customers gain familiarity and confidence in using the cloud, they are now starting to migrate existing workloads to run on cloud platforms. The first step is often to move dev/test environments, but this is increasingly extending to production workloads, as enterprises get a better understanding of which workloads are suitable, and of the potential cost-benefit equation. For Oracle, this move should translate into DBaaS business for the database tier, and IaaS business for the infrastructure tier.

IaaS is the next frontier for Oracle

Over the past two years, Oracle has signaled its intent to be a scale provider of IaaS, building up its global data center network, making significant executive and technology hires from its rivals, and launching a range of compute and storage services. In 2016, having already prepared the groundwork, the company announced its new Bare Metal Cloud Services, which is based on a
second-generation data center architecture, and aims to leapfrog the competition in terms of performance.

Oracle's Bare Metal Cloud Services are designed and deployed with at least three fault-independent availability domains in each region, with a low-latency, high-bandwidth network interconnect, enabling a range of high availability application architectures. Resources are virtualized and provisioned at the network layer, enabling on-demand bare metal compute instances, which offer extremely high peak and predictable performance to the tune of millions of IOPS per instance, supporting intensive workloads such as transactional databases, big data frameworks, and machine learning. Network virtualization also gives customers the maximum flexibility over the stack they use, and allows for a zero-trust relationship between the customer and the provider, and between the host and the network. Finally, every workload runs in a private overlay network, which isolates workloads from each other and increases security.

One early adopter of Oracle Bare Metal Cloud Services is UK-based YellowDog, which provides 3D rendering services to film and design studios. YellowDog is continually evaluating cloud infrastructure vendors for new and differentiated options to make available to their users as a part of normal business operations. When the company completed its evaluation, it found that Oracle Bare Metal Cloud Services were at least twice, and sometime up to 10 times as efficient as its existing providers for 3D rendering tasks. For YellowDog, this translates directly into increased price/performance, with additional benefits from a global data center network, security, and high availability.

The rollout of second-generation data center architecture is a work in progress for Oracle, beginning in the US, and Ovum expects to see announcements of new IaaS services in EMEA during Oracle's fiscal fourth quarter (ending May 31, 2017). With the availability of the second-generation IaaS services, Oracle can now run its customers' largest database and application workloads in its cloud, which will accelerate adoption. In support of this on the recent earnings call, Oracle revealed an increasing attach rate between its IaaS and PaaS services, and gave guidance of IaaS growth for the following quarter in the range of 25–29% in constant currency. Most notably, Oracle's chairman and CTO, Larry Ellison, predicted that IaaS would eventually become the largest pillar in Oracle's cloud business.

**NetSuite strengthens Oracle's mid-market proposition**

Fiscal-3Q17 was the first full quarter since Oracle completed its acquisition of NetSuite, and while its numbers were not broken out separately during the earnings call, Oracle CEO Mark Hurd stated that bookings growth for NetSuite during the quarter had exceeded that of the acquired company's last reported quarter prior to the acquisition. Oracle now has more than 13,000 active customers in its SaaS base, and the addition of NetSuite nearly doubles this figure to approximately 25,000.

Oracle's strategy for NetSuite is to continue its focus on the lower mid-market, particularly in verticals where it has been traditionally strong (such as manufacturing, wholesale distribution, retail, software, and services), and in new microverticals including apparel, footwear, and accessories, advertising agencies, and campus bookstores. The key opportunity for growth will be to internationalize the NetSuite business – both in terms of localization for new markets, and through expanding its reach and distribution network outside of North America. In the longer term, Oracle will augment the NetSuite products with its own capabilities in areas such as planning and HCM, but Ovum expects NetSuite to remain as a distinct product line for the foreseeable future.
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Oracle has significant headroom for cloud growth

Oracle is in the enviable position that it does not need to look far beyond its existing customer base for cloud growth. Across the broad product portfolio, there will be many on-ramps: customers wanting to modernize their existing enterprise applications using SaaS; those building new solutions in the cloud using PaaS services such as database-, analytics-, or integration-as-a-service; and enterprises looking to move existing Oracle workloads to IaaS (whether in public or private cloud). Oracle's commentary on its earnings call highlighted that there are increasing attach rates between these different cloud domains and, therefore, Ovum expects to see both an acceleration in customers adopting cloud services and an increase in the average contract value.

Ovum advises Oracle's enterprise customers who have not yet done so, to test out a range of the company's cloud services, to build up their knowledge in this domain. There is a rich range of PaaS services that are suitable for proof-of-concept projects, and as Oracle rolls out its next-generation IaaS services, we recommend evaluating price/performance against other leading cloud providers. Oracle has invested heavily in its cloud partner program, which alongside the major systems integrators and consultancies includes specialist cloud-native companies who can be a good choice to advise enterprises on cloud architectures and strategies.

Appendix

Further reading

"Oracle's ownership of NetSuite will shake up SME beyond the US," IT0020-000252 (March 2017)

"Bare metal becomes a key part of the Oracle IaaS cloud story," IT0014-003222 (January 2017)

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