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### PM Ad-hoc Market Commentary — Thoughts on Oracle's massive AI claims

Oracle, a mega-cap stock that is not owned in the BlueBox Global Technology Fund, yesterday rose 36%. This is a massive move for a company that already had a market cap of well over \$600bn, and it was enough to push Larry Ellison (Oracle's co-founder and Chairman) ahead of Elon Musk as the world's richest man ... at least briefly. The cause of this huge move was of course the company's report for the August quarter, which was released the evening before, after the US close.

The quarter wasn't actually as good as hoped: Oracle missed expectations for revenue (\$14.93bn vs \$15.03bn Bloomberg consensus) and both adjusted and GAAP EPS (\$1.47 vs \$1.48 and \$1.01 vs \$1.04 respectively). Even though revenue was up 12% in comparison to the year-ago quarter, GAAP EPS fell 2%. In an IT sector growing around 15% p.a., this was not particularly impressive, especially as Oracle and Mr Ellison have been touting themselves as the big new winner of the generative AI industry, which is growing far faster than the IT sector as a whole.

But no one paid any attention to the missed quarter, because Oracle claimed a truly staggering figure for its RPO: \$455bn, up more than \$300bn since last quarter. RPO stands for "remaining performance obligation", and is the sum of backlog and deferred revenue – in other words the revenue that its customers have contractually committed to pay, but which has not yet been recognised as revenue because the associated product/service has not yet been provided to the customer. This is a fairly poorly-defined figure: how far ahead are we talking, and how committed is the customer? Also, and this is an important one, who are the customers "committing" to paying Oracle almost half a trillion dollars (more than 1.5% of US annual GDP) at some point in the future, and will they be able to pay?

Oracle tells us that it signed 4 huge deals with 3 customers, one of whom appears to be OpenAI committing to \$30bn p.a. for an undefined period. Stargate is also widely mentioned, but as it is a JV between Oracle, OpenAI, Softbank and others, it may be that this is the same deal. So let's just think about OpenAI committing \$30bn a year. Why would Oracle have got this deal and can OpenAI come up with the money?

Up until now, OpenAI's main funder has been Microsoft, largely in the form of billions of dollars of free computing credit, so that OpenAI can train its massive LLMs (large language models) in Microsoft's data centres. Microsoft might not have had to hand over cash to OpenAI under this agreement, but it did have to make vast investments to service it: capex rose to \$65bn in FY25, up 170% in three years. Fortunately Microsoft is hugely cash-positive, so can fund this investment from operating cash flow and still have \$72bn of annual free cash flow left over.

In contrast, Oracle had negative FCF of \$5.9bn for the last four quarters, after it spent \$27.4bn on capex. In order to fund this investment and pay its dividend, the company took on an additional \$6.7bn of debt and raised \$1.0bn of fresh equity. So Oracle is already borrowing to invest in data centre capacity, while Microsoft is funding it out of operating cash flow – the money is sitting there anyway, looking for a productive use.

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Oracle claims to have a superior genAI architecture, with one AI processor able to read the memory of another directly, speeding up processing. This may well be correct – even if engineers will, I suspect, argue over this – but I doubt that this is enough to overcome Microsoft’s pre-existing relationship and far more abundant funding to win this massive deal. I suspect that Microsoft is beginning to have doubts as to whether OpenAI can actually pay.

OpenAI is a private company ... but not very private: it has had multiple funding rounds, at ever-higher implied valuations, and in order to attract that money and rising valuation, management has had to give hints publicly as to its success. As far as I can see, OpenAI’s most recent claim has been that it achieved a “revenue run rate” of \$12.6bn. Like RPO, revenue run rate is a pretty fuzzy concept: does it relate to a single day’s revenue x 365, or last month x 12, or 30 days to a carefully chosen day x 12? It probably completely ignores seasonality (do most students stop paying monthly subscriptions at the end of June and then restart in October?) Anyway, the implication is that the company is earning something like \$12bn annual revenue at present. Not profit. Not operating cash flow. Revenue. It is losing money at an extraordinary rate, hence the massive funding rounds.

And yet, somehow this company is promising \$30bn a year to Oracle, for multiple years? Apparently it’s okay, as revenue is going to be \$150bn a year in a few years. Now, I’m not saying it won’t be \$150bn, or even bigger, but we simply don’t know ... and OpenAI doesn’t know and Oracle and Microsoft don’t know either. And yet this company is committing to 238% of its current annual revenue run rate multiple years out? How long will investors be prepared to pour in billions of dollars to support even OpenAI’s current losses, let alone to pay for this “commitment”?

This seems to me to be the equivalent of an investment banking graduate trainee taking out a \$10 million mortgage, because “in 15 years I’ll be a private equity partner and can afford the repayments”. It might work out, ... but I’m not sure I’d stake my clients’ money on it!

It seems to me that either OpenAI or Oracle (or both) are being extremely loose with the concept of a “commitment”, making the RPO number pretty meaningless, except in the sense of “this is a huge opportunity, with luck, if we can pull it off”. But that proved good enough to distract investors from the missed quarter (low-double-digit revenue growth, declining earnings, in a technology bull market).

At present AI money is gushing in unimaginable torrents, and the main beneficiaries of this are not the firms investing it, or the companies spending it, or the ones building the data centres funded by it ... but the businesses that provide the vital components that make those data centres work: the technology enablers, our investments. I think this will probably end badly for OpenAI and its investors, and quite possibly also for Oracle, but not quite yet. In the meantime, the enablers are making and stashing real profits, as they will continue to do from whatever comes after generative AI.

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11 September 2025

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