

True Value

The Magical Thinking Behind Oracle's Valuation

Investors who drove up Oracle shares on its stunning cloud revenue projections are underappreciating risks and underlying costs.



Oracle chairman Larry Ellison. Photo via Getty

By Anita Ramaswamy

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For a company whose name refers to divine prophecies, Oracle hasn't done a very good job of predicting the future. Investors, though, appear to believe in the company's latest, most incredible forecast.

The database giant last week upped its forecast for future revenue it expects to generate, based on its current contracts, by a whopping \$317 billion. That's 359% higher than last quarter's projection. Executives attributed the boost to a set of new deals the company signed to rent cloud servers to AI firms. All told, the new contracts should help support Oracle's prediction that revenue from its cloud infrastructure business will be around \$144 billion in fiscal 2030, about 14 times bigger than in fiscal 2025.

The Takeaway

Oracle's cloud revenue forecast surged \$317 billion, driving valuation higher.

Oracle's new cloud revenue heavily depends on a risky OpenAI deal.

Cloud expansion will erode Oracle's margins and demand huge capital outlays.

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Investors went bonkers, driving Oracle's valuation multiple on next year's expected revenue to nearly 14 times—higher than Microsoft for the first time in 8 years.

But Oracle investors are taking serious risks, most obviously that much of the future contracted revenue is coming from a deal with OpenAI, according to The Wall Street Journal. Oracle's new deluxe valuation suggests investors are underappreciating the risk that stems from OpenAI's huge expected losses over the next several years, and overlooking the signs that Oracle's cloud infrastructure push more broadly could prove costlier than it's worth.

OpenAI is expected to pay tens of billions of dollars a year to Oracle for computing power. "That's a lot of money for a company that isn't making money right now," said Joe Tigay, a portfolio manager at Equity Armor Investments whose fund holds Oracle shares.

While Tigay acknowledges that OpenAI's prospects pose a "legitimate concern" for Oracle investors, he says his fund is holding onto the Oracle position it has held for about five years. If the OpenAI deal "backfires in five years, it's not going to be a problem," Tigay said, because he believes there will be demand from other customers for the infrastructure Oracle builds.

Tigay admits that such a bet hinges at least partly on trust he's placing in Oracle. Yet the company has fallen short of its own expectations many times before, including missing its projection for cloud revenue for its 2025 fiscal year, which ended in May. In December, Oracle CEO Safra Catz said that number would top \$25 billion, but it came in at \$24.4 billion.



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The miss is especially notable because Oracle's forecast of strong future growth comes from its cloud business, which involves developing and renting out data centers laden with AI chips to companies for model training. That business is far outpacing the company's core database software business, which has stagnated.

Margin Risk

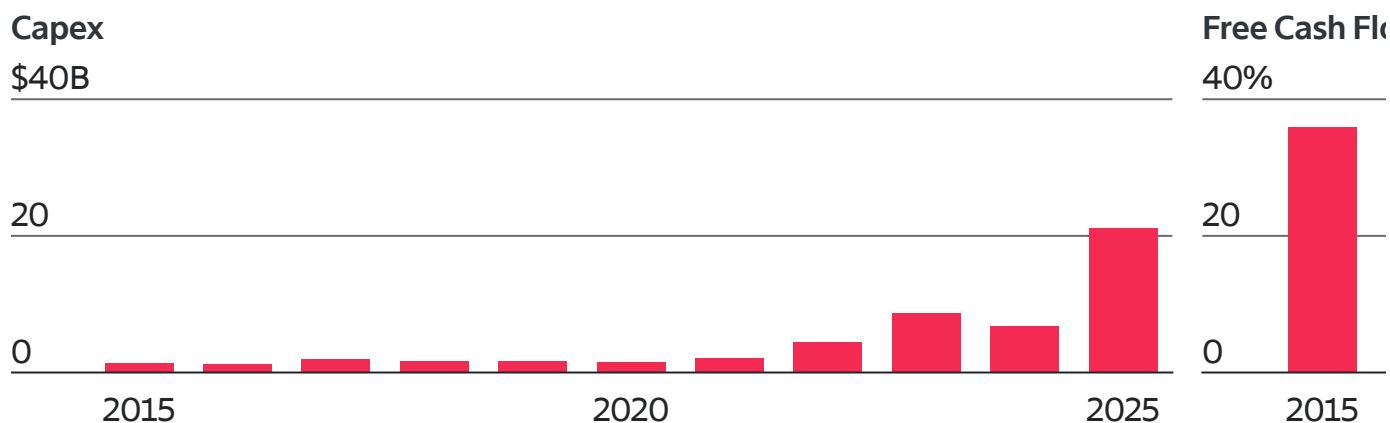
Oracle's cloud infrastructure unit makes up just shy of a fifth of the company's revenue today. The company's latest revenue forecast suggests that in 2030, that business will comprise close to three-fourths of the overall sales expected by analysts polled by S&P Global Market Intelligence.

As Oracle grows that business, which is fundamentally lower-margin than selling software because it is more capital-intensive, the expansion will likely erode Oracle's profitability, said UBS analyst Karl Keirstead, who added that a similar trend unfolded at Microsoft as it underwent its own cloud expansion.

Big Spender



Oracle's heavy spending on capex to fund its cloud computing push has turned its free cash flow margin negative for the first time in a decade.



Note: Years are fiscal
Source: Company filings

Today, Oracle's overall gross profit margin is around 70%. While Oracle hasn't disclosed details around the margin on new revenue it is getting from renting out compute capacity to AI customers, investors estimate it is probably closer to 30%, said Keirstead. Wall Street analysts are also projecting a decline in the company's operating margin, which they reckon will drop from around 43% today to 39% in four years.

Building up its server rental offering will be expensive, but to some extent it's essential, if Oracle is to deliver on its newly-linked contracts. As Charles Fitzgerald, an angel investor and former Microsoft executive, puts it, "if you don't have the capex, you don't have the data centers, you don't have the servers, you don't have anything to sell."

That's probably why Oracle executives shared a new forecast for the company's capital expenditures in fiscal 2026 of \$35 billion, \$10 billion higher than the projection they had previously shared with investors in June.

Can Oracle Afford It?

The biggest question for investors is how Oracle can continue funding that accelerating capex spend. Already, Oracle's free cash flow in fiscal 2025 was negative for the first time in over a decade, as its executives doubled down on their cloud dreams. And despite the recent stock surge, Oracle might be reticent to issue more equity, considering it has been buying back its shares for years.

That leaves borrowing to fund the buildout, which will be tough. As it is, Oracle is on the hook for over \$110 billion in total debt, and it has only about \$10 billion in cash on hand. That's a much bigger shortfall than Microsoft, which as of June had about \$18 billion in net debt, and Alphabet, which has much more cash than debt on its books.

"We expect the costs to buy equipment and secure real estate and utilities will be enormous," Moody's analysts wrote in a report last week following Oracle's new projections. "Whether these will be financed through traditional debt, leases or highly engineered financing vehicles, the overall growth in balance sheet obligations will also be extremely large."

Oracle doesn't have as much experience building a cloud business as its larger peers, which means it might be less efficient at setting up new data centers. That might be getting reflected in the fact that for every dollar Oracle spent on capex last fiscal year, it generated about \$2.70 in revenue. Microsoft, which like Oracle sells software and has a sizable cloud computing business, generated \$4.36 and Alphabet generated \$6.66.

Oracle's spending will mostly go towards data center gear used to train AI models. That gear needs to be cutting edge and can become outdated quickly. That's surely why Oracle's chairman said it was "aggressively pursuing" customers who in the future could use the data centers for running AI models rather than training them.

There's a risk to that too, because running AI models is most effective when the data centers are close to the AI's users. Oracle doesn't have the broad footprint of bigger data center companies, meaning its customers may look elsewhere for computing power to run their models, Fitzgerald said.

Already, Oracle has been struggling to keep pace with the spending of its cloud computing peers. Its capex of \$21 billion last year looks puny relative to Google, Microsoft, and Amazon, each of which both spent more than twice as much.

Those companies, unlike Oracle, "have figured out how to consistently and efficiently turn dollars into data centers," Fitzgerald added.

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