ORACLE CORP
Form 10-Q
September 25, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

—

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended August 31, 2006

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission file number: 000-51788

—

Oracle Corporation

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**54-2185193** **(I.R.S. Employer Identification no.)**

500 Oracle Parkway

Redwood City, California 94065

(Address of principal executive offices, including zip code)

(650) 506-7000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

The number of shares of registrant s common stock outstanding as of September 19, 2006 was: 5,195,473,642.

Table of Contents

ORACLE CORPORATION

FORM 10-Q QUARTERLY REPORT

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ORACLE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

As of August 31, 2006 and May 31, 2006

(Unaudited)

(in millions, except per share data)	August 31, 2006	May 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,446	$ 6,659
Marketable securities	2,852	946
Trade receivables, net of allowances of $331 and $325	2,118	3,022
Other receivables	229	398
Deferred tax assets	725	714
Prepaid expenses and other current assets	321	235
Total current assets	11,691	11,974
Non-current assets:		
Property, net	1,437	1,391
Intangible assets, net	4,640	4,528
Goodwill	10,529	9,809
Other assets	551	1,327
Total non-current assets	17,157	17,055
Total assets	$ 28,848	$ 29,029
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	$ 166	$ 159
Accounts payable	223	268
Income taxes payable	859	810
Accrued compensation and related benefits	840	1,172
Accrued restructuring	198	412
Deferred revenues	3,269	2,830
Other current liabilities	1,143	1,279
Total current liabilities	6,698	6,930
Non-current liabilities:		
Notes payable and long-term debt, net of current portion	5,737	5,735
Deferred tax liabilities	573	564
Accrued restructuring	277	273
Deferred revenues	114	114
Minority interests	323	202
Other long-term liabilities	227	199
Total non-current liabilities	7,251	7,087

Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value authorized: 1.0 shares; outstanding: none		
Common stock, $0.01 par value and additional paid in capital authorized: 11,000 shares; outstanding: 5,185 shares at August 31, 2006 and 5,232 shares at May 31, 2006	9,362	9,246
Retained earnings	5,295	5,538
Deferred compensation		(30)
Accumulated other comprehensive income	242	258
Total stockholders equity	14,899	15,012
Total liabilities and stockholders equity	$ 28,848	$ 29,029

See notes to condensed consolidated financial statements.

1

Table of Contents

ORACLE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three Months Ended August 31, 2006 and 2005

(Unaudited)

(in millions, except per share data)	Three Months Ended August 31, 2006	Three Months Ended August 31, 2005
Revenues:		
New software licenses	$ 804	$ 629
Software license updates and product support	1,941	1,502
Software revenues	2,745	2,131
Services	846	637
Total revenues	3,591	2,768
Operating expenses:		
Sales and marketing	750	615
Software license updates and product support	200	161
Cost of services	780	562
Research and development	506	400
General and administrative	157	156
Amortization of intangible assets	198	123
Acquisition related	48	28
Restructuring	9	11
Total operating expenses	2,648	2,056
Operating income	943	712
Interest expense	(83)	(21)
Non-operating income, net	102	42
Income before provision for income taxes	962	733
Provision for income taxes	292	214
Net income	$ 670	$ 519
Earnings per share:		
Basic	$ 0.13	$ 0.10
Diluted	$ 0.13	$ 0.10
Weighted-average common shares outstanding:		
Basic	5,217	5,148
Diluted	5,307	5,244

See notes to condensed consolidated financial statements.

Table of Contents

ORACLE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended August 31, 2006 and 2005

(Unaudited)

	Three Months Ended August 31,	
(in millions)	**2006**	**2005**
Cash Flows From Operating Activities:		
Net income	$ 670	$ 519
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	59	57
Amortization of intangible assets	198	123
Deferred income taxes	(6)	(46)
Minority interests in income	12	8
Stock-based compensation	50	12
Tax benefits on the exercise of stock options	49	31
Excess tax benefits from stock-based compensation	(30)	
In-process research and development	43	7
Net investment gains related to equity securities	(15)	(2)
Changes in assets and liabilities, net of effects from acquisitions:		
Decrease in trade receivables	1,040	913
Decrease in prepaid expenses and other assets	86	154
Decrease in accounts payable and other liabilities	(900)	(451)
Decrease in income taxes payable	(6)	(203)
Increase in deferred revenues	373	336
Net cash provided by operating activities	1,623	1,458
Cash Flows From Investing Activities:		
Purchases of marketable securities	(2,426)	(789)
Proceeds from maturities and sale of marketable securities	642	827
Acquisitions, net of cash acquired	(225)	(309)
Purchases of equity and other investments	(4)	(2)
Capital expenditures	(49)	(52)
Proceeds from sale of property		70
Net cash used for investing activities	(2,062)	(255)
Cash Flows From Financing Activities:		
Payments for repurchase of common stock	(936)	(250)
Proceeds from issuance of common stock	162	158
Proceeds from borrowings, net of financing costs		5,408
Payments of debt	(7)	(6,590)
Excess tax benefits from stock-based compensation	30	
Distributions to minority interests	(25)	(23)
Net cash used for financing activities	(776)	(1,297)
Effect of exchange rate changes on cash and cash equivalents	2	(10)

Net decrease in cash and cash equivalents		(1,213)		(104)
Cash and cash equivalents at beginning of period		6,659		3,894
Cash and cash equivalents at end of period	$	5,446	$	3,790
Non-cash financing transactions:				
Fair value of options and stock issued in connection with acquisitions	$	15	$	31
Debt issued in connection with acquisitions	$	13	$	

See notes to condensed consolidated financial statements.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2006

(Unaudited)

1. BASIS OF PRESENTATION

We have prepared the condensed consolidated financial statements included herein, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, we believe that the disclosures are adequate to ensure the information presented is not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2006.

We believe that all necessary adjustments, which consisted only of normal recurring items, have been included in the accompanying financial statements to present fairly the results of the interim periods. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for our fiscal year ending May 31, 2007. Certain prior period balances have been reclassified to conform to the current period presentation. Additionally, there have been no significant changes in new accounting pronouncements disclosed in our Form 10-K, except for our adoption of Financial Accounting Standards Board Statement No. 123 (revised 2004), *Share-Based Payment*, as discussed in Note 2.

2. STOCK-BASED COMPENSATION

Adoption of Statement 123R

On June 1, 2006, we adopted Statement 123R under the modified prospective method. Statement 123R generally requires share-based payments to employees, including grants of employee stock options and purchases under employee stock purchase plans, to be recognized in our consolidated statements of operations based on their fair values. Under the modified prospective method, prior period financial statements are not restated.

Prior to June 1, 2006, we accounted for our stock-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* and applied the disclosure provisions of Statement No. 123, *Accounting for Stock-Based Compensation*, as amended. Under Opinion 25, we generally did not recognize any compensation expense for stock options granted to employees or outside directors as the exercise price of our options was equivalent to the market price of our common stock on the date of grant. However, we recorded stock-based compensation for the intrinsic value associated with unvested options assumed in connection with acquisitions. For pro forma disclosures of stock-based compensation prior to June 1, 2006, the estimated fair values for options granted and options assumed were amortized using the accelerated expense attribution method. In addition, we reduced pro forma stock compensation expense for actual forfeitures in the periods they occurred.

In accordance with Statement 123R, we recognize stock-based compensation for grants issued or assumed after June 1, 2006 for awards that we expect to vest on a straight-line basis over the service period of the award, generally four years. In determining whether an award is expected to vest, we use an estimated forfeiture rate based on historical forfeiture rates. The estimated forfeiture rate is updated for actual forfeitures quarterly. The effect of forfeiture adjustments based on actual results was nominal for the three months ended August 31, 2006. The unvested portion of awards granted prior to June 1, 2006 will continue to be recognized over the remaining service period using the accelerated expense attribution method, net of estimated forfeitures.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

Stock-based compensation recognized in our condensed consolidated statements of operations is as follows:

	Three Months Ended August 31,			
(in millions)		**2006**		**2005**
Issued options	$	41	$	
Assumed options from acquisitions		9		12
Stock-based compensation recorded in operating expenses compensation cost		50		12
Estimated income tax benefit included in provision for income taxes		(14)		(4)
Stock-based compensation, net of estimated taxes	$	36	$	8

If we had continued to account for stock-based compensation in accordance with Opinion 25, income before provision for income taxes and net income for the three months ended August 31, 2006 would have been $44 million and $31 million higher, respectively, than the amounts we recognized in accordance with Statement 123R. Basic and diluted earnings per share for the three months ended August 31, 2006 would have been $0.01 higher if we had continued to account for stock-based compensation under Opinion 25.

The following table presents the effect on reported net income and earnings per share if we had accounted for our stock options under the fair value method of accounting for the three months ended August 31, 2005:

(in millions, except per share data)		**Three Months Ended August 31, 2005**
Net income, as reported	$	519
Add: Employee compensation expense included in net income, net of related tax effects		8
Deduct: Stock-based employee compensation expense determined under the fair value method, net of forfeitures and related tax effects		(34)
Pro forma net income	$	493
Earnings per share:		
Basic as reported	$	0.10
Basic pro forma	$	0.10
Diluted as reported	$	0.10
Diluted pro forma	$	0.09

Stock Option Plans

We adopted the 2000 Long-Term Equity Incentive Plan (the 2000 Plan), as amended, which replaced the 1991 Long-Term Equity Incentive Plan, in order to provide non-qualified stock options and incentive stock options, as well as stock purchase rights, stock appreciation rights and long-term performance awards to our eligible employees, officers, directors, independent consultants and advisers. Under the terms of the 2000 Plan, options to purchase common stock generally are granted at not less than fair market value, become exercisable as established by the Board of Directors (generally ratably over four years), and generally expire ten years from the date of grant. To date, we have not issued any stock purchase rights, stock appreciation rights, restricted stock units or long-term performance awards under this plan. We also have a separate stock option plan for our non-employee directors as well as plans assumed from acquisitions. Options assumed from acquisitions generally retain all of the rights, terms and conditions of the respective plans under which the options were originally granted. We do not grant additional options under assumed plans. At August 31, 2006, we had approximately 508 million options outstanding and approximately 346 million shares of common stock are available for future awards.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The following table summarizes stock options activity for the three months ending August 31, 2006:

(in millions, except exercise price)	Options Outstanding: Shares Under Option	Options Outstanding: Weighted Average Exercise Price	Options Exercisable: Options Exercisable	Options Exercisable: Weighted Average Exercise Price
Balance, June 1, 2006	473	$ 13.25	341	$ 13.91
Granted	55	14.58		
Assumed in connection with acquisitions	3	12.59		
Exercised	(20)	7.79		
Canceled	(3)	19.84		
Balance, August 31, 2006	508	$ 13.02	363	$ 13.10

Options outstanding that have vested and are expected to vest as of August 31, 2006 are as follows:

	Outstanding Options (in millions)	Weighted Average Exercise Price	Weighted Average Remaining Contract Term (in years)	In-the-Money Options as of August 31, 2006 (in millions)	Aggregate Value as of August 31, 2006 (1) (in millions)
Vested	363	$ 13.10	4.1	265	$ 2,020
Expected to vest (2)	121	12.82	8.8	119	354
Total	484	$ 13.03	5.2	384	$ 2,374

(1) The aggregate value was calculated based on the difference between our closing stock price on August 31, 2006 of $15.66 and the exercise prices for all in-the-money options outstanding.

(2) The unrecognized compensation expense associated under the fair value method for shares expected to vest (unvested shares net of expected forfeitures) as of August 31, 2006 was approximately $369 million and is expected to be recognized over a weighted average period of 1.4 years. Approximately 24 million shares are not expected to vest as of August 31, 2006.

Valuation of Options Granted

We estimate the fair value of our options using the Black-Scholes-Merton option-pricing model, which was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of assumptions, including stock price volatility. Changes in the input assumptions can materially affect the fair value estimates. The fair value of stock options is estimated at the date of grant using weighted-average assumptions as follows:

	Three Months Ended August 31,	
	2006	2005
Expected life (in years)	5.1	5.4
Risk-free interest rate	5.14%	3.88%
Volatility	26%	27%
Dividend yield		
Weighted average fair value at grant date	$ 4.88	$ 4.52

6

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The expected life is based on historical exercise patterns and post-vesting termination behavior, the risk-free interest rate is based on United States Treasury instruments and volatility is calculated based on implied volatility. We do not currently pay cash dividends on our common stock and do not anticipate doing so in the forseeable future. Accordingly, our expected dividend yield is zero.

Tax Benefits from Option Exercises

We settle employee stock option exercises primarily with newly issued common shares and, occasionally, with treasury shares. Total cash received as a result of option exercises was approximately $162 million and $158 million for the three months ended August 31, 2006 and August 31, 2005, respectively. The intrinsic value of options exercised for the three months ended August 31, 2006 and August 31, 2005 was $149 million for both periods. In connection with these exercises, the tax benefits realized by the company for the three months ended August 31, 2006 and August 31, 2005 were $49 million and $31 million, respectively. The adoption of Statement 123R required us to change our cash flow classification of certain tax benefits received from stock option exercises beginning June 1, 2006. Of the total tax benefits received, we classified excess tax benefits from stock-based compensation of $30 million as cash flows from financing activities rather than cash flows from operating activities for the three months ended August 31, 2006. To calculate the excess tax benefits available for use in offsetting future tax shortfalls as of our Statement 123R adoption date, which also affects the excess tax benefits from stock-based compensation that we reclassify as cash flows from financing activities, we adopted the alternative transition method as prescribed under FASB Staff Position FAS123R-3, *Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*.

3. ACQUISITIONS
i-flex solutions limited

In November 2005, we obtained a 42.8% interest in i-flex solutions limited, a provider of software solutions and services to the financial services industry (Bombay Stock Exchange: IFLX.BO and National Stock Exchange of India: IFLX.NS) pursuant to a Share Purchase Agreement with OribTech Limited, a subsidiary of Citigroup Inc., for $593 million and through our initial open offer in October 2005. We have made additional purchases of i-flex common stock through ordinary brokerage transactions from March 2006 through June 2006 and obtained a majority interest in i-flex on April 14, 2006. We originally accounted for i-flex under the equity method of accounting. Beginning in the first quarter of fiscal 2007, we changed our method of accounting and began consolidating the results of operations of i-flex once we obtained a majority interest. We consolidate the results of operations of i-flex two months in arrears as our reporting periods differ.

We own 40,148,312 shares of common stock or 52.5% of i-flex as of August 31, 2006. Our cumulative investment in i-flex as of August 31, 2006 was $847 million, which consisted of $827 million of cash paid for common stock, $6 million in transaction costs and $14 million in equity in earnings from our initial purchase date to April 14, 2006.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

Our cumulative investment in i-flex was allocated to 52.5% of i-flex s net tangible and identifiable intangible assets based on their estimated fair values. The minority interest in the net assets of i-flex has been recorded at historical book values. The excess of the cumulative purchase price over our 52.5% interest in the net tangible and identifiable intangible assets was recorded as goodwill. Our preliminary allocation of the cumulative purchase price including the minority interest in the net assets of i-flex is as follows:

		(in millions)
Cash and marketable securities	$	155
Trade receivables		125
Goodwill		559
Intangible assets		178
Other assets		98
Accounts payable and other liabilities		(49)
Deferred tax liabilities, net		(62)
Deferred revenues		(34)
In-process research and development		23
Minority interests		(146)
Total purchase price	$	847

The preliminary allocation of the purchase price was based upon a preliminary valuation and our estimates and assumptions are subject to change. The primary areas of the purchase price allocation that are not yet finalized relate to identifiable intangible assets, the valuation of consulting contract obligations assumed, certain legal matters, income and non-income based taxes and residual goodwill.

We recorded the minority interest in the net income of i-flex of $4 million as an expense in non-operating income, net, in our condensed consolidated statements of operations for the three months ended August 31, 2006.

Preferential Allotment and Open Offer

On September 14, 2006, i-flex issued approximately 4.45 million shares of common stock at a purchase price of 1,307.5 Indian rupees per share (Preferential Allotment). We purchased the Preferential Allotment for approximately $126 million and increased our ownership to approximately 55.1%. Proceeds from the Preferential Allotment are intended to be used to fund growth initiatives, including i-flex s pending acquisition of Mantas, Inc.

As required by Indian law, following the preferential allotment, we published an announcement on September 13, 2006 notifying the public shareholders of i-flex of our intention to make an open offer to purchase up to 16,629,023 additional shares of i-flex common stock, equal to 20% of the outstanding equity of i-flex. Holders of i-flex common shares who tender their shares will receive 1,475 Indian rupees per share. If the open offer is fully subscribed, the aggregated consideration for the open offer would be approximately $530 million. Pursuant to Indian laws, the open offer is expected to commence on November 6, 2006 and is expected to close on November 25, 2006. The open offer is not conditioned upon any minimum level of acceptance by i-flex shareholders.

Siebel Systems, Inc.

On January 31, 2006, we completed our acquisition of Siebel Systems, Inc. pursuant to our Merger Agreement dated September 12, 2005. We acquired Siebel to expand our presence in the customer relationship management (CRM) applications software market.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The total purchase price for Siebel was $6.1 billion which consisted of $4,073 million in cash paid to acquire the outstanding common stock of Siebel, $1,763 million for the value of Oracle stock issued in exchange for Siebel outstanding common stock, $245 million for the fair value of Siebel options assumed and restricted stock awards exchanged and $49 million for transaction costs. In allocating the purchase price based on estimated fair values, we recorded approximately $2,534 million in goodwill, $1,564 million of identifiable intangible assets, $1,968 million of net tangible assets and $64 million of in-process research and development. The preliminary allocation of the purchase price was based upon a preliminary valuation and our estimates and assumptions are subject to change. The primary areas of the purchase price allocation that are not yet finalized relate to certain legal matters, income and non-income based taxes and residual goodwill.

Other Acquisitions

During the first quarter of fiscal 2007, we acquired several software companies and purchased certain technology for approximately $355 million, which includes cash paid of $327 million including transaction costs of $7 million, fair value of options assumed of $15 million and debt issued of $13 million. We recorded approximately $176 million of goodwill, $131 million of identifiable intangible assets, $28 million of net tangible assets and $20 million of in-process research and development in connection with these acquisitions during the first quarter of fiscal 2007. We have included the effects of these transactions in our results of operations prospectively from the respective dates of the acquisitions.

During fiscal 2006, we acquired several software companies and purchased certain technology and development organizations for approximately $682 million, which includes cash paid of $648 million and the fair value of options assumed of $34 million. We recorded approximately $490 million of goodwill, $173 million of identifiable intangible assets, $5 million of net tangible assets and $14 million of in-process research and development in connection with these acquisitions during fiscal 2006. We have included the effects of these transactions in our results of operations prospectively from the respective dates of the acquisitions.

Unaudited Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of Oracle and Siebel, on a pro forma basis, as though the companies had been combined as of the beginning of each of the periods presented. Pro forma financial information for our other acquisitions have not been presented, as the effects were not material to our historical consolidated financial statements either individually or in aggregate. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions and $5.75 billion senior notes issued in January 2006 had taken place at the beginning of each of the periods presented. The pro forma financial information also includes the business combination accounting effect on historical Siebel support revenues, the charge for in-process research and development, amortization charges from acquired intangible assets, stock-based compensation charges for unvested options assumed, Oracle restructuring costs, adjustments to interest expense and related tax effects.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The unaudited pro forma financial information for the three months ended August 31, 2005 combines the historical results of Oracle for the three months ended August 31, 2005 and, due to differences in our reporting periods, the historical results of Siebel for the three months ended June 30, 2005.

(in millions, except per share data)		Three Months Ended August 31, 2005
Total revenues	$	3,016
Net income	$	389
Basic net income per share	$	0.07
Diluted net income per share	$	0.07

4. ACQUISITION RELATED CHARGES

Acquisition related charges primarily consist of in-process research and development expenses, integration-related professional services, stock-compensation expenses and personnel related costs for transitional employees. Stock-based compensation included in acquisition related charges resulted from unvested options assumed from acquisitions whose vesting was fully accelerated upon termination of the employees pursuant to the terms of these options.

	Three Months Ended August 31,			
(in millions)		2006		2005
In-process research and development	$	43	$	7
Transitional employee related costs		5		7
Stock-based compensation				3
Professional fees				11
Total acquisition related charges	$	48	$	28

5. NON-OPERATING INCOME, NET

Non-operating income, net consists primarily of interest income, net foreign currency exchange gains (losses), net investment gains related to marketable securities and other investments as well as the minority interests share in the net profits of i-flex and Oracle Japan.

Three Months Ended

(in millions)	August 31, 2006	2005
Interest income	$ 77	$ 25
Foreign currency gains	6	16
Net investment gains related to marketable securities	15	2
Minority interests	(12)	(8)
Other	16	7
Total non-operating income, net	$ 102	$ 42

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

6. GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill, which is not deductible for tax purposes, by operating segment for the three months ended August 31, 2006, were as follows:

(in millions)	New Software Licenses	Software License Updates and Product Support	Services	Other	Total
Balance as of May 31, 2006	$ 2,214	$ 6,741	$ 854	$	$ 9,809
Goodwill acquired [1]				735	735
Goodwill adjustments		(16)	1		(15)
Balance as of August 31, 2006	$ 2,214	$ 6,725	$ 855	$ 735	$ 10,529

[1] Represents preliminary goodwill associated with first quarter fiscal 2007 acquisitions, including i-flex, which will be allocated upon the finalization of our purchase price allocations before the end of our fiscal 2007.

The changes in intangible assets for the three months ended August 31, 2006 and the net book value of intangible assets at August 31, 2006 were as follows:

	Intangible Assets, Gross			Accumulated Amortization			Net Book Value		
(in millions)	May 31, 2006	Additions	Aug 31, 2006	May 31, 2006	Expense	Aug 31, 2006	May 31, 2006	Aug 31, 2006	Weighted Average Useful Life
Software support agreements and related relationships	$ 2,949	$ 52	$ 3,001	$ (329)	$ (76)	$ (405)	$ 2,620	$ 2,596	10 years
Developed technology	1,336	212	1,548	(333)	(76)	(409)	1,003	1,139	5 years
Core technology	594	23	617	(121)	(31)	(152)	473	465	5 years
Customer relationships	375	2	377	(41)	(10)	(51)	334	326	10 years
Trademarks	117	21	138	(19)	(5)	(24)	98	114	7 years
Total	$ 5,371	$ 310	$ 5,681	$ (843)	$ (198)	$ (1,041)	$ 4,528	$ 4,640	

The total amortization expense related to intangible assets was $198 million and $123 million for the three months ended August 31, 2006 and 2005, respectively. As of August 31, 2006, estimated future amortization expense related to intangible assets is $603 million for the remainder of fiscal 2007, $790 million in fiscal 2008, $783 million in fiscal 2009, $660 million in fiscal 2010, $454 million in fiscal 2011, $358 million in fiscal 2012 and $992 million thereafter.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

7. DEFERRED REVENUES

Deferred revenues consisted of the following:

(in millions)	August 31, 2006	May 31, 2006
Software license updates and product support	$ 2,913	$ 2,501
Services	245	246
New software licenses	111	83
Deferred revenues, current	3,269	2,830
Deferred revenues, non-current	114	114
Total deferred revenues	$ 3,383	$ 2,944

Deferred software license updates and product support revenues represent customer payments made in advance for annual support contracts. Software license updates and product support are typically billed on a per annum basis in advance and revenue is recognized ratably over the support period. The deferred software license updates and product support revenues are typically highest at the end of our first fiscal quarter due to the collection of cash from the large volume of service contracts that are sold or renewed in the fiscal quarter ending in May of each year. Deferred service revenues include prepayments for consulting, On Demand and education services. Revenue for these services is recognized as the services are performed. Deferred new software license revenues typically result from undelivered products or specified enhancements, customer specific acceptance provisions or software license transactions that are not segmentable from consulting services. Deferred revenues, non-current are comprised primarily of deferred software license updates and product support revenues.

In connection with purchase price allocations related to our acquisitions, we have estimated the fair values of the support obligations assumed. The estimated fair values of the support obligations assumed were determined using a cost-build up approach. The cost-build up approach determines fair value by estimating the costs relating to fulfilling the obligations plus a normal profit margin. The sum of the costs and operating profit approximates, in theory, the amount that we would be required to pay a third party to assume the support obligations. These fair value adjustments reduce the revenues recognized over the support contract term of our acquired contracts and, as a result, we did not recognize software license updates and product support revenues related to support contracts assumed in business acquisitions in the amount of $70 million and $139 million, which would have been otherwise recorded by the acquired entities, for the three months ended August 31, 2006 and 2005 respectively.

8. INCOME TAXES

The effective tax rate in all periods is the result of the mix of income earned in various tax jurisdictions that apply a broad range of income tax rates. The provision for income taxes differs from the tax computed at the federal statutory income tax rate due primarily to state taxes and earnings considered as indefinitely reinvested in foreign operations. The effective tax rate was 30.4% and 29.2% for the three months ended August 31, 2006 and 2005, respectively.

The Internal Revenue Service has examined our federal income tax returns for all years through 1999 without any material adjustment of taxes due. The IRS is currently examining our federal income tax returns for 2000 through 2003. We do not believe that the outcome of these matters will have a material adverse effect on our consolidated financial position or results of operations. We are also under examination by numerous state and

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

non-US tax authorities. We believe that we have adequately provided for any reasonably foreseeable outcome related to these audits.

Our intercompany transfer pricing is currently being reviewed by the IRS and by foreign tax jurisdictions and will likely be subject to additional audits in the future. We previously negotiated three unilateral Advance Pricing Agreements with the IRS that cover many of our intercompany transfer pricing issues and preclude the IRS from making a transfer pricing adjustment within the scope of these agreements. However, these agreements, which are effective for fiscal years through May 31, 2006, do not cover all elements of our intercompany transfer pricing issues and do not bind tax authorities outside the United States. We recently finalized one bilateral Advance Pricing Agreement and currently are negotiating an additional bilateral agreement to cover the period from June 1, 2001 through May 31, 2008. There can be no guarantee that such negotiations will result in an agreement.

9. RESTRUCTURING ACTIVITIES

Fiscal 2006 Restructuring Plans

During the third quarter of fiscal 2006, management approved and initiated plans to restructure certain operations of Oracle and pre-merger Siebel to eliminate redundant costs resulting from the acquisition of Siebel and improve efficiencies in operations. The cash restructuring charges recorded are based on restructuring plans that have been committed to by management.

The total estimated severance costs associated with the Fiscal 2006 Oracle Restructuring Plan are $93 million. We have incurred $82 million in restructuring expenses to date and expect to incur the remaining $11 million in the next three months. Changes to the estimates of executing the Fiscal 2006 Oracle Restructuring Plan will be reflected in our future results of operations.

The total estimated restructuring costs associated with exiting activities of Siebel is $587 million, consisting primarily of excess facilities obligations through fiscal 2022 as well as severance and other restructuring costs. These costs were recognized as a liability assumed in the purchase business combination and included in the allocation of the cost to acquire Siebel and, accordingly, have resulted in an increase to goodwill. Estimated restructuring expenses may change as management executes the approved plan. Decreases to the estimates of executing the Siebel restructuring plan are recorded as an adjustment to goodwill indefinitely, whereas increases to the estimates are recorded as an adjustment to goodwill during the purchase price allocation period (generally within one year of the acquisition date) and as operating expenses thereafter.

Fiscal 2005 Restructuring Plans

During the third quarter of fiscal 2005, management approved and initiated plans to restructure the operations of Oracle, PeopleSoft, Inc. and Retek Inc. We have completed our planned legal-entity mergers, information system conversions and integration of PeopleSoft s and Retek s operations as well as all Oracle restructuring activities. Total estimated restructuring costs associated with the Fiscal 2005 Oracle Restructuring Plan are $158 million. Total estimated restructuring costs associated with exiting activities of PeopleSoft and Retek are $403 million, consisting primarily of employee severance costs as well as excess facilities obligations through fiscal 2013 and other restructuring costs.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

Summary of All Plans

(in millions)	Accrued May 31, 2006	Three Months Ended August 31, 2006: Initial Costs	Adj. to Cost [3]	Cash Payments	Other [4]	Accrued Aug 31, 2006 [5]	Total Costs Accrued to Date	Total Expected Program Costs
Fiscal 2006 Oracle Restructuring Plan								
New software licenses	$ 25	$ 3	$	$ (13)	$	$ 15	$ 36	$ 37
Software license updates and product support	1					1	2	3
Services, principally consulting	8	2		(5)		5	15	17
Other [1]	8	4		(6)		6	30	36
Total Fiscal 2006 Oracle Restructuring	$ 42	$ 9	$	$ (24)	$	$ 27	$ 83	$ 93
Fiscal 2005 Oracle Restructuring Plan								
New software licenses	$ 3	$	$	$ (1)	$	$ 2	$ 37	$ 37
Software license updates and product support							6	6
Services, principally consulting	2			(1)		1	28	28
Other [1]	2			(2)			66	66
Total severance	7			(4)		3	137	137
Total facilities [2]	18					18	21	21
Total Fiscal 2005 Oracle Restructuring	$ 25	$	$	$ (4)	$	$ 21	$ 158	$ 158
Siebel Restructuring Plan								
Severance	$ 37	$	$	$ (13)	$ 1	$ 25	$ 71	$ 71
Facilities	446		(7)	(152)	1	288	477	477
Contracts and other	26		4	(17)		13	39	39
Total Siebel Restructuring	$ 509	$	$ (3)	$ (182)	$ 2	$ 326	$ 587	$ 587
PeopleSoft and Retek Restructuring Plan								
Severance	$ 3	$	$	$	$	$ 3	$ 195	$ 195
Facilities	95			(9)	1	87	157	157
Contracts and other	11					11	51	51
Total PeopleSoft and Retek Restructuring	$ 109	$	$	$ (9)	$ 1	$ 101	$ 403	$ 403
Total All Restructuring Plans	$ 685	$ 9	$ (3)	$ (219)	$ 3	$ 475		

[1] Other includes costs associated with research and development, general and administrative and marketing functions.

[2] Allocation of facility costs to operating lines of businesses and other functions was approximately $5 and $16, respectively.

(3) Primarily relates to the renegotiation of facility leases acquired in the Siebel acquisition as well as changes in estimates to severance and other restructuring obligations related to the PeopleSoft acquisition.

(4) Represents foreign currency translation adjustments.

(5) Accrued restructuring at August 31, 2006 and May 31, 2006 was $475 and $685, respectively. The balances include $198 and $412 recorded in accrued restructuring, current and $277 and $273 recorded in accrued restructuring, non-current in the accompanying condensed consolidated balance sheets at August 31, 2006 and May 31, 2006, respectively.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

10. STOCK REPURCHASE PROGRAMS

In 1992, our Board of Directors approved a program to repurchase shares of our common stock (1992 Program) to reduce the dilutive effect of our stock option and stock purchase plans. The Board has expanded the 1992 Program several times by either increasing the authorized number of shares to be repurchased or by authorizing a fixed dollar amount expansion. On January 31, 2006, we announced our plan to repurchase common stock equivalent to the amount of common stock issued in connection with the Siebel acquisition. Our Board approved a separate program (Siebel Program) to repurchase 140,720,666 shares of our common stock.

In June 2006, we announced that we intend to repurchase $1.0 billion of our common stock each quarter in fiscal 2007 and such repurchases may occur through the use of Rule 10b5-1 trading plans. On July 10, 2006, the Board combined the 1992 Program with the Siebel Program and authorized a total of $4.0 billion in share repurchases (2007 Authorization).

We repurchased 66.8 million shares for $1.0 billion during the three months ended August 31, 2006 (including 4.1 million shares for $64 million that were repurchased but not settled) and 18.1 million shares for $249.7 million during the three months ended August 31, 2005 under the applicable repurchase programs authorized. At August 31, 2006, approximately $3.2 billion was available for share repurchases pursuant to our 2007 Authorization.

11. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income for the period by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income for the period by the weighted-average number of common shares outstanding during the period, plus the dilutive effect of outstanding stock options and shares issuable under the employee stock purchase plan using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended August 31,	
(in millions, except per share data)	**2006**	**2005**
Net income	$ 670	$ 519
Weighted-average common shares outstanding	5,217	5,148
Dilutive effect of employee stock plans	90	96
Dilutive weighted-average common shares outstanding	5,307	5,244
Basic earnings per share	$ 0.13	$ 0.10
Diluted earnings per share	$ 0.13	$ 0.10
Shares subject to anti-dilutive stock options excluded from calculation [1]	105	109

[1] These weighted shares relate to anti-dilutive stock options and could be dilutive in the future.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

12. COMPREHENSIVE INCOME

Comprehensive income includes foreign currency translation gains and losses, unrealized gains and losses on equity securities as well as equity hedge gains and losses that are reflected in stockholders equity instead of net income. The following table sets forth the calculation of comprehensive income:

	Three Months Ended August 31,			
(in millions)		**2006**		**2005**
Net income	$	670	$	519
Net foreign currency translation loss		(31)		(12)
Unrealized gain on equity securities				3
Reversal of unrealized gain upon sale of equity securities		1		
Net equity hedge gain		14		8
Comprehensive income	$	654	$	518

13. SEGMENT INFORMATION

FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our Chief Executive Officer. We are organized geographically and by line of business. While our Chief Executive Officer evaluates results in a number of different ways, the line of business management structure is the primary basis for which the allocation of resources and financial results are assessed. We have two businesses, software and services, which are further divided into five operating segments. Our software business is comprised of two operating segments: (1) new software licenses and (2) software license updates and product support. Our services business is comprised of three operating segments: (1) consulting, (2) On Demand and (3) education.

The new software license line of business is engaged in the licensing of database and middleware as well as applications software. Database and middleware software includes database management software, application server software, analytics, development tools and collaboration software. Applications software provides enterprise information that enables companies to manage their business cycles and provide intelligence in functional areas such as financials, human resources, maintenance management, manufacturing, marketing, order fulfillment, product lifecycle management, procurement, projects, sales, services and supply chain planning. The software license updates and product support line of business provides customers with rights to unspecified software product upgrades and maintenance releases, internet access to technical content, as well as internet and telephone access to technical support personnel during the support period.

The consulting line of business provides services to customers in the design, implementation, deployment and upgrade of our database and middleware as well as our applications software. On Demand includes Oracle On Demand and Advanced Customer Services. Oracle On Demand provides multi-featured software and hardware management and maintenance services for our database and middleware as well as our applications software. Advanced Customer Services provide customers configuration and performance analysis, personalized support and annual on-site technical services. The education line of business provides instructor led, media based and internet based training in the use of our database and middleware as well as our applications software.

We do not track our assets by operating segments. Consequently, it is not practical to show assets by operating segments.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The following table presents a summary of our businesses and operating segments:

(in millions)	**Three Months Ended August 31, 2006**	**2005**
New software licenses:		
Revenues [1]	$ 802	$ 628
Sales and distribution expenses	627	501
Margin [2]	$ 175	$ 127
Software license updates and product support:		
Revenues [1]	$ 2,010	$ 1,641
Cost of services	185	151
Margin [2]	$ 1,825	$ 1,490
Total software business:		
Revenues [1]	$ 2,812	$ 2,269
Expenses	812	652
Margin [2]	$ 2,000	$ 1,617
Consulting:		
Revenues [1]	$ 636	$ 480
Cost of services	553	412
Margin [2]	$ 83	$ 68
On Demand:		
Revenues [1]	$ 125	$ 84
Cost of services	129	72
Margin [2]	$ (4)	$ 12
Education:		
Revenues [1]	$ 88	$ 74
Cost of services	64	54
Margin [2]	$ 24	$ 20
Total services business:		
Revenues [1]	$ 849	$ 638
Cost of services	746	538
Margin [2]	$ 103	$ 100
Totals:		

Revenues [1]	$ 3,661	$ 2,907
Expenses	1,558	1,190
Margin [2]	$ 2,103	$ 1,717

[1] Operating segment revenues differ from the external reporting classifications due to certain software license products that are classified as service revenues for management reporting purposes. Additionally, software license updates and product support revenues for management reporting include $70 and $139 of revenues that we did not recognize in the accompanying condensed consolidated statements of operations for the three months ended August 31, 2006 and 2005, respectively. See Note 7 for an explanation of these adjustments and the following table for a reconciliation of operating segment revenues to total revenues.

[2] The margins reported reflect only the direct controllable costs and expenses of each line of business and do not represent the actual margins for each operating segment because they do not contain an allocation of product development, information technology, marketing and partner programs, and corporate and general and administrative expenses incurred in support of the lines of business. Additionally, the margins do not reflect the amortization of intangible assets, restructuring costs, acquisition related costs and stock-based compensation.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The following table reconciles operating segment revenues to total revenues as well as operating segment margin to income before provision for income taxes:

	Three Months Ended August 31,	
(in millions)	**2006**	**2005**
Total revenues for reportable segments	$ 3,661	$ 2,907
Software license updates and product support revenues [1]	(70)	(139)
Total revenues	$ 3,591	$ 2,768
Total margin for reportable segments	$ 2,103	$ 1,717
Software license updates and product support revenues [1]	(70)	(139)
Product development and information technology expenses	(561)	(466)
Marketing and partner program expenses	(89)	(95)
Corporate and general and administrative expenses	(129)	(130)
Amortization of intangible assets	(198)	(123)
Acquisition related	(48)	(28)
Restructuring	(9)	(11)
Stock-based compensation	(50)	(9)
Interest expense	(83)	(21)
Non-operating income, net	96	38
Income before provision for income taxes	$ 962	$ 733

[1] Software license updates and product support revenues for management reporting include $70 and $139 of revenues that we did not recognize in the accompanying condensed consolidated statements of operations for the three months ended August 31, 2006 and 2005, respectively. See Note 7 for an explanation of these adjustments.

14. PEOPLESOFT CUSTOMER ASSURANCE PROGRAM

In June 2003, in response to our tender offer, PeopleSoft implemented what it referred to as the customer assurance program or CAP. The CAP incorporated a provision in PeopleSoft s standard licensing arrangement that purports to contractually burden Oracle, as a result of our acquisition of PeopleSoft, with a contingent obligation to make payments to PeopleSoft customers should we fail to take certain business actions for a fixed period. The payment obligation, which typically expires four years from the date of the contract, is fixed at an amount generally between two and five times the license and first year support fees paid to PeopleSoft in the applicable license transaction. PeopleSoft customers retain rights to the licensed products whether or not the CAP payments are triggered.

Table of Contents

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

The maximum potential penalty under the CAP, by version, as of August 31, 2006 was as follows:

	Dates Offered to Customers [1]		Maximum Potential	
CAP Version	**Start Date**	**End Date**	**Penalty (in millions)**	
Version 1	June 2003	September 12, 2003	$	76
Version 2	September 12, 2003	September 30, 2003		170
Version 3	September 30, 2003	November 7, 2003		40
Version 4	November 18, 2003	June 30, 2004		1,352
Version 5	June 16, 2004	December 28, 2004		792
Version 6	October 12, 2004	December 28, 2004		1,105
			$	3,535

(1) Some contracts originally submitted to customers prior to these end dates were executed following such dates. The majority of the CAP provisions will expire no later than four years after the contract date.

This purported obligation was not reflected as a liability on PeopleSoft s balance sheet as PeopleSoft concluded that it could be triggered only following the consummation of an acquisition. We have concluded that, as of the date of the acquisition, the penalty provisions under the CAP represented a contingent liability of Oracle. The aggregate potential CAP obligation as of August 31, 2006 was $3.5 billion. Unless the CAP provisions are removed from these licensing arrangements, we do not expect the aggregate potential CAP obligation to decline substantially until fiscal year 2008 when these provisions begin to expire. We have not recorded a liability related to the CAP, as we do not believe it is probable that our post-acquisition activities related to the PeopleSoft and JD Edwards product lines will trigger an obligation to make any payment pursuant to the CAP. While no assurance can be given as to the ultimate outcome of litigation, we believe we would also have substantial defenses with respect to the legality and enforceability of the CAP contract provisions in response to any claims seeking payment from us under the CAP terms.

15. LEGAL PROCEEDINGS

Securities Class Action

Stockholder class actions were filed in the United States District Court for the Northern District of California against us and our Chief Executive Officer on and after March 9, 2001. Between March 2002 and March 2003, the court dismissed plaintiffs consolidated complaint, first amended complaint and a revised second amended complaint. The last dismissal was with prejudice. On September 1, 2004, the United States Court of Appeals for the Ninth Circuit reversed the dismissal order and remanded the case for further proceedings. The revised second amended complaint named our Chief Executive Officer, our then Chief Financial Officer (who currently is Chairman of our Board of Directors) and a former Executive Vice President as defendants. This complaint was brought on behalf of purchasers of our stock during the period from December 14, 2000 through March 1, 2001. Plaintiffs alleged that the defendants made false and misleading statements about our actual and expected financial performance and the performance of certain of our applications products, while certain individual defendants were selling Oracle stock in violation of federal securities laws. Plaintiffs further alleged that certain individual defendants sold Oracle stock while in possession of material non-public information. Plaintiffs also allege that the defendants engaged in accounting violations. Currently, the parties are conducting discovery. Although trial had been set for September 11, 2006, the court vacated that trial date, and no new trial date has been set. Plaintiffs seek unspecified damages plus interest, attorneys fees and costs, and equitable and injunctive relief. We believe that we have meritorious defenses against this action, and we will continue to vigorously defend it.

ORACLE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

August 31, 2006

(Unaudited)

Siebel Securities Class Action

On March 10, 2004, William Wollrab, on behalf of himself and purportedly on behalf of a class of stockholders of Siebel, filed a complaint in the United States District Court for the Northern District of California against Siebel and certain of its officers relating to predicted adoption rates of Siebel v7.0 and certain customer satisfaction surveys. This complaint was consolidated and amended on August 27, 2004, with the Policemen s Annuity and Benefit Fund of Chicago being appointed to serve as lead plaintiff. The consolidated complaint also raised claims regarding Siebel s business performance in 2002. In October 2004, Siebel filed a motion to dismiss, which was granted on January 28, 2005 with leave to amend. Plaintiffs filed an amended complaint on March 1, 2005. Plaintiffs seek unspecified damages plus interest, attorneys fees and costs, and equitable and injunctive relief. Siebel filed a motion to dismiss the amended complaint on April 27, 2005, and on December 28, 2005, the Court dismissed the case with prejudice. On January 17, 2006, plaintiffs filed a notice of appeal, and on September 15, 2006, plaintiffs filed their opening appellate brief. Defendants responsive brief is due December 15, 2006. We believe that we have meritorious defenses against this action, and we will continue vigorously to defend it.

Intellectual Property Litigation

Mangosoft, Inc. and Mangosoft Corporation filed a patent infringement action against us in the United States District Court for the District of New Hampshire on November 22, 2002. Plaintiffs alleged that we are willfully infringing U.S. Patent Nos. 6,148,377 (the 377 patent) and 5,918,229 (the 229 patent), which they claim to own. Plaintiffs seek damages based on our license sales of the Real Application Clusters database option, the 9i and 10g databases, and the Application Server, and seek injunctive relief. We have denied infringement and asserted affirmative defenses and have counterclaimed against plaintiffs for declaratory judgment that the 377 and 229 patents are invalid, unenforceable and not infringed by us. On May 19, 2004, the court held a claims construction (Markman) hearing, and on September 21, 2004, it issued a Markman order. On June 21, 2005, plaintiffs withdrew their allegations of infringement of the 229 patent. Discovery closed on July 1, 2005. Summary judgment motions were filed on August 25, 2005, and the court held a hearing on these motions on October 17, 2005. On March 14, 2006 the court ruled that Oracle s Real Application Clusters database option did not infringe the 377 patent.

Oracle s counterclaims against Mangosoft, alleging that the 377 patent is invalid and unenforceable, are the only claims that the Court has left open for trial. On April 21, 2006 Mangosoft filed a motion asking that Mangosoft be allowed to appeal the non-infringement ruling immediately to the Federal Circuit Court of Appeals and that trial on Oracle s counterclaims be stayed until that appeal has been resolved. Oracle filed a brief opposing that motion on May 8, 2006. The Court has not yet ruled on the motion, nor has it set a trial date for the remaining two issues.

Other Litigation

We are party to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business, including proceedings and claims that relate to acquisitions we have completed or to companies we have acquired or are attempting to acquire. While the outcome of these matters cannot be predicted with certainty, we do not believe that the outcome of any of these claims or any of the above mentioned legal matters will have a material adverse effect on our consolidated financial position, results of operations or cash flow.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

We begin Management s Discussion and Analysis of Financial Condition and Results of Operations with an overview of our key operating business segments and significant trends. This overview is followed by a discussion of our critical accounting policies and estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then provide a more detailed analysis of our financial condition and results of operations.

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties that could cause our actual results to differ materially. When used in this report, the words expects, anticipates, intends, plans, believes, seeks, estimates and similar expressions are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this Quarterly Report. We undertake no obligation to publicly release any revisions to the forward-looking statements after the date of this document. You should carefully review the risk factors described in other documents we file from time to time with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended May 31, 2006 and the other Quarterly Reports on Form 10-Q to be filed by us in our fiscal year 2007, which runs from June 1, 2006 to May 31, 2007.

Business Overview

We are the world s largest enterprise software company. We are organized into two businesses, software and services, which are further divided into five operating segments. Each of these operating segments has unique characteristics and faces different opportunities and challenges. Although we report our actual results in United States dollars, we conduct a significant number of transactions in currencies other than United States dollars. Therefore, we present constant currency information to provide a framework for assessing how our underlying business performed excluding the effect of foreign currency rate fluctuations. An overview of our five operating segments follows.

Software Business

Our software business is comprised of two operating segments: (1) new software license revenues and (2) software license updates and product support revenues. We expect that our software business revenues will continue to increase, which should allow us to improve margins and profits and continue to make investments in research and development.

New Software Licenses: We license our database and middleware as well as our applications software to businesses of many sizes, government agencies, educational institutions and resellers. The growth in new software license revenues is affected by the strength of general economic and business conditions, governmental budgetary constraints, the competitive position of our software products and acquisitions. The new software license business is also characterized by long sales cycles. The timing of a few large software license transactions can substantially affect our quarterly new software license revenues. Since our new software license revenues in a particular quarter can be difficult to predict as a result of the timing of a few large software license transactions, we believe that analysis of new software revenues on a trailing 4-quarter period provides more visibility into the underlying fundamental performance of our software revenues than analysis of quarterly revenues. New software license margins have been affected by amortization of intangible assets associated with acquisitions.

Competition in the software business is intense. Our goal is to maintain a first or second position in each of our software product categories and certain industry segments as well as to grow our software revenues faster than our competitors. We believe that the features and functionality of our software products are as strong as they have ever been. We have focused on lowering the total cost of ownership of our software products by improving integration, decreasing installation times, lowering administration costs and improving the ease of use. Reducing the total cost of ownership of our products provides our customers with a higher return on their investment,

Table of Contents

which we believe will create more demand and provide us with a competitive advantage. We have also continued to focus on improving the overall quality of our software products and service levels. We believe this will lead to higher customer satisfaction and loyalty and help us achieve our goal of becoming our customers leading technology advisor.

Software License Updates and Product Support: Customers that purchase software license updates and product support are granted rights to unspecified product upgrades and maintenance releases issued during the support period, as well as technical support assistance. Substantially all of our customers renew their software license updates and product support contracts annually, thereby eliminating the need to repurchase new software licenses when new upgrades are released. The growth of software license updates and product support revenues is influenced by four factors: (1) the support contract base of companies acquired (2) the renewal rate of the support contract base, (3) the amount of new support contracts sold in connection with the sale of new software licenses and (4) inflationary support price increases.

Software license updates and product support revenues, which represent approximately 47% of our total revenues on a trailing 4-quarter basis, is our highest margin business unit. Support margins over the last trailing 4-quarters were 84%, and account for 76% of our total margins over the same respective period. We believe that software license updates and product support revenues and margins will continue to grow for the following reasons:

- Acquisitions over the past two years have significantly increased our support contract base, as well as the portfolio of products available to be licensed.

- Substantially all customers purchase license updates and product support subscriptions when they buy new software licenses, resulting in a further increase in our support subscription contract base. Even if license revenue growth was flat, software license updates and product support revenues would continue to grow assuming renewal and cancellation rates remained relatively constant since substantially all new software license transactions add to the support contract base.

- Substantially all of our customers, including customers from acquired companies, renew their support contracts when eligible for renewal.

- When support contracts renew, inflationary price increases are negotiated, where possible.

We record adjustments to reduce support obligations assumed in business acquisitions to their estimated fair value at the acquisition dates. As a result, we did not recognize software license updates and product support revenues related to support contracts in the amount of $70 million and $139 million that would have been otherwise recorded by acquired businesses as independent entities in the three months ended August 31, 2006 and 2005, respectively. To the extent underlying support contracts are renewed, we will recognize the revenue for the full value of the support contracts over the support periods, the majority of which are one year.

Services Business

Our services business consists of consulting, On Demand and education revenues. Our services business, which represents 20% of our total revenues on a trailing 4-quarter basis, has significantly lower margins than our software business.

Consulting: Consulting revenues have increased primarily due to consulting services provided by i-flex as well as an increase in application implementations resulting from higher applications new license revenue over the last year. We expect consulting revenues to continue to grow as consulting revenues tend to lag software revenues by several quarters since consulting services, if purchased, are typically performed after the purchase of new software licenses and our new license growth rates have increased over the last several quarters.

On Demand: On Demand includes our Oracle On Demand software as a service and outsourcing offerings as well as Advanced Customer Services. We believe that our On Demand offerings provide an additional opportunity for customers to lower their total cost of ownership and can therefore provide us with a competitive advantage. We have and plan to continue to make investments in Oracle On Demand to support current and future revenue growth, which has negatively impacted On Demand margins and may continue to do so in the future.

Education: The purpose of our education services is to further enhance the usability of our software products by our customers and to create opportunities to grow software revenues. Education revenues have been impacted by personnel reductions in our customers information technology departments, tighter controls over discretionary spending and greater use of outsourcing solutions. Despite these trends, we expect education revenues to increase in fiscal 2007, primarily due to an increase in customer training on the use of our acquired application products.

Operating Margins

We continually focus on improving our operating margins by providing our customers with superior products and services as well as improving our cost structure by hiring personnel in countries where advanced technical expertise is available at lower costs. As part of this effort, we continually evaluate our workforce and make adjustments where we deem appropriate. When we make adjustments to our workforce, we may incur expenses associated with workforce reductions that delay the benefit of a more efficient workforce structure, but we believe that the fundamental shift towards globalization is crucial to maintaining a long-term competitive cost structure.

Acquisitions

An active acquisition program is an important element of our corporate strategy. In the last two years, we have paid an aggregate of $20 billion for our acquisitions, including Siebel, a provider of customer relationship management software; PeopleSoft, a provider of enterprise applications software products; our investment in i-flex, a provider of software solutions and services to the financial services industry; and others. We completed all of our planned legal-entity mergers, information system conversions and integration related to our acquisitions except for our current quarter acquisitions which we expect to finalize in the next three months.

We believe our recent acquisitions support our long-term strategic direction, strengthen our competitive position, particularly in the applications market, expand our customer base and provide greater scale to increase our investment in research and development to accelerate innovation, increase stockholder value and grow our earnings. We expect to continue to acquire companies, products, services and technologies. See Note 3 of Notes to Condensed Consolidated Financial Statements for additional information related to our recent acquisitions.

We believe we can fund additional acquisitions with our internally available cash and marketable securities, cash generated from operations, amounts available under our commercial paper program, additional borrowings or from the issuance of additional securities. We estimate the financial impact of any potential acquisition with regard to earnings, operating margin, cash flow and return on invested capital targets before deciding to move forward with an acquisition.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Business Combinations
- PeopleSoft Customer Assurance Program
- Goodwill
- Revenue Recognition
- Accounting for Income Taxes
- Legal Contingencies
- Stock-Based Compensation
- Allowances for Doubtful Accounts and Returns

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management s judgment in its application. There are also areas in which management s judgment in selecting among available alternatives would not produce a materially different result. Our senior management has reviewed these critical accounting policies and related disclosures with the Finance and Audit Committee of the Board of Directors.

Business Combinations

In accordance with business combination accounting, we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed as well as to in-process research and development based on their estimated fair values. We engage third-party appraisal firms to assist management in determining the fair values of certain assets acquired and liabilities assumed. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets.

Management makes estimates of fair value based upon assumptions believed to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Critical estimates in valuing certain of the intangible assets include but are not limited to: future expected cash flows from license sales, maintenance agreements, consulting contracts, customer contracts and acquired developed technologies and patents; expected costs to develop the in-process research and development into commercially viable products and estimated cash flows from the projects when completed; the acquired company s brand awareness and market position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company s product portfolio; and discount rates. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

In connection with purchase price allocations, we estimate the fair value of the support obligations assumed in connection with acquisitions. The estimated fair value of the support obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin. The estimated costs to fulfill the support obligations are based on the historical direct costs related to providing the support services and to correct any errors in the software products acquired. We do not include any costs associated with selling efforts or research and development or the related fulfillment margins on these costs. Profit associated with selling effort is excluded because the acquired entities would have concluded the selling effort on the support contracts prior to the acquisition date. The estimated research and development costs are not included in the fair value determination, as these costs are not deemed to represent a legal obligation at the time of acquisition. The sum of the costs and operating profit approximates, in theory, the amount that we would be required to pay a third party to assume the support obligation.

Table of Contents

As a result, we did not recognize software license updates and product support revenues related to support contracts in the amount of $70 million and $139 million that would have been otherwise recorded by acquired businesses as independent entities in the three months ended August 31, 2006 and 2005, respectively. Historically, substantially all of our customers, including customers from acquired companies, renew their contracts when the contract is eligible for renewal. To the extent these underlying support contracts are renewed, we will recognize the revenue for the full value of the support contracts over the support periods, the majority of which are one year. Had we included our estimated selling and research and development activities, and the associated margin for unspecified product upgrades and enhancements to be provided under our assumed support arrangements, the fair value of the support obligations would have been significantly higher than what we have recorded and we would have recorded a higher amount of software license updates and product support revenue historically and in future periods related to these assumed contracts.

Other significant estimates associated with the accounting for acquisitions include restructuring costs. Restructuring costs are primarily comprised of severance costs, costs of consolidating duplicate facilities and contract termination costs. Restructuring expenses are based upon plans that have been committed to by management but which are subject to refinement. To estimate restructuring expenses, management utilizes assumptions of the number of employees that would be involuntarily terminated and of future costs to operate and eventually vacate duplicate facilities. Estimated restructuring expenses may change as management executes the approved plan. Decreases to the cost estimates of executing the currently approved plans associated with pre-merger activities of the companies we acquire are recorded as an adjustment to goodwill indefinitely, whereas increases to the estimates are recorded as an adjustment to goodwill during the purchase price allocation period (generally within one year of the acquisition date) and as operating expenses thereafter. Changes in cost estimates of executing the currently approved plans associated with our pre-merger activities are recorded in restructuring expenses.

For a given acquisition, we may identify certain pre-acquisition contingencies. If, during the purchase price allocation period, we are able to determine the fair value of a pre-acquisition contingency, we will include that amount in the purchase price allocation. If, as of the end of the purchase price allocation period, we are unable to determine the fair value of a pre-acquisition contingency, we will evaluate whether to include an amount in the purchase price allocation based on whether it is probable a liability had been incurred and whether an amount can be reasonably estimated. After the end of the purchase price allocation period, any adjustment that results from a pre-acquisition contingency will be included in our operating results in the period in which the adjustment is determined.

PeopleSoft Customer Assurance Program

As discussed in Note 14 of Notes to Condensed Consolidated Financial Statements, in June 2003, in response to our tender offer, PeopleSoft implemented what it referred to as the customer assurance program or CAP. The CAP incorporated a provision in PeopleSoft s standard licensing arrangement that purports contractually to burden Oracle, as a result of our acquisition of PeopleSoft, with a contingent obligation to make payments to PeopleSoft customers should we fail to take certain business actions for a fixed period, which typically expires four years from the date of the contract. We have concluded that, as of the date of the acquisition, the penalty provisions under the CAP represent a contingent liability of Oracle. We have not recorded a liability related to the CAP, as we do not believe it is probable that our post-acquisition activities related to the PeopleSoft and JD Edwards product lines will trigger an obligation to make any payment pursuant to the CAP. The maximum potential penalty under the CAP as of August 31, 2006 was $3.5 billion. Unless the CAP provisions are removed from these licensing arrangements, we do not expect the aggregate potential CAP obligation to decline substantially until fiscal year 2008 when these provisions begin to expire. While no assurance can be given as to the ultimate outcome of potential litigation, we believe we would also have substantial defenses with respect to the legality and enforceability of the CAP contract provisions in response to any claims seeking payment from Oracle under the CAP terms. If we determine in the future that a payment pursuant to the CAP is probable, the estimated liability would be recorded in our operating results in the period in which such liability is determined.

Goodwill

We review goodwill for impairment annually and whenever events or changes in circumstances indicate its carrying value may not be recoverable in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The provisions of Statement 142 require that a two-step impairment test be performed on goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. Our reporting units are consistent with the reportable segments identified in Note 13 of the Notes to Condensed Consolidated Financial Statements. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is considered not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, then we would record an impairment loss equal to the difference.

Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions and determination of appropriate market comparables. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates. In addition, we make certain judgments and assumptions in allocating shared assets and liabilities to determine the carrying values for each of our reporting units. Our most recent annual goodwill impairment analysis, which was performed during the fourth quarter of fiscal 2006, did not result in an impairment charge.

Revenue Recognition

We derive revenues from the following sources: (1) software, which includes new software license and software license updates and product support revenues, and (2) services, which include consulting, On Demand and education revenues.

New software license revenues represent fees earned from granting customers licenses to use our database and middleware as well as our applications software, and exclude revenues derived from software license updates, which are included in software license updates and product support. While the basis for software license revenue recognition is substantially governed by the provisions of Statement of Position No. 97-2, *Software Revenue Recognition*, issued by the American Institute of Certified Public Accountants, we exercise judgment and use estimates in connection with the determination of the amount of software and services revenues to be recognized in each accounting period.

For software license arrangements that do not require significant modification or customization of the underlying software, we recognize new software license revenue when: (1) we enter into a legally binding arrangement with a customer for the license of software; (2) we deliver the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is probable. Substantially all of our new software license revenues are recognized in this manner.

The vast majority of our software license arrangements include software license updates and product support, which are recognized ratably over the term of the arrangement, typically one year. Software license updates provide customers with rights to unspecified software product upgrades, maintenance releases and patches released during the term of the support period. Product support includes internet access to technical content, as well as internet and telephone access to technical support personnel. Software license updates and product support are generally priced as a percentage of the net new software license fees. Substantially all of our customers purchase both software license updates and product support when they acquire new software licenses. In addition, substantially all of our customers renew their software license updates and product support contracts annually.

Many of our software arrangements include consulting implementation services sold separately under consulting engagement contracts. Consulting revenues from these arrangements are generally accounted for separately from new software license revenues because the arrangements qualify as service transactions as defined in SOP 97-2. The more significant factors considered in determining whether the revenue should be accounted for separately include the nature of services (i.e., consideration of whether the services are essential to the functionality of the licensed product), degree of risk, availability of services from other vendors, timing of payments and impact of milestones or acceptance criteria on the realizability of the software license fee. Revenues for consulting services are generally recognized as the services are performed. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved. We estimate the proportional performance on contracts with fixed or not to exceed fees on a monthly basis utilizing hours incurred to date as a percentage of total estimated hours to complete the project. We recognize no more than 90% of the milestone or total contract amount until project acceptance is obtained. If we do not have a sufficient basis to measure progress towards completion, revenue is recognized when we receive final acceptance from the customer. When total cost estimates exceed revenues, we accrue for the estimated losses immediately using cost estimates that are based upon an average fully burdened daily rate applicable to the consulting organization delivering the services. The complexity of the estimation process and factors relating to the assumptions, risks and uncertainties inherent with the application of the proportional performance method of accounting affect the amounts of revenue and related expenses reported in our consolidated financial statements. A number of internal and external factors can affect our estimates, including labor rates, utilization and efficiency variances and specification and testing requirement changes.

If an arrangement does not qualify for separate accounting of the software license and consulting transactions, then new software license revenue is generally recognized together with the consulting services based on contract accounting using either the percentage-of-completion or completed-contract method. Contract accounting is applied to any arrangements: (1) that include milestones or customer specific acceptance criteria that may affect collection of the software license fees; (2) where services include significant modification or customization of the software; (3) where significant consulting services are provided for in the software license contract without additional charge or are substantially discounted; or (4) where the software license payment is tied to the performance of consulting services.

On Demand is comprised of Oracle On Demand and Advanced Customer Services. Oracle On Demand provides multi-featured software and hardware management and maintenance services for our database and middleware as well as our applications software. Advanced Customer Services are earned by providing customers configuration and performance analysis, personalized support and annual on-site technical services. Revenues from On Demand services are recognized over the term of the service contract, which is generally one year.

Education revenues include instructor-led, media-based and internet-based training in the use of our products. Education revenues are recognized as the classes or other education offerings are delivered.

For arrangements with multiple elements, we allocate revenue to each element of a transaction based upon its fair value as determined by vendor specific objective evidence. Vendor specific objective evidence of fair value for all elements of an arrangement is based upon the normal pricing and discounting practices for those products and services when sold separately and for software license updates and product support services, is additionally measured by the renewal rate offered to the customer. We may modify our pricing practices in the future, which could result in changes in our vendor specific objective evidence of fair value for these undelivered elements. As a result, our future revenue recognition for multiple element arrangements could differ significantly from our historical results.

We defer revenue for any undelivered elements, and recognize revenue when the product is delivered or over the period in which the service is performed, in accordance with our revenue recognition policy for such element. If we cannot objectively determine the fair value of any undelivered element included in bundled software and service arrangements, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, we use the residual method to record revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

Substantially all of our software license arrangements do not include acceptance provisions. However, if acceptance provisions exist as part of public policy, for example in agreements with government entities when acceptance periods are required by law, or within previously executed terms and conditions that are referenced in the current agreement and are short-term in nature, we provide for a sales return allowance in accordance with FASB Statement No. 48, *Revenue Recognition when Right of Return Exists*. If acceptance provisions are long-term in nature or are not included as standard terms of an arrangement or if we cannot reasonably estimate the incidence of returns, revenue is recognized upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.

We also evaluate arrangements with governmental entities containing fiscal funding or termination for convenience provisions, when such provisions are required by law, to determine the probability of possible cancellation. We consider multiple factors, including the history with the customer in similar transactions, the essential use of the software licenses and the planning, budgeting and approval processes undertaken by the governmental entity. If we determine upon execution of these arrangements that the likelihood of non-acceptance is remote, we then recognize revenue once all of the criteria described above have been met. If such a determination cannot be made, revenue is recognized upon the earlier of cash receipt or approval of the applicable funding provision by the governmental entity.

We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other revenue recognition requirements are met. Our standard payment terms are net 30; however, terms may vary based on the country in which the agreement is executed. Payments that are due within six months are generally deemed to be fixed or determinable based on our successful collection history on such arrangements, and thereby satisfy the required criteria for revenue recognition.

While most of our arrangements include short-term payment terms, we have a standard practice of providing long-term financing to credit worthy customers through our financing division. Since fiscal 1989, when our financing division was formed, we have established a history of collection, without concessions, on these receivables with payment terms that generally extend up to five years from the contract date. Provided all other revenue recognition criteria have been met, we recognize new software license revenues for these arrangements upon delivery, net of any payment discounts from financing transactions. We have generally sold receivables financed through our financing division on a non-recourse basis to third party financing institutions. We account for the sale of these receivables as true sales as defined in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Our customers include several of our suppliers and on rare occasion, we have purchased goods or services for our operations from these vendors at or about the same time that we have licensed our software to these same companies (Concurrent Transaction). Software license agreements that occur within a three-month time period from the date we have purchased goods or services from that same customer are reviewed for appropriate accounting treatment and disclosure. When we acquire goods or services from a customer, we negotiate the purchase separately from any software license transaction, at terms we consider to be at arm s length, and settle the purchase in cash. We recognize new software license revenue from Concurrent Transactions if all of our revenue recognition criteria are met and the goods and services acquired are necessary for our current operations.

Table of Contents

Accounting for Income Taxes

Significant judgment is required in determining our worldwide income tax provision. In the ordinary course of a global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of revenue sharing and cost reimbursement arrangements among related entities, the process of identifying items of revenue and expense that qualify for preferential tax treatment, and segregation of foreign and domestic income and expense to avoid double taxation. Although we believe that our estimates are reasonable, the final tax outcome of these matters could be different from that which is reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision and net income in the period in which such determination is made.

Our effective tax rate includes the impact of certain undistributed foreign earnings for which no U.S. taxes have been provided because such earnings are planned to be indefinitely reinvested outside the United States. Remittances of foreign earnings to the U.S. are planned based on projected cash flow, working capital and investment needs of foreign and domestic operations. Based on these assumptions, we estimate the amount that will be distributed to the U.S. and provide U.S. federal taxes on these amounts. Material changes in our estimates could impact our effective tax rate.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income in those jurisdictions where the deferred tax assets are located. We consider future market growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies in determining the need for a valuation allowance. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period in which we make such determination. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, we would reverse the applicable portion of the previously provided valuation allowance.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are generally recorded in the period when the tax returns are filed and the global tax implications are known.

The amount of income tax we pay is subject to ongoing audits by federal, state and foreign tax authorities, which often result in proposed assessments. Our estimate of the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which our earnings or deductions are realized may differ from our current estimates. As a result, our effective tax rate may fluctuate significantly on a quarterly basis.

As part of our accounting for business combinations, some of the purchase price is allocated to goodwill and intangible assets. Impairment charges associated with goodwill are generally not tax deductible and will result in an increased effective income tax rate in the quarter the impairment is recorded. Amortization expense associated with acquired intangible assets is generally not tax deductible; however, deferred taxes have been recorded for non-deductible amortization expense as part of the purchase price allocation. We have taken into account the allocation of these identified intangibles among different taxing jurisdictions, including those with nominal or zero percent tax rates, in establishing the related deferred tax liabilities. Income tax contingencies existing as of the acquisition dates of the acquired companies are evaluated quarterly and any adjustments are recorded as an adjustment to goodwill.

Table of Contents

Legal Contingencies

We are currently involved in various claims and legal proceedings. Quarterly, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position.

Stock-Based Compensation

On June 1, 2006, we adopted Statement No. 123 (revised 2004), *Share-Based Payment*, under the modified prospective method. Statement 123R generally requires share-based payments to employees to be recognized in our consolidated statements of operations based on their fair values. Prior to June 1, 2006, we accounted for our stock-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* and applied the disclosure provisions of Statement No. 123, *Accounting for Stock-Based Compensation*, as amended. Under Opinion 25, we generally did not recognize any compensation expense for stock options as the exercise price of our options was equivalent to the market price of our common stock on the date of grant. Substantially all of our stock-based compensation expense recognized under Opinion 25 related to options assumed from acquisitions. For pro forma disclosures, the estimated fair values for options granted and options assumed were amortized using the accelerated expense attribution method. In addition, we reduced pro forma stock compensation expense for actual forfeitures in the periods they occurred.

Upon our adoption of Statement 123R, we were required to estimate the awards that we ultimately expect to vest and to reduce stock-based compensation expense for the effects of estimated forfeitures of awards over the expense recognition period. Although we estimated forfeitures based on historical experience, forfeitures in the future may differ. Under Statement 123R, the forfeiture rate must be revised if actual forfeitures differ from our original estimates. Also in connection with our adoption of Statement 123R, we elected to recognize awards granted after our adoption date under the straight-line amortization method.

We estimate the fair value of employee stock options using a Black-Scholes-Merton option-pricing model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their options. The risk-free interest rate assumption is based upon United States treasury interest rates appropriate for the expected life of the awards. We use the implied volatility of our publicly traded stock options in order to estimate future stock price trends as we believe that implied volatility is more representative of future stock price trends than historical volatility. In order to determine the estimated period of time that we expect employees to hold their options, we have used historical rates of employee groups by job classification. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future.

We record deferred tax assets for stock-based awards that result in deductions on our income tax returns, based on the amount of stock-based compensation recognized and the statutory tax rate in the jurisdiction in which we will receive a tax deduction. Differences between the deferred tax assets recognized for financial reporting purposes and the actual tax deduction reported on our income tax returns are recorded in additional paid-in capital. If the tax deduction is less than the deferred tax asset, such shortfalls reduce our pool of excess tax benefits. If the pool of excess tax benefits is reduced to zero, then subsequent shortfalls would increase our income tax expense. Our pool of excess tax benefits is computed in accordance with the alternative transition method as prescribed under FASB Staff Position FAS123R-3, *Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*.

Table of Contents

The accounting guidance under Statement 123R is relatively new and several interpretations have been released since the pronouncement has been issued. Additional interpretations may be released and the application of these principles may be subject to further refinement over time. In addition, to the extent we change the terms of our employee stock-based compensation programs, refine different assumptions in future periods such as forfeiture rates that differ from our estimates and implement the changes in accounting methodologies prescribed by Statement 123R such as the change in our expense attribution method from accelerated to straight-line, the stock-based compensation expense that we record in future periods may differ significantly from what we have recorded in the current period.

Allowances for Doubtful Accounts and Returns

We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically reviewed, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current economic trends. If the historical data we use to calculate the allowance for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected.

We also record a provision for estimated sales returns and allowances on product and service related sales in the same period the related revenues are recorded. These estimates are based on historical sales returns, analysis of credit memo data and other known factors. If the historical data we use to calculate these estimates do not properly reflect future returns, then a change in the allowances would be made in the period in which such a determination is made and revenues in that period could be materially affected.

Results of Operations

The fluctuations in operating results of Oracle in the first quarter of fiscal 2007 compared with the same period in fiscal 2006 are affected by acquisitions, principally our acquisition of Siebel on January 31, 2006 and the consolidation of i-flex beginning June 1, 2006.

In our discussion of changes in our results of operations from the first quarter of fiscal 2007 compared to the first quarter of fiscal 2006, we quantify the contribution of our acquired products to growth in new software license revenues, the amount of revenues associated with software license updates and product support as well as On Demand services and present supplemental disclosure related to acquisition accounting where applicable. Although certain revenues were quantifiable, we are unable to identify consulting and education revenues of Siebel in the first quarter of fiscal 2007 as well as allocate costs associated with the Siebel products and services because the substantial majority of former Siebel sales and services personnel were fully integrated into our existing operations. We have also quantified the significant revenues and expenses of i-flex. We caution readers that, while pre- and post-acquisition comparisons as well as the quantified amounts themselves may provide indications of general trends, the information has inherent limitations for the following reasons:

- The quantification cannot address the substantial effects attributable to our sales force integration efforts, in particular the effect of having a single sales force offer similar products. The commissions earned by our integrated sales force generally do not vary based on the application product sold. We believe that if our sales forces had not been integrated, the relative mix of products sold would have been different.

- The acquisition of Siebel did not result in our entering a new line of business or product category. Therefore, we provided multiple products with substantially similar features and functionality.

- Although substantially all of our customers, including customers from acquired companies, renew their contracts when the contract is eligible for renewal, amounts shown as support deferred revenue in our supplemental disclosure related to acquisition accounting are not necessarily indicative of revenue improvements we will achieve upon contract renewal to the extent customers do not renew.

Constant Currency Presentation

We compare the percent change in the results from one period to another period in this annual report using constant currency disclosure. We present constant currency information to provide a framework for assessing how our underlying businesses performed excluding the effect of foreign currency rate fluctuations. To present this information, current and prior year results for entities reporting in currencies other than United States dollars are converted into United States dollars at the exchange rate in effect on May 31, 2006, which was the last day of our prior fiscal year, rather than the actual exchange rates in effect during the respective periods. For example, if an entity reporting in Euros had revenues of 1.0 million Euros from products sold on August 31, 2006 and August 31, 2005, our financial statements would reflect revenues of $1.28 million during the first quarter of fiscal 2007 (using 1.28 as the exchange rate) and $1.23 million during the first quarter of fiscal 2006 (using 1.23 as the exchange rate). The constant currency presentation would translate the results for the three months ended August 31, 2006 and 2005 using the May 31, 2006 exchange rate and indicate, in this example, no change in revenues during the periods. In each of the tables below, we present the percent change based on actual results as reported and based on constant currency.

Total Revenues and Operating Expenses

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	**2006**	**Actual**	**Constant**	**2005**
Total Revenues by Geography:				
Americas	$ 1,956	33%	32%	$ 1,476
EMEA [(1)]	1,140	29%	24%	883
Asia Pacific	495	21%	22%	409
Total revenues	3,591	30%	28%	2,768
Total Operating Expenses	2,648	29%	27%	2,056
Total Operating Margin	$ 943	32%	29%	$ 712
Total Operating Margin %	26%			26%
% Revenues by Geography:				
Americas	54%			53%
EMEA	32%			32%
Asia Pacific	14%			15%
Total Revenues by Business:				
Software	$ 2,745			$ 2,131
Services	846			637
Total revenues	$ 3,591			$ 2,768
% Revenues by Business:				
Software	76%			77%
Services	24%			23%

(1) Comprised of Europe, the Middle East and Africa

Total revenues increased in the first quarter of fiscal 2007 due to gains in market share across all product lines and geographies, incremental revenues from acquisitions and an increased demand for our service offerings. Excluding the effect of currency rate fluctuations, software license updates and product support revenues contributed 53% to the growth in total revenues, services revenues contributed 26% and new software licenses contributed 21%. Excluding the effects of currency rate fluctuations, the Americas contributed 60% to the increase in total revenues, EMEA contributed 28% and Asia Pacific contributed 12%. Total revenues in the Americas, specifically in the United States, increased at a faster rate than in other regions primarily due to the relative geographical mix of revenues from our acquired companies.

Table of Contents

Operating expenses were negatively affected by 2 percentage points as a result of the strengthening of the United States dollar relative to other major international currencies. Excluding the effect of currency rate fluctuations, the increase in operating expenses is primarily due to higher headcount levels and associated personnel related costs resulting from acquisitions as well as the hiring of personnel to support the growth in revenues. In addition, operating expenses also increased due to higher commissions as a result of the increase in revenues, greater amortization of intangible assets and higher stock-based compensation expenses related to the adoption of Statement 123R. Operating margins as a percentage of total revenues remained flat.

International operations will continue to provide a significant portion of total revenues. As a result, total revenues and expenses will be affected by changes in the relative strength of the United States dollar against certain major international currencies.

Supplemental Disclosure Related to Acquisition Accounting and Stock-Based Compensation

To supplement our consolidated financial information we believe the following information is helpful to an overall understanding of our past financial performance and prospects for the future. Readers are directed to the introduction under Results of Operations for a discussion of the inherent limitations in comparing pre- and post-acquisition information.

The results of operations include the following business combination accounting entries and expenses related to acquisitions as well as other significant expenses including stock-based compensation:

(in millions)	Three Months Ended August 31, 2006	2005
Support deferred revenues [1]	$ 70	$ 139
Amortization of intangible assets [2]	198	123
Acquisition related charges [3] [5]	48	28
Restructuring [4]	9	11
Stock-based compensation [5]	50	9
Income tax effect [6]	(114)	(91)
	$ 261	$ 219

(1) In connection with purchase price allocations related to our acquisitions, we have estimated the fair values of the support obligations assumed. Due to our application of business combination accounting rules, software license updates and product support revenues related to support contracts in the amount of $70 and $139 that would have been otherwise recorded by acquired businesses as independent entities, were not recognized during the three months ended August 31, 2006 and 2005, respectively. Estimated software license updates and product support revenues related to support contracts assumed that will not be recognized due to the application of business combination accounting rules in future periods are as follows:

Remainder of Fiscal 2007	$ 81
Fiscal 2008	9
Total	$ 90

To the extent customers renew these support contracts, we expect to recognize revenue for the full contract value over the support renewal period.

Table of Contents

(2) Represents the amortization of intangible assets acquired in connection with acquisitions, primarily PeopleSoft and Siebel. Estimated future amortization expense related to intangible assets is as follows:

Remainder of Fiscal 2007	$ 603
Fiscal 2008	790
Fiscal 2009	783
Fiscal 2010	660
Fiscal 2011	454
Fiscal 2012	358
Thereafter	992
Total	$ 4,640

(3) Acquisition related charges primarily consist of in-process research and development expenses, integration-related professional services, stock-based compensation expenses and personnel related costs for transitional employees.

(4) Restructuring costs relate to Oracle employee severance and facility closures in connection with restructuring plans initiated in the third quarter of fiscal 2006 and 2005.

(5) Stock-based compensation is included in the following operating expense line items of our condensed consolidated statements of operations:

	Three Months Ended August 31,	
	2006	2005
Sales and marketing	$ 10	$ 2
Software license updates and product support	3	1
Cost of services	3	2
Research and development	22	4
General and administrative	12	
Subtotal	50	9
Acquisition related charges		3
Total	$ 50	$ 12

Stock-based compensation included in acquisition related charges resulted from unvested options assumed from acquisitions whose vesting was fully accelerated upon termination of the employees pursuant to the terms of these options.

We adopted Statement 123R on June 1, 2006 under the modified prospective method. Statement 123R requires us to record non-cash operating expenses associated with stock option awards at their estimated fair values. Prior to our Statement 123R adoption, we were required to record stock-based compensation expenses at intrinsic values, which were substantially related to options assumed from acquisitions. In accordance with the modified prospective method, our financial statements for prior periods have not been restated to reflect, and do not include, the changes in methodology to expense options at fair values in accordance with Statement 123R. As of August 31, 2006, the unrecognized compensation expense associated under the fair value method for shares expected to vest was approximately $369 million and is expected to be recognized over a weighted average period of 1.4 years. See Note 2 of Notes to Condensed Consolidated Financial Statements for additional information regarding our adoption of Statement 123R.

(6) The income tax effect on purchase accounting adjustments and other significant expenses including stock-based compensation was calculated based on our effective tax rate of 30.4% and 29.2% in the three months ended August 31, 2006 and 2005, respectively.

Table of Contents

Software

Software includes new software licenses and software license updates and product support.

New Software Licenses: New software license revenues represent fees earned from granting customers licenses to use our database and middleware as well as our application software products. We continue to place significant emphasis, both domestically and internationally, on direct sales through our own sales force. We also continue to market our products through indirect channels.

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	**2006**	**Actual**	**Constant**	**2005**
New Software License Revenues:				
Americas	$ 362	31%	30%	$ 276
EMEA	260	28%	24%	204
Asia Pacific	182	22%	23%	149
Total revenues	804	28%	26%	629
Expenses:				
Sales and marketing [1]	740	21%	19%	613
Stock-based compensation	10	452%	452%	2
Amortization of intangible assets [2]	77	89%	89%	41
Total expenses	827	26%	25%	656
Total Margin	$ (23)	-13%	-18%	$ (27)
Total Margin %	-3%			-4%
% Revenues by Geography:				
Americas	45%			44%
EMEA	32%			32%
Asia Pacific	23%			24%
Revenues by Product:				
Database and middleware	$ 565	15%	13%	$ 492
Applications	228	80%	78%	127
Total revenues by product	793	28%	27%	619
Other revenues	11	15%	14%	10
Total new software license revenues	$ 804	28%	26%	$ 629
% Revenues by Product:				
Database and middleware	71%			79%
Applications	29%			21%

(1) Excluding stock-based compensation

(2) Included as a component of Amortization of Intangible Assets in our condensed consolidated statements of operations

Excluding the effect of currency rate fluctuations, new software license revenues increased 26% with strong revenue growth across all major product lines and geographies. Applications revenues contributed 60% to the increase in new software license revenues in the first quarter of fiscal 2007 while database and middleware revenues contributed 40%. The Americas contributed 50%, EMEA contributed 29% and Asia Pacific contributed 21% to the increase in new software license revenues.

We believe that the trailing 4-quarter growth rates more accurately reflect the underlying performance of our new software license business since large transactions can cause significant swings in our quarterly reported product revenue growth rates and are not predictive of our future quarterly or annual growth rates. Therefore, we provide a discussion of both quarterly and trailing 4-quarter product revenue growth rates.

Table of Contents

Excluding the effect of currency rate fluctuations, database and middleware revenues grew 13% in both the first quarter of fiscal 2007 and over the trailing 4-quarters as a result of a gain in market share, increased demand for our database and middleware products due to more competitive product features and functionality, better sales execution and incremental revenues from the licensing of Siebel products. Siebel products contributed $17 million to the total database and middleware revenue growth in the first quarter.

Excluding the effect of currency rate fluctuations, applications revenue increased 78% in the first quarter and 68% over the trailing 4-quarters as a result of a gain in market share, incremental revenues from acquired companies, better sales execution as a result of segmenting our sales force by product and a strengthening of our competitive position in the applications market across all geographic regions due to improved product features and functionality. Oracle products contributed $60 million to the growth in applications revenue in the first quarter of fiscal 2007, Siebel products contributed $31 million, and i-flex and other recently acquired products contributed $10 million.

New software license revenues earned from transactions over $0.5 million increased from 28% of new software license revenues in the first quarter of fiscal 2006 to 34% in the first quarter of fiscal 2007.

Excluding the effect of currency rate fluctuations, sales and marketing expenses increased in the first quarter of fiscal 2007 primarily due to higher salaries and related personnel expenses associated with our expanded sales force from acquired companies, most notably Siebel, higher amortization of intangible asset expenses as well as stock-based compensation expenses due to the adoption of Statement 123R. New software license margins improved slightly due to higher revenue volumes, partially offset by increased personnel related costs and higher amortization of intangible assets.

Software License Updates and Product Support: Software license updates grant customers rights to unspecified software product upgrades and maintenance releases issued during the support period. Product support includes internet access to technical content as well as internet and telephone access to technical support personnel. The cost of providing support services consists largely of personnel related expenses.

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	**2006**	**Actual**	**Constant**	**2005**
Software License Updates and Product Support Revenues:				
Americas	$ 1,103	30%	29%	$ 847
EMEA	614	31%	26%	467
Asia Pacific	224	19%	21%	188
Total revenues	1,941	29%	27%	1,502
Expenses:				
Software license updates and product support [1]	197	23%	21%	160
Stock-based compensation	3	225%	225%	1
Amortization of intangible assets [2]	111	44%	44%	77
Total expenses	311	30%	29%	238
Total Margin	$ 1,630	29%	27%	$ 1,264
Total Margin %	84%			84%
% Revenues by Geography:				
Americas	57%			56%
EMEA	32%			31%
Asia Pacific	11%			13%

(1) Excluding stock-based compensation

(2) Included as a component of Amortization of Intangible Assets in our condensed consolidated statements of operations

Excluding the effect of currency rate fluctuations, software license updates and product support revenues increased 27% as a result of the addition of software license updates and product support revenues associated

Table of Contents

with new software license revenues recognized over the trailing 4-quarters, the renewal of substantially all of the subscription base eligible for renewal in the current year and incremental revenues from the expansion of our customer base from acquisitions. Software license updates and product support revenues in the first quarter of fiscal 2007 include incremental revenues of $88 million from Siebel contracts. Excluding the effect of currency rate fluctuations, the Americas contributed 60% to the growth in software license updates and product support revenues, EMEA contributed 31% and Asia Pacific contributed 9%.

As a result of our acquisitions, we recorded adjustments to reduce support obligations assumed to their estimated fair value at the acquisition dates. Due to our application of business combination accounting rules, software license updates and product support revenues related to support contracts in the amounts of $70 million and $139 million that would have been otherwise recorded by our acquired businesses as independent entities, were not recognized in the first quarter of fiscal 2007 and 2006, respectively. Historically, substantially all of our customers, including customers from acquired companies, renew their support contracts when the contract is eligible for renewal. To the extent these underlying support contracts are renewed, we will recognize the revenue for the full value of the contracts over the support periods, the majority of which are one year.

Excluding the effect of currency rate fluctuations, software license updates and product support expenses increased primarily due to higher salary and benefits associated with increased headcount to support the expansion of our customer base and higher amortization of intangible asset expenses. The software license updates and product support margin as a percentage of revenues increased due to the expansion of our customer base, partially offset by higher amortization of intangible assets.

Services

Services consist of consulting, On Demand and education.

Consulting: Consulting revenues are earned by providing services to customers in the design, implementation, deployment and upgrade of our database and middleware as well as our applications software products. The cost of providing consulting services consists primarily of personnel related expenditures.

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	**2006**	**Actual**	**Constant**	**2005**
Consulting Revenues:				
Americas	$ 375	39%	39%	$ 270
EMEA	205	25%	20%	164
Asia Pacific	60	27%	28%	47
Total revenues	640	33%	31%	481
Expenses:				
Cost of services [(1)]	576	34%	31%	430
Stock-based compensation	2	9%	9%	2
Amortization of intangible assets [(2)]	4	362%	362%	1
Total expenses	582	35%	33%	433
Total Margin	$ 58	19%	18%	$ 48
Total Margin %	9%			10%
% Revenues by Geography:				
Americas	59%			56%
EMEA	32%			34%
Asia Pacific	9%			10%

(1) Excluding stock-based compensation
(2) Included as a component of Amortization of Intangible Assets in our condensed consolidated statements of operations

Table of Contents

Excluding the effect of currency rate fluctuations, consulting revenues increased in the first quarter of fiscal 2007 primarily due to an increase in application product implementations and billable hours. Consulting revenues include $66 million of revenues from i-flex. Excluding the effect of currency rate fluctuations, the Americas contributed 69% to the growth in consulting revenues, EMEA contributed 22% and Asia Pacific contributed 9%.

Excluding the effect of currency rate fluctuations, consulting expenses increased due to higher personnel related expenses attributed to higher headcount levels and third-party contractor expenses. Consulting expenses include $59 million of expenses from i-flex. The total consulting margin as a percentage of revenues declined due to lower utilization of resources, partially offset by higher margins contributed from i-flex.

On Demand: On Demand includes Oracle On Demand and Advanced Customer Services. Oracle On Demand provides multi-featured software and hardware management and maintenance services for our database and middleware as well as our applications software. Advanced Customer Services consists of configuration and performance analysis, personalized support and annual on-site technical services. The cost of providing On Demand services consist primarily of personnel related expenditures and hardware and facilities costs.

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	**2006**	**Actual**	**Constant**	**2005**
On Demand Revenues:				
Americas	$ 75	58%	58%	$ 48
EMEA	36	43%	37%	25
Asia Pacific	14	24%	23%	11
Total revenues	125	49%	47%	84
Expenses:				
Cost of services [(1)]	133	79%	76%	74
Stock-based compensation	1	100%	100%	
Amortization of intangible assets [(2)]	3	100%	100%	
Total expenses	137	85%	78%	74
Total Margin	$ (12)	-232%	-227%	$ 10
Total Margin %	-10%			12%
% Revenues by Geography:				
Americas	60%			57%
EMEA	29%			30%
Asia Pacific	11%			13%

(1) Excluding stock-based compensation

(2) Included as a component of Amortization of Intangible Assets in our condensed consolidated statements of operations

Excluding the effect of currency rate fluctuations, On Demand revenues increased in the first quarter of fiscal 2007 due to the expansion of our subscription base in Oracle On Demand services and higher revenues from Advanced Customer Services. On Demand revenues include $23 million of revenues from Siebel. Excluding the effect of currency rate fluctuations, the Americas contributed 69% to the increase in On Demand revenues, EMEA contributed 25% and Asia Pacific contributed 6%.

Excluding the effect of currency rate fluctuations, On Demand expenses increased due to higher personnel related expenditures in both our Oracle On Demand and Advanced Customer Services businesses as a result of additional personnel acquired from Siebel as well as higher computer and technology related costs. The total On Demand margin as a percentage of revenues declined due to lower margins associated with the Siebel On Demand offering as well as additional expenditures incurred to support planned future growth.

Table of Contents

Education: Education revenues are earned by providing instructor led, media based and internet based training in the use of our database and middleware as well as our applications software. Education expenses primarily consist of personnel related expenditures, facilities and external contractor costs.

(Dollars in millions)	2006	Actual	Constant	2005
	Three Months Ended August 31,	Percent Change		
Education Revenues:				
Americas	$ 41	17%	16%	$ 35
EMEA	25	10%	6%	23
Asia Pacific	15	6%	7%	14
Total revenues	81	13%	11%	72
Cost of Services	68	22%	18%	56
Total Margin	$ 13	-18%	-14%	$ 16
Total Margin %	16%			22%
% Revenues by Geography:				
Americas	51%			49%
EMEA	31%			32%
Asia Pacific	18%			19%

Excluding the effect of currency rate fluctuations, education revenues increased in the first quarter of fiscal 2007, primarily due to higher revenues from Siebel as well as an increase in customer training on the use of our products. The Americas contributed 70%, EMEA contributed 18% and Asia Pacific contributed 12% to the overall increase in education revenues.

Excluding the effects of currency rate fluctuations, education expenses increased due to incremental headcount and associated personnel related expenditures. Total education margin as a percentage of revenues decreased as expenses grew at a higher rate than revenues.

Research and Development Expenses: Research and development expenses consist primarily of personnel related expenditures. We intend to continue to invest significantly in our research and development efforts because, in our judgment, they are essential to maintaining our competitive position.

(Dollars in millions)	2006	Actual	Constant	2005
	Three Months Ended August 31,	Percent Change		
Research and development [(1)]	$ 484	22%	20%	$ 396
Stock-based compensation	22	436%	436%	4
Amortization of intangible assets [(2)]	3	-42%	-42%	5
Total expenses	$ 509	26%	26%	$ 405
% of Total Revenues	14%			15%

(1) Excluding stock-based compensation

(2) Included as a component of Amortization of Intangible Assets in our condensed consolidated statements of operations

Research and development headcount increased by approximately 2,500 in the first quarter of fiscal 2007 from the prior year corresponding period, which represented a 23% increase in the database and middleware divisions and a 17% increase in the applications division. The increase in database and middleware headcount was primarily due to hiring of resources outside the United States, while the increase in applications headcount was primarily due to i-flex, Siebel and resources from other recent acquisitions. Excluding the effect of currency rate fluctuations, research and development expenses increased due to higher personnel related expenses associated

39

Table of Contents

with higher headcount levels, increased use of third-party contractors and higher stock-based compensation expenses due to the adoption of Statement 123R.

General and Administrative Expenses: General and administrative expenses primarily consist of personnel related expenditures for information technology, finance, legal and human resources support functions.

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	2006	Actual	Constant	2005
General and administrative [1]	$ 145	-6%	-7%	$ 156
Stock-based compensation	12	100%	100%	
Total expenses	$ 157	1%	1%	$ 156
% of Total Revenues	4%			6%

[1] Excluding stock-based compensation

In the first quarter of fiscal 2006, we incurred a $24 million charge for a legal settlement. Excluding this charge and the effect of currency rate fluctuations, general and administrative expenses increased in the first quarter of fiscal 2007 as a result of the recognition of stock-based compensation expenses due to the adoption of Statement 123R as well as higher personnel related costs associated with our acquisition of i-flex and other acquired entities.

Amortization of Intangible Assets:

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	2006	Actual	Constant	2005
Software support agreements and related relationships	$ 76	41%	41%	$ 54
Developed technology	76	81%	81%	42
Core technology	31	72%	72%	18
Customer contracts	10	67%	67%	6
Trademarks	5	67%	67%	3
Total amortization of intangible assets	$ 198	61%	61%	$ 123

Amortization of intangible assets increased in the first quarter of fiscal 2007 due to amortization of acquired intangibles from Siebel, i-flex and other recent acquisitions.

Acquisition Related Charges: Acquisition related charges primarily consist of in-process research and development expenses, integration-related professional services, stock-compensation expenses and personnel related costs for transitional employees. Stock-based compensation included in acquisition related charges relates to unvested options assumed from acquisitions whose vesting was fully accelerated upon termination of the employees pursuant to the terms of these options.

	Three Months Ended August 31,			
		Percent Change		
(Dollars in millions)	2006	Actual	Constant	2005
In-process research and development	$ 43	514%	514%	$ 7
Transitional employee related costs	5	-29%	-29%	7
Stock-based compensation		-100%	-100%	3

Professional fees			-100%	-100%		11
Total acquisition related charges	$	48	71%	71%	$	28

Acquisition related charges increased in the first quarter of fiscal 2007 primarily due to higher in-process research and development charges due to i-flex and our other current quarter acquisitions partially offset by lower professional fees and transitional personnel related expenses.

Table of Contents

Restructuring: Restructuring expenses consist of Oracle employee severance costs and Oracle duplicate facilities closures which were initiated to improve our cost structure as a result of acquisitions. For additional information regarding the Oracle restructuring plans, as well as restructuring activities of our acquired companies, please see Note 9 of Notes to Condensed Consolidated Financial Statements.

	Three Months Ended August 31,		
(Dollars in millions)	**2006**	**Change**	**2005**
Severance costs	$ 9	-18%	$ 11

Restructuring expenses decreased in the first quarter of fiscal 2007 due to lower headcount terminations and related severance costs.

Interest Expense:

	Three Months Ended August 31,		
(Dollars in millions)	**2006**	**Change**	**2005**
Interest expense	$ 83	299%	$ 21

Interest expense increased in the first quarter of fiscal 2007 due to higher average borrowings related to the $5.75 billion senior notes issued in January 2006.

Non-Operating Income, net: Non-operating income, net consists primarily of interest income, net foreign currency exchange gains (losses), net investment gains related to marketable securities and other investments as well as the minority interests share in the net profits of i-flex and Oracle Japan.

	Three Months Ended August 31,		
(Dollars in millions)	**2006**	**Change**	**2005**
Interest income	$ 77	213%	$ 25
Foreign currency gains	6	-65%	16
Net investment gains related to marketable equity securities and other investments	15	771%	2
Minority interests	(12)	56%	(8)
Other	16	154%	7
Total non-operating income, net	$ 102	147%	$ 42

Non-operating income, net increased in the first quarter of fiscal 2007 primarily due to higher interest income due to higher cash balances and the increase in interest rates, as well as increased gains on sales of equity securities which were partially offset by lower foreign currency gains.

Provision for Income Taxes: The effective tax rate in all periods is the result of the mix of income earned in various tax jurisdictions that apply a broad range of income tax rates. The provision for income taxes differs from the tax computed at the federal statutory income tax rate due primarily to state taxes and earnings considered as indefinitely reinvested in foreign operations. Future effective tax rates could be adversely affected if earnings are lower than anticipated in countries where we have lower statutory rates, by unfavorable changes in tax laws and regulations, or by adverse rulings in tax related litigation.

Three Months Ended
August 31,

(Dollars in millions)	2006	Change	2005
Provision for income taxes	$ 292	36%	$ 214
Effective tax rate	30.4%		29.2%

Table of Contents

Provision for income taxes increased in the first quarter of fiscal 2007 due to higher earnings before tax and a higher effective tax rate. The increase in the effective tax rate is primarily attributable to the impact of non-deductible acquisition costs, partially offset by a higher percentage of earnings in lower tax jurisdictions.

Liquidity and Capital Resources

(Dollars in millions)	August 31, 2006	Change	May 31, 2006
Working capital	$ 4,993	-1%	$ 5,044
Cash, cash equivalents and marketable securities	$ 8,298	9%	$ 7,605

Working capital: The change in our working capital was nominal in the first quarter of fiscal 2007.

Cash, cash equivalents and marketable securities: Cash and cash equivalents consist of highly liquid investments in time deposits held at major banks, commercial paper, United States government agency discount notes, money market mutual funds and other money market securities with original maturities of 90 days or less. Marketable securities primarily consist of commercial paper, corporate notes and Unites States government agency notes. Cash, cash equivalents and marketable securities include $3.4 billion held by our foreign subsidiaries as of August 31, 2006. The increase in cash, cash equivalents and marketable securities is due to higher sales volumes and cash collections of trade receivables, partially offset by cash used to pay for acquisitions and the repurchase of our common stock.

Days sales outstanding, which is calculated by dividing period end accounts receivable by average daily sales for the quarter, was 52 at August 31, 2006 compared with 55 days at May 31, 2006. The days sales outstanding calculation excludes the adjustment to reduce software license updates and product support revenue related to adjusting the carrying value for deferred support revenues acquired to its estimated fair value. The decline in days sales outstanding is due to more timely collections as well as a shift in the mix of total revenues, partially offset by the assumption of accounts receivables from acquired companies. Software license updates and product support revenues are generally billed one year in advance, while the revenues are recognized ratably over the annual contract period. Software license updates and product support revenues as a percent of total revenues increased, resulting in higher cash collections and lower days sales outstanding.

	Three Months Ended August 31,		
(Dollars in millions)	2006	Change	2005
Cash provided by operating activities	$ 1,623	11%	$ 1,458
Cash used for investing activities	$ (2,062)	709%	$ (255)
Cash used for financing activities	$ (776)	-40%	$ (1,297)

Cash flows from operating activities: Our largest source of operating cash flows is cash collections from our customers following the purchase and renewal of their software license updates and product support agreements. Payments from customers for software license updates and product support are generally received by the beginning of the contract term, which is generally one year in length. We also generate significant cash from new software license sales and, to a lesser extent, services. Our primary uses of cash from operating activities are for personnel related expenditures as well as payments related to taxes and facilities.

Cash flows provided by operating activities increased in the first quarter of fiscal 2007 primarily due to higher sales volumes, higher net income and lower tax payments, partially offset by cash payments to terminate leases associated with excess facilities assumed in the Siebel acquisition and higher interest payments related to our $5.75 billion senior notes.

Cash flows from investing activities: The changes in cash flows from investing activities primarily relate to acquisitions and the timing of purchases and maturities of marketable securities. We also use cash to invest in capital and other assets to support our growth.

Table of Contents

Cash used for investing activities increased in the first quarter of fiscal 2007 primarily due to greater purchases of marketable securities. We also benefited from the sale of property in the prior year corresponding period.

Cash flows from financing activities: The changes in cash flows from financing activities primarily relate to borrowings and payments under debt obligations as well as stock repurchase activity.

Cash provided by financing activities decreased in the first quarter of fiscal 2007 primarily due to higher stock repurchases, partially offset by higher net borrowings. We intend to repurchase $4.0 billion of our common stock in fiscal 2007 under our stock repurchase program.

Free cash flow: To supplement our statements of cash flows presented on a GAAP basis, we use non-GAAP measures of cash flows on a trailing 4-quarter basis to analyze cash flow generated from operations. We believe free cash flow is also useful as one of the bases for comparing our performance with our competitors. The presentation of non-GAAP free cash flow is not meant to be considered in isolation or as an alternative to net income as an indicator of our performance, or as an alternative to cash flows from operating activities as a measure of liquidity. We calculate free cash flows as follows:

	Trailing 4-Quarters Ended August 31,		
(Dollars in millions)	**2006**	**Change**	**2005**
Cash provided by operating activities	$ 4,706	31%	$ 3,596
Capital expenditures [1]	$ (233)	13%	$ (206)
Free cash flow	$ 4,473	32%	$ 3,390
Net income	$ 3,532	22%	$ 2,896
Free cash flow as a percent of net income	127%		117%

[1] Represents capital expenditures as reported in cash flows from investing activities in our condensed consolidated statements of cash flows presented in accordance with U.S. generally accepted accounting principles.

Long-Term Customer Financing

We offer our customers the option to acquire our software and services through separate long-term payment contracts. We generally sell such contracts on a non-recourse basis to financial institutions. We record the transfers of amounts due from customers to financial institutions as sales of financial assets because we are considered to have surrendered control of these financial assets. In the first quarter of fiscal 2007 and 2006, $84 million and $52 million or approximately 11% and 8%, respectively, of our new software license revenues were financed through our financing division.

Contractual Obligations

The contractual obligations presented in the table below represent our estimates of future payments under fixed contractual obligations and commitments. Changes in our business needs, cancellation provisions, changing interest rates and other factors may result in actual payments differing from these estimates. We cannot provide certainty regarding the timing and amounts of payments. We have presented below a summary of the most significant assumptions used in our information within the context of our consolidated financial position, results of operations and cash flows.

Table of Contents

The following is a summary of our contractual obligations as of August 31, 2006:

		Year Ending May 31,						
(Dollars in millions)	**Total**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**Thereafter**
Principal payments on short-term borrowings and long-term debt	$ 5,915	$ 163	$	$ 1,500	$	$ 2,251	$ 1	$ 2,000
Capital leases	5	3	2					
Interest payments on short-term borrowings and long-term debt [(1)]	1,778	233	303	282	218	217	105	420
Operating leases [(2)]	1,298	222	241	206	166	124	98	241
Purchase obligations [(3)]	328	118	208	2				
Funding commitments [(4)]	5	5						
Total contractual obligations	$ 9,329	$ 744	$ 754	$ 1,990	$ 384	$ 2,592	$ 204	$ 2,661

(1) Interest payments were calculated based on terms of the related agreements and include estimates based on the effective interest rates as of August 31, 2006 for variable rate borrowings and borrowings for which we have entered into interest-rate swap agreements.

(2) Primarily represents leases of facilities and includes future minimum rent payments for facilities that we have vacated pursuant to our restructuring and merger integration activities. We have approximately $393 in facility obligations, net of estimated sublease income and other costs, in accrued restructuring for these locations in our condensed consolidated balance sheet at August 31, 2006.

(3) Represents amounts associated with agreements that are enforceable, legally binding and specify terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the payment.

(4) Represents the maximum additional capital we may need to contribute toward our venture fund investments which are payable upon demand.

On September 14, 2006, i-flex issued approximately 4.45 million shares of common stock at a purchase price of 1,307.5 Indian rupees per share (Preferential Allotment). We purchased the Preferential Allotment for approximately $126 million and increased our ownership to approximately 55.1%. Proceeds from the Preferential Allotment are intended to be used to fund growth initiatives, including i-flex s pending acquisition of Mantas, Inc.

As required by Indian law, following the preferential allotment, we published an announcement on September 13, 2006 notifying the public shareholders of i-flex of our intention to make an open offer to purchase up to 16,629,023 additional shares of i-flex common stock, equal to 20% of the outstanding equity of i-flex. Holders of i-flex common shares who tender their shares will receive 1,475 Indian rupees per share. If the open offer is fully subscribed, the aggregated consideration for the open offer would be approximately $530 million. Pursuant to Indian laws, the open offer is expected to commence on November 6, 2006 and is expected to close on November 25, 2006. The open offer is not conditioned upon any minimum level of acceptance by i-flex shareholders.

We believe that our current cash and cash equivalents, marketable securities and cash generated from operations will be sufficient to meet our working capital, capital expenditures, contractual obligations and investment needs. In addition, we believe we could fund other acquisitions and repurchase common stock with our internally available cash and investments, cash generated from operations, amounts available under our credit facilities, additional borrowings or from the issuance of additional securities.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Table of Contents

Stock Options

Our stock option program is a key component of the compensation package we provide to attract and retain talented employees and align their interests with the interests of existing stockholders. We recognize that options dilute existing stockholders and have sought to control the number of options granted while providing competitive compensation packages. Consistent with these dual goals, our cumulative potential dilution for each of the last three full fiscal years has been less than 2.0% and has averaged 1.4% per year. The potential dilution percentage is calculated as the new option grants for the year, net of options forfeited by employees leaving the company, divided by the total outstanding shares at the beginning of the year. This maximum potential dilution will only result if all options are exercised. Many of these options, which have 10-year exercise periods, have exercise prices substantially higher than the current market price. At August 31, 2006, 20% of our outstanding stock options had exercise prices in excess of the current market price. Consistent with our historic practices, we do not expect that dilution from future grants before the effect of our stock repurchase program will exceed 1.5% per year for our ongoing business. Over the last 10 years, our stock repurchase program has more than offset the dilutive effect of our stock option program; however, we may reduce the level of our stock repurchases in the future as we may use our available cash for acquisitions or to repay indebtedness. At August 31, 2006, the maximum potential dilution from all outstanding and unexercised option awards, regardless of when granted and regardless of whether vested or unvested and including options where the strike price is higher than the current market price, was 9.8%.

The Compensation Committee of the Board of Directors reviews and approves the organization-wide stock option grants to selected employees, all stock option grants to executive officers and any individual stock option grants in excess of 25,000 shares. A separate Plan Committee, which is an executive officer committee, approves individual stock option grants up to 25,000 shares to non-executive officers and employees.

Options granted from June 1, 2003 through August 31, 2006 are summarized as follows (shares in millions):

Options outstanding at May 31, 2003	455
Options granted	209
Options assumed	182
Options exercised	(216)
Forfeitures	(122)
Options outstanding at August 31, 2006	508
Average annualized options granted, net of forfeitures	83
Average annualized stock repurchases	117
Shares outstanding at August 31, 2006	5,185
Weighted-average shares outstanding from June 1, 2003 through August 31, 2006	5,185
Options outstanding as a percent of shares outstanding at August 31, 2006	9.8%
In the money options outstanding (based on our August 31, 2006 stock price) as a percent of shares outstanding at August 31, 2006	7.9%
Average annualized options granted, net of forfeitures and before stock repurchases, as a percent of weighted-average shares outstanding from June 1, 2003 through August 31, 2006	1.6%
Average annualized options granted, net of forfeitures and after stock repurchases, as a percent of average shares outstanding from June 1, 2003 through August 31, 2006	-0.7%

Our current policy with respect to annual stock option grants to key employees, including our executive officers (but excluding grants to newly hired employees) is that the option grants occur during the ten business-day period following the end of our no trading period (i.e. after the announcement of our earnings report) relating to our fiscal fourth quarter. During the first quarter of fiscal 2007, we made our annual grant of options and other grants to purchase approximately 55 million shares as well as options assumed of 3 million shares, which were partially offset by forfeitures of 3 million shares.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Income Rate Risk. In the first quarter of fiscal 2007, we began designating newly acquired fixed income investments as available-for-sale. As a result of the available-for-sale designation, all securities purchased after May 31, 2006, will be recorded on the balance sheet at fair market value. Securities purchased prior to that date will continue to be classified as held-to-maturity, until their actual maturity date, and recorded on the balance sheet at amortized cost.

The fair market value of these securities may fluctuate with changes in the overall level of interest rates. A substantial rise in interest rates could have a material adverse effect on the valuation of our investment portfolios. Decreasing interest rates could have an adverse effect on our interest income generated by the investment portfolios. A sensitivity analysis was preformed on the investment portfolio to determine the impact of 50 basis point and 100 basis point changes in interest rates during the next quarter. The interest rate increases resulted in estimated declines in fair market value of $4 million and $8 million respectively. If interest rates fell by those amounts, interest income for the quarter would decline by $10 million and $20 million respectively, assuming consistent investment levels.

For the three months ended August 31, 2006, total interest income was $77 million with investments yielding an average 3.65% on a worldwide basis. This interest rate level was up approximately 163 basis points from 2.02% for the three months ended August 31, 2005.

The table below presents the cash, cash equivalent and marketable securities balances and the related weighted average interest rates for our investment portfolio at August 31, 2006. The cash, cash equivalent and marketable securities balances approximate fair value at August 31, 2006:

(Dollars in millions)	Amortized Principal of Held-to-Maturity Securities	Market Value of Available-for-Sale Securities	Weighted Average Interest Rate
Cash and cash equivalents	$	$ 5,446	3.63%
Marketable securities	414	2,438	4.30%
Total cash, cash equivalents and marketable securities	$ 414	$ 7,884	3.86%

The following table includes the United States dollar equivalent of cash, cash equivalents and marketable securities denominated in foreign currencies. See discussion of our foreign currency risk below for a description of how we hedge net assets of certain international subsidiaries from foreign currency exposure.

(in millions)	Amortized Principal Amount at August 31, 2006
Japanese Yen	$ 663
Euro	635
Chinese Renminbi	275
British Pound	263
Canadian Dollar	206
Australian Dollar	155
South African Rand	110
Other currencies	1,127
Total cash, cash equivalents and marketable securities denominated in foreign currencies	$ 3,434

Table of Contents

Interest Expense Rate Risk. Borrowings as of August 31, 2006 were $5.9 billion, consisting of $4.3 billion of fixed rate borrowings and $1.6 billion of variable rate borrowings. Interest expense for the three months ended August 31, 2006 was $83 million. Based on effective interest rates at August 31, 2006, a 50 basis point increase in interest rates on our borrowings subject to variable interest rate fluctuations would increase our interest expense by approximately $8 million annually.

(Dollars in millions)		Borrowings	Effective Interest Rate
Floating rate senior notes due January 2009 [(1)]	$	1,500	5.73%
6.91% senior notes due February 2007 and related interest rate swap [(2)]		150	7.53%
Total borrowings subject to variable interest rate fluctuations	$	1,650	

(1) The 2009 Notes bear interest at a floating rate equal to three-month LIBOR plus 0.23% per year.

(2) We entered into an interest-rate swap agreement that has the economic effect of modifying the interest obligations associated with our 6.91% senior notes so that the interest payable on the senior notes effectively becomes variable based on the three month LIBOR set quarterly until maturity.

Foreign Currency Transaction Risk. We transact business in various foreign currencies and have established a program that primarily utilizes foreign currency forward contracts to offset the risk associated with the effects of certain foreign currency exposures. Under this program, increases or decreases in our foreign currency exposures are offset by gains or losses on the forward contracts, to mitigate the possibility of foreign currency transaction gains or losses. These foreign currency exposures typically arise from intercompany sublicense fees and other intercompany transactions. Our forward contracts generally have terms of 90 days or less. We do not use forward contracts for trading purposes. All outstanding foreign currency forward contracts (excluding our Yen equity hedge described below) are marked to market at the end of the period with unrealized gains and losses included in non-operating income, net. Our ultimate realized gain or loss with respect to currency fluctuations will depend on the currency exchange rates and other factors in effect as the contracts mature. Net foreign exchange transaction gains (losses) included in non-operating income, net in the accompanying condensed consolidated statements of operations were $(2) million and $11 million in the three months ended August 31, 2006 and 2005, respectively. The fair values of foreign currency forward contracts were not significant individually or in the aggregate.

Net Investment Risk. Periodically, we hedge the net assets of certain international subsidiaries (net investment hedges) using foreign currency forward contracts to offset the translation and economic exposures related to our investments in these subsidiaries. We measure the effectiveness of net investment hedges by using the changes in spot exchange rates because this method reflects our risk management strategies, the economics of those strategies in our financial statements and better manages interest rate differentials between different countries. Under this method, the change in fair value of the forward contract attributable to the changes in spot exchange rates (the effective portion) is reported in stockholders equity to offset the translation results on the net investments. The remaining change in fair value of the forward contract (the ineffective portion) is recognized in non-operating income, net.

At August 31, 2006, we had one net investment hedge in Japanese Yen. The Yen investment hedge minimizes currency risk arising from net assets held in Yen as a result of equity capital raised during the initial public offering and secondary offering of Oracle Japan. The fair value of our Yen investment hedge was nominal as of August 31, 2006 and 2005. The Yen investment hedge has a notional amount of $572 million and an exchange rate of 115.36 Yen per United States dollar.

Net gains on investment hedges reported in stockholders equity were $22 million and $14 million in the three months ended August 31, 2006 and 2005, respectively. Net gains on investment hedges reported in non-operating income, net were $7 million and $5 million in the three months ended August 31, 2006 and 2005, respectively.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 (Exchange Act) Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls. The Company s management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are effective at the reasonable assurance level. However, the Company s management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The material set forth in Note 15 of Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for our fiscal year ended May 31, 2006. The risks discussed in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In 1992, our Board of Directors approved a program to repurchase shares of our common stock (1992 Program) to reduce the dilutive effect of our stock option and stock purchase plans. The Board has expanded the 1992 Program several times by either increasing the authorized number of shares to be repurchased or by authorizing a fixed dollar amount expansion. On January 31, 2006, we announced our plan to repurchase common stock equivalent to the amount of common stock issued in connection with the Siebel acquisition. Our Board approved

Table of Contents

a separate program (Siebel Program) to repurchase 140,720,666 shares of our common stock. In June 2006, we announced that we intend to repurchase $1.0 billion of our common stock each quarter in fiscal 2007 and such repurchases may occur through the use of Rule 10b5-1 trading plans. On July 10, 2006, the Board combined the 1992 Program with the Siebel Program and authorized a total of $4.0 billion in share repurchases (2007 Authorization).

We repurchased 66.8 million shares for $1.0 billion during the three months ended August 31, 2006 (including 4.1 million shares for $64 million that were repurchased but not settled) and 18.1 million shares for $249.7 million during the three months ending August 31, 2005 under the applicable repurchase programs authorized. At August 31, 2006, approximately $3.2 billion was available for share repurchases pursuant to our 2007 Authorization. The following table summarizes the stock repurchase activity for the three months ending August 31, 2006 and the approximate dollar value of shares that may yet be purchased pursuant to our stock repurchase programs:

(in millions, except per share amounts)	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
June 1, 2006 June 30, 2006	5.9	$ 14.59	5.9	$ 1,753.5
July 1, 2006 July 10, 2006	7.3	14.69	7.3	1,646.0(1)
July 10, 2006				4,000.0(1)
July 11, 2006 July 31, 2006	21.6	14.72	21.6	3,680.8
August 1, 2006 August 31, 2006	32.0	15.26	32.0	3,192.4
Total	66.8	$ 14.96	66.8	

(1) On July 10, 2006, we had approximately $1.6 billion available for repurchase under the 1992 Program and 4,767,030 shares available for repurchase under the Siebel Program. On July 10, 2006, the Board combined the 1992 Program with the Siebel Program and authorized a total of $4.0 billion in share repurchases (2007 Authorization).

Item 6. Exhibits

Exhibit Number	Exhibit Title
10.27	Offer letter dated January 31, 1997 to Sergio Giacoletto and employment agreement dated February 20, 1997.
31.01	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act Lawrence J. Ellison
31.02	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act Safra A. Catz
32.01	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Oracle Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	ORACLE CORPORATION
Date: September 25, 2006	By: /s/ SAFRA A. CATZ
	Safra A. Catz
	President, Chief Financial Officer and Director
Date: September 25, 2006	By: /s/ JENNIFER L. MINTON
	Jennifer L. Minton
	Senior Vice President, Global Finance and Operations and Chief Accounting Officer

50