

Internet

AWS Summit GCR 2022: unveiled four strategic initiatives in China market

Amazon hosted (13-14 Oct) AWS Summit GCR 2022, during which announced it will enhance cloud business deployment in China market. AWS unveiled four strategic initiatives and highlighted six directions that it will continue investing in to propel cloud business innovation. Plus, it enhances partner network to better fulfil digital transformation demand, continue enhancing self-developed core system and chips capabilities, to help customer achieve better cost saving. China's cloud industry growth slowed in the near term due to short-term disruptions. AWS's China strategy echoes our view that Chinese enterprise demand for cost optimization and efficiency enhancement trend will resume pace in the long run, driven by more industries catching up on the digitalization trend. And early-mover industries will upgrade VAS cloud demand which will increase industry profitability.

- **AWS's four strategic initiatives to accelerate cloud business development in China market:** 1) helping Chinese enterprises gain access to technologies and services in overseas market to enhance their competitiveness and acceleration globalization; 2) empowering digital transformation and innovation of various industries, especially for those with large TAM such as financials, manufacturing, autos, and retail & FMCG; 3) growing AWS partner network to better fulfil digital transformation demand of customers; 4) helping enterprises to build a sustainable cloud infrastructure and innovate sustainable cloud services, thereby aiding enterprise to achieve sustainable long-term development.
- **Six directions in cloud technology evolution highlighted by AWS.** With the aim of propelling evolution and innovation of cloud business, the development focus directions are: 1) expanding infrastructure and broadening the boundaries of cloud services in order to meet customer demand anywhere; 2) innovating from the bottom up, helping customers optimize cloud service cost by using AWS's self-developed core system (Amazon Nitro) and chips (Amazon Graviton); 3) promoting an upgrade of database to cloud native era; 4) integrating machine learning capability to various types of cloud services; 5) promote cloud services to enter into "serverless" stage and increase business agility; 6) make cutting edge technologies, such as quantum computing and satellite communications, within reach for more enterprises through the cloud.
- **Implications for Chinese cloud players.** In 2Q22, cloud services revenue growth in China slowed to 11% YoY (2Q21: 54%), as compared to 33% YoY growth for global market (2Q21: 36%), due to softened macro and pandemic resurgence which delayed project deployment. We remain positive on enterprise digitization progress in the long term, as China is still in need of increasing production/operating efficiency to combat rising structural costs and competitive pressure. The agility and elasticity of cloud services will support enterprises to improve business flexibility and achieve effect cost control. A comparison between US and China's cloud market development suggests that China cloud market has long way to grow. Per Gartner and Statista, the Chinese public cloud market accounted for about 4.5% of China's overall IT spending in 2020 (2019: 3.2%), while that number reached 14.5% in the US in 2020. In China cloud infrastructure market, Alibaba Cloud takes the lead with 34% of the market share in 2Q22, followed by 19.0% for Huawei Cloud and 17.0% for Tencent Cloud.

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AWS Summit GCR 2022 update

AWS unveiled four strategic initiatives to accelerate cloud business development in China market, including: 1) helping Chinese enterprises gain access to technologies and services in overseas market to enhance their competitiveness and acceleration globalization; 2) empowering digital transformation and innovation of various industries, especially for those with large TAM such as financials, manufacturing, autos, and retail & FMCG; 3) growing AWS partner network to better fulfil digital transformation demand of customers; 4) helping enterprise to build a sustainable cloud infrastructure and innovate sustainable cloud services, thereby aiding enterprise to achieve sustainable long-term development.

Figure 1: AWS unveiled four strategic initiatives to accelerate cloud business development in China market



Source: Company data, CMBIGM

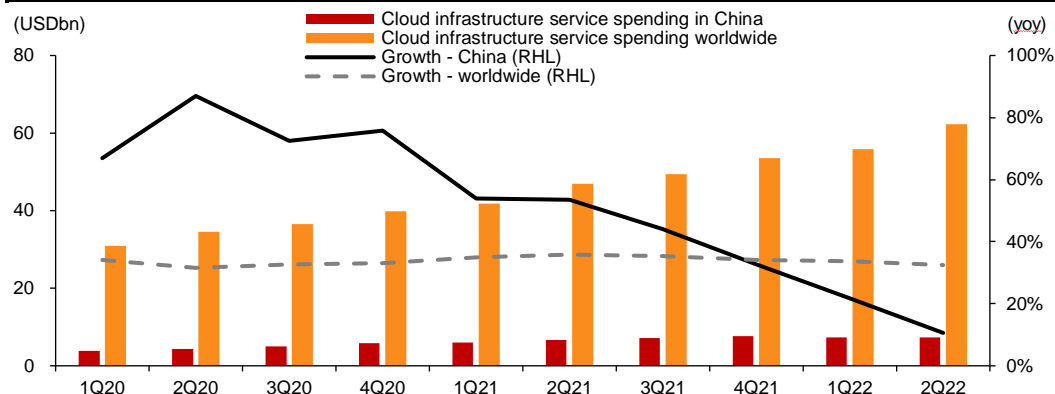
AWS highlighted six directions that it is exploring to propel evolution and innovation of cloud business, including: 1) expanding infrastructure and broadening the boundaries of cloud services in order to meet customer demand anywhere; 2) innovating from the bottom up, helping customers optimize cloud service cost by using AWS's self-developed core system (Amazon Nitro) and chips (Amazon Graviton); 3) promoting an upgrade of database to cloud native era; 4) integrating machine learning capability to various types of cloud services; 5) promote cloud services to enter into "serverless" stage and increase business agility; 6) make cutting edge technologies, such as quantum computing and satellite communications, within reach for more enterprises through the cloud.

China cloud: long-term digitalization intact despite short-term headwinds

In 1H22, cloud services revenue growth was impacted by the softened macro and pandemic resurgence. According to Canalys, cloud infrastructure services spending grew by merely 11% YoY in China in 2Q22 (2Q21: 54%; 1Q22: 22%), as compared to 33% YoY growth for global market (2Q21: 36%; 1Q22: 34%). Cloud infrastructure services spending in China accounted for 11.7% of the global total in 2Q22, down 1.3pp qoq and 2.3pp YoY. Looking ahead, a gradual recovery in macro could drive for a recovery in enterprise's digitization budget, and rising digitization demand from emerging industries such as new energy, smart manufacturing and other fields may help revive revenue growth for cloud computing industry. Over the long run, we believe enterprises' demand for cost optimization and efficiency enhancement should remain steady, and traditional industries other than the Internet industry (such as

manufacturing, retail, etc) are showing solid digital transformation needs, which could drive continued expansion of China's cloud computing market in our view.

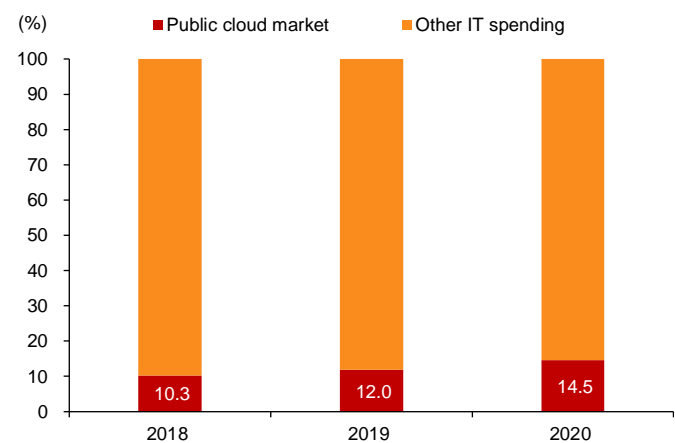
Figure 2: Cloud infrastructure service spending in China and in worldwide



Source: Company data, CMBIGM

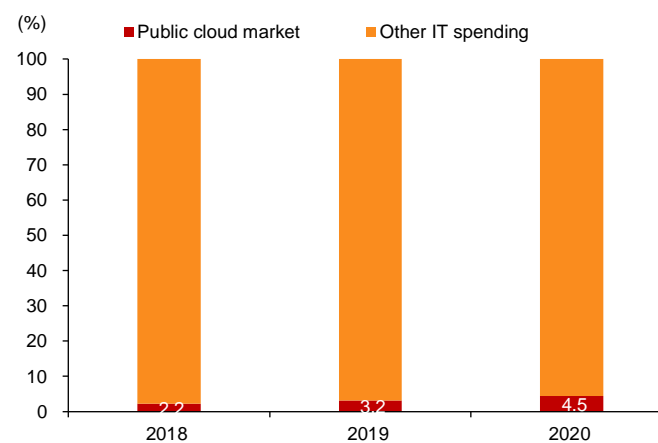
We are still positive on the long-term growth potential of China's cloud services, as compared with local deployment, the agility and elasticity of cloud services in our view could support enterprises to improve business flexibility and achieve effect cost control. A comparison between US and China also suggests that China cloud market has potential to grow. According to data from Gartner and Statista, the Chinese public cloud market accounted for about 4.5% of China's overall IT spending in 2020, an increase from 3.2% in 2019, but still representing room for improvement in our view, as that number reached 14.5% in the US in 2020.

Figure 3: US: public cloud services as a % of total IT spending



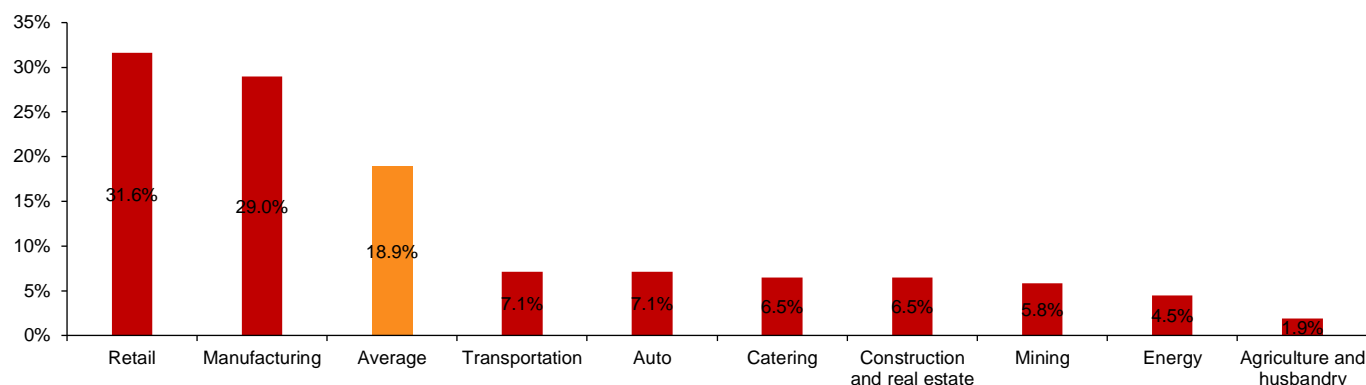
Source: Statista, CMBIGM

Figure 4: China: public cloud services as % of total IT spending



Source: Gartner, CMBIGM

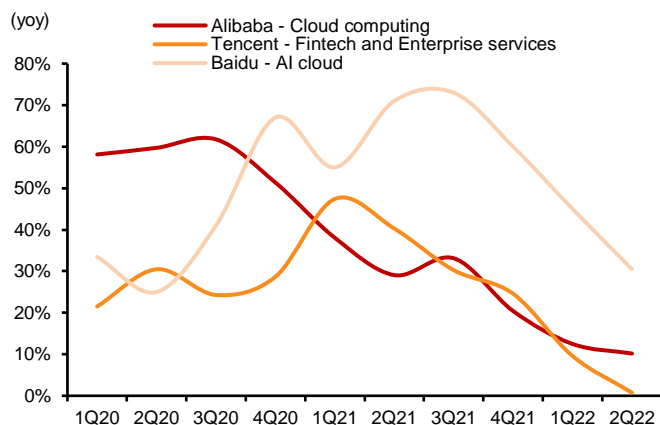
Moreover, per EO Intelligence survey, overall cloud penetration rate for industries in real economy was 18.9% in 2021, with retail and manufacturing industry higher than industry average, while that for industries such as transportation, auto, and energy are significantly lagging behind. Over the long run, we believe enterprises' demand for cost optimization and efficiency enhancement should remain steady, and the ramp up of penetration for cloud services in both emerging industries and traditional industries could drive cloud industry revenue growth in China, with a wane in pandemic impact and recovery in macro.

Figure 5: Cloud penetration rate for industries in real economy (2021)

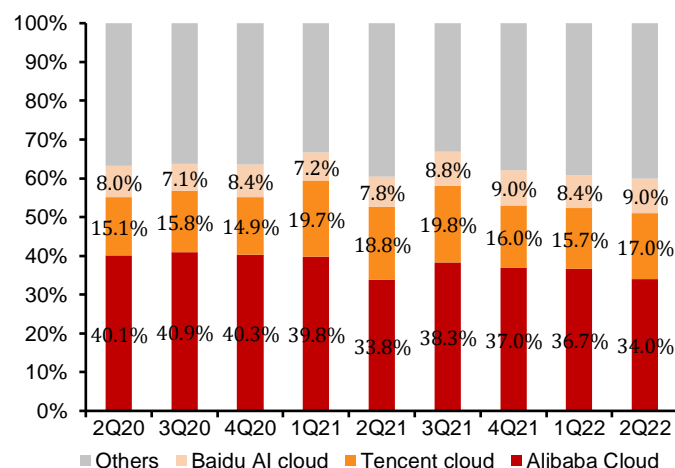
Note: results is generated from a survey of EO Intelligence; N=155.

Source: EO Intelligence, CMBIGM

Among leading cloud services providers in China, Alibaba Cloud accounted for the largest market share, and Baidu Cloud has the highest revenue growth rate among all internet companies. Baidu achieved the fastest cloud revenue growth of 30.5% YoY in 2Q22, compared to 10.2% YoY for Alibaba Cloud and 0.8% for Tencent's Fintech and enterprise services, which we attributed to Baidu's strong AI capability, as it helped Baidu established comparative advantage in industries such as smart transportation, manufacturing, energy & utilities and public services. According to Canalys data, Baidu AI Cloud's market share in China's cloud infrastructure spend increased to 9.0% in 2Q22, up from 7.8% in 2Q21 and 8.0% in 2Q20.

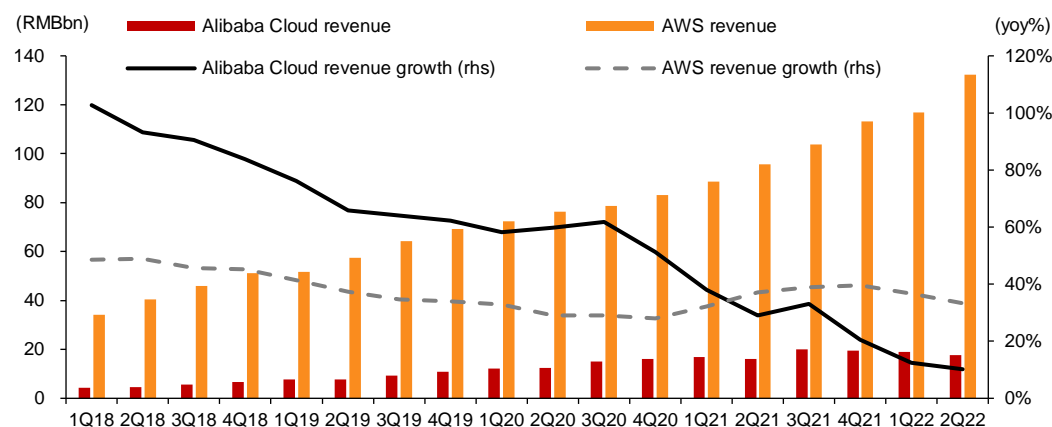
Figure 6: Cloud rev growth of key internet players

Source: Canalys, CMBIGM

Figure 7: China – cloud infrastructure market share

Source: Canalys, CMBIGM

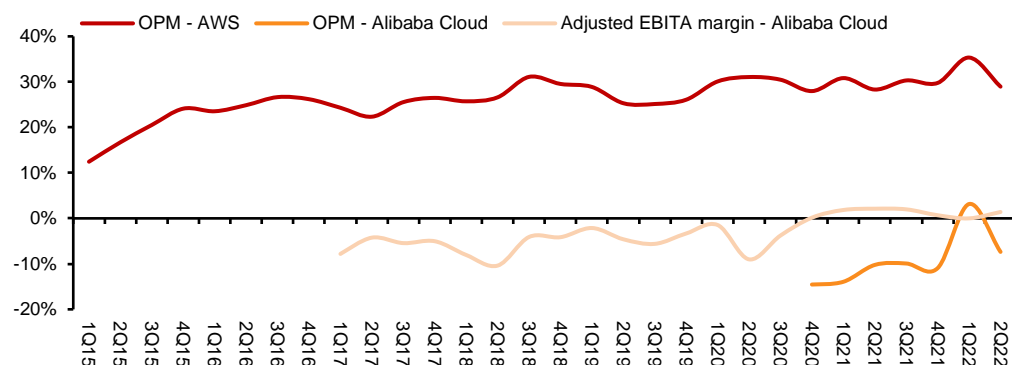
Although Alibaba takes the lead in China's cloud infrastructure market, its revenue scale is still much smaller than that of AWS. Alibaba's cloud segment revenue was RMB17.7bn in 2Q22, 13.4% of that of AWS. In the near term, soft macro which impacted enterprises budget for digital transformation likely to continue weighing on Alibaba Cloud's revenue growth, in our view, but we think the gradual recovery in macro, as well as the increase in demand generated from emerging industries such as smart manufacturing and new energy could support a recovery in revenue growth for Alibaba Cloud. Per company data, cloud revenue contribution from non-internet industry was 53% for Alibaba Cloud in 1QFY23, up 5pp YoY and 1pp qoq.

Figure 8: Cloud revenue and growth: Alibaba Cloud vs AWS

Note: 1) revenue of AWS has been converted RMB term using the exchange rate given in Alibaba's financial results each quarter; 2) Alibaba reclassified financial results of Dingtalk from innovation initiatives and others to cloud computing, and financial results of Dingtalk was included in Alibaba Cloud since 4Q20 (or 3QFY21, March year-end) in this chart.

Source: Company data, CMBIGM

China's cloud industry is still in the early stage of development, in our view, with majority of the players are still in loss making stage. We believe there is still abundant room for margin expansion for Chinese cloud players, suggested by the operating results of AWS, which could be driven by enlarging scale effect, and increase in revenue contribution from value-added services.

Figure 9: Operating margin comparison: Alibaba Cloud vs AWS

Source: Company data, CMBIGM

Note: Alibaba reclassified financial results of Dingtalk from innovation initiatives and others to cloud computing, and financial results of Dingtalk was included in Alibaba Cloud since 4Q20 in this chart.

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