



Why Cloud Computing Will be a Key Revenue Driver for Alibaba

Description

Shares of China's technology giant **Alibaba** ([NYSE: BABA](#)) have largely outperformed the market this year before a recent pullback that has still left the stock up over 20% year to date. But what has driven the company's stock higher? Alibaba continues to post solid results despite a sluggish domestic economy and the ongoing trade war between the U.S. and China.

Here, we'll look at Alibaba's fastest growing business segment and why it will be a key revenue driver going forward.

The huge market opportunity for Alibaba

We can see below how cloud computing revenue outpaced gains from the company's other business segments such as core commerce and digital media & entertainment in fiscal 2019 (which ended in March):

Segment	Fiscal 2018 Revenue	% of Revenue	Fiscal 2019 Revenue	% of Revenue	YoY Growth
Core Commerce	\$34.1 billion	85.5%	\$48.2 billion	85.8%	41.2%
Digital Media & Entertainment	\$3.1 billion	7.8%	\$3.6 billion	6.4%	15.0%
Cloud Computing	\$2.1 billion	5.4%	\$3.7 billion	6.6%	72.4%
Innovation Initiatives & Others	\$0.5 billion	1.3%	\$0.7 billion	1.2%	32.5%

Data source: S&P Capital IQ. Table by author.

Alibaba will be banking on cloud sales to help drive growth going forward. In the June quarter, the company's cloud computing revenue maintained its rapid expansion, growing 66% year over year to

\$1.1 billion and accounting for 7% of sales. This growth was driven by an increase in average revenue per customer.

The company launched over 300 new products and features in the second quarter with a focus on delivering value-added services to expand its customer base and increase enterprise engagement. Management aims to expand market leadership by increasing investments in research and development as well as investing heavily to attract the best human capital. In fact, in fiscal 2019, Alibaba increased its R&D spending by 64.5% — those expenses accounted for 9.9% of sales in 2019, up from 9.1% of sales in 2018.

Alibaba is also targeting growth by expanding its SaaS (software-as-a-service) offerings. It wants to work in collaboration with SaaS partners and build an ecosystem to provide exceptional service to enterprises.

China's cloud computing market accounts for over 25% of the global total and continues to grow at a rapid pace. According to market research firm Canalys, China's cloud infrastructure services market grew by 58% year over year to \$2.3 billion in the second quarter of 2019.

Competition from tech giants

Alibaba led China's cloud market with a share of 43% at the end of the second quarter. **Tencent** and **Baidu** held 17.4% and 8.7% shares of the market, respectively. Globally, Alibaba is competing with tech heavyweights like **Amazon**, **Alphabet**, and **Microsoft**. **Gartner** previously estimated Alibaba's IaaS (infrastructure-as-a-service) public cloud revenue growth at 92.6%, which was the highest among top players in 2018, besting impressive figures from Amazon (26.8%), Microsoft (60.9%), and Alphabet (60.2%).

One reason Alibaba will continue to grow cloud sales at an enviable pace is due to its traction among China's top companies. At the end of 2018, over 40% of China's top 500 companies and over 50% of the country's listed companies were on Alibaba Cloud. The company has successfully established itself as the primary public cloud platform for businesses across all industries in China (and importantly, 80% of the region's startups).

The verdict

China's 800 million internet users and the rapid transition to 5G will result in exponential data growth that will need to be stored in a secure environment. These tailwinds will drive demand for cloud services, providing a huge opportunity for Alibaba and its peers. China's cloud computing market is estimated to grow from \$14 billion in 2018 to \$25 billion in 2022, according to China Daily.

Though the cloud computing segment is still unprofitable, the company will aim to see bottom-line contributions from this segment in the near future. Investors need only look at Amazon Web Services, which made up less than 15% of revenue but 69% of total operating profit for the e-commerce giant in the most recently reported quarter. Alibaba will look to replicate its rival's success in turning the cloud into one of its key profit drivers as it benefits from economies of scale.

With demand for cloud services in China and other Asian economies growing, the segment will make

up an increasing share of Alibaba's sales, and if profitability can expand in tandem with the top line, the stock still has plenty of room to run.

CATEGORY

1. Investing
2. Tech Stocks

POST TAG

1. Syndicated

TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. NASDAQ:BIDU (Baidu, Inc.)
3. NASDAQ:GOOG (Alphabet)
4. NASDAQ:GOOGL (Alphabet Inc.)
5. NASDAQ:MSFT (Microsoft Corporation)
6. NYSE:BABA (Alibaba Group Holding Limited)
7. NYSE:IT (Gartner, Inc.)
8. OTC:TCEH.Y (Tencent Holdings Limited)

Category

1. Investing
2. Tech Stocks

Tags

1. Syndicated

Date

2025/06/29

Date Created

2019/10/02

Author

aditya-raghunath

default watermark

default watermark