Credit Suisse: China's rapid cloud migration in 2021 could catalyze opportunities in IaaS, SaaS, and data centers

Singapore, March 22, 2021 – **Credit Suisse believes China's accelerating cloud migration is driven by long-term structural trends in digitalization and domestic substitution, and expects rising business acceptance of cloud and Software as a Service (SaaS) solutions in 2021. Sub-layers of the cloud sector could benefit, according to Credit Suisse analysts presenting at the 24th Credit Suisse Asian Investment Conference (AIC), the most exclusive leadership gathering in the Asia-Pacific region for influential ideas and actionable advice.**

Commencing today (March 22), the five-day conference will take place virtually. This year's conference brings together more than 4,500 institutional investors, entrepreneurs, hedge funds, family offices and ultra- and high-net-worth investors, as well as chief executive officers and chief financial officers of more than 330 companies, representing over US$8 trillion of market capitalization.

Focusing on the theme of 'Disruption accelerated', the 2021 edition will feature more than 100 of the world's most influential thinkers and opinion leaders as they explore the disruptive forces that are changing our lives in a variety of ways at an exponential rate, how we can anticipate, understand and embrace them, and the investment opportunities they will create. Environmental, social and governance concerns will be discussed throughout the agenda.

Cloud migration and domestic substitution trends

The Chinese Ministry of Industry and Information Technology forecasts China's cloud market to enjoy a 30% compound annual growth rate (CAGR) for the period from 2019 to 2023.

Kyna Wong, Head of China Technology Research at Credit Suisse, said: "The onset of the COVID-19 pandemic led to an initial delay in contracts and implementation of software and cloud projects in China. Since then, sales and cloud growth have gradually resumed as remote work demand ramped up migration of offline workflows onto cloud. We believe that cloud penetration will be a multi-year trend, driven by rebounding information technology (IT) budgets, growing digitization demand, and the Chinese government's policy support."

China's IT spending is forecast to rebound to 7.2% year-on-year (YoY) in 2021 after a mild growth of 1.3% YoY in 2020[a]. The largest growth is expected to be in IT services (11.9% YoY) and enterprise software (10.4% YoY), as businesses grasp the importance of ensuring business continuity and remote education and healthcare, thus likely increasing their spending into data center builds and enterprise software in 2021.

[a] According to Gartner.

Accelerated digitalization post pandemic

Digitization has accelerated on the back of the pandemic, and many businesses are experiencing a shorter cycle of cloud adoption. Besides the push effect from COVID-19, 5G's prevalence has been a driving factor for cloud penetration and edge computing. Credit Suisse believes the digitalization trend is unlikely to reverse, as consumer habits and digitization across various larger enterprises are here to stay.

With China focusing more on "domestically developed and controlled" solutions, policy support is another driver of domestic substitution. In recent years, the Chinese government has prioritized cloud computing development, evident in the new infrastructure plans within its 14th Five-year Plan. It is believed that these policies will support both cloud and technology providers as well as business users in digitization, across ecosystem construction, services, and business models. These policies would likely provide tailwinds for China's cloud development in the upcoming years.

Credit Suisse expects fast demand growth for vertical applications, specifically social e-commerce. Demand is driven by strong gross merchandise volume (GMV) growth in WeChat mini-programs; lower SaaS penetration of mini-programs than Tmall and other centralized platforms; live-streaming, community group purchase and innovative methods that drive the social e-commerce GMV growth; and penetration of payable SaaS solutions among social e-commerce merchants.

Kenneth Fong, Head of China Internet Securities Research at Credit Suisse, said: "Given the robust underlying factors, we expect social e-commerce to grow at a 28% CAGR over the period from 2019 to 2022, with a penetration of 17% in the total e-commerce market by 2022. Live-streaming e-commerce GMV penetration is expected to reach 24% in 2025. China's digital payment market is forecasted to reach CNY295 trillion in 2022, representing a 14% CAGR over a three-year period. Post the pandemic in China, we expect the speed of growth for social e-commerce to normalize in 2021, but the structural growth trend will lead to rising penetration of e-commerce SaaS in the longer term."

Strong demand for IaaS solutions

Credit Suisse expects demand for Infrastructure as a service (IaaS) to remain robust, driven by Internet, enterprise applications, and new technologies like 5G, Artificial Intelligence (AI) and Internet of Things (IoT), which provide faster network speed and smart functionality. Multi-cloud adoption will also further increase.

The concentration in China's cloud market has been increasing due to faster growth of leading cloud service providers. However, Credit Suisse believes China's large cloud market still has space for small players to thrive with differentiated strategies.

Ms. Wong added: "Credit Suisse sees opportunities across the IaaS space amid four key developing trends, which we believe will extend into 2021. Firstly, there is a rising need for smaller players to secure their leadership position in niche vertical or certain customer segments to generate better profit in the long term. Secondly, cloud leaders are strengthening their cloud ecosystem construction and accelerating the development of their own chipsets. Thirdly, more cloud data centers are being constructed, leading to emerging demand for multi-cloud management. Lastly, a wider adoption of innovative new technologies will lower the entry barrier for the private cloud sector."

IDC to benefit from heightened data demand

Internet data centers (IDCs) are necessary infrastructure for telecoms and internet services; the more servers required to support internet content, the higher the demand for data centers.

Credit Suisse expects the IDC sector to benefit from rapid data volume growth as a result of higher data use per subscriber, which will likely continue rising given the transition from 4G to 5G and a healthy demand for streaming video services. Cloud computing is also set to be an important additional growth driver due to its demand for internet storage facilities.

The potential for future growth is material. China's carrier-neutral data center growth is forecast to be 16.7% CAGR, and hyperscale data-center growth is projected to record 29.2% CAGR over 2019 to 2024.

SaaS to benefit from swift IaaS penetration

China's SaaS market is fragmented and is estimated to be 10 years behind that of the US, however, Credit Suisse believes that the fast penetration of IaaS market in China would also likely support domestic SaaS solutions' fast growth due to their matching business and operation models.

Credit Suisse notes four prevalent trends for China's SaaS market – wider adoption of cloud-native technology; emergence of a domestic ecosystem, therefore supporting long-term substitution of international SaaS; initial public offerings of software players; and increasing focus on large or key account customers.

ERP and specific vertical applications to lead SaaS growth

SaaS enterprise resource planning (ERP) and specific vertical applications (e.g., e-commerce SaaS) are likely to enjoy fast growth due to their high level of standardization and customer value-add.

ERP and customer relationship management (CRM) tools play key roles in the remote work/education/sales demand and have increased businesses' acceptance of SaaS solutions to integrate business offline with online. The application of cloud technology has curtailed switching costs for customers due to lower upfront investment and shorter deployment cycle as compared to if on-premises software was used. The gap between domestic players and foreign leaders is narrowing, largely due to cloud penetration.

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