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China Software & IT Services

Implications of setting up state-owned cloud

OUTPERFORM (Maintain)

Tianjin gov't is reportedly asking SOEs to migrate from public cloud to state-owned private cloud platform. We think state gov't will still rely on third party cloud vendors to provider the underlying infrastructure and technology. The impact to China public cloud market is small that only 7% is related to gov't cloud. We maintain our view on public cloud landscape change as we see non-internet cloud companies gaining market share. Prefer Chinasoft.

- **SOEs to move from public cloud to sate-owned private cloud.** On 27 Aug, Reuters reported that Tianjin gov't has asked SOEs to move cloud systems deployed on public cloud to the state-owned private cloud. Also, SOEs cannot sign or renew contract with public cloud platforms. All migration should be completed before 30 Sep 2022. In fact, Tianjin is not the first province setting up state-owned cloud. Seeing increasing demand from SOEs in cloud, Sichuan gov't has launched first state-owned cloud in Apr 2021. The state-owned cloud is a private cloud dedicated for SOEs in Sichuan province. We believe this policy aims to accelerate SOEs moving to cloud environment but this does not mean the state gov't is trying to be a stand-alone cloud provider. Instead, Sichuan gov't will partner with China Telecom to co-manage the cloud platform and the underlying cloud technology is provided by Ali Cloud.
- **Public cloud market for SOEs was relatively small.** According to IDC, China gov't cloud market size was RMB27.1bn in FY20, of which 30% (RMB8.1bn) was deployed on public cloud. We roughly estimate that it only accounted for 7% of the China public cloud market (market size: RMB125bn in FY20). We think this state-owned cloud plan has limited impact to the overall public cloud market. Public cloud key customers are still internet companies that have higher demand in storage/ computing/ CDN services. As mentioned above, state gov't does not have the cloud technology and it still relies on third parties to deliver cloud infrastructure (IDC/ servers, etc.) and operating/ maintenance services. For the cloud infrastructure, Huawei (32%) and Inspur (25%) are the key providers in FY20. For the cloud service, market is more fragmented with Inspur, China Telecom, China Mobile and Huawei each having >10% of shares in FY20.
- **Prefer cloud names that their customers have lower regulatory risk.** For cloud-related companies under our coverage, we prefer Chinasoft over GDS/ Kingsoft Cloud. We continue to like Chinasoft for its Huawei cloud exposure (51% of FY1H21 revenue related to Huawei, +22% YoY). For GDS, its key customers are Ali/ Tencent (46.3% in FY2Q21 revenue) although the Company won first order from SOE - CEC in FY1H21. For Kingsoft Cloud, it is relatively neutral and its enterprise business growth was still robust at +153% YoY in FY2Q21 (29% of revenue).

Valuation Table

Company	Ticker	Mkt Cap (US$ mn)	Price (LC)	TP (LC)	EV/sales FY21E	P/E FY21E	ROE FY21E	Sales CAGR FY20-23E
Chinasoft	354 HK	4,910	13.16	17.53	1.7	24.3	13%	24%
Kingsoft Cloud	KC US	6,463	28.89	43.86	3.8	n.a.	n.a.	42%
GDS	GDS US	9,569	51.20	74.74	10.2	n.a.	n.a.	31%
GDS	9698 HK	9,840	51.25	72.38	10.4	n.a.	n.a.	31%

Source: Bloomberg, CMBIS estimates

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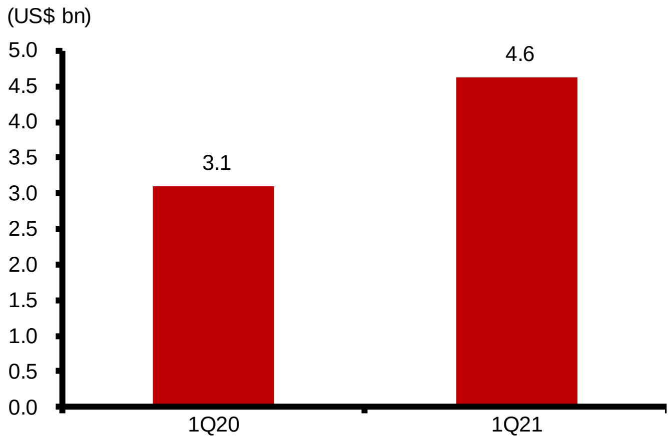
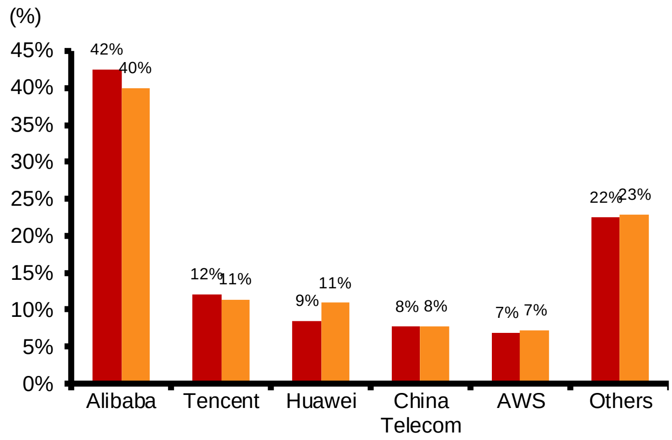
Focus Charts

Figure 1: China IaaS + PaaS market (1Q21)



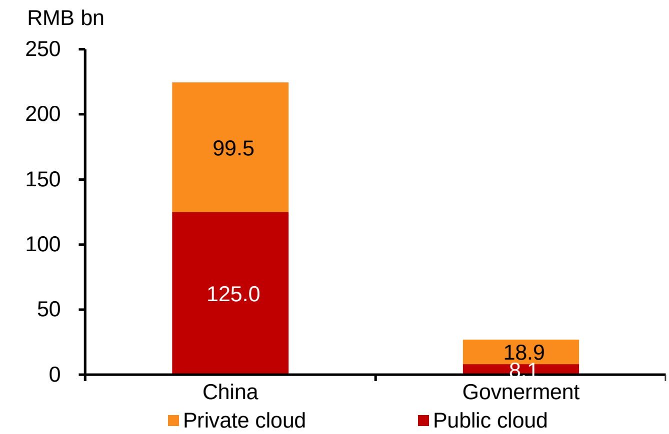
Source: IDC, CMBIS

Figure 2: China IaaS + PaaS market share (1Q21)



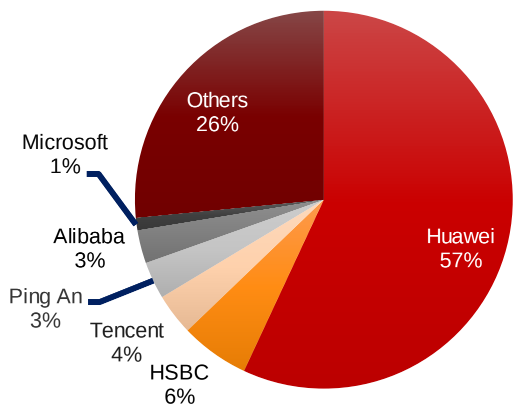
Source: IDC, CMBIS

Figure 3: Gov't public cloud size is relatively small



Source: IDC, CMBIS estimates

Figure 4: Chinasoft customer breakdown (FY20)



Source: Company data, CMBIS estimates

Figure 5: GDS wins CEC as new customer in 1H21

Source: Company data, CMBIS

Figure 6: Alibaba/Tencent: 47% of GDS

By Revenue (1)

End User	% Of 2Q21 Total Net Revenue
Customer 1	23.2%
Customer 2	23.1%
Customer 3	8.1%
Customer 4	6.3%
Customer 5	4.2%

Source: Company data, CMBIS

SOE to move from public cloud to state-owned private cloud

Building state-owned government cloud

On 27 Aug, Reuters reported that Tianjin government has asked SOEs to migrate cloud systems deployed on public cloud to the state-owned private cloud. Also, SOEs cannot sign or renew contract with third party public cloud platforms. All migration should be completed no later than 30 Sep 2022.

Figure 7: Tianjin is reported to be asking SOEs to move public cloud systems state-owned private cloud platform

各市管企业及所属企业原则上不再新建、升级或扩容数据中心（机房），不再新购服务器、存储设备等硬件资源。

（二）分类推进系统上云

按照市国资委《关于依托“国资云”加快推进企业数字化转型工作的通知》要求，为加快推进国企信息系统上云工作实施落地，为满足各企业实际需求，国资云公司提供多元化上云方案，满足企业个性化需求，保障不同类型信息系统顺利上云。

1.已建信息系统

（1）各企业已经部署在第三方公有云平台（如：“华为云”、“阿里云”、“腾讯云”、“沃云”、“天翼云”、“移动云”等）的信息系统，租约到期日起2个月内全部迁移至国资云，原则上最迟应于2022年9月30日前全部迁移至国资云。

即日起，各企业不得再与第三方公有云平台新签、续签云资源租用合同。

（2）各企业部署在非第三方公有云平台但以互联网方式提供服务的信息系统，应于2022年9月30日前全部迁移至“国资云”。

Source: 163.com

Cloud technology still provided by traditoinal cloud vendors

Tianjin is not the first province setting up state-owned cloud. Sichuan government is the first in China and launched the state-owned cloud in Apr 2021. Seeing increasing demand for SOEs in cloud services, the state-owned cloud is a special private cloud created for SOEs. Sichuan government and China Telecom will co-operate the platform while the underlying technology is provided by Ali Cloud.

Figure 8: Sichuan State-owned Cloud background

四川国资云简介

四川国资云是省内国资企业专属行业云，其建设的目的是依托云平台促进国资企业数字化转型应用示范和数据共享，探索全省国资国企数字化转型，协同创新的最优路径。2020年11月，四川省国资委将“四川国资云”正式授权给四川省能源投资集团下属四川省数字产业有限责任公司负责平台的建设和运营。同时，四川能投和四川电信在四川国资云运营上达成战略合作，形成了联合运营的创新模式，保证对川内所有省、市属国企的落地服务。

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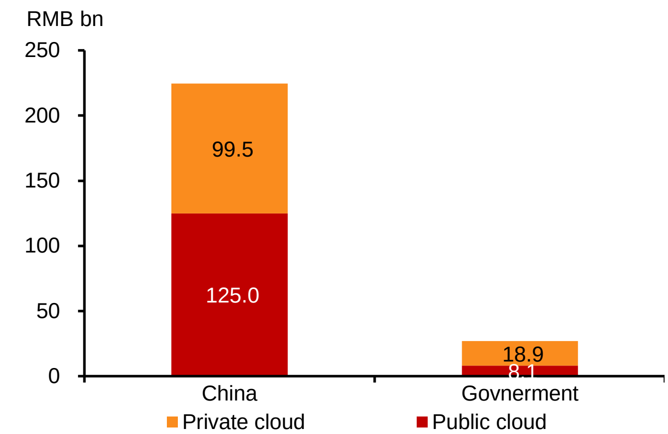
Source: scgzcloud.com

China government cloud market

SOEs prefers private cloud even before the state-owned cloud policy

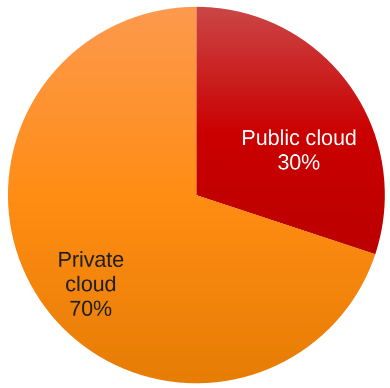
According to IDC, China gov't cloud market size was RMB27.1bn in FY20, of which 30% (RMB8.1bn) was deployed on public cloud. We estimate that in the China public cloud market with a size of RMB125bn in FY20, only 7% is related to gov't public cloud. We think the state-owned cloud plan has limited impact to public cloud vendors whose key customers are internet companies that have higher demand in storage/ computing/ CDN services.

Figure 9: China gov't public cloud accounted for 7% of China cloud market in FY20



Source: IDC, CMBIS

Figure 10: China gov't public cloud accounted for 30% of China gov't cloud market in FY20

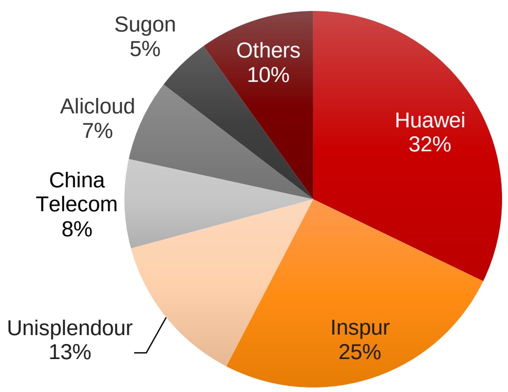


Source: IDC, CMBIS

Huawei, China Telecom, Inspur are potential beneficiaries

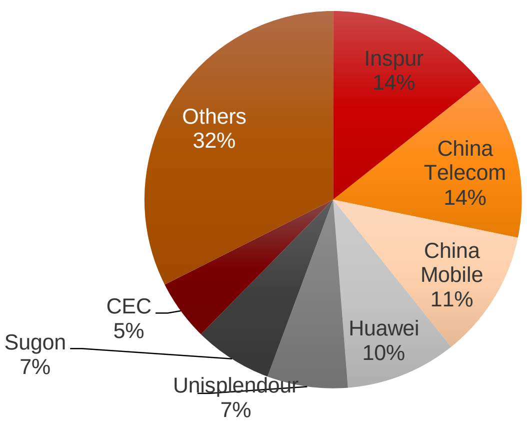
As state gov't does not have the cloud technology, it still relies on third parties to deliver cloud infrastructure (IDC/ servers, etc.) and operating/ maintenance services. For the cloud infrastructure, Huawei (32%) and Inspur (25%) are the key providers in FY20. For the gov't cloud service providers, the market is more fragmented. Inspur (600756 CH), China Telecom (728 HK), China Mobile (941 HK) and Huawei each has >10% of shares in FY20.

Figure 11: China gov't cloud infrastructure market share (FY20)



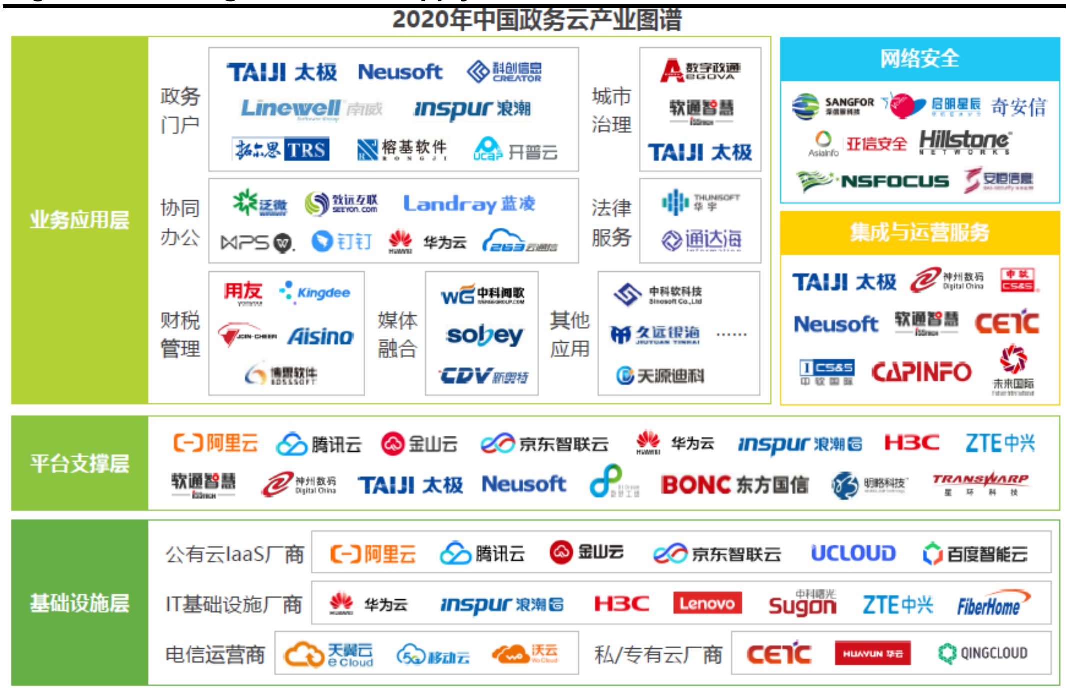
Source: IDC, CMBIS

Figure 12: China gov't cloud operators market share (FY20)



Source: IDC, CMBIS

Figure 13: China govn't cloud supply chain



Source: iResearch

Stock implications under our coverage

Chinasoft (354 HK, BUY, TP HK$17.53)

Chinasoft is a key partner to Huawei. Apart from traditional IT outsourcing, it provides managed cloud services (migration, configuration, maintenance etc.) for enterprises which use Huawei Cloud. We estimate Huawei (including Huawei, Honor and Huawei Cloud) accounted for 51% of Chinasoft FY1H21 revenue and is growing at 22% YoY despite tech war impact to Huawei. We think Huawei Cloud will continue to gain share from internet cloud service providers and Chinasoft will be a key beneficiary.

GDS (GDS US/ 9698 HK, BUY, TP US$74.74/ HK$72.38)

GDS provides IDC services to cloud vendors. Its key customers Alibaba and Tencent accounted for 46.3% of FY2Q21 revenue. GDS started to penetrate SOE clients in FY1H21 with new customer win – CEC. CEC has 5% share in China gov't cloud operator market in FY20. We think GDS near term growth visibility is high as given high capacity commitment. However, the cloud landscape change may affect GDS expansion schedule going forward.

Kingsoft Cloud (KC US, BUY, TP US$43.86)

Kingsoft Cloud (KC) is a relatively neutral cloud service providers, unlike Alibaba/ Tencent that run platform business and possess users' information. They face higher regulatory risks than KC. KC enterprise cloud business delivered robust growth of +153% YoY in FY2Q21 (29% of revenue). The enterprise cloud business mainly covers financial, healthcare and public service sectors. We think the impact from promoting state-owned cloud is not significant to KC.

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