
CLOUD COMPUTING: ARE SHARE PRICES HEADING TOWARD ZERO, OR IS IT AN OPPORTUNITY TO BUY?

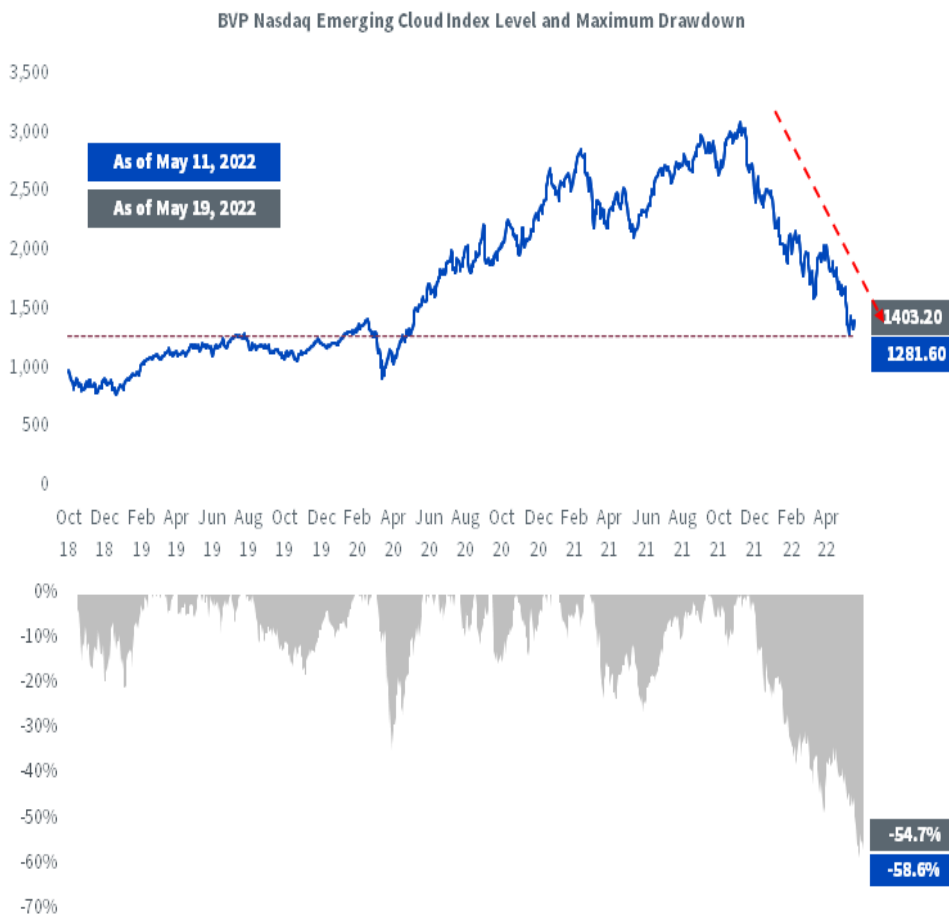
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The [drawdown](#) in many [stocks](#) focused on cloud computing software has been, in a word, unbelievable. In basically one month's time, from April 11 through May 11, the [BVP Nasdaq Emerging Cloud Index \(EMCLOUD\)](#)—a group of cloud-oriented companies—has lost roughly 30% of its value.

In figure 1, we see:

- The drawdown of EMCLOUD from the peak in November 2021, when the U.S. [Federal Reserve](#) began to discuss removing [liquidity](#) from the market in a serious way, has been more than 50%.
- From November 9, 2021, to May 11, 2022, the period of “maximum drawdown” to date, we had a 58.6% drop over 126 days.
- On May 11, the closing level of EMCLOUD fell below the closing levels observed for the first time in July 2019.

Figure 1: The Drawdown in Cloud Computing Share Prices Has Been INTENSE



Knowing this, the primary question comes back to the following, which we can simplify into two outcomes:

1. Cloud computing as a delivery mechanism through which customers subscribe to software is the wrong business model, and customers will vote with their wallets and go to something different.
2. Customers are at least equally excited, if not even more excited, about cloud computing as a delivery mechanism through which they can subscribe to software.

Company Results Support Outcome #2 over Outcome #1

While we are never able to view the future with certainty, the evidence that we can interpret today would tend to indicate that outcome #2 has a higher probability of becoming true.

The big players are still growing—FAST.

One of the risks we monitor in cloud computing regards the biggest players shifting from engines of growth to something more like “utilities”—the concept being that everyone able to adopt cloud computing has done so, so the future growth stabilizes.

- Amazon Web Services (AWS) indicated [revenue](#) growth of 37%, \$18.4 billion.
- Microsoft indicated that the part of its cloud business most directly comparable to AWS grew revenues at 46% year-over-year. It should be noted that it only had a 7% market share in 2016, so getting to 20% in this short time has been impressive.
- Google Cloud indicated year-over-year revenue growth of 44%, to \$5.8 billion.

M&A Activity Is Still Active

While it is true that not every cloud-focused company is involved in M&A, even amidst the share price performance turmoil of 2022, companies are still active.

- Google Cloud has announced its intention to buy Mandiant, a cybersecurity firm, for \$5.4 billion. The rationale is to provide its cloud customers with more robust cybersecurity solutions at a time when this is at the forefront of many customers' minds.
- Shopify has announced its intention to buy e-commerce fulfillment specialist Deliverr for \$2.1 billion.

Cloud Computing Stocks Are Still Delivering Elevated Growth Rates

Median Revenue Growth		
	Year-over-Year Trailing 12-Month	Quarter-over-Quarter Quarterly
BVP Nasdaq Emerging Cloud Index	32.8%	6.7%
Russell 1000 Growth Index	22.1%	1.8%

Sources: WisdomTree, FactSet, FTSE Russell, as of 5/19/22.

Conclusion: The Cloud Business Model Is Still Robust Amid Substantial Lowering of Equity Valuations

Some of us might have thought that there has been so much discussion about Western [central banks](#) shifting policy from extremely "easy" to extremely focused on mitigating the risk of runaway [inflation](#) that this must have been priced into equity markets. The recent behavior of software-oriented cloud computing companies would tell us something different—adjustments are clearly still being made. Our bottom line is this—these subscription-oriented businesses are still largely growing their revenues, even if that growth is nowhere near what would have been seen during the pandemic period in 2020. Those with a time horizon of the next few months may have an extremely uncertain outcome. Those with a time horizon in the range of 5, 7 or 10 years—as long as the cloud business model continues to find favor—may see this downdraft as an interesting opportunity.

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DEFINITIONS

Drawdowns : Periods of sustained negative trends of return.

Stock : A stock (also known as equity) is a security that represents the ownership of a fraction of a corporation. This entitles the owner of the stock to a proportion of the corporation's assets and profits equal to how much stock they own. Units of stock are called "shares."

BVP Nasdaq Emerging Cloud Index : designed to track the performance of emerging public companies primarily involved in providing cloud software to their customers.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Revenue : Income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

M&A : aspects of management dealing with the buying, selling, dividing and combining entities that can potentially help create value down the road.

Central bank : Refers to the the monetary authority of any country.

Inflation : Characterized by rising price levels.