Amazon's growing threat to HP, Dell and Oracle

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At any given moment, Netflix Inc. is serving up thousands, if not millions, of online videos from a big data center that the company's 33 million subscribers couldn't care less about, as long as those shows run immediately on demand.

While Netflix may be the face for providing its subscribers access to movies such as "The Hunger Games" and TV shows like "Mad Men," it's Amazon.com Inc. actually streaming that content to their screens. And the e-commerce giant has gone well beyond movie streaming, having used its massive technology backbone and expertise to solve the cloud computing needs of many large and small enterprises.

As such, Amazon has quickly become a significant force in the market for corporate IT services, where it now competes against big technology names like Hewlett-Packard Co., Dell Inc. and Oracle Corp., to name a few.

Just last week, Andy Jassy, senior vice president of Amazon Web Services, gave attendees at an AWS Summit in San Francisco an example of how much AWS has grown in the market for cloud-based data storage.

"If you look at how much new server capacity that AWS is delivering every day, it would have handled all of Amazon globally back in 2003, when we were a $5.2 billion business with 7,800 employees," Jassy told the crowd. "That's a lot of data centers."

That business is still relatively small compared with Amazon's massive retail operations. The company doesn't disclose exact revenue figures for AWS, but when Amazon reported its first-quarter results on April 25, the company listed what it called "other" revenue of $798 million. Analysts widely believe that AWS comprises the large bulk of the "other" category, and total revenue from that segment was up 60 percent in the first quarter.

By comparison, Amazon's $16.07 billion in total revenue for the quarter rose 22 percent in the same period.

Perhaps most importantly, the AWS business offers the promise of much higher profit margins at a time when Amazon has virtually trained investors to expect ultralow margins on its traditional online retail business. That is considered one of the main reasons behind the company's push to disrupt the cloud computing industry in much the same way it upended markets for books, consumer retail and even tablet computing.

"The company has sped up the rate of Web services releases in the first quarter," said Jillian Mirandi, cloud computing analyst with Technology Business Research. "We think AWS will see increased growth over 2013 due to an expanded portfolio (of cloud computing services), and the maturing of the public cloud market."

With the growth of AWS, Amazon has become an alternative to the traditional big iron server and data-storage technology providers such as HP, Dell, Oracle, International Business Machines Corp., SAP AG, EMC Corp. and NetApp Inc.

Brian Marshall of ISI Group told MarketWatch that AWS's storage offerings "will commoditize the crap out of servers, and will cannibalize some storage opportunities for EMC and NetApp, in particular." But he

added that, at least for now, he doesn't see a huge rush of companies abandoning what they have to let AWS run their cloud environments.

"It's way overblown today," Marshall said.

Not all agree. Last month, a team of analysts at Robert W. Baird issued a broad report, predicting that Amazon's AWS business will "catalyze a substantial and accelerating shift in the technology landscape," as money deployed by corporations to cloud services represents sales lost to traditional IT vendors.

"We estimate that for every dollar spent on AWS, there is at least $3-4 not spent on traditional IT, although this ratio will likely expand further with greater scale," the Baird team wrote. "In other words, AWS reaching $10 billion in revenues by 2016 translates into at least $30-40 billion lost from the traditional IT market."

Amazon didn't make any company officials available to comment on AWS. But Jassy, who runs AWS, spoke at an AWS summit in San Francisco on April 30, and outlined the business strategy, and why the company has cut prices on AWS services 31 times since its launch in 2006, including seven price cuts this year.

Jassy called it a "virtuous circle" that benefits customers and Amazon.

"As we have more AWS customers, it leads to more AWS usage," Jassy said. "As we have more AWS usage, we have to buy more infrastructure. As we buy more infrastructure, it gives us economies of scale, which lowers our infrastructure cost, which allows us to reduce our prices."

Some might think that Amazon's large investments in building out its network would boost business for providers of that technology, but that effect may be limited. In a note to clients on Friday, Trip Chowdhry of

Global Equities Research wrote that Cisco Systems' business "may be in secular decline," given that he believes Amazon builds its own routers to power AWS.

"Amazon.com is the standard. No other company comes even close to the scale of Amazon.com," Chowdhry wrote, adding that "AWS deploys servers worth $50 million every day."

Even though AWS is still a small part of Amazon's total sales, what it does for the company's profit margins is seen by some analysts as a key reason why the company is putting so much emphasis on the business. Amazon's total gross profit margins in the company's first quarter rose to 26.6 percent from 24 percent a year ago, but some analysts estimate that the margins from AWS are as high as 100 percent, because of how Amazon runs all the costs of the services.

"We expect (Amazon's) gross margin to continue to expand not only from higher contribution from third-party and digital content sales, but should also benefit from AWS growth, shipping and scale," said Needham & Co. analyst Kerry Rice, in a research note. Rice has a hold, or neutral, rating on Amazon's stock.

Still, the role of AWS also highlights an ongoing shift in what kind of company Amazon is becoming.

"A core skill set that AWS possesses is its ability to quickly build and launch web services," said Mirandi of Technology Business Research. "And it's in part due to (Amazon's) consumer business that led to expertise in quickly developing these services."