

Sky-high expectations for release of Amazon Web Services' numbers

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When Amazon.com reports its quarterly financial results Thursday, the company will do something it has never done before: provide detailed financial information about its Amazon Web Services division.

Prying data from Amazon has always been a struggle, and financial information about AWS is among the most prized, yet unavailable, detail for investors. That's because investors want to know as much as they can about AWS, which rents computing power and storage for businesses and is believed to be one of the fastest-growing pieces in Amazon's empire.

Amazon is breaking out the AWS financial because federal accounting standards require disclosure of units the size of AWS.

Breaking out that data has revived the question of whether Amazon might spin off AWS. To many, the division doesn't appear core to Amazon's giant retail operation. What's more, the hefty investments building the technical infrastructure behind AWS are a drain on Amazon's bottom line. And an AWS free of Amazon could open the unit up to capital markets, giving it more financial clout as it competes with Microsoft, Google and other deep-pocketed rivals.

To be sure, Amazon has never suggested that it would spin off AWS, and it declined to comment for this article. But when the senior brass has discussed AWS's future, it's always been in the context of being a part of Amazon.

"It's quite interesting to see how fast the business is growing," Andy Jassy, the executive vice president who runs AWS, said in an interview with The Seattle Times in 2013. "We believe it has the potential to be the largest business at Amazon one day."

It's a bold prediction for a company that, last year, generated \$60.9 billion in its "electronic and other general merchandise" segment.

There are plenty of reasons to keep AWS in the Amazon fold. Perhaps the biggest is that Amazon uses AWS to run its business. That makes Amazon more efficient, and it gives the company insight into how customers use AWS, fueling product development.

AWS was among the pioneers of renting computing power and storage over the Internet to companies who can build their technical infrastructure without ever having to buy a server. Early on, that helped it appeal to startups, such as Pinterest and Airbnb.

And while a steady stream of startups continues to turn to AWS, established giants such as Nike and Merck are using AWS's pay-as-you-go services for some of their operations as well. One of AWS's biggest coups came in 2013, when it won a \$600 million contract from the Central Intelligence Agency, a contract the company trumpets to illustrate its ability to handle the most secure information.

Those deals helped propel AWS to the top of the so-called infrastructure as a service market. Research firm Gartner calls it "the overwhelming market share leader" with more than five times the computing capacity as the next 14 rivals combined.

In San Francisco recently, Jassy noted that AWS revenue is growing more than 40 percent year over year. If AWS was a stand-alone business, it would be "the fastest growing multibillion-dollar enterprise IT

company in the world," Jassy claimed.

And yet, as big as AWS has become, there is still huge growth left for the burgeoning business. Gartner estimates that the cloud infrastructure market - which it pegs at \$17 billion this year - will double by 2018.

But seizing that business will require significant investment. Amazon has 11 massive data operations, which the company calls "regions," around the world. Those centers, plus 28 so-called "availability zones," mean the company could have more than 5 million servers, Deutsche Bank analyst Karl Keirstead recently wrote in a report.

Only a handful of companies have the financial wherewithal to compete at that level. The two most often mentioned are Microsoft, with its Azure service, and Google, with its Compute Engine.

And those companies have aggressively challenged AWS, competing with the same kind of tactics Amazon has used in the retail business. They've cut prices. A year ago, those companies, along with Cisco, sparked a price war in a bid to grab marketshare. AWS engaged in the battle as well, cutting prices 28 percent to 51 percent. But it's clear that, as the market grows, rivals are going to win customers, too.

"Microsoft is having material success driving Azure adoption and that Azure growth will be substantial in 2015," Deutsche Bank's Keirstead wrote recently.

As those companies continue to challenge AWS, they'll pressure the division to continue expanding. Amazon has never disclosed the cost of a region, but documents that emerged in the company's bid to get tax breaks and land for a new region in Ohio show the company plans to spend \$1.1 billion developing it.

Jassy subsequently said it would be a mistake to believe that each region costs the same amount Ohio authorities expect AWS to spend there. But it's clear the price of AWS expansion isn't cheap.

As much potential as the cloud infrastructure business has, some Amazon investors have shown a reluctance to absorb the significant costs AWS requires. Amazon shares tanked last July after the company posted larger-than-expected second-quarter losses, blaming the red ink, in part, on capital costs related to AWS expansion and the price cuts.

That's one reason why, as Amazon breaks out AWS's financial numbers for the first time, some investors are wondering if the [company](#) will someday make the unit independent. In November, the Financial Times' Lex column suggested spinning off the division as a way to make Amazon more profitable while garnering a lofty cloud-computing multiple for a separate AWS. A month later, the Edge Consulting Group, a London firm that specializes in spinoffs, suggested an independent AWS could attract a bidding war.

Robert W. Baird & Co. analyst Colin Sebastian estimates that AWS's market value is between \$40 billion and \$50 billion, while Amazon's overall market capitalization is \$178.8 billion. But Sebastian is dubious that Amazon will set AWS free.

"Never say never on a spinoff, but I think a large part of what makes AWS successful is that it is used by Amazon for their core revenue-generating businesses," Sebastian said. "This is an advantage that IBM, Rackspace and other competitors don't have."

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