

Network-related operational expenses. Tencent spends a significant portion of its operating expense budget to procure and operate its physical network of data center and related cloud resources. Tencent owns some of its data centers, but rents much of its footprint from both telcos (e.g. China Telecom) and carrier-neutral providers (e.g. GDS). In the optical transmission space, Tencent relies on a similar mix of owned network assets and leased bandwidth from third parties. In 2020, total “bandwidth and server custody fees” amounted to \$3.17B, or about 6.9% of operating expenses (excluding depreciation & amortization). That’s up slightly from the 6.7% recorded in 2019, but down from 7.8% in 2018. Tencent is likely to continue building out more of its own data center and fiber footprint over time, both domestically and overseas, but will continue to pay significant fees to third parties. That includes Chinese telcos which also provide cloud services, and in this market compete directly with the Tencent Cloud division. This raises the potential for clear competitive conflicts. Pricing and terms, however, are kept relatively reasonable through the availability of multiple sources for both fiber and colocation space rental in China. Outside of China, Tencent generally rents space and bandwidth from carrier-neutral providers, not telcos.

Content costs. Tencent’s spending on content costs amounted to 58.3B RMB (\$8.4B) in 2020, or roughly 18% of operating expenses (excluding depreciation & amortization). Content costs include payments to third parties for live broadcast and video subscription services. As a percentage of opex, Tencent’s content cost burden approaches the level often seen in the cable TV operator sector. Content costs have grown at roughly the same rate as overall opex since 2016 (both a bit more than doubled). Going forward it’s clear that Tencent aims to reduce the burden of content costs, which is one factor behind the company’s investments in content-related businesses including Tencent Pictures. That’s similar to what many cable TV companies have done, creating partnerships or merging with content developers. In 2013, for instance, US-based cable operator closed on its acquisition of NBCUniversal. In the webscale world, Amazon spends a significant part of its recorded R&D budget on content development for its Amazon Prime video platform.

Asset leasing costs. Like many network operators, Tencent has entered into some long-term (over 1 year) arrangements for the leasing of certain physical facilities, including both land/real estate (recorded as “buildings”) and fiber optic cables (recorded as “computer and other operating equipment”). In 2020, Tencent recorded approximately 4.1B RMB in operating lease expenses, or US\$589M.

Figure 7 below breaks down Tencent’s expenses by nature for 2020 (total: \$48.5B), from 2018-20.