

SOHU COM INC
Form 10-Q
November 08, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 0-30961

Sohu.com Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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Delaware
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

98-0204667
(I.R.S. EMPLOYER
IDENTIFICATION NUMBER)

Level 12, Sohu.com Internet Plaza

No. 1 Unit Zhongguancun East Road, Haidian District

Beijing 100084

People's Republic of China

(011) 8610-6272-6666

(Address, including zip code, of registrant's principal executive offices

and registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding at September 30, 2010
Common stock, \$.001 par value	37,937,980

SOHU.COM INC.

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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SOHU.COM INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(In thousands, except par value)

	As of	
	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 534,662	\$ 563,782
Investment in debt securities	74,615	0
Accounts receivable, net	70,102	46,610
Prepaid and other current assets	19,866	10,781
Total current assets	699,245	621,173
Fixed assets, net	119,207	115,088
Goodwill	67,736	55,555
Intangible assets, net	13,478	7,933
Prepaid non-current assets	138,992	26,207
Other assets, net	7,963	2,317
Total assets	\$ 1,046,621	\$ 828,273
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 7,475	\$ 4,602
Accrued liabilities to suppliers and agents	57,907	41,103
Receipts in advance and deferred revenue	49,555	36,944
Accrued salary and benefits	31,258	28,860
Tax payables	24,044	21,953
Other accrued liabilities	22,986	17,035
Total current liabilities	193,225	150,497
Contingent consideration	1,343	0
Total liabilities	194,568	150,497
Commitments and contingencies		
Shareholders equity		
Sohu.com Inc. shareholders equity:		
Common stock: \$0.001 par value per share (75,400 shares authorized; 37,938 and 37,749 shares issued and outstanding, respectively)	43	43
Additional paid-in capital	331,466	317,052
Treasury stock (5,389 shares)	(114,690)	(114,690)

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Accumulated other comprehensive income	30,890	21,502
Retained earnings	490,527	385,874
Total Sohu.com Inc. shareholders' equity	738,236	609,781
Noncontrolling interest	113,817	67,995
Total shareholders' equity	852,053	677,776
Total liabilities and shareholders' equity	\$ 1,046,621	\$ 828,273

The accompanying notes are an integral part of these condensed consolidated financial statements.

SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues:				
Advertising:				
Brand advertising	\$ 59,083	\$ 48,502	\$ 151,757	\$ 131,197
Sponsored search	5,367	2,292	12,092	5,623
Subtotal of advertising revenues	64,450	50,794	163,849	136,820
Online game	85,623	68,684	235,416	196,887
Wireless and others	13,991	17,107	40,350	45,701
Total revenues	164,064	136,585	439,615	379,408
Cost of revenues:				
Advertising:				
Brand advertising	23,256	15,418	62,795	43,213
Sponsored search	3,803	2,728	10,223	7,291
Subtotal of cost of advertising revenues	27,059	18,146	73,018	50,504
Online game	8,537	4,713	20,929	12,086
Wireless and others	7,580	10,331	20,976	26,972
Total cost of revenues	43,176	33,190	114,923	89,562
Gross profit	120,888	103,395	324,692	289,846
Operating expenses:				
Product development	19,454	14,531	51,853	42,482
Sales and marketing	25,410	25,457	78,025	68,093
General and administrative	10,619	10,721	29,886	27,823
Amortization of intangible assets	163	93	410	295
Total operating expenses	55,646	50,802	160,174	138,693
Operating profit	65,242	52,593	164,518	151,153
Other (expense) income	(939)	40	(1,294)	103
Interest income and exchange difference	1,050	1,469	3,207	3,865
Income before income tax expense	65,353	54,102	166,431	155,121
Income tax expense	(11,340)	(7,022)	(25,632)	(21,577)
Income from continuing operations	54,013	47,080	140,799	133,544
Gain from discontinued e-commerce operations	0	0	0	446
Net income	54,013	47,080	140,799	133,990

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Less: Net income attributable to the noncontrolling interest	13,004	9,726	36,146	18,506
Net income attributable to Sohu.com Inc.	\$ 41,009	\$ 37,354	\$ 104,653	\$ 115,484
Basic net income per share attributable to Sohu.com Inc.	\$ 1.08	\$ 0.97	\$ 2.77	\$ 3.02
Shares used in computing basic net income per share attributable to Sohu.com Inc.	37,896	38,410	37,832	38,286
Diluted net income per share attributable to Sohu.com Inc.	\$ 1.01	\$ 0.88	\$ 2.55	\$ 2.82
Shares used in computing diluted net income per share attributable to Sohu.com Inc.	38,377	39,082	38,370	38,985

The accompanying notes are an integral part of these condensed consolidated financial statements.

SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 140,799	\$ 133,990
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	15,320	12,007
Share-based compensation expense	19,542	13,385
Amortization of intangible assets and other assets	2,899	1,355
Provision for allowance for doubtful accounts	88	393
(Excess tax benefits) Reversal of excess tax benefits from share-based payment arrangements	(1,888)	678
Others	832	309
Changes in assets and liabilities, net of acquisition:		
Prepaid and other current assets	(8,449)	15,753
Accounts receivable	(19,002)	(23,167)
Tax payables	2,578	1,225
Accrued liabilities to suppliers and agents	16,804	5,990
Receipts in advance and deferred revenue	8,413	4,098
Accounts payable	2,873	2,485
Other accrued liabilities	3,308	(76)
Net cash provided by operating activities	184,117	168,425
Cash flows from investing activities:		
Purchase of fixed assets	(125,522)	(18,167)
Purchase of debt securities	(74,615)	0
Purchase of intangible and other assets	(5,305)	(319)
Decrease in restricted cash	0	2,671
Acquisitions, net of cash acquired	(14,166)	0
Net cash used in investing activities	(219,608)	(15,815)
Cash flows from financing activities:		
Issuance of common stock	968	3,787
Excess tax benefits (Reversal of excess tax benefits) from share-based payment arrangements	1,888	(678)
Proceeds from Changyou's initial public offering	0	128,340
Other payments relating to financing activities, net	(3,000)	(1,865)
Net cash (used in) provided by financing activities	(144)	129,584
Effect of exchange rate changes on cash and cash equivalents	6,515	(266)
Net (decrease) increase in cash and cash equivalents	(29,120)	281,928
Cash and cash equivalents at beginning of period	563,782	314,425
Cash and cash equivalents at end of period	\$ 534,662	\$ 596,353

The accompanying notes are an integral part of these condensed consolidated financial statements.

SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Nine Months Ended September 30, 2010

(In thousands)

	Sohu.com Inc. Shareholders Equity							
	Total	Comprehensive Income	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated		Noncontrolling Interest
Comprehensive Income						Retained Earnings		
Beginning balance	\$ 677,776	\$ 0	\$ 43	\$ 317,052	\$ (114,690)	\$ 21,502	\$ 385,874	\$ 67,995
Issuance of common stock	968	0	0	968	0	0	0	0
Share-based compensation expense	19,542	0	0	11,558	0	0	0	7,984
Excess tax benefits from share-based awards	1,888	0	0	1,888	0	0	0	0
Comprehensive income:								
Net income	140,799	140,799	0	0	0	0	104,653	36,146
Other comprehensive income:								
Foreign currency translation adjustment	11,080	11,080	0	0	0	9,388	0	1,692
Total other comprehensive income	11,080	11,080						
Total comprehensive income	151,879	151,879						
Comprehensive income attributable to the noncontrolling interest		(37,838)						
Comprehensive income attributable to Sohu.com Inc.		\$ 114,041						
Ending balance	\$ 852,053		\$ 43	\$ 331,466	\$ (114,690)	\$ 30,890	\$ 490,527	\$ 113,817

The accompanying notes are an integral part of these condensed consolidated financial statements.

SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Nine Months Ended September 30, 2009

(In thousands)

	Sohu.com Inc. Shareholders' Equity							
	Total	Comprehensive Income	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated		Noncontrolling Interest
Comprehensive Income						Retained Earnings		
Beginning balance	\$ 391,094	\$ 0	\$ 43	\$ 201,196	\$ (74,683)	\$ 21,349	\$ 238,041	\$ 5,148
Issuance of common stock	3,787	0	0	3,787	0	0	0	0
Share-based compensation expense	13,385	0	0	7,231	0	0	0	6,154
Reversal of excess tax benefits from share-based awards	(858)	0	0	(858)	0	0	0	0
Comprehensive income:								
Net income	133,990	133,990	0	0	0	0	115,484	18,506
Other comprehensive income:								
Foreign currency translation adjustment	311	311	0	0	0	118	0	193
Total other comprehensive income	311	311						
Total comprehensive income	134,301	134,301						
Comprehensive income attributable to the noncontrolling interest		(18,699)						
Comprehensive income attributable to Sohu.com Inc.		\$ 115,602						
Recognition of change in Sohu's economic interests in Changyou	125,375		0	100,552	0	0	0	24,823
Ending balance	\$ 667,084		\$ 43	\$ 311,908	\$ (74,683)	\$ 21,467	\$ 353,525	\$ 54,824

The accompanying notes are an integral part of these condensed consolidated financial statements.

SOHU.COM INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Basis of Presentation

Nature of Operations

Sohu.com Inc. (Sohu or the Company), a Delaware corporation organized in 1996, is a leading Internet company providing comprehensive online products and services in the People's Republic of China (the PRC or China). The Company, together with its wholly-owned and majority-owned subsidiaries and variable interest entities (collectively the Sohu Group) mainly offers advertising services (through brand advertising and sponsored search), online game services (through Changyou.com Limited) and wireless services through its Internet sites: sohu.com, 17173.com, focus.cn, chinaren.com, sogou.com and changyou.com.

Brand advertising and online game are the two core businesses of the Sohu Group. The brand advertising business provides advertisements on the Sohu Group's portal matrix to advertisers who wish to build up their brand awareness online. The online game business is conducted by a majority-owned subsidiary of Sohu, Changyou.com Limited (Changyou), which currently operates six massively multi-player online role-playing games (MMORPGs), (i) Tian Long Ba Bu (TLBB), (ii) Blade Online (BO), (iii) Blade Hero 2 (BH 2) which is the sequel to BO, (iv) Da Hua Shui Hu (DHSH), (v) Zhong Hua Ying Xiong (ZHYX) and (vi) Immortal Faith (IF). TLBB is Changyou's first in-house developed MMORPG and is one of the most popular online games in China.

On April 7, 2009, Changyou completed its initial public offering on the NASDAQ Global Select Market, trading under the symbol CYOU. After Changyou's offering, Sohu continues to consolidate Changyou in Sohu's consolidated financial statements, as Sohu is Changyou's controlling shareholder, but recognizes noncontrolling interest reflecting shares held by shareholders other than Sohu. As of September 30, 2010, 29% of the economic interest in Changyou was recognized as noncontrolling interest in Sohu's consolidated financial statements. See Note 2 Changyou Transactions Sohu's Shareholding in Changyou.

Basis of Consolidation

The consolidated financial statements include the accounts of Sohu and its wholly-owned and majority-owned subsidiaries and variable interest entities (VIEs). VIEs are consolidated if the Company is the primary beneficiary. All intercompany transactions are eliminated.

For majority-owned subsidiaries and VIEs, noncontrolling interest is recognized to reflect the portion of their equity which is not attributable, directly or indirectly, to the controlling shareholder. As Sohu is Changyou's controlling shareholder, Changyou's financial results have been consolidated with those of Sohu for all periods presented. To reflect the economic interest in Changyou held by shareholders other than Sohu, Changyou's net income attributable to these shareholders is recorded as noncontrolling interest in Sohu's consolidated statements of operations, and Changyou's cumulative results of operations attributable to these shareholders, along with its changes in shareholders' equity and adjustment for share-based compensation expense in relation to those share-based awards which are unvested and vested but not yet settled, are recorded as noncontrolling interest in Sohu's consolidated balance sheets. See Note 2 Changyou Transactions Sohu's Shareholding in Changyou and Note 10 Noncontrolling Interest.

Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. Results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results expected for the full fiscal year or for any future period. Certain comparative figures have been reclassified to conform to the current presentation.

These financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

2. Changyou Transactions

Share-based Award to Tao Wang, Chief Executive Officer of Changyou

In January 2008, Sohu communicated to and agreed with Tao Wang, who is now the Chief Executive Officer of Changyou, to grant him 700,000 ordinary shares and 800,000 restricted ordinary shares, in lieu of his contingent right in Beijing Fire Fox Digital Technology Co., Ltd. (Beijing Fire Fox), which was one of Sohu's subsidiaries devoted to the development of TLBB. The 800,000 restricted ordinary shares were subject to a four-year vesting period commencing February 1, 2008. In addition, Tao Wang would not be entitled to participate in any distributions on Changyou shares, whether or not vested, until the earlier of Changyou's completion of an initial public offering or February 2012, and in any event entitlement to distributions would be subject to vesting of the shares.

In January 2009, under Changyou's 2008 Share Incentive Plan described below, Changyou issued 700,000 of its Class B ordinary shares and 800,000 of its Class B restricted ordinary shares to Tao Wang through Prominence Investments Ltd. (Prominence), which is an entity deemed under applicable Securities and Exchange Commission (SEC) rules to be beneficially owned by Tao Wang.

In February 2009, 200,000 Class B restricted ordinary shares held by Prominence became vested. Upon this vesting, the number of Class B ordinary shares held beneficially by Tao Wang increased to 900,000 shares and the number of Class B restricted ordinary shares held beneficially by Tao Wang decreased to 600,000 shares.

In March 2009, in preparation for its initial public offering, Changyou effected a ten-for-one share split that resulted in the aforementioned 900,000 Class B ordinary shares and 600,000 Class B restricted ordinary shares becoming 9,000,000 Class B ordinary shares and 6,000,000 Class B restricted ordinary shares, respectively.

Upon the completion of Changyou's initial public offering in April 2009, vested Class B ordinary shares held by Prominence became entitled to participate in distributions on Changyou shares. Since the completion of the initial public offering, Class B restricted ordinary shares held by Prominence have continued, and will continue, to become vested from time to time in accordance with their terms.

Changyou's 2008 Share Incentive Plan

On December 31, 2008, Changyou reserved 2,000,000 of its ordinary shares, which included 1,774,000 Class B ordinary shares and 226,000 Class A ordinary shares, for issuance to certain of its executive officers and to certain of its employees as incentive compensation under Changyou's 2008 Share Incentive Plan. As described above, 700,000 ordinary shares and 800,000 restricted ordinary shares were granted to Tao Wang through Prominence under this incentive plan.

In March 2009, the 2,000,000 reserved ordinary shares were subject to a ten-for-one share split effected by Changyou and became 20,000,000 ordinary shares.

Initial Public Offering of Changyou

On April 7, 2009, Changyou completed its initial public offering on the NASDAQ Global Select Market, trading under the symbol CYOU.

The initial public offering consisted of American depositary shares (ADSs), with each ADS representing two Class A ordinary shares. Changyou's ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares and holders of Class B ordinary shares have the same rights in Changyou, with the exception of voting and conversion rights. Each Class A ordinary share is entitled to one vote on all matters subject to a shareholder vote, and each Class B ordinary share is entitled to ten votes on all matters subject to a shareholder vote. Each Class B ordinary share is convertible into one Class A ordinary share at any time at the election of the holder. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances.

At the closing of the initial public offering, Changyou issued and sold 7,500,000 Class A ordinary shares represented by 3,750,000 ADSs, and Sohu, through its indirectly wholly-owned subsidiary Sohu.com (Game) Limited (Sohu Game), sold 9,750,000 Class A ordinary shares represented by 4,875,000 ADSs, including 2,250,000 Class A ordinary shares represented by 1,125,000 ADSs sold pursuant to the exercise of the underwriters' over-allotment option.

Subsequent to the offering, Changyou had 102,500,000 Class A and Class B ordinary shares issued and outstanding. Those outstanding shares consisted of (i) 70,250,000 Class B ordinary shares held by Sohu through Sohu Game; (ii) 15,000,000 Class B ordinary shares held by Tao Wang through Prominence, including 6,000,000 Class B restricted ordinary shares that were not vested as of the completion of the offering; and (iii) 17,250,000 Class A ordinary shares held by public shareholders.

Net proceeds to Changyou and Sohu Game from this initial public offering were approximately \$54.7 million and \$70.7 million, respectively, for total proceeds of approximately \$125.4 million, after deducting underwriting discounts and commissions and offering expenses.

As a result of the completion of Changyou's initial public offering, in the second quarter of 2009, Sohu recognized a one-time gain of \$100.6 million in the shareholders' equity section of Sohu's consolidated balance sheets, to reflect the net proceeds Sohu received from the initial public offering and the incremental change in Sohu's economic interest in Changyou immediately before and after the offering.

Sohu's Shareholding in Changyou

Shareholding and Control

Through September 30, 2010, 1,220,000 Class B restricted share units granted to certain of Changyou's executive officers other than Tao Wang and to certain of its employees had become vested, and were settled in Class B ordinary shares and then converted into Class A ordinary shares; and 358,000 Class A restricted share units granted to certain of Changyou's executive officers other than Tao Wang and to certain of its employees had become vested, and were settled in Class A ordinary shares.

As of September 30, 2010, Changyou had outstanding a combined total of 104,078,000 Class A and Class B ordinary shares, consisting of (i) 70,250,000 Class B ordinary shares held by Sohu through Sohu Game; (ii) 14,400,000 Class B ordinary shares held by Tao Wang through Prominence, including 4,000,000 Class B restricted ordinary shares that were not vested; (iii) 17,850,000 Class A ordinary shares issued in Changyou's initial public offering; (iv) 1,220,000 Class A ordinary shares issued to certain of Changyou's executive officers other than Tao Wang and to certain of its employees upon conversion of Class B ordinary shares that had been issued upon the vesting and settlement of Class B restricted share units granted to them; and (v) 358,000 Class A ordinary shares issued to certain of Changyou's executive officers other than Tao Wang and to certain of its employees upon the vesting and settlement of Class A restricted share units granted to them.

As of September 30, 2010, treating Tao Wang's 4,000,000 Class B restricted ordinary shares as owned by Tao Wang, Sohu held approximately 68% of the combined total of Changyou's outstanding Class A and Class B ordinary shares and controlled approximately 81% of the total voting power in Changyou. As a result, Sohu had the power to elect the entire board of directors of Changyou and determine the outcome of all matters submitted to a shareholder vote. As Changyou's controlling shareholder, Sohu will continue to consolidate Changyou in Sohu's consolidated financial statements but recognize noncontrolling interest reflecting shares held by shareholders other than Sohu, as discussed above in Note 1 The Company and Basis of Presentation Basis of Consolidation.

Economic Interest

Because Tao Wang's 4,000,000 Class B restricted ordinary shares are subject to forfeiture to Sohu until they become vested, for accounting purposes those shares are treated as owned by Sohu, rather than as owned by Tao Wang, and therefore those shares are not included in the noncontrolling interest line items in Sohu's consolidated financial statements. As a result, as of September 30, 2010, Sohu was treated as holding approximately 71% of the economic interest in Changyou. Accordingly, shareholders other than Sohu were treated as holding the remaining 29% of the economic interest, which was recognized as noncontrolling interest in Sohu's consolidated financial statements, as discussed above in Note 1 The Company and Basis of Presentation Basis of Consolidation.

Sohu's economic interest in Changyou, as well as the noncontrolling interest recognized for Changyou in Sohu's consolidated financial statements, will continue to change as the Class B restricted ordinary shares granted to Tao Wang become vested, and the restricted share units granted to certain of Changyou's executive officers other than Tao Wang and to certain of its employees become vested and settled.

Dilutive Impact

Through September 30, 2010, under Changyou's 2008 Share Incentive Plan, Changyou has granted 11,000,000 Class B ordinary shares and 4,000,000 Class B restricted ordinary shares to Tao Wang through Prominence and 4,414,000 Class A and Class B restricted share units (setttable by Changyou's issuance of Class A ordinary shares and Class B ordinary shares, respectively) to certain of its executive officers other than Tao Wang and to certain of its employees. As of September 30, 2010, the number of Changyou's outstanding restricted share units decreased from 4,414,000 to 2,776,250, as a result of vesting and settlement or forfeitures of restricted share units.

Because no Class A ordinary shares or Class B ordinary shares will be issued with respect to these restricted share units until the restricted share units are vested and settled, the unvested restricted share units and vested restricted share units that have not yet been settled are not included as outstanding shares of Changyou and have no impact on Sohu's basic net income per share. Unvested restricted share units and vested restricted share units that have not yet been settled do, however, have a dilutive impact on Sohu's diluted net income per share.

For the third quarter of 2010, in the calculation of Sohu's diluted net income per share, Sohu's economic interest in Changyou was approximately 66%, treating all of Changyou's existing unvested restricted shares, unvested restricted share units, and vested restricted share units that have not yet been settled as vested, in the case of restricted shares, and vested and settled, in the case of restricted shares units. See Note 11 Net Income per Share.

3. Segment Information

The Sohu Group has determined that the business segments that constitute its primary reporting segments are brand advertising, sponsored search, online game and wireless, which is consistent with the Sohu Group's internal financial reporting structure.

Prior to 2009, the Company disclosed segment operating performance only through the gross profits line item, and did not allocate any operating expenses or assets to those segments, as management did not use this information to measure the performance of the operating segments.

Commencing January 1, 2009, the chief operating decision maker (CODM) began reviewing certain additional information for the online game segment. Accordingly, the Company has adjusted the online game segment operating performance measurement disclosures to include income from operations and the main segment assets for the online game segment. For the remaining segments, the operating performance measurements are unchanged. Consistent with prior periods, some items, such as share-based compensation expense, operating expenses, other income and expense, and income tax expense, are not reviewed by the CODM. These items are disclosed in the following segment information for reconciliation purposes only.

The following tables present summary information by segment (in thousands):

	Three Months Ended September 30, 2010				Segments Other Than Online Game			Consolidated
	Brand Advertising	Sponsored Search	Wireless	Others	Online Game	Online Game	Intercompany Eliminations	
Revenues (1)	\$ 61,597	\$ 5,367	\$ 13,593	\$ 398	\$ 80,955	\$ 85,624	\$ (2,515)	\$ 164,064
Segment cost of revenues	(22,234)	(3,802)	(7,381)	(199)	(33,616)	(8,497)	0	(42,113)
Segment gross profit	\$ 39,363	\$ 1,565	\$ 6,212	\$ 199	47,339	77,127	(2,515)	121,951
SBC (2) in cost of revenues					(1,023)	(40)	0	(1,063)
Gross profit					46,316	77,087	(2,515)	120,888
Operating expenses:								
Product development					(7,941)	(9,275)	0	(17,216)
Sales and marketing (1)					(16,951)	(9,703)	2,515	(24,139)
General and administrative					(5,721)	(2,909)	0	(8,630)
Amortization of intangible assets					(138)	(25)	0	(163)
SBC (2) in operating expenses					(3,749)	(1,749)	0	(5,498)
Total operating expenses					(34,500)	(23,661)	2,515	(55,646)
Operating profit					11,816	53,426	0	65,242
Other expense					(226)	(713)	0	(939)
Interest income and exchange difference					7	1,043	0	1,050
Income tax expense					(2,876)	(8,464)	0	(11,340)

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Income from continuing operations	\$ 8,721	\$ 45,292	\$ 0	\$ 54,013
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Note (1): The intercompany elimination for segment revenues mainly consists of marketing services provided by the brand advertising segment (banner advertisements etc.) to the online game segment (conducted through Changyou).

Note (2): SBC stands for share-based compensation expense.

Three Months Ended September 30, 2009
Segments Other Than Online Game

	Brand Advertising	Sponsored Search	Wireless	Others	Segments Other Than Online Game	Online Game	Intercompany Eliminations	Consolidated
Revenues (1)	\$ 52,082	\$ 2,292	\$ 16,788	\$ 319	\$ 71,481	\$ 68,684	\$ (3,580)	\$ 136,585
Segment cost of revenues (1)	(15,269)	(2,709)	(9,628)	(692)	(28,298)	(4,545)	1	(32,842)
Segment gross profit (loss)	\$ 36,813	\$ (417)	\$ 7,160	\$ (373)	43,183	64,139	(3,579)	103,743
SBC (2) in cost of revenues					(179)	(169)	0	(348)
Gross profit					43,004	63,970	(3,579)	103,395
Operating expenses:								
Product development					(7,425)	(4,902)	0	(12,327)
Sales and marketing (1)					(19,672)	(9,212)	3,579	(25,305)
General and administrative					(4,759)	(4,182)	0	(8,941)
Amortization of intangible assets					(92)	(1)	0	(93)
SBC (2) in operating expenses					(751)	(3,385)	0	(4,136)
Total operating expenses					(32,699)	(21,682)	3,579	(50,802)
Operating profit					10,305	42,288	0	52,593
Other income					6	34	0	40
Interest income and exchange difference					503	966	0	1,469
Income tax expense					(1,528)	(5,494)	0	(7,022)
Income from continuing operations					\$ 9,286	\$ 37,794	\$ 0	\$ 47,080

Note (1): The intercompany elimination for segment revenues mainly consists of marketing services provided by the brand advertising segment (banner advertisements etc.) to the online game segment (conducted through Changyou).

Note (2): SBC stands for share-based compensation expense.

Nine Months Ended September 30, 2010
Segments Other Than Online Game

	Brand Advertising	Sponsored Search	Wireless	Others	Segments Other Than Online Game	Online Game	Intercompany Eliminations	Consolidated
Revenues (1)	\$ 159,865	\$ 12,092	\$ 37,954	\$ 2,396	\$ 212,307	\$ 235,417	\$ (8,109)	\$ 439,615
Segment cost of revenues	(59,602)	(10,220)	(20,102)	(874)	(90,798)	(20,779)	0	(111,577)
Segment gross profit	\$ 100,263	\$ 1,872	\$ 17,852	\$ 1,522	121,509	214,638	(8,109)	328,038
SBC (2) in cost of revenues					(3,196)	(150)	0	(3,346)
Gross profit					118,313	214,488	(8,109)	324,692
Operating expenses:								
Product development					(23,519)	(21,433)	0	(44,952)
Sales and marketing (1)					(51,726)	(31,006)	8,109	(74,623)
General and administrative					(13,968)	(10,025)	0	(23,993)
Amortization of intangible assets					(381)	(29)	0	(410)
SBC (2) in operating expenses					(9,607)	(6,589)	0	(16,196)
Total operating expenses					(99,201)	(69,082)	8,109	(160,174)
Operating profit					19,112	145,406	0	164,518
Other expense					(863)	(431)	0	(1,294)
Interest income and exchange difference					546	2,661	0	3,207
Income tax expense					(5,085)	(20,547)	0	(25,632)
Income from continuing operations					\$ 13,710	\$ 127,089	\$ 0	\$ 140,799

Note (1): The intercompany elimination for segment revenues mainly consists of marketing services provided by the brand advertising segment (banner advertisements etc.) to the online game segment (conducted through Changyou).

Note (2): SBC stands for share-based compensation expense.

Nine Months Ended September 30, 2009
Segments Other Than Online Game

	Brand Advertising	Sponsored Search	Wireless	Others	Segments Other Than Online Game	Online Game	Intercompany Eliminations	Consolidated
Revenues (1)	\$ 148,385	\$ 5,623	\$ 45,117	\$ 584	\$ 199,709	\$ 196,887	\$ (17,188)	\$ 379,408
Segment cost of revenues (1)	(42,567)	(7,266)	(25,550)	(1,410)	(76,793)	(11,831)	12	(88,612)