

SOHU COM INC  
Form 10-Q  
August 05, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 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)  
**Level 12, Sohu.com Internet Plaza**

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

**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

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 June 30, 2010
Common stock, \$.001 par value	37,833,065



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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****SOHU.COM INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)****(In thousands, except par value)**

	June 30, 2010	As of December 31, 2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 599,105	\$ 563,782
Accounts receivable, net	62,014	46,610
Prepaid and other current assets	19,263	10,781
Total current assets	680,382	621,173
Fixed assets, net	119,136	115,088
Goodwill	67,708	55,555
Intangible assets, net	14,073	7,933
Other assets, net	73,242	28,524
Total assets	\$ 954,541	\$ 828,273
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,397	\$ 4,602
Accrued liabilities to suppliers and agents	49,233	41,103
Receipts in advance and deferred revenue	41,780	36,944
Accrued salary and benefits	29,697	28,860
Tax payables	19,997	21,953
Other accrued liabilities	23,436	17,035
Total current liabilities	171,540	150,497
Contingent consideration	1,325	0
Commitments and contingencies		
Total liabilities	172,865	150,497
Shareholders' equity		
Sohu.com Inc. shareholders' equity:		
Common stock: \$0.001 par value per share (75,400 authorized; 37,833 and 37,749 shares issued and outstanding, respectively)	43	43
Additional paid-in capital	325,611	317,052
Treasury stock (5,389 shares)	(114,690)	(114,690)
Accumulated other comprehensive income	23,692	21,502
Retained earnings	449,518	385,874
Total Sohu.com Inc. shareholders' equity	684,174	609,781

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Noncontrolling interest	97,502	67,995
Total shareholders' equity	781,676	677,776
Total liabilities and shareholders' equity	\$ 954,541	\$ 828,273

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

**Table of Contents****SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)****(In thousands, except per share data)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Revenues:</b>				
<b>Advertising:</b>				
Brand advertising	\$ 53,162	\$ 43,621	\$ 92,674	\$ 82,695
Sponsored search	3,891	1,769	6,725	3,331
<b>Subtotal of advertising revenues</b>	<b>57,053</b>	<b>45,390</b>	<b>99,399</b>	<b>86,026</b>
Online game	77,721	66,596	149,793	128,203
Wireless and others	11,323	15,099	26,359	28,594
<b>Total revenues</b>	<b>146,097</b>	<b>127,085</b>	<b>275,551</b>	<b>242,823</b>
<b>Cost of revenues:</b>				
<b>Advertising:</b>				
Brand advertising	22,256	14,065	39,539	27,795
Sponsored search	3,507	2,265	6,420	4,563
<b>Subtotal of cost of advertising revenues</b>	<b>25,763</b>	<b>16,330</b>	<b>45,959</b>	<b>32,358</b>
Online game	7,008	3,937	12,392	7,373
Wireless and others	6,150	8,512	13,396	16,641
<b>Total cost of revenues</b>	<b>38,921</b>	<b>28,779</b>	<b>71,747</b>	<b>56,372</b>
<b>Gross profit</b>	<b>107,176</b>	<b>98,306</b>	<b>203,804</b>	<b>186,451</b>
<b>Operating expenses:</b>				
Product development	16,881	14,637	32,399	27,951
Sales and marketing	29,606	25,810	52,615	42,636
General and administrative	9,384	9,208	19,267	17,102
Amortization of intangible assets	139	128	247	202
<b>Total operating expenses</b>	<b>56,010</b>	<b>49,783</b>	<b>104,528</b>	<b>87,891</b>
<b>Operating profit</b>	<b>51,166</b>	<b>48,523</b>	<b>99,276</b>	<b>98,560</b>
Other (expense) income	(330)	62	(355)	63
Interest income and exchange difference	958	1,274	2,157	2,396
<b>Income before income tax expense</b>	<b>51,794</b>	<b>49,859</b>	<b>101,078</b>	<b>101,019</b>
Income tax expense	6,329	7,969	14,292	14,555
<b>Income from continuing operations</b>	<b>45,465</b>	<b>41,890</b>	<b>86,786</b>	<b>86,464</b>
Gain from discontinued e-commerce operations	0	446	0	446
<b>Net income</b>	<b>45,465</b>	<b>42,336</b>	<b>86,786</b>	<b>86,910</b>

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Less: Net income attributable to the noncontrolling interest	12,012	8,801	23,142	8,780
Net income attributable to Sohu.com Inc.	\$ 33,453	\$ 33,535	\$ 63,644	\$ 78,130
Basic net income per share attributable to Sohu.com Inc.	\$ 0.88	\$ 0.88	\$ 1.68	\$ 2.04
Shares used in computing basic net income per share attributable to Sohu.com Inc.	37,822	38,284	37,800	38,223
Diluted net income per share attributable to Sohu.com Inc.	\$ 0.82	\$ 0.79	\$ 1.54	\$ 1.94
Shares used in computing diluted net income per share attributable to Sohu.com Inc.	38,289	39,018	38,366	38,935

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

**Table of Contents****SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)****(In thousands)**

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 86,786	\$ 86,910
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation	10,010	7,833
Share-based compensation expense	12,981	8,901
Amortization of intangible assets and other assets	1,139	902
Provision for allowance for doubtful accounts	301	485
(Excess tax benefits) Reversal of excess tax benefits from share-based payment arrangements	(1,155)	678
Others	73	209
<b>Changes in assets and liabilities, net of acquisition:</b>		
Prepaid and other current assets	(6,886)	13,692
Accounts receivable	(14,857)	(16,704)
Tax payables	(2,175)	1,700
Accrued liabilities to suppliers and agents	8,130	1,130
Receipts in advance and deferred revenue	638	(3,126)
Accounts payable	2,795	2,377
Other accrued liabilities	2,756	(1,623)
<b>Net cash provided by operating activities</b>	<b>100,536</b>	<b>103,364</b>
<b>Cash flows from investing activities:</b>		
Purchase of fixed assets	(47,843)	(4,954)
Purchase of intangible and other assets	(4,394)	(137)
Decrease in restricted cash	0	2,671
Acquisitions, net of cash acquired	(13,321)	0
<b>Net cash used in investing activities</b>	<b>(65,558)</b>	<b>(2,420)</b>
<b>Cash flows from financing activities:</b>		
Issuance of common stock	376	3,015
Excess tax benefits (Reversal of excess tax benefits) from share-based payment arrangements	1,155	(678)
Proceeds from Changyou's initial public offering	0	128,340
Other proceeds relating to financing activities	0	1,087
Other payments relating to financing activities	(3,001)	(263)
<b>Net cash (used in) provided by financing activities</b>	<b>(1,470)</b>	<b>131,501</b>
Effect of exchange rate changes on cash and cash equivalents	1,815	(124)
<b>Net increase in cash and cash equivalents</b>	<b>35,323</b>	<b>232,321</b>
Cash and cash equivalents at beginning of period	563,782	314,425
<b>Cash and cash equivalents at end of period</b>	<b>\$ 599,105</b>	<b>\$ 546,746</b>

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



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## SOHU.COM INC.

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Six Months Ended June 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	376	0	0	376	0	0	0	0
Share-based compensation expense	12,981	0	0	7,028	0	0	0	5,953
Excess tax benefits from share-based awards	1,155	0	0	1,155	0	0	0	0
Comprehensive income:								
Net income	86,786	86,786	0	0	0	0	63,644	23,142
Other comprehensive income:								
Foreign currency translation adjustment	2,602	2,602	0	0	0	2,190	0	412
Total other comprehensive income	2,602	2,602						
Total comprehensive income	89,388	89,388						
Comprehensive income attributable to the noncontrolling interest								(23,554)
Comprehensive income attributable to Sohu.com Inc.		\$ 65,834						
Ending balance	\$ 781,676		\$ 43	\$ 325,611	\$ (114,690)	\$ 23,692	\$ 449,518	\$ 97,502

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

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## SOHU.COM INC.

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Six Months Ended June 30, 2009

(In thousands)

	Total	Comprehensive Income	Common Stock	Additional Paid-in Capital	Treasury Stock	Sohu.com Inc. Shareholders Equity Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interest
Beginning balance	\$ 391,094	\$ 0	\$ 43	\$ 201,196	\$ (74,683)	\$ 21,349	\$ 238,041	\$ 5,148
Issuance of common stock	3,015	0	0	3,015	0	0	0	0
Share-based compensation expense	8,901	0	0	6,260	0	0	0	2,641
Reversal of excess tax benefits from share-based awards	(858)	0	0	(858)	0	0	0	0
Comprehensive income:								
Net income	86,910	86,910	0	0	0	0	78,130	8,780
Other comprehensive income:								
Foreign currency translation adjustment	189	189	0	0	0	12	0	177
Total other comprehensive income	189	189						
Total comprehensive income	87,099	87,099						
Comprehensive income attributable to the noncontrolling interest		(8,957)						
Comprehensive income attributable to Sohu.com Inc.		\$ 78,142						
Recognition of change in Sohu's economic interests in Changyou	125,375		0	100,552	0	0	0	24,823
Ending balance	\$ 614,626		\$ 43	\$ 310,165	\$ (74,683)	\$ 21,361	\$ 316,171	\$ 41,569

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

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**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 five massively multi-player online role-playing games (MMORPGs), (i) Tian Long Ba Bu (TLBB), (ii) Blade Online (BO), (iii) Blade Hero 2 (BH2) which is the sequel to BO, (iv) Da Hua Shui Hu (DHS), and (v) Zhong Hua Ying Xiong (ZHYX). 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 June 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 six months ended June 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.

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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.

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**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, 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.

In February 2010, 2,000,000 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 11,000,000 shares and the number of Class B restricted ordinary shares held beneficially by Tao Wang decreased to 4,000,000 shares. These numbers of Class B ordinary shares and Class B restricted ordinary shares remain unchanged as of June 30, 2010.

***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 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.



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Subsequent to the offering, Changyou has 102,500,000 Class A and Class B ordinary shares issued and outstanding. Those outstanding shares consist 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 June 30, 2010, 1,195,000 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 356,750 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 June 30, 2010, Changyou had outstanding a combined total of 104,051,750 Class A and Class B ordinary shares, consisting 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 4,000,000 Class B restricted ordinary shares that were not vested; (iii) 17,250,000 Class A ordinary shares issued in Changyou's initial public offering; (iv) 1,195,000 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 those employees; and (v) 356,750 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 those employees.

As of June 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 June 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 Changyou's executive officers other than Tao Wang and to certain of its employees become vested and settled.

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### *Dilutive Impact*

Through June 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 (settleable by Changyou's issuance of Class A ordinary shares and Class B ordinary shares, respectively) to its executive officers other than Tao Wang and to certain of its employees. As of June 30, 2010, the number of Changyou's outstanding restricted share units decreased from 4,414,000 to 2,807,500, as a result of forfeitures and vesting and settlement 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 second 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.