

SOHU COM INC
Form 10-Q
May 07, 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 MARCH 31, 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 March 31, 2010
Common stock, \$.001 par value	37,815,812

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SOHU.COM INC.

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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)**

	As of	
	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 599,153	\$ 563,782
Accounts receivable, net	47,849	46,610
Prepaid and other current assets	12,483	10,781
Total current assets	659,485	621,173
Fixed assets, net	116,828	115,088
Goodwill	57,440	55,555
Intangible assets, net	9,083	7,933
Other assets, net	31,750	28,524
Total assets	\$ 874,586	\$ 828,273
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,229	\$ 4,602
Accrued liabilities to suppliers and agents	41,722	41,103
Receipts in advance and deferred revenue	32,873	36,944
Accrued salary and benefits	26,216	28,860
Tax payables	21,547	21,953
Other accrued liabilities	17,201	17,035
Total current liabilities	146,788	150,497
Contingent consideration	1,318	
Commitments and contingencies		
Shareholders' equity		
Sohu.com Inc. shareholders' equity:		
Common stock: \$0.001 par value per share (75,400 authorized; 37,816 and 37,749 shares issued and outstanding, respectively)	43	43
Additional paid-in capital	318,335	317,052
Treasury stock (5,389 shares)	(114,690)	(114,690)
Accumulated other comprehensive income	21,566	21,502
Retained earnings	416,065	385,874
Total Sohu.com Inc. shareholders' equity	641,319	609,781

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Noncontrolling interest	85,161	67,995
Total shareholders' equity	726,480	677,776
Total liabilities and shareholders' equity	\$ 874,586	\$ 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)**

	Three Months Ended March 31,	
	2010	2009
Revenues:		
Advertising:		
Brand advertising	\$ 39,512	\$ 39,074
Sponsored search	2,834	1,562
Subtotal of advertising revenues	42,346	40,636
Online game	72,072	61,607
Wireless and others	15,036	13,495
Total revenues	129,454	115,738
Cost of revenues:		
Advertising:		
Brand advertising	17,283	13,730
Sponsored search	2,913	2,298
Subtotal of cost of advertising revenues	20,196	16,028
Online game	5,384	3,436
Wireless and others	7,246	8,129
Total cost of revenues	32,826	27,593
Gross profit	96,628	88,145
Operating expenses:		
Product development	15,518	13,314
Sales and marketing	23,009	16,826
General and administrative	9,883	7,894
Amortization of intangible assets	108	74
Total operating expenses	48,518	38,108
Operating profit	48,110	50,037
Other (expense) income	(25)	1
Interest income and exchange difference	1,199	1,122
Income before income tax expense	49,284	51,160
Income tax expense	7,963	6,586
Net income	41,321	44,574
Less: Net income (loss) attributable to non- controlling interest	11,130	(21)
Net income attributable to Sohu.com Inc.	\$ 30,191	\$ 44,595

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Basic net income per share attributable to Sohu.com Inc.	\$ 0.80	\$ 1.17
Shares used in computing basic net income per share attributable to Sohu.com Inc.	37,778	38,162
Diluted net income per share attributable to Sohu.com Inc.	\$ 0.73	\$ 1.15
Shares used in computing diluted net income per share attributable to Sohu.com Inc.	38,443	38,851

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)**

	Three Months Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 41,321	\$ 44,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,593	3,811
Share-based compensation expense	6,528	2,287
Amortization of intangible assets and other assets	475	426
Provision for allowance for doubtful accounts	88	51
Excess tax benefits from share-based payment arrangements	(531)	(103)
Others	132	(7)
Changes in current assets and liabilities:		
Prepaid and other current assets	(3,184)	12,613
Accounts receivable	(1,336)	(7,094)
Tax payables	266	6,021
Accrued liabilities to suppliers and agents	619	(3,292)
Receipts in advance and deferred revenue	(4,071)	(2,317)
Accounts payable	2,627	(137)
Other accrued liabilities	(4,598)	(148)
Net cash provided by operating activities	42,929	56,685
Cash flows from investing activities:		
Purchase of fixed assets	(6,113)	(2,154)
Purchase of intangible and other assets	(1,071)	(19)
Decrease in restricted cash		2,296
Acquisitions, net of cash acquired	(1,239)	
Net cash (used in) provided by investing activities	(8,423)	123
Cash flows from financing activities:		
Issuance of common stock	252	1,786
Excess tax benefits from share-based payment arrangements	531	103
Net cash provided by financing activities	783	1,889
Effect of exchange rate changes on cash and cash equivalents	82	44
Net increase in cash and cash equivalents	35,371	58,741
Cash and cash equivalents at beginning of period	563,782	314,425
Cash and cash equivalents at end of period	\$ 599,153	\$ 373,166

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)****Three Months Ended March 31, 2010****(In thousands)**

	Sohu.com Inc. Shareholders Equity							
						Accumulated		
						Other		
	Total	Comprehensive Income	Common Stock	Additional Capital	Paid-in Treasury Stock	Comprehensive Income	Retained Earnings	Noncontrolling Interest
Beginning balance	\$ 677,776	\$	\$ 43	\$ 317,052	\$ (114,690)	\$ 21,502	\$ 385,874	\$ 67,995
Issuance of common stock	252			252				
Compensatory share-based awards	6,528			500				6,028
Excess tax benefits from share-based awards	531			531				
Comprehensive income:								
Net income	41,321	41,321					30,191	11,130
Other comprehensive income:								
Foreign currency translation adjustment	72	72				64		8
Total other comprehensive income	72	72						
Total comprehensive income	41,393	\$ 41,393						
Ending balance	\$ 726,480		\$ 43	\$ 318,335	\$ (114,690)	\$ 21,566	\$ 416,065	\$ 85,161

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)****Three Months Ended March 31, 2009****(In thousands)**

		Sohu.com Inc. Shareholders Equity							
		Accumulated							
		Other							
	Total	Comprehensive Income	Common Stock	Additional Capital	Paid-in Treasury Stock	Comprehensive Income	Retained Earnings	Noncontrolling Interest	
Beginning balance	\$ 391,094	\$	\$ 43	\$	201,196	\$ (74,683)	\$ 21,349	\$ 238,041	\$ 5,148
Issuance of common stock	1,786				1,786				
Compensatory share-based awards	2,287				1,571				716
Excess tax benefits from share-based awards	37				37				
Comprehensive income:									
Net income (loss)	44,574	44,574						44,595	(21)
Other comprehensive income:									
Foreign currency translation adjustment	(18)	(18)					(18)		
Total other comprehensive income (loss)	(18)	(18)							
Total comprehensive income	44,556	\$ 44,556							
Ending balance	\$ 439,760		\$ 43	\$	204,590	\$ (74,683)	\$ 21,331	\$ 282,636	\$ 5,843

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 four 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 and (iv) Da Hua Shui Hu (DHS). 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 March 31, 2010, 28% 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). All intercompany transactions have been 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 months ended March 31, 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 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 March 31, 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 the three months ended March 31, 2010, 820,000 Class B restricted share units granted to certain of Changyou's employees had become vested, and were settled in Class B ordinary shares and then converted into Class A ordinary shares.

As of March 31, 2010, Changyou had outstanding a combined total of 103,320,000 Class A and Class B ordinary shares, consisting of (i) 70,250,000 Class B ordinary shares held by Sohu through Sohu Game; (ii) 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; and (iv) 820,000 Class A ordinary shares issued to certain of Changyou's 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.

As of March 31, 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 aforementioned 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, those shares are treated as owned by Sohu, rather than as owned by Tao Wang, in the noncontrolling interest line items in Sohu's consolidated financial statements. As a result, as of March 31, 2010, Sohu was treated as holding approximately 72% of the economic interest in Changyou. Accordingly, shareholders other than Sohu were treated as holding the remaining 28% of the economic interest, which was recognized as noncontrolling interest in Sohu's consolidated financial statements, as aforementioned 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 March 31, 2010, under Changyou's 2008 Share Incentive Plan, Changyou has granted 11,000,000 Class B ordinary shares (including 2,000,000 Class B restricted ordinary shares vested in February 2010) and 4,000,000 Class B restricted ordinary shares to Tao Wang through Prominence and 4,400,000 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 March 31, 2010, the number of Changyou's outstanding restricted share units decreased from 4,400,000 to 3,556,000, 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 first quarter of 2010, in the calculation of Sohu's diluted net income per share, Sohu's economic interest in Changyou was 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.

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

	Three Months Ended March 31, 2010							Consolidated
	Segments Other Than Online Game				Segments Other Than Online Game Total	Online Game	Intercompany Eliminations	
	Brand Advertising	Sponsored Search	Wireless	Others				
Revenues (1)	\$ 42,592	\$ 2,834	\$ 13,288	\$ 1,748	\$ 60,462	\$ 72,072	\$ (3,080)	\$ 129,454
Segment cost of revenues	(16,316)	(2,912)	(6,911)	(335)	(26,474)	(5,317)		(31,791)
Segment gross profit (loss)	\$ 26,276	\$ (78)	\$ 6,377	\$ 1,413	33,988	66,755	(3,080)	97,663
SBC (2) in cost of revenues					(968)	(67)		(1,035)
Gross profit					33,020	66,688	(3,080)	96,628
Operating expenses:								
Product development					(7,646)	(5,427)		(13,073)
Sales and marketing (1)					(15,510)	(9,624)	3,080	(22,054)
General and administrative					(4,327)	(3,463)		(7,790)
Amortization of intangible assets					(106)	(2)		(108)
SBC (2) in operating expenses					(2,590)	(2,903)		(5,493)
Total operating expenses					(30,179)	(21,419)	3,080	(48,518)
Operating profit					2,841	45,269		48,110
Other income (expense)					74	(99)		(25)
Interest income and exchange difference					384	815		1,199
Income tax expense					(1,684)	(6,279)		(7,963)
Net income					\$ 1,615	\$ 39,706	\$	\$ 41,321

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.

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Three Months Ended March 31, 2009								
Segments Other Than Online Game					Segments Other Than Online			
	Brand Advertising	Sponsored Search	Wireless	Others	Game Total	Online Game	Intercompany Eliminations	Consolidated
Revenues (1)	\$ 47,119	\$ 1,562	\$ 13,378	\$ 117	\$ 62,176	\$ 61,607	\$ (8,045)	\$ 115,738
Segment cost of revenues	(13,494)	(2,295)	(7,643)	(486)	(23,918)	(3,433)	5	(27,346)
Segment gross profit (loss)	\$ 33,625	\$ (733)	\$ 5,735	\$ (369)	38,258	58,174	(8,040)	88,392
SBC (2) in cost of revenues					(239)	(8)		(247)
Gross profit					38,019	58,166	(8,040)	88,145
Operating expenses:								
Product development					(6,641)	(5,399)		(12,040)
Sales and marketing (1)					(13,749)	(10,832)	8,040	(16,541)
General and administrative					(4,200)	(3,213)		(7,413)
Amortization of intangible assets					(73)	(1)		(74)
SBC (2) in operating expenses					(1,202)	(838)		(2,040)
Total operating expenses					(25,865)	(20,283)	8,040	(38,108)
Operating profit					12,154	37,883		50,037
Other income (expense)					2	(1)		1
Interest income and exchange difference					446	676		1,122
Income tax expense					(1,532)	(5,054)		(6,586)
Net income					\$ 11,070	\$ 33,504	\$	\$ 44,574

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.

As of March 31, 2010				
	Segments Other Than Online Game Total	Online Game	Intercompany Eliminations	Consolidated
Cash (1)	\$ 333,748	\$ 265,405	\$	\$ 599,153
Accounts receivable, net	46,726	1,123		47,849
Fixed assets, net	64,681	52,147		116,828
Total assets (2)	550,444	330,601	(6,459)	874,586

Note (1): The cash is mainly denominated in U.S. dollars, in Renminbi (RMB) and in HK dollars. For a discussion of foreign currency exchange risk which the Company is exposed to, please refer to Item 3 Quantitative and qualitative disclosure about market risks foreign currency exchange rate risk.

Note (2):

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The intercompany elimination for segment assets mainly consists of marketing services provided by the brand advertising segment to the online game segment (conducted through Changyou).

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	As of December 31, 2009			
	Segments Other Than Online Game Total	Online Game	Intercompany Eliminations	Consolidated
Cash(1)	\$ 336,881	\$ 226,901	\$	\$ 563,782
Accounts receivable, net	43,215	3,395		46,610
Fixed assets, net	65,910	49,178		115,088
Total assets (2)	544,942	289,391	(6,060)	828,273

Note (1): The cash is mainly denominated in U.S. dollars, in RMB and in HK dollars. For a discussion of foreign currency exchange risk which the Company is exposed to, please refer to Item 3 Quantitative and qualitative disclosure about market risks foreign currency exchange rate risk.

Note (2): The intercompany elimination for segment assets mainly consists of marketing services provided by the brand advertising segment to the online game segment (conducted through Changyou).

4. Share-Based Compensation Expense

Both Sohu and Changyou have incentive plans for the granting of share-based awards, including common stock, ordinary shares, share options, restricted shares and restricted share units, to their employees and directors.

Share-based compensation expense is recognized as costs and/or expenses in the consolidated financial statements based on the fair values of the related share awards on their grant dates. Share-based compensation expense is charged to the shareholders' equity section in the consolidated balance sheets. See Note 9 Sohu.com Inc. Shareholders' Equity Stock Incentive Plan.

Share-based compensation expense was recognized in costs and expenses for the three months ended March 31, 2010 and 2009, respectively, as follows (in thousands):

Share-based compensation expense	Three Months Ended March 31,	
	2010	2009
Cost of revenues	\$ 1,035	\$ 247
Product development expenses	2,445	1,274
Sales and marketing expenses	955	285
General and administrative expenses	2,093	481
	\$ 6,528	\$ 2,287

There was no capitalized share-based compensation expense for the three months ended March 31, 2010 and 2009.

Share-based compensation expense recognized for share awards granted by Sohu and Changyou, respectively, was as follows (in thousands):

Share-based compensation expense	Three Months Ended March 31,	
	2010	2009
For share awards granted by Sohu.com Inc.	\$ 3,585	\$ 1,570
For share awards granted by Changyou.com Limited	2,943	717
	\$ 6,528	\$ 2,287

5. Income Taxes

Sohu and Changyou.com (US) Inc. are subject to income taxes in the United States (U.S.). Some of the Company's subsidiaries are subject to income taxes in Hong Kong. The majority of the subsidiaries and VIEs of the Company are based in mainland China and are subject to income

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taxes in the PRC. These China-based subsidiaries and VIEs conduct substantially all of the Company's operations, and generate most of the Company's income.

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The Company did not have any interest or penalties associated with tax positions for the three months ended March 31, 2010, nor did the Company have any significant unrecognized uncertain tax positions as of March 31, 2010.

PRC Corporate Income Tax

Advertising Business and Wireless Business

Effective from January 1, 2008, the current PRC Corporate Income Tax Law (CIT Law) imposes a unified income tax rate of 25% for both domestic and foreign invested enterprises. Under the current CIT Law, New Technology Enterprises can enjoy a preferential income tax rate of 15%, but after a three-year validation period, New Technology Enterprises need to re-apply for this qualification. Under the previous income tax laws and regulations, New Technology Enterprises enjoyed a favorable tax rate of 15% and were exempted from income tax for three years beginning with their first year of operations, and were entitled to a 50% tax reduction to 7.5% for the subsequent three years and 15% thereafter. The current CIT Law provides grandfathering treatment for enterprises that were (i) qualified as New Technology Enterprises under the previous PRC income tax laws, and (ii) established before March 16, 2007, if they continue to meet the criteria for New Technology Enterprises under the current CIT Law. The grandfathering provision allows these enterprises to continue enjoying their unexpired tax holidays provided by the previous income tax laws and regulations.

During the year ended December 31, 2008, three China-based subsidiaries, Sohu Era, Sohu Media and Sogou Technology, qualified as New Technology Enterprises under the current CIT Law. As a result, for the fiscal years 2009 and 2010, Sohu Era was subject to a 15% income tax rate and Sohu Media and Sogou Technology enjoyed a 7.5% income tax rate due to their unexpired tax holidays. These three companies will reapply for this qualification in 2011.

During the year ended December 31, 2009, in addition to the three China-based subsidiaries discussed above, two China-based VIEs, Sohu Internet and Sogou Information, qualified as New Technology Enterprises under the current CIT Law. As a result, for the fiscal years 2009 and 2010, Sohu Internet was subject to a 15% income tax rate and Sogou Information enjoyed a 7.5% income tax rate due to its unexpired tax holidays. These two companies will reapply for this qualification in 2012.

Online Game Business

Under the current CIT Law, a Software Enterprise can enjoy an income tax exemption for two years beginning with its first profitable year and a 50% tax reduction to a rate of 12.5% for the subsequent three years.

In 2008, the China-based subsidiary and the VIE of Changyou, AmazGame and Gamease, qualified as Software Enterprises under the current CIT Law. As a result, for the fiscal years 2009 and 2010, they were subject to a 50% reduction to a tax rate of 12.5%. This favorable tax holiday will expire at the end of fiscal year 2011.

PRC Withholding Tax on Dividends

The current CIT Law imposes a 10% withholding income tax for dividends distributed by foreign invested enterprises to their immediate holding companies outside China. A lower withholding tax rate will be applied if there is a tax treaty arrangement between mainland China and the jurisdiction of the foreign holding company. Holding companies in Hong Kong, for example, will be subject to a 5% tax rate.

In the fourth quarter of 2008, AmazGame declared a dividend to its immediate holding company in Hong Kong and a withholding tax of approximately \$5.0 million was accrued based on a 5% withholding tax rate. This withholding tax was paid in the third quarter of 2009.

As of March 31, 2010, the Company had not recorded any withholding tax on the retained earnings of its foreign invested enterprises in the PRC, since the Company intends to reinvest its earnings to further expand its business in mainland China, and its foreign invested enterprises do not intend to declare dividends to their immediate foreign holding companies.

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Uncertain Tax Positions

With respect to PRC tax, in 2009 the PRC tax bureau communicated to some subsidiaries within the Sohu Group that certain expenses should not be treated as deductible for income tax purposes under the CIT Law, although the current CIT Law is silent in that regard. The Sohu Group had treated such expense as tax deductible in previous periods. This treatment had been communicated to the tax bureau, without the Sohu Group's receiving any objections or challenges with respect to prior PRC income tax filings. Based on the tax bureau's current interpretation, the Sohu Group concluded that it was more likely than not that such expenses would not be allowed by the tax bureau as deductions for income tax purposes. Hence, the Sohu Group recognized income tax expense of \$1.2 million in the second quarter of 2009 as a result of the change in the tax bureau's position. In addition, in order to be prudent, the Sohu Group will not reverse this treatment unless it receives a written clarification issued by the tax authority that this kind of expense is deductible for income tax purposes. The situation is unchanged as of March 31, 2010.

With respect to U.S. tax, the U.S. Congress currently is considering legislation that, if enacted in its current form, would retroactively reinstate certain favorable provisions that expired on January 1, 2010. This legislation was not enacted prior to the issuance of the Company's financial statements for the three months ended March 31, 2010, and as a result the Company is required to recognize an additional \$0.35 million income tax expense in the financial statements. However, the accrual of this tax liability would cause a cash payment by the Company to the U.S. taxing authorities of only \$0.02 million, based on the utilization of existing U.S. federal net operating losses generated from excess tax deductions related to share-based awards of \$0.33 million. This \$0.33 million excess tax benefit is treated under U.S. GAAP as an increase in shareholders equity. If the expired favorable tax provisions are reinstated retroactively to January 1, 2010, the foregoing amounts will be reversed on the Company's financial statements in the period in which such legislation is enacted.

6. Commitments and Contingencies

Contractual Obligation

On November 20, 2009, the Company entered into an agreement to purchase an office building to be built in Beijing, which will serve as the Company's headquarters, for a purchase price of approximately \$110 million denominated in RMB, of which \$22 million had been paid as of March 31, 2010 and was recognized as other assets in Sohu's consolidated financial statements. The remaining \$88 million will be paid in installments as various stages of the development plan are completed. The estimated payment in 2010 is around \$49 million. This construction is expected to be completed by the end of 2012.

The Sohu Group also has some commitments related to future minimum content and service purchases, bandwidth leasing obligations, operating lease obligations, and license fees of games developed by third-parties.

Litigation

The Sohu Group is a party to various litigation matters which it considers routine and incidental to its business. Management does not expect the results of any of these actions to have a material adverse effect on the Company's business, results of operations or financial condition.

In March 2008, the Sohu Group was sued by four major record companies, Sony BMG, Warner, Universal and Gold Label, which alleged that the Sohu Group provided music search links and download services that violated copyrights they owned. As of March 31, 2010, the lawsuits with these four record companies were still in process.

Laws and Regulations

The Chinese market in which the Sohu Group operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability to operate an Internet business, and to conduct brand advertising, sponsored search, online game and wireless and other services in the People's Republic of China (the PRC). Though the PRC has, since 1978, implemented a wide range of market-oriented economic reforms, continued reforms and progress towards a full market-oriented economy are uncertain. In addition, the telecommunication, information, and media industries remain highly regulated. Restrictions are currently in place and are unclear with respect to which segments of these industries foreign-owned entities, like the Sohu Group, may operate. The Chinese government may issue from time to time new laws or new interpretations of existing laws to regulate areas such as telecommunication, information and media.

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Regulatory risks also encompass the interpretation by the tax authorities of current tax laws and regulations, including the applicability of certain preferential tax treatments. The Sohu Group's legal structure and scope of operations in China could be subjected to restrictions, which could result in severe limits on its ability to conduct business in the PRC.

The Sohu Group's sales, purchase and expense transactions are generally denominated in RMB and a significant portion of the Sohu Group's assets and liabilities are denominated in RMB. The RMB is not freely convertible into foreign currencies. In China, foreign exchange transactions are required by law to be transacted only by authorized financial institutions. Remittances in currencies other than RMB by its subsidiaries in China may require certain supporting documentation in order to effect the remittance.

7. Fair Value of Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities. These financial instruments are measured at their respective fair values. For fair value measurement, U.S. GAAP establishes a three-tier hierarchy which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - include other inputs that are directly or indirectly observable in the marketplace.

Level 3 - unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As of March 31, 2010, the Company's cash equivalents include time deposits amounting to \$300.9 million which are classified within Level 2. This is because the time deposits are valued using pricing sources and models utilizing market observable inputs.

8. Variable Interest Entities (VIEs)

To satisfy PRC laws and regulations, the Company conducts certain business in the PRC through its VIEs. The Company consolidates all of its wholly-owned and majority-owned VIEs in its consolidated financial statements, as the Company is these VIEs' primary beneficiary. These consolidated VIEs are directly or indirectly owned by Dr. Charles Zhang (Dr. Zhang), the Company's Chairman, Chief Executive Officer and a major shareholder, and certain employees of the Sohu Group. Capital for the VIEs was funded by the Sohu Group through loans provided to Dr. Zhang and those employees, and was initially recorded as loans to related parties. These loans are eliminated for accounting purposes against the capital of the VIEs upon consolidation.

Under contractual agreements with the Sohu Group, Dr. Zhang and other employees of the Sohu Group who are shareholders of the VIEs are required to transfer their ownership in these entities to the Sohu Group, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Sohu Group at any time to repay the loans outstanding. All voting rights of the VIEs are assigned to the Sohu Group, and the Sohu Group has the right to designate all directors and senior management personnel of the VIEs. Dr. Zhang and the other employees of the Sohu Group who are shareholders of the VIEs have pledged their shares in the VIEs as collateral for the loans. As of March 31, 2010, the aggregate amount of these loans was \$11.9 million.

The following is a summary of the consolidated VIEs within the Sohu Group:

For Advertising Business

Brand Advertising Business

a) Sohu Entertainment

Beijing Sohu Entertainment Culture Media Co., Ltd. (Sohu Entertainment) was incorporated in the PRC in 2002 and is engaged in entertainment and advertising business in the PRC. As of March 31, 2010, the registered capital of Sohu Entertainment was \$1.2 million. Xin Wang (Belinda Wang), the Company's Co-President and Chief Operating Officer, and another employee of the Sohu Group, hold 80% and 20% interests,

respectively, in this entity.

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b) Feng Yang Tian Lang

Beijing Feng Yang Tian Lang Advertising Co., Ltd. (Feng Yang Tian Lang) was incorporated in the PRC in 2005 and is engaged in advertising services in the PRC. As of March 31, 2010, the registered capital of Feng Yang Tian Lang was \$0.2 million. Beijing Sohu Internet Information Service Co., Ltd. (Sohu Internet) and Beijing Century High Tech Investment Co., Ltd. (High Century) each holds a 50% interest in this entity.

Sponsored Search Business

c) Tu Xing Tian Xia

Beijing Tu Xing Tian Xia Information Consultancy Co., Ltd. (Tu Xing Tian Xia) was incorporated in the PRC in 1999 and is engaged in mapping services in the PRC. As of March 31, 2010, the registered capital of Tu Xing Tian Xia was \$0.2 million. High Century and Sohu Internet hold 56.1% and 43.9% interests, respectively, in this entity.

d) Sogou Information

Beijing Sogou Information Service Co., Ltd. (Sogou Information) was incorporated in the PRC in 2005 and is engaged in providing Internet information services in the PRC. As of March 31, 2010, the registered capital of Sogou Information was \$2.5 million. Each of two employees of the Sohu Group holds a 50% interest in this entity.

For Online Game Business

e) Gamease

Beijing Gamease Age Digital Technology Co., Ltd. (Gamease) was incorporated in the PRC in August 2007. It holds the licenses and approvals to operate online games in the PRC. Gamease's primary beneficiary is Beijing AmazGame Age Internet Technology Co., Ltd. (AmazGame), which is an indirect subsidiary of Changyou and Sohu. As of March 31, 2010, the registered capital of Gamease was \$1.3 million. Tao Wang, Chief Executive Officer of Changyou, and a Changyou employee hold 60% and 40% interests, respectively, in this entity.

For Wireless and Others Businesses

f) Sohu Internet

Sohu Internet was incorporated in the PRC in 2003 and is engaged in Internet information, wireless and advertising services in the PRC. As of March 31, 2010, the registered capital of Sohu Internet was \$2.4 million. High Century and Sohu Entertainment hold 75% and 25% interests, respectively, in this entity.

g) GoodFeel

Beijing GoodFeel Information Technology Co., Ltd. (GoodFeel) was incorporated in the PRC in 2001 and is engaged in value-added telecommunication services in the PRC. As of March 31, 2010, the registered capital of GoodFeel was \$1.2 million. Two employees of the Sohu Group, hold 58.1% and 41.9% interests, respectively, in this entity.

h) High Century

High Century was incorporated in the PRC in 2001 and is engaged in investment holding in the PRC. As of March 31, 2010, the registered capital of High Century was \$4.6 million. Dr. Zhang and another employee of the Sohu Group, hold 80% and 20% interests, respectively, in this entity.

i) 21 East Beijing

Beijing 21 East Culture Development Co., Ltd. (21 East Beijing) was acquired in October 2006. As of March 31, 2010, the registered capital of 21 East Beijing was \$0.1 million. High Century holds a 70% interest in this entity.

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j) New 21 East

New 21 East Art Development (Beijing) Co., Ltd. (New 21 East) was incorporated in December 2007. As of March 31, 2010, the registered capital of New 21 East is \$1.4 million. High Century holds a 70% interest in this entity.

As of March 31, 2010, the above VIEs had aggregate accumulated profits of approximately \$55.8 million, which are reflected in Sohu's consolidated financial statements.

9. Sohu.com Inc. Shareholders' Equity

(a) Stockholder Rights Plan

Sohu adopted a stockholder rights plan (the Plan) in 2001. The Plan is designed to deter coercive takeover tactics, including the accumulation of shares in the open market or through private transactions, and to prevent an acquirer from gaining control of Sohu without offering a fair and adequate price and terms to all of Sohu's stockholders. In general, the Plan vests stockholders of Sohu with rights to purchase preferred stock of Sohu at a substantial discount from those securities' fair market value upon a person or group acquiring without the approval of the Board of Directors more than 20% of the outstanding shares of common stock of Sohu. Any person or group who triggers the purchase right distribution becomes ineligible to participate in the Plan, causing substantial dilution of such person or group's holdings. The rights will expire on July 25, 2011.

(b) Treasury Stock

Treasury stock consists of shares repurchased by Sohu that are no longer outstanding and are held by Sohu. Treasury stock is accounted for under the cost method.

For the three months ended March 31, 2010 and 2009, Sohu did not purchase any shares of its common stock.

(c) Stock Incentive Plan

Both Sohu and Changyou have incentive plans for the granting of share awards, including ordinary shares, share options, restricted shares and restricted share units, to their employees and directors.

For the three months ended March 31, 2010 and 2009, total share-based compensation expense recognized was \$6.5 million and \$2.3 million, respectively. See Note 4 Share-based Compensation Expense.

1) Sohu.com Inc. Share Awards

Sohu's 2000 Stock Incentive Plan (the Sohu 2000 Stock Incentive Plan), which provided for the issuance of up to 9,500,000 shares of common stock, including pursuant to the exercise of share options and upon vesting and settlement of restricted share units, expired on January 24, 2010. As of the expiration of the plan, 9,128,724 shares of common stock had been issued or were subject to issuance upon the vesting and exercise of options or the vesting and settlement of restricted share units granted under the plan. The maximum term of any issued stock right is ten years from the grant date. In order to continue to incentivize the Company's employees and align their interests with those of the shareholders, the Company's Board of Directors is proposing a new plan for approval by the Company's shareholders at the Company's 2010 annual meeting.

For the three months ended March 31, 2010 and 2009, total share-based compensation expense recognized was \$3.6 million and \$1.6 million, respectively.

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Summary of Option and Restricted Share Unit Activity

i) Option activity

A summary of options activity under the Sohu 2000 Stock Incentive Plan as of and for the three months ended March 31, 2010 is presented below:

Options	Number Of Shares (in thousands)
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