

SOHU COM INC  
Form 10-Q  
August 08, 2012

**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 JUNE 30, 2012**

**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**  
**No. 1 Unit Zhongguancun East Road, Haidian District**  
**Beijing 100084**  
**People's Republic of China**  
**(011) 8610-6272-6666**

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

(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, 2012
Common stock, \$.001 par value	38,012,613

## 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)**

	June 30, 2012	As of December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 764,598	\$ 732,607
Short-term investments	21,793	17,560
Investments in debt securities	79,053	79,354
Accounts receivable, net	110,414	87,066
Prepaid and other current assets	40,927	53,894
Total current assets	1,016,785	970,481
Fixed assets, net	171,255	152,652
Goodwill	158,425	158,905
Intangible assets, net	82,160	69,762
Prepaid non-current assets	268,806	270,282
Other assets	10,970	11,212
Total assets	\$ 1,708,401	\$ 1,633,294
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 52,687	\$ 31,179
Accrued liabilities	97,903	95,409
Receipts in advance and deferred revenue	68,869	75,809
Accrued salary and benefits	49,233	45,300
Taxes payable	31,485	47,213
Deferred tax liabilities	5,789	0
Other short-term liabilities	42,972	35,816
Contingent consideration	778	476
Total current liabilities	349,716	331,202
Long-term accounts payable	13,838	3,612
Deferred tax liabilities	8,423	5,146
Contingent consideration	17,293	17,009
Total long-term liabilities	39,554	25,767
Total liabilities	389,270	356,969
Commitments and contingencies		
<b>MEZZANINE EQUITY</b>	52,400	57,254
<b>SHAREHOLDERS EQUITY</b>		

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Sohu.com Inc. shareholders' equity:

Common stock: \$0.001 par value per share (75,400 shares authorized; 38,013 shares and 38,082 shares, respectively, issued and outstanding)	44	44
Additional paid-in capital	357,590	366,210
Treasury stock (5,889 and 5,639 shares, respectively)	(143,858)	(131,292)
Accumulated other comprehensive income	73,053	76,219
Retained earnings	733,134	697,244
Total Sohu.com Inc. shareholders' equity	1,019,963	1,008,425
Noncontrolling interest	246,768	210,646
Total shareholders' equity	1,266,731	1,219,071
Total liabilities, mezzanine equity and shareholders' equity	\$ 1,708,401	\$ 1,633,294

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

## SOHU.COM INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues:</b>				
Online advertising:				
Brand advertising	\$ 69,312	\$ 67,728	\$ 130,280	\$ 124,881
Search and others	28,763	13,613	50,400	21,592
<b>Subtotal of online advertising revenues</b>	<b>98,075</b>	<b>81,341</b>	<b>180,680</b>	<b>146,473</b>
Online games	137,172	101,531	264,618	196,461
Wireless	15,598	11,645	28,949	23,349
Others	4,882	4,188	8,084	6,791
<b>Total revenues</b>	<b>255,727</b>	<b>198,705</b>	<b>482,331</b>	<b>373,074</b>
<b>Cost of revenues:</b>				
Online advertising:				
Brand advertising	50,963	24,937	87,855	46,721
Search and others	16,192	8,222	29,320	14,887
<b>Subtotal of cost of online advertising revenues</b>	<b>67,155</b>	<b>33,159</b>	<b>117,175</b>	<b>61,608</b>
Online games	18,301	9,950	34,709	18,918
Wireless	10,208	7,109	19,061	14,001
Others	4,180	4,220	8,421	6,890
<b>Total cost of revenues</b>	<b>99,844</b>	<b>54,438</b>	<b>179,366</b>	<b>101,417</b>
<b>Gross profit</b>	<b>155,883</b>	<b>144,267</b>	<b>302,965</b>	<b>271,657</b>
<b>Operating expenses:</b>				
Product development	43,340	25,839	81,933	49,062
Sales and marketing	48,999	36,492	87,653	65,125
General and administrative	17,508	13,148	35,302	25,314
Impairment of intangible assets via acquisition of businesses	2,906	0	2,906	0
<b>Total operating expenses</b>	<b>112,753</b>	<b>75,479</b>	<b>207,794</b>	<b>139,501</b>
<b>Operating profit</b>	<b>43,130</b>	<b>68,788</b>	<b>95,171</b>	<b>132,156</b>
Other income	1,818	1,479	3,431	1,989
Interest income	7,223	3,279	13,718	5,998
Exchange difference	45	(1,658)	(598)	(2,084)
<b>Income before income tax expense</b>	<b>52,216</b>	<b>71,888</b>	<b>111,722</b>	<b>138,059</b>
<b>Income tax expense</b>	<b>18,467</b>	<b>10,281</b>	<b>37,154</b>	<b>21,283</b>

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Net income	33,749	61,607	74,568	116,776
Less: Net income attributable to the mezzanine classified noncontrolling interest shareholders	1,095	361	2,206	361
Net income attributable to the noncontrolling interest shareholders	19,872	16,981	36,472	27,343
Net income attributable to Sohu.com Inc.	\$ 12,782	\$ 44,265	\$ 35,890	\$ 89,072
Net income	33,749	61,607	74,568	116,776
Other comprehensive income: Foreign currency translation adjustment, net of tax	(5,455)	10,634	(3,668)	18,060
Comprehensive income	28,294	72,241	70,900	134,836
Less: Comprehensive income attributable to the mezzanine classified noncontrolling interest	1,095	361	2,206	361
Comprehensive income attributable to noncontrolling interest shareholders	19,045	18,143	35,970	29,371
Comprehensive income attributable to Sohu.com Inc.	8,154	53,737	32,724	105,104
Basic net income per share attributable to Sohu.com Inc.	\$ 0.34	\$ 1.16	\$ 0.95	\$ 2.33
Shares used in computing basic net income per share attributable to Sohu.com Inc.	38,002	38,295	38,043	38,245
Diluted net income per share attributable to Sohu.com Inc.	\$ 0.28	\$ 1.10	\$ 0.81	\$ 2.11
Shares used in computing diluted net income per share attributable to Sohu.com Inc.	38,347	38,860	38,416	38,814

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)

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 74,568	\$ 116,776
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	17,959	11,987
Share-based compensation expense	6,359	9,684
Amortization of intangible assets	34,395	14,872
Impairment of intangible assets	3,564	233
Impairment of purchased video content	15,275	0
Provision for allowance for doubtful accounts	3,260	300
Excess tax benefits from share-based payment arrangements	(2,519)	(1,107)
Investment income of investments in debt securities	(2,727)	(1,450)
Others	(243)	347
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	(26,853)	(10,345)
Prepaid and other current assets	2,053	5,066
Deferred tax	5,590	(199)
Accounts payable	10,471	4,491
Taxes payable	(9,313)	(6,328)
Accrued liabilities	771	2,693
Receipts in advance and deferred revenue	(6,655)	4,979
Other short-term liabilities	9,612	4,079
Net cash provided by operating activities	135,567	156,078
Cash flows from investing activities:		
Purchase of fixed assets	(32,631)	(39,058)
Purchase of intangible and other assets	(27,462)	(21,923)
Purchase of /proceeds from short-term investments, net	(4,299)	1,856
Acquisitions, net of cash acquired	(683)	(69,175)
Other cash payments relating to investing activities	(2,877)	(2,787)
Net cash used in investing activities	(67,952)	(131,087)
Cash flows from financing activities:		
Issuance of common stock	139	1,444
Sohu's purchase of Sogou Series A Preferred Shares from Alibaba	(25,800)	0
Repurchase of common stock	(12,566)	0
Cash contribution received from the noncontrolling interest shareholders	0	159
Excess tax benefits from share-based payment arrangements	2,519	1,107
Exercise of share-based awards in subsidiary	1,360	0
Other cash payments relating to financing activities	(251)	0
Net cash (used in) /provided by financing activities	(34,599)	2,710
Effect of exchange rate changes on cash and cash equivalents	(1,025)	11,965
Net increase in cash and cash equivalents	31,991	39,666
Cash and cash equivalents at beginning of period	732,607	678,389
Cash and cash equivalents at end of period	\$ 764,598	\$ 718,055



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Supplemental schedule of non-cash investing activity:

Consideration payable for business acquisitions	0	28,983
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The accompanying notes are an integral part of these condensed consolidated financial statements.

## SOHU.COM INC.

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

Six Months Ended June 30, 2012

(In thousands)

	Sohu.com Inc. Shareholders Equity						
	Total	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated		
Comprehensive Income					Retained Earnings	Noncontrolling Interest	
Beginning balance	\$ 1,219,071	\$ 44	\$ 366,210	\$ (131,292)	\$ 76,219	\$ 697,244	\$ 210,646
Issuance of common stock	139	0	139	0	0	0	0
Repurchase of common stock	(12,566)			(12,566)			
Share-based compensation expense	6,359	0	3,180	0	0	0	3,179
Settlement of share-based awards in subsidiary	1,361	0	(7,364)	0	0	0	8,725
Sohu's purchase of Sogou Series A Preferred Shares from Alibaba	(25,800)	0	(14,219)	0	0	0	(11,581)
Changes in mezzanine equity of Changyou	6,836	0	6,836	0	0	0	0
Transaction cost for the sale of the 17173 Business from Sohu to Changyou	118	0	118	0	0	0	0
Deemed contribution from noncontrolling shareholders (related to sale of the 17173 Business by Sohu to Changyou)	0	0	171	0	0	0	(171)
Excess tax benefits from share-based awards	2,519	0	2,519	0	0	0	0
Net income attributable to Sohu.com Inc. and noncontrolling interest shareholders	72,362	0	0	0	0	35,890	36,472
Foreign currency translation adjustment, net of tax	(3,668)	0	0	0	(3,166)	0	(502)
Ending balance	\$ 1,266,731	\$ 44	\$ 357,590	\$ (143,858)	\$ 73,053	\$ 733,134	\$ 246,768

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

## SOHU.COM INC.

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

Six Months Ended June 30, 2011

(In thousands)

	Sohu.com Inc. Shareholders Equity						
	Total	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated		Noncontrolling Interest
Comprehensive Income					Retained Earnings		
Beginning balance	\$ 974,559	\$ 43	\$ 338,033	\$ (114,690)	\$ 38,228	\$ 534,503	\$ 178,442
Issuance of common stock	1,444	1	1,443	0	0	0	0
Contribution received from the noncontrolling interest shareholders	159	0	0	0	0	0	159
Share-based compensation expense	9,684	0	6,007	0	0	0	3,677
Settlement of share-based awards in subsidiary	0	0	(6,389)	0	0	0	6,389
Excess tax benefits from share-based awards	1,107	0	1,107	0	0	0	0
Net income attributable to Sohu.com Inc. and noncontrolling interest shareholders	116,415	0	0	0	0	89,072	27,343
Foreign currency translation adjustment, net of tax	18,060	0	0	0	16,032	0	2,028
Ending balance	\$ 1,121,428	\$ 44	\$ 340,201	\$ (114,690)	\$ 54,260	\$ 623,575	\$ 218,038

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 online media, search, gaming, community and mobile service group 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 online advertising services, online game services and wireless services.

Online advertising and online games are the core businesses of the Sohu Group.

*Online Advertising*

The online advertising business consists of the brand advertising business as well as the search and others business. The brand advertising business offers advertisements on the Web properties of the Sohu Group's portal to companies seeking to increase their brand awareness online. The search and others business, provided by our search subsidiary Sogou Inc. (Sogou), offers customers pay-for-click services, as well as online marketing services on Sogou Web Directory.

*Online Games*

The online game business is conducted by Sohu's majority-owned subsidiary Changyou.com Limited (Changyou).

The online game business consists of development, operation and licensing of massively multiplayer online games (MMOGs), which are interactive online games that may be played simultaneously by hundreds of thousands of game players, and Web games, which are played over the Internet using a Web browser. Changyou currently operates several MMOGs in China, including the in-house developed Tian Long Ba Bu (TLBB). Changyou's majority-owned subsidiary 7Road.com Limited (7Road) jointly operates DDTank and Wartune (also known as Shen Qu), which are two popular Web games in China, primarily through an extensive network of third-party game platforms in China and overseas.

*Basis of Consolidation and Recognition of Noncontrolling Interest*

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.

*Basis of Presentation*

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (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, 2011.

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 six months ended June 30, 2012 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.

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### *Change in Presentation to Properly Reflect the Classification of Expenses of Video Business*

Prior to 2012, the video division was a relatively small operation within the Sohu Group. It did not have clearly defined business departments and it was highly dependent on the Sohu Group's resources to sustain its operation. The video division's compensation and benefits expenses were recorded under cost of revenues and were not allocated to individual operating expense categories, in view of the fact that most of the employees in the video division provided services related to the maintenance of content and resources that directly contributed to video-related brand advertising revenues.

Commencing January 1, 2012, as the video division has grown significantly and business departments have been defined through the restructuring process to become more self-sustainable, compensation and benefits expenses have been allocated to the respective business departments to properly reflect the operating results of the video division. The video division's compensation and benefits expenses were classified as cost of revenues, product development, sales and marketing and general and administrative expenses, respectively, based on the nature of the related employees' roles and responsibilities. To conform to current period presentations, the relevant amounts for prior periods have been changed accordingly. The change from cost of revenues to operating expenses was not material to historical periods, and amounted to \$0.8 million and \$1.5 million, respectively, for the three and six months ended June 30, 2011.

*Reclassification of Expenses of Search and Others Business*

To expand distribution of customers' sponsored links or advertisements, the search and others business acquires traffic from third-party Websites. Most traffic acquisition payments are made to Sogou's Website Alliance members. Payments to Sogou's Website Alliance members are based on a portion of pay-for-click revenues generated from clicks by users of their properties, and are included in cost of revenues. A relatively small portion of traffic acquisition payments to third-party Websites are based on pre-agreed unit prices and the actual traffic volume they direct to the search and others business. Prior to 2012, traffic acquisition payments based on pre-agreed unit price and the actual traffic volume were recorded in sales and marketing expenses.

Commencing January 1, 2012, in order to enhance comparability with industry peers, all traffic acquisition payments were recorded in cost of revenues. To conform to current period presentations, the relevant amounts for prior periods have been reclassified accordingly. Such reclassifications amounted to \$2.1 million and \$3.9 million, respectively, for the three and six months ended June 30, 2011.

**2. Segment Information**

The Company's segments are business units that offer different services and are reviewed separately by the chief operating decision maker (CODM), or the decision making group, in deciding how to allocate resources and in assessing performance. The Company's CODM is the Chief Executive Officer. There are five segments in the Sohu Group, consisting of brand advertising, Sogou (which mainly consists of the search and related business), Changyou (which mainly consists of the online game business), wireless and others.

Beginning with the second quarter of 2011, to better reflect management's perspective and match the segment with the entity, the Company changed the segment names of sponsored search and game to Sogou and Changyou, respectively.

In December 2011, the Company sold the 17173 Business to Changyou. Beginning January 1, 2012, the Company began to review the 17173 Business as part of the Changyou segment and changed the Company's segment operating performance measurements by transferring the 17173 Business from the brand advertising segment to the Changyou segment. The comparative operating results of the brand advertising segment and the Changyou segment were retrospectively restated.

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 segment information for reconciliation purposes only. The Company has restated the presentation of its segments for prior periods to conform to the current presentation, and it will restate all comparable periods hereafter.

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

Three Months Ended June 30, 2012								
Brand Advertising, Wireless and Others								
	Brand Advertising	Wireless	Others	Brand Advertising, Wireless and Others	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 63,647	\$ 15,598	\$ 2,252	\$ 81,497	\$ 30,397	\$ 147,341	\$ (3,508)	\$ 255,727
Segment cost of revenues	(49,861)	(10,208)	(280)	(60,349)	(16,154)	(23,493)	76	(99,920)
Segment gross profit /(loss)	\$ 13,786	\$ 5,390	\$ 1,972	21,148	14,243	123,848	(3,432)	155,807
SBC (2) in cost of revenues				191	(38)	(77)	0	76
Gross profit				21,339	14,205	123,771	(3,432)	155,883
Operating expenses:								
Product development				(16,231)	(9,347)	(16,231)	0	(41,809)
Sales and marketing				(31,342)	(6,160)	(14,432)	3,432	(48,502)
General and administrative				(7,283)	(1,262)	(7,486)	0	(16,031)
Impairment of intangible assets via acquisition of businesses				0	0	(2,906)	0	(2,906)
SBC (2) in operating expenses				(1,311)	(1,295)	(899)	0	(3,505)
Total operating expenses				(56,167)	(18,064)	(41,954)	3,432	(112,753)
Operating profit /(loss)				(34,828)	(3,859)	81,817	0	43,130
Other income /(expense)				1,261	3	554	0	1,818
Interest income				3,089	99	4,035	0	7,223
Exchange difference				178	41	(174)	0	45
Income /(loss) before income tax expense				(30,300)	(3,716)	86,232	0	52,216
Income tax expense				(2,393)	0	(16,074)	0	(18,467)
Net income				\$ (32,693)	\$ (3,716)	\$ 70,158	\$ 0	\$ 33,749

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

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

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Three Months Ended June 30, 2011

Brand Advertising, Wireless and Others

	Brand Advertising	Wireless	Others	Brand Advertising, Wireless and Others	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 60,212	\$ 11,645	\$ 694	\$ 72,551	\$ 13,706	\$ 113,317	\$ (869)	\$ 198,705
Segment cost of revenues	(23,537)	(7,109)	(76)	(30,722)	(8,222)	(14,988)	49	(53,883)
Segment gross profit /(loss)	\$ 36,675	\$ 4,536	\$ 618	41,829	5,484	98,329	(820)	144,822
SBC (2) in cost of revenues				(506)	0	(49)	0	(555)
Gross profit				41,323	5,484	98,280	(820)	144,267
Operating expenses:								
Product development				(8,392)	(4,100)	(11,926)	0	(24,418)
Sales and marketing				(22,740)	(2,825)	(10,875)	820	(35,620)
General and administrative				(5,215)	(812)	(5,553)	0	(11,580)
SBC (2) in operating expenses				(1,516)	(974)	(1,384)	13	(3,861)
Total operating expenses				(37,863)	(8,711)	(29,738)	833	(75,479)
Operating profit /(loss)				3,460	(3,227)	68,542	13	68,788
Other income /(expense)				2,079	3	(603)	0	1,479
Interest income				908	26	2,345	0	3,279
Exchange difference				(1,400)	(85)	(173)	0	(1,658)
Income /(loss) before income tax expense				5,047	(3,283)	70,111	13	71,888
Income tax expense				(1,367)	0	(8,914)	0	(10,281)
Net income				\$ 3,680	\$ (3,283)	\$ 61,197	\$ 13	\$ 61,607

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

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



## Six Months Ended June 30, 2012

## Brand Advertising, Wireless and Others

	Brand Advertising, Wireless and Others			Sogou	Changyou	Eliminations	Consolidated	
	Brand Advertising	Wireless	Others	Brand Advertising, Wireless and Others				
Revenues (1)	\$ 119,900	\$ 28,949	\$ 3,275	\$ 152,124	\$ 53,175	\$ 284,106	\$ (7,074)	\$ 482,331
Segment cost of revenues	(85,295)	(19,061)	(929)	(105,285)	(29,277)	(44,792)	182	(179,172)
Segment gross profit /(loss)	\$ 34,605	\$ 9,888	\$ 2,346	46,839	23,898	239,314	(6,892)	303,159
SBC (2) in cost of revenues				16	(43)	(167)	0	(194)
Gross profit				46,855	23,855	239,147	(6,892)	302,965
Operating expenses:								
Product development				(29,484)	(16,877)	(32,869)	0	(79,230)
Sales and marketing				(58,778)	(10,584)	(24,152)	6,892	(86,622)
General and administrative				(14,701)	(2,711)	(15,459)	0	(32,871)
Impairment of intangible assets via acquisition of businesses				0	0	(2,906)	0	(2,906)
SBC (2) in operating expenses				(2,508)	(1,588)	(2,069)	0	(6,165)
Total operating expenses				(105,471)	(31,760)	(77,455)	6,892	(207,794)
Operating profit /(loss)				(58,616)	(7,905)	161,692	0	95,171
Other income /(expense)				2,555	(1)	877	0	3,431
Interest income				6,515	188	7,015	0	13,718
Exchange difference				100	27	(725)	0	(598)
Income /(loss) before income tax expense				(49,446)	(7,691)	168,859	0	111,722
Income tax expense				(4,814)	0	(32,340)	0	(37,154)
Net income				\$ (54,260)	\$ (7,691)	\$ 136,519	\$ 0	\$ 74,568

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

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

## Six Months Ended June 30, 2011

## Brand Advertising, Wireless and Others

	Brand Advertising, Wireless and Others				Sogou	Changyou	Eliminations	Consolidated
	Brand Advertising	Wireless	Others	Brand Advertising, Wireless and Others				
Revenues (1)	\$ 110,670	\$ 23,349	\$ 1,138	\$ 135,157	\$ 21,850	\$ 218,228	\$ (2,161)	\$ 373,074
Segment cost of revenues	(43,978)	(14,001)	(156)	(58,135)	(14,887)	(27,319)	214	(100,127)
Segment gross profit /(loss)	\$ 66,692	\$ 9,348	\$ 982	77,022	6,963	190,909	(1,947)	272,947
SBC (2) in cost of revenues				(1,172)	0	(118)	0	(1,290)
Gross profit				75,850	6,963	190,791	(1,947)	271,657
Operating expenses:								
Product development				(15,456)	(8,039)	(22,374)	0	(45,869)
Sales and marketing				(40,565)	(5,268)	(19,278)	1,947	(63,164)
General and administrative				(9,427)	(1,868)	(10,779)	0	(22,074)
SBC (2) in operating expenses				(3,478)	(1,690)	(3,239)	13	(8,394)
Total operating expenses				(68,926)	(16,865)	(55,670)	1,960	(139,501)
Operating profit /(loss)				6,924	(9,902)	135,121	13	132,156
Other income /(expense)				2,916	5	(932)	0	1,989
Interest income				1,784	30	4,184		5,998
Exchange difference				(1,614)	(141)	(329)	0	(2,084)
Income /(loss) before income tax expense				10,010	(10,008)	138,044	13	138,059
Income tax expense				(2,836)	0	(18,447)	0	(21,283)
Net income				\$ 7,174	\$ (10,008)	\$ 119,597	\$ 13	\$ 116,776

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

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

	As of June 30, 2012				
	Brand Advertising, Wireless and Others	Sogou	Changyou	Eliminations	Consolidated
Cash and cash equivalents	\$ 278,750	\$ 42,695	\$ 443,153	\$ 0	\$ 764,598
Accounts receivable, net	85,269	3,029	22,116	0	110,414
Fixed assets, net	65,231	39,150	66,874	0	171,255
Total assets (1)	\$ 884,911	\$ 89,203	\$ 917,719	\$ (183,432)	\$ 1,708,401

Note (1): The elimination for segment assets mainly consists of elimination of long-term investments in subsidiary and associate companies.

	As of December 31, 2011				
	Brand Advertising, Wireless and Others	Sogou	Changyou	Eliminations	Consolidated
Cash and cash equivalents	\$ 357,031	\$ 45,165	\$ 330,411	\$ 0	\$ 732,607
Accounts receivable, net	73,610	2,263	11,326	(133)	87,066
Fixed assets, net	61,636	22,622	68,394	0	152,652
Total assets (1)	\$ 934,096	\$ 73,970	\$ 753,073	\$ (127,845)	\$ 1,633,294

Note (1): The elimination for segment assets mainly consists of elimination of long-term investments in subsidiary and associate companies.

### 3. Share-Based Compensation Expense

Sohu, Changyou, Sogou and Fox Video Limited ( Sohu Video ) all 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 executive officers, management and employees.

For Sohu, Changyou and Sogou share-based awards, share-based compensation expense is recognized as costs and /or expenses in the consolidated statements of comprehensive income based on the fair value of the related share-based awards on their grant dates. Share-based compensation expense is charged to the shareholders' equity or noncontrolling interest section in the consolidated balance sheets.

On January 4, 2012, Sohu Video, the holding entity of Sohu's video division, adopted a 2011 Share Incentive Plan (the Video 2011 Share Incentive Plan ), which provides for the issuance of up to 25,000,000 ordinary shares of Sohu Video (amounting to 10% of the outstanding Sohu Video shares on a fully-diluted basis) to management and key employees of the video division and to Sohu management. As of June 30, 2012, grants of options for the purchase of 15,352,200 of ordinary shares of Sohu Video had been made and were effective under the plan. However, as of June 30, 2012, the restructuring of Sohu's video division was still in process and certain significant factors remained uncertain. For purposes of ASC 718, no grant date is established until mutual understanding of the option awards' key terms and conditions between Sohu Video and the recipients can be reached, and such mutual understanding cannot be reached until the video division's restructuring plan has been substantially fixed, so that the enterprise value of Sohu Video and hence the fair value of the options is determinable and can be accounted for. As of June 30, 2012, on the basis that the broader terms and conditions of the option awards had neither been finalized nor mutually agreed with the recipients, no grant of options had occurred for purposes of ASC 718 and hence no share based compensation expense was recognized.

Share-based compensation expense was recognized in costs and/or expenses for the three and six months ended June 30, 2012 and 2011, respectively, as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Share-based compensation expense				
Cost of revenues (1)	\$ (76)	\$ 555	\$ 194	\$ 1,290
Product development expenses	1,531	1,421	2,703	3,193

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Sales and marketing expenses	497	872	1,031	1,961
General and administrative expenses	1,477	1,568	2,431	3,240
	\$ 3,429	\$ 4,416	\$ 6,359	\$ 9,684

Note (1): In the second quarter of 2012, the Company trued up the shared-based compensation expense for forfeited restricted share units which would have become fully vested during the quarter.

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There was no capitalized share-based compensation expense for the three and six months ended June 30, 2012 and 2011.

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

Share-based compensation expense	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
For Sohu share-based awards	\$ 1,478	\$ 2,593	\$ 3,181	\$ 6,128
For Changyou share-based awards	813	1,305	2,019	3,038
For Sogou share-based awards	1,138	518	1,159	518
For Sohu Video share-based awards	0		0	
	\$ 3,429	\$ 4,416	\$ 6,359	\$ 9,684

#### 4. Fair Value Measurements

##### *Fair Value of Financial Instruments*

The Company's financial instruments include cash equivalents, short-term investments, accounts receivable, investments in debt securities, prepaid and other current assets, accounts payable, receipts in advance and deferred revenue, accrued liabilities and other short-term liabilities. The carrying amount of accounts receivable, prepaid and other current assets, accounts payable, receipts in advance and deferred revenue, accrued liabilities and other short-term liabilities approximates their fair value. Other financial instruments are measured at their respective fair values. For fair value measurements, 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 market place.

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.

The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of June 30, 2012 (in thousands):

Items	As of June 30, 2012	Fair value measurements at reporting date using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 136,346	\$ 0	\$ 136,346	\$ 0
Short-term investments	21,793	0	21,793	0
Investments in debt securities	79,053	0	0	79,053
Total	\$ 237,192	\$ 0	\$ 158,139	\$ 79,053



The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of December 31, 2011 (in thousands):

Items	Fair value measurements at reporting date using			
	As of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 166,675	\$ 0	\$ 166,675	\$ 0
Short-term investments	17,560	0	17,560	0
Investments in debt securities	79,354	0	0	79,354
Total	\$ 263,589	\$ 0	\$ 184,235	\$ 79,354

The following table sets forth the reconciliation of the fair value measurements using significant unobservable inputs (level 3) from December 31, 2011 to June 30, 2012 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Debt Securities
Beginning balance at December 31, 2011	\$ 79,354
Currency translation adjustment	(301)
Ending balance at June 30, 2012	\$ 79,053

### *Cash equivalents*

The Company's cash equivalents mainly consist of time deposits placed with banks with an original maturity of three months or less. The fair value of time deposits is determined based on the pervasive interest rates in the market, which are also the interest rates as stated in the contracts with the banks. The Company classifies the valuation techniques that use the pervasive interest rates input as Level 2 of fair value measurements. This is because there generally are no quoted prices in active markets for identical time deposits at the reporting date and as a result the Company, to determine the fair value, must use observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

### *Short-term investments*

In accordance with ASC 825, for investments in financial instruments with a variable interest rate indexed to performance of underlying assets, the Company elected the fair value method at the date of initial recognition and carried these investments at fair value. Changes in the fair value are reflected in the consolidated statements of comprehensive income as other income/(expense). Fair value is estimated based on quoted prices of similar products provided by banks at the end of each period. The Company classifies the valuation techniques that use these inputs as Level 2 of fair value measurements.

As of June 30, 2012, the Company's investments in financial instruments were mainly held by 7Road's VIE Shenzhen 7Road Technology Co., Ltd (Shenzhen 7Road), and totaled approximately \$21.8 million. The investments are issued by commercial banks in China with a variable interest rate indexed to performance of underlying assets. Since these investments' maturity dates are within one year, they are classified as short-term investments. For the three and six months ended June 30, 2012, the Company recorded in the consolidated statements of comprehensive income change in the fair value of short-term investments in the amount of \$0.3 million and \$0.6 million, respectively.

### *Investments in Debt Securities*

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In September 2011, the Company extended the maturity of a convertible debt security for six months to March 2012. This convertible debt security has a principal amount of \$74.6 million (equal to RMB0.5 billion) and with an interest rate of 6.8% per annum, payable quarterly in cash. In March 2012, the Company further extended the maturity of this convertible debt security for six months to September 2012. The interest rate remained at 6.8% per annum. This convertible debt security was purchased in September 2010 from a PRC-based company (the Debtor), and has an initial maturity of twelve months subject to extension at the Company's election in its sole discretion for additional sequential six-month periods. The Debtor's obligations on the debt are secured by a pledge from the Debtor's parent company of its entire equity interest in the Debtor. Under the terms of the security, if the Company continues to extend the maturity to March 31, 2014, it will have an option, exercisable on March 31, 2014, to convert the outstanding principal into fixed percentages of equity interests in two companies which are affiliates of the Debtor.

For the three and six months ended June 30, 2012, interest income generated from this debt security amounted to \$1.37 million and \$2.73 million, respectively. For the three and six months ended June 30, 2011, interest income generated from this debt security amounted to \$0.74 million and \$1.45 million, respectively.



The Company elected the fair value option to account for its investments in debt securities at their initial recognition. Changes in fair value were recognized in other income /(expense). For the three and six months ended June 30, 2012, there was no change in fair value. For the three and six months ended June 30, 2011, changes in fair value generated from exchange gain or loss were \$1.06 and \$1.75 million, respectively. To estimate fair value, the Company used the income approach, which considers the estimated future return from the investment and the probabilities of getting these returns. The Company classifies the valuation techniques that use these inputs as Level 3 of fair value measurements.

## 5. Impairment of purchased video content

The Company recorded payments for video content as prepaid assets when payment occurred, then capitalized the purchased video content as intangible assets when recognition criteria were met.

In the second quarter of 2012, the Company noted that the prices for purchased video content have decreased significantly. Under ASC 360-10-35-*Impairment or Disposal of Long-Lived Assets*, when events or changes in circumstances indicate that the carrying amount of long-lived assets may not be recoverable, an impairment test should be performed at the asset group level. The Company divided purchased video content into seven asset groups, consisting of TV series, Pay Channel, Overseas Content, Movies, Animations, Variety shows, and Documentary films. The Company tested the recoverability of the carrying values of these asset groups by comparing their carrying amounts to the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset groups. If the carrying amount of an asset group was determined to not be recoverable, an impairment loss was recognized, measured by comparing the carrying value of the asset group to the asset group's fair value. The fair values of the purchased video content were estimated using the discounted cash flow method. The impairment losses were allocated only to the purchased video content within the asset group, since the carrying amount of other long-lived assets within the asset group was considered to be already below their fair value.

In the second quarter of 2012, as a result of these impairment tests, the Company recognized total impairment losses of \$15.3 million in the consolidated statements of comprehensive income as cost of revenues. Also, the Company wrote down prepaid assets and intangible assets from their carrying values of \$5.5 million and \$29.7 million, respectively, to their fair values of \$2.9 million and \$17.0 million, respectively.

For the three and six months ended June 30, 2011, no impairment losses was recognized for purchased video content.

## 6. Goodwill

The changes in the carrying value of goodwill by segment are as follows (in thousands):

	Brand Advertising	Wireless	Sogou	Changyou	Total
Balance as of December 31, 2011					
Goodwill	\$ 59,978	\$ 15,942	\$ 2,042	\$ 121,932	\$ 199,894
Accumulated impairment losses	(19,846)	(15,942)	0	(5,201)	(40,989)
	\$ 40,132	\$ 0	\$ 2,042	\$ 116,731	\$ 158,905
Transactions in 2012					
Inter-segment transfers	(17,885)	0	0	17,885	0
Foreign currency translation adjustment	0	0	(8)	(472)	(480)
Balance as of June 30, 2012	\$ 22,247	\$ 0	\$ 2,034	\$ 134,144	\$ 158,425
Balance as of June 30, 2012					
Goodwill	\$ 42,093	\$ 15,942	\$ 2,034	\$ 139,345	\$ 199,414
Accumulated impairment losses	(19,846)	(15,942)	0	(5,201)	(40,989)

The inter-segment transfers are related to the sale of the 17173 Business by Sohu to Changyou. As aforementioned in Note 2 - Segment Information, beginning January 1, 2012, the Company began to review the 17173 Business as part of the Changyou segment and changed the Company's segment operating performance measurements by transferring the 17173 Business from the brand advertising segment to the

Changyou segment, therefore, the related goodwill was transferred accordingly.

**7. Income Taxes**

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

The Company did not have any penalties or significant interest associated with tax positions for the three and six months ended June 30, 2012, nor did the Company have any significant unrecognized uncertain tax positions for the three and six months ended June 30, 2012.

***PRC Corporate Income Tax***

*Related to High and New Technology Enterprises*

The PRC Corporate Income Tax Law (the CIT Law ) applies an income tax rate of 25% to all enterprises but grants preferential tax treatment to High and New Technology Enterprises ( NHTEs ). Under this preferential tax treatment, NHTEs can enjoy a preferential income tax rate of 15% for three years, but need to re-apply after the end of the three-year period. The CIT Law was effective beginning January 1, 2008.

Within the Sohu Group, there were five enterprises that qualified as NHTEs in 2008 and were qualified upon re-application in 2011. These enterprises are Beijing Sohu New Era Information Technology Co., Ltd. ( Sohu Era ), Beijing Sohu New Media Information Technology Co., Ltd. ( Sohu Media ), Beijing Sogou Technology Development Co., Ltd. ( Sogou Technology ), Changyou's China-based subsidiary Beijing AmazGam