

SUBAYE, INC.
Form 10-Q
August 16, 2010
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2010

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

Commission File Number: 333-62236

SUBAYE, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

35-2089848
(I.R.S. Employer
Identification No.)

9/F., Beijing Business World,
56 East Xinglong Street, Chongwen District,
Beijing, China 100062
(Address of principal executive offices) (Zip Code)

(86) 20 3999 0266
(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 website, 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.

Large accelerated filer Accelerated filer
Non-accelerated filer

Edgar Filing: SUBAYE, INC. - Form 10-Q

(Do not check if a smaller
reporting company)

Smaller reporting
company

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

As of August 16, 2010, the registrant had 7,444,931 shares of its common stock issued and outstanding.

TABLE OF CONTENTS

| | PAGE |
|---|------|
| PART I | |
| ITEM 1. | |
| Condensed Consolidated Financial Statements | F-1 |
| Condensed Consolidated Balance Sheets as of June 30, 2010 (Unaudited) and September 30, 2009 | F-1 |
| Unaudited Condensed Consolidated Statements of Operations for the Three and Nine Months Ended June 30, 2010 | F-2 |
| Unaudited Condensed Consolidated Statements of Cash Flows for the Nine Months Ended June 30, 2010 | F-3 |
| Notes to the Condensed Consolidated Financial Statements | F-4 |
| ITEM 2. | |
| Management's Discussion and Analysis of Financial Condition and Results of Operations | 3 |
| ITEM 4. | |
| Controls and Procedures | 10 |
| PART II | |
| ITEM 1. | |
| Legal Proceedings | 10 |
| ITEM 1A. | |
| Risk Factors | 10 |
| ITEM 2. | |
| Unregistered Sales of Equity Securities and Use of Proceeds | 11 |
| ITEM 3. | |
| Defaults Upon Senior Securities | 11 |
| ITEM 5. | |
| Other Information | 11 |
| ITEM 6 | 11 |
| Exhibits | |
| SIGNATURES | |
| | 12 |

SUBAYE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| | June 30, 2010 (Unaudited) | September 30, 2009 (Audited) |
|--|---------------------------------|------------------------------------|
| | (In Thousands) | |
| Assets | | |
| Current Assets | | |
| Cash | \$ 2,082 | \$ 2 |
| Accounts Receivable, Net of Allowance for Doubtful Accounts of \$363 as of June 30, 2010 and September 30, 2009, Respectively | 11,328 | 8,266 |
| Prepaid Expenses | 1,133 | 370 |
| Deposit for Purchase of Inventoriable Assets | 6,254 | 8,152 |
| Assets Held for Sale | 23,170 | 29,360 |
| Total Current Assets | 43,967 | 46,150 |
| Property and Equipment, Net of Accumulated Depreciation of \$17,758 and \$12,863 as of June 30, 2010 and September 30, 2009 | 26,099 | 10,580 |
| Total Assets | \$ 70,066 | \$ 56,730 |
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts Payable and Accrued Expenses | \$ 2,884 | \$ 566 |
| Taxes Payable | 2,221 | - |
| Liabilities Held for Sale | 8 | 5,275 |
| Total Current Liabilities | 5,113 | 5,841 |
| Total Liabilities | 5,113 | 5,841 |
| Commitments and Contingencies | | |
| Shareholders' Equity | | |
| Preferred Stock, \$0.001 Par Value, 50,000,000 Shares Authorized, 0 Shares Issued and Outstanding as of June 30, 2010 and September 30, 2009 | — | — |
| Common Stock, \$0.001 Par Value; 150,000,000 Shares Authorized; 7,444,931 and 2,479,243 Shares Issued and Outstanding as of June 30, 2010 and September 30, 2009 | 7 | 3 |
| Additional Paid in Capital | 58,949 | 32,452 |
| Deferred Stock Based Compensation | (8,945) | (2,908) |
| Accumulated Other Comprehensive Income | (149) | 54 |
| Retained Earnings | 15,091 | 11,108 |
| Total Shareholders' Equity | 64,953 | 40,709 |
| Noncontrolling Interest in Subsidiaries | - | 10,180 |
| Total Equity | 64,953 | 50,889 |
| Total Liabilities and Equity | \$ 70,066 | \$ 56,730 |

The accompanying notes to these consolidated financial statements are an integral part of these balance sheets.

F-1

SUBAYE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF OPERATIONS
AND OTHER COMPREHENSIVE INCOME

| | For the Three Months Ended June 30, | | For the Nine Months Ended June 30, | |
|--|--|-----------|---------------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| | In Thousands, Except per Share Amounts | | | |
| Net Sales | \$ 9,068 | \$ 6,829 | \$ 23,368 | \$ 19,226 |
| Cost of Sales | 2,745 | 1,415 | 5,971 | 4,258 |
| Gross Profit | 6,323 | 5,414 | 17,397 | 14,968 |
| Operating Expenses | | | | |
| Advertising | 1,003 | 110 | 2,031 | 7,123 |
| Other Selling, General and Administrative | 1,269 | 712 | 3,652 | 2,257 |
| Total Operating Expenses | 2,272 | 822 | 5,683 | 9,380 |
| Income From Continuing Operations Before Income Tax Expense | 4,051 | 4,592 | 11,714 | 5,588 |
| Income Tax Expense | (772) | - | (2,221) | - |
| Income From Continuing Operations | 3,279 | 4,592 | 9,493 | 5,588 |
| (Loss) Income From Discontinued Operations | (1,411) | (326) | (5,038) | 1,807 |
| Net Income | 1,868 | 4,266 | 4,455 | 7,395 |
| Net Income Attributable to the Noncontrolling Interest | - | (1,525) | (472) | (1,388) |
| Net Income Attributable to Subaye | \$ 1,868 | \$ 2,741 | \$ 3,983 | \$ 6,007 |
| Net Income From Continuing Operations Per Common Share: | | | | |
| Basic | \$ 0.44 | \$ 2.58 | \$ 1.45 | \$ 3.28 |
| Diluted | \$ 0.43 | \$ 2.58 | \$ 1.43 | \$ 3.28 |
| Net (Loss) Income From Discontinued Operations Per Common Share: | | | | |
| Basic | \$ (0.19) | \$ (0.18) | \$ (0.77) | \$ 1.06 |
| Diluted * | \$ (0.19) | \$ (0.18) | \$ (0.77) | \$ 1.06 |
| Net Income Per Common Share: | | | | |
| Basic | \$ 0.25 | \$ 2.40 | \$ 0.68 | \$ 4.34 |
| Diluted * | \$ 0.25 | \$ 2.40 | \$ 0.67 | \$ 4.34 |
| Weighted Average Common Shares Outstanding: | | | | |
| Basic | 7,444,931 | 1,781,089 | 6,561,121 | 1,702,010 |
| Diluted | 7,615,131 | 1,781,089 | 6,646,013 | 1,702,010 |
| Comprehensive Income: | | | | |
| Net Income | \$ 1,868 | \$ 4,266 | \$ 4,455 | \$ 7,395 |
| Foreign Currency Translation Adjustment, Net of Tax | (88) | 2 | (203) | 23 |
| Comprehensive Income | 1,780 | 4,268 | 4,252 | 7,418 |
| Comprehensive Income Attributable to the Noncontrolling Interest | - | (1,525) | (436) | (1,395) |
| Comprehensive Income Attributable to Subaye | \$ 1,780 | \$ 2,743 | \$ 3,816 | \$ 6,023 |

* Diluted loss per share calculated utilizing basic weighted average shares outstanding whenever a loss is presented per reporting period.

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

F-2

SUBAYE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASHFLOWS

| | For the Nine Months Ended June 30, | |
|---|---------------------------------------|----------|
| | 2010 | 2009 |
| | (In Thousands) | |
| Cash Flows From Operating Activities of Continuing Operations: | | |
| Net Income | \$ 4,455 | \$ 7,395 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities— | | |
| Depreciation and Amortization | 4,021 | 4,247 |
| Amortization of Stock Based Compensation | 4,053 | 949 |
| Bad Debt Expense | - | 332 |
| (Increase) Decrease in Assets— | | |
| Accounts Receivable | (3,062) | (880) |
| Prepaid Expenses | (763) | (1,672) |
| Deposits on Inventoriable Assets | 1,882 | (8,152) |
| Increase in Liabilities — | | |
| Accounts Payable and Accrued Expenses | 2,323 | 492 |
| Income Taxes Payable | 2,221 | - |
| Net Cash Provided By Operating Activities | 15,130 | 2,711 |
| Cash Flows From Investing Activities of Continuing Operations: | | |
| Purchase of Property and Equipment | (13,803) | - |
| Net Cash Used in Investing Activities | (13,803) | - |
| Cash Flows From Financing Activities of Continuing Operations: | | |
| Cash Proceeds From Sale of Common Stock | - | 394 |
| Net Cash Provided by Financing Activities | - | 394 |
| Cash Flows From Discontinued Operations: | | |
| Net Cash Provided By (Used in) Operating Activities | 956 | (2,598) |
| Net Cash Provided By (Used in) Discontinued Operations | 956 | (2,598) |
| Effect of Exchange Rate Changes in Cash | (203) | (55) |
| Increase in Cash | 2,080 | 452 |
| Cash, Beginning of Period | 2 | 49 |
| Cash, End of Period | \$ 2,082 | \$ 501 |
| Supplemental Cash Flow Information: | | |
| Cash Paid During the Period for | | |

Edgar Filing: SUBAYE, INC. - Form 10-Q

| | | | | |
|--|----|--------|----|-------|
| Interest, Net of Amounts Capitalized | \$ | — | \$ | — |
| Income Taxes | \$ | — | \$ | — |
| Supplemental Schedule of Noncash Investing and Financing Activities: | | | | |
| Issuance of Stock for Services, Deferred Compensation | \$ | 10,115 | \$ | 1,180 |
| Issuance of Stock for Acquisition of Websites and Related Assets | \$ | 5,760 | \$ | - |
| Adjustment of additional paid-in-capital and non-controlling interests from investment in Subaye Inc, by non-controlling interests | \$ | 10,652 | \$ | - |

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

F-3

SUBAYE, INC. AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED JUNE 30, 2010 AND 2009

NOTE 1 - BUSINESS DESCRIPTION AND ORGANIZATION

Subaye, Inc., a Delaware corporation (together with its consolidated subsidiaries, “Subaye” or the “Company”) is a leading outsourced services provider in China offering on-line video marketing(the “Video Showcase Product”) and cloud computing solutions (the “Cloud Product”).

Video Showcase Product

1. Subaye salespersons conduct business development activities in their territory to secure video showcase business with small to medium sized businesses (“SMEs”) who have revenues of less than \$1 million, are closely held enterprises, do not maintain their own websites and whose management does not regularly have the time or the necessary skills to develop a basic or comprehensive marketing plan, though business development is a primary concern of SMEs the Company works with.
2. Subaye’s salespersons and videographers work with SMEs to develop a professional-quality video showcase, approximately 5 to 30 minutes in length. Multiple video showcases and revisions to previous video showcases are offered to paying SMEs.
3. Subaye hosts the video showcase at www.subaye.com and places the video showcases at various other websites either controlled by Subaye or websites managed by business partners of Subaye. Paying SMEs are able to rotate the specific video showcase available at www.subaye.com, using Subaye’s proprietary online video management system.
4. SMEs utilize the video showcase as their primary sales tool by:
 - a. Notifying potential customers of the link to their video showcase at www.subaye.com, allowing their potential customers to view and understand the products or services being offered to the potential customer.
 - b. SMEs are also able to hire large out-sourced Sales forces that are common in China, provide the sales people with minimal training, and then successfully rely on a downloaded copy of the SME’s video showcase, which is used by each salesperson during their business development activities, rather than fully relying on the salespersons to develop and provide a consistent face to face sales pitch regarding the customer’s business and products. The lack of time devoted to training salespeople is also important due to high turnover of employees the SMEs generally encounter.

Cloud Product

Subaye charges an additional fee for online access to its cloud computing solutions, which include enhanced online tools for video management, content management and customer relationship management software, all of which are accessed through www.subaye.com. The Cloud Product was formerly referred to as the Company’s SaaS business solution in previous reporting periods.

Other Events

On March 16, 2010, the Company discontinued two of its operating segments, the trading services business segment and the entertainment media business segment. The Company disposed of the trading services business segment as of

April 29, 2010 and is seeking buyers for the assets of the entertainment media business on an asset by asset basis, with several transactions already having been consummated.

On October 26, 2009, the Company changed its name to Subaye, Inc.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated financial statements, prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”), include the assets, liabilities, revenues, expenses and cash flows of the Company and all its subsidiaries. This basis of accounting differs in certain material respects from that used for the preparation of the books and records of the Company’s principal subsidiaries, which are prepared in accordance with the accounting principles and the relevant financial regulations applicable to enterprises with limited liabilities established in China the accounting standards used in the place of their domicile. The accompanying consolidated financial statements reflect necessary adjustments not recorded in the books and records of the Company’s subsidiaries to present them in conformity with GAAP.

| Subsidiaries | Countries Registered In | Percentage of Ownership |
|--|---|-------------------------|
| MyStarU Ltd. | Hong Kong, The People’s Republic of China | 100.00% |
| 3G Dynasty Inc. | British Virgin Islands | 100.00% |
| Subaye.com, Inc. | United States of America, Delaware | 100.00% |
| Subaye IIP Limited | British Virgin Islands | 100.00% |
| Guangzhou Subaye Computer Tech Limited | The People’s Republic of China | 100.00% |
| Media Group International Limited | Hong Kong, The People’s Republic of China | 100.00% |

F-4

The accompanying unaudited consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q. They do not include all of the information and footnotes required by GAAP for a complete financial presentation. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation, have been included in the accompanying unaudited condensed consolidated financial statements. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the full year. The Company's accounting policies and certain other disclosures are set forth in the notes to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended September 30, 2009 as filed with the United States Securities and Exchange Commission on December 29, 2009. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Financial Accounting Standards Board's Accounting Standards Codification ("ASC") became the sole source of GAAP as of September 15, 2009. References to the ASC are made throughout this Form 10-Q and refer to specific sections of the ASC in relation to the topics referenced within this Form 10-Q.

Adoption of ASC 810-10-65, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB 51 ("ASC 810-10-65")

The adoption of ASC 810-10-65 did not have a material effect on the Company's financial condition, results of operations or cash flows for the three and nine months ended June 30, 2010 and 2009, respectively, or as of June 30, 2010 and September 30, 2009, respectively. However, as a result of the retrospective presentation and disclosure requirements of ASC 810-10-65, the adoption of ASC 810-10-65 did affect the presentation and disclosure of noncontrolling interests and basic and diluted earnings per common share in the Company's condensed consolidated financial statements for the three and nine months ended June 30, 2009 and as of September 30, 2009, respectively.

ASC 810-10-65 establishes new standards that govern the accounting for and reporting of (1) noncontrolling interest in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. Significant changes to the accounting for noncontrolling interests include (a) the inclusion of noncontrolling interests in the equity section of the controlling entity's condensed consolidated balance sheet rather than in the mezzanine section and (b) the requirement that changes in the controlling entity's interest in the noncontrolling interest, without a change in control, be recognized in the controlling entity's equity rather than being accounted for by the purchase method, which accounting under the purchase method would have given rise to goodwill.

The Company has owned a majority interest of its subsidiary, Subaye.com, Inc., since June 2006. The principal effect of the adoption of ASC 810-10-65 on the September 30, 2009 condensed consolidated balance sheet was to reclassify the noncontrolling interest of \$10,180 thousand from the mezzanine section of the balance sheet to stockholders' equity attributable to noncontrolling interest, thus increasing the total of the condensed consolidated stockholders' equity by that amount, as follows:

| | September 30, 2009 (Dollars in Thousands) |
|--------------------------------|---|
| Equity, as Previously Reported | \$ 40,709 |

| | |
|---|-----------|
| Increase for ASC 810-10-65 Reclassification of Non-Controlling Interest | 10,180 |
| Equity, as Adjusted | \$ 50,889 |

Additionally, the adoption of ASC 810-10-65 requires that net income, as previously reported prior to the adoption of ASC 810-10-65, be adjusted to include the net income attributable to the noncontrolling interest, and that a new separate caption for net income attributable to common shareholders be presented in the condensed consolidated statements of operations. Thus, after the adoption of ASC 810-10-65, condensed consolidated net income increased by \$1,525 thousand and \$1,388 thousand for the three and nine months ended June 30, 2009, respectively.

ASC 810-10-65 also requires similar disclosure regarding comprehensive income. Therefore, after the adoption of ASC 810-10-65 condensed consolidated comprehensive income increased by \$1,525 and \$1,388 thousand for the three and nine months ended June 30, 2009, respectively.

F-5

Revenue Recognition

Video Showcase Subscription Revenues

Revenue is generated by Subaye on a monthly subscription model basis through its Video Showcase Product. Customers are charged a monthly subscription fee of approximately \$117 beginning on the date the customer's video showcase is available for viewing online. Subscription revenues are recognized on a pro-rata basis, calculated on a day-to-day basis and invoiced at the end of each month in accordance under the relevant sections of the ASC, namely ASC Topic 605 "Revenue Recognition" ("ASC 605"). The Company does not currently charge for the production of the video showcase and does not charge a cancellation fee or penalty if and when a customer decides to terminate the subscription.

Cloud Subscription Revenues

Revenue is generated by Subaye on a monthly subscription model basis through the sale of its Cloud Product. Customers are charged a monthly subscription fee of \$100 beginning on the date the customer first has access to Subaye's online services network or through specific individually negotiated contracts, all of which have to date been in the form of a monthly subscription model with fees of \$100 per customer. Subaye's proprietary Cloud Product includes various software modules including content management, customer relationship management and video management solutions. The software and hardware behind the Cloud Product are not downloadable and are not capable of being installed and run on a customer's own computer network.

Costs of Sales

Subaye has entered into several agreements with sales and customer relationship agents (the "Agents") during the nine months ended June 30, 2010 covering a total of twelve new business development territories, primarily in mainland China. The chart below details the key terms of the agreements the Company has with each of the Agents.

| Territory Covered by Agent | Funding Commitment by Subaye (1) | New Member Commitment from Agent | Agent Fee Structure |
|----------------------------|----------------------------------|----------------------------------|---------------------|
| Anhui | \$ 1,500 | 10,000 | (3) |
| Chongqing City | \$ 1,500 | 10,000 | (3) |
| Fujian | \$ 2,796 | 20,000 | (3), (4) |
| Guangdong (2) | \$ 0 | N/A | N/A |
| Hainan | \$ 1,500 | 10,000 | (3) |
| Hebei | \$ 1,600 | 15,000 | (4) |
| Hong Kong | \$ 2,960 | 20,000 | (3), (4) |
| Hubei | \$ 1,500 | 10,000 | (3) |
| Hunan | \$ 1,500 | 10,000 | (3) |
| Jiangxi | \$ 2,148 | 15,000 | (3) |
| Guangxi | \$ 1,296 | 10,000 | (4) |
| Taiwan | \$ 2,000 | 10,000 | (3) |
| Zhejiang | \$ 1,500 | 10,000 | (3) |
| Total | \$ 21,800 | | |

(1) Dollars are in thousands, available to be advanced to the Company's Agents as needed and as approved by the Company

(2) Funding is not yet determined, marketing and agent plans in process

(3) A 25% cash commission on sales generated by the Agent net of income taxes and all agency commissions, in connection with agency agreements entered into in April 2010, apply to this territory and consist of the total compensation awarded to the agents in this territory unless otherwise noted

(4) A portion of \$5,800 thousand in stock compensation in connection with agency agreements entered into in October 2009, November 2009 and January 2010 apply to this territory and consist of the total compensation awarded to the agents in this territory unless otherwise noted

The Agents have two tasks: (i) to develop business for Subaye, by offering the Video Showcase Product or the Cloud Product and support the production of each customer's video showcase and/or the implementation of the customer's online services associated with the Cloud Product, and (ii) to manage the customer relationship and collect the monthly subscription fees, which are currently paid in cash, from each customer. Collecting these cash receipts, tracking which of the Company's many customers have paid and which have not, and remitting the cash to the Company, is a time intensive project each month. The Company has never experienced collection issues and does not expect any collection issues to occur in the future. The impact of the Company's agreements with these Agents on the condensed consolidated financial statements is as follows:

F-6

1. Stock based compensation is valued on the date of grant and amortized over the period of service. The period of service for Agents who received stock based compensation for covering territories in mainland China is two years. The period of service for Agents who received stock based compensation covering territories outside of mainland China is three years. The Company has estimated that 90% of the work performed by these Agents represent services considered to be related to the sales process and has therefore included 90% of the stock based compensation recorded per period in costs of sales. The remaining 10% of the stock based compensation recorded per period is recorded in operating expenses.
2. Other Agents for various mainland China territories are compensated with a 25% cash commission, determined based on total sales generated by the Agent in the territory net of applicable income taxes and total agency commissions recorded for the territory. The Company records the compensation paid to Agents under these terms as a reduction of revenues, in accordance with ASC 605-45 Principal Agent Considerations.

Advertising Costs

The Company expenses advertising costs incurred for its own online, print and outdoor advertising expenses as the costs are incurred in accordance with ASC 720-35 Advertising Costs.

Website Development Costs

The Company follows ASC 350-50, Website Development Costs, which specifies the appropriate accounting for costs incurred in connection with the development and maintenance of websites. Under ASC 350-50, costs related to certain website development activities are expensed as incurred (such as planning and operating stage activities). Costs relating to certain website application and infrastructure development are generally capitalized, and are amortized over their estimated useful lives. Since the Company's inception in January 2005, the Company has not capitalized any costs incurred in website development. All costs have been expensed as incurred. The Company has capitalized the cost of acquiring the www.subaye.com website from an unaffiliated third party and capitalized other websites acquired by the Company's other subsidiaries that previously acquired websites from unaffiliated third parties.

Reclassifications

Certain reclassifications to the Company's condensed consolidated balance sheets and condensed consolidated statements of operations and other comprehensive income have been made to the September 30, 2009 and June 30, 2009 financial statements to conform to the presentation of these financial statements. Other than adjustments required by ASC 810-10-65, these reclassifications did not impact the Company's revenues, net income, total assets, total liabilities or total equity for the three and nine months ended June 30, 2010 and 2009 and as of September 30, 2009 or June 30, 2009, respectively.

NOTE 3 – DIVESTITURE ACTIVITIES

The Company's management agreed to a plan for disposal of the Company's trading services business segment and also determined the Company would commence a formal search for potential buyers of the assets of the Company's entertainment media business segments, namely copyrights to entertainment productions originally created in China. In accordance with ASC 360-45-9, the Company met the conditions for classifying the assets and liabilities of the business segments and assets to be disposed of, as held for sale, on March 16, 2010. The assets and liabilities of the discontinued operations of the trading services and entertainment media business segments have been aggregated and presented as separate line items in the Company's condensed consolidated balance sheets for each period presented. The results of operations of the discontinued operations have been aggregated and presented as a separate line item in the condensed consolidated statement of operations for each period presented.

The following table provides the amount of cash proceeds, adjusted cost basis and gain or loss on the sale of assets and liabilities for the three and nine month periods ended June 30, 2010 and June 30, 2009, respectively:

| | Three Months Ended | | Nine Months Ended | |
|--|------------------------|------------------|-------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| | (Dollars in thousands) | | | |
| Gross Proceeds From the Sale of Assets | \$ 2,390 | \$ 4,123 | \$ 8,790 | \$ 4,123 |
| Adjusted Cost Basis of Assets Sold | 3,875 | 3,681 | 12,814 | 3,681 |
| (Loss) Gain on Sale of Assets | \$ (1,485) | \$ 442 | \$ (4,024) | \$ 442 |

F-7

During the three and nine months ended June 30, 2010, the Company realized a total loss of \$1,485 thousand and \$4,024 thousand on the sale of copyrights to one and four entertainment production titles, respectively. During the three months ended June 30, 2010, the Company sold "Qianfu." During the nine months ended June 30, 2010, the Company sold "Dayoucun," "True?," "Paobu" and "Qianfu." These copyrights were sold to unaffiliated entities based in China.

During the three and nine months ended June 30, 2009, the Company realized a gain of \$442 thousand on the sale of a copyright to an entertainment production titled "Stockbrokers." This copyright was sold to an unaffiliated entity based in China.

Assets Held for Sale

Assets held for sale at June 30, 2010 and September 30, 2009 are detailed in the table below.

| | June 30, 2010 | September 30, 2009 |
|----------------------------|------------------|-----------------------|
| (Dollars in Thousands) | | |
| Cash | \$ 157 | \$ 319 |
| Accounts Receivable | 10,744 | 7,441 |
| Inventory | - | 582 |
| Prepaid Expenses | 550 | 2,794 |
| Property & Equipment, Net | - | 46 |
| Copyrights, Net | 11,517 | 17,621 |
| Goodwill | 202 | 557 |
| Total Assets Held for Sale | \$ 23,170 | \$ 29,360 |

Liabilities held for sale at June 30, 2010 and September 30, 2009 are detailed in the table below.

| | June 30, 2010 | September 30, 2009 |
|---------------------------------------|------------------|-----------------------|
| (Dollars in Thousands) | | |
| Accounts Payable and Accrued Expenses | \$ 8 | \$ 3,867 |
| Customer Deposits | - | 545 |
| Bank Loan Payable | - | 863 |
| Total Liabilities Held for Sale | \$ 8 | \$ 5,275 |

The results of operations of the discontinued trading services business segment are presented in the condensed consolidated unaudited statement of operations for the three and nine month periods ended June 30, 2010 and 2009 presented below:

| | Three Months Ended | | Nine Months Ended | |
|------------------------|--------------------|------------------|-------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| (Dollars in thousands) | | | | |
| Sales | \$ 1,117 | \$ 2,698 | \$ 8,077 | \$ 7,106 |
| Costs of Sales | 1,097 | 2,634 | 7,867 | 6,923 |

| | | | | | | | | |
|-------------------|----|----|----|-----|----|-----|----|-----|
| Gross Profit | | 20 | | 64 | | 210 | | 183 |
| Net Income (Loss) | \$ | 40 | \$ | (7) | \$ | 59 | \$ | 12 |

On April 29, 2010, the Company entered into a purchase and sale agreement (the “Agreement”) with Superb Quality Limited (“Superb”), pursuant to which the Company sold its 100% ownership interest in Panyu M&M Co. Ltd., the Company’s wholly-owned PRC subsidiary (“Panyu”), to Superb in exchange for \$600 thousand in cash. Panyu has been disclosed previously as the Company’s trade services business segment and holds the necessary licenses to conduct international and domestic trading and provide logistics services to customers.

The results of operations of the discontinued entertainment media business segment are presented in the condensed consolidated unaudited statement of operations for the three and nine month periods ended June 30, 2010 and 2009 presented below:

F-8

Edgar Filing: SUBAYE, INC. - Form 10-Q

| | Three Months Ended | | Nine Months Ended | |
|---------------------|------------------------|------------------|-------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| | (Dollars in thousands) | | | |
| Sales | \$ 2,453 | \$ 410 | \$ 10,455 | \$ 9,221 |
| Costs of Sales | 3,858 | 389 | 14,622 | 4,840 |
| Gross (Loss) Profit | (1,405) | 21 | (4,167) | 4,381 |
| Net (Loss) Income | \$ (1,451) | \$ (248) | \$ (5,097) | \$ 3,900 |

The Company is attempting to complete all divestiture activities by September 30, 2010. However, it is possible the divestiture activities may not be completed until a later date.

NOTE 4 - ACCOUNTS RECEIVABLE

The Company's business operations are conducted in China. During the normal course of business, the Company extends unsecured credit to its customers. Management reviews its accounts receivable on a regular basis to determine if the allowance for doubtful accounts is adequate. An estimate for doubtful accounts is made when collection of the full amount is no longer probable. The Company has not experienced significant difficulty in collecting its accounts receivable in the past and has no reason to believe this may change in the near future.

Trade accounts receivable at June 30, 2010 and September 30, 2009 consisted of the following:

| | June 30, 2010 | September 30, 2009 |
|---------------------------------------|------------------------|--------------------------|
| | (Dollars in Thousands) | |
| Trade Accounts Receivable | \$ 11,691 | \$ 8,629 |
| Less: Allowance for Doubtful Accounts | (363) | (363) |
| Totals | \$ 11,328 | \$ 8,266 |

The activity in the allowance for doubtful accounts for trade accounts receivable as of June 30, 2010 and September 30, 2009 is as follows:

| | June 30, 2010 | September 30, 2009 |
|---|------------------------|--------------------------|
| | (Dollars in Thousands) | |
| Beginning Allowance for Doubtful Accounts | \$ 363 | \$ 31 |
| Additional Charge to Bad Debt Expense | - | 332 |
| Ending Allowance for Doubtful Accounts | \$ 363 | \$ 363 |

NOTE 5 – DEPOSIT FOR INVENTORIABLE ASSETS

On May 3, 16 and 26, 2009, the Company's subsidiary, Subaye IIP Limited, entered into three agreements with three consumer goods distributors in China. The products will include clothes, footwear, bags and garniture, jewelry and electronics. The consumer goods distributors committed to delivering goods ordered by Subaye IIP Limited or the members of www.subaye.com "just in time." If the consumer goods distributors do not deliver the products ordered by the first day subsequent to the order, the consumer goods distributors will pay Subaye IIP Limited a penalty equal to

5% of the cost of the product ordered per day it is delivered late. The contracts are valid from May 3, 16 and 26, 2009 through November 2, 15 and 25, 2010, respectively. In accordance with the contract, Subaye IIP Limited paid a deposit of \$8,152 thousand. The deposit will be used by the consumer goods distributor to ensure product is available for ordering by Subaye IIP Limited or the members of www.subaye.com on an as needed basis.

In June 2010, the contracts with the three consumer goods distributors were renegotiated and the deposit to be held by the consumer goods distributors was decreased. A refund to the Company of \$1,898 thousand was agreed to and had been received back by the Company in June 2010.

NOTE 6 - PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following:

F-9

| | June 30, 2010 | September 30, 2009 |
|---|------------------------|--------------------------|
| | (Dollars in Thousands) | |
| Computer Software & Equipment | \$ 16,431 | \$ 9,418 |
| Websites | 27,366 | 13,965 |
| Furniture & Fixtures | 60 | 60 |
| | 43,857 | 23,443 |
| Less: Accumulated depreciation and amortization | (17,758) | (12,863) |
| | \$ 26,099 | \$ 10,580 |

NOTE 7 – DEPRECIATION AND AMORTIZATION

The Company's depreciation and amortization recorded within these financial statements is significant and is related to the Company's websites, software and stock based compensation, respectively. Below is a table outlining depreciation and amortization included in costs of goods sold or operating expenses for each period presented within the financial statements.

| | Three Months Ended | | Nine Months Ended | |
|---|------------------------|---------------------|---------------------|---------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| | (Dollars in thousands) | | | |
| Amortization of Stock Based Compensation Included Within Costs of Sales | \$ 555 | \$ - | \$ 1,277 | \$ - |
| Amortization of Websites, Software and Hardware Included Within Costs of Sales | 1,821 | 1,837 | 4,005 | 4,654 |
| Amortization of Stock Based Compensation Included in Operating Expenses | 968 | 300 | 2,776 | 949 |
| Depreciation and Amortization Included Within Operating Expenses | 6 | 23 | 16 | 37 |
| Total Depreciation and Amortization | \$ 3,350 | \$ 2,160 | \$ 8,074 | \$ 5,640 |

NOTE 8 - STOCKHOLDERS' EQUITY

The Company is authorized to issue 200,000,000 shares, in aggregate, consisting of 150,000,000 shares of common stock, \$0.001 par value, and 50,000,000 shares of preferred stock, \$0.001 par value. The Company's Certificate of Incorporation authorizes the Board of Directors (the "Board") to determine the preferences, limitations and relative rights of any class or series of Company preferred stock prior to issuance and each such class or series must be designated with a distinguishing designation prior to issuance. As of June 30, 2010, no shares of the Company's preferred stock and 7,444,931 shares of the Company's common stock were issued and outstanding.

On March 11, 2010, the Company awarded a contract to a marketing and investor relations consultant and issued a stock warrant for a total of 125,000 shares of the Company's common stock valued at \$838 thousand. The agreement is for a term of one year. The stock warrant is exercisable at a price of \$18.00 per share and expires on March 11, 2014, if unexercised. The Company amortizes the compensation provided to the consultant over the contract term.

On March 8, 2010, the Company awarded an entity controlled by the Chief Financial Officer a total of 10,000 shares of the Company's common stock valued at \$125 thousand. The entity was awarded the shares as a result of the terms

of an agreement entered into on September 18, 2009 between the Company and the entity whereby upon approval of the Company's listing application for the NASDAQ Global Market, the shares would be awarded to the entity. The Company amortized the stock award as a one-time expense on March 8, 2010.

On March 2, 2010, the Company entered into an acquisition agreement (the "Agreement") with CoCloud Infoserve Limited, a Chinese company ("CIL"). Pursuant to the terms of the Agreement, the Company acquired all of the website domains and related assets, used by CIL to operate various online shopping websites, www.gzxiti.com, www.gzxing.com.cn, www.gzbuyun.com.cn, www.gzjinxiu.com, www.gznantian.com, and www.gzxhaxi.com, in exchange for 480,000 shares of the Company's common stock, valued at \$5,760 thousand.

On February 10, 2010, the Company awarded a stock option for a total of 23,200 shares of common stock to an independent board member valued at \$287 thousand. The stock option will be earned over one year, is exercisable at a price of \$16.05 per share and will expire on February 10, 2020. The Company amortizes the compensation provided to this independent board member over the one year term.

F-10

On February 10, 2010, the Company awarded contracts to three vice presidents for a total of 40,000 shares of the Company's common stock valued at \$642 thousand. The agreements are for a term of two years. The Company amortizes the compensation provided to these executives over each contract term.

On February 8, 2010, the Company awarded a contract to a Vice President for a total of 15,000 shares of the Company's common stock valued at \$239 thousand. The agreement is for a term of two years. The Company amortizes the compensation provided to this Vice President over the contract term.

On January 4, 2010, the Company awarded contracts to two Agents for a total of 240,000 shares of the Company's common stock valued at \$3,240 thousand. Each agreement is for a term of two years. The Company amortizes the compensation provided to these Agents over each contract term.

On November 18, 2009, the Company awarded a total of 23,200 shares of common stock to two of its independent board members valued at \$339 thousand. The stock awards will be earned over one year. The Company amortizes the compensation provided to each independent board member over each contract term.

On November 9, 2009, the Company awarded contracts to two consultants for a total of 96,000 shares of the Company's common stock valued at \$1,164 thousand. The agreements are for a term of two years. The Company amortizes the compensation provided to each consultant over each contract term.

On November 9, 2009, the Company awarded a contract to a marketing and investor relations consultant for a total of 30,000 shares of the Company's common stock valued at \$364 thousand. The agreement is for a term of two years. The Company amortizes the compensation provided to this consultant over the contract term.

On November 6, 2009, the Company entered into a Share Exchange Agreement with certain shareholders of its subsidiary, Subaye.com, Inc. Pursuant to the terms of the Share Exchange Agreement, the Company issued 3,408,852 shares of its common stock in exchange for all outstanding shares of common stock of Subaye.com, Inc. the Company did not already own (the "Share Exchange"). As a result of the Share Exchange, Subaye.com, Inc., and the wholly-owned subsidiaries of Subaye.com, Inc., effectively became wholly-owned subsidiaries of the Company.

On October 23, 2009, the Company effectuated a reverse stock split on a 100 to 1 (100:1) basis.

On October 11, 2009, the Company awarded a contract to its Chief Financial Officer for a total of 22,500 shares of the Company's common stock valued at \$259 thousand. The agreement is for a term of three years. The Company amortizes the compensation provided to the Chief Financial Officer over the contract term.

On October 2, 2009, the Company awarded contracts to two Agents for a total of 320,000 shares of the Company's common stock valued at \$2,560 thousand. Each agreement is for a term of three years. The Company amortizes the compensation provided to these Agents over each contract term.

On October 2, 2009, the Company awarded a contract to a Vice President for a total of 7,500 shares of the Company's common stock valued at \$60 thousand. The agreement is for a term of two years. The Company amortizes the compensation provided to this Vice President over the contract term.

NOTE 9 – NONCONTROLLING INTEREST

On November 6, 2009, the Company entered into a Share Exchange Agreement (the "Agreement") with certain shareholders of its subsidiary, Subaye.com, Inc. Pursuant to the terms of the Agreement, the Company issued 3,408,852 shares of its common stock, with a fair market value of \$46,360 thousand, in exchange for all of the outstanding shares of common stock of Subaye.com, Inc. that the Company did not already own (the "Share

Exchange”). As a result of the Share Exchange, Subaye.com, Inc. and each of the wholly-owned subsidiaries of Subaye.com, Inc. effectively became wholly-owned subsidiaries of the Company. The Share Exchange was accounted for as a change in the ownership interests of the Company with an entity under common control, in accordance with ASC 810-10-65. As a result, the value of the 3,408,852 shares issued to consummate the Share Exchange was recorded by the Company as an increase to stockholders' equity of \$10,652 thousand, which represented the historical cost basis of the balance of the net assets acquired through the Share Exchange, which included significant assets as well as liabilities owed to the Company.

The following disclosure provides details regarding the change in the noncontrolling ownership interests of the Company's subsidiaries, in accordance with ASC 810-10-55-4.

| | Three Months Ended | | Nine Months Ended | |
|---|------------------------|------------|-------------------|------------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in thousands) | | | |
| Net Income Attributable to Subaye, Inc. | \$ - | \$ (1,525) | \$ (472) | \$ (1,388) |
| Transfers from the Noncontrolling Interest | | | | |
| Increase in Subaye, Inc.'s Additional Paid in Capital for the Issuance of 3,408,852 Shares of Common Stock to the Shareholders of the Noncontrolling Interest | - | - | 10,652 | - |
| Change from Net Income Attributable to Subaye, Inc. and Transfers to the Noncontrolling Interest | \$ - | \$ (1,525) | \$ 10,180 | \$ (1,388) |

NOTE 10 - INCOME TAX

United States of America

The Company and its subsidiary, Subaye.com, Inc., do not conduct business within the United States of America. Therefore, there is no provision for United States taxes and there are no deferred tax amounts.

Delaware

The Company and its subsidiary, Subaye.com, Inc. are incorporated in Delaware but do not conduct business in Delaware. Therefore, the Company and Subaye.com, Inc. are not subject to Delaware corporate income tax.

British Virgin Islands

Subaye IIP, Limited is incorporated in the British Virgin Islands and, under the current laws of the British Virgin Islands, is not subject to income taxes.

People's Republic of China

Enterprise income tax in PRC is generally charged at 25% of a company's assessable profit, of which 22% is a national tax and 3% is a local tax. The Company's subsidiary, Guangzhou Subaye, is incorporated in the PRC, and is subject to PRC enterprises income tax at the applicable tax rates on the taxable income as reported in their Chinese statutory accounts in accordance with the relevant enterprises income tax laws.

No provision for enterprise income tax in the PRC had been made for the years ended September 30, 2009 and 2008 due to the fact that the Company was exempt from PRC tax based on the statutory provisions granting a tax holiday for a two year period, which was applicable for the years ended September 30, 2009 and 2008 respectively.

The Company is governed by the Income Tax Law of the People's Republic of China concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws ("the Income Tax Laws"). Under the Income Tax Laws, foreign investment enterprises ("FIE") generally are subject to an income tax at an effective rate of 25% on income as reported in their statutory financial statements after appropriate tax adjustments unless the enterprise is located in specially designated regions of cities for which more favorable effective tax rates apply.

The provision for enterprise income tax in the PRC is \$772 and \$2,221 thousand for the three and nine months ended June 30, 2010. No provision for enterprise income tax in the PRC had been made the three and nine months ended June 30, 2009 due to the fact that certain subsidiaries of the Company are exempt from PRC tax based on the statutory provisions granting a tax holiday for a two year period, as stated above, specifically for the years ended September 30, 2009 and 2008, respectively. The Company's PRC tax holiday expired on October 1, 2009. The following table details the aggregate effect of the tax holiday on the Company's results of operations.

| | Three Months Ended | | Nine Months Ended | |
|--|------------------------|------------------|-------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| | (Dollars in thousands) | | | |
| PRC Tax Without Consideration of Tax Holiday | \$ 772 | \$ 1,066 | \$ 2,221 | \$ 1,848 |
| PRC Tax Savings as a Result of Tax Holiday | \$ - | \$ 1,066 | \$ - | \$ 1,848 |
| | \$ - | \$ 0.60 | \$ - | \$ 1.09 |

Increase in Basic and Diluted Earnings Per
Share as a Result of Tax Holiday

The following table reconciles the U.S. statutory rates to the Company's effective tax rate for the three and nine months ended June 30, 2010 and 2009:

F-12

| | Three and Nine Months Ended | |
|---|-----------------------------|------------------|
| | June 30, 2010 | June 30, 2009 |
| U.S. Statutory Rates | 35.0% | 35.0% |
| Foreign Income | (35.0)% | (35.0) |
| China and Hong Kong Tax Rates, Blended Effective Rate | 18.0 % | 25.0 |
| China Income Tax Exemption | 0.0% | (25.0) |
| Effective Income Tax Rates | 18.0% | 0% |

NOTE 11 - COMMITMENTS & CONTINGENCIES

Operating Leases

In the normal course of business, the Company leases office space under operating lease agreements. The Company rents office space, primarily for regional sales administration offices, in commercial office complexes that are conducive to administrative operations. The operating lease agreements generally contain renewal options that may be exercised at the Company's discretion after the completion of the base rental terms. In addition, many of the rental agreements provide for regular increases to the base rental rate at specified intervals, which usually occur on an annual basis.

On July 1, 2008, the Company entered into a lease for new office space in Foshan City, Guangdong, China for approximately \$5 thousand per month through June 30, 2011.

On February 1, 2009, the Company entered into a lease agreement to utilize approximately 22,000 square feet of office space at 349 Dabei Road, Shiqiao Street, Panyu District, Guangzhou City, Guangdong, China 511400 for approximately \$9 thousand per month through January 31, 2011.

The following table summarizes the Company's future minimum lease payments under operating lease agreements for the five years subsequent to June 30, 2010:

| | |
|---|--------|
| Twelve Months Ended June, 2011 (in thousands) | \$ 123 |
|---|--------|

The Company recognizes lease expense on a straight-line basis over the life of the lease agreement. Contingent rent expense is recognized as it is incurred. Total rent expense in continuing operations from operating lease agreements was \$42 thousand and \$60 thousand and \$146 thousand and \$100 thousand for the three and nine months ended June 30, 2010 and 2009, respectively.

Litigation

We may be involved from time to time in ordinary litigation that will not have a material effect on our operations or finances. We are not aware of any pending or threatened litigation against the Company or our officers and directors in their capacity as such that could have a material impact on our operations or finances.

NOTE 12 - RECENTLY ISSUED ACCOUNTING STANDARDS

In October 2009, the Financial Accounting Standards Board (FASB) issued amended revenue recognition guidance for arrangements with multiple deliverables. The new guidance eliminates the residual method of revenue recognition and allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third-party evidence (TPE) is unavailable. For the company, this guidance is effective for all new or materially modified arrangements entered into

on or after October 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. The company is currently assessing its implementation of this new guidance, but does not expect a material impact on the consolidated financial statements.

In October 2009, the FASB issued guidance which amends the scope of existing software revenue recognition accounting. Tangible products containing software components and non-software components that function together to deliver the product's essential functionality would be scoped out of the accounting guidance on software and accounted for based on other appropriate revenue recognition guidance. For the company, this guidance is effective for all new or materially modified arrangements entered into on or after October 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. This guidance must be adopted in the same period that the company adopts the amended accounting for arrangements with multiple deliverables described in the preceding paragraph. The company is currently assessing its implementation of this new guidance, but does not expect a material impact on the consolidated financial statements.

F-13

On October 1, 2009, the company adopted the revised FASB guidance regarding business combinations which was required to be applied to business combinations on a prospective basis. The revised guidance requires that the acquisition method of accounting be applied to a broader set of business combinations, amends the definition of a business combination, provides a definition of a business, requires an acquirer to recognize an acquired business at its fair value at the acquisition date and requires the assets and liabilities assumed in a business combination to be measured and recognized at their fair values as of the acquisition date (with limited exceptions). There was no impact upon adoption and the effects of this guidance will depend on the nature and significance of business combinations occurring after the effective date.

In August 2009, the FASB issued guidance on the measurement of liabilities at fair value. The guidance provides clarification that in circumstances in which a quoted market price in an active market for an identical liability is not available, an entity is required to measure fair value using a valuation technique that uses the quoted price of an identical liability when traded as an asset or, if unavailable, quoted prices for similar liabilities or similar assets when traded as assets. If none of this information is available, an entity should use a valuation technique in accordance with existing fair valuation principles. The company adopted this guidance in the quarter ended September 30, 2009 and there was no material impact on the consolidated financial statements.

In June 2009, the FASB issued amendments to the accounting rules for variable interest entities (VIEs) and for transfers of financial assets. The new guidance for VIEs eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and requires ongoing qualitative reassessments of whether an enterprise is the primary beneficiary. In addition, qualifying special purpose entities (QSPEs) are no longer exempt from consolidation under the amended guidance. The amendments also limit the circumstances in which a financial asset, or a portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented, and/or when the transferor has continuing involvement with the transferred financial asset. The company will adopt these amendments for interim and annual reporting periods beginning on October 1, 2010. The company does not expect the adoption of these amendments to have a material impact on the consolidated financial statements.

In May 2009, the FASB issued guidelines on subsequent event accounting which sets forth: 1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; 2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and 3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. These guidelines were effective for interim and annual periods ending after June 15, 2009, and the company adopted them in the quarter ended June 30, 2009. There was no impact on the consolidated financial statements.

In April 2009, the FASB issued additional requirements regarding interim disclosures about the fair value of financial instruments which were previously only disclosed on an annual basis. Entities are now required to disclose the fair value of financial instruments which are not recorded at fair value in the financial statements in both their interim and annual financial statements. The new requirements were effective for interim and annual periods ending after June 15, 2009 on a prospective basis. The company adopted these requirements in the quarter ended June 30, 2009. There was no impact on the consolidated financial results as this relates only to additional disclosures.

In April 2008, the FASB issued new requirements regarding the determination of the useful lives of intangible assets. In developing assumptions about renewal or extension options used to determine the useful life of an intangible asset, an entity needs to consider its own historical experience adjusted for entity-specific factors. In the absence of that experience, an entity shall consider the assumptions that market participants would use about renewal or extension options. The new requirements apply to intangible assets acquired after October 1, 2009. The adoption of these new rules did not have a material impact on the Consolidated Financial Statements.

In December 2007, the FASB issued new guidance on noncontrolling interests in consolidated financial statements. This guidance requires that the noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. Pursuant to the transition provisions, the company adopted this new guidance on October 1, 2009 via retrospective application of the presentation and disclosure requirements.

In March 2008, the FASB issued new disclosure requirements regarding derivative instruments and hedging activities. Entities must now provide enhanced disclosures on an interim and annual basis regarding how and why the entity uses derivatives; how derivatives and related hedged items are accounted for, and how derivatives and related hedged items affect the entity's financial position, financial results and cash flow. Pursuant to the transition provisions, the company adopted these new requirements on October 1, 2009. These new requirements do not impact the consolidated financial results as they are disclosure-only in nature.

The FASB guidance on fair value measurements and disclosures became effective January 1, 2008. However, in February 2008, the FASB delayed the effective date regarding fair value measurements and disclosures of nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to October 1, 2009. The adoption of these provisions related to nonfinancial assets and nonfinancial liabilities on October 1, 2009 did not have a material impact on the consolidated financial statements.

In June 2008, the FASB issued guidance in determining whether instruments granted in share-based payment transactions are participating securities. The guidance became effective on October 1, 2009 via retrospective application. According to the new guidance, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. The adoption of these provisions is not expected to have a material impact on the consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide information that is supplemental to, and should be read together with, the Company's condensed consolidated financial statements and the accompanying notes contained in this Quarterly Report. Information in this Item 2 is intended to assist the reader in obtaining an understanding of the consolidated financial statements, the changes in certain key items in those financial statements from year to year, the primary factors that accounted for those changes, and any known trends or uncertainties that the Company is aware of that may have a material effect on the Company's future performance, as well as how certain accounting principles affect the consolidated financial statements. MD&A includes the following sections:

- Highlights and Executive Summary
- Results of Operations—an analysis of the Company's consolidated results of operations, for the four periods presented in the consolidated financial statements
- Liquidity and Capital Resources—an analysis of the effect of the Company's operating, financing and investing activities on the Company's liquidity and capital resources
 - Off-Balance Sheet Arrangements—a discussion of such commitments and arrangements
- Critical Accounting Policies and Estimates—a discussion of accounting policies that require significant judgments and estimates
- New Accounting Pronouncements—a summary and discussion of the Company's plans for the adoption of relevant new accounting standards

The following discussion contains forward-looking statements that reflect the Company's plans, estimates and beliefs. Actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this Quarterly Report.

Highlights and Executive Summary

For the nine months ended June 30, 2010, the Company reported revenues of \$23,368 thousand, an increase of 21.5% as compared to revenues of \$19,226 thousand for the nine months ended June 30, 2009. The Company generated additional revenues for its Video Showcase Product and Cloud Product, respectively. Net income from continuing operations for the nine months ended June 30, 2010 totaled \$9,493 thousand, an increase of 69.9% as compared to net income from continuing operations revenues of \$5,588 thousand reported for the nine months ended June 30, 2009. The Company decreased its advertising spending by 71.5% during the nine months ended June 30, 2010 and committed a fraction of the funds previously allocated to advertising promotions to its expansion initiative to increase its sales force to service a nation-wide market in mainland China.

For the three months ended June 30, 2010, the Company reported revenues of \$9,068 thousand, an increase of 32.8% as compared to revenues of \$6,829 thousand for the three months ended June 30, 2009. The Company generated additional revenues for its Video Showcase Product and Cloud Product, respectively. Net income from continuing operations for the three months ended June 30, 2010 totaled \$3,279 thousand, a decrease of \$1,313 thousand as compared to net income from continuing operations revenues of \$4,592 thousand reported for the three months ended

June 30, 2009. The Company increased its advertising spending by \$893 thousand and recorded a provision for income taxes of \$772 thousand as compared to 2009 when no income tax expense was recorded.

3

Adjusted Net Income

As a result of the tax exempt status of the Company's continuing operations, no income tax expense was recorded in the three and nine months ended June 30, 2009, respectively. The tax exemption expired as of September 30, 2009. Therefore an income tax expense is recorded for the three and nine months ended June 30, 2010, respectively. The Company also believes its profitability and specifically its cashflows from operations are not adequately apparent in its condensed consolidated financial statements due to the impact of current accounting regulations.

The Company has attempted to present adjusted financial results by subtracting an estimated income tax expense from net income from continuing operations for each period in which a tax exemption was applicable during 2009, and adding back depreciation and amortization for each period presented. The Company believes the results of operations for each period presented are more comparable and better reflect the Company's substantial cash profits and year over year revenue and adjusted net income growth, respectively. The tables below provide the adjusted net income from continuing operations and adjusted net income from continuing operations per basic common share.

Adjusted net income from continuing operations is calculated as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|------------------------|------------------|-------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| | (Dollars in thousands) | | | |
| Net Income From Continuing Operations | \$ 3,279 | \$ 4,592 | \$ 9,493 | \$ 5,588 |
| Add: Amortization of Computer Software and Hardware | 937 | 441 | 2,156 | 2,346 |
| Add: Amortization of Websites | 884 | 970 | 1,849 | 1,882 |
| Add: Amortization of Stock Based Compensation | 1,523 | 300 | 4,053 | 949 |
| Add: Depreciation Included in Operating Expenses | 6 | 5 | 16 | 19 |
| Add: Income Taxes | 772 | - | 2,221 | - |
| Adjusted Net Income From Continuing Operations | \$ 7,401 | \$ 6,308 | \$ 19,788 | \$ 10,784 |

Adjusted net income from continuing operations per basic common share is calculated as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|------------------------|------------------|-------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| | (Dollars in thousands) | | | |
| Net Income From Continuing Operations Per Basic Common Share | \$ 0.44 | \$ 2.58 | \$ 1.45 | \$ 3.28 |
| Add: Amortization of Computer Software and Hardware | 0.13 | 0.25 | 0.33 | 1.38 |
| Add: Amortization of Websites | 0.12 | 0.54 | 0.28 | 1.11 |
| Add: Amortization of Stock Based Compensation | 0.20 | 0.17 | 0.62 | 0.56 |
| Add: Depreciation Included in Operating Expenses | 0.00 | 0.00 | 0.00 | 0.01 |
| Add: Income Taxes | 0.10 | 0.00 | 0.34 | - |
| Adjusted Net Income From Continuing Operations Per Basic Common Share | \$ 0.99 | \$ 3.54 | \$ 3.02 | \$ 6.34 |

The following tables are key performance indicators utilized by management for internal decision making. We believe these performance indicators are likely also important for our shareholders to consider.

Nine
Months
Ended June
30, 2010

| | |
|---|-------|
| Revenues Growth Rate | 21.5% |
| Adjusted Net Income Growth Rate | 83.5% |
| Net Income From Continuing Operations Growth Rate | 69.9% |
| Gross Margin | 74.4% |
| Continuing Operations Net Margin | 40.6% |

4

Three
Months
Ended June
30, 2010

| | |
|---|---------|
| Revenues Growth Rate | 32.8% |
| Adjusted Net Income Growth Rate | 17.3% |
| Net Income From Continuing Operations Growth Rate | (28.6)% |
| Gross Margin | 69.7% |
| Continuing Operations Net Margin | 36.2% |

Results of Operations

For the Nine Months Ended June 30, 2010 Compared to the Nine Months Ended June 30, 2009

(In Thousands, Except per Share Data)

| | 2010 | 2009 |
|--|-----------|-----------|
| Revenues | \$ 23,368 | \$ 19,226 |
| Costs of Sales | 5,971 | 4,258 |
| Gross Profit | 17,397 | 14,968 |
| Total Operating Expenses | 5,683 | 9,380 |
| Income From Continuing Operations Before Income Taxes | 11,714 | 5,588 |
| Provision for Income Taxes | (2,221) | - |
| Income From Continuing Operations | \$ 9,493 | \$ 5,588 |
| (Loss) Income from Discontinued Operations | (5,038) | 1,807 |
| Net Income | \$ 4,455 | \$ 7,395 |
| Net Income Attributable to the Noncontrolling Interest | (472) | (1,388) |
| Net Income Attributable to Subaye | \$ 3,983 | \$ 6,007 |
| Basic Earnings Per Share, Continuing Operations | \$ 1.45 | \$ 3.28 |
| Diluted Earnings Per Share, Continuing Operations | \$ 1.43 | \$ 3.28 |
| Basic (Loss) Earnings Per Share, Discontinued Operations | \$ (0.77) | \$ 1.06 |
| Diluted (Loss) Earnings Per Share, Discontinued Operations | \$ (0.77) | \$ 1.06 |

Revenues

Revenues for the nine months ended June 30, 2010 were \$23,368 thousand as compared to \$19,226 thousand for the nine months ended June 30, 2009. The increase of \$4,142 thousand, or 21.5%, was due to the increase in revenues from both the Video Showcase Product and the Cloud Product. Video Showcase Product revenues for the nine months ended June 30, 2010 increased to \$18,330 thousand as compared to \$15,716 thousand for the nine months ended June 30, 2009, an increase of \$2,614 thousand, or 16.6%, over the same period a year ago. Cloud Product revenues increased to \$5,038 thousand for the nine months ended June 30, 2010 as compared to \$3,510 thousand for the nine months ended June 30, 2009, an increase of 43.5%. The Company's paying customers for the Video Showcase Product increased to 34,382 as of June 30, 2009, a 112.1% increase over the paying customers as of September 30, 2009. However, much of the growth in membership occurred in the four months ended June 30, 2010. The Company recognizes revenues on a pro-rata daily basis. In recent months the Company's paying membership growth has increased substantially. There is an inherent lag in the recognition of the additional revenues resulting from the Company's accounting policy for recognizing revenues on a pro-rata daily basis.

Costs of Sales

Costs of sales for the nine months ended June 30, 2010 were \$5,971 thousand as compared to \$4,258 thousand for the nine months ended June 30, 2009. The increase of \$1,713 thousand, or 40.2%, was primarily due to additional costs of sales associated with the stock based compensation to the Company's new Agents in certain Chinese provinces. Stock based compensation included in costs of sales was \$1,277 thousand and \$0 for the nine months ended June 30, 2010 and 2009, respectively. Depreciation and amortization of websites, software and hardware totaled \$4,005 thousand and \$4,654 thousand for the nine months ended June 30, 2010 and 2009, respectively.

Gross Margin

The Company's gross margin was 74.4% and 77.9%, respectively, for the nine months ended June 30, 2010 and 2009.

Operating Expenses

Operating expenses for the nine months ended June 30, 2010 amounted to \$5,683 thousand as compared to \$9,380 thousand for the nine months ended June 30, 2009. The decrease of \$3,697 thousand or 39.4% was primarily due to the curtailing of advertising costs during the nine months ended June 30, 2010. During the nine months ended June 30, 2010, the Company incurred \$2,000 thousand in advertising costs for a marketing promotion while during the nine months ended June 30, 2009, the Company incurred approximately \$6,737 thousand for a one-time marketing promotion. Other selling, general and administrative expenses increased 61.8% for the nine months ended June 30, 2010 as compared to the nine months ended June 30, 2009.

Provision for Income Taxes

Provision for income taxes was \$2,221 thousand and \$0 for the nine months ended June 30, 2010 and 2009, respectively. The Company's continuing business operations are estimated to be subject to PRC and Hong Kong income taxes of approximately 18% for the nine months ended June 30, 2010. For the nine months ended June 30, 2009, the Company's continuing business operations were not subject to any income taxes due to a PRC tax holiday and minimal operations in Hong Kong.

Net Income

Net income for the nine months ended June 30, 2010 was \$4,455 thousand as compared to \$7,395 thousand for the nine months ended June 30, 2009. Net income from continuing operations was \$9,493 thousand and \$5,588 thousand for the nine months ended June 30, 2010 and 2009, respectively. Net (loss) income from discontinued operations was \$(5,038) and \$1,807 thousand for the nine months ended June 30, 2010 and 2009, respectively.

Basic and Diluted Income per Share for Continuing Operations

The Company's basic net income per share for continuing operations was \$1.45 and \$3.28 for the nine months ended June 30, 2010 and 2009, respectively.

The Company's diluted net income per share for continuing operations was \$1.43 and \$3.28 for the nine months ended June 30, 2010 and 2009, respectively. A total of 170,200 shares of common stock are potentially issuable upon the exercise of stock warrant or stock option agreements as of June 30, 2010.

Basic and Diluted (Loss) Income per Share for Discontinued Operations

The Company's basic net (loss) income per share for discontinued operations was \$(0.77) and \$1.06 for the nine months ended June 30, 2010 and 2009, respectively.

The Company's diluted net (loss) income per share for discontinued operations was \$(0.77) and \$1.06 for the nine months ended June 30, 2010 and 2009, respectively. A total of 170,200 shares of common stock are potentially issuable upon the exercise of stock warrant or stock option agreements as of June 30, 2010.

The following tables set forth key components of the Company's results of operations for the three months ended June 30, 2010 and June 30, 2009, respectively. All numbers referenced herein are "in thousands".

Edgar Filing: SUBAYE, INC. - Form 10-Q

For the Three Months Ended June 30, 2010 Compared to the Three Months Ended June 30, 2009
(In Thousands, Except per Share Data)

| | 2010 | 2009 |
|--|-----------|-----------|
| Revenues | \$ 9,068 | \$ 6,829 |
| Costs of Sales | 2,745 | 1,415 |
| Gross Profit | 6,323 | 5,414 |
| Total Operating Expenses | 2,272 | 822 |
| Income From Continuing Operations Before Income Taxes | 4,051 | 4,592 |
| Provision for Income Taxes | (772) | - |
| Income From Continuing Operations | \$ 3,279 | \$ 4,592 |
| Loss from Discontinued Operations | (1,411) | (326) |
| Net Income | \$ 1,868 | \$ 4,266 |
| Net Income Attributable to the Noncontrolling Interest | - | (1,525) |
| Net Income Attributable to Subaye | \$ 1,868 | \$ 2,741 |
| Basic Earnings Per Share, Continuing Operations | \$ 0.44 | \$ 2.58 |
| Diluted Earnings Per Share, Continuing Operations | \$ 0.43 | \$ 2.58 |
| Basic (Loss) Earnings Per Share, Discontinued Operations | \$ (0.19) | \$ (0.18) |
| Diluted (Loss) Earnings Per Share, Discontinued Operations | \$ (0.19) | \$ (0.18) |

Revenues

Revenues for the three months ended June 30, 2010 were \$9,068 thousand as compared to \$6,829 thousand for the three months ended June 30, 2009. The increase of \$2,239 thousand, or 32.8%, was due to the increase in revenues from both the Video Showcase Product and the Cloud Product. Video Showcase Product revenues for the three months ended June 30, 2010 increased to \$7,164 thousand as compared to \$5,659 thousand for the three months ended June 30, 2009, an increase of \$1,505 thousand over the same period a year ago, representing an increase of 26.6%. Cloud Product revenues increased to \$1,904 thousand for the three months ended June 30, 2010 as compared to \$1,170 thousand for the three months ended June 30, 2009, an increase of 62.7%. The Company's paying customers for the Video Showcase Product increased to 34,382 as of June 30, 2010, a 56.1% increase over the paying customers as of March 31, 2010. The Company recognizes revenues on a pro-rata daily basis. In recent months the Company's paying membership growth has increased substantially. There is an inherent lag in the recognition of the additional revenues resulting from the Company's accounting policy for recognizing revenues on a pro-rata daily basis.

Costs of Sales

Costs of sales for the three months ended June 30, 2010 were \$2,745 thousand as compared to \$1,415 thousand for the three months ended June 30, 2009. The increase of \$1,330 thousand, or 94.0%, was primarily due to additional costs of sales associated with the stock based compensation to the Company's new Agents in certain Chinese provinces. Stock based compensation included in costs of sales was \$555 thousand and \$0 for the three months ended June 30, 2010 and 2009, respectively. Depreciation and amortization of websites, software and hardware totaled \$1,821 and \$1,837 for the three months ended June 30, 2010 and 2009, respectively.

Gross Margin

The Company's gross margin was 69.7% and 79.3%, respectively, for the three months ended June 30, 2010 and 2009, respectively.

Operating Expenses

Operating expenses for the three months ended June 30, 2010 amounted to \$2,272 thousand as compared to \$822 thousand for the three months ended June 30, 2009. The increase of \$1,450 thousand or 176.4% was primarily due to increased advertising costs during the three months ended June 30, 2010. During the three months ended June 30, 2010, the Company incurred \$1,000 thousand in advertising costs for a marketing promotion while during the three months ended June 30, 2009, the Company incurred only \$110 thousand for internet advertising promotions. Other selling, general and administrative expenses increased 78.2% for the three months ended June 30, 2010 as compared to the three months ended June 30, 2009.

Provision for Income Taxes

Provision for income taxes was \$772 thousand and \$0 for the three months ended June 30, 2010 and 2009, respectively. The Company's continuing business operations are estimated to be subject to PRC and Hong Kong income taxes of approximately 18% for the three months ended June 30, 2010. For the three months ended June 30, 2009, the Company's continuing business operations were not subject to any income taxes due to a PRC tax holiday.

Net Income

Net income for the three months ended June 30, 2010 was \$1,868 thousand as compared to \$4,266 thousand for the three months ended June 30, 2009. Net income from continuing operations was \$3,279 thousand and \$4,592 thousand for the three months ended June 30, 2010 and 2009, respectively. Net loss from discontinued operations was \$(1,411) and \$(326) thousand for the three months ended June 30, 2010 and 2009, respectively.

Basic and Diluted Income per Share for Continuing Operations

The Company's basic net income per share for continuing operations was \$0.44 and \$2.58 for the three months ended June 30, 2010 and 2009, respectively.

The Company's diluted net income per share for continuing operations was \$0.43 and \$2.58 for the three months ended June 30, 2010 and 2009, respectively. A total of 170,200 shares of common stock are potentially issuable upon the exercise of stock warrant or stock option agreements as of June 30, 2010.

Basic and Diluted Los per Share for Discontinued Operations

The Company's basic net loss per share for discontinued operations was \$(0.19) and \$(0.18) for the three months ended June 30, 2010 and 2009, respectively.

The Company's diluted net loss per share for discontinued operations was \$(0.19) and \$(0.18) for the three months ended June 30, 2010 and 2009, respectively. A total of 170,200 shares of common stock are potentially issuable upon the exercise of stock warrant or stock option agreements as of June 30, 2010.

Liquidity and Capital Resources

As of June 30, 2010, the Company's current assets were \$43,967 thousand and current liabilities were \$5,113 thousand. Cash and cash equivalents totaled \$2,082 thousand as of June 30, 2010. The Company's shareholders' equity at June 30, 2010 was \$64,953 thousand. The Company had cash provided by operating activities for the nine months ended June 30, 2010 and 2009 of \$15,130 thousand and \$2,711 thousand, respectively. The Company had net cash used in investing activities of \$13,803 thousand and \$0 thousand for the nine months ended June 30, 2010 and 2009, respectively. During the nine months ended June 30, 2010, the Company incurred \$6,850 thousand in fees paid to a contractor to begin development work on a video search software application. The remaining balance was used to purchase new computer software licenses and computer hardware related to the Cloud Product. The Company had net cash provided by (used in) discontinued operations of \$956 thousand and \$(2,598) thousand for the nine months ended June 30, 2010 and 2009, respectively.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that will have a current or future effect on our financial condition and changes in financial condition during the fiscal year ending September 30, 2010.

Protection of Intellectual Property

As of June 30, 2010, the Company held \$11,517 thousand in copyrights covering programming rights for movies, internet broadcasts, DVDs and television programming originally created in the PRC. These assets are included within the Company's balance sheets as Assets Held for Sale. The Company cannot guarantee that if a competitor or anyone else were to commence litigation against the Company, the Company would be able to adequately defend the Company's position and retain ownership and value in the intellectual property.

Capital Requirements

In the past several years, the Company has raised cash by issuing equity securities. Although management is attempting to raise capital through the sale of the assets of its discontinued businesses, management may determine that additional financing is necessary, and the Company may or may not be able to find adequate sources of financing in the future.

Trends, Events, and Uncertainties

The present demand for our products will be dependent on, among other things, market acceptance of the Company's concept, the quality of its products, and general economic conditions which are cyclical in nature. The Company's business operations may be adversely affected by increased competition and any slowdown in the economic expansion currently underway in the PRC.

Dividends

The Company does not expect to pay dividends for the foreseeable future.

Critical Accounting Policies and Estimates

The discussion and analysis of our results of operations and liquidity and capital resources are based on our consolidated financial statements, which have been prepared in accordance with GAAP. In connection with the preparation of consolidated financial statements, the Company is required to make assumptions and estimates about future events, and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures. The assumptions, estimates and judgments included within these estimates are based on historical experience, current trends and other factors we believe to be relevant at the time the consolidated financial statements were prepared. On a regular basis, the accounting policies, assumptions, estimates and judgments are reviewed to ensure that the consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from the assumptions and estimates, and such differences could be material.

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but are not limited to: (1) asset impairments and (2) depreciable lives of assets. Future events and their effects cannot be predicted with certainty, and accordingly, accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of the consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. We evaluate and update these assumptions and estimates on an ongoing basis and may employ outside experts to assist with these evaluations. Actual results could differ from the estimates that have been used.

Significant accounting policies are discussed in Note 1, Summary of Significant Accounting Policies, to the accompanying consolidated financial statements. We believe the following accounting policies are the most critical to aid in fully understanding and evaluating our reported financial results, as they require management to make difficult, subjective or complex judgments, and to make estimates about the effect of matters that are inherently uncertain.

| Description | Judgments and Uncertainties | Effect if Actual Results Differ from Assumptions |
|--|--|---|
| Impairment of Long Lived Assets | | |
| The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below | These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to | Estimates contemplated by the Company with regard to the recoverability of carrying amounts for its long lived assets may prove to be inaccurate, in which case property, plant and equipment may be understated or overstated. In the future, if property, plant and equipment are determined to be overvalued, the Company would be |

the carrying amounts.

precisely estimate selling price because quoted market prices for the Company's assets or cash-generating units are not readily available. In determining the value in use, expected cash flows generated by the asset or the cash-generating unit are discounted to their present value, which requires significant judgment relating to level of sales volume, selling price and amount of operating costs. The Company uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of sales volume, selling price and amount of operating costs.

required to recognize such costs in operating expenses at the time of such determination. Likewise, if property, plant and equipment are determined to be undervalued, operating expenses may have been over-reported in previous periods and the Company would be required to recognize such additional operating income at the time of sale.

4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-15(e)) under the Exchange Act) that is designed to ensure that information required to be disclosed by the Company in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Exchange Act, the Company carried out an evaluation with the participation of the Company's management, the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the nine months ended June 30, 2010. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of June 30, 2010, our disclosure controls and procedures were not effective at the reasonable assurance level due to the material weaknesses described below.

In light of the material weaknesses described below, we performed additional analysis and other post closing procedures to ensure our financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, we believe that the financial statements included in this report fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented.

A material weakness is a control deficiency (within the meaning of the Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5) or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management has identified the following three material weaknesses which have caused management to conclude that, as of June 30, 2010, our disclosure controls and procedures were not effective, including (i) the number of audit adjustments recorded for the fiscal year ended September 30, 2009 and 2008, (ii) a lack of segregation of duties, and (iii) weaknesses related to document control.

Remediation of Material Weaknesses

To remediate the material weaknesses in our disclosure controls and procedures identified above, we are developing a plan to ensure that all information will be recorded, processed, summarized and reported accurately, and as of the date of this report, we have taken the following steps to address the above-referenced material weaknesses in our internal control over financial reporting:

1. We will continue to educate our management personnel to comply with the disclosure requirements of Securities Exchange Act of 1934 and Regulation S-K; and
2. We will increase management oversight of accounting and reporting functions in the future.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes in the Company's internal control over financial reporting have come to management's attention during the Company's last fiscal quarter that have materially affected, or are likely to materially affect, the Company's

internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We may be involved in litigation, negotiation and settlement matters that may occur in our day-to-day operations. Management does not believe the implication of this type of litigation will have a material impact on our consolidated financial statements.

ITEM 1A. RISK FACTORS

As of the date of this filing, except for the addition of the specific risk factor below, there have been no material changes from the risk factors previously disclosed in our "Risk Factors" in the Form 10-K for the period ended September 30, 2009. An investment in our common stock involves various risks. When considering an investment in our common stock, you should consider carefully all of the Risk Factors described in our most recent Form 10-K. These risks and uncertainties are not the only ones facing us and there may be additional matters that we are unaware of or that we currently consider immaterial. All of these could adversely affect our business, financial condition, results of operations and cash flows and, thus, the value of an investment in our Company.

We may be unsuccessful in our attempt to sell our PRC entertainment business or the individual assets that make up the PRC entertainment business.

At the time that the Company decided to discontinue its entertainment media business segment, the Company was left with \$15,413 thousand of intellectual property, namely copyrights to PRC entertainment assets. The Company is attempting to sell these assets and has been successful selling similar assets in the past. However, the Company can not be certain that it will be able to sell these assets for the full current carrying value of the assets or that any transaction whereby credit is offered to potential purchasers of the assets will be free from default risk. If we are unable to sell such assets, it could negatively impact the Company's finances.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS

(a) Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certification (CEO) ++

31.2 Rule 13a-14(a)/15d-14(a) Certification (CFO) ++

32.1 Section 1350 Certification (CEO) ++

32.2 Section 1350 Certification (CFO) ++

11

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUBAYE, INC.

Date: August 16, 2010

By:

/s/ Zhiguang Cai
Zhiguang Cai
Chief Executive Officer and
President
(Principal Executive Officer)

Date: August 16, 2010

By:

/s/ James T. Crane
James T. Crane
Chief Financial Officer
(Principal Financial and Accounting
Officer)