
**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, 2004

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 0-30961

Sohu.com Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

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

**Suite 1519, Tower 2
Bright China Chang An Building
7 Jianguomen Nei Avenue
Beijing 100005
People's Republic of China
86-10-6510-2160**

(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE,
OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Class	Outstanding at July 31, 2004
Common stock, \$.001 par value	36,365,529

[Table of Contents](#)

SOHU.COM INC
Table of Contents

	<u>PAGE</u>
PART I	FINANCIAL INFORMATION
Item 1	Condensed Consolidated Financial Statements (unaudited) 3
	Condensed Consolidated Balance Sheets as of June 30, 2004 (unaudited) and December 31, 2003 3
	Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2004 and 2003 (unaudited) 4
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2004 and 2003 (unaudited) 5
	Condensed Consolidated Statement of Shareholders' Equity for the Six Months Ended June 30, 2004 and 2003 (unaudited) 6
	Notes to Condensed Consolidated Financial Statements 7
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations 11
Item 3	Quantitative and Qualitative Disclosure About Market Risk 34
Item 4	Controls and Procedures 35
PART II	OTHER INFORMATION
Item 1	Legal Proceedings 35
Item 2	Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities 35
Item 3	Defaults Upon Senior Securities 36
Item 4	Submission of Matters to a Vote of Security Holders 36
Item 5	Other Information 36
Item 6	Exhibits and Reports on Form 8-K 36
	SIGNATURES 37
	Exhibit Index 38

[Table of Contents](#)

PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

SOHU.COM INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	June 30, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 94,583	\$ 99,109
Accounts receivable, net	19,528	12,381
Prepaid and other current assets	4,344	4,050
Current portion of long-term investments in marketable debt securities	9,999	29,245
	<hr/>	<hr/>
Total current assets	128,454	144,785
Long-term investments in marketable debt securities	25,474	14,216
Fixed assets, net	9,223	6,846
Goodwill	39,453	31,664
Intangible assets, net	12,543	4,082
Other assets, net	3,178	3,462
	<hr/>	<hr/>
	\$ 218,325	\$ 205,055
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,571	\$ 1,101
Accrued liabilities	30,069	22,315
	<hr/>	<hr/>
Total current liabilities	31,640	23,416
Zero coupon convertible senior notes	90,000	90,000
	<hr/>	<hr/>
Total liabilities	121,640	113,416
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock: \$0.001 par value per share (75,400 authorized, 36,326 and 36,101 shares issued and outstanding at June 30, 2004 and December 31, 2003)	36	36
Additional paid-in capital	142,911	140,218
Treasury Stock	(19,724)	(2,003)
Deferred compensation	(1)	(14)
Accumulated other comprehensive income/(loss)	(516)	232
Accumulated deficit	(26,021)	(46,830)
	<hr/>	<hr/>
Total shareholders' equity	96,685	91,639
	<hr/>	<hr/>
	\$ 218,325	\$ 205,055
	<hr/>	<hr/>

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

SOHU.COM INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands except per share data)

	Three Months Ended		Six Months Ended	
	Jun. 30, 2004	Jun. 30, 2003	Jun. 30, 2004	Jun. 30, 2003
Revenues:				
Advertising (including \$121, \$0, \$245 and \$0 from related parties, respectively)	\$ 13,382	\$ 6,801	\$ 24,396	\$ 11,277
Non-advertising:				
Wireless (including \$0, \$10,967, \$0 and \$19,455 from related parties, respectively)	11,316	10,979	23,561	19,467
E-commerce (including \$0, \$984, \$0, and \$2,159 from related parties, respectively)	1,370	984	2,689	2,159
Other (including \$0, \$268, \$0 and \$334 from related parties, respectively)	1,199	585	2,556	857
Subtotal of non-advertising revenues	13,885	12,548	28,806	22,483
Total revenues	27,267	19,349	53,202	33,760
Cost of revenues:				
Advertising (including \$0, \$36, \$0 and \$72 from related parties, respectively)	3,372	1,750	6,160	3,352
Non-advertising:				
Wireless (including \$0, \$3,266, \$0 and \$5,767 from related parties, respectively)	4,132	3,266	8,313	5,767
E-commerce (including \$31, \$891, \$66 and \$1,899 from related parties, respectively)	1,346	891	2,632	1,899
Other (including \$0, \$282, \$0 and \$427 from related parties, respectively)	386	364	754	509
Subtotal of non-advertising cost of revenues	5,864	4,521	11,699	8,175
Total cost of revenues	9,236	6,271	17,859	11,527
Gross profit	18,031	13,078	35,343	22,233
Operating expenses:				
Product development	2,091	1,926	3,971	3,674
Sales and marketing	4,261	2,528	7,382	4,527
General and administrative	1,752	1,312	3,324	2,394
Amortization of intangibles	360	—	537	—
Total operating expenses	8,464	5,766	15,214	10,595
Operating profit	9,567	7,312	20,129	11,638
Other expense	(196)	(129)	(404)	(191)
Interest income	578	343	1,208	670
Net income before taxes	9,949	7,526	20,933	12,117
Income tax expense	70	—	124	—
Net income	9,879	7,526	20,809	12,117
Basic net income per share	\$ 0.27	\$ 0.21	\$ 0.57	\$ 0.35
Shares used in computing basic net income per share	36,349	35,286	36,302	35,020
Diluted net income per share	\$ 0.25	\$ 0.19	\$ 0.52	\$ 0.31
Shares used in computing diluted net income per share	40,893	40,036	40,939	39,405

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

SOHU.COM INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Six Months Ended	
	June 30, 2004	June 30, 2003
Cash flows from operating activities:		
Net income	\$ 20,809	\$ 12,117
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of other assets	2,758	2,410
Amortization of intangible assets	537	—
Other	415	125
Changes in assets and liabilities:		
Accounts receivable	(6,958)	(2,115)
Accounts receivable from a related party	—	(6,006)
Prepaid and other current assets	(542)	(470)
Accounts payable	272	223
Payable to related parties	—	(721)
Accrued liabilities	6,780	7,402
Net cash provided by operating activities	24,071	12,965
Cash flows from investing activities:		
Acquisition, net of cash acquired	(16,920)	—
Long term investments in marketable debt securities	7,242	1,120
Acquisition of fixed assets	(3,458)	(1,423)
Acquisition of other assets	(304)	(1,418)
Net cash used in investing activities	(13,440)	(1,721)
Cash flows from financing activities:		
Repurchase of common stock	(17,721)	—
Issuance of common stock	2,564	1,075
Net cash provided by/(used in) financing activities	(15,157)	1,075
Net increase/(decrease) in cash and cash equivalents	(4,526)	12,319
Cash and cash equivalents at beginning of period	99,109	18,929
Cash and cash equivalents at end of period	\$ 94,583	\$ 31,248

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

SOHU.COM INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(Unaudited, in thousands)

	Six Months Ended	
	June 30, 2004	June 30, 2003
Common stock		
Balance, beginning of period	\$ 36	\$ 35
Issuance of common stock	—	1
Balance, end of period	36	36
Additional paid-in capital		
Balance, beginning of period	140,218	129,881
Issuance of common stock	2,570	1,143
Tax benefit from stock options	124	—
Compensatory stock options	(1)	(30)
Balance, end of period	142,911	130,994
Treasury stock		
Balance, beginning of period	(2,003)	(2,003)
Repurchase of common stock	(17,721)	—
Balance, end of period	(19,724)	(2,003)
Accumulated deficit		
Balance, beginning of period	(46,830)	(73,187)
Net income	20,809	12,117
Balance, end of period	(26,021)	(61,070)
Accumulated other comprehensive income/(loss)		
Balance, beginning of period	232	547
Net unrealized gains/(losses) on marketable debt securities	(750)	12
Foreign currency translation adjustment	2	(2)
Balance, end of period	(516)	557
Deferred Compensation		
Balance, beginning of period	(14)	(42)
Compensatory stock options	13	17
Balance, end of period	(1)	(25)
Total stockholders' equity	\$ 96,685	\$ 68,489
Comprehensive Income:		
Net Income	20,809	12,117
Other comprehensive income/(loss):		
Net unrealized gains/(losses) on marketable debt securities	(750)	12
Foreign currency translation adjustment	2	(2)
Total comprehensive income	20,061	12,127
Number of Shares		
Common stock		
Balance, beginning of period	36,101	34,611
Issuance of common stock	1,225	1,009
Repurchase of common stock	(1,000)	—
Balance, end of period	36,326	35,620

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

SOHU.COM INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. THE COMPANY AND BASIS OF PRESENTATION

Sohu.com Inc., (the “Company”) is a leading provider of comprehensive online products and services to consumers and businesses in the People’s Republic of China (the “PRC” or “China”). The Company, a Delaware corporation, commenced operations in 1996.

The accompanying unaudited consolidated interim financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. Results for the three and six months ended June 30, 2004 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

These financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2003.

2. SEGMENT INFORMATION

During the three months ended June 30, 2004, the Company revised its segment reporting and has reclassified results from e-subscription services other than wireless services to other non-advertising operations and reports wireless as its own segment. The Company mainly operates in three principal segments: advertising, wireless and e-commerce. The amounts for prior periods have been reclassified to conform to current period presentation.

The Company does not allocate any operating costs, including Web site operating costs, or assets to its wireless and e-commerce segments as management does not use this information to measure the performance of the operating segments. The segment information has been included in the condensed consolidated statements of operations (unaudited) for the three and six months ended June 30, 2004 and 2003, respectively.

3. REPURCHASE OF SHARES

In April 2004, the Board of Directors of the Company approved a stock repurchase program pursuant to which the Company plans to purchase from time to time up to \$30,000,000 worth of outstanding shares of its common stock in the open market. During the three months ended June 30, 2004, the Company repurchased one million shares of its common stock at an average price of \$17.72. The one million shares are no longer outstanding and are being held as treasury stock. Treasury stock is accounted for under the cost method.

4. ACQUISITION

On May 31, 2004, the Company, through Sohu.com Limited and its variable interest entities, Beijing Century High Tech Co. Ltd. and Beijing Sohu Internet Information Service Co., Ltd., completed the acquisition of all of the outstanding capital stock of Beijing Goodfeel Information Technology Co., Ltd., a company incorporated in the PRC, and Marvel Hero Limited, a company incorporated in Hong Kong (collectively “Goodfeel”) for total consideration of \$18,153,000 consisting of the purchase price of \$18,000,000 in cash and estimated other acquisition costs of \$153,000. Goodfeel engages in web application protocol services, consisting mainly of ring tone downloads, to mobile phone users in the PRC. The acquisition has been accounted for as a purchase business combination and the results of operations from the acquisition date have been included in the Company’s consolidated financial statements.

[Table of Contents](#)

The allocation of the purchase price is as follows (in thousands):

Tangible assets acquired	\$ 2,176
Identifiable intangible assets	8,742
Goodwill	7,681
	<hr/>
Liabilities assumed	(446)
	<hr/>
Total	\$18,153

The excess of purchase price over tangible and identifiable intangible assets acquired and liabilities assumed was recorded as goodwill. Identifiable intangible assets associated with the acquisition are amortized over their expected useful lives. The allocation of the purchase price is based on preliminary valuation amounts which are expected to be finalized in the third quarter of 2004.

The goodwill and intangible assets associated with the acquisition are related to the wireless segment.

5. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of shares issuable upon the exercise of stock options (using the treasury stock method) and zero coupon convertible senior notes.

The following table presents the calculation of basic and diluted net income per share (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Numerator:				
Net income	\$ 9,879	\$ 7,526	\$ 20,809	\$ 12,117
Effect of dilutive securities:				
Liquidated damages	107	—	157	—
Amortization of offering costs for the zero coupon convertible senior notes	202	—	400	—
Net income adjusted for dilutive securities	\$ 10,188	\$ 7,526	\$ 21,366	\$ 12,117
Denominator:				
Weighted average basic common shares outstanding	36,349	35,286	36,302	35,020
Effect of dilutive securities:				
Stock options	2,533	4,750	2,626	4,385
Zero coupon convertible senior notes	2,011	—	2,011	—
Weighted average diluted common shares outstanding	40,893	40,036	40,939	39,405
Basic net income per share	\$ 0.27	\$ 0.21	\$ 0.57	\$ 0.35
Diluted net income per share	\$ 0.25	\$ 0.19	\$ 0.52	\$ 0.31

6. STOCK BASED COMPENSATION

The following table illustrates the effect on net income and income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 “Accounting for Stock-Based Compensation” to stock-based employee compensation for the three and six months ended June 30, 2004 and 2003 (in thousands except per share data):

	Three Months Ended		Six Months Ended	
	Jun. 30, 2004	Jun. 30, 2003	Jun. 30, 2004	Jun. 30, 2003
Net income as reported:	\$ 9,879	\$ 7,526	\$ 20,809	\$ 12,117
Add: Stock-based compensation expense included in reported net income	7	6	12	(12)
Deduct: Stock-based compensation expense determined under fair value based method	(1,478)	(665)	(2,947)	(1,378)
Pro forma net income attributable to common shareholders	\$ 8,408	\$ 6,867	\$ 17,874	\$ 10,727
Basic net income per share:				
As reported	\$ 0.27	\$ 0.21	\$ 0.57	\$ 0.35
Pro forma	\$ 0.23	\$ 0.19	\$ 0.49	\$ 0.31
Diluted net income per share:				
As reported	\$ 0.25	\$ 0.19	\$ 0.52	\$ 0.31
Pro forma	\$ 0.21	\$ 0.17	\$ 0.44	\$ 0.27

7. VARIABLE INTEREST ENTITIES (“VIEs”) AND RELATED PARTY TRANSACTIONS

(1) VIEs

The Company has adopted FASB Interpretation No. 46 “*Consolidation of Variable Interest Entities*” (“FIN46”). FIN 46 requires a VIE to be consolidated by a company if that company is the primary beneficiary of that VIE.

To satisfy PRC laws and regulations, the Company conducts its Internet information, wireless, Internet access, e-commerce and certain other businesses in the PRC via its VIEs. These VIEs are directly or indirectly owned by Dr. Charles Zhang (“Dr. Zhang”), the Company’s Chairman, Chief Executive Officer and a major Sohu shareholder, and certain employees of the Company. Capital for the VIEs is funded by the Company through loans provided to Dr. Zhang and the employees, and is initially recorded as loans to related parties. These loans are eliminated for accounting purposes with the capital of VIEs during consolidation.

Under contractual agreements with the Company, Dr. Zhang and other Sohu employees who are shareholders of the VIEs are required to transfer their ownership in these entities to the Company, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Company at any time to repay the loans outstanding. All voting rights of the VIEs are assigned to the Company, and the Company has the right to designate all directors and senior management personnel of the VIEs. Dr. Zhang and the other Sohu employees who are shareholders of the VIEs have pledged their shares in the VIEs as collateral for the loans. As of June 30, 2004, the amount of these loans amounted to \$5.2 million.

The following is a summary of the VIEs of the Company:

- a) Beijing Sohu Online Information Service Co., Ltd. (“Beijing Sohu”)

Beijing Sohu was incorporated in the PRC in 2000 and engages in Internet information, wireless and e-commerce services in the PRC on behalf of the Company. The registered capital of Beijing Sohu is \$242,000. Dr. Zhang and He Jinmei, another employee of the Company, hold 80% and 20% interests in Beijing Sohu, respectively.
- b) Beijing Century High Tech Investment Co., Ltd. (“High Century”)

High Century was incorporated in the PRC in 2001 and engages in investment holding in the PRC on behalf of the Company. The registered capital of High Century is \$4,595,000. Dr. Zhang and Li Wei, another employee of the Company, hold 80% and 20% interests in High Century, respectively.

Table of Contents

- c) Beijing Hengda Yitong Internet Technology Development Co., Ltd. (“Hengda”)
Hengda was incorporated in the PRC in 2002 and engages in Internet access and wireless services in the PRC on behalf of the Company. The registered capital of Hengda is \$1,210,000. High Century and He Jinmei hold 80% and 20% interests in Hengda, respectively.
- d) Beijing Sohu Internet Information Service Co., Ltd. (“Sohu Internet”)
Sohu Internet was incorporated in the PRC in 2003 and engages in Internet information and wireless services in the PRC on behalf of the Company. The original registered capital was \$605,000 and High Century and Li Wei held 80% and 20% interests in Sohu Internet, respectively. Hengda made a \$605,000 investment in Sohu Internet in December 2003, and, as a result, the registered capital is now \$1,210,000, with Hengda, High Century and Li Wei holding 50%, 40% and 10% interests, respectively.
- e) Beijing Goodfeel Information Technology Co., Ltd. (“Goodfeel”)
Goodfeel was incorporated in the PRC in 2001 and engages in value added wireless services in the PRC. The registered capital of Goodfeel is \$121,000. In May 2004, High Century and Sohu Internet acquired 73% and 27% interests in Goodfeel, respectively.

Pursuant to FIN 46, Beijing Sohu, High Century, Hengda, Sohu Internet, and Goodfeel are VIEs and the Company is the primary beneficiary. Accordingly, effective July 1, 2003, the VIEs have been consolidated in the Company’s financial statements.

As of June 30, 2004, the aggregate accumulated losses of the above VIEs were approximately \$635,000 and have been reflected in the consolidated financial statements.

(2) Related party transactions

Effective July 1, 2003, the VIEs have been consolidated in the Company’s financial statements. The Company has not restated earlier periods for the adoption of FIN 46. Thus, prior to July 1, 2003, the VIEs were not consolidated in the Company’s financial statements and transactions with and balances related to the VIEs have been disclosed as related party transactions.

Table of Contents

The following table summarized related party transactions during the three and six months ended June 30, 2004 and 2003, respectively: (in thousands)

Name or description of Related party	Description of transactions	Three Months Ended		Six Months Ended	
		Jun. 30, 2004	Jun. 30, 2003	Jun. 30, 2004	Jun. 30, 2003
Beijing Sohu	Wireless revenues	\$ —	\$ 10,967	\$ —	\$ 19,455
Beijing Sohu	Wireless cost of revenues	—	3,266	—	5,767
Beijing Sohu	Ecommerce revenues	—	984	—	2,159
Beijing Sohu	Ecommerce cost of revenues	—	857	—	1,834
Beijing Sohu	Service provided by Beijing Sohu	—	36	—	72
Hengda	Other revenues from a related party	—	268	—	334
Hengda	Cost of other revenues	—	282	—	427
Qinfan, a company controlled by Dr. Zhang's brother	Delivery service provided by Qinfan	31	34	66	65
An investee of one of the Company's shareholders	Advertising revenues	97	—	215	—
A company whose founder, Chief Executive Officer and Chairman is one of the directors of the Company	Advertising revenues	24	—	30	—

8. COMMITMENTS AND CONTINGENCIES

The Chinese market in which the Company operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability of the Company to operate an Internet and wireless business and to offer content, advertising, and wireless services in China. Though China has, since 1978, implemented a wide range of market-oriented economic reforms, continued reforms and progress towards a full market-oriented economy are uncertain. In addition, the telecommunication, information, and media industries remain highly regulated. Restrictions are currently in place or are unclear regarding in what specific segments of these industries foreign owned entities, like the Company, may operate. The Company's legal structure and scope of operations in China could be subjected to restrictions which could result in severe limits to the Company's ability to conduct business in China.

During the three months ended June 30, 2004, the Company recorded expenses of \$ 697,000 related to notices of penalties and complaints from one of its mobile network operators based on allegations of the breach of certain provisions of the agreements with the mobile network operator. The actual penalties may differ from the amount recorded. However, management does not expect the difference, if any, to have a material impact on the Company's financial position, results of operations or cash flows.

On June 17, 2004, the Company, as a result of an unintentional technical error, breached its provisions of an agreement with one of its mobile network operators. The technical error was rectified soon after it was detected by the Company. On August 3, 2004, the Company was first informed by the operator about the operator's knowledge of the breach. The Company has subsequently commenced discussion with the operator regarding measures to be taken to ensure future compliance with the agreement, and potentially a penalty or some other punitive actions to be taken as a result of the breach. As the discussions are still ongoing, the Company can not assess the likely amount of any potential penalty, if any, or the nature of any other punitive actions. Hence, no provision was made for the breach during the three and six months ended June 30, 2004.

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

As used in this report, references to "us," "we," "our," "our company," "Sohu" and "Sohu.com" are to Sohu.com Inc., and, except where the context requires otherwise, our subsidiaries ChinaRen Inc. (or ChinaRen), Sohu.com (Hong Kong) Limited (or Sohu Hong Kong), Sohu.com Limited, Kylie Enterprises Limited, All Honest International Limited, Sohu ITC Information Technology (Beijing) Co., Ltd. (or Beijing ITC), Beijing Sohu New Era Information Technology Co., Ltd. (or Sohu Era), and Beijing Sohu Interactive Software Co., Ltd. (or Sohu Software), and our VIEs Beijing Sohu Online Network Information Services, Ltd. (or Beijing Sohu), Beijing Century High Tech Investment Co., Ltd. (or High Century), Beijing Hengda Yitong Internet Technology Development Co., Ltd. (or Hengda), Beijing Sohu Internet Information Service Co., Ltd. (or Sohu Internet), and Beijing Goodfeel Information Technology Co., Ltd. (or Goodfeel) and these references should be interpreted accordingly. Unless otherwise specified, references to "China" or "PRC" refer to the People's Republic of

[Table of Contents](#)

China and do not include the Hong Kong Special Administrative Region, the Macau Special Administrative Region or Taiwan. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words “expect,” “anticipate,” “intend,” “believe,” or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information set forth below under the caption “Risk Factors.” Readers are cautioned not to place undue reliance on these forward-looking statements.

OVERVIEW

We are a leading provider of comprehensive online products and services to consumers and businesses in China, through our comprehensive matrixes of web properties, consisting of the mass portal and leading online media destination www.sohu.com; the online alumni club www.chinaren.com; the games portal www.17173.com; one of the top real estate websites www.focus.cn; and wireless services provider www.goodfeel.com.cn. We offer our user community very broad choices regarding information, entertainment, communication, wireless and e-commerce. We derive revenues principally from advertising, wireless and e-commerce services.

We were incorporated in August 1996 as Internet Technologies China Incorporated, and launched our original Web site, itc.com.cn, in January 1997. During 1997, we developed Sohu online directory, search engine and related technology infrastructure, and also focused on recruiting personnel, raising capital and aggregating content to attract and retain users. In February 1998 we re-launched our Web site under the domain name sohu.com and in September 1999 we re-named our company Sohu.com Inc. Our business operations are conducted primarily through our indirect wholly owned subsidiaries, Beijing ITC and Sohu Era, and our variable interest entities Sohu Internet and Beijing Sohu.

CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe accounting for advertising revenue, accounting for wireless revenues and cost of revenues, e-commerce, gross versus net basis of revenue recognition, allowance for doubtful accounts, valuation allowance against deferred tax assets and assessment of impairment for goodwill and other intangible assets represent critical accounting policies that reflect more significant judgments and estimates used in the preparation of our consolidated financial statements.

We generate advertising revenue from standard, sponsorship and retail contracts, most of which are one year or less in duration. Such contracts establish the fixed price and advertising services to be provided. Pursuant to advertising contracts, we provide advertisement placements on various Web site channels and in different formats, including but not limited to banners, links, logos, buttons, content integration and email marketing. Revenue is recognized ratably over the period the advertising is provided and, as such, we consider the services to have been delivered. We treat all elements of advertising contracts as a single unit of accounting for revenue recognition purposes. Based upon our credit assessments of our customers prior to entering into contracts, we determine if collectibility is reasonably assured. In situations where collectibility is not deemed to be reasonably assured, we recognize revenue upon payment from the customer.

Sponsorship contracts may include services similar to those in our standard advertising contracts, are generally for larger dollar amounts and for a longer period of time, may allow advertisers to sponsor a particular area on our Web site, may include brand affiliation services and/or a larger volume of services, and may require some exclusivity or premier placements. Sponsorship advertisement revenues are normally recognized on a straight line basis over the contract period and when collection of the resulting receivable is reasonably assured provided we are meeting our obligations under the contract. Pursuant to retail advertising contracts, which are normally for lower dollar amounts and are with small and medium size enterprises, we provide services which include listings in our search directory or our classified advertisements section, normally for a fixed annual fee, and priority placements on search results for a fixed fee or variable pricing based on bidding by different competitors. For retail advertising contracts, revenue is recognized as the service is provided, which is normally on a straight line basis over the term of the contract, and collection of the resulting receivable is reasonably assured. Material differences could result in the amount and timing of our revenue for any period if management made different judgments or utilized different estimates.

[Table of Contents](#)

Wireless revenues and corresponding cost of revenues are included within non-advertising revenues and cost of revenues. Wireless revenues are derived from providing short messaging services (“SMS”), multimedia messaging services (“MMS”), web application protocol services (“WAP”) and interactive voice response services (“IVR”), mainly consisting of alumni club, GGMM, and other community products, e-mail, ring tone and logo downloads, news, and various other mobile related products, to mobile phone users. Wireless service fees are charged on a monthly or per message basis. Wireless revenues and cost of revenues are recognized in the month in which the service is performed, provided no significant Sohu obligations remain. We rely on a number of mobile network operators in China to bill mobile phone users for wireless service fees. In order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises from providing Internet information and value added telecommunication services such as wireless, we rely on Beijing Sohu and Sohu Internet to contract with the mobile operators. Generally, (i) within 15 to 90 days after the end of each month, Beijing Sohu or Sohu Internet receives a statement from each of the operators confirming the amount of wireless service charges billed to that operator’s mobile phone users and (ii) within 30 to 120 days after delivering a monthly statement to Beijing Sohu or Sohu Internet each operator remits the wireless service fees, net of its service fees, for the month to Beijing Sohu or Sohu Internet, which then transfers the funds to our subsidiary Sohu Era. In order to recognize revenue and get paid for services provided, we rely on billing confirmations from the mobile network operators as to the actual amount of services they have billed to their mobile customers. We do not collect wireless services fees from an operator in certain circumstances due to technical issues with the operator’s network. This is referred to as the “failure rate,” which can vary from operator to operator. At the end of each reporting period, where an operator has not provided Beijing Sohu or Sohu Internet with the monthly statement for any month confirming the amount of wireless service charges billed to that operator’s mobile phone users for the month, Sohu, using information generated from its own internal system and historical data, makes estimates of the failure rate and collectable wireless service fees and accrues revenue accordingly. The quarterly historical differences in our estimated revenue which was recorded in the financial statements compared to the actual revenue have ranged from an underestimation of \$400,000 (gross margin underestimate of \$300,000) to an overestimation of \$160,000 (gross margin overestimate of \$120,000) since 2002 when wireless revenues represented a significant portion of our total revenues. We believe we have the ability to make a reasonable estimate. However, material differences could result in the amount and timing of our revenue and non advertising cost of revenue for any period because of differences between the actual failure rate per an operator’s statement and our internal records. For the three months ended June 30, 2004, 91% of our wireless revenues had been confirmed by the monthly statements received from the mobile operators.

E-commerce revenues are earned from direct sales of consumer products through Sohu’s Web site. We rely on Beijing Sohu to conduct our e-commerce business to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises from providing e-commerce services. In 2001, we established store.sohu.com, where we undertake fulfillment e-commerce activities and conduct e-commerce transactions. Our e-commerce products consist of over 4,000 consumer products such as books, health care products, cosmetics, videos, music and computer equipment. We purchase products from suppliers, stock the goods in our warehouse and, upon receiving the orders from our Web site, arrange for delivery to our customers, most of whom are individuals in Beijing, Shanghai and Guangzhou. Fulfillment is provided by delivery companies or through postal services. Substantially all sales are done on a cash on delivery basis. Product sales include the right of return within 10 days after the goods have been received if the products have quality problems and the buyer has retained the original order form. We record product sales net of the estimated amount of returns. We estimate an amount of product returns that is not significant.

Our management must determine whether to record revenue for our wireless and e-commerce business lines using the gross or net method of reporting. Determining whether revenue should be reported gross or net is based on an assessment of various factors, principally whether Sohu is acting as the principal in offering services to the customer or whether Sohu is acting as an agent in the transaction. To the extent Sohu is acting as a principal in a transaction Sohu reports as revenue the payments received on a gross basis and reports as costs of revenue the amounts attributable to goods and services provided by third party operators and other vendors. To the extent Sohu is acting as an agent in a transaction Sohu reports as revenue the payments received less commissions and other payments to third parties, i.e., on a net basis. The determination of whether Sohu is serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement. Based on our assessment, our wireless revenues are recorded on a gross basis. We have primary responsibility for fulfillment and acceptability of the wireless services. The content and nature of the wireless services are designed and developed by us (either independently or with third parties) and originate from our Web sites, our links located on third parties’ Web sites, or one of our dedicated phone numbers. The mobile operators that we contract with to deliver these services to the end customers are not involved in the design or development of the services that are provided by us. The end customer purchases the wireless content, community access or value added services, such as our online dating, mobile email and mobile alumni club that Sohu provides. The end customer receives identical services from us regardless of which third party mobile

[Table of Contents](#)

operator is used to deliver the message. In addition, when customers register on Sohu's Web sites to use wireless services, they execute an online contract with us that sets forth our obligations to the customer and the terms of the service that will be provided. Sohu has determined that in addition to the indicators of gross reporting, there are also certain indicators of net reporting, including the fact that the mobile operators set maximum prices that Sohu can charge and that the contracts call for the assumption of credit risk by the mobile operators after a certain fixed percentage is paid by Sohu as an estimated bad debt expense. This is part of the overall fees paid to the operators. The mobile operators also have the right to set regulations and procedures associated with using their platform. However, Sohu has determined that the gross revenue reporting indicators are stronger, because Sohu is the primary obligor, adds value to the products, has inventory risk related to content and products, and has reasonable pricing latitude.

The majority of our e-commerce revenues are recorded on a gross basis where Sohu is the primary obligor but, depending on the terms of particular contracts with our suppliers, the net basis is also used. Sohu considers itself the primary obligor in situations where Sohu has general and physical inventory risk and where we can set prices without any involvement from the suppliers. Transactions related to certain technology products, such as cameras, computers and memory cards, are recorded on a net basis when the suppliers set minimum prices, Sohu does not have inventory risk, Sohu does not maintain inventory to meet estimated customer demand and Sohu orders goods from suppliers only after receiving orders from customers.

To the extent revenues are recorded gross, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross revenues, less expenses) flows through operating income. Accordingly, the impact on operating income is the same whether Sohu records the revenue on a gross or net basis.

Our management must make estimates of the uncollectability of our accounts receivables. Management specifically analyzes accounts receivable, historical bad debts, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our accounts receivable balance was \$19.5 million net of allowance for doubtful accounts of \$0.6 million as of June 30, 2004. If the financial condition of Sohu's customers or telecom operators were to deteriorate, resulting in their inability to make payments, additional allowance might be required.

As of June 30, 2004, substantially all of our deferred tax assets are related to United States net operating losses. Because substantially all of our income is earned in China, and we do not intend in the foreseeable future to repatriate this income to the United States where it would be taxable, we have recorded a full valuation allowance against our gross deferred tax assets in order to reduce our deferred tax assets to the amount that is more likely than not to be realized. If events were to occur in the future that would allow us to realize more of our deferred tax assets than the presently recorded net amount, an adjustment would be made to the deferred tax assets that would increase income for the period when those events occurred.

Our long-lived assets include goodwill and other intangible assets. We test goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis, and between annual tests when an event occurs or circumstances change that could more likely than not reduce the fair value of goodwill below its carrying value. Application of a goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit. Any impairment losses recorded in the future could have a material adverse impact on our financial condition and results of operations.

As of June 30, 2004, we did not believe that any event or change of circumstances had occurred that would result in material impairment losses in goodwill.

In respect of our intangible assets, which mainly comprise domain names and marks and customer lists, we amortize the costs over their expected future economic lives. Management judgment is required in the assessment of the economic lives. Based on the existence of one or more indicators of impairment, we measure any impairment of intangibles based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our business model. An impairment charge would be recorded if we determine that the carrying value of intangible assets may not be recoverable. Our estimates of future cash flows require significant judgment based on our historical results and anticipated results and are subject to many factors.

As of June 30, 2004, we were not aware of any indication of impairment of our intangible assets.

**RESULTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2004 AND 2003**

REVENUES

Total revenues were \$27.3 million and \$53.2 million for the three and six months ended June 30, 2004, respectively, as compared to \$19.3 million and \$33.8 million for the corresponding periods in 2003.

Advertising Revenues

Advertising revenues increased by \$6.6 million to \$13.4 million for the three months ended June 30, 2004 and increased by \$13.1 million to \$24.4 million for the six months ended June 30, 2004 as compared to the corresponding periods in 2003. The increase of \$6.6 million for the three months ended June 30, 2004 from the corresponding period in 2003 consisted of: (i) \$7.8 million from new advertisers, as more companies used the Internet as an advertising medium; (ii) a \$1.4 million increase in revenues from the advertisers who advertised with us in the three months ended June 30, 2003 and who continued to do so in the three months ended June 30, 2004; and (iii) a \$1.2 million increase in fees we receive for listing companies in our search directory, offset by a reduction of \$3.8 million in revenues from some of our 2003 advertisers not advertising on our Web site in the three months ended June 30, 2004. The increase of \$13.1 million for the six months ended June 30, 2004 from the corresponding period in 2003 consisted of: (i) \$13.7 million from new advertisers, as more companies used the Internet as an advertising medium; (ii) a \$2.5 million increase in revenues from the advertisers who advertised with us in the six months ended June 30, 2003 and who continued to do so in the six months ended June 30, 2004; and (iii) a \$2.2 million increase in fees we receive for listing companies in our search directory, offset by a reduction of \$5.3 million in revenues from some of our 2003 advertisers not advertising on our Web site in the six months ended June 30, 2004. No single customer accounted for more than 10% of total advertising revenues for each of the three and six months ended June 30, 2004 and 2003. We have not recorded any revenue from advertising barter transactions. As of June 30, 2004 and 2003, we had \$4.1 million and \$2.7 million of deferred revenues, respectively.

We expect advertising revenues to increase further in the third quarter of 2004 as compared to the second quarter of 2004.

Non-advertising Revenues

Non-advertising revenues are derived principally from monetizing our users (i.e. consumers) via wireless and e-commerce services.

Non-advertising revenues increased by \$1.3 million to \$13.9 million for the three months ended June 30, 2004 and increased by \$6.3 million to \$28.8 million for the six months ended June 30, 2004 as compared to the corresponding periods in 2003. Non-advertising revenues for the three and six months ended June 30, 2004 included non-advertising revenues from Beijing Sohu and Sohu Internet of \$12.7 million and \$26.3 million, respectively, as compared to \$12.0 million and \$21.6 million for the corresponding periods in 2003. Because of restrictions on foreign owned companies engaging in the PRC wireless and e-commerce industries, we have used Beijing Sohu and Sohu Internet to contract on our behalf with PRC mobile network operators who provide the gateway for our wireless services and collect our wireless service fees. Beijing Sohu and Sohu Internet collect the fees from the operators and then transfer them to our subsidiaries. There was no material impact on our revenues or margins from our reliance on these related party arrangements. On July 1, 2003, we prospectively adopted FIN 46, which resulted in the consolidation of our variable interest entities, including Beijing Sohu and Sohu Internet. Thus, wireless and e-commerce revenues earned by Beijing Sohu and Sohu Internet after this date are not disclosed as revenue from related parties.

Wireless. Wireless revenues increased by \$337,000 to \$11.3 million for the three months ended June 30, 2004 and increased by \$4.1 million to \$23.6 million for the six months ended June 30, 2004 as compared to the corresponding periods in 2003. The increase for the three months ended June 30, 2004 from the corresponding period in 2003 was primarily due to: (i) an increase of \$1.8 million in revenues from multimedia message services (“MMS”) and web application protocol (“WAP”); and (ii) revenues of \$0.5 million as a result of the acquisition of Goodfeel, offset by a decrease of \$2.0 million in revenues from short messaging services (“SMS”). The increase for the six months ended June 30, 2004 from the corresponding period in 2003 was primarily due to: (i) an increase of \$2.5 million in revenues from MMS and WAP; (ii) an increase of \$1.1 million in revenues from SMS and (iii) revenues of \$0.5 million as a result of the acquisition of Goodfeel.

As a result of tightened controls over new billing procedures and practices by China Mobile Cooperation Corporation (“CMCC”) and China Unicom Co., Ltd. (“Unicom”), and the high churn rate in some existing SMS products, we expect revenues from SMS to continue to decrease in the third quarter of 2004 as compared to the second quarter of 2004. We expect revenues from WAP and MMS to increase further in the quarter. We expect our overall wireless revenues to decrease in the third quarter of 2004 as compared to the second quarter of 2004. There could be further decreases in the future.

E-commerce. E-commerce revenues are earned primarily from sales of consumer products through Sohu’s Web site. In 2001, we established store.sohu.com, where we undertake fulfillment e-commerce activities and conduct e-commerce transactions. Our e-commerce products consist of over 4,000 consumer products, such as books, health care products, videos, music and computer equipment. We purchase products from suppliers, stock the

[Table of Contents](#)

goods in our warehouse and, upon receiving the orders, arrange for delivery to our customers. Fulfillment is provided by delivery companies or through postal services. Substantially all sales are done on a cash on delivery basis. E-commerce revenues increased by \$386,000 to \$1.4 million for the three months ended June 30, 2004 and increased by \$530,000 to \$2.7 million for the six months ended June 30, 2004 as compared to the corresponding periods in 2003.

Other services mainly include online games, Internet access, and our design of Web sites and provision of Internet software to third parties.

COSTS AND EXPENSES

Cost of Revenues

Total cost of revenues was \$9.2 million and \$17.9 million for the three and six months ended June 30, 2004, respectively, as compared to \$6.3 million and \$11.5 million for the corresponding periods in 2003.

Advertising Cost of Revenues

Advertising cost of revenues increased by \$1.6 million to \$3.4 million for the three months ended June 30, 2004 and increased by \$2.8 million to \$6.2 million for the six months ended June 30, 2004 as compared to the corresponding periods in 2003. Advertising cost of revenues includes personnel costs and personnel overhead, content purchases, depreciation and bandwidth. The increase for the three months ended June 30, 2004 from the corresponding period in 2003 was primarily due to a \$550,000 increase in office and depreciation expense, a \$448,000 increase in personnel expense, a \$252,000 increase in content and license fees, a \$196,000 increase in retail revenues sharing with partners, a \$95,000 increase in traveling and entertainment expenses and a \$59,000 increase in other items including training expense and professional fees. The increase for the six months ended June 30, 2004 from the corresponding period in 2003 was primarily due to a \$965,000 increase in office and depreciation expense, a \$738,000 increase in personnel expense, a \$497,000 increase in content and license fees, a \$325,000 increase in retail revenues sharing with partners, a \$151,000 increase in traveling and entertainment expenses, a \$132,000 increase in other items including training expense and professional fees. Our advertising gross margin for each of the three and six months ended June 30, 2004 was 75% as compared to 74% and 70% for the corresponding periods in 2003. Our gross margins improved because of the fixed nature of the advertising costs of revenues, which have not increased at the same rate as revenues.

Non-advertising Cost of Revenues

Non-advertising cost of revenues increased by \$1.3 million to \$5.9 million for the three months ended June 30, 2004 and increased by \$3.5 million to \$11.7 million for the six months ended June 30, 2004, as compared to the corresponding periods in 2003. The increases are consistent with revenue growth.

Wireless. Wireless cost of revenues increased by \$0.9 million to \$4.1 million for the three months ended June 30, 2004 and increased by \$2.5 million to \$8.3 million for the six months ended June 30, 2004, as compared to the corresponding periods in 2003. Wireless cost of revenues consists mainly of collection and wireless transmission charges paid to third party network operators, expenses related to notices of penalties and complaints from CMCC subsidiaries based on allegations of the breach of certain provisions of the agreements with the mobile network operators, and fees or royalties paid to third party content providers for services and content associated with our wireless services. The expenses related to notices of penalties and complaints from CMCC subsidiaries were \$697,000 and \$977,000 for the three and six months ended June 30, 2004, as compared to \$0 for the three and six months ended June 30, 2003. The fees paid to third party providers vary between third party operators and include a gateway fee of \$0.006 to \$0.0151 per message, depending on the volume of the monthly total wireless messages, and a collection fee of 15% to 30% of total fees collected by the third party operators from mobile phone users and paid to us. As the operator fees are charged on a per message basis and as a percentage of revenue, the increase in wireless cost of revenues is consistent with our increase in wireless revenues. Content costs are also included in wireless cost of revenues but are immaterial as compared to collection and transmission charges. Wireless cost of revenues does not include allocations for Web site operating costs. Our wireless gross margin was 63% and 65% for the three and six months ended June 30, 2004, respectively, as compared to 70% for each of the three and six months ended June 30, 2003. Wireless gross margin decreased because wireless cost of revenues increased at a higher rate than revenues. We expect wireless gross margins to decrease by a few points in the coming two quarters, after which gross margins are expected to stabilize.

On June 17, 2004, Sohu, as a result of an unintentional technical error, breached its provisions of an agreement with one of its mobile network operators. The technical error was rectified soon after it was detected by the company. On August 3, 2004, Sohu was first informed by the operator about the operator's knowledge of the breach. Sohu has subsequently commenced discussion with the operator regarding measures to be taken to ensure future compliance with the agreement, and potentially a penalty or some other punitive actions to be taken as a result of the breach. As the discussions are still ongoing, Sohu can not assess the likely amount of any potential penalty, if any, or the nature of any other punitive actions. Hence, no provision was made for the breach during the three and six months ended June 30, 2004.

E-commerce. E-commerce cost of revenues was \$1.3 million and \$2.6 million for the three and six months ended June 30, 2004, as compared to \$0.9 million and \$1.9 million for the three and six months ended June 30, 2003, respectively. E-commerce cost of revenues consists mainly of the purchase price of consumer products sold and inbound and outbound shipping charges. E-commerce cost of revenues does not include allocations for Web site operating costs. The change in e-commerce cost of revenues from the comparative period in 2003 is attributable to the change in sales volume. Our e-commerce gross margin was 2% for each of the three and six months ended June 30, 2004, respectively, as compared to 9% and 12% for the three and six months ended June 30, 2003. For the three months ended June 30, 2004, approximately six percentage points of the reduction in gross margin were attributable to our providing free delivery for orders greater than \$6 and approximately one percentage point of the reduction was attributable to our lowering sales prices of our products, both of which we instituted in response to product pricing pressures from our competitors in e-commerce, including Joyo, Bertelsmann Online and Dang Dang, and our initiative to gain market share among consumers in Beijing. For

[Table of Contents](#)

the six months ended June 30, 2004, approximately six percentage points of the reduction in gross margin were attributable to our providing free delivery for orders greater than \$6 and approximately four percentage points of the reduction were attributable to our lowering sales prices of our products.

Product Development Expenses

Product development expenses increased \$165,000 to \$2.1 million for the three months ended June 30, 2004 and increased \$297,000 to \$4.0 million for the six months ended June 30, 2004, as compared to the corresponding periods in 2003. The increase for the three months ended June 30, 2004 from the corresponding period in 2003 was primarily due to a \$242,000 increase in personnel expense for additional employees to support our increased investment in our products and online games development and a \$57,000 increase in other items of including traveling and entertainment expenses, professional fees and communications, offset by a \$134,000 decrease in office and depreciation expense. The increase for the six months ended June 30, 2004 from the corresponding period in 2003 was primarily due to a \$544,000 increase in personnel expense for additional employees and a \$100,000 increase in other items including traveling and entertainment expenses, professional fees and communications, offset by a \$347,000 decrease in office and depreciation expenses.

Sales and Marketing Expenses

Sales and marketing expenses increased \$1.7 million to \$4.3 million for the three months ended June 30, 2004 and increased \$2.9 million to \$7.4 million for the six months ended June 30, 2004, as compared to the corresponding periods in 2003. The increase for the three months ended June 30, 2004 from the corresponding period in 2003 was primarily due to a \$643,000 increase in advertising and promotion expense to support our marketing strategy, a \$436,000 increase in personnel expenses, primarily the result of increased bonuses and commissions from increased advertising revenues, a \$283,000 increase in bad debt expense, a \$215,000 increase in traveling and entertainment expenses, and a \$156,000 increase in other items including office and depreciation expense and professional fees. The increase for the six months ended June 30, 2004 from the corresponding period in 2003 was primarily due to a \$1.3 million increase in advertising and promotion expense, a \$731,000 increase in personnel expenses, primarily the result of increased bonuses and commissions, a \$336,000 increase in bad debt expense, a \$328,000 increase in traveling and entertainment expenses, and a \$160,000 increase in other items including office and depreciation expense and professional fees.

General and Administrative Expenses

General and administrative expenses increased by \$440,000 to \$1.8 million for the three months ended June 30, 2004 and increased by \$930,000 to \$3.3 million for the six months ended June 30, 2004, as compared to the corresponding periods in 2003. The increase for the three months ended June 30, 2004 was primarily due to a \$270,000 increase in personnel expenses, a \$67,000 increase in traveling and entertainment expenses, a \$103,000 increase in other items including office, depreciation and training expenses. The increase for the six months ended June 30, 2004 was primarily due to a \$472,000 increase in personnel expenses, a \$177,000 increase in professional fees, a \$85,000 increase in franchise taxes and stamp duties, and a \$196,000 increase in other items including office, depreciation and training expenses.

Amortization of Intangibles

Amortization of intangibles of \$360,000 and \$537,000 for the three and six months ended June 30, 2004, respectively, was related to the acquisitions of the Focus.cn and 17173.com Web sites in the fourth quarter of 2003 and of Goodfeel in the second quarter of 2004. There was no amortization of intangibles recorded during the three and six months ended June 30, 2003.

Operating Profit

As a result of the foregoing, we had an operating profit of \$9.6 million and \$20.1 million for the three and six months ended June 30, 2004 as compared to \$7.3 million and \$11.6 million for the three and six months ended June 30, 2003. The operating profit for the three and six months ended June 30, 2004 included \$7,000 and \$12,000 for stock-based compensation expense recorded on the grant of certain stock options, which amounts are being amortized over the vesting period of the options, ranging from one to four years. The operating profit for the three and six months ended June 30, 2003 included \$6,000 and negative \$12,000, respectively, for stock-based compensation expense recorded on the grant or cancellation of certain stock options.

Other Expense

For the three and six months ended June 30, 2004, other expense of \$196,000 and \$404,000, respectively, consisted mainly of amortization of the offering costs of our zero coupon convertible senior notes. For the three and six months ended June 30, 2003, other expense of \$129,000 and \$191,000, respectively, consisted mainly of valuation allowances for long-term loans to related parties.

Interest Income

For the three and six months ended June 30, 2004, interest income was \$578,000 and \$1.2 million, as compared to \$343,000 and \$670,000 for the three and six months ended June 30, 2003. The increases were mainly due to our increased cash balance and marketable securities as a result of our private placement of zero coupon convertible senior notes in July 2003 and an increase in our profits.

[Table of Contents](#)

Income Tax Expense

Income tax expense was \$70,000 and \$124,000 for the three and six months ended June 30, 2004 due to tax benefits from stock options and there was no income tax expense recorded for the corresponding periods in 2003.

Net Income

As a result of the foregoing, we had net income of \$9.9 million and \$20.8 million for the three and six months ended June 30, 2004, as compared to a net income of \$7.5 million and \$12.1 million for the corresponding periods in 2003.

SEGMENT INFORMATION

During the three months ended June 30, 2004, the Company revised its segment reporting and has reclassified results from e-subscription services other than wireless services to other non-advertising operations and reports wireless as its own segment. The Company mainly operates in three principal segments: advertising, wireless and e-commerce. The amounts for prior periods have been reclassified to conform to current period presentation.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations principally through private sales of equity securities and convertible notes, and cash provided by operations. From inception through June 30, 2004, we have raised net proceeds of \$39.2 million through the sale of preferred stock in private placements, \$52.4 million from the sale of common stock in our initial public offering and \$87.4 million through the sale of zero coupon convertible senior notes, as described below. Sohu invests its excess cash in marketable debt securities of high quality investment grade. As of June 30, 2004, we had cash, cash equivalents, and investments in marketable debt securities totaling approximately \$130.1 million as compared to \$142.6 million as of December 31, 2003.

We completed a private placement on July 14, 2003 of \$90.0 million principal amount of zero coupon convertible senior notes due July 2023, which resulted in net proceeds to Sohu of approximately \$87.4 million after deduction of the initial purchaser's discount and our offering expenses. The notes do not pay any interest, have a zero yield to maturity, and are convertible into Sohu's common stock at a conversion price of \$44.76 per share, subject to adjustment. Each \$1,000 principal of the notes is initially convertible into 22.3414 shares of Sohu's common stock. Each holder of the notes will have the right, at the holder's option, to require Sohu to repurchase all or any portion of the principal amount of the holder's notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. Sohu may also redeem all or a portion of the notes for cash at any time on or after July 14, 2008 at 100% of the principal amount of the notes if the closing price of Sohu's common stock for each of the 30 consecutive trading days prior to such time was at least 130% of the conversion price or at such time at least 90% of the initial aggregate principal amount of the notes have been converted, repurchased or redeemed. In addition, upon a change of control event, each holder of the notes may require Sohu to repurchase some or all of its notes at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. We have filed a registration statement with the Securities and Exchange Commission to register for resale the notes and the common stock issuable upon conversion of the notes, which registration statement was declared effective by the Securities and Exchange Commission on July 8, 2004. Because the registration statement was not declared effective by January 10, 2004, we have been and will be required to pay liquidated damages beginning January 11, 2004, consisting of interest on the outstanding principal of the notes at the initial annual rate of 0.25% for the first 90 days after January 10, 2004 and thereafter until July 8, 2004 at the annual rate of 0.50%.

In April 2004, our Board of Directors approved a stock repurchase program pursuant to which we plan to purchase from time to time up to \$30,000,000 worth of outstanding shares of our common stock in the open market. In May 2004, we repurchased one million shares of our common stock at an average price of \$17.752 including brokerage commissions. Under the program, we may purchase up to an additional \$12.2 million worth of outstanding shares of our common stock in the open market. Any such purchases will depend upon market conditions. Management does not believe the Repurchases will have a material effect on Sohu's liquidity.

Net cash provided by operating activities was approximately \$24.1 million for the six months ended June 30, 2004, and was primarily attributable to our net income of \$20.8 million, depreciation and amortization of \$3.3 million and \$415,000 of other adjustments for non-cash activities, offset by \$448,000 of cash used as working capital. Net cash provided by operating activities was \$13.0 million for the six months ended June 30, 2003, primarily due to \$12.1 million of our net income, \$2.4 million of depreciation and amortization and \$125,000 of other adjustments for non-cash activities, offset by \$1.7 million of cash used as working capital.

Net cash used in investing activities was \$13.4 million for the six months ended June 30, 2004, and was primarily attributable to 16.9 million used in the acquisition of Goodfeel, the purchase of fixed assets of \$3.4 million and addition of other assets of \$0.3 million, offset by cash received from matured marketable debts of \$7.2 million. Net cash used in investing activities was \$1.7 million for the six months ended June 30, 2003, primarily due to \$1.4 million of purchase of fixed assets and \$1.4 million of addition of other assets, offset by cash received from matured marketable debts of \$1.1 million.

[Table of Contents](#)

Net cash used in financing activities was \$15.2 million for the six months ended June 30, 2004 and was attributable to \$17.8 million of repurchases of one million shares of our common stock offset by \$2.6 million of proceeds from the issuance of common stock pursuant to our stock incentive plan. Net cash provided by financing activities for the six months ended June 30, 2003 was \$1.1 million of proceeds from the issuance of common stock pursuant to our stock incentive plan.

We believe that current cash and cash equivalents will be sufficient to meet anticipated working capital (net cash used in operating activities), commitments and capital expenditures for at least the next twelve months. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue.

At June 30, 2004, we have an unused credit facility whereby we can borrow up to \$15.0 million by providing marketable securities on deposit with the financial institution as collateral.

Risk Factors

We incurred net losses from inception through the second quarter of 2002, and losses could recur in the future.

We incurred significant net losses from our inception in August 1996 through the quarter ended June 30, 2002. We had an accumulated deficit of approximately \$26.0 million at June 30, 2004. We may incur substantial net losses in the future due to the relative high risk associated with our revenue and the high level of planned operating and capital expenditures, including sales and marketing costs, personnel hires, and product development. Although we recorded net profits from the quarter ended September 30, 2002 through the quarter ended June 30, 2004, we may not sustain profitability or our profitability could decrease.

We have a limited operating history, which may make it difficult for investors to evaluate our business.

We began offering products and services under the www.Sohu.com Web site in February 1998. Accordingly, we have a limited operating history upon which investors can evaluate our business. In addition, our senior management and employees have worked together at our company for only a relatively short period of time. As an early stage company in the new and rapidly evolving PRC Internet market, we face numerous risks and uncertainties. Some of these risks relate to our ability to:

- increase our online advertising and wireless revenues;
- build our online game and e-commerce businesses successfully;
- continue to attract a larger audience to our portal by expanding the type and technical sophistication of the content and services we offer; and
- maintain our current, and develop new, strategic relationships to increase our revenue streams as well as product and service offerings.

Our operating results are likely to fluctuate significantly and may differ from market expectations.

Our annual and quarterly operating results have varied significantly in the past, and may vary significantly in the future, due to a number of factors which could have an adverse impact on our business, such as our reliance on mobile operators for our wireless revenue, the fact that the Chinese Internet industry is in an early stage of development and we are unsure if it will continue to grow or at what rate it will grow, and the fact that we are subject to government regulations that may change at any time or without notice. We rely on mobile operators for, among other things, billing of and collection of wireless service fees from mobile phone users. If our arrangements with the operators were to be terminated, altered or not renewed, or if the operators did not provide continuous or adequate service, our revenues could be reduced significantly.

As a result, we believe that year-to-year and quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. In addition, we have experienced very high growth rates in the recent past and there may be expectations that these growth rates will continue. It is likely that in some future quarter, our operating results will be below the expectations of public market analysts and investors. In this event, the trading price of our common stock may fall.

We face intense competition which could reduce our market share and adversely affect our financial performance.

The PRC Internet market is characterized by an increasing number of entrants because, among other reasons, the barriers to entry are relatively low. The market for Internet services and products, particularly wireless, online advertising, e-commerce and Internet search and retrieval services, is intensely competitive. In addition, the Internet industry is relatively new and constantly evolving and, as a result, our competitors may better position themselves to compete in this market as it matures.

There are many companies that provide or may provide Web sites and online destinations targeted at Internet users in China. Our major competitors in China include (i) U.S. listed companies, such as Sina Corporation, Netease, Tom Online, Kongzhong, Shanda, and Linktone; (ii) Hong Kong listed companies such as Tencent; and (iii) major United States Internet companies, such as Yahoo! Inc and its newly-acquired 3721.com. These competitors may also improve or enhance their positions in the PRC Internet market through mergers and acquisitions. In addition, we may face competition from existing or new domestic PRC Internet companies that are either affiliated with large corporations such as Legend Computer, America Online and Softbank Corporation, or controlled or sponsored by PRC government entities. These competitors may have certain advantages over us, including:

- substantially greater financial and technical resources;
- more extensive and well developed marketing and sales networks;
- better access to original content;
- greater global brand recognition among consumers; and
- larger customer bases.

With these advantages, our competitors may be better able to:

- develop, market and sell their products and services;
- adapt more quickly to new and changing technologies; and
- more easily obtain new customers.

We may not be able to compete successfully against our current or future competitors.

We depend on online advertising for a significant portion of our revenues.

We derive a significant portion of our revenues, and expect to derive a significant portion of our revenues for the foreseeable future, from the sale of advertising on our Web sites. Advertising revenues represented approximately 46% and 33% of our total revenues for the six months ended June 30, 2004 and 2003, respectively.

Our ability to generate and maintain significant online advertising revenues in China will depend, among other things, on the development of a large base of users possessing demographic characteristics attractive to advertisers. Accordingly, we may not be successful in generating significant future online advertising revenues.

Our ability to generate and maintain significant online advertising revenues may also be subject to downward pressure on online advertising prices and limitations on inventory.

Our ability to generate and maintain significant online advertising revenues will also depend upon acceptance by advertisers that online advertising is effective. The online advertising market is new and rapidly evolving, particularly in China, and the Internet has not been proven as a widely accepted medium for advertising.

The online advertising market is new and rapidly evolving, particularly in China. As a result, many of our current and potential advertising clients have limited experience using the Internet for advertising purposes and historically have not devoted a significant portion of their advertising budget to Internet-based advertising. Moreover, advertising clients that have invested substantial resources in other methods of conducting business may be reluctant to adopt a new strategy that may limit or compete with their existing efforts. The failure to successfully address these risks or execute our business strategy would significantly reduce our profitability.

[Table of Contents](#)

The acceptance of the Internet as a medium for advertising depends on the development of a measurement standard. No standards have been widely accepted for the measurement of the effectiveness of online advertising.

Industry-wide standards may not develop sufficiently to support the Internet as an effective advertising medium. If these standards do not develop, advertisers may choose not to advertise on the Internet in general or through our portals or search engines.

Our ability to generate and maintain significant online advertising revenues will also depend upon the effectiveness of our advertising delivery, tracking and reporting systems.

The expansion of Internet advertisement blocking software may result in a decrease of advertising revenues.

The development of Web software that blocks Internet advertisements before they appear on a user's screen may hinder the growth of online advertising. The expansion of advertisement blocking on the Internet may decrease our revenues because when an advertisement is blocked, it is not downloaded from our advertisement server. As a result, such advertisements will not be tracked as a delivered advertisement. In addition, advertisers may choose not to advertise on the Internet or on our portal because of the use by third parties of Internet advertisement blocking software.

We rely on wireless services for a significant portion of our revenues. Wireless revenues decreased in the first and second quarters of 2004 and may decrease further in the future.

We derive a significant portion of our revenues from wireless services. We derive our wireless revenue from providing short messaging services ("SMS"), multimedia messaging services ("MMS"), web application protocol services ("WAP") and interactive voice response services ("IVR"), mainly consisting of alumni club and other community products, e-mail, ringtone and logo downloads and news, to mobile phone users. For the six months ended June 30, 2004 and 2003, wireless revenues represented approximately 44% and 58%, respectively, of our total revenues. Wireless revenues decreased in the first and second quarters of 2004. Wireless revenues may decrease further in the future due to the possibilities that:

- Our consumers may not understand our services or the fees they are being charged, may not be satisfied with our services and/or may not use our services on a regular basis;
- Consumers may cancel their services at any time without notice;
- Currently over 83% of our wireless revenue is from consumers who subscribe for individual services for which we charge a monthly fee ranging from approximately \$0.36 to \$3.60. During the quarter ended June 30, 2004, we continued to churn out of our old community products such as GGMM, which led to a downward trend of our wireless revenues from SMS services.
- We rely on revenue growth from new wireless services such as MMS, WAP and IVR to drive a significant portion of wireless revenue growth or offset the decrease in revenues from SMS services. However, the current market size is relatively small and adoption rates are still relatively low for these services comparing to SMS services. We are not certain that revenues from these services will become a significant portion of our total wireless revenues.
- We face intense competition from a number of companies who may launch competing or better products than us at any time. In addition, there are limited barriers to entry in this area; and
- Changes in government policy could restrict or curtail the services which we provide.

As a result of tightened controls over new billing procedures and practices by CMCC and Unicom, and the high churn rate in some existing SMS products, we expect revenues from SMS to continue to decrease in the third quarter of 2004 as compared to the second quarter of 2004. We expect revenues from WAP and MMS to increase further in the quarter. We expect our overall wireless revenues to decrease in the third quarter of 2004 as compared to the second quarter of 2004. There could be further decreases in the future.

We rely on contracts with our mobile network operators in a number of ways with respect to our wireless services, including for billing of, and collection from, mobile phone users of wireless service fees. If our arrangements with mobile network operators were to be terminated, altered or not renewed, or if such operators did not provide continuous or adequate service, our revenues could be reduced significantly.

Our wireless services depend mainly on the cooperation of CMCC and its subsidiaries and to a lesser extent Unicom and its subsidiaries. We rely on CMCC and Unicom in the following ways:

- we provide wireless services through CMCC's and Unicom's network and gateway;

Table of Contents

- we utilize and rely on CMCC and Unicom's billing systems to charge our subscribers through the subscriber's mobile phone bill;
- we rely on their collection proxy services to collect payments from subscribers; and
- we rely on their infrastructure to further develop our wireless services.

We have established cooperation arrangements with CMCC and Unicom and their subsidiaries. The contracts are typically renewed on an annual basis. Under the agreements with CMCC and its subsidiaries, CMCC generally retains 15% of the fees we charge for wireless services provided to our users via their platform. In addition, CMCC deducts gateway fees from our portion of the wireless service fees. The amount of such gateway fee is charged on a per message basis, varies for different products and is dependent upon message volume or our ranking among all wireless service providers using the same operators. Under the agreements with Unicom, Unicom typically retains 10-40% (depending on the volume of messages) of the fees we charge for wireless services provided to our users via their platform. Unicom also deducts gateway fees, the amount of which is normally charged on a per message basis. Under the agreements with CMCC and Unicom we have the right to set fees for our wireless services at a maximum of \$0.25 per message or \$3.62 per month.

We face significant risks with respect to our arrangements with CMCC and Unicom, such as the following, which could adversely affect our wireless revenues:

- We provide wireless services through our Web site and record the delivery of the service in our internal systems. However, in order to recognize revenue and get paid for services provided, we rely on billing confirmations from CMCC and Unicom as to the actual amount of services they have billed to their mobile customers. We do not collect wireless service fees from an operator in certain circumstances due to technical issues with the operator's network. We refer to these failures as an operator's "failure rate," which can vary from operator to operator. An operator's failure rate can vary from month to month, ranging from 0% to 80% and may change at any time without notice. If an operator encounters technical problems, increases in the failure rate for that operator could occur.
- CMCC and its subsidiaries are currently in the process of establishing a new billing platform and may require us to switch to this platform in the near future. The new platform may result in higher failure rates or lower revenues associated with changes in the billing procedures. Changes in failure rates may result in significant reductions or fluctuations in our wireless revenues.
- The service fees we pay for using an operator's infrastructure are set based on the negotiation of annual contracts. Our contract with Unicom has been extended and will expire in March 2005. Our contracts with CMCC expire at various times from November 2004 to May 2006. Our negotiating power is limited and if an operator increases its service fees, or does not comply with the terms of our contract, our gross margin and profitability could be materially reduced.
- We rely on the operators to pay us the wireless service fees which they have billed to their mobile customers. If an operator refuses to pay us or limits the amount of wireless service fees which can be billed in a month, our revenues could be adversely affected.
- An operator could launch competing services at any time.
- The refusal of an operator to allow us to supply certain services or its refusal to allow us to charge our desired prices for our services could disrupt our wireless services.
- If CMCC or Unicom were unwilling to cooperate with us, we would not be able to find substitute partners.
- Pursuant to the regulations of CMCC and Unicom, Sohu has the right to charge consumers who have registered to be billed on a monthly basis even if they do not use our services in any month or on a regular basis. If CMCC and Unicom were to disallow us from billing consumers who do not actively use our services, our wireless revenue, generally, and our GGMM revenue, specifically, would be adversely affected.
- CMCC and Unicom have both recently changed their operating regulations and may make any further changes at any time. Such recent or any such future changes could result in our being required to pay penalties for breaching or being alleged to have breached certain provisions of our agreement with CMCC or Unicom under new billing rules or revised operation procedures, or having our service discontinued without notice. Changes in these operating regulations could also have a material impact

[Table of Contents](#)

on our revenue. For example, in July 2003, CMCC disallowed us from using third party Web sites which do not have Internet content provider licenses, or Web site union, to promote our e-subscriptions products. In addition, during the three months ended June 30, 2004 we recorded expenses of \$697,000 related to notices of penalties and complaints from subsidiaries of CMCC based on allegations of the breach of certain provisions of the agreements with the mobile network operators as a result of recent changes in CMCC operating regulations.

Many of our current and potential wireless customers have only limited experience using the Internet for subscription purposes, and may not be willing to fully embrace the products and services we offer, which would adversely affect our future revenues and business expansion.

The wireless market is new and rapidly evolving in China. Many of our current and potential wireless customers have limited experience using the Internet for subscription services. Our wireless revenue growth depends upon user acceptance of our existing and new services, such as our wireless dating, email, news, sports and jokes content, mobile alumni club and other products. Because these services are new and untested, we do not have a clear understanding of consumer behavior, making it difficult to predict future growth or usage. Customers may not be willing to fully embrace the products and services we offer.

Our investment in online games and e-commerce may not be successful.

We have invested and intend to invest further in our online game and e-commerce (online shopping) businesses. Online games are currently one of the fastest growing online services in the PRC, but remain unproven. The online shopping marketing is small and unproven in the PRC. Some of our competitors have entered these markets ahead of us and have achieved significant market positions. We cannot assure you that we will succeed in these markets despite our investments of time and funds. If we fail to achieve a significant position in these markets, we will fail to realize our intended returns in these investments. Moreover, our competitors who succeed may enjoy increased revenues and profit, and our results and share price could suffer as a result.

Our strategy of acquiring complementary assets, technologies and businesses may fail and may result in equity or earnings dilution.

As a component of our growth strategy, we have acquired and intend to actively identify and acquire assets, technologies and businesses that are complementary to our existing portal business. Our acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities, significant impairment losses related to goodwill or amortization expenses related to intangible assets and exposure to undisclosed or potential liabilities of acquired companies. Moreover, the resources expended in identifying and consummating acquisitions may be significant. Furthermore, any acquisitions we decide to pursue may be subject to the approval of the relevant PRC governmental authorities, as well as any applicable PRC rules and regulations.

The acquisitions and integration of 17173.com, Focus.cn and Goodfeel create certain risks and uncertainties.

We completed the acquisitions of 17173.com and Focus.cn in November 2003 and the acquisition of Goodfeel in May 2004. As a result of the acquisitions, we continue to spend considerable time and effort in integrating into our company the employees, organization, customers and operations of 17173.com, Focus.cn and Goodfeel. Also, there can be no assurance that we will succeed in realizing the anticipated economic benefits of the acquisitions, including increased advertising revenues.

We may be required to record a significant charge to earnings if we must reassess our goodwill or amortizable intangible assets arising from acquisitions.

We are required under generally accepted accounting principles to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined. At June 30, 2004, our goodwill and amortizable intangible assets arising from acquisitions were \$52.0 million.

We will not be able to attract visitors, advertisers, wireless and e-commerce customers if we do not maintain and develop the Sohu brand.

Maintaining and further developing our brand is critical to our ability to expand our user base and our revenues. We believe that the importance of brand recognition will increase as the number of Internet users in

[Table of Contents](#)

China grows. In order to attract and retain Internet users, advertisers, and wireless and e-commerce customers, we may need to substantially increase our expenditures for creating and maintaining brand loyalty. If our revenues do not increase proportionately, our results of operations and liquidity will suffer.

Our success in promoting and enhancing our brand, as well as our ability to remain competitive, will also depend on our success in offering high quality content, features and functionality. If we fail to promote our brand successfully or if visitors to our portal or advertisers do not perceive our content and services to be of high quality, we may not be able to continue growing our business and attracting visitors, advertisers, and wireless and e-commerce customers.

If we fail to establish and maintain relationships with content and technology providers and mobile network operators, we may not be able to attract and retain users.

We rely on a number of third party relationships to attract traffic and provide content in order to make our portal more attractive to users and advertisers. Some content providers have increased the fees they charge us for their content. This trend could increase our operating expenses and could adversely affect our ability to obtain content at an economically acceptable cost. Most of our arrangements with content providers are short-term and may be terminated at the convenience of the other party. In addition, much of the third party content provided to our portal is also available from other sources or may be provided to other Internet companies. If other Internet companies present the same or similar content in a superior manner, it would adversely affect our visitor traffic.

Our wireless revenues depend on mobile network operators for message delivery and payment collection. If we were unable to continue this arrangement, our wireless services would be severely disrupted.

Our business also depends significantly on relationships with leading technology and infrastructure providers and the licenses that the technology providers have granted to us. Our competitors may seek to establish the same relationships as we have, which may adversely affect us. We may not be able to maintain these relationships or replace them on commercially attractive terms.

We depend on key personnel and our business may be severely disrupted if we lose the services of our key executives and employees.

Our future success is heavily dependent upon the continued service of our key executives, particularly Dr. Zhang, who is the founder, chief executive officer and a major shareholder of our company and the president of Beijing Sohu, High Century, and Hengda. We rely on his expertise in our business operations and on his personal relationships with some of our principal shareholders, the relevant regulatory authorities, our customers and suppliers, Beijing Sohu, High Century, and Hengda. If one or more of our key executives and employees are unable or unwilling to continue in their present positions, we may not be able to easily replace them and our business may be severely disrupted. In addition, if any of these key executives or employees joins a competitor or forms a competing company, we may lose customers and suppliers and incur additional expenses to recruit and train personnel. Each of our executive officers has entered into an employment agreement and a confidentiality, non-competition and non-solicitation agreement with us. However, the degree of protection afforded to an employer pursuant to confidentiality and non-competition undertakings governed by PRC law may be more limited when compared to the degree of protection afforded under the laws of other jurisdictions. We do not maintain key-man life insurance for any of our key executives.

We also rely on a number of key technology staff for the operation of Sohu. Given the competitive nature of the industry, the risk of key technology staff leaving Sohu is high and could have a disruptive impact on our operations.

Rapid growth and a rapidly changing operating environment strain our limited resources.

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As our audience and their Internet use increase, as the demands of our audience and the needs of our customers change and as the volume of online advertising, wireless and e-commerce activities increases, we will need to increase our investment in our network infrastructure, facilities and other areas of operations. If we are unable to manage our growth and expansion effectively, the quality of our services could deteriorate and our business may suffer. Our future success will depend on, among other things, our ability to:

- adapt our services and maintain and improve the quality of our services;
- protect our Web site from hackers and unauthorized access;
- continue training, motivating and retaining our existing employees and attract and integrate new employees; and
- develop and improve our operational, financial, accounting and other internal systems and controls.

[Table of Contents](#)

To the extent we are unable to scale our systems to meet the increasing PRC Internet population, we will be unable to expand our user base and increase our attractiveness to advertisers and merchants.

As Web page volume and traffic increase in China, we may not be able to scale our systems proportionately. To the extent we do not successfully address our capacity constraints, our operations may be severely disrupted, and we may not be able to expand our user base and increase our attractiveness to advertisers and merchants.

If our current ownership structure is found to be in violation of current or future PRC laws, rules or regulations regarding the legality of foreign investment in the PRC Internet sector, we could be subject to severe penalties.

We conduct our Internet and value added telecommunication operations solely in the PRC through our indirect wholly owned subsidiaries, Beijing ITC and Sohu Era, and variable interest entities Sohu Internet and Beijing Sohu. We are a Delaware corporation, Sohu Hong Kong, our indirect wholly owned subsidiary and the parent company of Beijing ITC and Sohu Era, is a Hong Kong corporation and a foreign person under PRC law. Accordingly, Beijing ITC and Sohu Era are wholly foreign owned enterprises, or WFOEs, under PRC law and our Internet and value added telecommunication business is 100% foreign-owned. In order to meet ownership requirements under PRC law which restrict or prohibit WFOEs from operating in certain industries such as Internet information, wireless, Internet access, e-commerce and certain other industries, we have established Beijing Sohu, High Century, Hengda and Sohu Internet, which are companies incorporated in the PRC and owned by Dr. Zhang and certain other employees of Sohu. As of June 30, 2004, Sohu had invested \$5.2 million in Beijing Sohu, High Century, Hengda and Sohu Internet through loans to officers and employees. In 2000, we extended loans of \$242,000 to Dr. Zhang and a Sohu employee to set up Beijing Sohu. Pursuant to a restructuring in May 2000, we transferred certain of our assets and operations to Beijing Sohu, a PRC company that is 80% owned by Dr. Zhang. In 2001 and 2002, we made loans totaling \$4.6 million to Dr. Zhang and an employee of the company to establish High Century for the purposes of undertaking additional investments in the PRC where foreign ownership is prohibited or restricted. In 2002, we loaned \$242,000 to an employee of the company for the purpose of funding an investment in Hengda, a company incorporated in the PRC which engages in Internet access services in the PRC on behalf of Sohu. The \$242,000 investment represents a 20% interest in Hengda, with High Century holding the remaining 80% interest. In June 2003, we loaned \$121,000 to an employee of the company for the purpose of funding an investment in Sohu Internet, a company incorporated in the PRC which engages in Internet information services in the PRC on behalf of Sohu. The \$121,000 investment represents a 10% interest in Sohu Internet with High Century and Hengda holding 40% and 50% interests, respectively. In May 2004, High Century and Sohu Internet acquired 73% and 27% interests, respectively, in Goodfeel. We do not have any direct ownership interest in Beijing Sohu, High Century, Hengda, Sohu Internet or Goodfeel.

The PRC began several years ago to regulate its Internet sector by making pronouncements or enacting regulations regarding the legality of foreign investment in the PRC Internet sector and the existence and enforcement of content restrictions on the Internet. We believe that our current ownership structure complies with all existing PRC laws, rules and regulations. There are, however, substantial uncertainties regarding the interpretation of current PRC Internet laws and regulations. In addition, new PRC Internet laws and regulations were recently adopted. Accordingly, it is possible that the PRC government will ultimately take a view contrary to ours.

In addition, under the agreement reached in November 1999 between the PRC and the United States concerning the United States' support of China's entry into the World Trade Organization, or WTO, foreign investment in PRC Internet services are to be liberalized to allow for 30% foreign ownership in key telecommunication services, including PRC Internet ventures, for the first year after China's entry into the WTO, 49% in the second year and 50% thereafter. China officially entered the WTO on December 11, 2001. However, the implementation of China's WTO accession agreements is still subject to various conditions.

Accordingly, it is possible that the relevant PRC authorities could, at any time, assert that any portion or all of our, Beijing ITC's, Sohu Era's, Beijing Sohu's, Hengda's, High Century's, Sohu Internet's or Goodfeel's existing or future ownership structure and businesses violate existing or future PRC laws, regulations or policies. It is also possible that the new laws or regulations governing the PRC Internet sector that have been adopted or may be adopted in the future will prohibit or restrict foreign investment in, or other aspects of, any of our, Beijing ITC's, Sohu Era's, Beijing Sohu's, Hengda's, High Century's, Sohu Internet's and Goodfeel's current or proposed businesses and operations. In addition, any such new laws and regulations may be retroactively applied to us, Beijing ITC, Sohu Era, High Century, Hengda, Beijing Sohu, Sohu Internet or Goodfeel.

Table of Contents

If we, Beijing ITC, Sohu Era, High Century, Beijing Sohu, Hengda, Sohu Internet and Goodfeel were found to be in violation of any existing or future PRC laws or regulations, the relevant PRC authorities would have broad discretion in dealing with such violation, including, without limitation, the following:

- levying fines;
- confiscating our, Beijing ITC's, Sohu Era's, High Century's, Hengda's, Beijing Sohu's, Sohu Internet's or Goodfeel's income;
- revoking our, Beijing ITC's, Sohu Era's, High Century's, Hengda's, Beijing Sohu's, Sohu Internet's or Goodfeel's business licenses;
- shutting down our, Beijing ITC's, Sohu Era's, Beijing Sohu's, Sohu Internet's or Goodfeel's servers and/or blocking our Web sites;
- requiring us, Beijing ITC, Sohu Era, High Century, Hengda, Beijing Sohu, Sohu Internet or Goodfeel to restructure its ownership structure or operations; and
- requiring us, Beijing ITC, Sohu Era, High Century, Hengda, Beijing Sohu, Sohu Internet or Goodfeel to discontinue any portion or all of its Internet and value added telecommunication businesses.

We may be unable to collect long-term loans to officers and employees or exercise management influence associated with Beijing Sohu, High Century, Hengda, Sohu Internet, or Goodfeel.

At June 30, 2004, Sohu had provided long-term loans of \$5.2 million to Dr. Zhang, Sohu's chief executive officer and a major Sohu shareholder, and certain of our employees. The long-term loans are used to finance investments in Beijing Sohu and High Century, which are owned 80% by Dr. Zhang and 20% by certain of our employees, Hengda, which is owned 80% by High Century and 20% by an employee, and Sohu Internet, which is owned 50% by Hengda, 40% by High Century and 20% by an employee. Beijing Sohu, High Century, Hengda and Sohu Internet are used to facilitate our participation in telecommunications, Internet content and certain other businesses in China where foreign ownership is either prohibited or restricted. In addition, in May 2004, High Century and Sohu Internet acquired 73% and 27% interests, respectively, in Goodfeel.

The agreements contain provisions that, subject to PRC law, (i) the loans can only be repaid to us by transferring the shares of High Century, Hengda, Sohu Internet or Beijing Sohu to us, (ii) the shares of High Century, Hengda, Sohu Internet or Beijing Sohu cannot be transferred without our approval, and (iii) we have the right to appoint all directors and senior management personnel of High Century, Hengda, Sohu Internet and Beijing Sohu. Dr. Zhang and the other employee borrowers have pledged all of their shares in High Century, Hengda, Sohu Internet and Beijing Sohu as collateral for the loans and the loans bear no interest and are due on demand after November 2003, in the case of High Century, the earlier of a demand or 2010, in the case of Beijing Sohu, after January 2003, in the case of Hengda, and after June 2004, in the case of Sohu Internet, or, in any case, at such time as Dr. Zhang or the other employee borrowers, as the case may be, is not an employee of Sohu. Sohu does not intend to request repayment of the loans as long as PRC regulations prohibit it from directly investing in businesses being undertaken by High Century, Hengda, Sohu Internet and Beijing Sohu.

Because these loans can only be repaid by the borrowers' transferring the shares of the various entities, our ability to ultimately realize the effective return of the amounts advanced under these loans will depend on the profitability of Beijing Sohu, Hengda, Sohu Internet and High Century, which is uncertain. Furthermore, because of uncertainty associated with PRC law, ultimate enforcement of the loan agreements is uncertain. Accordingly, we may never be able to collect these loans or exercise influence over High Century, Hengda, Sohu Internet, Beijing Sohu and Goodfeel.

We depend upon contractual arrangements with Beijing Sohu, Hengda, High Century, Sohu Internet and Goodfeel for the success of our business and these arrangements may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.

Because we conduct our Internet operations only in the PRC, and because we are restricted or prohibited by the PRC government from owning Internet content or telecommunication operations in the PRC, we are dependent on Beijing Sohu, Hengda, High Century, Sohu Internet and Goodfeel in which we have no direct ownership interest, to provide those services through contractual agreements between the parties. These arrangements may not be as effective in providing control over our Internet content or telecommunications operations as direct ownership of these businesses. For example, Beijing Sohu and Sohu Internet could fail to take actions required for our business, such as entering into content development contracts with potential content suppliers or failing to maintain the necessary permit for the content servers. If Beijing Sohu, Hengda, High Century, Sohu Internet and Goodfeel fail to perform its obligations under these agreements, we may have to rely on legal remedies under PRC law, which we cannot assure you would be effective or sufficient.

[Table of Contents](#)

Dr. Zhang, our chief executive officer and a major shareholder of our company, is also the direct and indirectly majority shareholder of Beijing Sohu, Hengda, High Century, Sohu Internet and Goodfeel. As a result, our contractual relationships with those companies could be viewed as entrenching his management position or transferring certain value to him, especially if any conflict arises with him.

If we are found to be in violation of current or future PRC laws, rules or regulations regarding Internet-related services and telecom-related activities, we could be subject to severe penalties.

The PRC recently enacted regulations applying to Internet-related services and telecom-related activities. While many aspects of these regulations remain unclear, they purport to limit and require licensing of various aspects of the provision of Internet information and value added telecommunication services. If these regulations are interpreted to be inconsistent with our ownership structure and business operations, our business will be severely impaired and we could be subject to severe penalties as discussed above.

Activities of Internet content providers are or will be subject to additional PRC regulations, which have not yet been put into effect. Our operations may not be consistent with these new regulations when put into effect, and, as a result, we could be subject to severe penalties.

The Ministry of Information Industry, or MII, has stated that the activities of Internet content providers are subject to regulations by various PRC government authorities, depending on the specific activities conducted by the Internet content provider. Various government authorities have stated publicly that they are in the process of preparing new laws and regulations that will govern these activities. The areas of regulations currently include online advertising, online news reporting, online publishing, online securities trading and the provision of industry-specific (e.g., drug-related) information over the Internet. Other aspects of our online operations may be subject to regulations in the future.

Our operations may not be consistent with these new regulations when put into effect and, as a result, we could be subject to severe penalties as discussed above.

Even if we are in compliance with PRC governmental regulations relating to licensing and foreign investment prohibitions, the PRC government may prevent us from distributing, and we may be subject to liability for, content that it believes is inappropriate.

The PRC has enacted regulations governing Internet access and the distribution of news and other information. In the past, the PRC government has stopped the distribution of information over the Internet that it believes to violate PRC law, including content that is obscene, incites violence, endangers national security, is contrary to the national interest or is defamatory. In addition, we may not publish certain news items, such as news relating to national security, without permission from the PRC government. Furthermore, the Ministry of Public Security has the authority to cause any local Internet service provider to block any Web site maintained outside the PRC at its sole discretion. Even if we comply with PRC governmental regulations relating to licensing and foreign investment prohibitions, if the PRC government were to take any action to limit or prohibit the distribution of information through our network or to limit or regulate any current or future content or services available to users on our network, our business would be harmed.

We are also subject to potential liability for content on our Web sites that is deemed inappropriate and for any unlawful actions of our subscribers and other users of our systems under regulations promulgated by the MII.

Furthermore, we are required to delete content that clearly violates the laws of the PRC and report content that we suspect may violate PRC law. It is difficult to determine the type of content that may result in liability for us, and if we are wrong, we may be prevented from operating our Web sites.

Regulation and censorship of information distribution in China may adversely affect our business.

China has enacted regulations governing Internet access and the distribution of news and other information. Furthermore, the Propaganda Department of the Chinese Communist Party has been given the responsibility to censor news published in China to ensure, supervise and control a particular political ideology. In addition, the MII has published implementing regulations that subject online information providers to potential liability for content included on their portals and the actions of subscribers and others using their systems, including liability for violation of PRC laws prohibiting the distribution of content deemed to be socially destabilizing. Because many PRC laws, regulations and legal requirements with regard to the Internet are relatively new and untested, their interpretation and enforcement may involve significant uncertainty. In addition, the PRC legal system is a civil law system in which decided legal cases have limited binding force as legal precedents. As a result, in many cases it is difficult to determine the type of content that may result in liability for a Web site operator.

[Table of Contents](#)

Periodically, the Ministry of Public Security has stopped the distribution over the Internet of information which it believes to be socially destabilizing. The Ministry of Public Security has the authority to cause any local Internet service provider to block any Web site maintained outside China at its sole discretion. If the PRC government were to take action to limit or eliminate the distribution of information through our portal or to limit or regulate current or future applications available to users of our portal, our business would be affected.

The State Secrecy Bureau, which is directly responsible for the protection of state secrets of all PRC government and Chinese Communist Party organizations, is authorized to block any Web site it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the distribution of online information. Under the applicable regulations, we may be held liable for any content transmitted on our portal. Furthermore, where the transmitted content clearly violates the laws of the PRC, we will be required to delete it. Moreover, where the transmitted content is considered suspicious, we are required to report such content. We must also undergo computer security inspections, and if we fail to implement the relevant safeguards against security breaches, we may be shut down. In addition, under recently adopted regulations, Internet companies which provide bulletin board systems, chat rooms or similar services, such as our company, must apply for the approval of the State Secrecy Bureau. As the implementing rules of these new regulations have not been issued, however, we do not know how or when we will be expected to comply, or how our business will be affected by the application of these regulations.

We may not be able to collect payments of our wireless service fees if the PRC government determines that our existing ownership structure does not comply with PRC laws, rules or regulations.

As discussed above, the PRC began several years ago to regulate its Internet sector by making pronouncements or enacting regulations regarding the legality of foreign investment in the PRC Internet sector. We believe that our current ownership structure complies with all existing PRC laws, rules and regulations. There are, however, substantial uncertainties regarding the interpretation of current PRC Internet laws and regulations. In addition, new PRC Internet laws and regulations were recently adopted. Accordingly, it is possible that the PRC government will ultimately take a view contrary to ours. If the PRC government were to take a contrary view, we may not be able to collect payments of our wireless fees, which we receive from Beijing Sohu and Sohu Internet, which in turn collect the fees from mobile network operators.

We may not have exclusive rights over the marks that are crucial to our business, including but not limited to “Sohu.com,” “focus.cn,” “17173,” “Goodfeel” and “Sogou”

We have applied for the registration of our key marks, including but not limited to Sohu.com, focus.cn, 17173, Goodfeel, and Sogou, so as to establish and protect our exclusive rights to the marks. However, we have only succeeded in registering the mark “Sohu.com” in the PRC. The applications for the registration of the other marks are still under examination by the Trademark Office of PRC. Completion of the registrations is subject to a determination that there are no prior rights in the PRC. Any rejection of these applications could adversely affect our rights to these marks.

Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

We regard our copyrights, service marks, trademarks, trade secrets and other intellectual property as critical to our success. Unauthorized use of our intellectual property by third parties may adversely affect our business and reputation. We rely on trademark and copyright law, trade secret protection and confidentiality agreements with our employees, customers, business partners and others to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property in Internet-related industries is uncertain and still evolving. In particular, the laws of the PRC and certain other countries are uncertain or do not protect intellectual property rights to the same extent as do the laws of the United States. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Future litigation could result in substantial costs and diversion of resources.

We may be subject to intellectual property infringement claims, which may force us to incur substantial legal expenses and, if determined adversely against us, materially disrupt our business.

We cannot be certain that our products and services do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We have in the past been, are currently, and may in the future be, subject to claims and legal proceedings relating to the intellectual property of others in the ordinary course of our business. In particular, if we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, may be ordered to pay a fine and we may incur licensing fees or be forced to develop alternatives. We may incur substantial expenses in defending against these third party infringement claims, regardless of their merit. Successful infringement claims against us may result in substantial monetary liability or may materially disrupt the conduct of our business by restricting or prohibiting our use of the intellectual property in question.

[Table of Contents](#)

We may be subject to, and may expend significant resources in defending against claims based on the content and services we provide over our portal.

As our services may be used to download and distribute information to others, there is a risk that claims may be made against us for defamation, negligence, copyright or trademark infringement or other claims based on the nature and content of such information. Furthermore, we could be subject to claims for the online activities of our visitors and incur significant costs in their defense. In the past, claims based on the nature and content of information that was posted online by visitors have been made in the United States against companies that provide online services. We do not carry any liability insurance against such risks.

We could be exposed to liability for the selection of listings that may be accessible through our portal or through content and materials that our visitors may post in classifieds, message boards, chat rooms or other interactive services. If any information provided through our services contains errors, third parties may make claims against us for losses incurred in reliance on the information. We also offer Web-based e-mail and subscription services, which expose us to potential liabilities or claims resulting from:

- unsolicited e-mail;
- lost or misdirected messages;
- illegal or fraudulent use of e-mail; or
- interruptions or delays in e-mail service.

Investigating and defending any such claims may be expensive, even if they do not result in liability.

The telecommunications infrastructure in China, which is not as well developed as in the United States, may limit our growth.

The telecommunications infrastructure in China is not well developed. Our growth will depend on the PRC government and state-owned enterprises establishing and maintaining a reliable Internet and telecommunications infrastructure to reach a broader base of Internet users in China. The Internet infrastructure, standards, protocols and complementary products, services and facilities necessary to support the demands associated with continued growth may not be developed on a timely basis or at all by the PRC government and state-owned enterprises.

We depend on ChinaNet, China Netcom, China Telecom and the Beijing Telecom Administration for telecommunications services, and any interruption in these services may result in severe disruptions to our business.

Although private Internet service providers exist in China, almost all access to the Internet is maintained through ChinaNet, currently owned by China Netcom and China Telecom, under the administrative control and regulatory supervision of the MII. In addition, local networks connect to the Internet through a government-owned international gateway. This international gateway is the only channel through which a domestic Chinese user can connect to the international Internet network. We rely on this infrastructure and China Netcom and China Telecom to provide data communications capacity primarily through local telecommunications lines. Although the government has announced aggressive plans to develop the national information infrastructure, this infrastructure may not be developed and the Internet infrastructure in China may not be able to support the continued growth of Internet usage. In addition, we will have no access to alternative networks and services, on a timely basis if at all, in the event of any infrastructure disruption or failure.

We may not be able to lease additional bandwidth from the Beijing Telecom Administration on acceptable terms, on a timely basis or at all. In addition, we will have no means of getting access to alternative networks and services on a timely basis, if at all, in the event of any disruption or failure of the network.

The high cost of Internet access may limit the growth of the Internet in China and impede our growth.

Access to the Internet in China remains relatively expensive, and may make it less likely for users to access and transact business over the Internet. Unfavorable rate developments could further decrease our visitor traffic and our ability to derive revenues from transactions over the Internet.

[Table of Contents](#)

Unexpected network interruptions caused by system failures may result in reduced visitor traffic, reduced revenue and harm to our reputation.

Our portal operations are dependent upon Web browsers, Internet service providers, content providers and other Web site operators in China, which have experienced significant system failures and system outages in the past. Our users have in the past experienced difficulties due to system failures unrelated to our systems and services. Any system failure or inadequacy that causes interruptions in the availability of our services, or increases the response time of our services, as a result of increased traffic or otherwise, could reduce our user satisfaction, future traffic and our attractiveness to users and advertisers.

Our operations are vulnerable to natural disasters and other events, as we only have limited backup systems and do not maintain any backup servers outside of China.

We have limited backup systems and have experienced system failures and electrical outages from time to time in the past, which have disrupted our operations. All of our servers and routers are currently hosted in a single location within the premises of Beijing Telecom Administration. We do not maintain any back up servers outside Beijing. We do not have a disaster recovery plan in the event of damage from fire, floods, typhoons, earthquakes, power loss, telecommunications failures, break-ins and similar events. If any of the foregoing occurs, we may experience a complete system shutdown. We do not carry any business interruption insurance. To improve the performance and to prevent disruption of our services, we may have to make substantial investments to deploy additional servers or one or more copies of our Web sites to mirror our online resources. Although we carry property insurance with low coverage limits, our coverage may not be adequate to compensate us for all losses, particularly with respect to loss of business and reputation, that may occur.

Our network operations may be vulnerable to hacking, viruses and other disruptions, which may make our products and services less attractive and reliable.

Internet usage could decline if any well-publicized compromise of security occurs. "Hacking" involves efforts to gain unauthorized access to information or systems or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment. Hackers, if successful, could misappropriate proprietary information or cause disruptions in our service. We may be required to expend capital and other resources to protect our Web site against hackers. We cannot assure you that any measures we may take will be effective. In addition, the inadvertent transmission of computer viruses could expose us to a material risk of loss or litigation and possible liability, as well as materially damage our reputation and decrease our user traffic.

Political and economic policies of the PRC government could affect our business.

All of our business, assets and operations are located in China and all of our revenues are derived from our operations in China. Accordingly, our business could be adversely affected by changes in political, economic or social conditions in China, adjustments in PRC government policies or changes in laws and regulations.

The economy of China differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development in a number of respects, including:

- structure;
- level of government involvement;
- level of development;
- level of capital reinvestment;
- growth rate;
- control of foreign exchange; and
- methods of allocating resources.

Since 1949, China has been primarily a planned economy subject to a system of macroeconomic management. Although the Chinese government still owns a significant portion of the productive assets in China, economic reform policies since the late 1970s have emphasized decentralization, autonomous enterprises and the utilization of market mechanisms. We cannot predict what effects the economic reform and macroeconomic measures adopted by the Chinese government may have on our business or results of operations.

The PRC legal system embodies uncertainties which could limit the legal protections available to us and you.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. Our PRC operating subsidiary, Beijing ITC, is a wholly-foreign owned enterprise, or a WFOE, which is an enterprise incorporated in mainland China and wholly-owned by our indirect subsidiary, Sohu Hong Kong. Beijing ITC is subject to laws and regulations applicable to foreign investment in mainland China. However, these laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us and other foreign investors, including you. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws.

It may be difficult to enforce any civil judgments against us or our board of directors or officers, because a significant portion of our assets are located outside of the United States.

Although we are incorporated in the State of Delaware, a significant portion of our assets are located in the PRC. As a result, it may be difficult for investors to enforce outside the United States in any actions brought against us in the United States, including actions predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any state of the United States. In addition, certain of our directors and officers (principally in the PRC) and all or a significant portion of their assets may be located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon those directors and officers, or to enforce against them or us judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any state of the United States. We have been advised by our PRC counsel that, in their opinion, there is doubt as to the enforceability in the PRC, in original actions or in actions for enforcement of judgments of United States courts, of civil liabilities predicated solely upon the federal securities laws of the United States or the securities laws of any state of the United States.

We may rely on dividends and other distributions on equity paid by Sohu.com Limited, our wholly-owned subsidiary, to fund any cash requirements we may have. We may not be able to obtain cash from distributions to the extent such distributions are restricted by PRC law or future debt covenants.

We are a holding company with no operating assets other than investments in Chinese operating entities, including Beijing ITC, Sohu Era, and Sohu Software, through an intermediate holding company, Sohu.com Limited, our wholly-owned subsidiary in the Cayman Islands, and our variable interest entities, Beijing Sohu, High Century, Hengda, Sohu Internet and Goodfeel. We may need to rely on dividends and other distributions on equity paid by Sohu.com Limited for our cash requirements in excess of any cash raised from investors and retained by us. If Beijing ITC, Sohu Era, and Sohu Software incur debt on their own behalf in the future, the instruments governing the debt may restrict Beijing ITC's, Sohu Era's and Sohu Software's ability to pay dividends or make other distributions to us. In addition, PRC legal restrictions permit payment of dividends by Beijing ITC, Sohu Era, and Sohu Software only out of their net income, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, Beijing ITC, Sohu Era and Sohu Software are also required to set aside 10% of their net income each year to fund certain reserve funds until these reserves equal 50% of the amount of paid-in capital. These reserves are not distributable as cash dividends. Furthermore, dividends received by Sohu.com Inc. would be subject to taxation at United States tax rates of 34% or 35%. We do not expect any dividends or other distributions on equity from Sohu.com Limited in the foreseeable future.

If tax benefits presently available to certain of our subsidiaries and variable interest entities located in China were not available, the income tax rate on most of our profits in China could increase from 0% to 33%.

Our China-based subsidiaries Sohu Era and Sohu Software and our variable interest entity Sohu Internet enjoy tax benefits which are available to "new technology enterprises." Presently, PRC law requires that a company, in order to be considered a "new technology enterprise": (i) operate in the high-tech industry (which includes the Internet industry), (ii) be incorporated and operating in High and New Technology Development Zones, including Beijing Zhongguancun Science Park, (iii) receive 60% of its revenue from high-tech products or services, and (iv) have at least 20% of its employees involved in technology development. Each year new technology enterprises are subject to annual inspection to determine whether they continue to meet these requirements.

Subject to the approval of the relevant tax authorities, the effective income tax rate for new technology enterprises registered and operating in Beijing Zhongguancun Science Park is 15%, while the local income tax will be exempted as long as the enterprise holds the new technology enterprise status. New technology enterprises are exempted from Chinese state corporate income tax for three years, beginning with their first year of operations, and are entitled to a 50% tax reduction at the rate of 7.5% for the subsequent three years. Sohu Era, Sohu Software and Sohu Internet were incorporated in 2003 and, providing there is no change in their status as a new technology enterprise or a change in the relevant regulations, will be subject to an effective income tax rate of 0% in 2004 and 2005, 7.5% in 2006, 2007 and 2008 and 15% thereafter. Sohu Era, Sohu Software and Sohu Internet obtained approval from the relevant tax authorities for these tax benefits.

[Table of Contents](#)

We currently expect most of our income to be earned from Sohu Era. In addition to the office in Beijing Zhongguancun Science Park, Sohu Era also has offices outside Beijing Zhongguancun Science Park where portions of its operations are located. We believe that substantially all of Sohu Era's services are ultimately delivered in Beijing Zhongguancun Science Park. However, the relevant tax authorities could challenge whether Sohu Era is operating outside Beijing Zhongguancun Science Park, which could result in a withdrawal of the approval of the tax benefits by the tax authorities.

For these tax benefits to no longer be available, there would need to be a change in governmental policy or the governmental regulations concerning requirements necessary to be deemed a new technology enterprise, or we would have to be unable to meet the existing new technology enterprise requirements. If Sohu Era, Sohu Software and Sohu Internet did not meet the requirements of a new technology enterprise, we could be subject to enterprise income tax in China at rates up to 33%, which could cause a significant reduction in our after-tax income.

Restrictions on currency exchange may limit our ability to utilize our revenues effectively.

Substantially all of our revenues and operating expenses are denominated in Renminbi. The Renminbi is currently freely convertible under the "current account", which includes dividends, trade and service related foreign exchange transactions, but not under the "capital account", which includes foreign direct investment.

Currently, Beijing ITC may purchase foreign exchange for settlement of "current account transactions", including payment of dividends, without the approval of the State Administration for Foreign Exchange, or SAFE. Beijing ITC may also retain foreign exchange in its current account (subject to a ceiling approved by the SAFE) to satisfy foreign exchange liabilities or to pay dividends. However, the relevant PRC governmental authorities may limit or eliminate our ability to purchase and retain foreign currencies in the future.

Since a significant amount of our future revenues will be in the form of Renminbi, the existing and any future restrictions on currency exchange may limit our ability to utilize revenue generated in Renminbi to fund our business activities outside China, if any, or expenditures denominated in foreign currencies.

Foreign exchange transactions under the capital account are still subject to limitations and require approvals from the SAFE. This could affect Beijing ITC's ability to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from us.

We may suffer currency exchange losses if the Renminbi depreciates relative to the U.S. Dollar.

Our reporting currency is the U.S. Dollar. However, substantially all of revenues are denominated in Renminbi. Our revenues as expressed in our U.S. Dollar financial statements will decline in value if the Renminbi depreciates relative to the U.S. Dollar. Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure, if at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into U.S. Dollars.

The market price of our common stock has been and will likely continue to be volatile. The price of our common stock may fluctuate significantly, which may make it difficult for stockholders to sell shares of our common stock when desired or at attractive prices.

The market price of our common stock has been volatile and is likely to continue to be so. The initial public offering price of our common stock in July 2000 was \$13.00 per share. The trading price of our common stock subsequently dropped to a low of \$0.52 per share on April 9, 2001. On July 15, 2004, the trading price of our common stock reached a record high of \$43.40. During the six months ended June 30, 2004, the trading price of our common stock ranged from a low of \$15.00 per share to a high of \$40.15. On July 30, 2004, the closing price of our common stock was \$20.72 per share.

In addition, the Nasdaq Stock Market's National Market has from time to time experienced significant price and volume fluctuations that have affected the market prices for the securities of technology companies, and particularly Internet-related companies.

The price for our common stock may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products and media properties by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to

[Table of Contents](#)

us, and news reports relating to trends in our markets or general economic conditions. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom have been granted stock options or other stock awards.

Sales of a significant number of shares of our common stock in the public market, or the perception of such sales, could reduce our share price and impair our ability to raise funds in new share offerings.

There were 36,326,156 shares of our common stock outstanding as of June 30, 2004, as well as options to purchase an additional 3,556,253 shares of our common stock. Of the outstanding shares, 25,424,216 were issued prior to the initial public offering of our common stock. These shares are either freely tradable without restriction under Rule 144(k) under the Securities Act of 1933 or are tradable subject to the notice, volume and manner of sale restrictions of Rule 144 under the Securities Act.

Sohu issued 4,600,000 shares of common stock in connection with the initial public offering. All of these shares are freely tradable without restriction unless they are held by our “affiliates” as that term is defined in Rule 144 under the Securities Act.

On October 18, 2000, we issued an aggregate of 4,401,500 shares of our common stock to the former stockholders of ChinaRen in connection with our acquisition of that company. All of these shares are currently freely tradable without restriction.

On November 25, 2003, we issued an aggregate of 65,852 shares of common stock to Asia B2B Online Inc., the seller of the Focus.cn Web site, and to certain individuals in connection with our acquisition, through our wholly-owned subsidiary Sohu.com Limited, of All Honest International Limited, the owner of the Focus.cn Web site. Pursuant to a certain employee incentive plan which we assumed in connection with our purchase of All Honest International, we issued to certain individuals on May 25, 2004 an additional 2,499 shares of our common stock and we anticipate issuing to such individuals on or about November 25, 2004 an additional 23,198 shares of our common stock. Commencing one year after the applicable issue dates, we expect that these shares will be eligible for resale subject to the notice, volume and manner of sale restrictions of Rule 144 under the Securities Act.

The individuals referred to above are parties to an agreement with us that require us to register under the Securities Act for resale by them the shares of our common stock they received in connection with the acquisition and received or will receive pursuant to the employee incentive and retention plan. Pursuant to that agreement, we filed a Registration Statement on Form S-3 (SEC File No. 333-111495) to register the shares, which registration statement was declared effective by the SEC on July 8, 2004. The registration permits the sale of those shares without regard to the restrictions of Rule 144, so long as the stockholders comply with the prospectus delivery requirements of the Securities Act.

We issued \$90.0 million of zero coupon convertible senior notes due July 2023 which we may not be able to repay in cash and could result in dilution of our earnings per share.

In July 2003, we issued \$90.0 million aggregate principal amount of zero coupon convertible senior notes due July 2003. The notes are convertible into our common stock at a conversion price of \$44.76 per share, subject to adjustment upon the occurrence of specified events, which would result in the issuance of an aggregate of approximately two million shares. Therefore, each \$1,000 principal amount of the notes will initially be convertible into 22.3414 shares of our common stock. Each holder of the notes will have the right, at the holder’s option, to require Sohu to repurchase all or any portion of the principal amount of the holder’s notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. We may also be required to repurchase all of the notes following a fundamental change of Sohu, such as a change of control, prior to maturity. We may not have enough cash on hand or have the ability to access cash to pay the notes if presented for redemption on a fundamental change, on a redemption date referred to above or at maturity. In addition, the redemption or purchase of our notes with shares of our common stock or the conversion of the notes into our common stock could result in dilution of our earnings per share.

We are controlled by a small group of our existing stockholders, whose interests may differ from other stockholders.

Our chief executive officer, Dr. Zhang, beneficially owns approximately 26% of the outstanding shares of our common stock and is our largest stockholder. Our second largest stockholder, together with our chief executive officer, our other executive officers and members of our Board of Directors, beneficially own approximately 40% of the outstanding shares of our common stock. Accordingly these stockholders acting together will have significant influence in determining the outcome of any corporate transaction or other matter submitted to the stockholders for approval, including mergers, consolidations, the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have significant influence in preventing or causing a change in control. In addition, without the consent of these stockholders, we could be prevented from entering into transactions that could be beneficial to us. The interests of these stockholders may differ from the interests of the other stockholders.

[Table of Contents](#)

Holders of a significant percentage of the outstanding shares of our common stock are parties to an agreement under which they have agreed to vote together in favor of a nominee of one of our stockholders to our board of directors. As a result of their voting power, they will have significant influence in causing that nominee to be elected.

Anti-takeover provisions of the Delaware General Corporation Law, our certificate of incorporation and Sohu's Stockholder Rights Plan could delay or deter a change in control.

Some provisions of our certificate of incorporation and bylaws, as well as various provisions of the Delaware General Corporation Law, may make it more difficult to acquire our company or effect a change in control of our company, even if an acquisition or change in control would be in the interest of our stockholders or if an acquisition or change in control would provide our stockholders with a premium for their shares over then current market prices. For example, our certificate of incorporation provides for the division of the board of directors into two classes with staggered two-year terms and provides that stockholders have no right to take action by written consent and may not call special meetings of stockholders, each of which may make it more difficult for a third party to gain control of our board in connection with, or obtain any necessary stockholder approval for, a proposed acquisition or change in control.

In addition, we have adopted a stockholder rights plan under the terms of which, in general, if a person or group acquires more than 20% of the outstanding shares of common stock, all other Sohu stockholders would have the right to purchase securities from Sohu at a substantial discount to those securities' fair market value, thus causing substantial dilution to the holdings of the person or group which acquires more than 20%. The stockholder rights plan may inhibit a change in control and, therefore, could adversely affect the stockholders' ability to realize a premium over the then-prevailing market price for the common stock in connection with such a transaction.

The power of our Board of Directors to designate and issue shares of preferred stock could have an adverse effect on holders of our common stock.

Our certificate of incorporation authorizes our board of directors to designate and issue one or more series of preferred stock, having rights and preferences as the board may determine, and any such designations and issuances could have an adverse effect on the rights of holders of common stock.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

FOREIGN CURRENCY EXCHANGE RATE RISK

While our reporting currency is the U.S. dollar, to date virtually all of our revenues and costs are denominated in Renminbi and a significant portion of our assets and liabilities are denominated in Renminbi. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be impacted by fluctuations in the exchange rate between U.S. Dollars and Renminbi. If the Renminbi depreciates against the U.S. Dollar, the value of our Renminbi revenues and assets as expressed in our U.S. Dollar financial statements will decline. We do not hold any derivative or other financial instruments that expose us to substantial market risk. See "Risk Factors—We may suffer currency exchange losses if the Renminbi depreciates relative to the U.S. Dollar."

The Renminbi is currently freely convertible under the "current account", which includes dividends, trade and service-related foreign exchange transactions, but not under the "capital account", which includes foreign direct investment. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure at all. Accordingly, we may incur economic losses in the future due to foreign exchange rate fluctuations, which could have a negative impact on our financial condition and results of operations.

INVESTMENT RISK

Sohu invests in marketable debt securities to preserve principal while at the same time maximizing yields without significantly increasing risk. These marketable debt securities are classified as available-for-sale because we may dispose of the securities prior to maturity and they are thus reported at the market value as of the end of the period. As of June 30, 2004, unrealized losses of \$516,000 were recorded as accumulated other comprehensive income in shareholders' equity.

INTEREST RATE RISK

Our investment policy limits our investments of excess cash in high-quality corporate securities and limits the amount of credit exposure to any one issuer. We protect and preserve our invested funds by limiting default, market and reinvestment risk.

Investments in both fixed rate debt securities and callable range accrual notes carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while callable range accrual notes may not produce any income if interest rates increase and exceed certain levels. Due in part to these factors, our future interest income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities, which have declined in market value due to changes in interest rates.

ITEM 4. CONTROLS AND PROCEDURES

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report (the “Evaluation Date”), have concluded that as of the Evaluation Date our disclosure controls and procedures were effective and designed to ensure that material information relating to Sohu would be made known to them by others within the company. During the period covered by this quarterly report, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

There are no material legal proceedings pending or, to our knowledge, threatened against us. From time to time we become subject to legal proceedings and claims in the ordinary course of our business. Such legal proceedings or claims, even if not meritorious, could result in the expenditure of significant financial and management resources.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

On July 17, 2000, we completed an underwritten initial public offering of our common stock pursuant to a Registration Statement on Form S-1 (SEC file No. 333-96137), which became effective on July 10, 2000. Public trading of the common stock offered in the initial public offering commenced on July 12, 2000. We sold an aggregate of 4,600,000 shares of common stock in the offering at a price to the public of \$13 per share, resulting in gross proceeds of \$59.8 million. Our net proceeds, after deduction of the underwriting discount of \$4.2 million and other offering expenses of \$3.2 million, were approximately \$52.4 million. All shares sold in the offering were sold by us.

During the three months ended June 30, 2004, we did not use any proceeds from the offering. The remaining net proceeds from the offering have been invested in cash, cash equivalents, and marketable debt securities. The use of the proceeds from the offering does not represent a material change in the use of proceeds described in the prospectus contained in the Registration Statement on Form S-1 described above.

In April 2004, the Board of Directors of the Company approved a stock repurchase program pursuant to which the Company plans to purchase from time to time up to \$30,000,000 worth of outstanding shares of its common stock in the open market. During the three months ended June 30, 2004, the Company repurchased one million shares of its common stock at an average price of \$17.752 including brokerage commissions.

The following summarizes the purchases during the three months ended June 30, 2004:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Program (1)	(d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (1)
April 1 to April 30, 2004	—	—	—	\$ 30,000,000
May 1 to May 31, 2004	1,000,000	\$ 17.752	1,000,000	\$ 12,248,000
June 1 to June 30, 2004	—	—	—	\$ 12,248,000
Total	1,000,000	\$ 17.752	1,000,000	

(1) Program, for up to \$30,000,000, was announced in April 2004. The program will continue for not less than six months from inception.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

On May 14, 2004, Sohu held its Annual Meeting of Stockholders. At the meeting, the stockholders elected as directors Edward B. Roberts (with 31,378,787 affirmative votes and 274,204 votes withheld), Thomas Gurnee (with 28,894,461 affirmative votes and 2,758,530 votes withheld) and Mary Ma (with 31,186,745 affirmative votes and 466,246 votes withheld).

The stockholders also approved an amendment to Sohu's 2000 Stock Incentive Plan to increase the number of shares of common stock authorized for issuance under the plan from 7,000,000 to 8,000,000 (with 13,602,246 shares voting for, 6,996,132 against, 29,420 abstaining and 11,025,193 broker non-votes).

The stockholders also ratified the appointment of PricewaterhouseCoopers as Sohu's independent accountants for the fiscal year ending December 31, 2004 (with 31,448,495 shares voting for, 189,996 against, and 14,500 abstaining).

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Please see the Exhibit Index attached hereto.

(b) Reports on Form 8-K.

On April 22, 2004, Sohu filed with the Securities and Exchange Commission an amendment to its Current Report on Form 8-K initially filed on December 5, 2003 amending and restating the financial statements of the 17173.com Web site.

On April 22, 2004, Sohu filed with the Securities and Exchange Commission an amendment to its Current Report on Form 8-K initially filed on December 5, 2003 amending and restating the financial statements of the Focus.cn Web site.

On May 3, 2004, Sohu filed with the Securities and Exchange Commission a Current Report on Form 8-K announcing a stock repurchase program and its earnings results for the quarter ended March 31, 2004.

On May 18, 2004, Sohu filed with the Securities and Exchange Commission a Current Report on Form 8-K announcing its signing of a definitive agreement to acquire Beijing Good Feel Technology Co., Ltd.

On June 2, 2004, Sohu filed with the Securities and Exchange Commission a Current Report on Form 8-K in connection with its stock repurchase program and completion of the acquisition of Beijing Good Feel Technology Co., Ltd.

On June 23, 2004, Sohu filed with the Securities and Exchange Commission an amendment to its Current Report on Form 8-K initially filed on December 5, 2003 amending and restating the financial statements of the Focus.cn and 17173.com Web sites.

[Table of Contents](#)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 9, 2004

SOHU.COM INC.

By: /s/ Carol Yu

Chief Financial Officer (Principal
Financial Officer)

Sohu.com Inc.
Quarterly Report on Form 10-Q For Quarter Ended June 30, 2004

EXHIBITS INDEX

- 10.1 Stock Purchase Agreement among Sohu.com Limited, Marvel Hero Limited, the two Shareholders of Marvel (Kim Dong Gu, Kim Zhi Huan), and the two founders of Beijing Goodfeel Information Technology Co., Ltd. (Li Mingzhe and Yang Xianghua)
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Charles Zhang
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Carol Yu
- 32.1 Section 1350 Certification of Charles Zhang
- 32.2 Section 1350 Certification of Carol Yu

STOCK PURCHASE AGREEMENT

among

SOHU.COM LIMITED

MARVEL HERO LIMITED 建翠有限公司

THE SHAREHOLDERS LISTED
ON PART I OF EXHIBIT A

and

THE INDIVIDUALS LISTED ON PART II OF EXHIBIT A

Dated as of May 16, 2004

TABLE OF CONTENTS

	<u>Page</u>
 ARTICLE I DEFINITIONS 	
SECTION 1.01. Certain Defined Terms	1
SECTION 1.02. Definitions	6
SECTION 1.03. Interpretation and Rules of Construction	6
 ARTICLE II PURCHASE AND SALE 	
SECTION 2.01. Purchase and Sale of the Shares and the Registered Capital	7
SECTION 2.02. Purchase Price	7
SECTION 2.03. Closing	8
SECTION 2.04. Closing Deliveries by the Company	8
SECTION 2.05. Closing Deliveries by the Sellers	9
SECTION 2.06. Closing Deliveries by the Purchaser	9
 ARTICLE III ARTICLE III REPRESENTATIONS AND WARRANTIES OF THE COMPANY, EACH SELLER AND EACH SHAREHOLDER 	
SECTION 3.01. Organization and Qualification	10
SECTION 3.02. Affiliates	10
SECTION 3.03. Authority; No Conflict; Required Filings and Consents	10
SECTION 3.04. Capitalization of the Company; Affiliates	11
SECTION 3.05. Capitalization of Goodfeel.	12
SECTION 3.06. Financial Statements	12
SECTION 3.07. Absence of Certain Changes or Events	13
SECTION 3.08. Properties	13
SECTION 3.09. Permits; Compliance	13
SECTION 3.10. Contracts and Commitments	14
SECTION 3.11. Intellectual Property	16
SECTION 3.12. Litigation	17
SECTION 3.13. [Reserved]	18
SECTION 3.14. Insurance	18
SECTION 3.15. Employee Benefit Matters	18
SECTION 3.16. Labor Matters	19
SECTION 3.17. Employees of the Business	19
SECTION 3.18. Certain Interests	20
SECTION 3.19. Taxes	20
SECTION 3.20. Assets	20
SECTION 3.21. Books and Records	21
SECTION 3.22. Certain Business Practices	21
SECTION 3.23. Brokers	21
SECTION 3.24. Seller Authority; No Conflict; Required Filings and Consents	21
SECTION 3.25. [Reserved]	22
SECTION 3.26. Full Disclosure	22

ARTICLE IV REPRESENTATIONS AND WARRANTIES OF THE PURCHASER

SECTION 4.01. Organization and Qualification	22
SECTION 4.02. Authority; No Conflict; Required Filings and Consents	22
SECTION 4.03. Brokers	23

ARTICLE V ADDITIONAL AGREEMENTS

SECTION 5.01. Conduct of Business	23
SECTION 5.02. Access to Information	25
SECTION 5.03. Confidentiality	25
SECTION 5.04. Regulatory and Other Authorizations; Notices and Consents	26
SECTION 5.05. Notice of Developments	26
SECTION 5.06. No Solicitation or Negotiation	27
SECTION 5.07. Use of Intellectual Property	27
SECTION 5.08. Non-Competition	27
SECTION 5.09. Release of Indemnity Obligations	28
SECTION 5.10. Equity Transfer	28
SECTION 5.11. Government Approvals	28
SECTION 5.12. Further Action	28

ARTICLE VI CONDITIONS TO THE TRANSACTIONS

SECTION 6.01. Conditions to Obligations of the Company, the Sellers and the Founders	29
SECTION 6.02. Conditions to Obligations of the Purchaser	29

ARTICLE VII INDEMNIFICATION

SECTION 7.01. Survival of Representations and Warranties	31
SECTION 7.02. Indemnification by the Sellers and the Founders	31

ARTICLE VIII TERMINATION, AMENDMENT AND WAIVER

SECTION 8.01. Termination	33
SECTION 8.02. Effect of Termination	34
SECTION 8.03. Amendment	34
SECTION 8.04. Waiver	34

ARTICLE IX

POST CLOSING COVENANTS

SECTION 9.01. Post-Closing Employee Obligations.	35
SECTION 9.02. Assistance with Goodfeel's Trademark Application Assignment.	35
SECTION 9.03. Assistance with Contract Renewal.	35
SECTION 9.04. Assistance with Certain Contract Termination.	35
SECTION 9.05. Equity Transfer Agreement.	35
SECTION 9.06. Further Assurances .	36

ARTICLE X GENERAL PROVISIONS

SECTION 10.01. Expenses	36
SECTION 10.02. Notices	36
SECTION 10.03. Third-Party Beneficiaries	37
SECTION 10.04. Public Announcements	37
SECTION 10.05. Severability	37

SECTION 10.06. Assignment; Binding Effect	37
SECTION 10.07. Incorporation of the Disclosure Schedule and the Exhibits	38
SECTION 10.08. Governing Law	38
SECTION 10.09. Dispute Resolution	38
SECTION 10.10. Headings	38
SECTION 10.11. Counterparts	38
SECTION 10.12. Currency	38
SECTION 10.13. Entire Agreement	38

EXHIBITS

Exhibit A	The Sellers and the Founders
Exhibit B	Form of Equity Transfer Agreement

DISCLOSURE SCHEDULE

Section 3.02	Affiliates
Section 3.03	Required Filings and Consents
Section 3.04	Capitalization of the Company
Section 3.08	Properties
Section 3.10	Contracts and Commitments
Section 3.11	Intellectual Property
Section 3.14	Insurance
Section 3.15	Employee Benefit Matters
Section 3.17	Employees of the Business
Section 3.18	Certain Interests
Section 9.04	Certain Agreements

STOCK PURCHASE AGREEMENT (this "Agreement"), dated as of May 16, 2004, among SOHU.COM LIMITED, a company incorporated in the Cayman Islands (the "Purchaser"), MARVEL HERO LIMITED (建翠有限公司), a corporation organized under the laws of the Hong Kong Special Administrative Region (the "Company"), the shareholders of the Company listed on Part I of Exhibit A hereto (collectively, the "Sellers" and individually, a "Seller") and the individuals listed on Part II of Exhibit A hereto (collectively, the "Founders" and individually, a "Founder").

WHEREAS, the Company, through Beijing G. Feel Technology Co., Ltd. (北京吉菲尔技术有限公司) ("Goodfeel"), a limited liability company organized under the laws of the People's Republic of China (the "PRC"), is engaged in the business of providing value-added mobile data services (including the development and sales, through Monternet, of ring tones, pictures and K-Java games for mobile phones) in the PRC (the "Business");

WHEREAS, each Seller owns such number of ordinary shares, par value HK\$1.00 per share, of the Company (the "Company Common Stock") as is set forth opposite such Seller's name on Part I of Exhibit A hereto, which collectively represent all of the outstanding share capital of the Company (the "Shares");

WHEREAS, each of the Founders specified in Part II of Exhibit A hereto owns the amount of registered capital of Goodfeel as is set forth opposite such Founder's name on Part III of Exhibit A hereto, which collectively represent all of the subscribed and contributed registered capital of Goodfeel as of the date hereof (the "Registered Capital");

WHEREAS, the Sellers wish to sell to the Purchaser, and the Purchaser wishes to purchase or to cause its designee(s) (the "Purchaser Designees") to purchase from the Sellers, the Shares, upon the terms and subject to the conditions set forth in this Agreement;

WHEREAS, the Founders wish to sell to the Purchaser, and the Purchaser wishes to purchase or to cause its Purchaser Designees to purchase from the Founders, the Registered Capital, upon the terms and subject to the conditions set forth in this Agreement and that certain Equity Transfer Agreement set forth in the form attached as Exhibit B (the "Equity Transfer Agreement");

NOW, THEREFORE, in consideration of the premises and the mutual agreements and covenants hereinafter set forth, and intending to be legally bound, the Purchaser, the Sellers, the Company and the Founders hereby agree as follows:

ARTICLE I

DEFINITIONS

SECTION 1.01. Certain Defined Terms. For purposes of this Agreement:

"Action" means any claim, action, suit, arbitration, inquiry, proceeding or investigation by or before any Governmental Authority.

"Affiliate" means, with respect to any specified Person, any other Person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, such specified Person. For the avoidance of doubt, Goodfeel is an Affiliate of the Company.

“Ancillary Agreements” means the Employment Contracts and the Equity Transfer Agreement.

“Assets” means the tangible and intangible assets and properties of the Company and the Affiliates, including the Real Property.

“Business Day” means any day (other than a Saturday or Sunday) on which commercial banking institutions in the Hong Kong Special Administrative Region are open for business.

“China Mobile Cooperation Agreement” means the Corporation Agreement signed by China Mobile Communications Group Corporation and Goodfeel on May 21, 2003.

“Claims” means any and all administrative, regulatory or judicial actions, suits, petitions, appeals, demands, demand letters, claims, liens, notices of noncompliance or violation, investigations, proceedings, consent orders or consent agreements.

“Company Software” means all Software developed, used, owned, manufactured, sold, distributed or licensed by the Company or any of its Affiliates.

“control” (including the terms “controlled by” and “under common control with”), with respect to the relationship between or among two or more Persons, means the possession, directly or indirectly or as trustee, personal representative or executor, of the power to direct or cause the direction of the affairs or management of a Person, whether through the ownership of voting securities, as trustee, personal representative or executor, by contract, credit arrangement or otherwise.

“Disclosure Schedule” means the Disclosure Schedule attached hereto, dated as of the date hereof, delivered by the Company, Goodfeel, the Founders and the Sellers to the Purchaser in connection with this Agreement.

“Encumbrance” means any security interest, pledge, hypothecation, mortgage, lien (including environmental and tax liens), violation, charge, lease, license, encumbrance, servient easement, adverse claim, reversion, reverter, preferential arrangement, restrictive covenant, condition or restriction of any kind, including any restriction on the use, voting, transfer, receipt of income or other exercise of any attributes of ownership.

“Equity Amount” means RMB 4,000,000, net of individual income tax, which shall be withheld according to the PRC’s applicable taxation law, the purchase price for the Registered Capital paid by the Purchaser or the Purchaser Designees pursuant to Section 2.02 of this Agreement and the Equity Transfer Agreement as of the date hereof.

“Governmental Authority” means any PRC or non-PRC national, supranational, state, provincial, local, or similar government, governmental, regulatory or administrative authority, agency or commission or any court, tribunal, or judicial or arbitral body.

“Governmental Order” means any order, ruling, writ, judgment, injunction, decree, stipulation, determination or award entered by or with any Governmental Authority.

“Guangdong Mobile Cooperation Agreement” means the Cooperation Agreement signed by Guangdong Mobile Communications Co., Ltd. and Goodfeel on December 27, 2003.

“HK\$” means Hong Kong dollars, the lawful currency of the Hong Kong Special Administrative Region.

“Indebtedness” means, with respect to any Person, (a) all indebtedness of such Person, whether or not contingent, for borrowed money, (b) all obligations of such Person for the deferred purchase price of property or services, (c) all obligations of such Person evidenced by notes, bonds, debentures or other similar instruments, (d) all indebtedness created or arising under any conditional sale or other title retention agreement with respect to property acquired by such Person (even though the rights and remedies of the seller or lender under such agreement in the event of default are limited to repossession or sale of such property), (e) all obligations of such Person as lessee under leases that have been or should be, in accordance with U.S. GAAP, recorded as capital leases, (f) all obligations, contingent or otherwise, of such Person under acceptance, letter of credit or similar facilities, (g) all obligations of such Person to purchase, redeem, retire, defease or otherwise acquire for value any capital stock or registered capital of such Person or any warrants, rights or options to acquire such capital stock or registered capital, (h) all Indebtedness of others referred to in clauses (a) through (g) above guaranteed directly or indirectly in any manner by such Person, or in effect guaranteed directly or indirectly by such Person through an agreement (i) to pay or purchase such Indebtedness or to advance or supply funds for the payment or purchase of such Indebtedness, (ii) to purchase, sell or lease (as lessee or lessor) property, or to purchase or sell services, primarily for the purpose of enabling the debtor to make payment of such Indebtedness or to assure the holder of such Indebtedness against loss, (iii) to supply funds to or in any other manner invest in the debtor (including any agreement to pay for property or services irrespective of whether such property is received or such services are rendered) or (iv) otherwise to assure a creditor against loss, and (i) all Indebtedness referred to in clauses (a) through (g) above secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any Encumbrance on property (including accounts and contract rights) owned by such Person, even though such Person has not assumed or become liable for the payment of such Indebtedness.

“Intellectual Property” means (i) patents, patent applications and statutory invention registrations, (ii) trademarks, service marks, Company Marks, Internet domain names, trade dress, trade names, logos, and other source identifiers, including registrations and applications for registration thereof, (iii) copyrights, including registrations and applications for registration thereof, (iv) Software, and (v) confidential and proprietary information, including trade secrets, know-how, designs and drawings, engineering documents, technical manuals, patterns, processes, formulae, inventions and discoveries (whether patentable or not), and all related documentation, developer notes, comments and annotations, and other similar rights of the Company and its Affiliates, and all applications therefor and registrations thereof, and all rights to sue for past, present and future infringement or other violations of the Intellectual Property, and all goodwill associated with any of the foregoing.

“IP Agreements” means all (a) licenses of Intellectual Property by the Company or any Affiliate to any third party, (b) licenses of Intellectual Property by any third party to the Company or any Affiliate, (c) agreements between the Company or any Affiliate and any third party relating to the development or use of Intellectual Property, the

development or transmission of data, or the use, modification, framing, linking, advertisement, or other practices with respect to Internet web sites, and (d) consents, settlements, decrees, orders, injunctions, judgments or rulings governing the use, validity or enforceability of Intellectual Property.

“Law” means any PRC or non-PRC national, supranational, state, provincial, local or similar statute, law, ordinance, regulation, rule, code, Governmental Order, requirement or rule of law (including common law).

“Leased Real Property” means the real property leased by the Company or any Affiliate as tenant, together with, to the extent leased by the Company or any Affiliate, all buildings and other structures, facilities or improvements currently or hereafter located thereon, all fixtures, systems, equipment and items of personal property of the Company or any Affiliate attached or appurtenant thereto and all easements, licenses, rights and appurtenances relating to the foregoing.

“Liabilities” means any and all debts, liabilities and obligations, whether accrued or fixed, absolute or contingent, matured or unmatured or determined or determinable, including those arising under any Law (including any Tax Law), Action or Governmental Order and those arising under any contract, agreement, arrangement, commitment or undertaking.

“Licensed Intellectual Property” means all Intellectual Property licensed to the Company or any Affiliate pursuant to the IP Agreements.

“Material Adverse Effect” means any event, circumstance, change in or effect on the Business, the Company and the Affiliates or the Purchaser and its Affiliates, as the context dictates, that, individually or in the aggregate with all other events, circumstances, changes in or effects on the Business, the Company and the Affiliates or the Purchaser and its Affiliates, as the context dictates, has had or is reasonably expected to have a material adverse effect on the business, operations, prospect assets or liabilities (including without limitation, contingent liabilities) results of operations or the condition (financial or otherwise) of the Business, the Company and the Affiliates or the Purchaser and its Affiliates, as the context dictates, taken as a whole.

“Owned Intellectual Property” means all Intellectual Property owned by the Company or any Affiliate.

“Owned Real Property” means the real property in which the Company or any Affiliate has fee title (or equivalent) interest, together with all buildings and other structures, facilities or improvements currently or hereafter located thereon, all fixtures, systems, equipment and items of personal property of the Company or any Affiliate attached or appurtenant thereto and all easements, licenses, rights and appurtenances relating to the foregoing.

“PRC GAAP” means PRC Accounting Standards for Business Enterprises and other relevant accounting laws and regulations in effect from time to time applied consistently throughout the periods involved.

“Permitted Encumbrances” means such of the following as to which no enforcement, collection, execution, levy or foreclosure proceeding shall have been

commenced and as to which neither the Company nor any Affiliate is otherwise subject to civil or criminal liability due to its existence: (a) liens for Taxes not yet due and payable, for which adequate reserves have been maintained in accordance with U.S. GAAP; (b) Encumbrances imposed by Law, such as materialmen's, mechanics', carriers', workmen's and repairmen's liens and other similar liens arising in the ordinary course of business securing obligations that (i) are not overdue for a period of more than 30 days and (ii) are not in excess of RMB50,000 in the case of a single property or RMB500,000 in the aggregate at any time; (c) pledges or deposits to secure obligations under workers' compensation laws or similar legislation or to secure public or statutory obligations; and (d) minor survey exceptions, reciprocal easement agreements and other customary encumbrances on title to real property that (i) were not incurred in connection with any Indebtedness, (ii) do not render title to the property encumbered thereby unmarketable and (iii) do not, individually or in the aggregate, materially adversely affect the value of or the use of such property for its current and anticipated purposes.

"Person" means any individual, partnership, firm, corporation, limited liability company, association, trust, unincorporated organization or other entity, as well as any syndicate or group that would be deemed to be a person under Section 13(d)(3) of the Securities Exchange Act of 1934.

"RMB" means Renminbi Yuan, the lawful currency of the PRC.

"Real Property" means the Leased Real Property and the Owned Real Property.

"Reference Balance Sheet" means the unaudited balance sheet (including the related notes and schedules thereto) of Goodfeel dated as of April 30, 2004 prepared in accordance with PRC GAAP.

"Software" means computer software, programs and databases in any form, including Internet web sites, web contentlinks, source code, object code, operating systems and specifications, data, databases, database management code, utilities, graphical user interfaces, menus, images, icons, forms, methods of processing, software engines, platforms, and data formats, and all versions, updates, corrections, enhancements, replacements, and modifications thereof, and all documentation related thereto.

"Tax" or "Taxes" shall mean any and all taxes, fees, levies, duties, tariffs, imposts and other charges of any kind (together with any and all interest, penalties, additions to tax and additional amounts imposed with respect thereto) imposed by any Governmental Authority or taxing authority, including: taxes or other charges on or with respect to income, franchise, windfall or other profits, gross receipts, property, sales, use, capital stock, payroll, employment, social security, workers' compensation, unemployment compensation or net worth; taxes or other charges in the nature of excise, withholding, ad valorem, stamp, transfer, value-added or gains taxes; license, registration and documentation fees; and customers' duties, tariffs and similar charges.

"Technical Service Agreement" means the Technical Consulting and Service Agreement entered into by the Company and Goodfeel on May 1, 2003, as amended as of February 1, 2004.

"U.S. GAAP" means United States generally accepted accounting principles and practices in effect from time to time applied consistently throughout the periods involved.

SECTION 1.02. Definitions The following terms have the meanings set forth in the Sections set forth below:

<u>Definition</u>	<u>Location</u>
<u>“Aggregate Purchase Price”</u>	2.02(a)
<u>“Agreement”</u>	Preamble
<u>“Business”</u>	Recitals
<u>“Business Employee”</u>	9.01
<u>“Closing”</u>	2.03
<u>“Closing Date”</u>	2.03
<u>“Closing Deliveries”</u>	2.02
<u>“Closing Payment”</u>	2.02(b)
<u>“Company”</u>	Preamble
<u>“Company Common Stock”</u>	Recitals
<u>“Company Marks”</u>	5.07
<u>“Deposit”</u>	2.02 (b)(ii)
<u>“Employee Obligations”</u>	9.01
<u>“Employment Contracts”</u>	6.02
<u>“Equity Transfer Agreement”</u>	Recitals
<u>“Financial Statements”</u>	3.06(a)
<u>“Founders”</u>	Preamble
<u>“Goodfeel”</u>	Recitals
<u>“Loss”</u>	7.02(a)
<u>“Material Contracts”</u>	3.10(a)
<u>“Operational Records”</u>	3.06
<u>“Permits”</u>	3.09(a)
<u>“Plans”</u>	3.15(a)
<u>“PRC”</u>	Recitals
<u>“Purchaser”</u>	Preamble
<u>“Purchaser Designees”</u>	Recitals
<u>“Purchaser Indemnified Party”</u>	7.01(a)(2)
<u>“Registered Capital”</u>	Recitals
<u>“Registration”</u>	2.02(b)
<u>“Restricted Period”</u>	5.08(a)
<u>“Sellers”</u>	Preamble
<u>“Shares”</u>	Recitals
<u>“Third Party Claims”</u>	7.02(b)
<u>“Total Purchase Price”</u>	2.02(a)

SECTION 1.03. Interpretation and Rules of Construction. In this Agreement, except to the extent otherwise provided or that the context otherwise requires:

(a) when a reference is made in this Agreement to an Article, Section, Exhibit or Schedule, such reference is to an Article or Section of, or a Schedule or Exhibit to, this Agreement unless otherwise indicated;

(b) the table of contents and headings for this Agreement are for reference purposes only and do not affect in any way the meaning or interpretation of this Agreement;

(c) whenever the words “include,” “includes” or “including” are used in this Agreement, they are deemed to be followed by the words “without limitation”;

(d) the words “hereof,” “herein” and “hereunder” and words of similar import, when used in this Agreement, refer to this Agreement as a whole and not to any particular provision of this Agreement;

(e) all terms defined in this Agreement have the defined meanings when used in any certificate or other document made or delivered pursuant hereto, unless otherwise defined therein;

(f) the definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms;

(g) any Law defined or referred to herein or in any agreement or instrument that is referred to herein means such Law or statute as from time to time amended, modified or supplemented, including by succession of comparable successor Laws;

(h) references to a Person are also to its successors and permitted assigns; and

(i) the use of “or” is not intended to be exclusive unless expressly indicated otherwise.

ARTICLE II

PURCHASE AND SALE

SECTION 2.01. Purchase and Sale of the Shares and the Registered Capital.

(a) Upon the terms and subject to the conditions of this Agreement, at the Closing, the Sellers shall sell, assign, transfer, convey and deliver, or cause to be sold, assigned, transferred, conveyed and delivered, to the Purchaser or to one or more Affiliates or Affiliates designated by the Purchaser, the Shares and any and all right, title and interest of any Seller in and to the Shares, and the Purchaser shall purchase or shall cause such designee to purchase the Shares.

(b) The Founders shall sell, assign, transfer, convey and deliver to the Purchaser or the Purchaser Designees, and the Purchaser shall cause the Purchaser or the Purchaser Designees to purchase, the Registered Capital pursuant to the terms of the Equity Transfer Agreement and as set forth herein prior to the Closing.

SECTION 2.02. Purchase Price The aggregate purchase price for the Shares and the covenants contained in Section 5.08 shall be seventeen million five hundred sixteen thousand three hundred twenty-five U.S.dollars (U.S.\$17,516,325) (the “Aggregate Purchase Price”). The Aggregate Purchase Price for the Registered Capital shall be the Equity Amount payable in accordance with the terms of the Equity Transfer Agreement and as set forth herein. The Aggregate Purchase Price and the foregoing Equity Amount is referred to as the “Total Purchase Price.”

(b) The Total Purchase Price shall be paid as follows.

(i) Upon the signing of this Agreement, the Purchaser or its Purchaser Designees shall pay U.S. \$500,000 by check or wire transfer of immediately available funds in the form of a deposit (the "Deposit") to the Sellers to be credited at Closing towards the Aggregate Purchase Price.

(ii) Upon the registration of the transfer of the Registered Capital with the appropriate Governmental Authority (the "Registration"), which shall occur on or about May 28, 2004, the Purchaser or the Purchaser Designees shall pay the Equity Amount to the Founders according to the ratio specified in the Equity Transfer Agreement.

(iii) U.S. \$8,316,325 of the Aggregate Purchase Price shall be paid by the Purchaser or the Purchaser Designees to the Sellers at the Closing by wire transfer of immediately available funds to the account(s) designated in writing by the Sellers to the Purchaser (the "Closing Payment").

(iv) The remainder of the Aggregate Purchase Price (which for clarification is the Aggregate Purchase Price less the Deposit less the Closing Payment (i.e., US\$8,700,000)) shall be paid by the Purchaser or the Purchaser Designees to the Sellers upon satisfaction by the Founders of their obligations to be satisfied following the Closing under the Equity Transfer Agreement by wire transfer of immediately available funds to the account(s) designated in writing by the Sellers to the Purchaser.

(c) The Purchaser's obligation to pay each installment of the Total Purchase Price will be subject to the continued accuracy as of the date of such installment of the Company's, the Affiliates', Sellers' and the Founders' representations and warranties made herein and in the Equity Transfer Agreement. At the Closing, the Company, the Sellers and the Founders shall make the closing deliveries as set forth in Section 2.04 and 2.05, as applicable and the Purchaser or the Purchaser Designees shall make the closing deliveries as set forth in Section 2.06 (the "Closing Deliveries").

SECTION 2.03. Closing Subject to the terms and conditions of this Agreement, the sale and purchase of the Shares contemplated by this Agreement shall take place at a closing (the "Closing") to be held at the offices of the Purchaser, which are located at 15/F, Tower 2, Bright China Chang An Building, 7 Jianguomennei Avenue, Beijing, PRC following the satisfaction or, if permissible, waiver of all conditions to the obligations of the parties set forth in Article VI hereof (other than those conditions that will be satisfied at the Closing) which shall be targeted for May 28, 2004 but shall be no later than June 30, 2004, or at such other place or at such other time or on such other date as the parties may mutually agree upon in writing. The date and time of the Closing are herein referred to as the "Closing Date".

SECTION 2.04. Closing Deliveries by the Company. At the Closing, the Company shall deliver and the Sellers and the Founders shall cause to be delivered to the Purchaser:

(a) a true and complete copy of (i) the board resolutions duly and validly adopted by the Board of Directors of the Company and (ii) the resolutions of the shareholders of the Company, evidencing their respective authorization and approval of the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby;

(b) a true and complete copy of the board resolutions duly and validly adopted by the Board of Directors of the Company approving (i) the registration of the Purchaser or the Purchaser Designees as a shareholder of the Company subject only to the production of duly completed instruments of transfer in respect of the Shares; (ii) approving the appointment of Victor Koo, Carol Yu and Kim Zhi Huan as directors of the Company; and (iii) approving the resignation of the Sellers as directors of the Company;

(c) stock certificates evidencing the Registered Capital duly endorsed in blank, or accompanied by stock powers duly executed in blank, in form satisfactory to Purchaser and with all required stock transfer tax stamps affixed, along with the Purchaser Designees, investment certificates or other reasonable evidence issued by Goodfeel evidencing the ownership of the Registered Capital by the Purchaser;

(d) all filings, consents, approvals, permits and authorizations set forth in Section 6.02(iv);

(e) executed counterparts of the Employment Contracts;

(f) the opinion, certificates and other documents required to be delivered pursuant to Section 6.02.

SECTION 2.05. Closing Deliveries by the Sellers. At the Closing, each Seller shall deliver or cause to be delivered to Purchaser:

(a) duly executed instruments of transfer in respect of all of the Shares in favor of the Purchaser or the Purchaser Designees together with the relevant share certificates evidencing the Shares, along with investment certificates or other reasonable evidence issued by the Company evidencing the ownership of the Shares by the Purchaser or the Purchaser Designees;

(b) a receipt for the portion of the Total Purchase Price to be paid at Closing pursuant to Section 2.2(b);

(c) a letter of resignation as director of the Company;

(d) except for the items set forth in the Equity Transfer Agreement which are post Closing deliveries, the original and duplicate materials for the amendment of the business license and other registrations of the Company and/or Goodfeel evidencing the completion of the transactions contemplated by the Equity Transfer Agreement and of this Agreement;

(e) the opinion, certificates and other documents required to be delivered pursuant to Section 6.02.; and

(f) evidence that each of the Company and Goodfeel has removed those Persons who were bank signatories to any and all bank and deposit accounts of the Company and Goodfeel immediately prior to the Closing from such bank and deposit accounts.

SECTION 2.06. Closing Deliveries by the Purchaser. At the Closing, the Purchaser shall deliver to the Company, the Founders or the Sellers (as applicable):

(a) the portion of the Total Purchase Price to be paid at Closing pursuant to Section 2.2(b), in U.S. dollars by wire transfer in immediately available funds to the bank account designated by the Sellers;

(b) a true and complete copy of the resolutions duly and validly adopted by the Board of Directors of the Purchaser evidencing its authorization and approval of the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby;

(c) executed counterparts of the Employment Contracts; and

(d) the certificates and other documents required to be delivered pursuant to Section 6.01.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE COMPANY, EACH SELLER AND EACH FOUNDER

As an inducement to the Purchaser to enter into this Agreement, the Company, each Seller and each Founder, jointly and severally, represent and warrant to the Purchaser as follows:

SECTION 3.01. Organization and Qualification. Each of the Company and the Affiliates is a corporation duly incorporated, validly existing and in good standing under the laws of the jurisdiction of its organization and has all requisite power and authority to own, lease and operate its properties and to carry on its business as it is now being conducted. Neither the Company nor any Affiliate has conducted any business in any jurisdiction other than in the PRC. The Company has heretofore made available to the Purchaser a complete and correct copy of the Certificate of Incorporation, the Memorandum of Association and the Articles of Association or the equivalent organizational documents of the Company and each Affiliate. Such Certificates of Incorporation, the Memorandum of Association and the Articles of Association or equivalent organizational documents are in full force and effect. Neither the Company nor any Affiliate is in violation of any of the provisions of its Certificate of Incorporation, Memorandum of Association or Articles of Association or equivalent organizational documents. The Company and the Affiliates have no subsidiaries.

SECTION 3.02. Affiliates. (a) Section 3.02(a) of the Disclosure Schedule sets forth a true and complete list of all Affiliates, listing for each Affiliate its name, type of entity, the jurisdiction and date of its incorporation or organization, its authorized capital stock, registered capital, partnership capital or equivalent, the number and type of its issued and outstanding shares of capital stock, registered capital, partnership interests or similar ownership interests and the current ownership of such shares, partnership interests or similar ownership interests.

(b) Other than the Company and Goodfeel, there are no other corporations, partnerships, joint ventures, associations or other entities that participate in or that are involved in the Business. The Business is the sole business conducted, now and in the past, by the Company or Goodfeel.

SECTION 3.03. Authority; No Conflict; Required Filings and Consents. (a) Each of the Company and the Affiliates has all necessary corporate (or other requisite) power

and authority to execute and deliver this Agreement and the Ancillary Agreements to which it is a party and to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Ancillary Agreements by the Company and each Affiliate that is a party thereto and the consummation by the Company and each such Affiliate of the transactions contemplated hereby and thereby have been duly and validly authorized by all necessary corporate (or other requisite) action and no other corporate (or other requisite) proceedings on the part of the Company or any Affiliate are necessary to authorize this Agreement or the Ancillary Agreements or to consummate the transactions contemplated hereby or thereby. This Agreement has been, and upon their execution the Ancillary Agreements shall have been, duly and validly executed and delivered by the Company and each Affiliate that is a party thereto and, assuming the due authorization, execution and delivery by the Purchaser, constitutes, and upon their execution the Ancillary Agreements shall constitute, a legal, valid and binding obligation of the Company and each Affiliate that is a party thereto, enforceable against the Company and such Affiliate in accordance with their respective terms.

(b) The execution and delivery of this Agreement and the Ancillary Agreements by the Company and each Affiliate that is a party thereto do not and will not as the case may be, and the performance of this Agreement and the Ancillary Agreements by the Company and each such Affiliate will not, (i) conflict with or violate the Certificate of Incorporation, Memorandum of Association or Articles of Association or equivalent organizational documents of the Company or any Affiliate, (ii) assuming that all consents, approvals, authorizations and other actions described in Section 3.03(c) of the Disclosure Schedule have been obtained and all filings and obligations described in Section 3.03(c) of the Disclosure Schedule have been made, conflict with or violate any Law applicable to the Company or any Affiliate or by which any Asset is bound or affected, or (iii) result in any breach of or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any right of termination, amendment, acceleration or cancellation of, or result in the creation of any Encumbrance on any capital stock or registered capital of the Company or any Affiliate, including the Shares and the Registered Capital or on any Asset pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation.

(c) Except as disclosed in Section 3.03(c) of the Disclosure Schedule, the execution and delivery of this Agreement and the Ancillary Agreements by the Company and each Affiliate that is a party thereto do not and will not, as the case may be, and the performance of this Agreement and the Ancillary Agreements by the Company and each such Affiliate will not, require any consent, approval, authorization or permit of, or filing with or notification to, any third party or any Governmental Authority.

SECTION 3.04. Capitalization of the Company. The authorized share capital of the Company consists of 10,000 shares, par value HK\$1.00 of Company Common Stock. As of the date hereof, (a) 2 shares of Company Common Stock are issued and outstanding, all of which are validly issued, fully paid and nonassessable and are owned of record by the Sellers and beneficially by Kim Zhi Huan, free and clear of any Encumbrances (other than Encumbrances created by this Agreement), in the amounts set forth on Part I of Exhibit A hereto; such 2 shares constitute the “Shares;” and there are no issued shares of capital stock of the Company other than the Shares, (b) no shares of Company Common Stock are held in the treasury of the Company, (c) 9,998 shares of Company Common Stock are reserved for future issuance. Except for the foregoing 10,000 shares of Company Common Stock

described in the preceding sentence, there are no other shares of capital stock or securities convertible into or exercisable for shares of capital stock of the Company issued and outstanding. There are no options, warrants, notes, convertible securities, rights of first refusal, preemptive rights, subscription rights or other rights, agreements, arrangements or commitments of any character relating to the issued or unissued capital stock of the Company or obligating the Company to issue or sell any shares of capital stock, options, warrants or convertible securities of, or other interests in, the Company. There are no outstanding contractual obligations of the Company to repurchase, redeem or otherwise acquire any shares of capital stock of the Company. Except for this Agreement and as set forth in Section 3.04(a) of the Disclosure Schedule, there are no voting trusts, shareholder agreements, proxies or other agreements or understandings in effect with respect to the voting or transfer of any of the Shares. There are no material outstanding contractual obligations of the Company to provide funds to, or make any investment (in the form of a loan, capital contribution or otherwise) in, any Person. Upon the Closing, (a) the Purchaser will own all of the issued and outstanding capital stock of the Company, beneficially and of record, free and clear of all Encumbrances and (b) the Shares will be fully paid and nonassessable.

SECTION 3.05. Capitalization of Goodfeel. The Registered Capital of Goodfeel is RMB 1,000,000 of which 73% is held by Li Ming Zhe, and 27% is held by Yang Xiang Hua. The Registered Capital is owned of record by the Founders and beneficially by Kim Zhi Huan, free and clear of any Encumbrances (other than Encumbrances created by this Agreement or the Equity Transfer Agreement). Upon the consummation of the transactions contemplated by the Equity Transfer Agreement and this Agreement, the Purchaser or the Purchaser Designees will own all of the Registered Capital, beneficially and of record, free and clear of all Encumbrances.

SECTION 3.06. Financial Statements. (a) True and complete copies of the Reference Balance Sheet and the unaudited balance sheets of Goodfeel as at December 31, 2003 and April 30, 2004, respectively, and the related unaudited statements of operations, income, retained earnings, stockholders' equity and cash flows for the fiscal year ended as of December 31, 2003 and for the month ended as of April 30, 2004, respectively, together with all related notes and schedules thereto (collectively, the "Financial Statements") have been delivered by the Company to the Purchaser. The Financial Statements (i) were prepared in accordance with the books of account and other financial records of Goodfeel, (ii) present fairly the consolidated financial condition and results of operations of Goodfeel as of the dates thereof or for the respective periods indicated therein, (iii) have been prepared in accordance with PRC GAAP applied on a basis consistent with the past practices of Goodfeel and (iv) include all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial condition of Goodfeel and the results of the operations of Goodfeel as of the dates thereof or for the periods covered thereby.

(b) There are no Liabilities of the Company or the Affiliates other than Liabilities (i) reflected or reserved against on the Reference Balance Sheet, or (ii) incurred since April 30, 2004 in the ordinary course of business consistent with past practice that would not be material to the Company or Goodfeel under U.S. GAAP.

(c) Complete and accurate copies of all Operational Records at the end of each calendar month of 2003 and of the first quarter of 2004 have been provided by the Company to the Purchaser. Operational Records: (i) are in all material respects complete and correct, and do not contain or reflect any material inaccuracies or discrepancies and (ii) have

been maintained in accordance with good business and accounting practices. As used herein the term "Operational Records" means any and all of the books, records and accounts relating to the Business and which either are or have been (a) required by Law or prudent business practice to be maintained; or (b) in fact maintained by the Company or any Affiliate.

SECTION 3.07. Absence of Certain Changes or Events. Since December 31, 2003, except as otherwise permitted by this Agreement, the Company and each Affiliate has conducted its business only in the ordinary course and in a manner consistent with past practice.

SECTION 3.08. Properties. (a) The Company and the Affiliates own good, valid and marketable title to all of the tangible personal property shown on the Reference Balance Sheet and thereafter acquired, free and clear of all Encumbrances, except for Permitted Encumbrances, and except for inventory and other personal property sold, exchanged or otherwise disposed of in the ordinary course of business and in a manner consistent with past practice.

(b) Neither the Company nor any of its Affiliates has any Owned Real Property.

(c) Section 3.08(c) of the Disclosure Schedule lists: (i) the street address of each parcel of Leased Real Property, (ii) the identity of the lessor, lessee and current occupant (if different from lessee) of each such parcel of Leased Real Property, (iii) the terms (referencing applicable renewal periods) and rental payment amounts (including all escalations) pertaining to each such parcel of Leased Real Property, and (iv) the current use of each such parcel of Leased Real Property.

(d) There is no material violation of any Law (including any building, planning or zoning Law) relating to any of the Real Property. Neither the Company nor any Affiliate has leased or subleased any parcel or any portion of any parcel of Real Property to any other Person and no other Person has any rights to the use, occupancy or enjoyment thereof pursuant to any lease, sublease, license, occupancy or other agreement, nor has the Company or any Affiliate assigned its interest under any lease or sublease listed in Section 3.08(c) of the Disclosure Schedule to any third party. There are no condemnation proceedings or eminent domain proceedings of any kind or other matters affecting materially and adversely the current use, occupancy or value of the Real Property pending or, to the knowledge of the Company after due inquiry, threatened against the Real Property. Each lease agreement in respect of each parcel of Leased Real Property has been registered with the appropriate Governmental Authority. To the best knowledge of the Company after due inquiry, there are no facts that would prevent the Real Property from being occupied by the Company or any Affiliate, as the case may be, after the Closing in the same manner as occupied by the Company or such Affiliate immediately prior to the Closing. The Company is not in default under any lease agreement to which it is a party with respect to any Leased Real Property.

SECTION 3.09. Permits; Compliance. (a) The Company and each Affiliate is in possession of all material franchises, grants, authorizations, licenses, certifications, permits, easements, variances, exceptions, consents, certificates, approvals and orders of any Governmental Authority necessary for the Company and each Affiliate to own, lease and operate its properties or to carry the Business (the "Permits"), and no suspension or cancellation of any of the Permits is pending or, to the knowledge of the Company, threatened.

(b) The Company and the Affiliates have each conducted and continue to conduct the Business in accordance with all Laws applicable to the Company or any Affiliate or the Assets and neither the Company nor any Affiliate is in conflict with, or in default or violation of, any such Law or any Permits.

SECTION 3.10. Contracts and Commitments. (a) Section 3.10(a) of the Disclosure Schedule lists each of the following contracts and agreements, whether written or oral, to which the Company or any Affiliate is a party as of the date hereof (such contracts and agreements, being "Material Contracts"):

(i) any contract or agreement (including, without limitation, purchase orders and acknowledgments) which (A) is likely to involve consideration in excess of US\$50,000 during the fiscal year ending December 31, 2004, (B) is likely to involve consideration in excess of US\$50,000 over the remaining term of such contract or agreement or (C) except employment agreements with the employees (other than the senior management) of Goodfeel, cannot be cancelled by the Company or such Affiliate without penalty or further payment and without more than 30 days' notice;

(ii) any sales, distributor, dealer, franchise, agency, promotion, marketing or advertising contract or agreement;

(iii) any management contract or agreement or contract or agreement with independent contractors, consultants or advisors that is not cancelable without penalty or further payment and without more than 30 days' notice;

(iv) any contract or agreement relating to Indebtedness and the respective principal amounts outstanding thereunder as of the date of this Agreement;

(v) any contract or agreement with any Governmental Authority;

(vi) any contract or agreement that limits or purports to limit the ability of the Company or any Affiliate, or, to the Company's knowledge, any employee of the Company or any Affiliate, to compete in any line of business or with any Person or in any geographic area or during any period of time;

(vii) any contract or agreement that contains restrictions with respect to payment of dividends or any other distribution in respect of the capital stock or registered capital of the Company or any Affiliate;

(viii) any contract or agreement concerning a partnership or joint venture;

(ix) any contract or agreement with any employee, consultant or advisor of the Company or any Affiliate or other individuals, including any existing severance (including early retirement and redundancy) plans or arrangements for any current or former employee of the Company or any Affiliate;

(x) any contract or agreement relating to the Real Property;

(xi) any contract or agreement under which the Company or any Affiliate is lessee of or holds or operates any personal property providing for payments in excess of US\$50,000 annually;

(xii) any contract or agreement relating to the acquisition or divestiture of the capital stock or other equity securities, registered capital, assets or business of any Person involving the Company or any Affiliate or pursuant to which the Company or any Affiliate has any Liability, contingent or otherwise;

(xiii) any contract or agreement, other than contracts and agreements entered into in the ordinary course of business, which prevents the Company or any Affiliate from disclosing confidential information;

(xiv) any warranty, guaranty or other similar undertaking with respect to a contractual performance extended by the Company or any Affiliate;

(xv) any contract or agreement pursuant to which the Company or any Affiliate has agreed to defend, indemnify or hold harmless any other Person;

(xvi) any contract or agreement under which the Company or any Affiliate has advanced or loaned any amount to any stockholder, director, officer or employee of the Company or any Affiliate;

(xvii) any contract or agreement between the Company or any Affiliate on the one hand and any Founder or Seller or any Affiliate, spouse or relative of a Founder or Seller on the other hand;

(xviii) any inter-company contract or agreement between the Company or any Affiliate on the one hand, and any Affiliate or Affiliate of an Affiliate on the other hand;

(xix) the IP Agreements;

(xx) any agreement pursuant to which the Company or any Affiliate has agreed to settle any Liability for Taxes;

(xxi) any agreement pursuant to which the Company or any Affiliate has agreed to shift or allocate the Liability of the Company or any other person for Taxes; and

(xxii) any other contract or agreement, whether or not made in the ordinary course of business, which is material to the Company, any Affiliate or the conduct of the Business, or the absence of which would have a Material Adverse Effect.

(b) Each Material Contract: (i) is legal, valid, binding and enforceable on the parties thereto and is in full force and effect and (ii) upon consummation of the transactions contemplated by this Agreement shall continue in full force and effect and shall not give rise to any termination, amendment, acceleration, cancellation or penalty or other adverse consequence. None of the Company, any Affiliate or any Founder is in breach of, or default under, any Material Contract.

(c) To the best knowledge of the Company and the Founders after due inquiry, no other party to any Material Contract is in breach thereof or default thereunder (nor

does there exist any condition which upon the passage of time or the giving of notice would cause such a breach thereof or default thereunder), and none of the Company, any Affiliate or any Founder has received any notice of termination, cancellation, breach or default under any Material Contract.

(d) The Company has made available to the Purchaser true and complete copies of all written Material Contracts, together with all material amendments, waivers or other changes thereto, and has been given a written description of all oral contracts.

(e) There is no contract, agreement or other arrangement granting any Person any preferential right to purchase, other than in the ordinary course of business consistent with past practice, any of the Assets, Shares or Registered Capital. Without limiting the generality of the foregoing, there is no contract, agreement or other arrangement with Sina or any other Person and to which the Company, any Affiliate, any Seller or any Founder is a party or subject (or otherwise impacting or affecting the Assets, Shares or Registered Capital) which (a) includes a “no-shop” provision or otherwise limits or restricts the ability of the Company, any Affiliate, any Seller or any Founder to perform their obligations under this Agreement or the Ancillary Agreements or to consummate the transactions herein or therein; (b) limits or restricts the ability of the Company, any Affiliate, any Seller or any Founder to provide to the Purchaser or its Affiliates any information or materials relating to the Company, any Affiliate, any Seller or any Founder, or the Business; or (c) otherwise would be breached by the execution and delivery of, or performance of any obligations under, this Agreement or the Ancillary Agreements by the Company, any Affiliate, any Seller or any Founder. There is no contract or agreement to which a Founder or Seller or any spouse or relative or Affiliate of such Founder or Seller is a party or is otherwise obligated relating to the Business, other than any Material Contract.

SECTION 3.11. Intellectual Property. (a) Section 3.11(a) of the Disclosure Schedule sets forth a true and complete list of (i) patents and patent applications, trademark registrations and trademark applications, copyright registrations and copyright applications, Software and Internet domain names included in the Owned Intellectual Property, (ii) the IP Agreements, (iii) other Owned Intellectual Property that is material to the Business and (iv) any Licensed Intellectual Property that is material to the Business. Except for the Owned Intellectual Property and the Licensed Intellectual Property, there are no other items of Intellectual Property that are material to the ordinary conduct of the business of the Company.

(b) The operation of the business of the Company and the Affiliates as currently conducted or as contemplated to be conducted, and the use of the Owned Intellectual Property and the Licensed Intellectual Property in connection therewith, do not conflict with, infringe, dilute, misappropriate or otherwise violate the Intellectual Property of any third party, and no claim is pending or threatened against the Company or any Affiliate alleging any of the foregoing.

(c) To the best knowledge of the Company or any Seller or Founder after due inquiry, no person is engaging in any activity or using any Intellectual Property that infringes, dilutes, misappropriates or otherwise violates or conflicts with the Owned Intellectual Property or Licensed Intellectual Property.

(d) The Company and the Affiliates are the exclusive owners of the entire and unencumbered right, title and interest in and to each item of the Owned Intellectual

Property, and are entitled to use the Owned Intellectual Property and Licensed Intellectual Property in the ordinary course of their business as presently conducted or as contemplated to be conducted subject only to the terms of the IP Agreements.

(e) To the best knowledge of the Company or the Sellers and the Founders after due inquiry, the Owned Intellectual Property and the Licensed Intellectual Property are subsisting, valid and enforceable and have not been adjudged invalid or unenforceable in whole or in part. To the best knowledge of the Company and the Founders after due inquiry, the Owned Intellectual Property and the Licensed Intellectual Property, is not subject to any outstanding consent, settlement, decree, order, injunction, judgment or ruling restricting the use of such Intellectual Property or that would impair the validity or enforceability of such Intellectual Property.

(f) To the best knowledge of the Company, the Sellers and the Founders after due inquiry, no legal proceedings have been asserted, are pending or are threatened against the Company or any Affiliate (i) based upon or challenging or seeking to deny or restrict the use by the Company or any Affiliate of any of the Owned Intellectual Property or Licensed Intellectual Property, (ii) alleging that any services provided by, processes used by, or products manufactured, used or sold by the Company or any Affiliate infringe, misappropriate or otherwise violate any Intellectual Property right of any third party, or (iii) alleging that the Licensed Intellectual Property is being licensed in conflict with the terms of any license or other agreement.

(g) Neither the Company nor any Affiliate has granted any license or other right to any third party with respect to the Owned Intellectual Property or Licensed Intellectual Property. The consummation of the transactions contemplated by this Agreement will not result in the termination or impairment of any Owned Intellectual Property, Licensed Intellectual Property or the IP Agreements.

(h) The Company and each Affiliate has maintained the confidentiality of its trade secrets and other confidential Intellectual Property. There has been no misappropriation of any trade secrets or other confidential Intellectual Property of the Company or any Affiliate by any person. No employee, independent contractor or agent of the Company or any Affiliate has misappropriated any trade secrets of any other Person. Each technical employee, contractor or agent of the Company and the Affiliates has executed a confidentiality and non-compete agreement. No employee, independent contractor or agent of the Company or any Affiliate is in default or breach of any term of any employment agreement, confidentiality and non-compete agreement or similar agreement or contract relating in any way to the protection, ownership, development, use or transfer of Intellectual Property. The Company and each Affiliate has the right to use all software development tools, library functions, compilers and other third party software that are material to the Business.

SECTION 3.12. Litigation. There are no Actions by or against the Company or any Affiliate or otherwise affecting any of the Assets or the Business pending before any Governmental Authority (or, to the best knowledge of the Company, any Seller or any Founder after due inquiry, threatened to be brought by or before any Governmental Authority). None of the Company, the Affiliates or any material Asset is subject to any Governmental Order (nor, to the best knowledge of the Company, any Seller or any Founder after due inquiry, are there any such Governmental Orders threatened to be imposed by any Governmental Authority) or any continuing order of, judgment, award, consent decree,

injunction, order or settlement or other similar written agreement with any Governmental Authority (nor, to the best knowledge of the Company, any Seller or any Founder after due inquiry, is there any continuing investigation by any Governmental Authority).

SECTION 3.13. [Reserved].

SECTION 3.14. Insurance. Section 3.14 of the Disclosure Schedule lists all insurance policies issued in favor of the Company or any Affiliate, as the case may be.

SECTION 3.15. Employee Benefit Matters. (a) Plans and Material Documents. Section 3.15(a) of the Company Disclosure Schedule lists (i) all employee benefit plans and all bonus, stock option, stock purchase, restricted stock, incentive, deferred compensation, retiree medical or life insurance, supplemental retirement, severance or other benefit plans, programs or arrangements, and all employment, termination, severance or other contracts or agreements, whether legally enforceable or not, to which the Company or any Affiliate is a party, with respect to which the Company or any Affiliate has any obligation or that are maintained, contributed to or sponsored by the Company or any Affiliate for the benefit of any current or former employee, officer or director of the Business, (ii) any contracts, arrangements or understandings between the Company or any Affiliate and any employee of or consultant to any thereof including any contracts, arrangements or understandings relating to a sale of the Shares, the Registered Capital or the Business (collectively, the "Plans"). Each Plan is in writing and the Company has furnished the Purchaser with a true and complete copy of each Plan and has delivered to the Purchaser a true and complete copy of each material document, if any, prepared in connection with each such Plan. There are no other employee benefit plans, programs, arrangements or agreements, whether formal or informal, whether in writing or not, to which the Company or any Affiliate is a party, with respect to which the Company or any Affiliate has any obligation or that are maintained, contributed to or sponsored by the Company or any Affiliate for the benefit of any current or former employee, officer or director of the Company or any Affiliate. Neither the Company nor any Affiliate has any express or implied commitment, whether legally enforceable or not, (i) to create, incur Liability with respect to or cause to exist any other employee benefit plan, program or arrangement, (ii) to enter into any contract or agreement to provide compensation or benefits to any individual or (iii) to modify, change or terminate any Plan, other than with respect to a modification, change or termination required by applicable Law.

(b) Absence of Certain Types of Plans. None of the Plans provides for the payment of separation, severance, termination or similar-type benefits to any person or obligates the Company or any Affiliate to pay separation, severance, termination or similar-type benefits solely or partially as a result of any transaction contemplated by this Agreement and any Ancillary Agreements. None of the Plans provides for or promises retiree medical, disability or life insurance benefits to any current or former employee, officer or director of the Company or any Affiliate.

(c) Compliance. Each Plan is now and always has been operated in all material respects in accordance with its terms and the requirements of all applicable Law. The Company and each Affiliate have performed all obligations required to be performed by it under, are not in any respect in default under or in violation of, and the Company has no knowledge of any default or violation by any party to, any Plan. No action, claim or proceeding is pending or, to the knowledge of the Company, any Seller or any Founder, threatened with respect to any Plan (other than claims for benefits in the ordinary course) and no fact or event exists that could give rise to any such action, claim or proceeding.

(d) Plan Contributions and Funding. (i) All employer and employee contributions, premiums or payments required to be made by applicable Law or by the terms of any Plan have been made on or before their due dates or, if applicable, accrued in accordance with applicable normal accounting practices.

(ii) The fair market value of the assets of each funded Plan, the liability of each insurer for any Plan funded through insurance or the book reserve established for any Plan, together with any accrued contributions, is sufficient to procure or provide for the accrued benefit obligations, as of the date of this Agreement, with respect to all current and former participants in such Plan according to the actuarial assumptions and valuations most recently used to determine employer contributions to such Plan and no transaction contemplated by this Agreement shall cause such assets or insurance obligations to be less than such benefit obligations.

(e) Registration of Plans. Each Plan required to be registered has been registered and has been maintained in good standing with applicable regulatory authorities.

SECTION 3.16. Labor Matters. Neither the Company nor any Affiliate is a party to any collective bargaining agreement or other labor union contract applicable to persons employed by the Company or any Affiliate or otherwise in the Business, and currently there are no organizational campaigns, petitions or other unionization activities seeking recognition of a collective bargaining unit that could affect the Company, any Affiliate or the Business. There are no controversies, strikes, slowdowns or work stoppages pending or, to the best knowledge of the Company, any Seller or any Founder, after due inquiry, threatened between the Company or any Affiliate and any of their respective employees, and neither the Company nor any Affiliate has experienced any such controversy, strike, slowdown or work stoppage within the past three years. Neither the Company nor any Affiliate has breached or otherwise failed to comply with the provisions of any collective bargaining or union contract, and there are no grievances outstanding against the Company or any Affiliate under any such agreement or contract that could materially and adversely affect the Company or any Affiliate. The Company and each Affiliate are currently in compliance with all applicable Law relating to the employment of labor, including those related to wages, hours, collective bargaining and the payment and withholding of taxes and other sums as required by the appropriate Governmental Authority. There is no claim with respect to payment of wages, salary or overtime pay that has been asserted or is now pending or threatened before any Governmental Authority with respect to any persons currently or formerly employed by the Company or any Affiliate.

SECTION 3.17. Employees of the Business. (a) Section 3.17(a) of the Company Disclosure Schedule lists the name, the place of employment, the current salary rates, bonuses, deferred or contingent compensation, pension, social security and housing fund contributions, accrued vacation, severance and other like benefits paid or payable (in cash or otherwise) for the month of April 2004, the date of employment and a description of the position and job function of each current salaried employee, officer, director, consultant or agent of the Company and each Affiliate who is employed or otherwise engaged in the Business.

(b) All directors, officers, management employees, and technical and professional employees of the Company and each Affiliate are under written obligation to the

Company and each Affiliate, as applicable, to maintain in confidence all confidential or proprietary information acquired by them in the course of their employment and to assign to the Company and each Affiliate, as applicable, all inventions made by them within the scope of their employment during such employment and for a reasonable period thereafter.

SECTION 3.18. Certain Interests. (a) Except as set forth in Section 3.18(a) of the Disclosure Schedule, no officer, director, shareholder or Affiliate of the Company, any Affiliate, any Seller or any Founder, nor any Affiliate, relative or spouse of any such officer, director or shareholder or Affiliate:

(i) is a party to any agreement, contract, commitment, arrangement or transaction with the Company or any Affiliate or is entitled to any payment or transfer of any Assets from the Company or any Affiliate or has any direct or indirect interest in any Asset;

(ii) has any direct or indirect financial interest in any competitor, supplier or customer of the Company or any Affiliate or the Business; provided, however, that the ownership of securities representing no more than one percent of the outstanding voting power of any competitor, supplier or customer, and which are also listed on any national securities exchange, shall not be deemed to be a "financial interest" so long as the Person owning such securities has no other connection or relationship with such competitor, supplier or customer; or

(iii) has outstanding any Indebtedness to the Company or any Affiliate.

(b) Except as set forth in Section 3.18(a) of the Disclosure Schedule, neither the Company nor any Affiliate has any Liability or any other obligation of any nature whatsoever to any Founder or Seller or to any officer, director or shareholder of the Company or any Affiliate or to any relative or spouse or Affiliate of any Founder or Seller or any such officer, director or shareholder.

SECTION 3.19. Taxes. The Company and the Affiliates have timely filed, or will timely file, all Tax returns and reports required to be filed by them with respect to Taxes for any period ending on or before the Closing Date, and all such Tax returns and reports are, or will be (as of the Closing Date), true, accurate and complete in all material respects. All Taxes shown as due and owing on such Tax returns have been paid or will be paid by the Closing Date except such Taxes that are being contested in good faith and have been adequately reserved for. Neither the Company nor any Affiliate has granted any waiver of any statute of limitations with respect to Taxes or agreed to any extension of time with respect to any Tax assessment or deficiency. Neither the Company nor any of its Affiliates is a party to any income tax allocation or sharing agreement. There are no pending or, to the best knowledge of the Company, the Sellers and the Founders after due inquiry, threatened actions or proceedings for the assessment or collection of Taxes against the Company or any Affiliate.

SECTION 3.20. Assets. The Company and the Affiliates own, lease or have the legal right to use all of the material Assets, including, without limitation, the Real Property and personal property, used or intended to be used in the conduct of the Business or otherwise owned, leased or used by the Company or any Affiliate and, with respect to

contract rights, is a party to and enjoys the right to the benefits of all Material Contracts. Either the Company or an Affiliate has good and marketable title to, or, in the case of leased or subleased Assets, valid and subsisting leasehold interests in, all the Assets, free and clear of all Encumbrances, except Permitted Encumbrances.

SECTION 3.21. Books and Records. The minute books and similar records of the Company and the Affiliates accurately reflect all material actions taken by the shareholders, board of directors and committees of the board of directors of the Company and the Affiliates at any meetings thereof, and of all written consents executed in lieu of a meeting, through the date of this Agreement.

SECTION 3.22. Certain Business Practices. To the knowledge of the Company, the Sellers and the Founders, none of the Company, any Affiliate, any Seller or Founder or any director or officer of the Company, any Affiliate or any Seller has, on behalf of the Company or any Affiliate, (a) used any funds of the Company or any Affiliate for unlawful contributions, gifts, entertainment or other unlawful payments relating to political activity or any activity relating to the Business or (b) violated any provision of the Foreign Corrupt Practices Act of 1977, as amended.

SECTION 3.23. Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Founders, the Sellers, the Company or any of the Affiliates.

SECTION 3.24. Seller Authority; No Conflict; Required Filings and Consents. (a) Each of the Sellers and the Founders has full legal capacity and authority to execute and deliver this Agreement and the Equity Transfer Agreement and to perform such person's obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. This Agreement and the Equity Transfer Agreement have been duly and validly executed and delivered by the Sellers and the Founders and (assuming due authorization, execution and delivery by the Purchaser and the Company) this Agreement and the Equity Transfer Agreement each constitutes a legal, valid and binding obligation of each of the Sellers and the Founders enforceable against such Seller or Founder in accordance with their respective terms.

(b) The execution and delivery of this Agreement and the Equity Transfer Agreement by each of the Sellers and the Founders, do not, and the performance of this Agreement and the Equity Transfer Agreement by such Seller or Founder will not (i) assuming that all consents, approvals, authorizations and other actions described in Section 3.03(c) have been obtained and all filings and obligations described in Section 3.03(c) have been made, conflict with or violate any Law applicable to such Seller or Founder or by which the Company or any Affiliate or any Asset or any other property or asset of such Seller or Founder is bound or affected, or (ii) result in any breach of or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any right of termination, amendment, acceleration or cancellation of, or result in the creation of any Encumbrance on any capital stock or registered capital of the Company or any Affiliate, including, the Shares or Registered Capital or on any Assets or any other property or asset of such Founder or Seller pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation, except to the extent that such breach or default does not have a Material Adverse Effect on the Business, the Company or its Affiliates. Each Founder has

irrevocably waived the right of first refusal that such Founder has with respect to the transactions contemplated by the Equity Transfer Agreement under applicable Laws and Article 7(6) of the Articles of Association of Goodfeel, as amended.

(c) Except as disclosed in Section 3.03(c) of the Disclosure Schedule, the execution and delivery of this Agreement and the Equity Transfer Agreement by each Seller and Founder do not, and the performance of this Agreement and the Equity Transfer Agreement by such Founder will not, require any consent, approval, authorization or permit of, or filing with or notification to, any third party or any Governmental Authority.

SECTION 3.25. [Reserved]

SECTION 3.26. Full Disclosure. (a) Neither the Company, any Seller nor any Founder is aware of any facts pertaining to the Company, any Affiliate, the Assets or the Business which could affect adversely affect the Company, any Affiliate, the Assets or the Business or which are likely in the future to adversely affect the Company, any Affiliate, the Assets or the Business and which have not been disclosed in this Agreement or the Disclosure Schedule, or otherwise disclosed to the Purchaser by the Company in writing.

(b) No representation or warranty of the Company, the Sellers or the Founders in this Agreement, nor any statement or certificate furnished or to be furnished to the Purchaser pursuant to this Agreement or the Ancillary Agreements, or in connection with the transactions contemplated by this Agreement or the Ancillary Agreements, contains or will contain any untrue statement of material fact, or omits or will omit to state a material fact necessary to make the statements contained herein or therein not misleading.

ARTICLE IV
REPRESENTATIONS AND WARRANTIES
OF THE PURCHASER

As an inducement to the Company, the Sellers and the Founders to enter into this Agreement, the Purchaser hereby represents and warrants to the Company, each Seller and each Founder as follows:

SECTION 4.01. Organization and Qualification. The Purchaser is a corporation duly incorporated, validly existing and in good standing under the laws of the Cayman Islands and has all requisite corporate power and authority to own, lease and operate its properties and to carry on its business as it is now being conducted. The Purchaser is duly qualified or licensed as a foreign corporation to do business, and is in good standing, in each jurisdiction where the character of the properties owned, leased or operated by it or the nature of its business makes such qualification or licensing necessary.

SECTION 4.02. Authority; No Conflict; Required Filings and Consents. (a) The Purchaser has all necessary corporate power and authority to execute and deliver this Agreement and to perform its obligations hereunder and to consummate the transactions contemplated hereby. The execution and delivery of this Agreement by the Purchaser and the consummation by the Purchaser of the transactions contemplated hereby have been duly and validly authorized by all necessary corporate action and no other corporate proceedings on

the part of the Purchaser are necessary to authorize this Agreement or to consummate the transactions contemplated hereby. This Agreement has been duly and validly executed and delivered by the Purchaser and, assuming the due authorization, execution and delivery by the Company, the Sellers and the Founders, constitutes a legal, valid and binding obligation of the Purchaser, enforceable against the Purchaser in accordance with its terms.

(b) The execution and delivery of this Agreement by the Purchaser do not, and the performance of this Agreement by the Purchaser will not, (i) conflict with or violate the organizational documents of the Purchaser, (ii) conflict with or violate any Law applicable to the Purchaser or by which any property or asset of the Purchaser is bound or affected, or (iii) result in any breach of or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any right of termination, amendment, acceleration or cancellation of, or result in the creation of any Encumbrance on any property or asset of the Purchaser pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation.

(c) The execution and delivery of this Agreement by the Purchaser do not, and the performance of this Agreement by the Purchaser will not, require any consent, approval, authorization or permit of, or filing with or notification to, any third party or Governmental Authority, other than any of the foregoing required under US securities laws or which will not materially impair the Purchaser's ability to perform its obligations hereunder.

SECTION 4.03. Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Purchaser.

ARTICLE V

ADDITIONAL AGREEMENTS

SECTION 5.01. Conduct of Business. (a) The Company, the Sellers and the Founders covenant and agree that, between the date hereof and the time of the Closing, neither the Company nor any Affiliate shall conduct its business other than in the ordinary course and consistent with the Company's and such Affiliate's prior practice. Without limiting the generality of the foregoing, the Company shall, and the Company and the Sellers shall cause each Affiliate to (i) continue their advertising and promotional activities, and pricing and purchasing policies, in accordance with past practice; (ii) not shorten or lengthen the customary payment cycles for any of their payables or receivables; (iii) use their best efforts to (A) preserve intact their business organizations and the business organization of the Business, (B) keep available to the Purchaser the services of the employees of the Company and each Affiliate, (C) continue in full force and effect without material modification all existing policies or binders of insurance currently maintained in respect of the Company, each Affiliate and the Business, (D) preserve their current relationships with their customers, suppliers and other Persons with whom they have had significant business relationships and (E) maintain and protect its interest in each item of Owned Intellectual Property and Licensed Intellectual Property; and (iv) not engage in any practice, take any action, fail to take any action or enter into any transaction which could cause any representation or warranty of the Company, the Sellers and the Founders to be untrue or result in a breach of any covenant made by the Company, the Sellers and the Founders in this Agreement.

(b) The Company, the Sellers and the Founders covenant and agree that, between the date hereof and the time of the Closing, without the prior written consent of the Purchaser, neither the Company nor any Affiliate will:

- (i) permit or allow any of the Assets to be subjected to any Encumbrance, other than Permitted Encumbrances;
- (ii) amend, terminate, cancel or compromise any material claims of, or waive any other rights of substantial value to, the Company or any Affiliate;
- (iii) sell, transfer, lease, sublease, license or otherwise dispose of any properties or assets, real, personal or mixed, with a value in excess of U.S.\$12,000 individually or in the aggregate (including, without limitation, leasehold interests and intangible property);
- (iv) issue or sell any share capital, notes, bonds or other securities, or any option, warrant or other right to acquire the same, of the Company or any Affiliate;
- (v) redeem any of the share capital or declare, make or pay any dividends or distributions (whether in cash, securities or other property) to the holders of share or registered capital of the Company or any Affiliate or otherwise, other than dividends, distributions and redemptions declared, made or paid by any Affiliate solely to the Company;
- (vi) merge with, enter into a consolidation with or acquire an interest of 5% or more in any Person or acquire a substantial portion of the assets or business of any Person or any division or line of business thereof, or otherwise acquire any material assets other than in the ordinary course of business consistent with past practice;
- (vii) make any capital expenditure or commitment for any capital expenditure in excess of U.S. \$12,000 individually or in the aggregate;
- (viii) incur any Indebtedness in excess of U.S.\$12,000 individually or in the aggregate;
- (ix) fail to pay any creditor any amount owed to such creditor when due;
- (x) (i) grant any increase, or announce any increase, in the wages, salaries, compensation, bonuses, incentives, pension or other benefits payable by the Company or any Affiliate to any of its employees, including, without limitation, any increase or change pursuant to any plan, or (ii) establish or increase or promise to increase any benefits under any plan, in either case, except as required by Law for any severance payment;
- (xi) enter into any agreement, arrangement or transaction with any of its directors, officers, employees or shareholders (or with any relative, beneficiary, spouse or Affiliate of such Persons);
- (xii) allow any Permit that was issued or relates to the Company or any Affiliate or otherwise relates to the Business to lapse or terminate or fail to renew any insurance policy or Permit that is scheduled to terminate or expire prior to that date that is 45 calendar days after the Closing Date;

- (xiii) amend, modify or consent to the termination of any Material Contract or the Company's or any Affiliate's rights thereunder;
- (xiv) amend or restate the Memorandum of Association and Articles of Association (or other organizational documents) of the Company or any Affiliate, except as provided in the Equity Transfer Agreement;
- (xv) change any content of Operational Records; or
- (xvi) agree, whether in writing or otherwise, to take any of the actions specified in this Section 5.01 or grant any options to purchase, rights of first refusal, rights of first offer or any other similar rights or commitments with respect to any of the actions specified in this Section 5.01, except as expressly contemplated by this Agreement and the Ancillary Agreements.

SECTION 5.02. Access to Information. From the date hereof until the Closing, upon reasonable notice, the Company shall cause its officers, directors, employees, agents, representatives, accountants and counsel and shall cause the Affiliates and each of the Affiliates' officers, directors, employees, agents, representatives, accountants and counsel to afford the officers, employees, agents, accountants, counsel, financing sources and representatives of the Purchaser reasonable access, during normal business hours, to the offices, properties, plants, other facilities, books and records of the Company and each Affiliate and to those officers, directors, employees, agents, accountants and counsel of the Company and of each Affiliate who have any knowledge relating to the Company, any Affiliate or the Business.

SECTION 5.03. Confidentiality. The Company, the Sellers and the Founders agree to, and shall cause their respective agents, representatives, affiliates, employees, officers and directors to: (a) treat and hold as confidential all (and not disclose or provide access to any Person to) any information relating to trade secrets, processes, patent and trademark applications, product development, price, customer and supplier lists, pricing and marketing plans, policies and strategies, details of client and consultant contracts, operations methods, product development techniques, business acquisition plans, new personnel acquisition plans and any and all other confidential or proprietary information with respect to the Business, the Company and each Affiliate, (b) in the event that the Company, any Seller, Founder or any such agent, representative, affiliate, employee, officer or director becomes legally compelled to disclose any such information, provide the Purchaser with prompt written notice of such requirement so that the Purchaser, the Company or any Affiliate may seek a protective order or other remedy or waive compliance with this Section 5.03, (c) in the event that such protective order or other remedy is not obtained, or the Purchaser waives compliance with this Section 5.03, furnish only that portion of such confidential information which is legally required to be provided and exercise its best efforts to obtain assurances that confidential treatment will be accorded such information, and (d) promptly furnish (prior to, at, or as soon as practicable following, the Closing) to the Company or the Purchaser any and all copies (in whatever form or medium) of all such confidential information (and any analysis, compilations, studies or other documents prepared in whole or in part on the basis thereof) then in the possession of the Sellers and the Founders or any of their agents, representatives, affiliates, employees, officers and directors and destroy any and all additional copies then in the possession of the Sellers and the Founders or any of their agents, representatives, affiliates, employees, officers and directors of such information, analyses, compilations, studies or other documents; provided, however, that this sentence shall not

apply to any information that, at the time of disclosure, is available publicly and was not disclosed in breach of this Agreement or other obligation of confidentiality by the Company (prior to the Closing) or the Sellers or the Founders or any of their agents, representatives, affiliates, employees, officers or directors; and provided further that, with respect to Intellectual Property, specific information shall not be deemed to be within the foregoing exception merely because it is embraced in general disclosures in the public domain. In addition, with respect to Intellectual Property, any combination of features shall not be deemed to be within the foregoing exception merely because the individual features are in the public domain unless the combination itself and its principle of operation are in the public domain. The Company, the Sellers and the Founders agree and acknowledge that remedies at law for any breach of its obligations under this Section 5.03 are inadequate and that in addition thereto the Purchaser shall be entitled to seek equitable relief, including injunction and specific performance, in the event of any such breach.

SECTION 5.04. Regulatory and Other Authorizations; Notices and Consents. (a) The Company, the Sellers and the Founders shall use their best efforts to obtain (or cause the Affiliates to obtain) all authorizations, consents, orders and approvals of all Governmental Authorities and officials that may be or become necessary for their execution and delivery of, and the performance of their obligations pursuant to, this Agreement and the Ancillary Agreements and will cooperate fully with the Purchaser in promptly seeking to obtain all such authorizations, consents, orders and approvals.

(b) The Company, the Sellers and the Founders shall, or shall cause the Affiliates to, give promptly such notices to third parties and use its or their best efforts to obtain such third party consents and estoppel certificates as the Purchaser may in its sole discretion deem necessary or desirable in connection with the transactions contemplated by this Agreement.

(c) The Purchaser shall cooperate and use all reasonable efforts to assist the Company in giving such notices and obtaining such consents and estoppel certificates; provided, however, that the Purchaser shall have no obligation to give any guarantee or other consideration of any nature in connection with any such notice, consent or estoppel certificate or to consent to any change in the terms of any agreement or arrangement which the Purchaser in its sole discretion may deem adverse to the interests of the Purchaser, the Company, any Affiliate or the Business.

(d) None of the Company, the Sellers and the Founders knows of any reason why all the consents, approvals and authorizations necessary for the consummation of the transactions contemplated by this Agreement and the Ancillary Agreement will not be received.

SECTION 5.05. Notice of Developments. Prior to the Closing, the Company, the Sellers and the Founders shall promptly notify the Purchaser in writing of (a) all events, circumstances, facts and occurrences arising subsequent to the date of this Agreement which could result in any breach of a representation or warranty or covenant of the Company, a Seller or a Founder in this Agreement, or which could have the effect of making any representation or warranty of the Company, a Seller or a Founder in this Agreement untrue or incorrect in any respect, and (b) all other material developments affecting the Assets, Liabilities, business, condition (financial or otherwise), operations, results of operations, customer or supplier relations, employee relations, projections or prospects of the Company, any Affiliate or the Business.

SECTION 5.06. No Solicitation or Negotiation. The Company, the Sellers and the Founders agree that between the date of this Agreement and the earlier of (a) the Closing and (b) the termination of this Agreement without fault of the Company, the Affiliates, the Founders or the Sellers, none of the Company, the Affiliates, the Founders, the Sellers or any of their respective Affiliates, officers, directors, representatives or agents will (i) solicit, initiate, consider, encourage or accept any other proposals or offers from any Person (A) relating to any acquisition or purchase of all or any portion of the share or registered capital of the Company or any Affiliate or of the Assets (other than inventory to be sold in the ordinary course of business consistent with past practice), (B) to enter into any merger, consolidation or other business combination with the Company or any Affiliate or (C) to enter into a recapitalization, reorganization or any other extraordinary business transaction involving or otherwise relating to the Company or any Affiliate or (ii) participate in any discussions, conversations, negotiations and other communications regarding, or furnish to any other Person any information with respect to, or otherwise cooperate in any way, assist or participate in, facilitate or encourage any effort or attempt by any other Person to seek to do, any of the foregoing. The Company, the Sellers and the Founders immediately shall cease and cause to be terminated all existing discussions, conversations, negotiations and other communications with any Persons conducted heretofore with respect to any of the foregoing. The Company, the Sellers or the Founders, as the case may be, shall notify the Purchaser promptly if any such proposal or offer, or any inquiry or other contact with any Person with respect thereto, is made and shall, in any such notice to the Purchaser, indicate in reasonable detail the identity of the Person making such proposal, offer, inquiry or contact and the terms and conditions of such proposal, offer, inquiry or contact. The Company, the Sellers and the Founders agree not to, and to cause the Company and each Affiliate not to, without the prior written consent of the Purchaser, release any Person from, or waive any provision of, any confidentiality or standstill agreement to which the Company, any Affiliate any Founder or any Seller is a party.

SECTION 5.07. Use of Intellectual Property. The Sellers and the Founders acknowledge that from and after the Closing, the name “Goodfeel”, “吉菲尔” and all similar or related names, marks and logos (all of such names, marks and logos being the “Company Marks”) shall be owned by the Company or Goodfeel, that none of the Founders, the Sellers or any of their Affiliates shall have any rights in the Company Marks and that none of the Founders, the Sellers or any of their Affiliates will contest the ownership or validity of any rights of the Purchaser, the Company or any Affiliate in or to the Company Marks.

SECTION 5.08. Non-Competition. (a) For a period of three (3) years after the Closing or, with respect to Kim Zhi Huan and Yang Xiang Hua, three (3) years after the termination of their employment with the Purchaser or one of its subsidiaries (the “Restricted Period”), the Founders and the Sellers shall not engage, directly or indirectly, in any business anywhere in the PRC that manufactures, produces or supplies products or services of the kind manufactured, produced or supplied by the Business, the Company, or any Affiliate as of the Closing Date or, without the prior written consent of the Purchaser, directly or indirectly, own an interest in, manage, operate, join, control, lend money or render financial or other assistance to or participate in or be connected with, as an officer, employee, partner, stockholder, consultant or otherwise, any Person that competes with the Purchaser, the Business, the Company, or any Affiliate in manufacturing, producing or supplying products or services of the kind produced or supplied by the Business, the Company, any Affiliate any Founder or any Seller as of the Closing Date; provided, however, that, for the purposes of this Section 5.08, ownership of securities having no more than one percent of the outstanding

voting power of any competitor which are listed on any national securities exchange shall not be deemed to be in violation of this Section 5.08 as long as the Person owning such securities has no other connection or relationship with such competitor.

(b) The Restricted Period shall be extended by the length of any period during which a Seller or a Founder is in breach of the terms of this Section 5.08.

(c) The Sellers and Founders acknowledge that the covenants of the Sellers and the Founders set forth in this Section 5.08 are an essential element of this Agreement and that, but for the agreement of the Sellers and the Founders to comply with these covenants, the Purchaser would not have entered into this Agreement. The Sellers and the Founders acknowledge that this Section 5.08 constitutes an independent covenant and shall not be affected by performance or nonperformance of any other provision of this Agreement by the Purchaser. The Sellers and Founders have independently consulted with their counsel and after such consultation agree that the covenants set forth in this Section 5.08 are reasonable and proper.

SECTION 5.09. Release of Indemnity Obligations. The Sellers and the Founders covenant and agree, on or prior to the Closing, to execute and deliver to the Company, for the benefit of the Company and each Affiliate, a general release and discharge, in form and substance satisfactory to the Purchaser, releasing and discharging the Company and Affiliate from any and all obligations to indemnify the Sellers and the Founders or otherwise hold any of them harmless pursuant to any agreement or other arrangement entered into prior to the Closing.

SECTION 5.10. Equity Transfer. The Founders shall transfer their respective equity interests in Goodfeel to the Purchaser or the Purchaser Designees pursuant to the Equity Transfer Agreement.

SECTION 5.11. Government Approvals. As soon as is reasonably practicable, the Sellers, the Founders and the Company shall obtain, or cause to be obtained, (i) the registration of the Technical Service Agreement with the Beijing Municipal Bureau of Commerce and (ii) the issuance of an amended Business License of Goodfeel by the Beijing Municipal Administration of Industry and Commerce, pursuant to which Goodfeel's scope of business has been expanded to include Internet information services (including ring tone downloading services for mobile phones).

SECTION 5.12. Further Action. Each of the parties hereto shall use all reasonable efforts to take, or cause to be taken, all appropriate action, do or cause to be done all things necessary, proper or advisable under applicable Law, and to execute and deliver such documents and other papers, as may be required to carry out the provisions of this Agreement or the Ancillary Agreements and consummate and make effective the transactions contemplated by this Agreement or the Ancillary Agreements.

ARTICLE VI
CONDITIONS TO THE TRANSACTIONS

SECTION 6.01. Conditions to Obligations of the Company, the Sellers and the Founders. The obligations of the Company, the Sellers and the Founders to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment or written waiver, at or prior to the Closing, of each of the following conditions:

(i) Representations, Warranties and Covenants. The representations and warranties of the Purchaser contained in this Agreement shall have been true and correct when made and shall be true and correct in all material respects as of the Closing, except to the extent such representations and warranties are as of another date, in which case, such representations and warranties shall be true and correct as of that date, in each case, with the same force and effect as if made as of the Closing Date, other than such representations and warranties as are made as of another date, the covenants and agreements contained in this Agreement to be complied with by the Purchaser on or before the Closing Date shall have been complied with in all material respects, and the Sellers shall have received a certificate from the Purchaser to such effect signed by a duly authorized officer thereof; and

(ii) No Proceeding or Litigation. No Action shall have been commenced by or before any Governmental Authority against either the Company or the Purchaser, seeking to restrain or materially and adversely alter the transactions contemplated by this Agreement which is likely to render it impossible or unlawful to consummate such transactions; provided, however, that the provisions of this Section 6.01(ii) shall not apply if the Company or any Seller or Founder has directly or indirectly solicited or encouraged any such Action.

SECTION 6.02. Conditions to Obligations of the Purchaser. The obligations of the Purchaser to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment or written waiver, at or prior to the Closing, of each of the following conditions:

(i) Representations, Warranties and Covenants. The representations and warranties of the Company, a Seller or a Founder contained in this Agreement (i) that are not qualified by “materiality” or “Material Adverse Effect” shall have been true and correct in all material respects when made and shall be true and correct in all material respects as of the Closing Date with the same force and effect as if made as of the Closing Date and (ii) that are qualified by “materiality” or “Material Adverse Effect” shall have been true and correct when made and shall be true and correct as of the Closing Date, except to the extent such representations and warranties are as of another date, in which case, such representations and warranties shall be true and correct as of that date, in each case, with the same force and effect as if made as of the Closing Date, other than such representations and warranties as are made as of another date, the covenants and agreements contained in this Agreement to be complied with by the Company, the Sellers or the Founders on or before the Closing Date shall have been complied with, and the Purchaser shall have received a certificate of the Company and the Sellers signed by a duly authorized officer thereof and of the Founders and the Sellers to such effect;

(ii) No Proceeding or Litigation. No Action shall have been commenced or threatened by or before any Governmental Authority against either the Company or the Purchaser, seeking to restrain or materially and adversely alter the transactions contemplated by this Agreement which, in the reasonable, good faith determination of the Purchaser, is likely to render it impossible or unlawful to consummate such transactions or which could have a Material Adverse Effect or otherwise render inadvisable, in the sole discretion of the Purchaser, the consummation of the transactions contemplated by this Agreement;

(iii) Consents and Approvals. Except for any items set forth in the Equity Transfer Agreement which are post Closing deliveries, the Purchaser, the Company and Goodfeel shall have received, each in form and substance satisfactory to the Purchaser, all authorizations, consents, orders and approvals of all Governmental Authorities and officials which the Purchaser in its sole discretion deems necessary or desirable for the consummation of the transactions contemplated by this Agreement and the Ancillary Agreements, including, without limitation, (i) the approval of the Equity Transfer Agreement by the Beijing Telecommunications Bureau, and (ii) the registration of the Technical Service Agreement with the Beijing Municipal Bureau of Commence;

(iv) Equity Transfer Agreement. Except for any items set forth in the Equity Transfer Agreement which are post Closing deliveries, the transactions contemplated by the Equity Transfer Agreements shall have been consummated and all conditions precedent thereunder shall have been fully satisfied;

(v) Employment Contracts. Each of Kim Zhi Huan and Yang Xiang Hua shall have entered into employment contracts with the Purchaser or one of its subsidiaries for an employment term of no less than two (2) years commencing from the Closing Date and employee confidentiality and non-compete agreements for a term of three (3) years commencing after the termination of their employment with the Purchaser or one of its subsidiaries, in each case substantially in the form satisfactory to the Purchaser and on terms not more favorable to such individuals than the current terms of employment between Goodfeel and Kim Zhi Huan or Yang Xiang Hua (as applicable) (collectively, the "Employment Contracts"), and such Employment Contracts shall be valid and binding with full force and effect;

(vi) No Material Adverse Effect. No event or events shall have occurred, or be reasonably likely to occur, which, individually or in the aggregate, have, or could have, a Material Adverse Effect;

(vii) Resignation of Directors. The Purchaser shall have received the resignations, effect as of the Closing Date, of all of the directors and officers of the Company, except for such Persons as shall have been designated in writing prior to the Closing by the Purchaser to the Company; and

(viii) Opinion of Counsel. An opinion of counsel to the Sellers and Founders, satisfactory in form and substance to the Purchaser, shall have been delivered to the Purchaser.

ARTICLE VII
INDEMNIFICATION

SECTION 7.01. Survival of Representations and Warranties. The representations and warranties of the Company, a Seller or a Founder contained in this Agreement and the Ancillary Agreements shall survive the Closing until the third anniversary of the Closing Date; provided, however, that (i) the representations and warranties made pursuant to Sections 3.01, 3.02, 3.03, 3.04, 3.05, 3.24, 3.25 and 3.26 shall survive the third anniversary of the Closing and continue thereafter, (ii) the representations and warranties made pursuant to Sections 3.11, 3.13 and 3.19 shall survive the Closing until the expiration of the applicable statute of limitations (giving effect, in the case of tax matters, to any waiver, mitigation or extension thereof). Neither the period of survival nor the liability of the Company, the Sellers and the Founders with respect to the Company's, the Sellers' and the Founder's representations and warranties shall be reduced by any investigation made at any time by or on behalf of the Purchaser. If written notice of a claim has been given prior to the expiration of the applicable representations and warranties by the Purchaser to the Company, any Seller or Founder, then the relevant representations and warranties shall survive as to such claim, until such claim has been finally resolved.

SECTION 7.02. Indemnification by the Sellers and the Founders. (a) The Purchaser and its affiliates, officers, directors, employees, agents, successors and assigns (each a "Purchaser Indemnified Party") shall be indemnified and held harmless by the Sellers and the Founders, jointly and severally, for and against any and all Liabilities, losses, diminution in value, damages, claims (including, without limitation, claims by any third party against the Company or any Affiliate or the Purchaser alleging that the Company or any Affiliate infringed, misappropriated or otherwise violated the Intellectual Property of such third party during any period prior to the Closing), costs and expenses (including, without limitation, costs and expenses resulting from the correction or rectification by the Purchaser, the Company or any Affiliate after the Closing of any improper use, infringement, misappropriation or other violation by the Company or any Affiliate of the Intellectual Property of any third party during any period prior to the Closing) actually suffered or incurred by them (including, without limitation, any Action brought or otherwise initiated by any of them) (hereinafter a "Loss"), arising out of or resulting from:

(i) the breach of any representation or warranty made by the Company, a Seller or a Founder contained in this Agreement or in the Equity Transfer Agreement (it being understood that such representations and warranties shall be interpreted without giving effect to any limitations or qualifications as to "materiality" (including the word "material") or "Material Adverse Effect" set forth therein); or

(ii) the breach of any covenant or agreement by the Company, a Seller or a Founder contained in this Agreement or in the Equity Transfer Agreement; and

(iii) fraud, deceit or willful violation of Law by the Company, any Seller or any Founder.

To the extent that a Seller's and a Founders' undertakings set forth in this Section 7.02 may be unenforceable, the Sellers and the Founders shall contribute the maximum amount that it is permitted to contribute under applicable Law to the payment and satisfaction of all Losses incurred by the Purchaser Indemnified Parties.

(b) A Purchaser Indemnified Party shall give the Sellers and the Founders notice of any matter which a Purchaser Indemnified Party has determined has given or could give rise to a right of indemnification under this Agreement within 60 days of such determination, stating the amount of the Loss, if known, and method of computation thereof, and containing a reference to the provisions of this Agreement in respect of which such right of indemnification is claimed or arises. The obligations and Liabilities of the Sellers and the Founders under this Article VII with respect to Losses arising from claims of any third party which are subject to the indemnification provided for in this Article VII ("Third Party Claims") shall be governed by and be contingent upon the following additional terms and conditions: if a Purchaser Indemnified Party shall receive notice of any Third Party Claim, the Purchaser Indemnified Party shall give the Sellers and the Founders notice of such Third Party Claim within 30 days of the receipt by the Purchaser Indemnified Party of such notice; provided, however, that the failure to provide such notice shall not release the Sellers and the Founders from any of their obligations under this Article VII except to the extent that the Sellers and the Founders are materially prejudiced by such failure and shall not relieve the Sellers or the Founders from any other obligation or Liability that such individuals may have to any Purchaser Indemnified Party otherwise than under this Article VII. If the Sellers and the Founders acknowledge in writing its obligation to indemnify the Purchaser Indemnified Party hereunder against any Losses that may result from such Third Party Claim, then the Sellers and the Founders shall be entitled to assume and control the defense of such Third Party Claim at their expense and through counsel of their choice if they give notice of their intention to do so to the Purchaser Indemnified Party within five days of the receipt of such notice from the Purchaser Indemnified Party; provided, however, that if there exists or is reasonably likely to exist a conflict of interest that would make it inappropriate in the judgment of the Purchaser Indemnified Party in its sole and absolute discretion for the same counsel to represent both the Purchaser Indemnified Party and the Sellers/the Founders, then the Purchaser Indemnified Party shall be entitled to retain its own counsel in each jurisdiction for which the Purchaser Indemnified Party determines counsel is required, at the expense of the Sellers and the Founders. In the event that the Sellers and Founders exercise the right to undertake any such defense against any such Third Party Claim as provided above, the Purchaser Indemnified Party shall cooperate with the Sellers and the Founders in such defense and make available to the Sellers and the Founders, at the Sellers' and the Founders' expense, all witnesses, pertinent records, materials and information in the Purchaser Indemnified Party's possession or under the Purchaser Indemnified Party's control relating thereto as is reasonably required by the Sellers and the Founders. Similarly, in the event the Purchaser Indemnified Party is, directly or indirectly, conducting the defense against any such Third Party Claim, the Sellers and the Founders shall cooperate with the Purchaser Indemnified Party in such defense and make available to the Purchaser Indemnified Party, at the Sellers' and the Founders' expense, all such witnesses, records, materials and information in the Sellers' and the Founders' possession or under the Sellers' and the Founders' control relating thereto as is reasonably required by the Purchaser Indemnified Party. No such Third Party Claim may be settled by the Sellers and the Founders without the prior written consent of the Purchaser Indemnified Party.

(c) In the event that (A) a Purchaser Indemnified Party claims an indemnification payment is due pursuant to Section 7.02(a), the Purchaser may withhold a portion of the Total Purchase Price which is payable after the date hereof under Section 2.2(b), up to the amount not more than the amount of the indemnifiable Loss in dispute.

(d) Notwithstanding the other provisions of this Article VII, in the event a Purchaser Indemnified Party has a claim with respect to this Agreement or any Ancillary Agreement, it may proceed to collect and satisfy the same against any Seller or Founder pursuant to any right, remedy or relief available at Law.

ARTICLE VIII

TERMINATION, AMENDMENT AND WAIVER

SECTION 8.01. Termination. (a) This Agreement and the Equity Transfer Agreement may be terminated at any time prior to the Closing:

(i) by the Purchaser by delivering written notice to the Company and the Sellers at any time on or before 5:00 p.m., Beijing time, on May 21, 2004, if its termination is as a result of its good faith determination that, based upon the Purchaser's due diligence review, the Company's and its Affiliates' Business, operations, assets, financial statements, or business prospects are materially inferior to the reasonably ascertainable status of such matters presented to the Purchaser prior to the date hereof;

(ii) by the Purchaser if, between the date hereof and the Closing: (i) an event or condition occurs that has resulted in a Material Adverse Effect, (ii) any representations and warranties of the Company, a Seller or a Founder contained in this Agreement or the Equity Transfer Agreement (1) that are not qualified by "materiality" or "Material Adverse Effect" shall not have been true and correct in all material respects when made or (2) that are qualified by "materiality" or "Material Adverse Effect" shall not have been true and correct when made, (iii) the Company, the Sellers and the Founders shall not have complied with the covenants or agreements contained in this Agreement or the Equity Transfer Agreement to be complied with by it, or (iv) the Company or any Affiliate makes a general assignment for the benefit of creditors, or any proceeding shall be instituted by or against the Company or any Affiliate seeking to adjudicate any of them a bankrupt or insolvent, or seeking liquidation, winding up or reorganization, arrangement, adjustment, protection, relief or composition of its debts under any Law relating to bankruptcy, insolvency or reorganization;

(iii) by the Purchaser if the Closing shall not have occurred by June 30, 2004; provided, however, that the right to terminate this Agreement under this Section 8.01(ii) shall not be available to the Purchaser if its failure to fulfill any obligation under this Agreement or the Equity Transfer Agreement or its misrepresentation shall have been the cause of, or shall have resulted in, the failure of the Closing to occur on or prior to such date;

(iv) by either the Purchaser or the Company in the event that any Governmental Authority shall have issued an order, decree or ruling or taken any other action restraining, enjoining or otherwise prohibiting the transactions contemplated by this Agreement and such order, decree, ruling or other action shall have become final and nonappealable; or

(v) by the mutual written consent of the Company, the Purchaser, the Sellers and the Founders.

(b) Notwithstanding the foregoing, the Purchaser shall have the right to rescind this Agreement and the Equity Transfer Agreement at any time after the Closing by a written notice to the Company, the Sellers and the Founders in the event that (i) the Purchaser has sufficient evidence to determine that any revenue reported and recorded by Goodfeel in its books was not (A) bona fide revenue generated from the value-added mobile data communications services provided by Goodfeel and (B) confirmed and paid by any PRC mobile communications operator, or (ii) any of the Company, the Affiliates, the Sellers or the Founders committed fraud in connection with the operation of the Business and/or the transactions contemplated by this Agreement and the Ancillary Agreements prior to or after the Closing.

SECTION 8.02. Effect of Termination. (a) In the event of termination of this Agreement and the Equity Transfer Agreement as provided in Section 8.01(a), this Agreement and the Equity Transfer shall forthwith become void and there shall be no liability on the part of any party hereto except (a) as set forth in Sections 5.03, 8.02(c) and 10.01; (b) as specifically set forth in the Equity Transfer Agreement and (b) that nothing herein shall relieve any party from liability for any breach of this Agreement or the Equity Transfer Agreement.

(b) In the event of the rescission of this Agreement and the Equity Transfer Agreement as provided in Section 8.01 (b), this Agreement and the Equity Transfer Agreement shall forthwith be revoked and become void and the parties hereto shall be restored to the status quo ante as if this Agreement and the Equity Transfer had not been entered into except that nothing herein shall relieve any of the Sellers and the Founders from liability for any breach of this Agreement or the Equity Transfer Agreement. For clarification, in the event of termination of this Agreement and the Equity Transfer Agreement as provided in Section 8.01(a) or 8.01(b) prior to the Closing but after the Registration, the Purchaser or the Purchaser Designees, the Founders and Goodfeel shall transfer the Registered Capital back to the Founders.

(c) In the event of termination of this Agreement and the Equity Transfer Agreement as provided in Section 8.01(a) or 8.01(b), the Founders and the Sellers shall be jointly and severally responsible for returning the Deposit and the Equity Amount (if the Equity Amount was paid as set forth in Section 2.02(b)) to a bank account designated by the Purchaser or the Purchaser Designees in immediately available funds not later than three (3) Business Days after the termination of this Agreement.

SECTION 8.03. Amendment. This Agreement may not be amended or modified except (a) by an instrument in writing signed by, or on behalf of, the Company, the Purchaser, the Sellers and the Founders or (b) by a waiver in accordance with Section 8.04.

SECTION 8.04. Waiver. Any party to this Agreement may (a) extend the time for the performance of any of the obligations or other acts of the other parties, (b) waive any inaccuracies in the representations and warranties of the other parties contained herein or in any document delivered by the other parties pursuant hereto or (c) waive compliance with any of the agreements of the other parties or conditions to such parties' obligations contained herein. Any such extension or waiver shall be valid only if set forth in an instrument in writing signed by the party to be bound thereby. Any waiver of any term or condition shall not be construed as a waiver of any subsequent breach or a subsequent waiver of the same term or condition, or a waiver of any other term or condition of this Agreement. The failure of any party to assert any of its rights hereunder shall not constitute a waiver of any of such rights. All rights and remedies existing under this Agreement are cumulative to, and not exclusive of, any rights or remedies otherwise available.

ARTICLE IX
POST CLOSING COVENANTS

SECTION 9.01. Post-Closing Employee Obligations.

The Company and its Affiliates, Sellers, and Founders shall, promptly following Closing, pay or perform, or procure the Company and its Affiliates to pay or perform, all Employee Obligations (as defined below), or, if applicable, reimburse the Purchaser for the payment of such Employee Obligations. As used above, the term "Employee Obligations" means any and all obligations or Liabilities of the Company or its Affiliates, or any Affiliate thereof, to any employees of the Company or its Affiliates, or any Affiliate thereof (the "Business Employees"), which are due to such Business Employee as of the date of the Closing arising from the employment or prior employment of any such Business Employee by the Company or its Affiliates, or any Affiliate thereof, whether arising under applicable Laws or otherwise, including without limitation any such obligations or Liabilities with respect to accrued salary, social security contributions, vacation or sick pay, or severance, "stay-pay," or other benefits.

SECTION 9.02. Assistance with Goodfeel's Trademark Application Assignment.

The Sellers and the Founders shall use their best efforts to assist and shall work with the Company, Goodfeel and the Purchaser to cause Goodfeel's trademark registration application, which was accepted by the PRC Trademark Office on 12 January 2004, and any registered trademarks thereunder, to be assigned to the Purchaser as the owner of such trademark registration application and any registered trademarks thereunder.

SECTION 9.03. Assistance with Contract Renewal.

The Sellers and the Founders shall use their best efforts to assist and shall work with the Company, Goodfeel and the Purchaser to renew the Guangdong Mobile Cooperation Agreement and the China Mobile Cooperation Agreement for a period of at least two years, which shall commence on January 1, 2005 and expire on December 31, 2006.

SECTION 9.04. Assistance with Certain Contract Termination. The Sellers and the Founders shall use their best efforts to assist and shall work with the Company, Goodfeel and the Purchaser to terminate the two (2) fee-based cooperation agreements by and between Goodfeel and the Korean companies who are parties thereto, as more specifically described on Schedule 9.04 of the Disclosure Schedule.

SECTION 9.05. Equity Transfer Agreement. The Sellers and the Founders shall assist and work with the Company, Goodfeel and the Purchaser to (i) file any necessary changes with respect to the Equity Transfer Agreement with any Governmental Authority, including but not limited to any changes with respect to the web name registration, the domain name registration and any tax certification, and (ii) file any necessary changes with respect to the ICP license, the Import-Export Enterprise Certification and the Hi-Tech Enterprise Approval Certificate, as set forth in the Equity Transfer Agreement.

SECTION 9.06. Further Assurances At any time and from time to time, the Sellers and Founders, on the one hand, and Purchaser, on the other hand, shall promptly execute, acknowledge and deliver any other assurances or documents reasonably requested by the other, as the case may be, and necessary for it, as the case may be, to satisfy its respective obligations hereunder or obtain the benefits contemplated hereby

ARTICLE X.

GENERAL PROVISIONS

SECTION 10.01. Expenses. Except as otherwise expressly provided in this Agreement, all costs and expenses, including, without limitation, all fees and disbursements of counsel, accountants, financial advisors, experts and consultants incurred in connection with this Agreement and the transactions contemplated by this Agreement shall be paid by the party incurring such costs and expenses, whether or not the Closing shall have occurred. All stamp duty payable under any applicable law in connection with the completion of the transactions contemplated hereunder shall be borne by the Purchaser and the Seller in equal shares.

SECTION 10.02. Notices. All notices, requests, claims, demands and other communications hereunder shall be in writing and shall be given or made (and shall be deemed to have been duly given or made upon receipt) by delivery in person, by overnight courier service, by telecopy or by registered or certified mail (postage prepaid, return receipt requested) to the respective parties at the following addresses (or at such other address for a party as shall be specified in a notice given in accordance with this Section 10.02):

- (a) if to the Purchaser:
c/o Sohu.com Inc
15/F Tower 2 Bright China Chang An Building
7 Jianguomen Nei Avenue
Beijing, China
100005
Attn: Carol Yu

with copies to each of:
Goulston & Storrs, P.C.
400 Atlantic Avenue
Boston, MA 02110-3333
USA
Attn: Timothy B. Bancroft, Esq.

And

TransAsia Lawyers
Suite 3718 China World Tower 1
1 Jianguomenwai Avenue
Beijing 100004
China
Attn: Philip Qu, Esq.

(b) if to the Company, the Sellers or the Founders:

B901, COFCO Plaza
8 Jianguomennei Dajie
Dong Cheng District
Beijing, PRC
Telephone: (8610) 8512-0660/1/2
Telecopy: (8610) 8512-0665
Attention: Kim Zhi Huan

SECTION 10.03. Third-Party Beneficiaries. Except for the provisions of Article VII relating to indemnified parties, this Agreement shall be binding upon and inure solely to the benefit of the parties hereto and their permitted assigns and nothing herein, express or implied, is intended to or shall confer upon any other Person, including, without limitation, any union or any employee or former employee of the Company, any legal or equitable right, benefit or remedy of any nature whatsoever, including, without limitation, any rights of employment for any specified period, under or by reason of this Agreement.

SECTION 10.04. Public Announcements. No party to this Agreement shall make, or cause to be made, any press release or public announcement in respect of this Agreement or the transactions contemplated by this Agreement or otherwise communicate with any news media without prior notification to the other party, and the parties shall cooperate as to the timing and contents of any such press release or public announcement.

SECTION 10.05. Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of Law or public policy, all other terms, conditions and provisions of this Agreement shall nevertheless remain in full force and effect for so long as the economic or legal substance of the transactions contemplated by this Agreement is not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions contemplated by this Agreement be consummated as originally contemplated to the fullest extent possible.

SECTION 10.06. Assignment; Binding Effect. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto (whether by operation of law or otherwise) without the prior written consent of the other parties; provided, that, the Purchaser may assign any of its rights, interests or obligations to any Affiliate or Affiliate of the Purchaser. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and permitted assigns.

SECTION 10.07. Incorporation of the Disclosure Schedule and the Exhibits. The Disclosure Schedule and all Exhibits attached hereto and referred to herein are hereby incorporated herein by reference and made a part of this Agreement for all purposes as if fully set forth herein.

SECTION 10.08. Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware applicable to contracts executed in and to be performed in that State.

SECTION 10.09. Dispute Resolution. All disputes among the parties arising out of or relating to this Agreement shall be finally settled in accordance with the Rules of Arbitration of the International Chamber of Commerce. The arbitral tribunal shall be composed of three arbitrators. One arbitrator shall be appointed by the Company, the Founders and the Sellers, one arbitrator shall be appointed by the Purchaser, and the third arbitrator, who shall serve as Chairman of the arbitration panel, shall be appointed through the mutual agreement of the other two arbitrators. The place of arbitration shall be in Beijing, PRC. The arbitral procedure shall be conducted in the English language. The arbitrators shall not have the power to add to, subtract from or modify any of the terms or conditions of this Agreement. The arbitrators shall be experienced and have knowledge in the subject matter of the dispute. The resolution of any dispute by the arbitrators pursuant to this Section 10.09 shall be non-appealable, final, binding and conclusive on the parties to such dispute and may be enforced and entered as a judgment in any court of law with jurisdiction thereof. The fees and disbursements of the arbitrators shall be allocated to the party against whom any dispute decided hereunder is resolved. Each of the parties hereby irrevocably agrees that any service of process made with respect to a dispute under this Agreement may be made pursuant to the notice procedures set forth in Section 10.02.

SECTION 10.10. Headings The descriptive headings contained in this Agreement are included for convenience of reference only and shall not affect in any way the meaning or interpretation of this Agreement.

SECTION 10.11. Counterparts This Agreement may be executed and delivered (including by facsimile transmission) in one or more counterparts, and by the different parties hereto in separate counterparts, each of which, when executed and delivered, shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

SECTION 10.12. Currency. Unless otherwise specified in this Agreement, all references to currency and monetary values set forth herein shall mean U.S. Dollars, and all payments hereunder shall be made in U.S. Dollars. If any amount payable hereunder is expressed in RMB, such amount shall be translated into U.S. Dollars at a rate of exchange of U.S.\$1.00 = RMB 8.27.

SECTION 10.13. Entire Agreement. This Agreement (including the Exhibits and the Disclosure Schedule) and the Ancillary Agreements constitute the entire agreement among the parties with respect to the subject matter hereof and thereof and supersede all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter hereof and thereof.

[END OF PAGE]

IN WITNESS WHEREOF, each of the Purchaser, the Sellers, the Company and the Founders has duly executed, or has caused to be duly executed by their respective officers thereunto duly authorized, this Agreement as of the date first written above.

SOHU.COM LIMITED

By: /s/ Charles Zhang

Name: Charles Zhang
Title: Chairman and CEO

MARVEL HERO LIMITED 建翠有限公司

By: /s/ Kim Zhi Huan

Name: Kim Zhi Huan
Title: Director

SELLERS:

KIM DONG GU

By: /s/ Kim Dong Gu

KIM ZHI HUAN

By: /s/ Kim Zhi Huan

FOUNDERS:

/s/ Li Ming Zhe

LI MING ZHE

/s/ Yang Xiang Hua

YANG XIANG HUA

THE SELLERS AND THE FOUNDERS

Part I: The Sellers' Ownership Interests in the Company.

<u>Name of the Sellers</u>	<u>Number of Shares of Common Stock Owned in the Company</u>	<u>Percentage of Ownership</u>
Kim Zhi Huan	1	50%
Kim Dong Gu	1	50%

Part II: The Founders

Name of the Founders

Li Ming Zhe
Yang Xiang Hua

Part III: The Founders' Ownership Interests in Goodfeel

<u>Name of Founders</u>	<u>Amount of Registered Capital Owned in Goodfeel</u>	<u>Percentage of Ownership</u>
Li Ming Zhe	RMB730,000	73%
Yang Xiang Hua	RMB270,000	27%

I, Charles Zhang, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sohu.com Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2004

/s/ Charles Zhang

Chief Executive Officer and Chairman of the
Board of Directors

I, Carol Yu, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sohu.com Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2004

/s/ Carol Yu

Chief Financial Officer

SOHU.COM INC.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Sohu.com Inc. (the "Company") on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles Zhang, Chief Executive Officer and Chairman of the Board of Directors of the Company, certify, pursuant to U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition of the Company as of June 30, 2004 and results of operations of the Company for the three and six months ended June 30, 2004.

/s/ Charles Zhang

Charles Zhang, Chief Executive Officer and
Chairman of the Board of Directors

August 9, 2004

SOHU.COM INC.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Sohu.com Inc. (the "Company") on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Carol Yu, Chief Financial Officer of the Company, certify, pursuant to U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition of the Company as of June 30, 2004 and results of operations of the Company for the three and months ended June 30, 2004.

/s/ Carol Yu

Carol Yu, Chief Financial Officer

August 9, 2004