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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003  
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

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**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 April 30, 2003
Common stock, \$.001 par value	35,137,559

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SOHU.COM INC

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**SOHU.COM INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited, in thousands)**

	March 31, 2003	December 31, 2002
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,215	\$ 18,929
Accounts receivable, net	2,832	1,992
Accounts receivable from related parties	4,884	1,962
Prepaid and other current assets	2,428	2,009
Current portion of long-term investments in marketable debt securities	4,549	2,482
	<u>37,908</u>	<u>27,374</u>
Total current assets	37,908	27,374
Long-term investments in marketable debt securities	19,678	22,800
Fixed assets, net	5,897	6,012
Long-term loans to related parties	4,741	4,827
Other assets, net	907	959
	<u>\$ 69,131</u>	<u>\$ 61,972</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 853	977
Payable to related parties	1,563	1,455
Accrued liabilities and deferred revenues	6,693	4,309
	<u>9,109</u>	<u>6,741</u>
Total current liabilities	9,109	6,741
Commitments and contingencies (Note 5)		
Shareholders' equity:		
Common Stock: \$0.001 par value per share (75,400 authorized at March 31, 2003 and December 31, 2002, 34,878 and 34,611 shares issued and outstanding at March 31, 2003 and December 31, 2002, respectively)	35	35
Treasury Stock	(2,003)	(2,003)
Additional paid-in capital	130,065	129,881
Deferred compensation	(31)	(42)
Accumulated other comprehensive income	552	547
Accumulated deficit	(68,596)	(73,187)
	<u>60,022</u>	<u>55,231</u>
Total shareholders' equity	60,022	55,231
	<u>\$ 69,131</u>	<u>\$ 61,972</u>

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	
	Mar. 31, 2003	Mar. 31, 2002
Revenues:		
Advertising	\$ 4,476	\$ 2,511
Non-advertising (including \$8,554 and \$889 from related parties for the three months ended March 31, 2003 and 2002, respectively)	9,935	2,020
Total revenues	14,411	4,531
Cost of revenues:		
Advertising (including \$36 related party services for each of the three months ended March 31, 2003 and 2002)	1,602	1,463
Non-advertising (including \$2,646 and \$366 of related party services for the three months ended March 31, 2003 and 2002, respectively)	3,654	1,448
Total cost of revenues	5,256	2,911
Gross profit	9,155	1,620
Operating expenses:		
Product development	1,742	1,175
Sales and marketing	1,992	2,015
General and administrative	1,076	967
Total operating expenses	4,810	4,157
Operating profit/(loss)	4,345	(2,537)
Other income/(expense)	(81)	22
Interest income	327	306
Net income/(loss)	\$ 4,591	\$ (2,209)
Basic net income/(loss) per share	\$ 0.13	\$ (0.06)
Shares used in computing basic net income/(loss) per share	34,756	35,626
Diluted net income/(loss) per share	\$ 0.12	\$ (0.06)
Shares used in computing diluted net income/(loss) per share	39,186	35,626

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)**

	Three Months Ended	
	March 31, 2003	March 31, 2002
Cash flows from operating activities:		
Net income/(loss)	\$ 4,591	\$ (2,209)
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Depreciation and amortization	1,227	1,183
Provision for allowance for doubtful accounts	(26)	141
Provision for valuation allowance for long-term loans to related parties	86	—
Loss on disposal of fixed assets	2	—
Stock-based compensation expense	(18)	(6)
Changes in assets and liabilities:		
Accounts receivable	(813)	(150)
Accounts receivable from related parties	(2,922)	(52)
Prepaid and other current assets	(431)	326
Accounts payable	(95)	397
Payable to related parties	108	169
Accrued liabilities and deferred revenues	2,274	330
Net cash provided by operating activities	3,983	129
Cash flows from investing activities:		
Long term investments in marketable debt securities	1,061	(4,958)
Long-term loans to related parties	—	(1,880)
Acquisition of fixed assets	(759)	(977)
Acquisition of other assets	(213)	(9)
Net cash provided by/(used in) investing activities	89	(7,824)
Cash flows from financing activities:		
Issuance of Common Stock pursuant to Stock Incentive Plan	214	—
Net cash provided by financing activities	214	—
Net increase/(decrease) in cash and cash equivalents	4,286	(7,695)
Cash and cash equivalents at beginning of period	18,929	29,263
Cash and cash equivalents at end of period	\$23,215	\$21,568

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)**

	Common Stock		Treasury Stock	Additional Paid-in Capital	Deferred Compensation	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Shareholders' Equity
	Shares Issued	Amount						
Balance, December 31, 2002	34,611	\$ 35	\$(2,003)	\$ 129,881	\$ (42)	\$ 547	\$ (73,187)	\$ 55,231
Net income	—	—	—	—	—	—	4,591	4,591
Unrealized gains on marketable debt securities	—	—	—	—	—	6	—	6
Foreign currency translation adjustment	—	—	—	—	—	(1)	—	(1)
Comprehensive income								4,596
Compensatory stock options	—	—	—	(30)	11	—	—	(19)
Issuance of common stock pursuant to stock incentive plan	267	—	—	214	—	—	—	214
Balance, March 31, 2003	34,878	\$ 35	\$(2,003)	\$ 130,065	\$ (31)	\$ 552	\$ (68,596)	\$ 60,022

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. (“Sohu” or the “Company”) is a Delaware corporation. The Company does not have any substantive operations of its own and substantially all of its primary business operations are conducted through its wholly owned subsidiaries, Sohu ITC Information Technology (Beijing) Co., Ltd., Sohu.com (Hong Kong) Limited, and ChinaRen, Inc., and Beijing Sohu Online Network Information Services, Ltd. (“Beijing Sohu”), a related company.

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 months ended March 31, 2003 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 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.

**2. SEGMENT INFORMATION**

Based on the criteria established by SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information,” the Company operates in three principal business segments. The Company does not allocate any operating costs or assets to its non-advertising segments as management does not use this information to measure the performance of the operating segments. The Company doesn’t allocate any Web site operation cost to non-advertising cost of revenues.

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Summarized information by segment for the three months ended March 31, 2003 and 2002 is as follows (in thousands):

	Three Months Ended	
	March 31, 2003	March 31, 2002
<b>Revenues:</b>		
Advertising	4,476	2,511
<b>Non-advertising:</b>		
E-subscription	8,678	889
E-commerce	1,175	1,028
Other	82	103
<b>Subtotal non-advertising revenues</b>	<b>9,935</b>	<b>2,020</b>
<b>Total revenues</b>	<b>14,411</b>	<b>4,531</b>
<b>Cost of revenues:</b>		
Advertising	1,602	1,463
<b>Non-advertising:</b>		
E-subscription	2,646	366
E-commerce	1,008	905
Other	—	177
<b>Subtotal non-advertising cost of revenues</b>	<b>3,654</b>	<b>1,448</b>
<b>Total cost of revenues</b>	<b>5,256</b>	<b>2,911</b>
<b>Gross profit</b>	<b>9,155</b>	<b>1,620</b>

### 3. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and, if dilutive, common equivalent shares outstanding during the period. Common equivalent shares consist of the incremental common stock issuable upon the exercise of stock options and warrants (using the treasury stock method).

### 4. RELATED PARTY TRANSACTIONS

The Company has entered into the following arrangements with Dr. Charles Zhang, the Company's Chief Executive Officer and a major Sohu shareholder, and certain employees of the Company to satisfy People's Republic of China ("PRC") regulations which prohibit or restrict foreign companies from owning or operating telecommunications, internet content, financial services and certain other businesses in China. The Company expects that it will continue to be involved in and provide additional financial support under similar arrangements in the future, subject to the restrictions set forth in the Sarbanes-Oxley Act of 2002 with respect to loans to executive officers and directors.

In June 2000, the Company extended loans in the amount of \$193,000 to Dr. Charles Zhang and \$49,000 to He Jinmei, another employee of the Company, to finance their investments in Beijing Sohu, a company incorporated in the PRC. The shareholders of Beijing Sohu have pledged their shares in Beijing Sohu as collateral for the loan. These loans are included in long term loans to related parties, bear no interest and are due in full on the earlier of demand, in 2010 or at such time as Dr. Charles Zhang or He Jinmei, as the case may be, is not an employee of the Company. A subsidiary of the Company has entered into an option agreement giving it the right, at any time, subject to PRC law, to purchase the entire ownership in Beijing Sohu from the two Beijing Sohu shareholders for \$242,000. These loans are included in long-term loans to related parties. As of March 31, 2003, the Company had recorded a valuation allowance of \$56,000 against long-term loans to related parties for cumulative losses incurred by Beijing Sohu.



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Pursuant to the agreements with Beijing Sohu and the shareholders of Beijing Sohu, certain operations related to the Company's online content were transferred to Beijing Sohu in order to allow Beijing Sohu to develop and provide content to the Company for a monthly service fee, which will be subject to periodic adjustment as agreed between the parties. The Company paid \$36,000 in such service fees for each of the three months ended March 31, 2003 and 2002. Because of PRC regulations which prohibit foreign companies from operating in the telecommunications industry, Beijing Sohu contracted with network operators for e-subscription revenues of \$8,488,000 and \$889,000 during the three months ended March 31, 2003 and 2002, respectively. At March 31, 2003, accounts receivable from related parties included receivables from Beijing Sohu of \$4,818,000 primarily related to subscription revenues ultimately due from third party network operators. Beijing Sohu generated e-commerce sales of \$1,175,000 and \$300,000, respectively, during the three months ended March 31, 2003 and 2002.

In November 2001, the Company entered into a Loan and Share Pledge Agreement (the "Century Loan Agreement") with Dr. Charles Zhang, and Li Wei, another employee of the Company, for the purpose of funding an equity investment of \$4,595,000 by these two individuals in Beijing Century High-Tech Investment Co., Ltd. ("High Century"), a company incorporated in the PRC which engages in investment holding in the PRC on behalf of the Company. Pursuant to the Century Loan Agreement, the Company has extended total loans amounting to \$4,595,000 of which \$3,676,000 and \$919,000 were loaned to Charles Zhang and Li Wei, respectively. These loans are included in long-term loans to related parties. As of March 31, 2003, the Company had recorded a valuation allowance of \$4,000 against long-term loans to related parties for losses incurred by High Century.

In January 2002, the Company entered into a Loan and Share Pledge Agreement (the "Hengda Loan Agreement") with Li Wei for the purpose of funding an equity investment of \$242,000 by Li Wei in Beijing Hengda Yitong Internet Technology Development Co., Ltd. ("Hengda"), a company incorporated in the PRC which engages in Internet access services in the PRC on behalf of the Company. The \$242,000 investment represents a 20% interest in Hengda, with High Century holding the remaining 80% interest. These loans are included in long term loans to related parties. As of March 31, 2003, the Company had recorded a valuation allowance of \$3,000 against long-term loans to related parties for losses incurred by Hengda.

Because of PRC regulations which prohibit foreign companies from operating in certain industries, Hengda contracted with a network operator for e-subscription revenues of \$66,000 for Internet access services during the three months ended March 31, 2003. At March 31, 2003, accounts receivable from related parties included receivables from Hengda of \$66,000 primarily related to subscription revenues ultimately due from a third party network operator. There were no revenues recorded during the three months ended March 31, 2002 because this business started in the first quarter of 2003.

The Century Loan Agreement and Hengda Loan Agreement, which are subject to PRC law, include provisions that (i) the loans can only be repaid to the Company by transferring the shares of High Century or Hengda to the Company, (ii) the shares of High Century or Hengda cannot be transferred without the approval of the Company, and (iii) the Company has the right to appoint all directors and senior management personnel of High Century and Hengda. Charles Zhang and Li Wei have pledged all of their shares in High Century and Hengda 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, and January 2003, in the case of Hengda, or at such time as Dr. Charles Zhang or Li Wei, as the case may be, is not an employee of the Company. The Company does not intend to request repayment of the loans as long as PRC regulations prohibit the Company from directly investing in businesses being undertaken by High Century and Hengda.

In April 2002, High Century invested \$3,080,000 in Sohu-Guolian Information Technology Co., Ltd. ("Sohu-Guolian"), a company incorporated in the PRC, for a 51% equity interest in and joint control of Sohu-Guolian. Sohu-Guolian will provide technical services to the PRC online securities trading and financial services industries. As of March 31, 2003, the Company had recorded a valuation allowance of \$275,000 against long-term loans to related parties for losses incurred by Sohu-Guolian.

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As of March 31, 2003, payable to related parties included \$435,000 and \$1,128,000 payable to High Century and Hengda, respectively, as High Century and Hengda had transferred their unused cash to the Company. The Company may be required to repay these funds at any time.

PRC regulations currently restrict the Company from holding direct equity interests in Beijing Sohu, High Century and Hengda; therefore, the financial statements of these entities are not consolidated with those of the Company. As the shareholders of these entities are also officers and shareholders of the Company, these entities are related parties and, thus, transactions with these entities are disclosed in accordance with SFAS 57, "Related Party Disclosures." The Company expects that it will continue to be involved in and provide financial support to these entities.

### **5. 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 business and to conduct advertising, e-commerce and subscription services in the People's Republic of China. Though the People's Republic of 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 the People's Republic of China.

### **6. RECENT ACCOUNTING PRONOUNCEMENTS**

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF No. 00-21"). This Issue addresses how revenue arrangements with multiple deliverables should be divided into separate units of accounting and how the arrangement consideration should be allocated to the identified separate accounting units. EITF No. 00-21 is effective for fiscal periods beginning after June 15, 2003. The Company has not completed its assessment as to whether EITF No. 00-21 will have a significant impact on its financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of APB No. 50" ("FIN 46"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, FIN 46 must be adopted for the first interim or annual period beginning after June 15, 2003. The Company does not believe that this announcement will have a significant impact on its financial statements.

### **7. RECLASSIFICATIONS**

Certain amounts from prior periods have been reclassified to conform with current period presentation.

## **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 ITC Information Technology (Beijing) Co., Ltd. (or Beijing ITC), and our affiliates 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), and Sohu-Guolian Information Technology Co., Ltd. (or Sohu-Guolian), and these references should be interpreted accordingly. Unless otherwise specified, references to "China" or "PRC" refer to the People's Republic of 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*

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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**

Sohu, having introduced the first Chinese language online directory, is one of the leading Internet portals in China in terms of brand recognition. We are a Delaware corporation.

On October 18, 2000, Sohu acquired ChinaRen for total consideration of \$33 million, comprising 4,401,500 shares of Sohu common stock with an aggregate market value of approximately \$31.6 million, stock options granted to ChinaRen employees to purchase 221,002 shares of Sohu common stock valued at \$0.5 million and other acquisition costs aggregating \$0.9 million. Revenues and expenses from ChinaRen’s operations after the acquisition date have been included in Sohu’s consolidated financial statements.

We have incurred significant net losses since inception, except for each of the three quarters ended March 31, 2003. As of March 31, 2003, we had an accumulated deficit of \$68.6 million. These losses have been funded with proceeds of preferred stock private placements and our initial public offering completed in July 2000. 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. We anticipate funding such losses, if any, with the remaining proceeds from our initial public offering.

### **CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES**

Sohu’s discussion and analysis of its financial condition and results of operations are based upon Sohu’s 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 Sohu 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, Sohu evaluates its 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. Sohu believes accounting for advertising revenue, accounting for e-subscriptions revenues, gross versus net basis of revenue recognition, allowance for doubtful accounts, provision for long-term loans to related parties, and valuation allowance against deferred tax assets represent critical accounting policies which 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. Pursuant to standard advertising contracts, we provide placements on a number of different Web site channels and formats, including but not limited to banners, links, logos, buttons, content integration and email marketing. Revenue is normally recognized ratably over the period in which the advertising is displayed, when collectibility is reasonably assured. In estimating the fair value of individual services provided, we make estimates based on the value of services provided to our customers using prices contained in our standard rate card and actual average sell rates. Different sell rates can exist between contracts depending on the size, the respective advertiser and the location of the advertisements. 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.

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E-subscription revenues are included within non-advertising revenues and are derived principally from providing value added short messaging services such as alumni club, dating and friends matching, e-mail, ringtone and logo downloads and various other related products to mobile phone users. E-subscription fees are charged on a monthly or per message basis. E-subscription 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 e-subscription fees. In order to meet ownership requirements under PRC law which restrict or prohibit us from being an Internet content provider or directly providing telecommunications services such as e-subscriptions, we rely on Beijing Sohu to contract with the mobile operators. Generally, (i) within 15 to 90 days after the end of each month, Beijing Sohu receives a statement from each of the operators confirming the amount of e-subscription charges billed to that operator's mobile phone users and (ii) within 30 to 120 days after delivering a monthly statement to Beijing Sohu each operator remits the e-subscription fees, net of its service fees, for the month to Beijing Sohu, which then transfers the funds to Sohu. 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 e-subscription 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. An operator's failure rate can vary from month to month, ranges from 15% 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. At the end of each reporting period, where an operator has not provided Beijing Sohu with the monthly statement for any month confirming the amount of e-subscription 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 e-subscription fees and accrues revenue accordingly. Material differences could result in the amount and timing of our revenue for any period because of differences between the actual failure rate per an operator's statement and our internal records.

Our management must determine whether to record revenue for our e-subscriptions 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 e-subscriptions revenues are recorded on a gross basis. The majority of our e-commerce revenues are recorded on a gross basis but, depending on the terms of particular contracts with our suppliers, the net basis is also used. 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 from third parties and related parties. 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 non-related party accounts receivable balance was \$2.8 million net of allowance for doubtful accounts of \$646,000 as of March 31, 2003. Our accounts receivable from related parties was \$4.9 million and there was no allowance for doubtful accounts as of March 31, 2003. 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.

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Our management must make estimates of the valuation of long-term loans to related parties which were made to facilitate our participation in telecommunications, internet content, financial services and certain other businesses in China where foreign ownership is either prohibited or restricted (the “PRC Companies”). To the extent losses are incurred by the PRC companies, Sohu accrues for such losses by recording a valuation allowance against long-term loans to related parties. As of March 31, 2003, Sohu had recorded \$338,000 of such valuation allowance for losses incurred by the PRC Companies. If the regulatory environment was to change or business conditions were to deteriorate, additional allowances might be required.

As of March 31, 2003, due to our history of cumulative losses, 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, which are currently not contemplated in our current estimates, that would allow us to realize more of our deferred tax assets than the presently recorded net amount, an adjustment to the deferred tax asset would increase income when those events occurred.

### **RESULTS OF OPERATIONS**

#### **FOR THE THREE MONTHS ENDED MARCH 31, 2003 and 2002**

##### **REVENUES**

Total revenues increased by \$9.9 million to \$14.4 million for the three months ended March 31, 2003 as compared to the three months ended March 31, 2002. For the three months ended March 31, 2003, advertising revenues constituted \$4.5 million or 31% of total revenues and non-advertising revenues were \$9.9 million or 69% of total revenues. For the three months ended March 31, 2002, advertising revenues constituted \$2.5 million or 55% of total revenues and non-advertising revenues were \$2 million or 45% of total revenues.

##### **Advertising Revenues**

Advertising revenues increased by \$2 million to \$4.5 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002. The increase was primarily due to higher advertising rates, the increasing number of advertisers purchasing space on our online media properties as well as larger and longer-term purchases by certain advertisers. Sales to Sohu’s five largest advertisers were 13% of total advertising revenues for the three months ended March 31, 2003, as compared to 21% of total advertising revenues for the three months ended March 31, 2002.

##### **Non-advertising Revenues**

Non-advertising revenues which have been the fastest growing part of our business are derived principally from monetizing our users (i.e. consumers) via e-subscription services and to a lesser extent from e-commerce services.

Non-advertising revenues increased by \$7.9 million to \$9.9 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002. Non-advertising revenues were derived from e-subscription fees of \$8.7 million, e-commerce services of \$1.2 million, and e-technology services of \$82,000.

Most of the growth in non-advertising revenues was attributable to increases in e-subscriptions revenue. E-subscription revenues are derived principally from providing value added short messaging services such as alumni club, dating and friends matching, e-mail, ringtone and logo downloads and various other related products to mobile phone users. E-subscription fees are charged on a monthly or per message basis. E-subscriptions fees increased by \$7.8 million to \$8.7 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002. The increase was due to product development and consumer acceptance of short messaging services most of which were recently introduced.

E-commerce revenues are earned from direct 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, 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 who 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. E-commerce revenue increased by \$147,000 to \$1.2 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002, as a result of more people purchasing through our Web site.

## **COSTS AND EXPENSES**

### **Cost of Revenues**

Total cost of revenues increased by \$2.3 to \$5.3 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002. For the three months ended March 31, 2003, advertising cost of revenues constituted \$1.6 million or 30% of total cost of revenues and non-advertising cost of revenues were \$3.7 million or 70% of total cost of revenues. For the three months ended March 31, 2002, advertising cost of revenues constituted \$1.5 million or 50% of total cost of revenues and non-advertising cost of revenues was \$1.4 million or 50% of total cost of revenues.

### **Advertising Cost of Revenues**

Advertising cost of revenues increased by \$139,000 to \$1.6 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002 due to higher spending on headcount and content as we expanded our channel offerings.

### **Non-advertising Cost of Revenues**

Non-advertising cost of revenues increased by \$2.2 million to \$3.7 million for the three months ended March 31, 2003. For the three months ended March 31, 2003, non-advertising cost of revenues included \$2.6 million in e-subscription cost of revenues consisting of subscription collection and short message transmission charges paid to third party network operators and \$1 million in e-commerce cost of revenue consisting of the purchase price of consumer products sold by Sohu and inbound and outbound shipping charges. E-commerce and subscription cost of revenues do not include allocations for Web site operating costs. Substantially all non-advertising cost of revenues are variable costs and the increase is consistent with the increases in revenue.

### **Product Development Expenses**

Product development expenses increased by \$567,000 to \$1.7 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002. The increase was primarily attributable to increased headcount and licensing spending associated with our Sohu browser and online games development.

### **Sales and Marketing Expenses**

Sales and marketing expenses decreased by \$23,000 to \$2 million for the three months ended March 31, 2003 as compared to the three months ended March 31, 2002. Overall spending was largely unchanged.

### **General and Administrative Expenses**

General and administrative expenses increased by \$109,000 to \$1.1 million for the three months ended March 31, 2003, as compared to the three months ended March 31, 2002. The increase was primarily due to an increase in professional fees.

### **Operating Profit/(Loss)**

As a result of the foregoing, we had an operating profit of 4.3 million for the three months ended March 31, 2003 as compared to an operating loss of \$2.5 million for the three months ended March 31, 2002.

### **Other Expense**

For the three months ended March 31, 2003, other expense was \$81,000 and included a \$86,000 valuation allowance for long-term loans to related parties for investments in Sohu-Guolian and \$5,000 gain on disposal of fixed assets. There was no significant other expense recorded for the three months ended March 31, 2002.

### **Interest Income**

Interest income for the three months ended March 31, 2003 was \$327,000, approximately the same as for the three months ended March 31, 2002, as our cash balances and average rates of return were similar and we invested in longer term marketable securities which partly protected us from falling interest rates.

### **Net Income/(Loss)**

As a result of the foregoing, we had net income of \$4.6 million for the three months ended March 31, 2003, as compared to a net loss of \$2.2 million for the three months ended March 31, 2002. We did not record any income tax expense as we have approximately \$17 million in net operating losses which can be used to reduce taxes payable. As a Delaware company, after the utilization of remaining loss carryforwards we will be subject to tax at a maximum rate of 34 percent.

## LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations principally through private sales of preferred stock and our initial public offering completed in July 2000. From inception through March 31, 2003, we have raised net proceeds of \$39.2 million through the sale of preferred stock in private placements and \$52.4 million from the sale of common stock in our initial public offering. We invest our excess cash in marketable debt securities of high quality investment grade. As of March 31, 2003, we had cash, cash equivalents, and investments in marketable debt securities totaling approximately \$47.4 million.

Net cash provided by operating activities was approximately \$4 million for the three months ended March 31, 2003, primarily due to net income of \$4.6 million and depreciation and amortization of \$1.2 million, offset by an increase in working capital of \$1.9 million. Net cash provided by operating activities was \$129,000 for the three months ended March 31, 2002, primarily due to our net loss of \$2.2 million, depreciation and amortization of \$1.2 million, and a decrease in working capital of \$1 million.

There was no significant net cash provided by the investing activities for the three months ended March 31, 2003. During the three months ended March 31, 2003, \$1 million of marketable debt securities matured and approximately offset the payment for acquisition of fixed assets and other assets. Net cash used in investing activities was \$7.8 million for the three months ended March 31, 2002, primarily due to long-term investments in marketable debt securities of \$5 million, the purchase of fixed assets for \$1 million and long-term loans to related parties of \$1.9 million for financing an investment in High Century and Hengda.

There was no significant net cash provided by financing activities for each of the three months ended March 31, 2003 and 2002.

Our principal commitments consist of obligations under various operating leases for office facilities. We expect that capital expenditures in 2003 will primarily consist of purchases of additional servers, computer software, workstations and technological improvements to network infrastructure.

We believe that current cash and cash equivalents will be sufficient to meet the requirements of working capital (net cash used in operating activities), commitments and capital expenditures cash needs 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. If these sources are insufficient to satisfy cash requirements, we may seek to sell additional equity or debt securities or to obtain a credit facility. The sale of additional equity or convertible debt securities could result in additional dilution to stockholders. The incurrence of indebtedness would result in debt service obligations and could result in operating and financial covenants that would restrict operations. Financing may not be available in amounts or on terms acceptable to us, if at all.

Chinese regulations limit our ability to convert renminbi into foreign currency for capital items. While operations in China are currently a net user of cash, the ability to use future cash generated in China for expenditures outside of China may be restricted. If the renminbi were to decline in value, our revenues in US dollar terms would be reduced.

## RISK FACTORS

### Risks Related to Sohu.com

**Cases of Severe Acute Respiratory Syndrome, or SARS, may have an adverse effect on our business operations and financial results.**

Recently there have been a number of SARS cases in China, where we derive all of our revenues, and specifically in Beijing where most of our employees are based. Possible risks associated with SARS include a reduction in advertising revenue because advertisers may cancel existing contracts or defer future advertising expenditures, a reduction of non-advertising revenue because consumers' use of our e-subscriptions and e-commerce services is restricted, and severe disruption of our business operations if our suppliers or we are required to temporarily close our offices pursuant to health or other government regulations. With the health of our employees being the highest priority we have taken precautionary protection measures which include but are not limited to restricting travel and having most of our Beijing head office employees work from their homes. The situation with SARS could deteriorate or improve in a very short time.

**If we are unable to obtain adequate Director and Officer liability insurance against third party claims at economical rates, we could be exposed to increased risk of loss in the event of a claim.**

Pursuant to a policy expiring in July 2003, we have \$15 million in Director and Officer liability insurance coverage. As our market capitalization has recently increased significantly, this amount of insurance coverage may not be sufficient. Furthermore, because of market factors associated with the Sarbanes-Oxley Act of 2002 and the litigation environment in the United States, our premiums could increase significantly and we may not be able to obtain sufficient coverage at economical rates.

**Except for each of the three quarters ended March 31, 2003, we have incurred net losses since inception and losses could continue in the future.**

Except for each of the three quarters ended March 31, 2003, we have incurred significant net losses since our inception in August 1996. In addition, we had an accumulated deficit of approximately \$68.6 million at March 31, 2003. 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. We may not sustain profitability.

**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 revenues and successfully build our e-commerce, short messaging and subscription services businesses, given the early stage of development of the PRC Internet industry;
- 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.

**PRC Internet laws and regulations are unclear and will likely change in the near future. If we are found to be in violation of current or future PRC laws or regulations, we could be subject to severe penalties.**

We conduct our Internet business solely in the PRC through our wholly owned subsidiary, Beijing ITC. Beijing ITC is a wholly foreign owned enterprise, or WFOE, under PRC law. We are a Delaware corporation and a foreign person under PRC law. Accordingly, our Internet business is 100% foreign-owned. In order to meet ownership requirements under PRC law which restrict or prohibit Sohu from operating in certain industries such as Internet content provider, online stock trading and internet access, we have established Beijing Sohu, High



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Century and Hengda which are companies incorporated in the PRC and owned by Charles Zhang, our chief executive officer, and certain other employees of Sohu. As of March 31, 2003, Sohu had invested \$5.1 million in Beijing Sohu, High Century and Hengda through loans to related parties. In 2000, we extended loans of \$242,000 to Dr. Charles 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. Charles Zhang. In 2001 and 2002, we made loans of \$4.6 million to Dr. Charles 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 March 2002, High Century entered into a joint venture agreement with Guolian Securities Co., Ltd., pursuant to which High Century has invested \$3.1 million in Sohu-Guolian in return for a 51% equity interest in and joint control of Sohu-Guolian. Sohu-Guolian will provide technical services to the PRC online securities trading and financial services industries. We do not have any direct ownership interest in Beijing Sohu, High Century, Hengda or Sohu-Guolian.

The PRC has recently begun 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.

Issues, risks and uncertainties relating to PRC government regulation of the PRC Internet sector include the following:

- 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 services. If these regulations are interpreted to be inconsistent with our restructuring, our business will be severely impaired.
- 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 will 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.
- The Ministry of Information Industry, or MII, has also stated that the activities of Internet content providers are subject to regulation 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 regulation 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 regulation in the future.

The interpretation and application of existing PRC laws and regulations, the stated positions of the MII and the possible new laws or regulations have created substantial uncertainties regarding the legality of existing and future foreign investments in, and the businesses and activities of, PRC Internet companies, including us.

Accordingly, it is possible that the relevant PRC authorities could, at any time, assert that any portion or all of our, Beijing ITC's, Beijing Sohu's, Hengda's, High Century's or Sohu-Guolian'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, Beijing Sohu's, Hengda's, High Century's and Sohu-Guolian's current or proposed businesses and operations. In addition, these new laws and regulations may be retroactively applied to us, Beijing ITC, High Century, Hengda, Beijing Sohu, or Sohu-Guolian.

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If we, Beijing ITC, High Century, Beijing Sohu, Hengda, or Sohu-Guolian 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, High Century's, Hengda's, Beijing Sohu's or Sohu-Guolian's income;
- revoking our, Beijing ITC's, High Century's, Hengda's, Beijing Sohu's or Sohu-Guolian's business license;
- shutting down our, Beijing ITC's, or Beijing Sohu's servers and/or blocking our Web sites;
- requiring us, Beijing ITC, High Century, Hengda, Sohu-Guolian or Beijing Sohu to restructure its ownership structure or operations; and
- requiring us, Beijing ITC, High Century, Hengda, Beijing Sohu or Sohu-Guolian to discontinue any portion or all of its Internet business.

### **We may be unable to collect long term loans to related parties or exercise management influence associated with Beijing Sohu, High Century, Sohu-Guolian or Hengda.**

At March 31, 2003 Sohu had provided long term loans of \$5.1 million to Dr. Charles Zhang, Sohu's Chief Executive Officer and a major Sohu stockholder, 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. Charles Zhang and 20% by certain of our employees, and Hengda, which is owned 80% by High Century and 20% by an employee. Beijing Sohu, High Century and Hengda are used to facilitate our participation in telecommunications, Internet content, financial services and certain other businesses in China where foreign ownership is either prohibited or restricted. We expect that we will continue to be involved in and provide additional financial support under similar arrangements in the future, subject to the restrictions set forth in the Sarbanes-Oxley Act of 2002 with respect to loans to directors and executive officers.

The agreements contain provisions that, subject to PRC law, (i) the loans can only be repaid to Sohu by transferring the shares of High Century, Hengda or Beijing Sohu to Sohu, (ii) the shares of High Century, Hengda or Beijing Sohu cannot be transferred without the approval of Sohu, and (iii) Sohu has the right to appoint all directors and senior management personnel of High Century, Hengda and Beijing Sohu. Dr. Charles Zhang and the other employee borrowers have pledged all of their shares in High Century, Hengda 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, and after January 2003, in the case of Hengda, or, in any case, at such time as Dr. Charles 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-Guolian and Beijing Sohu.

Our ability to ultimately collect these loans will depend on the profitability of Beijing Sohu, Hengda, Sohu-Guolian and High Century, which is uncertain. As of March 31, 2003, the Company had recorded \$338,000 of valuation allowance for losses incurred by Beijing Sohu, High Century, Hengda, and Sohu-Guolian. 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-Guolian and Beijing Sohu.

As of March 31, 2003, payable to related parties of \$1.6 million represents funds initially used to capitalize High Century and Hengda which are currently not being used in the operations of High Century and Hengda and have been transferred to Sohu. Under PRC regulations, we could be required to repay these balances to High Century and Hengda at any time or High Century and Hengda could be penalized for this action. We do not intend to repay the balances at this time.

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**We have attempted to comply with restrictions on foreign investment in the PRC Internet sector imposed by the PRC government by transferring our content-related assets and operations to, and entering into agreements with, Beijing Sohu, a PRC company owned by our President and Chief Executive Officer. If the PRC government finds that these agreements do not comply with the relevant foreign investment restrictions, our business in the PRC will be adversely affected.**

Because the PRC government restricts foreign investment in Internet-related businesses, we have restructured our Internet operations by having Beijing Sohu acquire appropriate government approvals to conduct our content-related operations. In addition, we have transferred our content-related assets and operations to Beijing Sohu. The legal uncertainties associated with PRC government regulations and our restructuring may be summarized as follows:

- whether the PRC government may view our restructuring as being in compliance with its laws and regulations;
- whether the PRC government may impose additional regulatory requirements with which we or Beijing Sohu may not be in compliance; and
- whether the PRC government will permit Beijing Sohu to acquire future licenses necessary in order to conduct operations in the PRC.

We cannot be sure that our restructured operations and activities will be viewed by PRC regulatory authorities as in compliance with applicable PRC laws and regulations. Our business will be adversely affected if our business license is revoked as a result of non-compliance. In addition, we cannot be sure that we and Beijing Sohu will be able to obtain all of the licenses we or Beijing Sohu may need in the future. Future changes in PRC government policies affecting the provision of information services, including the provision of online services and Internet access, may impose additional regulatory requirements on us or Beijing Sohu or our service providers or otherwise harm our business.

**We depend upon contractual arrangements with Beijing Sohu, Hengda, Sohu-Guolian and High Century 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 business only in the PRC, and because we are restricted or prohibited by the PRC government from owning Internet content, financial services or telecommunication operations in the PRC, we are dependent on Beijing Sohu, Hengda, Sohu-Guolian and High Century 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, financial services or telecommunications operations as direct ownership of these businesses. For example, Beijing Sohu 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, Sohu-Guolian and High Century 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.

Charles Zhang, our chief executive officer, Beijing Sohu, Hengda, Sohu-Guolian and High Century. 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.

**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.

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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.

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

We derive a significant portion of our revenues from the sale of advertising on our Web sites. For the three months ended March 31, 2003 and 2002, advertising revenues represented approximately 31% and 55%, respectively, of our total revenues.

The online advertising market in China is new and relatively small. 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;
- downward pressure on online advertising prices;
- acceptance by advertisers that online advertising is effective;
- the development of independent and reliable means of verifying traffic; and
- the effectiveness of our advertising delivery, tracking and reporting systems.

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 ad blocking on the Internet may decrease our revenues because when an ad is blocked, it is not downloaded from our ad 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.

Accordingly, we may not be successful in generating significant future online advertising revenues.

### **We rely on e-subscription services for a significant portion of our revenues.**

We derive a significant portion of our revenues from e-subscription services on our Web sites. For the three months ended March 31, 2003 and 2002, e-subscription revenues represented approximately 60% and 20%, respectively, of our total revenues. We expect our reliance on e-subscription revenues to increase. Our business plan is dependent upon further increases in revenues from e-subscription services and the expansion of our subscriber base.

E-subscription revenue is derived principally from providing value added short messaging services such as alumni club, dating and friends matching, e-mail, ringtone and logo downloads and various other related products to mobile phone users. E-subscription fees are charged on a monthly or per message basis. Pursuant to contractual arrangements between Beijing Sohu and a number of mobile network operators in China which are subsidiaries of China Mobile Communication Corporation, or CMCC, and China Unicom Co., Ltd, or Unicom, Sohu relies on the operators for both billing of, and collection from, mobile phone users of e-subscription fees. The service fees range from approximately 10% to 50% of the e-subscription fees, and are based on contracted rates. Generally, (i) within 15 to 90 days after the end of each month, Beijing Sohu receives a statement from CMCC and Unicom confirming the amount of e-subscription charges billed to that operator's mobile phone users and (ii) within 30 to 120 days after delivering a monthly statement to Beijing Sohu, each operator remits the e-subscription fees, net of its service fees, for the month to Beijing Sohu which then transfers the funds to Sohu.

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With respect to our e-subscription services, we depend on the cooperation of CMCC and Unicom. We rely on CMCC and Unicom in the following ways:

- we provide short messaging services through CMCC's and Unicom's network and gateway;
- 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 subscription services.

We face significant risks in the area of e-subscription services, such as the following, which could adversely affect our e-subscription services and revenues:

- E-subscription services are provided through our Web site and recorded 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 e-subscription 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, ranges from 15% 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. Changes in failure rates may result in a significant reductions or fluctuations in our e-subscription 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 is currently under negotiation and the existing CMCC contract expires in September 2003. Our negotiating power is limited and if an operator increases its service fees, or does not comply with the terms of our contract, our revenue, gross margin and profitability could be materially reduced.
- We rely on the operators to pay us the e-subscriptions fees which they have billed to their mobile customers. If an operator refuses to pay us or limits the amount of e-subscriptions 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 e-subscription services.
- If CMCC or Unicom is unwilling to cooperate with us, we would not be able to find substitute partners.
- Currently over eighty percent of our e-subscriptions revenue is from consumers who subscribe for individual services for which we charge a monthly fee ranging from approximately US\$.60 to US\$4.0. Over the past six months, the largest contributor to our e-subscriptions growth and total e-subscriptions revenue has been from our online dating and friends matching service which we refer to as "Jiqingongshe" or "GGMM". Growth and sustainability of our e-subscription revenues is dependent upon user acceptance of our existing and new services, especially services such as GGMM which are paid by way of monthly subscriptions. 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.
- 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 e-subscriptions revenue, generally, and our GGMM revenue, specifically, would be materially impacted.

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- 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, each of which could result in decreases or fluctuations in our revenue.
- Also, consumers may cancel their services at any time without notice, which could result in significant reductions and fluctuations in our revenue.
- CMCC or Unicom may change their operating regulations at any time, which could result in our being fined or having our services discontinued for non-compliance with their regulations. Changes in these operating regulations could also have a material impact on our revenue. For example, in April 2003, CMCC announced or clarified regulations which prohibit utilizing its billing gateway for services which are not directly related to the mobile phone and prohibit billing for services which have not used by a user for more than three months.
- 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.

We also face the risk that changes in government policy could restrict or curtail the services which we provide.

### **We rely on e-commerce services for a significant portion of our revenues.**

We derive a significant portion of our revenues from e-commerce sales from our Web sites. For the three months ended March 31, 2003 and 2002, e-commerce revenues represented approximately 8% and 23%, respectively, of our total revenues.

Substantially all e-commerce revenues are earned from the sale of consumer products. Our business plan is dependent upon further increases in revenues from e-commerce.

We face the following risks with respect to our e-commerce business line:

- the online shopping market is small and unproven in China and, therefore, we may not be able to sustain revenue growth or maintain existing revenue levels;
- we may not be able to maintain our existing gross margins because of competitors such as Joyo, Bertelsmann Online and Dang Dang;
- credit cards are not widely used in China and, therefore, we rely on cash on delivery for collecting payments whereby we have a collection risk from the companies providing delivery service; and
- future government regulations could restrict us from further expanding or continuing this business.

### **In 2002, through High Century, we invested \$3.1 million in Sohu-Guolian, a joint venture which provides services to the online trading and financial services industries.**

The success of this investment depends, among other things, on the following factors:

- conditions and trading volumes in the China securities market which currently can be considered weak;
- the acceptability and development of online stock trading in China which is unknown at this time;
- expansion, which is dependent on the development of China's banking system (which currently does not allow for nation wide remote account opening);
- cooperation from Guolian Securities Co., Ltd., our joint venture partner, who we rely on to provide technical expertise, licensing and other resources to allow Sohu-Guolian to provide services; and
- future legislation to allow Sohu-Guolian to obtain its own online securities trading license (currently regulations do not exist which would allow Sohu-Guolian to obtain its own online trading license).

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There is no assurance that Sohu-Guolian will be successful, and, in addition, we believe that it is unlikely that Sohu-Guolian will be profitable in 2003 or 2004.

### **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, many of which are beyond our control. 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. It is likely that in some future quarter, our operating results may be below the expectations of public market analysts and investors. In this event, the trading price of our common stock may fall.

### **We will not be able to attract visitors, advertisers, paying subscribers, short messaging 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 China grows. In order to attract and retain Internet users, advertisers, subscribers, and short messaging and e-commerce customers, we may need to increase substantially 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 short messaging and e-commerce customers.

### **We may need additional capital and we may not be able to obtain it.**

Our capital requirements are difficult to plan in our rapidly changing industry. We currently expect that we will need capital to fund additions to our portal and computer infrastructure, including any acquisitions of complementary assets, technologies or businesses we may pursue, as well as the expansion of our sales and marketing activities.

Our ability to obtain additional financing in the future is subject to a variety of uncertainties, including:

- investors' perceptions of and appetite for Internet-related securities;
- conditions in the U.S. and other capital markets in which we may seek to raise financing;
- our future results of operations, financial condition and cash flows;
- the amount of capital that other PRC entities may seek to raise in foreign capital markets;
- PRC governmental regulation of foreign investment in Internet companies;
- economic, political and other conditions in the PRC;
- PRC governmental policies relating to foreign currency borrowings; and
- any new laws and regulations that may require various PRC government approvals for securities offerings by companies engaged in the Internet sector in the PRC.

Our inability to raise additional funds on favorable terms, or at all, could force us to scale back our planned expenditures, which could adversely affect our growth prospects.

### **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.

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Substantially all of our subscription revenue is generated through short messaging services where we depend on mobile network operators for message delivery and payment collection. If we were unable to continue this arrangement, our short messaging 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. Charles Zhang, who is the founder, President and chief executive officer of our company and the founder and 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 stockholders, 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, short messaging 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.

### **Our advertising pricing model, which is based on charging a fixed fee to display advertisements for a specified time period, may not be profitable.**

There are currently no industry standard pricing models used to sell advertising on the Internet. This makes it difficult to project our future advertising rates and revenues. The models we adopt may prove not to be profitable. A significant portion of our advertising revenues in 2003 and 2002 were derived from charging a fixed fee to display an advertisement over a given time period.



**We may not be able to track the delivery of advertisements through our portal, which may make us less attractive to potential advertisers.**

It is important to advertisers that we accurately measure the demographics of our user base and the delivery of advertisements through our portal. Companies may choose not to advertise on our portal or may pay less for advertising if they do not perceive our portal to be reliable. We depend on third parties to provide us with some of these measurement services. If they are unable to provide these services in the future, we would need to perform these services ourselves or obtain these services from other providers. This could cause us to incur additional costs or cause interruptions or slowdowns in our business during the time we are replacing these services. We are currently implementing additional systems designed to collect information on our users. We may not be able to implement these systems successfully.

**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 amortization expenses related to goodwill and other 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.

**We will rely on dividends and other distributions on equity paid by our wholly-owned operating subsidiaries to fund any cash requirements we may have.**

We are a holding company with no operating assets other than the shares of Beijing ITC, our wholly-owned subsidiary in the PRC that owns and conducts our Internet business. We will rely on dividends and other distributions on equity paid by Beijing ITC for our cash requirements in excess of any cash raised from investors and retained by us. If Beijing ITC incurs debt on its own behalf in the future, the instruments governing the debt may restrict Beijing ITC's ability to pay dividends or make other distributions to us. In addition, PRC legal restrictions permit payment of dividends by Beijing ITC only out of its net income, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, Beijing ITC is also required to set aside a portion of its net income each year to fund certain reserve funds. These reserves are not distributable as cash dividends.

Beijing ITC has incurred significant net losses since its inception. Therefore, we have not received any dividends or other distributions from Beijing ITC in the past and do not expect any dividends in the foreseeable future.

**We may not have exclusive rights over the mark "Sohu.com" in certain areas.**

We have applied for registration of the "Sohu.com" mark in Hong Kong and Taiwan, and plan to apply for registration in Malaysia and Singapore. Completion of these applications is subject to prior rights in the relevant jurisdictions. Any rejection of those applications may adversely affect our legal rights over the mark "Sohu.com" in those countries and regions.

**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.

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**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, and may in the future be, subject to legal proceedings and claims from time to time 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, 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.

**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.

### **Risks Related to Our Markets**

**We will rely on online advertising sales, subscription, short messaging and e-commerce services for a significant portion of our future revenues, but the Internet has not been proven as a widely accepted medium for advertising, subscription, short messaging or e-commerce services.**

We expect to derive a significant portion of our revenue for the foreseeable future from online advertising, subscription, short messaging and e-commerce services. If the Internet is not accepted as a medium for advertising, subscription, short messaging or e-commerce services, our ability to generate revenues will be adversely affected.

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.

**Many of our current and potential advertising and e-commerce customers have only limited experience using the Internet for advertising or commerce 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 online advertising and e-commerce markets are new and rapidly evolving, particularly in China. As a result, many of our current and potential advertising and e-commerce customers have limited experience using the Internet for advertising or commerce purposes and historically have not devoted a significant portion of their advertising and sales budgets to Internet-based advertising and e-commerce. Moreover, customers 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. In addition, companies may choose not to advertise or sell their products on our portal if they do not perceive our online advertising and e-commerce platform to be effective or our audience demographics to be desirable. The failure to successfully address these risks or execute our business strategy would significantly reduce our profitability.

**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 Internet search and retrieval services, short messaging and e-commerce services and online advertising, 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. Some of our major competitors in China are major United States Internet companies, such as Yahoo! Inc and Nasdaq listed companies Sina Corporation and Netease. 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.

**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.

**The acceptance of the Internet as a commerce platform in China depends on the resolution of problems relating to fulfillment and electronic payment.**

Our future growth of revenues depends in part on the anticipated expansion of e-commerce activities in China. As China currently does not have a reliable nationwide product distribution network, the fulfillment of goods purchased over the Internet will continue to be a factor constraining the growth of e-commerce. An additional barrier to the development of e-commerce in China is the lack of reliable payment systems. In particular, the use of credit cards or other viable means of electronic payment in sales transactions is not as well developed in China as in some other countries, such as the United States. Various government entities and businesses are working to resolve these fulfillment and payment problems, but these problems are expected to continue to hinder the acceptance and growth of the Internet as a commerce platform in China, which could in turn hinder our growth.

**Risks Related to the Internet and Our Technology Infrastructure**

**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.

**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.

**Concerns about security of e-commerce transactions and confidentiality of information on the Internet may increase our costs, reduce the use of our portal and impede our growth.**

A significant barrier to e-commerce and confidential communications over the Internet has been the need for security. Internet usage could decline if any well-publicized compromise of security occurred. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by these breaches. If unauthorized persons are able to penetrate our network security, they could misappropriate proprietary information or cause interruptions in our services. As a result, we may be required to expend capital and resources to protect against or to alleviate these problems.

**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, Economic and Regulatory Risks**

**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.

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.

**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 foreign investors. 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.

**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.

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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.

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

Although we are incorporated in the State of Delaware, substantially all 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 substantial 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.

### **Risks Related to the Market for Our Common Stock**

#### **The market price of our common stock has been and will likely continue to be volatile.**

The market price of our common stock has been volatile, and is likely to continue to be so. 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, particularly Internet companies. As a result, investors in our shares may experience a decrease in the value of their shares regardless of our operating performance or prospects.

#### **The sale or availability for sale of substantial amounts of our common stock could adversely affect its market price.**

There were approximately 34,878,143 shares of our common stock outstanding as of March 31, 2003, as well as options to purchase an additional 6,241,770 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 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.

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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.

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

Our chief executive officer beneficially owns approximately 25% 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 50% 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 and 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.

Holders of a majority 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 the ability to cause 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**

The majority of our revenues, expenses and liabilities are denominated in Chinese renminbi. Thus, revenues and operating results may be impacted by exchange rate fluctuations in the renminbi when financial results are translated in U.S. dollars on consolidation. Currency fluctuations and restrictions on currency exchange may adversely affect our business, including limiting the ability to convert Chinese renminbi into foreign currencies and, if the renminbi were to decline in value, reducing revenue in U.S. dollar terms. We have not tried to reduce exposure to exchange rate fluctuations by using hedging transactions but may choose to do so in the future. We may not be able to do this successfully. Accordingly, we may experience economic losses and negative impacts on earnings and equity as a result of foreign exchange rate fluctuations. The effect of foreign exchange rate fluctuations on us in the three months ended March 31, 2003 was not material.



## INVESTMENT RISK

### a) *Investments in Beijing Sohu, High Century, Hengda and Sohu-Guolian*

We have entered into the following arrangements with Dr. Charles Zhang, our Chief Executive Officer and a major Sohu shareholder, and certain of our employees to satisfy PRC regulations which prohibit or restrict foreign companies from owning or operating telecommunications, internet content, financial services and certain other businesses in China. We expect that we will continue to be involved in and provide additional financial support under similar arrangements in the future, subject to the restrictions set forth in the Sarbanes-Oxley Act of 2002 with respect to loans to directors and executive officers.

In June 2000, we extended loans in the amount of \$193,000 to Dr. Charles Zhang and \$49,000 to He Jinmei, another employee of Sohu, to finance their investments in Beijing Sohu, a company incorporated in the PRC. The shareholders of Beijing Sohu have pledged their shares in Beijing Sohu as collateral for the loan. These loans are included in long term loans to related parties, bear no interest and are due in full on the earlier of demand, in 2010 or at such time as Dr. Charles Zhang or He Jinmei, as the case may be, is not an employee of Sohu. A subsidiary of Sohu has entered into an option agreement giving it the right, at any time, subject to PRC law, to purchase the entire ownership in Beijing Sohu from the two Beijing Sohu shareholders for \$242,000. As of March 31, 2003, we had recorded a valuation allowance of \$56,000 against long-term loans to related parties for losses incurred by Beijing Sohu.

In November 2001, we entered into a loan and share pledge agreement with Dr. Charles Zhang, and Li Wei, another employee of Sohu, for the purpose of funding an equity investment of \$4,595,000 by these two individuals in High Century, a company incorporated in the PRC which engages in investment holding in the PRC on behalf of Sohu. Pursuant to the loan agreement, we have extended total loans amounting to \$4,595,000 of which \$3,676,000 and \$919,000 were loaned to Charles Zhang and Li Wei, respectively. These loans are included in long term loans to related parties. As of March 31, 2002, we had recorded a valuation allowance of \$4,000 against long-term loans to related parties for losses incurred by High Century.

In January 2002, we entered into a loan and share pledge agreement with Li Wei for the purpose of funding an equity investment of \$242,000 by Li Wei 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. These loans are included in long term loans to related parties. As of March 31, 2003, we had recorded a valuation allowance of \$3,000 against long-term loans to related parties for losses incurred by Hengda.

The loan agreements under which funds are provided to invest in High Century and Hengda are subject to PRC law and include provisions that (i) the loans can only be repaid to us by transferring the shares of High Century or Hengda to us, (ii) the shares of High Century or Hengda cannot be transferred without the approval of Sohu, and (iii) we have the right to appoint all directors and senior management personnel of High Century and Hengda. Charles Zhang and Li Wei have pledged all of their shares in High Century and Hengda 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, and January 2003, in the case of Hengda, or at such time as Dr. Charles Zhang or Li Wei, as the case may be, is not an employee of Sohu. We do not intend to request repayment of the loans as long as PRC regulations prohibit us from directly investing in businesses being undertaken by High Century and Hengda.

In April 2002, High Century invested \$3,080,000 in Sohu-Guolian, a company incorporated in the PRC, for a 51% equity interest in and joint control of Sohu-Guolian. Sohu-Guolian will provide technical services to the PRC online securities trading and financial services industries. As of March 31, 2003, we had recorded a valuation allowance of \$275,000 against long-term loans to related parties for losses incurred by Sohu-Guolian.

As of March 31, 2003, payable to related parties included \$435,000 and \$1,128,000 payable to High Century and Hengda, respectively, as High Century and Hengda had transferred their unused cash to Sohu. Sohu may be required to repay these funds at any time.

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*(b) Investment in marketable debt securities*

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 March 31, 2003, unrealized gains of \$546,000 were recorded as accumulated other comprehensive income in shareholders' equity.

**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-14(c) and 15-d-14(c)) as of a date, or the Evaluation Date, within 90 days before the filing date of this quarterly report, have concluded that as of the Evaluation Date, our disclosure controls and procedures were adequate and designed to ensure that material information relating to Sohu would be made known to them by others within the company. There were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect our disclosure controls and procedures subsequent to the Evaluation Date.

**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 AND USE OF PROCEEDS**

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 March 31, 2003, 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.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

Please see the Exhibit Index attached hereto.

(b) Reports on Form 8-K.

None.

## 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: May 12, 2003

**SOHU.COM INC.**

By: /s/Derek Palaschuk

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Chief Financial Officer & Senior Vice President (Principal  
Financial Officer)

## CERTIFICATIONS

I, Dr. 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 quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 12, 2003

/s/ Dr. Charles Zhang  
President, Chief Executive Officer and Chairman  
of the Board of Directors

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I, Derek Palaschuk, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sohu.com Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 12, 2003

/s/ Derek Palaschuk

Chief Financial Officer & Senior Vice President

Sohu.com Inc.  
Quarterly Report on Form 10-Q For Quarter Ended March 31, 2003

**EXHIBITS INDEX**

10.1	Employment Agreement, effective as of January 1, 2003, by and between Sohu.com Inc. and Victor Koo
10.2*	Employment Agreement, effective as of January 1, 2003, by and between Sohu.com Inc. and Charles Zhang
10.3*	Employment Agreement, effective as of January 1, 2003, by and between Sohu.com Inc. and Derek Palaschuk
99.1	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Incorporated herein by reference to the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

## EMPLOYMENT AGREEMENT

EMPLOYMENT AGREEMENT, effective as of January 1, 2003, by and between Sohu.com Inc., a Delaware corporation, and Victor Koo, an individual (the "Employee").

1. Definitions. Capitalized terms used herein and not otherwise defined in the text below will have the meanings ascribed thereto on Annex 1.

2. Employment; Duties.

(a) The Company agrees to employ the Employee in the capacity and with such responsibilities as are generally set forth on Annex 2.

(b) The Employee hereby agrees to devote his or her full time and reasonable efforts in such capacities as are set forth on Annex 2 on the terms and conditions set forth herein. Notwithstanding the foregoing, the Employee may engage in other activities, such as activities involving professional, charitable, educational, religious and similar types of organizations, provided that that the Employee complies with the Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement attached hereto as Annex 3 (the "Employee Obligations Agreement") and such other activities do not interfere with or prohibit the performance of the Employee's duties under this Agreement, or conflict in any material way with the business of the Company or of its subsidiaries and affiliates.

(c) The Employee will use reasonable efforts during the Term to ensure that the Company's business and those of its subsidiaries and affiliates are conducted in accordance with all applicable laws and regulations of all jurisdictions in which such businesses are conducted.

3. Compensation.

(a) Base Annual Income. During the Term, the Company will pay the Employee an annual base salary as set forth on Annex 2, payable monthly pursuant to the Company's normal payroll practices.

(b) Discretionary Bonus. During the Term, the Company, in its sole discretion, may award to the Employee an annual bonus based on the Employee's performance and other factors deemed relevant by the Company's Board of Directors.

(c) Stock Options. The Employee will be eligible to participate in any stock option or other incentive programs available to officers or employees of the Company.

(d) Reimbursement of Expenses. The Company will reimburse the Employee for reasonable expenses incurred by the Employee in the course of, and necessary in connection with, the performance by the Employee of his duties to the Company, provided that such expenses are substantiated in accordance with the Company's policies.

4. Other Employee Benefits.

(a) Vacation; Sick Leave. The Employee will be entitled to such number of weeks of paid vacation each year as are set forth on Annex 2, the taking of which must be coordinated with the Employee's supervisor in accordance with the Company's standard vacation policy. Unless otherwise approved by the Company's Board of Directors, vacation that is not used in a particular year may only be carried forward to subsequent years in accordance with the Company's policies in effect from time to time. The Employee will be eligible for sick leave in accordance with the Company's policies in effect from time to time.

(b) Healthcare Plan. The Company will arrange for membership in the Company's group healthcare plan for the Employee, the Employee's spouse and the Employee's children under 18 years old, in accordance with the Company's standard policies from time to time with respect to health insurance and in accordance with the rules established for individual participation in such plan and under applicable law.

(c) Life and Disability Insurance. The Company will provide term life and disability insurance payable to the Employee, in each case in an amount up to a maximum of one times the Employee's base salary in effect from time to time, provided however, that such amount will be reduced by the amount of any life insurance or death or disability benefit coverage, as applicable, that is provided to the Employee under any other benefit plans or arrangements of the Company. Such policies will be in accordance with the Company's standard policies from time to time with respect to such insurance and the rules established for individual participation in such plans and under applicable law.

(d) Other Benefits. Pursuant to the Company's policies in effect from time to time and the applicable plan rules, the Employee will be eligible to participate in the other employee benefit plans of general application, which may include, without limitation, housing allowance or reimbursement, tuition fees for the Employee's children at an international level school and tax equalization and which, in any event, shall include the benefits at the levels set forth on Annex 2.

5. Certain Representations, Warranties and Covenants of the Employee.

(a) Related Company Positions. The Employee agrees that the Employee and members of the Employee's immediate family will not have any financial interest directly or indirectly (including through any entity in which the Employee or any member of the Employee's immediate family has a position or financial interest) in any transactions with the Company or any subsidiaries or affiliates thereof unless all such transactions, prior to being entered into, have been disclosed to the Board of Directors and approved by a majority of the independent members of the Board of Directors and comply with all other Company policies and applicable law as may be in effect from time to time. The Employee also agrees that he or she will inform the Board of Directors of the Company of any transactions involving the Company or any of its subsidiaries or affiliates in which senior officers, including but not limited to the Employee, or their immediate family members have a financial interest.

(b) Discounts, Rebates or Commissions. Unless expressly permitted by written policies and procedures of the Company in effect from time to time that may be applicable to the Employee, neither the Employee nor any immediate family member will be entitled to receive or obtain directly or indirectly any discount, rebate or commission in respect of any sale or purchase of goods or services effected or other business transacted (whether or not by the Employee) by or on behalf of the Company or any of its subsidiaries or affiliates, and if the Employee or any immediate family member (or any firm or company in which the Employee or any immediate family member is interested) obtains any such discount, rebate or commission, the Employee will pay to the Company an amount equal to the amount so received (or the proportionate amount received by any such firm or company to the extent of the Employee's or family member's interest therein).

6. Term; Termination.

(a) Unless sooner terminated pursuant to the provisions of this Section 6, the term of this Agreement (the "Term") will commence on the date hereof and end on December 31, 2005.

(b) Voluntary Termination by the Employee. Notwithstanding anything herein to the contrary, the Employee may voluntarily Terminate this Agreement by providing the Company with thirty (30) days' advance written notice ("Voluntary Termination"), in which case, the Employee will not be entitled to receive payment of any severance benefits or other amounts by reason of the Termination other than accrued salary and vacation through the date of the Termination. The Employee's right to all other benefits will terminate as of the date of Termination, other than any continuation required by applicable law. Without limiting the foregoing, if, in connection with a Change in Control, the surviving entity or successor to Sohu's business offers the Employee employment on substantially equivalent terms to those set forth in this Agreement and such offer is not accepted by the Employee, the refusal by the Employee to accept such offer and the subsequent termination of the Employee's employment by the Company shall be deemed to be a voluntary termination of employment by the Employee and shall not be treated as a termination by the Company without Cause.

(c) Termination by the Company for Cause. Notwithstanding anything herein to the contrary, the Company may terminate this Agreement for Cause by written notice to the Employee, effective immediately upon the delivery of such notice. In such case, the Employee will not be entitled to receive payment of any severance benefits or other amounts by reason of the Termination other than accrued salary and vacation through the date of the Termination. The Employee's right to all other benefits will terminate, other than any continuation required by applicable law.



(d) Termination by the Employee with Good Reason or Termination by the Company without Cause. Notwithstanding anything herein to the contrary, the Employee may Terminate this Agreement for Good Reason, and the Company may Terminate this Agreement without Cause, in either case upon thirty (30) days' advance written notice by the party Terminating this Agreement to the other party and the Termination shall be effective as of the expiration of such thirty (30) day period. If the Employee Terminates with Good Reason or the Company Terminates without Cause, the Employee will be entitled to continue to receive payment of severance benefits equal to the Employee's monthly base salary in effect on the date of Termination for the shorter of (i) six (6) months and (ii) the remainder of the Term of this Agreement (the "Severance Period"), provided that the Employee complies with the Employee Obligations Agreement during the Severance Period. Such payments will be made ratably over the Severance Period according to the Company's standard payroll schedule. The Employee will also receive payment of the bonus for the remainder of the year of the Termination, but only to the extent that the bonus would have been earned had the Employee continued in employment through the end of such year, as determined in good faith by the Company's CEO, Board of Directors or its Compensation Committee based on the specific corporate and individual performance targets established for such fiscal year, and only to the extent that bonuses are paid for such fiscal year to other similarly situated employees. Health insurance benefits with the same coverage provided to the Employee prior to the Termination (e.g., medical, dental, optical, mental health) and in all other material respects comparable to those in place immediately prior to the Termination will be provided at the Company's expense during the Severance Period. The Company will also continue to carry the Employee on its Directors and Officers insurance policy for six (6) years following the Date of Termination at the Company's expense with respect to insurable events which occurred during the Employee's term as a director or officer of the Company, with such coverage being at least comparable to that in effect immediately prior to the Termination Date; provided, however, that (i) such terms, conditions and exceptions will not be, in the aggregate, materially less favorable to the Employee than those in effect on the Termination Date and (ii) if the aggregate annual premiums for such insurance at any time during such period exceed two hundred percent (200%) of the per annum rate of premium currently paid by the Company for such insurance, then the Company will provide the maximum coverage that will then be available at an annual premium equal to two hundred percent (200%) of such rate.

(e) Termination by Reason of Death or Disability. A Termination of the Employee's employment by reason of death or Disability shall not be deemed to be a Termination by the Company (for or without Cause) or by the Employee (for or without Good Reason). In the event that the Employee's employment with the Company Terminates as a result of the Employee's death or Disability, the Employee or the Employee's estate or representative, as applicable, will receive all accrued salary and accrued vacation as of the date of the Employee's death or Disability and any other benefits payable under the Company's then existing benefit plans and policies in accordance with such plans and policies in effect on the date of death or Disability and in accordance with applicable law. In addition, the Employee or the Employee's estate or representative, as applicable, will receive the bonus for the year in which the death or Disability occurs to the extent that a bonus would have been earned had the Employee continued in employment through the end of such year, as determined in good faith by the Company's CEO, Board of Directors or its Compensation Committee based on the specific corporate and individual performance targets established for such fiscal year, and only to the extent that bonuses are paid for such fiscal year to other similarly situated employees.

(f) Misconduct After Termination of Employment. Notwithstanding the foregoing or anything herein the contrary, if the Employee after the termination of his or her employment materially violates or fails to comply with the Employee Obligations Agreement, thereafter (1) the Employee shall not be entitled to any payments from the Company and (2) any insurance or other benefits that have continued shall terminate immediately.

## 7. Option-Related Provisions.

(a) Termination by the Company Without Cause after a Change in Control. If Company Terminates this Agreement without Cause within twelve (12) months following a Change in Control, the vesting and exercisability of each of the Employee's outstanding stock options or other stock-based incentive awards ("Awards") will accelerate such that the Award will become fully vested and exercisable upon the effectiveness of the Termination, and any repurchase right of the Company with respect to shares of stock issued upon exercise of the Award will completely lapse, in each case subject to paragraph (c) below ("Forfeiture of Options for Misconduct") and provided that, in the event of a liquidation of the Company where no provision is being made for the Employee's employment by the Company's successor in interest, the vesting and exercisability of

each of the Employee's outstanding Awards will accelerate such that the Award will become fully vested and exercisable ten (10) days prior to the effectiveness of the liquidation.

(b) Termination other than by the Company Without Cause after a Change in Control. If the Employee's employment with the Company Terminates for any reason, unless the Company Terminates this Agreement without Cause within twelve (12) months following a Change in Control, the vesting of each of the Employee's outstanding Awards shall cease upon the effectiveness of the Termination, such that any unvested Award shall be cancelled.

(c) Forfeiture of Options for Misconduct. If the Employee materially fails to comply with the terms of this Agreement, the Employee Obligations Agreement, or the written policies and procedures of the Company, as the same may be amended from time to time, or acts against the specific instructions of the Board of Directors of the Company or if this Agreement is terminated by the Company for Cause, the Employee will forfeit any unvested Awards that have been granted to him or her or to which the Employee may be entitled.

8. Employee Obligations Agreement. By signing this Agreement, the Employee hereby agrees to execute and deliver to the Company the Employee Obligations Agreement, and such execution and delivery shall be a condition to the Employee's entitlement to his or her rights under this Agreement.

9. Governing Law. This Agreement will be governed by and construed and enforced in accordance with the laws of the State of Delaware if the dispute is resolved therein, and in accordance with the laws of the People's Republic of China ("China") if the dispute is resolved therein or in any other jurisdiction other than the State of Delaware, in each case exclusive of such jurisdiction's principles of conflicts of law. If, under the applicable law, any portion of this Agreement is at any time deemed to be in conflict with any applicable statute, rule, regulation or ordinance, such portion will be deemed to be modified or altered to conform thereto or, if that is not possible, to be omitted from this Agreement; the invalidity of any such portion will not affect the force, effect and validity of the remaining portion hereof.

10. Notices. All notices, requests and other communications under this Agreement will be in writing (including facsimile or similar writing and express mail or courier delivery or in person delivery, but excluding ordinary mail delivery) and will be given to the address stated below:

- (a) if to the Employee, to the address or facsimile number that is on file with the Company from time to time, as may be updated by the Employee;
- (b) if to the Company:

Sohu.com Inc.  
7 Jianguomennei Avenue  
Suite 1519, Tower 2  
Bright China Chang An Building  
Beijing 100005  
People's Republic of China

Attention: Charles Zhang  
Chairman and Chief Executive Officer  
Derek Palaschuk  
Chief Financial Officer

fax: (86-10) 6510-1388

with a copy to:  
Goulston & Storrs  
400 Atlantic Avenue  
Boston, MA 02110

Attention: Timothy B. Bancroft

fax: (617) 574-4112

or to such other address or facsimile number as either party may hereafter specify for the purpose by written notice to the other party in the manner provided in this Section 10. All such notices, requests and other communications will be deemed received: (i) if given by facsimile transmission, when transmitted to the facsimile number specified in this Section 10 if confirmation of receipt is received; (ii) if given by express mail or courier delivery, five (5) days after sent; and (iii) if given in person, when delivered.

11. Miscellaneous.

(a) Entire Agreement. This Agreement constitutes the entire understanding between the Company and the Employee relating to the subject matter hereof and supersedes and cancels all prior and contemporaneous written and oral agreements and understandings with respect to the subject matter of this Agreement. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not set forth expressly in this Agreement.

(b) Modification; Waiver. No provision of this Agreement may be modified, waived or discharged unless modification, waiver or discharge is agreed to in writing signed by the Employee and such officer of the Company as may be specifically designated by its Board of Directors. No waiver by either party at any time of any breach by the other party of, or compliance with, any condition or provision of this Agreement to be performed by such other party will be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time.

(c) Successors; Binding Agreement. This Agreement will be binding upon and will inure to the benefit of the Employee, the Employee's heirs, executors, administrators and beneficiaries, and the Company and its successors (whether direct or indirect, by purchase, merger, consolidation or otherwise), subject to the terms and conditions set forth herein.

(d) Withholding Taxes. All amounts payable to the Employee under this Agreement will be subject to applicable withholding of income, wage and other taxes to the extent required by applicable law.

(e) Validity. The invalidity or unenforceability of any provision or provisions of this Agreement will not affect the validity or enforceability of any other provision of this Agreement, which will remain in full force and effect.

(f) Language. This Agreement is written in the English language only. The English language also will be the controlling language for all future communications between the parties hereto concerning this Agreement.

(g) Counterparts. This Agreement may be signed in any number of counterparts, each of which will be deemed an original, with the same effect as if the signatures thereto and hereto were upon the same instrument.

12. Dispute Resolution. Either party may bring a legal action arising out of, or relating to this Agreement in any court of the State of Delaware in the United States of America and each party hereby expressly and irrevocably waives any claim or defense in any action or proceeding brought in said jurisdictions based on any alleged lack of personal jurisdiction, improper venue, forum non conveniens, or any similar basis. Except as relates to the enforcement of the Employee Obligations Agreement (Section 8(b) of which provides that the party initiating a claim may bring such claim in the courts of either the State of Delaware or in the courts of China, at such party's option), any dispute, controversy or claim arising out of or relating to this Agreement may also be submitted to arbitration administered by the International Chamber of Commerce ("ICC"). The award rendered in such an arbitration proceeding will be final and binding and judgment on the award rendered may be entered in any court having jurisdiction over the parties. Such arbitration shall be held in Hong Kong and shall be conducted in accordance with the ICC International Arbitration Rules, except as may be modified by the following:

(a) The number of arbitrators will be three, one of whom will be appointed by the party asserting a claim against the other party or parties, one of whom will be appointed by the party or parties (acting together), as the case may be, against whom a claim has been asserted, and the third of whom will be selected by mutual agreement, if possible, within thirty days after the selection of the second arbitrator.

(b) The language of the arbitration will be conducted in the English language and any

foreign-language documents presented at such arbitration will be accompanied by an English translation thereof that shall be prepared at the expense of the party seeking to present such document.

(c) Any award of the arbitrators (i) will be in writing and (ii) will state the reasons upon which such award is based.

(d) The arbitrators will have no authority to award punitive damages or any other damages not measured by the prevailing party's actual damages, and may not, in any event, make any ruling, finding or award that does not conform to the terms and conditions of this Agreement.

(e) Notwithstanding the foregoing, any party may apply to any court having jurisdiction over the parties to obtain injunctive relief in order to maintain the status quo until such time as an arbitration award may be rendered or the dispute, controversy or claim may be otherwise resolved.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on May 9, 2003 as of the year and day first above written.

Signature of Employee:

Sohu.com Inc.

/s/ Victor Koo

By: /s/ Derek Palaschuk

Printed name of employee:

Name: Derek Palaschuk

Title: Chief Financial Officer

Victor Koo

Certain Definitions

“Cause” means:

- (i) willful misconduct or gross negligence by the Employee, or any willful or grossly negligent omission to perform any act, resulting in injury to the Company or any subsidiaries or affiliates thereof;
- (ii) misconduct or negligence of the Employee that results in gain or personal enrichment of the Employee to the detriment of the Company or any subsidiaries or affiliates thereof;
- (iii) breach of any of this Agreement or the Employee Obligations Agreement which is not remedied within thirty (30) days of the Company’s providing written notice thereof to the Employee. For purposes of this clause, “breach” includes, but is not limited to, the repeated failure of the Employee to perform substantially his duties to the Company or any subsidiaries or affiliates thereof, excessive absenteeism or dishonesty;
- (iv) any attempt by the Employee to assign or delegate this Agreement or any of the rights, duties, responsibilities, privileges or obligations hereunder without the prior consent of the Company (except (a) in respect of any delegation by the Employee of his employment duties hereunder to other employees of the Company in accordance with its usual business practice and (b) the Employee may assign his right to receive his salary to third parties by giving notice to the Company);
- (v) the Employee’s indictment or conviction for, or confession of, a felony or any crime involving moral turpitude under the laws of the United States or any State thereof, or under the laws of China, or Hong Kong;
- (vi) declaration by a court that the Employee is insane or incompetent to manage his business affairs;
- (vii) habitual drug or alcohol abuse which materially impairs the Employee’s ability to perform his duties; or
- (viii) filing by the Employee of, or consent by the Employee to, any petition or other proceeding in bankruptcy with respect to the Employee, or the filing by a third party of any petition or other proceeding which is not stayed within sixty (60) days of such filing seeking to find the Employee bankrupt or insolvent.

“Change in Control” means the occurrence of any of the following events:

- (i) any person (within the meaning of Section 13(d) or Section 14(d)(2) of the Securities Exchange Act of 1934) other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company or any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportion as their ownership of stock of the Company, becomes the direct or beneficial owner of securities representing fifty percent (50%) or more of the combined voting power of the Company’s then-outstanding securities;
- (ii) during any period of two (2) consecutive years after the date of this Agreement, individuals who at the beginning of such period constitute the Board of Directors of the Company, and all new directors (other than directors designated by a person who has entered into an agreement with the Company to effect a transaction described in (i), (iii), or (iv) of this definition) whose election or nomination to the Board was approved by a vote of at least two-thirds of the directors then in office, cease for any reason to constitute at least a majority of the members of the Board;
- (iii) the effective date of a merger or consolidation of the Company with any other entity, other than a merger or consolidation which would result in the voting securities of the Company

outstanding immediately prior to such merger or consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 50% of the combined voting power of the voting securities of the surviving entity outstanding immediately after such merger or consolidation and with the power to elect at least a majority of the board of directors or other governing body of such surviving entity; or

(iv) the complete liquidation of the Company or the sale or disposition by the Company of all or substantially all of the Company's assets.

"Company" means Sohu.com Inc and, unless the context suggests to the contrary, all of its subsidiaries and related companies.

"Disability" means the Employee becomes physically or mentally impaired to an extent which renders him or her unable to perform the essential functions of his or her job, with or without reasonable accommodation, for a period of six consecutive months, or an aggregate of nine months in any two year period.

"Good Reason" means the occurrence of any of the following events without the Employee's express written consent, provided that the Employee has given notice to the Company of such event and the Company has not remedied the problem within fifteen (15) days:

- (i) any significant change in the duties and responsibilities of the Employee inconsistent in any material and adverse respect with the Employee's title and position (including status, officer positions and reporting requirements), authority, duties or responsibilities as contemplated by Annex 2 to this Agreement. For the purposes of this Agreement, because of the evolving nature of the Employer's business, the Company's changing of Employee's reporting relationships and department(s) will not be considered a significant change in duties and responsibilities;
- (ii) any material breach by the Company of this Agreement, including without limitation any reduction of the Employee's base salary or the Company's failure to pay to the Employee any portion of the Employee's compensation; or
- (iii) the failure, in the event of a Change in Control in which the Company is not the surviving entity, of the surviving entity or the successor to the Company's business to assume this Agreement pursuant to its terms or to offer the Employee employment on substantially equivalent terms to those set forth in this Agreement.

"Termination" (and any similar, capitalized use of the term, such as "Terminate") means, according to the context, the termination of this Agreement or the Employee's ceasing to render employment services.

**Particular Terms of Employee's Employment**

Title(s): Chief Operating Officer

Reporting Requirement: The Employee will report to the Company's Board of Directors and to the Company's Chief Executive Officer.

Responsibilities: Such duties and responsibilities as are ordinarily associated with the Employee's title(s) in a United States publicly-traded corporation and such other duties as may be specified by the Board of Directors from time to time.

Base Salary: One Hundred Fifty Thousand United States Dollars (U.S. \$150,000).

The Employee's base salary may be adjusted (but not below the base salary stated above) during the term of this contract at the discretion of the Board of Directors.

# of Weeks of Paid Vacation per Year: Four (4).

Other Benefits:

Monthly housing allowance or reimbursement after tax of up to a maximum of U.S. \$2,000 per month, tax equalization on salary and bonus to 15%, health, life and disability insurance and tuition fees for the Employee's children as per company policy and bonus as specifically approved each year.



**FORM OF EMPLOYEE NON-COMPETITION, NON-SOLICITATION, CONFIDENTIAL  
INFORMATION AND WORK PRODUCT AGREEMENT**

In consideration of my employment and the compensation paid to me by Sohu.com Inc., a Delaware corporation, or a subsidiary or other affiliate or related company thereof (Sohu.com Inc. or any such subsidiary or related company or other affiliate referred to herein individually and collectively as "SOHU"), and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, I agree as follows:

1. **Non-Competition.** During my employment with SOHU and continuing after the termination of my employment for the longer of (i) one year after the termination of my employment with SOHU for any reason and (ii) such period of time as SOHU is paying to me any severance benefits, (the "Noncompete Period"), I will not, on my own behalf, or as owner, manager, stockholder (other than as stockholder of less than 2% of the outstanding stock of a company that is publicly traded or listed on a stock exchange), consultant, director, officer or employee of or in any other manner connected with any business entity, participate or be involved in any Competitor without the prior written authorization of SOHU. "Competitor" means any business which operates a horizontal portal or which directly competes with any business in which SOHU engages during the time of my employment, or during the time of my employment has made formal plans as documented by senior management or Board of Director minutes to engage, in the Mainland Chinese market and may include, without limitation, an individual, company, enterprise, partnership enterprise, government office, committee, social organization or other organization that, in any event, produces, distributes or provides the same or substantially similar kind of product or service as SOHU. On the date of this Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement (this "Agreement"), "Competitor" includes without limitation: Sina.com, Yahoo Inc., Tom.com, Netease.com Inc., Linktone, 263.com, AOL Time Warner Inc., JOYO and Dangdang.

2. **Nonsolicitation.** During the Noncompete Period, I will not, either for my own account or for the account of any other person: (i) solicit, induce, attempt to hire, or hire any employee of SOHU, (ii) solicit, induce, attempt to hire, or hire any other person who may have been employed by SOHU during the term of my employment with SOHU unless that person has not worked with SOHU within the six months following my last day of employment with SOHU; (iii) solicit business or relationship in competition with SOHU from any of SOHU's customers, suppliers or partners or any other entity with which SOHU does business; (iv) assist in such hiring or solicitation by any other person or business entity or encourage any such employee to terminate his or her employment with SOHU; or (iv) encourage any such customer, supplier or partner or any other entity to terminate its relationship with SOHU.

3. **Confidential Information.**

(a) While employed by SOHU and indefinitely thereafter, I will not, directly or indirectly, use any Confidential Information (as hereinafter defined) other than pursuant to my employment by and for the benefit of SOHU, or disclose any such Confidential Information to anyone outside of SOHU or to anyone within SOHU who has not been authorized to receive such information, except as directed in writing by an authorized representative of SOHU.

(b) Notwithstanding anything in Section 3(a) to the contrary, the Employee may disclose Confidential Information pursuant to a duly issued request or order of any court or governmental agency of competent jurisdiction, provided, however, that the Employee provides the Company prompt notice of any such request or order and, prior to releasing such information, provides reasonable cooperation (at the Company's expense) in the efforts of the Company to contest or limit the scope of such request or order.

(c) "Confidential Information" means all trade secrets, proprietary information, and other data and information, in any form, belonging to SOHU or any of their respective clients, customers, consultants, licensees or affiliates that is held in confidence by SOHU. Confidential Information includes, but is not limited to computer software, the structure of SOHU's online directories and search engines, business plans and arrangements, customer lists, marketing materials, financial information, research, and any other information identified or treated as confidential by SOHU or any of their respective clients, customer, consultants, licensees or affiliates. Notwithstanding the foregoing, Confidential Information does not include information which

SOHU has voluntarily disclosed to the public without restriction, or which is otherwise known to the public at large.

4. Rights in Work Product.

(a) I agree that all Work Product (as hereinafter defined) will be the sole property of SOHU. I agree that all Work Product that constitutes original works of authorship protectable by copyright are "works made for hire," as that term is defined in the United States Copyright Act and, therefore, the property of SOHU. I agree to waive, and hereby waive and irrevocably and exclusively assign to SOHU, all right, title and interest I may have in or to any other Work Product and, to the extent that such rights may not be waived or assigned, I agree not to assert such rights against SOHU or its licensees (and sublicensees), successors or assigns.

(b) I agree to promptly disclose all Work Product to the appropriate individuals in SOHU as such Work Product is created in accordance with the requirements of my job and as directed by SOHU.

(c) "Work Product" means any and all inventions, improvements, developments, concepts, ideas, expressions, processes, prototypes, plans, drawings, designs, models, formulations, specifications, methods, techniques, shop-practices, discoveries, innovations, creations, technologies, formulas, algorithms, data, computer databases, reports, laboratory notebooks, papers, writings, photographs, source and object codes, software programs, other works of authorship, and know-how and show-how, or parts thereof conceived, developed, or otherwise made by me alone or jointly with others (i) during the period of my employment with SOHU or (ii) during the six month period next succeeding the termination of my employment with SOHU if the same in any way relates to the then present products, programs or services of SOHU or to tasks assigned to me during the course of my employment, whether or not patentable or subject to copyright or trademark protection, whether or not reduced to tangible form or reduced to practice, whether or not made during my regular working hours, and whether or not made on SOHU premises.

5. Employee's Prior Obligations. I hereby certify I have no continuing obligation to any previous employer or other person or entity which requires me not to disclose any information to SOHU.

6. Employee's Obligation to Cooperate. At any time during my employment with SOHU and thereafter upon the request of SOHU, I will execute all documents and perform all lawful acts that SOHU reasonably considers necessary or advisable to secure its rights hereunder and to carry out the intent of this Agreement. Without limiting the generality of the foregoing, I agree to render to SOHU or its nominee all reasonable assistance as may be required:

- (a) In the prosecution or applications for letters patent, foreign and domestic, or re-issues, extensions and continuations thereof;
- (b) In the prosecution or defense of interferences which may be declared involving any of said applications or patents;
- (c) In any administrative proceeding or litigation in which SOHU may be involved relating to any Work Product; and
- (d) In the execution of documents and the taking of all other lawful acts which SOHU considers necessary or advisable in creating and protecting its copyright, patent, trademark, trade secret and other proprietary rights in any Work Product.

The reasonable out-of-pocket expenses incurred by me in rendering such assistance at the request of SOHU will be reimbursed by SOHU. If I am no longer an employee of SOHU at the time I render such assistance, SOHU will additionally pay me a reasonable fee for my time.

7. Termination; Return of SOHU Property. Upon the termination of my employment with SOHU for any reason, or at any time upon SOHU's request, I will return to SOHU all Work Product and Confidential Information and notes, memoranda, records, customer lists, proposals, business plans and other documents, computer software, materials, tools, equipment and other property in my possession or under my control belonging to SOHU. Further, before obtaining my final paycheck, I agree to sign a certificate stating the following:

## “Termination Certificate

This is to certify that I do not have in my possession or custody, nor have I failed to return, any Work Product (as defined in the Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement between me and Sohu.com Inc. (“SOHU”)) or any notes, memoranda, records, customer lists, proposals, business plans or other documents or any computer software, materials, tools, equipment or other property (or copies of any of the foregoing) belonging to SOHU.”

### 8. General Provisions.

(a) This Agreement contains the entire agreement between me and SOHU with respect to the subject matter hereof and supersedes all prior and contemporaneous agreements and understandings related to the subject matter hereof, whether written or oral. This Agreement may not be modified except by written agreement signed by SOHU and me.

(b) This Agreement will be governed by and construed and enforced in accordance with, the laws of the State of Delaware, U.S.A. if the dispute is resolved therein, and in accordance with the laws of the People’s Republic of China (“China”) if the dispute is resolved therein or in any other jurisdiction other than the State of Delaware, in either case without giving effect to the conflicts of laws rules of such jurisdiction. I consent to jurisdiction and venue in any court in the State of Delaware or any other country having jurisdiction over me for the purposes of any action relating to or arising out of this Agreement or any breach or alleged breach thereof, and to service of process in any such action by certified or registered mail, return receipt requested. Without limiting the foregoing, I specifically consent to jurisdiction and venue in any court in China for the purposes of any action relating to or arising out of this Agreement or any breach or alleged breach thereof that occurs in whole or in part in China.

(c) In the event that any provision of this Agreement will be determined by any court of competent jurisdiction to be unenforceable by reason of its extending for too great a period of time, over too large a geographic area, over too great a range of activities, it will be interpreted to extend only over the maximum period of time, geographic area or range of activities as to which it may be enforceable.

(d) If, after application of paragraph (c) above, any provision of this Agreement will be determined to be invalid, illegal or otherwise unenforceable by any court of competent jurisdiction, the validity, legality and enforceability of the other provisions of this Agreement will not be affected thereby. Any invalid, illegal or unenforceable provision of this Agreement will be severed, and after any such severance, all other provisions hereof will remain in full force and effect.

(e) SOHU and I agree that either of us may waive or fail to enforce violations of any part of this Agreement without waiving the right in the future to insist on strict compliance with all or parts of this Agreement.

(f) My obligations under this Agreement will survive the termination of my employment with SOHU regardless of the manner of or reasons for such termination, and regardless of whether such termination constitutes a breach of any other agreement I may have with SOHU. My obligations under this Agreement will be binding upon my heirs, executors and administrators, and the provisions of this Agreement will inure to the benefit of the successors and assigns of SOHU.

(g) I agree and acknowledge that the rights and obligations set forth in this Agreement are of a unique and special nature and necessary to ensure the preservation, protection and continuity of SOHU’s business, employees, Confidential Information, and intellectual property rights. Accordingly, SOHU is without an adequate legal remedy in the event of my violation of any of the covenants set forth in this Agreement. I agree, therefore, that, in addition to all other rights and remedies, at law or in equity or otherwise, that may be available to SOHU, each of the covenants made by me under this Agreement shall be enforceable by injunction, specific performance or other equitable relief, without any requirement that SOHU have to post a bond or that SOHU have to prove any damages.

IN WITNESS WHEREOF, the undersigned employee and SOHU have executed this Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement.

Effective as of January 1, 2003 and dated May 9, 2003

Signature of Employee:

Sohu.com Inc.

/s/ Victor Koo

By: /s/ Derek Palaschuk

Printed name of employee:

Name: Derek Palaschuk

Title: Chief Financial Officer

Victor Koo

## 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 March 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Dr. Charles Zhang, President, 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 March 31, 2003 and results of operations of the Company for the three months ended March 31, 2003.

/s/ Dr. Charles Zhang

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

May 12, 2003

## 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 March 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Derek Palaschuk, Senior Vice President and 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 March 31, 2003 and results of operations of the Company for the three months ended March 31, 2003.

/s/ Derek Palaschuk

Derek Palaschuk, Senior Vice President and Chief Financial Officer

May 12, 2003